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President Bullard Discusses Current Monetary Policy

Recorded on November 23, 2009

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Would you describe current Fed policy?

I like to think of current Fed policy in three different parts — three easy pieces. The first piece is that we have our liquidity programs; we have a wide variety of liquidity programs, many different acronyms; that's one part of the policy. The second part is an interest rate policy. Right now our Federal funds rate, our policy rate, is close to zero and is expected to remain there for an extended period. And the third part of policy is a quantitative easing policy that we're implementing through our asset purchase program, and that's been going on through most of 2009 and will continue on into 2010.

What are the liquidity facilities?

The liquidity facilities are ways to do collateralized lending, and this is a standard way for the central bank to respond to a crisis. It's been going on for centuries, really; certainly, the Bank of England for hundreds of years has responded to a crisis in this way. What this means is the central bank has some money; you lend it out against collateral, usually for short periods of time, 30 days, 60 days. And then as the crisis passes, you give the collateral back and you take the money back. This is the nature of a lot of our liquidity programs.

At the peak, late December 2008, early part of 2009, we had \$1.5 to \$1.6 trillion out in these programs. They tend to wind down naturally as the panic subsides, and they've come all the way down to about \$200 billion, as I talk today, and they're expected to wind down further. I think that as we get into 2010, these liquidity programs will come completely off the Fed balance sheet.

Is all the liquidity provision inflationary?

I don't think that this kind of liquidity provision in a panic is inflationary. Even though it does temporarily increase the monetary base a lot, it also comes quickly back out of the system. And for that reason, I don't think it's a sustained increase in the raw material for the money supply, and for that reason, I don't think it's inflationary.

What is the near-zero interest rate policy?

Starting in December of 2008, the FOMC lowered its policy rate, the Federal funds rate target, close to zero; not exactly zero, but very close to zero. And we've maintained that up until now, and the committee has also stated that we plan to keep our policy rate low for an extended period. We've been joined in this policy by the rest of the G-7 economies. Japan coming into this episode was already at very low rates, but the others have all come down, including the ECB, the Bank of England, and the Bank of Canada. When we're thinking about how the FOMC might behave going forward, you might look a little bit to a history lesson. If you look at the past two recessions, one of them was in 1990-91, and the other one was in 2001. And in those two cases, after the recession had ended, it was about two and a half to three years before the committee decided to come off the low interest rates associated with those two recessions. Those two recessions, we did not go all the way down to zero; we went down to low levels but not to zero. And it was quite a while, really, before we raised rates in either of those circumstances. The key issue for the committee is whether that was actually viewed as good policy in the past and we got good outcomes from those policies or whether you think that we could do better this time around.

Why might it be different this time?

The decision to raise interest rates depends on incoming information concerning the economy. We watch inflation developments very carefully, of course, at the Fed, but also the real economy, and we want the recovery to be well established before we'd start raising interest rates again, and we'd want some evidence that inflation was not getting out of control during this period. Certainly, it's a state-contingent policy; that means it depends on how the economy performs and how the information comes in about the strength of the recovery. After the 2001 recession especially, the inflation rate was quite low. And, you know, there seemed to be no hurry to raise interest rates following that recession, because we had low inflation outcomes already. But a lot of people have said, with a fairly convincing tone, that staying that low for that long may have created other problems, and specifically a bubble in the housing market. And that really came back to haunt us later in the decade when this bubble blew up on us and caused a big financial crisis. I think that this will weigh heavily on the committee this time around, whether it's really the optimal policy to stay very low for a very long time, given that you might be driving other kinds of problems that might come back to haunt you later on. That's the biggest issue facing the committee in the next couple of years.

One thing to keep in mind about the last two recessions is that they're followed by so-called "jobless recoveries." And when this first occurred in the early 1990s, it was considered a shock in Fed policy circles, because the previous recessions from the '70s and the '60s and the '50s always showed a rapid response of jobs; once the recession was over, businesses would come back in, they would start hiring again. That didn't happen in the early 1990s; that was called the jobless recovery. Then, after the 2001 recession, we again had a jobless recovery; we had very mixed data on the labor markets for quite a while after the recession ended in 2001. Again, as far as the Fed's mandate is concerned, you're looking at inflation and you're looking at the real activity in the economy; inflation was low, and at least in terms of the job market,

things weren't picking up very rapidly, and there's really no imperative to raise rates during that period.

This time around, the question will be: Will we have another jobless recovery? If we have three jobless recoveries in a row, I think we're going to have to say that that has become the norm and it's no longer an aberration. I mean, I think for a long time, it's been viewed as an aberration, but if it happens again, I don't think we can really maintain that as a hypothesis. We will have to entertain the idea that something fundamental has changed about how the economy comes out of recessions and how the labor market reacts in a recessionary situation.

What is the asset purchase program?

The asset purchase program is outright purchases of assets, mainly agency MBS — this is Fannie Mae and Freddie Mac mortgage-backed securities. That's the bulk of the program. We also had purchases of longer-dated Treasuries, securities; that part is actually over now, as I speak. And then also, agency debt. But the bulk of the purchases are the agency MBS. And the commitment is to buy, all combined, more than \$1.7 trillion in assets by the first quarter of 2010. The idea was that after the policy rate came down to zero, you should take some other kind of action to influence the economy and try to get a recovery started and be able to sustain that recovery. The quantitative easing that comes from the asset purchase program is substituting for the fact that you can't move the policy rate below zero. It's ongoing right now, because we're not done purchasing; as I talk here, this is going to go on into the first quarter of 2010. We're going to taper off those purchases slowly, make sure that the private sector can come back into these markets and play an important role. And I think the overall assessment, at least the ones I've seen, are that the quantitative easing has been relatively successful in lowering longer-term rates and has helped foster a recovery in the U.S. economy.

One idea would be that, well, if it's been successful, and you can use this tool to influence the economy while your policy rate is sitting at zero, you should probably keep that program open. You should be able to adjust the program going forward both on the positive side and on the negative side. You get good information about the economy, you may want to sell off some of these assets that you've purchased. If you get not such good information about the economy, things aren't going so well, then maybe you'd want to extend the program and purchase more assets. I think it's important, since you have a tool that's at your disposal that you can use to influence the economy and perform stabilization policy, you should keep that option open going forward in 2010.