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Economic & Financial Markets Monthly Review | August 2025

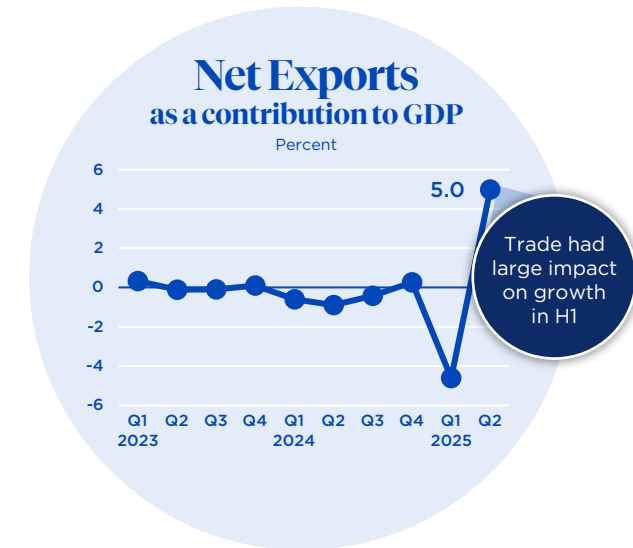
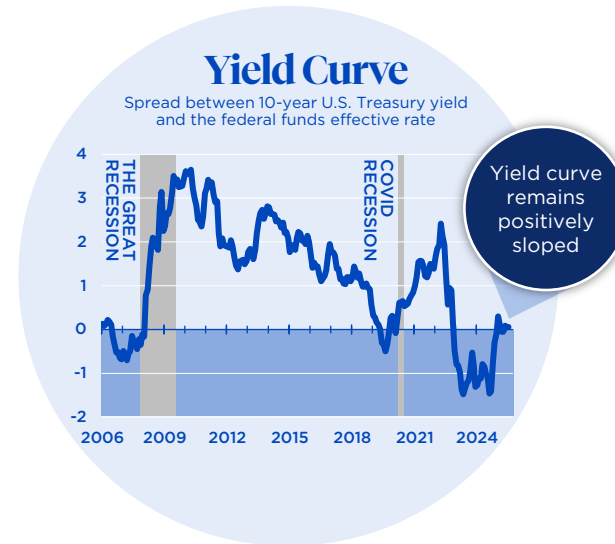
Fed poised to lower rates as growth slows



Economic Overview

Where is the economy now?

The economy showed clear signs of slowing at the outset of the second half of 2025. Consumer demand remained subdued as households adjust to higher prices in some areas and a labor market that is softer than prior reports suggested. We continue to expect sub-1.0 percent growth in H2 and Fed rate cuts starting in September to support a sluggish economy.



Where we are this month

What does this mean

Economic data have broadly weakened

Cracks are beginning to show in the economy as consumers and businesses and have pulled back on spending and hiring, respectively, but the data are not expected to become recessionary.

- Growth should remain challenged in coming months with higher prices and uncertainty weighing on activity. But recession odds are lower with peak uncertainty passed and activity should pick up toward the end of the year.
- The market expects rate cuts by year end, and lower tax burdens and greater business incentives in 2026 along with less uncertainty should help propel business spending and hiring next year.

Steady, positive yield curve

Interest rates across the Treasury yield curve moved in relative lockstep through July. Following the weak July employment report in early August, short-term rates fell more than 10-year yields as rate cut expectations rose.

- The 10-year Treasury yield moved only mildly between June and July with inflation data showing less tariff impact than anticipated. Long-term yields dipped lower on the weak jobs report.
- We expect the Fed to restart rate cuts in September as officials look through faster inflation and respond to weaker labor market and spending data. This has led two-year note yields to fall markedly lower.

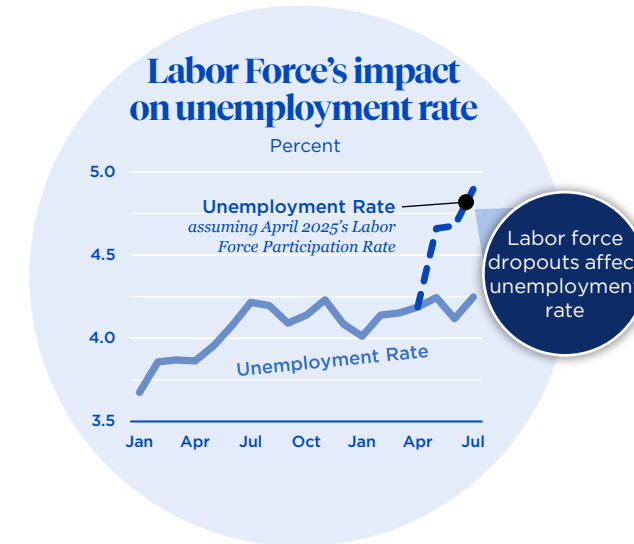
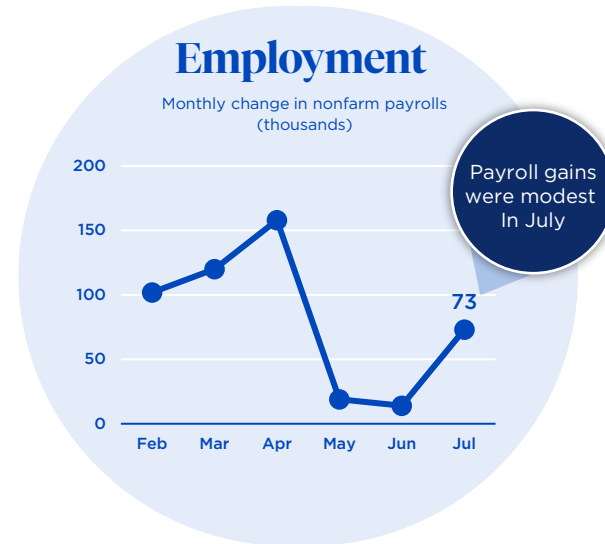
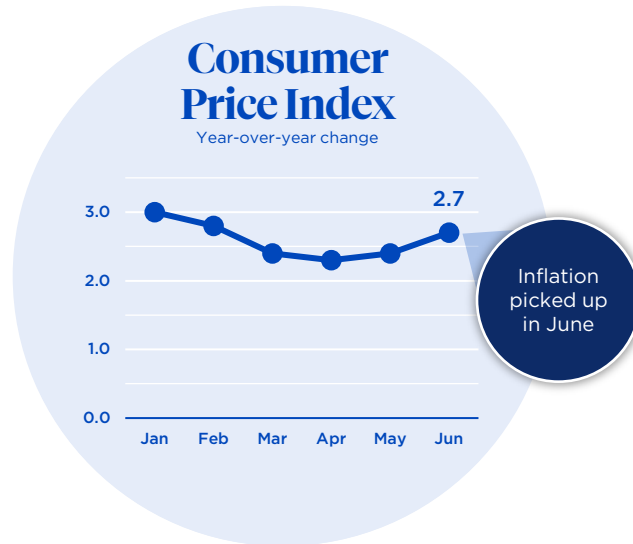
Trade has greatly distorted GDP

Net exports contributed a record 5.0 percentage points to real GDP growth in the second quarter — a reversal of the 4.6 percentage points it detracted from growth in the first quarter.

- Tariff disruptions resulted in trade having a massive impact on growth. The impact to growth from net exports in the Q1 and Q2 were the largest ever on the negative and positive sides, respectively.
- The higher tariffs will affect trade flows, but not nearly to the extent seen in H1. We expect future GDP prints to more closely reflect the health of the economy rather than the short-term impacts of trade policy.

Economic data starts second half on soft footing

Job growth was modest in July and outside of health care and social services employment has flatlined. However, the bigger story in the July jobs reports was the massive downward revisions to prior job gains which paint the picture of a labor market that is far weaker than previously believed. Despite expectations for more significant tariff-related price increases in the coming month, we expect the weaker data to convince the Fed to resume cutting rates in September.



Where we are this month

What does this mean

Tariff impacts on prices are still mild

Headline CPI inflation climbed modestly to 2.7 percent, while the core rate rose to 2.9 percent. Tariff-induced price increases have begun only gradually.

- Price gains were softer than expected in June due to declines in new and used motor vehicle prices, airfares, and a particularly large decline in hotel costs.
- Even after broader tariff passthroughs begin, we expect the Fed to look through the temporary rise in inflation by cutting rates to support a slowing economy. We project rate cuts to resume in September and total 75 bps before year end.

Hiring has stalled in most industries

Nonfarm payrolls increased only by 73,000 in July, but massive downward revisions to prior months point to a labor market that is weaker than previously estimated.

- The headline July payroll advance was modest and was accounted for entirely in health care and social services. More importantly, downward revisions to prior months totaled more than 250,000 and indicate that hiring in cyclical sectors is already contractionary.
- With input costs rising and consumer demand cooling, we expect more soft labor market data in the coming months.

Labor supply declines

The official unemployment rate ticked up to 4.2 percent in the July household survey, but it has been held lower by a steep fall in the labor force participation rate.

- Absent the decline in the labor force participation rate since April, the unemployment rate would have increased sharply to 4.9 percent.
- A lower level of labor force participation may hold down the unemployment rate through the trough of the cycle. However fewer works will negatively impact the economic activity as aggregate household income growth slows.

Investors stay optimistic as Fed rate cuts approach

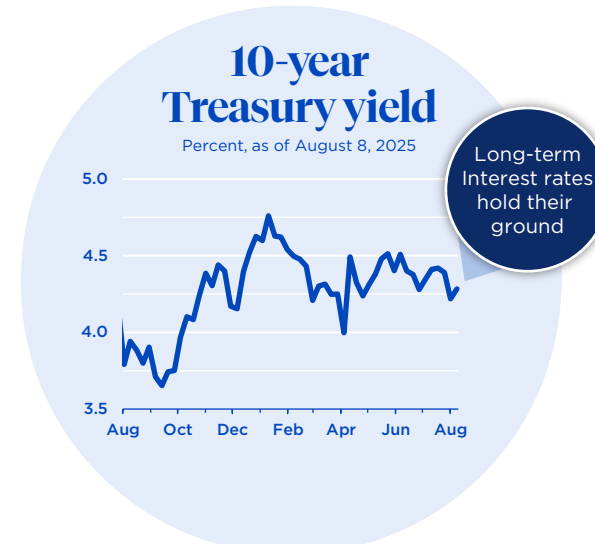
Risky assets are advancing on a positive track as reduced tariff uncertainty and buoyant Q2 earnings keep investors optimistic despite sectoral tariff threats and other policy-related risks. We expect positive fundamentals and looser Fed policy to support equity values and keep interest rates elevated through the remainder of 2025 and into 2026. The Fed is likely to lower interest rates again in September, and we forecast 75 basis points of easing by year end.



Stocks add to gains

Greater clarity on tariff policy, encouraging second-quarter earnings reports, and a still-positive economic backdrop, albeit softening, are lifting equity prices higher.

- The S&P 500 index is only a shade below its new all-time high hit in July and is up more than 26 percent from its April 8th low. Limited negative impacts from tariffs are instilling investors with confidence that trade policy won't dramatically damage the economy.
- Continued relative outperformance of cyclical vs. defensive stocks — a barometer of market attitudes — indicates upbeat investor sentiment.



Steady long-term yields

Long-term Treasury yields have been range-bound over the summer as upward pressure from rising deficits and resilient activity are offset by ebbing inflation fears and other downside pressures.

- Excluding the most recent fall related to a soft July jobs report, the 10-year Treasury yield is largely steady compared to where it stood a month ago. We expect long-term interest rates to stay well above their post-Global Financial Crisis averages into 2026.
- Treasury issuance driven by the “One Big Beautiful Bill” will place upward pressure on the term premium and keep the key 10-year Treasury yield elevated.



Positive earnings bolster equity gains

Second-quarter earnings results have been positive, quelling fears of a decline. Earnings were up a buoyant eight percent year-over-year last quarter, using the latest earnings data.

- U.S. equity returns were running ahead of earnings growth in the runup to the April 2025 downturn, a marker of overly enthusiastic attitudes. But the disparity has normalized and returns and earnings are now rising at a similar pace.
- The narrowed gap suggests market sentiment and fundamentals are roughly in balance and that equities have further room to run.

Where we are this month

What does this mean

Outlook

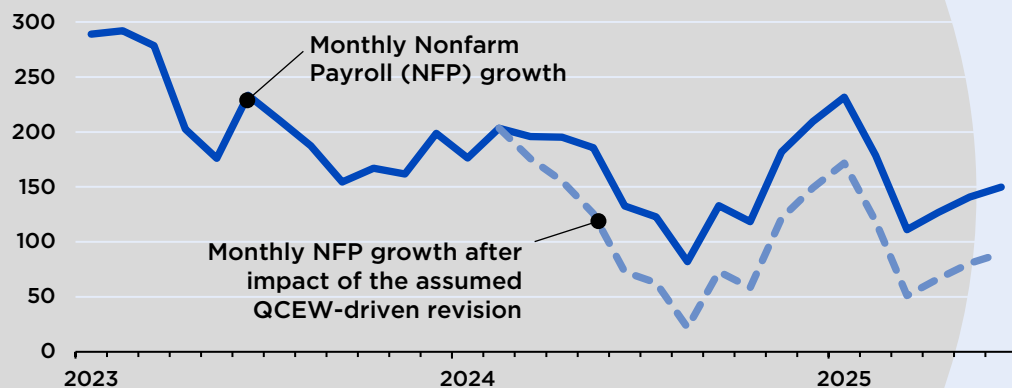
Is the labor market even softer than reported?

While monthly nonfarm payroll growth has averaged around 150,000 in recent months, concern is growing that the labor market is weakening. Job gains have been increasingly concentrated within non-cyclical industries such as education, health care, and local governments. Hiring across the remaining private sector areas has flatlined as many firms within manufacturing, retail, construction and other industries control costs in the face of elevated economic uncertainty.

Additionally, it is likely that nonfarm payrolls will be revised lower when annual benchmark revisions are preliminarily estimated on September 9th. Employment levels within the broader **Quarterly Census of Employment and Wages (QCEW)** indicate that job growth over the past 18 months could be lower by about 40,000 to 60,000 per month than the reported figures. If true, this pace of hiring would be in line with labor force growth, placing the labor market at stall speed in aggregate. This is a much weaker assessment than currently thought and supports our view of the Fed lowering rates again in September.

Potential revisions to nonfarm payrolls

Thousands, three-month moving average



Latest Forecast

Data as of August 2025

	2024 ACTUAL	2025 ESTIMATE	2026 FORECAST	2027 FORECAST	2028 FORECAST
REAL GDP	2.8%	1.6%	1.8%	2.4%	2.3%
UNEMPLOYMENT RATE	4.0%	4.3%	4.4%	4.2%	4.2%
INFLATION¹ (CPI)	2.7%	3.0%	2.5%	2.0%	2.0%
TOTAL HOME SALES	4.75	4.65	5.00	5.82	5.95
S&P/CASE-SHILLER HOME PRICE INDEX	3.7%	2.9%	3.1%	3.0%	3.0%
LIGHT VEHICLE SALES	15.8	16.2	16.5	16.5	16.5
FEDERAL FUNDS RATE²	4.25%	3.50%	3.50%	3.00%	3.00%
5-YEAR TREASURY NOTE²	4.38%	3.70%	3.65%	3.55%	3.55%
10-YEAR TREASURY NOTE²	4.58%	4.15%	4.10%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE²	6.91%	6.60%	5.60%	5.00%	5.00%
MONEY MARKET FUNDS	4.96%	4.03%	3.53%	3.15%	3.03%

Soft second half of 2025 projected

Real GDP growth is expected to struggle over the rest of 2025 as rising prices and uncertainty weigh on consumer spending. The outlook for growth in 2026 is brighter with fiscal stimulus and greater clarity on policy projected to boost activity.

Fed easing expected to resume soon

With the labor market softening and growth slowing, we expect the FOMC to cut rates by a total of 75 basis point by year end. This would bring the federal funds rate much closer to our estimate of the neutral rate around 3.0 percent heading into 2026.

¹ Percent change Q4-to-Q4

² Year end

^a Actual

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Sources

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Yield Curve
Real GDP growth and forecast

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Bloomberg; National Bureau of Economic Research
Bureau of Economic Analysis; Nationwide Economics

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