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CNBC – "Squawk Box"

James Bullard Discusses the Economic Outlook and Regulatory Reform on CNBC

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Participants:

James Bullard, president and CEO, Federal Reserve Bank of St. Louis
United States Senator Evan Bayh (D-IN)
Steve Liesman, CNBC senior economics reporter
Joe Kernen, CNBC "Squawk Box" co-anchor
Becky Quick, CNBC "Squawk Box" co-anchor

Joe Kernen: And now on to Fed matters. Our Steve Liesman joins us with a special guest, St. Louis Fed President James Bullard. Steve, good morning.

Steve Liesman: Yeah, what a day we've got. Jim Bullard, thanks for joining us.

James Bullard: Glad to be here. Thanks.

Steve Liesman: And it just so happens, it's coincidence that your district includes two-thirds of the state of our guest host's district.

James Bullard: It's no coincidence.

Steve Liesman: No coincidence.

Joe Kernen: I'm going to be listening carefully here, Jim.

Steve Liesman: Okay. Let's start off with a whole other area, which is in play right now, which is Fed policy. The Federal Reserve just affirmed the language, "exceptionally low for an extended period," and you've voiced your objections about that. Are you still opposed to the use of that language in the statement?

James Bullard: I haven't come out and opposed the language. I said I was sympathetic to President Hoenig of Kansas City, who dissented. I think the "extended period" language is putting us in a box by — people are interpreting that as a date-certain when we're going to raise rates. That isn't the truth. The truth is that it will depend on the data. If we could switch to some language that would get the data dependence in there a little better, I'd be for that.

Steve Liesman: Do you feel like that language is going to serve the Fed well for the next several meetings, or is it something that the Fed, you think, needs to start backing off from right now?

James Bullard: Again, I think if we could do it in a way that would get the markets to focus on, well, "how is the economy going to perform? How is inflation coming in," and so on and so forth, and then have that be what's dictating when we're going to raise rates, instead of saying, "Oh, at some certain calendar date, we're going to raise rates" — that makes no sense.

Steve Liesman: President Bullard, on Friday, the Second Circuit Court of Appeals out of New York ruled against the Federal Reserve and said it had to disclose borrowers from the discount window. How do you feel about that?

James Bullard: I think the Chairman has said on many occasions that it's not a good idea to be revealing people who are borrowing at the discount window. That can trigger a run and really can be a very contagious thing that goes from bank to bank to bank, and then you collapse the whole banking system. This is a case where I'm all for revealing as much information as possible, but this is a case where it could be very dangerous. I think we oppose that.

Steve Liesman: Today the Senate is going to start marking up the regulatory reform bill that excludes — or it will take away supervision of the Federal Reserve of the small banks, which are the banks that you routinely supervise.

James Bullard: I've argued against that. I think it's a bad idea. The way the bill is right now, you've got the Fed in charge of the very largest banks and nothing to do with the community banks. That's going to create a biased Fed going forward that's only looking out for the very largest banks.

Steve Liesman: Jim, don't talk to me. Talk to him.

James Bullard: I'm sure the Senator knows this argument well.

Evan Bayh: I've spoken up on behalf of the Fed retaining a robust regulatory presence, Steve. I think it's important to getting the monetary policy right. I also think anybody else is going to have to work their way up the information curve. The Fed made some mistakes; I think they learned from the mistakes. So, Jim, I'm all for you guys keeping your finger on the pulse of the economy. But let me ask you, though, what would you learn from the community banks you can't get by retaining your regulatory role over the big ones?

James Bullard: The big banks are these big global enterprises. They're in the middle of big deals that are putting together huge companies and things like this. The small banks are really lending to small businesses — the job creators in the economy. It seems to me you'd want to know a lot about that if you want to make good monetary policy.

Becky Quick: The Fed can't get that information at this point?

James Bullard: I think you lose touch. You definitely lose touch. Maybe you can find other ways to get the information, but I think you'd lose touch with 'Main Street America.'

Evan Bayh: So you're saying it's qualitatively different data you get from the small banks than the large ones?

James Bullard: It means that you're in the bank and…

Evan Bayh: In terms of informing your monetary policy decisions?

James Bullard: I think so. I think it means that you're in the bank. You understand what kind of problems they're facing, what their loan demand really is. You're understanding what they're really facing on the ground. I think it's a very different thing than to go into Goldman Sachs and start talking about, "Well, maybe we'll do this" — I don't know what, we're advising the Greek government or something...

Evan Bayh: A very wise man you have with us here this morning; he got his Ph.D. from Indiana University.

James Bullard: You got to love it.

Evan Bayh: It certainly works for me.

Becky Quick: President Bullard, you talk about the oversight that you've had in the past, and Senator Bayh pointed out that he's very much in favor of you keeping those oversight powers. But there were some mistakes that were made. What happened, and where did the regulators — not only at the Fed, but at other places in Washington —

James Bullard: Yeah.

Becky Quick: — fall down in terms of seeing things like RICO 105, in terms of seeing some of these problems and the big leverage that was taking place?

James Bullard: Mistakes were made, but not in the small bank regulation; that part has worked fairly well. Even though that system, even though that's under stress right now, that has worked fairly well. For the very large organizations, frankly, the Fed didn't have any regulatory authority over a Lehman or a Bear Stearns or any of the investment banks, none of the big insurance companies — Prudential, AIG — and none of these financial hybrid-type companies like GE Capital. What you've got to get going forward is you've got to get the central bank to have this complete view of the whole financial landscape. They have to understand everything that's going on, because what has happened over time, we used to have a banking system, but this shadow banking system has grown and grown and grown, and that's where most of the problematic institutions were. Those weren't under Fed guidance during this —

Becky Quick: What about the mortgage…

James Bullard: — during this thing. We did not have a team sitting in Bear Stearns telling us, "Okay, here's what Bear Stearns is really facing; you know, here's what's really going on at Bear Stearns." We did not have that, so we're sitting there as outsiders, and then we have to make a decision in 24 hours about what to do about that.

Becky Quick: That's an argument for even broader expansion.

James Bullard: Yes, and that's where we should be going, and some of the provisions of the bill are going in that direction.

Joe Kernen: I can remember when Trechet said, "It's much easier over here, because all we have to worry about is price stability." Remember when he said that, "We only have one role for the Fed"? Can you tell me all of the varied and sundry roles for the Fed now? How many — are there five, six, seven? You just said that you're uncomfortable with that language. It almost seemed to indicate that you want to tackle bubbles before they get too inflated. Is that part of your role with …

James Bullard: I think what you're saying — what is the mandate?

Joe Kernen: How many different roles does the Fed have, and is there any way that you can be a jack-of-all-trades?

James Bullard: I think the Fed has three roles, and there's just no getting around it: You've got to keep inflation low and stable; you want to stabilize the economy to the best of your ability; and you want this financial stability. I think implicitly, those three roles have always been there.

Joe Kernen: But that last one …

James Bullard: They've always been there.

Joe Kernen: — could be consumer protection, monitoring banks. You can do all those things. You're very smart, you have a Ph.D., as we just figured out. But that's a lot of —

James Bullard: That doesn't mean anything.

Unidentified Male: Indiana, no less.

Joe Kernen: I mean, for a guy like Ron Paul, who said — I don't know, that there wasn't even — part of the Constitution creating the Fed. That's a lot of responsibility for one organization.

James Bullard: Okay, it's a daunting task, but this is what you have to do. What are you going to do, let financial stability slip through the cracks? I mean, that doesn't work very well. So this is where you have to go.

Steve Liesman: Jim you've made the point that no matter what happens, because the Fed basically controls the printing presses and has the emergency lending facility, that no matter what system you design, the country is going to look to the Fed in a financial crisis.

James Bullard: Yeah, and it's just so true. If you look at the U.K., they made a decision to separate off regulatory authority into the FSA, and then they've got the Bank of England sitting over here. When the crisis came, everybody when running to the Bank of England. Why? They've got the money. They've got the money. That's what happens in a crisis. So you've got this lender of last resort role, and there's no getting around that, no matter what you do in the legislation — everyone will run to the central bank, so you have to be ready to handle that.

Becky Quick: But back to Joe's point. The consumer protection, having a dual mandate of protecting the nation's monetary policy and making sure that the financial system's in the right place, does it make sense to mix that with consumer protection, because when we've seen institutions that have had dual mandates like that before, you think of Fannie Mae and Freddie Mac?

James Bullard: I don't know, maybe the Senator can comment on consumer protection. What I understand the bill is, is it's an independent entity inside the Fed. I have questions about that, but maybe the Senator can talk…

Evan Bayh: It's a kind of an unusual hybrid we have here, which his — what's the old saying, a camel is a horse that was designed by a committee? This is a consumer protection bureau housed in the Fed, but for all intents and purposes, they're just renting space there. They have their own budget, their own rule-making authority. But if one of their rules threatens the financial integrity of the system, that can be appealed by the prudential overseer to the Systemic Risk Council that the Fed is a part of. It's a pretty complicated system.

Steve Liesman: It's like the Sunglass Hut at the mall, right? It just sets up and just leases space right there in the lobby.

Becky Quick: Right.

Steve Liesman: Something like that. Jim …

[Inaudible - talkover]

Steve Liesman: No, you had a [inaudible].

Evan Bayh: I tell you, I guess we have …

[Inaudible - talkover]

James Bullard: Can I just bring up one concern about that?

Steve Liesman: Yeah, yeah.

James Bullard: I do not …

Steve Liesman: The Sunglass Hut.

James Bullard: I do not like importing Fed credibility, then, on some …

Steve Liesman: Right.

James Bullard: — on some …

[Inaudible - talkover]

James Bullard: — some bureau that we don't have any say over.

Evan Bayh: I was going to say, they'll have all the responsibility but none of the authority.

Joe Kernen: Yeah, exactly.

Becky Quick: That's problematic. I mean, Senator, do you think that that's something that should stand as the …

Evan Bayh: The compromise, Becky, was clearly, the consumer needed greater protection, and some of that came to light following this crisis. But at the same time, people had concerns about establishing a separate entity that might take on a whole new level of mission creep, so to speak. This was the compromise: How do you protect the consumer on the one hand without creating an entity that might get outside of its lane on the other? It's one of the things that perhaps has to be debated further as this legislation goes along.

Joe Kernen: We heard the Fed's Chairman Greenspan say since he can only control the short end that he really wasn't responsible for what happened in the long end — sort of a continuing defense of that low interest rate policy. But then we've had guys like Bob Barbera in here saying you need to watch credit spreads, and when they get to zero, you need to know that it’s not safe keeping things that low. Has the Fed learned? Is that what you’re talking about, about …

James Bullard: Didn’t Chairman Greenspan famously say that history has not treated low-risk spreads very well? I think that it turned out to be a very prescient statement.

Joe Kernen: But it happened again, didn’t it?

James Bullard: It did.

Joe Kernen: It almost took us down all the way this time.

James Bullard: No, I thought he said that in 2004–2005 period. We were looking at the low spreads, but maybe not enough emphasis on that.

Evan Bayh: You’ve got some really important decisions to make with regard to the quantitative easing and how we begin to get back to a more normal situation. What will you look at, Jim? What are the data you will look at to determine whether this recovery has become self-sustaining and we’ve achieved what they call the “escape velocity” that will give you the confidence to begin getting back to a more normal situation?

James Bullard: I think we’re on track. I do think we’re recovering and we’ll continue to have positive GDP growth in the first half and throughout the year where …

Evan Bayh: Do you look at job creation? Do you look at consumer confidence? Do you look at — what …

James Bullard: We definitely look at jobs, and it’s been frustratingly slow, I know. But listen here, I think we’ll get some good months of jobs reports coming up very, very soon. We’re looking for March to be strong, and I’m hoping that will carry on in the couple months following that. So I do think we’re about to turn the corner on jobs, and we’ll be watching that very carefully.

Evan Bayh: Non-census-related jobs?

James Bullard: Yeah. When you see that jobs report, you’ll want to be sure to separate out, well, how much is census and how much is not — although the census jobs are jobs. You can’t —

Evan Bayh: They’re real, but most people …

James Bullard: They’re real, but they’re temporary.

Evan Bayh: — expect us to create jobs other than government, I think.

James Bullard: Absolutely. Absolutely.

Steve Liesman: Jim, picking up on the Senator's question, what is your preferred way for the Fed to get out? Should the Fed raise rates and keep that $2 trillion balance sheet the same, or should it be selling assets first, and then raise rates?

James Bullard: I've been advocating sort of a LIFO policy — last in, first out. You've brought your rates down to zero. Then you substituted quantitative easing for the fact that you couldn't bring rates any lower. Now it seems to me like the natural thing is to withdraw the quantitative easing, and then, at some later point, raise interest rates. But I'm a minority on that, but I'm working on it.

Steve Liesman: This is what's so great about having Senator Bayh on, right, because Senator Bayh, if the Fed starts selling mortgages, and that ends up raising interest rates, there's going to be a lot of political blow-back.

Evan Bayh: Particularly at a time we have a lot of the adjustable rates resetting on the residential side, and you've got some bills coming due on the commercial real estate side; it's not a great time to have rates potentially rising.

James Bullard: This is a story about ordering. The question is: Should you raise your traditional short-term rate, which is supposed to have an effect on the whole term structure —

Steve Liesman: Right.

James Bullard: — or should you sell some mortgage-backed securities in a very slow and easy way in order to get the balance sheet back to normal in a reasonable amount of time? I'd take the second policy versus the first policy. They're both tightening policies, and you wouldn't embark on either until the data tell you that the recovery's strong enough to withstand a little bit higher interest rates.

Steve Liesman: What about the timing of all that? You guys are doing a lot of stuff to get ready for a party that doesn't have a date yet. When you say, I mean, we're dressing up with — we're raising the discount window, we're dressing up with reverse repos, we've increased the end of our counterparties — is that a "this year" story? Is it a "next year" story?

James Bullard: No, I know that there's been a lot of talk about exit strategy for a long time, but that's because these policies are extraordinary policies. They're really, really off-the-charts policies — zero rates, double or — or triple the balance sheet. You have to be planning ahead about how you're going to get out of here. These things do not happen in a quarter or two — they're going to happen over a period of years.

Steve Liesman: I talked to Tom Hoenig — you mentioned him earlier, the President of the Kansas City Fed. He says we should be at 1 percent now, because that is closer to where we're going than zero is.

James Bullard: He makes a powerful argument that if you come up a little bit, it's still a really, really easy policy, and I have some sympathy for that, but I think it's a little early to go there.

Steve Liesman: Would you embark, then, earlier on a strategy of actually selling assets, because there's not a lot of support for that on the board, from what I can tell?

James Bullard: I think there's more support than you think, and I think you can do it slowly. You can do a little bit at first and then ramp up later. Again, it's all data-dependent, so the prerequisite to do anything is to see the economy on a firm recovery.

Steve Liesman: And you expect that?

James Bullard: I do expect that. It's not going to be a roaring recovery, it doesn't look like, but it is going to be a reasonable recovery during 2010 here.

Steve Liesman: Joe?

Joe Kernen: No, that's great.

Evan Bayh: We'll take it.

Steve Liesman: Yeah.

Joe Kernen: A reasonable recovery compared to what we've been through.

Steve Liesman: I just wonder if there are any more questions from your colleague from Indiana there?

Evan Bayh: I'm just glad it's the Ph.D. from IU, not the undergrad from IU making these decisions.

Steve Liesman: Are you concerned, though, that the Senate's going to come up with a bill that's going to basically, I don't know, strip the Fed of the whole district system that really was ultimately designed as the counterweight to Washington and Wall Street?

Evan Bayh: I have some concerns about that, but you've got to remember the initial proposal was to strip them of everything. This is one of several items that needs to be further debated as we go along. As I understand it, Bob Corker's coming on here in a little bit.

Steve Liesman: Uh-huh.

Becky Quick: 8:30.

Evan Bayh: I'm going to be interested to hear from my friend and colleague. It could be that the committee process is fairly truncated, so most of this could play itself on the floor of the United States Senate, which — well, we'll just have to wait and see.

Joe Kernen: Do you think we're going to have the deck stacked with doves by the President — the deck stacked with doves by the President?

Becky Quick: Three of the positions?

James Bullard: No, I don't really think so. Janet Yellen is on the committee now, so she's kind of moving —

Evan Bayh: She's already there.

James Bullard: — from one side of the table to another side of the table. She's been in the Fed both as a governor and as a president, so she has great perspective on the — I'm not sure who the other two appointees might be.

Joe Kernen: Yeah. I went both ways. You know, "Let the good times roll — let's go, we can" — how much longer are we going to live, Senator, right? I mean, an easy monetary policy now; you guys can tighten when I'm 80 if you need to or something, right?

Steve Liesman: But then other days, you think it's the right thing to do?

Joe Kernen: No, other days, I ...

Evan Bayh: You're a true Keynesian, Joe.

Joe Kernen: Yeah, yeah, I …

Evan Bayh: A little bit longer and we're all dead.

Joe Kernen: Yeah, exactly, a little longer and we're all dead. Can't we print — I mean, just do it, let's go. All right. Everybody else is.

Becky Quick: President Bullard, thank you very much. And Steve, thank you.

(End of Recording)