

# **U.S. Economic Outlook and Monetary Policy**

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*The text is as prepared for delivery.*

Good morning. It is my pleasure to join you here in Rogers for the 32nd annual Arkansas Business Forecast Luncheon. For their kind invitation, I would like to thank University of Arkansas Chancellor Charles Robinson, Walton College of Business Dean Brent Williams, and the host of this event and Director of the Center for Business and Economic Research, Mervin Jebaraj. This is my fourth visit to Arkansas in the past year and a half, and I always learn a great deal about this dynamic state and economic conditions when I'm here.

I look forward to taking questions from my St. Louis Fed colleague Matuschka Lindo Briggs in a few minutes. But first, I will offer some remarks on the economic outlook and monetary policy. Note these are my personal views and are not necessarily shared by my FOMC colleagues.<sup>1</sup>

I will begin with a summary of my remarks and then elaborate.

First, the U.S. economy has been resilient, with considerable momentum coming into 2026. I expect the economy will continue to grow at or above trend this year. Of course, nothing is certain, but I see tailwinds supporting economic growth.

Second, the labor market has been cooling over the past 18 months in a gradual and orderly way. The unemployment rate has remained near the level economists generally associate with full employment—the so-called “natural” rate. While further cooling is possible, I believe the risk of a substantial deterioration in labor market conditions has been lessening.

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<sup>1</sup> The Federal Open Market Committee (FOMC) is the Federal Reserve committee responsible for setting monetary policy. It is comprised of the seven members of the Fed's Board of Governors, the president of the Federal Reserve Bank of New York, and four other Reserve bank presidents who serve on a rotating basis. All 12 Reserve bank presidents attend FOMC meetings and participate in its deliberations.

Third, at 2.8%, price inflation exceeds the Fed’s 2% target.<sup>2</sup> Core inflation, which is a measure of underlying inflation that excludes food and energy prices, is also 2.8%. Inflation has eased gradually in recent months, and I believe the risk of higher inflation has diminished. As the effects of tariffs on inflation ebb, I expect inflation to resume a path toward our 2% target. However, I also perceive a meaningful risk that inflation could remain above 2% for longer than we all would like.

That leads me to my fourth point—on monetary policy. I supported the FOMC’s decision earlier this week to maintain the policy rate—the federal funds rate—in the range of 3.5% to 3.75%. I believe that this setting is neutral in inflation-adjusted, or “real,” terms—neither restrictive nor accommodative—and is appropriate given my assessment of the baseline path for the economy and balance of risks. With inflation above target and the risks to the outlook evenly balanced, I believe it would be unadvisable to lower the rate into accommodative territory at this time. I could support a lower policy rate if further signs of labor market weakness emerge, provided there are no signs of increased persistence in above-target inflation and inflation expectations remain anchored. I could also support lowering the nominal policy rate if expected inflation declines sustainably to 2% or below.

I will now elaborate on these points.

### **Economic Activity**

Economic activity measured by real GDP rose at a 4.4% annual rate in the third quarter of 2025—more than twice the long-run average. Many tracking forecasts peg fourth-quarter real GDP growth at 2% or higher, and forecasters have been marking up their growth projections for 2026. I expect the economy will continue to expand at or above its long-run trend rate in 2026.

### *Consumer Spending*

Consumer spending was solid in October and November, and retailers reported a good holiday shopping season.<sup>3</sup> Reports indicate that consumer spending was especially strong in late December and into January.

A resilient labor market, income growth and accumulated wealth have all supported consumer spending. Analysis of spending in recent months by St. Louis Fed staff finds little difference in real spending growth across cohorts of households grouped by spending levels.<sup>4</sup> However,

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<sup>2</sup> The inflation measure referred to in this sentence is the 12-month percentage change in the price index for personal consumption expenditures (PCE) as of November 2025, the most recent month for which data are available.

<sup>3</sup> See [Personal Income and Outlays, October and November 2025](#) from the U.S. Bureau of Economic Analysis. Total and core retail sales rose 1.3% and 1.6%, respectively, in December, according to the [CNBC/National Retail Federation Retail Monitor](#).

<sup>4</sup> The methodology used to obtain this result is described in the article [“Real-Time Estimates of Differences in Real Expenditure Growth and Inflation across Households,”](#) by Masataka Mori and Juan M. Sánchez, Federal Reserve Bank of St. Louis *Review*, Fourth Quarter 2025.

reports from card issuers and others indicate that credit and debit card spending growth was stronger among higher-income groups in 2025.<sup>5</sup> Illustrating how wealth gains can affect discretionary spending, a CEO of a firm that sells recreational vehicles recently told me that he has observed his firm's sales are higher on days when the stock market rises.

Consumer spending is also affected by inflation, and reducing inflation to target could help consumer demand by supporting real incomes. In conversations with business and community leaders and others, I am frequently reminded that inflation is continuing to erode the public's purchasing power, and that the high cost of living is especially challenging for those of limited means. These conversations drive home the importance of finishing the job of restoring price stability.

### *Tailwinds Supporting Economic Growth*

Several tailwinds support my baseline expectation of solid economic growth at or above its long-run trend in 2026.

Supportive financial conditions are among those tailwinds. The buoyant stock market, historically tight credit spreads, and solid growth in bank lending and corporate debt issuance are all indicative of that support. Credit is widely available for households, firms, and state and local governments. Furthermore, beginning in September 2024, the Federal Reserve lowered its policy rate by 175 basis points (1.75 percentage points), moving the stance of monetary policy from restrictive to neutral. This easing has likely provided momentum to the economy.

Changes in tax law and various forms of deregulation could also lift spending in 2026. Estimates vary, but reductions in individual income tax rates and changes that incentivize firms to increase business capital expenditures enacted in 2025 are expected to boost GDP in 2026.<sup>6</sup>

Productivity growth is another potential tailwind. Both labor and total factor productivity have been recovering and on an upswing since early 2023, with marked improvement in the second and third quarters of 2025. This is an encouraging trend, and I am hopeful it will continue.

I perceive three contributing factors or phases to the recovery in productivity. Initially, firms invested in traditional automation and other labor-saving technology in response to tight post-COVID labor markets and rapidly rising labor costs. Additional investments came later, in response to rising materials and other nonlabor costs as inflation rose. More recently, firms have been deploying artificial intelligence, and many are reporting efficiency gains. St. Louis Fed economists have found evidence that AI is contributing to higher productivity for certain types of jobs and in particular sectors.<sup>7</sup> Conceivably, these investments could result in lasting productivity gains that raise the economy's growth potential.

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<sup>5</sup> See, for example, the January 2026 Bank of America Institute *Consumer Checkpoint* article "[Choppy start, solid finish.](#)"

<sup>6</sup> See, for example, the [Hutchins Center Fiscal Impact Measure](#).

<sup>7</sup> For example, see Alexander Bick, Adam Blandin and David Deming, "[The Impact of Generative AI on Work Productivity](#)," *St. Louis Fed On the Economy*, Feb. 27, 2025.

However, it seems early to label the recent productivity recovery a renaissance. Productivity growth has been only modestly above historical averages, whether measured over the last four, eight or 12 quarters against the period from 1980 to now.<sup>8</sup>

While the recent upswing in productivity is a potential tailwind, the housing market has been weak for several quarters and poses some downside risk. The housing market is an important sector of the economy, so much so that economists have sometimes argued, “Housing is the business cycle.”<sup>9</sup> Declines in mortgage rates and home prices sparked a modest increase in sales in the second half of 2025, and the decline in building permits for new single-family homes appears to have stabilized. Still, the housing market is not expected to be an engine of growth in the near term.

### **Labor Market**

The Fed’s mandate from Congress is to focus on achieving maximum employment and price stability. Accordingly, we pay close attention to the labor market and inflation.

Recent data indicate the labor market is regaining some of its footing. At 4.4%, the unemployment rate is at or near the natural rate that economists typically associate with a full-employment labor market. It is also within the range of longer-run unemployment rate projections of FOMC participants.<sup>10</sup>

At 50,000 jobs, the December increase in payrolls is within the range that St. Louis Fed staff and others estimate will keep the unemployment rate from rising. The 29,000 monthly average of new private sector jobs created between October and December is also within that range. However, job growth has been narrowly focused in one or two sectors, which is concerning, as are surveys indicating the public has low job-finding expectations. Still, job postings rose in December and layoff announcements declined. Initial claims for unemployment insurance also remain low, and continuing claims have fallen. Although hiring remains soft, continued above-trend economic growth should support the demand for labor while low levels of immigration limit growth in labor supply.

### **Inflation**

Inflation has been stubborn. As I mentioned earlier, at 2.8%, both headline and core inflation remain above the Fed’s 2% target. However, both rates moved lower in November on a three-month annualized basis, reflecting subdued goods inflation and lower housing inflation. This is encouraging. But measures of services inflation that exclude housing have remained sticky at above 3%. Further, the absence of complete price information for October and the delayed

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<sup>8</sup> See recent estimates of labor productivity and total factor productivity from the [Federal Reserve Bank of San Francisco](#).

<sup>9</sup> See, for example, Edward E. Leamer, “[Housing IS the Business Cycle](#),” NBER Working Paper 13428, September 2007.

<sup>10</sup> See the [FOMC’s Summary of Economic Projections from December 2025](#).

November collection because of the government shutdown may have introduced some downward bias in reported inflation data.<sup>11</sup>

The recent paths of goods and housing inflation, along with lower oil and gasoline prices, have nevertheless increased my confidence that inflation is unlikely to accelerate in the near term. Rather, I expect inflation will resume a path toward 2% as tariff effects ebb later this year. Nonetheless, persistence in above-target inflation remains a risk. Business surveys report input and selling prices are continuing to rise for both goods and services, indicating inflation has some momentum.<sup>12</sup>

Surveys often cite tariffs as a source of higher prices. Tariff effects on prices should be temporary, however, and I expect the effects from tariffs implemented in 2025 to wane in coming months.

But tariffs don't appear to be the only reason inflation is running above target. St. Louis Fed staff estimate that, through November, tariffs accounted for only half the excess of headline inflation above 2% and less than half the excess of core inflation above 2%. If inflation remains elevated as tariff effects wane, then other sources of inflation—potentially including monetary policy—will need to be considered.

### **Monetary Policy**

As I said at the outset, I supported the FOMC's decision this week to leave the policy rate unchanged. I also supported the Committee's moves last fall to lower the policy rate from restrictive to neutral as an appropriate response to downside labor market risk. Some risk remains, but recent signs of resilience and the tailwinds supporting economic activity suggest that risk has lessened.

I believe that policy is now well positioned to respond as needed to either of the Fed's dual mandate objectives. I could support additional reductions in the policy rate if new evidence of labor market weakness or risks emerge, absent further signs of persistent above-target inflation or rising inflation expectations. I could also support lowering the nominal policy rate if expected inflation declines to target or falls below it.

However, given the current data and the balance of risks, I believe it would be unadvisable to lower the rate into accommodative territory at this time. Aside from risking higher or more persistent inflation, easing could be counterproductive for the labor market by raising inflation expectations and long-term interest rates, thus slowing the economy and hurting employment. Ultimately, a strong labor market and economy depend on achieving and maintaining price

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<sup>11</sup> See, for example, the Dec. 18, 2025, CNBC article "[Trust these numbers? Economists see a lot of flaws in delayed CPI report showing downward inflation](#)" or the Jan. 22, 2026, Reuters article "[US consumer spending increases solidly in October and November.](#)"

<sup>12</sup> See, for example, the [S&P Global Flash US PMI](#) for January 2026. Recent Federal Reserve bank surveys include those from the [Dallas](#), [Kansas City](#), [Philadelphia](#), [Richmond](#) and [Chicago](#) banks, and the Federal Reserve Bank of New York's [Business Leaders](#) and [Empire State Manufacturing](#) surveys.

stability, and my FOMC colleagues and I are firmly committed to achieving maximum employment and price stability for all Americans.

Finally, to conclude, I would like to speak briefly about the important role that each of you plays in the work of the Federal Reserve. The economy affects everyone in the country, and therefore it is important that everyone has a voice. Federal Reserve banks such as the St. Louis Fed serve as that voice. Your experiences with the economy are critically important to the monetary policy decisions we make. Your input helps us understand what's really going on in the economy and avoid groupthink. That is why I appreciate the opportunity to meet with you today. When you hear people talking about the independence of the Fed, you should know that you are a part of it. Your perspectives help us make informed, independent decisions on behalf of the American people.

Thank you.