Three Questions for U.S. Monetary Policy

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Any opinions expressed here are my own and do not necessarily reflect those of the Federal Open Market Committee.
Introduction
Key themes in this talk

• The U.S. remains in a slow-growth regime.
• Inflation in the U.S. has surprised to the downside this year.
• U.S. labor market performance has been good.
• Implications for near-term U.S. monetary policy: The current level of the policy rate is likely to remain appropriate over the near term.
Questions for U.S. monetary policy

• Is U.S. economic growth poised for a rebound in the second half of 2017, as compared to the first half?
• Is the downside inflation surprise in the first half of 2017 likely to reverse in the second half of 2017?
• Will continued strong performance of U.S. labor markets put upward pressure on inflation?
• The answer to all these questions:
  o “Probably not.”
Will Real GDP Growth Be Higher in the Second Half of 2017?
U.S. real GDP growth in 2017

• The data since the financial crisis suggest that the U.S. has converged to 2 percent real GDP growth.
• The current estimate for U.S. real GDP growth in the first half of 2017 is 2.1 percent at an annual rate.
• Second-quarter real GDP growth showed some improvement from the first quarter, but not enough to move the U.S. economy away from a regime characterized by 2 percent trend growth.
• The 2 percent growth regime appears to remain intact.
The 2 percent growth regime since the Great Recession

Source: Bureau of Economic Analysis. Last observation: 2017-Q2. The shaded area indicates NBER recession.
Will growth be faster during the second half of 2017?

• During the summer, there was some hope that the second half of 2017 would display faster growth, perhaps at a 3 percent pace.
• Since then, two developments have dampened those hopes.
  o One is that some macroeconomic data came in weaker than anticipated.
  o Another is that major hurricanes caused substantial damage in some parts of the country.
• The economy should rebound somewhat in the fourth quarter as hurricane damage is repaired.
### Tracking estimates for 2017-Q3 U.S. real GDP growth have declined

<table>
<thead>
<tr>
<th>Source</th>
<th>Date</th>
<th>Estimate*</th>
<th>Date</th>
<th>Estimate*</th>
<th>Diff. †</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blue Chip Consensus</td>
<td>Aug. 10</td>
<td>2.7%</td>
<td>Sept. 10</td>
<td>2.7%</td>
<td>0</td>
</tr>
<tr>
<td>Atlanta Fed GDPNow</td>
<td>Aug. 10</td>
<td>3.6%</td>
<td>Sept. 19</td>
<td>2.2%</td>
<td>−1.4</td>
</tr>
<tr>
<td>St. Louis Fed Economic News Index</td>
<td>Aug. 11</td>
<td>3.7%</td>
<td>Sept. 22</td>
<td>2.8%</td>
<td>−0.9</td>
</tr>
<tr>
<td>FRBNY Staff Nowcast</td>
<td>Aug. 11</td>
<td>2.0%</td>
<td>Sept. 22</td>
<td>1.6%</td>
<td>−0.4</td>
</tr>
<tr>
<td>Macroeconomic Advisers</td>
<td>Aug. 11</td>
<td>2.8%</td>
<td>Sept. 22</td>
<td>1.7%</td>
<td>−1.1</td>
</tr>
<tr>
<td>CNBC Moody’s Consensus (median)</td>
<td>Aug. 15</td>
<td>2.6%</td>
<td>Sept. 20</td>
<td>2.4%</td>
<td>−0.2</td>
</tr>
</tbody>
</table>

* percent change from the previous quarter, annualized
† percentage points
## Estimates of hurricane damage

<table>
<thead>
<tr>
<th>Source</th>
<th>Reduction in 2017-Q3 real GDP growth estimate due to hurricanes Harvey and Irma*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goldman Sachs</td>
<td>−0.8</td>
</tr>
<tr>
<td>Macroeconomic Advisers</td>
<td>−0.7</td>
</tr>
<tr>
<td>Moody’s</td>
<td>−0.5</td>
</tr>
<tr>
<td>Oxford Economics</td>
<td>−0.4</td>
</tr>
</tbody>
</table>

*percentage points

Source: S. Liesman, “Hurricanes Irma, Harvey will have a significant negative impact on third-quarter GDP growth,” CNBC, Sept. 13, 2017.
Bottom line for real GDP growth

• Real GDP growth has not differed meaningfully from 2 percent during recent years.
• Hopes for faster growth in the second half of 2017 have been tempered by weaker macroeconomic data and by hurricane damage.
• There will be some rebound in the fourth quarter due to rebuilding after storm damage, but whether this will be significant enough to move second-half real GDP growth meaningfully above 2 percent remains to be seen.
• My answer is “probably not.”
Will the Low-Inflation Trend Reverse Itself?
U.S. inflation in 2017

• The U.S. inflation rate has been below the 2 percent inflation target since 2012.*

• Inflation data during 2017 have surprised to the downside and call into question the idea that U.S. inflation is reliably returning toward target.

* The inflation target is in terms of the annual change in the price index for personal consumption expenditures (PCE).
U.S. inflation since 2012

Inflation readings are lower in 2017

<table>
<thead>
<tr>
<th>Inflation measure</th>
<th>Dec-2016</th>
<th>Last obs.</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sticky CPI (FRB of Atlanta)</td>
<td>258</td>
<td>210</td>
<td>-48</td>
</tr>
<tr>
<td>Median CPI (FRB of Cleveland)</td>
<td>250</td>
<td>215</td>
<td>-35</td>
</tr>
<tr>
<td>Core CPI</td>
<td>220</td>
<td>170</td>
<td>-50</td>
</tr>
<tr>
<td>Trimmed-mean PCE (FRB of Dallas)</td>
<td>191</td>
<td>164</td>
<td>-27</td>
</tr>
<tr>
<td>Core PCE</td>
<td>187</td>
<td>141</td>
<td>-46</td>
</tr>
</tbody>
</table>

Values are expressed in basis points. Inflation rates are measured as percent changes from one year earlier. Sources: Bureau of Labor Statistics, FRB of Cleveland, FRB of Atlanta, Bureau of Economic Analysis, FRB of Dallas and author’s calculations. Last observation: July 2017 (PCE) and August 2017 (CPI).
Trimmed-mean PCE inflation lower than expected

Core PCE inflation lower than expected

Bottom line on the 2017 inflation surprise

• Noise in the data might be expected to balance out, but over longer periods of time.
• The Federal Open Market Committee does make projections for core PCE inflation.
• The current median projection for core PCE inflation is 1.5 percent at the end of 2017.
• The answer to whether the low-inflation trend will reverse in 2017 is “probably not.”
Are U.S. Labor Markets Signaling a Meaningful Rise in Inflation?
U.S. labor market performance

• The pace of growth in employment has been at or above expectations in recent months.
• The unemployment rate is relatively low.
• These are sometimes cited as factors that will eventually drive the inflation rate higher.
Employment growth has slowed to the lowest rate since 2013

The unemployment rate is low

Will low unemployment drive inflation higher?

• The U.S. unemployment rate was 4.4 percent in the August reading.
• Does this mean that U.S. inflation is about to increase substantially?
• The short answer is no, based on current estimates of the relationship between unemployment and inflation.
The estimated influence of unemployment on inflation

• Let’s consider one study, Blanchard (2016), which estimates a Phillips curve relationship for the U.S.*

• Let’s suppose the unemployment rate continued to fall from current levels.

• How much would the inflation rate increase according to these estimates?

The estimated influence of unemployment on inflation

<table>
<thead>
<tr>
<th>If the unemployment rate was ...</th>
<th>The predicted core PCE inflation rate would be ...</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.4% *</td>
<td>1.4% *</td>
</tr>
<tr>
<td>4.0%</td>
<td>1.5%</td>
</tr>
<tr>
<td>3.5%</td>
<td>1.6%</td>
</tr>
<tr>
<td>3.0%</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

* current value (August 2017 for unemployment, July 2017 for inflation)

- **Bottom line:** Even if the U.S. unemployment rate declines substantially further, the effects on U.S. inflation are likely to be small.
Conclusion
Conclusion

• Recent data indicate that U.S. real GDP growth remains consistent with the low-growth regime of recent years.
  o Hurricane effects will add uncertainty to the interpretation of macroeconomic data in the months ahead.
• U.S. inflation has surprised to the downside in recent months, and the surprise is unlikely to reverse during 2017.
• Low unemployment readings are probably not an indicator of meaningfully higher inflation over the forecast horizon.
• The current level of the policy rate is appropriate given current macroeconomic data.
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