Understanding Uncertainty: FOMC Briefing

Fed Challenge October 2025

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Agenda

I. **Overview of the Current Economy**

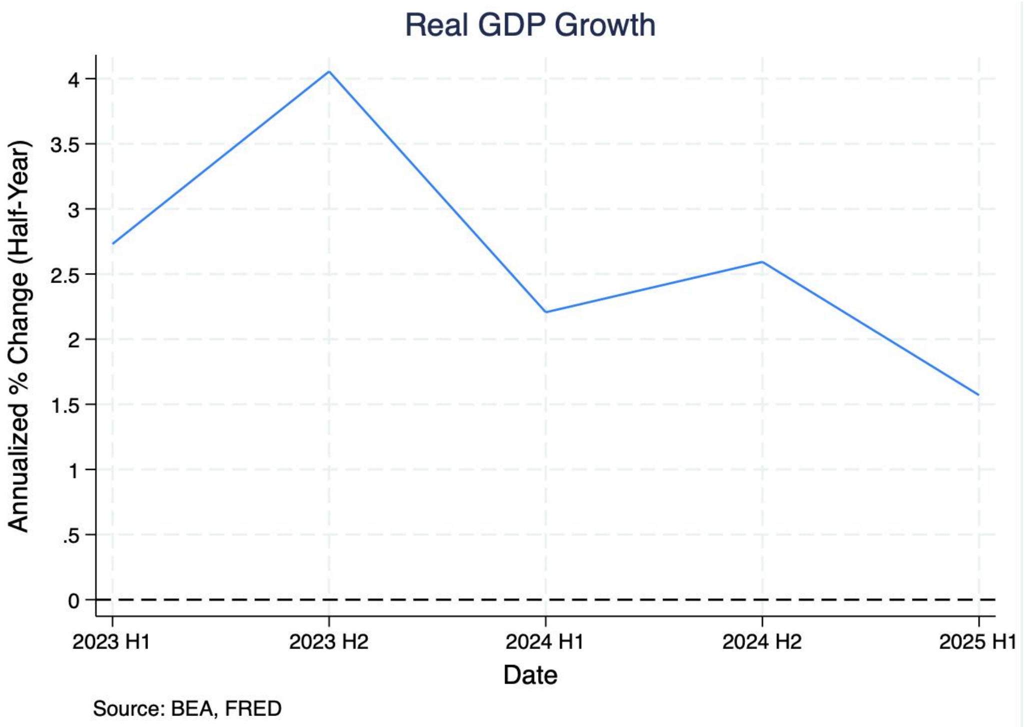
II. Economic Risks

III. Policy Recommendations

Economic Activity

Headline Real GDP shows growth in 2025 H1…

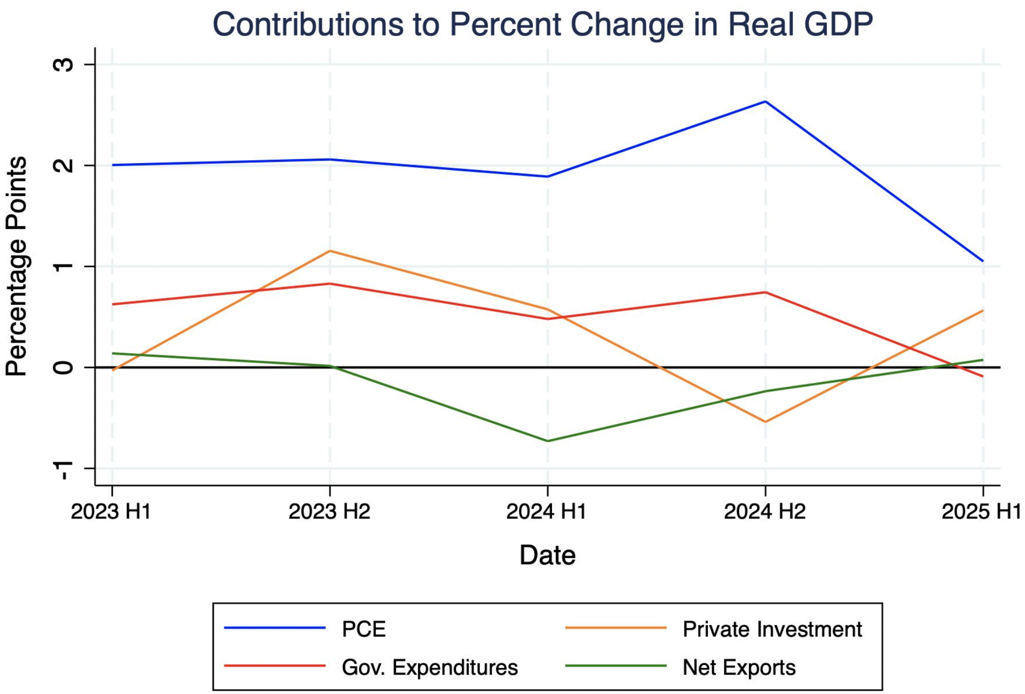
- Real GDP grew at an annualized rate of 1.6% in 2025 H1
- But is output growth being driven sustainably?



…components of GDP indicate softening consumption

In 2025 H1:

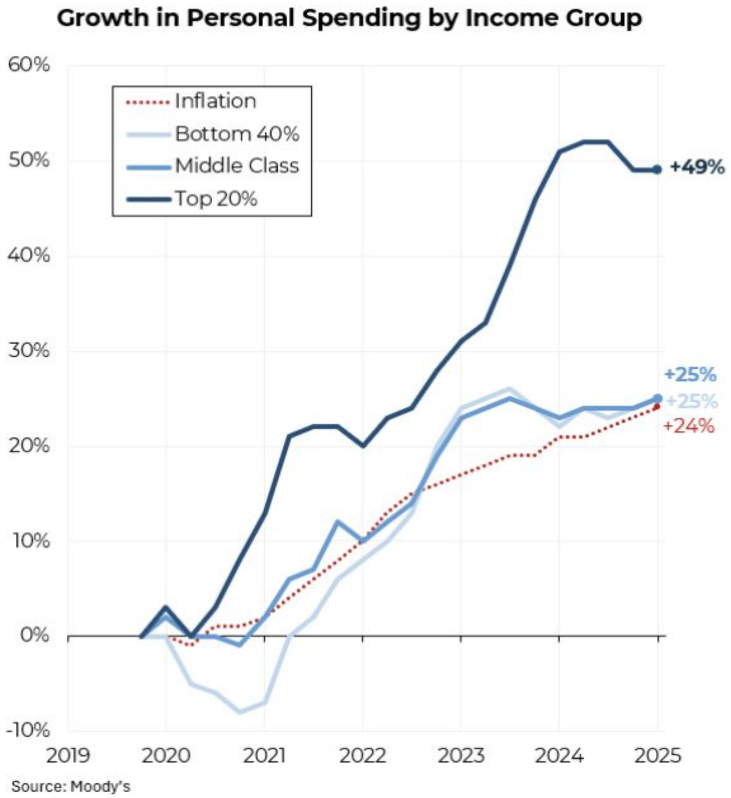
- Net exports: **.08** ppts.
- Consumer spending: **1.05** ppts
- Private investment: **0.57** ppts
- Government spending: **-0.09** ppts



Source: BEA, FRED, Federal Reserve Bank of St. Louis

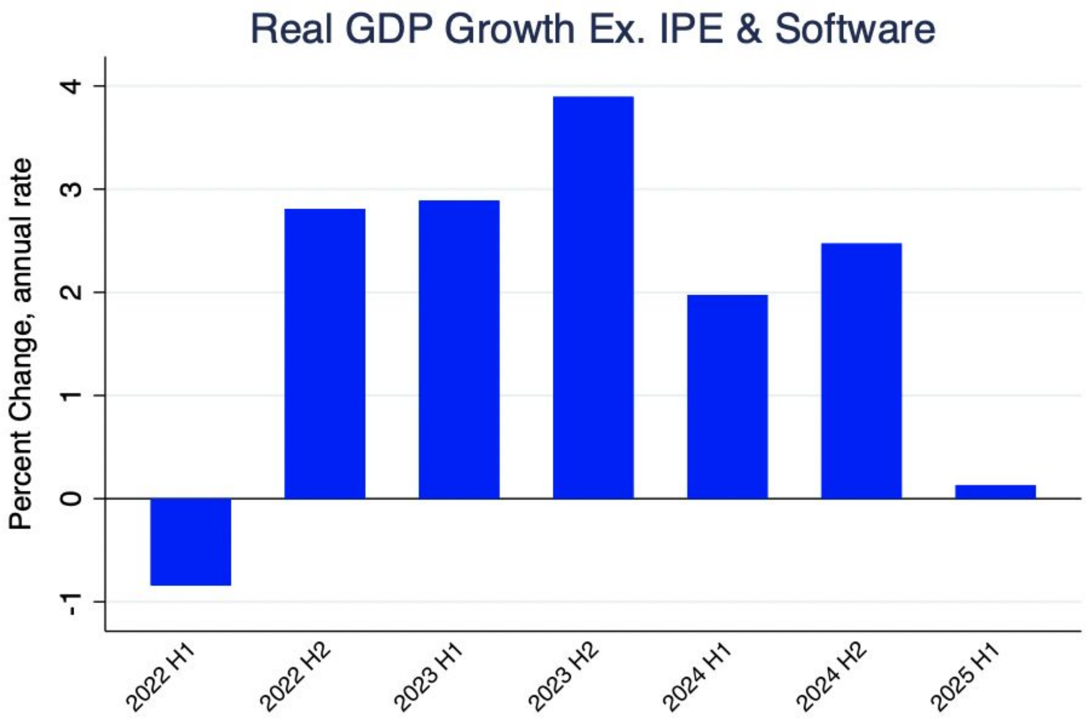
Bifurcation in spending reveals softness in consumption

- Top 20% spending outpaced others
- Most households barely kept up with inflation → real gains concentrated in higher income households



Real GDP growth slows without technology investment

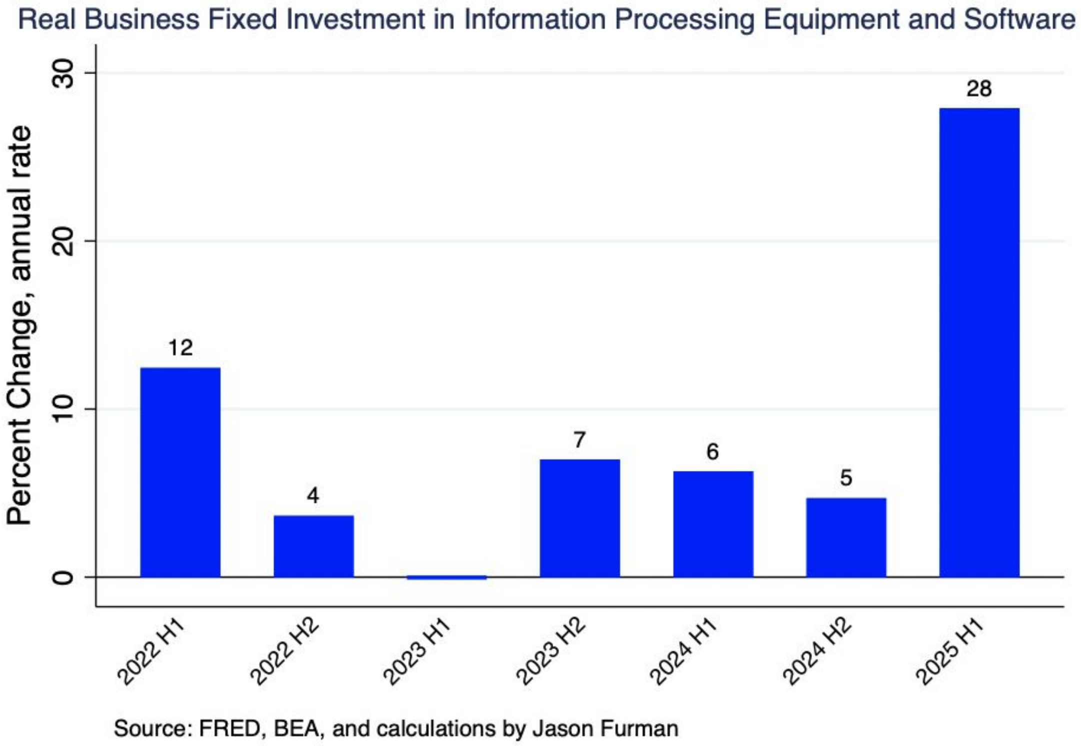
- Growth of real GDP excluding investment in information processing equipment and software suggests that it only grew .1% in 2025 H1



Source: BEA, FRED, and calculations by Jason Furman

Investment in technology sharply increases

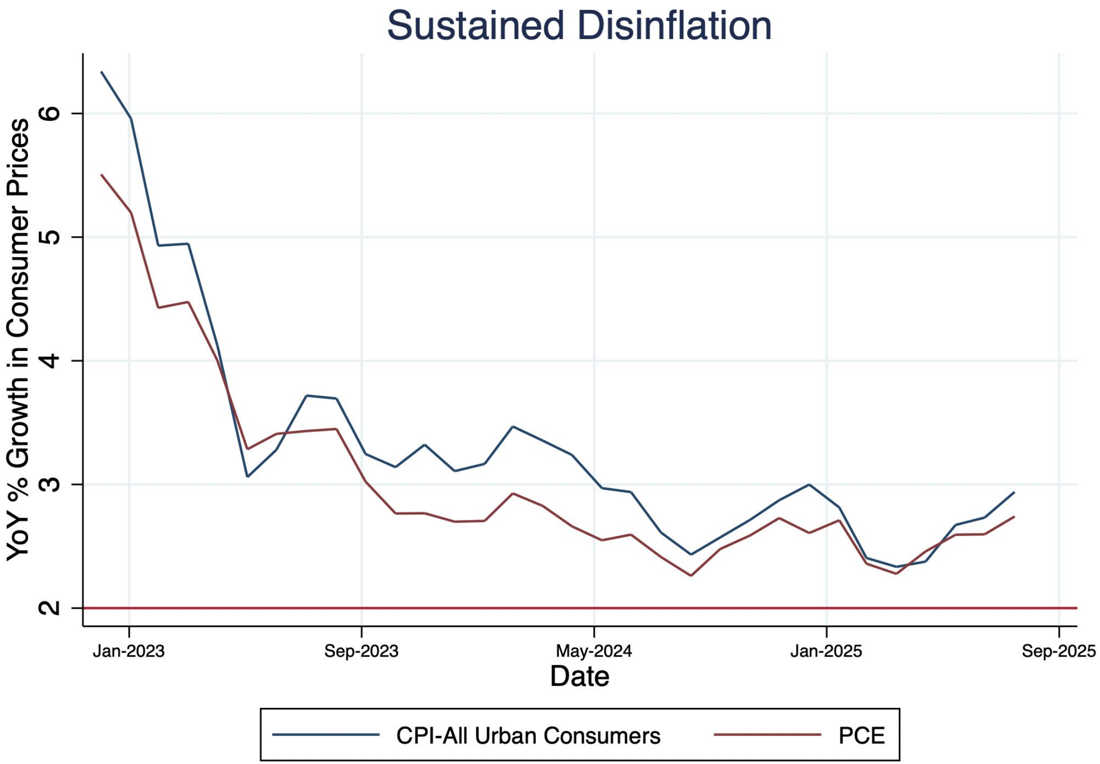
- In 2025 H1, business investment in information processing equipment and software rose to 28%
- This suggest that growth is consolidated to a few technology driven sectors



Inflation

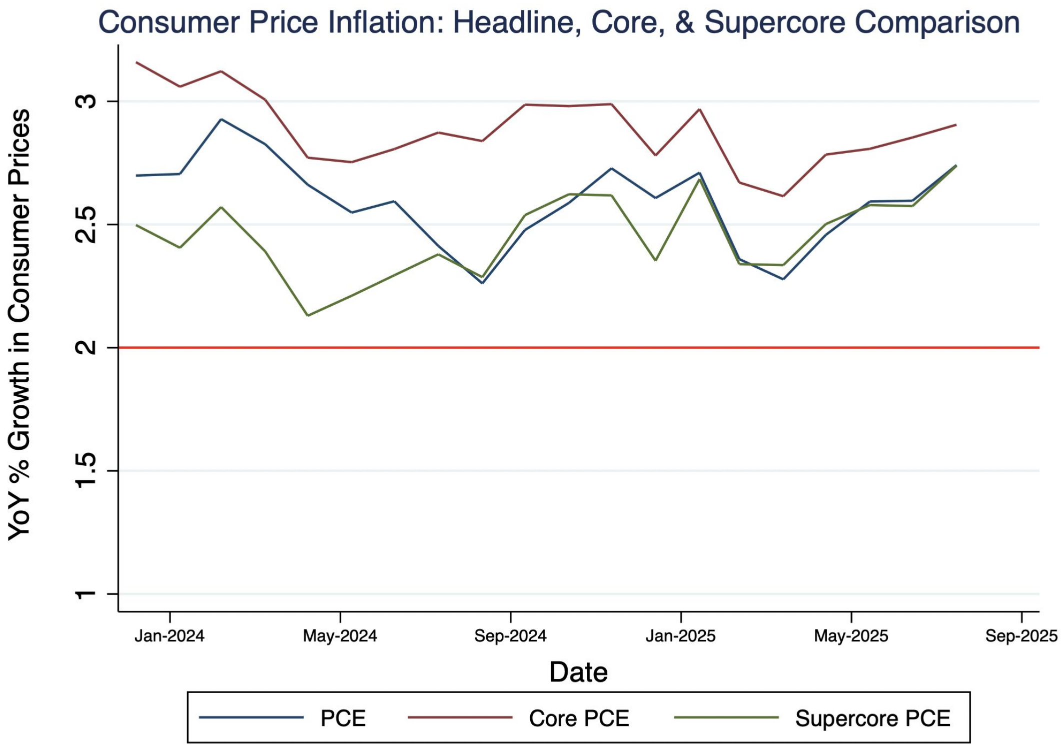
Sustained disinflation, but recent uptick in both CPI and PCE

- We are cautious as the effects of tariffs remain to be seen in Q4.
- CPI rose to 2.9% YoY
- PCE rose to 2.7% YoY
- Uptick in both CPI and PCE since April 2025



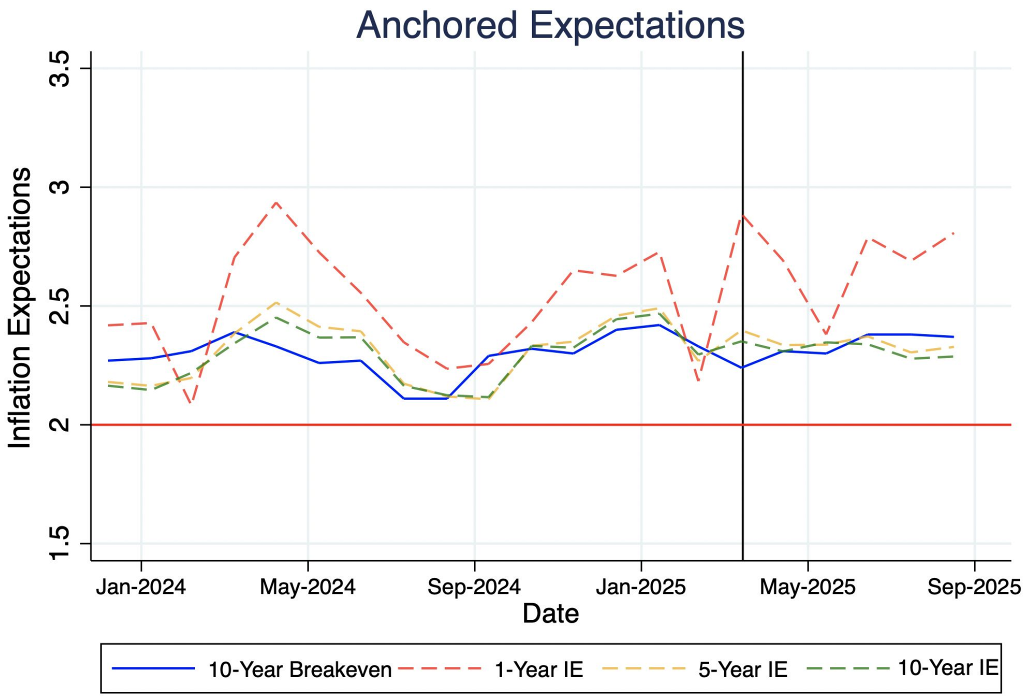
Recent uptick in all types of consumer prices

- Underlying inflationary trends follow nearly identical pattern.
- Core PCE and Supecore PCE have both risen since April 2025
- Core PCE rose to 2.9% YoY in August
- Supercore PCE rose to 2.6% YoY in August



However, longer-run inflation expectations remain anchored

- Volatile short run IE contrasts with medium and long run expectations.
- Medium and long run expectations remain anchored
- Short run IE increased from to 2.8% in September

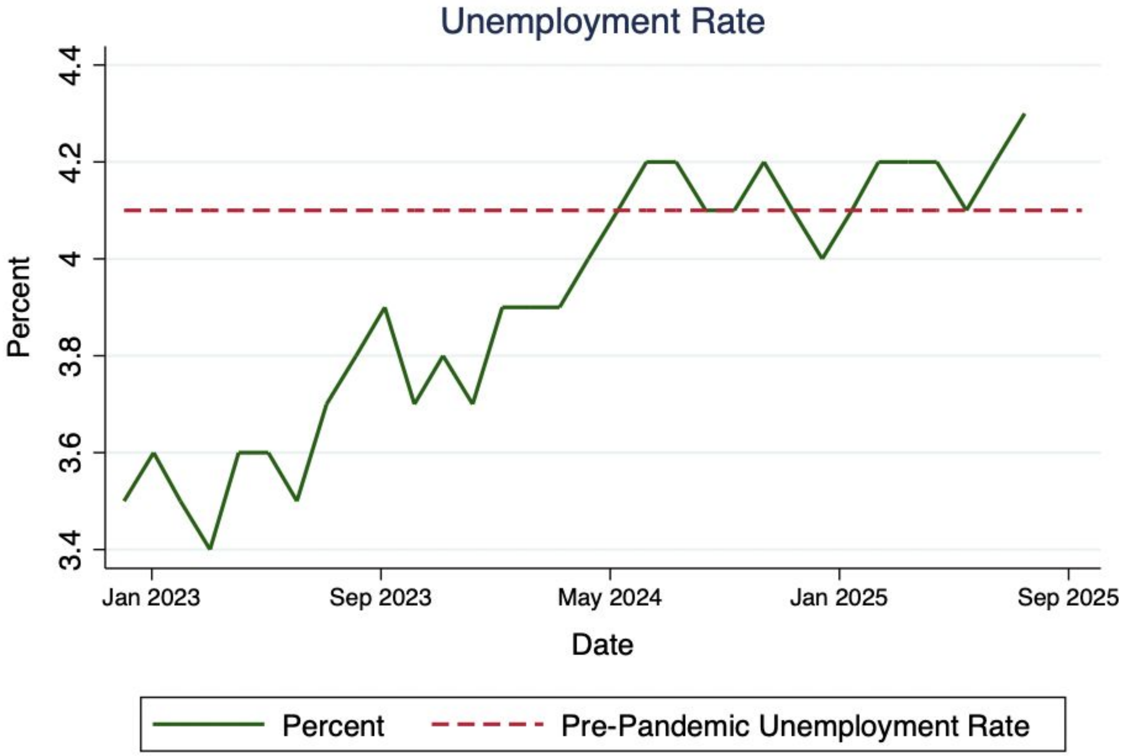


Source: Federal Reserve Bank of Cleveland, retrieved from FRED, Federal Reserve Bank of St. Louis

Labor Market

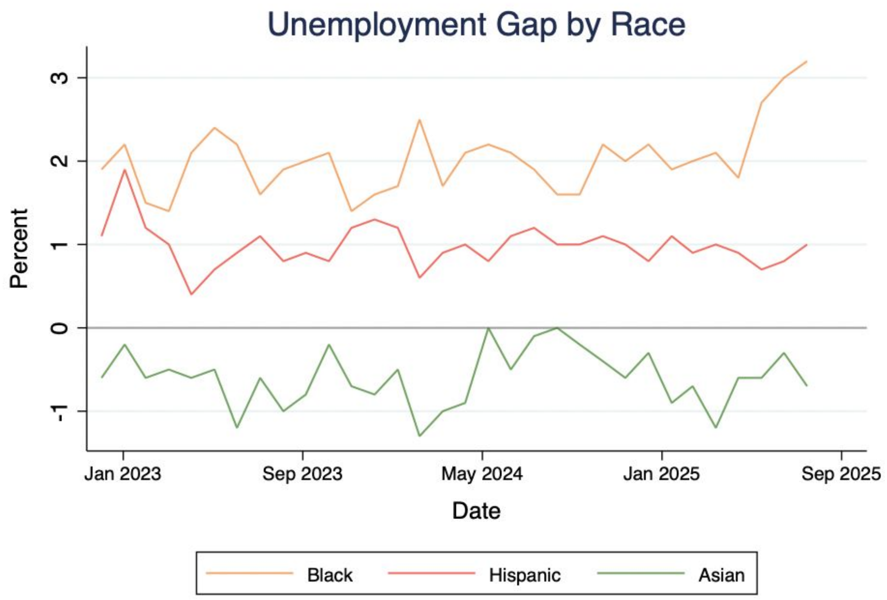
Slowing Unemployment Rate and Payrolls

- Rate was 4.3% in August, up from 4.2% in July
- Highest unemployment rate since October 2021
- Payrolls increased by just 22,000 last month

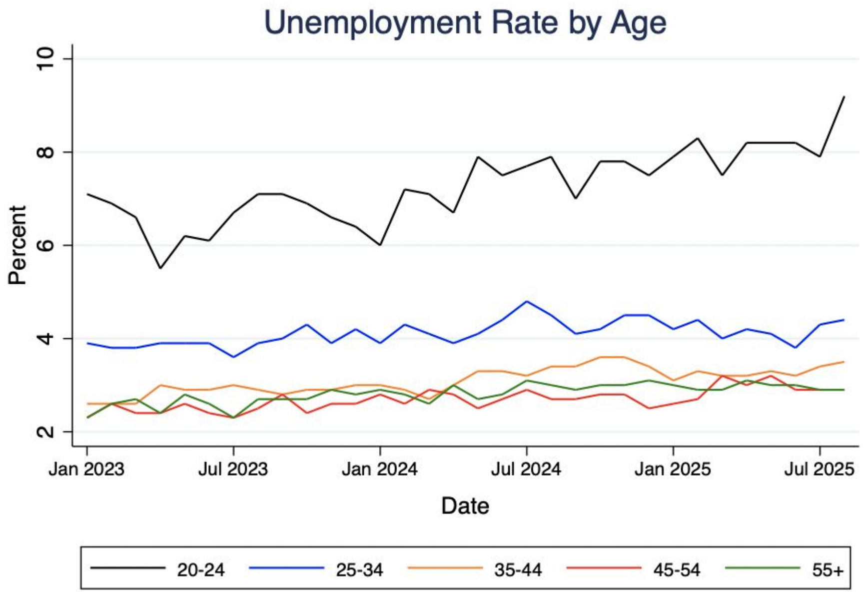


Source: FRED, Federal Reserve Bank of St. Louis

Fragmented Labor Market



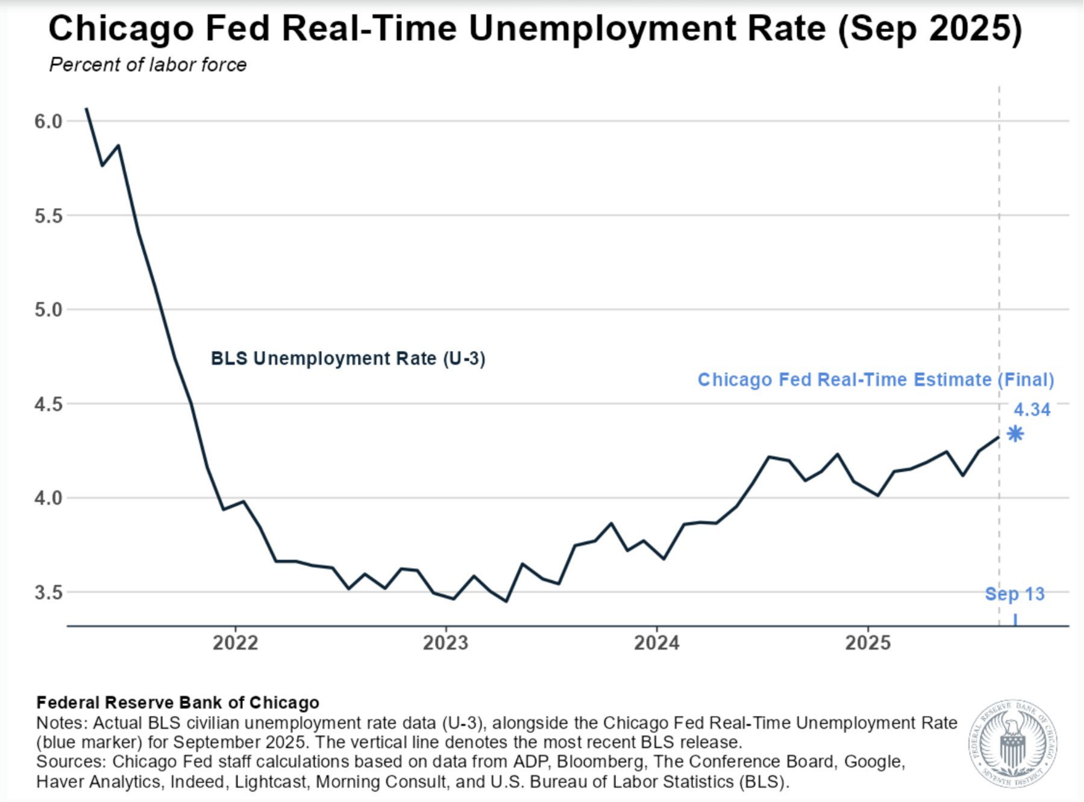
Source: BLS, FRED



Source: BLS, FRED

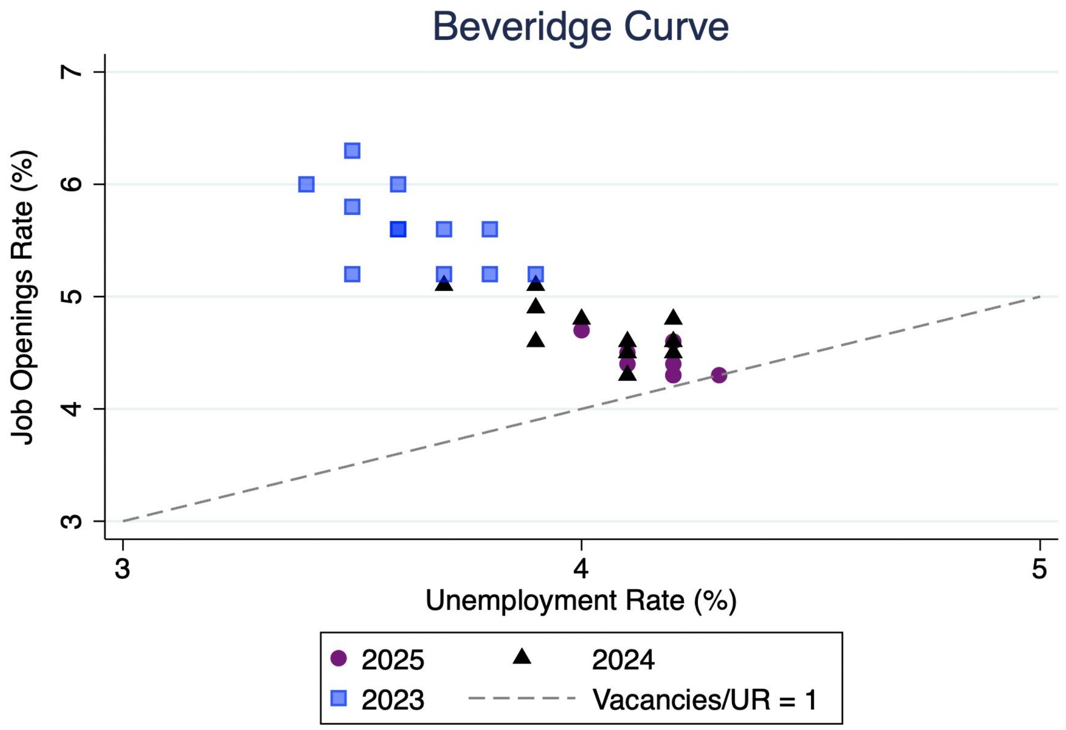
Current Estimates

- ADP also reported a loss of 43,000 private payroll jobs in September.
- Chicago Fed's latest estimate of unemployment was 4.34% in September



A Precarious Balance

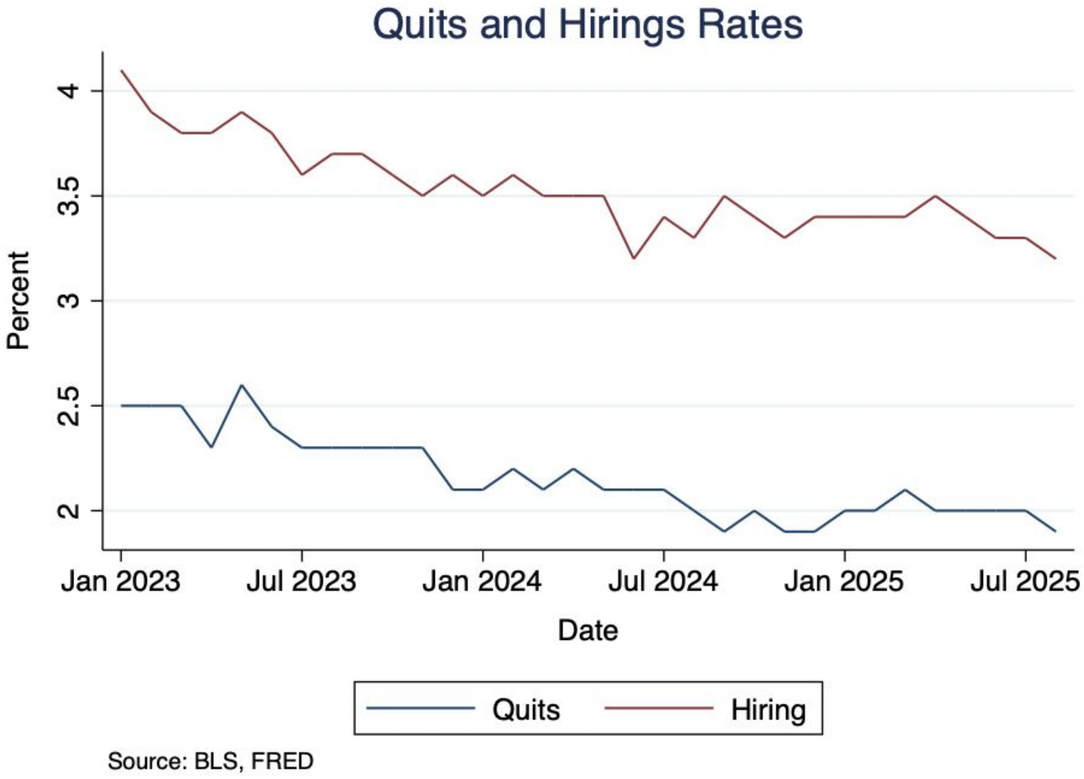
- V/U ratio maintained at or near 1 for the past year
- Slowing in supply and demand suggests market is stagnant, not secure
- Recent slippage indicates weakening



Source: BLS, FRED, Federal Reserve Bank of St. Louis

Slowing Demand and Supply

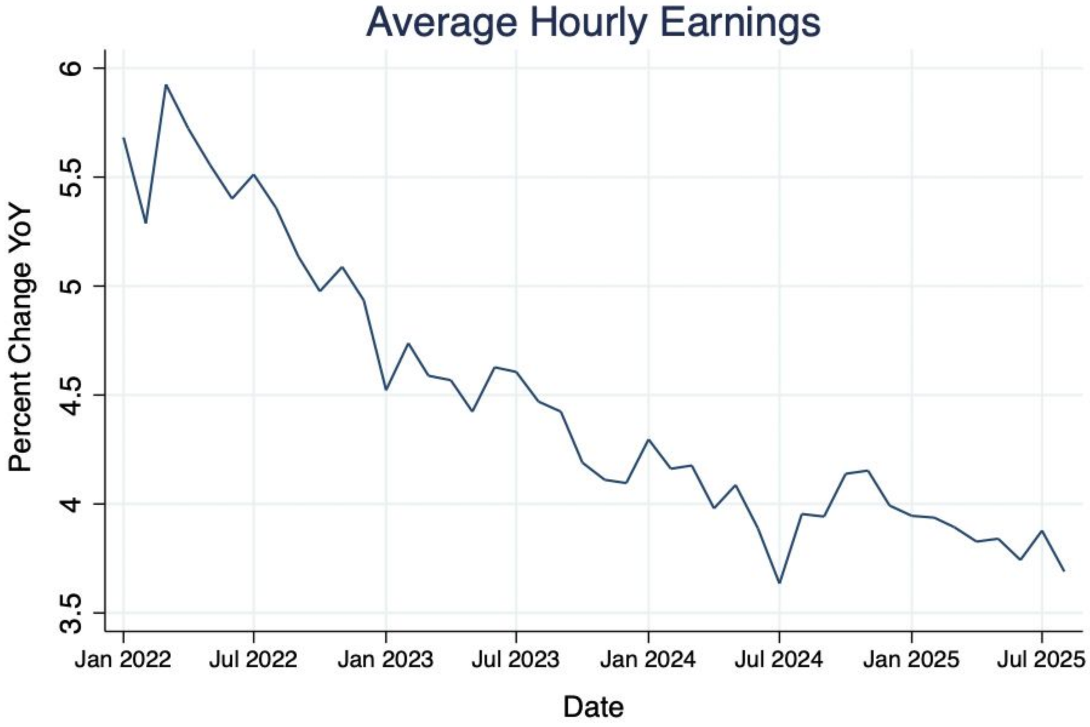
- Hiring rate at 3.2% in August
- Quits rate at 2% in August
- Chicago Fed's Labor Market Indicators show persistence of unemployment for unemployed people
- Slowing supply due to drops in net immigration



Moderate Wage Growth

- Slowing real wage growth reflects softer worker bargaining power

- Share of workers with zero wage growth risen to 13.6%

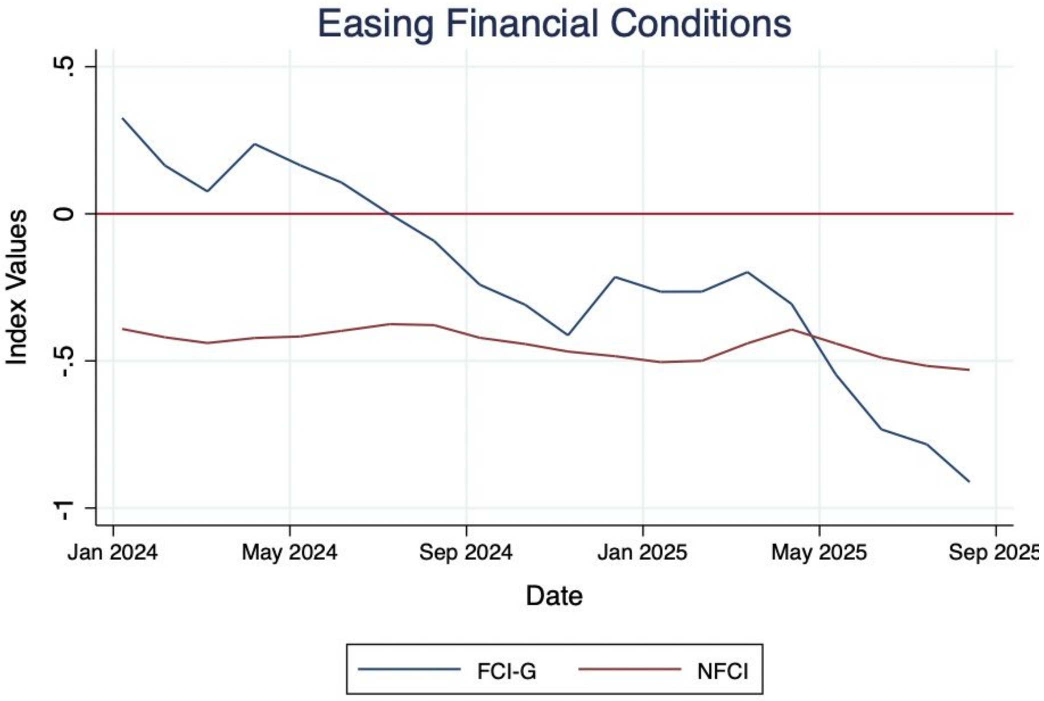


Source: BLS, FRED

Financial Conditions

NFCI and FCI-G suggest easing financial conditions….

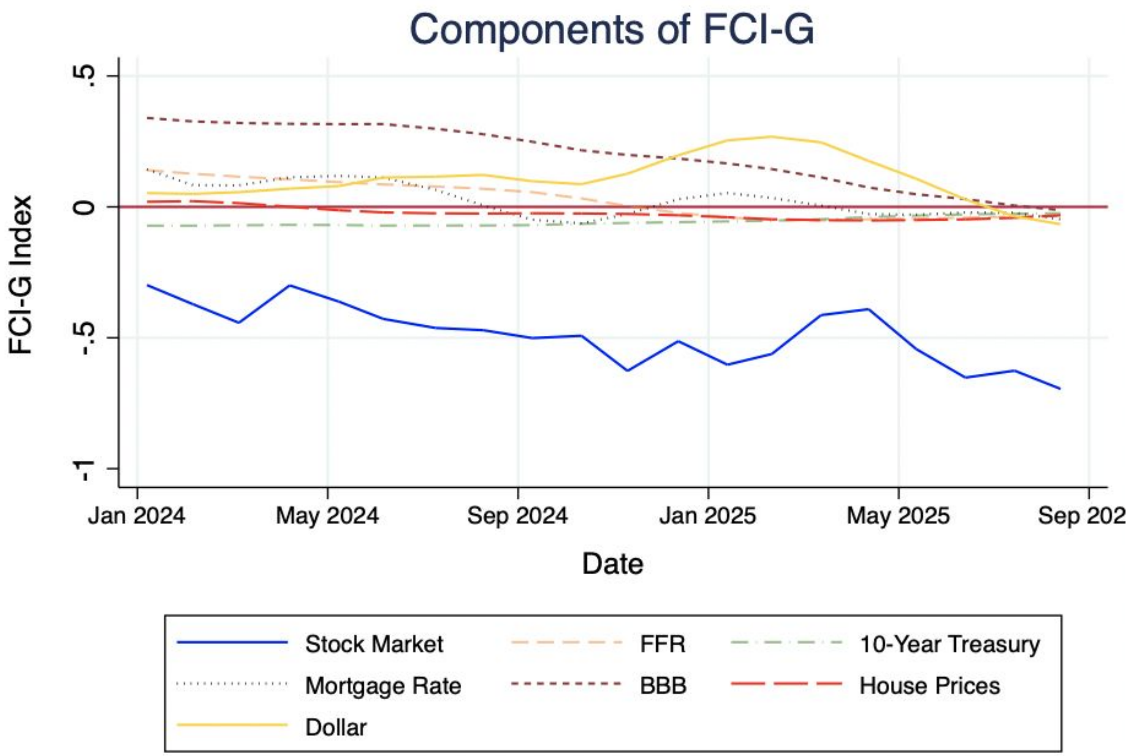
- Chicago Fed's National Financial Conditions Index (NFCI) measures tight vs. loose conditions
    - Loose but flat since early 2024 (–0.55)
- Financial Conditions Impulse on Growth (FCI-G) maps 7 variables into expected impact on GDP growth (Ajello et al. 2023)
    - Financial conditions providing growing tailwind to GDP (-0.91)



Source: Board of Governors and St. Louis Fed

….but equities market is driving FCI-G declines

- Rapid gain in the equity markets continues to drive drop in FCI-G
- However, stock market rallies concentrated in a few AI-exposed mega caps (Mag7)
- Stock market strength may be overstating true financial easing



Source: Board of Governors

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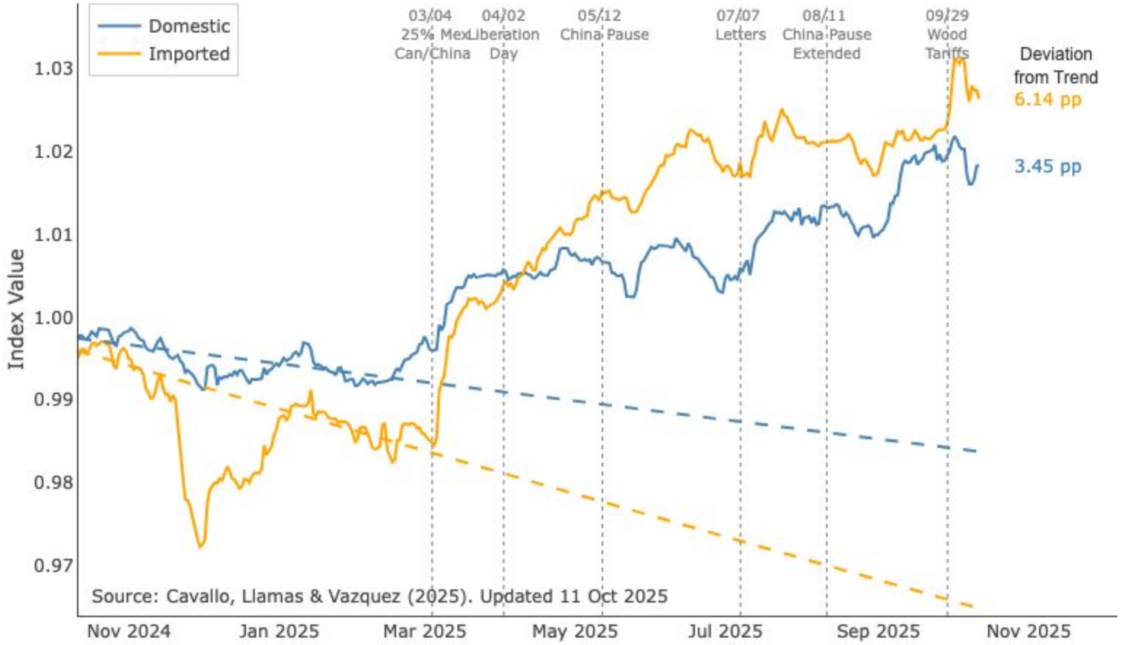
Inflation Risks

Tariffs are impacting goods prices with a lag

- Tariffs currently stand at **18% ,** highest since 1934 (The Budget Lab, 2025)
- Tariffs on import spillover to domestic goods
- Producer initially shoulder the cost of tariffs (Cavallo, Gopinath, Neiman, and Tang)

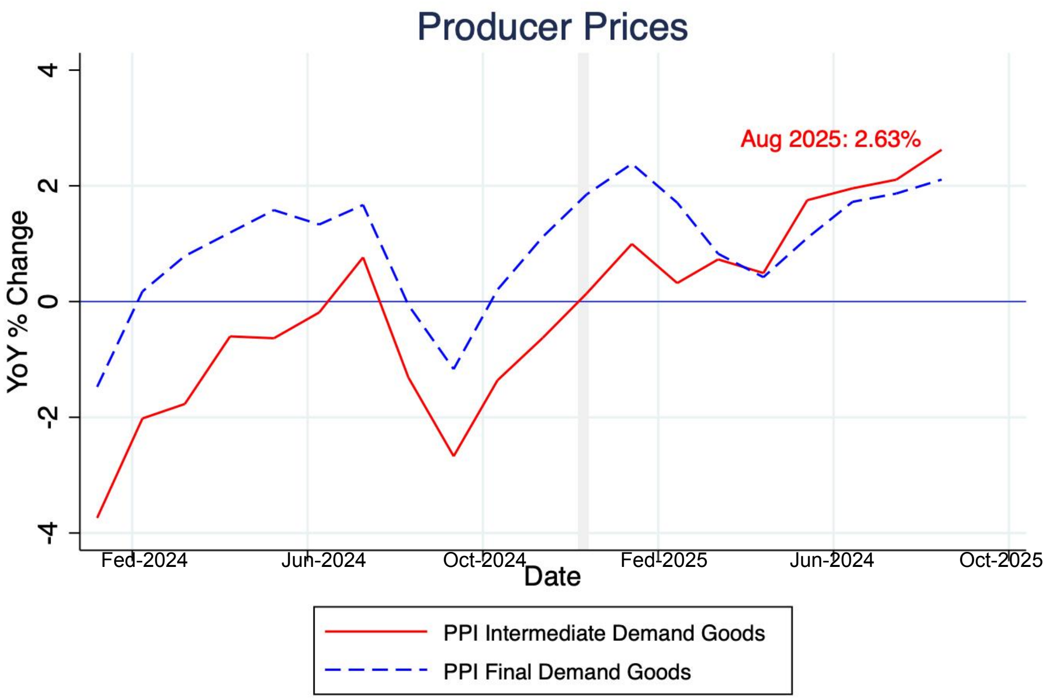
U.S. Retail Price Indices with Pre-Tariff Trends



Tariffs putting pressure on prices for producers

- YoY Change in PPI final demand has been at its highest point since beginning 2024

- There is a real pipeline between Producer and Consumer Prices (O'Trakoun, Ramachandran, 2022)



Sources: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics via FRED®

Fed projects sustained disinflation but 2% target not achieved until 2028

2024 and 2025 September SEP Report - Median[1]

	Year	2024	2025	2026	2027	2028	longer-run
PCE Inflation	2024	2.3	2.1	2.0	2.0		2.0
	2025		3.0	2.6	2.1	2.0	2.0
FFR	2024	4.4	3.4	2.9	2.9		2.9
	2025		3.6	3.4	3.1	3.1	3.0

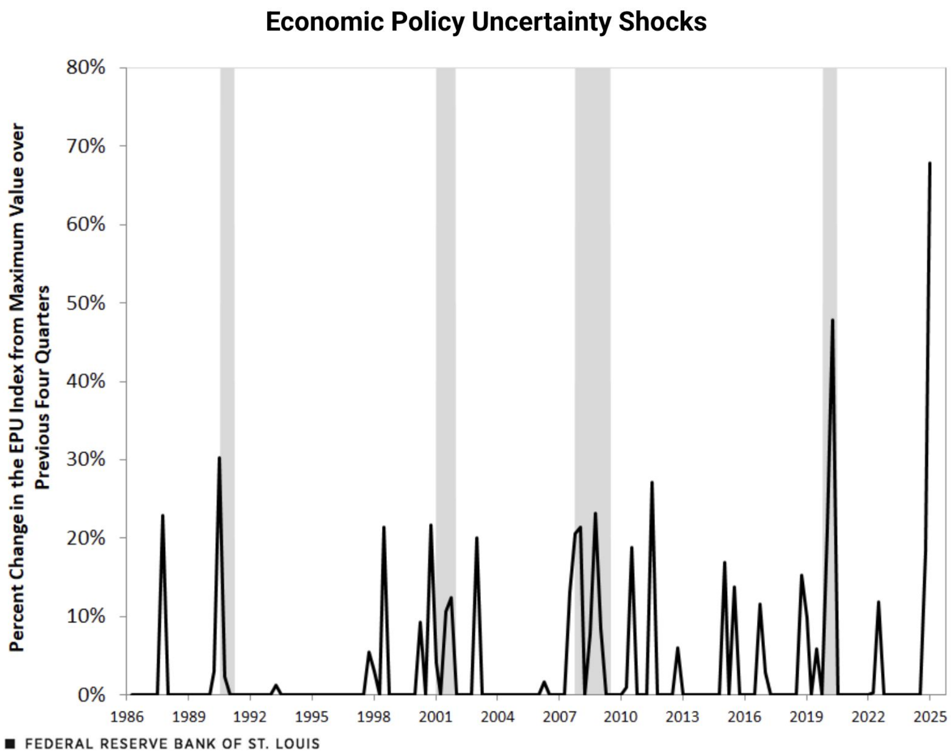
Source: Summary of Economic Projections, September 17, 2025

1. The median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.

Recessionary Risks

Economic Policy Uncertainty Poses Risk

- Jackson, Kliesen, and Owyang (2020) show high uncertainty (as a shock) amplifies contractionary effects

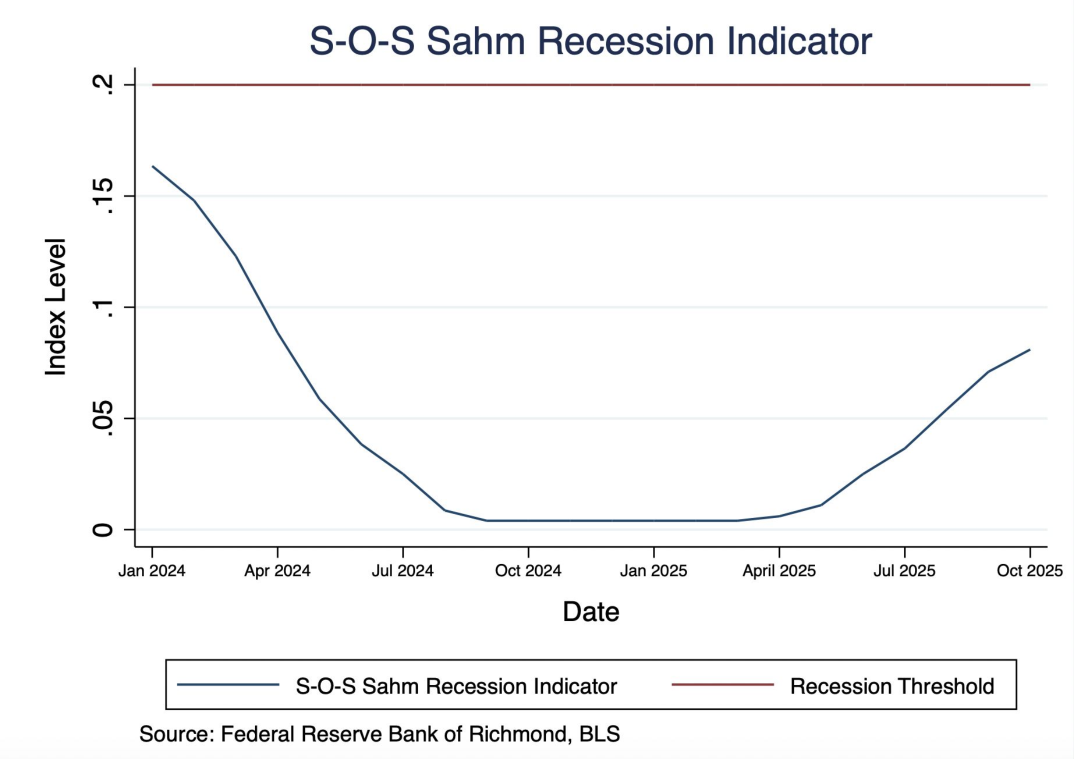


SOURCES: Author's calculations.

Scavette-O'Trakoun-Sahm-Style Indicator

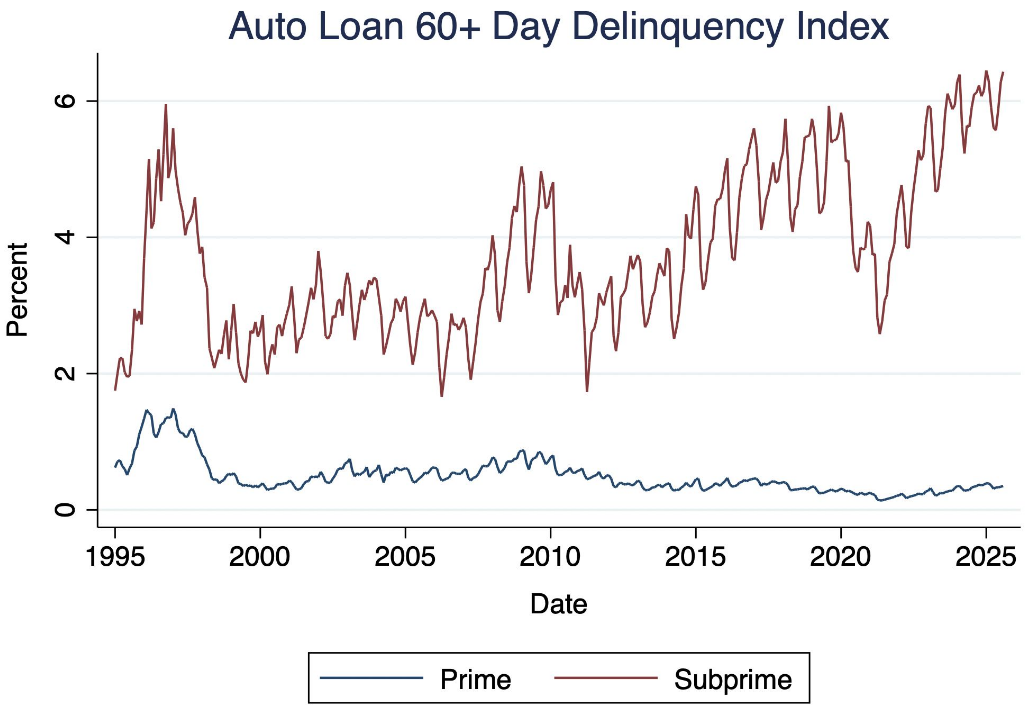
- Uses the weekly insured unemployment rate with the methodology of the Sahm Rule

- Remains below the 0.2 threshold, but risk is increasing



Increasing Distress in the Debt Market

- Wage growth for lowest-paid workers rose just 1.4% YoY, failing to keep pace with inflation
- Seriously delinquent student loans jumped to 10.2% in Q2
- Subprime auto loans 60+ days past due hit record of 6.43% this year



Source: Fitch Ratings

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Three Key Aspects of Policy

Monetary Policy Tool	Recommendation
Federal Funds Rate	Reduce the FFR by **25bps** to a target range of **3.75 - 4.00%**
Balance Sheet Normalization	End quantitative tightening in a timely manner
Communication Policy	**Maintain its commitment to balancing risks** to achieve the dual mandate and **reinforce its credibility** on long-term forward guidance

Empirical Basis

On maximum employment:

- Softening payrolls and unemployment
- Fragmented labor market indicates unequal burden of economic downturn
- Slowing in both labor supply and demand → stagnant market

On price stability:

- Sustained disinflation, however inflation is still above 2% target
- Potential effects of tariffs complicate path to 2%

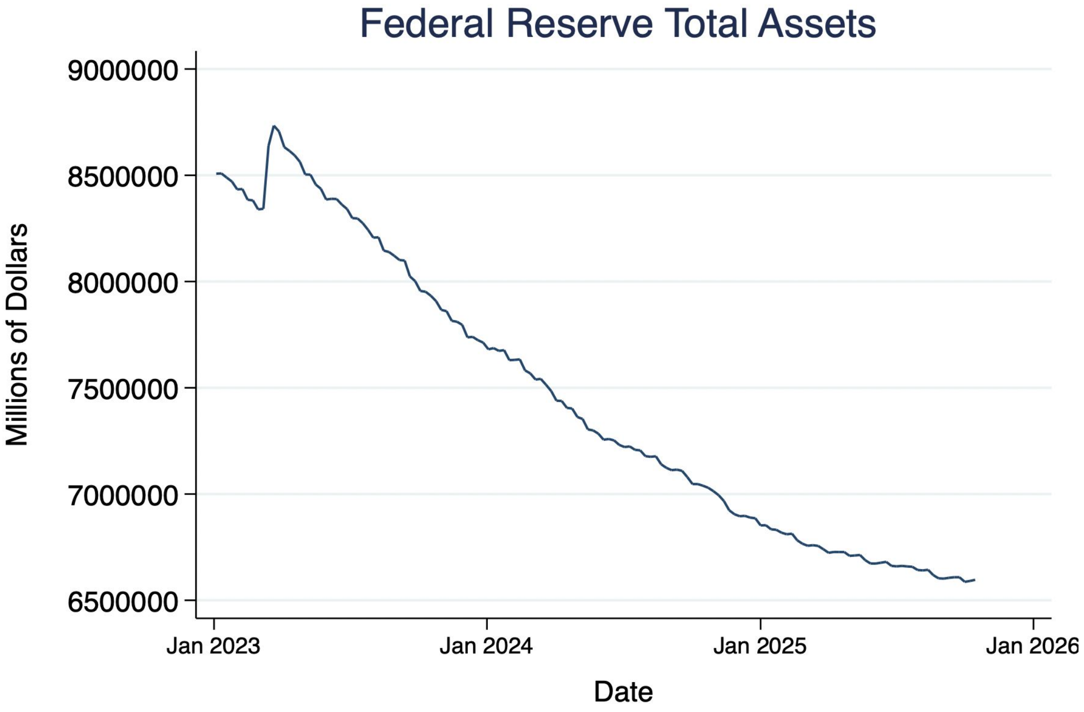
Empirical evidence suggest a rate cut of 25 bps

Balance Sheet Policy

- QT since pandemic-era peak of $9 trillion

- Financial conditions driven by stock market gains and lending excess

- Begin to taper QT



Source: Board of Governors

Communication Policy

On maximum employment:

- Stimulate labor market activity amid a slowing employment growth and uncertainty
- Support resilient growth without overreacting to temporary data swings

On price stability:

- Emphasize 2% inflation target
- Fed’s long standing credibility allows measured easing while keeping long-run inflation expectations firmly anchored

On clear guidance:

- Continue to be data driven but not data anchored
- “No risk free path” - Chair Powell

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Thank You

Fed Challenge October 2025

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