

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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- **March 26, 2015.** Presentation. ["U.S. Monetary Policy Normalization,"](#) OMFIF City Lecture, Frankfurt am Main, Germany.
[Presentation \(pdf\) \(bullard-omfif-city-lecture-frankfurt-26-march-2015pdf\)](#) | [Press Release](#) | [Related news articles](#).

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.

[Presentation (pdf)](<https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard-omfif-city-lecture-frankfurt-26-march-2015.pdf>) | [Press

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- [Fed's Bullard Says Keeping US Policy Rates at Zero May be Risky](<http://www.nasdaq.com/article/feds-bullard-says-keeping-us-policy-rates-at-zero-may-be-risky2nd-update-20150326-00219>), by Brian Blackstone, Dow Jones Institutional News.
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- [Fed's Bullard: It's time to normalize U.S. monetary policy](<http://seekingalpha.com/news/2392546-feds-bullard-its-time-to-normalize-u-s-monetary-policy>), by Yoel Minkoff, Seeking Alpha.

St. Louis Fed's Bullard Discusses U.S. Monetary Policy Normalization

FRANKFURT, Germany – Federal Reserve Bank of St. Louis President James Bullard discussed [“U.S. Monetary Policy

Normalization”](<https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard-omfif-city-lecture-frankfurt-26-march-2015.pdf>) at the Official Monetary and Financial Institutions Forum’s (OMFIF) City Lecture on Thursday.

In addition to touching on the Federal Open Market Committee’s (FOMC) removal of the word “patient” from its policy statement last week, 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; 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”

“The FOMC has appropriately returned to data-dependent monetary policy by removing ‘patient,’” 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 noted, “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.” In addition, he said that removing this forward guidance should be interpreted as a sign of the strength of the U.S. economy.

Bullard noted that meeting-by-meeting judgment on an appropriate policy rate will depend on incoming data relative to FOMC forecasts. “Better-than-expected outcomes may push the Committee toward a somewhat higher policy rate path, while worse-than-expected outcomes may push the

Committee toward a somewhat lower policy rate path,” he said.

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 central tendency of the March 2015 SEP.

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

“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), with each eventually bursting. 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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Remarks given at the 10th Annual Delaware Economic Forecast

February 3, 2015

An audio recording of Pres. Bullard's remarks, the moderated discussion and audience Q&A from the 10th Annual Delaware Economic Forecast event is available via Bloomberg at the following URL:

<http://www.bloomberg.com/news/videos/2015-02-03/bullard-urges-fed-to-drop-patient-to-give-flexibility>(1:30:35).

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- [Bullard Urges Fed to Drop 'Patient' to Provide Flexibility](<http://www.bloomberg.com/news/articles/2015-02-03/bullard-urges-dropping-patient-to-provide-flexibility-on-rates>), by Christopher Condon and Sophia Pearson, Bloomberg.
- [Fed's Bullard Calls For Breaking Up Nation's Biggest Banks](<http://blogs.wsj.com/economics/2015/02/03/feds-bullard-calls-for-breaking-up-nations-biggest-banks/>), by Michael S. Derby, Dow Jones.
- [Fed's Bullard Shrugs Off Inflation Expectations Drop, Favors Rate Rises](<http://blogs.wsj.com/economics/2015/02/03/feds-bullard-shrugs-off-inflation-expectations-drop-favors-rate-rises/>), by Michael S. Derby, Dow Jones.
- [Fed's Bullard calls for deleting 'patient' from rate guidance](<http://www.reuters.com/article/2015/02/03/usa-fed-bullard-idUSL1NOVD1MX20150203>), by Michael Flaherty, Reuters.
- [Fed's Bullard calls for splitting up big