

Fed seen as unlikely to push for inflation target

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Victory for the Democrats in this month's congressional elections could slow Ben Bernanke's drive to lead the Federal Reserve towards adopting a numerical inflation target, leading Fed watchers say.

With the new Democratic majority seen as more likely to react adversely to a decision to adopt an inflation target than its Republican predecessor, the Fed chairman is expected to tread even more carefully than before in building support for any such move. Larry Meyer, a former Fed governor, says Mr Bernanke and his colleagues are paying attention to the change in the political environment. "It has certainly gotten their attention."

Mr Meyer says that while an inflation target is not a party issue, as a rule, "Republicans would have less problem with this than the Democrats."

Ned Gramlich, another former governor, says, "Republicans had more or less said if you want to target inflation just go ahead and do it. I am not sure the Democrats would say that. So I think it might be slightly harder for him."

Mr Bernanke, a long-time advocate of inflation targeting, has made no secret of the fact that he would like the Fed to state a numerical inflation goal.

One of the biggest obstacles to this has always been the danger that Congress would see an inflation target as a violation of the "dual mandate" - which places equal weight on inflation and unemployment.

Advocates of a numerical inflation target at the Fed say this fear is misplaced, and that by locking down inflation expectations, a well-designed inflation target can actually give a central bank more latitude to stabilise the economy.

Some favour underscoring this flexibility by calling the goal an "objective" rather than a "target" and setting no fixed time-frame over which to achieve it.

But these are not easy arguments to explain. In a worst-case scenario, Congress could react to a Fed decision to adopt an inflation target by holding hostile hearings or introducing legislation imposing a matching target for unemployment. Rather than risk this outcome, Mr Bernanke

will wait until he is confident there will not be a hostile backlash in Congress.

Analysts close to the Fed do not think the Democrat win makes it impossible for Mr Bernanke to achieve the changes he wants. They point out that the Fed chairman has always understood the need to build a broad consensus, across institutions and across the political divide, before adopting a numerical inflation target.

Largely for this reason, he sees it as a long-term endeavour with no specific deadline.

Yet there is broad agreement that the change in the composition of Congress and the committees, combined with the mood of economic populism in the country, does make it somewhat more difficult to proceed. "One does get the sense that the Democrat leadership on these committees is going to want to weight a little more carefully the dual mandate," says Peter Hooper, chief economist at Deutsche Bank Securities and a former Fed official. "Progress in this direction would probably be a little bit slower under Democratic leadership than it was previously."

What is certain is that in the new political context even more than the old, Mr Bernanke will have to demonstrate the kind of political skill for which his predecessor Alan Greenspan was known if he is to proceed in the direction he desires.