FEDERAL RESERVE BANK *of* ST. LOUIS

Discussion of Bordo and Levy: The 50-Year History of the SOMC and the Evolution of Monetary Policy

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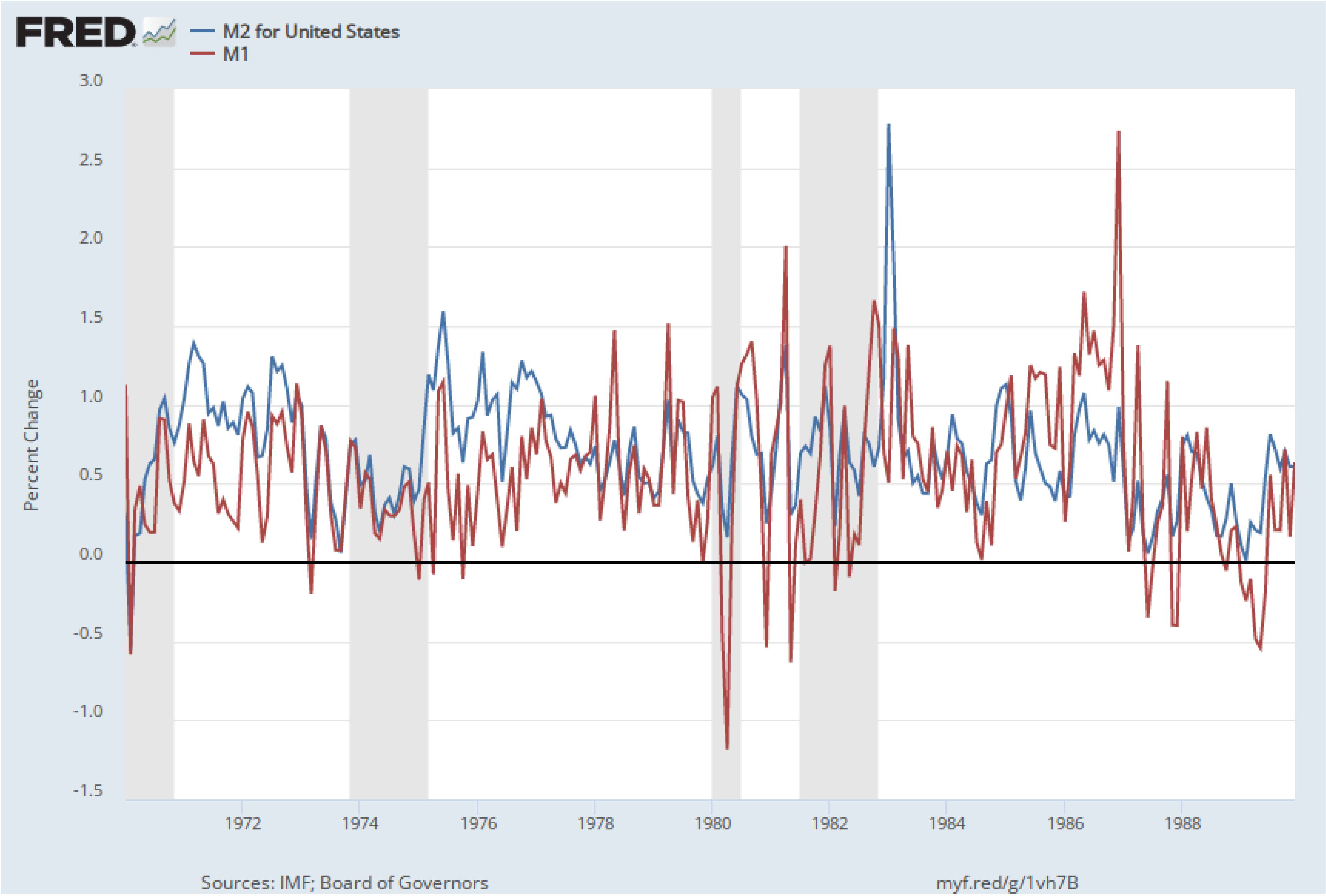
Views expressed in this presentation are those of the author and not official positions of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

Highlights

- The definitive history of the SOMC's first 50 years
- Links SOMC policy positions to the major policy challenges of the era
- Mostly a friendly history of the SOMC but notes a few shortcomings, esp., when the SOMC "overplayed its monetarist hand."
- Has the SOMC influenced policy?
- The similar and shared histories of the SOMC and St. Louis Fed
- The next 50 years

Influence? The Great Inflation

- Bordo and Levy write the SOMC “likely” influenced Volcker to shift gears to fight inflation in 1979.
- But Volcker already was an inflation hawk and financial markets were demanding a change.
- Volcker did not adopt the gradualist approach advocated by the SOMC.
- Monetary aggregates became even less stable.



FRED
M2 for United States
M1
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
-1.5
Percent Change
1972
1974
1976
1978
1980
1982
1984
1986
1988
Sources: IMF; Board of Governors
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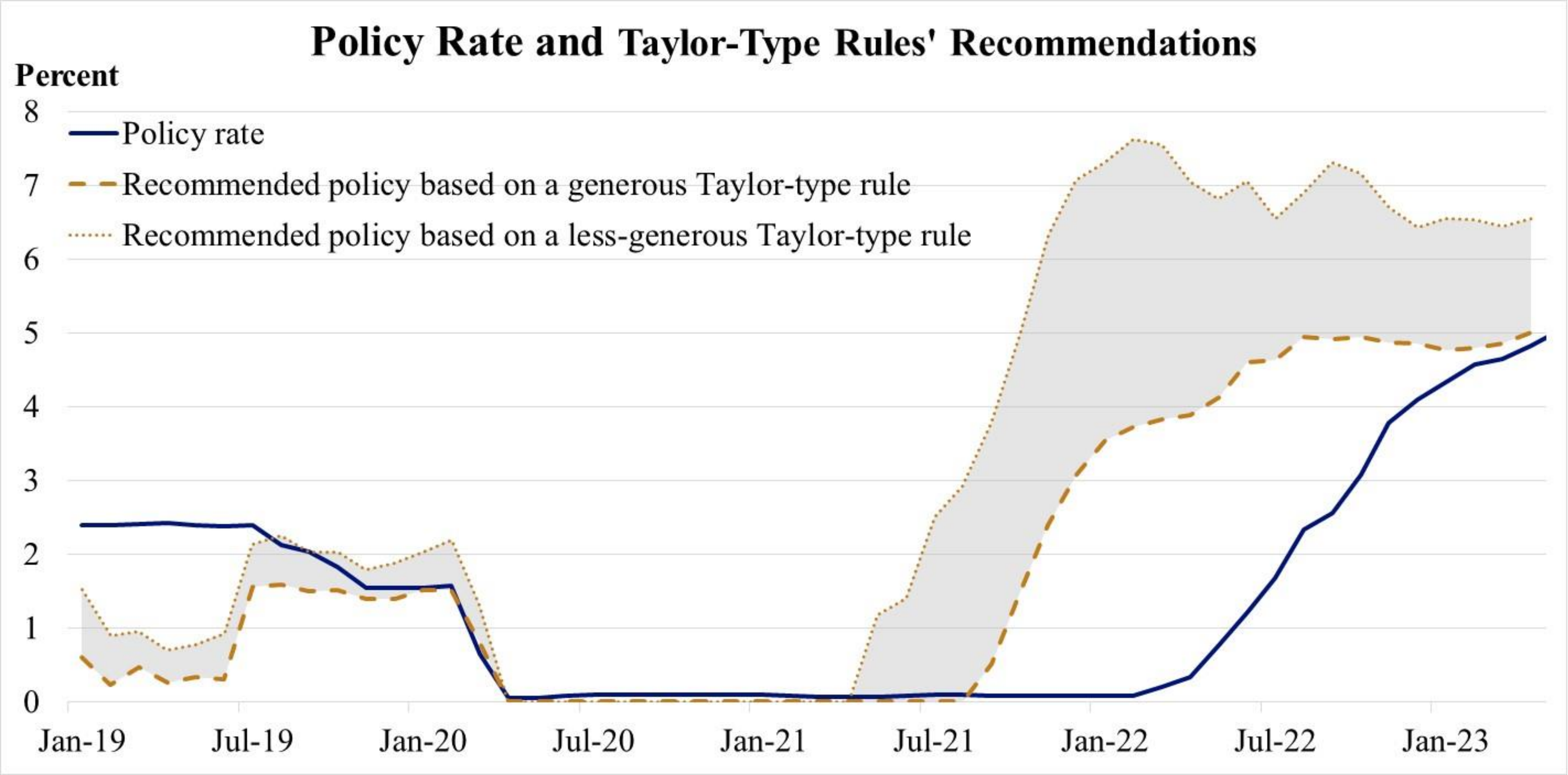
SOMC on the Inside in St. Louis

- Homer Jones brought monetarism to the St. Louis Fed.
- The Bank had close ties to Brunner, Meltzer and Friedman
- The Bank's presidents advocated monetarist policy at the FOMC and publicly while its economists published supporting research.
- The St. Louis model: Forecasting success tempted "fine tuning" based on narrow monetary aggregates.
- Like the SOMC, the St. Louis Fed continued to argue for targeting monetary aggregates (M1) well into the 1980s, despite unstable velocity.

St. Louis Under Poole and Bullard

- Poole (former SOMC member) was reluctant to give up monetary aggregates (MZM).
- But he advocated for price stability, rules, and clear communications. He also highlighted risks posed by Fannie and Freddie.
- Bullard advanced policy views rigorously grounded in economic theory and used rules to benchmark policy (along the lines of McCallum in a SOMC paper).
- A “generous” (i.e., dovish) Taylor rule – an effective vehicle to send a message.


Policy Rate and Taylor-Type Rules' Recommendations
Percent
8
7
6
5
4
3
2
1
0
Policy rate
Recommended policy based on a generous Taylor-type rule
Recommended policy based on a less-generous Taylor-type rule
Jan-19
Jul-19
Jan-20
Jul-20
Jan-21
Jul-21
Jan-22
Jul-22
Jan-23

The Next 50 Years

- Bordo and Levy demonstrate how the SOMC lost and regained its relevance over the first 50 years.
- The policy debates and challenges are going to continue.
- Is the SOMC set up for the next 50 years?
- Mix of academics and former Fed officials are its strength.
- Influence will require maintaining touch with advances in monetary and macroeconomics (and a good marketing plan!).