

August 2025 Muni MOment: A Patient Fed Navigates an Uncertain Economy

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In July, the market continued to exhibit uncertainty about the confounding economic policy mix the Trump administration is implementing and the patient approach that the Fed has adopted. The fed funds market was settled on the immediate future for fed funds, consistently forecasting less than a 5% probability that the Fed would cut rates at its July meeting. But future activity, at the September meeting, has been more of a question mark. At the beginning of July, the market was forecasting a 100% probability of a 25 bps rate cut. By mid-month, that had changed to a 50/50 probability. Post-meeting, that probability slipped a bit more to 40%.

The employment report released the morning of the writing of this piece (August 1st) caused a seismic shift in the markets. That report, in which nonfarm payrolls grew by just 83k (versus an already-weak consensus forecast of 104k), revealed a severely weakening job picture. Even more, the revisions to previous data (prior month revised from 74k to 3k, and a two-month payroll revision of negative 258k) changed market perceptions instantly. The mild concerns about the state of the labor market – concerns the market seemed able to shrug off as interest rates and equity prices both rose during the month of July – have suddenly elevated to become alarm bells. As of this writing, the 2-year treasury yield is down 23 bps from the prior night's close and domestic equity markets are down between 1-2%. The probability of an easing in fed funds at the September meeting have risen to 87%.

The last six months have been turbulent, and sentiment has undergone polar shifts several times. This may be nothing more than another of those shifts, subject to subsequent change(s) in direction – but it certainly feels different. The market's reaction makes this feel more like a confirmation of what investors had feared. After all, it's not just the weakness in employment that is of concern. The first reading of Q2 GDP growth was released during the month. The prevailing opinion of economists who dig through the component numbers is that the 3% reading this quarter overstates the "true" growth in the same way that the -0.5% contraction in Q1 understates the true growth – and that the more reasonable picture emerges by simply averaging those quarters. That approach reveals an economy growing at an anemic 1.25% rate with (most worryingly) a consumer-led slowdown pulling the economy down.

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