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VICE CHAIRMAN JIM SAXTON

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FEDERAL RESERVE'S IMPACT ON INTERNATIONAL ECONOMY OF GROWING IMPORTANCE

WASHINGTON, D.C. — The Federal Reserve should continue to give consideration to the international economic effects of its monetary policies, according to a new study released today by Vice Chairman Jim Saxton of the Joint Economic Committee (JEC). The study, "*International Dimensions to U.S. Monetary Policy*," highlights the growing international importance of Federal Reserve monetary policy in an increasingly integrated global economy.

"Federal Reserve monetary policy can have important effects on other economies, just as external economic forces can affect our domestic economy," Saxton said. "For example, one of the most impressive actions of the Federal Reserve in recent years was its three interest rate cuts in the fall of 1998 that stemmed potentially deflationary forces in the international economy as well as our own. As the new JEC study notes, this example also demonstrates how the Federal Reserve can successfully assume international lender-of-last-resort responsibilities.

"According to the study, several recent trends may have increased the international impact of U.S. monetary policy. First, in recent years there has been increasing international financial integration and growing capital mobility. Second, the international importance of the U.S. dollar as a reserve currency has continued. Third, there has been unofficial and official dollarization in a number of emerging market economies.

"The evidence indicates that changes in U.S. monetary policy can affect emerging market economies in several ways. Federal Reserve monetary policy can affect capital flows, the potential for financial instability, and interest rates and financial markets in emerging market economies. Of course, these international effects can produce feedback effects in our own economy.

"The study discusses these issues in light of the monetary policy "trilemma": a nation cannot maintain fixed exchange rates, capital mobility, and domestic inflation objectives all at the same time. In this context, the Fed's *de facto* inflation targeting regime must be viewed as very successful in terms of its economic results, especially given its actions as a lender of last resort.

"One major challenge for U.S. monetary policy is to retain its focus on price stability while taking these international effects of U.S. policy into account. The maintenance of price stability directed by close monitoring of forward-looking market price indicators -- such as various measures of the dollar exchange rate, commodity prices and bond yields, along with similar global measures -- provides guides to attain these monetary policy goals."

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