[Presentation (pdf) (bullard_keio_university_26_may_2017pdf)] | [Press Release].

Current Growth, Inflation and Price Level Developments in the U.S.

May 26, 2017

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In a lecture at Keio University in Tokyo, St. Louis Fed President James Bullard said that the U.S. price level is falling short of the 2 percent path maintained between 1995 and 2012. The gap between the current price level, measured by the personal consumption expenditures price index, and the previously established path has now widened to 4.6 percent. He also said that U.S. macroeconomic data have been relatively weak, on balance, since the Federal Open Market Committee (FOMC) met in March and raised the fed funds rate. Financial market readings since then have moved in the opposite direction of what would typically be expected. “This may suggest that the FOMC’s contemplated policy rate path is overly aggressive relative to actual incoming data,” Bullard said. He also discussed the relationship between unemployment and inflation and said that, even if U.S. unemployment declines substantially further, the effects on U.S. inflation are likely to be small.

St. Louis Fed's Bullard Discusses Current Growth, Inflation and Price Level Developments in the U.S.

TOKYO – Federal Reserve Bank of St. Louis President James Bullard addressed [“Current Growth, Inflation and Price Level Developments in the U.S.”](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2017/bullard_keio_university_26_may_2017.pdf)during a lecture Friday at Keio University in Tokyo.

During the lecture, he explained that the U.S. price level has begun to deviate noticeably from the 2 percent path established in the mid-1990s and maintained through 2012.

“Standard macroeconomic theory suggests that the signature of optimal monetary policy is maintenance of a price level path,” Bullard said. However, he noted that the gap between the current price level (as measured by the personal consumption expenditures price index) and the previously established 2 percent path has now widened to 4.6 percent. “This is not as severe as the 1990s Japanese experience, but it is worrisome,” he said.

Also in his lecture, Bullard discussed how U.S. macroeconomic data since the March 2017 meeting of the Federal Open Market Committee (FOMC) have been relatively weak, on balance. For instance, he noted that U.S. inflation and inflation expectations have surprised to the downside in recent months. He also addressed the financial market reaction to the FOMC’s March decision to increase the policy rate (i.e., the federal funds rate target). In addition, he examined the relationship between unemployment and inflation and whether the current low unemployment rate may signal a meaningful increase in inflation.

In explaining these themes, Bullard explored the following topics:

Recent Economic Growth in the U.S.
He said that real GDP growth, as measured from one year earlier, has averaged just 2.1 percent over the last seven years and that the last two years have shown very little change. “A natural conclusion is that the economy has converged upon a growth rate of about 2 percent,” he said, adding that the U.S. economy is not likely to move meaningfully off of this trend in 2017.

He noted that U.S. real GDP grew at an annual rate of 0.7 percent in the first quarter, according to the current (advance) estimate from the Bureau of Economic Analysis (BEA). (The second estimate will be released by the BEA on May 26 at 8:30 a.m. EDT.) Furthermore, the current estimate for the year-over-year growth rate through the first quarter is 1.9 percent.

“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,” he said.

There is also the question of residual seasonality, he said, explaining how first-quarter real GDP growth in recent years has generally been lower than in other quarters, despite the underlying data being adjusted to remove seasonal effects. He noted that the magnitude of this effect is debatable and that it may be better to use real GDP growth measured from one year earlier to gauge performance.

“If residual seasonality is the issue, then second-quarter real GDP growth should be discounted appropriately,” Bullard added.

Financial Market Reaction to March Policy Rate Increase
He then described how the financial market reaction to the March policy rate increase has been the opposite of what would typically be expected.

He noted that the increase was viewed in financial markets as suggesting a policy rate increase at the upcoming June FOMC meeting as well. “Ordinarily, when the policy rate is on an increasing path, longer-term interest rates are expected to rise in tandem, both inflation and inflation expectations are expected to remain consistent with the FOMC’s 2 percent inflation target, and financial market expectations of the policy rate path should remain consistent with the Committee’s projections,” Bullard explained.

Instead, since the March decision, “longer-term U.S. yields have declined, U.S. inflation expectations have weakened, and market expectations of the policy rate path have remained below the median path in the FOMC’s Summary of Economic Projections,” he said.

“This may suggest that the FOMC’s contemplated policy rate path is overly aggressive relative to actual incoming data on U.S. macroeconomic performance,” he said.

Slowing Labor Market Improvement
Turning to the U.S. labor market, Bullard explained that labor input growth has slowed over the last two years. For example, nonfarm payroll employment growth measured from one year earlier was 2.3 percent in February 2015 and has slowed to 1.6 percent today. Growth in private hours measured from one year earlier was 3.4 percent in February 2015 and has slowed to 1.7 percent today.

"Labor market improvement has been slowing, perhaps close to a trend pace, given the current labor productivity growth regime," he said.

Low Unemployment and Inflation
With the U.S. unemployment rate at 4.4 percent, Bullard discussed whether that means that inflation is about to increase substantially. Given current estimates of the relationship between unemployment and inflation, he indicated that he doesn't expect a meaningful increase in inflation.

"Low unemployment readings are probably not an indicator of meaningfully higher inflation over the forecast horizon," he said. "Even if the U.S. unemployment rate declines substantially further, the effects on U.S. inflation are likely to be small."

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- **May 19, 2017**. Presentation. "Recent Developments in U.S. Monetary Policy," Association for Corporate Growth–Monthly Breakfast Meeting, Olin Business School, Washington University in St. Louis, St. Louis, Mo. Presentation (pdf) (bullard_acg_breakfast_19_may_2017pdf) | Press Release.

Recent Developments in U.S. Monetary Policy