target after the financial crisis, it has declined about 3 percentage points since 2012.

"Developments in the G-7 since 2012 could be interpreted as neo-Fisherian effects taking hold," Bullard said. In addition, he discussed how euro area data also point to a compelling neo-Fisherian story. "If ZIRP was sufficient to drive inflation back to target by 2012, why has continued ZIRP not kept inflation close to target or pushed it even higher?"

In conclusion, given the focus of the conference on issues that may be important for the medium- and long-term monetary policy outlook, Bullard said, "Neo-Fisherian ideas may have an important impact on our thinking about monetary policy in the future."

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- **February 24, 2016**. Presentation. "More on the Changing Imperatives for U.S. Monetary Policy Normalization," Money Marketeers of New York University, New York, N.Y.
  Presentation (pdf) (bullard-money-marketeers-nyu-24-feb-2016pdf) | Press Release.

  **More on the Changing Imperatives for U.S. Monetary Policy Normalization**

  February 24, 2016

  St. Louis Fed President James Bullard said that recent data-based developments—namely, further declines in inflation expectations and a reduced risk of asset price bubbles—likely give the FOMC more leeway in its normalization program. During his presentation to the Money Marketeers of New York University, he discussed whether inflation expectations have fallen too far for comfort and raised concerns about central bank credibility

with respect to the inflation target. He also reiterated that the FOMC may wish to consider changes to the way it approaches the policy rate projections in the Summary of Economic Projections.

**St. Louis Fed's Bullard Discusses Falling Inflation Expectations and Monetary Policy Normalization**

NEW YORK – Federal Reserve Bank of St. Louis President James Bullard discussed [“More on the Changing Imperatives for U.S. Monetary Policy Normalization”](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard-money-marketeers-nyu-24-feb-2016.pdf)in a presentation Wednesday to the Money Marketeers of New York University.

Bullard said that two pillars of the Federal Open Market Committee’s (FOMC) 2015 case for monetary policy normalization have changed in 2016. In particular, he noted that market-based inflation expectations have fallen further and that the risk of asset price bubbles over the medium term appears to have diminished. “These data-dependent changes likely give the FOMC more leeway in its normalization program,” he said.

He discussed whether inflation expectations have fallen too far for comfort and raised concerns about central bank credibility with respect to the inflation target. He cited the example of the euro area, where 10-year government bond yields have fallen to the levels of Japan and Switzerland, “arguably because the credibility of the inflation target has eroded,” he said.

Bullard also reiterated the need for monetary policy to be more clearly data dependent and whether the FOMC should rethink its approach to the Summary of Economic Projections (SEP). “The Committee may wish to consider changes to the way it approaches the policy rate projections in the SEP to better align market expectations of future policy moves,” he said.

Declining Inflation Expectations

Bullard noted that modern theory suggests inflation expectations are a more

important determinant of actual inflation than traditional “Phillips curve” effects, and that market-based measures of inflation expectations have been declining in the U.S. since the summer of 2014. “The decline has been highly correlated with the decline in oil prices,” he said.

While he had suggested in 2015 that inflation expectations would rise back toward July 2014 levels once oil prices stabilized, Bullard noted that oil prices did not stabilize and instead fell further beginning in November 2015. “Since then, market-based measures of inflation expectations have declined too far for comfort, the oil price correlation notwithstanding,” he said.

Turning to the FOMC’s normalization strategy being predicated on an environment of stable inflation expectations, Bullard said this renewed downward pressure on market-based measures of inflation expectations during 2016 has called this assumption into question. “I regard it as unwise to continue a normalization strategy in an environment of declining market-based inflation expectations,” he said. “A decline in inflation expectations represents an erosion of central bank credibility with respect to the inflation target.”

He addressed the argument sometimes made that the components of TIPS-based measures of inflation compensation other than inflation expectations (i.e., risk premia and liquidity premia) are rather large and volatile. “My preferred interpretation is that risk and liquidity premia associated with inflation compensation are relatively small with low volatility,” he explained. “Hence, I interpret declines in TIPS spreads as reflecting mostly declines in inflation expectations.”

The Eurozone Experience

Bullard discussed the potential outcome of a scenario in which market-based measures of inflation expectations continue to decline. He said the euro area arguably reacted too slowly to this type of development before it ultimately committed to a major quantitative easing program in January 2015. “The result has been uncomfortably low inflation in the euro area, which is now not projected to rise to target for some time,” he said.

He examined a chart of 10-year government bond yields since 2012 for Japan, Switzerland, Germany, the U.K. and the U.S., with the chart showing the 10-year bond yield for Germany dropping to nearly the same level as yields for Japan and Switzerland. Bullard explained that all of these countries have similar inflation goals and, arguably, expected real rates of return on bonds of the same maturity. “What is different is that longer-term inflation credibility may differ across countries,” he said, noting that Germany seems to have moved from the relatively credible group to the less credible group since January 2012.

## Asset Price Bubbles

Bullard then discussed how the risk of asset price bubbles over the medium term has been reduced. “Steps toward normalization of U.S. monetary policy help to lessen the risk that very low interest rates might feed into a third major asset price bubble in the U.S.,” Bullard said, adding, “The recent sell-off in global equity markets, along with increases in risk spreads in corporate bond markets, may have made this risk less of a concern over the medium term.”

## The FOMC and Data Dependence

Bullard noted that the FOMC has repeatedly stated in official communication and public commentary that future monetary policy adjustments are data dependent. He addressed the possibility that the financial markets may not believe this since the SEP may be unintentionally communicating a version of the 2004-2006 normalization cycle, which appeared to be mechanical.

“Post liftoff, communicating a path for the policy rate via the median of the SEP could be viewed as an inadvertent calendar-based commitment to increase rates,” he said. “While the Committee has certainly stressed data dependence, its past behavior belies that emphasis and therefore may not carry as much weight as it should with the financial markets.”

Bullard said that a possible change to the SEP is an important issue for the FOMC to consider. “The FOMC could change its approach to the SEP in a way that would cease giving such explicit guidance on the likely path of the policy

rate going forward," he said. "Such a change might help better align the Committee with financial markets on the idea that policy is data dependent and does not follow a predetermined path."

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**Changing Imperatives for U.S. Monetary Policy Normalization**

February 17, 2016

During a presentation to the CFA Society St. Louis, President James Bullard said that recent data-based developments—namely, further declines in inflation expectations and a reduced risk of asset price bubbles—likely give the FOMC more leeway in its normalization program. He also discussed the need for monetary policy to be more clearly data dependent and suggested that the FOMC may wish to consider changes to the way it approaches the policy rate projections in the Summary of Economic Projections.

**St. Louis Fed's Bullard Discusses Changing Imperatives for U.S. Monetary Policy Normalization**

ST. LOUIS – Federal Reserve Bank of St. Louis President James Bullard discussed ["Changing Imperatives for U.S. Monetary Policy Normalization"](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard-cfa-stlouis-17feb2016.pdf)in a presentation Wednesday to the CFA Society St. Louis.