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Fed Pianalto: Policy Highly Accommodative, CPI Target Opportune

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ROME -(Dow Jones)- The Federal Reserve's policy can fairly be described as "highly accommodative" but "has been effective," Sandra Pianalto, head of the Federal Reserve Bank of Cleveland, said Thursday in a speech in Rome.

Pianalto said there were signs that the U.S. economic recovery "appears to have established a firmer footing" and that she expected stronger job growth in the coming months.

The U.S. economy should grow above 3%, she said, defining that as the economy's long-term potential growth rate.

Pianalto's speech was posted on the website of the Cleveland Fed. She will later speak on a panel with economists from the Bank of Italy.

Energy prices are raising headline inflation rates but their effect is likely to remain mild so long as the U.S. economy remains firm, Pianalto said.

Oil prices won't cause "lasting" inflation, she said, adding that there were no signs of spillover from rising energy and commodities prices on broader price trends. She said she was "keeping a close eye" out for signs of such spillovers.

"Median CPI," a measure of the consumer-price index developed by the Cleveland Fed, remains very low and has risen less than 1% in the past year, Pianalto said.

Underlying inflation in the U.S. will probably rise "gradually" to 2% by 2013, she said.

The Federal Reserve will eventually begin to remove its accommodative policy, and that will involve raising short-term interest rates, draining bank reserves and returning the size of its balance sheet to "more normal levels," she said.

It is the outlook for economic conditions, not current conditions, that are critical for setting policy, she emphasized, noting that the effects of monetary policy are felt with significant delay from policy actions.

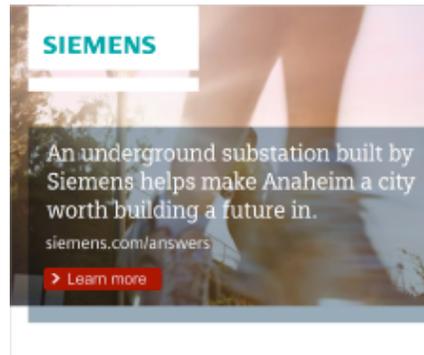
She also reiterated that she thinks now is an "opportune" time to introduce an explicit CPI objective, adding that 2% would be her preferred target.

An explicit inflation target would help shepherd expectations and establishing one "need not imply any material change in the current condition of monetary policy," Pianalto said.

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