Fed Unfiltered, Transcript
9/29/22 – James Bullard, Speech/Interview: HSBC Global Emerging Markets Forum

Janet Henry:

Hello and welcome. Thank you for joining us on the penultimate day of HSBC's Global Emerging Markets Conference for this very special session with James Bullard, president and CEO of the Federal Reserve Bank of St. Louis. My name's Janet Henry. I'm HSBC's global Chief Economist and I'm delighted to be joined in conversation with President Bullard. Now, as you would expect in someone in his role, he's had a long in distinguished career in policy making, in academia. And in addition to his broad ranging responsibilities at the St. Louis Fed, he has had and still has an array of other roles, only some of which include serving on the board of directors of Concordance Academy of Leadership, being a member of the editorial advisory board of the National Institute Economic Review and an honorary professor of economics at Washington University in St. Louis.

Janet Henry:

I think equally importantly I should highlight that President Bullard has made fair transparency and dialogue a priority on the international and national stage as well of course as on main street. I think that's something very clear by his willingness to engage in conversation with all of us today. And despite all of his experience as an economist and a scholar, if you read anything recently on Bloomberg, on Reuters or indeed pretty much any other financial press, Jim is typically described as known hawk for his desire to move early and swiftly on raising interest rates. But particularly for younger participants on this call, we need to remember that a decade ago he was widely viewed as an arch dove.

Janet Henry:

He was an early advocate of QE in 2008 and then warning about the possibility of Japanese style deflation, he wrote an important paper in 2010 which helped to move the FOMCs thinking towards a second round of QE. Let's now hear from President Bullard. This will of course be an interactive session initially led by conversations from me. I have that privilege, but please do send in your questions on Slido at HSBCGEMS2020 or indeed vote for others questions. But first of all, I want to start with a fairly broad question on where the US economy and the thinking of the OMC is right now.

Janet Henry:

President Bullard, thank you again for joining us. We clearly had a 75 basis point rate move in September and seemingly a clear message from Chair Powell on near term intentions. My question is, are you comfortable with the markets interpretation of the outcome of the meeting?

James Bullard:

Thanks very much. It's a pleasure to be here and I'm looking forward to the questions and conversation because I always learn a lot about what's on the minds of market participants. Our recent meeting included around of the so-called dot plot, which I complained about at times. But here the September meeting in particular is one where the near time horizon shortens because you're just giving a dot for the rest of the year on the policy rate and on the other variables that are in that exercise. And if you look at the dot, it does look like the committee is expecting a fair amount of additional moves this year, at least as of the September meeting. And so I think that that was digested by markets and does seem to be the right interpretation for now. Of course we also had the press conference, which Jay Powell always handles very well.

James Bullard:

We also have the Jackson Hole speech, which Jay gave and was very forthright about what needs to be done in the US because we do have a lot of inflation in the US. The CPI inflation rate year over year has an eight handle, that's the one that most households are seeing and that kind of inflation's very tough on low and moderate income households. If you look at other measures, the PCE measure is somewhat lower and if you want to abstract from food and energy prices or extreme movements in prices either on the high side or the low side, you might look at something like the Dallas Fed Trimmed Mean inflation rate, that looks at the entire distribution of price changes and throws out some on the high side and some on the low side.

James Bullard:

There you're just looking at the center of the price change distribution, that number is 4.4% in the US measured for one year ago. So no matter how you cut it, I'm afraid we have quite a bit of inflation in the US way above our 2% inflation target. And that's why the committee has moved aggressively this year starting in the second quarter, really the end of the first quarter I guess, to try to get policy positioned to bring inflation down in an as expedient way as we can. And we're hopeful that by acting sooner and with transparency and with clear communication that we'll be able to get inflation down now as opposed to the 1970s where inflation at these levels lingered for 15 years or so.

James Bullard:

The problem with the 1970s was that we had not just high inflation, wasn't just that you're putting up with the price increases, it's that the real economy was also volatile during that period. You had four recessions in 13 years culminating in the 1981, 82 recession where the unemployment rate in the US went to double digits. It's imperative I think that we avoid that kind of scenario, that we remain credible and consistent about our 2% inflation target, that we take action to move inflation back to 2%. And so that's been a theme that I would say during this part of the cycle. Now, I can talk about other parts of the outlook labor market, but maybe I'll just briefly say a few things and then we can elaborate as we go forward here.

James Bullard:

But the labor markets in the US are extremely strong and if you want to ask about that, I'll go into more detail. But I think claims this morning came in at under 200,000 is a super low number for the US and that was something that during the summer people were saying was rising but it is not. But many other measures of labor markets continue to indicate a lot of strength there. GDP, we can talk about that. We actually had negative GDP growth in the first quarter and the second quarter, but I'm looking for, that's a bit inconsistent with the strong labor market. So we can talk about that issue as well. Most people's assessment is that that doesn't seem to be the right metric right now to think about the US economy. And of course we also have international considerations, which I think will be front and center here probably.

Janet Henry:

Right. Thank you for that. And you touched on a lot of points and I can see looking at Slido, the questions are already piling in. But first of all I wanted to pick up on a few of the things that you already said. And you did mention the labor market in particular. As you said, looking at the initial jobless claims of under 200,000 by that report, it does still seem to be a labor market that's still very hot. I know you've mentioned that the Kansas City Fed Labor market index and vacancies to unemployment ratio is still very high. That seems to be happening at the national level. I suppose one of the questions is, especially

when we're thinking about inflation going forward, how much softening would you be looking to see from indicators such as job openings and unemployment and wage growth before you would be comfortable with the idea of pausing on rate hikes?

Janet Henry:

And perhaps as part of that you might pick up on the whole Beveridge debate. It's a strange world when even non-economists are talking about Beveridge curves, but suddenly everyone seems to be aware of the Feds Waller and Figura paper that we really don't need to see unemployment rise because vacancies are just going to fall back in line. But clearly you've got Summers and Blanchard on the other side of the debate that we would need to see 6% unemployment or so. What would you look at and do you have a view on what the new narrow is or do you just wait to see what it takes for wage growth to come down?

James Bullard:

I think it's just a very tight labor market, no matter how you'd cut it. I do like to look at the Kansas City Feds labor market conditions index because that aggregates many different measures of labor market performance into one single metric and it is at a high that is similar to the late 1990s and the late 1990s in the US was considered the best labor market of the entire postwar era. We're really at that kind of level as far as labor market performance in the US and you've got this vacancies, two vacancies for every unemployed worker. It does seem like even a worker that became unemployed today that the firm had trouble and got rid of some workers, then that person would still have quite a few choices going to get back into the labor market and get back into a good job.

James Bullard:

I think it's very encouraging to have that kind of labor market, but it also means that this is probably a good time to try to get the inflation under control while the labor market is performing so well. Now on that Beveridge curve, I think the Figura, Waller argument is carrying the day so far, the job openings, I guess have fluctuated, somehow they've come down since earlier this year and the unemployment rate really hasn't moved. So that would be consistent with their argument, which I think is more of a short term argument. I would see Blanchard, Summers, thinking more like two years out into the future. If you think that far into the future then probably unemployment will return to mean and job openings will return to mean over a two or three year period.

James Bullard:

I think that's probably a simple sort of forecast that everybody would make. 3.7% unemployment in the US is not the most common thing if you look at the postwar data. If it goes up as the summary of economic projections indicated to something like 4.4%, I would interpret that as just a return to mean of the unemployment rate to something closer to the natural rate of unemployment for the US economy, which is often estimated to be four and a quarter to four and half percent. And of course has wide confidence bonds around those estimates. I don't think it's reasonable to expect that you'd stay at 3.7% for a long time into the future.

James Bullard:

But with all these job openings, maybe that's what will happen. I have a hard time seeing the unemployment rate go up very much with all these job openings because this would be so easy right now anyway for a worker that got displaced to find a new job. We've also got quits at high levels, which

is indicating that people are confident that they can quit their job and take a new job. That's happening as well. A lot to like about the labor market and it suggests that the Fed can concentrate on the inflation part of its mandate.

Janet Henry:

Thank you. I want to turn to global developments, but at the moment I want to stay on the subject of further tightening of policy because I'm getting some questions on the housing market. You might want to touch on that. But the other one that I wanted to ask you about is really the role of the balance sheet in policy as opposed to just interest rates. That's really what are the factors that are most important to keep in mind when considering the longer term size and composition of the balance sheet? But also just the question of to what extent does quantitative tightening actually tighten financial conditions? Is it just a signaling of policy or do you think it is something that is tightening US financial conditions or indeed global financial conditions?

James Bullard:

Well I was pleased that we got the balance sheet runoff started in the second quarter of this year. We phased that in. It's really just hitting full stride I believe here in September. My preference is to wait and see on that part of the policy how things are developing at least six months or even longer to make sure that it's doing what we think it's doing, which should be to help put upward pressure on the longer end of the yield curve compared to what it would otherwise be. I think we were a little late in getting started on the balance sheet runoff. Financial conditions actually stabilized a lot even in the fall of 2020. It's true that in March and April of 2020 financial stress measures such as the St Louis Fed financial stress measure were at 2008 levels.

James Bullard:

So at that point it looked like you could have a financial crisis on top of the pandemic and that would've been a clear disaster I think. But we avoided that and financial conditions eased considerably by the time we got to the fall of 2020 and we could have contemplated somehow thinking about, okay, well maybe we don't need all these purchases as we go through. Also I think the initial impetus of asset purchases was to include the mortgage backed securities in that calculation because I thought, and I think probably everyone thought, well, that the housing market would have trouble as we tried to our way through the pandemic. But it turned out to be the opposite case where the housing market actually boomed in the US and prices were up dramatically until just now with finally turning down a little bit. But they've been up dramatically in the US.

James Bullard:

I argued that in 2021 that maybe we shouldn't be feeding into that process, but we had to look for the right moment to pull back on our asset purchases. We got that going in the spring of this year and now I want to see how that affects the economy. As you know the academic estimates on this are kind of all over the map and even the market commentary is widespread. It's kind of a part of the policy that's hard to assess and we're obviously focused on the interest rate part of our toolkit right now. I like having the QT going on because I think that's helping us, but to what degree it's helping us I think is a good question and something I want to get feedback on from financial markets and elsewhere as we go forward.

Janet Henry:

Absolutely. As you say it's trying to forecast something we have little or no experience of historically, but there are no shortage of estimates out there from academics [inaudible 00:33:07].

James Bullard:

I do want to say one other thing about this that I like to emphasize, which is that in other parts of the last 15 years you might have one central bank with a quantitative easing program and not the other major central banks, but here you've got central banks moving in the same direction on this dimension. And so it's a global QT and I'm anxious to see to what extent that affects global financial conditions. We'll see as we go forward, but we'll keep an eye on this, but the balance sheet expanded a lot in the US and I think we can pull back and get some help on our inflation objective through this channel.

Janet Henry:

And related to that, as you say, even though there is a global monetary tightening underway, in many ways it is being led by the world's most important central bank, which is of course the Federal Reserve. I suppose in the course of the last week, particularly sitting here in London, it's clear that what's happening, the global tightening like it or not, is coming through thick and fast. You've seen some central banks globally being reluctant to raise rates for one reason or another, they've been intervening on their currency. But I suppose for you, the setting policy primarily, well, entirely for the US economy and US inflation, how are you thinking about some of these global influences?

Janet Henry:

I know that the US dollar policy sits with treasury, but a strong dollar and the impact of a strong dollar on the rest of the world, how does that impact on the FOMCs discussion on inflation? Because I suppose it's quite helpful in the fight against inflation. And related to that I suppose partly to do with the strength of the dollar, the volatility that we are seeing in global markets, how does that feed into the discussions and the way that you think about the outlook for what is appropriate policy for the US economy?

James Bullard:

Well, we certainly do look at international developments carefully and try to calibrate what the impact will be backed to the US. I have been pleased as we got going here in 2022 that many central banks around the world anticipated Fed action and moved ahead of the Fed as part of their policy understanding where the Federal Reserve was likely to go going forward, understanding the inflation situation in the US and that we were going to have to act aggressively to bring inflation under control. And so I think that has helped limit the damage that might have otherwise occurred from let's say a surprise move in the US that other central banks didn't have time to react to. We certainly heard a lot about this in the earlier era, the quantitative easing era where foreign central banks said that they were surprised by Fed action and they weren't sure what our policy was and then this just feeding back to them.

James Bullard:

But here I think we've made it clear and we've been forthright, we've had a lot more transparency about what we're trying to do. And that has allowed many central banks around the world to act in tandem and calibrate their policies appropriately for their jurisdictions as the Fed was moving. That part I think has helped us a lot this year to limit the sorts of disorderly adjustment that might otherwise occur. And obviously the UK's been the focal point just here in recent days, but I would just step back from that a

little bit and say that the broader picture, considering how much we've moved and how fast we've moved, I think the transparency and forthrightness and the communication around this has worked to our advantage globally, and overall I think we've had a pretty good response.

Janet Henry:

The strength of the dollar at the moment, as you say, you watch it as it goes along, but I don't want to dwell on the dollar too long, but there are a lot of questions related to it. I just want to draw on a couple of these. I think you addressed it, have the dollar strengthened enough yet to be a factor in policy making for the US. But also a couple of questions relating to the financial stability angle. Given the sense of the dollar and so many currencies, is there a risk when, I suppose there always has to be a risk, doesn't matter, there that somewhere in the world you could have a financial event that could have a feedback effect into the US economy. Someone's liken it to an LTCM type of risk.

James Bullard:

I think this is something we're always watching and always monitoring. If you look at the 94 tightening cycle, which was also 300 basis points at that time, one day you woke up and you got Orange County, California declaring bankruptcy. I think that's the sort of thing that can happen. LTCM was another episode in the annals of financial instability. We do watch this very carefully I think. But I also think that by being clear and having forward guidance on likely moves going forward, that you can mitigate some of that risk because people aren't taken by surprise as much as they otherwise would've been by the upward movement at the short end of the yield curse. I think so far so good, but I would continue to watch this carefully.

Janet Henry:

Yes, of course. Going back to inflation, because the top question on Slido by far is about CPI, the reported CPI. The question is, is the Fed two focused bracket backward looking on year on year CPI? I would just point you that, I think it's very clear that the US does look at monthly inflation rates and that's given long lag times for policy efficacy. I think the basic question is, and we're getting a few of them, is are the risks increasingly skewed towards over tightening rather than under tightening by looking at these reported inflation figures?

James Bullard:

I don't really think so. I think at least speaking for myself, my goal has been to get the policy rate to a level that I think is reasonable for this environment. And just to remind everybody, we started at near zero, which I think was not reasonable. And so we've had to move a lot in a short period of time. However, I think we can get to a level that makes sense. And then at that point I think you could argue that we'd be back to more ordinary monetary policy where you'd be taking account of the recent data and you'd be making adjustments or standing pat depending on how the data come has come in. But starting out at the beginning of 2022 here, we were still in pandemic mode, which maybe was appropriate still.

James Bullard:

But as we've moved to the endemic phase of the pandemic and we've had much higher inflation than anticipated, it's been imperative that we move the policy rate off the zero, near zero level and get up to some level that would be appropriate for the amount of inflation that we have, and we have quite a bit.

If you do some Taylor rule calculation, the Taylor rule calculation that you do will be dominated by the amount of inflation that you put in the inflation gap part of the Taylor rule. It's almost all being driven by inflation. You have to make other assumptions there about the real short term interest rate and output gaps and things like that, coefficients that you want to use. But no matter how you cut it, that inflation gap term is going to be the dominant term.

James Bullard:

So if those that are listening here and want to see what I've been thinking about, I did give a talk at Stanford in May that address that issue and that calculation at that time said, well the minimal level that we have to get up to is probably 3.5%. But unfortunately since that time, that was only, that's only four months ago. But since that time the data has come in even worse than we're anticipating and if you do that over again, you get more like 4.5% on that kind of calculation. You saw that in the dot plot that came out in September where the dots policy had moved up quite a bit for 2022.

James Bullard:

But I think appropriately given that markets and us were expecting inflation to moderate and it didn't really moderate, went in the other direction. On this issue about you're looking at this lagging indicator of inflation and is that really the right thing to do? I think we do pay a lot of attention to inflation expectations and I in particular like the market based measures of inflation expectations that are derived from the TIPS market, also inflation swaps and other methods. I'm pleased that those have come back down under 3%, even under 2.5% for the five year forward. That's very encouraging from my point of view.

James Bullard:

Markets are expecting inflation to come back under control at those kinds of horizons and I think that's exactly what we need here. Plenty of credibility on that. However, markets are also wrong sometimes about what's actually going to happen and we're also wrong sometimes. I think there's a risk management element to this where we stay higher for longer to make sure that we're actually seeing the disinflation that we're going to need to send inflation back to 2%.

Janet Henry:

Yes, as you say markets are sometimes wrong and I suppose financial markets still are based on what central banks are telling them and most central banks in the world if they have a broadly speaking a 2% inflation target in two years time, they're pretty much always forecasting that it's going to get back to 2% levels. Actually I think that feeds into the whole framework at the moment. It's very clear that the intent is to raise rates swiftly to get them back to an appropriate level and at least get them a bit more restrictive as soon as possible. I don't think anyone doubts the intention that the Fed and others want to prevent a weight price spiral and get inflation on a downward track.

Janet Henry:

But it's interesting when I talked to clients and I've been in Singapore earlier this week, it was remarkable how many people asked the question, are we ever going to get back to 2%? Even though a central bank wasn't going to say it, once we get back to maybe three, isn't enough that we're not going to continue to squeeze the economy to be intent on getting to the 2% level. So maybe you could talk a little bit about that as much as I think, one, I suppose is there any possibility that an inflation target is

moved or would that be dangerous in itself? Are you worried that people are asking that question that central banks are just not going to stick to their policy until they get back to that 2% level? How do you think about not just financial market measures of inflation expectations, but the fact that these conversations are now being had?

James Bullard:

I think the notion that you would start to mess around with the inflation target when you get challenged with high inflation, that sounds like a replay the 1970s to me. And so I think this is just a totally bad idea. I know people are talking about that, but we'll maintain credibility inflation target, we will push inflation to 2% and we'll do it in a reasonably compact timeframe. The thing about the 2% target is that it was enormously successful since the 1990s when it was first introduced and has been adopted around the world as a global standard. I think if you had a major central bank like the Fed deviating from that, that you'd have other central banks then also deviating and you'd get a chaotic situation around the world where you're back in the 1970s soup where economies are volatile, recessions are common and inflation's high and variable.

James Bullard:

I don't think we want to go in this direction. What you want to do is press on to get inflation back to 2% as soon as is reasonably possible. I think it is possible because I think what's really going on here, a better way to think about it is that we've been through a war, George Hall of Yale University and Tom Sargent of NYU have a paper called Financing Three World Wars. And what they meant was World War I, World War II and the pandemic. I think it is like a war in the sense that the national crisis occurs, the government borrow a lot of money to pay for mitigating the crisis and the central bank accommodates that borrowing. But this all makes sense because you're in a national crisis as we were in especially in March and April of 2020. But then the war's over and we know wars around the world both for the winners and losers tends to create inflation.

James Bullard:

But when the war's over, you switch back to the pre-war policy of less deficit spending and a monetary authority that concentrates on its inflation target. And that to me is exactly what's happening both on the fiscal side in US politics and also on the monetary side with the FOMC that you're switching back to the pre pandemic policy. And what this does is drive inflation expectations right back to the target and actual inflation follows behind and comes right back to target. I'm hopeful that we can get that kind of dynamic going and I think we're in process here of having exactly the right kind of policy to get that to happen. It's not coming through Phillips curve according to as my assessment here and that's why I deemphasize labor markets.

James Bullard:

So Phillips curve is very flat in the US and if you tried to use that channel to get inflation down, unemployment would really have to go to very high levels. I'm not quite sure what people have in mind that are talking through that kind of language about how we're going to get inflation down. I don't think that's how this works. What you do is you get inflation expectations back to the 2% target and you get a disinflationary process going in the US that doesn't have that much to do with labor markets themselves and has more to do with the pricing power of firms and the fear of firms that they might lose market share if they continue to be cavalier about their price increases. That's my interpretation of the 1980s as to what happened.

James Bullard:

Those firms that were lazy and thought they would just increase prices whenever they wanted, got put out of business by other firms that were productivity oriented and low cost oriented and those latter firms carried the day, that drove a fierce disinflationary process that pushed inflation down dramatically in the US. I think we can get that kind of process going, we'll see disinflation in the US and we'll get back to the target in relatively short timeframe.

Janet Henry:

Thank you for that because actually the top question here, but I think you've answered it already, is how much of inflation is related to supply issues? Is there a risk that higher rates bring demand down but inflation remains high due to supply constraints? Happy for you to add anything if you want to on that, but it's still in terms of the policy setting.

James Bullard:

Of course we look at global commodity prices, they have come off their highs and you've got other obviously factors driving that with the war in Ukraine and to some extent Chinese policy as well. But the numbers I cited at the beginning for the Dallas Fed trimmed mean inflation rate, you're already throwing out the most extreme increases and decreases in the price change distribution. You're just looking at the center of the price change distribution and that is still 4.4% in the US, so you might interpret that as the inflation that the Fed has to take care of as opposed to the inflation that might be due to global factors that are bouncing up and down because of the war or because of Chinese policy.

James Bullard:

I think this notion of throwing out food and energy or using some other method to look at the center of the price change distribution gets at the question of commodity price movements. I think it's clear that we have to act even knowing what's happening with commodity prices, but we have to act because the center of the price change distribution is also moving pretty aggressively and we have to get that part under control

Janet Henry:

And in terms of getting back to the whole policy framework regarding inflation, Flexible Average Inflation Targeting, is it over? Is it just back to 2% core PCE now and always? Or is, and you've mentioned Taylor rules a couple of times in this discussion already, because at least gives you an assessment of where the current appropriate policy setting might be. But are there advocates on the FOMC, do you think for a more systematic rates policy like a Taylor rule or do you see Flexible Average Inflation Targeting being talked about again a lot more or is it just we're going back to 2% core PCE?

James Bullard:

I think Taylor rules were developed in an era of trying to explain the 80s and the 90s, which is pretty successful policy in the US and which did bring inflation by about 1995 to 2%. And over the 95 to 2005 period inflation was averaged almost exactly 2%. So pretty successful. I think that those rules were not designed to talk about the effective lower bound and so you had a lot of trouble once we hit the zero lower bound after the global financial crisis. You had a lot of trouble talking about policy in Taylor rule terms. But now that we're back in the higher inflation environment, it makes complete sense I think again to think in terms of Taylor rules as far as where the level of the policy rate should be. I'd certainly

be an advocate of looking at that and considering that as giving us a recipe for the right types of policy moves to make in this environment.

James Bullard:

Now, a lot would depend on exactly what inflation gap are you going to put into that Taylor rule, because if you just take CPI inflation and take the inflation target off and multiply it by something, you're going to get a very, very high policy rate. And so maybe that's not the way to think about it. But I think to look at other types, other measures of inflation that throw out the most extreme movements on high end, the low side would be give you a better, a more realistic idea of where you should be on the policy rate. As far as the Flexible Average Inflation Targeting framework, I guess what I'd like to say about that is that you should draw a little picture in your mind and there are two branches in this picture. One is the low inflation branch and the effective lower bound branch, and the other is the high inflation branch.

James Bullard:

And on the low inflation branch, monetary policy should be looking at the Flexible Average Inflation Targeting framework because that was designed to talk about the effects of the zero lower bound on monetary policy. What do you do in a world where inflation's very low and nominal interest rates are very low? How do you conduct stabilization policy in that environment? That's what the Flexible Average Inflation Targeting framework was for. If it's a high inflation environment, it's just C Volcker. We know as it was often said as we were developing the Flexible Average Inflation Targeting framework, well, if inflation's high we know what we have to do. And so we're not trying to design something for that.

James Bullard:

We know that we'll have to conduct policy in a way to return inflation to target from the high side. The question is when inflation's very low, it's below your target and now interest rates are very low. How should you conduct monetary policy then? There are kind of two branches to this. If inflation's low then I think FAIT might still be very relevant, but if inflation's high, we got the recipe from the Volcker era.

Janet Henry:

Absolutely. And you mentioned Taylor rules being devised during the 80s and the 90s and used then, but for the last couple of decades perhaps less so. Which leads me to a question regarding globalization effects. We think about the last few decades in particular what we had persistent globalization until a couple of years before the pandemic and a lot of automation in the good sector. How much of the last 20 years would you say the low stable inflation was a function of central bank credibility? But to what extent did central banks also get lucky by global developments? And that actually now maybe we are in a more volatile world, maybe it is just going to be more like the 70s or the 80s where we get external factors, whether it's a war, a pandemic or deglobalization forces, are just persistently going to mean an era of more volatility in activity and in inflation and potentially interest rates.

James Bullard:

Inflation targeting is inflation targeting and it doesn't say, you can miss your inflation target if there's globalization going on or there's globalization going on. I think the whole key to this is to take those factors into account appropriately and then to put it in Milton Friedman kind of terms, print the right amount of money for the situation that you're in so that you hit the inflation target. That's the art of

central banking. But just because there are our factors, winds are blowing in one direction or another, doesn't mean that you can't hit your inflation target. I think you still can, but it's the amount of money that you have to print is somewhat different in one situation versus another.

James Bullard:

I push back a little bit against these kinds of arguments to say, well we're going to miss on the high side for a long time because of some kind of factors, that we should be taking those into account and then conducting the right monetary policy in that environment so that we hit the inflation target. If you continually miss your inflation target, then you just lose credibility on the entire policy and markets start to doubt that you're trying to do anything at all. That's the recipe for the earlier era in the 70s where inflation drifted around in all different countries and you had high invariable inflation and a volatile real economy, lots of recessions. I appreciate that fundamentals of the global economy may be changing and probably are changing, but our job is to take those into account and get the right monetary policy given those changes.

Janet Henry:

I suppose if it is going to be a world where we are subject to perhaps less favorable influences on inflation, it sounds like you are talking about a world of a deterioration in the growth inflation trade off. I wanted to link that into the idea of the dots. You started off with the dots, what they were pointing to for the end of the year, which as you said in September doesn't leave too much scope for a big divergence so late in the year. But a few years ago you said you wouldn't submit a long term dot, such that that dot wasn't particularly useful. Is that still your view in this particularly uncertain world that are long term dot is not useful?

Janet Henry:

But also could you just talk even if there isn't a number on it, do you have any thoughts about even the direction of the long term equilibrium rate or natural rate? A few years ago you'd suggested some demographic factors, a productivity factors and demand for safe assets might mean a persistently low natural interest rate, or do you think that there are factors that may have forced it a little bit higher in terms of the long term natural rate?

James Bullard:

This is a great thing to talk about further. I think when we do this dot plot, the place where there's the most uncertainty is actually the long run column there where people are saying where are we going to be 10 or 20 years from now or something like that. There's actually tremendous amounts of uncertainty about that. I would say if you look at economic history, there are long eras of let's say high productivity growth or low productivity growth, there are changes in demographics over very long time periods. And so I think that you're better off thinking about, well if we could be in a say a low productivity era in the future and that would dictate one type of monetary policy, but you could be in a high productivity era in the future and that would dictate different levels of the policy rate and so on.

James Bullard:

Because of that I did quit submitting longer run dots except on the inflation target because I think given those fundamentals you should be able to conduct a policy that hits your inflation target if you understand what the fundamentals are for the economy. I still like the regime switching idea. If you look

back historically, there are clearly periods that are dominated by certain types of fundamental developments and then there are other long periods that are characterized by other types of developments and monetary policy would have to be different in those two worlds. So averaging across those and saying, well that's your long run outcome, is not really giving you the right picture of how the world works. I think you take that average, that average is something that never occurs. You're either in the high regime or the low regime, so you're getting the wrong idea if you look at that.

James Bullard:

Also the long run part of the dot plot or any forecast because there's a lot of mean reversion, that gives you this path for the policy rate and for other variables because what happens is you just take from wherever you are today and then you draw a line back to whatever you think the mean is in the long run. And that path is what's critical for the implementation of monetary policy. But the path could be far away from what is realistic, because you don't know what the long run outcome is and so you're drawing pass into a dot that has a lot of uncertainty around it. This is kind of technobabble, but I think this is an important consideration for how we communicate a policy.

Janet Henry:

Yeah, no, no, I would agree with that. And in fact there's a question here that a lot of people like the sound of actually. How do you interpret US real yields now all comfortably over 1.5%?

James Bullard:

I've been pleased that we've been able to get real yields higher and I think that that is consistent with our policy goals and consistent with the idea that we want to get inflation back down to 2%. I would say overall it's still a low real interest rate world, but to have real interest rates above that low level now and into positive territory is an encouraging sign.

Janet Henry:

Okay, so we're still low because that was another question. I'm going to spend the last eight minutes on questions all on Slido. The next question was, has higher for longer now officially replaced lower for longer? It sounds like you're saying we're still low, just not the lower road. There's also a quick question-

James Bullard:

I would say on that the higher for longer. I do think that markets and maybe policy makers too are coming around to the view that, okay, well we have quite a bit of inflation and it will take a while for it to go back to 2% and it probably won't go back in a straight line. You wouldn't ever expect that and the Fed is going to have to be careful about not overinterpreting a decline in inflation as it goes back to 2%. So all those things seem to indicate that you'd have a higher policy rate for longer than markets might have thought even one year ago. This isn't the kind of thing where you can just move the policy rate up and everything corrects itself immediately. That's not how macroeconomics works. So even though I gave a story about why I think this will be successful and happened in a relatively short timeframe, that still probably means higher for longer than what markets would've anticipated previously.

Janet Henry:

Right. Okay. Thank you for clarifying that. But on your point there when you set policy it doesn't always work in a straight line against everything you're trying to influence. There are a few questions here

related to what you are looking for on the inflation side and on the labor market side. Obviously the Fed does have a dual mandate at the moment. Unemployment is arguably too low, the labor market's too tight, inflation's definitely too high. Both goals are quite consistent. Presumably as tightening continues, you will see that the prospect especially if inflation is lagging and rise in unemployment, that the goals may no longer be consistent. Or do you not think that's possible? Do you think for now it will be the inflation concerns that will dominate what the Fed does regarding decisions as to when to take a pause on the tighten side?

James Bullard:

I would just point to the 1990s which was a very good decade for the US on the whole, we did have this tightening cycle in the middle of the 90s and then by the late 90s the policy rate was actually quite a high level, unimaginably high compared to what we got used to after that. And the unemployment rate went all the way down to below 4%. So by 2000, we did have a recession, kind of a mild recession at that point, but I don't think it's quite as mechanical as what people make it out to be. The dot plot did suggest that unemployment would tick up here to 4.4%, but as I said earlier you might make that kind of prediction just based on reversion to the mean in the US that the unemployment rate probably wouldn't remain at 3.7% indefinitely.

James Bullard:

I think it may be a reasonable assumption, I didn't put that down, but it may be a reasonable assumption just to say, well, unemployment will probably go back to something over 4% because that's what the US economy can sustain over the medium term. A recession I would say is caused by a shock. So the problem for us is that we're raising rates, we're trying to get inflation under control. I've said that's like walking a tight rope between two tall buildings and you're trying to walk the tight rope. You sure hope there isn't a big gust of wind as you're trying to walk the tight rope. But I think that as we're trying to go through this process, if something else happens that's very negative for the US economy, then that's what would push you into a recession.

James Bullard:

I think we're at higher recession risk, but I don't think that's the base case at this point. And it's not just because of short term interest rates being a 3.13. The policy rate. I don't think by itself that's not enough to cause a recession in the US. But because we're raising rates and relatively quickly and growth is pretty slow, we haven't talked about growth, but growth is pretty slow in the US, you could get some other kind of shock that would send you into recession. We're taking more recession risk than otherwise would, but I still think it's not the base case for the US economy.

Janet Henry:

Picking from that and linking it into another question. The question here is, every cycle's different, is there any past period of rate hikes, inflation, et cetera that you find comparable to our present conditions? And certainly you mentioned the 1990s and the 2000 recession is basically barely a recession, and as you said, it was something happens and it was the dot com burst arguably that played a bit of a role there. Obviously in the 90s we had a soft landing, in the mid of the 1990s. But if we do go back earlier, they were almost planned recessions. Weren't they? The Volcker shock was definitely a planned recession.

Janet Henry:

It was the only way we're going to squeeze inflation out of the system would be to force this economy into a recession. But it sounds like maybe you think the current period despite the high inflation is not like the 70s or 80s. It is still closer to the 90s. Would that be fair?

James Bullard:

I don't think we have a very good historical comparison and that's why I've emphasized other types of things. But Volcker in particular came to be chair of the Fed at a point where the Federal Reserve had squandered it's credibility over the previous 15 years and had basically no credibility at all when he came into office. And so markets didn't believe anything that he said or did would contain inflation. And there was very little idea even that the central bank could control inflation. There were many other theories around and ideas that didn't have much to do with central banking. So Volcker had to earn credibility every step of the way. He was sort of fighting with markets every day to convince them that he was serious about getting inflation low.

James Bullard:

Now, then you had inflation targeting come along in the 1990s and all these central banks around the world were able to get inflation lower and closer to target, less variable. It was a tremendous success story in the 90s of the 2000s. And it was very clear you assigned the responsibility to the central bank, you let them do what they need to do and you will get low and stable inflation out of that. In that sense we have way more credibility than Volcker had and that's why I think we have a much higher chance of success both at getting inflation back to target and possibly doing it without serious damage to the economy. I'm still hopeful that we can achieve that, but we are, as I just said, we're certainly taking more recession risk than we otherwise would have to if we didn't the high inflation.

Janet Henry:

President Bullard Jim, I have about another 150 questions, but myself and our clients would love to ask you. You've been very generous with your time with us today. We greatly appreciate it and we are very much with you in hoping that this doesn't end in a recession for the US economy. But thank you very much for covering so of our questions, being very thank frank with your commentary and we look to hearing more of what you have to say in the coming weeks and months. Thank you very much.

James Bullard:

Thanks very much for having me. This is a lot of fun. Thanks.

Janet Henry:

Thanks.