St. Louis Fed's Bullard Discusses "A Soft Landing in 2020?"

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MADISON, Wis. – Federal Reserve Bank of St. Louis President James Bullard presented "A Soft Landing in 2020?" to the Wisconsin Bankers Association on Thursday.

Bullard discussed how U.S. economic growth slowed on a year-over-year basis in 2019. "The Federal Open Market Committee (FOMC) took action to help ensure a soft landing by dramatically altering the path of monetary policy during 2019," he said. "The current baseline economic outlook for 2020 suggests a reasonable chance that the soft landing will be achieved."

Bullard noted the slowdown in 2019 was widely expected because the economy tends to return to its potential growth rate, which is sometimes referred to as a soft landing. He added that the key risk in 2019 was that this slowing would be sharper than anticipated, i.e., a hard landing.

U.S. Monetary Policy Changes in 2019

The FOMC was cognizant of the slowing economy during 2019 and began to project fewer increases in the policy rate during the first half of 2019, Bullard noted. In June, the FOMC indicated that a lower policy rate might be warranted, he added. The FOMC then made policy rate cuts at three successive meetings, ending 2019 with a net reduction of 75 basis points.

Bullard said that the size of this turnaround in U.S. monetary policy has been much larger than those rate reductions alone would suggest, given the fact that the expectation as of late 2018 was that the FOMC would actually raise rates further, not lower rates, in 2019.

He pointed out that, because of FOMC actions, the two-year Treasury yield dropped by 144 basis points during the last 14 months, which he noted is a very large change over this time frame. He added that these policy actions influenced longer-term U.S. yields, which are more important for investment decisions.

"The bottom line is that U.S. monetary policy is considerably more accommodative today than it was as of late 2018," he said.

Insurance against Downside Risks to Growth

"The FOMC's adjustment toward lower rates in 2019 may help facilitate somewhat faster growth in 2020 than what might have otherwise occurred," Bullard said. "One could view this as insurance against the possibility that nonmonetary factors could have larger-than-expected negative effects on growth."

He then addressed three such factors:

Global Trade Policy Uncertainty

Even though recent developments suggest that near-term uncertainty on global trade policy has abated somewhat, Bullard said he expects continuing uncertainty to characterize global trade policy over the medium term. At the same time, he noted that he expects that firms in the U.S. and abroad will continue to adjust their business strategies to remain profitable even in an environment with trade policy uncertainty that is much higher than the postwar norm.

"Business strategy adjustment will make trade policy uncertainty less of an issue in 2020 than it was during 2019," he said.

Financial Markets

Market observers have noted the outsize advances in equity market valuations during 2019, often citing gains of approximately 30% for the year, Bullard pointed out. "However, those gains are measured from the depths of a selloff in the latter portion of 2018, as it became clear that the economy would slow," he said.

In fact, he noted, the level of the S&P 500 index was essentially unchanged between early October 2018 and early October 2019. He added that the value of the U.S. corporate sector as measured by the S&P 500 index has been increasing at an annual pace of approximately 9.5% over the past two years.

Renewed Geopolitical Risk

Turning to renewed tensions in the Middle East in recent days, Bullard noted that one important macroeconomic impact could come to the U.S. economy through oil price movements.

However, Bullard said that oil price shocks probably do not mean what they once may have for the U.S. economy due to lower oil intensity (in terms of petroleum products supplied per real dollar of GDP) compared with levels in previous decades, and due to higher U.S. oil production.

“Geopolitical risk is elevated, but oil shocks may be neutral on net for the U.S., not negative on net as in much of the postwar era,” he said.

Conclusion

“The FOMC has a reasonable chance of achieving a soft landing for the U.S. economy in 2020 following a large adjustment to monetary policy during 2019,” Bullard concluded.

Regarding downside risks, he said, “Global trade policy uncertainty is likely to remain high over the medium term, but firms are now adjusting business strategies to remain profitable in the face of this uncertainty.” He also noted, “Intensification of geopolitical risk may mean higher oil prices, but the ultimate impact of that on the U.S. economy may be approximately neutral given lower oil intensity and higher production in the U.S. than historical levels.”