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Economic Conditions and Monetary Policy

Remarks by

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Thank you for the opportunity to speak to you today.¹ It's wonderful to be back in Michigan and in this great city. For more than a century, Detroit has been at the center of the U.S. economy, driving America's growth and prosperity, while also reflecting the profound forces that have transformed our economy in recent decades. Detroit is a good place to discuss the outlook for the U.S. economy and monetary policy because I believe it continues to be an important part of that story.

Detroit's Economy

As a longtime Michigander who has worked to promote entrepreneurship and community development in Detroit, I've seen firsthand the spirit that has driven its rebirth and growth. I've seen it in the economic growth in the Live6 community where I will visit later today. I've seen it among new entrepreneurs at Newlab and the Mezz at Michigan Central and in the economic revitalization of the surrounding Corktown neighborhood. I've seen it in the faces of hundreds of entrepreneurs who have worked with students and faculty in the Detroit Neighborhood Entrepreneurs Project. And I know each of you has seen it all across the city of Detroit in the work you do here every day.

Detroit, as you know well, still faces significant challenges. For example, unemployment in the Detroit area is estimated to be around 11 percent, much higher than Michigan's rate of 5 percent and the U.S. rate of 4.1 percent. But the entrepreneurship I have mentioned is an engine for job creation. As it did in other places around the country, new business formation in Detroit rose after the pandemic, to an average of

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.

about 6,000 firms each year, adding 30,000 jobs a year to the city's economy. In Detroit, the share of all businesses that are new has outpaced the share in Michigan overall.

The automobile industry, of course, remains critical for Detroit and for Michigan. Twelve percent of U.S. auto assembly and auto parts jobs are in the Detroit metro area. National sales have grown strongly recently, hitting an annualized rate of 16.8 million in August, a solid pace. Automakers are investing in battery technology and in electric vehicle design and production, which is creating engineering and other high-tech jobs in this region.

National Economy

A big economic issue for Michigan and for the United States is the technological revolution under way in artificial intelligence (AI). The Federal Reserve—and, indeed, the country—is grappling with what AI will mean for U.S. businesses and workers. I would like to dig into that question with you, after an update on the state of the U.S. economy and the outlook for what lies ahead. I will conclude with a discussion of the role of monetary policy in helping to shape that outcome.

Economic activity in the United States has grown at a solid pace in 2026 and has recently gained momentum. Real gross domestic product grew at roughly a 2 percent rate in the first half of the year, and I expect it will pick up a bit in the second.

This growth shows remarkable resilience given the series of significant shocks we have faced. The COVID-19 pandemic caused massive disruptions to the economy, and fiscal and monetary policy stepped in to support economic growth. Then came Russia's war on Ukraine, which disrupted energy and commodity markets. Then came the price increases and disruptions to trade from sharply higher import tariffs as well as continuing

uncertainty about tariff levels. Most recently, there is the conflict in the Middle East and its effect on energy prices. On top of that, we have seen a surge in investment to support the AI buildout, which has particularly boosted demand for certain high-tech goods. All of these factors have had the effect of raising the prices that consumers and businesses face, which has been a key concern for me as a monetary policymaker.

Inflation

Inflation, which has been a problem for consumers and businesses, has run above the Federal Open Market Committee's (FOMC) 2 percent target for five and a half years. Inflation as measured by the personal consumption expenditures (PCE) price index surged in the wake of the pandemic and with the escalation of the war in Ukraine, peaking at a 12-month rate of 7 percent in 2022. Significant monetary policy tightening by the FOMC, along with an easing of supply constraints, helped lower inflation, and by early 2025 it was running close to our objective. Tariff increases in April of that year pushed up goods prices, but at the time it was reasonable to forecast that tariffs would be a one-time increase in prices. Then the Middle East conflict drove energy prices and inflation higher still.

While the effects of tariffs may have diminished, high energy prices are still with us, and there is considerable uncertainty about when the conflict driving them may be resolved. At the same time, it is apparent that the surge of investment, and related demand from the AI buildout, is having a measurable effect on prices. The combined effect has meant we have been knocked off course on our progress toward our 2 percent goal.

Digging into inflation data, although the monthly prints have been highly volatile during this inflationary period, one can discern trends over longer time periods. I count only two months of data consistent with 2 percent core PCE inflation over the past 20 months. And I don't yet see a clear trend toward a timely return to 2 percent.

Labor Market

While inflation is significantly above the FOMC's goal, strong business investment and resilient spending by consumers is supporting a solid labor market. A year ago, when job growth slowed and the unemployment rate rose, there were questions about whether the labor market would hold up to the effects of the shocks we experienced. Since then, the unemployment rate has improved, and it now appears that supply and demand in the labor market are in rough balance. On the labor supply side, lower net immigration has reduced the number of new jobs needed to keep pace with growth in the labor force. Job creation has averaged around 80,000 a month this year, close to reasonable estimates of its breakeven pace, and the unemployment rate of 4.1 percent is close to many estimates of maximum sustainable employment.

AI and the Implications for Labor Productivity

A key question for monetary policy, both in the near term and for years to come, will be the effect of AI on the productive capacity of the economy and the structure of the labor market. While there are some indications that AI may already be a factor limiting new job opportunities for entry-level workers in sectors heavily exposed to AI, across the economy there is little evidence of significant displacement so far, and there are notable examples of how AI is increasing the productivity of many workers. Past technological revolutions have tended to create more, usually higher-skilled, jobs than the ones they

displaced, but AI may be more revolutionary, and its effects could be different. That's why I find it helpful to consider different scenarios to explore the implications of AI and potential effects over different time horizons. Before I discuss the implications of the economic outlook I have just described for monetary policy, let me lay out those scenarios for AI.

Short-term effects of AI investment on the economy

Starting with the near term, in the next year or so, the most important effects of the AI buildout on the U.S. economy are likely to be a strong boost to economic activity from business fixed investment and a surge in prices for computer chips and related equipment. Those price increases are spreading to other products that require chips and related goods and services. Supply constraints, especially for chips, are emerging. It is also likely that the big boost that valuations of technology firms are giving to major stock price indexes is in turn supporting spending by those made wealthier by these gains.

Longer-term effects of AI investment on the economy

Turning to the longer-term effects of AI on productivity, as I have discussed in a number of previous speeches, I am optimistic about the potential of AI to enhance human potential, including significantly improving productivity and raising living standards.² This would mean the economy can grow faster, and real income can grow more, without feeding into higher inflation.

² See, for example, Michael S. Barr, "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, 2026, <https://www.federalreserve.gov/newsevents/speech/barr20260217a.htm>.

Medium-term effects of AI on the economy

I have mentioned the potential short- and longer-term outcomes for AI. Where I see the greatest uncertainty that might be relevant to monetary policy decisionmaking—not today, but down the road—is how AI will affect the economy in the medium term, by which I mean the next two to five years.

Penciling in a projection for a productivity boost from AI in the medium term makes a lot of sense to me given the massive investment and indications of adoption we are increasingly seeing. But it is difficult to project how and when those productivity gains would take hold.

The “J curve effect” refers to the delay we have historically seen in the productivity boost of technology investment. When a new technology is adopted, productivity may dip as firms devote resources not only to installing the technology, but also to reorganizing their business processes—a transformation that is necessary for the productivity improvements to be realized. While, historically, the adoption of new technologies has taken years to onboard and transform the way people work, the pace of AI adoption so far indicates that this technology could spread more quickly and have a faster effect, boosting output, at least in some sectors. Some firms, especially those in computer coding and high tech, are seeing rapid productivity gains, but for the economy as a whole, broad productivity gains may take some time.

A second key question is whether investors will see returns on the AI buildout consistent with their expectations, or whether a reassessment could lead to a repricing. A realignment of investment that would occur in this scenario could result in a hit to growth (from both the direct effect of a drop in investment and the knock-on wealth effects).

Interrogating assumptions and exploring scenarios will remain crucial as we grapple with the implications of this technology in the years ahead.

A third key question for the medium term is the extent to which AI proves to be a labor substitute or a labor complement, and at what pace we might expect to see labor market changes. We are already seeing signs that AI may be a labor substitute in some sectors, especially for younger, less experienced workers. Other evidence points to the labor-augmenting effects of AI, suggesting a more sanguine outlook for the labor market. Some tasks that are easily automated with clear guardrails and predictable outcomes might see rapid labor substitution, while other tasks that require human judgment, management, coordination and relationships, creativity, or outputs that are hard to measure might see more labor augmentation.³ If labor market changes happen quickly, it will be hard for workers to adjust and dislocations might be large, whereas a more gradual adoption might permit more orderly adjustments.

That said, we should be prepared for the possibility that there might be serious short-term disruptions in the labor market that need to be managed effectively to ensure the benefits of AI are realized over the long term. If AI proves to be capable of work that

³ See Erik Brynjolfsson, Bharat Chandar, and Ruyu Chen, “No Widespread Displacement, but the AI Employment Gap for Young Workers Has Widened to 19%,” Stanford Digital Economy Lab, August 12, 2026, <https://digitaleconomy.stanford.edu/news/canariesaug26>; David Autor, Caroline Chin, Anna M. Salomons, and Bryan Seegmiller, “What Makes New Work Different from More Work?” NBER Working Paper No. 34986 (National Bureau of Economic Research, March 2026), <https://www.nber.org/papers/w34986>; Isabella Loaiza and Roberto Rigobon, “The EPOCH of AI: Human-Machine Complementarities at Work,” MIT Sloan Research Paper No. 7236-24 (November 21, 2024; revised October 1, 2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5028371; Wilbur Xinyuan Chen, Suraj Srinivasan, and Saleh Zakerinia, “Displacement or Complementarity? The Labor Market Impact of Generative AI,” Harvard Business School Working Paper No. 25-039 (December 2024), www.hbs.edu/ris/Publication%20Files/25-039_05fbec84-1f23-459b-8410-e3cd7ab6c88a.pdf; and Kathryn Bonney, Cory L. Breaux, Emin Dinlersoz, Lucia S. Foster, John C. Haltiwanger, and Aditya A. Pande, “The Microstructure of AI Diffusion: Evidence from Firms, Business Functions, and Worker Tasks,” NBER Working Paper No. 35141 (National Bureau of Economic Research, April 2026), <https://www.nber.org/papers/w35141>.

displaces humans, the extent of the disruption to the labor market will depend in part on whether society undertakes the investments needed in new job creation, worker training, connecting workers to new jobs, and other efforts to mitigate adverse effects for the long term. In my judgement, now is the time for society to begin to consider how to address these potential disruptions, while AI adoption is in its relatively early stages so we can realize the long-term benefits for society.⁴

Of course, many other issues are being raised about the safety of AI, privacy, tradeoffs for local communities with respect to data center buildouts, energy and water usage, national security, appropriate governmental policies, and other issues. These issues are beyond the scope of central bankers, but they are important for us all to consider.

Implications of AI for Monetary Policy

In terms of monetary policymaking, as I have noted in a previous speech, monetary policy is not well suited to dealing with structural changes in the economy, and it could be difficult for policymakers to assess in real time whether changes to the labor market are structural or cyclical.⁵ In the event that we see a long-lasting boost to productivity growth, wages and economic activity could grow more than would otherwise be the case without putting upward pressure on inflation, as I mentioned. But at the same time, demand for capital would rise because of the higher returns on investment, and household savings would fall due to expectations of stronger real wage growth and, thus,

⁴ See Michael S. Barr, “Will Artificial Intelligence Broadly Raise Living Standards or Drive Income and Wealth Inequality?” speech delivered at “Next-Gen Financial Inclusion,” the third annual Financial Inclusion Conference hosted by the Federal Reserve Board, July 14, 2026, <https://www.federalreserve.gov/newsevents/speech/barr20260714a.htm>.

⁵ See Barr, “What Will Artificial Intelligence Mean?”

higher lifetime earnings. Balancing this shift in savings and investment would require higher interest rates in equilibrium—what monetary economists would call a rise in r^* . That, in turn, implies a higher setting for the policy rate. In my view, it is too early to know if these dynamics are in play right now. What is clear right now is that inflation is too high. And that brings me to my current views on monetary policy.

Earlier this month, the FOMC unanimously agreed to raise short-term policy interest rates to support achieving our dual mandate of maximum employment and stable prices. With economic growth strong and the labor market solid, we need to address risks to achieving our inflation target in a timely fashion. Risks to achieving our inflation target have increased, while risks to the labor market have receded, so we need to recalibrate policy to get us in a better position that more evenly balances risks to both components of our dual mandate.

In my base case, further policy adjustments are likely to be needed to ensure inflation comes down to target in a timely fashion. We want to support sustainable, durable growth in support of maximum employment, and price stability is crucial to that.

I will leave it there, and I look forward to some questions and conversation.