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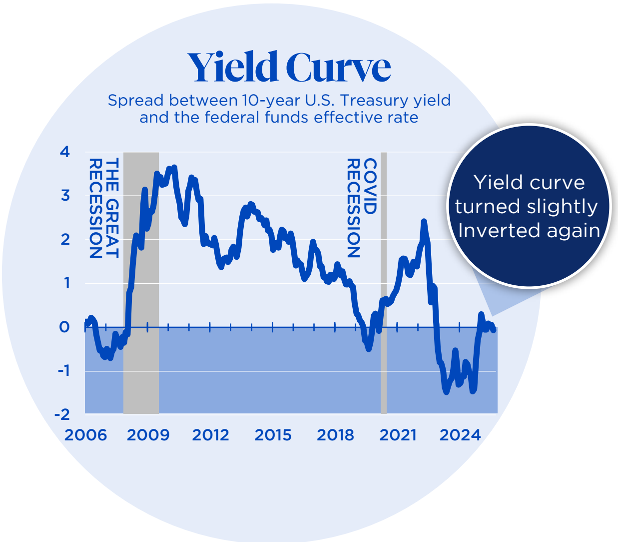
Economic & Financial Markets Monthly Review | September 2025

Weak job gains spur the Fed to cut rates

Economic Overview

Where is the economy now?

With the labor market rapidly losing steam and tariff impacts on inflation moderate, the Fed has restarted the process of cutting interest rates. Lower interest rates should help to shore up activity until fiscal stimulus and tax incentives arrive in 2026. While economic activity is still expected to dip in Q4, recession odds look low as peak uncertainty surrounding the tariffs and its impact is behind us.



Where we are this month

Activity slows but not recessionary

While the economy throttles back as businesses slow hiring and consumers curtail spending plans, the current expansion is projected to continue over the rest of 2025.

Yield curve returns to inverted shape

As odds of Fed rate easing climb, interest rates across the yield curve dropped in August and into September. 10-year yields fell faster than the Fed cut rates, leading to a return to a slight reversion in the curve.

Market's inflation expectations steady

While consumers are concerned that inflation will shift permanently higher in coming years, market inflation expectations remain anchored just above 2.0 percent.

What does this mean

- Data for the third quarter point to slower domestic activity, which is poised to moderate even further in Q4. That said, recession odds remain lower with peak uncertainty passed and activity should pick up as the calendar turns to 2026.
- Interest rate cuts in late 2025, combined with lower tax burdens and enhanced business incentives in 2026 as well as reduced uncertainty, should propel business spending and hiring next year.

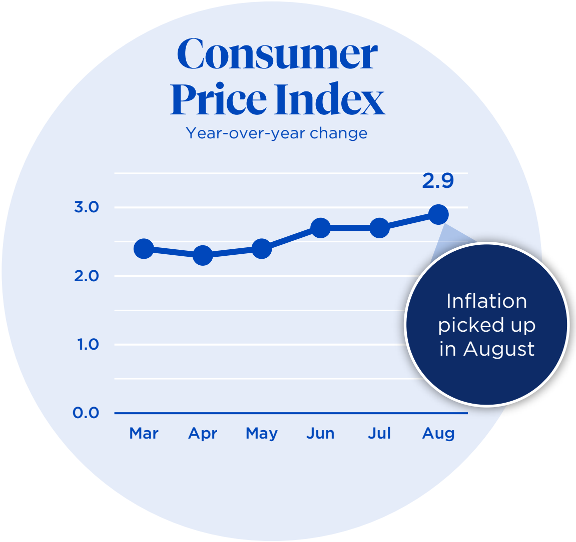
- Yields on 10-year Treasury notes dropped sharply in September as concerns about slowing growth drove real yields lower. However, we look for a steeper yield curve to re-emerge as the Fed engineers a series of rate cuts in the coming months..
- We expect the Fed to cut rates by a total of 75 basis points before year end and the odds of further declines in 2026 are rising as the makeup of the FOMC changes.

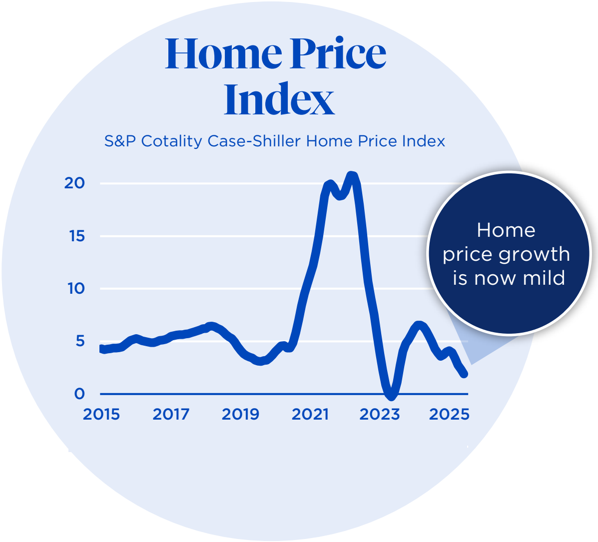
- Survey responses from consumers on forward inflation tend to be unreliable in predicting measured inflation. This is especially the case in the current volatile policy environment. Financial markets are expecting that any acceleration in inflation tied to tariffs or other policy changes will be short-lived and temporary.
- While Fed officials will monitor consumer surveys, the Fed places more importance on market expectations, allowing them to keep cutting rates.

Economic Review

Stall in hiring sets the stage for rate cuts

Job growth stalled in August and continued to be contractionary outside of education and healthcare. The BLS' preliminary benchmark revisions amount to a large downward revision of 911,000 jobs from April 2024 to March 2025, which reduces the number of estimated jobs created by roughly half. As such, just 70,000 jobs per month on average were created in that period versus the prior estimate of 146,000. The softening of job growth supports more Fed rate cuts.





Where we are this month

Inflation continues to creep up

Headline CPI inflation climbed to 2.9 percent in August, while the core rate held steady at 3.1 percent. Also, tariff-induced price increases picked up in some sectors.

Job growth slows to a crawl

Nonfarm payrolls increased by 22,000 in August, marking a fourth straight month of subpar gains and bringing the three-month average for job gains to only 29,000.

Home price appreciation is fading

The year-on-year growth in home prices fell below 2.0 percent in June, according to the S&P Cotality Case-Shiller Home Price Index.

What does this mean

- There was a greater degree of tariff pass-through in August, particularly for non-discretionary items like food at home which helped to lift the headline higher than the core rate.
- The mildly hotter-than-expected inflation data will do little to dissuade the Fed from engineering a series of rate cuts considering the weakening in the labor market. We see the Fed cutting the fed funds rate by 75 bps by year end .

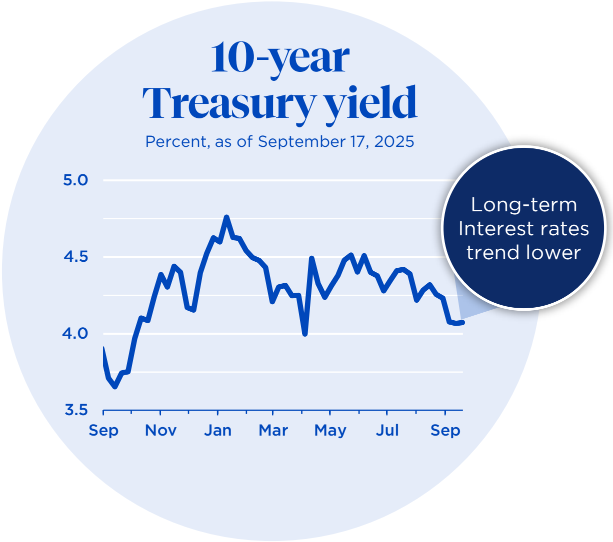
- The pace of hiring is even weaker when looking beneath the surface. Nonfarm payroll gains less private education and health care services have contracted by a combined 87,000 over the last four months.
- While most firms aren't pursuing layoffs right now, the tepid pace of hiring is a hit to consumer incomes and adds to concerns that the labor market could soften further. We expect consumer spending and the overall economy to be sluggish over the rest of the year.

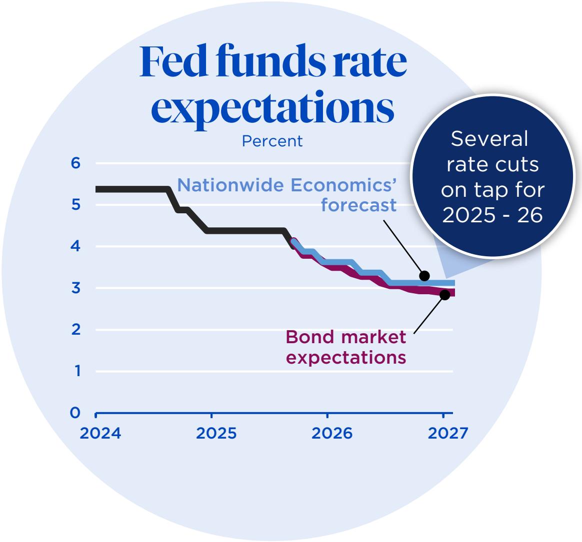
- The downtrend in home prices correlates with the recovery in new listings from the record low in February 2022. Some housing markets are showing falling values this year.
- Affordability remains a hindrance for buyers in the housing market. While sales activity should be limited in the near term, the combination of falling rates and increased supply should lead to a livelier market later in 2026 and into 2027.

Financial Market Review

Markets stay buoyant with Fed rate cuts on deck

Risky assets are adding to their gains, with equities rising and corporate credit spreads remaining very tight as a positive Q2 earnings and continued economic resilience lift investors' spirits. We expect positive fundamentals and looser Fed policy will support equity values and lead to a steeper Treasury yield curve. After 75 basis points (bps) of Fed easing by year end, we look for another 50bps of cuts in 2026 as the Fed shifts to shoring up the labor market.





Where we are this month

Equities remain on a positive track

Stock investors are holding onto relatively ebullient attitudes after a reassuring Q2 earnings season and expectations for a series of Fed rate cuts. Earnings rose a strong 12 percent year-over-year last quarter.

Long-term yields drop

The weak August jobs report and downward revisions to prior employment data have triggered a decline in long-term Treasury yields. However, we look for higher term premium to prevent further significant declines.

Fed begins policy easing

As widely anticipated, the Fed restarted its rate cuts this month. Chair Powell's latest public comments have struck a notably more dovish tone as Fed officials assesses the downside risks to employment are rising materially.

What does this mean

- The S&P 500 index continues marching higher, making a new all-time high in early September and is up more than 30 percent from its April 8th low. Modest impacts from tariffs and positive momentum are bolstering investor confidence.
- The outperformance of cyclical relative to defensive stocks — a barometer of market attitudes — also indicates ebullient investor sentiment.

- Looking beyond the recent drop in the 10-year Treasury yield, we do not expect significant further declines as the bond market has already priced in our forecast for future Fed rate cuts.
- Treasury issuance driven by the "One Big Beautiful Bill" and some lingering inflation concerns will underpin upper pressure on the term premium and keep the key 10-year Treasury yield from falling much lower.

- We expect another 50bps of rate cuts by year end, bringing the total reduction over 2025 to 75bps. Additionally, we anticipate 50bps of cuts in 2026 as policymakers focus on supporting the job market while looking past a modest and temporary rise in inflation.
- In September, Fed officials also signaled an additional 50bps in rate easing by year end with the labor market now on a much weaker footing. The odds that the FOMC announces a larger 50bps cut at one of the remaining 2025 meetings are climbing.

Outlook

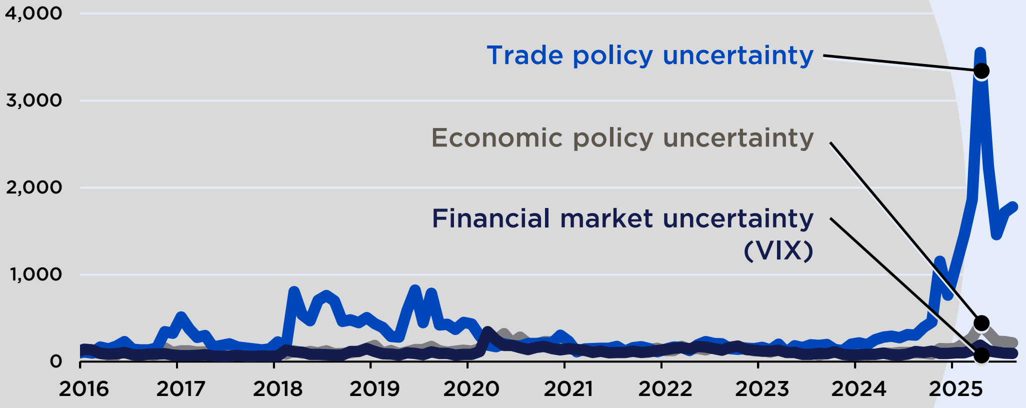
Peak uncertainty has likely passed

Economic uncertainty has been a key theme for 2025 as consumers and businesses adjust to shifts in policy on trade, immigration, and interest rates. Rising prices for inputs and supply chain disruptions have cut into investment and hiring plans for many firms, also blunting spending by many households. But policy uncertainty likely peaked on Liberation Day in early April as subsequent trade deals have reduced tariff rates while businesses have altered operations for a more permanent higher-tariff environment.

There are likely to be further policy announcements, and we still expect growth to be challenged in the near term. But the forward path is becoming clearer. Price impacts tied to tariffs have been delayed in many areas but should induce only a temporary increase in inflation. Fed policy is expected to be easier going forward with lower interest rates for consumer and business loans. The combination of reduced uncertainty with the tax incentives and fiscal stimulus set to start in 2026 should boost investment and spending next year.

Uncertainty measures

Index, 2015 = 100



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Forecast

Data as of September 2025

	2024 ACTUAL	2025 ESTIMATE	2026 FORECAST	2027 FORECAST	2028 FORECAST
REAL GDP	2.8%	1.8%	1.8%	2.3%	2.3%
UNEMPLOYMENT RATE	4.0%	4.3%	4.4%	4.2%	4.2%
INFLATION [1] (CPI)	2.7%	**3.0%**	**2.5%**	2.0%	2.0%
TOTAL HOME SALES	4.75	4.66	5.00	5.82	5.95
S&P/COTALITY HOME PRICE INDEX	3.7%	2.4%	3.0%	3.1%	3.0%
LIGHT VEHICLE SALES	15.8	16.2	16.4	16.5	16.5
FEDERAL FUNDS RATE [2]	4.25%	**3.50%**	**3.00%**	3.00%	3.00%
5-YEAR TREASURY NOTE [2]	4.38%	3.60%	3.55%	3.55%	3.55%
10-YEAR TREASURY NOTE [2]	4.58%	4.10%	4.10%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE [2]	6.91%	6.50%	5.60%	5.00%	5.00%
MONEY MARKET FUNDS	4.96%	4.03%	3.22%	3.03%	3.03%

Faster inflation as tariffs pass through

Inflation is expected to accelerate moderately in coming months as businesses pass on a larger share of tariff costs into consumer prices. But annual inflation should peak just above 3.0% in early 2026 before easing over the year as temporary tariff impacts fade.

Fed easing could continue in 2026

The FOMC is widely expected to ease several times in late 2025 to support the weakening labor market and waning consumer activity. After a brief pause in early 2026, the easing cycle likely resumes with a few additional rate cuts as new leadership steps on to the committee.

[1] *Percent change Q4-to-Q4*
[2] *Year end*
[a] *Actual*

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Sources

Page 1	**Where is the economy now?**	
	Business Cycle	*Nationwide Economics*
	Yield Curve	*Bloomberg; National Bureau of Economic Research*
	Inflation expectations	*University of Michigan; Bloomberg*
2	**Economic Review**	
	Consumer Price Index	*Bureau of Labor Statistics*
	Nonfarm payroll gains	*Bureau of Labor Statistics*
	S&P Cotality Home Price Index	*S&P; Cotality*
3	**Financial Markets Review**	
	S&P 500	*Standard & Poor's*
	10-year Treasury yield	*Federal Reserve Board*
	Fed funds rate expectations	*Nationwide Economics, Bloomberg, Haver Analytics*
4	**Outlook**	
	Uncertainty Measures	*PolicyUncertainty.com, Matteo Iacoviello, Haver Analytics*
	Latest Forecast	*Nationwide Economics*

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