MONETARY AFFAIRS:

Preview: Fed To Resume Easing, as Labour Market Downside Risks Outpace Inflation Upside Risks

by

Nouriel Roubini, Brunello Rosa

and Nato Balavadze

16 September 2025

Nouriel Roubini, Brunello Rosa and Nato Balavadze

Preview: Fed To Resume Easing, as Labour Market Downside Risks Outpace Inflation Upside Risks

16 September 2025

Executive Summary

- **Expected Decision**: *We expect the Fed to cut rates in September.* In line with consensus, we expect the Fed to cut its target Fed funds range by 25 bps to 4.00% - 4.25% in September. But some dissent in the FOMC may emerge as some members – including the newly appointed Steve Miran – may vote for a 50bps rate cut. Regarding *forward guidance*, the Fed will continue to be data-dependent regarding further policy changes. The Fed is set to begin cutting rates this month after August payrolls nearly stalled at 22,000, the unemployment rose to 4.3% and previous job growth was revised downward; the labor market is clearly softening. Powell warned that even small layoffs could quickly push joblessness higher. Regarding *balance sheet policy,* in May last year the FOMC decided to slow down the pace of QT.
- **Policy Discussion**: *The Fed looks set to begin easing at its September meeting, with the focus shifting from inflation risks to growing labor market weakness.* August data showed payroll growth nearly stalling at just 22,000 jobs, while unemployment climbed to 4.3%, the highest since 2021. At Jackson Hole, Powell warned that slower hiring and even modest layoffs could push unemployment higher, underscoring the risks of inaction. He stressed that while Trump's tariffs are adding to consumer prices, these effects may be temporary, and the Fed must balance containing inflation with protecting jobs. Powell signaled the central bank will "proceed carefully," pointing to gradual, limited cuts rather than aggressive easing.

  US growth is moving towards a growth recession this year, with growth well below potential but short of an outright recession; this will lead to a further modest uptick in the unemployment rate. In 2026, after a soft patch in H1, growth will strengthen given tailwinds from capex, fading of the tariffs uncertainty, still loose financial conditions, easier monetary policy and some existing fiscal stimulus still in the pipeline. Next year inflation will gradually fall after the rise in 2025 as base effects of tariffs will fade, wage growth will remain moderate and technology driven productivity gains may reduce costs in some sectors.

  While the Fed may likely end up cutting rates 3 times this year (September, October and December) it is our view that the SEP projections will continue to show only 2 rate cuts this year even if a number of FOMC members – but not the median – will signal 3 rate cuts. We expect that the SEP projections will be revised to show 3 rate cuts in 2026 rather 2 with the terminal rate unchanged to 3%. While the FOMC may not commit to a rate cut in October or 3 cuts this year, Powell may use the presser to signal that an October cut cannot be ruled out if macro conditions – a weaker goods and labor market and still contained inflation – justify it.

  So while the dot plot may still signal only 2 rate cuts this year the policy hint will be that 3 cuts are possible and likely. Given recent political attacks on the Fed independence Powell will need to manage a delicate balance between recogninizing the economic softening that justifies a series of rate cuts ahead, with the need to remain data dependent and not be bullied into committing into excessive policy easing.

  Markets now see a 90% chance of a 25bp cut next week and just 10% odds of a 50bp move, with analysts generally expecting either another cut this year or even back-to-back reductions rather than a single large adjustment. Some, including Barclays, Macquarie, and Bank of America, have revised forecasts to include multiple 25bp cuts this year. Market are pricing 3 rate cuts this year. While inflation data remain elevated, the Fed is increasingly focused on future inflation expectations and the deteriorating labor outlook. The September decision will likely confirm the start of a new easing cycle, though the pace will depend heavily on incoming data and the balance between still-high inflation and mounting job market stress.

- **Changes to Economic Forecasts:** *The Fed is set to launch a new easing cycle next week, with the dot plot expected to signal two 25bp cuts this year*. Weakening labor market data underpins this shift. Jobless claims also climbed, reinforcing signs of cooling employment, even as August inflation came in hotter. The Fed is likely to opt for the smaller move while signalling stronger support for the labor market. Updated projections on growth, inflation, and rates through 2028 will be closely watched, particularly as political pressure from President Trump intensifies, adding another layer of uncertainty to the Fed's policy path.

Key Picture: US Federal Reserve Forecasts – 2025-2027

	2025*f*			2026*f*		2027*f*		Longer Run	
	Latest Reading	September Report	June Report	September Report	June Report	September Report	June Report	September Report	June Report
GDP *(real growth, y-o-y)*	2.0	1.4	1.4	1.6	1.6	1.8	1.8	1.8	1.8
Unemployment rate *(%, y-o-y)*	4.1	4.5	4.5	4.5	4.5	4.4	4.4	4.2	4.2
PCE Inflation *(%, y-o-y)*	2.9	3.0	3.0	2.4	2.4	2.1	2.1	2.0	2.0
Core PCE Inflat. *(%, y-o-y)*	3.1	3.1	3.1	2.4	2.4	2.1	2.1	-	-
Federal Funds Rate *(%)*	4.327	3.9	3.9	3.3	3.6	3.1	3.4	3.0	3.0

Source: Federal Reserve '*Summary of Economic Projections*' June 2025. *Note:* 1. GDP reading for Q1-2025; 2. Unemployment rate as of June 2025; 3. PCE and core PCE inflation as of August 2025; 4. Projections reflect the median of FOMC projections

Analysis

- **EXPECTED DECISION**: *On September 17, we expect the US Federal Reserve's FOMC to cut its Fed funds range by 25 bps to 4.00% - 4.25%.* In 2024, the Fed cut interest rates for three consecutive meetings, for a total of 100bps of easing. In July, FOMC wad divided, but it held rates steady, despite pressure from President Trump and dissent from Governors Michelle Bowman and Christopher Waller, who favored cuts. The arrival of Steve Miran at the Board will add pressure for the FOMC to act in line with Donald Trump's desire for much lower policy rates.

  Regarding *forward guidance*, the Fed will continue to be data-dependent regarding further policy changes with decisions being made meeting by meeting. In this meeting, the Fed is poised to begin rate cuts this month after August data showed job growth nearly stalled at 22,000 and unemployment rose to 4.3%, its highest since 2021. Powell has warned that even modest layoffs could quickly push joblessness higher in a weak hiring environment.

  Regarding *balance sheet policies*, the Fed in May last year decided to slow down the pace of QT from June. The Committee will continue reduce the size of its balance sheet made of Treasury securities, agency debt, and agency mortgage-backed securities holdings. Starting in April, the Committee slowed the reduction of its securities holdings by lowering the monthly Treasury redemption cap from $25 billion to $5 billion, while keeping the agency debt and mortgage-backed securities cap at $35 billion.

- **POLICY DISCUSSION**: *August jobs report solidifies the Fed's shift from inflation worries to labor market weakness.* At Jackson Hole, Powell signaled the Fed is preparing to cut rates in September, warning that risks are shifting as job growth slows and unemployment threats rise, even while inflation remains high.

He stressed tariffs may cause only temporary price pressures and said the Fed faces a delicate balance between supporting jobs and containing inflation. Powell emphasized the need to "proceed carefully," suggesting rate cuts will be gradual and limited.

The Fed is highly expected to begin rate cuts this month after the most recent jobs data showed payrolls nearly stalled at 22,000 and unemployment rose to 4.3%, the highest since 2021. Powell has warned that slow hiring and even modest layoffs could drive joblessness sharply higher. After weak August jobs data, White House adviser Kevin Hassett also suggested a larger cut, aligning with Trump's push for lower rates. Markets still see only a 10% chance of a half-point cut, with most betting on quarter-point reductions at upcoming meetings.

Fed Policymakers received fresh inflation data before the meeting, showing Trump's tariffs pushing up consumer prices. Still, the weak labor market has become the Fed's main concern, after holding rates at 4.25%–4.50% all year. A stronger print could lock in a quarter-point cut, though upside surprises complicate policy given the tension between high inflation and a weakening labor market. Still, economists expect the Fed to lean toward easing, focusing more on future inflation expectations than current readings.

August jobs data has also fuelled debate over a possible 50-bp "catch-up" cut in September, though most analysts expect smaller moves. However, the report is too weak for a half-point cut but supportive of back-to-back reductions. Markets now price a 90% chance of a 25-bp cut next week and 10% odds of a 50-bp move. Barclays, Macquarie, and Bank of America all revised forecasts to include multiple 25-bp cuts this year.

- **MACROECONOMIC ANALYSIS:** *Fresh labor data points to growing economic risks.* US growth is moving towards a growth recession this year, with growth well below potential but short of an outright recession; this will lead to a further modest uptick in the unemployment rate. In 2026, after a soft patch in H1, growth will strengthen given tailwinds from capex, fading of the tariffs uncertainty, still loose financial conditions, easier monetary policy and some existing fiscal stimulus still in the pipeline. Next year inflation will gradually fall after the rise in 2025 as base effects of tariffs will fade, wage growth will remain moderate and technology driven productivity gains may reduce costs in some sectors.

The U.S. economy rebounded more strongly in Q2 than first reported, with GDP growing at an annualized 3.3% versus the initial 3%. The pickup was driven by upward revisions to consumer spending (1.6% vs. 1.4%) and business investment (5.7% vs. 1.9%), particularly in intellectual property. The rebound followed a 0.5% contraction in Q1 and suggests the economy has held up better than expected against Trump's tariffs and high interest rates. Still, underlying momentum looks weaker, and economists expect growth to slow below 1% in the second half as labor markets soften and tariff-driven inflation weighs on demand.

U.S. manufacturing posted its strongest growth in over three years in August, with the S&P Global PMI rising to 53.0, just below the forecast of 53.3. Output and hiring accelerated as factories faced rising sales, backlogs, and inventory building amid tariff concerns. Input costs and factory-gate prices climbed, raising the risk of higher consumer inflation in the months ahead.

U.S. job growth slowed sharply in August, with payrolls rising just 22,000 and unemployment climbing to a near four-year high of 4.3%. June saw the first job losses since 2020, underscoring a weakening labor market and reinforcing expectations of a Fed rate cut. Economists blame tariffs, immigration curbs, and public-sector layoffs, while Trump fired the BLS commissioner after data revisions showed deeper declines.

US consumer prices rose more than expected in August, with CPI up 0.4% m-o-m and 2.9% y-o-y, the highest since January. Core inflation, excluding food and energy, matched forecasts at 0.3% monthly and 3.1% y-o-y, keeping pressure on the Fed ahead of the meeting.

- **CHANGES TO ECONOMIC FORECASTS:** *The Fed is expected to begin a new easing cycle this week, its first since December 2024, with the dot plot likely signaling 25bp cuts this year amid a weakening job market.* Ahead of the Fed's September meeting, fresh data show unemployment rising to 4.3% in August, June jobs revised into negative territory, and nearly a million fewer jobs added through March than initially reported. Combined with a jump in jobless claims, the figures point to a cooling labor market, even as August inflation accelerated. The revisions to the economic forecasts for growth, unemployment and inflation will be very modest relative to the June SEP ones.

  While the Fed may likely end up cutting rates 3 times this year (September, October and December) it is our view that the SEP projections will continue to show only 2 rate cuts this year even if a number of FOMC members – but not the median – will signal 3 rate cuts. We expect that the SEP projections will be revised to show 3 rate cuts in 2026 rather 2 with the terminal rate unchanged to 3%.

  Markets expect a 25bp cut next week, though some analysts argue for 50bp given the pace of labor market deterioration and benign inflation expectations. The Fed is likely to compromise with a smaller move while signaling stronger support for jobs. Updated projections for growth, inflation, and interest rates through 2028 will provide further guidance, especially as political pressure from President Trump intensifies.

- **MARKET IMPLICATIONS:** *The Fed's September 17th meeting could backfire for markets, even though investors are counting on rate cuts to extend the stock rally*. Since Powell's dovish Jackson Hole speech, equities have surged on expectations of easier policy, with the Dow, Nasdaq, and S&P 500 all reaching new highs. US Treasury yields and the dollar fell as weak labor data fueled rate-cut bets, outweighing a hotter-than-expected inflation print. The markets are pricing 3 rate cuts this year while the dot plot is likely to show only 2 even if Powell May hint that 3 cannot be ruled out. So, the market may be over optimistic on the number of cuts the Fed may be willing to commit to. To put things into context, *in the fixed-income space,* UST Yields fell as investors assessed the economy and recent trade news. As of September 15, the 2*y UST* fell by 40 bps to around 3.53% since the last meeting on July 30 (-71 bps y-t-d). The *10y UST* edged down by 36 bps to 4.03% since the last meeting (-53 bps y-t-d). *In the currency space,* the dollar extended losses after the latest weak U.S. jobs report reinforced expectations of a rate cut this month. As of September 15, and since the last meeting in July, the *dollar index* edged down by -2.3% and trades around 97.3 (-10.9% y-t-d). *EUR/USD* rose by 3.1% to 1.18 since June meeting (+6.5% y-t-d). *In the equity space,* U.S. stocks rose ahead of the Fed's September meeting, with investors expecting rate cuts and riding optimism over AI. Oracle's upbeat guidance and major AI deals boosted sentiment, while Tesla and Nvidia helped push the S&P 500 to a record close above 6,600. As of September 15, S&P 500 is up by 4.0% to 6615.28 (+12.7% y-t-d).

- **APPENDIX (Macro Background):** *In Q2 GDP revised up to 3.3%, showing resilience amid tariff and rate pressures.* In Q2, according to the second estimate, the US economy grew by an annualized 3.3% (*c*: -0.5%; *p:* 3.1%). The figure was revised up from 3%, driven by stronger investment and consumer spending, partly offset by lower government spending and higher imports Consumer spending rose (1.6% vs 0.5% in Q1). Government spending contracted (-0.2% vs -0.6%) and resident investment also shrank (-4.7% vs -1.3%). Exports shrank (-1.3% vs. 0.4%), while imports contracted by far more (-29.8% vs. 37.9%). The economy grew 2% y-o-y in Q2 2025, matching Q1 and marking the slowest pace since late 2022, the advance estimate showed.

  Slower growth stemmed from weaker services, despite the fastest manufacturing rebound since May 2022. In August, *the S&P Global US Composite PMI* revised down to 54.6 (*c*: 55.4; *p:* 55.1). The *Services PMI* declined to 54.5 (*c:* 55.4; *p:* 55.7). The *Manufacturing* PMI rose to 53.0 (*c*: 53.3; *p:* 49.8).

  Labour market cools. In July, *the unemployment rate* edged up to 4.3% (*c:* 4.3%; *p:* 4.2%). Total nonfarm payroll employment increased by 22K (*c*: 75K; *p:* 79K). Wage growth increased by 5.4% in July (*p:* 4.7%). The U-6 unemployment rate, which includes those marginally attached to the labour force and those working part-time for economic reasons, increased to 8.1% (*p:* 7.9%).

  Inflation climbed in August as companies passed Trump's tariffs through to consumers. In July, the *personal consumption expenditures* (*PCE*) – the Fed's preferred inflation gauge – rose to 2.6% y-o-y (*c:* 2.6%; *p*: 2.6%). The *core-PCE* – which excludes volatile energy and food prices –increased to 2.9% y-o-y (*c:* 2.9%; *p:* 2.8%). In August, headline and core inflation rates accelerated to 2.9% y-o-y (*c:* 2.9%; *p:* 2.7%) and 3.1% y-o-y (*c:* 3.1%; *p*: 3.1%).