

## FINANCIAL TIMES

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# Seventies stagnation shows the value of monetary stability

*From Mr Daniel J. Aronoff.*

Sir, Martin Wolf endorses the US Federal Reserve's open-ended mortgage-backed securities purchase programme essentially because doing "something" seems preferable to doing "nothing" in the face of stagnation ("Bernanke makes a historic choice", Comment, September 19). I disagree.

Mr Wolf contends the move will counter deficient demand, but the chance of success on this ground is trivial as monetary expansion can neither lower interest rates by much, when they are near zero, or incentivise lending when banks are awash in liquidity. Any benefit derived from a replacement demand for real estate securities or improvement in collateral on bank lending is tenuous and more appropriately addressed through other channels.

A monetary expansion materially increases the risk of monetary disorder. It is already the case that the massive monetary expansion employed (successfully and necessarily, in my opinion) to maintain liquidity and avoid deflation has created uncertainty over the future path of inflation, even among the most sophisticated investors. A further bloating of the Fed's balance sheet can only increase doubt over whether it will be able to counter inflationary forces when velocity recovers. Mr Wolf is wrong to count hyperinflation – which I agree is a remote possible outcome – as the only potential cost of the expansion. The US and Europe suffered stagnation in the 1970s when inflation was far short of "hyper".

We perhaps underestimate the cost of price level instability (and instability of price expectations) because we are the beneficiaries of a generation of monetary stability. We would do well to reflect on the high cost of instability in the 1970s that engendered the move toward stability, and the high price that was paid in establishing Fed credibility in the early 1980s, before we endorse a policy that mortgages our inheritance.

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