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A Framework for Practical Monetary Policy Decision Making

Remarks by

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at

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Good afternoon. I would like to thank Governor Jónsson for the invitation to take part in the Central Bank of Iceland's Reykjavík Economic Conference. It is a pleasure to be here in Reykjavík with you and to share my thoughts on formulating a practical approach to monetary policy decision making.<sup>1</sup>

As you know, the Federal Reserve conducts monetary policy to support a strong and stable economy. In doing so, the Federal Open Market Committee (FOMC) pursues the congressionally mandated goals of maximum employment and price stability. The Fed uses a variety of tools to carry out its monetary policy strategy and implementation. Our primary monetary policy tool is the federal funds rate, which is a key interest rate for commercial bank overnight borrowing that influences other interest rates throughout financial markets and the economy. Lower interest rates reduce borrowing costs and tend to raise asset prices and wealth, thereby stimulating consumer spending and business investment—especially on vehicles and other durables goods, housing, and equipment and intangibles—and, ultimately, supporting employment. By stimulating demand, lower interest rates also have the potential to raise inflation. In contrast, higher interest rates generally exert a drag on economic activity and employment and tend to lower inflation.

Over my tenure on the Board and the FOMC, we revised our monetary policy framework twice. While I appreciate that frameworks may evolve over time, I am pleased that the FOMC returned the framework to basic principles last year. Since joining the Board in 2018, the Committee has faced a number of significant economic challenges—including both very high inflation and unemployment, and many economic shocks. This experience has given me valuable perspective in assessing economic conditions and the balance of risks to the labor market and inflation in considering the appropriate stance and direction of policy.

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<sup>1</sup> 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. I would like to thank Michele Cavallo and Eugenio Pinto for their assistance in preparing these remarks.

Today, I will describe the decision making framework that I use to guide my approach to setting the target range for the federal funds rate. Specifically, I will discuss how I consider the conditions that would lead to a decision to cut, increase, or hold the policy rate constant. I will also share a few specific examples to illustrate how my own decision making framework has informed my votes on policy decisions since joining the FOMC.

### **The Inputs into My Policy Assessments**

A critical input to the monetary policy decision making process is an analysis of current economic conditions and the economic outlook. As we approach each FOMC meeting, I consider a range of indicators for economic activity and our maximum employment and stable price objectives to inform my assessment of whether the existing stance of monetary policy is appropriate. Frequent discussions with a broad range of contacts, including businesses and other market participants, ensure that I understand conditions and expectations and provide context to economic data, helping shape my views about how the economy is evolving. This is especially valuable because data can be difficult to interpret in real time and in recent years have been more volatile and subject to significant revision.

My analysis often begins with a broad measure of economic activity—looking at the recent path and composition of real GDP. Economic growth is not one of the Federal Reserve’s statutory goals, but it carries signals that may indicate which conditions drive changes to inflation and employment. When the economy is near full employment, strong GDP growth could lead the economy to overheat and spark inflationary pressures. On the other hand, GDP growth below its potential may signal that aggregate demand has weakened, and that unemployment could increase above its natural rate as a result. Looking deeper into GDP, I focus on private domestic final purchases. This measure aggregates personal consumption expenditures (PCE) and private fixed investment and can provide insights into the underlying momentum in aggregate demand because it excludes the components of GDP that are volatile, hard to measure, or not related to the business cycle.

As I look at employment, I focus on the unemployment rate and payroll employment. Assuming the underlying data are reliable, the unemployment rate can help determine whether the labor market is tight or is experiencing slack. Comparing the published unemployment rate with my own estimate of its natural rate allows me to gauge how close we are to achieving our maximum-employment objective, which our latest Statement on Longer-Run Goals and Monetary Policy Strategy defines as “the highest level of employment that can be achieved on a sustained basis in a context of price stability.”<sup>2</sup>

Payroll employment growth can be an indicator of labor market momentum and can help identify shifts in the path of the unemployment rate. Strong payroll gains relative to trend labor force growth point to a lower unemployment rate and stronger labor market conditions, whereas weak payroll gains can point to a higher unemployment rate. One caveat is that, since these data can be volatile or unreliable for a variety of reasons, I pay closer attention to average payroll gains over a few months to help understand whether the labor market is moving closer to or further away from full employment.

Of course, I look at a multitude of other data, both from the employment report and other public and private surveys, to assess momentum and slack in the labor market. On slack, data on discouraged and marginally attached workers and involuntary part-time employment can indicate the extent of hidden unemployment and fragile employment. Data on wage growth can help assess the relative strength of labor demand and supply, and the ratio of vacancies to unemployment is also a measure of labor market tightness. On momentum, the composition of job gains by industry indicates the breadth and depth of employment gains, and I adjust the payroll data for persistent bias or expected revisions. Indicators of layoffs, like unemployment insurance claims, can detect early signs of a pickup in unemployment. And data on job openings also provide a signal about the strength in labor demand.

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<sup>2</sup> The FOMC's revised Statement on Longer-Run Goals and Monetary Policy Strategy is available on the Board's website at [https://www.federalreserve.gov/monetarypolicy/files/FOMC\\_LongerRunGoals.pdf](https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf).

On price stability (or inflation), in 2012, the FOMC established 2 percent as the inflation goal, as measured by the annual change in the PCE price index. As a result, policymakers closely monitor the recent path of total PCE inflation and how it is expected to evolve going forward.

Because food and energy prices tend to be volatile, core PCE inflation—which excludes changes in these categories—tends to predict future total PCE inflation more accurately than total PCE inflation.<sup>3</sup> Excluding volatile components from inflation measures filters out noisy price changes and is generally thought to improve their ability to be predictive. Given that monetary policy affects the economy with a lag, it is important to look at core PCE inflation because it helps us better understand how inflation will evolve once our policy actions begin to take effect.<sup>4</sup>

Over the past year, when I have referred to core PCE inflation, I have specifically excluded temporary effects, like tariffs, on goods prices. I have also referred to PCE trimmed mean inflation—which excludes items with outsized price changes—as an alternative measure of the underlying trend in inflation that can look through large one-time factors affecting a few goods categories. As I mentioned earlier, monetary policy actions take time to work their way through the economy. Therefore, looking through temporary inflation shocks may be appropriate to achieve optimal policy, as long as doing so

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<sup>3</sup> For the predictive properties of core inflation see Alan S. Blinder and Ricardo Reis (2005), “Understanding the Greenspan Standard,” in *The Greenspan Era: Lessons for the Future*, proceedings of a symposium sponsored by the Federal Reserve Bank of Kansas City, held in Jackson Hole, Wyo., pp. 11–96, <https://www.kansascityfed.org/JacksonHole/documents/3312/PDF-Blinder-Reis2005.pdf>; Michael W. McCracken and Trần Khánh Ngân (2023), “Using Core Inflation to Predict Headline Inflation,” *On the Economy Blog*, November 28. <https://www.stlouisfed.org/on-the-economy/2023/nov/using-core-inflation-predict-headline-inflation>; and Matteo Luciani and Riccardo Trezzi (2018), “Comparing Two Measures of Core Inflation: PCE Excluding Food & Energy vs. the Trimmed Mean PCE Index,” memorandum, Board of Governors of the Federal Reserve System, September 14. <https://www.federalreserve.gov/monetarypolicy/files/FOMC20180914memo02.pdf>.

<sup>4</sup> In a congressional testimony, then-Chairman Bernanke articulated this view during the runup in oil prices that occurred in the 2000s. See Ben. S. Bernanke (2007), “Statement of Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System,” in *Monetary Policy and the State of the Economy, Part II, hearing before the Committee on Financial Services*, U.S. House of Representatives, July 18, 110th Cong. (Washington: U.S. Government Printing Office), p. 65, [https://fraser.stlouisfed.org/files/docs/historical/house/cmp/2000s/CMP\\_110HR\\_07182007.pdf?utm\\_source=direct\\_download](https://fraser.stlouisfed.org/files/docs/historical/house/cmp/2000s/CMP_110HR_07182007.pdf?utm_source=direct_download).

does not affect our credibility to bring inflation back to 2 percent. The tricky part is understanding what may or may not have persistent effects on inflation.

Ahead of each FOMC, my analysis also relies on regular interactions with a broad range of contacts to better understand how the economy is evolving. This provides insight into how households and business leaders, including financial market participants, are experiencing the economy and how they expect conditions to evolve. This can give me an early indication of changing conditions that will be reflected in future official data releases, likely with a significant delay.

Relying upon the most recent data, or even model forecasts based on this data, provides an inherently backward-looking assessment of economic conditions. This increases the risk that policymakers fall “behind the curve” in addressing risks to employment and inflation. In extreme cases, the policy delay ultimately requires larger and more rapid policy adjustments than would otherwise be necessary. An economic outlook that is informed by ongoing engagement with the private sector is more likely to reflect how the economy is performing and how it will evolve going forward, enabling policymakers to be well positioned to act in real time and support a strong economy.

In addition to paying close attention to the economic indicators and forming a view about how the economy will likely evolve over coming months, another consideration is where the current federal funds rate stands relative to my estimate of the neutral rate of interest. The neutral rate is the level of the policy rate that is consistent with the FOMC’s inflation and maximum-employment goals. This is essentially equivalent to having a view about the degree to which the existing policy stance is restrictive, close to neutral, or accommodative. This view helps clarify whether—conditional on my assessment of the existing economic conditions and the outlook—the current level of the policy rate is appropriate for achieving the dual mandate or whether an adjustment is needed.

## Putting Policy Assessments into Practice

At each FOMC meeting, my colleagues and I evaluate incoming data, the evolving outlook, and the balance of risks to achieve our dual-mandated goals of maximum employment and price stability. With regard to the policy decision, each FOMC member carefully weighs all of these factors before voting to support a policy action.

As the recently revised consensus statement notes, monetary policy plays an important role in stabilizing employment and inflation in response to economic and financial shocks. If unemployment is above its natural rate, other things being equal, the policy rate needs to be accommodative, or below its neutral setting, in order to stimulate demand and raise employment. In contrast, if inflation is high relative to our goal, other things being equal, the policy rate needs to be restrictive, meaning above neutral, in order to moderate spending and reduce upward pressure on prices.

But conducting monetary policy to achieve both dual-mandate goals can be challenging, since the policy objectives of price stability and maximum employment can be in tension. In the past, I have advocated for a flexible approach to policymaking that supports adjusting the focus on policy objectives when they are not complementary.<sup>5</sup> Our dual mandate places equal weight on maximum employment and price stability. Consequently, when there is tension in achieving the two objectives, in my view it is important not to favor one side of the mandate over the other. Instead, we should be flexible and focus on the one that deviates the most from its goal or that shows the greater risk of persistently departing from it. In my view, flexibility in addressing existing or emerging departures from our goals allows policymakers to approach policy decisions in a timely and measured way. Policymakers should also consider how the economy will evolve—and help to support employment and price stability, while

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<sup>5</sup> See Michelle W. Bowman (2025), “Thoughts on Monetary Policy Decisionmaking and Challenges Ahead,” speech delivered at the Forecasters Club of New York Luncheon, New York, September 26. <https://www.federalreserve.gov/newsevents/speech/files/bowman20250926a.pdf>.

limiting the risk of unnecessary volatility. I consider this flexible approach to be consistent with the framework's balanced approach which considers both the extent of departures of employment and inflation from their goals and the time horizons over which they are projected to return to levels in line with our goals.

Another challenge in setting monetary policy is that important indicators about the state of the economy and the actual monetary policy stance can only be estimated with a considerable degree of uncertainty and may vary over time—for example, due to structural changes in the economy. Since variables like the natural rate of unemployment and the neutral interest rate are fundamentally unobservable, policymakers face uncertainty in assessing the degree of slack or tightness in the labor market and of restraint or accommodation for the existing policy stance. This further emphasizes the need to be flexible in setting monetary policy.

I will turn now to describing how economic conditions influence my policy assessment and note a few specific cases to connect prevailing economic conditions to my policy votes over my tenure on the FOMC and how I think about future policy actions.

#### *Lowering the Policy Rate*

I will start with a hypothetical set of conditions that could lead to lowering the target range for the federal funds rate. Most often, this occurs when inflation is already near or expected to run below 2 percent and the labor market is fragile or expected to deteriorate, with rising unemployment and relatively weak job gains. In these conditions, when the policy stance is somewhat restrictive or close to neutral, policymakers should cut the federal funds rate to bring it into an accommodative position. And if the policy stance is already accommodative but not sufficient to align inflation and employment to their goals, it would be appropriate to gradually add additional accommodation. These conditions

existed during the second half of 2019, when I supported reducing the federal funds rate by 25 basis points at three consecutive FOMC meetings.

Another case that could lead to reducing the policy rate is when the inflation and employment objectives appear to be in conflict and policy starts from a restrictive position. Specifically, when inflation is above target and the labor market is fragile and at risk of deteriorating, it could be appropriate to cut the policy rate and slowly remove restraint to bring the dual-mandate goals into better balance, provided that weak labor market conditions can also contribute to bringing inflation toward its target. Under these conditions, waiting to lower the policy rate could lead to persistent labor market damage that would be difficult for the Committee to address with our monetary policy tools.

This view informed my FOMC policy votes during the second half of last year. At the July 2025 meeting, I dissented from the Committee's decision to maintain the target range for the federal funds rate at its then-current level and voted for a 25 basis point cut to support the labor market.<sup>6</sup> With economic growth slowing, the unemployment rate continuing to rise, signs of a less dynamic labor market becoming clear, and inflation, excluding tariff effects, descending toward 2 percent, I preferred to begin the process of moving the policy stance from restrictive toward neutral. That action would have begun the process to proactively hedge against the risk of greater and more persistent damage to the labor market and weakening economic activity one meeting earlier. For the same reasons, at our September meeting last year, and again at our meetings in October and December, I supported the Committee's actions to lower the policy rate by a total of 75 basis points. We may now be seeing that those rate cuts contributed to pausing the deterioration in labor market conditions.

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<sup>6</sup> For more information about Vice Chair for Supervision Michelle W. Bowman's dissent, see Michelle W. Bowman, (2025), "Statement by Vice Chair for Supervision Michelle W. Bowman," August 1 (Washington: Board of Governors of the Federal Reserve System), <https://www.federalreserve.gov/newsevents/speech/files/bowman20250801a.pdf>.

### *Raising the Policy Rate*

In the alternative, let's consider the conditions that would warrant an increase in the target range for the policy rate. One straightforward case that would call for raising the policy rate reflects elevated inflation that is likely to continue to move higher, with the labor market showing no sign of slack and GDP rising much faster than its potential. The question would be by how much and how quickly to increase the policy rate. If the existing monetary policy stance is accommodative or close to neutral, in my view, it would be appropriate to withdraw any remaining accommodation by raising the policy rate deliberately or even expeditiously. For example, over the course of 2022, I strongly supported the FOMC's forceful policy actions to sharply increase the target range for the policy rate to curb high inflation, which was more persistent than many forecasters had expected and reached levels not seen in the U.S. in 40 years. Strong demand fueled in part by extraordinary monetary and fiscal stimulus and reduced labor supply from the pandemic resulted in a tight labor market that amplified existing inflationary pressures. In 2021, I noted that those pressures would likely take longer to subside. And in early 2022, I saw a substantial risk that high inflation could persist and began to argue in support of prompt and decisive action to tighten monetary policy to lower inflation.<sup>7</sup>

Under conditions of above-target inflation and no labor market slack, if the policy stance is already restrictive but not yet sufficiently restrictive to achieve the price-stability and maximum-employment goals, it would be appropriate to add additional policy restraint and raise the policy rate—but at a measured pace. During 2023, with monetary policy already restrictive, I supported raising the federal funds rate in smaller increments than in 2022.

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<sup>7</sup> See Michelle W. Bowman (2022), "High Inflation and the Outlook for Monetary Policy," speech delivered at the American Bankers Association Community Banking Conference, Palm Desert, Calif., February 21.  
<https://www.federalreserve.gov/newsevents/speech/files/bowman20220221a.pdf>.

### *Maintaining the Policy Rate Unchanged*

Finally, I will discuss the conditions that would support keeping the target range for the federal funds rate unchanged, including examples in which policy is already well positioned. This was the case between our September 2023 and July 2024 policy meetings. At that time, the FOMC decided to hold the federal funds rate at a restrictive level to address persistently above-target inflation and a tight labor market. I supported the decisions because the degree of policy restraint was appropriately calibrated to reduce inflationary pressures.

Another example is when inflation is at or below target but employment seems near or higher than estimates of its maximum level and the policy stance is close to neutral or accommodative. As described in the FOMC's consensus statement, maximum employment is not directly measurable and evolves over time due to factors that are largely non-monetary. Changes to the underlying structure of the economy that are expected to persist in the longer run may result in employment rising above existing assessments of maximum employment without necessarily generating upward pressure on inflation above 2 percent.<sup>8</sup> The combination of low inflation and low unemployment may reflect positive supply shocks that are working their way through the economy. In that case, absent price-stability risks, the dual-mandate objectives may not necessarily be in tension, and employment that appears stronger than its estimated maximum level may not require a policy response. This dynamic occurred during the second half of the 1990s, when then-Chairman Greenspan led the FOMC to hold off on rate increases even as unemployment moved below the estimated natural rates, as strong productivity growth allowed for a combination of strong output growth and low and falling inflation.<sup>9</sup>

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<sup>8</sup> For a discussion of assessing maximum employment, see Christopher Foote, Shigeru Fujita, Amanda Michaud, and Joshua Montes (2025), "Assessing Maximum Employment," Finance and Economics Discussion Series 2025-067 (Washington: Board of Governors of the Federal Reserve System, August), <https://doi.org/10.17016/FEDS.2025.067>.

<sup>9</sup> See Jerome H. Powell (2018), "Opening Remarks: Monetary Policy in a Changing Economy," in *Changing Market Structures and Implications for Monetary Policy*, proceedings of a symposium sponsored by the Federal Reserve Bank of Kansas City, held in Jackson Hole, Wyo., pp. 1–18, [https://www.kansascityfed.org/Jackson%20Hole/documents/6973/OpeningRemarks\\_JH2018.pdf](https://www.kansascityfed.org/Jackson%20Hole/documents/6973/OpeningRemarks_JH2018.pdf).

I will conclude this part of the discussion with an example of tension between our goals, with inflation somewhat elevated, a weak or weakening labor market, and a policy stance that is already accommodative. Under these conditions, balancing the maximum-employment and price-stability goals would call for holding the policy rate at an accommodative level.

### **The Current Situation**

Turning to the current economic conditions, how does this framework apply in today's economy? The U.S. economy has been resilient, but the labor market remains vulnerable to adverse shocks and PCE inflation has moved up, due largely to higher energy prices. And my outlook remains influenced by the conditions resulting from the conflict in Iran.

Over the past few quarters, real GDP growth has been rising at a moderate to solid pace, supported by strong AI-related business investment. Growth has slowed since last summer, as both softness in real personal income and the severe winter weather have weighed on consumer spending. The U.S. economy seems to be benefitting from a favorable technology shock that has boosted productivity and investment demand. The surge in AI-related investment may be exerting some supply chain pressures, but strong productivity growth may put some downward pressure on inflation because of lower production costs in the medium term. Supportive supply-side policies, including less restrictive regulations and lower business taxes, will also likely favor these conditions.

While the labor market appears to have become more stable in recent months, there are still signs of fragility. The unemployment rate remained at 4.3 percent in April, with stronger payroll employment gains so far this year, but other indicators continue to show signs of labor market softening. Perceptions of labor market tightness in consumer and business surveys point to somewhat higher unemployment. The job-finding rate, which measures the percentage of unemployed workers that are able to find a job, has continued on a downward path in recent months. And employment growth has been concentrated in

less cyclically sensitive industries like health care and social assistance. In addition, the share of long-term unemployed remains around 25 percent, reflecting a labor market with low dynamism.

Progress on lowering inflation appears to have stalled, with measures of PCE inflation moving up recently. On a 12-month basis, total PCE inflation picked up to 3.8 percent in April, mostly reflecting higher gasoline and fuel oil prices, and core PCE inflation rose further to 3.3 percent last month, up noticeably since September. However, other measures of inflation that focus on the central tendency of price changes, including the trimmed mean PCE measure, indicate that core inflation has moved down closer to 2 percent since last September. Price pressures have become increasingly concentrated in a few goods categories, reflecting tariff effects and idiosyncratic changes in software prices. After removing these one-off factors, core PCE inflation would have continued to hover only a bit above 2 percent, reflecting no pressures from the labor market and weakness in market rents.

It still seems early to assess the size and persistence of the economic effects from the Iran conflict. I am optimistic that, once the conflict is resolved, supply disruptions will ease, leaving a temporary imprint in PCE inflation and minimal impacts on domestic economic activity. This view seems consistent with oil futures prices and with financial market optimism. But, should disruptions persist well into the second half of the year, we could start to see broader effects on inflation.

As I think about the path forward for monetary policy, I would like to have more clarity on the economic impacts from the conflict in the Middle East and the durability of those effects. In this regard, I appreciated and supported keeping the language from the March post-meeting statement about additional policy rate adjustments. It is appropriate to look through temporarily elevated inflation readings largely due to higher energy prices, provided that we remain credible in our commitment to achieve our inflation goal and one-off tariff effects wane, as I expect.

Economic research suggests that, in response to temporary adverse energy supply shocks, policy should not be overly aggressive at stabilizing total inflation to keep employment close to our maximum-employment goal.<sup>10</sup> Reacting to temporarily elevated energy price inflation would add unwarranted policy restraint, weighing unnecessarily on economic activity and labor market conditions.

For now, our moderately restrictive policy stance is intended to help maintain stable labor market conditions while allowing inflation to resume its downward trend toward 2 percent once the effects of tariffs and oil prices dissipate. But the longer the conflict persists, the more we should consider the effects on inflation in our outlook. In particular, the more persistent higher oil prices are—or if we start to see broader effects of higher energy prices on PCE inflation—the more likely I will consider shifting my approach to thinking about the balance of risks. Before our next meeting in June, we will have received one additional month of employment and inflation data. In the meantime, I will continue to evaluate the incoming data and to assess the risks to the outlook as conditions evolve.

### **Closing Thoughts**

In conclusion, I would again like to thank the organizers for the invitation to join you for this conference. Taking into account the experience and the lessons I have learned over my tenure on the FOMC, it is important that policy decisions are transparent, clearly communicated, and consistent. Our public communications should be clear about our progress and expectations for meeting inflation and employment goals.

We should also be clear in how we view economic conditions and how those conditions inform our policy decisions. Providing a transparent and repeatable framework will help to ensure that the

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<sup>10</sup> See Martin Bodenstein, Christopher J. Erceg, and Luca Guerrieri (2008), “Optimal Monetary Policy with Distinct Core and Headline Inflation Rates,” *Journal of Monetary Economics*, vol. 55 (October), pp. S18–S33, <https://doi.org/10.1016/j.jmoneco.2008.07.010>; and Nicolò Gnocato (2025), “Energy Price Shocks, Unemployment, and Monetary Policy,” *Journal of Monetary Economics*, vol. 151 (April), 103734, <https://doi.org/10.1016/j.jmoneco.2025.103734>.

public can understand how we respond to economic conditions and that we are consistent in our approach to policy over time.

Our credibility relies on consistency in our approach and in the assessment of the underlying conditions that inform our policy decisions. Our credibility and effectiveness are of utmost importance in achieving our maximum-employment and price-stability goals.