

What the FOMC Says and Does When the Stock Market Booms

Abstract

Central bankers and monetary economists continue to debate the wisdom of adjusting policy in reaction to asset price misalignments or bubbles. Experts on both sides have marshaled theoretical and practical arguments, but failed to achieve consensus. In this paper, I first summarize the argument in favor of interest rate reactions to equity price misalignments, and then provide evidence that Federal Reserve words and actions were influenced by the Internet bubble as it was in progress. That is, I show that as equity prices boomed, members of the Fed' policymaking body, the FOMC, spoke more intensively about the stock market, and adjusted interest rates accordingly. The debate should not be about whether they should have reacted, but whether they did enough.