

What Monetary Policy Can and Cannot Do

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Media Seminar  
Federal Reserve Bank of Cleveland  
July 20, 1992

NATURE OF AUDIENCE: The reporters who will attend the seminar do not follow monetary policy closely, and have a much more limited understanding of it than did the reporters in attendance at the Money Marketeers speech in New York. For example, some of the reporters do not know the difference between the discount rate and the federal funds rate.

A. PERSONAL INTRODUCTION

1. I recently returned:

to the Fed from the private sector.

to the industrial heartland from California (comments on bicoastal economies).

2. Reasons for these moves:

Banks here are among the strongest in the country.

The Cleveland Fed has a good reputation.

B. INTRODUCTION TO THE TOPIC

1. Now that I'm back at the Fed, many media people want to label me:

Hawk -- anti-inflation

Dove -- pro-growth

This is a false dichotomy.

Those who are anti-inflation are pro-growth.

Those who believe inflation is necessary to achieve growth are mistaken about the long-run relationship between inflation and growth, or else they don't care about the long run.

2. Reporters often ask my reaction to the latest economic statistics.

--to get clues about future Federal Reserve policy actions.

3. This focus on current statistics, and on Hawks and Doves, stems from confusion about what policy can and can't do. It also promotes that confusion.

4. I will discuss:

What monetary policy cannot do.

What monetary policy and the Fed can and should do.

The role of the press.

C. WHAT MONETARY POLICY CANNOT DO

1. Monetary policy cannot:

Produce real goods and services.

Create employment.

Reduce the unemployment rate.

Peg the real interest rate.

2. The Phillips Curve illusion:

The Phillips Curve illusion is that output and inflation are positively correlated -- that output will grow faster if only we accept more inflation.

In fact, inflation is negatively correlated with output in the long run.

3. Unfortunately, many of the financial press, and many government officials, use a Phillips Curve illusion framework when thinking about monetary policy.

4. The Fed cannot control the real interest rate.

The real interest rate is the rate that remains after the portion of the interest rate that compensates the lender for inflation has been subtracted from the actual, or nominal, rate.

It is the rate that matters for real economic activity.

It depends on the marginal rate of return to capital.

It depends on people's willingness to save -- their willingness to consume in the future instead of now.

It is not determined by monetary policy.

5. The Fed cannot push down nominal long-term interest rates through faster money growth.

D. WHAT MONETARY POLICY CAN AND SHOULD DO

1. What monetary policy can do:

It can avoid being a source of economic disturbances.

It can stabilize the aggregate price level.

Both of these foster real economic growth.

2. What a central bank should focus on:

Price level stability.

Creating a climate of certainty about future price levels.

3. How such a focus would help the economy:

Confidence in price level stability would remove an important uncertainty for all of us. It would enable business people, investors, workers, and consumers to make wiser plans for saving and investment.

It would eliminate the need for people and companies to spend time and effort trying to find ways to predict inflation and to hedge against it.

#### F. THE ROLE OF THE PRESS

1. In doing its everyday work, the press contributes to economic efficiency:

Business people, investors, workers, and consumers make decisions about what to produce, where to produce it, what to charge, what occupation to enter, what to invest in, what to buy, etc.

The better those decisions, the more efficient the economy, and the greater the rate of economic growth.

To make good decisions, people need accurate information about all manner of conditions, trends, changes, and events.

The press helps make such information available. That is one of the reasons why your work is so important.

2. Monetary policy is one of the most difficult topics to report on.

The Americas Cup races analogy illustrates the difficulty of formulating monetary policy, and the difficulty of discerning and communicating the logic behind its formulation and implementation.

3. My hope is that in reporting on monetary policy you will strive to take the view from the blimp rather than the view from the mast.

4. Also, my hope is that you will keep in mind that if economic growth is our ship's goal, inflation is an anchor and not a sail.

G. CLOSING

1. I will be glad to take a few questions.

2. Concluding comments:

Thank you for coming.

I hope the program has been productive for you.

# **FOURTH DISTRICT MEDIA SEMINAR**

**JULY 20, 1992**



**FEDERAL RESERVE BANK  
OF CLEVELAND**

## PROGRAM

<b>Who</b>	Business writers and reporters in the Fourth Federal Reserve District	<b>9:00 a.m.</b>	<b>Registration and Continental Breakfast</b> (9M Conference Room)
<b>What</b>	A half-day workshop focusing on banking and economic issues	<b>9:15 a.m.</b>	<b>Responsibilities of the Federal Reserve Bank of Cleveland and its Board of Directors</b>  Sandra Pianalto, Vice President, Public Affairs and Bank Relations, and Secretary of the Board
<b>When</b>	Monday, July 20, 1992	<b>9:45 a.m.</b>	<b>Performance of Fourth District Banks</b>  Chris Moore, Vice President, Banking Supervision and Regulation
<b>Where</b>	Federal Reserve Bank of Cleveland East 6th St. and Superior Ave. Cleveland, Ohio	<b>10:15 a.m.</b>	<b>Break</b>
<b>Why</b>	Provide background information on issues of interest to the news media	<b>10:30 a.m.</b>	<b>Update:</b> <b>Home Mortgage Disclosure Act (HMDA)</b> <b>Community Reinvestment Act (CRA)</b>  Mark Sniderman, Vice President and Director of Research; Mike Carroll, Senior Director, Banking Supervision and Regulation
<b>Questions?</b>	Contact June Gates, Public Affairs Department, at 216/579-2048	<b>11:30 a.m.</b>	<b>Environmental Issues and Local Economic Development</b>  Randall Eberts, Assistant Vice President and Economist
		<b>12:00 noon</b>	<b>Lunch</b> (Large Dining Room, 8th Floor) <b>What Monetary Policy Can and Cannot Do</b>  Jerry Jordan, President, Federal Reserve Bank of Cleveland
		<b>1:30 p.m.</b>	<b>Bank Tour</b> (optional)

Yes, I will be attending the Fourth District Media Seminar on July 20, 1992:

Name \_\_\_\_\_

Company \_\_\_\_\_

Address \_\_\_\_\_

Telephone \_\_\_\_\_

Please detach and return this reply card by Thursday, July 9, 1992.