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A LENDER BENDER

By KAJA WHITEHOUSE

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While the government rescue of the financial sector will likely do much to soothe frayed nerves on Wall Street, the experts say it probably won't make it easier - or cheaper - to borrow money.

Read The Rescue Bill (PDF)

"It will allow volatility to die down, but it doesn't mean we're off to the races," said one hedge fund manager.

At best, economists say, the rescue plan will prevent the credit crunch from worsening. But it will take a lot more than Uncle Sam's lifeline to jump-start the credit markets, they add.

Indeed, the experts say the lending market will begin getting oiled up only when the economy is healthy again, meaning lower unemployment, higher consumer spending and affordable energy prices.

Even if the stock market stages a rally this week on the federal rescue news, the credit crunch won't be solved, sources said.

"The fact is, the US is still in a recession," said John Lonski, chief economist at Moody's capital-markets group. "And creditors are not going to be anxious to lend money for mortgages as long as the value of the home is expected to decline," he said.

That's illustrated by how little the credit markets have improved despite the Federal Reserve last week injecting more than $1 trillion into the financial system in a bid to thaw the frozen market. European central banks have also contributed hundreds of billions toward that same goal.

Yet credit continues to be tight: The US commercial-paper market, a short-term borrowing tool widely used by corporations, shrank to $1.702 trillion last week from $1.763 trillion the week before, according to the Fed. It's the lowest level of commercial-paper volume since early 2006.

Lonski noted that yield spreads on junk bonds - the riskiest form of debt - are currently a whopping 965 basis points, or 1/100th of a percent, compared with an average of 500 basis points, which means borrowing costs associated with junk securities have nearly doubled.

If Congress and the White House ink a rescue plan, Lonski predicted the spread would only dip to about 800 basis points.

Lonski thinks the Federal Reserve should top off the bailout with a rate cut of one half of one percent, to ensure a thaw in lending.

And Campbell R. Harvey, a professor of finance at Duke's Fuqua School of Business, is calling for the Federal Deposit Insurance Corp., which protects bank deposits, to beef up its staff to handle what he predicts will be 750 to 1,000 more bank failures over the next six months.

Harvey is also calling for an extension of credit to small- and medium-size nonfinancial companies, which he says are "the engine of economic growth and jobs." *With Michael Gray* *kaja.whitehouse@nypost.com*

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