St. Louis Fed's Bullard Discusses the Path Forward for U.S. Monetary Policy

NASHVILLE, Tenn. – Federal Reserve Bank of St. Louis President James Bullard addressed ["The Path Forward for U.S. Monetary Policy"](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2017/bullard_iba_nashville_23_june_2017.pdf)during his presentation Friday at the annual conference of the Illinois Bankers Association in Nashville, Tenn.

Bullard explained that current data readings suggest the Fed can wait and see how the economy develops before making any further adjustments to the policy rate (i.e., the federal funds rate target).

He noted that the U.S. economy remains in a low-growth, low-inflation, low-interest-rate regime, and that the current level of the policy rate is likely to be appropriate for this regime over the forecast horizon. "Many future developments could impact this policy path, but the Fed does not need to pre-empt any of them," he said.

In explaining this view, Bullard explored the following considerations:

Low Growth, Low Inflation and Low Interest Rates
Bullard explained that recent data indicate that the growth in real gross domestic product (GDP) remains consistent with the low-growth regime of recent years. He noted that the current estimate for real GDP growth in the first quarter is 1.2 percent at an annual rate (according to the Bureau of Economic Analysis). He also observed that tracking estimates for second-quarter real GDP growth suggest some improvement from the first quarter, but not enough to move the U.S. economy away from a regime characterized by 2 percent trend growth. Bullard added that real GDP growth measured from one year earlier has averaged 2.1 percent over the last seven years.

"The 2 percent growth regime appears to remain intact," he said.

Bullard then discussed the low level of inflation. He noted that the rate has been below the 2 percent target of the FOMC since 2012. “Recent inflation data have surprised to the downside and call into question the idea that U.S. inflation is reliably returning toward target,” he said.

Bullard then talked about the financial market reaction to U.S. monetary policy normalization. He noted that the Fed has been normalizing by increasing the policy rate, but with a backdrop of relatively weak real GDP growth, downside U.S. inflation surprises and a global regime of low policy rates.

“The financial market reaction has been reflected in a lower U.S. 10-year Treasury yield, lower market-based U.S. inflation expectations and an implied policy rate path closer to the St. Louis Fed path for 2017 and 2018 of 113 basis points,” he said.

Other Developments
Bullard then turned to additional developments concerning the U.S. macroeconomic outlook.

With the U.S. unemployment rate at 4.3 percent in May, Bullard examined the relationship between unemployment and inflation and whether the current low unemployment rate may signal a substantial increase in inflation. He explained that that is not the case, based on current estimates of the relationship between unemployment and inflation. He added, “Even if the U.S. unemployment rate declines substantially further, the effects on U.S. inflation are likely to be small.”

Bullard then discussed the prospect of higher U.S. growth under new fiscal and regulatory policies. In exploring whether the policies could move the U.S. into a higher-growth regime, he noted two points. First, the economy is not in recession today, so fiscal policies should not be viewed as countercyclical measures, but rather as supply-side improvements. Second, low U.S. productivity growth could be improved considerably through deregulation, infrastructure spending and tax reform.

Bullard turned to global growth, explaining that recent improvements won’t

translate to a major economic impact on the U.S. He noted that the International Monetary Fund (IMF) upgraded its world economic outlook for 2017, and that key upgrades occurred for Japan, Europe and China. “Nevertheless, these upgrades are too small and too uncertain to have a meaningful impact on U.S. macroeconomic performance,” he said.

Bullard then discussed the improvements in financial conditions since the December 2016 meeting of the FOMC, as suggested by standard financial conditions indexes (FCIs). He explained that this type of improvement is sometimes interpreted to mean that the FOMC decisions to increase the policy rate are not having any effect. He noted that some of the drivers of FCI movements include low volatility as measured by the VIX, higher equity valuations and lower credit spreads. “It is far from clear that a goal of monetary policy is to cause a deterioration in these aspects of financial markets,” he said.

Bullard concluded that, given the current low-growth regime, the downside surprises in U.S. inflation and inflation expectations, and the fact that low unemployment readings are probably not indicative of meaningfully higher inflation, the FOMC should take a wait-and-see approach to the policy rate.

“The FOMC can wait and see how key macroeconomic developments play out in the quarters ahead,” he said. “The current level of the policy rate is appropriate given current macroeconomic data.”

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A Case for Shrinking the Fed's Balance Sheet