SOMC POLICY STATEMENT SUMMARY

September 27, 1999

WASHINGTON, D.C.—"The risk of higher inflation remains," concluded the Shadow Open Market Committee (SOMC) at its semiannual meeting today.

According to the SOMC, "Money growth remains too high, raising growth of nominal aggregate demand." It urged the Federal Reserve to "act promptly to bring the growth rate of the monetary base back to 4 percent"

The SOMC noted that falling prices of imports and traded commodities had suppressed reported inflation in 1997-98. These one-time changes are now ending, so the measured rate of inflation will rise.

Higher wages are not the source of inflation as is commonly believed, the committee said in its statement. The most reliable evidence shows that "on average, wage changes do not lead price changes. Wages and prices are jointly determined." Instead of wage trends, the Federal Reserve and markets should watch money growth and productivity changes, the best predictors of the rate of price change.

The future pace of productivity gains is uncertain due to the difficulty of measuring output and productivity in many industries and the very narrow base of recent productivity gains in the durable goods industry, the SOMC said. Fortunately, precise knowledge about productivity growth is not necessary for the conduct of monetary policy: "If the Federal Reserve conducted monetary policy to achieve a zero inflation rate the error in assumed growth of output and productivity would not be a problem," the committee said.

The SOMC concluded that the Federal Open Market Committee's (FOMC's) "bias announcements" are a bad idea, creating more uncertainty and confusion than transparency. "Members of the FOMC have not agreed on what the announcement means," said the SOMC statement. It went on to emphasize that the best way for the Federal Reserve to achieve transparency and enhance long-run economic performance is to institutionalize explicit policy procedures" for achieving zero inflation.

The SOMC noted the weakness of the Euro currency but concluded that it was too early to be either euphoric or pessimistic about long-term prospects for the new currency.

Whether the Euro becomes a strong stable currency “depends on the ability of the European Central Bank to sustain credibility at low inflation and the ability of European governments to solve structural problems.”