

ECONOMY AND MONETARY POLICY UPDATE WITH JAMES BULLARD

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Alongside my co-host, Wharton School finance Professor Jeremy Siegel, I had the opportunity to speak with St. Louis Federal Reserve Bank President James Bullard on our “Behind the Markets” podcast. Bullard is renowned for being a flexible thinker. We’ve spoken to Bullard at times when he was perhaps the most [hawkish](#) member of the [Federal Open Market Committee \(FOMC\)](#) and he wanted the committee to [raise rates](#) faster than the FOMC was doing. We would describe Bullard now as having the lowest dot for the future trajectory of policy in the infamous dot plots of future [Federal Funds Rates](#). As discussed in past conversations with Bullard, his swing to the [dovish](#) side of the spectrum happened because [inflation](#) did not manifest itself after the Fed’s extremely stimulative policies.

Checking in with Bullard on the Current Policy Regime

- **Low Rates:** He still believes we are in a low interest rate regime and that the policy rate is appropriate where it is today. Unlike many of his colleagues at the FOMC, he does not see a need for the Fed Funds Rate to march higher in order to keep unemployment at a low level and inflation under control. Bullard is surprised by how inflation has been running quite low in 2017 and how low inflation expectations are trending.
- **On Powell:** Bullard said Jerome Powell has been a great colleague since he came on as governor to the Federal Reserve System—he has been involved in operational issues, along with regulatory and [monetary policy](#) issues. He is a consensus builder and sharp businessperson with a lot of acumen. He has a depth of experience in the capital markets that Federal Reserve chairs Ben Bernanke and Janet Yellen did not possess.
- **Global Yield Pressures:** While Bullard sees the growth picture in the U.S. improving and being robust, he points out that in the global environment we still have negative interest rates in Europe and negative rates in Japan far the [yield curve](#)—you have to wonder how far U.S. rates can move up while much of the world has extremely low or even negative rates that seem like they will persist for a while.
- **Inflation Disappointing:** Bullard has been concerned that inflation is falling below the FOMC’s target, with the latest core [personal consumption expenditures \(PCE\)](#) up 1.3% year-over-year, and it has been trending down. Bullard is concerned that raising rates in December could send the wrong signal and depresses inflation expectations. Bullard is willing to move with the data, and he does see growth factors trending positively. One question is whether we will get the positive growth surprises from 2017 continuing into 2018 and 2019, although Bullard sees more of a 2% trend growth.
- **Taylor Rule Followers?:** Republicans have been proponents that the Fed should follow the Taylor rule, and Powell is a Republican—so we’ll get some commentary at his confirmation hearing about how he views this. Bullard’s preference is for the committee to incorporate a Taylor-style rule for communication of Fed policy—and specify a baseline path for the Fed policy rate and when deviating from that baseline. Bullard emphasizes how important it is to have a flexible mindset about the path for the r^* in the Taylor rule¹—or the long-term rate real rate.

- **Tax Reform a Good Idea:** Bullard thinks there is fairly widespread agreement that to be competitive in today's global environment, there is bipartisan consensus (though that doesn't mean Democrats will vote for the current package) that we need to change the corporate tax structure, which is at the core of this reform package. Bullard said due to our odd tax structure, which is out of step with global tax rates, our corporations do odd things such as keeping money in overseas economies and setting up offshore accounts with armies of lawyers and accountants. And from Bullard's economist perspective, we should not be encouraging this activity with our tax system.
- **Is There a Greenspan Put in the Market?:** We talked about whether the Fed has become a slave to the market and why the Fed seems to cut rates when the market is falling. Bullard described how both the Fed and the market are looking into the future and anticipating the economy. To the extent they are both looking at the same forces, the market is a discounting mechanism and the Fed is reacting to changes in the economy, so Bullard would not describe this as a "put" on the market to support the market, but rather both the market and Fed see the future in a similar way.
- **No Relationship between Unemployment Rate and Inflation:** Bullard commented that the transmission mechanism currently between the unemployment rate and inflation pressures is small—maybe zero—and that we are not seeing pressures from the continued drop in unemployment to nearly 50-year lows. We are already below the target for unemployment, and yet still no inflation pressures are evident. Labor force participation has been declining since 2000 and Bullard was projecting it would continue to decline, although it looks to be flattening out more recently. We may be attracting some of the marginal workers from off the sidelines, which Bullard sees as a positive.

We always enjoy the conversation with President Bullard. Listen to the full podcast [here](#).

¹Stands for the real Federal Funds Rate.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Hawkish : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.

Federal Open Market Committee (FOMC) : The branch of the Federal Reserve Board that determines the direction of monetary policy.

Rate Hike : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

Federal Funds Rate : The rate that banks that are members of the Federal Reserve system charge on overnight loans to one another. The Federal Open Market Committee sets this rate. Also referred to as the “policy rate” of the U.S. Federal Reserve.

Dovish : Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.

Inflation : Characterized by rising price levels.

Monetary policy : Actions of a central bank or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates.

Yield curve : Graphical Depiction of interest rates on government bonds, with the current yield on the vertical axis and the years to maturity on the horizontal axis.

Personal Consumption Expenditure (PCE) Price Index : measure of price changes in consumer goods and services in the U.S. economy.

“Taylor Rule” : approach to determining an appropriate level of the Federal Funds rate based on economic inputs developed by Professor John B. Taylor of Stanford University.