

Fed Note 17 September 2025

At the September meeting, the U.S. Federal Reserve Open Market Committee voted to reduce the Fed funds rate by -0.25% to a range of 4.00-4.25%. This was not without some outside drama, though, as the committee vote was the first for new member Stephen Miran, who was confirmed just prior to the meeting. Also, an appeals court ruled that Lisa Cook would still be able to vote, despite the administration's efforts to fire her from the FOMC due to alleged mortgage application improprieties. This was the first policy change this year, and there was one dissent, from new voter Miran, who desired a half-percent cut instead.

The formal statement removed the reference to data being affected by net exports (which were strong influences in both directions for Q1 and Q2 GDP), as well as noting that "job gains have slowed," and the unemployment rate ticked up, "but remains low." Inflation was described as "somewhat elevated," but also "has moved up." Most importantly from a decision standpoint, "downside risks to employment have risen," as the committee "is attentive to the risks to both sides of its dual mandate."

The quarterly Summary of Economic Projections (SEP, or 'dot plot,' displaying a voting graphic of all FOMC members), indicated an estimated median year-end 2025 Fed funds rate of 3.6% (down from 3.9% in June), 3.4% for 2026 (down from 3.6%), 3.1% for 2027 (down from 3.4%), a new estimate of 3.1% for 2028, and an unchanged long-term rate estimate of 3.0%. However, the range in dots is wide for the next few years, ranging from 2.5% to 4.0%, showing a dispersion in views within the committee.

CME Fed funds futures markets had expected this outcome for several months, with the probability steadily rising from 80% towards 100%, depending on the state of economic data. While a 0.50% 'jumbo' cut possibility had been thrown around in the media, the chances were only priced at around 5%. Odds for 2025 in total have risen from two cuts to three, taking the year-end rate to 3.50-3.75%. For 2026, three additional cuts are now expected (also up from two), which would put the year-end rate at 2.75-3.00%. That ending rate is nearly spot on with the long-run terminal rate noted in the SEP, which assumes a nominal rate consisting of inflation plus an assumed 'real' rate, which is difficult to pinpoint in real time. The pace of cuts expected by futures markets appears to be a bit faster and more dovish than what a variety of Wall Street economists have called for, but this all depends on the trajectory of economic and labor data over the next several quarters.

Economy. While Q2 U.S. real GDP growth came in at an upgraded 3.3%, conditions are generally assumed to be slowing. In the Fed's SEP, estimated median 2025 GDP growth was upgraded to 1.6% (from 1.4% in June), 1.8% for 2026 (from 1.6%), 1.9% for 2027 (up from 1.8%), and a new estimate of 1.8% for 2028, which matches the longer-run estimate. The Atlanta Fed GDPNow growth estimate for Q3 has remained high, now at 3.3%, with the Blue Chip economist consensus growth rate improving a bit but still falling in the 1.0-1.5% range. Trade conditions continue to be the wildcard this year, with higher quoted tariff rates than last year for sure, even though a variety of production goods are still protected by prior treaties, making the calculations of final impacts convoluted. It appears that importing companies have been absorbing at least some of the added costs, at least for now, but how long that continues before they need to be passed on to consumers to preserve still-high profit margins remains a question. While some natural slowing seems to be occurring in some industries, sentiment is still high that artificial intelligence-driven productivity gains (and growth from related construction and capex in the meantime) will lead to stronger U.S. trend growth in coming years.

Inflation. For August, headline CPI ticked up to 2.9% over the trailing 12 months, while core CPI ex-food and energy was steady at 3.1%. Core PCE for July has continued to run above-target at 2.9%. The Fed September SEP for core PCE assumed 3.1% for year-end 2025 (matching June's estimate), 2.6% for 2026 (up from 2.4%) and 2.1% for 2027 (unchanged), with 2.0% assumed for 2028 and the longer run, in line with the Fed's policy objectives. Officials remain hopeful that this year's tariffs will represent a 'one-time price bump,' but not end up perpetuating higher long-term inflation, which had been inching back down toward target. That path has taken a detour, but any price bump and subsequent moderation could end up creating further deceleration in the rate of change back down more significantly next year. However, the majority of the voting public doesn't make the distinction between inflation as a mathematical rate of change and simply higher price levels (which began five years ago during the pandemic), a distinction that Chair Powell has alluded to many times in his comments about inflation-fighting efforts.

Employment. Labor conditions at the margin have slowed, which appears to be the catalyst as to why the Fed has started easing. The unemployment rate has risen slowly, now at 4.3% for August, which at face value continues to be quite low from a historical perspective. The SEP showed an expected unemployment rate of 4.5% for year-end 2025 (unchanged from June, but further deterioration from today), 4.4% for 2026 (down from 4.5% in June's estimate), 4.3% for 2027 (down from 4.4%), and 4.2% for 2028 and over the long-term. Much has also been made of the Bureau of Labor Statistics downward revisions for payrolls in recent months and the removal of nearly a million jobs from the ledger for the prior year

ended in March, although further edits to the data are likely coming. Some of this has been due to increasing difficulties in data gathering (from lower response rates and delays in submissions), seasonal adjustments that are still askew post-pandemic, and rapid changes in immigration and the foreign-born worker population, which has altered the sample results and demand/supply dynamics. So, looking at a variety of labor measures is worthwhile, and shows a gradual erosion in activity. The slowing is either not as dramatic as it appears, or it may have begun far earlier than many economists assumed, which echoes weaker job-finding responses in consumer confidence surveys.

Today's rate cut was largely expected, so it didn't take financial markets by surprise. Based on historical precedents, and by no means a prediction for every case, both stock and bond markets have tended to fare well during periods after the Fed eases. (For stocks, the caveat is that a recession doesn't show up shortly thereafter.) In fixed income, this is based on the shape of the yield curve, which remains bowl-shaped with short rates likely to come down with the Fed funds rate, with longer rates affected by uncertainty around growth, inflation, and government fiscal deficits, which require more debt issuance and some apparent additional term premium. Stocks benefit from easier conditions and cheaper financing, as well as the math behind future discounted cash flows. Unsurprisingly, real estate has also fared well as rates are cut for many of the same reasons. From a seasonal standpoint, looking back over 100 years of U.S. stock market data, September has been the only month with net negative returns. However, November and December have been two of the best traditionally, as markets absorb the 'old' news of a year just ending and often take an optimistic stance on the year to come. Markets in general tend to be optimistic, unless a recession is forthcoming, of course, where optimism can be delayed for a bit. So far, despite some signs of slowing, overall conditions continue to look benign for the time being, with hope that the positive seasonal trends keep us moving along.

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Sources: CME Group, Federal Reserve Bank, U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, FocusPoint Solutions calculations.

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