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Outlook for the Economy and Monetary Policy

Remarks by

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at the

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Good morning, and thank you for the invitation to join you today.[1] It is a pleasure to be with you for the Southwestern Graduate School of Banking's 161st Assembly for Bank Directors. Before we get started on the fireside chat, since the Federal Open Market Committee (FOMC) concluded its January meeting earlier this week, I think it would be helpful to summarize my views on the recent policy decision. I will then offer some remarks on the economy and also share my perspective on the outlook for monetary policy.

As we enter 2026, the economy has continued to grow, and I see inflation moving closer to our goal. But beneath the surface, the labor market is fragile. I will provide some perspective on why I think that fragility poses the greater risk and what that means for the path of policy.

Update on the Most Recent FOMC Meeting

At our FOMC meeting this week, my colleagues and I voted to hold the federal funds rate target range at 3-1/2 to 3-3/4 percent. Let me explain why I agreed to support this decision. I continue to see policy as moderately restrictive, and, looking ahead to 2026, my Summary of Economic Projections includes three cuts for this year. In my mind, the question at this meeting was about the timeline for implementing these cuts, essentially choosing between continuing to remove policy restraint and arriving at my estimate of neutral by the April meeting, or moving policy to neutral at a more measured pace throughout this year.

I do not consider downside risks to the employment side of our mandate to have diminished, and I see several indications that the labor market remains vulnerable. I could have voted in favor of continuing to remove policy restraint in order to hedge more against the risk of further labor market deterioration. But we have seen some signs of stabilization, and, after lowering the policy rate by a total

[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.

of 75 basis points in the latter part of last year, in my view, we can afford to take time and "keep policy powder dry" for a little while in order to carefully assess how the lower degree of policy restraint is flowing through to broader financial conditions and strengthening the labor market. I am also reluctant to take meaningful signal from the latest data releases given the statistical noise introduced by the government shutdown. And, given that by the time of our March meeting we will have received two additional inflation and employment reports, I saw merit in waiting to take action.

It was not a straightforward decision. Ultimately, also considering that inflation remains somewhat elevated, at this meeting I decided to lean in favor of waiting for the upcoming sequence of data releases in order to gain more certainty about how the economy is likely to evolve in the coming months.

Current Economic Conditions

Since I presented a detailed assessment of economic conditions in a speech two weeks ago, today I will mention a few highlights and some new data points.[2] As the flow of official economic reports has been normalizing, my views on the economy have not changed appreciably, in part because I am not taking much signal from the employment and prices data given increased measurement challenges in the wake of the government shutdown. The U.S. economy has been resilient and has continued to expand at a solid pace, but I remain concerned about fragility in the labor market. I am also confident that inflation will come down toward 2 percent as tariff effects on goods inflation continue to wane in coming months.

GDP growth strengthened in the third quarter of last year as consumer spending accelerated. However, growth likely slowed in the fourth quarter, reflecting the government shutdown and softer

[2] See Michelle W. Bowman (2026), "Outlook for the Economy and Monetary Policy," remarks delivered at "Outlook 26: The New England Economic Forum," Foxborough, Massachusetts, January 16, https://www.federalreserve.gov/newsevents/speech/files/bowman20260116a.pdf.

momentum in consumer spending, consistent with recent weakness in personal income. Disappointingly, residential investment seems on track to decline again in the fourth quarter.

Labor Market Conditions

Turning to the labor market, we have seen conditions gradually weaken over the past year, as unemployment rose and payroll employment flattened out. Private payroll employment growth slowed further to about 30,000 per month in the fourth quarter, and weekly ADP data show job gains remaining at a similarly subdued pace through early January, well below earlier last year and below the level necessary to keep unemployment stable.

Although the unemployment rate edged down to 4.4 percent in December and has moved sideways in recent months, it has increased by 1/4 percentage point since the middle of last year. Moreover, the Conference Board job availability index dropped sharply in January to its lowest value since early 2021, suggesting that the unemployment rate could move back up in the first quarter.

The labor market has become increasingly fragile over the past year and could continue to deteriorate in the near term. Despite some tentative signs of the unemployment rate leveling off, it seems too early to say that the labor market has stabilized, especially with the added statistical noise from the government shutdown and the sharp drop in the CPS survey response rate to below the pandemic lows. Job gains have been concentrated in just a few nonbusiness service industries that are less cyclically sensitive, with health care accounting for all private job gains last quarter.

With a less dynamic low-hiring, low-firing labor market, which some have said is giving rise to a "jobless expansion," we could see layoffs rise quickly if firms begin to reassess their staffing needs in response to weaker activity. Although initial claims for unemployment insurance have remained low, private job cut announcements increased considerably last year, and there has been news of significant additional layoffs in January, as we heard this week from two large employers.

Inflation Developments

On inflation, we have seen considerable progress in lowering the underlying trend, considering that still-elevated inflation mostly reflects tariff effects on goods prices that I expect will fade this year. After removing these effects, core PCE inflation would have hovered close to 2 percent in recent months. The underlying trend in core PCE inflation appears to be moving much closer to our 2 percent target than is currently showing in the data.

Based on the latest consumer and producer price reports, 12-month core PCE inflation likely stood at or a little below 3 percent in December, up somewhat since September. However, the Dallas and Cleveland Fed trimmed-mean measures of PCE and CPI price indexes suggest that 12-month core inflation has continued to decline. The discrepancy between these alternative measures of core inflation seems to reflect increased volatility in the recent data, with unusually large price increases in small categories, like software and video streaming, largely explaining the pickup in the core PCE inflation measure since September.

Outlook for the Economy

Looking ahead, my baseline expectation is that economic activity will continue to expand at a solid pace and the labor market will stabilize near full employment as monetary policy moves closer to a neutral setting. Less restrictive regulations, lower business taxes, and a more favorable business environment will continue to boost supply—largely due to higher productivity—and more than offset any negative effects on economic activity and inflation from other policies. I expect that the supply-side policies that I just mentioned, along with strength in AI-related investment, will continue to boost productivity gains and help ensure that inflation remains on a downward path.

The Path Forward

On the outlook for monetary policy, with inflation close to 2 percent, after excluding one-off tariff effects, and with unemployment near estimates of its natural rate but at risk of deteriorating, I continue to see policy as moderately restrictive. Downside risks to the labor market have not diminished, and we should not overemphasize the latest reading on the unemployment rate.

I appreciated and supported the language in the post-meeting statement about the recent data, which reflects an appropriate characterization of the unemployment data as showing "some signs of stabilization."[3] It will take time to get a clear signal about stability in the labor market. My view is that we should continue to focus on downside risks to our employment mandate, and the description of the labor market is helpful to communicate that we are not overly confident. History tells us that the labor market can appear to be stable right up until it isn't.

As I think about the upcoming data, I am aware that first-quarter data tend to be more volatile. Therefore, in my view, we should not rely on these data as a reason to delay policy action if we see a sudden and significant deterioration in labor market conditions. We should also not immediately react if we see inflation go up in January, which has been common in recent years and could reflect residual seasonality or additional statistical noise from the government shutdown and ongoing measurement challenges.

I recognize and appreciate that other FOMC members may be concerned that inflation remains somewhat elevated and that we have not achieved our inflation goal for some time. However, absent a clear and sustained improvement in labor market conditions, we should be ready to adjust policy to bring it closer to neutral. We should also not imply that we expect to maintain the current stance of

[3] See the January 2026 FOMC statement, which is available on the Board's website at https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm.

policy for an extended period of time because it would signal that we are not attentive to the risk that labor market conditions could deteriorate.

At the same time, it is important to remember that monetary policy is not on a preset course. At each FOMC meeting, my colleagues and I will evaluate incoming data, the evolving outlook, and the balance of risks to our dual-mandated goals of maximum employment and price stability. I will also continue to meet with a broad range of contacts to inform my assessment of economic conditions and the appropriate stance of policy.

Closing Thoughts

As the economy continues to evolve, policy must evolve with it. My focus will remain on acting early enough to preserve both price stability and a strong labor market. Thank you again for the invitation to share my views with you today. It is a pleasure to join you.