Nick Timiraos:

Hello and welcome back to WSJ's Live Q&A. I'm Nick Timiraos, chief economics correspondent for the Wall Street Journal, and I'm really happy to be joined today by Jim Bullard, president of the Federal Reserve Bank of St. Louis. I want to thank all of you in the audience for joining us. And Jim, thank you for joining us.

James Bullard:

It's great to be here. Thanks for having me today.

Nick Timiraos:

Some quick housekeeping, if you're part of our audience viewing on wsj.com, you can send us your questions in the chat. Those are being sent over to me. We've got a lot of questions. I'm going to try to get to as many of them as we can over the next 30 minutes. And so to start, Jim, in the summary of economic projections released last month, if I did the math right, 17 of 19 policy makers or colleagues, maybe you said that under the most likely economic scenario rates would need to rise above 5% this year. Seven of those projections had rates rising this year above five and a quarter, and two of them had rates topping out above 5.5%. What was your projection last month and why?

James Bullard:

We put in a dot for the end of 2023 at five and a quarter of 5.5%. So I guess we're calling it five and three eights, so that would be slightly higher than the median dot. Although I would caution everyone that these kinds of things are a guess year from now. We're not exactly sure where the economy will be or where inflation will be. I guess the underlying judgment on my part is that inflation will probably recede during 2023, but not as fast as it's projected to by financial markets. They have inflation kind of crashing in 2023 and while I hope that happens and I think they're expressing a lot of confidence in Fed policy, which is great, but the history of core PC inflation is that it probably doesn't fall that fast and so we'll probably still have some inflation at the end of the year.

Nick Timiraos:

So that would imply roughly a percentage point increase from here in interest rates. But a number of people are looking at some of the recent declines we've seen in goods prices and the anticipated disinflation in the rental and the housing market and they're saying, gee, haven't you done enough? Why not take some time here to see if the impact of all the increases that you did last year slow the economy down maybe more than you think. What do you make of that argument that why not just take your breath here and see what's going to happen?

James Bullard:

Well, we moved very rapidly during 2022 and I think that was the appropriate policy. We've got the policy rate much higher, one of the fastest rates of policy change that we've seen since the 1980s, but it was all very appropriate because we've also seen the level of inflation that we had in the early 1980s. So we had to move very quickly. We're almost into a zone that you could call restrictive. We're not quite there yet. If you check out my getting in the zone speech I gave in Louisville late last year and updates that I gave in St. Louis here I guess a week or two ago, yes, we're coming closer, but we're not quite in the zone yet.

And I think you'd probably have to get over 5% to say with a straight face that we've got the right level of the policy rate that will continue to push inflation down during 2023. We want to guarantee to the extent we can that inflation will come down and get back on a steady path toward the 2% target. And we don't want to waiver in that because one of the problems in the 1970s was that inflation kept coming back just when you thought you killed it. So I think the policy has to stay on the tighter side during 2023 as we're watching this disinflation process unfold.

Nick Timiraos:

So Jim, just an hour ago, the commerce Department reported on retail sales and for December and the so-called control group that feeds into the GDP calculation fell for second straight month, that was down 0.7%. We also saw this morning a bigger decline in the producer price index measure of inflation. So when you talk about the need to raise interest rates a little bit more from here, are you talking about is this essentially an insurance policy taking out insurance against the risk that you really don't want to see inflation to move higher? What's the right way to think about this next phase of ballpark estimate of percentage point and interest rate increases from here?

James Bullard:

I think insurance is a good way to think about it, that we want to err on the tighter side to make sure that it get the dis inflationary process to take hold in the economy and push inflation back to the 2% target. So I do think that's a good description. During 2022, we didn't really start raising rates till March of 2022 and then we had the four outsized increases in the middle part of the year and into the fall.

That was because we were way behind, in my judgment anyway, we were way behind where we needed to be. We're still a little bit behind, but we're much closer. So I would say get into this over 5% regime and then go from there. Hopefully markets will be right. Inflation will come down rapidly during 2023 and we'll put this inflation episode behind us, but we're not quite there yet. If you look at core PCE inflation measured on a 12 month basis or Dallas Fed trim mean inflation, yes, it's down slightly. Dallas Fed trim mean just barely coming down. So I'm very hopeful for 2023, but we're not really there yet. We have to react to the data that we have and not the data that we hope we have in the future.

Nick Timiraos:

So some of those people I was talking about before that maybe are reacting more of the data that they hope they have in the future, they're arguing that most of the disinflation in consumer prices that we're seeing right now is happening without any direct or clear effect from monetary policy. For example, from supply chain bottlenecks easing or the shock of the war in Europe, easing what Jim, is the mechanism through which you expect monetary policy to bring inflation down and are we seeing those effects already on consumer price inflation?

James Bullard:

Yeah, I would say some in financial markets are telling the transitory story over again, one that has failed us miserably during 2022. If we were sitting here last year at this time, you would've heard the same story that these prices were going to come down all by themselves. And I don't think that that's the way this has worked historically, but the difference between last year and this year is that the FOMC has put a dis inflationary policy in place and that's why I think we can be successful in 2023 in a way that we weren't in 2022. So I do think there's some factors also that are leaning against the idea that you'll get this sort of transitory story. Global factors have improved. So we were even six or eight weeks ago talking about recession in Europe, one of the biggest economies in the world.

Now we hear news that it doesn't look like they'll be in recession the way they were previously predicting they may skirt recession. And for China also a very large economy, they've abandoned their COVID zero policy and are moving toward a reopening of China sooner than HA was previously expected. So that sounds like renewed upward pressure on the margin on global commodity markets and some the factors that went in favor of the transitory story in 2022 may be reversing here. So I am nervous that that will lead to upward pressure on inflation more generally. So that's a risk that we have to factor in when we're making monetary policy.

Nick Timiraos:

And in that last round of economic projections in December, I don't know about yours, but most of your colleagues, if you look at the range, most of your colleagues revised up their projection of where they thought inflation would be at the end of this year versus their projection for the same time submitted in September. But the consumer price index in October and November and December has been better behaved. So what accounted for that upward revision in the inflation projection for the end of this year?

James Bullard:

Yeah, you'd have to ask the other participants what drove their forecast, but I would say that the September forecast was based on expectations for what would happen at the end of the year. And yes, we got better data, but some might've expected even better data than that. And so because of that, the inflation rate was higher at the end of the year than they have previously anticipated, and so they moved their number up for 2023.

Also, labor markets have been very strong in the US to the extent people want to look at the Phillips curve and wage growth, some of those numbers have surprised to the upside in the second half of 2022. I think the general story here is that the second half of 2022 came in much stronger than was anticipated, let's say last summer. So we've been surprised to the upside on economic growth GDP now for the fourth quarter, Atlanta Fed still running around 4%. Third quarter came in stronger than expected, so you have a second half growth rate for 2022. That's quite a bit stronger than most people expected and stronger than the potential growth rate of the US economy. So that's putting us in better positions starting 2023 than we previously thought is pushing off recession forecasting way into the second half of 2023 and now it's not all that clear that will even materialize. I think the prospects for a soft landing have improved markedly here.

Nick Timiraos:

Some people have made the point that to achieve the soft landing, if that's what you're going for, it's easier if you slow the pace at which you raise rates, which of course the committee did in December. You raised rates by 50 basis points after having done four increases of 75 basis points. And then there's some discussion now about slowing the pace again at your next meeting. That concludes on February 1 to 25 basis points. What will go into your thinking about the tactics there about whether rates should rise by 25 versus 50 basis points? Do you see a stronger argument in either direction?

James Bullard:

The risk to the soft landing is that the inflation data doesn't cooperate and goes in the other direction, which it has just during 2022. There was a moment where people thought it was kind of coming down, then it went back up and that could happen again. Surely we don't expect everything to happen in a straight line here. That's not the way the macroeconomy works.

And so if you got into a situation where it again looked like inflation was increasing and then the Fed had to react to that, you'd probably have to react more strongly at that point to reinforce credibility that we want to get on this dis inflationary track and get inflation back to 2%. So to avoid that, I think the front loading has served us well. I think you should move as rapidly as we can get into this over 5% range, which is basically where the median dot was. And then from there you could say, okay, well you think we have the right level, the policy rate, we think this is putting downward pressure on inflation and we'll react to data from there. So I like the front loading story. I think it may be a good way to play this, but I don't know where my colleagues are going to come out on this.

Nick Timiraos:

So that sounds like an argument. Saying you like the front loading strategy, I don't want to put words in your mouth, but it sounds to me like you're saying you'd be open to raising rates by 50 basis points.

James Bullard:

Why not go to where we're supposed to go, where we think that the policy rate should be for the current situation? And then once you get there, then you can say, okay, now we're going to just react to data. If markets are right and all these things happen, the economy, we can adjust, but why not get to the level that you want to be at? Why stall and not quite get to that level? That seems like you'd have risk that inflation would turn around, then you'd have to move more strongly later on in 2023 in order to reestablish the idea that you're you, you're going to have a restrictive policy and get inflation back to target. So I think there is something to be said for let's move the policy rate to the right level, which according to the SEP was over 5%. Let's do that as quickly as we can and then we'll see how 2023 unfolds.

Nick Timiraos:

You've also, I think when you spoke about this a couple of weeks ago, you said those decisions should be subject to the data and some people wonder if that introduces an element of maximum discretion into your decisions. Is there data that you're looking at right now? I mean there's not a whole lot of data that's going to come out be before your meeting, but is there data you're looking at that would let you conclude maybe 25 is okay here and maybe you actually don't have to get above five and a quarter or 5% this year. What data would it take for you to change your expectations about where that terminal level of interest rates ought to be and how quickly you should get there?

James Bullard:

Well, I think there has been important data over the holidays here that has changed the complexion of the macroeconomic outlook for the US coming into 2023. First of all, as I've already cited the GDP growth was just quite a bit faster in the second half of 2022 than was previously anticipated. So that's one piece of noons. The labor market has been much stronger I think than many predicted. It has slowed down from super high levels in 2021, but still you've got non-farm payrolls growing well above the trend pace and you've got unemployment ticking down, not up ticking down to 3.5%, one of the lowest values that we've seen. You've got job openings relative to the number of unemployed at 1.7. It's hard to see exactly how we're going to get increases in unemployment with that many job openings. It seems like a disrupted worker should be able to find a job in that environment.

Let's hope that they can. But there are plenty of opportunities out there still, and that's going to have to come down if you're worried about labor market performance. So I think labor markets are now jiving with the GDP data and making more sense. Both of them are suggesting growth that is relatively strong

given the Fed's monetary policy and putting us in good position for a soft landing going forward. So I do think there's been news, it's true that inflation is moderated, but I'm not sure the core measures have really moderated as much as the market pricing seems to suggest. And from a policy maker's perspective, you still got this upside risk to inflation that you want to make sure that we're conducting policy in a way that's going to contain that upside risk on inflation.

Nick Timiraos:

You referred a little while ago into a speak you gave last fall, getting in the zone and just for our audience that maybe didn't follow the speech, you can go to the St. Louis Feds website and download it, but Jim has used certain monetary policy rules called Taylor rules over the past year to spotlight the estimated range of rates that might be appropriate here to get inflation down. And Jim, in the first half of last year, those estimates you had a range that interest rates would need to get to three and three quarters percent to 5%, the lower bound and the upper bound of those estimates in the second half of the year. Those estimates, do I have it right that you were saying interest rates needed to get somewhere between 5% and the high 6% area. And so the question I have here is what would you need to see for those estimates of where interest rates need to go to move down?

James Bullard:

Yeah, so I do think that that is kind of techy and geeky, but it is a way to frame the idea that the Fed started a little bit late and I think in retrospect it would've been nice to have started a little bit earlier, but we do what we can and then we moved quickly. And those estimates are driven by inflation itself mostly because inflation is so far above target. That is kind of no matter how you cut the data, you have to have a higher policy rate if you're going to control inflation and move it back to 2%. Now, one interesting thing about the zone argument is that the zone does move around based on incoming data. And so if markets are right and inflation does fall dramatically, then that's going to contribute to policy recommendations from the zone that are lower than they are right now.

But the spirit of the Taylor rule is to say that you should always be in that zone somewhere, and that would be the right level, the policy rate for that situation. If the situation changes, then it's going to give a different recommendation that's totally appropriate. So we're getting close to being in that zone based on the data we have right now, but we're not quite there yet. And it is true that as we go through 2023, the complexion of the macroeconomy could change in ways that will call for different values in that zone. Also, this is generous assumptions here about where we are with respect to the economy, meaning that it's kind of tilted toward the low end of policy rate recommendations, but I think it's appropriate for the way I think about monetary policy.

Nick Timiraos:

So analysts, economists at Morgan Stanley did some back of the envelope math recently. They took the latest projections from you and your colleagues in the December policy meeting and they plugged those into, you're getting into the zone recommendations and those show that if inflation decelerates, as you and your colleagues have projected, that zone would decline this year to somewhere between 2.75% And 4.25%, which would imply the need to actually consider cutting interest rates beginning in the third quarter of this year. Is that a fair way to read this, that if inflation comes down as you and your colleagues expect this year, that the committee could actually be looking at cutting interest rates to stay in that zone in the second half of the year?

James Bullard:

Yeah, I think if all that happens, that would be a judgment that the committee would have to make. But I would say our earlier discussion about insurance is important here. I think you'd want to lean toward the high side in that situation because you'd be concerned that we not replay the 1970s. Think that we have inflation in the bag and then it re-erupts on us. So we'd have to read the macroeconomics accurately and kind of lean to the hawkish side during 2023 to make sure that, I think as chair Paul said, the job is well and truly done. I think he said. So you'd have this insurance aspect to it where you'd want to stay a little bit more hawkish than maybe what the policy rules will require necessarily require during that period as you're making sure that inflation is under control and on a path to 2%. So that those would be complicated judgements that would have to be made later.

But I would say this, markets are expecting inflation to fall dramatically during 2023. If that happens, that's going to be very good news for monetary policy. So they're expressing a lot of confidence in Fed policy. I love that. Inflation expectations measured by swaps markets have come back down to where they were before all of this inflation got started in 2021, and that's very encouraging. So I think we've got the right policy path and what we'll have to have some insurance as inflation is coming down to make sure it doesn't reappear on us and we got to a replay of the 1970s. And the '70s took 15 years to really get inflation under control, and then in the end you had to go to a policy rate of 20%. So we don't want to get into that kind of dynamic here. We want to get this done as much as possible in 2023 and finish the job in 2024.

Nick Timiraos:

So in the 10 minutes or so we have left, I want to get in questions from our readers. Argen asks "What to do about loosening financial conditions?" And to put my own spin on this, we've seen market determined interest rates come down in recent weeks. To what extent, Jim, is it a problem for the monetary policy authority to have financial conditions easing when the central bankers raising rates, if the Fed hikes rates and yields move lower, did the Fed really hike rates?

James Bullard:

Yeah, the financial conditions indexes are interesting, but they also have an equity pricing component in there. And I've always felt it's hard to read equity price movements. It depends if you think the market was at fair value or overvalued or undervalued, you've got global developments feeding into that. So I think I'd prefer to look at something a little more narrow just like rates themselves. And it is true that longer term rates have come down.

But markets also think there's less inflation out there in the future. And because of that, they need less of an inflation premium than they previously would have needed. And so I think part of this is just the expectation of lower inflation, let's say at a five year horizon or a 10 year horizon creates less need for an inflation premium in those rates. And partly because of that you've got this inverted yield curve, but it's partly a nominal inversion, is partly a story about confidence in the Fed's policy that inflation is going to come down fairly rapidly to the 2% target and therefore they don't have to price those out years as aggressively as previously.

Nick Timiraos:

Eugene here asks, "Are higher wages a cause of inflation or a result of inflation?"

James Bullard:

Yeah, on this I've always felt like the wage price spiral story was not a good one to tell from a macro perspective. I think any economy around the world that would have high inflation would also logically have high nominal wage growth because that's the only way the economy can operate. So I think you'd expect those two to be correlated, but that's not the cause of inflation. The cause of inflation is ultimately monetary policy that can't react fast enough or doesn't do enough to react to shocks that come to the economy. And so I think that the wage price spiral story is one that gets told too often. But we do nevertheless, track wage growth. It has been high. [inaudible 00:26:25] wage trackers certainly showing relatively fast wage growth hasn't kept up with inflation by and large for most workers. So I think that's a factor that's driving the dis inflationary process.

Households somehow have to find ways to cut back, and the firms that don't realize this and try to raise prices too much are going to get hit hard. I think by that. Yeah, you're certainly hearing lots of stories around the economy about sort of household purchasers sort revolting against particularly high prices, and they're perfectly willing to cut out a particular product in order to make their budget constraint whole. So firms that don't realize that may lose market share, and once you lose market share, it's very hard to win it back. The cost of acquisition of customers is very high. So I think the wage price spiral story is not a good one, but it does have some ramifications when you think about this dis inflationary process through a markup kind of story.

Nick Timiraos:

Prashant asks, sticking with this subject here, "During the next few months, the decline in inflation could lead to an increase in real or inflation adjusted incomes, temporarily levitating demand. How do these types of transitory factors inform Fed policy?"

James Bullard:

So the question is that this could turn around and now the wage growth will be positive? [inaudible 00:28:08].

Nick Timiraos:

Well if fuel prices, if inflation's coming down and real incomes are rising, how does that factor into your thinking about the outlook? Could you see a boost to consumption here because people are spending less on gas goods prices coming down gives them positive real incomes?

James Bullard:

Yeah, I would regard that as a bullish factor for the economy. If you really think that real wages will start expanding again, that's going to make it easier for households to return to their pre covid consumption patterns and the whole economy to return to its pre-crisis balanced growth path in real terms. So I do think that that would be a bullish factor. There are other bullish factors, I think for 2023. One is that households generally speaking are still flush in terms of covid dollars that have not yet been spent. That's trickling out and supporting consumption spending. The wealth to disposable income ratio, even though it's come down because equity prices came down and house prices to some extent have come down, the wealth to disposable income ratio is still very, very high. So I think hustles feel flush in that sense. State and local governments also have a lot of covid dollars that are unspent and will be spilling out here during 2023 and 2024. So I think those factors all suggest to me that consumption and government spending will be stabilized as we go through this dis inflationary process.

Nick Timiraos:

We're almost out of time, and I apologize to all the questions I couldn't get in. We have a lot of monetarists asking about the money supply. A lot of people want to ask about the balance sheet. This is the $8 trillion portfolio of assets that the Fed has been shrinking passively. And I want to ask one of these questions before we finish, Jim. Danielle asks, "Can the balance sheet continue to shrink after the rate hike campaign has concluded?"

James Bullard:

I think the answer to that is yes. We expanded the balance sheet tremendously after March and April of 2020 as the pandemic came on. And in my opinion, we overstayed our welcome somewhat on that. It would've been nice to be able to find a time to scale that back, but I think the way the pandemic evolved and the macroeconomic situation evolved, we just couldn't find a moment to do that until last spring. And I was pleased that we got that process in place last spring. But basically we expanded the balance sheet a lot. It makes a lot of sense that we'd roll some of that back.

It seems to be going fine over the last six months where it really got to its peak level of runoff. So I think we're in good shape for that policy, and I wouldn't want to review that at least until the second half of 2023 and probably even beyond that. So we'll let that, or at least in my opinion, I think we should just allow that to continue on the money. I'll say to the monitors out there, keep the faith. M2 growth is exploded, inflation came right behind it. M2 growth has now come down to zero or below zero. It makes sense that we've got the right policy to disinflate now and get inflation back to 2%.

Nick Timiraos:

Great. Well, that's all the time we have today. Jim, thank you so much for taking the time to be with us this morning.

James Bullard:

Thanks, Nick, and thanks to the Wall Street Journal for having me today.

Nick Timiraos:

And if you missed part of this event and the full program will be available to re watch on our live Q&A page. And I also want to thank all of you, including our journal subscribers for joining us today. My colleague Gunjan Banerjee. We'll be back on Friday with investors, Jim Chanos and Ross Gerber to discuss the bull and bear case for Tesla stock. Check back on this page for updates and we'll see you next time.