



St. Louis Fed's Bullard Discusses Monetary Policy and Commodity Prices

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LITTLE ROCK, Ark. – Federal Reserve Bank of St. Louis President James Bullard delivered remarks titled [“U.S. Monetary Policy and Commodity Prices”](#) at the Arkansas State Banking Department’s “A Day with the Bank Commissioner” event today.

Bullard said that, based on leading economic research on oil shocks, the current surge in oil prices does not seem to qualify as an important macroeconomic shock. In addition, he discussed headline and core inflation and stressed that the key policy goal with respect to prices is headline inflation rather than core. With respect to monetary policy, Bullard said that “higher inflation expectations in conjunction with a zero policy rate amount to an easing of financial conditions” and that “going on hold allows more time to assess the strength of the recovery.” Finally, Bullard briefly discussed the merits of commodity standards and inflation targeting, concluding that “inflation targeting is a better choice in the current environment.”

Commodity Prices

While there have been substantial increases in commodity prices in recent months, Bullard noted that energy prices cannot continue to increase indefinitely. “Still, some sector prices do continuously move in one direction for a long time,” he added, citing as examples prices for medical care, which have increased, and prices for computer technology, which have decreased.

Bullard then discussed oil price shocks, citing James Hamilton of the University of California at San Diego, who has argued that certain types of oil price shocks precede U.S. recessions.

Bullard said that “increases in oil prices like the ones we have recently experienced have occurred many times in the past without seeming to have much effect on the economy,” and that “it is only the really extreme ones that are reliably related to U.S. recessions.”

“This gives me some confidence that the U.S. can weather the current price shock without a significant slowdown,” he added.

Core vs. Headline Inflation

Bullard discussed headline and core inflation measures, which refer to overall price index measures and measures without the food and energy components, respectively.

He said core inflation is often smoother than headline inflation, but “the ‘core’ concept has little theoretical backing” and is “very arbitrary.”

“Headline inflation is the ultimate objective of monetary policy with respect to prices,” Bullard said, noting that these are the prices that households actually pay. “Core inflation is not an objective in itself,” he added. “The only reason to look at core is as an indicator for headline.”

However, “from 2003-2006, core inflation was consistently below headline inflation,” Bullard said. Core inflation averaged about 2 percent while headline inflation averaged about 2.9 percent for the Consumer Price Index (CPI) and about 2.6 percent for the Personal Consumption Expenditures (PCE) price index. He concluded, “Core was not a good indicator of headline during this period.” He added that “energy prices were rising and the economy was expanding” during those years.

U.S. Monetary Policy

“Since last summer, financial conditions have eased considerably,” Bullard said, noting that the policy rate has remained near zero but expected inflation has risen. “To the extent expected inflation continues to rise, financial conditions continue to ease,” he said.

“Past behavior of the FOMC indicates that the Committee sometimes puts policy on hold,” Bullard said. “This gives the Committee more time to assess economic conditions.”

He added that hold in the current environment would mean:

- the policy rate remains near zero;
- the “extended period” language remains intact; and
- the balance sheet remains at the level as of the time of the decision to go on hold.

Commodity Standards and Inflation Targeting

Although commodity standards were last discussed in the 1970s when U.S. inflation was high and variable, Bullard noted that today, inflation is quite low. He added, “Tying the currency to commodities when commodity prices are highly variable is questionable.”

While a commodity standard forced some accountability on the central bank, “it did not always work because governments sometimes changed the rate between the commodity and the currency,” Bullard said.

“Inflation targeting is another way to force more accountability to the central bank and anchor longer-term inflation expectations,” he said. “Make the central bank say what it intends to do, and hold the central bank accountable for achieving the goal.”

“In this sense, inflation targeting is the modern successor to a commodity standard,” Bullard said.

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