St. Louis Fed

Press Release

St. Louis Fed's Bullard Presents "The Monetary-Fiscal Policy Mix and Central Bank Strategy"

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STANFORD, Calif. – Federal Reserve Bank of St. Louis President James Bullard presented "The Monetary-Fiscal Policy Mix and Central Bank Strategy" (PDF) on Friday at a conference hosted by Stanford University's Hoover Institution.

Bullard said that the pandemic fiscal-monetary response created too much inflation. To eliminate the excess inflation, the fiscal-monetary response must be countered, he noted, adding that this is happening.

"The fiscal stimulus is receding, and monetary policy has been adjusted rapidly in the last year to better align with traditional central bank strategy," he said. "Accordingly, the prospects for continued disinflation are good but not guaranteed."

The Monetary-Fiscal Response

Think of the pandemic as a global war that induced large-scale deficit spending combined with accommodative monetary policy, Bullard suggested.

"The spirit of the macroeconomic policy response to the pandemic was to err on the side of too much rather than too little," he said. "This could be thought of as risking a high-inflation regime, as the monetary authority did not attempt to offset the inflationary impulse unleashed by the fiscal authority."

The deficit spending was used for transfer payments to disrupted workers and businesses, which shows up as a sharp increase in personal saving relative to trend, Bullard explained. Meanwhile, the monetary policy reaction to the pandemic was to lower the policy rate sharply, accommodating the deficit spending.

"In macroeconomic historical context, this combination of policies often leads to substantial inflation," he said.

The Switch to Disinflationary Policy

According to economic literature, what is now required is a switch back to the pre-pandemic monetary-fiscal regime that featured inflation near target, Bullard said, asking "is such a switch occurring?"

The effects of the fiscal stimulus have been fading, he said, and personal saving is now below the pre-pandemic trend line. Although excess savings are diminishing, more than $400 billion of excess savings remain.

Sufficiently Restrictive Monetary Policy

In examining whether monetary policy is sufficiently restrictive, Bullard used Taylor-type monetary policy rules to obtain recommendations for the value of the policy rate given current macroeconomic conditions. He noted that a Taylor-type monetary policy rule with generous assumptions will give a minimal recommended value for the policy rate, while less generous assumptions will give an upper bound for a desirable target range for the policy rate. The recommended "zone" is the area between the two bounds, he said.

Bullard illustrated the results of his calculations in a chart, which suggested that monetary policy settings were about right before the pandemic and were behind the curve in 2022.

"Monetary policy is now at the low end of what is arguably sufficiently restrictive given current macroeconomic conditions," he said.

The Prospects for Disinflation

Discussing disinflation, Bullard said that so far, core personal consumption expenditures (PCE) inflation has declined only modestly from the peak levels observed last year.

"However, an encouraging sign that the switch to pre-pandemic fiscal-monetary policy is working comes from market-based inflation expectations," he said. "These expectations were near 2% in the first quarter of 2021, before any inflation had appeared or was widely expected. After moving higher in the last two years, these expectations have now returned to levels consistent with 2% inflation."