

## **Fed Plosser: Skeptical Further Asset Buying to Have Much Effect**

-Fed's Unconventional Policies Pose Substantive Long-Term Risks

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WASHINGTON (MNI) - Philadelphia Federal Reserve Bank President Charles Plosser Thursday said he remains unconvinced the injection of additional monetary stimulus will have a material impact on job growth or the economy, and warned that the venture into uncharted waters to spark the recovery raises the spectre of "substantive" risks down the road.

In remarks prepared for delivery to the Cato Institute Monetary Conference, Plosser also declared his preference for a systemic approach to monetary policy rather than the use of employment and inflation thresholds, arguing that it is more transparent.

"The ability of monetary policy to influence employment has long been recognized as tenuous at best," Plosser said. "I join many economists who are skeptical that further asset purchases will have much effect on longer-term interest rates."

"Even if they do, the declines in long rates are likely to have fairly negligible effects on employment or growth at best," he added.

He noted that despite the Fed's best efforts, the U.S. economy remains "lackluster," with unemployment still uncomfortably high, economic growth "mediocre," and confidence in the future remaining at subpar levels.

"One could conclude that the factors contributing to mediocre economic performance cannot be offset by monetary policy," Plosser said.

On a day when Fed Chair Ben Bernanke said the central bank will continue to do what it can to support the recovery, Plosser warned that an excessive focus on the short term can result in long-term problems.

"I believe the extraordinary policies the Fed has pursued pose substantive longer-term risks," he said. "It is very hard to quantify the risks associated with our unconventional policies. But they are real."

Plosser said these risks include moral hazard, future inflation and loss of institutional credibility.

On the moral hazard front, he said the Fed runs the risk of altering the public's expectations of how policy will be conducted in the future.

With regard to inflation, he again warned of a potentially rapid rise in loan growth once the recovery strengthens, forcing Fed action to restrain inflation.

In addition, "The bigger our balance sheet, the more difficult it will be to exit in a way that meets our inflation objective without creating instability in the real economy, thereby undermining our credibility and reputation," Plosser said.

With the Fed's balance sheet now mostly made up of long-term securities, Plosser predicted that as interest rates rise, the Fed would very likely incur substantial losses if it had to sell its assets at a very rapid rate to restrain inflation.

Plosser went on to lay out four principles that he believes should guide monetary policy decisions: be clear and explicit about the goals and objectives of policy; articulate a reaction function or rule that will guide policy decisions consistent with those goals; be clear and transparent in communicating to the public the policy actions that are taken; and strive to ensure independence.

The Fed should have "a more rule-like approach" to its decision-making process, he argued.

The central bank should put in place a robust set of rules that suggest "policy should respond aggressively to deviations of inflation from target but more modestly to measures of economic slack, such as output gaps or unemployment," Plosser said.

"These robust rules also tend to exhibit inertia that prevents the policy rate from significant swings or volatility," he added.

Laying out these rules as guides provides the best kind of forward guidance, he said, which would be helpful in stabilizing the economy and the path of inflation.

While some would favor the use of thresholds in communication by the Federal Open Market Committee, the Fed's steering group, Plosser said there is no empirical evidence that such a strategy would succeed or that it would be of quantitative significance.

"The systematic approach I advocate is more transparent than thresholds because it gives the public much more information on how those policy decisions will be made, based on changes in economic conditions," he said.