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The Economic Outlook and Some Thoughts on Labor Market Dynamism

Remarks by

Christopher J. Waller

Member

Board of Governors of the Federal Reserve System

at

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Thank you, Paul, and welcome to Bank of England watchers, who I suspect are watching the Federal Reserve as well.[1]

My subject today is the outlook for the U.S. economy and the implications for monetary policy. I think there is little disagreement about the basics of that outlook. The U.S. economy is growing strongly, with a labor market that has brought employment close to its long-term rate. But inflation remains too high, so I will explain why I believe further tightening of monetary policy will be needed, sooner rather than later, to return inflation to a path that will reach 2 percent in the medium term.

The outline of my speech is to first explain why I voted to hold the policy rate steady at the most recent meeting of the Federal Open Market Committee (FOMC). Then I will talk about the general state of the U.S. economy. After that, I will ask some open-ended questions about the dynamism of the U.S. labor market that are important to consider over the longer run. I'll follow that by a discussion of recent inflation data and then describe my views about the future path of monetary policy.

At our most recent meeting, I supported the FOMC majority in holding monetary policy at its current setting. As I said in a speech a couple weeks before then, my rationale was that the Committee's communication about the likely tightening of policy had already led financial markets to price in some tightening.[2] When this communication is clear and credible, what really matters is that those hikes are eventually carried out—it is not necessary, for example, to raise rates at consecutive meetings.

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[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.

[2] See Christopher J. Waller (2026), "The Signaling Value of the Summary of Economic Projections," speech delivered at the Istanbul Economic Forum, Central Bank of the Republic of Türkiye, Istanbul, October 8, https://www.federalreserve.gov/newsevents/speech/waller20261008a.htm.

If, however, the hikes are not carried out, markets will reduce expectations of rate hikes and rates will immediately fall, which would loosen monetary policy in an undesirable way. So, while the precise timing of the hikes doesn't matter, ensuring that the promised hikes are implemented in a reasonable period of time does.

Let me turn to the economy. Economic output continues to grow at a healthy pace. The initial estimate was that real gross domestic product (GDP) rose 3.4 percent in the third quarter, supported by strong consumer spending and robust investment. Consumption growth was helped by a booming stock market, and investment by businesses continued to surge, especially in high-tech equipment associated with the artificial intelligence (AI) buildout. I expect GDP growth is backing off a bit in the current quarter, as consumer spending slows to levels that I think are more consistent with household income and wealth, but output will continue to grow at a solid pace.

The labor market has also been solid. The unemployment rate ticked down to 4.1 percent in October, the same rate it was over the summer. Job creation, which has been fluctuating widely month to month for some time, saw October gains of 165,000 jobs and 85,000 jobs added to estimates of the previous two months. To look through the volatility, the 6-month and 12-month average payroll gains have been closer to 80,000 jobs a month. This level is a bit above most estimates of the breakeven level needed to keep the unemployment rate steady but entirely consistent with my view that the supply and demand for labor are in rough balance.

While the labor market has been stable, for over a year now it has been what is best characterized as "low hire, low fire." One can understand this characterization by looking at job separation and hiring rates today and comparing them with what they were

before the pandemic (see figures 1 and 2). You will see that the rate of separations, the sum of layoffs and quits, has been persistently low the past few years compared with a decade ago. The hiring rate is also low. This is unusual because, in a strong labor market, the hiring rate is usually high. Hiring tends to be low when the labor market is weak, which is when the firing rate is often elevated. What is unusual today, and may be unprecedented, is the extent to which both firing and hiring are now so low.

These data have led me to consider a question that has longer-term implications for the economy and monetary policy: Does a stable labor market necessarily mean it's a healthy labor market? To illustrate the difference, if your mom was in the hospital and the doctor told you her condition was stable, you would be relieved but you wouldn't say she is healthy. I am concerned that the low hire, low fire equilibrium in the labor market means it has lost some of its dynamism, which is important for productivity growth and real wages. If the labor market is in fact showing less dynamism, is it an issue for monetary policy? While I don't have answers to these questions, I do think the questions are worth asking.

This discussion starts with distinguishing between net employment growth and gross flows in and out of employment. Behind the monthly job creation numbers that get most of the world's attention is the enormous churn in the labor market. For example, the 60,000 jobs created in September was a net change in the level of employment, but it is dwarfed by the more than 5 million people who left their jobs that month and the more than 5 million who were hired. Despite the low separation and hiring rates, the level of separations and hiring is huge. When I was a professor, I would use the following analogy for my students. If you stand by a river, you can measure the water level. If you

return the next day and measure again, you will likely find that the water level is unchanged—it is stable. But in fact, a massive amount of water has flowed downstream since the day before. The same goes for the labor market—there is a lot of churning even if the level of employment is stable.

The question is, does churn in the labor market matter? If so, is labor market churn bad or good? One could argue that this churn is inefficient. Why are people and firms wasting time swapping workers across jobs? If workers simply stayed at their firms, and firms never let them go, employment would be stable and resources would be saved from putting workers into new jobs. But would it mean the labor market is healthy?

The answer is that the churn in hiring and firing is actually good for the economy. This churn reflects a dynamic market that allows labor resources to be allocated to more productive uses. If a worker and firm are not in a good, productive match, then it is more efficient and better for the economy for the worker and firm to separate and look for new partners. When more productive matches are formed, productivity, real wages, and profits will be higher. In this situation, employment may not be stable, but it is healthier.

I believe this churn is what leads to the exceptional performance of the U.S. economy. The relative ease of starting businesses in the United States, compared with many other advanced economies, is a big advantage. The relative ease of firing employees, compared with many European Union economies, is surely not welcome by the workers affected, but cumulatively it was a factor that drove the stronger recovery in the United States from the pandemic recession. This flexibility in hiring and firing promotes a better match between skills of the worker and those demanded by businesses,

making the most productive use of their abilities. As a result, this churn boosts the capacity of the economy and allows incomes to grow without inflationary pressure.

So, given this discussion, how do we interpret the current low hire, low fire economy? Does it indicate that the U.S. labor market has become less dynamic and less healthy, which has implications for the economic outlook and for monetary policy? I will first consider the possible causes of this lower dynamism and then the possible implications.

One explanation for the lower dynamism is that some of the decline in both hiring and firing may reflect, in part, a continuation of longer-run trends that were in place even before the pandemic. First, it is well known that the workforce is aging for a number of reasons: People are living longer and are healthier and more active at older ages; many members of the large post–World War II baby boom are in their 60s and 70s; and birth rates have declined, which increases the relative age of the workforce. This aging affects the dynamism of the labor market because older workers switch jobs less frequently, since many have managed over time to find better job matches and because older workers are less likely to relocate for work. The second trend is that the level of education of the workforce is increasing over time. More educated workers experience less job churn in general and, during downturns, face lower rates of job separations. Since 2010, the share of adults 25 and older with at least a bachelor's degree has increased from 28 percent to 37 percent.[3]

[3] Shakeena J. King and Daniela Mejía (2026), "Women Ages 65 and Over Now Make Up the Largest Share of Education Bachelor's Degree Holders," U.S. Census Bureau, *America Counts: Stories Behind the Numbers,* October 29, https://www.census.gov/library/stories/2026/10/education-college-degrees.html.

If these were the only reasons for the decline in labor market dynamism, then it would be at a level consistent with these trend factors, suggesting an appropriate degree of dynamism with no implications for monetary policy. But the data suggest that, even after accounting for these factors, labor market dynamism still seems somewhat low. There are several possible reasons.

One is that hiring and job-switching may have been restrained by the confluence of factors that have raised economic uncertainty since early 2025: the advent of AI, tariffs, changes in immigration policy and enforcement, and a general level of uncertainty about the economic outlook that has made business planning particularly challenging. One piece of evidence was a special question posed in the Federal Reserve's November 2025 Beige Book survey of economic conditions: Employers reported in November 2025 that hiring was unusually restrained because of uncertainty. I don't think uncertainty has diminished much since then. And another piece of evidence is in the most recent Beige Book, showing that several Fed Districts reported firms had delayed hiring or anticipate less job creation after investing in AI.

Another reason for low dynamism is that low firing may be a consequence of the huge surge in job-switching from 2020 to 2023 related to the pandemic. Workers in new jobs are less inclined to change jobs again, and that may be limiting job-switching. If this is a large factor, it may be temporary—workers are in their jobs for a median of three years before switching again, and we are nearing that threshold for the last of the pandemic job switchers. But it's possible they could be staying longer now if the job-switching triggered by the pandemic had been unusually effective at improving the

matches between workers and jobs—many relocated or chased dreams and new careers and may not be as willing to switch again.

As you can tell, it is hard to pin down and properly weigh the possible causes of lower labor market dynamism and then judge how long that phenomenon might continue. This makes it hard to know the implications for the economic outlook and monetary policy.

But we can talk more constructively, I think, about the possible effects of the current low hire, low fire environment. While low layoffs imply that fewer workers experience unemployment, a low hiring rate means that those who do become unemployed may experience longer unemployment spells. And, in fact, the percentage of unemployed people who have been looking for work for more than six months has climbed steadily since 2022 and is now quite elevated for a period of economic expansion.[4] Another logical consequence of lower dynamism in the labor market would be that new entrants, typically young and with less experience, are having a harder time finding jobs. I think anyone paying attention to the U.S. economy has been hearing about the challenges young workers are facing. Indeed, the share of new labor force entrants in unemployment has been rising and has reached close to the highest levels of the past twenty years.

Both these developments may reflect a labor market that is not as healthy as the headline unemployment rate indicates, with implications for the longer-term path of monetary policy. If hires and separations are low because worker matches have

[4] The three-month moving average of workers reporting that they have been unemployed for 27 weeks or more increases from around 18 percent at the end of 2022 to more than 27 percent through September 2026.

improved, then this may be a boost to productivity and can be largely ignored in assessing the state of the labor market. But I worry that today's labor market dynamism may be low due to impediments to mobility that are affecting long-term and youth unemployment, and this may lead to a less-efficient distribution of workers across jobs, hindering productivity growth. This possibility is important to monitor because productivity growth is a crucial factor in judging how fast the economy can grow without undesirable inflationary pressure. As I said earlier, I don't have the answers to the questions I have posed, but I believe the questions are worth asking and addressing with more research.

Let me put aside this discussion about the health of the labor market for now. What is important in the near term is that I see the labor market as stable and employment at a level close to the FOMC's maximum-employment goal.

By contrast, inflation is well above 2 percent and the focus of my attention. For reasons I explained at the start of this speech, I was willing to wait to tighten monetary policy at the FOMC's October meeting. Inconveniently for today's event, we will get consumer price index (CPI) inflation for October in a few hours. While I am hoping for an improvement over September, even if this occurs, I would still support a 25 basis point increase in the FOMC's policy rate at our December meeting. However, if inflation comes in substantially higher than I expect, more robust action by the FOMC may be called for.

Let's just say it. September's inflation data were bad. There was no silver lining. Inflation based on personal consumption expenditures (PCE), the measure targeted by the FOMC, rose at a monthly rate of 0.5 percent in September and 3.7 percent over the

previous 12 months. Core PCE inflation, excluding food and energy prices, rose 0.3 percent in September and 3.1 percent from that time last year. Both these measures are too high, and I am particularly concerned about the breadth of price increases. Earlier this year, excessive inflation was driven by nonmarket prices that are estimated rather than observed by the government, and ones that I tend to discount as hard to measure and as an unreliable guide to the overall trend for core inflation. But now, two components with greater relevance to future inflation are elevated—core goods prices and those for core market-based services excluding housing. More than 70 percent of the components of core PCE service prices saw 12-month increases above 3 percent in September.

Later today, I will be looking to see whether this breadth of elevated inflation continues, including whether high-tech goods prices related to the AI buildout continue to rise at the very high rate of recent months. I also want to know if the run-up in energy prices of the past several months is being passed through to goods and services directly or indirectly, because of higher input costs. While I am pleased to see energy prices down from their high rates over the past week or so, they are still quite elevated relative to the start of the year, and the ultimate effect on inflation will depend on what levels are sustained.

Federal Reserve staff have been thinking hard about the effects on inflation of the AI buildout and elevated energy prices, and their findings do not encourage me to think that these factors will be fading anytime soon.

In one exercise, researchers tried to capture imminent price pressures with a textual analysis of the well-known surveys of purchasing managers conducted by the

Institute for Supply Management (ISM).[5] ISM surveys ask purchasing managers to list specific commodities, materials, and services whose prices rose or fell that month.[6] Staff used these responses to construct monthly price pressure indexes that correspond with actual categories of the producer price index (PPI). They found these indexes provide information about future changes in producer prices and, as a result, should have some signal about future PCE inflation. For example, the index for high-tech products rose in December 2025 and jumped further in January 2026, ahead of an escalation in those goods prices that eventually showed up in the February PPI and inflation data. The most recent ISM data, for October, point to the possibility of more price increases ahead.

Some other Fed research indicates to me that energy price pressures may pass through to goods and services in a more sustained way than in the past.[7] The researchers find a potential shift in the inflation process after the pandemic that suggests core inflation may be more responsive to energy shocks. Central bankers have tended to look through energy price shocks and expect that their effects on inflation will soon fade, but this new work cautions against taking too much comfort in this view. Their analysis suggests that, especially if oil prices were to remain elevated, these pressures could be larger than previously though and persist well into 2027.

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[5] Tomaz Cajner, Leland D. Crane, Christopher J. Kurz, Paul E. Soto, and Betsy Vrankovich (2026), "Pricing Sentiment: Measuring Input Cost Pressure from ISM Survey Responses," FEDS Notes (Washington: Board of Governors of the Federal Reserve System, October 1), https://doi.org/10.17016/2380-7172.4191.

[6] For the prices paid question, respondents indicate whether prices increased, decreased, or stayed the same relative to the previous month and are asked to list specific commodities, materials, or services in an accompanying text field.

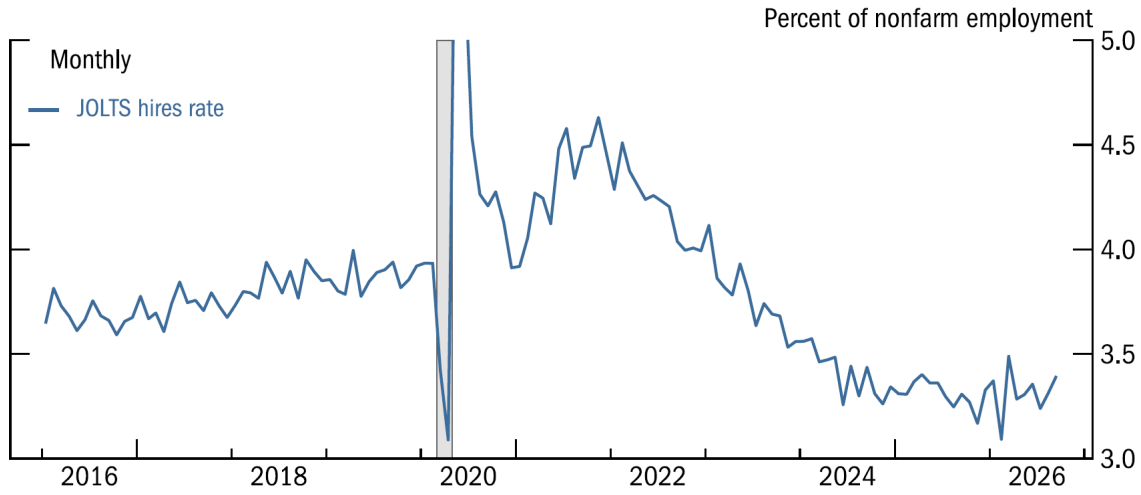
[7] Andrea De Michelis, Musa Orak, Avani Pradhan, and Albert Queralto (2026), "The Effect of Oil Prices on Core Inflation: Recent Evidence from the Advanced Economies," FEDS Notes (Washington: Board of Governors of the Federal Reserve System, November 9), https://doi.org/10.17016/2380-7172.4190.

And there are reasons to also expect elevated energy prices to persist. First, even as there is increased tanker traffic through the Strait of Hormuz, that traffic is moving at great expense. The insurance now needed for ships making this passing, and the ship-to-ship transfer of oil necessary to guard against Iranian attacks, are reportedly boosting oil prices by $20 to $30 a barrel. A second problem is that diesel oil production is affected by limited refining capacity and other constraints. As a consequence, elevated prices for diesel in the United States are not expected to moderate as readily as crude oil prices would in a more peaceful Middle East.

To recap my economic outlook, economic activity is strong, the labor market is stable, but inflation is too high, well above the FOMC's 2 percent goal. This means that even if, as I expect, the monthly rate of inflation improves in October, I am leaning toward supporting an increase in our policy rate of 25 basis points at the FOMC's December meeting.

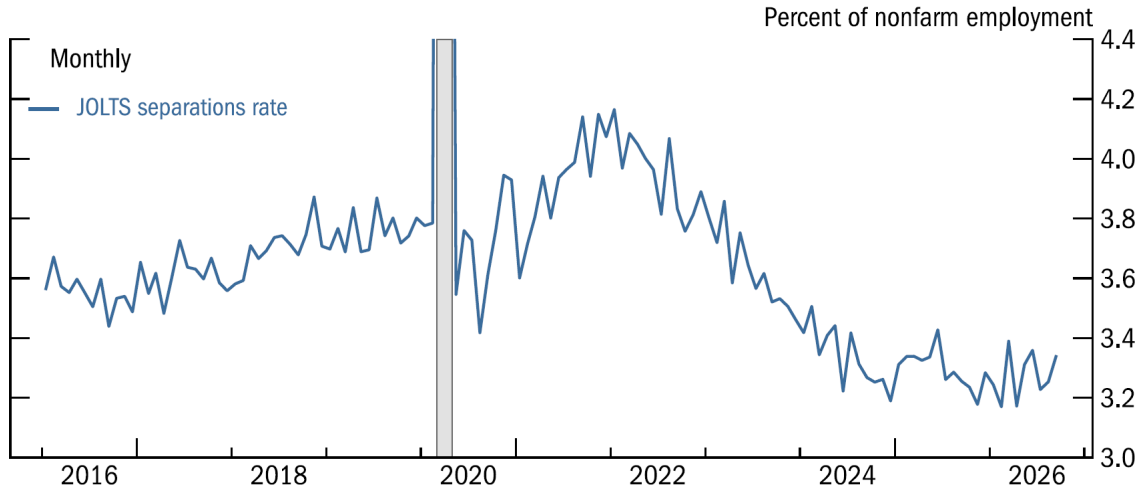
That's my plan if things proceed as I expect. But if the October CPI inflation data out later today are similar to the past two monthly readings—with core CPI inflation around 0.3 percent or even higher—then a stronger policy move may be needed. In that case, I believe a 50 basis point hike in the policy rate should be considered at the December meeting. Hiking only 25 basis points would put our credibility at risk, a risk I am not eager to take.

Figure 1.



Note: The shaded bars indicate periods of business recession as defined by the National Bureau of Economic Research: February 2020–April 2020.
Source: U.S. Bureau of Labor Statistics, Job Openings and Labor Turnover Survey.

Figure 2.



Note: The shaded bars indicate periods of business recession as defined by the National Bureau of Economic Research: February 2020–April 2020.
Source: U.S. Bureau of Labor Statistics, Job Openings and Labor Turnover Survey.