

expectation of quantitative easing in the euro area had on U.S. and global markets. In my view, the ECB's undertaking of quantitative easing was a momentous decision and a major milestone in global monetary policy.

#### Endnotes

1. Although U.S. inflation has not been what was expected, it has not gone down to zero. Headline inflation has been drifting down in recent months due largely, in my view, to the decline in oil prices. U.S. inflation refers to the year-over-year percent change in the Personal Consumption Expenditures Price Index, and euro area inflation refers to the year-over-year percent change in the Harmonized Index of Consumer Prices. [ [back to text](<https://www.stlouisfed.org#1##1>)]
2. After raising its benchmark rate twice in 2011, the ECB has since lowered it to near zero. [ [back to text](<https://www.stlouisfed.org#2##2>)]

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- **April 15, 2015.** Presentation. "[Some Considerations for U.S. Monetary Policy Normalization.](#)" 24th Annual Hyman P. Minsky Conference on the State of the US and World Economies, Washington, D.C. [Presentation \(pdf\) \(bullard-minsky-15-april-2015pdf\)](#) | [Press Release](#) | [Related news articles.](#)

### **Some Considerations for U.S. Monetary Policy Normalization**

April 15, 2015

St. Louis Fed President James Bullard discussed factors that are weighing on the decision to begin normalizing U.S. monetary policy and the recent removal of the word “patient” from the FOMC statement, during the 24th Annual Hyman P. Minsky Conference, in Washington, D.C. He said that now may be a good time to begin normalizing monetary policy so that it is set appropriately for an improving economy over the next two years.

[Presentation (pdf)](<https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard-minsky-15-april-2015.pdf>) | [Press Release](<https://www.stlouisfed.org/news-releases/2015/04/15/st-louis-feds-bullard-discusses-considerations-for-us-monetary-policy-normalization>)

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- [Fed's Bullard presses on need for rate rises to prevent bubbles](<http://www.ft.com/intl/cms/s/0/304adc50-e37f-11e4-9a82-00144feab7de.html#axzz3XxfKuuJW>), by Sam Fleming, Financial Times.
- [Fed's Bullard repeats call to hike now, cites asset bubble risk](<http://www.reuters.com/article/2015/04/15/usa-fed-bullard-rates-idUSL2N0XC1GR20150415>), by Michael Flaherty, Reuters.
- [Should The Fed Raise Interest Rates? Part I](<http://seekingalpha.com/article/3082696-should-the-fed-raise-interest-rates-part-i>), Seeking Alpha.
- [St. Louis Fed's Bullard details reasons to begin rate hikes](<http://www.bizjournals.com/stlouis/blog/2015/04/st-louis-fed-s-bullard-details-reasons-to-begin.html>), by Greg Edwards, St. Louis Business Journal.
- [Bullard: Now May Be Good Time to Start Raising Rates](<http://blogs.wsj.com/economics/2015/04/15/bullard-now-may-be-good-time-to-start-raising-rates/>), by Michael S. Derby and Jeffrey Sparshott, Wall Street Journal.

### **St. Louis Fed's Bullard Discusses Considerations for U.S. Monetary Policy Normalization**

WASHINGTON, D.C. – Federal Reserve Bank of St. Louis President James Bullard discussed [“Some Considerations for U.S. Monetary Policy Normalization”](<https://www.stlouisfed.org/->

/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard-minsky-15-april-2015.pdf)at the 24th Annual Hyman P. Minsky Conference on Wednesday.

In addition to touching on the Federal Open Market Committee's (FOMC) recent removal of the word "patient" from its policy statement, Bullard highlighted some of the factors weighing on the decision to begin normalizing U.S. monetary policy. These include: 1) U.S. labor markets have been improving at a rapid pace over the last year; 2) U.S. GDP growth prospects remain relatively robust; 3) today's low U.S. inflation is due mostly to temporary factors, which will likely reverse over the medium term; 4) some standard Taylor-type rules suggest the U.S. should already be off the zero lower bound; and 5) financial stability risks are asymmetric toward staying too long at zero.

Bullard noted that the U.S. economy is much closer to normal than it has been for many years. "Now may be a good time to begin normalizing U.S. monetary policy so that it is set appropriately for an improving economy over the next two years," he said. He added, however, that "Even with some normalization, monetary policy will remain exceptionally accommodative."

#### The FOMC Removes "Patient"

"At its March meeting, the FOMC appropriately returned to data-dependent monetary policy by removing 'patient' from its statement," Bullard said. He explained the word "patient" was a particular type of forward guidance that suggested the policy rate would not be adjusted over the next "couple of meetings." He added, "By removing 'patient,' the Committee can return to more standard monetary policy decision-making, under which an appropriate policy rate is decided at each meeting."

Bullard noted that this removal might be thought of as "the end of forward guidance." While forward guidance was viewed as appropriate during the period of zero interest rates, it is unlikely to be appropriate in less extreme circumstances, he added.

"Decisions now depend on incoming data relative to forecasts," Bullard said.

While better-than-expected or worse-than-expected outcomes may push the FOMC toward a somewhat different policy rate path, he noted the general trend is for an improving U.S. economy to lead to higher interest rates. “To say otherwise risks the ‘perma-zero’ equilibrium experienced by Japan over the last two decades,” he added.

Regarding expectations for the policy rate path, Bullard remarked that financial markets indicate they currently expect the policy rate to cross 50 basis points in the first quarter of 2016, which is somewhat later than indicated in the FOMC’s latest Summary of Economic Projections (SEP). “This difference of views on the nature of the U.S. policy rate path will need to be reconciled at some point,” Bullard said.

#### Five Factors

As the FOMC considers the normalization of U.S. monetary policy, the following factors are weighing on the decision to begin the normalization process, Bullard said, noting this is not an exhaustive list.

#### Continued Improvement in U.S. Labor Markets

Bullard noted that the unemployment rate in the U.S. has generally fallen faster in recent years than the FOMC expected and that jobs have been created at a rapid pace over the last year. He added that today’s unemployment rate is approaching the range of longer-run or normal values suggested by the FOMC.

In terms of current projections, he noted that the SEP central tendency suggests unemployment will decline only gradually from its current level, which is the same type of projection made in previous years. However, Bullard said, “The history of the last two expansions in the U.S., the 1990s and the 2000s, suggests that unemployment will reach much lower levels.”

He also discussed broader measures of labor market performance, including the labor market conditions index developed by Federal Reserve Board of Governors staff. “The level of this index has risen above its long-run average value. This suggests that accounting for a variety of labor market indicators,

labor market performance today is above average,” Bullard explained.

“In summary, labor markets continue to improve and are approaching or even exceeding normal performance levels,” Bullard said, and he added that labor market outcomes will likely significantly overshoot long-run levels over the next two years, since monetary policy will remain highly accommodative as normalization begins.

#### U.S. Growth Prospects Remain Robust

Despite a slowdown in the first quarter, Bullard said that real GDP growth will likely continue apace. “I think that the U.S. economy is likely to maintain a growth rate near 3 percent over the medium term,” he said. He added that with potential growth rates in the U.S. now centering around 2 percent, a 3 percent growth rate represents growth well above trend.

Bullard noted that two important tailwinds are aiding the U.S.: the persistent decline in global oil prices and the onset of sovereign-debt quantitative easing in the euro area, which has driven U.S. bond yields lower. “Both lower oil prices and lower long-term yields tend to be important factors for U.S. macroeconomic performance,” Bullard said. Regarding exchange rates, he noted that a broad range of macroeconomic research suggests limited effects of exchange rate movements on U.S. economic performance.

#### U.S. Inflation Is Temporarily Low

While inflation was above the FOMC’s 2 percent target as of January 2012, Bullard noted that it ran below target in 2013 and 2014. In addition, market-based measures of inflation expectations have declined to low levels in recent months. “Most likely, these expectations will rise back toward the FOMC’s inflation target in coming months and quarters,” Bullard said. “However, this bears careful watching. Inflation and inflation expectations moving away from target is a concern.”

While market-based measures of inflation expectations from five to 10 years in the future should not be significantly impacted by gyrations in global oil markets, Bullard pointed out that the decline in these inflation expectations

does seem to be highly correlated with oil price movements since last summer. “I am reserving judgment concerning these inflation expectations until oil prices show consistent stabilization,” he said.

He also discussed nominal wage growth, which is sometimes cited as a factor that may influence inflation going forward. “However, nominal wages tend to lag inflation outcomes,” Bullard said. “In addition, nominal wages have a component related to productivity growth, a variable that is difficult to measure and predict.”

### Taylor-type Rules

As monetary policy approaches normalization, it is interesting to re-examine Taylor-type policy rules, Bullard said. He explained that in a Taylor-type rule, the short-term nominal interest rate should respond to deviations of inflation from target and of actual unemployment from its long-run level.

He looked at one such policy rule—the Taylor (1999) rule with interest rate smoothing—which suggests that liftoff should already have occurred by now. “The Committee has not moved off of the zero interest rate policy so far, despite standard policy rule recommendations. In this sense, the Committee is already exhibiting considerable patience,” Bullard said.

### Financial Stability Risks Are Asymmetric Toward Remaining Too Long at Zero

Given that the FOMC has not altered the policy rate in more than six years, Bullard posed the question of whether the Fed is unwittingly following an “interest rate peg” policy and is therefore risking a possible scenario of asset-price bubbles. He explained that under an interest rate peg, the policy rate never moves despite changing economic circumstances. According to New Keynesian literature, a key consequence of such a policy is that many different equilibria are possible, including some that may have wide asset-price swings that look like bubbles.

Thus, “A risk of remaining at the zero lower bound too long is that a significant asset market bubble will develop,” Bullard said. He noted that the

U.S. has been plagued by such bubbles in the 1990s (tech/NASDAQ) and the 2000s (housing prices). Each one eventually burst, and the aftermath included a recession. Bullard said that such an outcome would be unwelcome and constitutes a significant risk for U.S. monetary policy, much larger than the risks associated with the zero lower bound.

“If a bubble in a key asset market develops, history has shown that we have little ability to contain it,” Bullard said. “A gradual normalization would help to mitigate this risk while still providing significant monetary policy accommodation for the U.S. economy. Such an approach may extend the expected length of the current economic expansion.”

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## **U.S. Monetary Policy Normalization**

March 26, 2015

St. Louis Fed President James Bullard discussed the recent removal of the word "patient" from the FOMC statement and factors that are weighing on the decision to begin normalizing U.S. monetary policy. During an event in Frankfurt, he said that now may be a good time to begin normalizing monetary policy so that it is set appropriately for an improving economy over the next two years.

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