The Fed on Pause

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Any opinions expressed here are my own and do not necessarily reflect those of others on the Federal Open Market Committee.
This talk

- The Fed on pause.
- Risks to the pause policy.
- Fed communications: Time for a more fulsome report?
The Fed on Pause
The Fed has been easing aggressively since 2008

- The policy rate was lowered in early 2008, hit near-zero in late 2008, and remains there today.
- The FOMC purchased agency MBS in 2009.
- The FOMC began QE2 in 2010 as deflation loomed.
- In 2011, the FOMC began a version of “Operation Twist” which continues today.
- Also in 2011, the Committee began to give calendar date guidance regarding the first increase in the policy rate, currently set at “late 2014.”
Easy policy remains in effect

- These Fed actions remain impactful today.
- The policy rate remains near-zero.
- The large Fed balance sheet remains in place.
- “Operation Twist” is still ongoing and will alter the balance sheet composition for some time to come.
- The calendar date language is still in effect.
U.S. macro data have been relatively strong

- Meanwhile, the U.S. macroeconomic data have been stronger than expected as of last autumn.

- The U.S. avoided the “recession scare” of last August-September, instead growing at a moderate rate.

- Labor market data have been moderately strong, and unemployment has fallen faster than expected.

- Inflation has moved up over the last 18 months.
The Fed on pause

- The ultra-easy monetary policy …

- … much of which is still impacting the U.S. economy …

- … along with better-than-expected data over the last 9 months …

- … combine to put the FOMC on hold, or pause, in its aggressive easing campaign.
The Risks
The main risk

- The main risk is that the Committee will, as it has in the past, overcommit to the ultra-easy policy.
- The policy has been appropriate so far, but could reignite a 1970s-type experience globally if pursued too aggressively.
- The 1970s era included 4 recessions in 13 years, double-digit inflation, and double-digit unemployment.
- The lesson was clear: “Do not let the inflation genie out of the bottle.”
Other risks

- The Committee has done too little?
  - This seems unlikely given the litany of major policy actions listed in earlier slides.
  - If anything, the Committee may be trying to do too much with monetary policy, risking monetary instability for the U.S. and the global economy.

- The U.S. economy may encounter further negative shocks?
  - It is possible, but the Committee can respond as appropriate to a significant deterioration relative to the current forecast.

- The FOMC has allowed the price level to fall off the appropriate path?
Price level path seems appropriate

Labor market policies

The U.S. has about 12.5m unemployed people, against 142m employed and 88.4m out of the labor force.*

Labor market policies such as unemployment insurance and worker retraining have direct effects on the unemployed.

Monetary policy is a blunt instrument which affects the decision making of everyone in the economy.

It may be better to focus on labor market policies to directly address unemployment instead of taking further risks with monetary policy.

Additional distortions

- The near-zero rate policy has been in place for more than three years, and is projected for several more.

- This length of time is far beyond the typical recession/recovery discussion in the academic literature.

- The near-zero rates cause other distortions in the economy, including punishing savers.
Fed Communications
The Fed has become more transparent

- The FOMC has increased the degree of transparency surrounding monetary policy in a variety of ways since the 1990s.
- In January 2012, the Committee began releasing forecasts of the FOMC participants.
- The forecasts include a future path for the policy rate.
- The reception for this aspect of increased transparency has been mixed.
Possible improvements to communications

- The current communication strategy operates with only a few variables, while the economy is described by many variables.

- The FOMC could instead publish a quarterly document akin to the Bank of England’s “Inflation Report.”

- This could potentially provide a more fulsome discussion of the outlook for the U.S. economy and for policy than is currently provided.
A broader discussion of the U.S. outlook

- A report of this type could potentially lay down a benchmark "Fed view" on the key issues facing the U.S. economy.

- Release of the report could be coordinated with the quarterly press briefings conducted by Chairman Bernanke.

- FOMC participants could point out where their views differ from the benchmark.

- Many other central banks proceed in this manner.
Conclusions
Summary

- The Fed is on pause because:
  - The existing stance of policy is already ultra-easy.
  - The economy has outperformed expectations since last fall.

- The main risk lies in potentially overcommitting to the ultra-easy monetary policy, reigniting the global inflation debacle of the 1970s.

- It may be possible to improve FOMC communications further by producing a quarterly report similar to those produced by other central banks.