

Balance-Sheet Policy Space

Permitting some adjustments to the balance sheet may also create balance-sheet “policy space,” Bullard noted.

“Some have argued that the size of the balance sheet should not be reduced until the policy rate is high enough that the policy rate can be reduced appropriately should a recession develop. This is sometimes called ‘policy space,’” he explained.

Furthermore, the same “policy space” argument can be made for the size of the balance sheet, he said, adding, “we should be allowing the balance sheet to normalize naturally now, during relatively good times, in case we are forced to resort to balance sheet policy in a future downturn.”

¹For more information on the St. Louis Fed’s regime-based approach to near-term projections, see the [“Key Policy Papers”](<https://www.stlouisfed.org/from-the-president/key-policy-topics>)section of Bullard’s webpage.

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- **February 21, 2017.** Article. ["The Policy Rule Debate: A Simpler Solution,"](#) Federal Reserve Bank of St. Louis *The Regional Economist*, First Quarter 2017. This article also appeared in the [St. Louis Fed On the Economy blog](#), February 23, 2017.

The Policy Rule Debate: A Simpler Solution

There has been growing public debate over how the Federal Reserve should conduct and communicate monetary policy. Some recent proposals, for instance, would require the Fed to specify a monetary policy rule that it would follow in adjusting the key policy rate (i.e., the federal funds rate

target) and for the Fed to explain any deviations from that rule.

Questions abound about these proposals: Is the idea for the Fed to use only one rule or a suite of rules, each with its own strengths and weaknesses? Among a suite of rules, which ones should receive more emphasis? What does “follow a rule” mean for the Fed, and what are the implications for not doing so? And, what about when the policy rate is near the zero lower bound? Should the Fed be encouraged to follow a rule even if it means that the policy rate would be negative?

These are good questions, but the case in favor of monetary policy rules is also compelling. We cannot really talk coherently about the future evolution of the macroeconomy without also talking about the future evolution of monetary policy. The two subjects go hand-in-hand: A monetary policy rule helps to map out the path of policy consistent with an envisioned path for the macroeconomy.

In light of these considerations, my recommendation is for the Fed to issue a quarterly monetary policy report to better explain its actions and projections on a regular basis. Reports like this are often issued by other central banks around the world. The information in the report could be organized around recommendations from a standard suite of monetary policy rules. This could improve the U.S. monetary policy debate by orienting it more toward a comparison of actual policy to recommendations from standard monetary policy rules.

Many Rules Already Used

In recent decades, monetary policy rules have become standard in the macroeconomics literature. A policy rule, such as the Taylor rule, named after John Taylor of Stanford University, is an equation that provides a recommended setting for a central bank’s targeted interest rate. It is based partly on values and targets for macroeconomic variables, including inflation as well as output or unemployment. Policy rules are popular among many economists and policymakers—including at the Fed—because these rules, when applied, help provide an understanding about future monetary policy, which is in turn important to households and businesses making investment and consumption decisions.

Much Fed communication, some within the Fed and some directed to the public, already involves using policy rules as benchmarks. As an input for the deliberations at each Federal Open Market Committee (FOMC) meeting, for instance, staff economists produce and distribute a briefing document to the FOMC known as the Tealbook. Publicly-released Tealbooks have included policy rate recommendations from a suite of monetary policy rules.¹ Similarly, there are many examples of public remarks by FOMC participants in which actual policy outcomes are compared with the prescription from a monetary policy rule. That includes remarks by the FOMC chair. For example, Fed Chair Janet Yellen discussed in 2012 (when she was Vice-Chair) what a variant of the original Taylor rule had prescribed for monetary policy at that time.² Another example is from 2010, when then-Fed Chair Ben Bernanke gave a speech that used a Taylor-type rule to argue that monetary policy had not been too accommodative during the period 2002-2006, which coincided with the housing bubble.³

A Solution to the Communication Problem

Monetary policy rules have been and will continue to be useful as guides for conducting monetary policy. A rules-based quarterly monetary policy report could provide a more complete and fulsome discussion of how the FOMC views the current state of the U.S. economy and the Committee's expectations going forward. Such a report, which I have advocated in the past,⁴ could include a regular discussion of various monetary policy rules and explain why any deviations from those rules seemed appropriate at that time. This type of reporting may provide an improvement over the so-called "dot plot," which is released each quarter in the FOMC's Summary of Economic Projections and shows FOMC participants' projections for the policy rate over the next few years. The dot plot does not allow the public to infer which policy rule any of the participants are using since individual dots are not connected across the years shown in the chart or to his or her projections for changes in real gross domestic product, unemployment and inflation.

Conclusion

The Fed has made significant strides in increasing the transparency of its actions since the financial crisis and recession of 2007-2009. Still, there is

room for improvement, and further transparency regarding the Fed's use of policy rules in its monetary policymaking is within reach. Because the Fed already uses policy rules in many ways to describe monetary policy and to make a case for a particular policy, the Fed could push its public communications more in that direction.

Endnotes

1. For example, see Tealbook B for the FOMC meeting in December 2010, at [\[www.federalreserve.gov/monetarypolicy/files/FOMC20101214tealbookb20101209.pdf\]](http://www.federalreserve.gov/monetarypolicy/files/FOMC20101214tealbookb20101209.pdf) (<https://www.federalreserve.gov/monetarypolicy/files/fomc20101214tealbookb20101209.pdf>). [[\[back to text\]\(https://www.stlouisfed.org#1##1\)](https://www.stlouisfed.org#1##1)]
2. See Yellen, Janet L. "Perspectives on Monetary Policy," speech on June 6, 2012. [[\[back to text\]\(https://www.stlouisfed.org#2##2\)](https://www.stlouisfed.org#2##2)]
3. See Bernanke, Ben S. "Monetary Policy and the Housing Bubble," speech on Jan. 3, 2010. [[\[back to text\]\(https://www.stlouisfed.org#3##3\)](https://www.stlouisfed.org#3##3)]
4. For example, see my column in the April 2013 issue of The Regional Economist, "A Quarterly Monetary Policy Report Would Improve Fed Communications." [[\[back to text\]\(https://www.stlouisfed.org#4##4\)](https://www.stlouisfed.org#4##4)]

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The text below, written by Federal Reserve Bank of St. Louis President James Bullard, first appeared as the President's Message in the first quarter 2017 issue of The Regional Economist .

There has been growing public debate over how the Federal Reserve should conduct and communicate monetary policy. Some recent proposals, for

instance, would require the Fed to specify a monetary policy rule that it would follow in adjusting the key policy rate (i.e., the federal funds rate target) and for the Fed to explain any deviations from that rule.

Questions abound about these proposals: Is the idea for the Fed to use only one rule or a suite of rules, each with its own strengths and weaknesses? Among a suite of rules, which ones should receive more emphasis? What does “follow a rule” mean for the Fed, and what are the implications for not doing so? And, what about when the policy rate is near the zero lower bound? Should the Fed be encouraged to follow a rule even if it means that the policy rate would be negative?

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Notes and References

1For example, see Tealbook B for the FOMC meeting in December 2010, at [www.federalreserve.gov/monetarypolicy/files/FOMC20101214tealbookb20101209.pdf](http://www.federalreserve.gov/monetarypolicy/files/fomc20101214tealbookb20101209.pdf).

2See Yellen, Janet L. "[Perspectives on Monetary Policy](https://www.federalreserve.gov/newsevents/speech/yellen20120606a.htm)," speech on June 6, 2012.

3See Bernanke, Ben S. "[Monetary Policy and the Housing Bubble](https://www.federalreserve.gov/newsevents/speech/bernanke20100103a.htm)," speech on Jan. 3, 2010.

4For example, see my column in the April 2013 issue of The Regional Economist, "[A Quarterly Monetary Policy Report Would Improve Fed Communications](https://www.stlouisfed.org/publications/regional-economist/april-2013/a-quarterly-monetary-policy-report--would-improve-fed-communications)."

Additional Resources

- Regional Economist: [The Policy Rule Debate: A Simpler Solution](https://www.stlouisfed.org/publications/regional-economist/first_quarter_2017/the-policy-rule-debate-a-simpler-solution)
- From the President: [President Bullard Discusses Low Interest Rates, Fed Transparency on CNBC](https://www.stlouisfed.org/from-the-president/video-appearances/2017/bullard-cnbc-part-2-fed-transparency)
- Regional Economist: [A Quarterly Monetary Policy Report Would Improve Fed Communications](https://www.stlouisfed.org/publications/regional-

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 \(pdf\) \(bullard_stl_finforum_breakfast_feb_9_2017pdf\)](#)
[\(bullard_stl_finforum_breakfast_feb_9_2017pdf\)](#)
[\(bullard_stl_finforum_breakfast_feb_9_2017pdf\)](#)
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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