Fed should focus on inflation, not bubbles: Plosser

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(Reuters) - The Federal Reserve must focus primarily on inflation as a means to support growth and employment, not try to fight asset bubbles, Philadelphia Fed President Charles Plosser said on Thursday.

Plosser, an inflation hawk who has voiced some skepticism about the ability of the U.S. central bank's latest push to ease monetary policy, said he was not as pessimistic about U.S. growth prospects as many forecasters.

"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," Plosser told a conference sponsored by the CATO Institute.

"Some even worry that the economy might fall into a deflationary trap. I am not one of them. Indeed, I am more optimistic than many about the future path of the economy."

Following the deepest recession in more than 70 years, the U.S. economy has expanded unevenly since last summer, growing just 2 percent in the third quarter on an annualized basis.

At the same time, the jobless rate remains stuck at an elevated 9.6 percent, while inflation is running well below the Fed's target of about 2 percent or a bit below.

These conditions prompted the central bank this month to announce an additional $600 billion of Treasury bond purchases in an effort to boost business and consumer spending. That's on top of slashing interest rates to effectively zero and buying up some $1.7 trillion in government and mortgage-backed securities during the financial crisis.

But Plosser, whose speech focused primarily on dismissing the notion that monetary policy can target asset bubbles, argued that the Fed should stick to the one thing it can control -- inflation.

"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," Plosser said.

He blamed the high U.S. inflation rates of the 1970s in part on monetary policy that overemphasized the notion of slack in the economy, the idea that growth is below its natural potential.

"Mismeasured or misperceived output gaps were a significant contributor to the excessive monetary accommodation that led to the Great Inflation in the 1970s -- not one of the Fed's finer moments," Plosser said.

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(Editing by James Dalgleish)