Sincerely,

James Bullard President and CEO

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  Presentation (pdf) (bullard_omfif_goldenserieslecture23may2013finalpdf) | Press Release | Related news articles.
  Similar remarks were also given at the IMFS Distinguished Lecture House of Finance—Goethe Universität Frankfurt, Frankfurt am Main, Germany, on May 21, 2013.
  Related news articles.

Monetary Policy in a Low Policy Rate Environment

May 23, 2013

St. Louis Fed President James Bullard discussed five monetary policy options while policy rates remain near zero during the Official Monetary and Financial Institutions Forum (OMFIF) Golden Series Lecture in London.

[Presentation (pdf)](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard_omfif_goldenserieslecture23may2013final.pdf)| [Press Release](https://www.stlouisfed.org/news-releases/2013/05/23/st-louis-feds-bullard-discusses-monetary-policy-in-a-low-policy-rate-environment)

Related News Articles:
• [Bullard Says Fed Should Wait to Slow Bond Buying](http://www.bloomberg.com/news/2013-05-23/fed-s-bullard-says-bond-buying-should-respond-to-economic-data.html), by Steve Matthews and Scott Hamilton, Bloomberg.
• [Fed's Bullard on Tapering, Inflation, U.S.

Growth](http://www.bloomberg.com/video/fed-s-bullard-on-tapering-inflation-u-s-growth-Rc~Rw~m9Qza91sw37ES8sA.html), Bloomberg(video link).
• [Bullard says inflation must pick up before asset purchases can be slowed](http://www.centralbanking.com/central-banking/news/2270253/bullard-says-inflation-must-pick-up-before-asset-purchases-can-be-slowed), Central Banking Journal.
• [Fed's Bullard: Need Faster Inflation Before Tapering Stimulus](http://www.nasdaq.com/article/feds-bullard-need-faster-inflation-before-tapering-stimulus-20130523-00196), by Jason Douglas, Dow Jones.
• Fed's Bullard: QE Most Effective Stimulus When Rates near Zero, Dow Jones.
• [Fed's Bullard: US Growth Could Hit 3% this Year](http://www.nasdaq.com/article/feds-bullard-us-growth-could-hit-3-this-year-20130523-00393), by Jason Douglas, Dow Jones.
• [Need inflation pick-up before starting policy taper - Fed's Bullard](http://www.reuters.com/article/2013/05/23/fed-bullard-idUSL6N0E426120130523), by Marc Jones, Reuters.
• [Need small scale tapering of bond buys when it starts - Fed's Bullard](http://www.reuters.com/article/idUSL6N0E42JB20130523), Reuters.
• [Fed Bullard: Tapering Should Be By Moderate Amount](https://mninews.marketnews.com/index.php/fed-bullard-tapering-should-be-moderate-amount?q=content/fed-bullard-tapering-should-be-moderate-amount), by Steven K. Beckner and David Thomas, Market News International.

Similar remarks were also given at Goethe University Frankfurt's Institute for Monetary and Financial Stability (IMFS) Distinguished Lecture, Frankfurt am Main, Germany, May 21, 2013.

News articles related to the May 21, 2013, presentation:
• [Fed's Bullard Says ECB Needs 'Aggressive' QE to Avoid Japan Fate](http://www.bloomberg.com/news/2013-05-21/fed-s-bullard-says-ecb-needs-aggressive-qe-to-avoid-japan-fate.html), by Jeff Kearns and Jeff Black, Bloomberg.
• [Bullard Says Fed Should Maintain 'Effective' QE

Program](http://www.bloomberg.com/news/2013-05-21/bullard-says-fed-should-maintain-effective-bond-buying-program.html), by Jeff Kearns, Bloomberg.
• [Fed's Bullard QE Best Policy Option in Low Rate Environment](http://www.bondbuyer.com/issues/122_98/feds-bullard-qe-best-policy-option-in-low-rate-environment-1051828-1.html), by Gary Siegel, The Bond Buyer.
• [Fed's Bullard recommends QE for ECB's next move](http://www.centralbanking.com/central-banking/news/2269627/fed-s-bullard-says-ecb-should-follow-us-example-on-qe), Central Banking Journal.
• [Fed's Bullard: Adjustable Bond Buying Best Fit for Policy](http://blogs.wsj.com/economics/2013/05/21/feds-bullard-adjustable-bond-buying-best-fit-for-policy/), by Michael S. Derby, Dow Jones.
• Fed's Bullard: Fed Could Cut Deposit Rate, But Not Enough Support, Dow Jones.
• [Fed's Bullard: Continued Q.E. Best Mon Policy Option Presently](https://mninews.marketnews.com/index.php/feds-bullard-continued-qe-best-mon-policy-option-presently?q=content/feds-bullard-continued-qe-best-mon-policy-option-presently), by Steven K. Beckner, Market News International.
• [Fed's Bullard: IOER Could Go Negative, But Don't Have Support](https://mninews.marketnews.com/index.php/feds-bullard-ioer-could-go-negative-dont-have-support?q=content/feds-bullard-ioer-could-go-negative-dont-have-support), Market News International.
• [Fed's Bullard: No Good Case For Tapering QE Unless Infl Rises](https://mninews.marketnews.com/index.php/feds-bullard-no-good-case-tapering-qe-unless-infl-rises?q=content/feds-bullard-no-good-case-tapering-qe-unless-infl-rises), Market News International.
• [Fed's Bullard: No tapering with inflation so low](http://www.marketwatch.com/story/feds-bullard-no-tapering-with-inflation-so-low-2013-05-21?link=MW_home_latest_news), by Greg Robb, MarketWatch.
• [Fed's Bullard backs continuing QE program](http://www.marketwatch.com/story/feds-bullard-backs-continuing-qe-program-2013-05-21-11912956?link=MW_latest_news), by Greg Robb, MarketWatch.

• [In Europe, a Fed President Urges Quantitative Easing](http://www.nytimes.com/2013/05/22/business/global/in-europe-a-fed-president-urges-quantitative-easing.html?_r=1&), by Jack Ewing, The New York Times.
• [Fed's Bullard recommends euro zone consider QE](http://www.reuters.com/article/2013/05/21/us-usa-fed-bullard-idUSBRE94K0RP20130521), by Paul Carrel and Eva Kuehnen, Reuters.
• [Fed's Bullard: don't see support for negative rates](http://www.reuters.com/article/2013/05/21/us-usa-fed-bullard-negativerates-idUSBRE94K0WD20130521), by Eva Kuehnen and Paul Carrel, Reuters.
• [Fed's Bullard-don't see case for tapering with inflation so low](http://www.reuters.com/article/2013/05/21/us-usa-fed-bullard-tapering-idUSBRE94K0Y020130521), by Eva Kuehnen and Paul Carrel, Reuters.

St. Louis Fed's Bullard Discusses Monetary Policy in a Low Policy Rate Environment

LONDON, U.K. – Federal Reserve Bank of St. Louis President James Bullard gave remarks Thursday on [“Monetary Policy in a Low Policy Rate Environment”](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/bullard_omfif_goldenserieslecture23may2013final.pdf)at the Official Monetary and Financial Institutions Forum (OMFIF) Golden Series Lecture.

During his presentation, Bullard said, “The most important monetary policy question during the last five years has been how to pursue easier monetary policy when the policy rate is already near zero.” He discussed several policy options—do nothing, forward guidance, quantitative easing (QE), negative interest rates on reserves and the twist program—and concluded that quantitative easing remains the best monetary policy option in this situation. “Quantitative easing is closest to standard monetary policy, involves clear action and has been effective,” he explained.

Regarding the other options, he said, “Doing nothing risks the mildly deflationary situation experienced by Japan in recent years.” Furthermore, “Forward guidance depends on the credibility of promises for future central bank behavior, and can send an unwitting pessimistic signal about future macroeconomic performance.” Bullard added that negative deposit rates and the twist program are likely to be only minimally effective.

The EU-U.S. Macroeconomic Situation

Bullard noted that since 2010, the U.S. recovery has been slower than expected from the financial crisis and the ensuing recession. Nonetheless, the U.S. unemployment rate has continued to fall despite relatively slow growth. In contrast, the Euro area has recently returned to recession, and its unemployment rate has increased. However, he pointed out that in both the U.S. and the Euro area, inflation has recently been below target and on a downward trend.

Given low inflation and a near-zero policy rate, Bullard noted that policymakers around the world have used a variety of unconventional approaches to monetary policy since 2008. “If these policies are effective, they should be able to keep inflation and inflation expectations near target despite relatively weak macroeconomic performance,” he said.

Monetary Policy Option 1: Do Nothing

One might argue that the near-zero policy rate provides sufficient monetary accommodation to keep inflation near target and assist the real economy to the extent possible, Bullard said. However, “The experience from Japan seems to indicate that merely keeping the policy rate near zero for an extended period of time does not by itself keep inflation positive,” he said. “In particular, there seems to be a steady state equilibrium in which the nominal rate remains near zero and inflation remains mildly negative.” (For more on this topic, see Bullard’s ["Seven Faces of ‘The Peril’”](https://research.stlouisfed.org/publications/review/10/09/Bullard.pdf)article from 2010.)

While academic and policymaker reactions to the possible existence of such a steady state are varied, “many seem to agree that it is insufficient to simply count on the fact that the policy rate is near zero to provide enough accommodation to maintain inflation near target," Bullard said.

Monetary Policy Option 2: Forward Guidance

In regard to forward guidance, Bullard cited New Keynesian literature relying on sticky prices that has been influential in U.S. monetary policymaking and for making the argument for forward guidance. Led by economist Michael Woodford, this line of research argues that policy accommodation can be provided even when the policy rate is near zero, Bullard said. He explained that the extra accommodation comes from a promise to maintain the near-zero policy rate beyond the point when ordinary policymaker behavior would call for raising the policy rate.

However, "The 'Woodford period' approach to forward guidance relies on a credible announcement made today that future monetary policy will deviate from normal," Bullard said. "If the announcement is not credible, then the private sector will not react with more consumption and investment today—that is, any effects would be minimal." Thus, forward guidance may have a credibility issue.

Bullard also noted that forward guidance may give a pessimistic signal. "In general, any attempt to provide additional policy accommodation today by promising easy policy in the future can be viewed as suggesting the future will be characterized by poor macroeconomic performance," he explained. "This can be extremely counter-productive, as firms and households may prepare for a prolonged stagnation."

The Federal Open Market Committee (FOMC) has used forward guidance and has tried to make a credible commitment to relatively easy future policy without sending a pessimistic signal, Bullard said. In recent months, the FOMC has turned to thresholds on inflation (2.5 percent) and unemployment (6.5 percent) as minimal criteria for raising the policy rate. "The adoption of threshold-based forward guidance was a clear improvement on the previous calendar-based forward guidance, which seemed to be plagued by the pessimistic signal problem," Bullard said.

Bullard pointed out that other central banks, including the European Central Bank and the Bank of England, have been more circumspect concerning the use of forward guidance as a policy tool than the Fed. “There is a strong tradition in central banking that suggests that policymakers should never pre-commit to a particular policy course in part because future circumstances are unpredictable,” Bullard said. “At a minimum, the correct use of forward guidance as a policy tool is a subtle matter.”

Monetary Policy Option 3: Quantitative Easing

As another option, Bullard noted that the central bank can make outright purchases of government debt (or mortgage-backed securities) by creating base money. The FOMC and the Bank of England have adopted this approach to monetary policy. “Quantitative easing is relatively close to standard monetary policy in that it puts downward pressure on nominal and real interest rates,” Bullard explained.

“The reaction in financial markets clearly indicates that such purchases are effective in easing financial conditions,” Bullard said. For instance, the traditional effects of “easier monetary policy” include higher inflation expectations, currency depreciation, higher equity valuations and lower real interest rates. “All of these have been associated with quantitative easing in the U.S.,” he stated. Given that financial markets tend to anticipate a policy change ahead of the actual policy action, the effects of QE2 and QE3 can be seen in the data in the months prior to the FOMC’s actual decisions.

Bullard discussed a similar experience in Japan, where policymakers have recently embarked on a new quantitative easing program. He noted that financial markets anticipated the actual policy move. In the months leading up the adoption of the policy, the yen depreciated and Japanese equity valuations rose; however, he said, the effects on real interest rates and inflation expectations are harder to discern in Japanese data.

While the evidence suggests that outright asset purchases ease financial conditions according to conventional definitions, the ultimate effects of these easier financial conditions can be linked to changes in real economic activity six to 18 months later, Bullard said. “Discerning these effects on real activity requires careful econometrics because other shocks are influencing the economy during the period of interest," he added.

Monetary Policy Option 4: Negative Interest on Reserves

Bullard noted that the Fed and other central banks pay interest on reserves—currently 0.25 percent. While one could argue that this rate is too high if the objective is to encourage banking institutions to lend out available funds, "the extent to which the central bank could charge for the holding of reserves is probably limited," he explained. "Effects of moving in this direction are probably minor."

Monetary Policy Option 5: Twist Program

The FOMC used this tool between mid-2011 and the end of 2012. The central bank can sell short-term government debt and buy longer-term government debt, hence removing duration from the market. "There is little historical evidence that the maturity structure of the U.S. debt is an important macroeconomic variable," Bullard said. "Any effects from the twist operation were probably minor."

Which Monetary Policy Option Is Best?

Based on his review of these five policy options, Bullard said that quantitative easing has been the most reliable tool while policy rates have been near zero. Thus, for near-term stabilization policy, Bullard's conclusion for the U.S. is to "continue with the present quantitative easing program, adjusting the rate of purchases appropriately in view of incoming data on both real economic performance and inflation."

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