

The Economic Outlook and Monetary Policy

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The views expressed by the author are his own and do not necessarily reflect those of the Federal Reserve System, its governors, officers or representatives.

Thank you for the invitation to speak today. I look forward to our discussion. Events like this are essential to how the Fed operates and reflect the importance of the Fed's regional structure. The district I represent at the Federal Open Market Committee (FOMC) covers a seven-state region, and discussions with local businesses and communities underpin my participation in the Committee. An important part of my job is to give voice to the concerns and insights of individuals in the 10th District when it comes to the economy and monetary policy. One of the benefits of the Fed's structure, with 12 independent regional banks spread across the country, is that it allows a level of interaction and participation that would not be possible if operations were centralized in Washington. We are your Fed. You should feel a connection with this institution, and I hope our discussion today will make that connection more immediate and real.

Before turning to the outlook for the economy and policy, let's take a minute to look back. Way back. This year marks America's 250th birthday. Though that might seem like some time ago, it is important to remember how new and revolutionary the United States was (and still is) as a system of governance and political organization. This is an experiment that has evolved and continues to evolve. But one outcome of that experiment has been the most dynamic and innovative economy the world has ever known. The Federal Reserve, at a relatively spry 113 years old, has been an important part of this success story. The United States has the deepest and most liquid financial markets in the world, and the dollar is the currency of international commerce. These developments have been supported by the history and institutional strength of the Federal Reserve.

Part of what has made the Federal Reserve successful has been that its design and structure reflect one of America's most important and defining strengths—its decentralized,

federated system of distributed authority. The Federal Reserve, with 12 distinct regional banks working alongside the Board of Governors, embodies this national belief in decentralization. This model for managing monetary policy is uniquely American. I spend a lot of time in Kansas City and in our branches in Denver, Oklahoma City, and Omaha, and throughout our seven-state region, talking to business and community leaders about the economic conditions they face and the problems they are solving. These conversations inform my views on the economy and provide the input I need as I travel to Washington to participate in the FOMC meetings that set monetary policy.

Today I will outline some thoughts on monetary policy, but first I would like to review some of the important, and often overlooked, non-monetary policy functions the Fed performs in support of the U.S. economy. It is probably surprising to some, but the vast majority of those working for the Fed here in Denver, as well as in our other offices, are less involved in monetary policy than in what I like to call monetary operations.

For example, Kansas City Fed staff are essential to the flow of money into and out of the U.S. Treasury. The Fed acts as the Treasury's banker, and our staff are integral to the daily transfer of billions of dollars, from Social Security to disaster recovery payments. Millions of Americans count on the reliability and security of Fed systems as they interact with the U.S. government in their financial lives.

We also help ensure the safety and soundness of banking institutions throughout our seven-state region, bringing local knowledge and understanding to our interaction with district bankers. By enhancing confidence in the security of institutions of all sizes, our supervisors help level the playing field and support the many smaller banks that operate in the rural communities that define a large portion of our region.

And importantly, the Fed maintains the payments infrastructure that is the circulatory system of our \$30 trillion economy. These systems are essential to our economic health, and they must work consistently, safely, and securely. One example of this is the Federal Reserve’s 24-by-7-by-365 instant payments system, called FedNow. FedNow is the Fed’s first major new payment rail in over 40 years, and it is bringing instant payments technology to all financial institutions, no matter their size or location.

The Economic and Policy Outlook

Turning to the outlook for the economy and monetary policy, the word I hear most frequently when discussing the economy with contacts throughout the district is “uncertainty.” However, despite elevated uncertainty, the economy performed well last year. Real GDP grew 2¼ percent in 2025, about the same pace as in 2024 and not that different than the average growth rate over the past 15 years. Growth would have been a bit stronger had the government not shut down towards the end of the year. For the most part, I am hearing optimism from contacts about the year ahead, an optimism that I share. I believe our growth trajectory remains strong, in part as expansionary fiscal policy supports demand, with consumers benefiting from larger tax refunds and businesses taking advantage of investment tax incentives.

In setting the stance of monetary policy, Congress has directed the Fed to support stable prices and full employment, a combination often referred to as the Fed’s dual mandate. Although growth remains solid, both sides of the dual mandate—labor and inflation—present some challenges.

On the labor side, employment growth in 2025 was weak. The economy reportedly added only 181,000 new jobs over the entire year, the slowest pace of job growth outside of a recession

on record. However, even as hiring has slowed, there have been few signs that firing has risen, leading to what many have called a low-hire/low-fire job market. The unemployment rate, at 4.3 percent, remains low by historical standards. Much of the slowdown in hiring has been balanced by structural features that have led to a sharp falloff in the supply of new workers looking for jobs. This includes a steep decline in immigration as well as an aging workforce and an increase in retirements--a topic I will return to later. All in all, given these developments, the economy needs to produce fewer new jobs to keep the unemployment rate from rising and the labor market in balance.

With many different indicators of labor market health, not to mention frequent large revisions to the data, it can sometimes be confusing to determine the ultimate signal that should be taken from the data. A useful summary of the sometimes conflicting data is the Kansas City Fed's Labor Market Conditions Indicators, released monthly and accessible on the Bank's website^[1]. This measure, which combines 24 different data series to measure labor market health, has been cooling but remains a touch above historical averages and largely appears to suggest the labor market is in balance.

Turning to the other side of the Fed's mandate, inflation remains too hot. The recent data suggest that inflation remains closer to 3 percent than the Fed's 2 percent inflation objective. Higher goods prices, partly on account of tariffs, are certainly part of the story, but the inflation rate for services is also running strong, and faster than what is consistent with us returning to our overall 2 percent inflation objective.

Inflation has been above the Fed's objective for nearly five years now. I don't think we have room to be complacent. History has shown us that persistent inflation can shift the psychology around price-setting, and inflation can become ingrained. Were that to occur, re-

anchoring inflation at 2 percent would be difficult and costly. It is unlikely that we would still be talking about soft landings.

Looking back over the past few decades, one of the greatest economic policy successes for the Fed, for the country, and perhaps for the world, has been the decline in worries about inflation. It is not just that the pace of inflation has decreased, but also households' and businesses' perception that higher inflation could happen again. The declining risk of inflation for most of the past three decades has had real benefits, allowing greater certainty and better planning.

Former Fed Chair Alan Greenspan defined price stability as “inflation so low and stable over time that it does not materially enter into the decisions of households and firms.” By this metric, we still have some work to do. In 2019 only 1 percent of small businesses reported inflation as their most important problem. In January, 12 percent of small businesses reported inflation as their number one problem. We should never underestimate how much people hate inflation—and for good reason. Inflation is an economic thief. Holding all else equal, a 1 percentage point increase in inflation lowers the purchasing power of U.S. household income by close to \$300 billion. Though I believe our credibility on inflation remains intact, I don't think we can be complacent, and the costs of losing that credibility are high.

Structural Change and Demographics

I have talked a bit about the near-term. Now I would like to take a step back and talk about a structural transformation that the economy is undergoing right now that has important implications not only for the future but also for the present. You might be expecting me to launch into a discussion of artificial intelligence, its impact on investment and energy prices, and the

prospect of substantial productivity gains. And it is true that the pace of technological innovation around AI has been astounding. The potential disruptive effects of AI are being felt in the stock market, written about in countless editorials, and discussed at dinner tables around the country.

But there is another transformation going on right now that I think is as important and perhaps attracting a little less attention. I'm referring to the demographic transition and the aging of the population. Unlike the novelty and uncertainty around AI, population aging is slow moving and predictable. However, while we might all know that we are getting older—though some might try to personally deny it—less discussed is the fact that we are currently at an inflection point.

Last August, demographic transition was the subject of the Jackson Hole Symposium gathering of global central bankers the Kansas City Fed hosts every year in Wyoming. (I recommend looking at the excellent papers from that meeting, available on our website, [KansasCityFed.org](https://www.kansascityfed.org).) There are two interrelated demographic changes discussed at the Symposium that I would like to highlight. First, the slowing of population growth and second, the rapid aging of the population. In the United States, the population increased $\frac{1}{2}$ percent in 2025, the slowest pace on record outside of war and pandemic, and it is projected to only slow further in the years ahead. As the baby boom generation retires, the growth of the workforce is even more anemic and is projected to start shrinking around the middle of the century.

The numbers from overseas are even more stark. Projections show the Chinese workforce declining next year and continuing to shrink through the remainder of the century. In all, the working age population in China is projected to decline by two-thirds, or almost $\frac{3}{4}$ of a billion people, by the end of the century.

Fewer people and fewer workers means slower economic growth. Historically, more labor has been one of the fundamental drivers of economic growth. In the United States this has been particularly true, and our economy is likely to need some adjustment to adapt to this new era.

While an aging population will weigh on growth in the long-run, it is possible that population transition is supporting growth in the near-term. One place we see this is in the outsized role of health care in employment and consumption over the past year. Over the past five years there has been an almost 20 percent increase in the proportion of the U.S. population that is 75 or older, an age at which health care expenditure increases dramatically, and there are even steeper increases on the horizon. Between 2020 and 2040, the proportion of the U.S. population above 75 is expected to almost double to 12 percent.

We could already be seeing the impact of this increase on the health care sector. As I mentioned earlier, in 2025 the economy saw overall job gains of 181,000, whereas jobs in the health care and social assistance category increased by 693,000. Absent health care, the economy actually lost jobs last year. Within health care and social assistance, jobs in the home health care and services for the elderly sectors increased by 300,000.

Higher spending on health care in 2025 also supported consumption and economic growth. Consumption was the largest contributor to economic growth last year, contributing 1.8 percentage points to total real GDP growth of 2.2 percent. Within consumption, about two-thirds of this increase can be attributed to health care, pharmaceuticals, and social care for the elderly. Looking at the separate categories of health care spending, the fast-growing segment is home health care, consistent with the strong employment growth in this sector.

While demand for health care is increasing rapidly, so far inflation in the sector has been high, but not especially so. However, wage growth for health care workers remains far higher than the pre-pandemic pace—not surprising given the need to attract a growing number of workers into the sector. Overall, higher labor costs and relatively moderate price increases have increased pressure on margins in the sector, certainly something I have been hearing about from contacts in the industry. And there is considerable risk that further increases in prices and inflation might be forthcoming.

Monetary Policy and the Balance Between Supply and Demand

What does this mean for monetary policy? As I discussed in a recent speech, when it comes to the outlook for inflation, not all growth is created equal. Growth led by increased supply, perhaps on account of AI-led advances in productivity, can boost output and lower inflation. That’s a winning combination. In contrast, demand-led growth, such as increased health care spending related to an aging population, can increase output but often at the cost of higher inflation. Simply put, supply-driven growth is disinflationary. Demand-driven growth is not.

Is growth being led by supply or demand? With so many competing but intertwined developments, it can be hard to tell. But we do have one reliable indicator that can cut through all the confusion and provide a quick answer. That is inflation. Overall, with inflation still running hot, it appears that demand is outpacing supply across much of the economy. I remain open to the possibility, and I’m even optimistic, that AI and other innovations will eventually lead to a non-inflationary, supply-driven growth cycle. In fact, AI might be necessary to offset the drain on

growth from a smaller workforce. However, based on the current rate of inflation, we are not there yet.