Fed Unfiltered, Transcript
3/22/22 – James Bullard, Interview: Asian Investment Conference

Speaker 1:

Okay, whenever you're ready.

Christian Meissner:

Good morning, ladies and gentlemen. I'm Christian Meissner, CEO of the Investment Bank at Credit Suisse. I'm delighted to introduce you to the president of the Federal Reserve Bank of St. Louis, James B. Bullard. Mr. Bullard is an influential member of the Federal Open Markets Committee or FOMC. He is also an honorary professor of economics at Washington University in St. Louis. He's also a staunch supporter of central bank independence, arguing that independent regulation of the financial sector is crucial for maintaining orderly markets.

Christian Meissner:

When it comes to interest rate decisions, Mr. Bullard combines his deep academic insights with a practical view of the markets, challenging long established policies in favor of acting on economic data. He has supported quantitative easing as a response to economic crisis and argued convincingly that central bank's true focus should be headline inflation rather than their usual concern with core inflation. Combined with this approach, he advocates total transparency in central bank decision making as a way of ensuring accountability and the communication of relevant information to the public markets.

Christian Meissner:

As we encounter inflationary pressures coming out of two years of pandemic intensified by geopolitical turmoil, we have the opportunity to draw on Mr. Bullard's insights into what levers central banks can access to keep the global economy on track. Thank you, Mr. Bullard, for joining Credit Suisse and our valued clients today. I'm now pleased to invite my colleague, Michael Strobaek, global chief investment officer at Credit Suisse to host the conversation.

Michael Strobaek:

Well, thank you, Christian and welcome, James Bullard or as I will address here through the session, Jim, to this session with myself, Michael Strobaek, global CIO of Credit Suisse. We will be discussing with Jim for the next 40 minutes or so the outlook for inflation, global growth, the state of the economy, and some questions around the financial system.

Michael Strobaek:

We're obviously in times of heightened uncertainty because of the backdrop of the geopolitical situation in Ukraine, but also at the same time, the US and other countries are facing high levels of inflation coming out of the pandemic. And the purpose of this session is with, of course, an expert in the field and operating in the field is to get a feel for how central bank's thinking about this.

Michael Strobaek:

So my first question, Jim, to you, is the Fed moving quickly enough in your view to rein in inflation here and prevent the US economy from overheating?

James Bullard:

Well, thanks, Michael. Thanks for having me today, and I'm happy to participate. I wish I could participate in person. Maybe we'll get back to the in-person meeting soon. Yeah, I'd be happy to start with inflation and the Fed's response to inflation. I think broadly speaking, the inflation has surprised us to the upside as we've come out of the pandemic. I will say though, that even a year ago, if we were having the same interview a year ago, we would've thought that US inflation would be near 2% for the foreseeable future. So it's really just a development in the last year or so. And the US data did jump up in the April, May, June timeframe of last year. And I think there was a story to be told that that was a reopening of the economy and that it was global supply chain, which are talked about a lot and that it might subside, it might be temporary.

James Bullard:

But then for those of you that followed the US data closely, once we got to October, November, December, January, February data, all of that was hotter than expected and really has put us up at inflation rates that are the highest in 40 years. So this is really moved very quickly and has upset the strategy that the fed had in place initially last year at this time. And so, I think we've had to maneuver. And if you look at how the committee's adjusted, it has adjusted a lot in even the last six months. And more at the meeting last week where the committee's now projecting based on the summary of economic projections. That's the dot plot that we put out that rates would rise substantially this year.

James Bullard:

So, are we moving fast enough? I actually dissented last week, and I said that I thought we should start moving sooner and faster. I would've liked to have gone 25 basis points. I'm sorry, 50 basis points at that meeting along with getting going on balance sheet runoff. I think that it's not so much that we're certainly moving in the right direction, but you have to move at a pace that makes sense for the situation. And right now, we're putting upward pressure on inflation in a world where we have headline PC inflation, which is really our target. It's really 6% right now. So we're running 400 basis points over target. So I think we have to move faster to keep inflation under control.

James Bullard:

And as we go through this here, I just suggest to listeners that we're at least in my mind, I'm thinking about the 1994 reset of monetary policy, where just to refresh your memory on US macroeconomics, that in 1994, the policy rate was increased 300 basis points in a single year, but this was an excellent move at that time because he needed to reset the policy rate. He established the 2% inflation target for the US, inflation average 2% over the next five years or so. And then the economy actually boomed during that period.

James Bullard:

So I think it's something like that is more what we want to have in mind, more what I want to have in mind when I think about how to approach the current situation with respect to inflation in the US. It's not that really the degree of raising rates, it's that you have to move in response to the data and we were at zero because of the pandemic. So it makes sense that we have to move quite a bit to get to neutral here, to make sure we're not continuing to put upward pressure on inflation.

Michael Strobaek:

I mean, you mentioned yourself. I mean, we are looking at some of the highest inflation rates in 40 years. In your view, why has inflation become such a serious issue, at least here and now. What are the key drivers for that? And do you think that central banks are able to prevent it from becoming more entrenched and/or even endemic?

James Bullard:

Well, I think central banks do control inflation over the medium term. So any horizon like five years, I think the inflation targeting era has shown us that credible central banks can control their inflation rates in their countries over that time horizon. And I think this time, this is no exception here, we'll also be able to do that. So I do think it's really helped us a lot to have an inflation target, but you still have to take action to make sure that you achieve the inflation target.

James Bullard:

The sources of the inflation, I think are monitoring fiscal policy jointly. I think the response to the pandemic certainly in the US was very extensive, both on the fiscal side and on the monetary side. And I think that was completely appropriate for the situation that we faced, especially in the spring of 2020. The economy has adapted quite readily to the pandemic even while the pandemic has still been going on and all the way to the point where GDP in the US is now at or close to the trend line that would've been drawn had there been no pandemic at all.

James Bullard:

So we made it all the way back to the trend line in just two years or so, that's very impressive. Labor markets in the US at a generational high as far as the strength of the labor market. So I think it's probably natural that with that kind of policy response to the pandemic and then the economy adapting so readily to the situation, you probably are going to get some inflation out of that. And that is exactly what has happened during 2021 and into 2022 here.

Michael Strobaek:

Inflation seems to be a global phenomenon by now, many of us saw that emerging markets started to raise rates already last year and they didn't wait for the Fed to lead on this front. Is this decoupling something that the equation of the Fed is of thinking about?

James Bullard:

This is a good question. So I'll just mention Japan here. Japan doesn't seem to be in the same boat as far as inflation developments. And I think that is something to ponder regarding the story that this global supply chains were messed up and that's what's caused a global inflation. So I think it must be that, yes, there was a supply shock, but it's also how aggressively did the various central banks and fiscal policy in the various countries respond to the pandemic.

James Bullard:

And it's those factors together that have brought the inflation on. So I think it may be instructive to study or think about the Japanese situation separately. What was the second part of the question? I'm sorry, Michael.

Michael Strobaek:

In terms of how the central banks in other countries started before the Fed in this rate high trials.

James Bullard:

Oh, yeah. The decoupling idea. So one thing I would stress on this is that it's true that the Fed didn't make the first move until the March meeting here just last week where we raised the policy rate 25 basis points. However, it became clear starting in November and December, that the Fed would have to move faster. And that got priced in into the two-year treasury yield, which moved up substantially from, let's say the fourth quarter of 2021 and in the first quarter of 2022.

James Bullard:

Most people, I think including me, would interpret that as anticipation of Fed policy action. So I'm not sure there's quite as much decoupling even though the committee itself did wait until we got the tapering finished before we made the first rate move. I think much has been anticipated by financial markets here and by foreign central banks.

Michael Strobaek:

So looking at the global recovery and obviously 2022 has started with a new, if you will, risk situation, geopolitical situation around the conflict in Ukraine. What is your biggest worry from here on, in terms of the global economic recovery and what is your blue sky or best-case scenario?

James Bullard:

Well, the Russian invasion of Ukraine has been a terrible humanitarian disaster and is weighing on everybody from a humanitarian point of view. And then I think from an economic point of view, my key concern would be Europe and the European economy and how Europe will be able to weather the shock coming from the Russian aggression. And unfortunately, it doesn't look like this geopolitical rift will be resolved at any time in the near future, even in the next few years. Even if the war ends, you'd probably expect sanctions to continue for a long time to come here and people are using a phrase new cold war or just a very difficult geopolitical situation for a very long time. And so, markets have to price this in, but it is a geopolitical shift that is most likely to affect Europe most directly.

James Bullard:

In the intricacies of a global economy, there can be other places that actually do well in this circumstance if demand for their products gets beefed up because Europe or Russian exports aren't as robust as they would've been. And I expect to see some of that possibly from the United States as well. US agriculture for instance, seems like it would be poised to be successful, more successful US energy, I think would be more successful given the shock. There's a flight to safety in the US, so rates would be lower in the US than they otherwise be. That's a bullish factor. So there will be winners and losers from this. But my main concern would be whether Europe can stay out of recession in response to the shock.

Michael Strobaek:

I mean, perhaps a related question to that, because obviously, it is a very uncertain situation and I don't know how policy thinking is shaped by this, but bit in general, can you reflect on how financial market stability is factored into monetary policy making and our policymaker? If markets really drop sharply, are they prepared to step in? How does that play into the reaction function?

James Bullard:

Well, we don't look at markets directly, but markets and the Fed are looking at the same things. We're trying to predict the future of certainly, the US economy and the global economy. And so, if there is a big issue or problem as there was during the global financial crisis, then we'd certainly react to that.

James Bullard:

So sometimes it looks like we're reacting to the market, but the market and the Fed are actually looking at the same thing. We are concerned about financial stability. I think there is a case to be made that there are excesses in US financial markets. If you look at things like the housing market in the US, which is very robust, has had very high price gains rents in the US, also moving up very quickly, which is contributing to the inflation problem and is likely to be persistent. You've got other types of assets, non-traditional types of assets that seem to be selling at high prices.

James Bullard:

So a lot has gone on, obviously equities have sold off in the first part of this year. So there's probably less froth there than there was, but there's certainly points of the US economy that you could point to that look like they might be overvalued.

Michael Strobaek:

Maybe sort of shifting back a bit to the core mandate of the Feds. The Fed obviously, has a dual mandate to support full employment, as well as price stability. We are coming out of the COVID pandemic, or at least we're coming out of the difficult situations of the lockdowns and so on and so forth. But we are seeing at least in the US, millions of people that seem to be leaving the workforce since the start of the COVID-19 pandemic including those who may not intend to go back ever to full-time jobs. How does the Fed think about these chains of unemployment willingness and situation?

James Bullard:

Well, as I was saying, I think the labor market is at a generational high, as far as the robustness of the labor market. I like to cite the Kansas City Fed Labor Market Conditions Index, because that is an index that gathers together all kinds of different labor market indicators in the US and puts it into one number. And that index was at one of the lowest levels it's ever been in spring of 2020. But as I was saying that the economy has reacted so quickly and adjusted so fast to the pandemic that now it's actually at a almost or just about to go to an all-time high.

James Bullard:

And a lot of that comes from job openings, which are very strong, and I think the latest number is 1.7 job openings for every person that is unemployed. So it's a great time for those that are in the market to go get a job. It's a great time to switch jobs and get a better match. The unemployment rate itself, only 3.8 in the US, very similar to the pre-pandemic unemployment rate. And we've got further reopening that come and probably above trend growth in the US economy for 2022 and 2023. So it seems like the labor market's going to get even tighter in the US going forward.

James Bullard:

Now there have been some supply changes. Some people decided to retire early because of the pandemic. And I think that that was probably a pretty good decision for many people, because they were at more risk from the disease. They had nest eggs that were at all-time highs, their house values were high, their equities or other market instruments were high. And working wasn't very much fun during the pandemic, so I think that they could make a decision to pull up their retirement date. I'm not really expecting that group to be very likely to return to the market, so I think they probably left, and it'll take several years to get to that normal trend line for retirement from that angle.

James Bullard:

And then you also had people that were, let's say, dual earner couples or other situations at home where one wage earner might have decided that this is a good time to stay home with children. They also are known to have very slow reentry rates. So I expect that only it will change, but it will change only slowly going forward. Also, the childcare issue, that was a very disrupted industry, one of the most disrupted because it's a high contact industry and you can't vaccinate the kids and so on.

James Bullard:

So it's unclear, that's going to be only a slow healing process there, I think. So at least in the medium term, not really expecting a lot on the labor supply side, although I will say that most recent jobs reports have shown improvements in labor force participation.

Michael Strobaek:

Perhaps coming back to the role of monetary policy and the Fed. You've been a very vocal communicator about the role of monetary policy and have also pushed central banks in general to become more transparent. How do you think and how do we make sure perhaps that policy making avoids creating confusions at times when policy is changing for markets and make them perhaps more volatile or more in stable?

James Bullard:

Yeah, I think former chair, Ben Bernanke, was an advocate for more transparency from the central bank. I think it's a good policy. And maybe I have a slightly different view from others on this, but there's a debate that goes on 365 days a year, 24 hours a day about US monetary policy. And most of the participants in this debate are also market participants or academics that are commenting in various ways, which I think is great. There's a lot of input and that's great, but I think the policy makers themselves also have to participate so that you can control the narrative to some degree and give good ideas about where policy should go and receive, I think good ideas about what the best path forward is.

James Bullard:

But the nature of the business is that shocks are happening every day. And so markets naturally want to know, well, given that that's happened now, would you want to shade the policy one way or another? And so I think that ideally, there's this continuous communication that's going on and this continuous debate by people both on and off the committee. So I think to me, that's all a healthy process and part of the transparency. These are complicated issues, so it's never really just going to be something simple that you can just say, "Well, we're just going to have a really simple, easy policy," because you can't really do that given all the shocks that occur all the time.

Michael Strobaek:

I've only been in the financial industry, 26 years. My history book is not that full, but I have been in two large financial institutions at different times. One during the great financial crisis and one here during the pandemic at Credit Suisse.

Michael Strobaek:

If you look back at your time in the wake of the great financial crisis, the actions that were taken then, if you think about it, how did they contribute to the recovery that came after? And what were the lessons for that? And if you then compare that with the reaction function in the great pandemic, which for me... I mean, as I said, only been 26 years here, I mean, so enormously impactful, at least in the pandemic, did the Fed and the central banks learn something from the financial crisis that they carried over to the pandemic reaction?

James Bullard:

I think that's a great question and that'll be debated for a long time, but I'll give you my take on it. The global financial crisis is a vexing shock because it really originated on Wall Street in US, the heart of US financial markets and maybe the heart of global financial markets and then spread out from there, and it caused distrust amongst financial institutions. You had assets that looked like they were worthless, that had to be dealt with. And so this is a classic and maybe one of the most classic financial crisis that we've seen. And Reinhart and Rogoff taught us that when there is a financial crisis, it takes a long time to recover. That certainly turned out to be completely true. And it took years and years before output in the US even returned to its pre-crisis peak.

James Bullard:

The shock at the pandemic was a very different animal, I think even as the pandemic was gathering speed in the US in late February of 2020, and early March of 2020. People understood right away, this was an exogenous thing, it was coming from nature, not from inside the financial markets, so it was an exogenous event. And we had to react to it and you could predict fairly quickly what kinds of things were going to have to happen. You were going to have to tell certain types of workers that, "I'm very sorry, but you won't be able to go to work for a while, while we're trying to deal with this public health problem. But don't worry, we'll borrow on international markets, and we'll replace your income while you're gone from work." That was a brilliant policy response. And in addition, the Fed lowered interest rates and provided stability to financial markets, which I think was very important as well.

James Bullard:

So that is a place where there's a tie. I think we avoided having a financial crisis on top of the pandemic, which could have happened, but did not happen. And so, the net effect was that by the time you got to July and August of 2020, financial market stress had reduced way down again. It was up at 2008 levels, but it reduced way down to the pre-pandemic levels. And so, that part of the policy was extremely successful, I would say. And the replacement of income, especially during the second quarter of 2020 was also super successful.

James Bullard:

So it helps, I guess if the shock is well under... It was a terrible shock, a terrible thing to happen but on the other hand, it was well understood. You could say, "Okay, this is a disease. People are going to get sick, we have to stop interacting as much." And so there were ways to deal with the crisis that were clearer than during the global financial crisis. There, you couldn't tell what was going on even a year into the crisis. You really couldn't tell what was going on. And that's what makes it so difficult to untangle that crisis as opposed to something like a pandemic. So that's my take on.

Michael Strobaek:

Okay. Well, thank you. Being market participant, it certainly felt very powerful at the time of the interventions, I guess in March and April 2020. And I must say the way that we came out of this was with pretty mind-boggling speed certainly from financial markets perspective. And also now economically, it seems.

Michael Strobaek:

Before we come to the last two questions, just perhaps one that is related also to yourself. I mean, you've been ready to challenge established central bank norms repeatedly, refreshingly, recently suggesting that rate hikes could also take place between the Feds monthly meetings as a more nimble approach to steering things. How important is the innovation part of central bank in today's environment?

James Bullard:

Well, we certainly have had to be innovative, and I try to play my role in that. But I would say that the committee as a whole has had a lot of really good ideas coming from different parts of the committee at different times. And I think that's been a successful strategy. I don't think in any business endeavor or policy endeavor, you don't want to get stuck in dogma and think that you've got everything figured out and that's the only way policy can be in every situation.

James Bullard:

So I think chair Bernanke in particular, is very innovative during the financial crisis and deliberately but many others as we've gone along here during my tenure, have thought about new ways to approach monetary policy and new ways to deal with really unique situations. I mean, the idea that we would be stuck at the effective lower bound for such a long time, that would've been completely foreign to me anyway before 2007. My first 18 years in the Fed, we would've said that that was almost a zero-probability event but then it happened, and we had to deal with it and had to make monetary policy in that situation.

James Bullard:

So similarly, you might say a pandemic only occurs once a century, but of this magnitude only occurs once a century, but if you're there, when it happens, then you really have to scramble to make sure that you contain the fallout economically speaking as best you can. So I do think it's important to be innovative and not to be stayed when you're trying to deal with the various challenges that we face.

Michael Strobaek:

Okay. Now, I mean, that leads me directly into my second final question. I mean, at your time at the St. Louis Fed, you've witnessed several serious economic appeals that have required some unprecedented action by central banks with the Fed in my view, by the way, leading the charts especially in the pandemic.

Michael Strobaek:

For us market participants, I think the question that I get the most from clients and investors is whether we think that Fed and its international peers still have enough firepower to really respond to the next global economic crisis, I dare not use the word meltdown, but at least a very serious situation where... I mean, we know we're faced with unprecedented levels of indebtedness. We've spent a lot of money getting out of the pandemic. But the next policy response facing a recession or a shock, I mean, does it have to be more and more extreme to really help?

James Bullard:

I would say to the extent the next challenge is inflation and certainly looks like, that's the challenge in front of central banks right now. That I think we can deal with, but it does mean raising the policy rate to appropriate levels, to contain inflation and to put downward pressure on inflation. So I think the legacy of inflation targeting, which took hold in central banks around the world during the 1990s, is that inflation targeting was super successful.

James Bullard:

In all these different times and places around the world, inflation targeting central banks were able to get inflation down close to their target. They were able to keep it close to the target. They were able to keep inflation expectations close to the target. So in that sense, I think there's plenty of firepower at central banks, including the Fed to deal with inflation risk.

James Bullard:

On the other side, which is what we came out of before the pandemic, which is the effective lower bound and how to make sure that you can still run an effective monetary policy at the effective lower bound. I think there are two things have become clear, one is forward guidance and the other one is quantitative easing. And those seem to be effective tools again during the pandemic here. So it does seem like we have a toolkit for that scenario as well. So I guess knock on wood, but I do think we have the right set of tools to maintain a good stabilization policy going forward even if we get hit by pretty big shocks.

Michael Strobaek:

That brings me to my final question, which is the following. So this year is the Asia Investor Conference's 25th anniversary. Looking back if we can, that the past 25 years, what do you see as the biggest achievements in central banking during that time? Which is, I know is a long time. And looking forward, what do you think are the biggest economic threats that we have in front of us for, let's say the next 25 years?

James Bullard:

Yeah. I've been to the conference before and it's been great. I've met a lot of friends there, so hopefully we can, as I was saying at the beginning, we'll be able to do this in person, in the not-too-distant future. I think the Asian perspective is excellent for me to be reminded and to understand the dynamic of the robustly developing Asian economy and how powerful it's going to be going forward and its many components, it's a big place. And so, I actually think that it will continue to be or is the biggest challenge for global central banking. It's been a story about Europe and the US for a long time, the European economy, if you add it all together a little bit bigger than the US economy. So you had these two big players, if you want to think of it that way, and then this rising Asia, but so much of Asia is now so powerful and looks to be in very good shape for years to come.

James Bullard:

And so, how is monetary policy going to be coordinated across is try a tripolar regional world, as opposed to a bipolar one that you might have thought characterized the postwar era. So I think that that's interesting, of course, the US has the advantage of the political unification, and Europe has some political unification but is still fractured in many ways. And Europe has even less political unification looks less likely and so will the US continue to play the lead role or will it be more evenly split between the three parts of the world, I think.

James Bullard:

And then finally, I think of course, China is a part of that and how the war now will affect geopolitics going forward or whether we'll get a split again. New cold war sort of split between east and west I think is also a big challenge. And then how would you conduct policy in that environment, which is different than the integrating one that has occurred over the last 25 years.

Michael Strobaek:

Very interesting and good comments to set the scene for the next many years. I'd like to thank you, Governor Bullard, for joining us today and then for joining us again at this conference. We're really most grateful to have you, and we hope to see you in person again soon here at the AIC.

Michael Strobaek:

I thought the comments have been very insightful and I'm sure our clients will be able to work with them in their thinking about their investment decisions, their business decisions and overall, their worldview. So again, thank you, Jim, Governor Bullard for joining us. We look forward to seeing you soon.

James Bullard:

Thank you, Michael. Thanks to the conference, really fun. Thanks a lot.

Michael Strobaek:

Thank you.