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The U.S. Economy and Considerations for Monetary Policy

Remarks by

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at the

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Good afternoon. It is a pleasure to join you today at the Council on Foreign Relations to discuss my outlook for the U.S. economy.[1]

Economic growth has gained momentum this year, driven by robust investment demand and solid consumer spending, and the labor market now appears to have stabilized. These outcomes suggest that the policy rate cuts toward the end of last year helped to address some labor market weakness. We are experiencing rapid technological change and ongoing geopolitical tensions, while inflation pressures have persisted for longer than I had hoped and have shown recent signs of broadening. Despite these challenges, increased investment in and use of artificial intelligence (AI), or super intelligence, are boosting economic growth and productivity and American families appear to be resilient.

The Federal Reserve's monetary policy goals are to achieve maximum employment and price stability. While the labor market has improved more than I expected this year, our progress on lowering inflation has disappointed. Therefore, bringing inflation down remains a priority. I am also monitoring expectations about AI and energy prices, and how they influence the risks to achieving our mandates. Consistent with my views following our September FOMC meeting, I continue to focus on interpreting the underlying trends in the economy and the evolution of financial conditions.[2]

In my remarks today, I will review our most recent FOMC policy meeting and discuss current economic conditions and my near-term outlook for the economy. I will then turn to recent developments in energy markets and the AI buildout and will conclude with my thoughts on the appropriate path of monetary policy.

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[1] The views expressed here are my own and are not necessarily those of my colleagues on the Federal Open Market Committee (FOMC) or the Board of Governors of the Federal Reserve System.

[2] See Atlantic Council (2026), "Federal Reserve Vice Chair Michelle Bowman on Modernizing Financial Regulation," AC Front Page event, Washington, October 1, https://www.atlanticcouncil.org/event/federal-reserve-vice-chair-michelle-bowman-on-modernizing-financial-regulation.

Update on the Most Recent FOMC Meeting

At last month's FOMC meeting, I joined my colleagues to support holding the federal funds rate target range at 3-3/4 to 4 percent. This approach was consistent with my view that further changes in the policy rate should wait until we had a better understanding of how conditions would evolve and how the recent rate increase would influence the underlying trends in the economy. Maintaining the policy stance at the October meeting allowed us to assess the incoming data. While I continue to expect that several of the factors currently boosting inflation will abate next year, currently inflation has proven to be more persistent than I had anticipated. It is also important to gain greater clarity on the effect of recent market volatility on financial conditions.

Economic and Financial Conditions

U.S. economic growth has stepped up this year. After rising a solid 2.4 percent during the first half of the year, real gross domestic product (GDP) likely increased at an even stronger pace of more than 3 percent in the third quarter, well above last year's 2 percent pace.[3] Economic growth has been supported by robust increases in AI-related capital expenditures and solid consumer spending. However, some interest-rate-sensitive sectors like residential investment have declined, and the recent rise in mortgage rates appears to be dragging home construction and sales down further. Consumer spending has strengthened this year, despite softness in real incomes and declining sentiment, which are partly due to higher energy prices.

Labor Market Conditions

Labor market conditions look to have improved since last year. Over the course of this year, the unemployment rate has edged down to 4.1 percent in October, remaining close to my estimate of its

[3] Note that currently reported GDP growth in the first half of this year may be overestimated by about 0.3 percentage point, reflecting downward revisions in the retail sales annual update that were not folded into the Bureau of Economic Analysis (BEA) 2026 annual revision of the national accounts.

natural rate. Job gains have been above last year's anemic pace, averaging about 80,000 per month through October, and have broadened across industries beyond health care and social assistance.

The labor market continues to show low dynamism, with low-hiring and low-firing conditions as we sometimes see in a late-cycle expansion. The job-finding rate has been low, especially for new labor force entrants, and the share of long-term unemployed workers has moved up significantly. Workers' perceptions of job availability in the Conference Board survey have remained soft in recent months. On their own, these data would be consistent with a higher unemployment rate than currently reported. However, layoffs have moved down this year, offsetting the softness in hiring. In plain terms, workers are both less likely to find a new job and less likely to be laid off, a somewhat unusual pattern.

Although stable, the labor market does not appear to be tight, as wage growth has slowed to a modest pace. On a 12-month basis, the wages and salaries component of the employment cost index increased 3.1 percent in September, the same pace as the change in average hourly earnings for October. Both measures have slowed noticeably from a year ago. An increasing number of workers have taken on a supplemental part-time job to make ends meet, as the share of multiple job holders has increased back to levels seen in early 2025. Given strong productivity gains in recent years, wage growth at this pace is in line with or even below the pace we would expect if inflation was running at 2 percent.

Inflation

Progress on lowering inflation has stalled over the past two years or so. Today's consumer price index suggests that 12-month core PCE inflation likely moved up further to 3.3 percent in October, as upward pressures from higher energy prices and AI-related demand continue to flow through to core goods and services prices.

Lack of progress on lowering inflation largely reflects a confluence of shocks unrelated to conditions in the labor market. Tariffs, energy, and AI-related price pressures each accounted for

roughly one-fourth of above-target core PCE inflation over the 12 months ending in September. The remaining one-fourth likely reflects persistent effects from the inflationary shocks in recent years. Price pressures had been concentrated in a few categories, but the latest data suggest that these pressures may be broadening.

It is important to ensure that those inflationary pressures do not intensify, further broaden, or become embedded in consumer and business expectations. But today's consumer price index data suggest that inflation pressures may persist for longer. Tariff effects should further wane going forward. Energy-related price pressures should unwind when the Middle East conflict resolves. And inflation pressures related to the AI buildout seem to persist despite some early signs of slowing. I mostly view these pressures as reflecting relative price shocks in specific sectors of the economy. For example, the AI buildout has quickly shifted investment demand toward specific types of high-tech capital, putting upward pressure on prices due to relatively inelastic supply in the near term. As these shocks wane or unwind and with no inflationary pressures emerging in the labor market, my forecast is for core PCE inflation to move closer to 2 percent next year.

Financial Conditions

Financial conditions have tightened a bit recently because of lower equity prices, higher private interest rates, and a stronger dollar. That tightening comes against a backdrop of increased market volatility. Corporate bond and mortgage rate spreads have widened, and equity valuations in the tech sector have dropped, as investors appear to be reassessing expected returns and the risks associated with increased external financing for AI investment projects.

Economic Outlook and Risks

Looking ahead, my expectation is that policies designed to boost the economic potential of the U.S. economy would continue to support productivity, growth, and business confidence. These policies

include pragmatic regulations, lower taxes, and more supportive policies toward businesses. I expect the labor market to remain stable and inflation to slow, as special factors currently holding inflation elevated gradually wane or unwind next year. Over time, I also expect increased AI adoption to raise productivity and put some downward pressure on inflation as lower production costs are passed through to consumer prices.

On risks to the outlook, with the labor market improving since last year, I am more attentive to the inflation side of our mandate. Sustained supply-chain pressures from the AI buildout or greater pass-through of higher energy costs could cause inflation pressures to persist. I can also envision a scenario in which the effects of the Middle East conflict and the tech investment boom wane or unwind quickly. In this scenario, I would also expect a timelier return of core PCE inflation toward our target.

I also see a number of risks to the outlook for economic activity, many originating in financial markets. These risks include a large correction in equity valuations, if returns on AI investment fall short of expectations, and a sharp increase in private longer-term interest rates. Lower equity prices could undermine the resilience in consumer spending. And higher interest rates could further strain interest-rate-sensitive sectors of the economy, like housing and small business investment. I will continue to closely monitor developments in credit and equity markets to assess risks to economic growth and financial stability.

Important Issues for Monetary Policy

I see conditions in energy markets and the AI buildout as two important issues for the economy in the months ahead. Developments in these two areas could have material effects on both sides of our mandate and could influence my views on the path for monetary policy.

Energy Markets

The Middle East conflict has disrupted energy markets, impairing the flow of oil and other commodities passing through the Strait of Hormuz, which accounted for about 20 percent of global oil supply before the conflict—roughly equivalent to total U.S. oil consumption. As tensions rose, Brent oil prices moved up to and above $110 per barrel in the second half of October before dropping sharply last week on optimism that an agreement between the U.S. and Iran could be reached following the midterm elections. Although crude oil flows in the Persian Gulf have recovered to near pre-conflict levels in recent weeks, freight rates and insurance premiums have surged because of more complex logistics and ongoing geopolitical risk, raising the cost of delivered oil to many markets around the world.

Prices for gasoline, diesel, and jet fuel also moved up to near or even above their highs in the spring. These higher prices reflected both higher crude oil prices and wider refining margins, as refineries in both the Persian Gulf and Russia have been damaged as a result of ongoing military conflicts in both regions. Prices for refined products have retraced some of the earlier gains more recently as crude oil prices have receded and margins have shown signs of normalizing.

While the outcomes of these conflicts remain uncertain, my approach is to look through temporary energy-driven inflation, when possible, and to remain alert to signs that it is spreading into broader prices or expectations. If geopolitical tensions persist, energy prices may stay elevated in the near term, increasing risks that core inflation may also stay elevated because of increased pass-through to consumer prices of higher production and transportation costs.

Although the U.S. economy is now a net exporter of oil products and less energy intensive, we could still see an impact on economic activity from higher energy prices. The recent deterioration in consumer sentiment measures suggests households may be internalizing a more persistent reduction in their purchasing power. I would be especially concerned about effects on both sides of our mandate if

there were further significant disruptions to energy markets. An escalation of geopolitical tensions could have more meaningful effects on real activity because of higher uncertainty and the larger impact of energy prices on lower- and middle-income consumers.

Even with a quick resolution to the Middle East conflict, it may take some time for energy prices to normalize. Futures markets expect oil prices to decline only gradually, as global oil consumption is projected to exceed supply at least through the end of this year. As inventories have been drawn down, the U.S. Strategic Petroleum Reserve (SPR) has reached a bit less than 50 days of crude oil imports, the lowest level since the early 1980s, reflecting both this year's and the larger 2022 SPR releases. A number of new Gulf pipelines to bypass the Strait of Hormuz are under construction or expansion, with the United Arab Emirates' West–East expansion coming online in early 2027 and most others in 2028 and beyond. Domestic oil production could also continue to rise, which would put downward pressure on fuel costs.

AI Buildout

In remarks earlier this year, I discussed the responsible use of AI in the financial system.[4] Today I will describe how this technology is shaping the broader economy. Given the transformative promise of this technology, investment in data centers has boomed and has been a major influence on the U.S. economy. With plans for new data centers continuing to surge, I expect the AI shock to play out over some time. However, as these investments are increasingly being financed with external funds, including off-balance-sheet liabilities, I am also focused on potential risks to the economy and financial stability if revenues from AI customers disappoint.

[4] See Michelle W. Bowman (2026), "Artificial Intelligence in the Financial System," remarks delivered at the Financial Stability Oversight Council Artificial Intelligence Series Roundtable on Cybersecurity and Risk Management, Washington, May 1, https://www.federalreserve.gov/newsevents/speech/files/bowman20260501a.pdf.

We may still be in the early days when investment rises rapidly while workers and firms determine the best use cases before we see more meaningful effects on productivity. The boom in data center investment is undeniable, with growth in real business fixed investment strengthening further this year to a pace like the 1990s tech boom. High-tech equipment, software, and data center construction have accounted for the large majority of growth in business investment since 2025, with gains broadening to other categories this year.

AI adoption has grown significantly, especially among larger firms, with about 25 percent of businesses and roughly 10 percent of workers reporting using AI every day in their work. However, use varies greatly across industries and occupations, with stronger adoption in information and other business services sectors. I think there is a risk that some workers will be displaced as firms adopt this technology, even as others see their productivity—and wages—rise. Monetary policy cannot address that transition directly, but it should support a dynamic labor market that facilitates the necessary retraining and mobility of workers across jobs.

AI revenues have been rising quickly but are not yet sufficient to pay for the expense of maintaining existing and developing new AI models and data centers. As capital spending has surged, hyperscalers and other companies have increasingly been sourcing funds from credit and equity markets. And as investors see an increased risk in these investments, the cost of financing has been rising notably.

In addition to financing costs, the AI buildout is also putting upward pressure on a number of price categories. Prices of memory chips, semiconductors, computers, and other electronic products have increased sharply this year—in a few categories by double digits—as demand from data centers has outpaced supply. I expect production capacity to catch up to demand gradually over time.

AI-related debt has been rising rapidly, with notable gains in corporate bonds, private credit, and project finance, and is on track to exceed $800 billion this year. Other obligations, in the form of long-

term lease and contract commitments and residual value guarantees, have also surged and their potential payments are estimated at more than three times the amount of debt. Given their strong credit ratings, hyperscalers and large tech firms have assumed off-balance-sheet liabilities to allow smaller and riskier companies to use them as collateral in asset-based financing for data center construction and the purchase of accelerated computing equipment. These connections among AI firms have also been accompanied by hyperscalers and chip designers making equity investments in smaller companies that purchase their products, creating the appearance of circular financing.

The largest U.S. bank holding companies have some exposure to AI-related financing, which is scrutinized during annual supervisory stress tests. Life insurance companies, pension funds, private credit, and mutual funds also have exposure. Most of these entities are well capitalized and have stable funding. But the complex nature of the financing structures makes it difficult to properly assess counterparty risk.

Risks seem to be concentrated in only a few large firms that provide AI services, including AI labs and the hyperscalers. If AI-related revenues fall short of sharply rising costs, especially as public sentiment and local opposition could lead to increased regulation and delays, we could see a sharp correction in equity prices for AI firms, higher financing costs, and reduced access to credit. This shock would likely slow the AI buildout and soften both economic activity and inflation.

We may have already seen some reassessment of expected returns play out in recent weeks as equity valuations dropped, corporate bond spreads widened, and credit default swaps increased for some companies involved in the AI buildout. I will be looking at how momentum in adoption of and investment in this technology evolves and for possible effects on both inflation and employment.

The Path Forward for Monetary Policy

As we think about the path ahead, it is important to remember that over the past two years the U.S. economy has experienced successive inflationary shocks that have not been driven by labor market conditions. Monetary policy cannot offset the direct effects of tariffs and energy costs on inflation, but it plays a central role in containing the second-round effects. Monetary policy also has limited influence on AI-related price pressures. However, in certain segments of AI-intensive sectors, particularly among newer and medium-sized firms, higher interest rates appear to be holding back investment and purchasing decisions.

As I noted earlier, financial conditions have tightened. Against this backdrop, the benefit of additional policy tightening has to be carefully weighed against its costs for interest-rate-sensitive sectors. The October Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) suggests that the concentration of demand weakness in real estate loan categories reflects existing headwinds in those sectors.[5]

Time will help us learn more about the durability of momentum in AI-related demand and the evolution of geopolitical risks, both of which could be critical in the months ahead for setting our policy stance. Greater clarity on AI-related financing conditions and the sustainability of AI investments should increase my confidence in future policy decisions. Geopolitical conditions affect commodity markets and the degree of economic uncertainty perceived by households and businesses.

Before our next meeting in December, we will receive the PCE inflation report for October and the employment report for November. Today, I am seeing signs that inflation pressures are persisting, while labor market conditions appear to be firming. This indicates that there is still work to do to bring

[5] The October 2026 SLOOS is available on the Board's website at https://www.federalreserve.gov/data/sloos/sloos-202610.htm.

inflation closer to 2 percent. Given the recent market volatility, I will also continue to closely monitor how developments in financial conditions influence the economic outlook.

In the meantime, I will continue to meet with a broad range of contacts to inform my assessment of economic conditions and the appropriate stance of policy. 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 implications for the risks to our dual-mandate goals of maximum employment and price stability.

Thank you again for the invitation to join you this afternoon. I look forward to our discussion.