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VICE CHAIRMAN JIM SAXTON

PRESS RELEASE

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Contact: Christopher Frenze
Chief Economist to the V.C.
(202) 225-3923

NEW GREENSPAN LETTER EXPLAINS THINKING ON INFLATION/UNEMPLOYMENT TRADEOFF THEORY

– Greenspan Letter Also Reflects on Use of Market Price Indicators –

WASHINGTON, D.C. – Federal Reserve Board Chairman Alan Greenspan's expression of scepticism of the notion that there is a simple tradeoff between rates of unemployment and inflation was welcomed today by Vice Chairman Jim Saxton of the Joint Economic Committee. Saxton also welcomed Chairman Greenspan's use of market price indicators – bond yields, commodity prices, and exchange rates – along with other data. Greenspan's letter was a response to a letter of Saxton's inquiring about the analytical basis for current Fed interest rate policy.

"I am encouraged with the clarity with which Chairman Greenspan discusses the Phillips curve issue," Saxton said. "Chairman Greenspan views the supposed Phillips curve tradeoff between unemployment and inflation as simplistic. Greenspan also notes his review of the market price indicators as important components in an evaluation of the inflation outlook and their implications for monetary policy. Here at the JEC, we have found these same market price indicators to be extremely useful, although their direct applications for monetary policy are subject to interpretation," Saxton concluded.

The text of the letter to Vice Chairman Saxton follows:

Dear Mr. Vice Chairman:

Thank you for giving me the opportunity to respond to the concerns regarding monetary policy that you raised in your recent letter.

I am confident that we agree on the long-run objectives for monetary policy. We also both recognize the existence of significant lags in the effects of monetary policy on the economy and inflation. The challenge for monetary policy is to form reasonably accurate judgments about the effects of current financial conditions, as influenced by the stance of monetary policy, on the economy and prices in the future.

In my experience, there is simply no substitute in forming such judgments for examining a very broad range of economic and financial data for implications about the future situation. In particular, I have often stated that I am quite skeptical of highly simplified rules of thumb that relate changes in inflation to the unemployment rate. I believe that the economy is far too complex to be reduced to such simple relationships as are represented by Phillips curves. Indeed, I have found it useful in discerning economic and price trends to examine intensively a large volume of highly detailed and disaggregated information--including both statistical data and anecdotal information--drawn from all aspects of the economy.

Economic imbalances that may foreshadow inflationary or other adverse developments in the future can, of course, be manifested in nonfinancial measures of performance in product or labor markets. But it would be a mistake to restrict one's attention, or give particular emphasis, to such nonfinancial data. For example, I have recently been closely examining yields on corporate bonds for information about market expectations about the future path of the economy, inflation, and the stance of monetary policy. Similarly, I continue to monitor carefully trends in commodity prices and exchange rates.

We also are trying to interpret the yield curve on Treasury securities for clues about the appropriate course of policy. However, Treasury yields evidently have been distorted by market expectations of declines in the supply of Treasury debt triggered by the development of federal budget surpluses and the related program instituted by the Treasury to buy back outstanding debt. This development illustrates quite clearly that economic and financial relationships seldom are immutable and points up the risks that would be entailed in keying monetary policy closely to a small set of indicators, be they nonfinancial or financial.

I hope these comments are helpful. Please let me know if I can be of further assistance. I very much appreciate the support you have given to the Federal Reserve in its conduct of monetary policy over the years.

Sincerely,
Alan Greenspan

For more information on the Federal Reserve and monetary policy, please visit our website at www.house.gov/jec.

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