economist/april-2013/a-quarterly-monetary-policy-report--would-improve-fed-communications)

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- **February 9, 2017**. Presentation. "The 2017 Outlook for U.S. Monetary Policy," St. Louis Financial Forum, Olin Business School, Washington University in St. Louis, St. Louis, Mo.
Presentation (pdf) (bullard_stl_finforum_breakfast_feb_9_2017pdf) (bullard_stl_finforum_breakfast_feb_9_2017pdf) (bullard_stl_finforum_breakfast_feb_9_2017pdf) (bullard_stl_finforum_breakfast_feb_9_2017pdf) | Press Release.

The 2017 Outlook for U.S. Monetary Policy

February 9, 2017

Speaking to the St. Louis Regional Chamber's Financial Forum, President James Bullard addressed four key questions related to the economy and monetary policy in the coming year. He discussed, among other things, the current "regime" of low real interest rates on short-term government debt, the potential impact of the administration's policies on those rates and on productivity, the likelihood of the economy overheating in 2017, and a possible reduction in the size of the Fed's balance sheet.

St. Louis Fed's Bullard Discusses the Outlook for U.S. Monetary Policy in 2017

ST. LOUIS – Federal Reserve Bank of St. Louis President James Bullard discussed ["The 2017 Outlook for U.S. Monetary

Policy”](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2017/bullard_stl_finforum_breakfast_feb_9_2017.pdf)at the St. Louis Financial Forum on Thursday.

Bullard noted that there has been a problem in recent years with the policy projections of the Federal Open Market Committee (FOMC), which continued to project a significantly rising policy rate (i.e., federal funds rate target) over the forecast horizon that did not materialize in the subsequent years. The St. Louis Fed concluded that the model behind this type of projection was questionable, Bullard noted, explaining how the St. Louis Fed came to its decision in 2016 to move to a regime-based approach to near-term projections.

A core issue today is that the policy rate, at just 63 basis points, appears to be too low when casually compared to past historical experience, he said. He noted that, in the past, when unemployment was relatively low and inflation was close to target, the policy rate was much higher.

“We at the St. Louis Fed concluded that what is different today is that the safe real interest rate is better thought of as being in a ‘low regime,’” he said, adding that it is unlikely to change in the near term.

With this low-rate regime in mind, Bullard then addressed the following questions regarding the economy and monetary policy:
• Will the low-safe-real-rate regime go away naturally in 2017?
• Will the new administration’s policies drive the safe real interest rate higher in 2017?
• Will the U.S. economy overheat in 2017?
• Is the Fed’s normalization program limited to increases in the policy rate?

Bullard said the answer to all of these questions is “no,” and then explained why this is the case.

Regarding the first question, whether the low-safe-real-rate regime will go away naturally in 2017, Bullard said that given that the low-real-rate regime is a global phenomenon, and that it has been many years in the making, it is

unlikely to turn around quickly. “This suggests that the regime will not go away naturally—therefore, a relatively low policy rate will remain appropriate,” he explained.

He then addressed the question of whether the new U.S. administration’s policies have the potential to drive the safe real interest rate higher. “The new administration’s policies may have some impact on the low-safe-real-rate regime if they are directed toward improving medium-term U.S. productivity growth,” he said.

He noted that deregulation, infrastructure spending and tax reform are three areas of policy change that could lead to improved productivity in 2018 and 2019. Other policy proposals, such as those related to trade and immigration, have the potential to affect the macroeconomy over the longer term, he said.

Bullard then addressed the question of whether the U.S. economy is at risk of overheating in 2017. He first noted that inflation has been below the FOMC’s 2 percent target in recent years, due in part to commodity-price effects. Net of commodity-price effects, inflation is close to target, and headline inflation is expected to return closer to target in the quarters ahead. He also noted that market-based measures of inflation expectations remain somewhat low. “Consequently, it does not appear that undue inflationary pressure is building so far,” he said.

In terms of implications for the policy rate in 2017, he reiterated that any effects from the new administration’s policies will likely not be observed until 2018 and 2019. In addition, the prerequisites for meaningfully higher inflation do not seem to have materialized so far, and real rates of return on short-term safe assets seem likely to remain low globally in 2017. “These considerations suggest that the policy rate can remain fairly low in 2017,” he explained.

Regarding the question of whether the FOMC’s normalization program is limited to changes in the policy rate, Bullard said that “adjustments to balance sheet policy might be viewed as a way to normalize Fed policy without relying exclusively on a higher policy rate path.”

He noted that the Fed's balance sheet has been an important monetary policy tool during the period of near-zero policy rates, and that the FOMC has not set a timetable for ending the current reinvestment policy. "Now that the policy rate has been increased, the FOMC may be in a better position to allow reinvestment to end or to otherwise reduce the size of the balance sheet," he said.

In addition, Bullard noted that current FOMC policy is distorting the yield curve. "The current FOMC policy is putting some upward pressure on the short end of the yield curve through actual and projected movements in the policy rate," he said, adding, "at the same time, current policy is putting downward pressure on other portions of the yield curve by maintaining a $4.45 trillion balance sheet."

He noted that this type of "twist operation" does not appear to have a theoretical basis and that a more natural normalization process would allow the entire yield curve to adjust appropriately as normalization proceeds.

He concluded, "Ending balance sheet reinvestment may allow for a more natural adjustment of rates across the yield curve as normalization proceeds."

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