OCTOBER 2025 FOMC ASSESSMENT

U.S. Monetary Policy Assessment

Balancing upside risks to inflation against downside risks to the labor market

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OUR RECOMMENDATION

25 bps cut

Federal funds rate to 3.75–4.00%

Maintain

Pace of balance sheet reduction

Data-dependent

Evidence-based forward guidance

Balancing Both Sides of the Dual Mandate

Inflation has refrained from accelerating past 3%, but upside price risks persist while labor conditions change and jobs are revised down

THE QUESTION

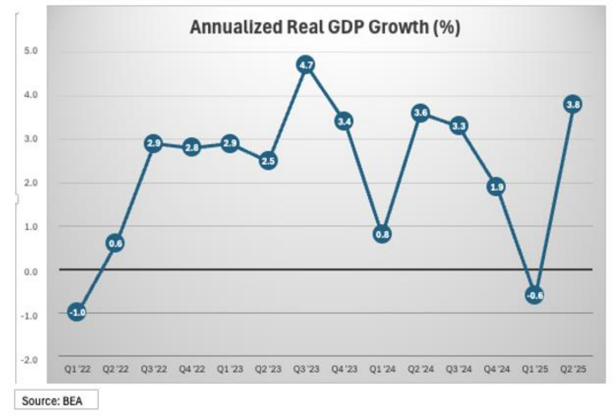
With rate cuts underway while we aim to reduce the balance sheet, is the current policy stance too restrictive, warranting a more aggressive path to neutral, or does the current path effectively address our inflation and employment mandate?

AGENDA

Sources: Federal Reserve, BEA, BLS, FRED

Growth Outlook Amid Soft Demand

Q2 growth rebounded, but the rise was primarily driven by a decrease in imports, and the outlook for demand is foggy



Median Forecasts for Selected Variables

Variable	Real GDP Growth (%)		Unemployment Rate (%)	
Forecast Release	Q2 2025	Q3 2025	Q2 2025	Q3 2025
Estimate for:				
Q3 2025	0.9	1.3	4.3	4.3
Q4 2025	1.4	1.3	4.5	4.4
Q1 2026	1.7	1.9	4.5	4.4
Q2 2026	1.9	1.3	4.5	4.5

Source: FRB of Philadelphia; Survey of Professional Forecasters

KEY DATA

-0.6% / 3.8%

Real GDP, Q1 / Q2 2025 actual

2.1% → 1.4% → 1.6%

Median 2025 projection: Dec '24, June '25, Sept '25 SEP

TAKEAWAYS

01 Q2 real GDP growth was revised up to 3.8% SAAR after a -0.6% Q1, putting 1H 2025 growth at 1.5%, down from about 2.5% in 2024 (Jerome Powell); actuals are in line with updated 2025 forecasts

02 Consumer spending is healthy, but the Q2 rise came primarily from lower imports, partially offset by declines in residential and non-residential fixed investment and exports

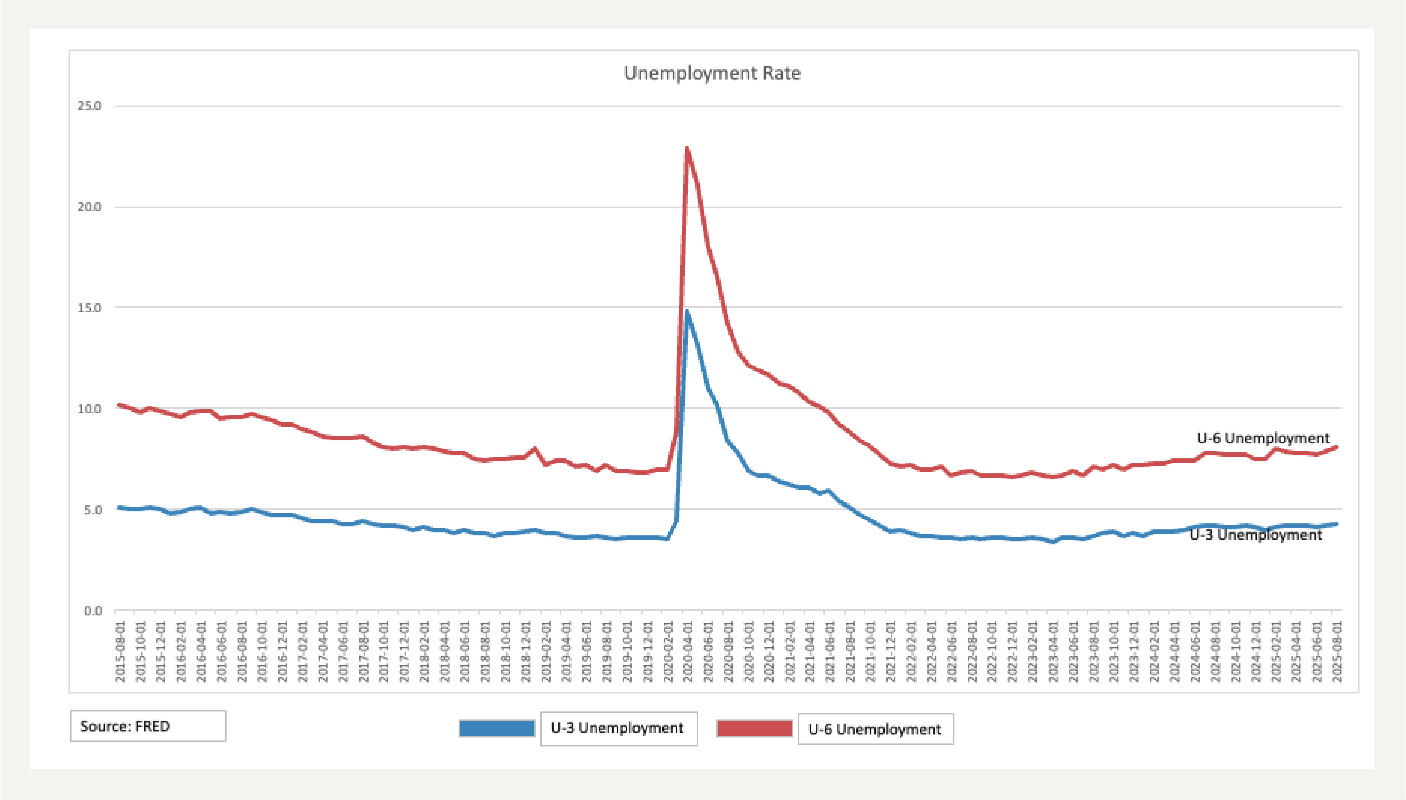
03 Manufacturers' new orders have stagnated since 2024, well off June 2022 highs; the ISM PMI recorded its 6th consecutive contraction reading, with firms citing tariffs as a drag

04 Weakening demand has implications for the employment mandate, and we must account for the risk of tariffs becoming persistent upward pressure on prices

Sources: BEA, FRB of Philadelphia (SPF), ISM

Unemployment Has Risen, In Line With Projections

Unemployment is up to 4.3%, in line with SEP forecasts, and is expected to move higher as the year progresses



KEY DATA

4.0% → 4.3%

U-3 unemployment, January to August 2025

4.3% → 4.5% → 4.5%

Median 2025 projection: Dec '24, June '25, Sept '25 SEP

TAKEAWAYS

01 Up to 4.3% in August from 4.2% in July and 4.1% in June, and up from the recent low of 3.4% in April 2023

02 Job openings have moderated to 2024 levels, down from 2023 levels

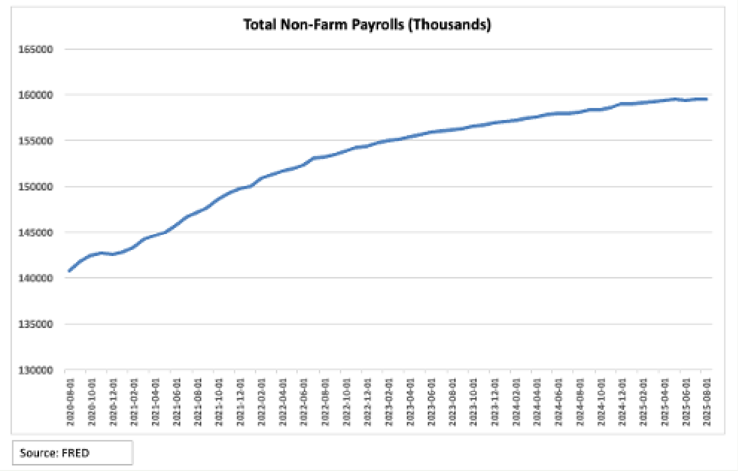
03 Employment in many industries showed little change but declined in manufacturing and the federal government

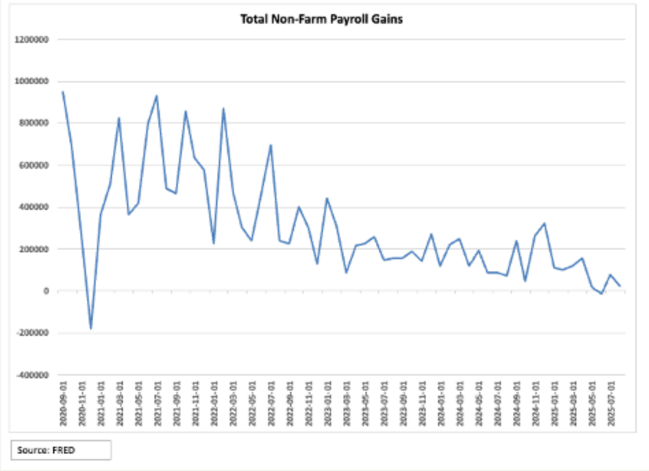
04 The average workweek was stagnant for all employees and down for manufacturing

Sources: FRED, Federal Reserve SEP

Slowing Job Growth Hints at a Weaker Labor Market

Payroll gains have slowed, and large downward revisions suggest the labor market and economy are weaker than anyone thought





KEY DATA

+22,000
August 2025 payroll gains

+79,000 / -13,000
July / June 2025

+139,800
Average, May 2024 – May 2025

TAKEAWAYS

01 The labor market was particularly hot during the recovery from the pandemic, but payroll gains have since slowed

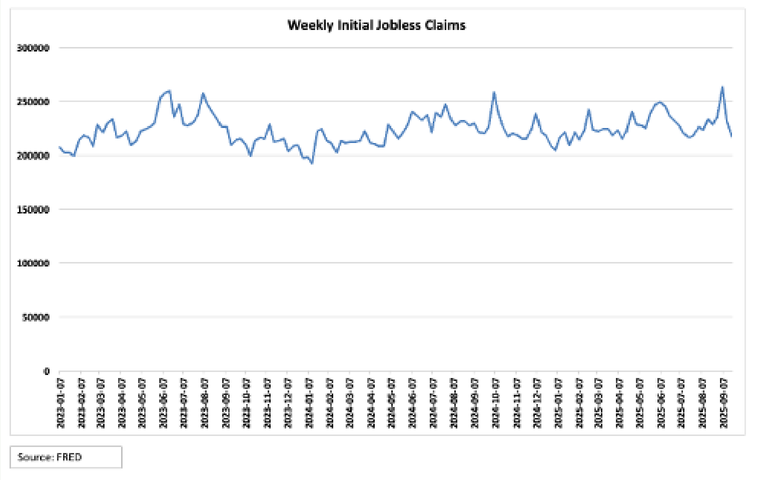
02 We must take these revisions into account to adequately address the labor market and maintain our data-dependent approach

03 Given policy lags, we must consider what labor market conditions might look like a few months from now under the current policy path

Sources: FRED, BLS

A Deeper Look at the Labor Market

Unemployment at 4.3% and drifting up would put the economy above CBO estimates of long-run unemployment (u)*



TAKEAWAYS

01 Initial jobless claims have declined recently, but unemployment sits at 4.3% and is expected to drift up in the short term

02 Should the labor market continue to cool, conditions could deteriorate rapidly, a dangerous combination if tariffs result in persistent upward price pressure

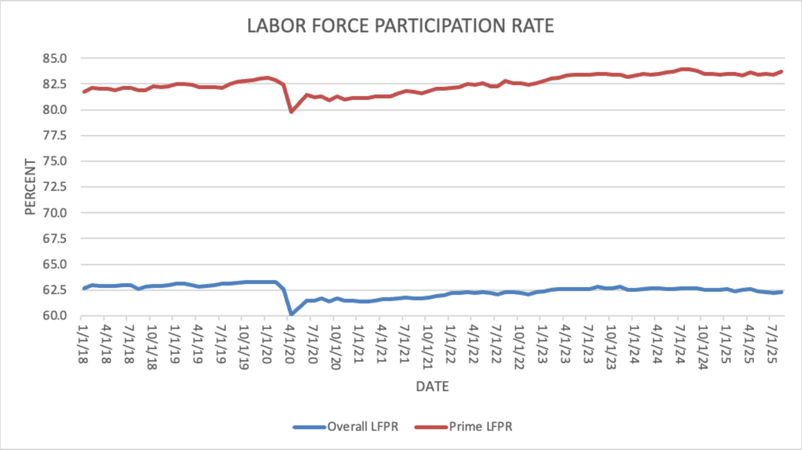
03 Lower immigration and below-replacement fertility suggest the recent uptick in unemployment is unlikely to be the result of labor force expansion

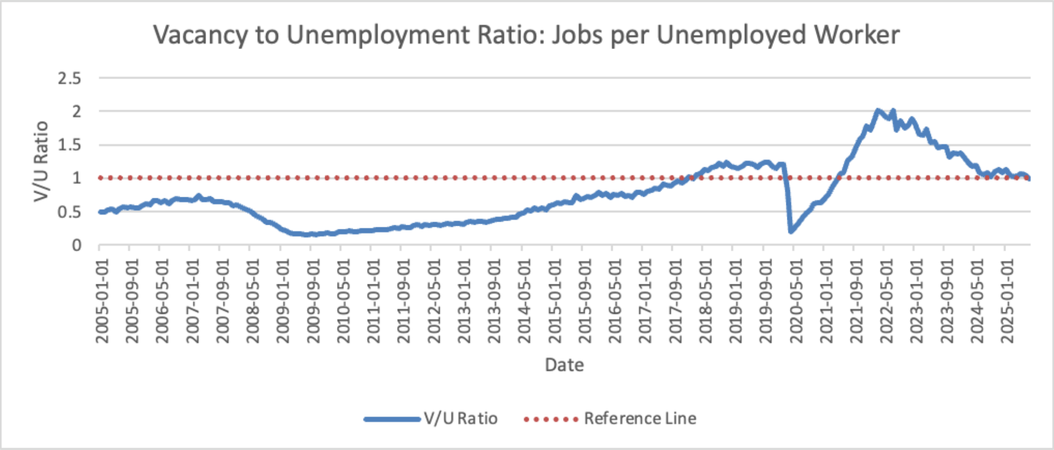
04 A tight labor supply risks domestic bottlenecks and skill mismatches, which could increase jobless claims and push up wages in affected sectors

Sources: FRED, CBO via FRED

Labor Force Trends Indicate Tightening Supply

Relatively constant participation alongside rising unemployment indicates a tightening of the labor supply





KEY DATA

83.5% / 83.4% / 83.7%
Prime-age participation, Jun / Jul / Aug 2025

62.3% / 62.2% / 62.3%
Overall participation, Jun / Jul / Aug 2025

~1.0 → >2.0
V/U ratio: pre-COVID vs. 2021–22; now cooling toward 1.0 but still elevated

TAKEAWAYS

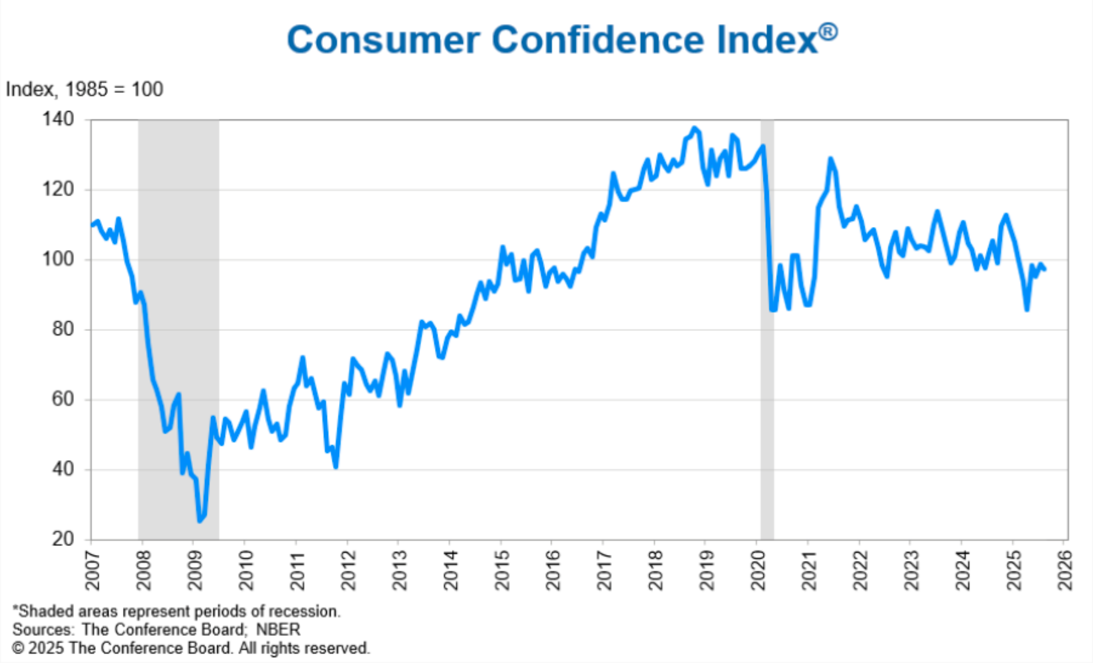
01 As Michelle Bowman noted, the impacts of immigration are difficult to project

02 Quit rates have remained constant for the year and are down slightly from 2024, indicating a potential lag behind the observed decline in expectations

Sources: FRED, BLS

Deteriorating Expectations

Declining job availability expectations alongside tightening labor supply and weak demand indicate cyclical weakness



KEY DATA

39.1%

NY Fed mean unemployment expectations (12-mo avg 38.1%)

14.5%

Perceived probability of job loss in 12 months (12-mo avg 14.0%)

51.7

UMich index of consumer expectations, down 30% YoY

TAKEAWAYS

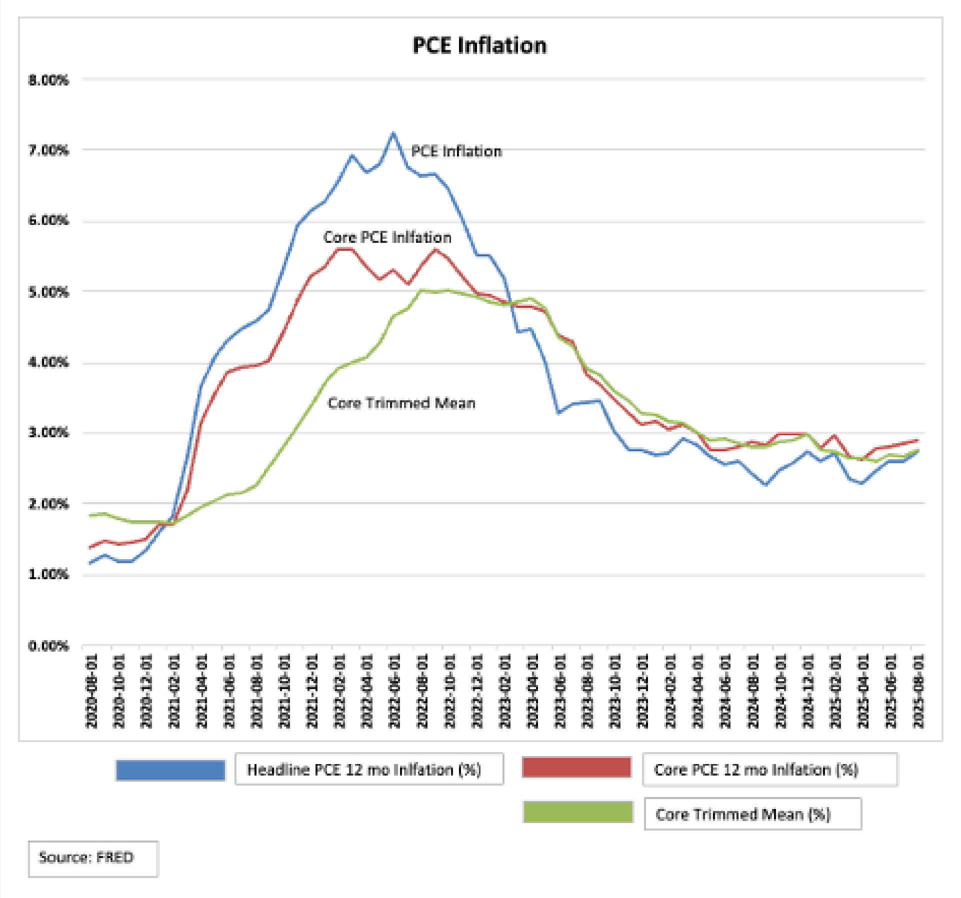
01 Conference Board: rising worries about jobs and income offset more optimistic views of business conditions

02 Consumers' appraisal of current job availability declined for the eighth consecutive month; pessimism about future jobs inched up and optimism about future income faded slightly

03 Confidence fell for consumers under 35, was stable for ages 35 to 55, and rose for those over 55; under-35s historically experience more volatile unemployment outcomes

Preferred Inflation Measure

PCE inflation is picking up in 2025 after a short-term low in 2024, trending up away from our 2% target



KEY DATA

2.5% → 2.7%

PCE inflation, January to August 2025 (BEA)

2.5% → 3.0% → 3.0%

Median 2025 projection: Dec '24, June '25, Sept '25 SEP

TAKEAWAYS

01 Headline PCE was 2.7% and core was up 2.9% from a year ago, driven by transportation and financial services, food services, recreational goods, and vehicles

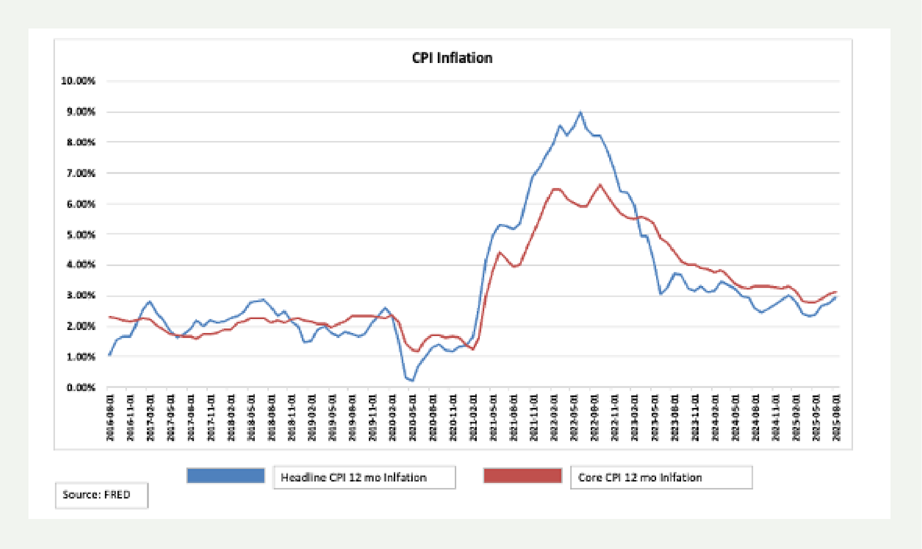
02 CPI inflation is also picking up, confirming inflation is trending up away from our 2% target

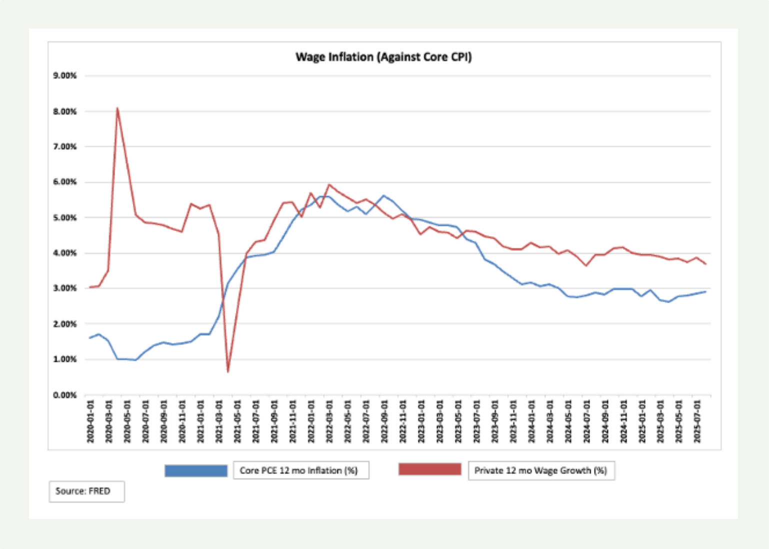
03 Cutting risks letting inflation run too hot, which would be costly to bring back down, but the risk of not cutting to the labor market must also be considered

Sources: BEA, FRED, Federal Reserve SEP

Goods & Services vs. Wage Inflation

Wage growth has maintained a dominant spread over inflation, but that trend seems to be reversing





TAKEAWAYS

01 Wage growth edged down in August and core CPI ticked up in September

02 Wage inflation from a tightening labor supply, coupled with tariff risks, could exacerbate upward pressure on prices and result in an inflationary loop

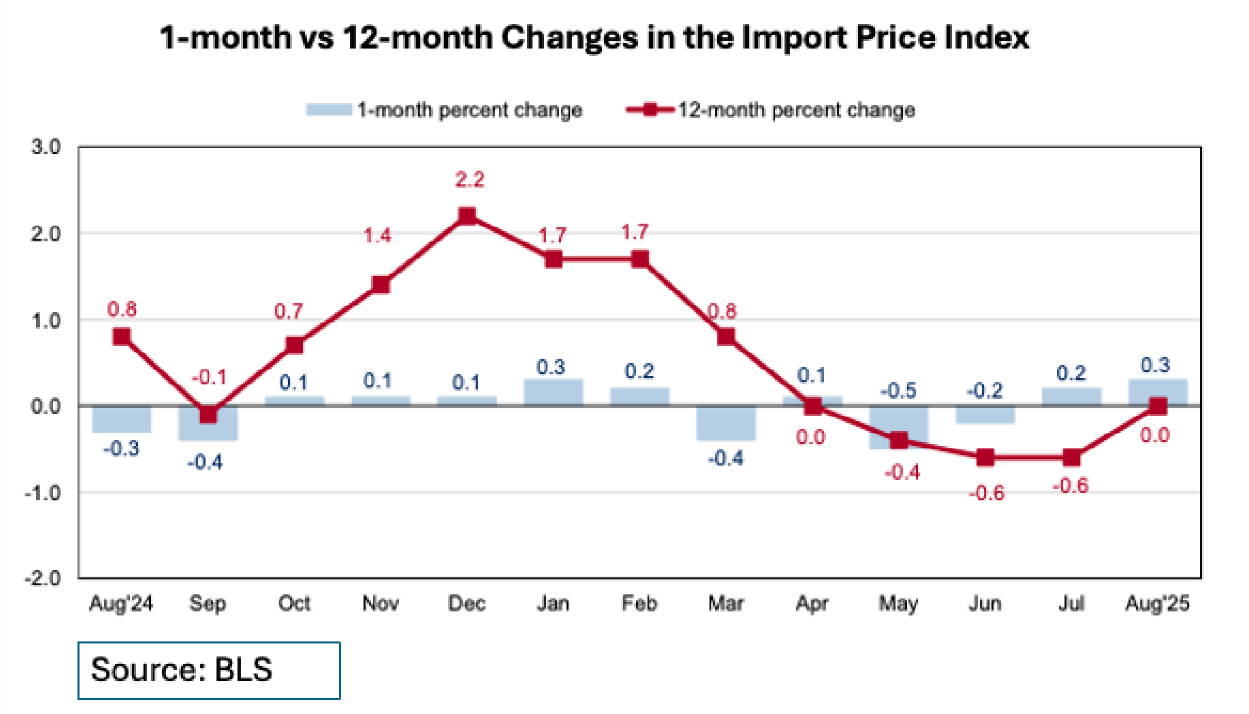
03 We must monitor the effects of labor market conditions on wages and of tariffs on prices to ensure a reversal to restrictive policy is not warranted

04 We aim for a balanced approach, but the risks of inflation running too hot cannot be overlooked

Sources: FRED, BLS

Verdict on Tariffs?

Upside risks remain, but our employment mandate is particularly susceptible to downside risks and policy should reflect this skewed balance



KEY DATA

+0.3%
Import prices in August (July: +0.2%)

Unchanged
Import prices, August 2024 to August 2025

+0.9% / ~0.1 pp
Nonfuel import prices YoY / est. addition to overall inflation

TAKEAWAYS

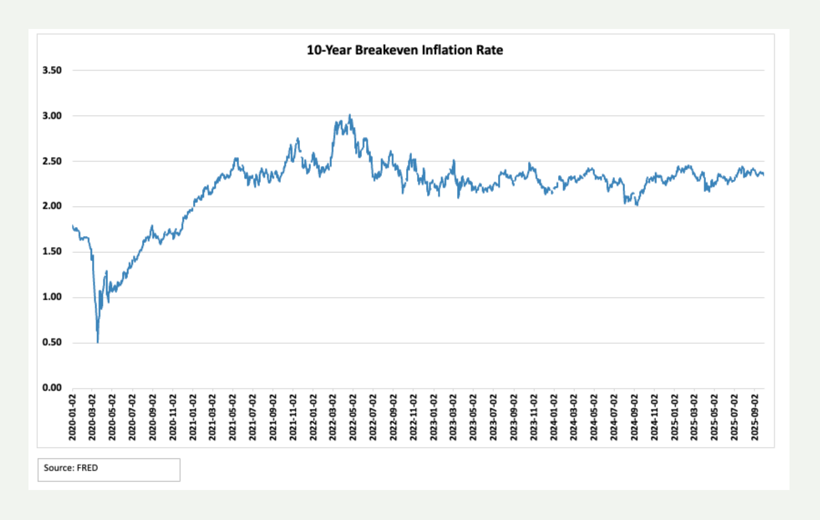
01 Higher August prices for consumer goods, nonfuel industrial supplies and materials, capital goods, and autos more than offset lower prices for foods, feeds, and beverages

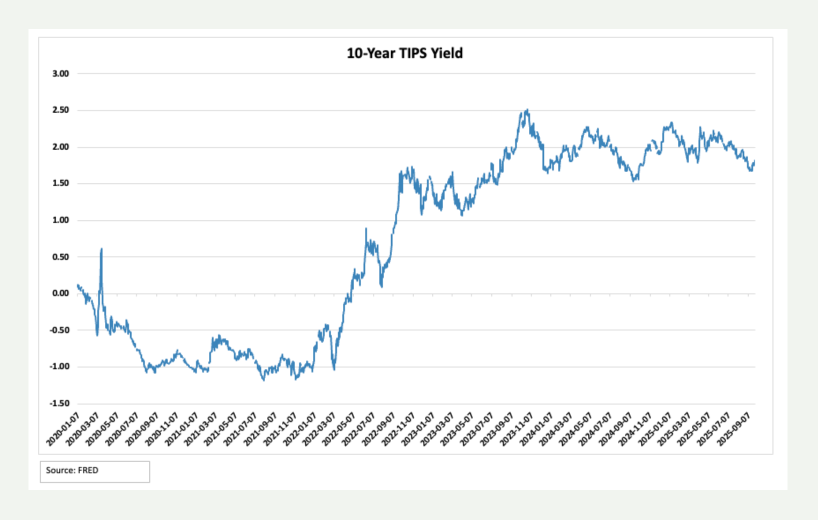
02 The decline in import price growth has reversed in the back half of 2025, but absolute rates of change remain relatively low

03 Deteriorating labor conditions, weakening demand, moderating growth, and pessimistic consumer expectations tilt the balance of risks toward employment

Anchored Inflation Expectations & Restrictive Real Yields

Markets currently view the policy path as restrictive and long-term inflation expectations as anchored





KEY DATA

2.35%

10-year breakeven inflation (as of 9/29/25)

1.82%

10-year TIPS yield (as of 9/26/25)

TAKEAWAYS

01 The 10-year TIPS yield is the market's real (inflation-adjusted) interest rate over the next decade; the breakeven (nominal yield less TIPS yield) is implied average expected inflation

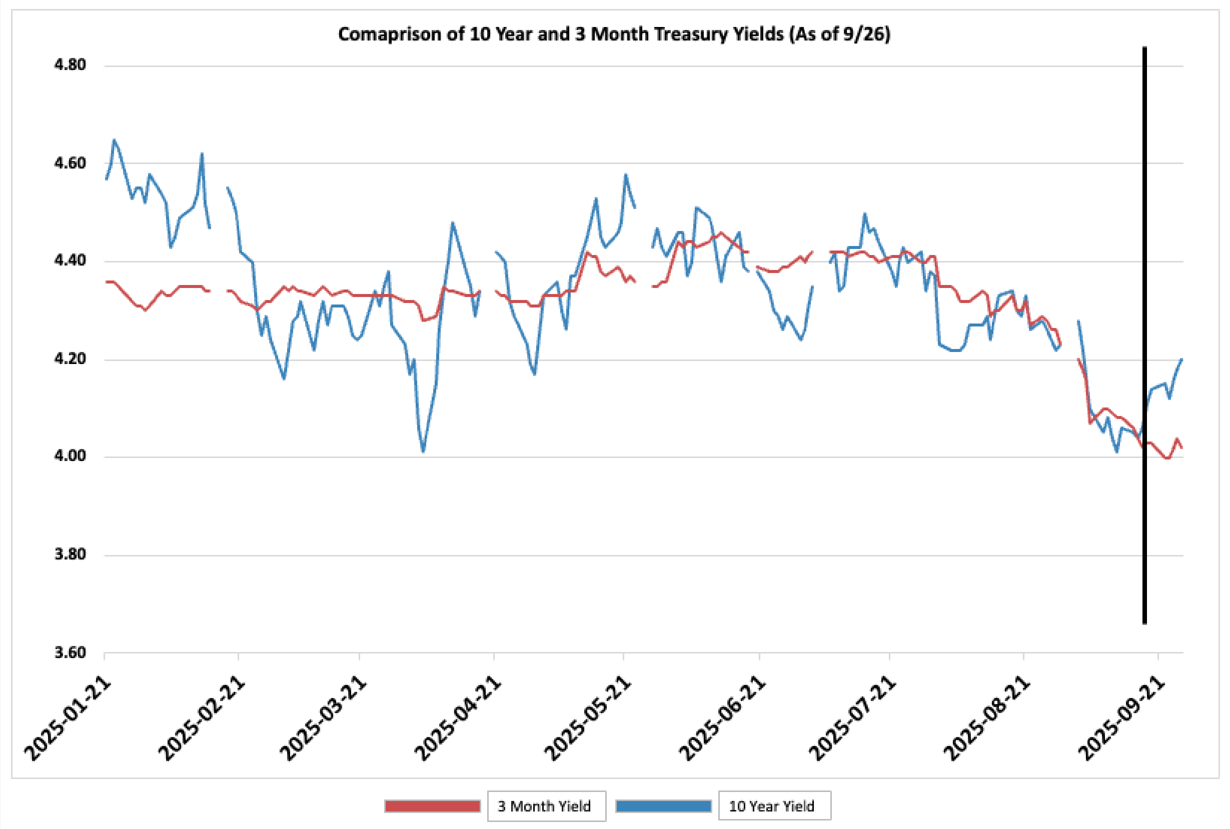
02 A breakeven of 2.35% suggests markets expect inflation to average slightly above the 2% target, so expectations remain anchored

03 A real yield of 1.82% is meaningfully positive, implying tight financial conditions and a stance restrictive relative to growth

Sources: FRED

Divergence in Yields

Since our last cut, 3-month and 10-year Treasury yields have diverged, complicating the balance between our mandates



TAKEAWAYS

01 The falling 3-month yield indicates markets are pricing in the immediate cut and possibly further near-term cuts

02 The rising 10-year yield indicates investors are less convinced inflation will remain contained, or worry the Fed might cut too soon

03 We do not believe the rise reflects increased Treasury issuance, given the administration's focus on raising short-term debt

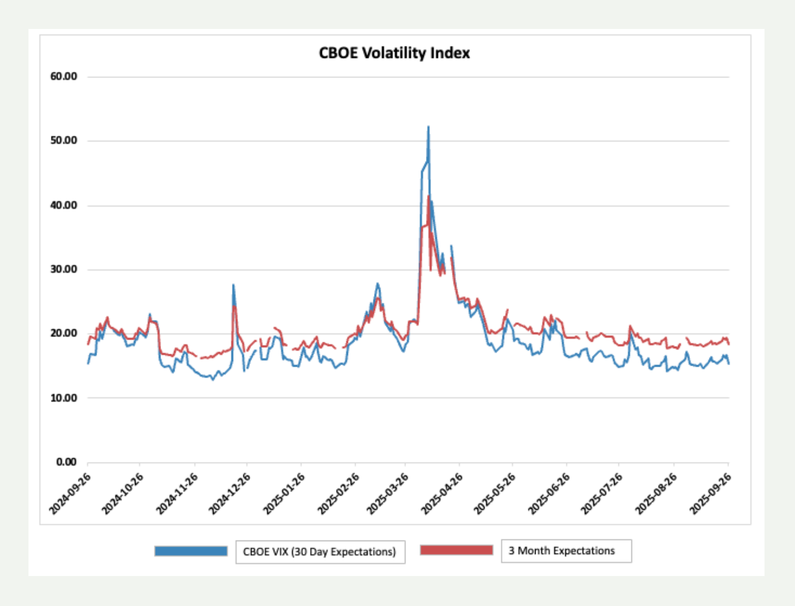
04 Cut too quickly and we risk unanchoring expectations and pushing long yields up; stay too tight and we risk worsening the labor market

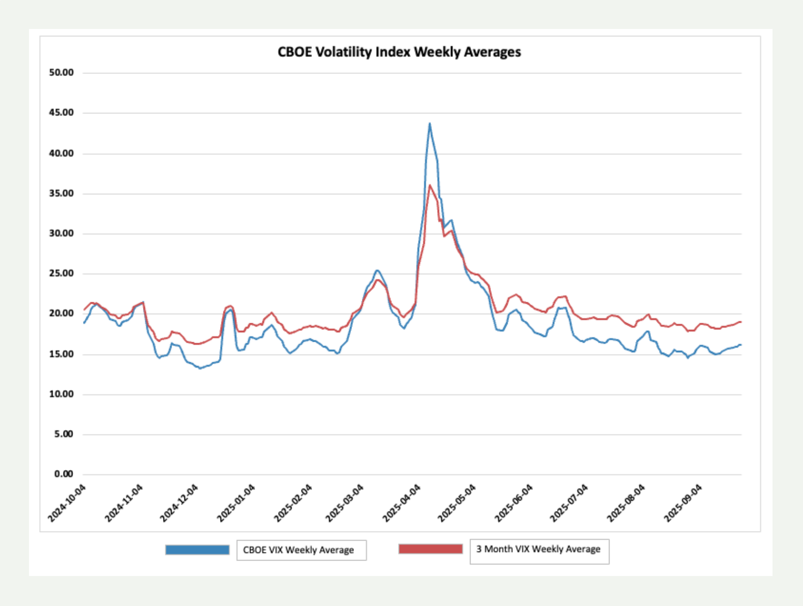
05 Watch whether increasing short-term issuance interferes with our ability to target short-term rates

Sources: FRED

Stock Market Volatility Possibly Reflects Broader Uncertainty

Volatility has retreated significantly since the tariff shock earlier in the year, but has been steadily upticking in recent weeks





TAKEAWAYS

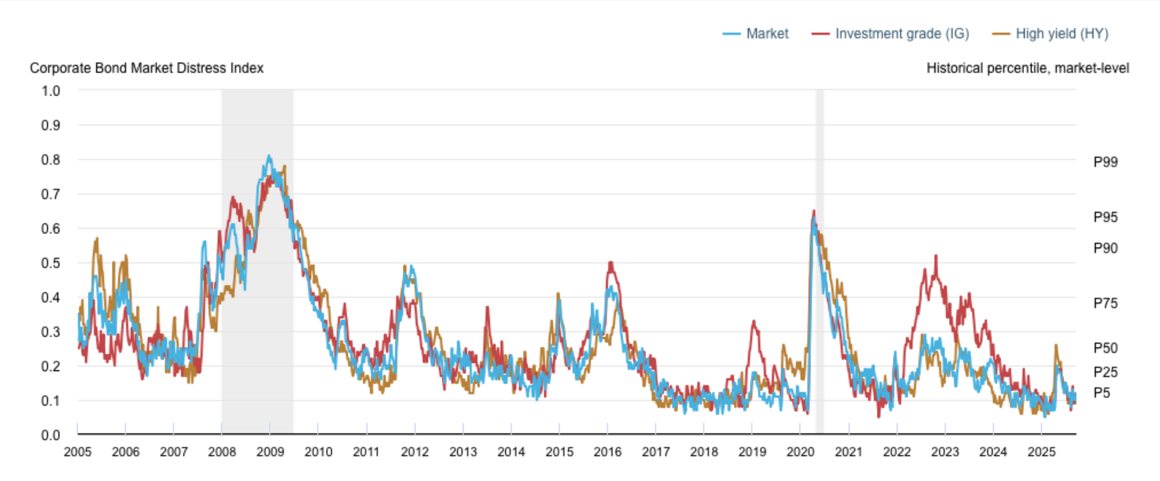
01 Current levels have moderated to around the 2024 lows, with what appears to be more consistency

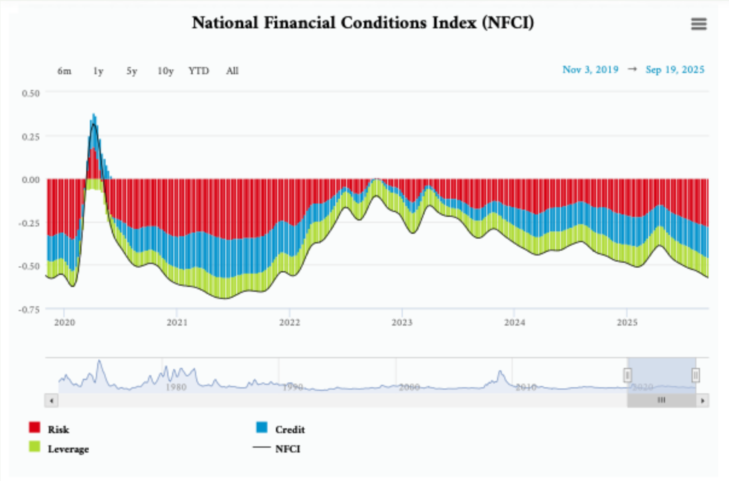
02 The recent uptick possibly reflects uncertainty in the markets regarding tariffs and a challenging balancing act for monetary policymakers

Sources: CBOE, FRED

Financial Conditions Are Loose, Not Stressed

Measures from the FRBs of New York and Chicago indicate corporate bond markets and the financial system are functioning smoothly





TAKEAWAYS

01 A low reading of the Corporate Bond Market Distress Index (FRB of New York) indicates tight credit spreads, sufficient liquidity, and little extra compensation demanded for risk

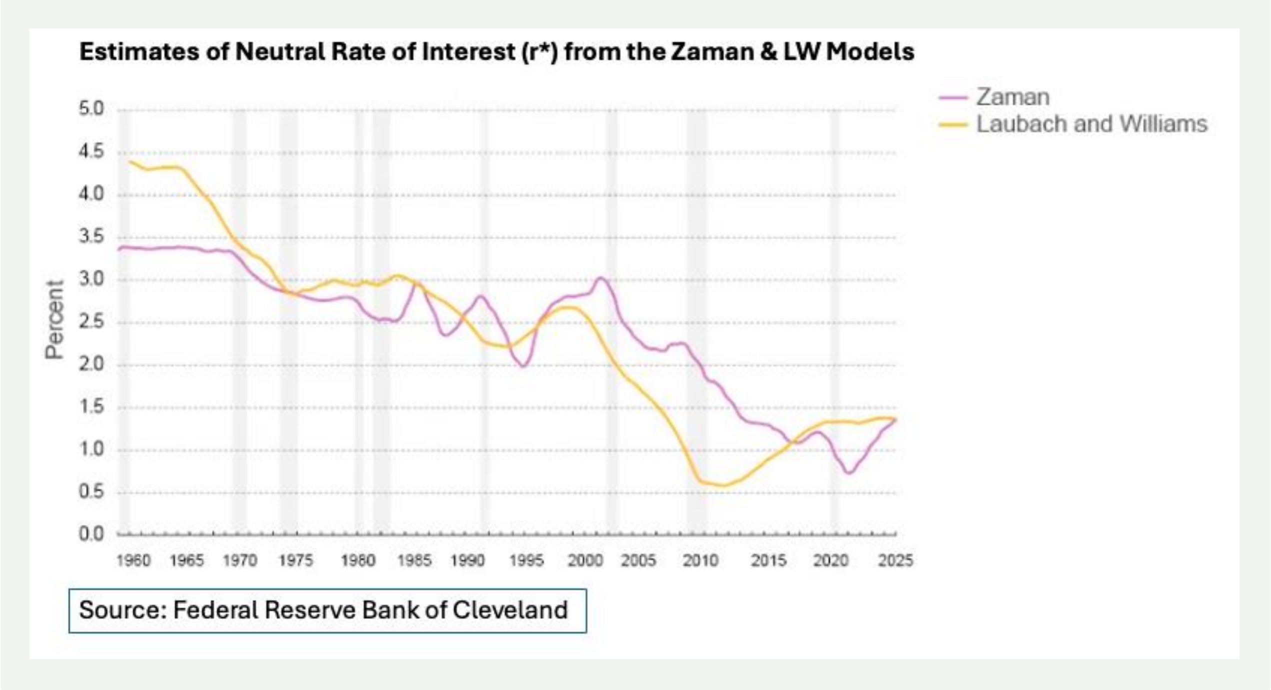
02 Negative values of the NFCI (FRB of Chicago) mean financial conditions are looser than average, with easy credit, low volatility, and supportive liquidity

03 While generally positive, we must keep monitoring to ensure demand for credit and risk-taking do not become stronger than desired

Sources: FRB of New York, FRB of Chicago

Estimates of r* Indicate Slightly Restrictive to Neutral Policy

With the target federal funds rate at 4.00–4.25%, policy is within restrictive territory and a path towards neutral is warranted



KEY DATA

1.5% / 1.3%
Zaman / Laubach-Williams r*, 2025 Q2

3.7%
Zaman nominal estimate, 2025 Q2 (68% interval 2.9–4.5%)

4.00–4.25%
Current federal funds target range

TAKEAWAYS

01 Any inflationary effects from tariffs have yet to present themselves and may reflect one-time price increases, so deteriorating labor conditions warrant greater weight on employment in the short term

02 A meaningfully positive TIPS yield and r* estimates leave room to move toward neutral

03 With a declining long-run u* and well-anchored expectations, a rate cutting cycle can support the labor market without great risk of accelerating inflation

Monetary Policy Recommendation

We emphasize the rise in downside risk to employment and recommend a 25 bps cut at the October 2025 FOMC meeting

Federal Funds Rate	Cut rates by **25 bps** at the October 2025 FOMC meeting to bring the FFR target range down to **3.75–4.00%**. We will closely monitor inflation and labor market data until the December meeting to gauge the appropriate policy at that time.
Balance Sheet	Maintain pace of reduction in the size of the balance sheet to ensure sufficient liquidity in the system, with the **monthly redemption cap on Treasuries at $5 billion** and on **MBS at $35 billion**
Forward Guidance	Continue to provide evidence-based communication in line with a data-dependent approach to managing uncertainty regarding upside risks to inflation and downside risks to the labor market, in an attempt to balance both sides of the dual mandate

DATA-DEPENDENT MONITORING

01 Given the unique balance of risks, the Committee should stand ready to adjust its stance should the labor market and inflation risk dynamic change

02 Diligently monitor the labor market, inflation readings, and expectations to track changing labor force dynamics and import tariffs, balancing maximum employment and stable inflation at our 2% target

Sources: Federal Reserve