Michelle W Bowman: Outlook for 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 "Outlook 26: The New England Economic Forum, Foxborough, Massachusetts, 16 January 2026.

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Good morning and thank you for the invitation to join you today.[1] It is a pleasure to be with you here in Boston at the New England Economic Forum to share my outlook on the economy and monetary policy, and I would like to thank Kathleen Murphy, the CEO of the Massachusetts Bankers Association, for inviting me to speak at your first economic forum.

I am also grateful for the kind introduction from Susan Collins. I greatly value her perspective, and I appreciate the opportunity to work closely with her as president of the Federal Reserve Bank of Boston and as a fellow member of the Federal Open Market Committee (FOMC).

It is good to see so many bank and business leaders from across the Northeast here at Gillette Stadium. Throughout my time at the Federal Reserve-and earlier in my career as a community banker-I have made it a priority to engage directly with bankers and business leaders to better understand how economic conditions affect local communities. These conversations provide important context for my views on the economy and monetary policy.

With the FOMC having concluded its final meeting of 2025 a little over a month ago, and with our next meeting at the end of this month, today I will share my perspective on recent policy decisions, discuss how my assessment of the economy evolved over the past year, review current economic conditions, and then outline my outlook for the economy and monetary policy.

As we enter 2026, the economy has continued to grow, and I see inflation moving closer to our goal. But beneath the surface, the labor market has become more fragile. My focus today is why that fragility poses the greater risk and what that means for the path of policy.

Update on Recent Monetary Policy Decisions

At our September meeting last year, the Committee resumed the process of gradually removing policy restraint and bringing the federal funds rate closer to its neutral level. At that meeting, and again at our meetings in October and December, the Committee voted to lower the target range for the federal funds rate by 25 basis points, bringing the range to 3-1/2 to 3-3/4 percent.

These decisions were intended to proactively limit the risk of greater and more persistent damage to the labor market, while inflation continued to show signs that it is on a sustained downward trajectory toward our 2 percent objective. The policy rate now reflects a total of 75 basis points of cuts since September and is closer to my estimate of its neutral level.

I voted in favor of each of these actions in light of the weakening in labor market conditions and my expectation that inflation, excluding the effects of tariffs, would soon be within close range of our 2 percent goal. Looking ahead, as we gather additional evidence on economic activity, labor market conditions, and inflation, it will be important to continue assessing the appropriate path of policy and the timing of further adjustments.

How My Views on the Economy Evolved over the Past Year

Before turning to current economic conditions, I would like to spend a few minutes explaining how my views on the economy and monetary policy evolved over the past year. I believe this context is important, particularly at a time when the balance of risks around our dual mandate has been shifting.

At the December 2024 FOMC meeting, my projections for 2025 anticipated that real gross domestic product (GDP) would rise in the mid–2 percent range, that core personal consumption expenditures (PCE) inflation would slow by a bit less than one-half percentage point, and that the unemployment rate would increase moderately to about its longer-run level. Those projections also included three quarter-point reductions in the federal funds rate over the course of 2025. In hindsight, the economy seems to have evolved largely in line with those expectations, especially if we consider inflation excluding the estimated effect of tariffs.

Throughout much of last year, I reserved judgment on the effects of new policy initiatives and instead maintained an overall optimistic view of the economy. In particular, I did not assume that changes in trade or immigration policy would necessarily lead to persistent inflationary pressures or large negative effects on economic activity. I also considered the potential for positive supply-side effects from other policy developments, including regulatory changes, tax policy, and a business-friendly approach.

With respect to trade policy, I expected that initial tariff proposals would likely be scaled back over time, that there would be little retaliation from trade partners, and that foreign producers, importers, and consumers would adjust in ways that would help limit pass-through to inflation. Substitution across goods and suppliers appeared to play an important role in moderating the effects of tariffs on both economic activity and prices.

On immigration, I anticipated that a reduced inflow of new immigrants would restrain demand for rental and affordable housing and ease upward pressure on housing inflation in the near term. While changes in population affect both supply and demand, I viewed the near-term demand effects as particularly relevant for inflation dynamics. I also expected relatively small effects on GDP growth from lower immigration, despite reduced labor supply and employment growth, as these new immigrants tend to have lower income and be less productive than the overall U.S. workforce.

Although inflation remained a concern for me early in the year, my assessment shifted as I began to see clearer signs of slowing economic growth and increasing fragility in the labor market. I became more confident that the inflationary effects of tariffs would largely be one-off, as I observed growing evidence that businesses were less able to pass through higher costs to consumers. I saw this as a sign of weakness in demand and consistent with the cooling labor market. These developments led me to place increasing weight on risks to employment and to signal a shift in my balance of risks in June, after which I dissented at the July meeting favoring a 25-basis point reduction to reflect this shift.[2]

Economic activity seems to have been supported by a surge in equity prices and investment activity related to artificial intelligence (AI). Although stock market valuations may appear stretched, expected earnings growth for AI-related companies has been high, and, so far, a substantial part of the investment has been self-financed. I am concerned that disappointing news on AI investment returns could lead to a sharp correction in equity prices, but the economy continues to show elevated productivity growth likely due, in part, to increased adoption of AI technologies.

Higher productivity gains have helped ease inflationary pressures and encouraged me to support cutting the policy rate last year, especially since we have not seen consistent signs that the labor market is stabilizing.

Current Economic Conditions

Turning to current economic conditions, the U.S. economy has been resilient and has continued to expand at a solid pace, but I remain concerned about signs of fragility in the labor market. I am also increasingly confident that inflation will come down toward 2 percent as tariff effects on goods inflation continue to wane in coming months.

Real GDP growth appears to have exceeded 2 percent last year. Although growth was somewhat volatile, it still averaged close to its pace in 2024 despite the drag from lower immigration, especially if we consider the effects of the government shutdown. Growth was supported by strength in business investment, including data center projects and a surge in high-tech AI investment. These types of projects tend to be relatively insensitive to interest rates and have the potential to significantly raise productivity.

At the same time, other areas of demand softened last year. Consumer spending and residential investment weakened, as slower growth in real disposable income and house prices weighed on demand. The weakness in housing activity and prices over the past year likely reflected some pullback in housing demand. Elevated mortgage rates may have exerted a more persistent drag as income growth expectations declined and house prices remained 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. But the recent firming in house prices and home sales seems encouraging, suggesting less restraint on housing demand following the decline in mortgage rates since the middle of last year.

The latest data releases show that GDP significantly increased in the third quarter, as consumer spending accelerated, but likely slowed in the fourth quarter, reflecting a drag from the government shutdown and softer momentum in retail sales through November, consistent with recent weakness in personal income. Disappointingly, residential investment seems on track to decline again in the fourth quarter. Although home sales are rising in response to lower mortgage rates, residential improvements and new construction activity have remained slow.

Labor Market Conditions

Over the past year, as unemployment rose and payroll employment flattened out, we saw labor market conditions gradually weaken. During that time, the unemployment rate increased substantially to 4.4 percent in December, reflecting a decline in hiring rather than a sharp increase in layoffs, as many firms appeared focused on retaining workers rather than expanding payrolls. Payroll employment growth slowed significantly, and job gains became increasingly concentrated in a relatively small number of nonbusiness service industries. Private job gains averaged only about 30,000 per month in the fourth quarter, well below what is needed to keep the unemployment rate from rising, with job gains more than accounted for by the health-care and social services industries, suggesting that labor demand has continued to gradually soften since early last year. Wage growth has slowed to a pace consistent with 2 percent inflation, reflecting both easing labor demand and strong productivity growth, and the labor market is no longer a significant source of inflationary pressure.

Although the labor market is still near full employment, it has become increasingly more fragile and could continue to deteriorate in the coming months. The rise in unemployment has been experienced mostly by demographic groups that tend to be more affected by the business cycle. The share of those working part time for economic reasons, meaning not by choice, has increased considerably over the past two months. This has coincided with a rise in the share of multiple job holders, suggesting that an increasing number of workers struggle to make ends meet.

Job gains have been concentrated in just a few services industries that tend to be less affected by the business cycle. The share of industries with positive job growth over the past six months has been hovering around historically low levels. Private payroll employment may have started to fall in recent months, as the sizable upward bias in the published data implied by the Quarterly Census of Employment and Wages seems to have persisted at least through the second quarter.

Although initial claims for unemployment insurance have remained low, there are signs that layoffs may have increased as Challenger private job cut announcements have reached their highest 12-month level since 2010, outside of the pandemic. We could see layoffs rise quickly since job openings have softened and hiring rates are already low. The share of long-term unemployed workers reached 26 percent in December, the highest since early 2022, reflecting a less dynamic, low-hiring, low-firing labor market that some have said is giving rise to a jobless expansion.

All of these indicators point to growing labor market fragility, and this configuration of the labor market raises the risk that conditions could deteriorate further if demand does not strengthen. With hiring rates already low, layoffs could rise more quickly if firms begin to reassess their staffing needs in response to weaker activity.

Inflation Developments

On inflation, we have seen considerable progress in lowering the underlying trend, considering that still-elevated inflation mostly reflects tariff effects that I expect will fade this year. When those effects are taken into account, core PCE inflation appears to be much closer to 2 percent.

Based on the latest consumer and producer price reports, 12-month core PCE inflation likely stood at 2.9 percent in December. However, after removing estimated tariff effects, core PCE inflation would have hovered close to 2 percent in recent months, well below the 3 percent reading at the end of 2024. This progress in the underlying trend of inflation reflects a considerable slowing in core services inflation, consistent with the easing in labor market pressures and housing inflation given the weakness in market rents.

The underlying trend in core PCE inflation appears to be moving much closer to our 2 percent target than is currently showing in the data. Core services inflation is already roughly consistent with our target, and only core goods inflation remains elevated, but I expect it to start moving down in coming months as the effects of earlier price increases and one-time tariff-related adjustments fade.

Economic Outlook and Risks

Looking ahead, my baseline expectation is that economic activity will continue to expand at a solid pace and the labor market will stabilize near full employment as monetary policy becomes less restrictive. Less restrictive regulations, lower business taxes, and a more favorable business environment will continue to boost supply-largely due to higher productivity-and more than offset any negative effects on economic activity and inflation from tariffs. As the tariff effects continue to wane, these supply-side policies, along with strength in AI-related investment, will continue to boost productivity gains and help ensure that inflation remains on a downward path.

That said, the outlook is subject to risks on both sides of our mandate, and those risks are not symmetric. On the inflation side, potential upside risks include renewed pressures in services prices, a change in firms' pricing behavior, or disruptions to global supply chains stemming from trade or geopolitical developments. This could include changes to oil prices based on reactions to recent events in Venezuela and in the Middle East.

While the risks merit close monitoring, I currently view them as less likely to materialize in a sustained way. First, there has been willingness to negotiate trade policy, and supply chains have largely been unaffected thus far. Second, foreign suppliers and importers have been adjusting to the new tariffs, and there are many anecdotes of businesses being unwilling to raise prices because of higher consumer price sensitivity, especially among low-income consumers. Reduced immigration will also continue to lessen demand, especially for housing, and will be a drag on inflation.

On the employment side, I continue to see downside risks. Continued softness in hiring, combined with already low hiring rates, means that even a small decline in demand could translate into a larger increase in unemployment. Once firms begin to shift from slowing hiring to reducing head count, labor market conditions could quickly deteriorate.

Memories of pandemic worker shortages are still fresh, and, so far, businesses have mostly maintained, rather than reduced, their workforce. They also seem to be more willing to compress profit margins, since consumers are less willing to accept higher prices. Without a broad improvement in demand conditions, 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.

The Path Forward for Monetary Policy

With inflation on a sustained trajectory toward 2 percent and signs of fragility in the labor market, my view is that we should continue to focus on risks to our employment mandate and preemptively stabilize and support labor market conditions. Over the second half of last year, I frequently pointed to a shift in economic conditions and in the balance of risks to our employment and inflation goals. I also noted the signs of weakening labor market conditions shown in the flattening of payroll employment gains and the rise in the unemployment rate. But with a rising unemployment rate and inflation remaining slightly above target, our maximum-employment and price-stability goals have been in tension. With our goals in tension, our framework calls for a balanced approach-taking into account not only the size of deviations from our goals, but also the likelihood that those deviations could become persistent.[3]

In considering the appropriate path for monetary policy, my approach remains intentionally proactive and forward looking. It takes time to see the full effects of monetary policy on the economy. Placing too much weight on the most recent data can result in an inherently backward-looking assessment of economic conditions. In my view, that approach increases the risk of falling behind the curve and ultimately requiring more abrupt and larger policy adjustments than would otherwise be necessary.

Instead, we should rely on forecasts that are informed by a broad set of indicators and by ongoing engagement with businesses and communities across the country. In my view, this approach is more likely to capture how the economy will evolve over time. Acting in a timely and measured way, based on how we expect the economy to evolve, can help support employment and price stability while limiting the risk of unnecessary volatility.

With inflation pressures easing-after excluding one-off tariff effects-and with the risk that labor market conditions could weaken further, I see policy as moderately restrictive. The labor market can appear to be stable right up until it doesn't. Absent a clear and sustained improvement in labor market conditions, we should remain ready to adjust policy to bring it closer to neutral. We should also avoid signaling that we will pause without identifying that conditions have changed. Doing so will indicate that we are not attentive or responsive to the recent and expected path of the labor market.

At the same time, I want to emphasize 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 balance of risks to our dual-mandated goals of maximum employment and price stability. I will also continue to meet with a broad range of contacts to inform my assessment of economic conditions and the appropriate stance of policy.

Supervisory and Regulatory Priorities

Before I conclude my remarks today, I would like to briefly touch on the Federal Reserve's supervisory and regulatory agenda, which I know is of particular interest to many of you here today.

While monetary policy often takes center stage, effective supervision and regulation are essential to maintaining a safe, sound, and resilient banking system-one that supports economic growth and serves communities across the country.

Since the President appointed me as Vice Chair for Supervision last June, we have made meaningful progress on several priorities that will improve transparency, efficiency, and focus within our supervisory and regulatory framework. My objective is to ensure that supervision and regulation are appropriately tailored, risk focused, and grounded in our statutory responsibilities.

Congress has also taken several steps in this regard. The passage of the GENIUS Act (Guiding and Establishing National Innovation for U.S. Stablecoins Act), along with ongoing consideration of banking and other digital assets legislation, underscores the importance of regulatory clarity as innovation enables the banking and financial systems to continue to evolve. We are actively working to implement the Federal Reserve's responsibilities under this new law.

Last week, I shared my agenda and provided an update on our work to modernize bank supervision and regulation.[4] I will highlight a few of these and the concrete steps we have taken since last June to enhance supervision and regulation. We have

- finalized changes to rationalize the large financial institution ratings framework, to better reflect a firm's condition based on material financial risks
- finalized revisions to the enhanced supplementary leverage ratio, returning it to its traditional role as a capital backstop and helping to reduce the risk of market disruptions
- proposed recalibration of the community bank leverage ratio to the statutory minimum, providing greater flexibility for eligible community banks
- removed reputational risk from the examination toolkit, allowing examiners to focus on material financial risks
- issued, for the first time, a set of supervisory operating principles to enhance transparency, accountability, and consistency in examinations-to benefit both examination staff and the banks we supervise
- published a request for information on payments fraud to support a more coordinated and effective response
- proposed improvements to reduce volatility in supervisory stress tests and enhance the transparency and public accountability of the stress testing framework

- withdrawn climate-related supervisory guidance that diverted supervisory resources away from risks that are material to the safety and soundness of banks
- issued a new policy statement to facilitate responsible innovation by Board-supervised banks
- initiated a review of regulatory reporting requirements to ensure the data we collect are useful and necessary for supervisory and regulatory purposes

While we have made progress, there is more work ahead. We will continue to focus on improving the mergers and acquisitions review process, assessing the appropriateness of capital requirements across the banking system, addressing payments and check fraud, and strengthening examiner training and development.

Closing

As the economy continues to evolve, policy must evolve with it. My focus will remain on acting early enough to preserve both price stability and a strong labor market. Thank you again for the invitation to share my views with you today. It is a pleasure to join you for this forum.

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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 Michelle W. Bowman (2025), "Unintended Policy Shifts and Unexpected Consequences," (PDF) remarks delivered at "Assessing the Effectiveness of Monetary Policy during and after the COVID-19 Pandemic," a research conference sponsored by the *International Journal of Central Banking* and the Czech National Bank, Prague, Czech Republic, June 23.

[3] The FOMC's revised Statement on Longer-Run Goals and Monetary Policy Strategy is available on the Board's website at https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf.

[4] See Michelle W. Bowman (2026), "Modernizing Supervision and Regulation: 2025 and the Path Ahead," (PDF) remarks delivered at the California Bankers Association Bank Presidents Seminar, Laguna Beach, Calif., January 7.