pushing in the wrong direction in trying to solve an important social problem, which is how best to facilitate market-based exchange," Bullard said.

Similar remarks were delivered at Alternative Money University, Cato Institute, Washington, D.C., July 15, 2018, [(presentation pdf)](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2018/bullard_amu_cato_15july2018.pdf)and at The Canon Institute for Global Studies, Conference on Macroeconomic Theory and Policy 2018, Tokyo, Japan, June 4, 2018, [(presentation pdf)](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2018/bullard_cigs_tokyo_4_june_2018.pdf).

- **May 31, 2018**. Panel Discussion. 2018 BOJ-IMES Conference, Central Banking in a Changing World, Tokyo, Japan.
  Round 1: The Case of the Disappearing Phillips Curve (pdf) (bullard_boj_imes_tokyo_31_may_2018_round_1pdf)
  Round 2: Exchange Rate Volatility and Cryptocurrencies (pdf) (bullard_boj_imes_tokyo_31_may_2018_round_2pdf)
- **May 29, 2018**. Presentation. "A Cautionary Note on U.S. Monetary Policy Normalization," Japan Center for International Finance, Global Finance Seminar, Tokyo, Japan.
  Presentation (pdf) (bullard_jcif_tokyo_29_may_2018pdf) | Press Release.

A Cautionary Note on U.S. Monetary Policy Normalization

May 29, 2018

[Presentation (pdf)](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2018/bullard_jcif_tokyo_29_may_2018.pdf)| [Press Release](https://www.stlouisfed.org/news-releases/2018/05/29/bullard-a-cautionary-note)

Speaking in Tokyo, St. Louis Fed President James Bullard discussed three reasons why caution may be justified in deciding whether to raise the U.S.

policy rate (the fed funds rate target) further in the near term. First, market-based inflation expectations in the U.S. remain somewhat low. Second, the current level of the policy rate appears to be neutral, meaning it is putting neither upward nor downward pressure on inflation. Third, the U.S. nominal yield curve could invert later this year or in 2019, which would be a bearish signal for U.S. macroeconomic prospects, he said.

St. Louis Fed's Bullard Discusses "A Cautionary Note on U.S. Monetary Policy Normalization"

TOKYO – Federal Reserve Bank of St. Louis President James Bullard discussed ["A Cautionary Note on U.S. Monetary Policy Normalization"](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2018/bullard_jcif_tokyo_29_may_2018.pdf)on Tuesday at the Japan Center for International Finance's Global Finance Seminar.

In the talk, Bullard explained that U.S. monetary policy has been normalizing during the last 2½ years, with the Fed's balance sheet shrinking relative to U.S. GDP and the Fed's policy rate (i.e., the federal funds rate target) increasing relative to policy rates in key foreign economies.

He posed the question: "How far can the Fed go along the current normalization path, given the likely paths of other key economies?" He then presented three reasons for caution in deciding whether to raise the U.S. policy rate further in the near term. The reasons spanned the following areas: inflation expectations, the neutral policy rate and the flattening yield curve.

U.S. market-based inflation expectations remain somewhat low
"Inflation expectations in the U.S. remain somewhat low, suggesting that further normalization may not be necessary to keep inflation near target," Bullard said.

He noted that, on a PCE basis, U.S. market-based inflation expectations remain centered below the Federal Open Market Committee's (FOMC or

Committee) 2 percent inflation target, inhibiting the FOMC's ability to maintain the credibility of the target. 1

Bullard explained that these market-based inflation expectations can be interpreted as saying that financial markets don't believe the Fed will quite hit its inflation target, even over the next five years. He added that this market judgment already prices in all current macroeconomic developments, including a market expectation of future Fed policy, which tends to be somewhat more dovish than the FOMC's policy rate outlook.

"These developments suggest that financial markets believe inflationary pressure in the U.S. is likely to be muted over the forecast horizon," he said.

Bullard pointed out that market-based inflation expectations may have increased recently, in part, because of developments in global crude oil markets, a factor that should ultimately have only temporary effects on inflation.

"A reasonable policy going forward may be to temper the pace of normalization in order to re-center inflation expectations at the Committee's 2 percent target," he said.

The current U.S. policy rate is neutral

Bullard noted that the policy rate setting is likely at the longer-run neutral level today, putting neither upward nor downward pressure on inflation. "This suggests that it may not be necessary to change the policy rate to keep inflation at target," he said.

In recalling analysis he did earlier this year, he said the level of the trend short-term safe real interest rate, the so-called "r-star," is a starting point for the appropriate nominal policy rate. His analysis suggests that r-star remains in negative territory.

"That analysis also suggests that the nominal policy rate set by the FOMC is already pressing against the upper bound of a neutral setting," he said.

The U.S. yield curve is relatively flat

Bullard noted that the U.S. nominal yield curve has flattened since 2014. The spread between the 10-year and one-year Treasury yields went from close to 300 basis points at the beginning of 2014 to only 76 basis points as of the week of May 16. He attributed the flattening to rising short-term yields vis-à-vis relatively stable or slowly rising long-term yields.

He noted that it is possible that the yield curve will invert sometime in the next year. If inversion does occur, he said, research by the Federal Reserve Bank of San Francisco suggests that the signal of an impending economic downturn would be strong. "In my view, it is unnecessary for the FOMC to be so aggressive as to invert the yield curve," he said.

He also pointed out that the international evidence on the relationship between yield curve inversions and subsequent recessions is not as strong as it is for the U.S. alone.

"The U.S. nominal yield curve could invert later this year or in 2019, which would be a bearish signal for U.S. macroeconomic prospects," he said.

1The FOMC's inflation target is in terms of the annual change in the price index for personal consumption expenditures (PCE). Bullard explained that market-based measures of inflation expectations, which are for CPI inflation, need to be adjusted downward somewhat to roughly translate into PCE inflation.

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- **May 16, 2018**. Welcoming Remarks. Given at the *Homer Jones Memorial Lecture*, Federal Reserve Bank of St. Louis.
  Remarks (pdf) (welcoming_remarks_homer_jones_2018pdf) | Event Videos.
  Related interview: Bullard Speaks with Bloomberg about Interest Rates, Yield Curve, Inflation.