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Let's Get On with It

Remarks by

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at the

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Thank you, Jon, and thank you for the opportunity to speak to you today.<sup>1</sup>

Since I last spoke on the economy and monetary policy on July 17, economic data have reinforced my view of the outlook and my judgment that the time has come to ease monetary policy and move it to a more neutral stance.<sup>2</sup>

In July, I argued that, looking through tariff effects, with underlying inflation near target and the upside risks to inflation limited, the Federal Open Market Committee (FOMC) should not wait until the labor market deteriorates before we cut the policy rate. Based on all the data in hand, I believe this argument is even stronger today, and that the downside risks to the labor market have increased.

In July, I warned that job creation was weaker than it seemed in the payroll numbers and that data due in early September would indicate that payroll growth will be significantly lowered when annual revisions are made next spring. But even before then, job creation came in soft in the employment report for July, and May and June were revised down sharply, for a three-month average pace for total nonfarm payroll growth of only 35,000. After accounting for these revisions and what we will learn in a couple of weeks, the data are likely to indicate that employment actually shrank over those three months. I will have more to say about labor market data revisions and how they should be treated in evaluating the monthly jobs report, one of the most valuable tools we have for judging economic conditions.

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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.

<sup>2</sup> See Christopher J. Waller (2025), “The Case for Cutting Now,” speech delivered at the Money Marketers of New York University, New York, July 17, <https://www.federalreserve.gov/newsevents/speech/waller20250717a.htm>.

I favored reducing the federal funds rate by 25 basis points at the FOMC's July meeting, and subsequent data on the labor market and inflation indicate this was the right call. That also seems to be the message from financial markets, which now expect a 25-basis-point cut at the FOMC's September meeting and put significant odds on an additional one or two cuts at the final two meetings of 2025. As I will discuss, factoring out estimates of the temporary effects of import tariffs, underlying inflation remains close to 2 percent. I believe the data on economic activity, the labor market, and inflation support moving policy toward a neutral setting. Based on the median of FOMC participants' estimates of the longer-run value of the federal funds rate, neutral is 125 to 150 basis points lower than the current setting. While I believe we should have cut in July, I am still hopeful that easing monetary policy at our next meeting can keep the labor market from deteriorating while returning inflation to the FOMC's goal of 2 percent. So, let's get on with it.

Economic activity has slowed significantly in 2025 from 2024. Growth for the first half of the year was 1.4 percent. Looking ahead, the limited evidence we have is consistent with continued sluggish growth. We don't have much data for the second half, but smoothing through the monthly volatility, retail sales for July suggest that consumers are continuing to spend, albeit at a slower pace than last year. Meanwhile, manufacturing output in the report on industrial production was flat in July, and according to purchasing managers, new orders for manufacturing are consistent with a modest decline in the next few months. For the large majority of businesses outside of manufacturing, new orders are consistent with roughly flat production in the coming months.

Many forecasters have said they expect household and business spending and investment decisions will be weighed down by tariffs—those enacted, and the uncertainty about tariff levels in the future. Tariffs affect the costs and profits of businesses and, to the degree that they raise prices, also affect the real disposable income of consumers. Some businesses will be directly affected by tariffs, but many more will be affected by how tariffs crimp household spending. Tariff effects on households and businesses also will weigh on employment. All of this is consistent with what my business contacts are telling me, which is that they are postponing investment and hiring because of the uncertainty about how tariffs will affect their input costs and demand for their products. That said, I'm starting to hear some rumblings that businesses cannot sit on the sidelines forever. So we could see, at least, investment projects that were postponed begin to pick up, which would be positive for the economy. But how employment decisions evolve is more up in the air. I will be monitoring these business decisions because they are key to how activity will unfold in the second half of the year.

Returning to the labor market, risks are continuing to build. In my July 17 speech, I said that private-sector job creation was nearing stall speed, and the data received since then have put an exclamation point on this statement. I always say that one month is not a trend, but now we have three months of weak job-creation data from the Current Employment Statistics. After revisions included in the July report, private-sector job creation averaged 52,000 in May, June, and July, about half the rate in the first quarter of 2025. The headline numbers, including public-sector workers, are, as I noted earlier, even worse, but I tend to focus on the private sector as a better indication of the underlying momentum in the labor market.

That's the picture after the unusually large revisions to May and June payrolls and the soft reading for July that was included in the latest jobs report. In addition to those revisions, on September 9 we will get a preliminary estimate of what to expect in the annual "benchmark" revisions to 2025 early next year. I estimate that monthly job creation will be reduced by an average of about 60,000 a month.<sup>3</sup> That would mean that private-sector employment actually shrank, on average, in the past three months and that job creation earlier in the year was weaker than currently reported.<sup>4</sup>

I have heard the argument that declining labor supply due to lower immigration means that low jobs numbers aren't as bad as they look and that the "breakeven" number for keeping the unemployment rate steady is declining. To those people, I would say: Yes, these estimates have been falling, but I haven't heard anyone say the breakeven level is negative. Supply-side changes can't account for the ugly jobs numbers of the past three months.

Other data support the idea that labor demand may be on the edge of a sharp decline. For example, wage growth for people switching to new jobs is lower than for people staying in the same job, the opposite of what we see in a strong labor market. A few years ago, the rate of people quitting their jobs surged, and job switchers were getting substantially larger raises than those staying in their jobs. Today the quits rate is

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<sup>3</sup> My estimate of the anticipated revision is based on the difference between the currently published level of payroll employment and the count of employment from the Quarterly Census of Employment and Wages (QCEW), which is used to benchmark the payroll employment figures. The QCEW data, which are currently available through 2024:Q4, suggest that the monthly change in payroll employment has been overstated by roughly 60,000 per month since March 2024.

<sup>4</sup> I also look at timely data that Federal Reserve staff maintains in collaboration with the employment services firm ADP to construct a measure of weekly payroll employment, which covers about 20 percent of the nation's private workforce. This measure is comparable to the one ADP publishes. The current May–July contour for the staff measure of ADP-based private employment is broadly consistent with that of the Current Employment Statistics numbers. And in the weeks after the July jobs report's reference period, preliminary estimates from ADP show continued deterioration.

back down to its mid-2010s level, and these individuals must be switching jobs for reasons other than gains in compensation.

Another sign of a weakening in the labor market is that the unemployment rates for some cyclically sensitive groups of workers, such as teenagers, are up sharply this year, to levels, again, similar to those in the softer job market of the mid-2010s.

Supplementing this hard evidence of falling labor demand is the consistent story from my business contacts that they are not hiring. The mix of reasons is not only uncertainty over tariff policy and slowing demand for their goods and services, but also, increasingly, uncertainty over how to use artificial intelligence, which is especially freezing hiring for some entry-level jobs.<sup>5</sup>

This softening in labor demand is occurring at the same time, as I noted earlier, that there is a decline in labor supply. I often hear the argument that the unemployment rate is the key labor market indicator because it reflects what is happening in both demand and supply. And given that the current unemployment rate is 4.2 percent, close to most estimates of maximum employment and barely changed over the last year, this suggests that the labor market is solid. While I would normally agree with this statement, I do not think it is accurate now. I believe that any decline in labor supply is only masking weakening demand in the labor market. Whether or not supply is down, weakening demand is not good, and it is specifically what monetary policy is intended to address.

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<sup>5</sup> If artificial intelligence (AI) is affecting employment decisions, an important question for policymakers is whether such effects are temporary or permanent. Like many other innovations, AI will most likely shift displaced workers into new roles.

Before I move on from the labor market, let me address a question of some public debate recently, which is the quality of the payroll data. As should be obvious from these remarks and others I have delivered, I consider the monthly jobs report, including its estimate of payroll employment, an absolutely indispensable tool in evaluating the economy and setting monetary policy, and that view is close to unanimous among economic forecasters and policymakers. Considering how important this data is in getting an accurate and reliable read on the state of the labor market, it is entirely appropriate to examine the quality of the jobs numbers and the process by which they are collected. There is always room for improvement in data collection and analysis. In fact, the Bureau of Labor Statistics (BLS) and other agencies that collect economic data have benefited from expert committees of outside advisers who have provided advice on ways to improve data quality.

There has been substantial commentary since the last jobs report regarding the declining response rate of establishments and individuals in the employment survey and the outsized revisions of the data. This commentary has raised questions about the quality of the employment survey data. So I want to address this issue and clarify some facts about the survey response and the revisions. When the BLS sends out the establishment survey for a given month, it gives firms three months to return the survey—they can return it in the first month, the second month, or the third month. Some firms do not respond at all. Firms that submit their responses in the first month are the basis for the initial, or preliminary, payroll estimate. Those firms that respond in the second month get added to the first-month responders to get an updated number, which yields the first revision that is published a month later. Then the firms that respond in the

final month provide the BLS with the final numbers for the original month. This is the second revision and is the official payroll estimate for that month.

A decade ago, the response rate for the first month was 75 percent, meaning three-fourths of the firms surveyed responded immediately. But the initial response rate has fallen to 60 percent recently. Does that imply that the overall response rate for the entire three-month period has fallen? No, response rates by the final estimate have not fallen—about 95 percent of firms responded a decade ago, and that is how many are responding now. What has happened is that U.S. firms are slower in returning the survey. Ten years ago, if the survey had been sent to 100 firms, 75 would respond in the first month, and 20 firms would respond in the next two months. But now only 60 firms respond in the first month, and 35 firms respond in the second and third months. But in both cases, 95 out of 100 firms surveyed responded.<sup>6</sup>

What are the implications of this delayed response pattern? First, if more data come in later in the survey period, then the initial estimate is less likely to accurately represent the final estimate, which means you are more likely to get significant revisions in the second and third months. The revisions do not mean the quality of the data has declined; it simply reflects the fact that more data is coming in late in the survey period.

A second point is that revisions have been, on average, negative for the past couple of years, and while the recent revisions were large, revisions have not been getting bigger, on average, based on an analysis recently issued by economists at J.P. Morgan.<sup>7</sup>

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<sup>6</sup> The initiation rate has fallen significantly since the onset of the pandemic. This is an area where additional resources dedicated to recruiting participants could improve data collection.

<sup>7</sup> See J.P. Morgan (2025), “US Focus: Jobs Revisions,” webpage, August 15, <https://markets.jpmorgan.com/research/email/scx/1h6t2ulk/GPS-5056358-0/dcb73cdb-097b-4cdc-807f-bccb79320a11>.

They did find that large revisions are often associated with major turning points in the labor market. One possibility is that the recent large revisions in the payroll data for May and June indicate the labor market is at an inflection point and may worsen in coming months.

Overall, the delay in responses does mean that we can expect initial reports to be noisier and more prone to revision. One month of data has never constituted a trend, but it is going to be especially important to take near-month payroll data with a grain of salt and form a picture of the labor market based on several months of results and a range of other labor market indicators. I hope my analysis of the labor market shows you that I do exactly that.

Let me now turn to the outlook for inflation. Earlier this month, we received consumer and producer price information for July that allows for an estimate of inflation based on personal consumption expenditures (PCE), the FOMC's preferred measure. Based on those reports, PCE inflation increased 2.6 percent over the 12 months ended in July, and PCE inflation excluding volatile food and energy prices increased 2.9 percent. We will get the official data tomorrow.

Inflation has increased since the first quarter, but these numbers include the effects of import tariff increases, which, with inflation expectations anchored, I continue to expect will only temporarily raise inflation. Federal Reserve staff has extracted the tariff effects of inflation, and their latest estimates imply that without these effects, underlying inflation continues to run close to the FOMC's 2 percent target.<sup>8</sup>

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<sup>8</sup> For a detailed discussion of the methodology to detect tariff effects on inflation, see Robbie Minton and Mariano Somale (2025), "Detecting Tariff Effects on Consumer Prices in Real Time," FEDS Notes (Washington: Board of Governors of the Federal Reserve System, May 9),

There is still considerable uncertainty about how much more, and how quickly, tariffs will pass through to consumer prices. I have seen estimates that vary widely in the share of tariffs borne by exporters, importers, and consumers, and that tells me that one must be careful not to presume that some will bear a lot more than others. I continue to assume that the three groups affected by tariffs will share the costs roughly equally—one-third, one-third, and one-third. Most forecasts are for 12-month inflation to continue to slowly increase for a couple more months, with monthly tariff effects dissipating by early 2026.

I believe that monetary policy should look through the tariff effects on inflation. With underlying inflation close to 2 percent, market-based measures of longer-term inflation expectations firmly anchored, and the chances of an undesirable weakening in the labor market increased, proper risk management means the FOMC should be cutting the policy rate now. I felt this way in July, and all the evidence since then has led me to feel more strongly about it today. Based on what I know today, I would support a 25 basis point cut at the Committee's meeting on September 16 and 17. While there are signs of a weakening labor market, I worry that conditions could deteriorate further and quite rapidly, and I think it is important that the FOMC not wait until such a deterioration is under way and risk falling behind the curve in setting appropriate monetary policy.

My eagerness to move now is supported by my view that monetary policy is moderately restrictive. In June, the median of FOMC participants estimated that the longer-run value of the federal funds rate, akin to what it would be now without

restricting or stimulating the economy, is 3 percent. With the target for the federal funds rate in a range of 4.25 percent to 4.5 percent, that means we are 1-1/4 to 1-1/2 percentage points above neutral.

While I judge that the FOMC should have begun this process in July, based on the data in hand, I don't believe that a cut of larger than 25 basis points is needed in September. That view, of course, could change if the employment report for August, due out a week from tomorrow, points to a substantially weakening economy and inflation remains well contained.

I think there is a growing consensus that monetary policy needs to be more accommodative, and even some recognition that it would have been wise to begin this process in July. I don't believe that policy has fallen substantially behind the curve, but one way to signal that I don't intend to allow that happen is to talk about where we go after September. Like other participants, I will be updating my economic projections just before the next FOMC meeting, including my assessment of the appropriate level of the federal funds rate at the end of this year and next. The totality of the data and the outlook will determine how quickly I believe we need to move policy to a neutral setting, but as I stand here today, I anticipate additional cuts over the next three to six months, and the pace of rate cuts will be driven by the incoming data.<sup>i</sup>

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<sup>i</sup> On August 29, on page 2, a correction was made to the growth rate for real gross domestic product in the first half of 2025. The corrected sentence reads: "Growth for the first half of the year was 1.4 percent."