

Economic Summary – Q3 2025

The driving narrative of the third quarter was an abrupt slowdown in job growth, which validated the first Fed rate cut since last December. Whether the long-awaited September easing move will be the first in a series or a limited adjustment is unclear. Fed decisions are data-driven, and the data patterns have been wildly erratic. Further complicating the outlook is a government shutdown that began at midnight on the first day of the new quarter. This suspension of non-essential government services includes several agencies Fed officials rely on for critical data, meaning policymakers could begin the last quarter of this historically challenging year with even less clarity.

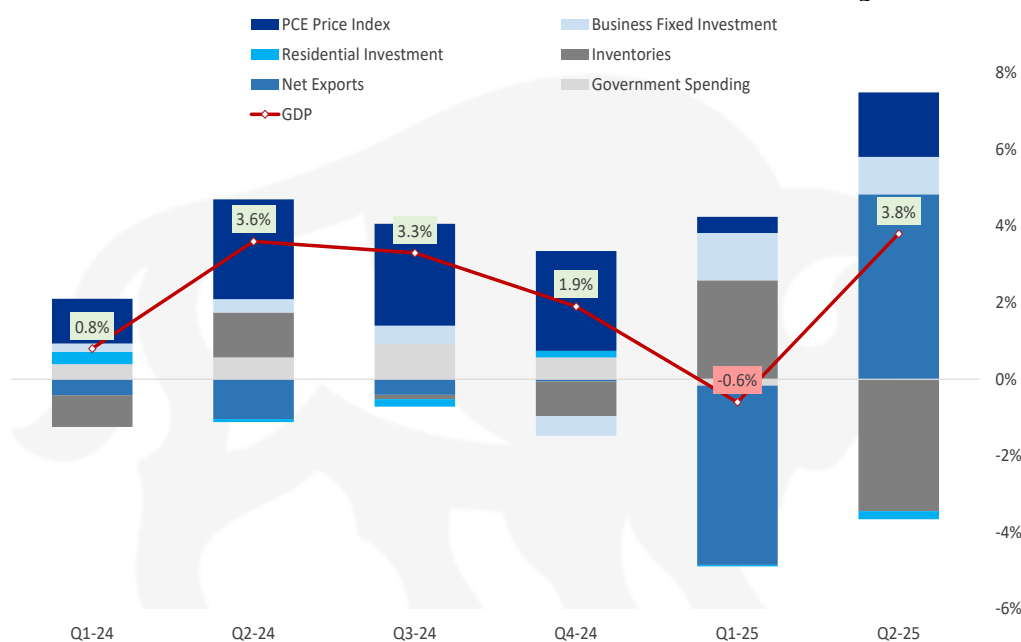
Economic growth, despite extreme trade uncertainty, accelerated unexpectedly. The final revision to second quarter GDP boosted growth from +3.3% to +3.8% as both consumption and business investment were revised higher. The first half of the year is difficult to gauge given the muddiness of the tariffs, but the Atlanta Fed's GDPNow estimate of (presumably cleaner) third quarter growth ended the quarter at +3.9%.

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Gross Domestic Product (Quarter-over-Quarter Annualized Percent Change)



Source: Bureau of Economic Analysis

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Whereas market news during the first two quarters of 2025 was dominated by tariff threats, trade talk is no longer front-page news, primarily because early concerns were clearly overblown and attention spans are short. It's also become impossible to know, with any degree of certainty, whether an import tax will be imposed, reduced or removed altogether.

The 90-day pause in the implementation of President Trump's "Liberation Day" tariff plan ended on July 9 but was extended to August 1 ... before being extended again to

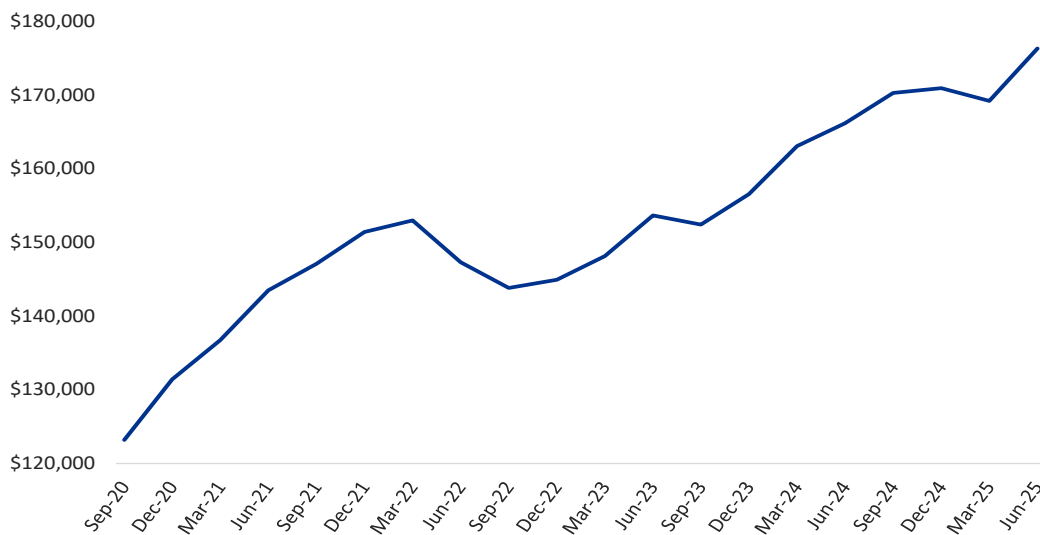
August 7. On this day, import duties ranging from 10% to 40% kicked in for 69 U.S. trade partners, pushing the average U.S. tariff rate to its highest level in a nearly a century. China was granted an additional 90-day reprieve, which should cushion most of the negative impact associated with the holiday shopping season.

The bigger impact in the near-term may play out on the geopolitical arena as the Trump administration doubled the tax on Indian imports to 50% when India refused to halt purchases of Russian oil. This gambit quickly failed as India continues to buy discounted Russian crude, while China has increased its purchases. On September 1, Indian Prime Minister Modi, Russian President Putin and Chinese President Xi Jinping met in China along with other members of the Shanghai Cooperation Organization (SCO), a group that includes Iran and Pakistan, to discuss potential new trade alignments and a unified response to recent U.S. policies. This troubling summit stood in sharp contrast to the Trump/Putin gathering two weeks earlier, which seemed to accomplish little beyond the photo opportunity. The potential for enhanced partnerships between countries representing half the world's population could have negative implications for U.S. companies and consumers, *but any impact is years away.*

The current economic situation in the U.S., on the whole, *appears* to be just fine. So far, the 2025 outcome has far exceeded dire median forecasts. U.S. household net worth reached another record high in the second quarter, and *those with money are spending*. Retail sales were unexpectedly strong, up +0.6% in August, well above the median forecast, bringing Q3 core sales growth to its fastest quarterly pace since 2023.

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Household Net Worth (\$ in billions)



Source: Federal Reserve

One explanation for this outperformance is that high-income households are driving consumption. Much of the wealth created post-pandemic has been in the form of record stock and housing valuations. Lower-income households, generally not homeowners or market participants, accrued little or no benefit. These Americans are also disproportionately impacted by higher rent, food and energy prices.

This “K-shaped” economy, in which a portion of the country has recovered from the pandemic and are thriving while others have not and are suffering, might explain why consistently soft survey data hasn’t translated into slower economic growth.

Moody's Chief Economist Mark Zandi recently posted on X that “As long as they (wealthy individuals) keep spending, the economy should avoid recession, but if they turn more cautious, for whatever reason, the economy has a big problem.” (Sep. 16, 2025)

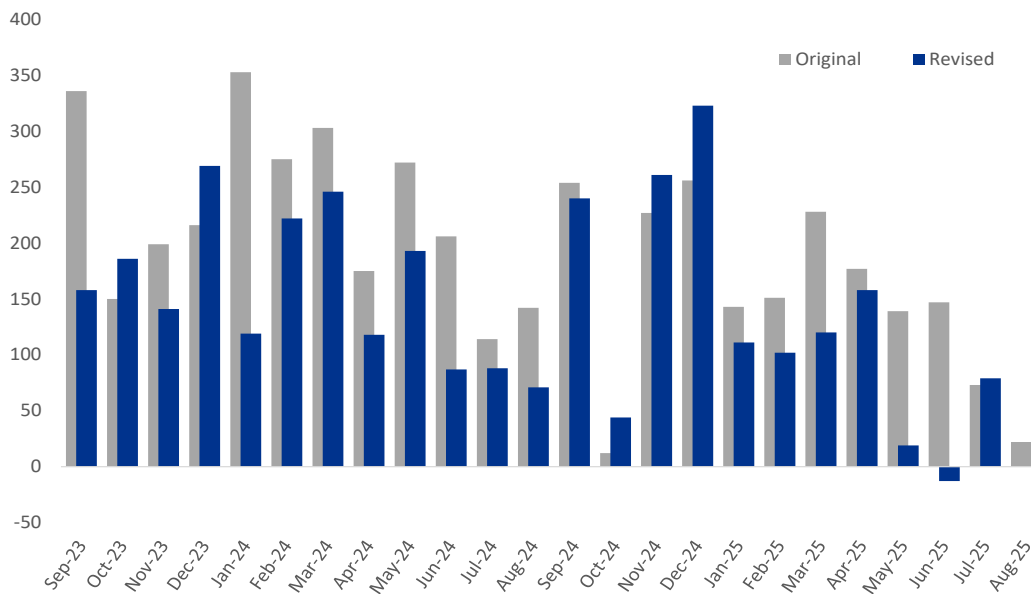
Employment

Perhaps the most obvious sign of a nation’s more immediate health is its job market. The prevailing employment situation has been widely-described as “no hire/no fire,” with layoffs hovering near historical lows and the so-called “quits rate” falling to levels last seen in 2016. Workers are increasingly choosing stability over risk, a trend referred to as “job hugging,” an abrupt reversal from the post-pandemic “great resignation.”

The July employment report from the Bureau of Labor Statistics (BLS) was arguably the single most impactful news of the quarter. Non-farm payrolls rose by just +73k, but it was the massive -256k downward revision to the two prior months that shocked the markets. When the smoke cleared, the three-month average payroll gain had been reduced from +150k per month to a paltry +35k.

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Non-Farm Payrolls Total Change (in thousands)



Source: Bureau of Labor Statistics

President Trump responded by accusing the BLS commissioner of manipulating the numbers to make him look bad. She was promptly fired and replaced. The following month, employment conditions appeared to deteriorate further as August payrolls rose by just +22k, while revisions shaved -21k from the previous two months. Most notable, June payrolls were revised down to -13k, the first outright decline since 2020. The annual

BLS benchmark revision would later subtract -911k jobs from the previously reported April 2024 to March 2025 payroll count. The largest annual revision on record suggested the hiring slowdown had started long before summer.

Manufacturing jobs declined for the fifth straight month, the number of temp jobs continued to fall, and federal employment dropped by another -12k. Healthcare and hospitality continued to add jobs but declines in the traditionally higher-paying tech and finance sectors offset those gains.

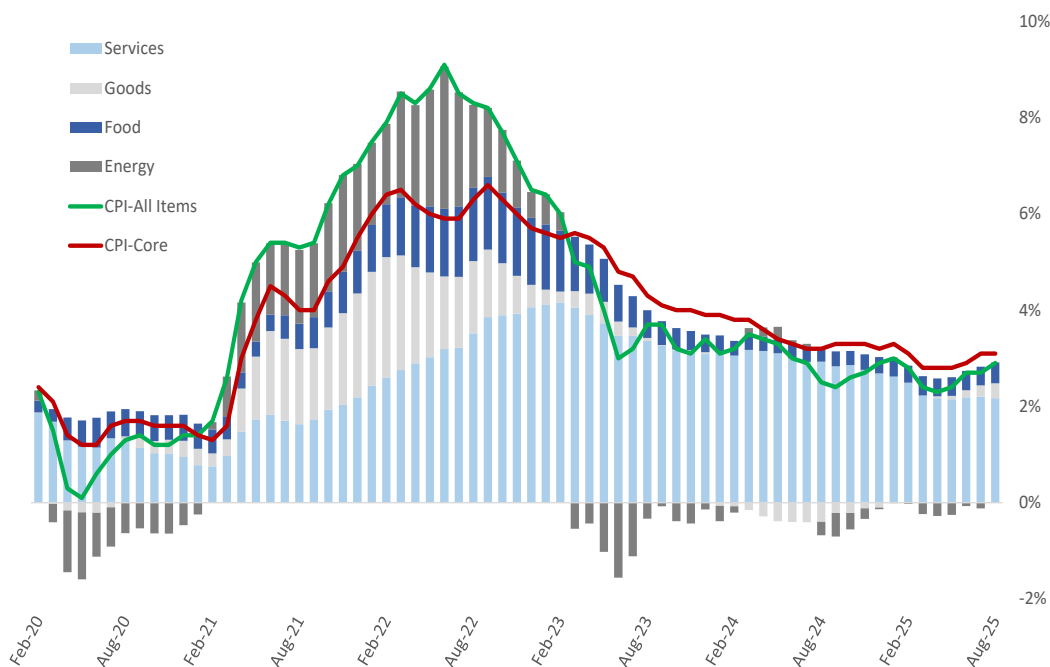
In the separate household survey, new jobseekers exceeded those finding work, pushing headline unemployment up from 4.2% to 4.3%. While the historically low unemployment rate seems to conflict with the feeble payroll gains, *fewer jobs may simply require fewer workers*. As analysts grapple with the impact of the first instance of negative net migration in at least 50 years (CNN, Aug. 2025) and roughly 11,000 Americans reaching retirement age every day through 2027 (Census Bureau, estimated based on population growth), *tepid payrolls may be the new normal*.

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Inflation

Inflation, the Fed's other mandate, took a backseat during the quarter, although *concerns are far from over*. Prices moved higher in July and August, but the tariff impact was muted and increases weren't as bad as expected. On a year-over-year basis, overall CPI climbed from +2.7% to +2.9% in August, while core CPI held steady at +3.1%. However, since much of the price pressure came from necessities, *it felt worse*.

Consumer Price Index (Year-Over-Year Percent Change)



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Source: Bureau of Labor Statistics

- Grocery prices rose +0.6% in the August CPI report, the steepest single-month increase in almost three years.
- Meat prices were up +2.7%, the most in nearly four years, while fruits and vegetables climbed +1.6%, as tomato prices rose +4.5%. This probably reflects the fact that most tomatoes come from Mexico and are subject to tariffs.
- US Beef prices reached a record high in July as Americans continue to consume more beef than the domestic industry can produce. With cattle inventories near a 75-year low, little near-term relief is expected.
- Over the past nine months, egg prices have dropped by about 13%, although avian flu cases are on the rise, prompting the Agriculture Secretary to warn of “a potentially challenging fall.”
- Coffee prices jumped another +3.6% in August, the largest monthly increase since 2011, and are now up +20.9% year-over-year. Since the U.S. imports virtually all of its coffee, extreme crop-damaging weather in Vietnam and Brazil along with a 50% tariff imposed on Brazilian imports are to blame.
- Earlier this year, the USDA had forecast U.S. orange production would fall to its lowest level in almost 90 years due to inclement weather and crop disease. In response, orange prices are just below the historical high and should increase further as the weather cools.
- The price of electricity is back at all-time highs, and although natural gas fell for the second straight month it’s up +7% since January.
- Gasoline prices jumped +1.9% following a -2.2% drop in July. Fuel costs likely had an impact on airfares which continue to edge higher, up +5.9% in August after a +4.0% July gain.

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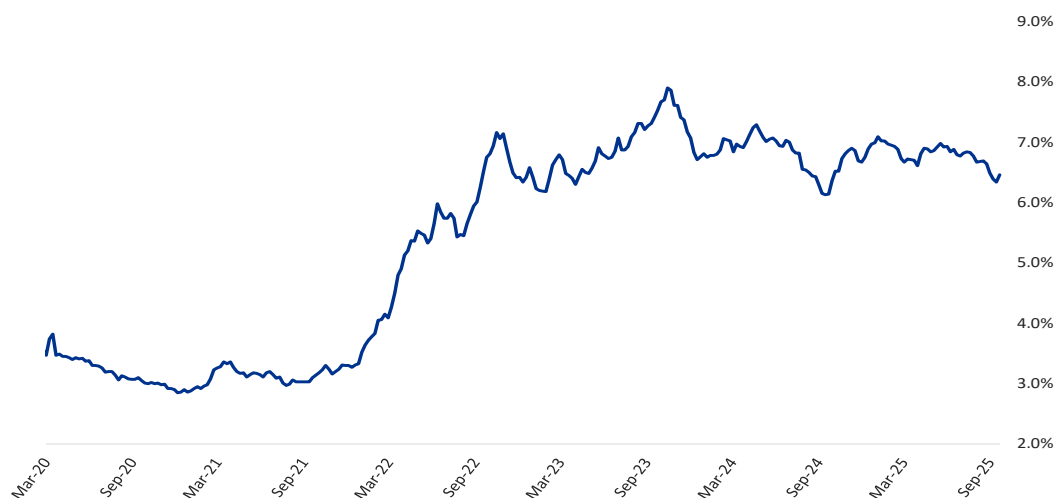
When the FOMC met in late July, Fed officials had not yet witnessed labor market deterioration but opened the door to a possible rate cut at the next meeting. On September 17, the committee ended its nine-month pause with a quarter point rate cut, bringing the overnight target range down to 4.00% to 4.25%. Among the 12 voting members, there was just one dissent, the newly appointed Fed Governor Stephen Miran, who favored a larger 50 bp move. The committee cited rising downside risks to employment as a key factor in its decision and referred to the move as a “risk management cut,” suggesting little urgency going forward.

The first “dot plot” since June indicated quarter point cuts at both of the remaining Fed meetings (in late October and mid-December), *but just barely*. There was nothing resembling a consensus.

Housing

When the Fed finally cut the overnight rate, many expected mortgage rates to drop. So far, *that hasn't been the case*. At the quarter end, the average 30-year fixed-rate mortgage was 6.46%, up from 6.39% two weeks earlier. (MBA)

US Fixed-Year Mortgage 30-Yr Contract Rate



Source: Mortgage Bankers Association

Mortgage rates are forecast to end 2025 at 6.4% and 2026 at 5.90%. (Fannie Mae) For perspective, this is down from a peak of 7.90% in October 2023, but well above the pandemic low point of 2.85% in December 2020 (MBA).

The primary housing issue in the post-pandemic era has been a lack of supply, but as home inventories increase, it's become apparent that affordability may be the bigger impediment. According to Realtor.com, the total inventory of homes for sale rose for the 22nd straight month in August, bringing active listings up +20.9% year over year. *The problem for most potential buyers is price.* The average cost to purchase a home in July was 57% higher than the same period in 2019. (S&P CoreLogic Case-Shiller)

Harvard University's Joint Center for Housing Studies reported the homeownership rate dropped for the first time in eight years to 65.6% in 2024, and slid to 65.1% in the first quarter of 2025, with the largest decline in buyers under the age of 35, emphasizing the distress inherent in the K-shaped recovery.

And the wealth gap only widened in the third quarter as the Dow rose +5.2%, the S&P 500 gained +7.8%, and the NASDAQ surged +11.8%, a remarkable +48.4% bounce from the lows in early April when tariff concerns were at their peak.

Treasury yields finished the quarter lower across the board, although the yield curve steepened as longer yields drifted higher after the September Fed meeting.

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Q3 Interest Rates

		Fed Funds	3 mo. T-bill	12 mo. T-bill	2 yr. T-note	5 yr. T-note	10 yr. T-note
Last	6/30/2025	4.25-4.50%	4.29%	3.97%	3.71%	3.80%	4.23%
High			4.34%	4.13%	4.38%	4.04%	4.79%
Low			3.95%	3.60%	3.49%	3.56%	3.73%
End	9/30/2025	4.00-4.25%	3.95%	3.63%	3.61%	3.74%	4.15%

Source: Federal Reserve, U.S. Department of the Treasury

Economic and Interest Rate Outlook

If current growth measures are any indication of where the economy will be at year end, there's reason for optimism. The passage of the GOP's business-friendly funding bill in early July lifted business confidence from the historical lows of the previous quarter. The Q3 2025 Outlook Survey from the National Association of Manufacturers (NAM) jumped almost 10 percentage points with 65% of factory managers now reporting a positive outlook, up from 55.4% in Q2.

NAM President and CEO Jay Timmons tempered expectations, cautioning that "the (factory) sector is still enormously challenged as manufacturing output took four months to recover from this spring's dip, and optimism still falls below the survey's historical average of 74%." The top business concerns - trade uncertainty, rising material prices and the higher cost of health insurance - all rose during the quarter, reiterating Timmon's concern.

In a similar vein, the Conference Board's Measure of CEO Confidence jumped from a 50-year low of 34 to 49 in the third quarter, although there were still slightly more negative than positive responses. CEO views of current conditions made the sharpest recovery, while the six-month outlook also brightened. According to the Conference Board, "the improvement is a continuation of the trend seen after tariff disputes between the US and China became less intense and potentially reflects ongoing progress on trade negotiations."

Apparent improvement in the economy should revive job growth in the fourth quarter and the 90-day tariff pause extended to China should keep the holiday shopping season merry. However, it's currently far from clear that the usual economic data will be available to confirm or dispute the outcome. It's also unclear as to whether the data will be trusted now that the BLS and the Fed have been so heavily criticized by the President, the Treasury Secretary and the Commerce Secretary.

This suggests that alternate information could play a bigger role in analyzing the health of the economy. The media has already latched onto statistical oddities like increased use of *hamburger helper*, rising food bank requests, falling cardboard demand, waning heavy truck sales and fewer visitors to Las Vegas.

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Google searches for “*help with mortgage*” have risen to the highest point in 16 years, indicating homeowner stress, while searches for “*second job*” reached an all-time high at quarter end, surpassing the 2008 financial crisis and the COVID pandemic levels.

The September Bloomberg survey showed U.S. economists expect two additional quarter point rate cuts in 2025 and two more in 2026, but the post-pandemic track record is weak. Last September, the same survey had indicated 250 basis points of easing over the coming year. At the time, it made sense. *But then things changed, as they always do.*

The Fed’s September dot plot indicated a similar rate path, but just nine of 19 FOMC members were in line with the two cut median forecast for the remainder of 2025, while two members called for just one cut, and six forecasted no cuts. One member (clearly Miran) believes an additional 125 bps in cuts is appropriate for 2025, while one actually called for a quarter point hike. *So (again) no real consensus from the Fed.*

The dot plot continues to indicate one cut in 2026 and one in 2027, but there’s more perceived downside risk to short rates next year as Fed Chair Powell’s replacement will be much more inclined to argue in favor of aggressive easing to cushion the blow of any economic contraction.

But while the Fed can dictate the overnight rate target, the long end of the yield curve is more focused on inflation expectations, the ballooning national debt, and to some degree the perception that Fed independence might be compromised in the coming months. *All legitimate concerns.*

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