FED EYES MOVES TO LANCE ASSET BUBBLES

By Krishna Guha in Washington
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The US Federal Reserve is reconsidering the way it deals with asset price bubbles in the wake of the housing and credit bust in a move which could see the central bank using extra regulation - or even interest rates - to fight unjustified increases.

Top officials are re-examining the Alan Greenspan doctrine that central banks should not try to tackle asset bubbles and should focus on mitigating the fallout when they burst.

They are open to the possibility that the Fed might have to adopt a different approach in future, deploying either interest rates or more likely enhanced regulatory powers to put the brake on emerging bubbles.

However, they have not reached any conclusions yet and could end up reaffirming their traditional hands-off stance.

Any move by the Fed to focus more explicitly on asset prices rather than simply take into account their expected effect on growth and inflation would be a radical break.

The Fed has long stood out among central banks as the least willing to embrace the idea that it should “lean against the wind” when asset prices are rising rapidly.

Former chairman Mr Greenspan famously argued that it is in practice impossible to identify bubbles before they burst, and attempts to prick them by raising rates are likely to do more harm than good.

Ben Bernanke, the current Fed chairman, endorsed the Greenspan view in 2002 following the bursting of the dotcom bubble, though with the caveat that central banks should use microeconomic regulation to mitigate the risks caused by bubbles.

Six years on, he and other top Fed officials are reviewing the Fed approach following the second big and disruptive bubble in a decade.

One option would be for the Fed to tackle bubbles with monetary policy, setting interest rates higher than they would otherwise be when asset prices appear to be inflating beyond levels justified by economic fundamentals.

Mr Bernanke rejected this approach in 2002, but is willing to re-evaluate it in the light of recent events.