MarketNews international | DEUTSCHE BÖRSE GROUP

Fed Lacker/Media:Less Confident Re MMFs Ability To Weather EU

By Brai Odion-Esene

November 16, 2011

--Does Not See Need For Addt'l MBS Buys; Can Have Impact W/Just Tsys

WASHINGTON (MNI) - Richmond Federal Reserve President Jeffrey Lacker Wednesday said the Fed is working to ensure U.S. financial firms are prepared to deal with a potential meltdown in the euro area, however, he is more concerned about the ability of money market funds to weather an escalation in the crisis

Speaking with reporters after remarks to the Cato Institute's annual monetary policy conference, Lacker was asked by Market News International to comment on the U.S. banking system's level of preparedness for a worsening of conditions in the Eurozone.

Lacker said the Fed has "done a lot" to prepare the banking sector for the potential of a major financial market fallout from the EU sovereign debt crisis.

"I'm less confident about money market funds and their ability to weather major problems at European institutions," he said.

Pressed to provide more detail on what the Fed could do to aid U.S. financial institutions should problems in Europe escalate, Lacker said the Fed has learned as much as it can -- and made sure banks do the same

-- about their direct and indirect exposures.

"All the measures we've generally taken to promote financial stability -- increasing capital, increasing their liquidity buffers -- would all be useful in the event of such a problem," he added.

Lacker, who will be a voter on the Federal Open Market Committee next year, said in his prepared remarks that he favored a regime in which the Fed was restricted to just purchases of U.S. Treasury securities on the open market.

Asked if this means he would oppose any additional large-scale purchases of mortgage-backed securities by the Fed, Lacker replied that while he will reserve judgment until a proposal is made, he would have to ask the question of, "Could we achieve an equivalent monetary stimulus without having to go into the MBS market?"

"My sense is given the magnitude of Treasuries outstanding, anything we can do with MBS we can do, in my mind, even better with Treasuries," Lacker argued.

The Federal Reserve has been exploring measures to enhance its transparency and communications with regard to future monetary policy, but the FOMC has yet to announce any new initiatives.

Lacker said greater transparency should be achievable for the Fed. He added, however, that deliberation within the committee on this issue have been slowed down because there are so many different perspectives.

"It might be the case that we could have achieved a consensus on transparency measures more rapidly with a more cohesive group," he said.

Lacker said there are many ways through which the Fed could increase transparency, adding, "For a long time I've advocated an explicit numerical inflation objective."

"Compared to other things we could do ... I think that is the most important thing we could do to clarify our framework," he said.

As for his outlook for the economy, Lacker said he believes growth is likely to trend up from around 2.5% to "the neighborhood" of 3% to 3.5% over the next couple of years. On the inflation front, he sees prices to remain around 2% in the same period.

The unemployment rate, on the other hand, is likely to fall "only slowly" in that timeframe, Lacker said, "maybe a percentage point or two."

Recent data has shown the pace of inflation in the U.S. has moderated, with October's Consumer Price Index falling by 0.1% and rising a mere 0.1% excluding food and energy.

Lacker said while he was pleased to such very moderate inflation figures, he remains apprehensive about inflation risk in the United States.

"We've tolerated a good half year of 4% inflation," Lacker said. He added that the 3.5% year-over-increase in CPI is too high in his opinion.

"I remain concerned about the possibility of upside risks to inflation," he said.