General Discussion: Monetary Policy Strategies: A Central Bank Panel

Chair: Malcolm D. Knight

Mr. Mussa: We are asked to draw lessons from the experience of the Greenspan era for the future. It is relevant to note that the problems with which the Greenspan era started—the stock market crash of 1987, the issues that arose subsequently, the productivity acceleration, and other issues of that kind—were not broadly anticipated at the time. What we can anticipate now is that the next 18 years will probably look somewhat different from the past 18 years. Accordingly, Mervyn King's advice to keep an open mind and look at the facts as they evolve is going to be particularly important. That certainly has been a hallmark of Alan's tenure and will remain key to successful central banking, not to have too much of an *idée fixe* governing policy.

Now, I want to note in that regard that I am concerned with the reverse of Mervyn's risk. In an environment of very low inflation and stable inflationary expectations, indicators of inflation or of inflationary pressures may be less reliable and less acute in providing a guide for the conduct of monetary policy than an environment of higher inflation and less stable inflationary expectations.

That brings me to the central point, which is the question of asset prices and how they might influence monetary policy, which we have kind of passed over. I like Raghu Rajan's paper. I am pleased that my successor once removed is—like Bill White at the Bank for International Settlements (BIS) and myself—a bit of a nut on the issue of financial sector stability and what it implies for the conduct of monetary policy. I am very much concerned that we have a problem that public policy is *adding undesirably to* the systemic risk of a major financial crisis by subsidizing excessive risk taking.

The right policy when you have a collapse in asset prices is to mop up the mess. We don't want to go back to the 1930s, with a 46 percent decline in nominal GDP in the United States, and say, "That's great! Really taught 'em a lesson that time."

You do want to mop up the crisis' effects on the economy very vigorously. That is not the way to deal with the issue that I am concerned with. But if you have a policy of mopping up the mess, then you ought to recognize that policy does have some cost to some people.

Interest rates in the United States are now probably 200 basis points lower than they would have been if we hadn't had the recession, which was partly the counterpart of the stock market decline. That means about $200 billion a year is being transferred from savers to somebody else in the economy. That is a subsidy to excessive risk taking that was built up in the stock market excess. And policy needs to be concerned about countervailing the up as well as the down.