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WASHINGTON, DC -- With core inflation hovering at 2 percent and headline inflation exceeding 3 percent, “the Federal Reserve must take additional steps to ensure that long-run inflation remains low and that inflationary expectations remain anchored,” the Shadow Open Market Committee said at its semi-annual meeting today.

The SOMC noted that even though the Fed will have raised the federal funds rate to 5 percent with this week’s widely anticipated rate hike, from 1 percent in mid-2004, and the monetary aggregates have been rising modestly, “the Fed’s inflation fighting credibility is being challenged.” With nominal Gross Domestic Product (GDP) growing rapidly and core inflation at the upper bounds of its acceptable range, “some further increase in the federal funds rate may be required.”

The recent episode in which Chairman Bernanke was misinterpreted, which, according to the SOMC, is “to some extent a product of the Fed’s own action ... [and] highlights the Fed’s continuing communication problems.”

The SOMC repeated its long-standing recommendation urging the Fed to adopt an explicit inflation target and in addition urged the Fed to begin issuing a periodic inflation report that includes the Fed’s inflation outlook and its views on the inflation process. Such reports are common among the major central banks that target inflation, the SOMC noted, and “they have proved to be valuable communication devices.”

The SOMC also suggested that the Fed reassess its responsibilities in activities beyond the conduct of monetary policy – such as margin requirements and foreign exchange intervention. The SOMC expressed concern that “the scope of these activities diverts the Fed from its primary responsibility of conducting monetary policy,” and called the start of Chairman Bernanke’s term “an opportune time for the Fed to reexamine the scope of its activities.”

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