Re: When should the Fed act against inflation?

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- *Date*: 16 Jun 2006 11:11:58 −0700

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root wrote:

> Take two scenarios:
> 1. the government runs a deficit, pumps money into the economy and
> prices rise as a consequence.
> 2. global demand for oil exceeds supply leading to an increase in
> the cost of energy which trickles through the economy causing
> an increase in prices.
> What tools does the Fed use to differentiate between these two effects?

For the second scenario the price index can be split into seperate parts and therefore major price rise in certain catergories can be noted and treated e.g. decrease tax on oil, (if you believe high oil problems are a bad thing?)
The first scenario can be considered by looking at the rate of growth and other factors that increase aggregate demand e.g. rise in house prices and this can be controlled by adjusting interest rates.

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