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Inland economist, borrowers await effect of rate cut



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By **JACK KATZANEK** and **LESLIE BERKMAN**
The Press-Enterprise

Inland Southern California consumers and businesses could see some relief with Wednesday's interest rate cut, but experts say it will take time and an atmosphere of trust to nurse a sick economy back to health.

The Federal Reserve's emergency move to drop its key lending rate from 2 percent to 1.5 percent will help some borrowers, including some homeowners with adjustable-rate mortgages, and credit card holders.

The hope is that by lowering the rate it charges major banks to borrow money, the Federal Reserve will entice banks to lend to businesses with plans to expand.

There is no way to know whether banks that are sitting on billions of dollars in bad loans will respond the way the government wants.

Making it easier for businesses to borrow would allow them to expand and help boost the job market in Riverside and San Bernardino counties. The jobless rate in the Inland area was estimated at 9.2 percent in August, and there were 25,000 fewer jobs than a year ago.

Economists and others say the rate cut was one of many steps needed to improve the bleak outlook for the national and Inland economies. Banks have to feel like there's a comfort zone for their own risk before they start lending money, meaning there won't be instant relief.

"It is a higher dose of medication but the patient is still sick," said Scott Anderson, vice president and senior economist for Wells Fargo.

Lower interest rates will not stave off the flood of foreclosures that are depressing the economy, said Christopher Thornberg, an economist and principal with Los Angeles-based Beacon Economics. Mortgages are not failing because interest rates are too high, he said.

"Real estate is in a free-fall because prices are too high and people borrowed too much," Thornberg said. "People can't afford (their mortgages) if they cut the interest rate to zero."

Leslie Appleton-Young, chief economist for the California Association of Realtors, said the difficulty of getting mortgages -- not the affordability of interest rates -- has been hurting home sales.

"The mortgage rates are very affordable," Appleton-Young said. "It is not a question of interest rates right now. It is about the availability of capital and the willingness of lenders to make loans. We hope the rate cut will calm markets and provide stability to the financial sector and unfreeze credit markets so it is easier for people to get mortgages."

Anderson said the lowering of the rate for banks to borrow money from the Federal Reserve was "a much needed move because the credit markets are frozen solid right now."

Anderson said the financial crisis and the negative reaction to it, including the stock market declines, is likely to delay the recovery of the housing market for as long as six months. He predicted that sales in Inland Southern California could recover by the end of the first quarter of 2009, but home prices could drop into 2010.

He said the rising unemployment rate could lead to more delinquencies and foreclosures, which could flood a market already brimming with unsold inventory and further push down home values.

"I can't see people going out and buying large-ticket items like houses and cars until we get clarity on how long this recession is going to be," Anderson said.

Inland economist John Husing said he spent part of Wednesday meeting with entrepreneurs who had expansion ideas that would lead to new jobs. But, he said, none of them had the capital to accomplish that goal.

"The Fed is doing anything they can to get the banks to start lending again," Husing said.

Stephen Wacknitz, president and chief executive officer of Temecula Valley Bank, said since money the bank borrows is tied to the prime lending rate, the Fed's move could make it easier for the bank to obtain funds it can loan to local customers.

Also, the bank has a portfolio of Small Business Administration loans that reset quarterly, meaning those rates would become more favorable on Jan. 1, Wacknitz said.

He added that the Fed stepping in could help businesses' psyches.

"The psychological benefits of this will have some impact," Wacknitz said.

Richard Green, director of the Lusk Center for Real Estate at the University of Southern California, is less optimistic. He does not expect Wednesday's rate cut to stimulate the economy because he does not think banks will respond by increasing their lending.

"They are more afraid of losing money than of not making money," Green said.

Esmael Adibi, chief economist at Chapman University, said there is enough fear to go around for all parties. The Fed's move is not going to solve the problem unless the banks and other lenders start trusting each other again.

"Ultimately the problem is a lack of confidence, and I think the only solution is time," Adibi said. "Once some time goes by and we see the bailout kick in, the banks will start lending to each other again."
