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CENTRAL BANKING

Recession Fears Have Been 'Blown Out of the Water,' Long-Serving Fed President Says

Former St. Louis Fed chief James Bullard warns that stronger growth will require even higher rates

By Nick Timiraos Follow

Aug. 23, 2023 5:30 am ET

James Bullard, now dean of Purdue University's business school, says he thinks the Fed's policy has been successful. PHOTO: FREDRIK SOLSTAD/BLOOMBERG NEWS

James Bullard, who was the longest tenured of the 12 regional Federal Reserve Bank presidents when he stepped down last month, thinks the U.S. economy faces new risks of stronger growth that could require higher interest rates to keep up the fight against inflation in the months ahead.

Bullard took over as the dean of Purdue University's Daniels School of Business this month. In an interview Monday, ahead of the Kansas City Fed's annual economic symposium in Jackson Hole, Wyo., he said central bankers ought to be pleased with the economy so far this year.

Fed officials raised interest rates last month by a quarter percentage point to a 22-year high. Bullard said he thought they would need to lift them again this fall. The Fed might have to raise rates even more if the recent economic acceleration continues in the coming months, he said. "I don't think markets are really ready for that."

Here's what he had to say (with this partial transcript lightly edited for clarity):

WSJ: How do you see the U.S. economic outlook right now?

Bullard: I think it's turning out that the Fed's policy has been very successful, and I think that will be the buzz at Jackson Hole. I don't know what will be in the speeches, but the talk will be that this has been quite successful. If you look at [the consumer-price index], headline CPI inflation was 9%; it's now just a little over 3% and on a declining trend. The core inflation measures [which exclude volatile food and energy prices], which were hanging up for a while, have turned down.

This is all looking very good because this is occurring in an environment with 3.5% unemployment. Those that said it couldn't be done are having troubles here.

There were a lot of heavy predictions of recession. I think those were just overblown. There was risk of recession, but it wasn't as high as it was made out to be on Wall Street. And then I think the [Silicon Valley Bank] situation, a lot of people felt like, "Aha, this is the moment!"

Because of the SVB situation, rates actually went down in the spring. And there's been an unwitting easing of financial conditions, which is feeding into a stronger second half for the U.S. economy. And now everyone's scrambling to reprice based on that stronger economy.

WSJ: To what extent would the Fed need to worry about stronger growth, even in the context of continued declines in inflation from things like shelter and cars?

Bullard: The faster growth is a bit of a threat because the forecast was that you'd have very weak growth or even a recession, and now that doesn't really look like it is materializing. So you'd have to upgrade your outlook for inflation probably based on that alone. You still have a very tight labor market, and now you have a reacceleration in the U.S. economy. The risks are tilting a little bit more toward the idea that inflation won't fall as fast as anticipated.

WSJ: Do you think we'll return to the prepandemic environment of low interest rates and low inflation?

Bullard: I'm skeptical that we're returning to that. You've got inflation above [the Fed's 2%] target, and it's probably going to be relatively sticky above target. Roughly speaking, the policy rate would have to be higher than the inflation rate during that whole period when inflation is above target. That sounds like a higher interest-rate regime than the one that has existed since 2008.

WSJ: How much of the recent decline in inflation can be attributed to Fed policy versus simply good luck on energy and supply chains?

Bullard: I think the Fed should get a lot of credit. Yes, there are shocks out there in the world, but the question is how do you react to those shocks? And in the '70s, you had similar shocks and the Fed didn't react enough or fast enough. They stopped up short, and you got a decade of high and variable inflation. This time we reacted more appropriately and more effectively, and now we're getting the fruits of that by getting inflation down. So far, so good.

WSJ: In June, most of your former colleagues thought the Fed would have to raise rates one more time this year. What would be the right test for pausing rate increases?

Bullard: The [Fed's rate-setting] committee will have to re-evaluate its forecast in September for the summary of economic projections. And those projections in June still had a big element of a recessionary scenario—which at least, as of today, looks like it's blown out of the water.

That suggests that the committee would keep its rate increase in there for sometime this fall. It seems like you'd probably follow through on the rate increase that was penciled in in June.

The bigger question for markets, though, is whether the economy really does accelerate quite a bit in the second half of 2023 and the committee feels compelled to, let's say, go above 6% on the policy rate—possibly because some of the inflation readings turn around and blip up or maybe have a little bit of a sustained increase.

I don't think markets are really ready for that. But that's an increasing risk now.

Write to Nick Timiraos at Nick.Timiraos@wsj.com

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