

Christopher J Waller: Labor market data - signal or noise?

Speech by Mr Christopher J Waller, Member of the Board of Governors of the Federal Reserve System, at the 42nd Annual NABE (National Association for Business Economics) Economic Policy Conference "The great realignment: navigating AI, demographic and geoeconomic change", Washington DC, 23 February 2026.

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Thank you, Constance, and thank you for the opportunity to speak to you today.¹ Let me commend NABE for focusing this year's conference on economic disruptions including artificial intelligence, a subject I have spoken on often lately, and which I will address again tomorrow at a Boston Fed conference. But today, I will turn to another topic that I know is of interest, the outlook for the U.S. economy and the implications for the Federal Open Market Committee's (FOMC) goals of maximum employment and stable prices.

At our January meeting, the FOMC voted to hold our policy rate steady, following three 25-basis-point cuts since September. The Committee had cut rates because job gains had slowed and downside risks to employment had increased, amid somewhat elevated inflation. In my view, appropriate policy should look through tariff effects on inflation. Underlying inflation was running close to 2 percent while the labor market remained at risk, and these circumstances led me to favor another cut in January, and to dissent against the Committee's decision. I felt that the risk of a substantial downturn in the labor market combined with a limited risk of higher inflation warranted another cut, bringing the policy rate closer to a neutral setting. Even in the absence of some data due to last year's government shutdown, a factor cited by some FOMC colleagues voting to pause, the balance of risks for me were weighted toward further policy easing.

Since that meeting, we have received quite a bit of economic data. In particular, the January employment report came in substantially stronger than I and most forecasters and market participants expected. Before we delve into the implications for monetary policy, let's celebrate this as some welcome good news. According to newly updated payroll numbers for the past year, the initial estimate is that the U.S. economy created more jobs in January than in the previous *nine months* combined. Many workers have been struggling to find new jobs in a labor market with a low hiring rate, so this sign of a pickup in hiring is fortunate for them, and a suggestion that labor market risks have diminished. Other data showed that underlying inflation is running close to 2 percent.

Taken together the data were positive, but not conclusive that the labor market is on a more solid footing and, hence, also not conclusive about the proper setting of monetary policy. One month of good news does not constitute a trend, but a year does, and the year of 2025 was an extraordinarily weak one for job creation—the weakest outside of a recession since 2002. We will not know whether the upturn in this initial estimate of job creation is signal or noise until we get more data. Fortunately, before the next meeting of the FOMC on March 17 and 18, we will get employment and inflation data for February, as well as more data on job openings and retail sales. If these data support the idea of an improvement in the labor market in January that continued in February, along with additional progress toward 2 percent inflation, that could result in my outlook

turning a bit more positive and my view of appropriate monetary policy may tilt toward a pause at our upcoming meeting, a possibility that I will discuss in greater detail in a moment.

But even if inflation continues to make progress toward 2 percent, if the new labor data dent the idea of a turnaround and instead point to continued weakness like we saw in 2025, then there may be an equally credible case for a further reduction in the policy rate, and I will lay out that argument as well.

With those cases outlined, let's talk about where things stand as of today. Overall economic activity has been growing at a solid pace. On Friday, we received the advanced estimate of real gross domestic product (GDP) growth in the fourth quarter of 2025 of 1.4 percent at an annual rate. Purchases by consumers and businesses, often referred to as private domestic final purchases, increased by 2.4 percent. The government shutdown last year reduced growth in the fourth quarter and has likely boosted it in the first quarter of 2026, both by about 1 percentage point. Smoothing through those effects, I expect real GDP to grow above 2 percent for these six months, with both business and household spending continuing at a solid pace.

The Supreme Court ruling Friday overturning a large share of import tariffs imposed last year may have a positive impact on spending and investment, but how large that impact may be and how long it could last is unclear. The Administration plans to reimpose at least some of the tariffs using other laws, but there is considerable uncertainty over to what extent tariffs will continue.

As of now, business surveys indicate a pickup in activity in January. Manufacturing production increased 0.6 percent last month, the strongest reading in almost a year. Manufacturing supply managers also reported an increase last month. The message was broad in the survey-increases in all the aspects of manufacturing surveyed: inventories, new orders, supplier deliveries, and production and employment. In services, which accounts for the majority of business output, purchasing managers reported that activity increased for the 19th straight month. This is all good news and should support GDP growth this quarter. That said, business investment last year was largely due to data center construction and related investments-still a relatively narrow slice of the economy and not representative of overall economic activity.

Data for household spending is fairly solid but has shown some signs of softening. Personal consumption expenditures (PCE) growth slowed from 3.5 percent in the third quarter of 2025 to 2.4 percent in the fourth quarter, still solid spending growth.

Retailers who I talk to continue to report a divergence between higher income shoppers, whose spending remains resilient, and lower- and middle-income customers, who are starting to spend less or switch to lower-cost goods and services. The strong gains in the stock market in 2025 boosted wealth for higher income households, which should support their spending in 2026, but it will probably do little for lower income households. The highest-earning 20 percent of households account for 35 percent of spending, and their share of stocks is even higher. Research shows they are relatively less affected by higher prices or a slower economy. By contrast, the bottom 60 percent of households by income own only 15 percent of stocks, and account for 45 percent of spending. And, I'm hearing that some of these shoppers are making more frequent trips

to stores with fewer purchases during each visit. More trips to stores sounds good, but fewer purchases may indicate people feel a pinch in their wallets and pocketbooks, and this behavior may presage cutbacks in discretionary purchases.

As I said in a speech last October, I worry that the still-solid spending increases lately may be driven by stock-rich households and thus be masking weakness in the still substantial share of spending that relies on lower- and middle-income people.² For these latter households, spending is highly influenced by their view of the labor market, so let me turn to that.

The January employment report included the usual annual revisions that affected the payroll data for all of 2025, which adjusted the picture we have of the labor market going into 2026. As expected, the data were revised down, turning 2025 from a year with relatively weak job creation into one of the weakest years in decades outside of a recession. For the year, 181,000 new jobs were reported. This amounts to an average of only 15,000 a month. But 2025 was even worse than that, because even after those revisions, there likely remains an upward bias in the payrolls from April through December and the correction to those numbers won't happen until 2027.³ Accounting for those upcoming revisions, it seems clear that payroll employment in the United States probably fell in 2025, only the third year that has happened, unrelated to a recession, since 1945. There is no doubt that the decline in net immigration last year has significantly lowered labor force growth and thus the number of new jobs that are needed to reflect a healthy labor market. However, last year the labor force grew by 2.9 million while payroll gains were much less.

There has been much discussion of the current low-hire, low-fire labor market. A relatively low level of layoffs means that slow hiring is not as bad as it looks. Even so, I continue to believe that close to zero net job creation over 2025 indicates a weak, and fragile job market, and this is some important context for the data we received in January.

The labor data that came out the week before the jobs report was bleak—Job Openings and Labor Turnover Survey data showed a dramatic decline in job openings and the payroll services firm ADP reported January was a lackluster month of hiring with job gains of only 22,000. So, when the jobs report showed that the total number of jobs grew by 130,000, and that private sector payroll growth was even stronger at 172,000, this was a welcome surprise. Even with downward revisions to the previous two months, the three-month average of total payroll increases was 73,000, which is above current estimates of breakeven net hiring. And unemployment did fall last month though it is still higher than a year ago. This report was clearly a surprise to the upside and suggests that the labor market may be turning a corner.

But how much signal can we take from this jobs report about the future health of the labor market? I have some concerns that the report may contain more noise than signal. First, job gains were concentrated in a few sectors of the economy, primarily health care and construction, that constitute around only around 20 percent total employment. Health care and social assistance accounted for nearly 125,000 of the 130,000 jobs and the jump in construction jobs may have been influenced by warm

weather last month during the week that the government surveyed firms. Many other sectors lost jobs, more consistent with what happened in 2025. All this does not suggest the whole labor market is heading for a more robust footing.

Second, initial payroll reports for January in each of the past few years have seen big revisions downward in subsequent reports a month or two later, and two other estimates of private-sector employment suggest something similar may be happening now. In contrast to the 172,000 gains reported by the Bureau of Labor statistics, as I noted, ADP reported that U.S. businesses created only 22,000 jobs last month. Another firm, Revelio, estimated only 3,000 new private-sector jobs in January. A less scientific survey of layoff announcements by the outplacement firm Challenger Gray and Christmas counted 108,000 layoff announcements last month, the most since October and the worst January for job cuts since 2009. Again, this conflict between private data sources and the initial jobs numbers leaves me concerned that the jobs report may contain more noise than signal.

Make no mistake-official government data, which I still consider the gold standard, was positive for January and a very encouraging sign of a turnaround. But I will say again, one month is not a trend, and that is especially true after the kind of labor market that limped along in 2025. There are enough asterisks around the January data that I will need to see the February report due March 6 before forming any judgment on whether there has been a rebound in the labor market. It will contain a second estimate for January and indications of whether the good news has continued.

Now let's talk about the FOMC's 2 percent inflation goal. Headline consumer price index (CPI) inflation came in below expectations for January, in part due to lower energy prices. However, excluding volatile food and energy prices, core CPI inflation rose a strong 0.3 percent and was up 2.5 percent over the previous 12 months. Based on what we know today, PCE inflation targeted by the FOMC is estimated to have been higher than CPI inflation in January, around 2.8 percent over the previous 12 months, with core, a better guide to future inflation, about 3 percent over that same period. We will have a clearer picture of January PCE inflation after producer prices are reported on February 27.

PCE inflation has crept up in the past few months, and is meaningfully above the FOMC's 2 percent goal, but a crucial factor has been the estimated effect of tariffs. I think it is widely acknowledged now that tariff increases have not affected longer-term inflation expectations and thus will only temporarily boost inflation rather than be a source of ongoing inflationary pressure. So, I estimate that what I call underlying inflation-inflation without the effects of tariffs-is close to the FOMC's 2 percent goal.

Two questions are how much tariff effects will be, and how long they will last. Over 2025, the inflationary effects from tariffs tended to be smaller than expected, in part from downward adjustments to the ultimate size of tariffs. However, I also suspect that exporters and importers were eating a sizable share of the costs to maintain market share and retain customers. There were many anecdotal reports that firms had been holding the line on prices through 2025 but planned markups in January as contracts were renewed at the start of the year. But we didn't see as large a jump in prices as

some expected in the CPI data and it's hard to believe that February is 'the new January' when it comes to resetting contract prices. So that story doesn't seem to be holding water.

Looking forward, there is now a question of how Friday's Supreme Court ruling may affect near-term price increases. Perhaps firms will lower their prices as their input costs associated with tariffs decline Or, prices may be unaffected if the Administration quickly reimposes at least some of the tariffs under other laws. It is too soon to know. In any case, since tariffs only temporarily affect inflation, that is why I consider underlying inflation for my policy decisions. Traditional central bank wisdom suggests that we should "look through" tariffs. I did this when they went up and will do so if they come down. So, this ruling is unlikely to have a significant impact on my view of the appropriate stance of policy.

We will get another CPI report for February on March 11, a week before the next FOMC meeting, and, along with the February labor report, it will be an important basis for my judgment on the proper stance of monetary policy. Assuming underlying inflation continues to signal we are close to our 2 percent goal, the key to setting appropriate policy will be my view of the labor market. If the labor market data for February are consistent with the stronger job creation and low unemployment rate initially reported in January, indicating that downside risks to the labor market have diminished, it may be appropriate to hold the FOMC's policy rate at current levels and watch for continued progress on inflation and strength in the labor market. But if the good labor market news of January is revised away or evaporates in February, it would support my position at the FOMC's last meeting, that a 25-basis-point reduction in the policy rate was appropriate, and that such a cut should be made at the March meeting.

As things stand today, I rate these two possible outcomes as close to a coin flip. There is no dismissing the weakness of job creation in 2025, and, for the reasons I have noted, it won't be a huge surprise if the strong January report turns out to be noise and not signal. But it is also true, as I have noted before, that data on economic activity have been consistently stronger than one might expect based on the weakness in the payroll numbers. So I can't dismiss the possibility that the labor market data has pivoted to a more solid footing. As we get more data, I will be able to decipher which of these cases we are in and can then be more deliberate in my decision on the appropriate setting of policy.

¹ The views expressed here are my own and are not necessarily those of my colleagues at the Federal Reserve Board or the Federal Open Market Committee.

² See Christopher J. Waller, "[Cutting Rates in the Face of Conflicting Data](#)," speech, October 16, 2025.

³ 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 that are currently available through 2025:Q2.

i. Note: On February 23, 2026, a correction was made on page 5 to the number of years since 1945 that U.S. nonfarm employment has shrunk. The correct sentence should read: "Accounting for those upcoming revisions, it seems clear that payroll employment in the United States probably fell in 2025, only the third year that has happened, unrelated to a recession, since 1945."