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- **June 30, 2009.** Speech. ["Exit Strategies for the Federal Reserve." \(philadelphiagic28june2009final653pmpdf\)](#) delivered at the Federal Reserve Bank of Philadelphia, organized by the [Global Interdependence Center](#).
Jim Bullard speaks on exit strategies for the Federal Reserve: [Video](#) | [Transcript \(20090630-exit-strategies-transcriptpdf\)](#) | [Press Release](#) | [Related news articles](#).

President Bullard on Exit Strategies for the Fed

June 30, 2009

St. Louis Fed President James Bullard explores exit strategies for the Fed from extraordinary lending programs since the financial crisis began. He covers why the Fed is thinking about an exit strategy while monetary policy is accommodating, the success and unwinding of the liquidity programs, and whether the asset purchase program will lead to inflation.

St. Louis Fed's Bullard Addresses the Need for Developing Exit Strategies

PHILADELPHIA — While the Fed's current monetary policy is very accommodative and will remain so in the foreseeable future, a plan for unwinding the Fed's liquidity and asset purchase programs needs to be developed to avoid high inflation expectations and rising long-term interest rates, said St. Louis Fed President James Bullard on Tuesday.

The Fed's short-term goal has been to avoid a deflationary trap in 2009, such as the one experienced in Japan during the past decade. To combat this threat, the Fed has dramatically increased the monetary base. While this policy may be appropriate in the near term, large monetary base increases

paired with large fiscal deficits may pose inflation threats in the medium term.

"Without an exit strategy, expectations of high inflation may develop," said Bullard in a speech at a Global Interdependence Center event held at the Federal Reserve Bank of Philadelphia. "If expectations of inflation feed into today's long-term yields, those yields will rise today and hamper recovery prospects."

Read [Bullard's presentation](<https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/philadelphiagic28june2009final653pm.pdf>) in more detail.

The implementation of a successful exit strategy will keep inflation in check while at the same time avoiding major disruptions to financial markets.

Bullard said three separate issues need to be taken into account while planning the exit:

- the fading need for liquidity facilities,
- the ongoing asset purchase program, and
- an exit from zero short-term nominal interest rates.

The fading need for the emergency liquidity facilities

The liquidity facilities created in 2007 and 2008 were intended to improve market functioning during the crisis, and while some stress remains, "by many metrics, financial markets are less strained than they have been," Bullard said. "Many of the programs are being used less intensively than in the recent past."

"As market functioning improves, these programs are not as necessary," he said, "Liquidity programs also cause the monetary base to rise rapidly, but are easier to unwind." Bullard said that these liquidity programs can "wind down naturally." He sees keeping them in place until next year, in case financial turmoil returns. While this liquidity program run-off will draw down some of the monetary base, it will not be enough.

The ongoing asset purchase program

The Fed has also made large purchases of longer-term securities in response to the crisis, including commitments to buy up to \$300 billion in longer-maturity U.S. Treasuries, up to \$200 billion in agency debt and up to \$1.25 trillion in agency mortgage-backed securities.

This means the monetary base will still be more than twice what it was in September 2008, even as the liquidity facilities unwind.

"The monetary base is expanding rapidly. This is unprecedented in U.S. postwar monetary policy," said Bullard. "This is one way to move inflation higher in an environment where inflation is 'too low' and short-term nominal interest rates are near zero."

He added, "In teaching money and banking, we say, 'permanently doubling the money supply eventually doubles the price level.'" While this may take some time, "probably 'more later than sooner,' this gives a rough idea of the type of threat we face."

To cope with this medium-term inflation threat, some alternatives to creating reserves and increasing the monetary base may be:

- Selling assets from the Fed's SOMA (System Open Market Account) portfolio to finance purchases; using the Treasury's supplementary financing account and instituting the issuance of "Fed bills."
- Tools for managing reserves, including paying interest on reserves and conducting reverse repos.
- Management of the assets, including allowing the assets to mature and selling assets if inflation becomes a more pressing problem.

Going forward, Bullard said he would like a policy feedback rule put in place for handling asset purchases.

"I would like to see a policy feedback rule that could describe, in rough terms, what level of asset purchases is appropriate in the current environment," he stated. "While we are not there yet, I want to encourage staff to work in this direction. Without this, we have been forced to make judgment calls."

An exit from zero short-term nominal interest rates

Bullard said it is crucial for the markets to understand that the FOMC, by continuing to state it will keep the fed funds target rate range low for an extended period, means that "should economic performance improve and inflation begin to rise ... the promise is to maintain zero rates longer than might be indicated by simple rules of thumb. It also means that most of the action on monetary policy will be with the asset purchase program in the near term."

With branches in Little Rock, Louisville and Memphis, the Federal Reserve Bank of St. Louis serves the Eighth Federal Reserve District, which includes all of Arkansas, eastern Missouri, southern Indiana, southern Illinois, western Kentucky, western Tennessee and northern Mississippi. The St. Louis Fed is one of 12 regional Reserve banks that, along with the Board of Governors in Washington, D.C., comprise the Federal Reserve System. As the nation's central bank, the Federal Reserve System formulates U.S. monetary policy, regulates state-chartered member banks and bank holding companies, provides payment services to financial institutions and the U.S. government, and promotes community development and financial education.

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- **June 19, 2009.** Speech. ["Regulatory Reform After the Fall of Wall Street." \(frrc18june2009washingtondc957apdf\)](#) delivered at the Financial Regulation Reform Collaborative Conference, Washington D.C.
 - **May 12, 2009.** Speech. ["Financial Market Turmoil and Recession: What's Next." \(bullard_indiana_university_may12pdf\)](#) organized by the College of Arts and Sciences, Indiana University Bloomington. Remarks by Eric Leeper: ["The Fiscal Policy Response." \(stlouis_leeperpdf\)](#)