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Closing Remarks

by

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Board of Governors of the Federal Reserve System

at

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The Federal Reserve will almost surely face as many uncertainties over the next eighteen years as it has over the past eighteen. Technology continues to bring rapid change and, hence, considerable uncertainty, to the global marketplace. Monetary policy, supervision and regulation activities, and payments system operation will need to be calibrated to respond to the influences of that technological change.

Other forces will be at work on the economic environment as well. The inexorable aging of our population will markedly influence the policy milieu in the years ahead. Monetary policy, for example, cannot ignore the potential inflationary pressures inherent in our current fiscal outlook, especially those that could arise in meeting commitments to future retirees. However, I assume that these imbalances will be resolved before stark choices again confront us and that, if they are not, the Fed would resist any temptation to monetize future fiscal deficits. We had too much experience with the dangers of inflation in the 1970s to tolerate going through another bout of dispiriting stagflation. The consequences for both future workers and retirees could be daunting.

Nearer term, the housing boom will inevitably simmer down. As part of that process, house turnover will decline from currently historic levels, while home price increases will slow and prices could even decrease. As a consequence, home equity extraction will ease and with it some of the strength in personal consumption expenditures. The estimates of how much differ widely.

The surprisingly high correlation between increases in home equity extraction and the current account deficit suggests that an end to the housing boom could induce a significant rise in the personal saving rate, a decline in imports, and a corresponding improvement in the current

account deficit. Whether those adjustments are wrenching will depend, as I suggested yesterday, on the degree of economic flexibility that we and our trading partners maintain, and I hope enhance, in the years ahead.

On monetary policy, I envision a continuous refinement of our risk-management paradigm. I presume maximum sustainable economic growth will continue to be our goal, with price stability pursued as a necessary condition to promote that goal. To date, we have chosen not to formulate explicit inflation targets, in part, out of concern that they could inhibit the effective pursuit of our goal.

I remain unpersuaded that explicit numerical inflation targets are a key characteristic that distinguishes behavior among the world's central banks. Despite the various public characterizations of the form of monetary policy regime, the Federal Reserve and most other central banks generally pursue price stability and, consistent with that goal, ease when economic conditions soften and tighten when they firm. That said, I am certain this will remain a topic of lively discussion here and at other monetary forums in years to come. Participants on all sides of that debate will be well served by keeping open minds and remaining attentive to the evidence as events unfold and practices evolve.

Debates on the relative merits of asset price targeting also will continue and possibly intensify in the years ahead. The configuration of asset prices is already an integral part of our evaluation of the large array of forces that influence financial stability and economic growth. But given our current state of knowledge, I find it difficult to envision central banks successfully targeting asset prices any time soon. However, I certainly do not rule out that future work could improve our understanding of asset price behavior, and with it, the conduct of monetary policy.

I will miss debates on such topics with members of the Federal Open Market Committee and with the staffs of the Board and the banks. The Federal Reserve is a remarkable institution. Aside from its technical expertise in supervision and regulation and in overseeing an increasingly complex payments system, it combines for monetary policy an academic sophistication and a market-sensitive understanding that is brought to bear in formulating the tie between instruments and the goals of monetary policy.

Surely difficult challenges lie ahead for the Fed, some undoubtedly of our own making, and others that will be thrust on us by market or other forces. Having been exposed to the inner workings of this extraordinary institution for nearly two decades, I have little doubt that my successors, and theirs, will continue to sustain the leadership of the American financial system in an ever-widening global economy.