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Fed's Plosser: 'More Optimistic' Than Many About Economic Outlook

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NEW YORK (Dow Jones)--A key Federal Reserve official disagreed Thursday with much of the gloom surrounding the economic outlook.

"I share the frustration of many with the pace of recovery," Federal Reserve Bank of Philadelphia President Charles Plosser said. But he added "I am more optimistic than many about the future path of the economy."

The central banker also noted "the severity and financial nature of this recession has led many forecasters to anticipate a protracted period of modest economic growth, accompanied by a slow decline in unemployment. Some even worry that the economy might fall into a deflationary trap. I am not one of them."

Plosser's comments came from a speech he was giving to a gathering held at the Cato Institute in Washington. He did not have much to say about the monetary policy outlook, refraining from comment despite recent signs he is uncomfortable with the Fed's decision to buy $600 billion in Treasury securities. He did allow that it appears as though the Fed made mistakes when it kept interest rates very low during the middle of the last decade.

While many Fed critics have argued the Fed should have raised rates then to lean into what turned out to be a surging housing market, Plosser said that conception is not quite right.

"The error may not have been that policymakers failed to pay attention to the fast upward rise in asset prices, but that they deviated from a systematic approach to setting nominal interests," he explained.

The bulk of Plosser's speech was dedicated to familiar themes. He said monetary policy is typically ill suited to dealing with financial market bubbles.

"While I understand the desire to use monetary policy to reduce or eliminate misalignment of asset prices, I believe that implementing such a policy as a practical matter would not help us deliver better performance in terms of price stability and sustainable output growth," Plosser said.

As he has in a number of his past addresses, the official again affirmed what be believes is the primacy of rules-based policy making, directed mainly at currents taking place in the economy, and not markets.

"I continue to advocate that the Fed follow a systematic approach that keeps monetary policy focused squarely on inflation and output growth, but especially on inflation," Plosser said. He did say he could envision times when policy could take aim at assets, which the performance of a given sector posed a threat to overall economic health.

"To the extent that booms may engender excess leverage in systemically sensitive parts of our financial system, we need to ensure that regulations and institutional structures are designed to enhance market discipline in ways that keep risk-taking under control," the official said.

"Monetary policy should retain its focus on providing price stability as a means to support sustainable growth in employment and output over the long run and not chasing incipient bubbles," the official said.

Plosser will be a voting member of the Federal Open Market committee in 2011.

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