SHADOW OPEN MARKET COMMITTEE
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Contacts: Charles Plosser (716) 275-3316, Anna Schwartz (212) 817-7957

WASHINGTON, DC—At its semiannual meeting today the Shadow Open Market Committee (SOMC) referred to its forecast of a strong economic rebound made at its last meeting in October 2001 and stated that now "the recovery is well under way, and the risks of higher inflation are growing."

According to the SOMC, "The negative real federal funds rate and excess liquidity are incompatible with stable, low inflation and a sustained healthy economic expansion." The SOMC urged the Federal Reserve to raise its federal funds rate target and tighten monetary policy promptly. It noted that, "as real rates rise with an improving economy, increasing the real federal funds rate will not adversely affect the recovery." Delayed tightening risks higher inflation and potentially undesired volatility in economic performance.

The SOMC repeated its long-standing recommendation that Congress "adopt a monetary standard that would establish price stability as the Federal Reserve's primary responsibility."

In a time when corporate governance is under close scrutiny, the committee also recommended that the Federal Reserve conduct a self-examination of its own governing rules with the objectives of further improving transparency, enhancing information flow about commercial banks' use of off-balance sheet activities, and ending the Federal Reserve's "warehousing" arrangement for foreign intervention.

Addressing the issues of corporate governance and accounting standards, the SOMC argued that the government must maintain property rights and contracts and provide remedies against fraud and misrepresentation; it should, however, avoid intruding into private matters through regulatory expansion, recognizing that markets provide effective discipline against misbehavior.

The SOMC noted that Argentina has failed to address its structural and fiscal problems, and that its economic prospects remain dismal. It urged the IMF to hold off making further loans until Argentina's internal problems are addressed. With respect to the Argentina debt crisis and consequent reverberations in currency markets, the committee said that the use of floating exchange rates is often part of a desirable monetary policy regime.

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