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VICE CHAIRMAN JIM SAXTON

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Contact: Christopher Frenze
Chief Economist to the V.C.
(202) 225-3923

FEDERAL RESERVE POLICY FACILITATED BY MARKET PRICE INDICATORS ACCORDING TO NEW JEC STUDY

WASHINGTON, D.C. – To the extent that the Federal Reserve relies more on market price indicators and less on labor market or output indicators to guide its policy, it will be more likely to be successful in producing price stability, a Joint Economic Committee (JEC) study released today by Vice Chairman Jim Saxton finds. According to the study, market price indicators -- commodity prices, bond yields, and the value of the dollar -- better reflect future changes in prices than do labor market or output measures. The new study, *The Performance of Current Monetary Policy Indicators*, analyzes the effectiveness of alternative monetary policy indicators under a regime of informal inflation targeting, as successfully practiced by the Federal Reserve under Chairman Greenspan.

"This study explains why the Federal Reserve has been wise to follow Chairman Greenspan's lead in de-emphasizing the role of the Phillips curve and similar ideas in setting monetary policy," Saxton said. "As Chairman Greenspan has explained many times before the Joint Economic Committee and elsewhere, there is no reliable trade-off between inflation and unemployment. The Fed under Greenspan has demonstrated that its policy of informal inflation targeting can reduce inflation, interest rates, and unemployment all at the same time. Greenspan also resisted the pressure of those who periodically urged Fed tightening because of strong economic growth and a healthy labor market characterized by low unemployment.

"I think the critical role of inflation targeting in Fed policy has not received adequate public attention. Greenspan's great success is due to his implementation of informal inflation targeting, and the economic success of this policy speaks for itself. My own view is that inflation targeting should be formalized, and I have introduced legislation to accomplish this objective. As a recent article in the *Wall Street Journal* suggested, it also appears that the Fed's implementation of informal inflation targeting has been influenced to some extent by the work of the Swedish economist Knut Wicksell.

"An explicitly Wicksellian analytical framework is the basis of the new JEC study. This study builds on earlier JEC research in explaining not only the central importance of inflation targeting for a successful monetary policy, but the need for implementing this policy through intermediate market price indicators rooted in the work of Wicksell. To evaluate the forces affecting the general stability of prices and the potential for inflation, the focus should be on price measures, not output or labor markets. More specifically, a focus on commodity prices, bond yields, and the value of the dollar together is shown to be a far more reliable guide to monetary policy than alternatives related to the low unemployment rate that would have implied a tighter monetary policy in recent years at a time of great international economic volatility,'' Saxton concluded.

Former Federal Reserve economist Dr. Robert E. Keleher authored the new study, as well as a number of related studies on monetary policy available from the Joint Economic Committee.

For more information on the Federal Reserve and monetary policy, please visit our website at www.house.gov/jec.

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