ASK AN ECONOMIST

Richard G. Anderson is an economist in the Research division. He joined the Federal Reserve Board staff in Washington, D.C., in 1988. He transferred to the St. Louis Fed in late 1992. He is a native Minnesotan with a bachelor's degree from the University of Minnesota and a Ph.D. from MIT in Cambridge, Mass. He is also a visiting professor in the Management School at the University of Sheffield, Sheffield, U.K., and is a member of that school's international academic advisory committee. His research interests include applied econometrics, macroeconomics and financial markets. Beyond economics, he has extensive background and experience in information technology. For more on his work, see http://research.stlouisfed.org/econ/anderson/

Q. On Jan. 25, the Federal Open Market Committee issued a press release summarizing its "longer-run goals and monetary policy strategy." Chairman Ben Bernanke, in his press conference on the same day, referred to 2 percent inflation as an "inflation target." Why did the FOMC set an inflation target?

A. Setting a long-run inflation goal, or target, is an important element in achieving the Federal Reserve's mandate from Congress. Further, the FOMC has behaved for a number of years as if a 2 percent long-run inflation rate was its target. The announcement removes any remaining doubts.

Commentators sometimes incorrectly discuss the Federal Reserve as if it were an independent fourth branch of government, similar to Congress, the Supreme Court or the executive branch. It is not. The Federal Reserve was created by Congress in 1913, and Congress sets guidelines for the Federal Reserve's conduct of monetary policy.

Prior to World War II, the Federal Reserve's principal focus was on banking and financial market stability, including providing additional money and credit during economic expansions and assisting banks during financial panics. As the war ended, Congress feared that high unemployment would follow reductions in government spending and that inflation would follow the end of price controls. In the Employment Act of 1946, Congress charged the Federal Reserve with adopting policies to promote both maximum economic growth and stable prices—the so-called dual mandate.

Tension has often surrounded the dual mandate. The historical record suggests that policies to reduce unemployment may be ill-suited to periods of high inflation and that policies to reduce inflation tend to slow aggregate demand and increase unemployment. In its Jan. 25 announcement, the FOMC clarified that its monetary policy is the primary determinant of the economy's long-run inflation rate. Because uncertainty regarding long-run inflation harms long-run economic growth, a long-run inflation objective (or target) is an important aspect of fulfilling the FOMC's dual mandate from Congress.

For related reading, see the President's Message on Page 3.

Submit your question in a letter to the editor. (See instructions at right.) One question will be answered by the appropriate economist in each issue.

LETTERS TO THE EDITOR

This is in response to the President's Message that appeared in the January 2012 issue. The message, by President James Bullard, was headlined "The Economic Recovery: America's Investment Problem."

Dear Editor:

The "falsification of the truth" as highlighted in Mr. Bullard's letter is point-on. This type of testimony shows great leadership as we begin to establish the new "baseline" in our return to a normal state of economic principles. In my opinion, this housing bubble and its impact on the traditional banking industry have created a generation of borrowers whose psychology will take us a generation to transform. The admitting to what has caused these problems is a great first step in transforming our abilities to fix these housing issues. I applaud Mr. Bullard for addressing this, and now it is up to each head of the household to begin to get their "financial" house in order, and let's return to the basics of consumer finance and to the new norm.

Rick Ocheltree, banking executive in Richmond, Va.

This is in response to "Commodity Price Gains: Speculation vs. Fundamentals," which appeared in the July 2011 issue.

Dear Editor:

This was a good and very useful article. I referenced it in an article I've written for *Business Economics.* (Mr. Synnott's article, "The Long Wave Revisited," appears in the April issue of this National Association for Business Economics publication.) Thanks to the authors and *The Regional Economist.*

Thomas Synnott, adjunct professor of industrial engineering at The Cooper Union in New York City

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