Irish Times, 28 October 2005

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Freethinker with strong opinions may defy preconceptions

Some commentators have suggested that Ben Bernanke's tenure as Federal Reserve chief will be deliberately downbeat, even boring, and, unlike Alan Greenspan, the new Fed boss will not weigh in on political battles over fiscal policy, pension reform and other controversial issues.

But that doesn't sound like the Ben Bernanke that I know from my time as an economic adviser at the Fed. For the legion of Fed-watchers across the world, Ben's leadership of the Fed will likely prove every bit as enthralling as Greenspan's 18 years at the helm.

When Ben first arrived at the Federal Reserve Board in August 2002 to take up a position of Fed governor, I couldn't help notice that he seemed to wear the same dark blue suit every day. Ben either had several identical suits or, more likely, had only one (he had, after all, spent his entire career until then as an academic).

He famously quipped that the biggest downside of being at the Fed was that he had to wear a suit to work. Ben even proposed that Fed governors should signal their commitment to public service by wearing Hawaiian shirts and Bermuda shorts.

In many ways, Ben didn't seem to fit the stereotype of a top government official. He continued to talk and act like a university professor, mingling effortlessly with Fed staff, attending academic-type seminars, collaborating with staff on research papers, and dining in the staff cafeteria.

He was quick to offer us guidance on research projects, much like a professor giving advice to his PhD students. Unlike "the maestro" Greenspan who chose to conduct from a pedestal, Ben preferred to pick up an instrument and sit among the orchestra.

From the outset, what most struck me about Ben was that he was very much a free-thinker. He had strong opinions on a wide range of issues, and he was not afraid to express them.

In May 2003, for example, he delivered a speech in Japan publicly calling for more aggressive action by the Bank of Japan to end deflation.

It is rare for Fed officials to give such explicit advice to a foreign central bank on how best to conduct monetary policy.

Controversially, he put the blame for the large and growing US current account deficit as much on foreign countries as on the United States, and called for policymakers in Europe and Asia to promote growth in domestic demand to alleviate what he termed the "global saving glut".

Ben left the Fed last June to join the White House as President George W Bush's chief economic adviser, giving the president the opportunity to have a closer look at the man many observers were tipping to succeed Greenspan.

Bush must have liked what he saw. Ben's combination of academic expertise and practical experience in monetary and fiscal policy gave him the edge over other leading candidates.

Moreover, Ben is a moderate Republican, making him more palatable to Democrats. The White House was obviously anxious to avoid a repeat of the controversy that followed Bush's nomination of long-time family friend Harriet Miers to the Supreme Court.

Ben's nomination was welcomed by financial markets, which is crucial given the tough challenges that await Ben when he returns to the Fed in February.

For starters, he faces a delicate balancing act in deciding how much further to raise interest rates. The Fed has tightened monetary policy 11 times over the past year and a half, bringing short-term interest rates from 1 per cent in June 2004 to 3.75 per cent today. Financial markets expect another three-quarters of

a percentage point in hikes by April.

Despite higher interest rates, inflation has surged recently, though most of the increase reflects soaring energy costs. Additional increases in interest rates may be necessary to prevent higher energy prices from spilling over into broader inflation measures or into expectations that businesses and households

have about future inflation, but further hikes also run the risk of choking off economic growth.

A complicating factor is that house prices in the US have soared in recent years. Pushing up interest rates too far might pop the US house price bubble, with potentially devastating effects on the economy.

Another question is how Ben's approach to monetary policy will differ from Greenspan's. Ben favours an "inflation targeting" framework for monetary policy in which the central bank has an explicit target for inflation. On the face of it, this puts him at odds with Greenspan, who prefers a more flexible approach

without explicit targets. However, in practice, the approaches differ little.

Under Greenspan, the Fed has conducted monetary policy as if it has had an implicit target for inflation. Moreover, Bernanke favours a flexible version of inflation targeting, in which important short-run economic and financial goals are not sacrificed in order to hit the long-term inflation target more quickly.

That will give Ben's Fed the flexibility to respond rapidly to shocks, just as Greenspan was able to react swiftly following the stock market crash in 1987 and the September 11th attacks.

Ben may not win awards for best-dressed man, but I have little doubt that the attention of global financial markets will remain riveted on the head of the world's most powerful central bank.

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