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Fed's Plosser More Sanguine on Growth Than Many Forecasters

By Scott Lanman and Alex Kowalski - Nov 18, 2010

Federal Reserve Bank of Philadelphia President Charles Plosser said he's more sanguine than many economists about the outlook for U.S. growth and isn't concerned about the risk of deflation.

Many forecasters "anticipate a protracted period of modest economic growth, accompanied by a slow decline in unemployment," Plosser said today in a speech in Washington. "I am more optimistic than many about the future path of the economy. However, I share the frustration of many with the pace of recovery."

Plosser didn't elaborate on his outlook or discuss current Fed policy in his prepared text, including the Nov. 3 decision to buy $600 billion in Treasuries in a bid to reduce unemployment. Plosser, who isn't a voting member of the Fed's Open Market Committee this year, said before the action that he didn't support further asset purchases.

"Some even worry that the economy might fall into a deflationary trap," Plosser said at the Cato Institute's annual monetary conference. "I am not one of them."

Plosser devoted most of his speech to discussing why central banks shouldn't raise interest rates to pop asset-price bubbles.

Some Fed officials, including Chairman Ben S. Bernanke, have been rethinking views in light of criticism that low Fed interest rates helped fuel the U.S. home-price bubble in the past decade. The bursting in home prices triggered the worst financial crisis since the Great Depression.

Housing Bubble

Bernanke said in January that monetary policy wasn't responsible for causing the housing bubble and the best response to the problem would have been "regulatory, not monetary." At the same time, he said that if the next wave of regulation proves "insufficient to prevent dangerous buildups of financial risks, we must remain open to using monetary policy as a supplementary tool for addressing those risks."

Plosser said today that "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."

Instead, "the central bank should systematically vary its target interest rate in line with movements in an estimate of the real interest rate," Plosser said.

Pop Bubbles

In some ways, the arguments against using interest rates to pop asset-price bubbles are similar to those against using monetary policy to narrow the so-called output gap between actual and potential growth, Plosser said. If the "current high unemployment rate" is the result of other causes besides aggregate demand, "accommodative monetary policy will not effectively address the problem, and thus risks higher inflation," he said.

Some economists have "argued that the heavy reliance on mismeasured or misperceived output gaps was 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. He didn't refer to the Fed's current situation.

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