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Fed's $1 tn recession remedy just what India ordered

Unexpected Move To Help Indian Corporates In Hunt For Dollars And Check Greenback's Rise

Our Bureau
MUMBAI

A WORLD haunted by the spectre of deflation, sputtering growth engines and job losses is now hoping for the mother of all stimuli to work. In a dramatic move to battle recession, the US Federal Reserve — the world's most powerful monetary authority — will spend $1 trillion to buy government bonds and mortgage-backed securities.

The move will lower interest rates across the spectrum, free up loan markets, flush international money markets with dollars and help mortgage borrowers, particularly in America.

US bond yields crashed, clocking the biggest drop since '87, after the unexpected announcement, stocks rose across various markets while the dollar slipped against most currencies, including the rupee, which closed at 50.37 on Thursday, after gaining 91 paise from its previous close.

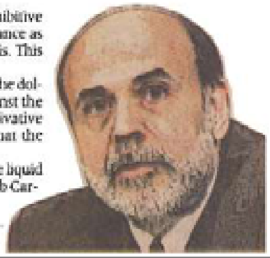
Even though the excitement in western markets did not boil over to Dalal Street, with the Sensex rising just 25 points to close at 9001.75, the Fed buying will have its rub-offs here.

First, it would certainly make it easier and cheaper for Indian corporates fishing for dollar funds. Though benchmark rates like Libor had crashed, the risk premium attached to companies from emerging markets such as India had made borrowings prohibitive for most firms. Libor had partly lost its relevance as bankers were pricing loans on cost-plus basis. This would begin to change.

Secondly, it would finally arrest the rise of the dollar. As the dollar breached the 50-mark against the rupee, hundreds of corporates booked derivative losses while unhedged importers, hoping that the dollar would slip, were caught offguard.

"The interest rate market will become more liquid and there will be more transactions," said Rob Carnell, chief international economist, ING.

▶ To buy bonds worth $300 b: P 13



Fed to buy govt bonds worth $300 b

▶ Continued From: P 1

"IT WILL bring down the entire interest rate structure, lower mortgage rates and benefit existing and future mortgage borrowers," he added.

The Fed has said that it will buy government bonds worth $300 billion, for the first time since '61, and $850 billion of mortgage-backed assets.

This will give US banks an opportunity to turn more liquid and clean up their balance sheets. Faced with uncertain global markets, banks had pulled back the dollar they had lent, causing a money market crunch which is expected to ease now.

According to SA Narayan, MD of Kotak Securities, the Fed move will positively impact Indian equities in the near term.

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