Daiwa Capital Markets

U.S. Economic Comment

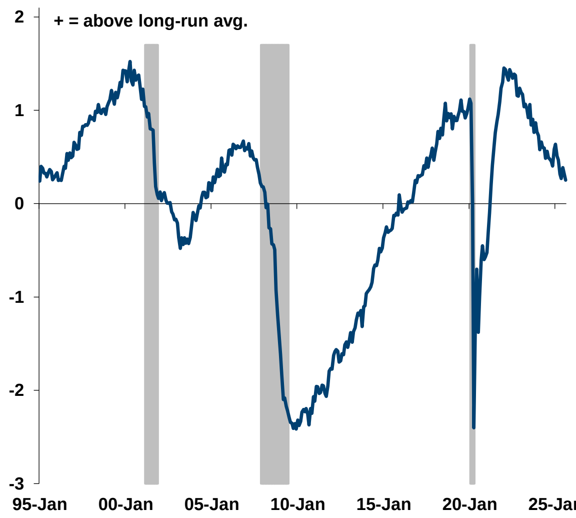
- Updated Fed call: further cuts in 2025 and 2026 in support of the labor market
- The path ahead for the Fed: robust debate likely given competing dual mandate objectives
- Leading indicators: a warning for the U.S. economy?

Lawrence Werther
lawrence.werther@us.daiwacm.com
+1-212-612-6393
Brendan Stuart
brendan.stuart@us.daiwacm.com
+1-212-612-6172

A New Fed Call

In light of this week's easing in monetary policy by the Federal Open Market Committee, we are compelled to recalibrate our expectations for the federal funds rate for the remainder of 2025 and into next year. We had previously anticipated that cooling in the labor market would spur cuts later this year (although admittedly we were struck by the speed of the recent deceleration in job growth) and we continue to expect that the inflationary impulse from tariffs will fall shy of the worst fears expressed in the wake of President Trump's "Liberation Day" announcements, factors which led us to forecast two cuts of 25 basis points in the target range for the federal funds rate over the final three meetings of 2025 (year-end range of 3-3/4 percent to 4 percent) with two additional same-sized reductions at the end of the first and second quarters of next year (year-end 2026 target range of 3-1/4 to 3-1/2 percent). The call coincided with an expectation that the economy would grow at a modestly below-potential rate, the labor market would find an equilibrium consistent with unemployment in the vicinity of 4-1/2 percent maintained by job growth in the area of 125,000 per month, and gradually easing inflation after a peak later this year.

Labor Market Conditions Indicator: Activity*

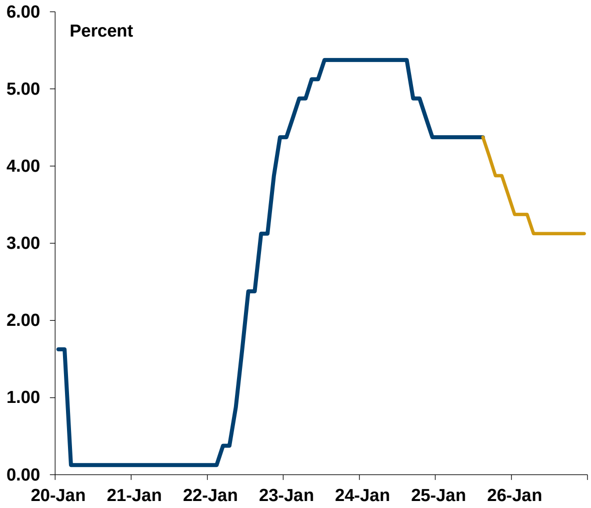


** The Labor Market Conditions Indicator (LMCI) is a monthly measure of activity that is based on 24 labor market variables. A positive reading indicates that labor market conditions are above their long-run average, whereas a negative value indicates that conditions are below their long-run average. The shaded areas on the graph indicate periods of recession in the United States.*

Sources: Federal Reserve Bank of Kansas City, National Bureau of Economic Research via Haver Analytics

Although recent economic developments have aligned to a degree with our baseline forecast, labor market developments stand out as a notable exception. The chart to the right, which depicts the Kansas City Fed's Labor Market Conditions Indicator that is based on 24 key labor market variables, shows that activity remains above its longer-run equilibrium but has trended sharply lower since its recent peak in January 2022, when the labor market had previously been overheating. The current trend, which is key to our expectations for the path of policy, is now more consistent with an economy flirting with recession (chart, above right). We don't see recession as a foregone conclusion – or even the most likely outcome for the economy – but the deterioration in the employment situation, which prompted the latest FOMC statement to note a "shift in the balance of risks" and for Chair Powell to acknowledge in his press conference that what he observed was "a very different picture of the risks to the labor market," suggests that a more deliberate series of cuts geared at the achievement of neutral is warranted at this time. Thus, we now expect the FOMC to ease at the final two meetings of 2025 (year-end range of 3-1/2 to 3-3/4 percent) with additional reduction more tightly clustered in early 2026 (i.e., cuts of 25 basis points at the January 27-28 and April 27-28 FOMC meetings, 2 of the first three meetings of the year versus dispersed over the first four meetings previously; chart, next page, left).

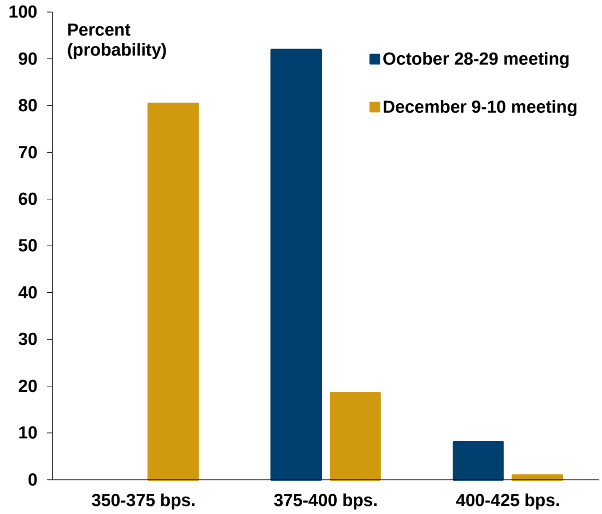
Federal Funds Target Rate*



** The gold line is the forecasted path of the federal funds rate through year-end 2026.*

Sources: Federal Reserve Board via Haver Analytics; Daiwa Capital Markets America; Bloomberg

Federal Funds Target Rate Probabilities*



** The implied target range for the federal funds rate based on futures pricing data as of September 19, 2025*

Source: CME Group, FedWatch Tool

Economic Projections of the FOMC, September 2025*

	2025	2026	2027	2028	Longer Run
Change in Real GDP	1.6	1.8	1.9	1.8	1.8
Range	1.3-2.0	1.5-2.6	1.7-2.7	1.6-2.6	1.7-2.5
Unemployment Rate	4.5	4.4	4.3	4.2	4.2
Range	4.2-4.6	4.0-4.6	4.0-4.5	4.0-4.5	3.8-4.5
PCE Inflation	3.0	2.6	2.1	2.0	2.0
Range	2.5-3.2	2.2-2.8	2.0-2.4	2.0	2.0
Core PCE Inflation	3.1	2.6	2.1	2.0	--
Range	2.7-3.4	2.2-2.9	2.0-2.4	2.0-2.2	--
Federal Funds Rate	3.6	3.4	3.1	3.1	3.0
Range	2.9-4.4	2.6-3.9	2.4-3.9	2.6-3.9	2.6-3.9

** Median projections*

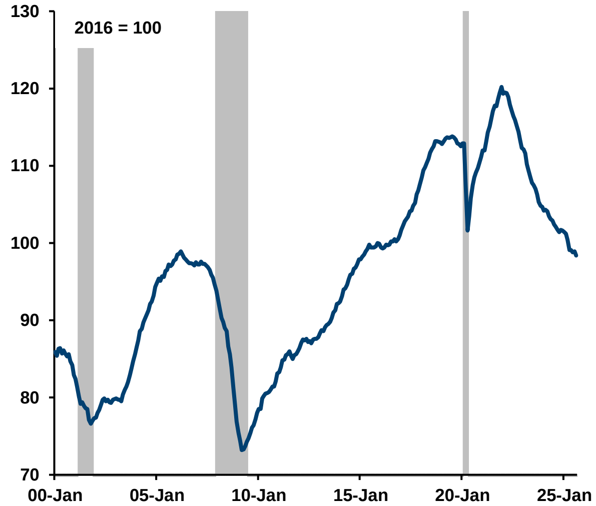
Source: Federal Open Market Committee, Summary of Economic Projections, September 2025

The path of the federal funds rate from here is almost certainly lower, as Chair Powell's discussion of "a risk management cut" suggested to us the initiation of a process rather than an end unto itself. With that said, market participants may be underpricing the risk of further cuts occurring irregularly (or a portion of those not materializing should inflation remain sticky). In other words, market-based probabilities for cuts at the final two meetings of the year, while aligning with our view, have seemingly eliminated the prospect of high-side misses on upcoming inflation prints pushing officials to the sidelines (chart, above right; note the pricing of a near-certain 25 basis point cut in October and probability of approximately 80 percent for a same-sized cut in December). Contrastingly, consideration of that risk is still represented in the range of views in the September Summary of Economic Projections (table, right). Given post-meeting comments by newly appointed Governor Miran, we assume inflation readings on the left tails of the distributions for headline and core PCE are his (and we would add likely unattainable barring a sharp –and highly improbable -- easing in price pressure into year-end) while others remain more guarded in their assessments. On the point, the central tendency (which excludes the three highest and three lowest projections for each variable) for headline inflation in 2025 was 2.9-3.0 percent and 3.0-3.2 percent for core, which spoke to why 2 policymakers have penciled in only one more cut this year and a further six anticipate no further easing (while one policymaker had submitted a pre-meeting forecast that indicated no cuts at all in 2025, associated with a year-end midpoint of 4.375 percent). Thus, we find ourselves in a situation where elements of the data are concerning for different reasons (upside risks to inflation and downside risks to employment) and market participants are perhaps leaning more heavily into the idea of additional policy easing whereas FOMC members are somewhat less committed to a preset path of lower rates. All this to say, we expect the next few months of employment and inflation data to remain highly consequential, and for debate amongst policymakers to be robust, with Chair Powell remarking at one point that "it's not incredibly obvious what to do."

Trouble Ahead?

The Conference Board Leading Economic Index, which provides insights into the future path of the economy, fell 0.5 percent in August (published Thursday) – the largest decline since the swoon of 1.3 percent this past April which was influenced by President Trump's tariff announcements and the associated market volatility. While the measure has slipped in 39 of the past 44 months, it had previously surged above pre-pandemic highs before retreating on account of, at least in part, previously restrictive monetary policy. Most recently, the downward shifts have become concerning as the velocity of the decline has accelerated (the measure dropped 2.8 percent in the six months ended August versus -0.9 percent in the previous six-month period spanning August 2024 to February 2025).

Index of Leading Economic Indicators*



** The shaded areas indicate periods of recession in the United States.*

Sources: The Conference Board, National Bureau of Economic Research via Haver Analytics

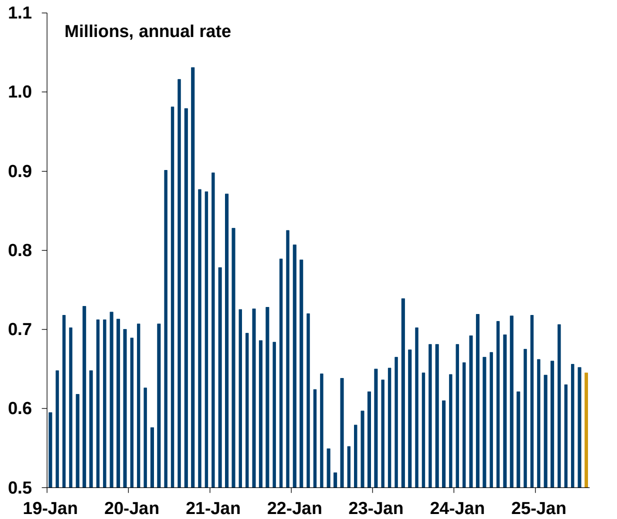
Assessments by Justyna Zabinska-La Monica, Senior Manager, Business Cycle Indicators, at The Conference Board, were far from rosy. She noted in the press release accompanying the Leading Indicators report: "Besides persistently weak manufacturing new orders and consumer expectation indicators, labor market developments also weighed on the Index with an increase in unemployment claims and a decline in average weekly hours in manufacturing. Overall, the LEI suggests that economic activity will continue to slow. A major driver of this slowdown has been higher tariffs…" Again, the assessment doesn't necessarily indicate recession, but rather heightened risks on account of policy uncertainty, depressed consumer expectations, and a softening labor market. Easing in monetary policy, if realized in coming months, could arrest further deterioration through easing financial conditions. Even so, in light of recent developments, we do find it interesting that the latest SEP recorded upward adjustments to median expectations for growth over the 2025-2027 horizon (1.6 percent, 1.8 percent, and 1.9 percent, respectively, as of September versus 1.4 percent, 1.6 percent, and 1.8 percent as of June). Another economic indicator is flashing red, further complicating the road ahead for the FOMC.

The Week Ahead

New Home Sales (August) (Wednesday)
Forecast: 0.645 Million (-1.1%)

Depressed buyer traffic (as measured by the National Association of Home Builders) and restrained mortgage applications for a home purchase suggest that marginally lower mortgage rates did little to reinvigorate new home sales in August. If the forecast of a dip in activity is realized, it would leave sales in the lower end of the past two years – sluggish by recent standards although a bit better when compared to the performance in the year or so preceding COVID. With that said, inventories have surged in recent years, which could leave homebuilders in precarious positions should a stagnant market deteriorate further.

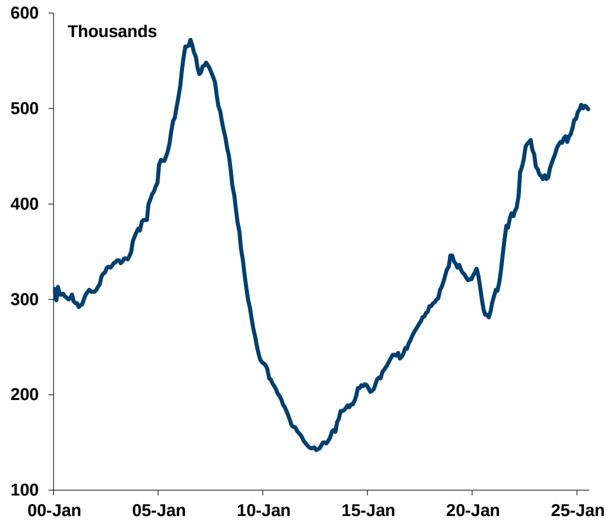
New Home Sales*



** The gold bar is a forecast for August 2025.*

Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

New Single-Family Homes for Sale



Source: U.S. Census Bureau via Haver Analytics

Revised GDP (25-Q2) (Thursday)
Forecast: +3.3% (Unchanged from Preliminary Estimate)

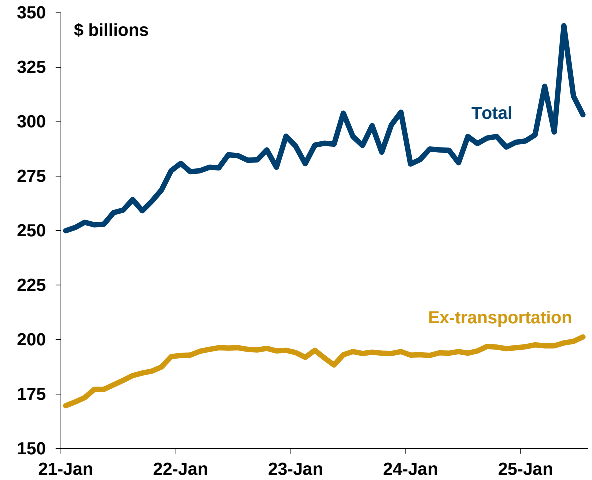
The third (revised) estimate of quarterly GDP is usually close to the second (preliminary) tally. Consumer spending, was a key driver of growth in Q2 (+1.6 percent, annual rate, published in the previous estimate, contribution of 1.07 percentage points to growth in Q2). Recall also that inventory investment and international trade remained volatile on account of disruptions generated by the Trump administration's tariff agenda. Inventories were a constraint of 3.29 percentage points on growth in Q2 after contributing 2.59 percentage points in the previous quarter, while net exports added 4.95 percentage points to growth in the latest survey period amid a contraction in imports that far exceed that in exports after a surge of imports in Q1 (which were spurred by efforts to front-run tariffs) led to a prior drag of 4.61 percentage points.

Keep in mind that the Bureau of Economic Analysis will release the 2025 annual updates to the National Economic Accounts along with the third estimate of Q2 GDP. Revisions will cover the first quarter of 2020 through the first quarter of 2025 and will lead to adjustments to data including: GDP, GDP by industry, and gross domestic income (GDP), among others.

Durable Goods Orders (August) (Thursday)
Forecast: -0.3% Total, -0.1% Ex. Transportation

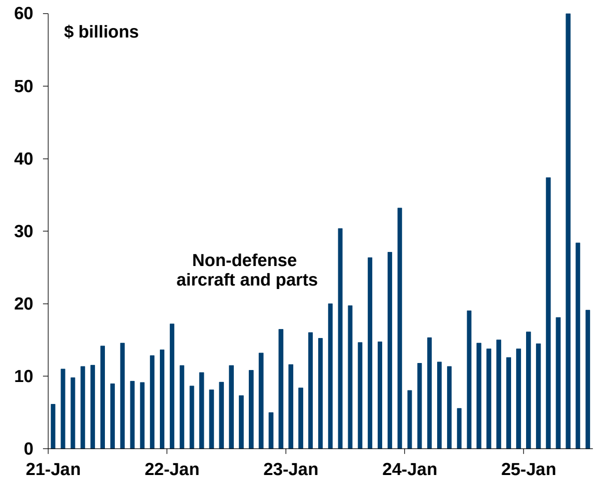
The transportation category has introduced significant volatility to headline durable goods orders over the past few years, influenced importantly by swings in the civilian aircraft bookings. Data from Boeing raise the possibility of another decline in aircraft bookings in August (and by extension transportation orders), but it is anticipated to be much smaller than other recent declines (drops of 32.7 and 52.7 percent, respectively, in July and June civilian aircraft orders). Bookings excluding transportation have tilted higher since the spring, but a pause could be in store in August as several categories recorded notably above trend readings in July that drove the prior jump of 1.0 percent.

New Orders for Durable Goods



Source: U.S. Census Bureau via Haver Analytics

New Orders for Durable Goods

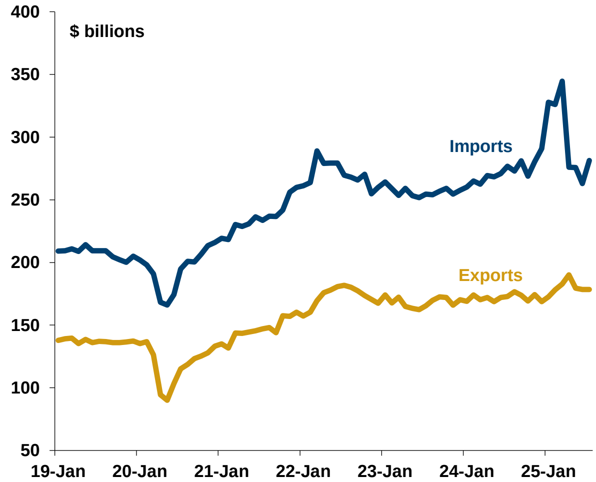


Source: U.S. Census Bureau via Haver Analytics

International Trade in Goods (August) (Thursday)
Forecast: -$95.0 Billion ($7.8 Billion Narrower Deficit)

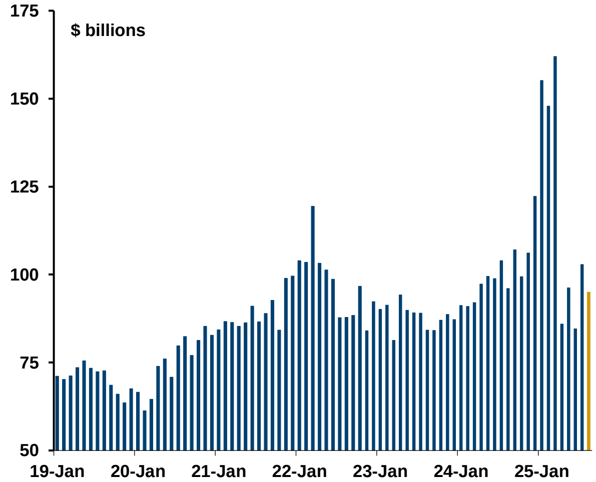
Trade flows are often volatile from month-to-month, especially in light of recent distortions caused by the Trump administration's trade policies. Previously in July, the nominal goods trade deficit surged by $18.3 billion to $102.8 billion after a marked narrowing in Q2 (average deficit of $88.9 billion following an average of $155.0 in Q1 driven by an import surge ahead of tariffs). In the prior month, imports of capital goods and industrial supplies jumped, possibly again reflecting tariff-related volatility, with a reversion in these areas in August possibly leading to a narrowing in the monthly deficit. U.S. exports, in contrast, have drifted lower since May – with sluggish economic growth abroad possibly again acting as a constraint on demand for U.S. goods.

Imports & Exports of Goods



Source: U.S. Census Bureau via Haver Analytics

Nominal Trade Deficit in Goods*



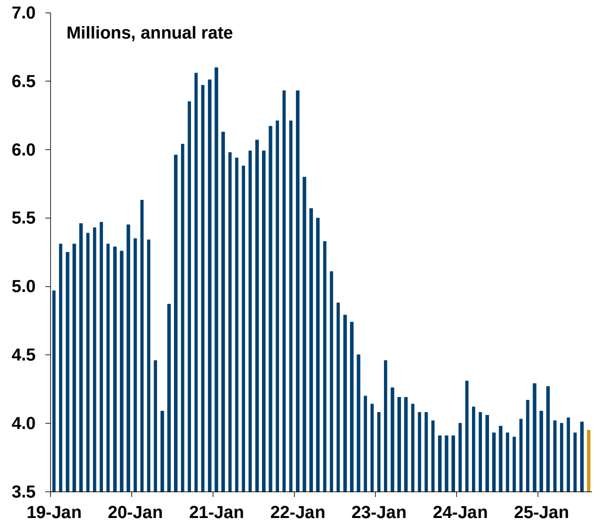
** The gold bar is a forecast for August 2025.*

Sources: U.S. Census Bureau via Haver Analytics; Daiwa Capital Markets America

Existing Home Sales (August) (Thursday)
Forecast: 3.95 Million (-1.5%)

Back-to-back declines in the index pending home sales raise the possibility of existing home sales easing in August after an increase of 2.0 percent in the prior month (note that pending home sales, which measures contract signings, typically lead existing home sales, which measures closings, by one to three months). By and large, prevailing conditions in the housing market remain unfavorable. Though the tight inventory situation has improved in recent months, which has constrained further price appreciation in many markets, still-elevated mortgage rates and pronounced economic uncertainty amid a slowing labor market and tariff-driven prices increases have likely contributed to sluggish sales. Thus, we expect the current pace of sales to remain in the low end of the long-term range.

Existing Home Sales*



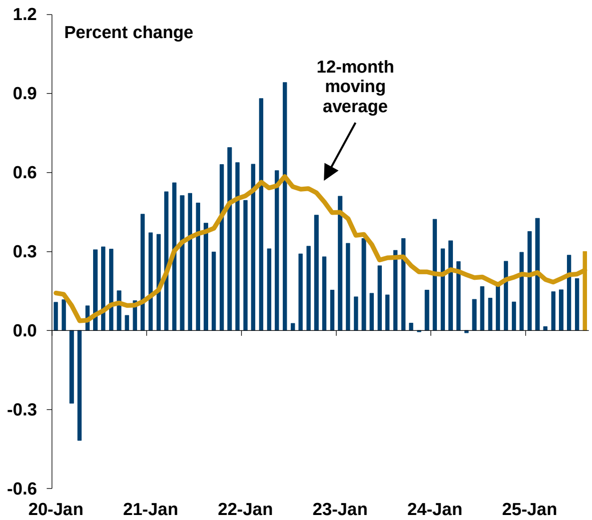
** The gold bar is a forecast for August 2025.*

Sources: National Association of Realtors via Haver Analytics; Daiwa Capital Markets America

Personal Income, Consumption, Price Indexes (August) (Friday)
Forecast: +0.3% Income, +0.4% Consumption, +0.3% Headline, +0.2% Core

An advance of 0.3 percent in average hourly earnings could drive a solid advance in overall income growth in August. On the consumption side, results from the latest retail sales report indicate firm spending for nondurable items while a dip in vehicle sales point to a decline in outlays for durables. Spending on services has remained on a favorable trend in 2025 thus far, although it slowed a bit in recent months. Data from the latest CPI and PPI reports suggest month-to-month increases of 0.3 and 0.2 percent for the headline and core PCE price indexes, respectively. The projected readings would translate to year-over-year advances of 2.8 percent for the headline (versus 2.6 percent in July) and 2.9 percent for the core (essentially unchanged from the July reading).

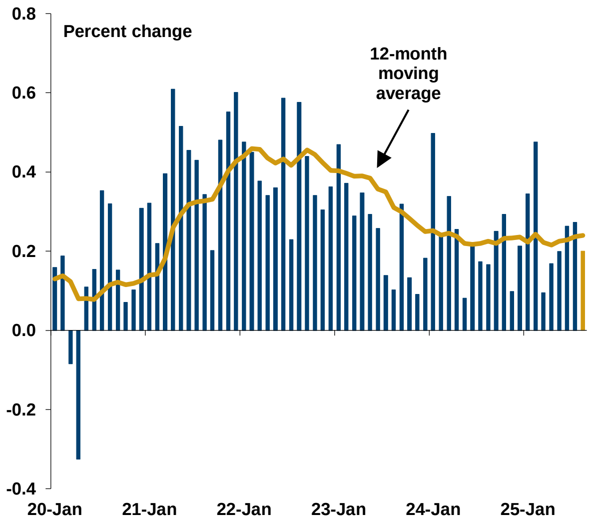
Headline PCE Price Index*



** The gold bar is a forecast for August 2025.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Core PCE Price Index*



** The gold bar is a forecast for August 2025.*

Sources: Bureau of Economic Analysis via Haver Analytics; Daiwa Capital Markets America

Economic Indicators

September/October 2025

Monday 15

EMPIRE MFG

July	5.5
Aug	11.9
Sep	-8.7

Tuesday 16

RETAIL SALES

	Total	Ex.Autos
June	1.0%	0.9%
July	0.6%	0.4%
Aug	0.6%	0.7%

IMPORT/EXPORT PRICES

	Non-Petrol Imports	Nonagri. Exports
June	-0.2%	0.6%
July	0.0%	0.3%
Aug	0.2%	0.3%

IP & CAP-U

	IP	Cap.Util.
June	0.5%	77.8%
July	-0.4%	77.4%
Aug	0.1%	77.4%

NAHB HOUSING INDEX

July	33
Aug	32
Sep	32

BUSINESS INVENTORIES

	Inventories	Sales
May	0.0%	-0.4%
June	0.2%	0.7%
July	0.2%	1.0%

FOMC MEETING (FIRST DAY)

Wednesday 17

HOUSING STARTS

June	1.382 million
July	1.429 million
Aug	1.307 million

FOMC RATE DECISION

Thursday 18

UNEMPLOYMENT CLAIMS

	Initial (millions)	Continuing (millions)
Aug 23	0.229	1.939
Aug 30	0.236	1.927
Sep 6	0.264	1.920
Sep 13	0.231	N/A

PHILADELPHIA FED MFG BUSINESS OUTLOOK

July	15.9
Aug	-0.3
Sep	23.2

LEADING INDICATORS

June	-0.3%
July	0.1%
Aug	-0.5%

TIC FLOWS

	Long-Term	Total
May	$266.8B	$319.5B
June	$151.0B	$92.1B
July	$49.2B	$2.1B

Friday 19

Monday 22

CHICAGO FED NATIONAL ACTIVITY INDEX (8:30)

	Monthly	3-Mo. Avg.
June	-0.18	-0.26
July	-0.19	-0.18
Aug	--	--

Tuesday 23

CURRENT ACCOUNT (8:30)

24-Q4	-$312.0 bill.
25-Q1	-$450.2 bill.
25-Q2	--

Wednesday 24

NEW HOME SALES (10:00)

June	0.656 million
July	0.652 million
Aug	**0.645 million**

Thursday 25

UNEMP. CLAIMS (8:30)

GDP (8:30)

	GDP	Chained Price
25-Q1	-0.5%	3.8%
25-Q2(p)	3.3%	2.0%
25-Q2(r)	**3.3%**	**2.5%**

DURABLE GOODS ORDERS (8:30)

June	-9.4%
July	-2.8%
Aug	**-0.3%**

INTERNATIONAL TRADE IN GOODS (8:30)

June	-$84.6 billion
July	-$102.8 billion
Aug	**-$95.0 billion**

ADVANCE INVENTORIES (8:30)

	Wholesale	Retail
June	0.2%	0.2%
July	0.1%	0.2%
Aug	--	--

EXISTING HOME SALES (10:00)

June	3.930 million
July	4.010 million
Aug	**3.950 million**

Friday 26

PERSONAL INCOME, CONSUMPTION, AND CORE PRICE INDEX (8:30)

	Inc.	Cons.	Core
June	0.3%	0.4%	0.3%
July	0.4%	0.5%	0.3%
Aug	**0.3%**	**0.4%**	**0.2%**

REVISED CONSUMER SENTIMENT (10:00)

July	61.7
Aug	58.2
Sep(p)	55.4

Monday 29

PENDING HOME SALES

Tuesday 30

FHFA HOME PRICE INDEX

S&P COTALITY CASE-SHILLER 20-CITY HOME PRICE INDEX

MNI CHICAGO BUSINESS BAROMETER

JOLTS DATA

CONFERENCE BOARD CONSUMER CONFIDENCE

Wednesday 1

ADP EMPLOYMENT

ISM MFG. INDEX

CONSTRUCTION

VEHICLE SALES

Thursday 2

UNEMP. CLAIMS

FACTORY ORDERS

Friday 3

EMPLOYMENT REPORT

ISM SERVICES INDEX

Monday 6

Tuesday 7

TRADE BALANCE

CONSUMER CREDIT

Wednesday 8

FOMC MINUTES

Thursday 9

UNEMP. CLAIMS

WHOLESALE TRADE

Friday 10

CONSUMER SENTIMENT

FEDERAL BUDGET

Forecasts in bold. (p) = preliminary (2nd estimate of GDP), (r) = revised (3rd estimate of GDP)

Treasury Financing

September/October 2025

Monday	Tuesday	Wednesday	Thursday	Friday
15	16	17	18	19
AUCTION RESULTS: Rate / Cover 13-week bills 3.905% 3.11 26-week bills 3.715% 3.09 **SETTLE:** $58 billion 3-year notes $39 billion 10-year notes $22 billion 30-year bonds	**AUCTION RESULTS:** Rate / Cover 6-week bills 4.040% 2.82 20-yr bonds 4.613% 2.74 **ANNOUNCE:** $65 billion 17-week bills for auction on Sep 17 $100 billion 4-week bills for auction on Sep 18 $85 billion 8-week bills for auction on Sep 18 **SETTLE:** $65 billion 17-week bills $100 billion 4-week bills $85 billion 8-week bills	**AUCTION RESULTS:** Rate / Cover 17-week bills 3.815% 3.06	**AUCTION RESULTS:** Rate / Cover 4-week bills 4.040% 2.71 8-week bills 3.965% 2.76 10-yr TIPS 1.734% 2.20 **ANNOUNCE:** $155 billion 13-,26-week bills for auction on Sep 22 $85 billion 6-week bills for auction on Sep 23 $69 billion 2-year notes for auction on Sep 23 $70 billion 5-year notes for auction on Sep 24 $44 billion 7-year notes for auction on Sep 25 $28 billion 2-year FRNs for auction on Sep 24	**SETTLE:** $155 billion 13-,26-week bills $85 billion 6-week bills
22	23	24	25	26
AUCTION: $155 billion 13-,26-week bills	**AUCTION:** $85 billion 6-week bills $69 billion 2-year notes **ANNOUNCE:** $65 billion* 17-week bills for auction on Sep 24 $100 billion* 4-week bills for auction on Sep 25 $85 billion* 8-week bills for auction on Sep 25 **SETTLE:** $65 billion 17-week bills $100 billion 4-week bills $85 billion 8-week bills	**AUCTION:** $65 billion* 17-week bills $70 billion 5-year notes $28 billion 2-year FRNs	**AUCTION:** $100 billion* 4-week bills $85 billion* 8-week bills $44 billion 7-year notes **ANNOUNCE:** $155 billion* 13-,26-week bills for auction on Sep 29 $85 billion* 6-week bills for auction on Sep 30 $50 billion* 52-week bills for auction on Sep 30 **SETTLE:** $155 billion 13-,26-week bills $85 billion 6-week bills	**SETTLE:** $28 billion 2-year FRNs
29	30	1	2	3
AUCTION: $155 billion* 13-,26-week bills	**AUCTION:** $85 billion* 6-week bills $50 billion* 52-week bills **ANNOUNCE:** $65 billion* 17-week bills for auction on Oct 1 $100 billion* 4-week bills for auction on Oct 2 $85 billion* 8-week bills for auction on Oct 2 **SETTLE:** $65 billion* 17-week bills $100 billion* 4-week bills $85 billion* 8-week bills $13 billion 20-year bonds $19 billion 10-year TIPS $69 billion 2-year notes $70 billion 5-year notes $44 billion 7-year notes	**AUCTION:** $65 billion* 17-week bills	**AUCTION:** $100 billion* 4-week bills $85 billion* 8-week bills **ANNOUNCE:** $155 billion* 13-,26-week bills for auction on Oct 6 $85 billion* 6-week bills for auction on Oct 7 $58 billion* 3-year notes for auction on Oct 7 $39 billion* 10-year notes for auction on Oct 8 $22 billion* 30-year bonds for auction on Oct 9 **SETTLE:** $155 billion* 13-,26-week bills $85 billion* 6-week bills $50 billion* 52-week bills	
6	7	8	9	10
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**Estimate*