

The Economy After Greenspan

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Alan Greenspan's 18-year tenure as the head of the FED came to an end at the end of January. With the end of his era, many economic experts agree that his "legacy rests on his inflation fighting success."¹ He effectively continued Paul Volker's strategy aiming to reduce price distortions, achieving record inflation lows (near 1% in 2002), and keeping price index increases in single-digit levels (3.4% for 2005).² During his time as Chairman of the FED the US enjoyed the longest economic expansion in history, from 1991 to 2001.

Some external factors might have aided Mr. Greenspan's success, such as a steadily decreasing oil price during most of his tenure. But there were situations in which he demonstrated his ability as policy-maker and crisis manager. He successfully weathered the market crash of 1987, the dot.com bubble, the September 11 attacks, and worked under the "war on terror" economy towards the end of his job at the FED.³

Greenspan's last move as head of the FED was to increase short-term interest rates to 4.5%, to contain inflationary pressures. The consensus among analysts is that the economy is being left in a "healthy" condition, and that 2006 will continue to improve on 2005's 3.5% economic growth and strong labor market (unemployment has fallen below 5%). This outlook makes us believe that Ben Bernanke (Greenspan's successor approved by the Senate) will follow Greenspan's policy strategy, at least in the short term.⁴

Nevertheless, there are some issues that will require Bernanke's attention sooner than later. The way he deals with them will mark the beginning of his tenure and will set the trend of the post-Greenspan economy. These issues are:⁵

- The real estate market has been fueled by low interest rates. The increase in interest rates to contain inflation might generate a slowdown which could affect the broader economy.

¹ Derby, Michael S (January 31, 2006). "Greenspan Gets Credit for Low Inflation." SmartMoney.com.

² Hagenbaugh, Barbara (January 31, 2006). "Bigger-than-life' Fed chairman retires." USA Today.

³ Andrews, Edmund L. (February 4, 2006) "Can this man fill Greenspan's shoes?" The New York Times

⁴ Associated Press. (February 1, 2006) "Bernanke succeeds Greenspan". Caymanian Compass.

⁵ Ibid 3 & 4.

- The toll that increasing energy prices will have in businesses, households and inflation.
- The increasing US Current Account deficit (\$750 billion in 2005)
- The increasing federal budget and its impact on the overall economy.
- An increasing wage gap between blue and white collar workers. This is due mainly to loss of factory jobs to foreign competitors and to technology innovations.

For good or bad, Mr. Greenspan didn't leave a recipe to follow on these critical topics. The uncertainty of the current economic situation makes Bernanke's start as Chairman of the FED more challenging, and as the newly appointed "most influential economist on Earth", the world is listening.

Bernanke faces only one certainty in his new position: he has very big shoes to fill after Greenspan. Will he do a good job? Will he do a bad job? What do you think?