



Fed Moves Beat Stimulus in Boosting Economy

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Efforts to shore up liquidity in the wake of the subprime collapse are better suited to help the economy than those aimed at boosting consumer confidence and demand, two economists concluded in a **National Bureau of Economic Research** [paper](#).

"For the subprime mortgage crisis, our analysis suggests that policies that aim primarily at restoring consumer confidence and increasing demand, such as a tax rebate to households, will probably be insufficient to help the real economy," economists **Hui Tong** of the **International Monetary Fund** and **Shang-Jin Wei** of **Columbia University** wrote.

In contrast, "policies that could relax liquidity constraints faced by non-financial firms are likely to be indispensable," they wrote.

Their model examined stock-price sensitivity to demand shocks — based on responses to the 9/11 shock — and liquidity constraints, which they noted "refers to difficulties in raising external finance of all kinds, not merely in borrowing from banks."

According to their model, from July 31, 2007 to March 31, 2008, a one- standard-deviation rise in liquidity constraints had almost four times the effect on nonfinancial firms' stock prices than a similar change in sensitivity to consumer confidence.

"A tightened liquidity squeeze appears to be economically more important than reduced consumer confidence or spending in explaining cross-firm differences in stock price declines," they wrote.

The findings appear consistent with recent economic and financial trends. While tax rebate checks that were the cornerstone of a fiscal stimulus package earlier this year helped second-quarter growth, the effect appears to have already faded.

And when concerns have flared in financial markets, they've tended to be fueled by liquidity fears and not the state of the consumer.

Federal Reserve officials have acted aggressively to channel liquidity into credit markets by creating new lending facilities like the primary dealer credit facility and term auction facility. — *Brian Blackstone*

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