Written by Thomas R. Eddlem on November 2, 2012

Boston Fed Chairman Calls for More Inflation, Even If It Doesn't Help Economy

Federal Reserve Bank of Boston President and CEO Eric S. Rosengren told a Babson College audience November 1 he favored the Federal Reserve continuing QE3 policies at least until unemployment falls below the 7.25 percent marker, even if the policies fail to stop another recessionary spike in unemployment. The Federal Reserve Bank's third round of "quantitative easing," popularly called QE3, is an inflationary monetary policy that suppresses short-term interest rates through the Fed's discount "Federal Rate" to banks to near zero, and suppresses long-term interest rates by the Fed purchase of $40 billion per month of mortgage-backed securities on the open market.

"The program has so far worked as expected," Rosengren told the Boston-area college audience. "Our use of unconventional policy tools has led to lower longer-term interest rates; higher equity prices; and, in a peripheral by-product of lower U.S. rates, exchange-rate effects." But later in the speech the Federal Reserve Bank branch chairman admitted the Fed didn't really have any confidence their policies would work. "We must acknowledge the uncertainty surrounding the efficacy of these policies, as well as our ability to execute a graceful exit from unconventional policy."

Rosengren said he wanted the Fed to follow the current open-ended policies at least until unemployment levels fall below 7.25 percent, though possibly even beyond that marker. "My own personal assessment is that as long as inflation and inflation expectations are expected to remain well-behaved in the medium term, we should continue to forcefully pursue asset purchases at least until the national unemployment rate falls below 7.25 percent and then assess the situation."

Free market Austrian school economists — among the few in the profession who warned of a Federal Reserve-created housing bubble from suppressed interest rates as early as 2001 — have warned that suppressing interest rates just creates more economically inefficient borrowing that leads to economic bubbles, bankruptcies and recessions.

Interestingly, Rosengren said he would seek to continue and possibly accelerate the inflationary policy even if it doesn't work. "Should the economy experience another shock — say from a U.S. "fiscal cliff" situation or a shock from abroad, then we could lengthen the period of purchases or increase the amounts (or both)."

Rosengren said that the Federal Reserve will follow the model of Japan, a nation that has pursued for two decades almost identical policies those which the Fed embarked upon in September. "Beyond the U.S. situation, I would also point to Japan's experience as instructive. As I have pointed out many times, despite having an expanded balance sheet for an extended period, the Japanese continue to struggle with a deflation problem rather than an inflation problem." The problem is that in its push for monetary easing (inflation), Japan has experienced a two-decade-long drought of economic growth. Austrian school economists see a cause-and-effect with the Bank of Japan policies, while establishment U.S. Keynesian economists such as Rosengren see the Japanese problem as not having created enough inflation.

Official Federal Reserve policy was reiterated on October 24 by the Federal Reserve Bank's ruling Open Market Committee (FOMC), of which Rosengren is a member. "Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability," the FOMC stated, "the Committee also decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015." But FOMC Chairman Ben Bernanke has also set a goal of changing prices — by increasing the prices of commodities as measured by the Consumer Price Index by two percent per year. "The Committee also anticipates that inflation over the medium term likely would run at or below its 2 percent objective."

So how is seeking perpetually rising prices fulfilling it's legal mandate of "price stability"? It isn't, except in the expectations game.

The Open Market Committee had only one dissenting vote in pursuing QE3 — Jeffrey M. Lacker, chairman of the Federal Reserve's Richmond branch — out of 13 total votes. Lacker argued in a speech posted on the Richmond Fed website that he was concerned about inflation and that "that labor market conditions have been held back by real impediments that are beyond the capacity of monetary policy to offset." Lacker, while not making a free market argument for leaving markets to heal themselves, argued that excessive investment in the housing sector had displaced too many workers for economists to reasonably expect a quick recovery.

Photo of Federal Reserve Bank of Boston President and CEO Eric S. Rosengren: AP Images