THE FEDERAL RESERVE BANK of ST. LOUIS

NEWS RELEASE

The Federal Reserve Bank of St. Louis
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Contact:
Charles B. Henderson, (314) 444-8311

St. Louis Fed's *Review*:
Price-Level Uncertainty and Inflation Targeting
The FOMC in 1998: Can It Get Any Better Than This?
Can Market-Clearing Models Explain U.S. Labor Market Fluctuations?
Is Inflation Too Low?

ST. LOUIS, Mo. — The latest edition of *Review*, the Federal Reserve Bank of St. Louis' journal of economic and business issues, features the following articles:

• **"Price-Level Uncertainty and Inflation Targeting."** At least eight central banks around the world have adopted explicit targets for inflation. Yet because these countries have to weigh numerous variables, such as employment and GDP, there is considerable uncertainty about future prices. Mathematician Robert Dittmar and economists William T. Gavin and Finn E. Kydland suggest that adding a long-term price-level objective to the short-run inflation targeting process may reduce the long-run uncertainty about prices without giving up concern for other things. They show that if the long-run goal is credible, private sector expectations will have a stabilizing effect on inflation and the business cycle.

• **"The FOMC in 1998: Can It Get Any Better Than This?"** The U.S. economy displayed another solid performance in 1998, with faster real growth and employment gains and lower inflation than many observers had expected. Looking at the FOMC's actions last year,

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economist David C. Wheelock shows that from the standpoint of monetary policy, the year's pivotal point occurred in August, when the Russian government defaulted on its domestic debt and devalued the ruble. Before August, however, policymakers focused on whether an explicit policy tightening would be needed to slow domestic demand enough to prevent an increase in inflation. An upset in the financial markets triggered by the Russian government's actions, coupled with ongoing weakness in Asia and Latin America, precipitated a scramble for liquidity and safety affecting U.S. financial markets. Wheelock concludes that the FOMC eased policy on three occasions not only to alleviate financial markets but also to preserve the ongoing economic expansion.

• **"Can Market-Clearing Models Explain U.S. Labor Market Fluctuations?"** The theory of the Real Business Cycle (RBC) explains how disturbances to national productivity affect the cyclical behavior of GDP, consumption and investment. One of the primary weaknesses of the standard RBC model, however, is its inability to account for some important aspects of U.S. labor markets. Economist Victor E. Li summarizes facts about the U.S. business cycle and looks at how — and why — these market-clearing models have so much difficulty explaining facts about the labor market. Li demonstrates how more realistic treatment of unemployment and incomplete risk-sharing may better account for these facts.

• **"Is Inflation Too Low?"** Inflation, as measured by the Consumer Price Index, seems to have settled at an annual rate of about 2 percent. Is that rate too low? William Poole, the president of the St. Louis Fed, states his belief that the Federal Reserve's target should be zero inflation. His

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argument is that an inflation rate of zero would maximize the credibility of monetary policy and minimize distortions in the economy arising from uncertainty over the rate of inflation and the tax code.

Subscriptions to ***Review*** are free and can be obtained by calling (314) 444-8809. The publication is also available on the St. Louis Fed's Web site: www.stls.frb.org.

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