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Navigating Uncertainty: Inflation, Labor Markets, and the Stance of Monetary Policy

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Anna Paulson

President and Chief Executive Officer
Federal Reserve Bank of Philadelphia

The views expressed today are my own and not necessarily those of the Federal Reserve System or the Federal Open Market Committee (FOMC).

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**Navigating Uncertainty: Inflation, Labor Markets,
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Technology's Transformative Role in Finance and Central Banking
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Good evening. Thank you, Colby,¹ for that kind introduction. It's great to be here.

As many of you know, Congress has given the Federal Reserve and specifically the Federal Open Market Committee the job of delivering stable prices and maximum employment for the American people. I am focused on understanding economic conditions and where they are headed — so that we can position monetary policy to achieve those goals.

My team and I spend a lot of time analyzing data and listening to people. We talk to households across the economic spectrum, firms of every size and sector, nonprofits, and a wide range of financial institutions. These conversations tell the stories behind the data and provide a glimpse into the future, since the plans we hear about are not yet reflected in official statistics.

The people behind these conversations — employers, workers, families and their communities — are at the forefront of my mind when I'm making monetary policy decisions. Right now, these conversations reflect strain and uncertainty.

Inflation is taking a toll. Many families are struggling to make ends meet, especially with the jump in gas prices. Workers are anxious about the job market, both those seeking employment and those worried about keeping their jobs as artificial intelligence (AI) reshapes the workplace.

Businesses are navigating enormous change: tariffs, evolving regulations, and now the conflict in the Middle East. All of this is creating opportunity but also disruption. Firms are managing — but planning is hard and they worry about what's next.

So, there's a lot going on — and the data and what we hear in our conversations aren't always pointing in the same direction. My goal for this evening is to share my take on the economic outlook, highlight some key risks and discuss what this means for monetary policy. The bottom line: I believe monetary policy is appropriately positioned to

¹ Colby Smith, reporter, *The New York Times*, <https://www.nytimes.com/by/colby-smith>.

navigate current challenges. Policy is mildly restrictive and that restrictiveness is helping to keep inflation pressures in check while the labor market remains stable.

As always, these are my own views and not necessarily those of my colleagues on the Federal Open Market Committee (FOMC).

Taking Stock of Current Conditions

Let me start with the obvious. Inflation is too high. Even before the conflict in the Middle East and the recent spike in oil and gas prices, inflation was elevated. At the same time, the labor market continues to be pretty stable; the consumer is resilient; and we are seeing solid growth, bolstered by investment in AI infrastructure. Last year, real gross domestic product (GDP) grew 2 percent, and it is on track to do the same this year. Headline growth in the first quarter was solid, and business investment was a bright spot.

Investment growth is particularly strong in categories related to the AI buildout and that is supporting business conditions more broadly. Contacts tell us that data center construction and other AI spending is boosting activity in many communities.

Growth in consumer spending, which is roughly two-thirds of GDP, is more modest. Consumers are continuing to spend — although at a slower pace. In the first quarter, consumption grew at an annual real rate of 1.6 percent, down from 2.1 percent last year.

A dominant theme in our conversations is the pressures that families are feeling from elevated inflation. Gas prices, which are up more than 50 percent since the beginning of the year, are adding significantly to those challenges. People tell us that some of the strategies they had been using to bring in extra income to cover monthly expenses — like driving for ride-sharing services or doing delivery work — no longer make economic sense once you factor in the cost of gas. We continue to hear about consumers trading down from premium brands to cheaper alternatives, and some families are relying more on credit cards and other debt to maintain spending.

Still, the overarching theme is resilience: While many families are feeling stretched by inflation, there are few signs that consumers are pulling back sharply in the aggregate.

Looking ahead, however, both households and businesses are cautious. Business contacts emphasize that uncertainty — particularly uncertainty related to the conflict in the Middle East — is taking a toll. Some projects are being put on hold until there's more clarity. Many consumers express pessimism about the economy and their own prospects. You can see this in very low readings in surveys of consumer sentiment. In addition to pressures from inflation, people are wondering if their job will still be there tomorrow.

The Labor Market: A Historical Anomaly

Still, the unemployment rate has been remarkably steady and near what I consider to be full employment for many months. It has edged up slowly, going from a historical low of 3.4 percent in April 2023, to 4.5 percent in November of last year, to a still low 4.3 percent last month.

Going all the way back to 1948, when the official unemployment rate data began, this is the only time the unemployment rate has risen by one percentage point or more outside of a recession. Usually, when the unemployment rate goes up, it goes up quickly — fueled by an escalating cycle of layoffs, falling incomes, and lower spending. But over the past couple of years, layoffs have been low and spending has been steady.

Given how unusual it is for the unemployment rate to increase gradually, the nervousness we hear about the labor market is understandable. One source of anxiety relates to AI and what it will mean for jobs. Some contacts tell us that there is growing pressure in corporate boardrooms for companies to translate AI efficiencies into cost savings, including through layoffs. Not all of our contacts share this view, however. Many expect AI to slow hiring rather than trigger job cuts.

Whether it is driven by AI or other factors, labor market pessimism is widespread. According to the [New York Fed Survey of Consumer Expectations](#), the mean probability that the unemployment rate will be higher a year from now was 44 percent in April, up from 34 percent in January of last year. Taking this altogether, the hard data suggest a labor market that is stable and consistent with full employment. But what we are hearing from people — both directly and through surveys — suggests somewhat softer labor market conditions. My base case is that the labor market will remain stable and that we will end the year with an unemployment rate in the range that has prevailed over the past few years.

Inflation: Elevated and Driven by Supply Shocks

And now, turning to inflation. Here the data and what we are hearing from contacts are aligned: inflation is too high. Multiple forces have kept inflation elevated. Most recently, tariffs and the spike in energy and commodity prices associated with the conflict in the Middle East are pushing inflation higher.

At the beginning of last year, inflation had declined significantly but remained above our 2 percent target. Headline PCE inflation was 2.6 percent (year-over-year) in January of 2025, and core inflation — which excludes more volatile food and energy prices — was 2.8 percent. The last stretch of disinflation was proving bumpy, although the underlying components of inflation were generally moving in the right direction.

Since then, inflation has moved higher. Headline PCE inflation was 3.5 percent in March, and core was 3.2 percent. Last week's data on consumer and wholesale prices for April point to continuing pressures as oil and gas prices rose further. Both tariffs and

the disruptions to production and shipping associated with hostilities in the Middle East are classic supply shocks. Directionally, they increase prices and reduce output.

Should Monetary Policy Look Through These Shocks?

Conventional wisdom says that monetary policy should look through the inflationary effects of a temporary supply shock. The logic is straightforward. Monetary policy works with a lag. It takes time — say 12 to 18 months — for monetary policy tightening to impact inflation. By that time, the effect of a temporary shock to prices is likely to have already subsided. So that's the conventional wisdom.

But does the conventional wisdom apply today? To answer this question, I'm assessing whether there are forces in the economy now that could amplify these supply shocks and lead to broader and more lasting inflationary pressures. I'm focused on three factors.

The first factor is the strength of economic activity. After the pandemic, we saw how strong demand, flush households, tight labor markets, and high resource utilization could combine to amplify supply shocks and push inflation higher. I don't see a significant cause for concern today: GDP is growing at roughly potential, the labor market is approximately in balance, and wage growth is consistent with 2 percent inflation. Businesses, and especially consumers, are cautious and we've seen some moderation in consumption growth. I am monitoring business investment and the possibility that strong stock market returns fuel consumption. But overall, the pace of economic activity does not appear to be adding materially to inflationary pressures.

The second important factor is inflation expectations. If households and businesses anticipate that supply shocks will leave a lasting impact on inflation, then monetary policy might need to be tightened to align inflation expectations with our 2 percent goal. After five years of elevated inflation and a series of supply shocks, this is a real concern. Surveys and market pricing show that short-term inflation expectations have, quite understandably, moved up. But longer-term expectations have remained stable, indicating that both market participants and survey respondents — professional forecasters and regular people — expect inflation to come back down. For example, market-based expectations of average inflation five to 10 years from now have been steady, fluctuating between 2 and 2.5 percent since March of 2021. This is an area I'm watching closely, but currently long run expectations are in a good place.

A third important factor is the stance of monetary policy. If monetary policy were accommodative — if it were actively pushing growth higher — then I would be more worried that the supply shocks we are experiencing could lead to persistent inflation. But in my view, monetary policy is mildly restrictive and that restrictiveness is helping to keep the effects of both tariffs and the price increases associated with the conflict in the Middle East in check. Taking these three factors together, I believe the current stance of monetary policy is appropriate. While there are certainly risks, for now, monetary policy, economic forces, and inflation expectations are all helping to keep price pressures from

tariffs and the conflict in the Middle East from turning into a more lasting inflation problem.

Implications for Monetary Policy

So, what does this mean for the path of monetary policy? I believe monetary policy is currently well-positioned to balance the risks that I've described and to react if the risks become manifest. And, importantly, people understand how monetary policy is likely to respond as conditions evolve.

You can see this in the way market expectations for the path of the funds rate have moved with economic news. In January, markets were pricing in about three rate cuts this year. The conflict in the Middle East and its impact on energy prices changed those expectations. Right before the April FOMC meeting, markets were anticipating perhaps one rate cut this year. More recently, expectations have shifted to incorporate the possibility of steady rates or even a modest tightening.

The way the market has moved in reaction to economic news over the last few months largely aligns with my own thinking. And I should note that there are definitely times when my thinking and market moves are not aligned. I want to be clear: I believe monetary policy is in a good place now. Keeping rates steady allows us to assess how the economy is evolving and the risks to both price stability and the labor market. Assuming the labor market remains in balance, rate cuts would only become appropriate once we have seen sustained progress on inflation. However, I think it is healthy that market participants have taken on board scenarios where the funds rate remains unchanged for an extended period, as well as scenarios where further tightening becomes necessary.

The path forward will depend on how economic conditions evolve. I expect the labor market will remain stable and that inflation will gradually return to 2 percent as the effects of recent shocks fade. But risks to inflation have increased and the timing and pace of any policy adjustments will be determined by the incoming data.

Other scenarios are certainly possible. If the conflict in the Middle East is resolved soon and shipping and oil production return to normal quickly, inflation and inflation risks are likely to subside relatively quickly. If it takes more time to resolve, inflation and inflation risks, along with risks to the labor market, are likely to be elevated for longer.

Conclusion

This brings me back to where I started and the conversations that help me understand the economy and how people are experiencing it. Inflation has been too high for too long and families and businesses are feeling stretched. The future feels uncertain. At the same time, they are resilient and that resilience is reflected in solid economic growth and the stable labor market.

The best way for me to respond to their concerns is to do my job and that means being laser focused on bringing inflation back to 2 percent while preserving full employment. The current stance of monetary policy is helping us make progress towards that goal. As we move forward, I will be focused on what I learn from the data and from my conversations. The American people deserve both stable prices and a healthy labor market. That's what I'm committed to delivering.

Thank you. I look forward to continuing the conversation with Colby.