

For release on delivery
4:30 a.m. EDT (11:30 a.m. local time)
October 8, 2026

The Signaling Value of the Summary of Economic Projections

Remarks by

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at the

Istanbul Economic Forum
Central Bank of the Republic of Türkiye

Istanbul, Türkiye

October 8, 2026

Thank you to the Central Bank of Türkiye for the opportunity to speak to you.¹ I look forward today to hearing perspectives on the global economy and Türkiye's role in it, but I thought the most constructive use I can make of the valuable time you have granted me is to offer a brief update on the U.S. economy and then offer some thoughts on central bank communication.

As you know, in September the Federal Open Market Committee (FOMC) voted to raise our policy rate 25 basis points to 3.75 percent to 4 percent after nine months during which we held it steady. When monetary policy changes in this fashion, one question that most people ask is, what comes next? And I promise that I will do my best to answer that today, but first I will address another question raised by this shift in policy, which is, what changed? Was there new evidence, or did my thinking about the economy change? It turns out that the answer to this second question has a lot to do with the first one—about where policy goes from here.

I have mentioned that last month's increase in the federal funds rate came after nine months of holding it steady. When I ask "What changed?" I am obviously asking what changed in the seven weeks between July 29, when the FOMC voted to hold rates steady, and September 16, when we raised them. But I am also asking about what changed from the second half of 2025, when the FOMC reduced rates 75 basis points over three successive meetings. While it might seem to some that monetary policy has turned on a dime, or on one or two data points, in my case my decision last month was the culmination of factors that developed over the past year, and I would like to describe them.

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.

When the FOMC cut rates from September through December 2025, we did so with inflation fairly close to our 2 percent target, after accounting for tariff effects that research found were passing through measures of inflation. At the same time, there was significant evidence of a weakening labor market, with an increase in unemployment over the first eight months of the year and very low job creation. Though the picture was less sharp after official data was interrupted because of the government shutdown that began on October 1, other data supported the view that the balance of risks to the FOMC's employment and inflation goals seemed clearly skewed toward employment. I considered our cuts to the policy rate last year as insurance against an economic slowdown.

But then, over the course of the first half of this year, the labor market appeared to stabilize, while progress on inflation stalled due in part to the conflict in the Middle East that drove energy prices very high. I supported no change in the policy rate in the spring and summer with the hope that the conflict would end soon and that the oil price surge would not have a lasting effect on inflation. And there were some signs of an easing of inflation. While headline inflation seesawed based on oil prices and the state of the Middle East conflict, core personal consumption expenditures (PCE) inflation—which excludes volatile food and energy prices—moderated to 0.1 percent in June and an initial estimate of 0.2 percent in July, later revised to 0.1 percent.

But other forces were undermining my faith in this progress. First, hopes for a quick ending to the Middle East conflict faded, and experts warned that low inventories and damaged infrastructure could keep oil prices high through 2027. Second, evidence mounted that the artificial intelligence buildout was significantly driving up high-tech

consumer prices, and projections for the size of that buildout ballooned. Third, continuing trade conflicts threatened new tariffs that could put upward pressure on inflation yet again. In most cases, these were forces that became clearer as the year passed, swamping the fleeting signs of progress toward 2 percent inflation. When the first inflation reading for August came in hot just before the FOMC's September meeting, it was impossible to deny that inflation was still too high and not making sufficient progress toward our target.

While some suggested that monetary policy shifted in September based largely on the single data point of consumer price index inflation for August, I hope it is now apparent that this wasn't the case for me. Instead, it was a preponderance of evidence over several months that the risks for monetary policy had shifted, reflecting a strengthened labor market and a range of persistent inflationary forces. For me, this led to the judgment that the policy setting that the FOMC maintained from December 2025 through September of this year would not be sufficient to return inflation to 2 percent in a timely manner. My decision to change the stance of policy emerged over time because it is not one that I take lightly. With evidence that economic activity is strengthening in the second half of this year, I am not greatly concerned that tighter monetary policy threatens a damaging slowdown in the economy. But I am concerned that the recent acceleration in inflation—after what soon will be five and a half years of it above the FOMC's target—will lead consumers, investors, and price-setting businesses to revise up their expectations for future inflation.

Based on some key data released last week, I see the economy in roughly the same place as it was at the time of the FOMC's September meeting. While the number of

jobs created was down overall, the employment report indicated that the labor market continued to be solid and stable in September. The unemployment rate remains relatively low and near the median of policymakers' projections of its longer-run level, while payroll gains are in the range of estimates of breakeven to keep the unemployment rate steady. August inflation data, which included revisions to the government's methodology, showed monthly core PCE inflation of 0.25 percent and the 12-month change at 3 percent. Looking at the history of 12-month core inflation, it has been between roughly 2.5 percent and 3.0 percent since the spring of 2024. This is obviously higher than we want, above our target, and not showing sufficient progress. Overall, the new data reinforce my view that the labor market is stable and inflation is too high. For at least the near term, policy will be focused on the inflation side of our mandate.

For the remainder of my remarks, I want to discuss a particular way of communicating the expected future stance of monetary policy that has the flavor of forward guidance but isn't forward guidance. Let me illustrate what I have in mind with an example.

Suppose that a majority of FOMC voters decide that policy needs to be more restrictive and that it is fairly clear to the public that some tightening is likely. What needs to be determined by both policymakers and markets is the number of rate hikes and the pace of rate hikes. Each policymaker thinks about his or her anticipated appropriate policy path to assist them in moving the economy toward the Fed's dual mandate. Markets estimate what the FOMC voters believe is the appropriate path of policy to assist them in pricing various assets.

So how could policymakers communicate the expected policy path to markets? There are several options. To explain, let's assume the number of hikes that policymakers have in mind is three 25 basis point hikes so that they anticipate policy will ultimately be 75 basis points higher than it currently is.

First, policymakers could choose to say nothing about the expected path of the policy rate. But that approach could surprise markets and create volatility. Without additional information, in an extreme case, they could price in zero or even potentially five hikes in future meetings. The point is that if too few or too many hikes are priced in, the change in financial conditions would mean too little or too much of an effect on economic activity.

Second, policymakers could use a strong form of forward guidance and communicate their support for raising the policy rate, let's say, every other meeting by 25 basis points until a total of 75 basis points worth of hikes has been enacted. The market would respond by pricing in 75 basis points of hikes over five meetings. While this eliminates any uncertainty about the future path of policy, it ignores the possibility that incoming data would suggest going faster or slower or hiking more or less than 75 basis points. Indeed, locking in a policy path over such a long period is unlikely to lead to good outcomes given the uncertainty around how the economy will evolve over time.

Finally, there is something in between these two approaches that I will call the signaling option. What I have in mind is that policymakers could signal that the policy rate will likely be hiked 75 basis points over some time interval—say, the next six months. However, policymakers do not say what the pace of hikes will be or how large of an increment the rate hike will be. And we could emphasize that the course of

monetary policy is not predetermined and will depend on incoming data and its implications for our dual-mandate goals. This approach provides some information regarding what the terminal rate will be after hiking but allows the pace and the size of rate hikes to be data dependent. Simply put, policymakers could signal where they are likely headed while acknowledging that there is no fixed final destination—except for the achievement of price stability and maximum employment.

I see Federal Reserve policymakers' communications fitting in this last approach, both in their public remarks and their quarterly submissions of economic projections. The Summary of Economic Projections (SEP) is serving that signaling role for policymakers. The projections submitted at the September meeting showed that a large majority of FOMC participants believe it will be appropriate to raise rates at least once more this year. Sixteen of the 18 participants who submitted dots anticipated at least one more hike during the two remaining meetings this year. Four of those 16 expected two additional hikes. It gets a little complicated reading the dots for the full year of 2027, since they may reflect hikes early in the year and then cuts later in the year, but eight participants expect that rates will be 50 basis points higher at the end of 2027 than they are today.

Between the SEP and policymakers' outlook speeches that encompass their interpretation of additional economic data, markets have interpreted that the Committee is likely to raise the policy rate 50 basis points in the coming months. According to futures market prices for the federal funds rate as of yesterday, traders see an 85 percent chance of at least one hike by the end of the FOMC's December meeting and nearly 20 percent chance of two hikes. And, by the March 2027 meeting, markets see nearly an 80 percent

chance of at least two hikes and a 33 percent chance of three or more hikes. This signaling helps to anchor the path of short-term interest rates but provides flexibility in adjusting rate hikes based on incoming data.

If the economic data continue to come in as expected, I anticipate additional hikes to support a timelier return of inflation to our 2 percent goal. But there is some flexibility about when those hikes will occur. The hikes do not need to come at consecutive meetings, but they should be in place in an acceptable period of time.

I think I will stop here to make sure there is enough time for our discussion.