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The Economic Indicators That Shape Fed Policy

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Executive Summary

Economic data dominates news headlines every day. New releases of data reshape expectations about economic growth, inflation, and the interest rates set by the Federal Reserve, also referred to as "the Fed." In turn, investors quickly update their assumptions of future profits and financial conditions, and markets can reprice in a matter of seconds. In recent months, the Fed has faced increasing challenges over the quality of the data it uses,[1] as well as the lack of data available as a result of the 43-day government shutdown, the longest in history.[2] In spite of recent criticism regarding the independence and reliability of this data, a review of how the data is collected by the Federal government career staff at the statistical agencies reveals a meticulous effort on breadth and accuracy.

Despite the importance of the economic measures that shape the Fed's monetary policy decisions, many of these measures are not widely understood or easily interpreted. A strong understanding and belief in the accuracy of key economic indicators is crucial for market participants, policymakers, and anyone seeking to make an informed decision related to the economy.

By approaching both sides of the Fed's dual mandate, this white paper aims to explain the key measures used by the Fed to set monetary policy, including their data sources, how they are calculated, their significance, and other important details.

The Dual Mandate

Since 1977, the Fed has followed the "dual mandate" assigned by Congress to promote maximum employment and stable prices. Since 2012, price stability has been defined by the Fed as inflation averaging 2%. The Fed believes this increase in the average price level is an appropriately low and stable number, allowing for informed decisions regarding saving, borrowing, and investment.[3] Maximum employment cannot be defined by a single measure. "Headline unemployment rate by itself can obscure important dimensions of labor market slack, so it is important to … consult a broad set of aggregated and disaggregated measures," former Fed governor and current Distinguished Fellow at the Psaros Center Lael Brainard has said.[4] Before the Fed adjusts monetary policy, it must weigh the data informing both sides of the dual mandate. Ultimately, the Fed uses its monetary policy tools to steer inflation and the labor

[1] Lucia Mutikani, Nandita Bose, and Michael S. Derby, "Trump Fires US Labor Official over Data and Gets Earlier Than Expected Chance to Reshape Fed," *Reuters*, August 2, 2025, https://www.reuters.com/legal/litigation/trump-fires-us-labor-official-over-data-gets-earlier-than-expected-chance-2025-08-02/
[2] Vince Golle and Craig Stirling, "Data Fog Intensifying for Fed as Shutdown Delays US Inflation Numbers," *Bloomberg*, November 8, 2025, updated November 9, 2025, https://www.bloomberg.com/news/articles/2025-11-08/data-fog-intensifying-for-fed-as-shutdown-delays-us-inflation-numbers
[3] Federal Reserve, "What is Inflation, and How Does the Federal Reserve Evaluate Changes in the Rate of Inflation?" *Federal Reserve*, last modified August 22, 2025, https://www.federalreserve.gov/faqs/economy_14419.htm
[4] Lael Brainard, "How Should We Think about Full Employment in the Federal Reserve's Dual Mandate?" Federal Reserve, February 24, 2021, https://www.federalreserve.gov/newsevents/speech/brainard20210224a.htm

market back to their ideal levels. The primary tool is interest on reserve balances, which is the lowest rate a bank will lend funds at. By increasing or decreasing interest on reserve balances, the Fed adjusts the floor that steers the federal funds rate, the benchmark for market interest rates.[5] Ultimately, this directly impacts the cost of borrowing and saving for millions of consumers in the United States.

Inflation

There are two primary measures of price changes faced by consumers in the United States. The consumer price index (CPI) measures changes in out-of-pocket spending for all urban households using a fixed basket of goods and services. It was first published in 1919, and since 1940 has been published monthly. CPI is used for cost-of-living adjustments to Social Security and other income payments.[6] However, since 2000, the Fed's preferred measure for inflation is the personal consumption expenditures (PCE) price index. In fact, the Fed explicitly states that an annual two percent increase in the PCE index is most consistent with its long-run goals. This is because the PCE price index extends to rural households and covers a broader range of household spending, including spending made directly by or on behalf of households, such as employer-provided or federal healthcare services.[7]

The PCE and CPI come from different data sources and are calculated differently. The PCE is produced by the Bureau of Economic Analysis (BEA), an agency within the Department of Commerce. PCE relies on vast datasets from business surveys, government sources such as the Census, and data from other agencies. CPI data is produced by the Bureau of Labor Statistics (BLS), an agency within the Department of Labor. BLS data collectors survey prices for approximately 80,000 goods and services through in-person visits, telephone calls, and a separate housing evaluation.[8]

Both measures use weights to reflect how much each category of goods or services contributes to overall consumer spending. PCE has a relatively higher weighting of healthcare and relatively lower weighting of shelter compared to the CPI. PCE updates weights monthly, while CPI updates weights annually. Because PCE updates weights more regularly, it can adjust for changes in consumption patterns, such as substitution effects towards cheaper goods. As a result, PCE inflation tends to run lower than CPI inflation. A higher spread can indicate more economic stress due to substitution or faster price increases in healthcare relative to housing.

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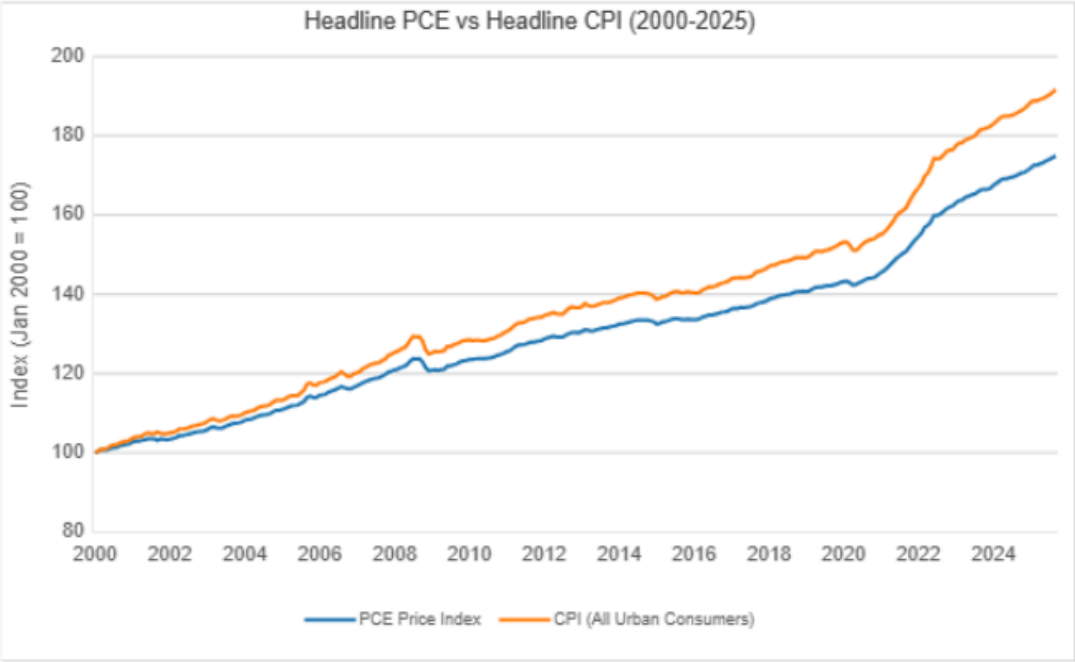
[5] Federal Reserve Bank of St. Louis. "*How the Fed Implements Monetary Policy with Its Tools*." *In Plain English*. Last modified January 2026. https://www.stlouisfed.org/in-plain-english/the-fed-implements-monetary-policy

[6] U.S. Bureau of Labor Statistics. *Consumer Price Index: Questions and Answers*. U.S. Department of Labor. https://www.bls.gov/cpi/questions-and-answers.htm

[7] Federal Reserve Bank of Cleveland. *"Consumer Price Data and Measures Explained."* Center for Inflation Research. https://www.clevelandfed.org/center-for-inflation-research/consumer-price-data

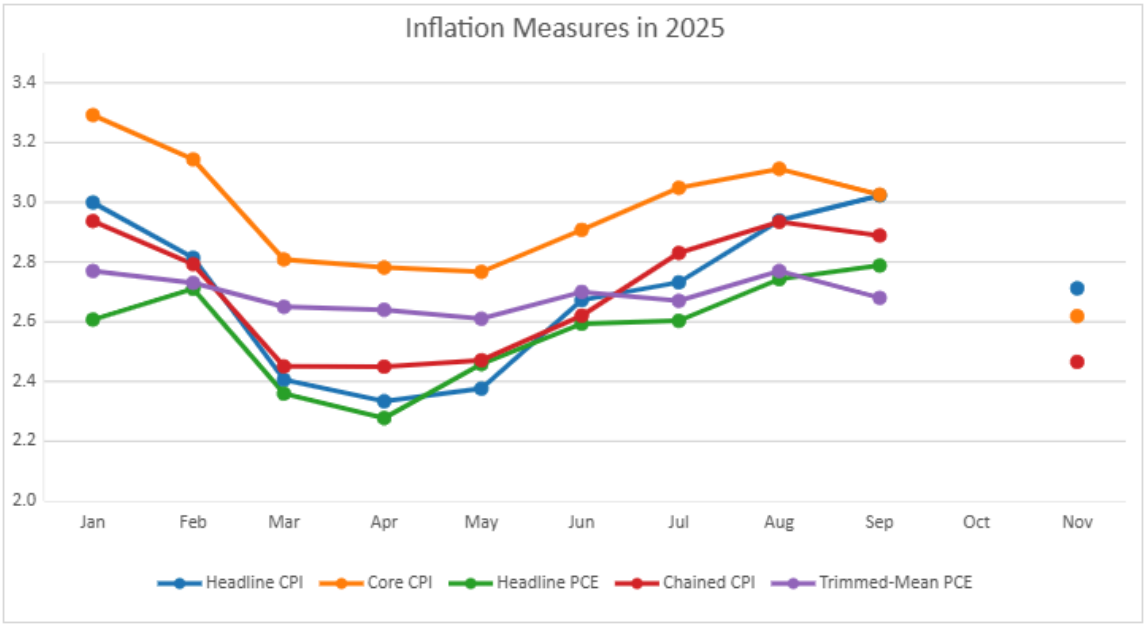
[8] Salwati, Nasiha, and David Wessel. "How Does the Government Measure Inflation?" *The Brookings Institution*, June 28, 2021. https://www.brookings.edu/articles/how-does-the-government-measure-inflation/



Source: Federal Reserve Economic Data (FRED)

MoM, or Month-over-Month inflation, reports the percentage change in inflation from one month to the preceding month. YoY, or Year-over-Year inflation, measures the percentage change in inflation from a month or period in the current year to the same month or period in the previous year. Although "headline" inflation reports the total price change, it can be misleading due to seasonal changes or volatility. Core inflation excludes the more volatile costs of food and energy. While PCE already accounts for substitutions, chained CPI is a variant of CPI that accounts for substitutions and thus runs slightly lower. Other common deviations include trimmed-mean inflation, which excludes components with the most extreme changes, and median inflation, which reflects changes in the center of the price change distribution.[9]

[9] Salwati, Nasiha, and David Wessel. "How Does the Government Measure Inflation?" *The Brookings Institution*, June 28, 2021. https://www.brookings.edu/articles/how-does-the-government-measure-inflation/



Source: Federal Reserve Economic Data (FRED)

While the Fed prefers the PCE, markets and the media focus primarily on the CPI. In fact, market volatility is roughly twice as large after CPI releases as after PCE releases. This is partly explained by timing: the CPI is released two weeks before the PCE for the same prior month's data. As a result, the CPI has greater significance for markets, and the PCE often only gains significance if it strongly contradicts the previous CPI figure.[10]

In 2025, inflation remained elevated above the Fed's 2% target for both headline and core inflation. Underlying price pressures in core services and non-housing both remained elevated. Notably, goods inflation re-accelerated after previous disinflation, possibly due to tariff pressures.

Unemployment

While a small set of price indices can summarize inflation, maximum employment is far more complicated. When assessing the labor market, it's important to consider not only whether individuals are working, but also who is working, where they are working, demand for work, and the wages being paid for their work.

The most visible indicator of unemployment is the headline unemployment rate (U-3), which measures the percentage of the labor force who are not employed but are actively seeking and available for employment. The labor force is the sum of employed and unemployed people over

[10] Iuorio, Jim. *"Why the Fed Prefers PCE Over CPI for Inflation Insights." OpenMarkets*, CME Group, October 6, 2025. Accessed January 8, 2026. https://www.cmegroup.com/openmarkets/equity-index/2025/Why-the-Fed-Prefers-PCE-Over-CPI-for-Inflation-Insights.html

the age of 16. If workers are unemployed, they lose wages, their purchasing power decreases, the country loses goods and services, and this can often lead to unemployment for others. When the economy is near maximum employment, the unemployment rate is near its natural rate (u*). This natural rate can only be estimated, and it is not zero because there will always be unemployed workers in between jobs or retooling to find new careers.[11]

Another key measure is the U-6 unemployment rate. U-6 includes the underemployed, those who would prefer to work full-time but currently work part-time for economic reasons. It also includes discouraged workers, those who have stopped looking for jobs because they believe none are available to them. U-6 can provide a fuller picture of the labor market; however, headline and U-6 unemployment movements during times of economic growth and contraction are highly correlated.

To determine whether changes in the unemployment rate are due to jobs being created or people leaving the labor force, the Fed also closely watches two other measures. The labor force participation rate is the percentage of the working-age population that is part of the labor force. The employment-to-population ratio is a broader measure of how much of the population is working. It is defined as the share of the working-age population that is currently employed.

To assess job creation and the strength of labor demand, the Fed looks at nonfarm payroll employment data. Nonfarm payroll refers to the number of workers in the U.S. economy excluding farm employees, private household employees, and the self-employed. Often, headlines refer to the change in non-farm payroll employment, which is simply a measure of the net gain or loss of jobs in the time period outside the agricultural sector.[12]

The data for these measures is provided by the Bureau of Labor Statistics, typically on the first Friday of each month. The data is collected by highly trained officials at the Census Bureau, who survey over 60,000 eligible households each month. Although this only surveys a fraction of the entire population, the BLS estimates that the monthly unemployment estimate is 90% likely to be within 300,000 of the true number. This is considered a small amount of error relative to the 8 million people currently unemployed.[13] Another factor to consider is seasonality, since hiring patterns often change depending on the time of year. For example, there is typically a decline in employment from December to January due to layoffs of temporary holiday workers.[14] The BLS uses a technique called seasonal adjustment to remove the effects of seasonal fluctuations between months or seasons.

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[11] Weinstock, Lida R. *Introduction to U.S. Economy: Unemployment.* CRS In Focus IF10443. Congressional Research Service, Library of Congress, February 24, 2025. https://www.congress.gov/crs-product/IF10443

[12] Stephanie Aaronson. *"What Does the Unemployment Rate Measure?" Brookings Institution*, February 18, 2021. https://www.brookings.edu/articles/what-does-the-unemployment-rate-measure/

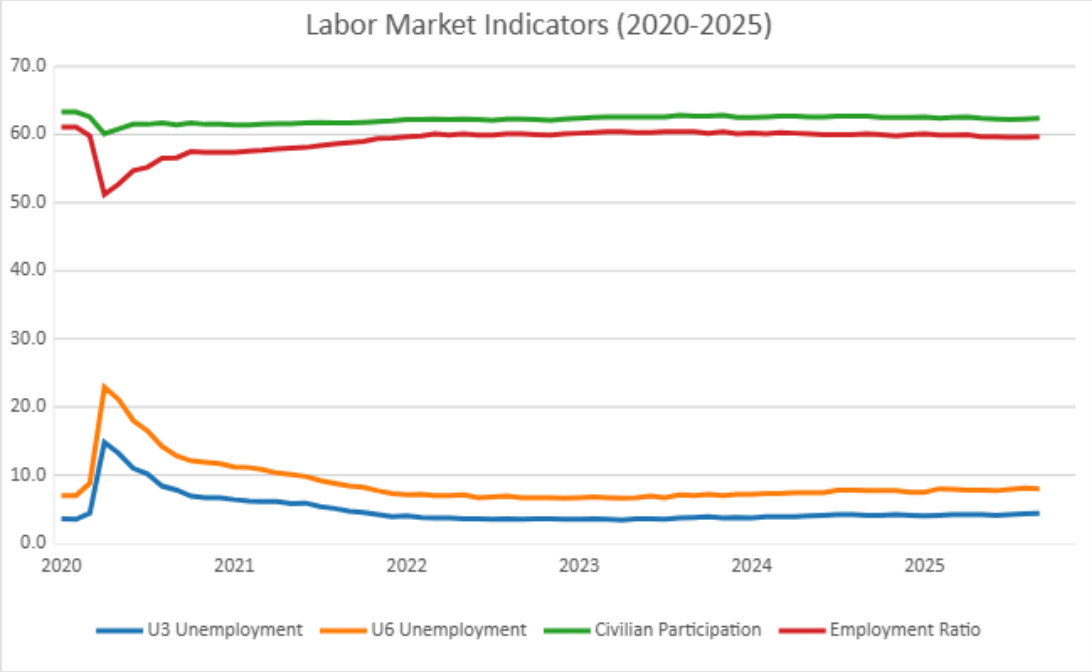
[13] U.S. Bureau of Labor Statistics. *How the Government Measures Unemployment.* U.S. Department of Labor. https://www.bls.gov/cps/cps_htgm.htm

[14] Federal Reserve Bank of Dallas. *"Two-Step Seasonal Adjustment." Data Basics*, Federal Reserve Bank of Dallas. https://www.dallasfed.org/research/basics/twostep

In 2025, the labor market softened as employment growth slowed and the unemployment rate increased moderately. This was often referred to as a "no-hire, no-fire" environment. However, while the headline measures provide an important overview of the labor market, they fail to recognize differences across groups of the population. For example, unemployment and participation rates can vary significantly across race, age, gender, geographic region, and employment sector. Even if overall measures suggest a strong labor market, younger workers, minority groups, and workers in specific industries may experience higher unemployment.

Currently, the softening labor market is especially hurting young college graduates.[15] In addition, marginalized workers such as Black men and single mothers have been disproportionately affected by the downturn in the labor market.[16] Black unemployment steadily increased throughout 2025, reaching 8.2% in November, the highest monthly level since 2021. Research has shown that unemployment rates of Black and Hispanic men often can be an early warning signal for trouble in the economy, as these groups tend to occupy jobs more sensitive to periods of economic growth and decline.[17] It is important for the Fed, therefore, to go beyond aggregate statistics and examine disparities across groups.

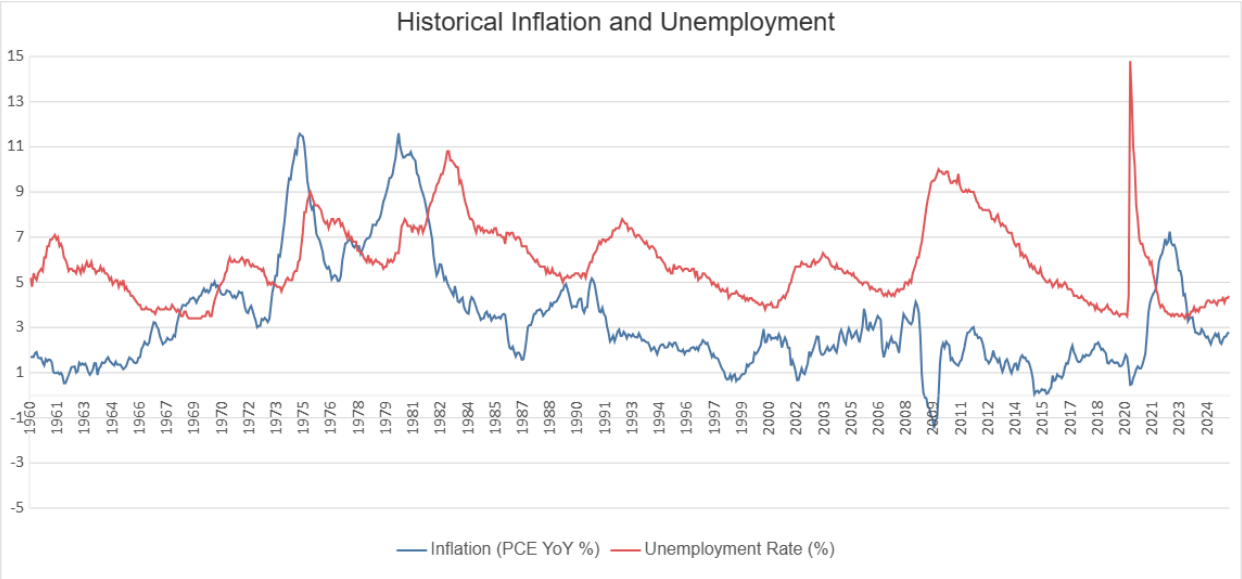
[15] Ozkan, Serdar, and Nicholas Sullivan. *"Recent College Graduates Bear Brunt of Labor Market Shifts."* On the Economy (blog), St. Louis Fed, August 25, 2025.
https://www.stlouisfed.org/on-the-economy/2025/aug/recent-college-grads-bear-brunt-labor-market-shifts
[16] Nyandoro, Aisha. *"Job Market Reveals Growing Risks for Marginalized Workers—And the Entire Economy."* Forbes, August 7, 2025.
https://www.forbes.com/sites/aishanyandoro/2025/08/07/job-market-reveals-growing-risks-for-marginalized-workers-and-the-entire-economy/
[17] Duzhak, Evgeniya A. *"How Do Business Cycles Affect Worker Groups Differently?"* Economic Letter 2021-25, Federal Reserve Bank of San Francisco, September 7, 2021.
https://www.frbsf.org/research-and-insights/publications/economic-letter/2021/09/how-do-business-cycles-affect-worker-groups-differently/



Source: Federal Reserve Economic Data (FRED)

Challenges and Controversies

Together, these two sides of the dual mandate and the data used to study them bring about important monetary policy decisions that affect all Americans. They also provide a useful tool to analyze the broad health of the economy. While many in politics or the media have referred to the current economy as the "greatest" or "worst" of all time, comparing the current inflation and unemployment to the last hundred years shows moderate inflation and relatively low unemployment. Neither measure is at historically unprecedented levels. The "misery index" is a simple economic indicator that adds the rate of unemployment and inflation. As of September 2025, the misery index stood at 7.2 (4.4% unemployment, 2.8% PCE inflation). This is far from the highs during COVID (15.2) and lower than any given month from 1968 to 1995.



Source: Federal Reserve Economic Data (FRED)

The reliability and independence of the data used to make these decisions are of critical importance, yet they have faced unprecedented scrutiny amid political pressure. Large downward revisions to the May and June payroll employment change led the White House to accuse the Bureau of Labor and Statistics of manipulation. This culminated in the firing of Bureau of Labor Statistics Commissioner Erika McEntarfer, raising concerns about the independence and accuracy of official economic statistics.

A central part of this debate stems from the practice of data revisions. First estimates of the monthly CPI, PCE, or nonfarm payrolls are based on preliminary information and can be updated as more complete data becomes available. For example, the employment survey covers more than 600,000 workspaces, with only 60% of firms responding in time for the initial release, a decrease from 70% before the pandemic.[18] Revisions incorporate data from the remaining firms as they come in. Seasonal adjustment can also lead to revisions as seasonal factors are recalculated.

While large or unexpected revisions in the data can create uncertainty and might be used by some to undermine confidence in future initial releases of the data, a review of the methods and procedures used to produce these datasets shows a meticulous effort on breadth and accuracy. These data collection efforts have encountered challenges in the past year due to staffing and funding pressures.

[18] Michael W. Horrigan, *"BLS Revisions to Payroll Data Are Concerning, but Not for the Reasons the Trump Administration Thinks," Upjohn Institute for Employment Research,* September 29, 2025, https://www.upjohn.org/horrigan-bls-revisions-payroll-data-are-concerning-not-reasons-trump-administration-thinks

Due to the government shutdown, October data was not released, and later monthly data releases were postponed. The shutdown provided an additional reason for some to question the reliability of recent economic data, as much of it was impacted by the shutdown. Under a public economic data blackout, the Fed was forced to rely on private-sector or limited available public data. This created high uncertainty and made the policy decision far more difficult.

Today, much of the public and media coverage on economic data focuses on headline numbers, often without context. Approaching economic data more carefully and gaining a greater understanding can help set appropriate future expectations for policymakers, market participants, and the general public.