



Monetary Policy and the Fed's Framework Review

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Jackson Hole Prepared Remarks Summary

INTRODUCTION

- U.S. economy has shown resilience.
- The labor market remains near maximum employment.
- Inflation, though still somewhat elevated, has come down a great deal from its post-pandemic high.
- The balance of risks appears to be shifting.

NEAR-TERM OUTLOOK

- **INFLATION**
 - The restrictive policy stance last year was appropriate to help bring down inflation and to foster a sustainable balance between aggregate demand and supply.
 - Inflation had moved much closer to the 2% objective, and the labor market had cooled from its formerly overheated state.
 - Upside risks to inflation had diminished, but the unemployment rate had increased by almost a full percentage point, a development that historically has not occurred outside of recessions.
 - The upward pressure on prices from tariffs could spur a more lasting inflation dynamic, and that is a risk to be assessed and managed.
- **LABOR ECONOMY**
 - Higher tariffs are remaking the global trading system while a tighter immigration policy has led to an abrupt slowdown in labor force growth.
 - The payroll job growth slowed to an average pace of only 35,000 per month over the past three months. It does not appear that this has opened up a large margin of slack in the labor market.
 - The unemployment rate stands at a historically low level of 4.2 percent and has been broadly stable over the past year.
 - Labor supply has softened in line with demand, sharply lowering the "breakeven" rate of job creation needed to hold the unemployment rate constant. Indeed, labor force growth has slowed considerably this year.
 - A marked slowing in both the supply of and demand for workers is an unusual situation suggesting that downside risks to employment are rising, and if those

risks materialize, they can do so quickly in the form of sharply higher layoffs and rising unemployment.

- THE ECONOMY
 - The decline in GDP growth has largely reflected a slowdown in consumer spending.
 - The effects of tariffs on consumer prices are now clearly visible. It is expected those effects will accumulate over the coming months, with high uncertainty about timing and amounts.

INTEREST RATES

- With policy in restrictive territory, the baseline outlook and the shifting balance of risks may warrant adjustment of the Fed's policy stance.
- Monetary policy is not on a preset course. FOMC members will make these decisions based solely on their assessment of the data and its implications for the economic outlook and the balance of risks.

CHALLENGES

- In the near term, risks to inflation are tilted to the upside, and risks to employment to the downside - a challenging situation.
- There is significant uncertainty about where tariff, immigration, tax, spending and regulatory policies will eventually settle and what their lasting effects on the economy will be.
- Distinguishing cyclical developments from trend or structural developments is difficult. This distinction is critical because monetary policy can work to stabilize cyclical fluctuations but can do little to alter structural changes.

THE NEW FRAMEWORK

- A key objective has been to make sure that the framework is suitable across a broad range of economic conditions. At the same time, the framework needs to evolve with changes in the structure of the economy and our understanding of those changes.
- At the time of the last review in 2020, the new normal environment was characterized by the proximity of interest rates to the effective lower bound (ELB), along with low growth, low inflation, and a very flat Phillips curve—meaning that inflation was not very responsive to slack in the economy. Inflation and inflation expectations could then decline in a weak economy, raising real interest rates as nominal rates were pinned near zero. A flexible average inflation targeting was adopted - a "makeup" strategy to ensure that inflation expectations would remain well anchored even with the ELB constraint.
- Economic conditions have evolved over the past five years. With inflation above target, the Fed's policy rate is modestly restrictive. There is no certainty as to where rates will settle out over the longer run. The neutral level may now be higher than during the 2010s, reflecting changes in productivity, demographics, fiscal policy, and other factors that affect the balance between saving and investment.
- The new framework updates the 2020 framework as follows:
 - 1) REMOVED: language indicating that the ELB was a defining feature of the economic landscape and is not the primary focus.

- 2) RETURNED TO: flexible inflation targeting and eliminated the "make-up" strategy with emphasis on the commitment to act forcefully to ensure that longer-term inflation expectations remain well anchored, to the benefit of both sides of the dual mandate. In the absence of inflationary pressures, it might not be necessary to tighten policy based solely on uncertain real-time estimates of the natural rate of unemployment.
- 3) REMOVED: the use of "shortfalls" which was not intended as a commitment to permanently forswear preemption or to ignore labor market tightness. And added "the Committee recognizes that employment may at times run above real-time assessments of maximum employment without necessarily creating risks to price stability."
- 4) UPDATED: when the employment and inflation objectives are not complementary, a balanced approach in promoting them is followed by taking into account the extent of departures from the goals and the potentially different time horizons over which each is projected to return to a level consistent with our dual mandate.

Continue to view a longer-run inflation rate of 2 percent as most consistent with dual-mandate goals.