Bullard Discusses the Fed’s Monetary Policy Framework Review

August 14, 2019

This 13-minute podcast was released Aug. 14, 2019.

TIMELY TOPICS
Bullard Discusses the Fed’s Monetary Policy Framework Review
30 00:00:00 / 00:13:23 30

The Federal Reserve is currently undertaking a monetary policy framework review. Why is the Fed doing this review, and what does it entail? “I would say that it’s best practice among central banks to review their policymaking framework on a regular basis,” says St. Louis Fed President James Bullard. He also discusses what policymakers will do with the information gathered during the review.

Transcript

Karen Mracek: Welcome to the Timely Topics podcast series from the Federal Reserve Bank of St. Louis. I’m Karen Mracek, your host for this podcast. With me today is St. Louis Fed President James Bullard. President Bullard, thank you for being here.

James Bullard: Happy to be here.

Mracek: Today we will be talking about the monetary policy framework review that the Federal Reserve is currently undertaking. At a high level, what does this review entail?

Bullard: Well, I would say that it’s best practice among central banks to review their policymaking framework on a regular basis, let’s say five years or seven years. This was pioneered by the Bank of Canada. And I think this gives an opportunity to think about changes that might be made outside of the normal policy cycle because you don't want this to get wrapped up with current-day decision-making on monetary policy. This is more long-run thinking about monetary policy strategy.

Mracek: OK. So, to be clear, is the dual mandate or the 2% inflation target under review?

Bullard: The dual mandate would be part of the legislation in the Federal Reserve Act. So, that's not under review. The inflation target is something the [Federal Open Market] Committee adopted in 2012, and Chair [Jerome] Powell has said that we're not going to review that as part of the discussion.

Mracek: Can you tell us a little bit about why the Fed is doing this review now?

Bullard: Macroeconomic outcomes are quite good for the United States. Unemployment is near a 50-year low. Inflation is low and stable. I've argued that it's a little bit too low, but it's basically low and stable. The economy's not in recession. So, it's actually a good time to do strategic thinking for the future. You're trying to think over five or 10 years into the future here. And so, I think it's a good opportunity for that.

Mracek: OK. So, let's discuss some of the specifics of the review, starting with the monetary policy strategies. Can you tell us a little bit about the Fed's current strategy for meeting its dual mandate of price stability and maximum employment?

Bullard: I think most people would describe the current strategy as inflation targeting, which has swept the world of central banking since the 1990s. We named an official inflation target in January 2012. We conduct policy to try to maintain that rate of inflation over time, but we also adjust appropriately to meet the employment side of our mandate. And ideally, we'd be able to hit both of them at the same time.

The only problem with this framework is that it may lead to inflation being too low on average over time because, as we found out in the last 10 years, the policy rate can hit the effective lower bound. And when it does that, then you have to resort to other types of policies like quantitative easing and so on. And because of that, people are thinking about: Well, are there ways to better manage the monetary policy framework going forward?

Mracek: What are some ways that the economy has evolved since the financial crisis and Great Recession that you might have to take into consideration when looking at the monetary policy framework?

Bullard: I think the biggest issue has been this zero lower bound. We started calling it effective lower bound because some countries have negative interest rates now. But the zero lower bound means that you kind of get stuck in monetary policy. You can't move the policy rate anymore. And then you have to resort to other types of policies as I was just noting.

And the question is whether you might get stuck at an inflation rate that's lower than your inflation target. Certainly, the case in Japan where their policy rate hasn't been above 50 basis points in 20 years and their inflation rate has been low or negative over that horizon. So, how can we stay out of that kind of trap, I think, is a key issue for this review.

Mracek: What are some possible alternative strategies that the Fed is discussing during this review?

Bullard: The key alternative would be to target the price level instead of targeting the inflation rate, which sounds like a minor change. But what it would say is that you pay attention to the fact that you might miss your inflation target, let's say, to the low side for a while. And then you might make up for that by missing your inflation target to the high side for a while so that, on average, you still hit the inflation target. That's often called price-level targeting as opposed to inflation targeting, which has a subtle difference. In inflation targeting, if you were below target, you would just try to go back to the target. You wouldn't try to go above the target.

So, the good thing about price-level targeting type strategies is that you hit the inflation rate better on average during the long run. And this better cements inflation expectations, and so you get better policy out of that. I would also say that price-level targeting is closely related to nominal GDP targeting, which is another version of the same idea basically.

Mracek: Turning to the review of monetary policy tools, are the tools that the Fed currently uses adequate for setting the stance of monetary policy?

Bullard: Well, that's part of this discussion. Normal times would call for adjustments to the policy rate up or down in various situations depending on how the economy's evolving. And that's how you would conduct monetary policy. Certainly all during the [former Fed Chairman Alan] Greenspan era, for instance, that's exactly what we did. A lot of theory and empirics grew up around analyzing just that particular channel.

But when you hit the zero lower bound or the effective lower bound, then a whole new set of tools comes on board. Probably the most famous one is quantitative easing or bond-buying programs by central banks. The Fed did a lot of that during the period when we were at the effective lower bound.

But there are other policies. Forward guidance is another one. And I think a good question for this review is how effective forward guidance is when you're not at the zero lower bound. When you're away from the zero lower bound, should you be giving guidance on where you think the policy rate is going to go in the future?

And then there are other types of policies that probably aren't getting as much analysis. But one is negative interest rate policies. Those are being used in Europe and in Japan. They haven't been as popular in the U.S., but that's something else that certainly could be looked at. There are probably a host of others that we could talk about, but those are probably the main ones.

Mracek: And the review also looks at ways in which the Fed communicates monetary policy. So, to start with, what do you think is going well?

Bullard: The U.S. has begun to meet an international standard by having press conferences after every meeting. I think markets always want to know what the Federal Reserve is thinking, what the Committee is thinking. Even if nothing is happening, they want to know, "OK, nothing is happening." So, we've begun to do that this year, and I think it does provide better communication on the whole. So, I think it's working well.

Mracek: And are there further improvements in communication that you'd like to see?

Bullard: The Committee has a Summary of Economic Projections, [with] the so-called dot plot, which is put out once a quarter. I don't think our communication there is as good as foreign central banks have. The Bank of England [and] the ECB [European Central Bank] put out more comprehensive descriptions of their forecasts—usually their staff forecasts—and then the policymakers themselves can comment on the staff forecast, which I think is maybe one way that we could change the system that we use. So, I think there are some improvements that could be made.

Mracek: And this monetary policy framework review includes *Fed Listens* events throughout the Federal Reserve System. What is the purpose of holding these events? And can you describe for us the setup for the upcoming meeting here in St. Louis in September and what you hope to learn from that meeting?

Bullard: Well, we wanted the framework review to get input from a wide variety of sources, and we're certainly doing that. We'll basically talk to anybody who is interested in this, but, in particular, constituents in the various parts of the country. And we're doing that in the Eighth District.

And what we're going to do for our *Fed Listens* event is bring all our councils together on a single day into St. Louis and get the whole shebang at one time. That's a special event. But it just reflects part of what we do all the time here at the St. Louis Fed, which is try to stay in close touch with economic actors on the ground and see what's happening in their lives and their businesses on a day-to-day basis in order to allow that to be an input into monetary policy.

Mracek: And what will policymakers at the Fed do with the information gathered during this whole review?

Bullard: Well, I think the code word here is evolution, not revolution. I don't think we want to give the impression that we're going to overturn the current Fed operating framework or strategic framework overnight. I don't think that's realistic or desirable. But I do think that many of these ideas will feed into future monetary policy as we go forward and creep in in various ways. Some of them might be more visible than others, but I would not expect a manifesto to come out that radically reorients Fed policy.

There is one focal point, which is the January statement of long-run monetary policy strategy and goals. We could make changes to that statement, but it is a relatively terse statement. It has only a few paragraphs. And the most we could do is make some changes to a few parts of those paragraphs. So, I don't think the person on the street would take that as too significant. But that's the nature of evolution, not revolution. I think we could tweak that a little bit, and that might be a visible outcome of this process.

Another outcome could just be that we're happy with our inflation-targeting process and we think it's a good strategy going forward. Some of the Bank of Canada reviews that they've done over the years have come exactly more or less to that conclusion, where they reviewed everything but then they reaffirmed the previous strategy. And I think that's a perfectly fine outcome as well.

This is not necessarily meant to suggest that there are big changes afoot. But it is meant to be thoroughgoing, get lots of input, think about these issues deeply on a calendar basis, something like five years or seven years. Because otherwise you might go 50 years and you never changed your framework, and it gets badly out of date and it really doesn't work very well. But because you've never thought about the strategy, you've never changed it. And if you are going to change it, you would have to change it in small ways in order to make progress.

Mracek: So, you mentioned the Bank of Canada and their review. Do you think that the Fed will start reviewing its monetary policy framework on a regular frequency?

Bullard: Well, that would be the hope. We're not done with this one yet, so we'll see how successful this is. But we're certainly learning as we go along. I would be hopeful that we would get five or seven years down the line and then we would say, "OK, let's go through this again and see if anything's changed or if we want to change our approach."

Mracek: And is there anything else you want our listeners to know about the Fed's monetary policy framework review?

Bullard: Well, I just think this is such a good kind of corporate practice. So, I do think it's a good thing that we're doing. When you think about the crisis 10 years ago, we had to do a lot of improvisation, on-the-run changes in monetary policy, new tools being introduced. That causes a lot of volatility. People aren't really sure how this is going to work. Policymakers themselves aren't really sure how it's going to work. So, I think it's very useful to try to do as much as you can in good times so that when bad times come again, you've at least got some basis to go ahead and make decisions.

Mracek: All right. President Bullard, thank you for joining us today and sharing your views on the monetary policy framework review.

For more of his remarks, you can go to our website, stlouisfed.org, and select "From the President" from the main menu. To hear more podcasts from the St. Louis Fed's Timely Topics audio channel, visit stlouisfed.org/timely-topics.

Related Topics

Federal Reserve

Monetary Policy

Inflation