

The Economic Outlook and Monetary Policy

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The text is as prepared for delivery.

Good morning. I would like to thank the American Enterprise Institute for the invitation to speak with you today, and I look forward to an engaging discussion with Michael Strain.¹

The AEI is dedicated to advancing free markets and improving lives, for example, by focusing on growth, jobs and inflation. AEI scholars have emphasized the importance of basing monetary policy decisions on economic facts and data—rather than the political needs of the moment. That is the cornerstone of central bank independence.

History has shown that countries with independent central banks have better outcomes in terms of stronger economic growth and low and stable inflation. With independence comes an obligation for accountability and transparency. That is why my Federal Open Market Committee (FOMC) colleagues and I are constantly engaging with stakeholders, why we are transparent about the factors that go into our decision-making, and why I am here today to share my views. These are my personal views and not necessarily those of other FOMC participants.

The economic outlook is highly uncertain. A baseline scenario for 2026 has real GDP growing close to potential, the unemployment rate holding around its current level, and core inflation beginning to gradually ease toward 2% later in the year. But other outcomes are plausible. The risks to the labor market and inflation both tilt in unfavorable directions, that is, toward a weaker labor market and greater persistence of above-target inflation.

I supported the FOMC's recent decision to hold the policy rate in the range of 3.5% to 3.75%. The real policy rate, that is, the nominal rate adjusted for expected inflation, was already in the neutral range before the recent increase in energy prices and has declined further since. I also

¹ I would like to thank David Wheelock, Bill Dupor and Riccardo DiCecio for their assistance in preparing these remarks.

believe the current policy rate appropriately balances the risks to our dual mandate of maximum employment and stable prices and will likely remain appropriate for some time.

I will continually reassess my views as new information becomes available, and I will discuss some alternative scenarios for the economy and monetary policy in a few minutes.

Economic Activity and Outlook

Economic Activity

The U.S. economy has been resilient. Real GDP growth moderated in the fourth quarter, partly due to the government shutdown, but final sales to private domestic purchasers rose at a respectable pace. Tracking forecasts indicate that first-quarter growth was around potential.²

Consumer spending was soft in the first two months of 2026, partly due to winter storms, but solid wage growth, fiscal policy and wealth effects should support consumer spending in coming quarters. Federal income tax refunds are projected to average about \$1,000 more per household in 2026 than last year, and households are seeing additional tax relief from lower withholding.³

Uncertainty from the Middle East conflict and unsettled tariff policy could weigh on consumer and business spending in the first half of the year. So could higher fuel, aluminum and fertilizer prices, which are especially sensitive to supply chain disruptions in the region. Estimates by St. Louis Fed staff suggest that the increase in fuel prices since the start of the conflict could cost consumers the equivalent of some 10% to 15% of this year's tax relief for every quarter that fuel prices remain around current levels.

Several tailwinds are supporting the economy, however. Financial conditions remain broadly accommodative, despite tightening since the beginning of the conflict. Capital market and bank lending flows have been solid. For now, recent stress in private credit markets appears mostly due to liquidity issues and some marking down of net asset values, rather than widespread credit quality problems. I am, however, watching vigilantly for a more meaningful tightening in financial conditions and their interaction with higher fuel prices.

² For example, the Atlanta Fed's [GDPNow](#) projects first-quarter growth at 2.0%.

³ See the Feb. 12, 2026, [Bipartisan Policy Center](#) explainer by Andrew Lautz for data on average refunds by year and why refunds are projected to rise in 2026.

Additional tailwinds that should help propel the economy in coming quarters include fiscal policy support, deregulation, the AI-related boom in capital expenditures and the easing of monetary policy since the fall of 2024.

Labor Market

The labor market has cooled gradually over the past 18 months, and recent data indicate it may have stabilized, albeit in a “low hire, low fire” state. Monthly payroll growth has been choppy, clouded by strikes and weather. Reduced labor demand and supply growth have both contributed to low payroll growth. Reduced net immigration and slower population growth, for example, have been important causes of the downshift in labor supply.

Analysis by St. Louis Fed staff found that negative supply factors explain much of the private employment growth shortfalls from trend in February, as well as over the three, six and 12 months through February.⁴ This suggests to me that the unemployment rate and other ratios, such the vacancy to unemployed ratio, provide more information about current labor market conditions than payroll growth.

The unemployment rate has risen gradually since mid-2023 but remains close to the natural rate.⁵ Similarly, the ratio of job openings to unemployed people has fallen modestly since 2023 but remains well above its long-run average. Initial claims for unemployment insurance have also stayed low.

I perceive labor market risks as weighted to the downside, however. The three-month rates of total and private payroll growth have been narrowly concentrated in just a few sectors, and have been at the low end of estimates of the so-called breakeven rate needed to prevent the unemployment rate from rising.⁶ Surveys suggest that payroll growth slowed further in March as firms reported greater reluctance to hire amid heightened geopolitical uncertainty.⁷ With the pace of hiring already low, an increase in layoffs could lead to a rapid increase in the unemployment rate.

⁴ See Maximiliano A. Dvorkin and Cassie Marks, “[Drivers of Wage and Employment Growth in Recent Years: A Supply and Demand Decomposition](#),” Federal Reserve Bank of St. Louis Working Paper 2026-004, March 2026.

⁵ The natural rate of unemployment reflects frictions and structural rigidities in the labor market and is the rate that would be observed in the absence of fluctuations in demand associated with business cycles. For a discussion, see David Brauer, “[The Natural Rate of Unemployment](#),” Congressional Budget Office Working Paper 2007-06, April 2007.

⁶ For discussion and estimates of the breakeven rate, see Alexander Bick, “[Breakeven Employment Growth: Estimate Range Widens in 2026](#),” *St. Louis Fed On the Economy*, March 24, 2026.

⁷ See, for example, [S&P Global US Flash PMI](#), March 24, 2026.

Inflation

I perceive upside risk to inflation—at least of extended persistence of inflation above target. Core PCE inflation—which I view as the best measure of underlying inflation—was 3.1% in January, and estimates suggest it was little changed in February. Inflation in core services excluding housing has proved especially sticky, and rising prices for core goods have also contributed to sustained inflation in recent months.

Estimates by St. Louis Fed staff indicate that tariffs can explain about half of the excess 12-month inflation above 2%.⁸ The effect on inflation of the tariffs implemented last year should fade over the next couple of quarters. I have been expecting core PCE inflation to begin to edge toward 2% in the second half of 2026. But geopolitical developments have clouded that forecast, and I now see more risk of persistent above-target inflation throughout 2026.

The recent increases in energy prices will put upward pressure on headline inflation in the near term with some pass-through to core inflation. A March business survey found that firms were passing on higher energy prices to their customers and recorded the largest increase in selling prices since August 2022.⁹ The 8% fuel surcharge on package deliveries recently announced by the U.S. Postal Service is just one example. Near-term inflation expectations have also risen, though longer-term expectations have mostly been stable.

Supply Shocks and Demand Pressures

Strong demand and supply forces are currently buffeting the U.S. economy. Since 2020, the economy has faced a series of adverse supply shocks, including: supply chain disruptions during the pandemic, an oil shock when Russia invaded Ukraine, lower net immigration, new tariffs, and the oil shock associated with the latest Middle East conflict. It might be tempting to always “look through” the effects of negative supply shocks on inflation and to focus on their impacts on labor markets and growth. History suggests caution is warranted, however, especially when underlying inflation is persistently above target.

In the 1970s, two oil shocks hit the economy, causing inflation to spike when underlying inflation was already elevated and rising. Policymakers at the time attributed inflation to oil shocks and other non-monetary factors. Further, they overestimated productivity growth. Their

⁸ For a description of the approach St. Louis Fed economists use to estimate the pass-through of tariffs to inflation, see Maximiliano A. Dvorkin, Fernando Leibovici and Ana Maria Santacreu, “[How Tariffs Are Affecting Prices in 2025](#),” *St. Louis Fed On the Economy*, Oct. 16, 2025.

⁹ See [S&P Global US Flash PMI](#), March 24, 2026.

misreading of underlying inflation and the economy's growth potential allowed inflation to become entrenched.

Ultimately, the forceful measures undertaken by the Volcker-led FOMC brought inflation under control, but the costs were high. Though necessary, the harsh monetary medicine led to a severe recession and a prolonged period of high real interest rates. Real rates stayed high because, after years of rising inflation, the public doubted the Fed would stick to an anti-inflation policy and therefore demanded high rates to compensate for inflation risk.

Today's environment differs in many ways, but, as in the 1970s, the public is sensitive to inflation. In this environment, supply shocks may be more likely to have a persistent impact on inflation and inflation expectations, especially given the difficulty of identifying how much underlying inflation is due to temporary supply shocks as opposed to persistent demand pressures.

Our current environment is also sometimes compared with the 1990s, when a positive supply shock—advances in information processing technologies—boosted productivity growth and resulted in a more favorable Phillips curve tradeoff. Labor productivity growth has risen since 2022, reflecting firms' investments in automation technologies to drive efficiency gains in the face of higher labor and other input costs. So far, this looks more like a productivity recovery than a renaissance, because labor and total-factor productivity growth have both remained near their post-World War II averages.

Going forward, I am hopeful that AI will boost aggregate productivity growth and the supply side of the economy further. To date, however, AI has mostly been a force driving demand higher today on the prospect of gains in productivity and aggregate supply in the future. The data center construction buildout and rising equity prices, with consumer spending driven by wealth effects, are two ways the AI boom is boosting demand today. Rising electricity prices are among the most visible effects of the strong demand. In my view, it is important to consider demand pressures today even if we anticipate higher potential growth in the future, especially because inflation is already elevated.

Monetary Policy

Turning to monetary policy, I supported the FOMC's decision to leave the policy rate unchanged at its two most recent meetings in January and March. In real terms, the policy rate appears to be in the lower portion of the neutral range, which I believe is appropriate given the economic outlook, balance of risks and unusual degree of uncertainty. Policy is well positioned to address

risks to both dual mandate objectives, and I expect the current setting of the policy rate will remain appropriate for some time.

However, I will support adjustments in the stance of policy if the evidence indicates the economy requires them. I could support additional easing if a greater risk of a weakening labor market becomes apparent, provided inflation and inflation expectations are not moving persistently higher. I could also support lowering the policy rate to prevent the real rate from rising if actual or expected inflation falls.

By the same token, I could support raising the policy rate to avoid an inadvertent real easing that would result from holding the policy rate constant if core inflation or medium- to long-term inflation expectations moved persistently higher and away from 2%. Allowing inflation expectations to become unanchored would risk not only higher inflation but also slower growth and a weaker labor market.

That brings me to a final point: It is sometimes said that the Fed is “anti-growth” for pursuing price stability while AI and other forces could be lifting the economy’s growth potential.

I am hopeful—even optimistic—that higher productivity and potential growth lie ahead. But I believe it would be risky to ease monetary policy solely on the prospect of a future increase in productivity growth, especially with demand pressures at play and inflation running persistently above target today.

In my view, a “pro-growth” monetary policy is one that maintains a credible commitment to price stability. Markets and investors demand higher interest rates to compensate for higher expected inflation and inflation risk. Price stability and anchored inflation expectations minimize those effects and provide the stable price backdrop that is a foundation for economic growth and maximum employment.

In the weeks and months ahead, I will continue to refine my economic outlook and assessment of the balance of risks to seek a forward-looking path of interest rates that best positions monetary policy for achieving and maintaining maximum employment and price stability for all Americans.

Thank you.