WASHINGTON, D.C. – At its semi-annual meeting today, the Shadow Open Market Committee said it approved of recent monetary policy actions. To sustain an inflation rate of 1 to 2 percent, the SOMC recommends that the Federal Reserve take actions to maintain the recent 3-5 percent growth of the monetary base.

The SOMC noted that as the economy slows, real interest rates are likely to decline. As economic conditions change short-term interest rates are not a reliable measure of monetary thrust.

“Thus, the federal funds rate may need to be adjusted to maintain money growth along a stable, low-inflation path,” the committee’s statement said.

The SOMC cautioned that estimates by some observers and policy makers of potential GDP growth of 4-5 percent are excessive. It said, “sustainable trend growth of approximately 3 to 3½ percent is a sounder basis for conducting monetary policy.”

Future budget surpluses are likely to be smaller than current projections, the SOMC said. It questions the assumption that tax receipts will remain at the current historical high share of GDP, and notes that spending on discretionary programs have already violated their legal caps established by the Budget Control Act of 1997. It urged policy makers to step beyond politics and “face up to the problems of Social Security and Medicare.”
The large trade and current account deficits should not be of concern to policy makers in the SOMC’s view. It urged officials to resist pressures to manipulate the exchange rate or reduce imports through protectionist policies. “The U.S. should not be lured into debate or action over the value of the Euro,” said the SOMC.

The new Administration and Congress should aggressively pursue reform of the IMF and World Bank. Without reforms, including limitations on the scope of the IMF, “the world is likely to experience crises that it could otherwise avoid.”

Noting the Federal Reserve’s successful reduction of inflation, the SOMC strongly urges that the U.S. follow other nations and institutionalize an ongoing commitment to price stability.

The SOMC announced that its founding chairman, Prof. Allan H. Meltzer of Carnegie Mellon University, is retiring from the committee. Prof. Bennett McCallum of Carnegie Mellon University and Prof. Alan C. Stockman of the University of Rochester have joined the committee. Prof. Charles Plosser of the University of Rochester and Dr. Anna J. Schwartz of the National Bureau of Economic Research, succeed Prof. Meltzer as co-chairs.

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