WASHINGTON: Over a frantic weekend in mid-March, Ben Bernanke rewrote the rule book as chairman of the U.S. Federal Reserve Board. Like a military commander applying overwhelming force, he took steps then and over the following two months that some at the central bank are now calling the Bernanke Doctrine.

Today, Bernanke appears to have quieted many critics, especially on Wall Street, who had been saying he was overly academic and slow to react to market conditions.

But at the same time, new criticisms have surfaced that Bernanke has fanned inflation and contributed to the decline of the dollar by aggressively cutting interest rates. Some say he has put at risk billions in public funds by accepting devalued assets like mortgages and auto loans as collateral for loans to financial institutions. And by thrusting the Fed into new realms of intervention and regulation, he has raised questions about whether he is threatening its independence.

"It has been a really head-spinning range of unprecedented and bold actions," Charles Calomiris, professor of finance and economics at the business school of Columbia University, said, referring to the Fed's lending activities. "That is exactly as it should be. But I'm not saying that it's without some cost and without some risk."

Timothy Geithner, president of the Federal Reserve Bank of New York, more easily wins praise as the Fed's point person on Wall Street. As one of Bernanke's closest allies, he has used his connections to help the Fed chief gain acceptance, but Geithner acknowledged that the Fed had carved out hazardous new territory.

"Ben has, in very consequential ways, altered the framework for how central banks operate in crises," he said. "Some will criticize it and some will praise it, and it will certainly be examined for decades."

Bernanke's actions have transformed the image of a self-effacing former economics professor.

"I am tempted to think of him as somewhat Buddha-like," Richard Fisher, president of the Federal Reserve Bank of Dallas, said. "He's developed a serenity based on a growing understanding of the hardball ways the system actually works. You can see that it's no longer an academic or theoretical exercise for him."

Within the Bush administration, Bernanke's willingness to work with Democrats in Congress on measures to prevent mortgage foreclosures has stirred unease. "The fact that he, an appointee of George Bush, has come very close to advocating - though he hasn't quite advocated it - a piece of legislation that George Bush threatened to veto is an illustration of his willingness to put his head on the chopping block," said Alan Blinder, a professor of economics at Princeton University who is friend of Bernanke's.

Bernanke, a Republican, had previously been criticized by such Democratic luminaries as the two Clinton administration Treasury secretaries, Robert Rubin and Lawrence Summers, both of whom worried that he was playing down the dangers of a recession. But that view has changed.

"I think in the last few months they've handled themselves very sure-footed," Rubin said of the Fed. Many Democrats in Congress agree.

"They say that crisis makes the man," said Senator Charles Schumer, a New York Democrat who is chairman of the Joint Economic Committee of Congress. "He's made believers out of people who were just not sure about him before."
To lessen the chances of a financial market collapse, Bernanke engineered the takeover of one investment bank, Bear Stearns, and tossed credit lifelines to others with exotic new lending facilities. The Fed now has seven such lending windows, some of them for investment banks as well as commercial banks.

He also allowed the Fed to accept assets of debatable value - mortgage-backed securities, car loans and credit card debt - as collateral for some Fed loans. For the first time ever, he installed Fed regulators inside investment banks to inspect their books.

Much to the dismay of rightist economists, Bernanke has also presided over aggressive interest rate cuts, lowering the federal funds rate seven times, to 2 percent from 5.25 percent, since last September, though the Fed has signaled a pause in further rate-cutting, barring a further crisis.

That performance has brought outside criticism as well as dissent within the Fed.

Economists who played prominent roles in past Republican administrations, including John Taylor at Stanford University and Martin Feldstein at Harvard University, are among the critics. Taylor, who promulgated a mathematical rule for ideal Fed interest rates that is based on inflation expectations, said that he was concerned that the Fed's rate-cutting was "risky with respect to inflation and the dollar" but that the lending facilities set up by the Fed seemed reasonable for now.

His criticism, and the fact that other economists cite the Taylor rule, has made the Fed somewhat defensive. In a recent speech, one member of the Federal Reserve Board, Kevin Warsh, a Bernanke ally, said that while the Taylor rule provided a "reasonable description" of the past 20 years, it failed to account for the crisis that unfolded this year.

Feldstein, in an interview, said the lower interest rates made him nervous, as did the new lending windows and acceptance of questionable collateral. These steps, he added, are not likely to help an economy that needs time to digest the housing crisis and the lack of confidence among consumers.

"I frankly don't think there is more that the Fed can do to deal with the fundamental problems of the economy right now," he said. "They have done at least as much as they needed to do. They may have done too much."

Also warning against Fed overreaching has been Paul Volcker, a Democrat who battled inflation as Fed chairman in the 1980s. In speeches and testimony, Volcker suggested that the central bank's interventions, particularly its direct role in the fire sale of Bear Stearns to JPMorgan Chase in March, could compromise its independence.

Another friend of Bernanke's, Kenneth Rogoff, a Harvard economist, said that by aggressively intervening and then devising almost overnight a new regulatory framework for investment banks, Bernanke was taking the central bank into an era in which it could be difficult to ward off political pressures.

"The Fed has been spectacularly successful at maintaining its independence," Rogoff said. "That's going to be much tougher if they take on a lot of new regulatory responsibilities."

The Bush administration has proposed that the Fed be given an expanded regulatory role. But Treasury Secretary Henry Paulson Jr., in presenting a blueprint for change, has left unclear what powers the Fed would have, and Bernanke has said that he does not want an expanded role without new authority to carry it out.

Fed officials and those close to them say that all the recent actions under Bernanke have been taken in an atmosphere of searching debate and even anguish, in recognition that there is almost always a downside.

The policy of lowering interest rates was especially hotly debated within the Fed, according to the minutes of the last meeting of policy makers.

"The Fed has worked hard for 30 years to develop credibility with the public that we will deliver on low and stable inflation," said Charles Plosser, who as president of the Federal Reserve Bank of Philadelphia voted against the two recent interest cuts. "That credibility is hard to earn, but easy to lose if you're not careful."
But both Plosser and the other dissenter on interest rates in April, Fisher of the Dallas Fed, said in interviews that they appreciated Bernanke's efforts at listening to dissent and his creativity.

"These new facilities are Ben's initiatives," Mr. Fisher said in an interview. "He has been willing to take a fresh look at how the system works and press the boundaries in a thoughtful way."

Bernanke has impressed many colleagues and lawmakers with his political skills, gently conveying his views behind the scenes to both Democrats and Republicans.

For example, in the past month, he and his staff have worked with Democrats in Congress to produce housing legislation to prevent more mortgage foreclosures, getting well out in front of President George W. Bush, who was threatening to veto one version of the legislation.

On another occasion, when the Fed chairman called for banks to write down the principal of delinquent mortgages, his pre-emptive move rankled some in the Bush administration. Bernanke called Paulson to apologize for not giving advance warning.

Bernanke, on the other hand, pleased the Bush administration by pressing reluctant Democrats to seek more drastic changes in the governance and capitalization of the two big federal mortgage-finance companies, Fannie Mae and Freddie Mac.

"You're never going to have two people with an identical approach," Paulson said of himself and Bernanke. "But not only have our goals been the same, I think the way we've come together has been similar. Ben is smart, creative, open to new ideas and always looking around the next corner."

Other associates of the Fed chief say the extraordinary crisis atmosphere of the past year has stiffened Bernanke's resolve, but also caused him anguish.

"Ben is one of these guys who is outwardly calm and has inner stomachaches," Blinder said. "He's under a tremendous amount of strain."

Jenny Anderson contributed reporting.
Abstract (Summary)
In a speech scheduled for delivery Thursday night, Fed Governor Frederic Mishkin suggested that while it was inappropriate to use the blunt instrument of interest-rate increases to prick bubbles, if too-easy credit appeared to be fueling a mania, policy makers might craft a regulatory response that could "help reduce the magnitude of the bubble."

PRINCETON, N.J. -- First came the tech-stock bubble. Then there were bubbles in housing and credit. Chinese stocks took off like a rocket. Now, as prices soar on every material from oil to corn, some suggest there's a bubble in commodities.

But how and why do bubbles form? Economists traditionally haven't offered much insight. From World War II till the mid-1990s, there weren't many U.S. investing manias for them to look at. The study of bubbles was left to economic historians sifting through musty records of 17th-century Dutch tulip-bulb prices and the like.

The dot-com boom began to change that. "You were seeing live, in action, the unfolding of lots of examples of valuations disconnecting from fundamentals," says Princeton economist Harrison Hong. Now, the study of financial bubbles is hot.

Its hub is Princeton, 40 miles south of Wall Street, home to a band of young scholars hired by former professor Ben Bernanke, now the nation's chief bubble watcher as Federal Reserve chairman. The group includes Mr. Hong, a Vietnam native raised in Silicon Valley; a Chinese wunderkind who started as a physicist; and a German who'd been groomed to take over the family carpentry business. Among their conclusions:

Bubbles emerge at times when investors profoundly disagree about the significance of a big economic development, such as the birth of the Internet. Because it's so much harder to bet on prices going down than up, the bullish investors dominate.

Once they get going, financial bubbles are marked by huge increases in trading, making them easier to identify.

Manias can persist even though many smart people suspect a bubble, because no one of them has the firepower to successfully attack it. Only when skeptical investors act simultaneously -- a moment impossible to predict -- does the bubble pop.

As a result of all that and more, the Princeton squad argues that the Fed can and should try to restrain bubbles, rather than following former Chairman Alan Greenspan's approach: watchful waiting while prices rise and then cleaning up the mess after a bubble bursts.

If the tech-stock collapse didn't make that clear, the damage done by the housing and credit bubbles should, argues Jose Scheinkman, 60 years old, a theorist Mr. Bernanke recruited in 1999 from the University of Chicago. "Advanced economies are very dependent on the health of the financial system. What this bubble did was destroy the capacity of the financial system to finance the U.S. economy," Mr. Scheinkman says.

The Fed is giving the activist approach some thought. In a speech scheduled for delivery Thursday night, Fed Governor Frederic Mishkin suggested that while it was inappropriate to use the blunt instrument of interest-rate increases to prick bubbles, if too-easy credit appeared to be fueling a mania, policy makers might craft a
regulatory response that could "help reduce the magnitude of the bubble."

Yet the very concept of bubbles is at odds with the view of some that market prices reflect the collective knowledge of multitudes. There are economists who dispute the existence of bubbles -- arguing, for instance, that what happened to prices in the dot-com boom was a rational response to the possibility that nascent Internet firms might turn into Microsofts. But these economists' numbers are thinning.

When Mr. Bernanke became head of Princeton's economics department in 1996, he saw finance as a fertile field for economic research. Princeton was weak in it. Mr. Bernanke raised $10 million from the Leon Lowenstein Foundation to create the Bendheim Center for Finance, named for the foundation's president, Robert Bendheim, an alumnus.

Mr. Bernanke hired finance experts who had broad interests and were eager to work with the university's deepening bench of theorists. He lured Dilip Abreu, known for work in game theory, back from Yale, to which he had earlier defected. Making a virtue of an institutional weakness, the absence of a business school, Princeton assimilated the finance scholars into the economics department and freed them to pursue research.

They are building on work done by the late Hyman Minsky, whose once-ignored ideas about investing manias are now in vogue, and the late economic historian Charles Kindleberger, whose 1978 "Manias, Panics and Crashes" is a classic. But compared with Mr. Minsky or another student of bubbles, Yale's Robert Shiller, the Princeton trio focuses less on mass psychology than on mathematical models. These they use to show how bubbles can be created even in markets that include rational, calculating investors.

Bubbles don't spring from nowhere. They're usually tied to a development with far-reaching effects: electricity and autos in the 1920s, the Internet in the 1990s, the growth of China and India. At the outset, a surge in the values of related businesses and goods is often justified. But then it detaches from reality.

Mr. Hong, growing up in Sunnyvale, Calif., and teaching at Stanford, had a front-row seat to the technology boom. Recognizing a mania, he resisted investing in tech stocks himself -- until they were about to crest.

He recalls his thought process: "My sister's getting rich. My friends are getting rich . . . . I think this is all crazy, but I feel so horrible about missing out, about being left out of the party." In 2000, "I finally caved in," he says. "I put in some money just as a hedge against other people getting richer than me and feeling better than me." But 2000, of course, was the year the bubble burst.

Mr. Hong, who came to Princeton two years later, and now is 37, argues that big innovations lead to big differences of opinion between bullish and bearish investors. But the deck is stacked in favor of the optimists.

One who believes a stock is too high can short it, borrowing shares and selling them in hopes of replacing them when they're cheaper. But this can be costly, both in the fees and in the risk of huge losses if the stock keeps rising. Many big investors rarely short stocks. When differences between bullish investors and bearish ones are extreme, many of the bears simply move to the sidelines. Then, with only optimists playing, prices go higher and higher.

In housing and the credit markets, the innovation was slicing and dicing loans in novel ways. As investors bought the resulting mortgage securities, they provided abundant capital for home buyers; buoyed by this and falling interest rates, house prices surged.

Betting against house prices is hard; only a few sophisticated investors found roundabout ways to do it, in derivatives markets. Most skeptics about the housing boom just sat it out; the optimists were unchecked.

At some point in a bubble, optimists' enthusiasm runs its course. Prices turn down. There's an expectation that at this point, investors who were skeptical may see prices as more reasonable and start buying. If they don't, that's a signal that prices had gotten way too high -- and then they tumble.

The insights of bearish investors "are more likely to be flushed out through the trading process when the market is falling, as opposed to when it's rising," Mr. Hong and Harvard's Jeremy Stein write. They say this explains why prices fall more rapidly than they go up. Over 60 years, nine of the 10 biggest one-day percentage moves in the S&P 500 were down.

When a lot of borrowed money is involved -- as it often is in a bubble -- once prices peak, the speed of their fall is intensified as investors sell urgently to pay down debt. That pattern offers a strong argument, in Mr. Hong's view, for government to restrain bubbles and the borrowing that fuels them.
At the height of the tech bubble, Internet stocks changed hands three times as frequently as other shares. "The two most important characteristics of a bubble," says Wei Xiong, are: "People pay a crazy price and people trade like crazy."

After finishing undergraduate studies in China at age 18, Mr. Xiong came to the U.S. intent on becoming a particle physicist. He earned a master's from Columbia but decided physics was too mature for him to make a mark. He switched to economics and earned a Ph.D. from Duke University. He was just 24 when Mr. Bernanke hired him in 2000.

According to a model he developed with Mr. Scheinkman, investors dogmatically believe they are right and those who differ are wrong. And as one set of investors becomes less optimistic, another takes its place. Investors figure they can always sell at a higher price. That view leads to even more trading, and, at the extreme, stock prices can go beyond any individual investor's fundamental valuation.

China's stock market gave Mr. Xiong, Mr. Scheinkman and New York University's Jianping Mei a laboratorylike setting to study. Chinese companies issued two classes of shares, representing identical stakes. Only Chinese could buy Class A shares, and, until 2001, only foreign investors could buy Class B shares.

When other countries have used such setups, the foreign-owned shares have traded at higher prices. But in China between 1993 to 2000, the economists found, Class A shares averaged more than five times the price of Class B shares and were traded five times as frequently -- a hint they were infected with bubble virus.

Companies with fewer A shares outstanding tended to see both higher trading volume and higher prices. That was consistent with a theory Mr. Xiong developed with Messrs. Scheinkman and Hong: In markets with lots of disagreement about values, the optimists are better able to dominate when there are fewer shares available.

Today, there's disagreement over commodity prices: to what extent do they reflect fundamentals like Chinese demand, and to what extent investment mania? Trading points toward a bubble: Daily volume on crude-oil contracts is running 50% above last year. Yet the initial findings of work Mr. Hong has done with Motohiro Yogo of the Wharton School -- comparing cash prices and futures prices -- suggest that "prices for commodities are expensive," but not a bubble, Mr. Hong says.

Mr. Xiong's father-in-law and brother trade stocks in China. At the start of 2007, he cautioned his brother to get out, to no avail. But Chinese stocks are higher today, despite falling since November. "If he actually followed my advice I'm not sure what he would think of me," Mr. Xiong says.

Bubbles often keep inflating despite cautions such as Mr. Greenspan's famous warning of "irrational exuberance." Tech stocks rose for more than three years after he said that, in late 1996. Markus Brunnermeier, 39, thinks he understands why this happens.

Growing up near Munich, Germany, he expected to become a carpenter like his father. A building slump dissuaded him, and after stints in a tax office and the army he enrolled at the University of Regensburg.

He had struggled to understand why West Germany, where he lived, was so much more prosperous than East Germany. At Regensburg, he came across the work of Friedrich Hayek, the Nobel prize-winning Austrian economist known for a spirited defense of free-market capitalism. Mr. Hayek noted that while East Germany's government set prices, in the west the market set them -- and provided information about supply and demand that helped the economy adjust.

Inspired by Mr. Hayek's work, Mr. Brunnermeier studied economics. But in the 1990s, soaring tech stocks made him skeptical of the quality of information that prices convey. As a graduate student at the London School of Economics, he wrote a survey of research on bubbles and crashes that turned into a book.

Under the Hayek view, bubbles don't make sense. As soon as some group of traders irrationally pushes prices way up, more-rational traders should take advantage of the mispricing by selling -- bringing prices back down. But the tech boom reinforced an oft-quoted warning from John Maynard Keynes: "The market can stay irrational longer than you can stay solvent."

So investors who spot the bubble attack only if each is confident that other skeptics are on board. In work done with Mr. Abreu, Mr. Brunnermeier concluded that if all the rational investors could agree to bet against the bubble, they could make big profits. But if they can't coordinate, it's risky for any one of them to bet against a bubble. So it makes sense to ride it up and then get out quickly as soon as the bubble's existence becomes common knowledge.
That's what Pequot Capital Management did. The hedge-fund company boarded the Internet bandwagon early, investing in America Online in 1994. It was heavily invested in tech stocks through the late 1990s. When they started falling in March 2000, Pequot got hurt. But it was agile enough to take bearish positions on the stocks, and its funds posted strong performances for the year.

Looking through security filings, Mr. Brunnermeier and Stanford's Stefan Nagel found that hedge funds on the whole "skillfully anticipated price peaks" in individual tech stocks, cutting back before prices collapsed and shifting into other tech stocks that were still rising. Hedge funds' overall exposure to tech stocks peaked in September 1999, six months before the stocks peaked. They rode the bubble higher and got out close to the right time.

Mr. Brunnermeier saw the bubble, too. He thought people were crazy for buying tech stocks. But as both the hedge funds' gains and his theoretical work suggest, even if you know there's a bubble, it might be smart to go along.

"I was always convinced that there was an Internet bubble going on and never invested in Internet stocks," he says. "My brother-in-law did. My wife always complained that I studied finance and her brother was making a lot of money on Internet stocks."
Great Speculations

Three highfliers soared over five years; two then fell

Las Vegas home prices
Peak: Aug. 2006

Oil
June 2003 — to present

Nasdaq Composite
March 1995 through 2002
Peak: March 2000

Sources: Thomson Reuters Datastream; S&P/Case-Shiller Home Price Indices
The Greenspan Era

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IN 18 YEARS AT THE HELM of the Federal Reserve, Alan Greenspan faced nearly every challenge possible for an economic policy maker. Review Mr. Greenspan's long stewardship of the U.S. central bank. — Compiled by Tim Annett

1987 – 1991

MERE MONTHS after being tapped by President Reagan to succeed Paul Volcker as Federal Reserve chairman, Alan Greenspan would face his first big test: preventing the October 1987 stock-market crash from becoming a full-blown economic slump. Under his leadership the Fed responded to the market's dive by driving down interest rates and averting a credit crunch. The Fed tamped down another potential crackup by helping to stanch a sharp decline in the dollar. Those rescue missions helped solidify Mr. Greenspan's standing with Wall Street early on.

By the spring of 1988, the Fed had begun to raise rates in a bid to keep core inflation under wraps, but prices kept rising and growth sputtered in 1989. Then, the August 1990 start of the Gulf War complicated the balancing act by driving up energy prices, leading households and businesses to forestall spending. As a result, the economy dipped into a recession that lasted through the first quarter of 1991. But the Fed's hawkish policy stance helped push down inflation, and the central bank was able to slash interest rates rapidly in the second half of 1991, from 6% down to 4% at year's end.

Boom and Bust

Economic growth was strong despite the stock-market crash, but higher energy prices tipped the economy into recession.
Inflation Creeps
Prices crept higher in the late 1980s, and war-churned oil prices led the consumer-price index to a crescendo in 1990.

Hawkish Tone
The Fed kept interest-rates high to tamp down inflation, but eased off as high oil prices faded.
Crisis & Recovery

The market crashed and slowly recovered until war and recession swamped equities again in mid-1990.

THE FED CONTINUED to cut rates through October of 1992, bringing the fed-funds rate to 3%, where it would remain for 16 months. Inflation continued to recede, falling to
around 3% in 1992. Accommodative monetary policy helped ease concerns about high unemployment.

The economic recovery continued throughout 1993, and by February 1994 the Fed had once again become concerned about higher prices and moved to preempt inflation by raising interest rates. The Fed would tighten the funds rate from 3% to 6%, and inflation idled while economic growth picked up and the unemployment rate fell.

The beginning of the Fed's preemptive tightening cycle marked another change: the Fed's increased effort to be more transparent. At the February 1994 meeting, the Fed began to announce its the funds-rate target after each meeting, along with its assessment of economic conditions and its policy bias moving forward. The change meant that the once-mysterious proceedings at the central bank were now better understood by markets and the public.

Steady March
Economic growth was strong through most of the early 90s, though the jobless rate was slow to fall.

Sources: U.S. Bureau of Economic Analysis, Bureau of Labor Statistics

Under Control
Inflation pressures remained largely under control as the Fed moved to cut off any threat from rising prices.
Preemptive Moves
The Fed moved rates higher as it sought to head inflation off before it could slow
economic growth.

Climbing Higher
With the Fed on inflation watch and productivity growing, stocks began a long voyage
higher.
WITH INFLATION seemingly under lock and key, the stage was set for the long technology-led boom. Economists had hoped technological improvements would help productivity recover from a long decline that started in the 1970s. They would get their wish, as between 1996 and 2000 productivity grew by 2.4% a year on average. Wages also rose, stimulating demand, and company's earnings and share prices grew. The "productivity miracle" reinforced the view of some that inflation was permanently under control. But the boom had a dark side, and Mr. Greenspan gave it a name: "irrational exuberance." The Fed faced a choice: keep monetary policy accommodative and risk feeding an asset bubble, or tighten rates and risk causing a slowdown. The Fed thus did relatively little tinkering with rates from 1996 through 1999, with the exception of three consecutive quarter-point cuts in the fall of 1998 after Russia defaulted on its debt. The Fed unwound those reductions with three quarter-point increases in June, August and November of 1999, and raised the funds rate by another full point to 6.5% by May 2000. The Fed held steady there even as growth dipped in late 2000.

Dot-Com Driven
The economy continued its robust expansion and the jobless rate dwindled, but signs of weakness would emerge.
Price Stability
Inflation remained at bay, but pressure grew slightly more intense as tech stocks peaked.

Steady Hand
The Fed made little movement in interest rates, risking fanning an asset bubble.
Peak and Plunge
Stocks continued their long rally, led by the boom in technology shares. But in 2000, tech stocks fell back sharply.

THE ECONOMIC EXPANSION continued to falter in 2001 as it became clear that many businesses had overzealously increased capacity during the boom, and recession set in.
in. Consumers became more cautious, curbing spending, and many firms put investment plans on hold. Then, the Sept. 11, 2001, attacks further cast a pall over the economy, wrecking consumer confidence and leading to the loss of 800,000 jobs in October and November. The Fed, already in the midst of a string of rate cuts, took rates down as far as 1.75% by December.

Policy makers would eventually bring the funds rate down to 1%, a 46-year low. Growth recovered in 2002 and 2003, but critics charged the rate reductions had simply replaced one asset bubble in equity markets with another asset bubble in housing. The Fed began to raise rates in 2004, but long-term borrowing costs, including mortgage rates, failed to follow suit as bond yields remained low -- a phenomenon Mr. Greenspan called a "conundrum." The failure of long rates to respond to the Fed's tightening led some economists to worry the spread between short and long interest rates would invert -- typically a signal of recession.

Terror's Toll
The economy dipped into recession and the Sept. 11 attacks damped sentiment. But by 2003, the recovery gained steam.

Deflation vs. Oil
Policy makers began the period worried about falling prices, but rising oil costs would change that bias.
Accommodation

All Over the Map
The markets took a wild ride, but began to bounce back as major combat in Iraq wound down.
Conclusion

AS MR. GREENSPAN turns over the reins to the next chairman, there is little sign that the central bank will alter its present policy course. Forecasters and financial markets expect that the Fed will continue to raise rates, with economists surveyed this month by the Wall Street Journal Online predicting that the federal-funds rate will be equal to 4.25% at the end of this year and 4.5% by June 2006. Though many observers had expected the Fed to tap on the brakes following Hurricane Katrina, policy makers have made clear that they are more worried about inflation than they are about any short-term decrease in economic growth.

To be sure, the new chairman will face many of the same challenges that Mr. Greenspan did in assuring markets that he is committed to the Fed's mandate, and that he will remain impervious to outside pressure if the nation's economic headaches require what may be politically unpopular prescriptions. That adjustment period could come at some cost to the markets -- transitions at the Fed have typically been met with some unease. But many of the innovations that Mr. Greenspan has brought to the Fed, including its greater public transparency, will aid his successor.

Long-Run Strength

The Greenspan Era saw two brief recessions and one of the longest periods of expansion in U.S. History.
Stable Prices
Greenspan's Fed kept a vigilant focus on controlling inflation throughout his term.

Heading Off Danger
Since the mid-1990s, the Fed has moved in an aggressive, pre-emptive fashion to maintain growth and price stability.
Trending Higher

Stocks were roiled at times by war, terrorism and recession, but over the long term moved upward.