FEDERAL RESERVE BANK of ST. LOUIS

Remarks on the U.S. Economy and Monetary Policy

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The text is as prepared for delivery.

Good afternoon. I would like to thank the Shadow Open Market Committee, and especially Jim Bullard, for the invitation to address you today. This committee has produced critical commentary and monetary policy analysis for more than 50 years, and I've been looking forward to speaking with you.

I will begin with a few remarks on economic conditions and conclude with some comments on monetary policy. I'll then put on my catcher's mask to field some questions from Jeff Lacker. I'm hoping for softballs, but I'm expecting fastballs and a few curves! Let me state at the outset that my remarks do not necessarily represent the views of my Federal Open Market Committee (FOMC) colleagues.[1]

To get right to the point, I will summarize my four main messages:

1. Persistent demand forces have kept the U.S. economy growing at or above potential despite a series of negative supply shocks. The labor market is stable and balanced around full employment. Looking ahead, I perceive the risks around economic growth and the labor market to be symmetric.

2. Inflation is too high, exceeding the FOMC's 2% target. I perceive inflation risks are skewed toward persistent above-target inflation.

3. I focus on economic scenarios over an 18-month horizon, which I view as the appropriate time frame for monetary policy to have an effect. I will discuss two plausible inflation scenarios:

[1] I thank Riccardo DiCecio and David Wheelock for assistance in preparing these remarks.

   a. Under one scenario, which I view as the more likely, inflation persists meaningfully above 2% absent further removal of monetary policy accommodation.

   b. Under a second, less likely but still plausible scenario, inflation recedes and converges to 2% in 18 months without any further lessening of monetary policy accommodation. Such a scenario could unfold for a variety of reasons, as I will discuss.

4. I judge that additional firming of monetary policy will be necessary, and soon. Incremental adjustments made earlier are usually less disruptive than larger and abrupt actions taken later. Moving sooner in smaller steps while inflation expectations are anchored has a better chance of succeeding without adverse impact on the labor market or economic growth.

I will now elaborate on these points.

Economic Conditions

The U.S. economy has been resilient. Real GDP is growing at a strong pace, close to or exceeding potential. Third-quarter data confirm the underlying strength of the economy. Consumer spending is strong and showing no signs of slowing, while the data center buildout is powering double-digit growth in nonresidential fixed investment.

Tailwinds and Potential Headwinds and Risks

Several tailwinds are supporting economic activity. I am optimistic that real GDP will continue to grow at or above potential for the foreseeable horizon. The AI-driven boom in capital expenditures and wealth effects-driven consumption spending might slow from their current pace but are likely to remain a tailwind for some time. Corporate earnings have been strong — unusually so for this stage in the business cycle. Fiscal policy is continuing to support economic activity, as is deregulation, most notably in the energy and financial sectors.

I believe that monetary policy and financial conditions remain accommodative. Financial conditions tightened recently, both in anticipation and as a result of our September policy action, and markets have become more selective in allocating capital. Credit spreads in cyclical sectors and for high-yield borrowers have widened, especially for those borrowers involved in the AI infrastructure build. Total net new financing of the economy by banks and capital

markets has moderated but remains healthy, and bank financing has strengthened as capital market activity has slowed.

On balance, the recent tightening of financial conditions has been less than during recent stress events, such as Liberation Day and the beginning of the Middle East conflict earlier this year. The economy remained solid after those events, so I am not overly concerned by the recent tightening of financial conditions.

The home mortgage market remains an area where financing conditions are tight. The housing market remains significantly challenged by high mortgage rates, building costs and supply shortages.

Besides the housing market, stagnant real personal disposable income growth and geopolitical tensions are potential headwinds to growth. Various financial, physical, social and political constraints could also slow the pace of investment in data centers or lower the valuations of AI-related companies. But for now, I perceive these potential headwinds as less likely or impactful than the tailwinds propelling the economy forward.

Let me now make a few observations about the labor market and inflation.

Labor Market

The labor market has been remarkably stable and balanced, and close to full employment for more than a year. At 4.2%, the unemployment rate lies at the median of the long-run projections of FOMC participants, as reflected in the September Summary of Economic Projections.[2]

Payroll growth has been near the breakeven rate needed to maintain a low unemployment rate; the ratio of job vacancies to unemployed persons hovers close to 1; and claims for unemployment insurance remain low. An elevated long-term unemployment rate and low job-finding expectations bear watching.

Real wages have been increasing rapidly for a few occupations, such as electricians and other skilled trades involved in the data center buildout. This is spilling over into higher real wages and labor costs in proximate construction activities. However, on average across the economy,

[2] See the FOMC's Summary of Economic Projections from September 2026.

nominal wage growth has not kept up with inflation, and many workers are falling behind in real terms.

Inflation

The labor market has not been driving inflation. Nonetheless, inflation is elevated and broad-based, and I perceive meaningful risk that above-target inflation will persist longer than consistent with price stability. Headline and core inflation continue to run at 3% or higher. September data on PCE inflation show upward momentum in goods inflation driven by higher energy prices, while services inflation remains sticky above 3%.

Inflation expectations have thus far remained mostly well anchored. Some survey measures of expected inflation have recently drifted higher, a trend mostly due to higher energy and other commodity prices, which bears watching. However, market-implied long-term inflation expectations remain anchored, consistent with market expectations that the FOMC will raise its real policy rate to an appropriate level within the next few months.

The increase in long-term nominal bond yields in recent months mostly reflects higher expected real policy rates. Higher real rates, in turn, have been driven by expectations of strong real economic growth and competition for financing between the public and private sectors. Nominal bond yields would likely rise further if the public comes to doubt the Fed's resolve to achieve price stability, unnecessarily increasing financing costs for borrowers.

Scenarios and Monetary Policy

Looking ahead, I am focused on two plausible inflation scenarios for the next 18 months.

Under the first and more likely scenario, persistent strong demand and ongoing supply pressures keep inflation elevated absent some additional firming of monetary policy. I agree with Fed Chairman Warsh's characterization of the recent increase in the FOMC policy rate as "removing a dose of accommodation." In my view, policy remains accommodative, and further firming will likely be necessary to ensure inflation converges to 2% in a timely manner.

However, there is a less likely but plausible scenario in which additional policy firming will not be required. Falling energy prices and lower shipping costs, or an increase in potential output growth driven by higher productivity growth, might ease inflation pressures. Alternatively, aggregate demand might slow more than is now expected, perhaps because spending on AI or

data centers slows substantially, or financial conditions tighten abruptly and wealth effects-driven consumption spending decelerates.

Because I view the second scenario as less likely than the first, I continue to judge that a further removal of monetary policy accommodation will be required to ensure inflation converges to 2% within 18 months.

Conclusion

My FOMC colleagues and I are committed to achieving price stability. Inflation is a distortionary tax, and a regressive one at that. In my meetings with business leaders, representatives of community groups, and elected officials, the conversation often turns to inflation and its adverse effects on the people we serve.

As you know, the Fed has a dual mandate — maximum employment and price stability. The Fed is sometimes accused of killing jobs or of being anti-growth when it takes action to contain inflation. In the 1970s, Allan Meltzer, Karl Brunner, Anna Schwartz and other members of the Shadow Open Market Committee argued persuasively that price stability is, in fact, a prerequisite for achieving maximum employment and sustained economic growth. History has since borne out their view.

The best that monetary policy can do now for employment and economic growth is to restore price stability in a timely manner. The short-run economic costs of reducing inflation are less when the central bank acts before inflation has become entrenched and is expected to persist. Acting sooner and incrementally now is likely to be less disruptive or costly than delaying and being forced to take large, abrupt actions later.

I am committed to achieving price stability and maximum employment for the American people and to working expeditiously with my FOMC colleagues until the job is finished.

Thank you.