

President's Message

Times are a lot better today than they were 21 years ago. In 1975, we were in the midst of the worst recession since the Great Depression, inflation was accelerating by any measure, and the worst was yet to come. The inflationary boom and subsequent disinflation reverberated around the globe. You didn't need a micrometer to measure inflation or the devastation it was wreaking in wasted resources.

These days are glorious by comparison. Inflation, as measured by the various indexes, has been mild for several years. Most measures calculate it in the range of 2 percent to 3 percent a year. Furthermore, as measured officially, the economy has grown in real GDP terms at a healthy rate since the end of the 1982 recession. In fact, there has not been a period of cyclical stability to match the experience since 1982: Through 1996 there were 57 expansion quarters and only three mild contraction quarters.

Although the official measures indicate that real growth has been somewhat muted over this 15-year period compared with earlier long-term trends, there is some reason to believe that the official measures have overstated inflation and understated real growth. Some of the conference participants had insights to offer on that important measurement issue, which is a key to comparing whether households are better or worse off than they used to be.

Another important issue we sought to shed some light on was the question of which inflation measure should be used to guide monetary policy. Because individual prices are denominated in monetary terms, money and prices are inextricably linked. Thus, there simply is no more fundamental role for monetary policy than to influence the price level. But how does one measure the price level to which monetary policy should respond? By the CPI? By the PPI? By those measures less food

and energy? By the GDP fixed-or chain-weight price indexes? Or by some other measure entirely?

This question has become important in recent years because, unlike the early 1980s when all the measures indicated that inflation was far above zero, today they all indicate inflation to be comparatively low. In the early 1980s, by any inflation measure, monetary policy needed to be anti-inflationary. At low levels of inflation, on the other hand, the differences among the measures become important, particularly if zero is a threshold with special significance. In any event, we need an operational definition of price stability toward which to direct monetary policy. And that definition can be achieved only through solid theoretical and empirical research. Moreover, the nation needs a clearer standard for judging whether monetary policy has done its job in managing money to enable the economy to function efficiently.

There are important policy issues that depend on accurate measurement. Is the 3 percent CPI inflation of recent years biased upward enough that we should not try to conduct monetary policy to lower it further? Since monetary policy needs to be forward looking, we also need to know how current details in price data might provide information about future inflation trends.

For many years here at the St. Louis Fed, we have argued that monetary policy ought to focus on a single, long-run goal: lowering inflation toward price-level stability. In our view, policies directed at such a goal would provide an environment within which our market economy could function efficiently. Such policies would encompass actions that would tend to keep the economy on a stable growth path and the financial system sound, thus preventing a repeat of the most flagrant inflationary and deflationary monetary policies in history.

Our Director of Research, William Dewald, maintains that we will know markets are expecting little or no inflation when the federal government can once again borrow long-term at no more than 4 $\frac{1}{4}$ percent. That was the most it ever had to pay before a point in the 1960s when the public concluded that inflation had become endemic. I would like to think that we can find a more direct approach to identifying a relevant measure of inflation and then craft a policy to keep that rate low and stable.

It is significant that many central banks from around the world sent representatives to attend the 1996 conference. All of us still have a lot to learn about measuring inflation and real output from each other and from economists in the universities and research institutions. In my judgment, measurement is an underemphasized activity among economists these days. The fact that the 1996 conference was directed at such an important topic as "Measuring Inflation and Real Growth" is a natural complement to this Bank's long-term commitment to measuring money.

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