- **May 11, 2018**. Presentation. "U.S. Monetary Policy: A Case for Caution," Springfield Area Chamber of Commerce, Springfield Business Development Corp. Meeting, Springfield, Mo. Presentation (pdf) (bullard_springfield_chamber_11_may_2018pdf) | Press Release | Photos of Visit to Springfield.

  U.S. Monetary Policy: A Case for Caution

  May 11, 2018

  [Presentation (pdf)](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2018/bullard_springfield_chamber_11_may_2018.pdf)| [Press Release](https://www.stlouisfed.org/news-releases/2018/05/11/bullard-a-case-for-caution)| [Photos](https://www.stlouisfed.org#photos)

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  During a Friday presentation, Bullard outlined five reasons for caution in raising the policy rate (fed funds rate) further based on current macroeconomic conditions. Those reasons are: 1) inflation expectations remain low; 2) the current policy rate setting is neutral; 3) the yield curve is relatively flat and yield curve inversion is possible; 4) business investment has room to grow; and 5) labor markets are in equilibrium.

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St. Louis Fed's Bullard Discusses "U.S. Monetary Policy: A Case for Caution"

SPRINGFIELD, Mo. – Federal Reserve Bank of St. Louis President James Bullard discussed [“U.S. Monetary Policy: A Case for Caution”](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/2018/bullard_springfield_chamber_11_may_2018.pdf)on Friday at the Springfield Area Chamber of Commerce.

In the talk, Bullard explained that U.S. monetary policy has been normalizing during the last two and a half 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?” He then presented five reasons for caution in deciding whether to raise the policy rate further in the near term. The reasons spanned the following areas: inflation expectations, the neutral policy rate, the flattening yield curve, room to grow business investment, and labor markets in equilibrium.

Inflation expectations remain low
Bullard noted that market-based inflation expectations are still low. On a PCE basis, they remain centered somewhat below the Federal Open Market Committee’s (FOMC) 2 percent inflation target, inhibiting the FOMC’s ability to maintain the credibility of the target, he explained. 1

“By keeping the policy rate steady, the FOMC may be able to appropriately re-center inflation expectations at the target outcome for the next several years," he said.

The current policy rate is neutral
Bullard noted that the policy rate setting is likely neutral today, putting neither upward nor downward pressure on inflation. "This suggests that it is not 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. He suggested 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 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 72 basis points as of the week of May 2.

"The yield curve could invert later this year or early next year if the Committee continues increasing the policy rate and longer-term yields do not move higher," he said.

He cited research by the Federal Reserve Bank of San Francisco, which suggests that yield curve inversion is a reliable bearish signal for the U.S. economy. "It is unnecessary to press policy rate normalization to the point of inverting the yield curve since inflation and inflation expectations are either at or below target," he said.

Business investment has room to grow
Bullard noted that investment in the U.S. economy as a fraction of GDP remains low and that it has room to grow. He also noted that the corporate tax reform recently signed into law was meant in part to address the dearth of investment.

“To the extent the corporate tax reform is successful today and over the next few years, the economy could grow more rapidly without inflationary side effects,” he said. “For this reason, I would caution against translating faster real GDP growth into increased inflationary pressures.”

Labor markets are in equilibrium

Bullard recalled that after being dislocated during the aftermath of the 2007-2009 recession, U.S. labor markets have recovered to an equilibrium state. This means that the suppliers of labor (households) and the employers of labor (firms) are now on the same footing in the labor market, he explained, adding that this is an appropriate situation that the Fed should not disturb.

He also noted that labor market outcomes are not tightly associated with inflation. He explained that when compensation paid to workers increases, firms have increased incentives to substitute away from labor and toward capital investment, an effect that keeps the labor market in equilibrium without inflationary consequences.

“It is not necessary to disrupt this equilibrium to keep inflation under control given the current macroeconomic circumstances,” 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 4, 2018**. Presentation. "Optimal Monetary Policy for the Masses," 2018 Texas Monetary Conference, Austin, Texas.