St. Louis Fed's Bullard Calls for the Development of Quantitative Rules for U.S. Monetary Policy That Could Be Implemented in the Current Environment

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ZURICH, Switzerland — During a speech Friday in Zurich, Switzerland, St. Louis Fed President James Bullard called for a policy rule for the Federal Reserve's asset purchase program that is consistent with price stability and sustainable economic growth.

Bullard addressed the "Financial Markets, Liquidity, and Monetary Policy" research conference that was organized by the Swiss National Bank.

Bullard's presentation, "Monetary Policy Feedback Rules at the Zero Lower Bound," is available on the Bank's web site.

"The Federal Reserve needs to avoid falling into a low nominal interest rate trap," a prolonged environment of low nominal interest rates and possible deflation, Bullard said. The Fed also "needs to be able to communicate to the private sector how it intends to react to shocks in the future."

Prior to December 2008, the Fed communicated its monetary policy via adjustments in interest rates. But with nominal interest rates currently near zero, the likely path of the Fed's monetary policy is unclear to financial markets, causing additional uncertainty.

"We have spent 20 years refining ideas about interest rate rules and optimal monetary policy," Bullard said. "We should now consider quantitative rules because we are at the zero bound, and may remain there for some time depending on how the economy performs."

Bullard noted that while the FOMC had announced its intention to buy up to $1.75 trillion in asset-backed securities by the first quarter of 2010, "there has been little indication of how or whether these amounts might be adjusted given incoming information on economic performance."

"It is also unclear whether this policy is consistent with price stability," he added. "Unclear policy creates uncertainty in financial markets."

"The key issue is how to think about the asset purchase program," Bullard said, adding that the inflationary impact of unwinding the asset purchase program hinges on the financial markets' expectations of future policy.

Bullard said that an optimal asset purchase program would:

- be contingent on the state of the economy;
- use a Taylor-type rule that could communicate how purchases would be adjusted as additional information on the economy becomes available;
- help communicate to markets how the purchase program is consistent with price stability and sustainable economic growth;
- reduce uncertainty and make the program more effective, and
- assist in pinning down the optimal size of the program.

Bullard stressed that quantitative rules, while perhaps not as “satisfactory” as interest rate rules, are certainly worthy tools for running monetary policy, especially in the current environment.

He outlined some of the models and research that have been previously conducted and their potential applications for today. In general, “these rules do not recommend the rapid expansion of the monetary base that we have seen recently,” Bullard said.

“The doubling of the monetary base could be viewed as destabilizing from the perspective of quantitative rules,” Bullard said. “The asset purchase program has made the doubling of the monetary base very persistent, as well as very large.”

In his speech, Bullard also discussed research that suggests the Great Depression and the Japanese slowdown could have been prevented had quantitative rules for monetary policy been in place during these periods.

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