St. Louis Fed's Bullard Discusses "The U.S. Economic Situation and Regulatory Reform" at Tennessee's "A Day with the Commissioner"

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NASHVILLE, Tenn. — In remarks today at the Tennessee Department of Financial Institutions' "A Day with the Commissioner," St. Louis Fed President James Bullard discussed the U.S. economic situation and provided an overview of the Tennessee economy. He also repeated his call for regulatory reform that enhances the Fed's regulatory authority and maintains its ability to remain at arm's length from politics.

The State of the U.S. Economy

"We are seeing continued signs of recovery for the U.S.," Bullard said in his presentation, "The U.S. Economic Situation and Regulatory Reform." In particular, he noted that real gross domestic product has surpassed pre-crisis levels and is expected to reach its 2008 second quarter peak before the end of this year.

"Real consumption of nondurables and services held steady during the recession and has increased," Bullard said. "While real investment had declined more than 30 percent at one point during the recession, it is now improving." He added, "We have had five positive employment reports in the past six months, which is evidence that labor market conditions are slowly improving," and noted that he expects this trend to continue going forward through the spring and summer. Bullard also said the U.S. has led G-7 economies in productivity improvements since 2007, and that "U.S. monetary policy remains extremely accommodative."

One risk to the outlook is the sovereign debt crisis in Greece, Bullard said. "The crisis in Greece has escalated and spread, leading to volatility in world markets," Bullard explained. "This is causing a flight to safety, depressing U.S. Treasury yields."

He added, "Some of this flight to safety reversed after the announcement of major initiatives by EU governments over the weekend," and although LIBOR-OIS spreads — a measure of market stress — have increased during the recent weeks, they are "nowhere near 2008-2009 peaks."

Bullard also noted that the debt burdens of U.S. states are an order of magnitude lower than typical European sovereign debt burdens.

Tennessee's Economy

Turning to Tennessee, Bullard addressed the state's economic situation.

"Like nearly all states, Tennessee's state government is facing a budget crisis in 2010, which will be more challenging than it was in 2009," Bullard said, noting that in 2009, Tennessee's total tax revenue was nearly 9 percent lower than in 2007, the year before the recession began.

Bullard noted that in percentage terms, Tennessee's job losses during the recession have been higher that the U.S. as a whole. "At the beginning of the recession, Tennessee's unemployment rate was higher than that of the U.S., and it also rose by more during the recession, reaching nearly 11 percent last summer," Bullard said. "It has since begun to drift down along with the U.S. unemployment rate."

On the foreclosure front, Bullard said, "The foreclosure wave for the U.S. peaked through 2009 and began to fall by the end of the year. At its peak, the U.S. foreclosure rate was about 3.5 times its 2005 level. Tennessee's foreclosure rate rose more steadily and less sharply and ended 2009 a bit below its high of about 1 percent."

Financial Regulatory Reform

As the debate continues in Congress over financial regulatory reform, Bullard said that under the current system, "Regulation works well for the thousands of community banks in the U.S. This system features deposit insurance plus prudential regulation, and also allows failure — capitalism at work — but prevents bank runs and the associated panic."

In addition, Bullard noted, some reform proposals would have created a "Wall Street-only" Fed.

"The Fed should remain involved with community bank regulation so that it has a view of the entire financial landscape," Bullard explained. "It is important that the Fed does not become biased toward the very large, mostly New York-based institutions."

He further explained, "Community banks tend to fund smaller businesses, an important source of job growth for the economy. Understanding the entire financial landscape helps the Fed make sound monetary policy decisions."

"The Federal Reserve's regional structure was designed to keep some power out of New York and Washington and allow for input on key policy questions from around the U.S.," he said. "Some proposals for auditing monetary policy would have diminished the independence of the Fed. Allowing short-term politics to mix too closely with monetary policy leads to poor economic outcomes. The consequences for the U.S. and the global economy would be large. No one would be served well by this outcome."