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ECONOMIC NEWS UPDATE

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18 November 2005

The easy part is almost over. The Senate Banking committee has declared itself satisfied with Ben Bernanke's responses to its members' not particularly penetrating questions, and overwhelmingly recommended that the full Senate confirm the president's choice to succeed Alan Greenspan for a 14-year term as Governor of the Federal Reserve System, and a four-year term as its Chairman. The press was impressed with Bernanke's combination of modesty and command of his material and his audience. "The nominee, with a serene smile and droopy eyelids, leaned forward in his chair and clasped his fingers as the praise washed over him. Bernanke defanged the senators...". Judge Alito should be so lucky.

Bernanke's formal coronation is set for January.

Now comes the hard part -- filling the shoes of a predecessor who has become a legend in his own time, a man whom Richard Shelby, chairman of the Senate Banking committee, said is considered by some "to be the greatest central banker of all time." Bernanke adds his own homage to the legend

when he says that he aspires to succeed Greenspan, but it is not possible to replace him.

In addition to an oversize pair of empty brogans, Greenspan has left the new boy an inheritance that includes not only a rapidly growing economy, but a few ticking time bombs.

True, the economy is growing at an annual rate of almost 4%; the unemployment rate is a low 5%; oil prices are heading down; the dollar remains strong as foreigners pour money into US assets; and retail sales (excluding cars) are growing at a rate that has many shopkeepers quietly optimistic about the coming holiday season.

But even Greenspan concedes there is "froth" on house prices. The double-digit price rises of recent years have had two important economic consequences. First, Americans are growing wealthier, and therefore confidently spend just about every dollar they earn. Second, rising prices created a source of wealth that could be tapped by extracting equity from consumers' increasingly valuable homes. And tap it

they did, to the tune of some \$600 billion per year.

With interest rates heading up, inventories of unsold houses rising, mortgage applications falling, housing starts down 5.6% in October, buyers hesitating before signing on the dotted line even when offered free memberships in golf clubs, the froth may be off the rose, to mix metaphors. But Bernanke will have little choice but to continue Greenspan's program of interest rates increases, at least early in his tenure. With the core inflation rate seeping above the chairman-to-be's "comfort range" of 1%-2%, inflation expectations would soar were he to call a halt to rate increases.

In short, Bernanke might have to keep raising rates as the housing industry, the most interest-sensitive sector of the economy, goes from boom to bust, perhaps dragging the economy down with it.

He also worries that the burgeoning trade deficit, now well above levels previously considered unsustainable, might during his tenure bring to an end the recently exhibited strength of the dollar. Greenspan has warned that there will be a point at which the rest of the world will no longer want to increase the height of the pile of dollars it now holds. Bernanke agrees. When that point is reached, the dollar might begin a gentle slide -- or it might plummet, triggering an inflationary spiral. If the grimmer of the possible scenarios unfolds, we will get an answer to the one question that troubles even Bernanke's many admirers. Will he be able to cope with crises with the sure, calming touch that Greenspan demonstrated time after time during his 18-year tenure?

Meanwhile, we now know more about this academic, monetary economist than we did a short while ago. He believes that "long-run price stability is essential for achieving maximum employment", that monetary policy should be "coherent, consistent, and predictable" as well as "increasingly transparent". No surprises there. Nor should anyone be surprised at Bernanke's reiteration of his long-held support for "the explicit statement of a long-run inflation objective" -- read "inflation targeting" -- in the style of the Bank of England and other central banks in countries with such explicit objectives but, it should be noted, with economies less successful than America's. True, the nominee argues that such a policy is consistent with what the Fed has done under Greenspan, but that argument is more a bow to legislators and investors who fear a break with the past, than an entirely persuasive proposition. Be sure of one thing: Bernanke will rely less on intuition and anecdote than Greenspan famously and effectively does, and more on transparent data and economic theory.

The use of explicit targeting by a Bernanke Fed instead of the more flexible policy favored by Greenspan might well be a distinction without a difference, since an inflation target of 2% per year would not produce very different policies than have been applied by the outgoing chairman, who would also be concerned if the inflation rate exceeded 2%. But the more mechanistic approach might cause the new Bernanke-led Fed to miss major structural changes in the economy. Perhaps Greenspan's greatest contribution to America's long-running economic growth was his early understanding that a productivity

revolution was underway, but was not yet revealed in the usual data. Knowing that rising productivity would keep costs down, Greenspan was convinced that an expansionary monetary policy would not lead to inflation. So he kept interest rates low, stimulating sustained growth.

Bernanke also understands the importance of growth, and is keenly aware that one of his responsibilities is to maintain maximum employment. Shortly before he was chosen by the president, Bernanke told a meeting of economists, “For meaningful economic opportunity to be available to everyone... the economy as a whole must be growing and developing in a healthy way... [and] there must be a

reasonable expectation that anyone who plays by society’s rules will share in the economy’s gains.”

One thing is certain: when Bernanke speaks, fewer brows will furrow; for better or worse, clarity will be the order of the new day at the Fed.

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THE SUNDAY TIMES

A version of this Update appeared in
The Sunday Times (London)