FINANCIAL TIMES

March 11, 2015 9:10 am

# Fed rate rise is overdue, warns Bullard

Sam Fleming in St Louis


The end of the Federal Reserve's near-zero interest rate policy is overdue given the rapid pace of improvement in the jobs market, a senior policy maker has said.

James Bullard, head of the Reserve Bank of St Louis, said that the Fed risked holding fire too long on rate hikes given the tumbling unemployment rate and that even after the central bank starts tightening, monetary policy will remain easy by normal standards.

US employers added 295,000 jobs in February, figures released on Friday showed, in defiance of bad weather, and the unemployment rate fell to 5.5 per cent, the lowest level since 2008, triggering a spike in bond yields and the dollar. By autumn the rate of unemployment should be below 5 per cent — near levels it had last seen in the "bubble years" of the 1990s and 2000s — Mr Bullard said.

"We are a little bit too late in this process," Mr Bullard said in an interview, arguing that the jobless rate had already fallen in line with Fed estimates of its long-run rate and that, netting out oil price effects, inflation was not that far below target. "Those kinds of readings on the economy are not sufficient to rationalise the zero policy rate."

Mr Bullard, who does not vote on rates this year, has recently been at the aggressive end of the spectrum among Fed policy makers when advocating tighter monetary policy. He spoke on Monday before the Federal Open Market Committee goes into its customary blackout ahead of a policy meeting next week at which it is expected to drop a previous pledge to be "patient" before lifting interest rates.

Even if the Fed raises rates as soon as June, Mr Bullard said, it was more or less guaranteeing what would traditionally be called "very easy monetary policy" over the next two years because hikes would be gradual and data-dependent.

This came at a time of a "rapidly improving situation" in the economy. "I think we have to move now or soon, in order to be in the right position as the economy continues to evolve," he said.

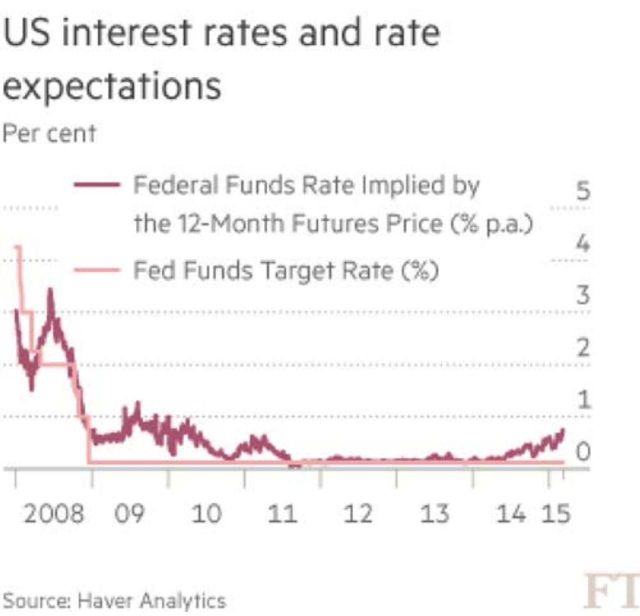
Some observers have been urging the Fed to hold fire on rates because of the soaring dollar, which is likely to squeeze US exports.

However, Mr Bullard argued that it was "not so clear going forward that we will see big moves in the dollar the way we have", because the European Central Bank has now embarked on its quantitative easing plans and traders are more realistic about the US interest rate outlook. "A lot has been priced in at this point" in currency markets, he said.

Large companies had options including using currency hedges to dampen the revenue repercussions from currency movements, he added.

"This has been quite a big move in the dollar so I can understand some of the consternation," he said. However, "the bottom line is we have a flexible exchange rate system. We are trying to run the best monetary policy for the United States that we can. We are going to let the exchange rate go where it needs to go to equilibrate international markets."

Analysts are also arguing the Fed should hold fire on rates until there is a stronger rise in wages, but Mr Bullard dismissed that argument. Wages were a lagging indicator, not a leading indicator of inflation outcomes, he argued, adding that current earnings growth should not be compared with the performance of the 1990s, when there was much higher productivity growth. "With this kind of improvement in labour markets surely wage growth is not that far behind," he added.




Inflation is likely to be low going into the FOMC's June meeting, which some economists say will make for an awkward backdrop for a rate rise. However, Mr Bullard discounted that concern.

Recent upward movements in market-based inflation expectations were encouraging, he said, adding: "It is a story about the outlook for inflation, not the actual level of inflation, at the time of the June meeting. If inflation expectations are at reasonable levels and we can make a case that inflation is likely to return to target that will be a reasonable basis for a rate increase."

Mr Bullard said the US had entered a period where the data were "a little softer" early this year, but that this was likely due to the temporary impact of bad weather on the northeast of the country. "To the extent we have had weakness in the first quarter it will probably bounce back in the second quarter, as it did last year," he said.

Mr Bullard said he worried that investors are understating the likely upward path of interest rates compared with the Fed policy makers' own forecasts. The sharp move in bond yields following the jobs report on Friday showed how "abrupt this kind of thing can be", he warned. "It would be an improvement if the Fed and the markets were more or less on the same page about how this is going to evolve going forward. We are not there today."

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