Fed Unfiltered, Transcript
4/18/22 – James Bullard, Interview: Council on Foreign Relations virtual meeting

Steve Liesman:

Thanks very much, Carrie, I'm always honored to be asked to do these Council on Foreign Relation meetings, mostly because of the great guests that they have, but also because of the great questions that come from the audience, and we're going to have a chance to do that. I'm going to talk to our guest, St. Louis Fed President Jim Bullard, for about 30 minutes, and then we'll open it up to questions and Carrie's going to handle that part of it.

Steve Liesman:

Before I start let me just remind you, this is part of the C. Peter McColough Series on International Economics, and now maybe you'll join me in welcoming St. Louis Fed President James Bullard, who I think needs no introduction. He's been president of the St. Louis Fed, and before that a research director, and I think I've known him almost that entire time. Jim, thanks for joining us.

James Bullard:

Thanks for having me, I'm looking forward to the discussion today.

Steve Liesman:

I think it's going to be interesting. Jim, let me start with your outlook for policy, which is pretty interesting. Could you walk us through how much in the way of rate hikes, as well as balance sheet reduction, you think the federal reserve needs to do this year and what its purpose would be?

James Bullard:

Yeah, I think the US economy will continue to grow at above trend pace in 2022. Inflation's far too high for comfort and so we have to move to get inflation under control. I think we've got a good plan in place. I, earlier this year, argued that we needed to be at 100 basis points on the Fed funds rate by July one, now it looks like the market pricing will have that and more priced in, so I think that's good. I also argued that the balance sheet runoff should start in the second quarter, so I'm hopeful that we'll get that going very soon here at a coming meeting.

James Bullard:

And I think those promised actions have put in motion market pricing, which is also helping us to keep inflation under control, to your treasury now trading at, I didn't check it today, but around 250. If you look pre-pandemic it was maybe about 150, so about 100 basis points there, and then if you look at a mortgage rate trading close to 5%, or around 5% on a 30 year fixed, before the pandemic that was maybe 375, so 125 basis points there.

James Bullard:

So I think this kind of pricing shows that if you think the pre-pandemic economy was one where we were on the balanced growth path with no upward or downward pressure on inflation, now we've got a little bit hawkish policy going that's helping us to put downward pressure on the very significant inflation readings that we're seeing. In addition, I think inflation will moderate partly on its own, but there's still a component that won't moderate all by itself. We can argue, I think maybe a good topic for today is which component won't moderate all by itself? But a minimum I would say would be to look at the Dallas Fed trim mean 3.6%, that probably represents a pretty persistent component of inflation, and

3.6% is well above our inflation target of 2%, so we have to put downward pressure on that component of the inflation series.

James Bullard:

So that's how I'm looking at things right now. I guess one last thought I'd give in my opening remark here is just to say that we want to get to neutral expeditiously, I guess is the word of the day, and even if inflation was just at 2% today you'd still want to get to neutral today because you're removing accommodation that was put in place during the pandemic. But inflation's far above our 2% target, so there are two reasons to go to neutral very quickly. Once we get to neutral we can assess the situation and see where we want to go from there. I've even said that we should try to get above neutral as early as the third quarter and try to put further downward pressure on inflation at that point.

James Bullard:

But one step at a time, we have to go meeting by meeting here, and I would just say that I also, I don't want to disrupt markets, but we do have to move quickly here, more quickly than we're used to in the past.

Steve Liesman:

Jim, the last I read you were in favor of getting the funds right up to 3.5% by the end of the year. Is that still where you'd like to be?

James Bullard:

Yeah, I gave a speech, for those that are interested, at University of Missouri here about 10 days ago where I talked about a 3.5% being a minimum about where you'd want to be based on simple Taylor Rule type calculations. But the reason I say it's a minimum is that I gave a lot of very kind assumptions in setting up the Taylor Rule, you forget about the output gap, or unemployment gap component, just set that part to zero, put a R-star in of very generous minus 50 basis points, use Dallas Fed trim mean as your measure of inflation, so that's the lowest one of the ones we track, 3.6%, use a relatively small coefficient on that inflation gap. If you do all those generous things when you're looking at a Taylor Rule you still get that we should be at 3.5% on the funds rate, so you can't do it all at once, but I do think it behooves us to try to get to that level by the end of this year.

Steve Liesman:

Jim, you're going to make me do some translation here, obviously. The Taylor Rule is a rule that people follow from famed economist John Taylor who wrote a monetary policy rule that works very well in retrospect, and maybe in the future, we can argue about that. R-star, folks, is the neutral rate of interest if the federal reserve would aim to neither increase nor decrease inflation and or unemployment. Although Jim, of course, might correct me on that very simple explanation of both. 3.5%, Jim, I've done some high level math, you have six meetings left, which is eight minus the two you've had already, 3.5% divided by six is 50 basis points at every meeting. So I guess I'd ask you, is my math correct, sir? And whether or not you'd consider maybe doing more than 50 basis points at a meeting?

James Bullard:

Yeah, more than 50 basis points is not my base case at this point. I would point out that the 1994 cycle where we raised the policy rate 300 basis points in a year, first of all, that one was successful and did set up the US economy for a speller second half of the 1990s, one of the best periods in US macroeconomic history, so it was successful, and in that cycle there was a 75 basis point increase at one point. So I wouldn't rule it out, but it's not my base case here. And I would stress, as I did in my opening statement that the market pricing is doing some of the work for the fed for it, so what we really need to do is just ratify the promised increases in the funds rate that we've already got out there that are partially priced into markets, and so there isn't as much need to surprise as there may have been in '94 when the fed had less credibility on its 2% inflation target.

Steve Liesman:

I want to come back to that, Jim, because I think that's an important point, but I want to talk about the risks of following through on your outlook, which I'm sure you've considered. One of the reasons the fed has typically gone slowly is giving the market a chance to adjust. Are you concerned that 50 basis point rate hikes, repeated 50 base point rate hikes, a quicker move in fact than at least '94, if you include the balance sheet reduction as well, could create serious market disruptions, taper tantrums, those sorts of things?

James Bullard:

Well, I think it has, the hawkish shift of the Fed since last November has caused volatility in markets and there has been repricing, and I am very sympathetic to financial markets, they have to price trillions of dollars worth of assets globally every day, not the easiest chore, and they want to know where policy's going to be. So there has been a lot of adjustment already, I'm not sure that there would be further reaction to the follow through part of that, there would be some reaction, but probably not too much. So at this point quite a bit has been priced in, we'd be following through, and there may be corners of the market that haven't adjusted yet and they would still have to adjust. So I think we'd be asking households and firms and financial market participants to shoulder some of the volatility that's going to occur, because we're going to have to do this in order to keep inflation under control.

Steve Liesman:

Yeah, and let's go from the effect on Wall Street to the impact on Main Street. Do you think this could potentially cause an increase of joblessness and unemployment? I've looked at the history of the Fed's fights against inflation since 1977, inevitably involves some amount of increase of inflation from anywhere from two points to even five percentage points, like we saw in the late 70s, early 80s. How much unemployment do you think might result as a result of a very quick increase of the funds rate?

James Bullard:

That's not my base case, I don't really think that's what's going to happen. I still think that the US economy is going to grow faster in 2022 and in 2023 than the trend base of growth for the US economy. So potential growth, often pegged at 1.75% or 2% for the US economy, I think we're going to get growth rates in excess of that in both of those years. So just on the basis of that I would say unemployment's likely to at least stay where it is, and possibly fall further, during 2022 as we move to keep inflation under control. So it's true that we wouldn't grow quite as fast as otherwise because of the rate increases, but we're still growing at an above trend pace that should continue to lead to further improvements in overall labor market performance. So one thing I often say about this is that to me it still looks like unemployment will go below 3% this year, 2022, based on these considerations.

Steve Liesman:

I'm having a little trouble with the logic of that, and I'm sure there's a logic there that I could understand, but how do you ever get inflation under control with an unemployment rate that continues to decline, and an economy that continues to run above potential? It must be that you create some slack in the economy and that slack is what brings down inflation, but that's my simplistic understanding of the inflation dynamic.

James Bullard:

The biggest determinant of inflation is inflation expectations, not the Phillips curve, the Phillips curve has a very poor track record over the last 20 years so it isn't really a good guide to policy. What we need to do is establish inflation expectations at 2% and show that we're going to do what needs to be done to get inflation to 2%, inflation expectations will adjust, and actual inflation will follow behind. Most of that doesn't have very much to do with the labor market.

Steve Liesman:

So just so I get this right, we can still run above potential growth, we can still have a declining and low unemployment rate that's below say a NAIRU rate, which I guess you're rejecting by rejecting the Phillips curve, but in any event, the NAIRU rate is the non-accelerating inflation rate of unemployment, or as you might say, nothing about inflation relates to unemployment, which is another way of describing what the NAIRU is. In any event I just want to confirm, Jim, that's what you think, we can have low unemployment, above potential growth, and still get a handle on inflation if we get a handle on inflation expectations?

James Bullard:

Yeah, and that's why I think the emphasis has been on acting early, front loaded action, sooner is better, a lot of rhetoric has been in that direction, I've certainly been a participant in that myself, because if you keep inflation expectations under control then you won't have to regain inflation credibility later. Volcker had to regain and established Fed credibility that we would do what we had to do in order to keep inflation under control, and that involved very heavy recessions in 1980 and '82. And we're not in that position, but we still have to act to show that we're not going to get in that position, we're not going to let the inflation expectations get out of control.

Steve Liesman:

So the way you see the world is that the market has priced in what, the next two, three or four 50 basis point rate hikes, so you wouldn't see an accelerating rate of interest as the fed hikes because a bunch of it's priced in, it's only with a re-pricing of where the market believes the Fed will go that you would see, say, the two year, or the five year, or the 10 year move higher.

James Bullard:

I could see them moving somewhat higher as we actually make these moves because there's some probability that we wouldn't move because of other things that might happen, or whatever, so it isn't that all the pricing's been in, there's nothing like the certainty of an actual move, but I wouldn't expect that much of that given that a lot of it's already happening, and arguably we're already pursuing a restrictive policy, if you like the pre-pandemic benchmark interest rates as a comparison point.

Steve Liesman:

Jim, forgive me for saying that there's a certain, it could be will different this time, aspect to what you're saying in the sense that when I look back at prior efforts of the Federal Reserve to fight inflation, you win all the time, by the way, but sometimes you win ugly, and sometimes it ends up in a recession. Why will it be different this time? Are you very, very confident that this fight against inflation will not only succeed because there's a recession?

James Bullard:

Yeah, I mean, one thing that we've been talking, bantering about with the staff here is that the Fed seems to have a lot of credibility when it comes to five year, five year forward inflation expectations, everyone says, "Oh, the Fed will get inflation back to 2%," so we have a lot of credibility there. But then when people talk about the causing recession all of a sudden we're incompetent, we're going to overdo it, or we're not going to pay enough attention to what we're doing and what the data is. So I think we can execute on this and we can do it well, but it is a tough situation, we're going to have to move now, and we're going to have to move quickly, and we're asking markets and households and businesses to shoulder some of the volatility that we're going to get from all this repricing that's going to have to go on. But I do think we can bring inflation under control without going into recession.

Steve Liesman:

And this is a tough question, but is a recession an acceptable outcome to you if it is needed to break the back of inflation?

James Bullard:

Yeah, I just think this is just, it's just all way premature, we're not really even to this point yet. Is there a little bit of humor? I mean, we've moved 25 basis points, and immediately we're talking about recession. Let us get to neutral, let's get to neutral, and unless we get above neutral, I don't think you can blame a recession on the Fed. So I think we need to get to neutral, then there will be a question in the future about how far to go, and where's inflation, are we putting enough downward pressure on inflation? Those would be tough judgements to make, but let's not prejudge that and say we're going to screw that up and make a bad decision, and we're quite a ways from it right now. What we need to do right now is get expeditiously to neutral and then go from there.

Steve Liesman:

Jim, you had wanted to talk earlier about what parts of the economy the Federal Reserve would impact through higher rates, and it's really interesting because things do seem to be different this time. You're hiking interest rates, for example, into a housing market that has been under-supplied by some estimates by 10 years. So you make it more expensive to buy a home, but it's entirely unclear to me, for example, that you're going to put much downward pressure at all on housing prices. Does that make it very difficult for the Federal Reserve?

James Bullard:

I think that's traditionally a very interest sensitive sector, and I think it will be sensitive to mortgage rates, which have gone up dramatically just in the last six weeks or so. So I think that'll be a factor, and I think a lot of household are finding, unfortunately, that the prices have gone up so rapidly that they're priced out of the kind of house they'd like to buy, so I think there will be people that will stay on the sidelines because of that.

James Bullard:

Of course, you've got many things going on in housing here. You've also got this post-pandemic shift where people want more square footage, they want a nicer place to live thinking that they're going to spend a lot more time there, including some of their work time, so it's a different market than it was pre-pandemic. And yeah, maybe we haven't built enough either, and so you've got many factors, demand has shifted perhaps permanently, supply is low, you've had trouble getting enough workers in the field, so many things going on, but I have been concerned about the house prices, they're up dramatically, and in the past that has gotten us into a lot of trouble, so if it cooled off a little bit I think it might be reasonable.

Steve Liesman:

How about automobiles, another area where we're running at 13 million annual units, and usually it's 16 or even 17, it seems like one of the things the Fed can do is make automobiles financing more expensive, at the same time you might have a big rebound in automobiles if the chip supply disruption clears.

James Bullard:

Yeah, that's certainly been a supply story, and we're hopeful that that will clear up, but now it looks like that may take into 2023 before that would clear up in any reasonable way. In the meantime you've got a lot of demand and not enough supply of cars, so there's no question that that's a major factor that we want to get ironed out here. But I think the issue for me anyway is that we can't wait for that to get fixed, we have to react to the inflation problems right now, not after the auto market re-equilibrates.

Steve Liesman:

Let me shift gears, Jim, to the war in Ukraine, which obviously has visited devastation and horror on a very large country and millions and millions of people. The Federal Reserve, in the March meeting, many members of the fed had wanted to go 50 but their hand was stayed by uncertainty over the war in Ukraine, and I think that concern was in part because of the impact on potential economic growth here rather than the inflationary impact. Is it now decided and believed that the impact, such as it hits the US economically I mean, of course, is one of inflation and not one that will reduce that demand and output of the country?

James Bullard:

Yeah, my assessment of the war in Ukraine is that it will have a meaningful impact on the European Union and the Euro area, and I'm waiting to hear more from my European colleagues to see what their assessment is of the damage in Europe, but less impact on North America and the US. I think the oil price component of this is not what it used to be for the US, a big increase in oil prices hurts consumers but helps our producers, and that probably doesn't affect the US nearly as much as it once might have. Europe is a different story on that dimension. You have a flight to safety so that longer term yields are lower than they otherwise would be, that's a bullish factor for the US. So I think it's really the price impact that's most concerning, from my perspective, and less the impact on the real economy.

James Bullard:

I would also say about this that I very much think that this is a schism in geopolitics, a irreversible moment where Russia has altered its status in the global pecking order, perhaps permanently, and this is a very serious situation which could evolve into something more difficult to handle, even from a macroeconomic point of view. However, I think if something bigger happened here that we would just simply react to that shock when it occurs. The base case is that this would be a long, drawn out conflict which will realign now Russia, and with China sitting on the fence, how we're going to handle the geopolitical situation going forward. That's far from monetary policy.

Steve Liesman:

Sure.

James Bullard:

But the issue for us is just to try to get a handle on the impact on the economy,

Steve Liesman:

But not far from monetary policy is that notion you brought up earlier, which is this notion of R-star, which is the neutral rate, and the idea was that over the course of the 90s and the 2000s that globalization, along with immigration, and all sorts of other factors, brought down R-star effectively, meaning so that there was a lower inflation rate in the world, and we had steadily declining interest rates. Are you worried now that we may be moving away from globalization, away from supply chain that are efficiently organized and organized around security, that maybe there's a higher R-star, or a higher level of base inflation in the country?

James Bullard:

I think a lot of interesting debates are going on about the future of globalization. I'm a little skeptical that you're going to really have countries that want to drop out. You've got two really big economies in the world, the European Union and the United States, Europe is actually a little bigger than the US if you add it all together. Do other countries really not want to participate and try to go it alone? I'm not so sure about that. As we go forward we'll see, it could be that you get this two bloc kind of idea, but I'm a little skeptical, I think, economic incentives are pointing in the other direction, that you'd want to integrate, continued to integrate as much as possible and get the benefits of the free flow of goods and ideas across trading blocks. But we'll see how this goes, obviously China is a huge factor here.

Steve Liesman:

Jim, as you know we at CBC do a lot of surveying of the public, of the vesting public, of the public at large, and we just reported our national survey showing some of the lowest numbers, or some of the weakest sentiment about the economy that we have almost ever, even within recessions we've had some low numbers relative to even recession levels, and yet, as you said earlier, the unemployment rate is among the lowest we ever had, and probably heading lower, you're forecasting above potential growth. So two questions, is it makes sense that people have these very downbeat views on the economy, and what do you do with those downbeat views on the economy and low consumer sentiment relative to your outlook for consumer spending and economic growth?

James Bullard:

Yeah, my reading of the consumer sentiment numbers over the years has been that they tend to reflect the news cycle. Some of it, the political news cycle, certainly a war, a land war in Europe is not going to be good for consumer sentiment. I also think there's an economic factor at play here which is that for many workers, this is a time of declining real wages. Maybe not every single worker, but for a lot of them, they did get raise, but the raise didn't keep up with inflation in the last year. And that's a very tangible thing that people feel in their lives, they really notice that they have to cut back on some aspect of the way they like to live, and that's unpleasant, and it's very real and tangible, and so I think they're reacting partly to that and partly to the news cycle.

Steve Liesman:

Does it cause you to think that maybe it could have a negative impact on consumer spending?

James Bullard:

Oh well, to the extent real resources are less at the household level, those households are definitely, they're worse off, absolutely, and they're going to spend less, they're going to cut back, they're going to shift away from higher cost goods, or maybe a cut out a vacation, or something like that. They aren't going to like that, but that's what they're going to have to do if they have lost real resources this year than they had last year.

Steve Liesman:

Jim, just a couple minutes and we're going to open it up to the floor here. I do want to ask you a technical question, which is this.

James Bullard:

I love technical questions.

Steve Liesman:

This is for the market aficionados, I guess is the best way to put it. You have, I believe, in the past advocated for using the balance sheet to steepen the curve. Do you still believe that should be done? And that would be done essentially by selling more shorter dated ones, shorter dated instruments, rather than longer dated ones. Are you in favor of that idea?

James Bullard:

Yeah, I think... You mean a reverse twist-

Steve Liesman:

Right, reverse twist.

James Bullard:

Yeah, I'd be open to that, that's for sure. I think for now we're looking at a passive runoff program as described in the minutes from our last meeting, and for now I'm happy to get going on that passive runoff program. I feel like we've inadvertently overstayed our welcome on asset purchases, and now it's time to take back some of that accommodation that was provided through that channel. Our rhetoric was that that was lowering longer term yields relative to what they otherwise would've been.

Steve Liesman:

Right.

James Bullard:

So I think if we reverse that process it should put upward pressure on longer term yields relative to where they otherwise would be, and you seem to see that just in recent pricing and recent weeks, where the 10 year has gone up a fair amount as it has become clear that the time at which we're going to allow passive runoff is getting close.

Steve Liesman:

What would prompt you to want to move from a passive runoff to more active when we try to engineer the curve?

James Bullard:

Yeah, I mean, we've talked before but I always like to have other tools that we can deploy later if the situation isn't improving, or the data isn't going in our direction. And that's something I could see looking at, in an environment where things aren't going quite as smoothly as we had hoped with respect to inflation, it isn't coming down, we could do something like an operation twist, or I also talked about selling assets. I don't want to do that right now, but as a plan B, if things aren't going well in the future, then I'd want to ramp up what we did with the balance sheet and hopefully get more downward pressure on inflation, if we needed it at that juncture,

Steve Liesman:

It did seem that active sales of mortgages was something that's considered down the road for the federal reserve, is that the right way to think about that?

James Bullard:

It's the way I think about it, but you'd have to ask other participants on the committee how they feel about that.

Steve Liesman:

Okay. Carrie, if we could open up the floor now.

Carrie:

Of course. As a reminder, to ask a question please click on the raised hand icon on your Zoom window. When you're called on, accept the unmute now button, and proceed with your name, affiliation, and question. To view the roster of CFR members registered to attend this meeting, please click on the link in your Zoom chat box. We'll take our first question from Hani Findakly.

Hani Findakly:

Thank you very much, and thank you for this extremely good conversation. I have a quick question about Fed policy in the past 15 years, since the 2007-8 crisis. There's an impression that the Fed is more following the markets and trying to satisfy markets expectation as compared to focus on the real economy, and my question is that, is this impression correct? And if so, how do you justify adding $8 trillion to the Fed's balance sheet at a time when the economy has, by in large, in most of the last 15 years, has done very well, with the exception of the 2020 pandemic. Thank you so much.

James Bullard:

I think this is an interesting question because it speaks to the issue of who's moving first, are markets moving first and then the Fed follows, or is it Fed moving first and then markets follow? I think in macroeconomics two things are jointly determined, both markets are looking at the Fed and the Fed is looking at markets. Now the way I've always described this is that both the Fed and financial markets are looking forward at the forward performance of the US economy, and they're seeing the same data and they're making similar assessments, I would say, of how the economy's going to evolve going forward, and this is leading, on the Fed, side to make public policy with interest rates and balance sheet and the financial markets to price financial assets accordingly.

James Bullard:

So I like to think it's a joint process, and I think that's why communication and transparency, initiated especially in the Bernanke era, are so valuable to the central bank so we can get a good sense of what both sides are thinking as we're going forward in trying to make policy. So that's maybe more complicated than people want to hear, but I think that's the truth of the situation with the Fed and markets.

Carrie:

We'll take our next question from Jay Bacow.

Jay Bacow:

Thank you for taking the time, it's Jay Bacow from Morgan Stanley. In regards to the question that Steve asked earlier around asset sales, the minutes suggested it would be appropriate to consider sales of agency mortgages to enable suitable progress to move the portfolio to primarily treasuries when runoff was well underway. Given that you don't want to disrupt markets, but want to move quickly, and mortgage rates have gone up from 3.75 to 5%, as you mentioned, what are some of the guideposts that would cause you to think that it's appropriate to consider asset sales, particularly with agency mortgages?

James Bullard:

Yeah, I think the sentiment there is that the committee has said repeatedly that we would like to return to an all treasuries balance sheet, and we've said that in various ways over the last decade, but with the mortgage backed securities purchases and with rates increasing to where they are now, you don't have very much refinance activity, so it would actually take a long time to run off the mortgage backed securities. So the committee, in the future, would have to make a judgment about the tension between the desire to have an all treasuries portfolio and the fact that you've still got a lot of mortgage backs that would take many years to run off the balance sheet. So I'm not quite sure where the committee will come down on that judgment, but it would depend on how fast mortgage backs were running off and how intensely the committee desires to have treasuries only portfolio in the future.

Steve Liesman:

If I could just follow up with a quick question, Jim, does the fact that the Fed books, or at least a mark to market way, or otherwise would book through sales losses on its portfolio, does that affect decisions by the Federal Reserve? Does it matter that the Federal Reserve has losses in a sale?

James Bullard:

Yeah, that's been an issue in the past, that was an issue for the Bernanke Fed, that's, I think, been handled with the idea of the controversial, I would say, idea of the deferred asset, if we ever got into a position of negative capital. But we're a long ways from anything like that right now, and we're not talking about selling assets right now. So I think that could be something that will come into play in the future, but it would be quite a ways in the future, I think.

Steve Liesman:

Thanks. Carrie?

Carrie:

I'll take our next question from Mahesh Kotecha.

Mahesh Kotecha:

Hello, thank you very much, I greatly appreciate the opportunity to ask this question. What keeps bothering me is the issue that Steve raised about the juxtaposition between the political, AKA, war in Ukraine, and the macroeconomic conditions. There is obviously the force of growth, which has been strong, and inflationary expectations that you mentioned, and on the other hand there is such a degree of uncertainty that you face with what's in Putin's head, and what he might put on the ground. How do you adjust for something like that, which is so unlike anything that you have to deal with? Thank you.

James Bullard:

Yeah, I think it's a great question, and I do acknowledge that there are very serious risks around the war in Ukraine, and that if it took a turn for the worse that it could affect the US economy and monetary policy. But my position on this is that that's not the base case, first of all, and secondly, if something really did go badly, much more badly than it's already going, then we could react in that situation, we could just simply react to that. So I think, at least in my mind, that's the general strategy here.

James Bullard:

The alternative would be, let's say, sit and wait until you see some kind of resolution to Russia, Ukraine, and I don't think that's advisable in this circumstance because we've got so much inflation, and so much risk that the inflation will get out of control. Also I think that the base case is that North America, and the US in particular, are probably not going to be harmed directly from war in Ukraine and might actually benefit in some ways during the second and third quarter, so we'll see if that actually pans out.

Steve Liesman:

How do you mean benefit?

James Bullard:

Well, you've got flight to safety and lower rates than you would otherwise have, usually that's a bullish factor for the US. You've got US production, let's say agricultural production, favored compared to other places. Ukraine, in particular, can't produce as much right now. You've got US oil production, which might do better now than it would've done otherwise. So there are some silver linings coming from this, so just the fact that we're not in the theater, not that close to the war zone, is probably helpful for the US economy.

Steve Liesman:

It's maybe worth reminding people that we have a economy the size of Saudi Arabia, or oil production the size of Saudi Arabia, inside the US economy. We're doing, actually I think more production than they are, and that changes the economics, doesn't it, Jim? Of the oil price spike this time around compared, for example, to what happened in the 70s.

James Bullard:

Yeah, there are three big players these days, the US, Russia, and Saudi, and they fluctuate around, but I think you're right, I think US is larger than the Saudi right now. I'm not too... Let me start over. I think Russia will be able to sell it through oil. They won't sell it through the same channels, and in the same way that they did before, and it's disruptive to try to have to send it somewhere in some other direction, but I think they will be able to sell it. So what you're really doing is reorienting global supply chains for oil and natural gas relative to what they would've otherwise been, and that probably means a more costly distribution system than you would otherwise have. But once you get that one time cost factored into global prices, it would settle into an equilibrium once again, and then we'd go forward from there and grow from there.

Steve Liesman:

Carrie?

Carrie:

We do not currently have any questions in the queue, so Steve, I'll turn it back over to you.

Steve Liesman:

I have 14 more, so that's fine, if it's okay with Jim. So let's just follow that through a little bit, Jim, if you don't mind, this idea. Would you expect, one of the channels where we get an impact from high oil prices is through the investment channel, and not, by the way, through an increase in the trade deficit, which would normally happen if we were sending all that money abroad for oil, so that would seem to be something that would help the US economy in the quarters ahead. Do you expect the investment channel, both for oil production and other parts of the economy, to be rather buoyant in the next couple quarters?

James Bullard:

Yeah, I think the shale industry has been a little bit burned here with volatility in mobile oil markets, and so they're understandably cautious. I think they'd rather stick to their knitting, so to speak, and pump the oil that they have, sell it at a relatively high price and take the profits. Whether they'll be willing to invest more at this point depends on what they think about where the level of oil prices will remain. Another reason I don't think that the US would go into recession at this juncture is that we've seen oil prices at this level before, $100 Barrel oil in 2011 to 2014, and during that period it didn't cause recession, instead US production expanded dramatically. Now that we're already at that relatively high level of production it's not clear it'll go a lot higher, we'll see. So you're right, it's not the same analysis that it would've been in the 90s or the 80s, or especially the 70s, where you have much less US production, much more dependence on Middle Eastern oil.

Steve Liesman:

And going along with that is the stronger dollar, that's going to help a little bit with the inflation story, I don't know how much though.

James Bullard:

Yeah, dollar has been stronger, although if you look at a trade weighted basis, the chart I looked at suggested it wasn't all that different than it's been in the last few years, at least from a macro perspective. I think if you're trading it every day, then of course small movements matter a lot, but as far as the bigger movements in the dollar, I'm not seeing it on the trade weighted basis, at least not yet.

Steve Liesman:

Jim, I want to shift gears. When I first started in the newspaper business and I'd make a mistake my editor made me write up a note about how I got it wrong, and how I would not get it wrong the next time, and he'd read it and rip it up and throw it away, which is to say I'm not that interested in the blame game here, but I am interested in what the Federal Reserve as a system has learned about how it missed and seemed to be misplaced in terms of policy relative to the inflation that happened in 2021. Are there lessons here that you think should cause some change in how inflation is evaluated and in how policy is set that are useful for the future?

James Bullard:

Yeah, I think one idea we've been kicking around here is econometrics versus credibility. So if you take a strict econometrics approach to forecasting inflation, you're going to build a model based on the most recent data, the most recent decade of data, or maybe two decades of data, and what you're going to be working with is a world in which inflation didn't move around all that much, and it was hard to relate inflation to any real variables, and basically inflation just stayed around 2%, give or take, over that whole period. So if you do your empirical analysis based on that, you're going to always predict that inflation's going to stay right there around that number, around 2%.

James Bullard:

And then when the post-pandemic economy comes along and inflation goes way up, you're going to say, well, according to my model that couldn't have happened, so it must be some random event. But at that moment, it's exactly at that moment you got to throw your model out and go to a different model, which was the credibility issue and the inflation expectations issue. So a lot of the earlier literature on inflation from the 70s and 80s was game theoretic, so there was all this stuff about credibility, and what is the public believe about the Fed? What does the Fed believe about public expectations? Everything was determined by the credibility of the Fed with respect to its inflation target.

James Bullard:

So I think we're now in that period where our credibility's being tested, and we have to take actions to enforce our credibility, and it's exactly that process that will keep inflation under control, and it doesn't have that much to do with the last 20 years of inflation. That's not telling you very much about the current situation, this is a situation where inflation expectations could get out of control if we don't act quickly and forthrightly, and if we do act quickly and forthrightly we'll keep inflation expectations under control and inflation will go back to 2%.

Steve Liesman:

Jim, I get that, and it makes sense to me, but it's hard to understand how... You would need to have adopted that model in, I don't know, February or March of 2021 when inflation had just begun, and it would be very difficult to be concerned about inflation expectations when you had, I don't know what the first month was, February it was 4% and then it started to snowball, the Fed doesn't pivot until November, how do you get to a place where you say, wait a second, this is getting out of control, our transitory explanation is just plain wrong. I mean, I get that you eventually do pivot, as an organization, as an institution, I think it's fair to say that you were early on in seeing the concerns about this, but it did take a long time, like an oil tanker, to make that turn and make that change.

James Bullard:

Yeah, I would just push back a little bit, in macroeconomic time it's only been a year, and this is actually not, if we were sitting here a year ago I probably still would've made an argument that inflation's close to 2% and is going to stay close to 2%. And it's really, I actually think that the transitory argument was reasonable up until the September timeframe, August, September timeframe, I was getting more worried about at that point, but you had the vaccines coming in, you had reopening of the economy, and globally, and it was reasonable to make these arguments about supply and demand shifts during that period.

James Bullard:

What was the kicker, though, was the inflation reports in October, November, December, January, there not only did inflation not turn around and go down, it actually went up higher, took a leg higher, and it's during that period that the Fed has shifted, and I give a lot of credit to Chair Powell for his shift in November, and it's really there that the new market pricing has come into play, which is helping us a lot here, even though the policy rate itself has only moved 25 basis points.

James Bullard:

So I think not all hope is lost here, I think we're in a position where we can maintain credibility and get inflation lower. And can I just say one other thing about this? I think one of the most interesting papers of the 20th century was by Tom Sargent, The Ends of Four Big Inflations. That paper was written in the early 1980s when the Fed was trying to get inflation under control and people said, "You can't really get inflation under control," was the argument that was being made.

James Bullard:

So he went back to the hyperinflations in post-World War I Europe, if you look at those hyperinflations they ended on ridiculous levels of inflation, so I'm not really saying we're at that point, but the point is that they were all ended when there was a credible commitment by the central bank, and by the government, to adopt a new policy, and once that credible commitment was made, inflation ended pretty much on the day that the agreements were signed in all four countries that he looked at. So that was an argument that the inflation expectations-

Steve Liesman:

Credibility argument.

James Bullard:

Is by far the most important component, and that the feedback from labor markets to inflation, when you're at low levels of inflation that might be an interesting dynamic, but when you have a lot of inflation it's really the credibility that's most important, and that's what we have to keep under control here.

Steve Liesman:

Do you think the Fed made a mistake in being too concerned about markets in that it continued, even after the November pivot, to buy assets? In fact, I believe it bought assets in the same month that it raised interest rates. Was that a mistake?

James Bullard:

Well, I wouldn't say it was a mistake, I would say we were using the playbook from the previous time that we had tried to reduce asset purchases, and that playbook went very slowly and worried about a taper tantrum, which did occur in 2013, and because of that we had this slow winding down of asset purchases in 2014, that was all very successful. And so the aim was to replay that this time around, however, what I think happened, and I warned about, was that events were moving too quickly this time around to have that kind of a slow timeline, and so if I had my brothers, I think we would've wound on asset purchases faster.

James Bullard:

The committee actually did what I recommended eventually, but I think I would've gone even faster in retrospect, try to get done by the end of last year, or even earlier than that. So we would've had to be thinking about winding down asset purchases at this time last year and we weren't really in the mode to do that that quickly, so unfortunately we got stuck with the old playbook in an environment where the data moved too quickly on us.

Steve Liesman:

Jim, I believe there's a few more questions. Carrie, are they still there?

Carrie:

Yes, we'll take our next question from Lyric Hughes Hale.

Lyric Hughes Hale:

Yes, hi, I'm with Econvue in Chicago, thank you very much. The world isn't the same as it was in the 1980s in terms of globalization, and I realize the mandate of the Fed is to take care of the United States economy. But the reality is, is the Fed influences interest rates around the world, and the dollar is the reserve currency of the world, so I'm wondering what kind of impact that has now on Fed decisions. Global debt has skyrocketed since COVID, and so when interest rates go up here it's very likely that that's going to have quite negative impact, particularly in the developing world, with dollar denominated debt. So how do we keep from having that become a vicious cycle, and also with what's going on right now in the world's second largest economy, in China, how is that going to play out in this increasingly turbulent world that we're living in? How can the fed hope to influence that in a positive way so that we don't create a negative feedback loop into the US economy? Thank you.

James Bullard:

Yeah, I think this is a great question. This has been a concern of the participants on the open market committee ever since the global financial crisis, and earlier, but especially since the global financial crisis.

And yeah, I'm very cognizant that US policy has an important impact around the world, I do try to stay in touch with policy makers and market participants in Asia, Europe, and other spots, Latin America, Africa, Middle East. So I think transparency helps a lot on this dimension, if we can be clear about what we're trying to do and why we're trying to do it. I also think inflation is very hard on low and moderate income households, and as you go outside the US you have poorer countries on average, and so the inflation component is very serious in many countries, as it is here, but even more serious in other countries.

James Bullard:

We've also got foreign central banks really ahead of the Fed, in many ways, in moving the policy rate, and ahead of Europe, so they're leading the way and managing knowing that we're going to raise rates to keep our inflation under control, so I think the transparency aspect is helping us to manage this situation.

Steve Liesman:

We have a few more questions, but Jim, we're not going to have a few more questions and the ability for you to give any closing remarks, so you can make a choice if you want to redirect on anything that you've said or take another question, up to you.

James Bullard:

No, I'll take more questions, I like to hear what's on people's minds.

Steve Liesman:

Great. Okay, Carrie, go ahead.

Carrie:

Take our next question from Guillermo Christensen.

Guillermo Christensen:

Thank you, and Steve, by the way, I had a boss when I was at CIA that used to do the same thing after you screwed up, except I think he kept them, so hopefully he won't declassify them someday.

Steve Liesman:

No, no, no, he wouldn't put him in the file, and shout out to my former business editor at the St. Pete Times Rob Hooker who taught me that little trick.

Guillermo Christensen:

It's a great idea.

Steve Liesman:

It's a great idea.

Guillermo Christensen:

More of a personal opinion question here. There's a lot of exciting stuff happening in the FinTech world, obviously cryptocurrencies, decentralized finance, all those things. At the same time, regulators are getting more antsy about those developments, and there's more pressure to slow down, regulate, control. Your view on where we're striking the balance right now in those areas, and are there some things that you'd say we should be very mindful of that we don't either overdo it on the regulation, or lose focus on where the systemic risks might be?

James Bullard:

Yeah, there's a lot of great innovation going on, it's all very interesting. I would say very generally speaking that the Silicon Valley mantra of move fast and break things is diametrically opposed to the financial stability mantra, which is let's keep things smooth and stable so we don't have a financial crisis. So I think these two forces are clashing, and with unknown results going forward, so I do think that's a concern.

James Bullard:

Stablecoins have been flagged as quasi fix exchange rate regimes. We've seen fixed exchange rate regimes get attacked over the past 25 or 30 years, and in the end the exchange rate regime breaks down. So whether we've got a similar situation with stablecoins is a great question and I think has caused a legitimate concern. I think the other freely floating cryptocurrencies, they have what I would call the chaos of exchange rate regimes, they have freely floating values so they're more like commodities, and buyers can buy as much or as little as they wish of them, so in that sense I'm not sure there's a financial stability argument around those.

James Bullard:

I think the biggest issue for the crypto currencies is that there's free entry into this market. Pretty much anybody that wants to can create a new coin, and it can be traded. And so I think what Freedman said about this was that if you're going to allow private currency issues, you're going to get a lot of private currency issues. And so I think he's exactly right about that, and we are seeing lots of private currency issues.

James Bullard:

There are many other dimensions to this debate, we actually have our annual report coming out on decentralized finance and crypto, and so there's a lot of great information there, we're hoping that that will lay out many of the issues that we're looking at.

Steve Liesman:

Guillermo, thanks for your question, and Jim, I promised our host that we'd get done by 5:00, it's 5:01, so I'm still calling it a win. I want to thank you for joining the C. Peter McColough Series on International Economics, this was easily one of the best conversations on Fed policy that I've had in a very long time and I appreciate you joining us.

James Bullard:

Great, thanks so much for having me, thanks for all the questions, and have a great day.