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Plosser Says Price Stability Should Be Fed's Primary Mandate

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Federal Reserve Bank of Philadelphia President Charles Plosser, an opponent of Fed bond purchases, said the central bank should focus on price stability as its primary objective, and not worry as much about "fluctuations" in employment.

"It would be appropriate to redefine the Fed's monetary policy goals to focus solely, or at least primarily, on price stability," Plosser said today in prepared remarks for a speech at the Cato Institute in Washington. "I base this on two facts: Monetary policy has very limited ability to influence real variables, such as employment. And, in a regime with fiat currency, only the central bank can ensure price stability."

Plosser's remarks underscore the tensions on the Federal Open Market Committee that Janet Yellen is poised to lead. While he argues in favor of a single mandate at the Cato Institute, Yellen today will go through her confirmation hearing in the U.S. Senate, where her prepared remarks show her endorsing the Fed's current approach to policy.

Yellen will tell the Senate Banking Committee that unemployment remains too high and the economy is performing well below its potential, warranting a strategy of "unconventional policy tools such as asset purchases," according to prepared remarks released yesterday.

Fed presidents rotate voting on monetary policy on the FOMC, with Plosser voting next year. Fed Chairman Ben S. Bernanke's term as central bank chief expires Jan. 31, and so if Yellen is confirmed she will have Plosser on her committee.

Congressional Mandate

Plosser, 65, said that while Congress has given the Fed the mandate to promote "the goals of maximum employment, stable prices and moderate long-term interest rates," the Federal Reserve Act "doesn't mention reducing short-term fluctuations in employment."

He said "focusing on short-run control of employment weakens the credibility and effectiveness of the Fed in achieving its price stability objective."

In answer to a question, Plosser said he would prefer a lower inflation target than the 2 percent that the FOMC has set.

He said he's not as concerned as some of his colleagues that inflation can fall too low. "It's not obvious to me that mild deflation is such a bad thing," he said. "For me, I think the value of an inflation target is a form of commitment, and it really doesn't matter quite as much whether the number was 1.5 percent or 2.5 percent or 2 percent. It's the signaling of a commitment of the institution to deliver something in particular."

'Rule-Like Approach'

Plosser also called for broader limits to the central bank's authority, saying that the Fed should be restricted to purchases of Treasury securities and should be required to follow a "systematic, rule-like approach" to policy.

Plosser's limits would prevent the Fed from engaging in its current strategy of \$85 billion a month of bond purchases, divided between \$45 billion in Treasuries and \$40 billion of mortgage-backed securities. The MBS purchases are aimed at boosting housing, and Plosser said that "programs to allocate credit rightfully belong in the realm of the fiscal authorities -- not the central bank."

The Philadelphia Fed chief has spoken out against the second and third round of bond purchases. The last year he voted on monetary policy, in 2011, he dissented against a pledge to hold interest rates near zero until mid-2013 and against the Fed's so-called Operation Twist program, designed to lower interest rates.

Today, he also opposed efforts to focus the Fed on ensuring financial stability.

"Some have even called for an expansion of the monetary policy mandate to include an explicit goal for financial stability," Plosser said. "I think this would be a mistake."

"By taking a highly discretionary approach to monetary policy, policy makers increase the risks of financial instability by making monetary policy uncertain," he said.