SHADOW OPEN MARKET COMMITTEE
News Release
May 2, 2005

HOLD FOR RELEASE UNTIL 11 A.M., May 2, 2005
Contacts: Charles Plosser (585) 275-3316, Anna Schwartz (212) 817-7957

Washington, DC -- The Shadow Open Market Committee (SOMC) today encouraged the Federal Reserve to continue to tighten monetary policy.

"We believe that a higher federal funds rate is necessary to restrain growth in the monetary aggregates and thereby maintain a credible policy of low and stable inflation," the committee said.

The SOMC urged that the Fed act given the sustained monetary policy accommodation and in accordance with the asymmetric loss from ignoring adverse developments in inflation and inflation expectations.

At its semi-annual meeting, the committee also pointed to large fiscal deficits as symptomatic of the excessive size of government. With respect to monetary policy, however, it noted that "although ongoing fiscal deficits can be undesirable, the Fed should not tailor its monetary policy in any way to prospects for such deficits. Instead the Fed should simply be resolute in conducting monetary policy so as to achieve its (implicit) target for inflation."

The SOMC also advocated that the Fed adopt a more tangible inflation goal in order for the institution to retain its credibility regardless of who becomes the next FOMC chairman. It noted that "an explicit institutional pre-commitment to longer term price stability as the dominant objective of monetary policy would enhance the credibility of the Fed and limit future monetary policy mistakes." The committee stressed that such a commitment leaves ample flexibility for the Fed to respond to other developments if it deems it prudent.

The committee noted that important "factors underlie the country's sound economic fundamentals and distinguish its performance from other large industrialized nations." Real output growth for the first quarter of 2005, well within the range of potential growth, whose standard estimates center around 3.5 percent.

The SOMC also urged the Bush Administration to remain vigilant in support of free trade and to oppose protectionism in the face of a declining dollar and a high current account deficit. Protectionist measures have "not served to narrow the current account deficit in the past, and won't do so now." Rather the U.S. should help "newly emerging economies develop the institutions that will allow free markets to flourish."

Shadow Open Market Committee Web Site:
http://www.somc.rochester.edu