The U.S. Economy in a Time of Policy and Meta-Policy Change

62nd Annual ASU/PNC Bank Economic Forecast Luncheon

November 12, 2025

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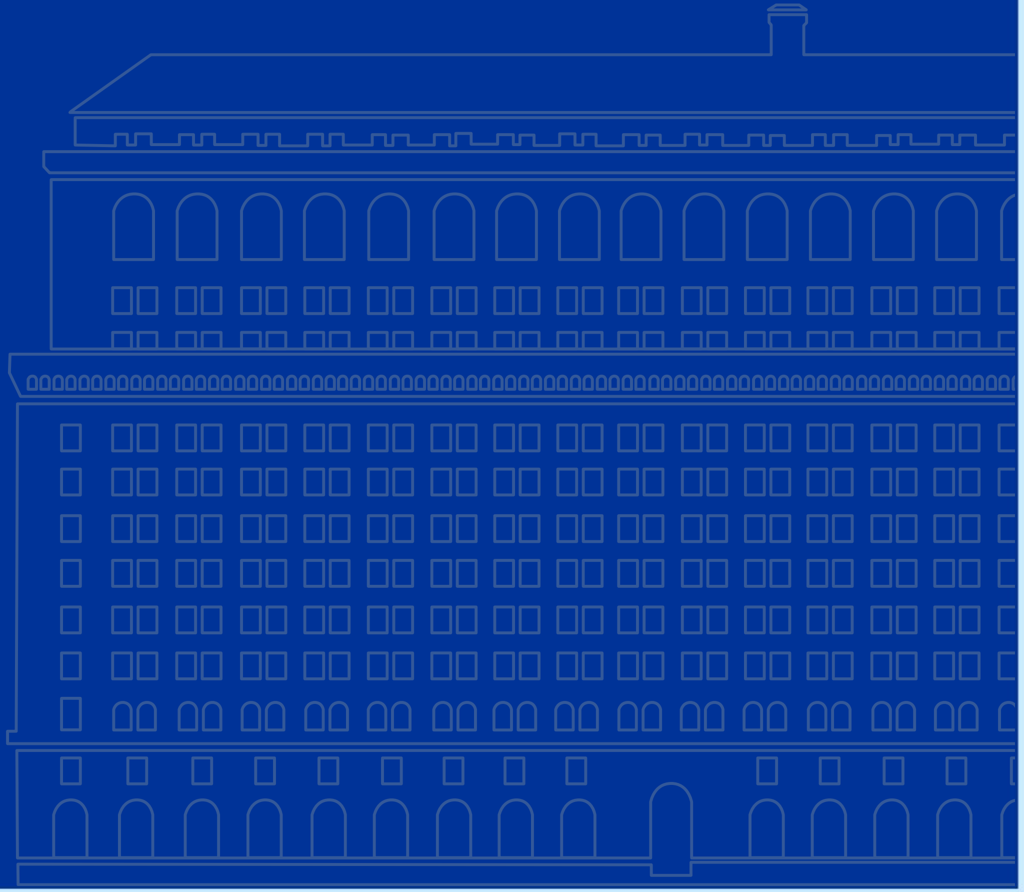
Slides prepared by Elizabeth Li and William Zeng

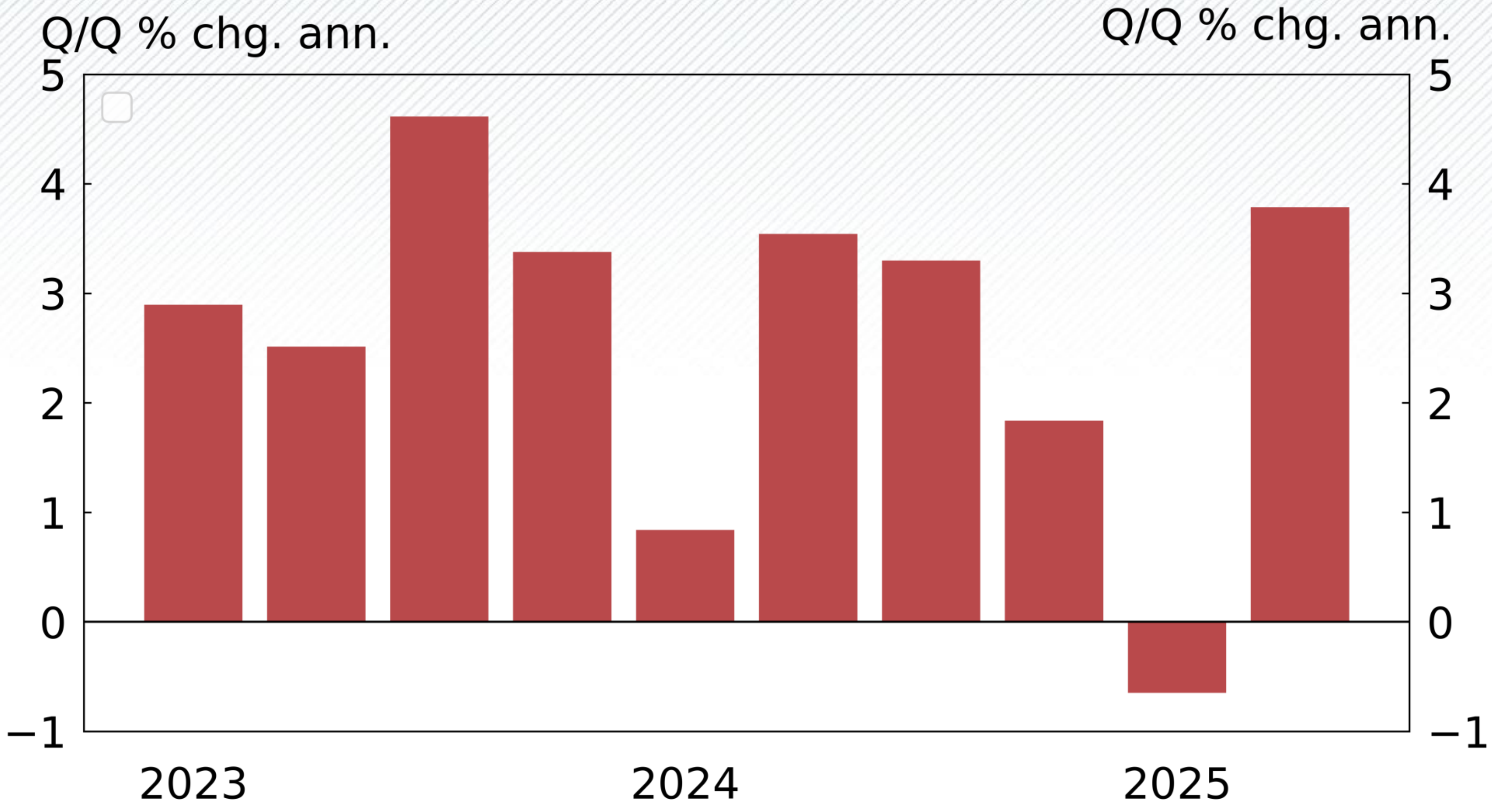
Where Are We At?
A Wild Year, Only Slight Macroeconomic Change



Current U.S. Economy: Strong but Cooling

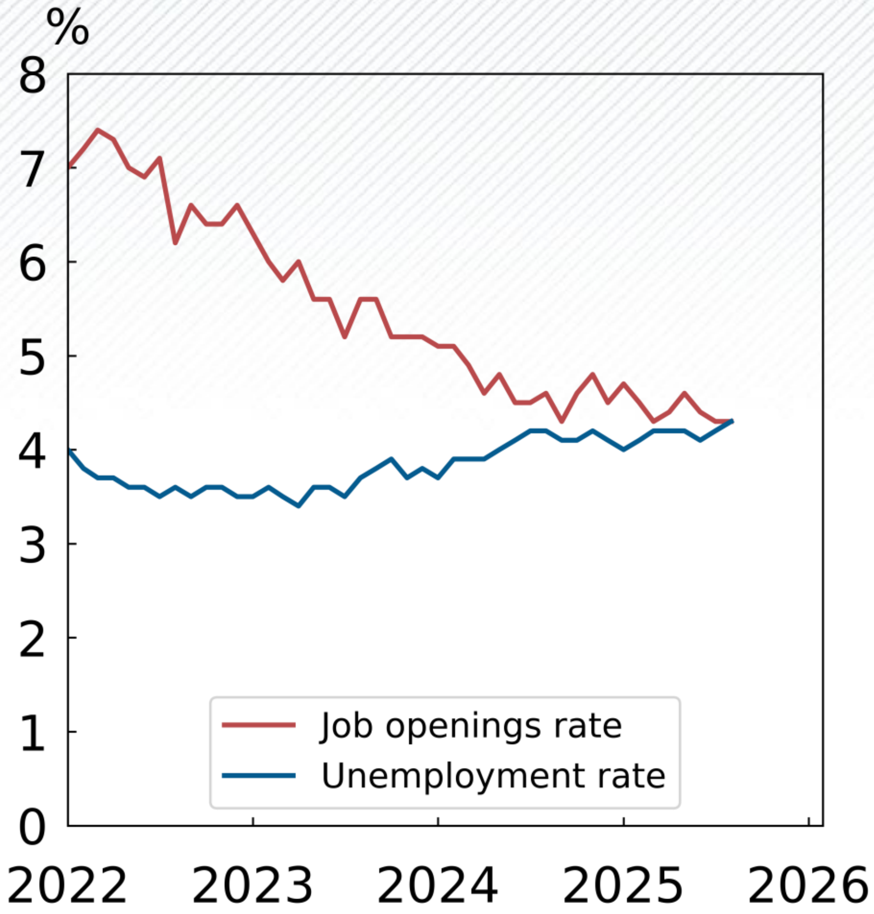
- **Growth:**
  - Real GDP grew at a >3% annual rate in 2025Q2, expecting 2025 to come in around 2%.
- **Labor market:**
  - Conditions remains good overall (4.3% unemployment).
- **Inflation:**
  - Above target still. (Latest PCE inflation reading at 2.7%, and, no, that is not close enough.)
- **Uncertainty remains highly *elevated*, but economy appears to be *softening*.**
  - Fewer vacancies now than unemployed.
  - Investment soft outside of data centers (and even that is cooling).

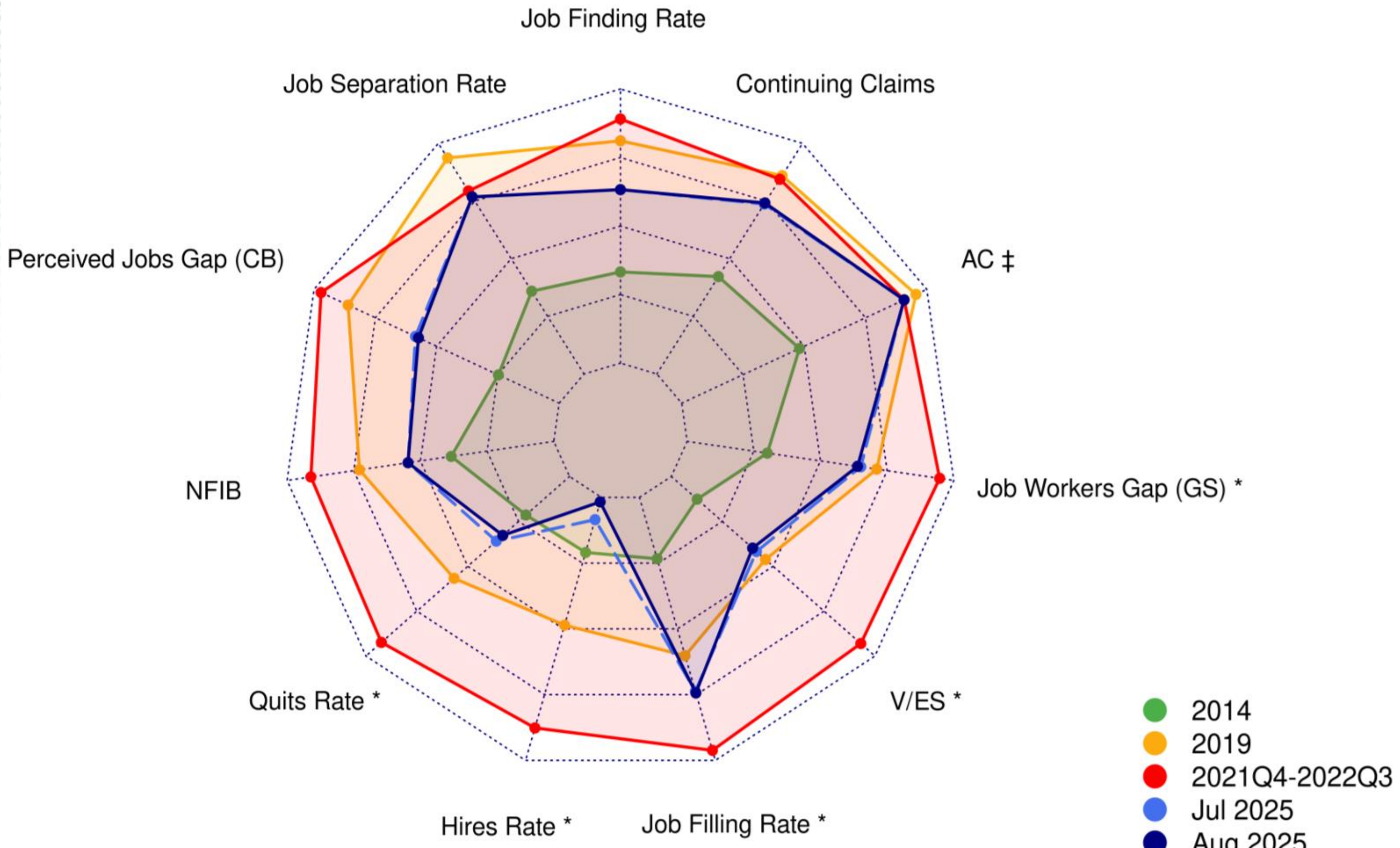
Top Line: So Far, So Good—GDP Not Slowing



Source: Bureau of Economic Analysis via Haver Analytics

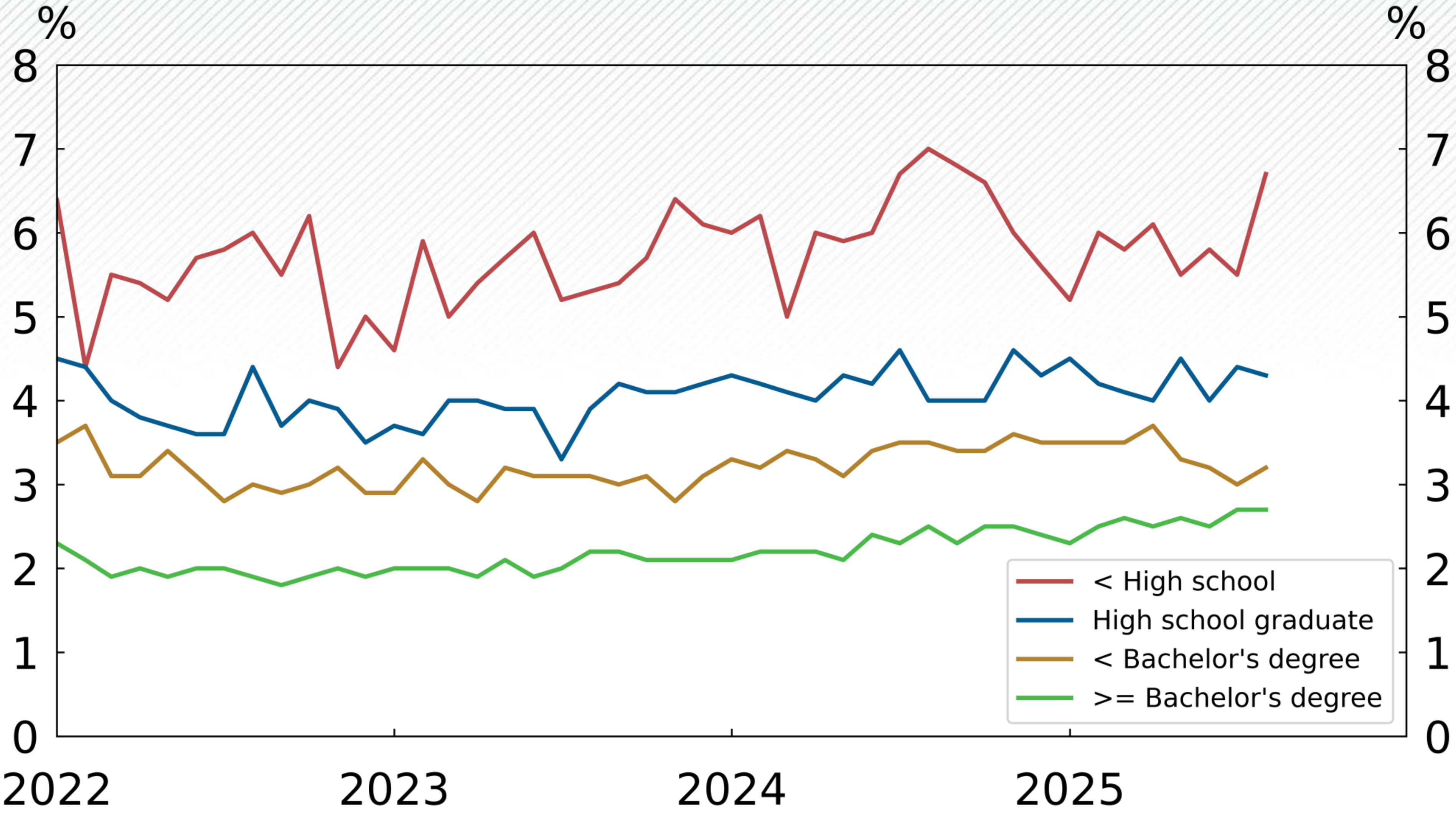
Labor Market Still Strong, But Cooling is Now Evident





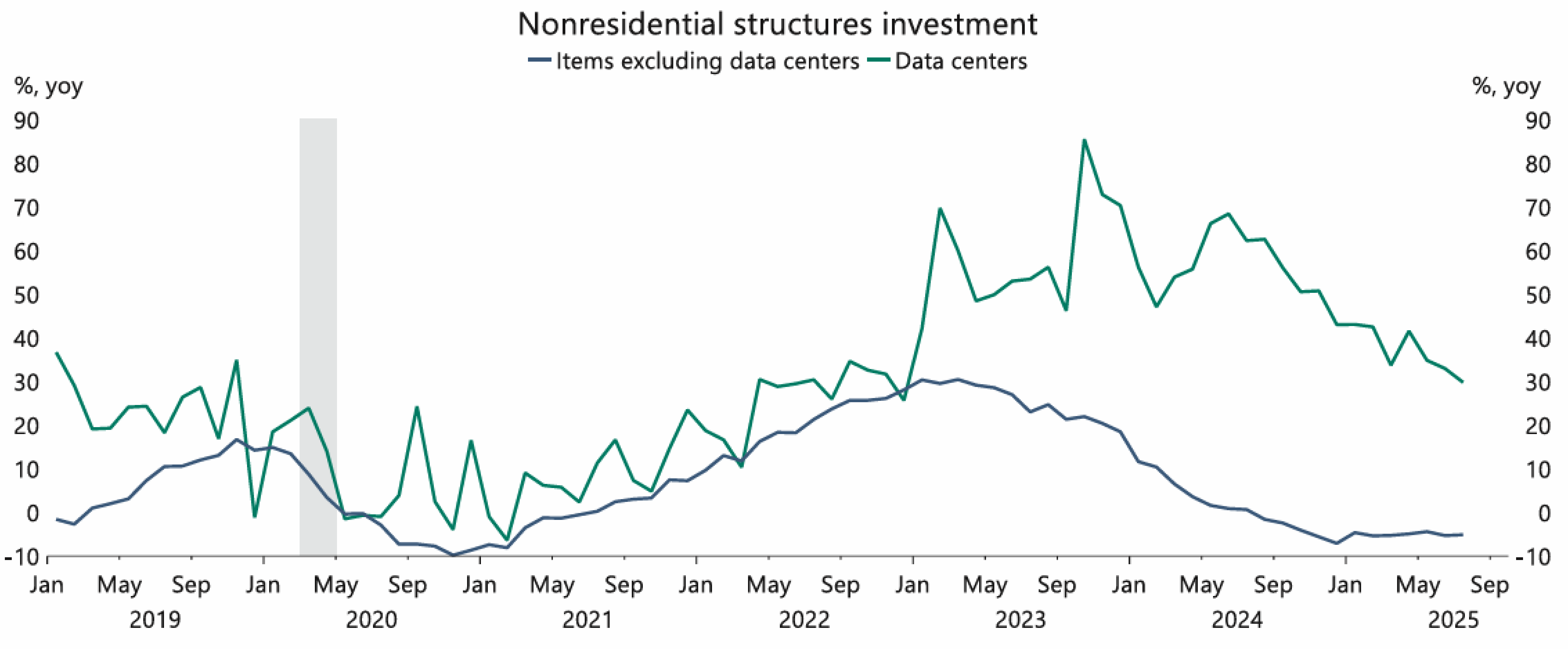
Sources: Bureau of Labor Statistics via Haver Analytics; Current Population Survey via Census Bureau

And it's Cooling for Many (Unemployment by Education)



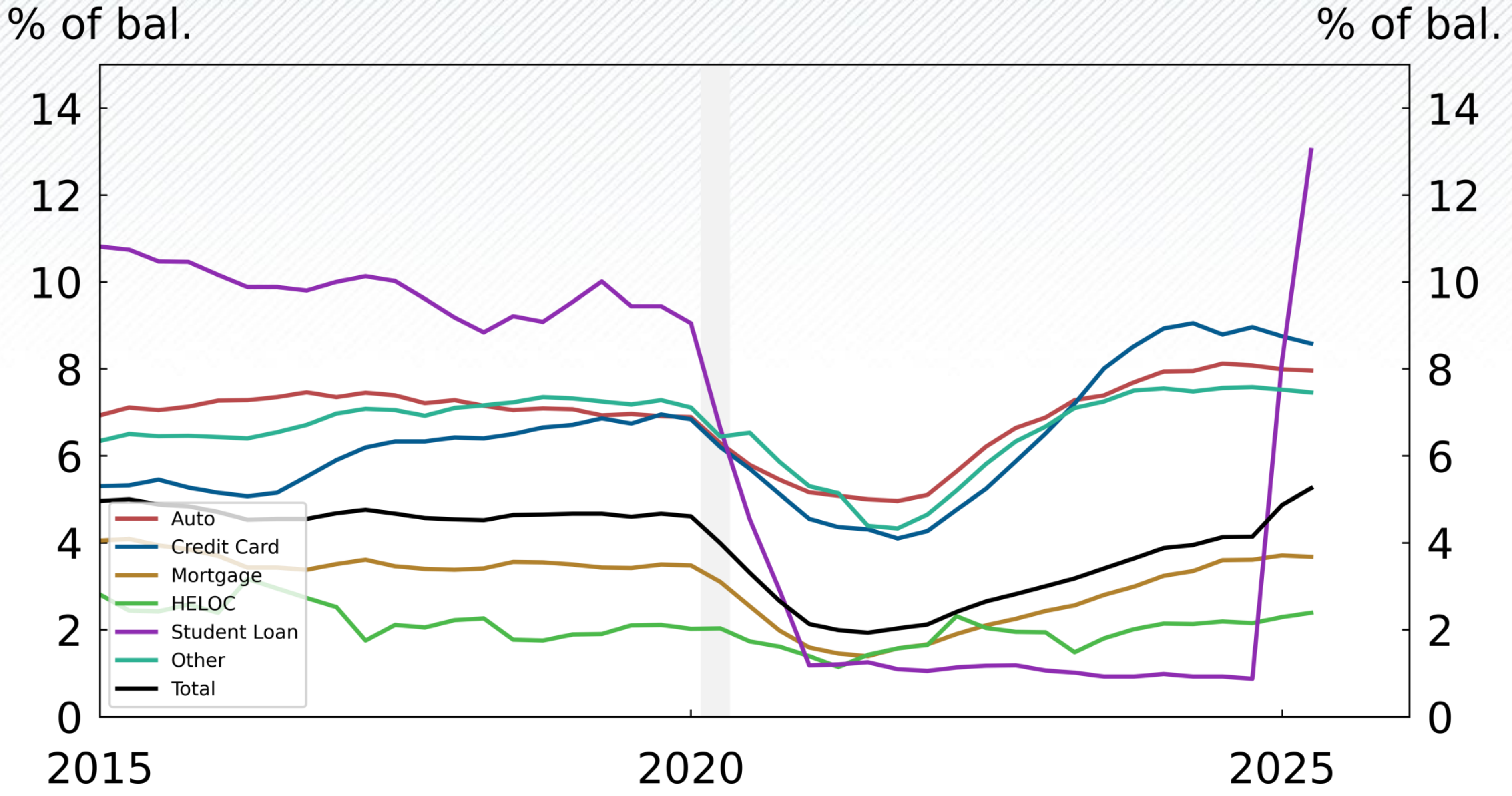
Source: Bureau of Labor Statistics via Haver Analytics

Cooling Investment (Including for Data Centers)



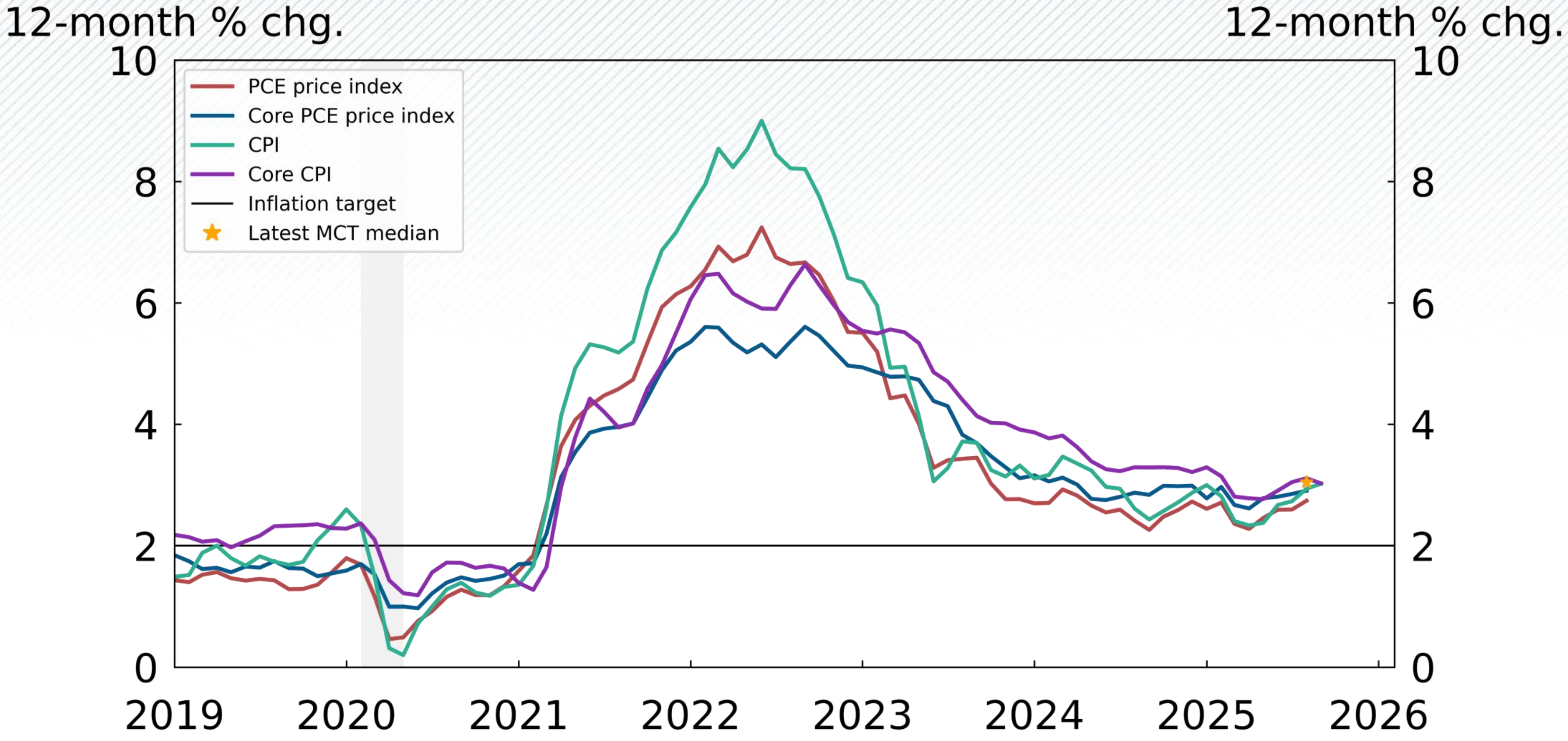
Sources: U.S. Census Bureau; Macrobond; Apollo Chief Economist

Consumers Feel the Cooling, Too



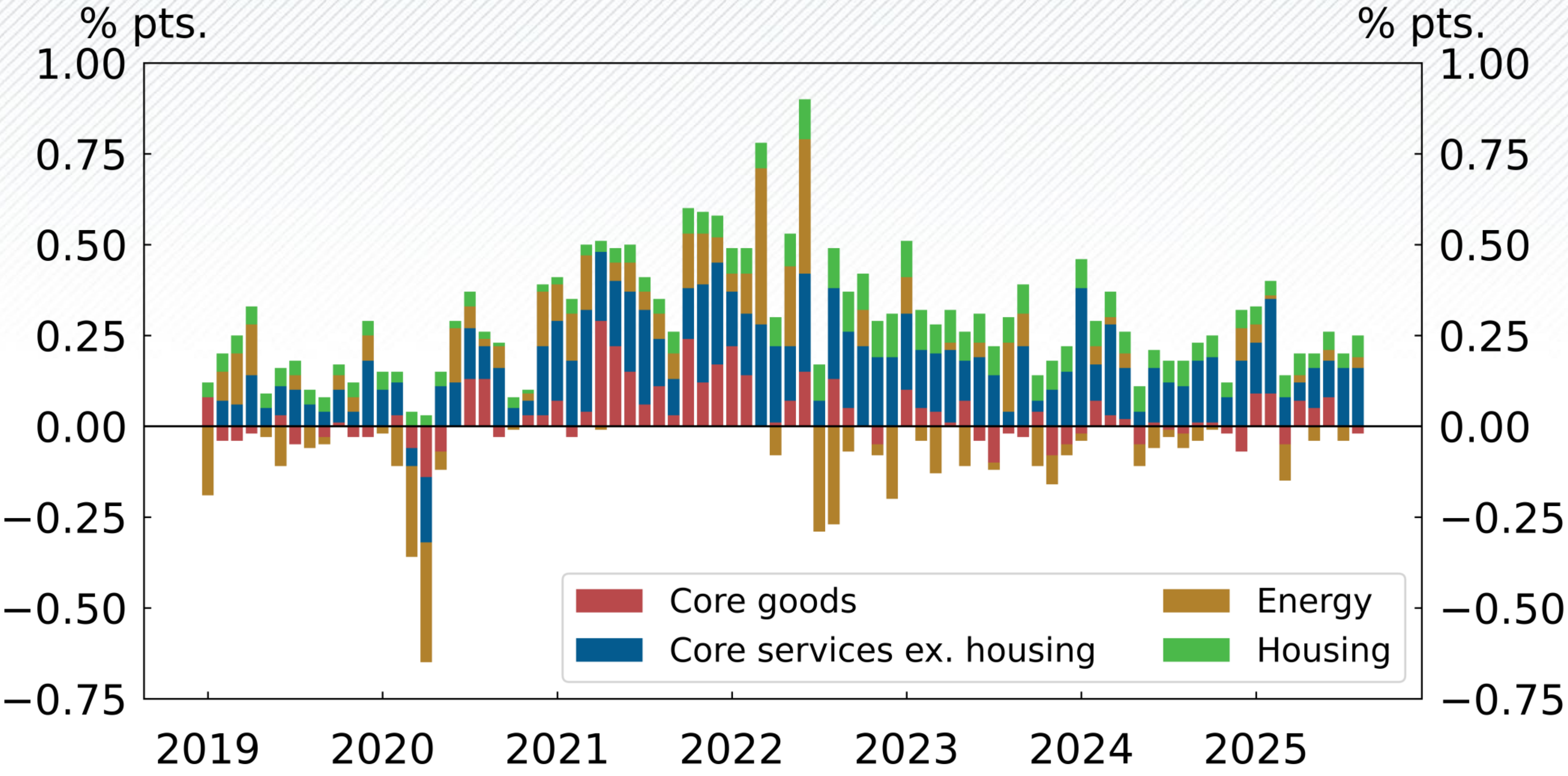
Source: New York Fed Household Debt and Credit Report (Q2)
Note: Early Delinquency Balances (30+ Days) by Loan Type

Disinflation: Not Yet Complete



Sources: Bureau of Labor Statistics, Bureau of Economic Analysis via Haver Analytics

Inflation Components Returning to Historical Norms



Source: Bureau of Economic Analysis via Haver Analytics
Note: Contribution to Monthly PCE Price Index Changes

We’re Here Today to Look Ahead:

health
dollar's role
energy
a slowdown now
supply chains redefined
USTs as safe-haven assets
trade policy shifts
What is to come?
stock market unfazed
R&D
uncertain times
disinflation
K-shaped economy
stablecoins
AI booming

But Outlooks are Hard

So, Let's Start With Something More Fun!

Source: Arizona Sports

Ask Yourself: What if the NFL Let Defenses Hit Sliding QBs?

- **We might look at past data when similar rules were in place.**
  - Examples: defensive coverages, which QBs thrived, etc.
- **However, things then may have been different in *many* ways.**
  - The skillsets of players, their size, and overall capabilities may have changed to be well-adapted to the new rules!

Two Main Questions Arise:

- Near-Term: How will the proposed rule change alter how we play the game with the players we have now?

- Longer-Term: How will the change alter what the Cardinals seek in a QB? In their DBs?

My Answers:

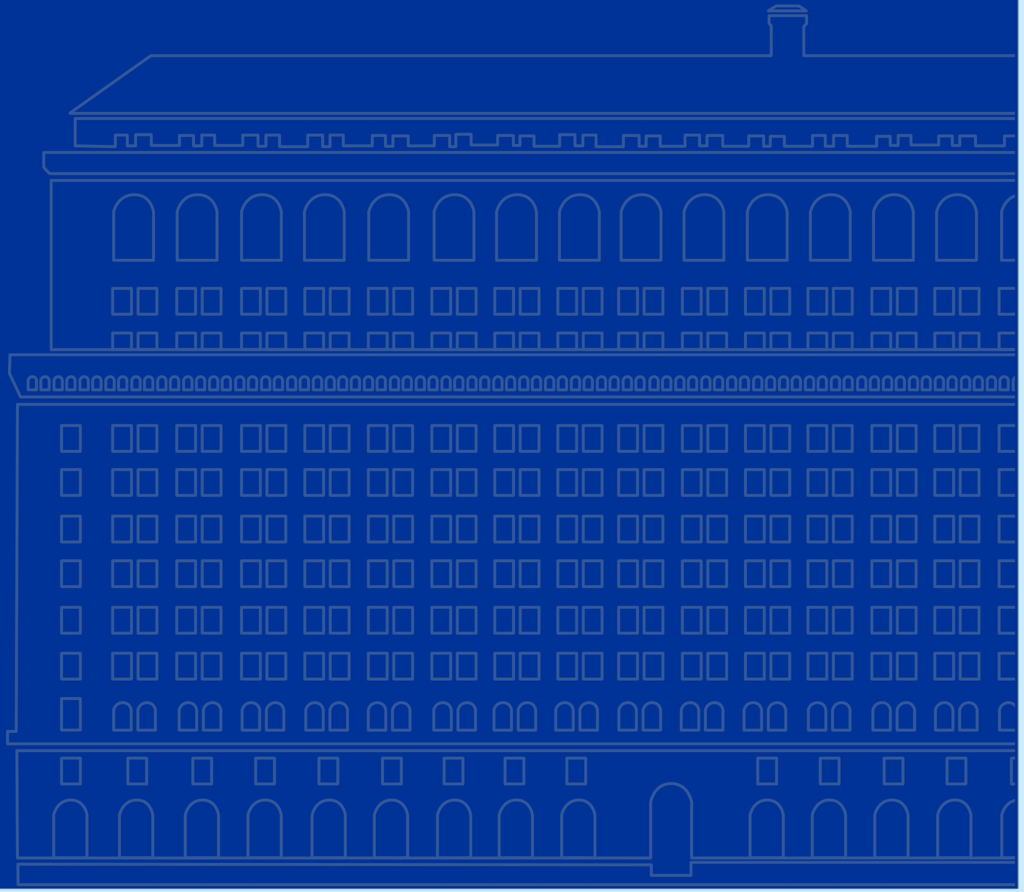
- **Near-Term: How will the proposed rule change alter how we play the game now?**
  - **A: Coaches will know.**
    - Examples: tell Kyler Murray to "stay home" more, run fewer RPOs, etc.

- **Longer-Term: How will the change alter what the Cardinals seek in a QB? In their DBs?**
  - **A: It *depends*.**
    - Coaches must assess what other teams will do and which conditions could trigger further rule changes.
    - A critical issue*:* Will the league stick to the new rule no matter what?

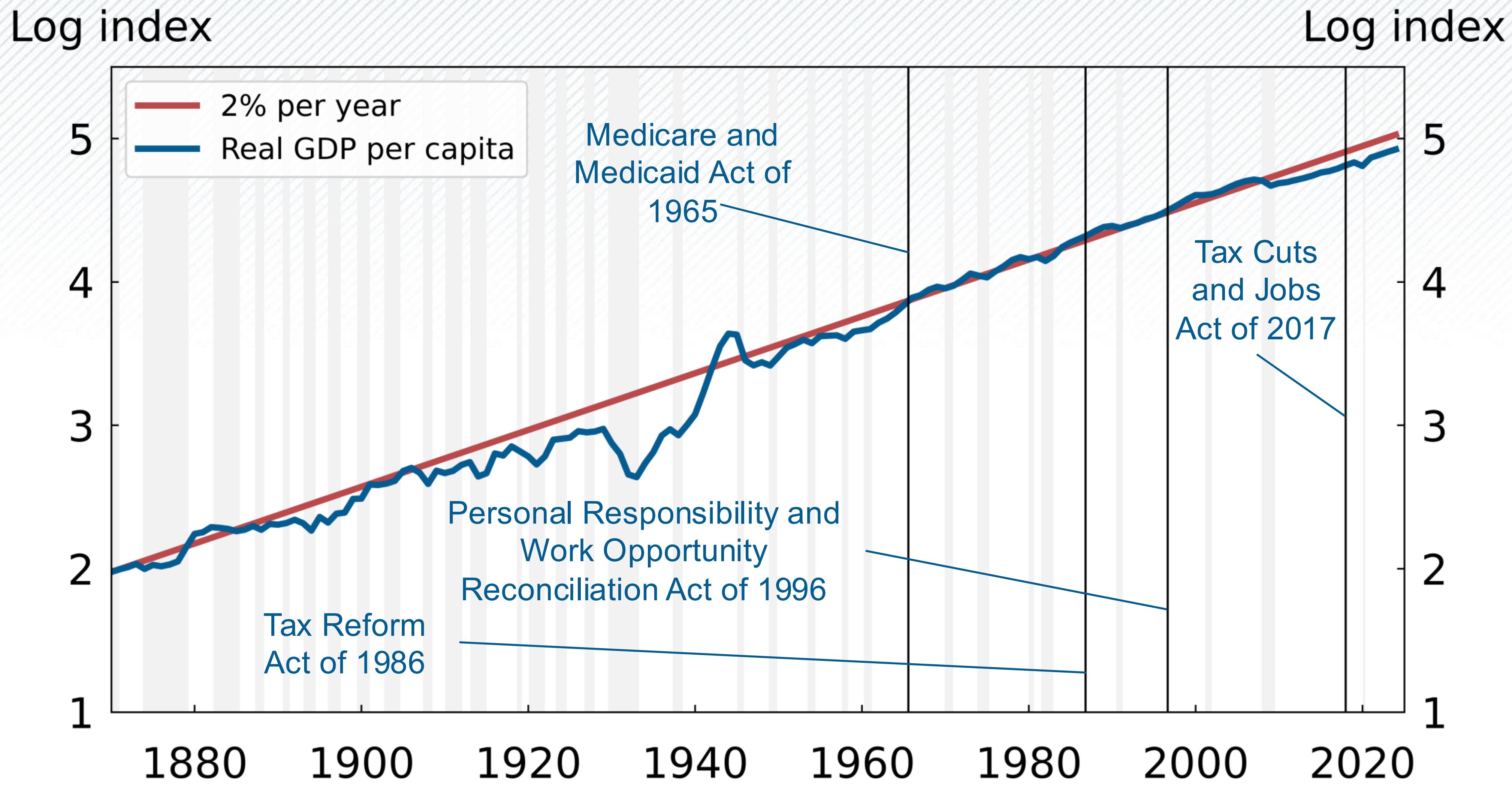
The impact of rule changes, especially novel rule changes, is hard to predict.

When you change the rules, everyone changes how they play the game.

Now, Back To The U.S. Economy



Try to Spot Some Major Policy Changes



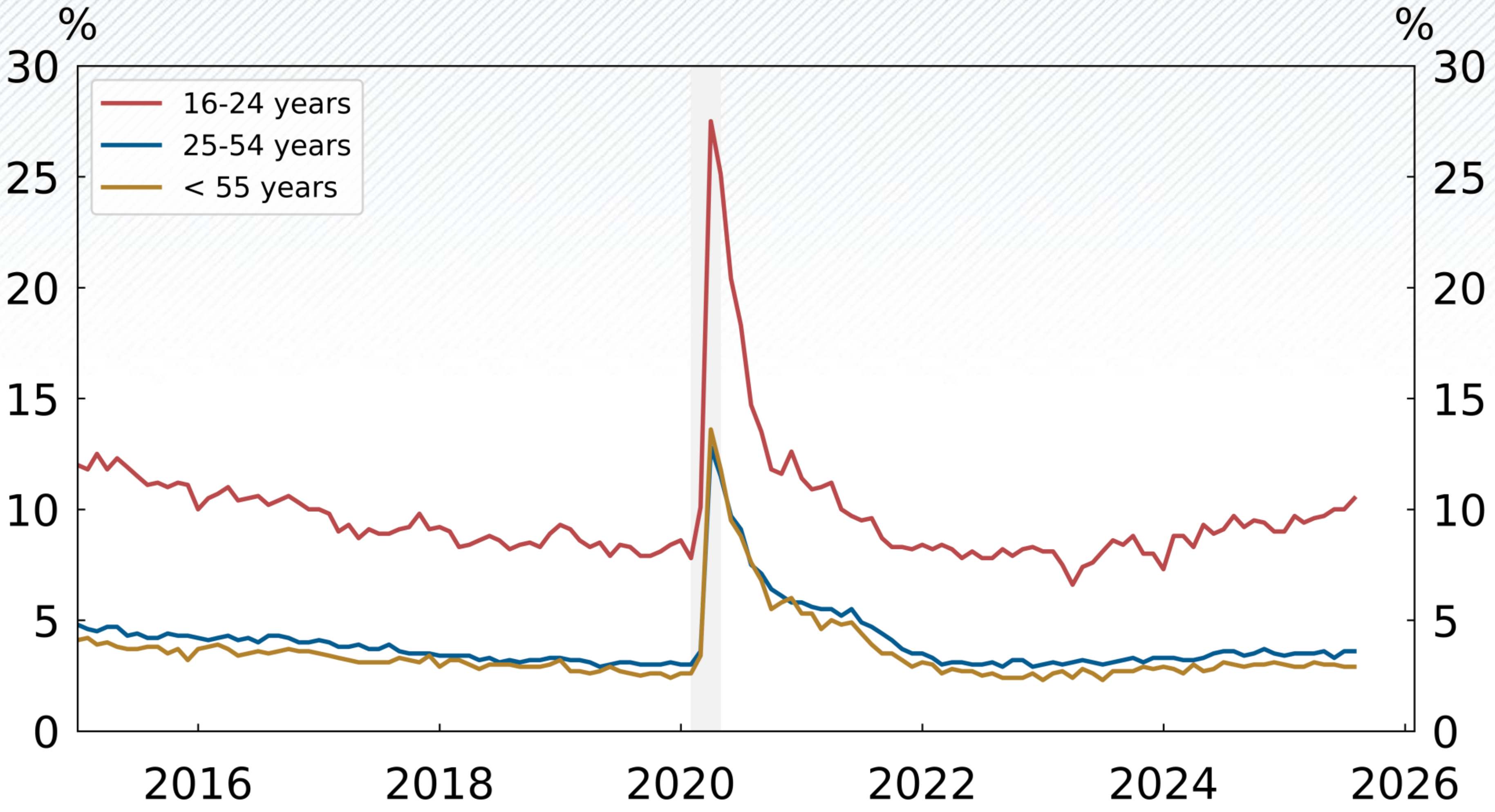
Sources: Chad Jones (2023); Barro and Ursua (2010); Bureau of Economic Analysis and Census Bureau via Haver Analytics

However, "Macro" Stability Hides Household Churn

- **Nearly all economic churn and trauma occurs at the "people and household" level.**
  - In a typical year, nearly 20 million job losses occur.
  - In recessions—about 2/3 of the drop in hours is because of job loss, not fewer hours by the employed.
  - Both unemployment and inflation are very hard on people.
- **Recessions (and inflation) are harmful primarily because bad things happen to huge numbers of people.**
  - In typical recent recessions, additional 7-8 million job losses.

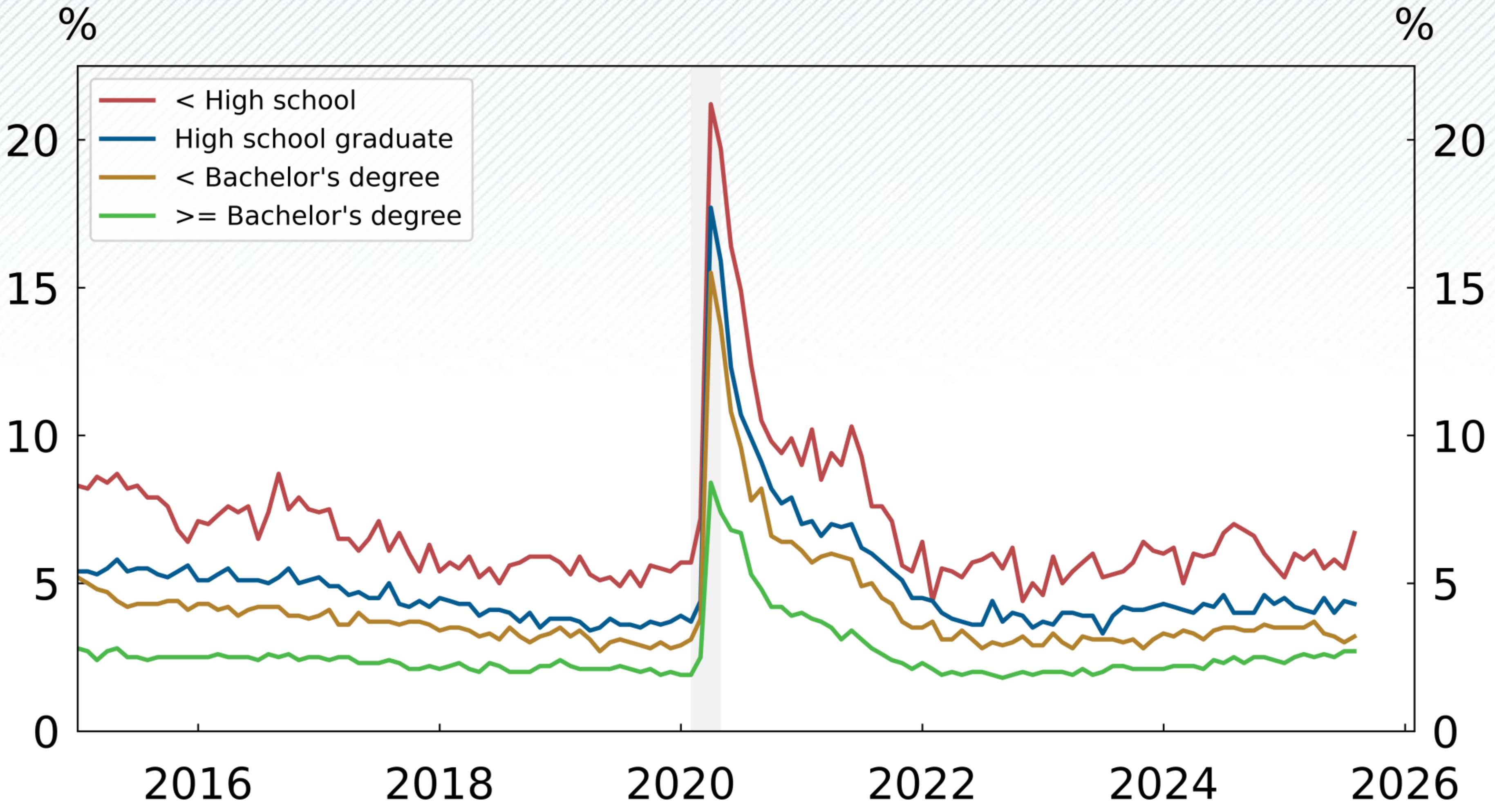
Source: Bureau of Labor Statistics via Haver Analytics

Unemployment Can Happen to All of Us (Across Age)



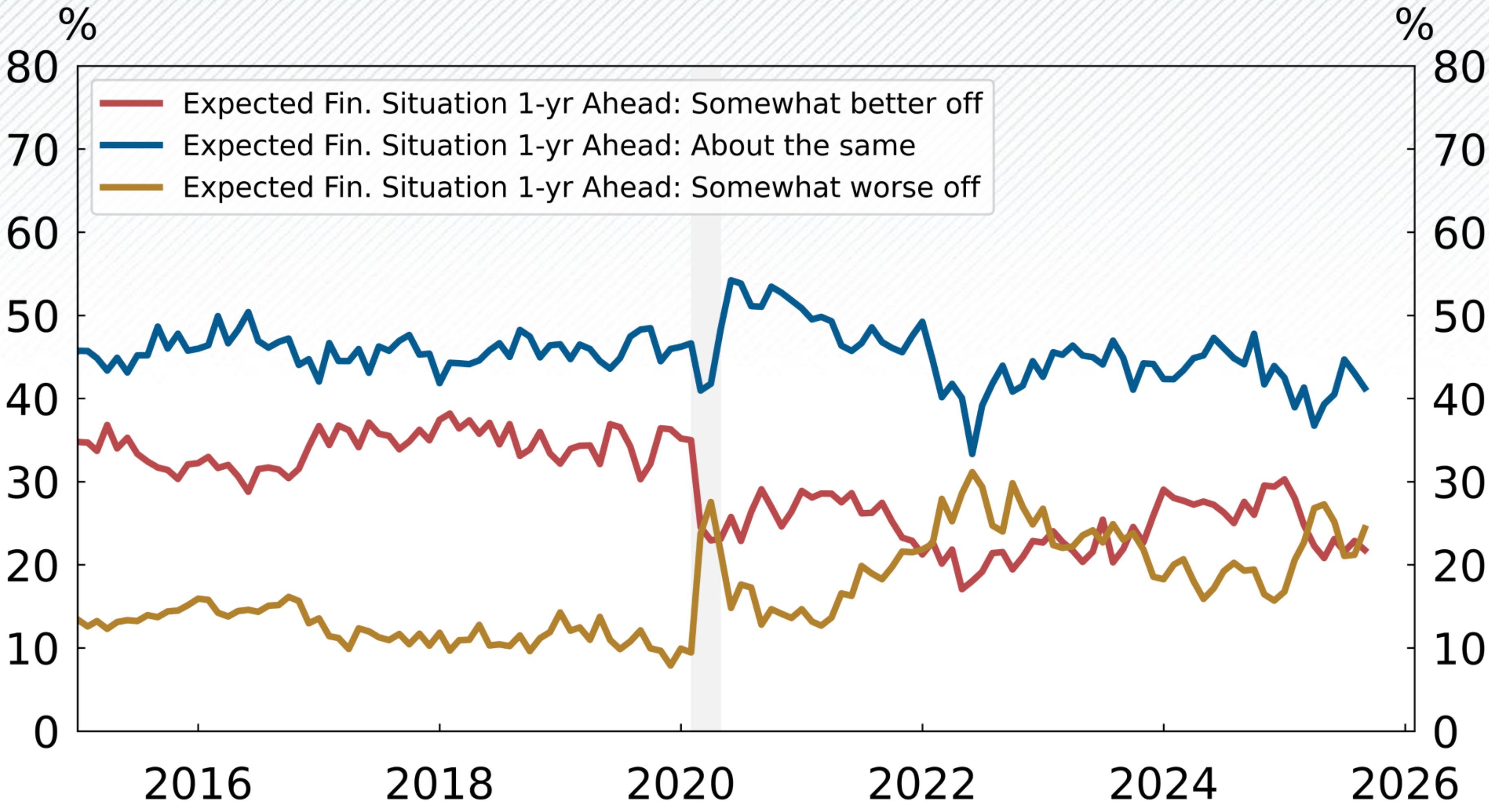
Source: Bureau of Labor Statistics via Haver Analytics

Unemployment Can Happen to All of Us (Across Education)



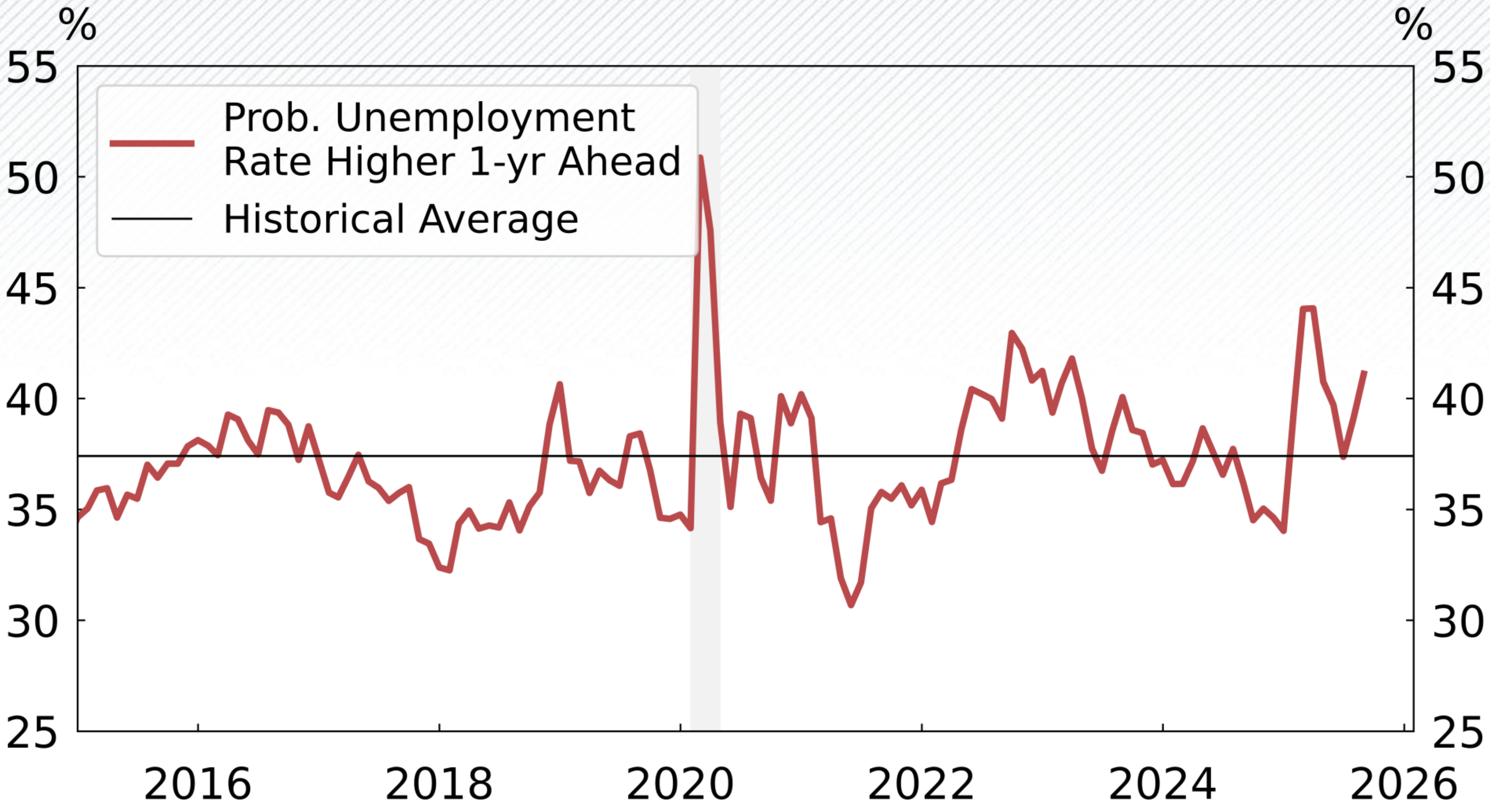
Source: Bureau of Labor Statistics via Haver Analytics

Looking Ahead, Households Expect Greater Downside Risk



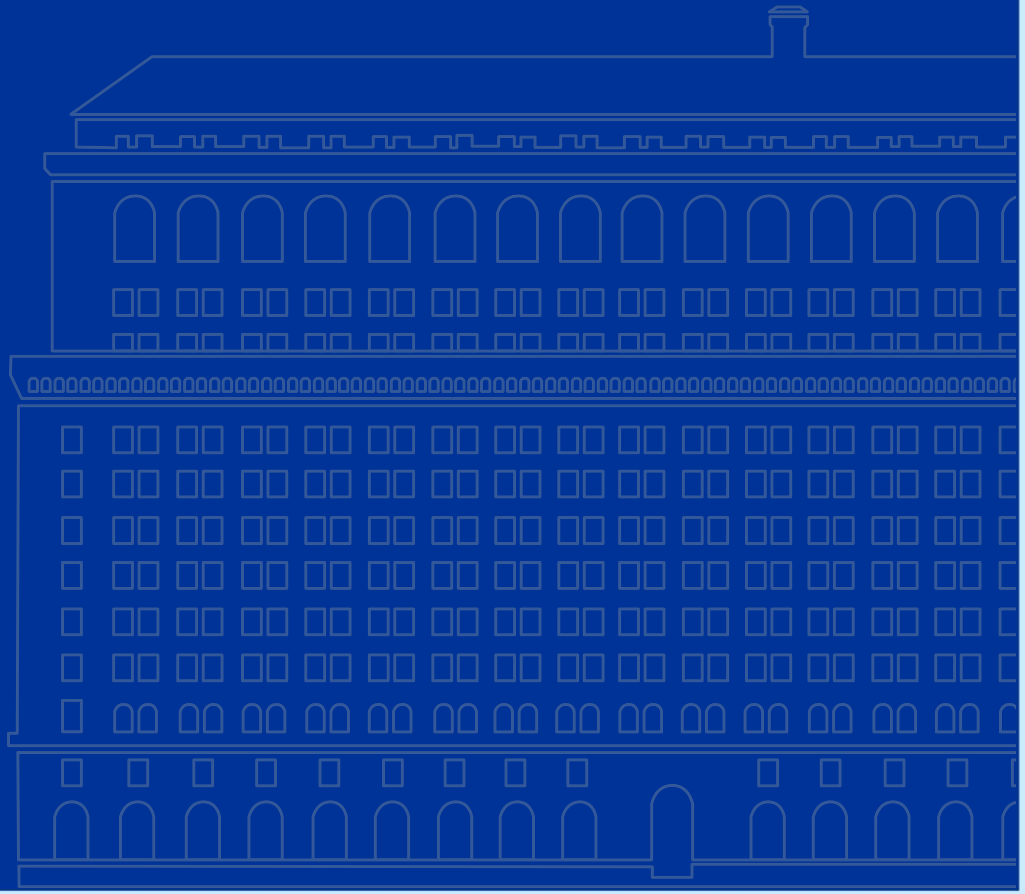
Source: New York Fed Survey of Consumer Expectations via Haver Analytics

Households Show Greater Concern Over Unemployment

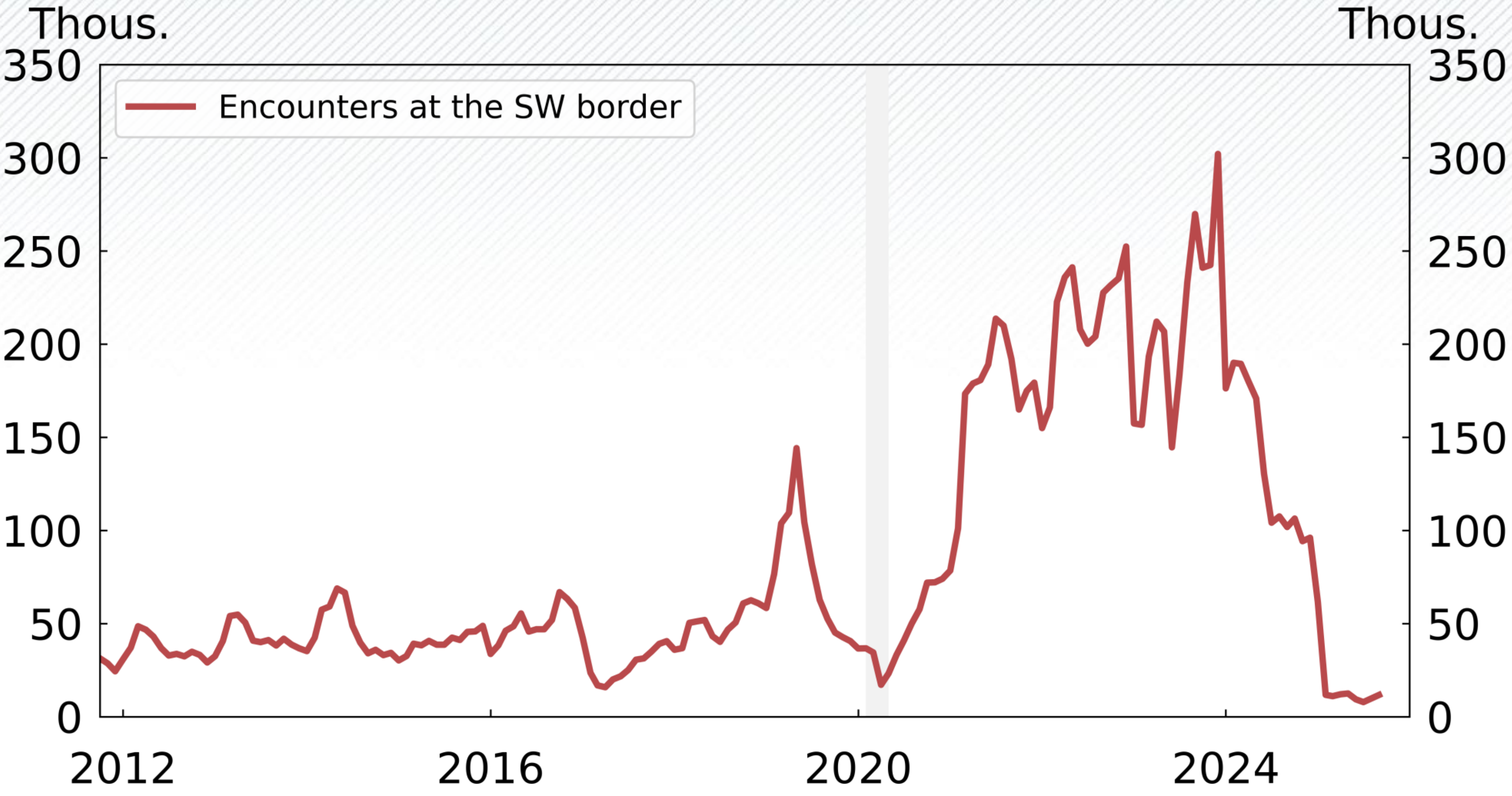


Source: New York Fed Survey of Consumer Expectations via Haver Analytics

Unpacking Policy in 2025: Two Big Shifts



Shift #1: Large Immigration Changes

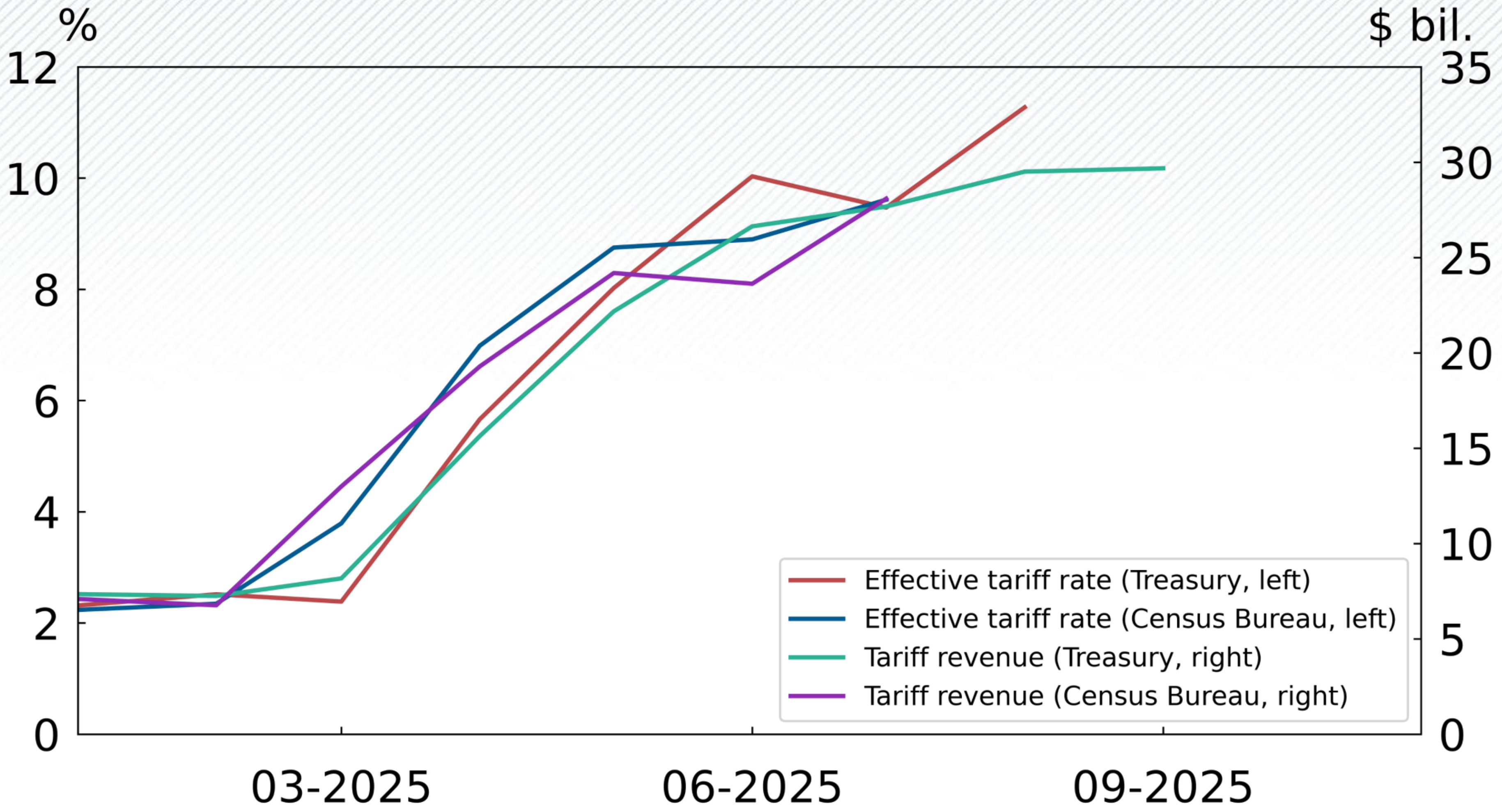


Source: Customs and Border Protection via Haver Analytics

An Aside: What's *Now* a Good Payroll Number?

- The growth rate of the labor force has slowed—a lot.
- If labor "supply" has dropped, so should the "normal" rate of hiring.
- 30K may not be a far-off estimate—but it is *super uncertain*!

Shift #2: Effective Tariff Rates and Revenue



Source: Census Bureau, U.S. Treasury via Haver Analytics
Note: Rate = Duties / Imports

Both Policy Shifts Heavily *Distributional*

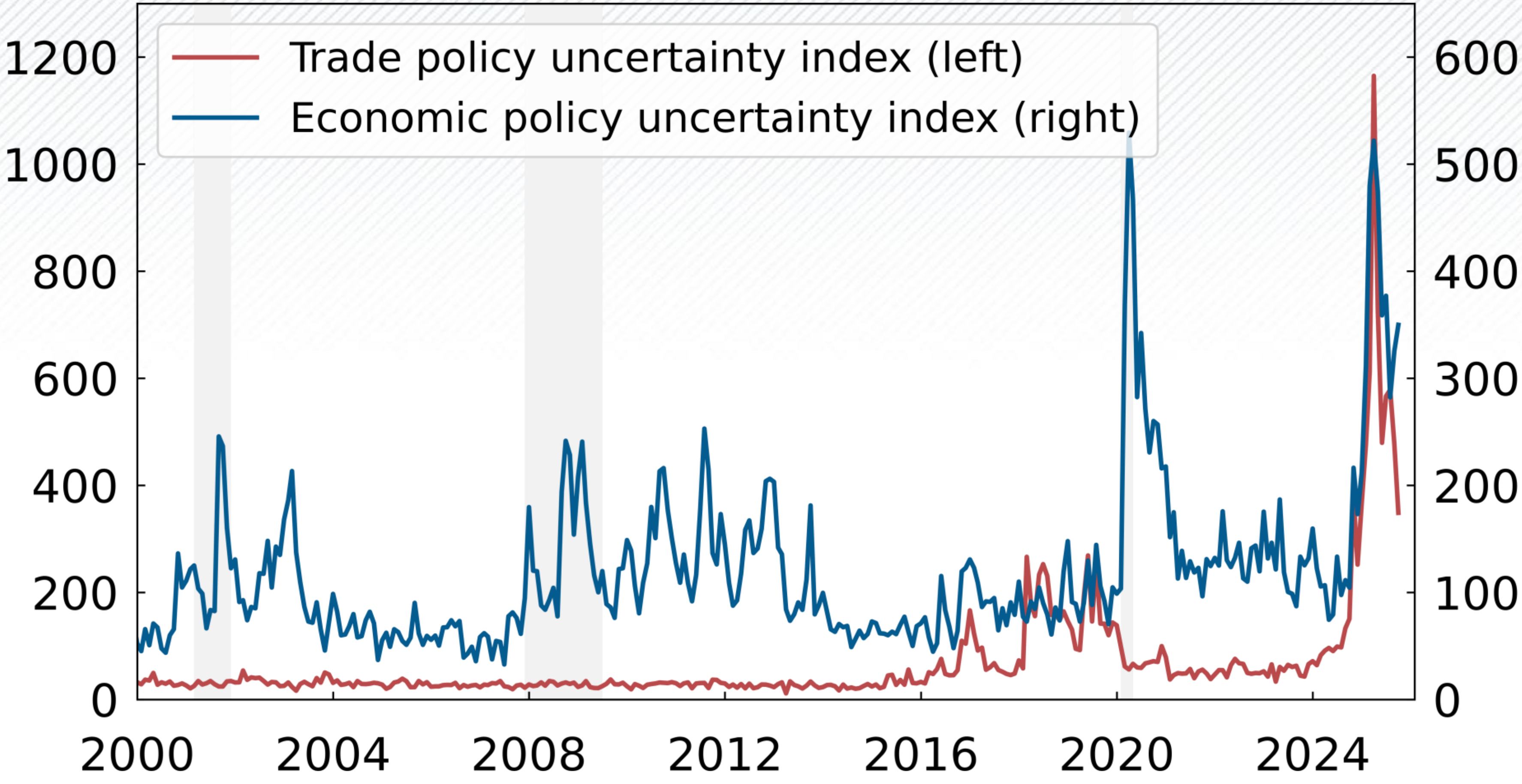
- **What does this mean for the macroeconomic outlook?**
- **Recall the "good news" from earlier slide on policy changes and GDP:**
  - Historically, fiscal policy changes are hard to see at the macro level.
  - Supply-side of U.S. is broadly very resilient, and not too sensitive to policy.

What About Meta-Policy?

Beyond the Actual Policy Shifts:

- All of us in the economy want to understand how "meta-policy," i.e., "policy about economic policy," is made.
- How far from "goldilocks" is our current meta-policy? How uncertain is it? And is there flexibility for change?

Currently, Policy Uncertainty Remains Elevated

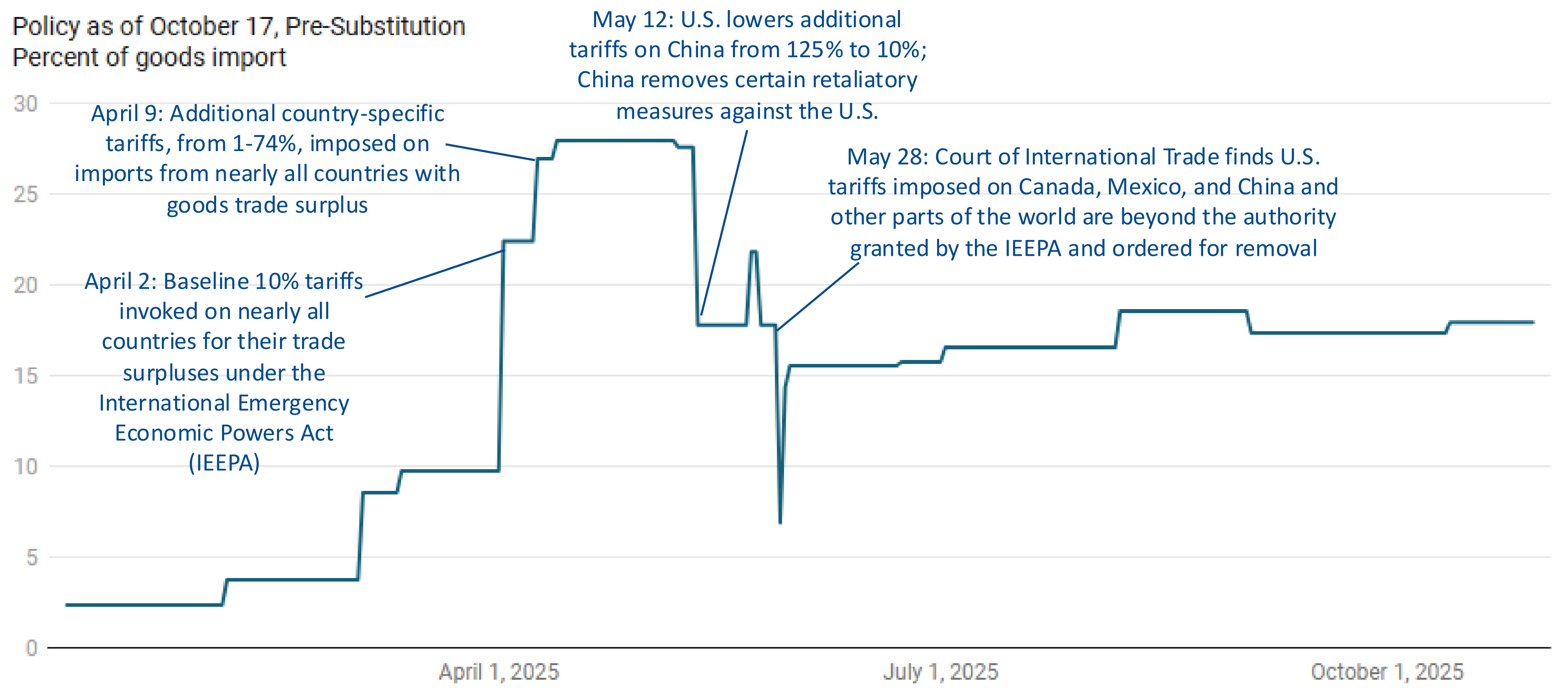


Sources: Caldara et al. (2020) via matteoiacoviello.com/tpu.htm; PolicyUncertainty.com (Baker, Bloom, and Davis) via Haver Analytics
Note: Monthly Average of Daily Data

Changing Meta-Policy Means Uncertainty for Economic Actors

- If policy reversals are easy: **Experiments with the rules can yield new and better pathways.**
  - *Caveat:* It also makes planning harder.
    - Incentivizes short-term thinking, with an eye to preserving flexibility. (Example: Cardinals sign more short-term player contracts.)
- If not: **Experiments with the rules are lotteries with serious downside.**
  - *Caveat:* We may be better able to plan.
    - American business: “Just tell me the rules, and we’ll figure it out.”

Are Changes to the Changes Possible? (Tariffs)



Sources: Yale Budget Lab; Peterson Institute for International Economics
Note: U.S. Average Effective Tariff Rate Since January 1, 2025

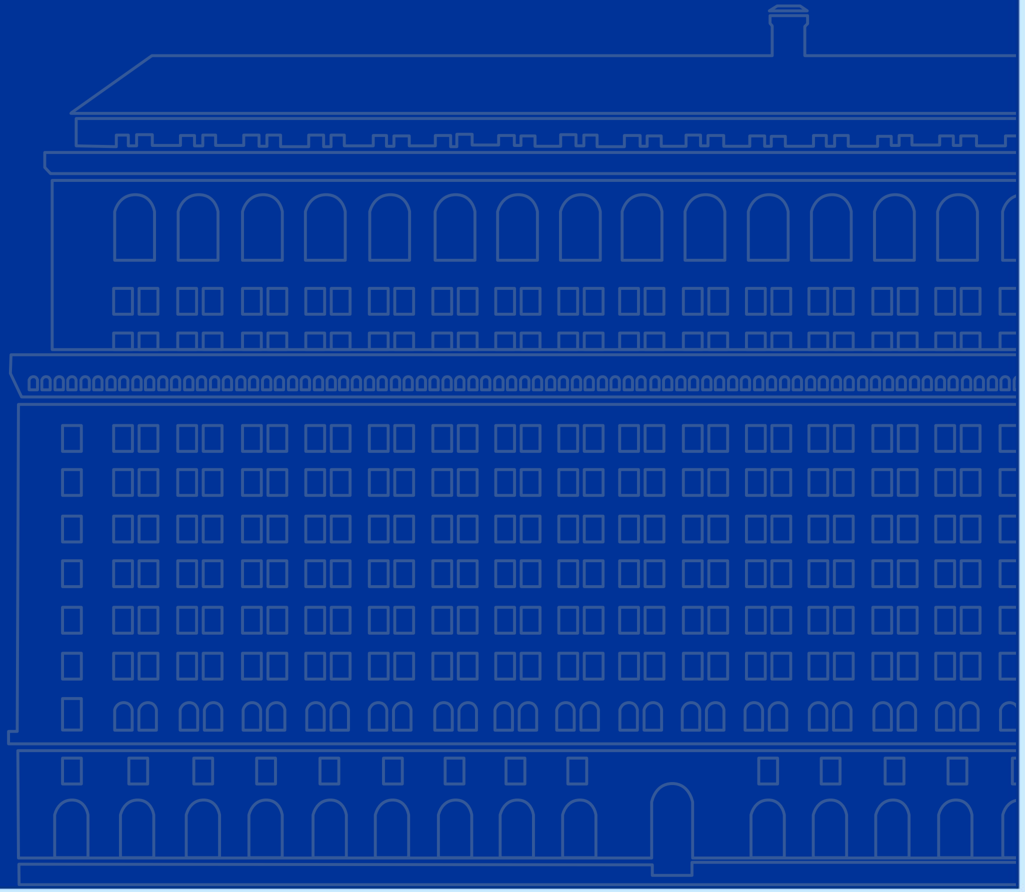
Are Changes to the Changes Possible? (Immigration)

- **Immigration policy for highly skilled workers has gone through several iterations.**
  - International student enrollment projected to decrease by 180,000+ between the 2024-25 and 2025-26 academic years (AY).
- **International student recruitment at ASU:**
  - ASU has made a bet on international student talent, and therefore the global talent acquisition pool.
  - 17,900+ international students, 4.7% international undergraduates as of AY 2024-25.

Sources: Arizona State University; NAFSA: Association of International Educators; Open Doors; Institute of International Education; Bureau of Educational and Cultural Affairs (U.S. Department of State)

**The more novel rule changes are,
the harder it is to predict what will come next,
because the past will not be prologue.**

Monetary Policy: Here and Ahead



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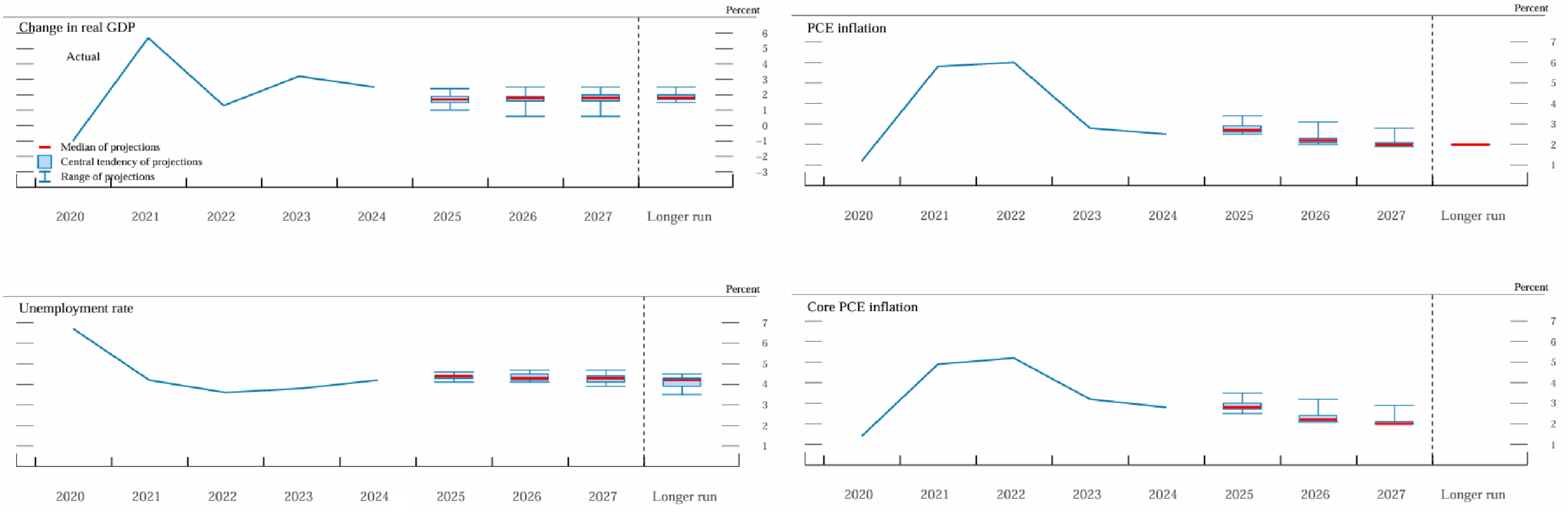
A Bird's-Eye View of Monetary Policy

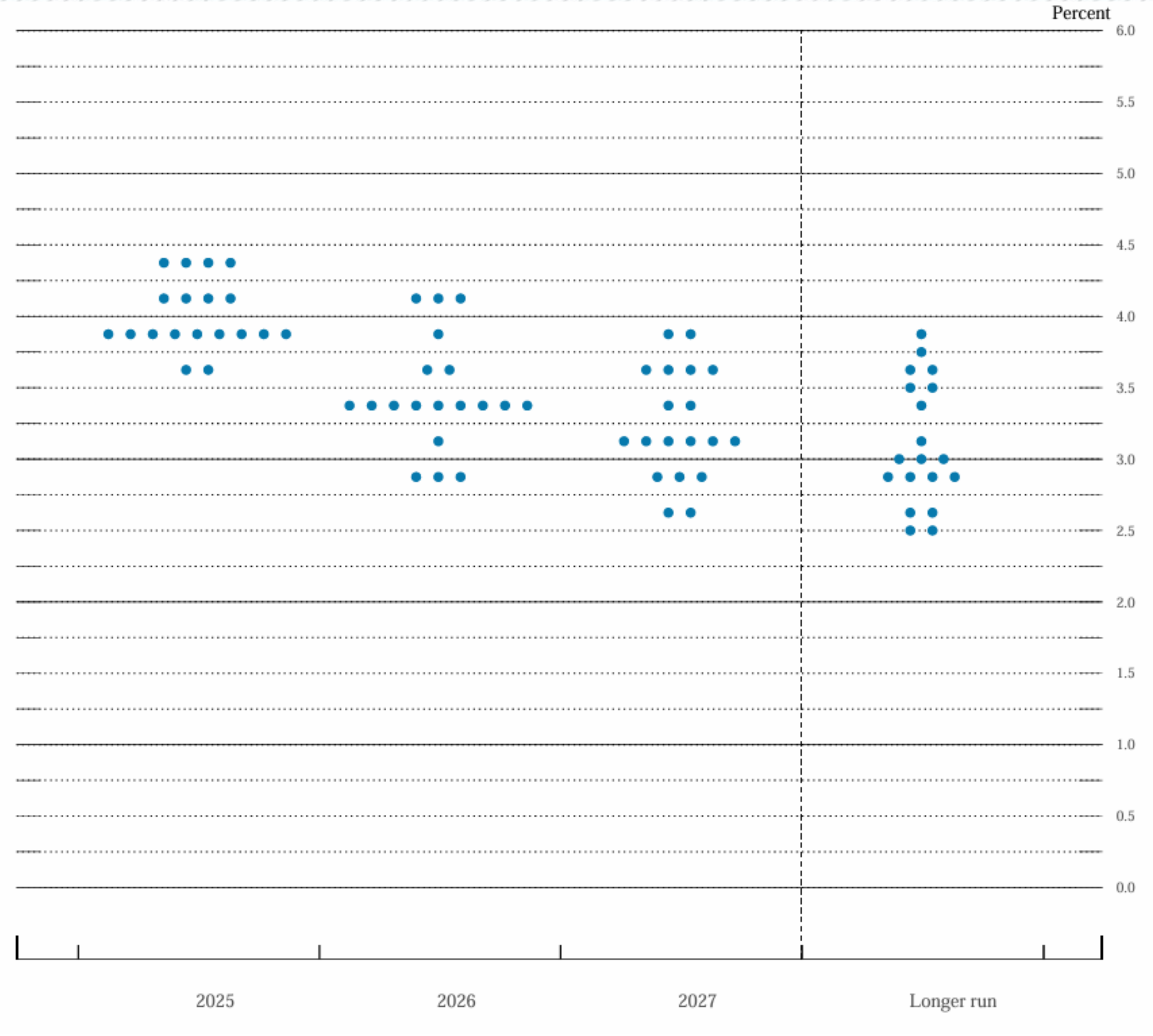
- **Two key observations:**
  - **<u>Fact 1</u>: Monetary policy can have big real effects in the short-run.**
    - Implication: Use monetary policy to help manage shocks hitting the economy, especially to prevent or soften recessions.
  - **<u>Fact 2</u>: Monetary policy can at best control only inflation in the longer run.**
    - Implications:
      - Do not get carried away in the pursuit of Fact 1.
      - Be very careful not to be a source of macro shocks that cause widespread harm at the micro level.
- **Congress's Dual Mandate to Fed: Conduct monetary policy to attain maximum employment and price stability.**

Per Policymakers: A Quiet Disinflation is Still the Baseline



Source: Survey of Economic Projections from the September Federal Open Market Committee Meeting

FOMC Policymakers' View on Rates Ahead:



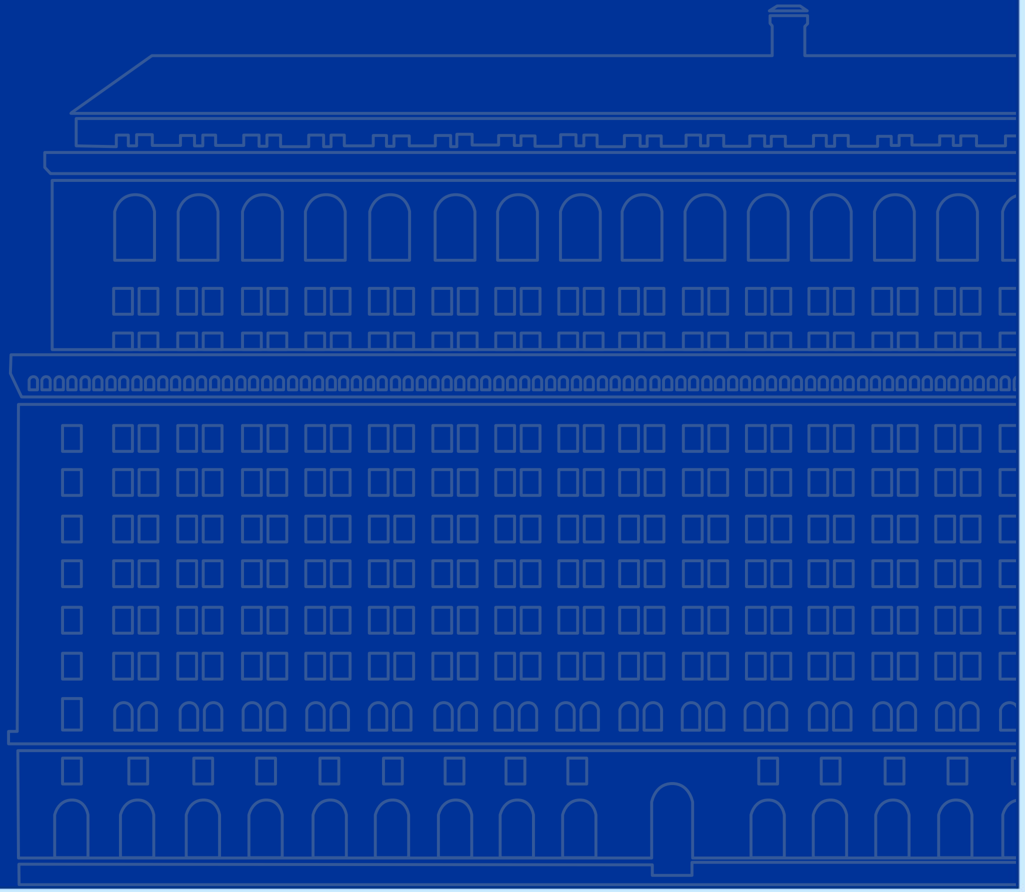
Source: Survey of Economic Projections from the September Federal Open Market Committee Meeting

October FOMC Statement

- **Fundamentals:**
  - "**Job gains have slowed** this year, and **the unemployment rate has edged up but remained low** through August…inflation has moved up since earlier in the year and remains somewhat elevated."
- **Uncertainty:**
  - "**Uncertainty about the economic outlook remains elevated.** The Committee is attentive to the risks to both sides of its dual mandate and judges that downside risks to employment rose in recent months."

Source: Statement from the October Federal Open Market Committee Meeting

A Longer-Term Outlook: AI's Effects



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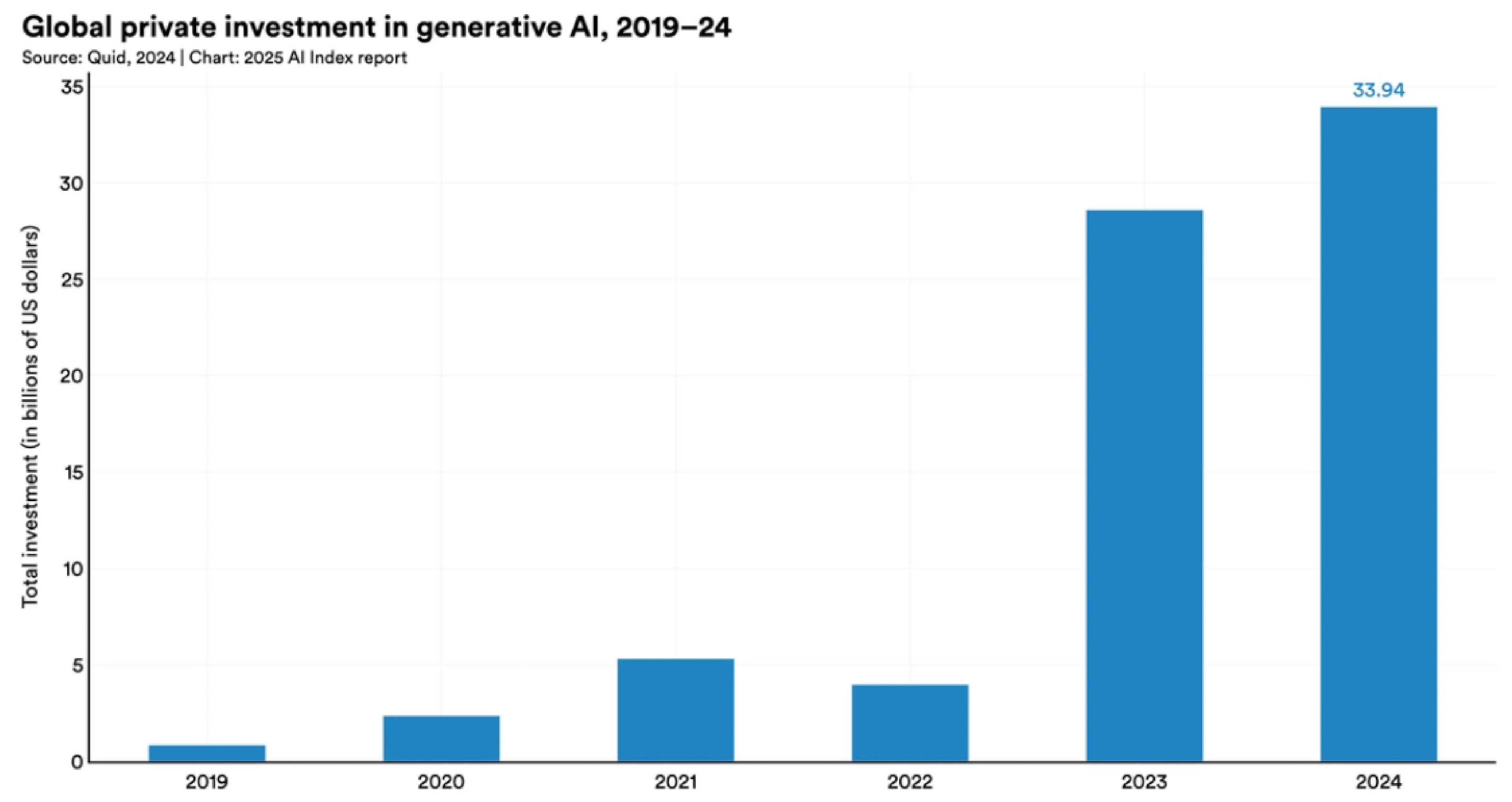
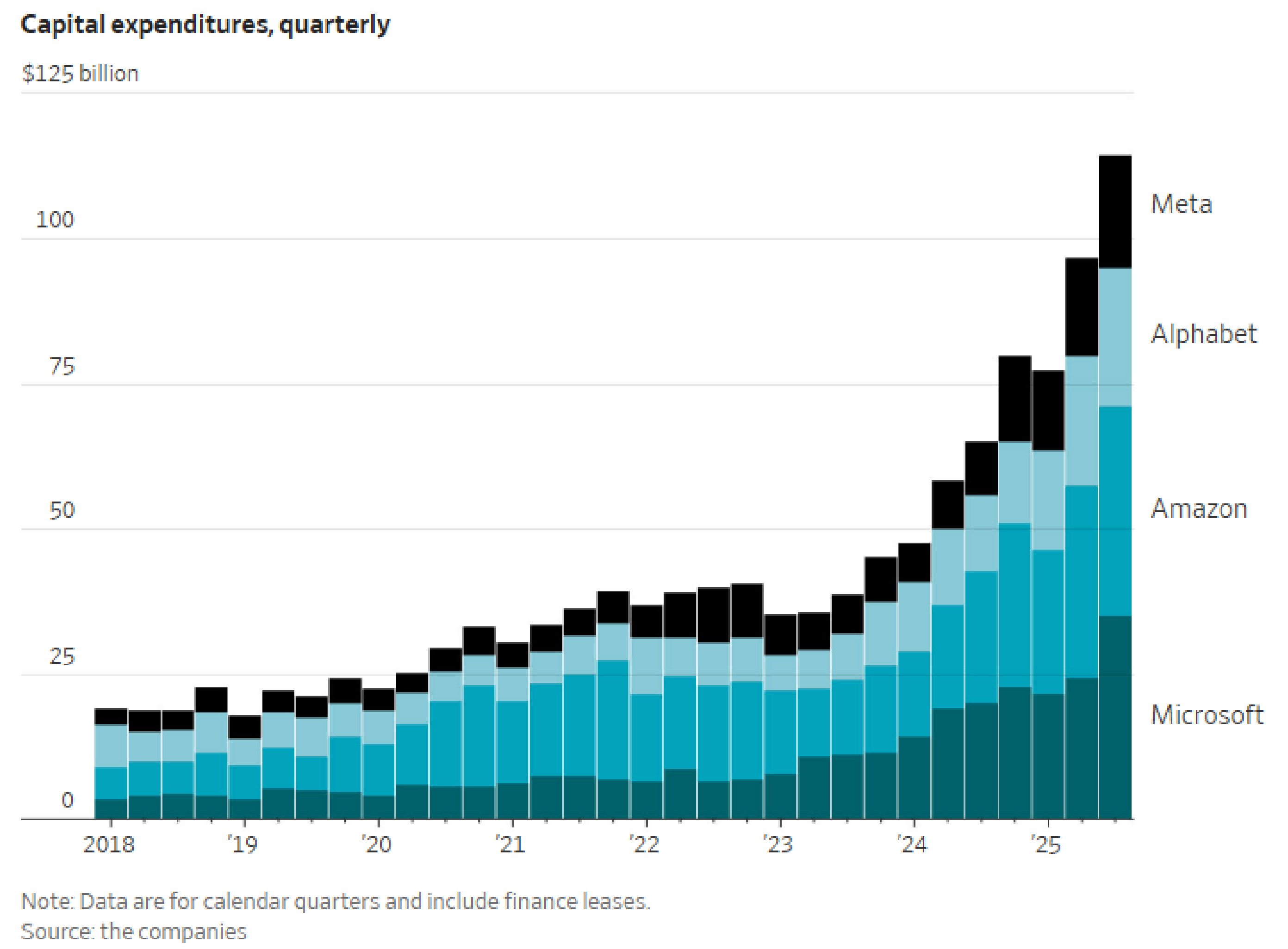
Is AI Here to Stay? Generative AI Funding Soars



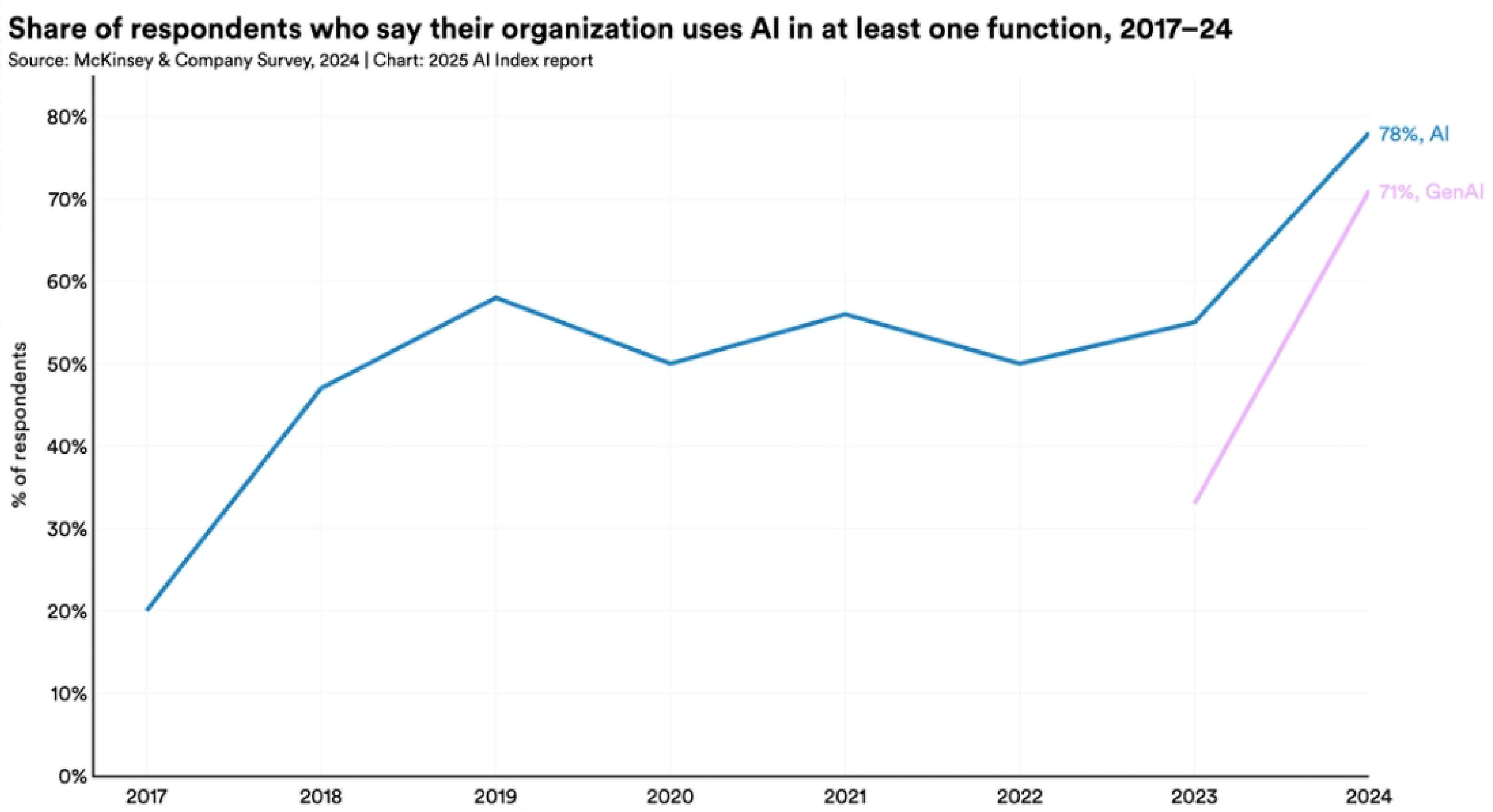
Sources: Stanford Human-Centered Artificial Intelligence Lab; Quid

Aggressive Investments in Capacity to Match Growing Demand



Sources: Wall Street Journal; Meta; Alphabet; Amazon; Microsoft

AI Usage Climbs Unprecedentedly

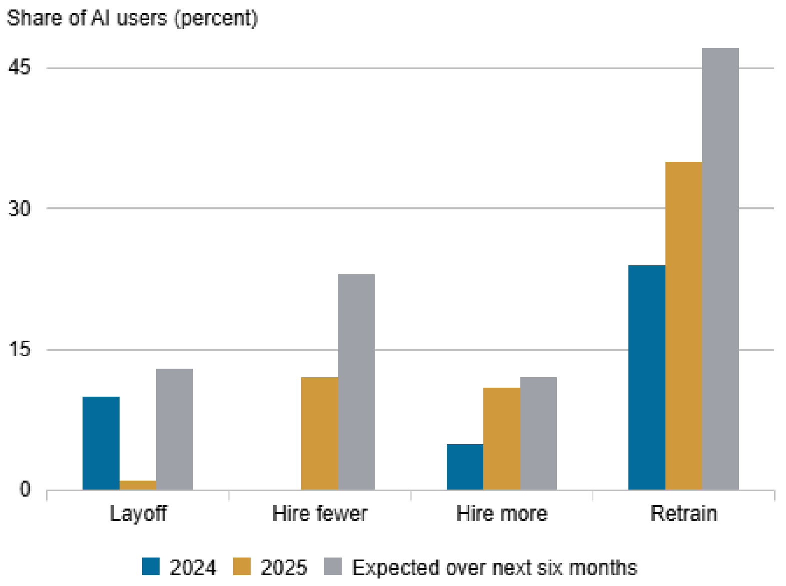


Sources: Stanford Human-Centered Artificial Intelligence Lab; McKinsey and Company Survey

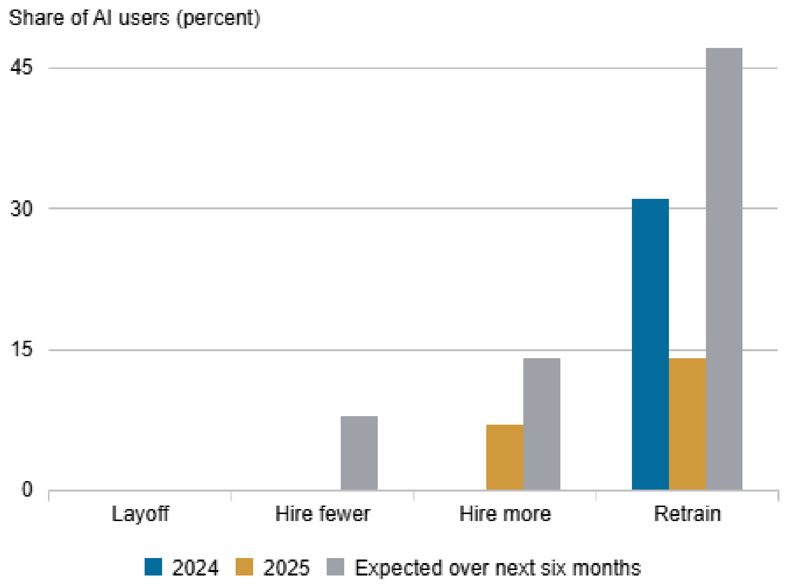
How Firms are Using AI Affects Workforce Adjustments:

How Firms are Using AI

Ways Service Firms Are Adjusting Their Workforces



Ways Manufacturers Are Adjusting Their Workforces

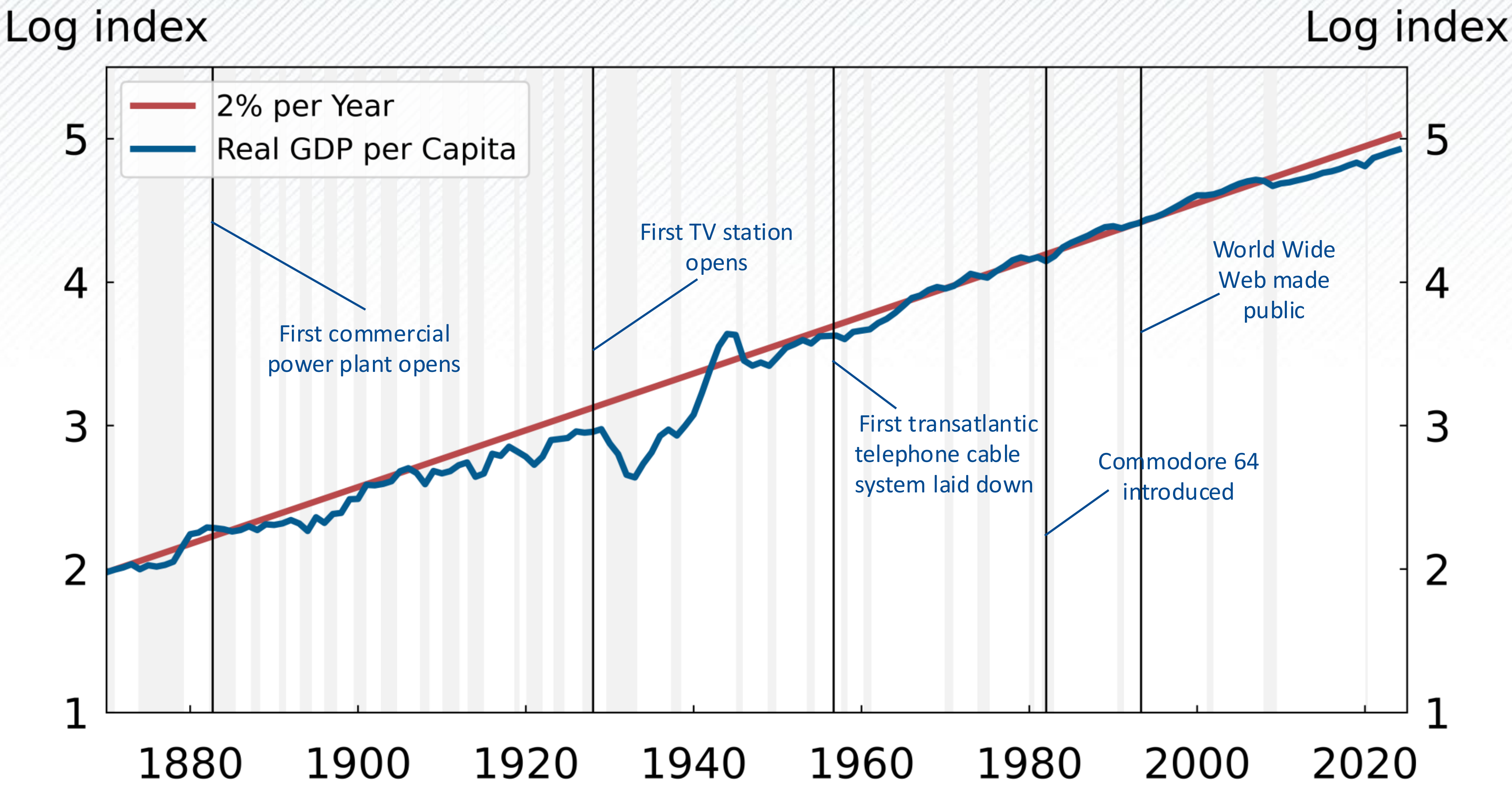


Source: New York Fed Regional Business Surveys, August 2025
Note: Firms were not asked whether they hired fewer workers in 2024.

Yes: AI is Here, For Good. What Now?

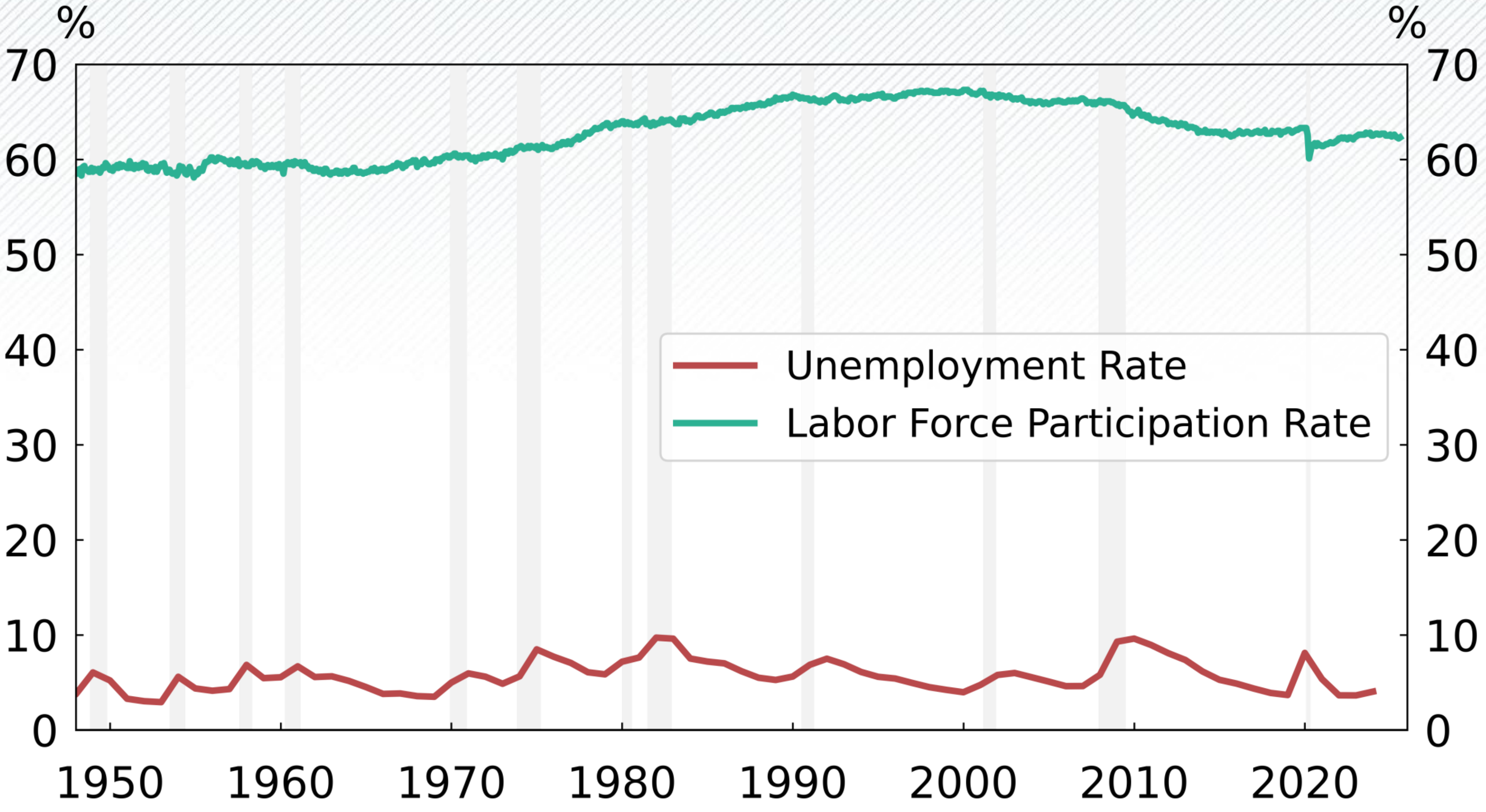
- **If AI's implications are disruptive, what then?**
  - We meaningfully curtailed the use of nuclear power. Is this going to happen with AI?
  - How will electricity demand be met?
    - Power generation is intensely political—local politics matter a lot!
    - Will nuclear come back in the conversation if power demand balloons?
  - Deterioration of not only verbal, but now physical (visual—Sora, etc.) truth.
    - How do you convey credible information when fakes are so good?
    - How closed can your fact bubble be/get?
    - If everything allows wildly varying interpretations, look out.
- **More broadly, AI innovation happens globally, so how can the U.S. ensure talent wants to come here?**
- **What are the implications for AI policy and meta-policy?**

What Tech Revolution?



Sources: Chad Jones (2023); Barro and Ursua (2010); Bureau of Economic Analysis and Census Bureau via Haver Analytics; NBER via FRED

We've Never Had Mass Unemployment



Source: Bureau of Labor Statistics via Haver Analytics and bls.gov

Resting on Our Laureate: Kenneth Arrow in 1972

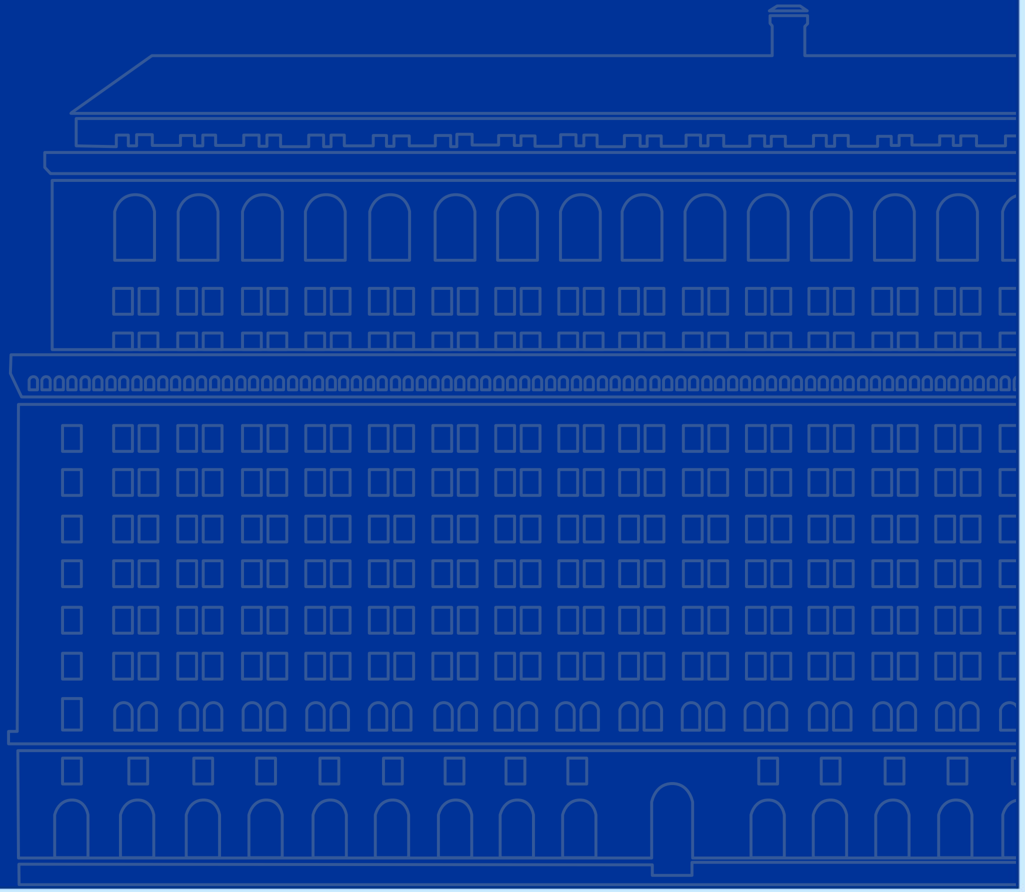
"As technology improves exogenously, through innovations, the labor force made redundant does not become permanently unemployed, but finds its place in the economy. It is truly amazing that the lessons of both theory and over a century of history are still so misunderstood."

"On the other hand, a growing accumulation of instruments of production in turn induces a rise in the prices of labor-intensive commodities relative to those which use little labor."

"…the economic system adjusts with a considerable degree of smoothness and indeed of rationality to changes in the fundamental facts within which it operates."

Source: Kenneth Arrow Nobel Memorial Lecture (1972)

Summing Up



#1: As Usual, Macro Steady

- **The U.S. economy is steady at the macro level, and continued *macro* steadiness is my base case.**
  - A century of data—and SEP—suggest continued 2% per-capita growth (with headwinds outside AI).
  - Labor market cooling, but not icing: low-4s unemployment.
  - Inflation closer to 3% this year, but SEP expects closer to target as 2026 ends.
  - Fed policy: SEP modal view—heading gradually to around 3%.
- **However...**

#2: As Usual, Macro Masks Micro Turbulence

- **Micro (household and business-level) uncertainty is unusually high.**
  - Labor market cooling.
  - Consumer debt repayment is showing stress.
  - Path ahead for conditions less optimistic.

#3: As Unusual, This is a time of Policy and Meta-Policy Uncertainty

- **Policy change has been large:**
  - Trade and immigration, above all.
  - AI is advancing.
  - Meta-policy change maybe even larger—currently unclear.
- **Meta-policy change can bring risk and upside:**
  - “Policy changes” and AI “tech disruption" ask us to gauge how and when policies will flex as circumstances change.

Relevant New York Fed Content

- **Trade**
  - A Country-Specific View of Tariffs
  - Do Import Tariffs Protect U.S. Firms?
  - Does Trade Uncertainty Affect Bank Lending?
  - The Global Supply Side of Inflationary Pressures
  - The Impact of Import Tariffs on U.S. Domestic Prices
  - Do Import Tariffs Help Reduce Trade Deficits?
- **Monetary Policy**
  - Why Do Forecasters Disagree about Their Monetary Policy Expectations?
  - The Federal Reserve and its Monetary Policy Implementation Framework
  - Firms' Inflation Expectations Have Picked Up
- **AI**
  - Are Businesses Scaling Back Hiring Due to AI?
- **Household Issues**
  - Borrower Expectations for the Return of Student Loan Repayment
  - When the Household Pie Shrinks, Who Gets Their Slice?
- **Banking Matters**
  - Flood Risk Outside Flood Zones — A Look at Mortgage Lending in Risky Areas
  - The Adverse Effect of "Mandatory" Flood Insurance on Access to Credit
- **Treasury Market**
  - Measuring Treasury Market Liquidity