Michelle W Bowman: Views on the economy and monetary policy

Speech by Ms Michelle W Bowman, Vice Chair for Supervision of the Board of Governors of the Federal Reserve System, at the 2025 Kentucky Bankers Association Annual Convention, Asheville, North Carolina, 23 September 2025.

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Good morning.[1] I would like to thank the Kentucky Bankers Association for the opportunity to join you again for your annual convention, this time with an important difference. Earlier this year, the President nominated, and the Senate confirmed, me as the Fed's Vice Chair for Supervision. It's the first time someone with community banking experience has served in this role, and I am working to make sure that the Federal Reserve is addressing the issues I have discussed with you and other community bankers over the past nearly seven years that I've been a member of the Board of Governors.

It is really a pleasure to be with you again, and especially in Asheville, North Carolina, after the terrible flooding this area experienced last year.

Since the Federal Open Market Committee (FOMC) met for our September meeting last week, I thought I would share my views on the U.S. economy and monetary policy, including on my policy vote.

Update on the Most Recent FOMC Meeting

At last week's FOMC meeting, the Committee voted to lower the target range for the federal funds rate by 1/4 percentage point, bringing it to 4 to 4-1/4 percent, and to continue to reduce the Federal Reserve's securities holdings. In my view, the Committee should have begun lowering the policy rate at the July meeting, so, of course, I supported reducing the policy rate at this meeting.

For several months, I have been pointing out signs of potential labor market fragility. Since the June FOMC meeting and in public remarks following that meeting, I have argued that increasing signs of weakening labor market conditions provide a basis for beginning to move the policy rate closer to neutral to proactively support the employment side of our mandate. Recent data have revealed a materially more fragile labor market along with inflation that, excluding tariffs, has continued to hover not far above our target. Given this shift in labor market conditions, I am pleased that we have finally begun the process of removing policy restraint, reflecting the economic conditions and the balance of risks to our employment and inflation goals. Assuming the economy evolves as I expect, last week's action should be the first step to bring the federal funds rate back to its neutral level.

Economic Conditions and Outlook

The U.S. economy has been resilient, but I am concerned about the weakening in labor market conditions and softer economic growth. I am also more confident that, as trade policy has become more certain, tariffs will have only a small and short-lived effect on inflation going forward.

GDP growth slowed to a modest pace in the first half of the year, as consumer spending softened and both investment in residential and commercial real estate and federal government purchases declined. A surge in high-tech investment, likely related to interest-rate-insensitive AI and data-center projects, accounted for at least half of the increased demand in the first six months of the year, while there was weakness in other categories. The incoming data for July and August point to an improvement in third-quarter consumer expenditures.

Declines in housing activity, including single-family home construction and sales, have been accompanied by higher inventories of homes for sale and falling house prices, suggesting that housing demand has also weakened. Elevated mortgage rates may be exerting a more persistent drag as income growth expectations have declined while house prices remain high relative to rents. Given very low housing affordability, existing home sales have remained depressed since 2023 and at levels only comparable with the early 2010s following the financial crisis. I am concerned that, in the current environment, declines in house prices could accelerate, posing downside risks to housing valuations, construction, and inflation.

Turning to the labor market, conditions have weakened this year as shown by the rise in the unemployment rate and essentially flat payroll employment, which rose only about 25,000 per month since April. This is down sharply from the moderate pace of job gains seen earlier in the year and well below estimates of breakeven rates, due to softening in labor demand. The unemployment rate moved up to 4.3 percent in August, largely reflecting reduced hiring as businesses continue to retain existing workers instead of increasing layoffs. Wage growth has slowed closer to a pace consistent with 2 percent inflation, indicating that the labor market is no longer a source of inflation pressures.

Although still near full employment, the labor market has become more fragile and could deteriorate more significantly in the coming months. The unemployment rate has increased notably among groups that tend to be more affected by the business cycle, including teenagers. And the employment-to-population ratio has dropped significantly this year, showing more softening than the unemployment rate implies. Layoffs have edged up from low levels and could rise quickly if the economy weakens further since hiring rates have remained low. One consequence of a less dynamic labor market this year is the significant increase in the number of long-term unemployed workers.

Payroll employment growth has been concentrated in just a few services industries that tend to be less affected by the business cycle, with healthcare, social services, and leisure and hospitality more than accounting for all job gains since April. The share of industries with positive job growth over the last six months dropped below 50 percent in August to a historically low level.

Actual payroll employment may have started to fall in recent months given the sizable upward bias in the published data implied by the Q1 Quarterly Census of Employment and Wages report. Although less immigration likely explains some of the slower payroll gains and economic growth this year, immigration does not fully explain the slowing. The surge in immigration likely boosted the rise in unemployment through mid-2024, and lower immigration may now be masking a steeper rise in unemployment this year. In addition, these immigrants likely make a smaller contribution to economic activity than the average U.S. worker, as they tend to work in jobs and industries with lower wages and lower productivity.[2]

On price stability, we have seen some progress in lowering inflation, excluding one-off tariff effects on goods prices. Based on the latest consumer and producer price reports, 12-month core PCE inflation likely stood at 2.9 percent in August. However, after removing estimated tariff effects, core PCE inflation has hovered around 2.5 percent in recent months, which is significant progress and within range of our target. This progress reflects a considerable slowing in core services inflation, which is consistent with recent softness in consumer spending and the labor market no longer being a source of inflation pressures.

The underlying trend in core PCE inflation appears to be moving much closer to our 2 percent target than is currently shown in the data. With housing services inflation on a sustained downward trajectory, and further progress on other categories within core services inflation, only core goods inflation remains elevated, likely reflecting limited pass-through from tariffs.

In terms of risks to achieving our dual mandate, as I gain even greater confidence that tariffs will not present a persistent shock to inflation, I see that upside risks to price stability have diminished. With softness in aggregate demand, and signs of fragility in the labor market, I think that we should focus on risks to our employment mandate and preemptively stabilize and support labor market conditions.

Memories of pandemic worker shortages are still fresh, and businesses have so far chosen to maintain, rather than to reduce, their workforce in response to the slowing economic conditions. They also seem to be more willing to reduce profit margins as they are less able to fully pass through higher costs and raise prices given the weakness in demand. If demand conditions do not improve, businesses may need to begin to lay off workers, recognizing that it will not be as difficult to rehire given the shift in labor market conditions.

On trade policy, foreign suppliers are absorbing some of the new tariffs, and importers are shifting to lower-tariffed sources. Slack in the economy should also allow for only limited one-time price effects this year and very little, if any, "second round" effects on inflation in the medium term. I expect that lower immigration will continue to lessen demand and reduce inflation, especially on housing services. I also expect that less restrictive regulations, lower business taxes, and a more friendly business environment are likely to boost supply and offset any tariff-related effects on economic activity and prices over the medium term.

The Policy Decision and the Path Forward

So far this year, even with inflation within range of our target, the Committee has focused primarily on the inflation side of the dual mandate. Now that we have seen many months of deteriorating labor market conditions, it is time for the Committee to act decisively and proactively to address decreasing labor market dynamism and emerging signs of fragility. In my view, the recent data, including the estimated payroll employment benchmark revisions, show that we are at serious risk of already being behind the curve in addressing deteriorating labor market conditions. Should these conditions continue, I am concerned that we will need to adjust policy at a faster pace and to a larger degree going forward.

I recognize and appreciate concerns that we have not yet perfectly achieved our inflation goal. Because our dual mandate places equal weights on the two goals, we should turn our focus toward the side of the mandate that is showing signs of deterioration or fragility even though inflation is above but within range of our target. This should be especially the case since forecasters widely expect inflation to significantly decline next year, and as further deterioration in labor market conditions would likely lead to more persistent damage to the employment side of the mandate that would be difficult to address with our tools.

In my role as monetary policymaker, I am agnostic about why shocks happen, I take conditions as they are, and I make monetary policy decisions to support the economy. The credibility and effectiveness of the Federal Reserve depend on the public's trust that we will not bring a value judgment into our assessment of the underlying conditions.

Economic research is clear that, when conditions exist like those we are currently facing, monetary policy should de-emphasize inflation. The U.S. economy is experiencing aspects of a negative supply shock from higher tariffs that is also affecting aggregate demand. Since these conditions are unlikely to lead to persistent effects on inflation, and because changes in monetary policy take time to work their way through the economy, optimal policy calls for looking through temporarily elevated inflation readings. Therefore, we should proactively remove some policy restraint on aggregate demand to avoid damage to the labor market and a further weakening in the economy, provided that long-run inflation expectations remain well anchored.

In addition, putting tariffs aside, the U.S. economy may also be experiencing an extended productivity surge, in large part because of recent technological advances. And productivity growth has likely been higher than reported due to the downward benchmark revisions to payroll gains. These developments reinforce the case for removing policy restraint because monetary policy should accommodate productivity shocks that raise potential output.

In light of all these considerations, in my view, it was appropriate to begin the process of moving policy toward a more neutral stance at this meeting, and it has been for several months. In thinking about the path forward, I supported revising the characterization of the policy outlook in the post-meeting statement. It is important we signal that last week's action includes a forward-looking view of additional adjustments. If the statement had not included a reference to additional cuts, it would have signaled to markets that the Committee would not be responsive to weakening labor market conditions.

I am concerned that the labor market could enter into a precarious phase and there is a risk that a shock could tip it into a sudden and significant deterioration. Characterizing an appropriate forward-looking view of additional policy adjustments is important because it shapes the expected path of short-term interest rates, which, in turn, affects longer-term interest rates, including mortgage and corporate bond rates, that are key for household and business decisionmaking. Cutting the policy rate 25 basis points and signaling additional adjustments at upcoming meetings should allow longer-term interest rates to remain materially lower than earlier this year and help to support the economy.

Finally, I should note that the rising downside risks to employment and the potential for greater damage to the labor market underscore the need to shift our focus away from overemphasizing the latest data points. A strict interpretation of data dependence is inherently backward looking and would guarantee that we remain behind the curve, requiring us to overcorrect in the future. I think we should consider reframing our focus from overweighing the latest data to a proactive forward-looking approach and a forecast that reflects how the economy is likely to evolve going forward. This approach would better position us to avoid falling behind the curve and then having to implement abrupt and dramatic policy actions.

During this intermeeting period, I will continue to carefully monitor the incoming data and information as the Administration's policies, the economy, and financial markets continue to evolve. Before our next meeting in October, we will have received one additional month of employment and inflation data. I will also continue to meet with a broad range of contacts to discuss economic conditions as I assess the appropriateness of our monetary policy stance going forward.

It is important to note that monetary policy is not on a preset course. At each FOMC meeting, my colleagues and I will make our decisions based on each of our assessments of the incoming data and the implications for risks to the outlook, guided by the Fed's dual-mandate goals of maximum employment and stable prices.

Closing Thoughts

Before we move on to the discussion, I'd like to touch on the supervision and regulatory work underway. We have made a lot of progress in the past few months since I officially became the Vice Chair for Supervision. And Congress has been hard at work considering important banking and digital assets legislation and the passage of the GENIUS Act.[3]

In addition to working to implement the Fed's responsibilities under this law, we are making significant progress on a number of priorities in supervision and regulation. Early in my tenure, I described my approach that would require taking a fresh look at our activities.[4]

While we are making progress in a number of areas, there is much left to do. Some of this work will include improving the M&A process; reviewing the appropriateness of capital requirements for all banks, including revising the community bank leverage ratio and approaches for mutual banks; and addressing payments and check fraud (our request for information comment period ended last week). We are continuing to enhance examiner training and development, and we will continue to prioritize economic growth and safety and soundness in the bank regulatory framework. I look forward to sharing details with you during our discussion.

Thank you again for the invitation to join you today. It's a pleasure to spend time with our nation's community bankers.

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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 George Borjas (2015), "The Slowdown in the Economic Assimilation of Immigrants: Aging and Cohort Effects Revisited Again," *Journal of Human Capital*, vol 9 (4), pp. 483–517; and Congressional Budget Office (2024), *Effects of the Immigration Surge on the Federal Budget and the Economy* (Washington: CBO, July).

[3] The Guiding and Establishing National Innovation for U.S. Stablecoins Act was enacted on July 18, 2025.

[4] Michelle W. Bowman, "Taking a Fresh Look at Supervision and Regulation," (PDF) (remarks at the Georgetown University McDonough School of Business, Psaros Center for Financial Markets and Policy, Washington, D.C., June 6, 2025).