Greg Rob:

Good afternoon, everyone. Welcome to Barons Live. My name is Greg Rob, I'm the economics editor at Market Watch. Joining us today in a special appearance, I guess I would say, is St. Louis Fed President Jim Bullard. Really thank you for coming to Market Watch and Barons. We appreciate it so much.

James Bullard:

Happy to be here. Thanks for having me.

Greg Rob:

We have a lot of questions and a lot of viewer questions already, so let's get into it, see how much we can get done.

James Bullard:

Okay.

Greg Rob:

Inflation is well above 2%. The Fed has raised rates rapidly, signaled that they have to raise rates more. You don't think the Fed has done enough to bring down inflation? How high do you think rates need to go to bring inflation down?

James Bullard:

Yeah. I would refer listeners and viewers to my speech in Louisville last week, which was all about the level of the policy rate that would be sufficiently restrictive. And the answer in that talk, which used tailor type monetary policy rules, was 5 to 7%. So, I do think that the committee at least needs to get into the bottom end of that range in order to be sufficiently restrictive, given the data that we have today. And then, I also think that we're going to have to continue to pursue our interest rate increases into 2023, and there's some risk that we'll have to go even higher than the lower end of that range as we go through 2023, if the inflation data in particular does not cooperate with us. So, I guess I think markets are under pricing a little bit the risk that the FOMC will have to be more aggressive rather than less aggressive, in order to contain the very substantial inflation that we have in the US.

Greg Rob:

Hasn't that been the case all year with the market doubting that the Fed was going to raise rates to 3 to 4%? It's been that way all year. What do you make of that?

James Bullard:

Yeah, hope springs eternal always around the corner, and I think it's a little bit of continuing overemphasis on the transitory argument for inflation. Even though Chair Powell retired the word transitory a year ago, I think there's still a heavy degree that inflation will naturally go away without the Fed putting downward pressure on inflation. And I think that's been proven wrong during 2022 here. This will be the second year in a row it looks like where we'll have core PC inflation around 6%. That's a lot of inflation for the US and it means rates will have to get higher in order to bring that down.

Greg Rob:

One counter argument I've heard to this 5 to 7% level comes from research from the San Francisco Fed. They sort of have a proxy fed funds rate, so right now the Fed funds rate is 3.75 to 4% and they see calculations that when you bring in quantitative tightening and other factors, that the real proxy fed funds rate is already in the 6% range, so they're worried about going too far. How do you respond to that argument?

James Bullard:

Yeah. I think if you wanted to put heavy weight on the quantitative tightening part of our policy and you wanted to count that for a lot, that would be one way to make the argument. Chair Powell has talked about this in the past and admitted, and I've admitted too that the estimates are all over the map on this, as far as how many basis points the quantitative tightening policy is worth. So, the calculation that I did in the little bill talk was more about just a straight tailored type rule calculation. But I made very generous assumptions and even if you make these very generous assumptions, you still get a 5% lower bound, and if you're a little less generous you get the 7%.

So, I think we've got a ways to go, to get restrictive. One thing I would say about my talk was that the shaded region in that diagram, for those that want to actually check it, the shaded region can move around based on the data. If you have strong conviction, then inflation is going to come down, then that shaded region would also come down, and maybe the policy rate would move into the shaded region and you'd be in the zone.

Greg Rob:

I hope to come back to the inflation outlook a little bit later. But the second part to the how high, then, is how fast? And you think that 5% ranges where you want to get to. Does it matter how fast the Fed goes? Do you still want to see another significant 75 basis point increase in December?

James Bullard:

Yeah. Generally speaking, I've advocated that sooner is better, that you do want to get to the right level of the policy rate for the current data and the current situation. But I would defer to the chair as to whether how he wants to play the tactics on this. In macroeconomic terms, I'm not so sure that it matters that much, whether it's we get there, the exactly what date we get there, or what meeting we get there. But the most important thing is this sufficiently restrictive level and that level is well understood by financial markets.

Greg Rob:

Now, there's a lot of talk about the go slow argument, that the senses that the Fed is kind of driving fast down the highway. You've done a lot of rate hikes this year and that you're going to go so fast that you miss the exit, maybe over-tighten, hurt the economy too much. Talk about over-tightening. Is that a risk in your outlook?

James Bullard:

Yeah. I think people are counting... We started from a very low level here, close to zero and they're counting the first 250 basis points as if that was a tightening of monetary policy. But really, that's just getting up to the long run neutral level of the policy rate, and since then we've moved above that, but I'm not sure you can really count the first part of that effort this year as being true policy tightening. So, we've only recently moved into restrictive territory and we're going to have to move farther in order to

keep inflation under control. I think all will go better if we get to the restrictive levels sooner, put downward pressure on inflation, and get 2023 to be a year of disinflation for the US.

Greg Rob:

One of the questions we had this morning already was saying that just recently the Fed had been trying so hard to get inflation up and so some people, I think, are getting a little bit of a whiplash now that the Fed really wants to get inflation down. Just explain to people a little bit how that has changed so quickly here. You've changed your whole....

James Bullard:

Yeah. Well, you have to keep up with the times and the times are changed here. I think we were all taken by surprise in the aftermath of the pandemic onset that we ended up with as much inflation as we did. But now we're going to be and have been forthright in trying to turn that around, get the inflation under control, and get the economy back on the balanced growth pass. I think it makes sense. We haven't had this much inflation in the US since the early 1980s. This calls for much higher interest rates than what we've been used to over the pre-pandemic era. It's very much a change in the winds here.

Greg Rob:

Another, the third question out of the box is how long the Fed will have to stay at a high level. You think rates have to get into that gray box, 5 to 7%, but then sit there?

James Bullard:

I think we probably have to stay there all during 2023 and into 2024, given the historical behavior of core PC inflation or Dallas Fed trim, mean inflation. They will come down, I think. That's my baseline. But they probably won't come down quite as fast as markets would like and probably the Fed would like. Everybody would like them to come out rather quickly. But that isn't the historical behavior of these time series.

Greg Rob:

Your colleagues focus on the labor markets, saying that they're going to be able to gauge how high rates need to go based on the labor market, but that's not your central focus. Could you talk about that a little bit to our listeners?

James Bullard:

Yeah. Labor markets continue to be extremely strong. I see that markets are expecting maybe 200,000 jobs to be created in this upcoming jobs report. That would still be well above the longer run trend for the US economy. We've also got unemployment at 3.7%, historically a very low value for the US economy. Labor market conditions index still at near 1990s highs, one of the best labor markets of the post-war era. There's a lot to like about the current state of the labor market.

I don't think that the feedback from the labor market to inflation is nearly as strong as many people portray it. I think that the Phillips curve has been flat, and the relationship has broken down compared to what it was in the seventies and earlier, so that I've tried to deemphasize the links between labor markets and inflation, any direct links there. I do think that the fact that the labor market is so strong gives us license to pursue our disinflationary strategy now, and try to get the inflation under control right now so we don't replay the 1970s, where the FMC at that time took 15 years to get inflation under

control, culminating in the 1981/82 recession, with unemployment at 10.8%. We don't want to go back to that. We want to get this inflation under control much sooner than they would've in the 1970s.

Greg Rob:

The strong labor market raises the hope of a soft landing, then? Or it's kind of a one factor that talk?

James Bullard:

I think that it's a slow growth economy and that's probably helping us right now. Growth was actually negative in the first half of 2022, now looks like it'll be positive in the second half of 2022, so arguably a stronger second half than a first half. I think that's interesting. Tracking estimates of the fourth quarter, the current quarter look like they're trending positive, and GDP now is actually very strong for the fourth quarter. I still think we'll have below trend growth in 2023, but the slow growth part may help us in trying to bring the inflation under control.

Greg Rob:

And economists definitely think that a slow growth is inevitable, but they're debating whether there's going to be a recession. You don't think it's inevitable?

James Bullard:

I don't think it's inevitable. Recessions are caused by shocks. It's possible that we could get a shock that we can't anticipate right now during 2023, and that would send us into recession. We don't know what that would be. Positive things can happen, too, so it's possible to go the other way, but my base case is just for slow growth in 2023.

Greg Rob:

Just to remind viewers that if they put some questions into the chat, I'll try to save some time at the end for questions. And thanks again for listening. I think inflation expectations is a topic I wanted to talk to you about a little bit. Some people when I read commentary after your speeches, that economists think you're talking tough because you really want to keep inflation expectations down and want the people to really get the sense that the Fed isn't going to tolerate high inflation. Are inflation expectations important to you, and is that part of your strategy here?

James Bullard:

Yes, they're very important variable in honored macroeconomics, and one of the things that happened in the seventies was that the inflation expectations did get out of control and it took a long time to bring inflation down. I have been encouraged that market based, tips based inflation expectations are in a reasonable range, at least for now. And that suggests confidence in financial markets that we've got the right policy to bring inflation under control. But on the other hand, markets are sometimes wrong, and so it could be that they're just over optimistic about inflation, so it's hard to read that, but at least we're not going in the other direction where markets had lost faith in the Fed that we would be able to bring inflation down in relatively short order. So far so good on that dimension.

Greg Rob:

When you talk about market expectations, then, you're sort of leaving off the table consumer expectations. Do you think consumer expectations surveys on inflation are less valuable for the outlook?

James Bullard:

Yeah, I haven't found them to be as informative. I do look, however, at business inflation expectations, because they're the price setters in the economy and I think how they're assessing the situation is important, but they're more closely tied to market based inflation expectations than the households. The households inflation expectations have tended to be biased to the upside. They tend to be heavily influenced by gasoline prices and food prices, which is fine, that's what they actually have to pay. But I haven't found them to be as reliable for a day-to-day read on what's going on and how markets are interpreting the incoming data.

Greg Rob:

In the minutes of the Fed November meeting that came out last week, there was some concern that some of the inflation expectation readings might be getting hotter than you might like. And I noted that the Economist talked about the Cleveland Fed study that said businesses expect 7% inflation next year. So, are you worried a little bit that maybe things... I mean, we've had this high inflation and people aren't really... They don't know what to expect maybe, right? Businesses too.

James Bullard:

I think that's right. Obviously, we don't have that much experience with this kind of inflation over the last couple of decades, so it's been quite a while and people aren't sure what to make of it. And so, it's not surprising to me that the dispersion would be very wide. You have different people espousing different theories about what's going to happen, and who's to say that they're wrong. I mean, we haven't been in this situation for a long time, so I think you would expect the dispersion to be wide here.

Greg Rob:

What is now the outlook for inflation? Let's talk a little bit about that in. Chair Powell's Jackson Hole speech, he said something that I thought was... He quoted Paul Voker, the former Fed chairman from the 1980s who famously brought inflation under control and he said inflation feeds upon itself. Is that something that we're seeing now? Even though people are focused on just inflation slowly coming down, it does seem a little bit solid. Is there some dynamic that's keeping inflation?

James Bullard:

Yeah, I'm not a big believer in the vaunted wage price spiral. I think nominal wages and prices in a high inflation economy would naturally go up together. If you look at somewhere like Turkey or Argentina, which have very high inflation rates, 75 to 100% or in that magnitude, you would expect nominal wages to be moving at the same level as overall prices in those economies. I think that's a symptom of a high inflation economy, that's not a cause of a high inflation economy. The cause is inappropriate monetary policy in both those situations. And so, for the US, we want to run the appropriate monetary policy, and then we'll get inflation back down to our 2% target and meet both sides of our mandate. Strong labor market, low and stable inflation.

Greg Rob:

So many forecasters, and I guess some Fed officials see commodity prices coming down and see signs that inflation might be easing over the medium term, which I guess is next summer or so. What's your thought about that? Is that your outlook for inflation?

James Bullard:

One of the things I said and little bit, and I'll repeat today, is that there is a good dynamic that could take hold in 2023 and I very much hope it does, which is that markets turn out to be right, inflation does come down in 2023, we move the policy rate to the appropriately restrictive level, let's say in the first quarter of 2023, and then we leave it there as inflation is coming down. I could see that being a very good dynamic for the US economy, because there would be evidence that the disinflationary policy is working. Inflation would still be relatively high, but falling. The Fed, in my view, would stick with it as the chair has emphasized, in order to make sure inflation returned to target in a reasonable timeframe, and we could put this episode behind us, or we could at least see the light at the end of the tunnel at that point. So, I think that if that dynamic gets started, it could be a good year in 2023

Greg Rob:

The other day, Olivier Blonkchart who was president of the American Economics Association and then a top economist, he said that he was concerned about something like a false dawn, where inflation comes down from like 7% where it is now, then really gets stuck around 4%. But meanwhile, everybody will have declared victory. Is that something you're concerned about that we might get some decline in inflation but just then it gets stuck?

James Bullard:

Yeah, I would definitely listen to Olivier on that. I think that's a risk and we do have to maintain downward pressure until it's clear that we're going to achieve our 2% inflation target. And so, I think that's something to watch out for. In the seventies, and again under Volker, mistakes were made at various points where what looks now, when you look back at the data, it looks like relatively small movements or temporary movements in inflation got over-interpreted, and you got the so-called stop go monetary policy. So, I think we have to avoid that temptation here and really stay with the restrictive level of the policy rate longer, in order to be sure that we're pushing inflation back to the 2% target.

Greg Rob:

And some observers and economists think that the Fed's 2% inflation target might be too low now, and that maybe 3% might be a more better place for an inflation target.

James Bullard:

Yeah. Completely terrible idea for this environment. One of the advantages we have today is that we actually have a inflation target, and we benefited from the inflation targeting experience of the 1990s across the globe, which brought global inflation down to 2% and set an international standard. So, as soon as you get into hot water, you say I'm going to abandon my inflation target, especially for one of the leading economies in the world, would unleash global chaos on the inflation front, and return us almost surely to the 1970s kind of chaos. We don't want to go there, that's for sure. There would be a time for this debate, but it would be well after we've returned to the 2% inflation target.

Greg Rob:

And one factor that people are talking about in inflation is companies being able to raise prices in this environment. And do you think that companies are going to run into a place where they will no longer be able to raise their prices so freely as they have been?

James Bullard:

Yeah, I think that's the disinflationary dynamic that we'll get going here. The concern will be among management teams at these companies will be... If they raise prices too much or try to overdo it, they will lose market share. And if they lose market share, that tends to be a permanent loss. You have a customer that got disgusted with your product and decided to abandon it all together, it's very hard to get that customer back. And so, that's the situation that businesses really fear, and they should fear it. If you misplay this as a management team, you can send your company all the way out of business. That's my interpretation of what happened during the 1980s disinflation, I think that will happen again here, or some will misplay this. They'll think that they can raise prices too much and they'll get a large loss of their customer base or possibly their rivals will come in and undercut them completely. So, I do think that's an important part of the dynamic that I'm expecting in 2023.

Greg Rob:

Some people are talking about that it's, I guess, the progressives in congress or talking a little bit about that there's a price gouging going on from companies, and that's feeding inflation. Is that something that fits into your worldview of the economy, price gouging?

James Bullard:

Well, I suppose as consumers we all feel like all the good should be free, and so we shouldn't have to pay anything for it. The firms don't see it that way. They have a cost of production and they want to make a profit for their shareholders, some of them, who are actually the actual customers that are buying the thing. This is all part of the equilibrium in the economy and I think we have to let that process play out.

Greg Rob:

I want to switch gears here and talk a little bit about quantitative tightening. It really just has gotten underway in September. I mean, it's probably early to ask you, but I want to say how do you think it's going? How long do you think it will last? Do you have a timeframe in mind?

James Bullard:

I've been pleased with the QT program. I was pleased that we got it decided in the second quarter and moving at full speed in the third quarter. I think it's time to let it run for now. We can evaluate next year sometime and see how it's going. But so far, so good. And I think this is helping us in our disinflationary program

Greg Rob:

And another topic, the yield curve, fairly super inverted. Is that a big signal for markets here?

James Bullard:

Yes. The vaunted yield curve inversion. I have cited this in the past and I do respect the signal sent by the yield curve, but at this particular moment, I think that this is mostly nominal. You have markets seeing a lot of inflation today, maybe over the next year or two, but not seeing very much inflation over the next five years or the next 10 years. That would naturally, even if you thought the real interest rate was not going to change in that entire timeframe, that would lead to a nominal inversion because you're expecting inflation to fall.

You could interpret that as confidence in the Fed's program, that we're going to be able to get inflation back down to 2%, and that would lead to part of the inversion here. You could tell a lot of stories around this, but I think in this particular moment, this expected disinflation is partly leading to the yield curve inversion. It's not sending the recessionary signal necessarily, that it would in other circumstances, where the yield curve version would be in the context of inflation being a 2% and expected to remain at 2% in that situation, where then there's the yield curve inversion, which was the case in 2019. Then, I think the markets really did expect recession ahead. Here, post pandemic, they've got this expected disinflation and that's leading the part of the yield curve inversion. That's why it's not sending quite the same signal that it would've in 2019 or in the earlier episodes.

Greg Rob:

We're running out of time. I appreciate you've been so generous with your time and joining us today. I'll ask a couple questions from the audience. Just there's a question about the housing market. Housing market has been hurt hard as interest rates rose. What's your outlook for housing and will housing be a real drag on the overall economy?

James Bullard:

Housing is reversing and has been. During 2022, this is one place where there are not long and variable lags with respect to policy, pretty much an immediate impact on the housing market. The only thing I would say about this is that this is on the heels of a booming housing market, so I'd like to think that this is returning more toward the balanced growth path for housing. I was surprised, and I think many were surprised that the pandemic, instead of causing problems in the housing market, actually led to a housing market boom, certainly in terms of prices and other factors. Maybe we'll get some better equilibrium here eventually, in housing.

Greg Rob:

We have about 50 questions, so I'm going to have to invite you back for a second round. But thank you again for your time today, I really appreciate it. I have a little promo to announce and then we'll be finished. And that is Baron's Live will continue tomorrow. There's a Baron's associate editor, Reshma Kapadia. We'll speak with Sarah Malik, chief investment officer of Nuvene tomorrow, to talk about investing in these turbulent times. I wanted to thank you so, so much everyone and for joining us and especially President Bullard from St. Louis Fed for the time today. Thank you everyone. Keep reading Market Watch.