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Brief Remarks on the Economic Outlook and Monetary Policy

by

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Thank you to Brookings for the invitation to speak to you this evening. Before we sit down, I thought I might offer some context for our conversation by outlining my views on the outlook for the U.S. economy and the implications for monetary policy.¹ I will also touch briefly on regulatory matters.

As you know, the Federal Open Market Committee (FOMC) met last week and chose to maintain the current setting of monetary policy—a decision I supported. The U.S. economy has thus far remained resilient, despite having experienced a series of shocks over the past year. But these shocks have complicated the Committee’s efforts to return inflation to our 2 percent goal while also supporting maximum employment.

The backdrop for these developments has been an economy that has continued to grow at a solid pace, supported by resilient consumer spending, substantial productivity growth over the past several years, and exceptionally strong business investment in artificial intelligence (AI) and data centers. Higher productivity growth in the wake of the COVID-19 pandemic has likely been driven by technological enhancements and business process improvements that economize on labor as well as by strong new business formation, which both directly and through competition enhances productivity. In my view, investments in AI are likely in the future to contribute to strong productivity growth as these technologies are integrated into business processes and become more widespread. While in the long run AI is likely to contribute to a stronger economy, this may occur following some significant labor market disruptions.²

¹ The views expressed here are my own and are not necessarily those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

² See Michael S. Barr (2026), “What Will Artificial Intelligence Mean for the Labor Market and the Economy?” speech delivered at the New York Association for Business Economics, New York, New York, February 17, <https://www.federalreserve.gov/newsevents/speech/barr20260217a.htm>; Michael S. Barr (2025), “AI and Central Banking,” speech delivered at the Singapore Fintech Festival, Singapore, November 11, <https://www.federalreserve.gov/newsevents/speech/barr20251111a.htm>; Michael S. Barr

Let me turn now to the shocks to the U.S. economy that I mentioned. The latest of these developments has been the current conflict in the Middle East, which has affected both oil production and transportation in much of the region, driving up energy prices and affecting other commodities as well. If the conflict were to end soon, it is possible its effects on inflation and economic activity could be limited. But if it continues for some time, the spike in energy prices and other commodities could have broader implications for both prices and economic activity. We have had five years now of inflation at elevated levels, and near-term inflation expectations have risen again, so I am particularly concerned that yet another price shock could increase longer-term inflation expectations. Consumers and businesses factor future inflation into their current economic decisions, so there is a risk that this dynamic could lead to inflation persistence, making it more difficult to return inflation to 2 percent. We need to be especially vigilant. Uncertainty about how these developments will unfold is just one of the reasons why I thought it necessary to hold policy steady at least week's FOMC meeting.

A key factor we have been contending with over the past 12 months is the impact of tariffs on inflation. Tariffs have driven up goods prices. Elevated goods inflation has contributed significantly to a stalling in the disinflationary process. While the effective tariff rate had been fluctuating at a high but variable level for around a year now, the recent Supreme Court ruling has led to a reduced rate of around 10 percent—a still-high level. And additional measures could move tariffs higher again. These fluctuations add to uncertainty about the ultimate effects of tariffs on inflation. A reasonable base case is

(2025), “Artificial Intelligence and the Labor Market: A Scenario-Based Approach,” speech delivered at the Reykjavik Economic Conference 2025, Central Bank of Iceland, Reykjavik, Iceland, May 9, <https://www.federalreserve.gov/newsevents/speech/barr20250509a.htm>.

that tariff effects on inflation will wane later this year, but there is some risk that tariff effects will take longer to dissipate.

A third force affecting the economy has been the significant slowdown in the growth of the labor force, mostly caused by a sharp reduction in net immigration and some reduction in labor force participation. Labor force growth is close to zero. Job creation has also been close to zero for the past year, a highly unusual experience outside of a recession. We are in a “low hire, low fire” environment. So far, the low levels of job creation and the lack of labor force growth have been roughly balanced, which can be seen by the unemployment rate remaining fairly low and steady since last fall. Yet low levels of hiring likely leave the labor market vulnerable to shocks, so continued vigilance on labor market conditions remains warranted.

At the same time, a key concern right now is the trajectory for inflation. Separate from the effects of tariffs on goods inflation, nonhousing services inflation has also remained elevated. Core inflation, which excludes volatile food and energy prices and is a good guide to future inflation, likely was 3 percent in February, about where it was a year ago. The longer inflation remains above 2 percent, the greater the risk that it becomes entrenched in expectations, making it harder to achieve the FOMC’s goal.

Given the considerable uncertainty about the potential effects of developments in the Middle East on our economy, as well as the other factors I mentioned, it makes sense to take some time to assess conditions. Our current policy stance puts us in a good place to hold steady while we evaluate incoming data, the evolving forecast, and the balance of risks.

Lastly, let me say a brief word about regulation. As you may know, I have dissented from a number of actions the Federal Reserve Board has taken over the past year that, in my judgment, weaken individual firm's safety and soundness and increase risks to financial stability.³ The combined effects of stress testing changes, downward deviations from the Basel III standard, reductions to the surcharge for global systemically important banks, and reductions to the enhanced supplementary leverage ratio will leave the banking system with less resiliency. There has been discussion about weakening liquidity regulation next. Supervisory staff at the Board are being cut by over 30 percent, and other changes have weakened prudential supervisory practices. The safety and soundness of the banking system is built on trust, and I fear we are eroding that trust.

Thank you.

³ See Michael S. Barr (2025), "Statement on Stress Test Proposal by Governor Michael S. Barr," press release, April 17, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20250417.htm>; Michael S. Barr (2025), "Statement on Large Financial Institution Rating Framework by Governor Michael S. Barr," press release, November 5, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20251105.htm>; Michael S. Barr (2025), "Statement on Enhanced Supplementary Leverage Ratio Final Rule by Governor Michael S. Barr," press release, November 25, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20251125b.htm>; Michael S. Barr (2026), "Statement on Bank Capital Proposals by Governor Michael S. Barr," press release, March 19, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20260319.htm>.