

## President's Message

When the adjusted monetary base was first published by the Federal Reserve Bank of St. Louis 28 years ago, many economists doubted that monetary policy played a significant role in the behavior of the economy. To them, publication of monetary aggregates—including the adjusted monetary base—at best was a waste of resources and at worst reflected a lack of the rare imagination necessary to pursue more subtle questions in economic science. The economic discomfort that occurred during the 1970s as policymakers sought to subdue accelerating inflation proved them wrong. Central banks worldwide adopted monetary aggregates as policy guides.

Today, the pendulum has swung back a great distance toward the 1960s. Monetary aggregates are—again—regarded by many as unreliable policy guides. Although most central banks continue to publish data on monetary aggregates, few allow the aggregates a significant role in policymaking. Today's monetary policy environment differs in a critical respect from that earlier period, however. Many central banks, including the Federal Reserve, have adopted the goal of “containing inflation in the near term and moving over time toward price stability,” to quote Chairman Greenspan's recent Humphrey-Hawkins Act testimony. By publicly articulating such an approach while arming themselves solely with a short-term interest rate for their policy instrument, central bankers have set out a difficult task. Interest rates are buffeted by many winds in the economy, only one of which is monetary policy.

Monetary aggregates can assist policymakers' efforts to achieve and maintain price stability. The adjusted monetary base provides, in a single index, a summary of the Federal Reserve's monetary

policy actions. Unlike broader monetary aggregates such as M1 and M2, the monetary base changes only because the Federal Reserve chooses to permit it to change. Households, firms, and depository institutions cannot change the monetary base without Federal Reserve action. Hence, growth of the adjusted monetary base furnishes important supplemental information about the stance of policy, relative to any selected federal funds rate target.

The research discussed in this symposium issue presents a new measure of the adjusted reserves component of the monetary base and reappraises historical studies of the monetary base as a policy indicator. Reserve requirements have been reduced or eliminated in many countries during the last 15 years, sharply increasing the role of the payments system as a determinant of the demand for central bank deposits. In countries such as Canada and the United Kingdom that do not have statutory reserve requirements, depository institutions hold central bank deposits solely for payments-related purposes. The first article in this issue suggests that the United States may be approaching the same position, in which the demand by depository institutions for the monetary base is determined primarily by their need to convert deposits into currency and to absorb and originate interbank payments. Such a change in our financial system makes it appropriate to reconsider our measures of adjusted reserves and the monetary base.

Today's environment of nonbinding reserve requirements, relatively low inflation, and moderate interest rates presents monetary policymakers with a “brave new world” never before experienced in the history of the Federal Reserve System. Recalling the founding of the Federal

Reserve System, some are calling on the European Central Bank to set reserve requirements sufficiently high that the requirements, not payments activity, will determine the demand by depository institutions for deposits at the Bank. It seems to me that the value of such an approach for the conduct of monetary policy remains an open question. I trust that this exchange of ideas will stimulate further discussion and research on the role of central banks in modern monetary economies—and on measures of the stance of monetary policy.

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