GENERALI ASSET MANAGEMENT

MARKET COMMENTARY

Labour market worries lead the Fed to a steeper path of easing for this year

Paolo Zanghieri

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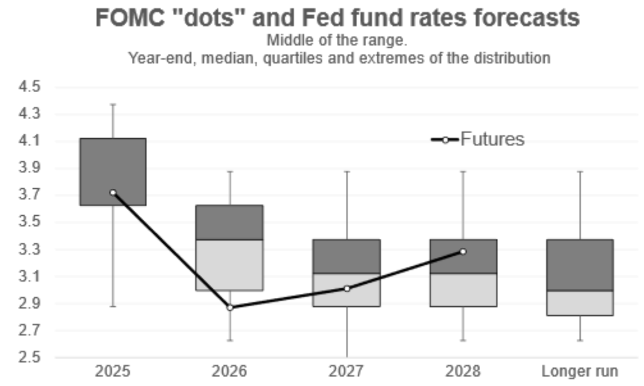
• The recent disappointing labour market data and the expectation of a short-lived inflationary impact from tariffs have shifted the balance of risks and urged the Fed to accelerate easing. It now signals three rate cuts this year, up from the two indicated in June, followed by one cut in both 2026 and 2027.

• The decline in both labour demand and supply leaves the job market in an uneasy situation, prone to the risk of a sudden spike in joblessness. Risks to unemployment and inflation are roughly in balance, which forces the Fed to move with even greater caution, as shown by the fact that more than two cuts this year are supported by the slimmest possible majority (10 out of 19 members).

• We had expected the Fed to stick to two cuts this year and we will revise our forecast with the new employment data. Market pricing (150 bps cut by year-end 2026 versus 100 shown by the dots) remains far too dovish

As downside risks to the labour market increase and the upside risks for inflation marginally ebb, the Fed opted for a risk man-agement approach and decided to signal the need for a slightly steeper path of rate cuts. The median dot is now signal-ling three rate cuts this year, followed by one in 2026 and 2027. This results in a shift of the path with no changes to its steep-ness beyond this year. As pointed out by Chair Powell, the FOMC was split on the decision, as 9 out of 19 members preferred just one or no rate cuts this year. Only one member dissented: the newly appointed Steve Miran, who preferred a half-point cut.



Source:Federal Reserve Board,Datastream,GenAM estimates

The press release focussed on the changed outlook for the labour market after the strong downward revision in past employ-ment and the softening in job creation over the last months, and on the shift in the balance of risks. Therefore, the FOMC signals a stronger commitment to bring back down the policy rate to the neutral level.

~~Although swings in net exports continue to affect the data, recent~~Recent indicators suggest that growth of economic activity moderated in the first half of the year. ~~The~~ Job gains have slowed, and the unemployment rate has edged up but remains low~~, and labor market conditions remain solid.~~. Inflation has moved up and remains somewhat elevated.

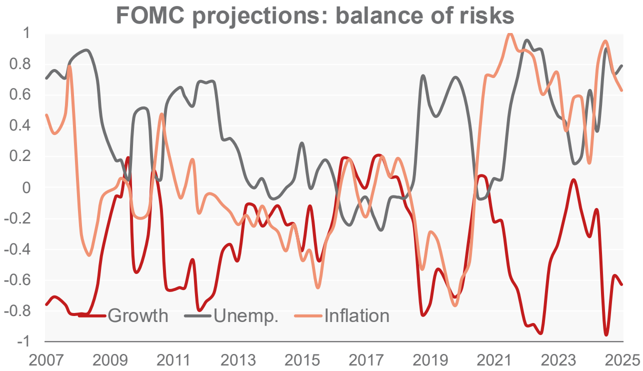
The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. Uncertainty about the economic outlook remains elevated. The Committee is attentive to the risks to both sides of its dual mandate and judges that downside risks to employment have risen.

In support of its goals and in light of the shift in the balance of risks, the Committee decided to ~~maintain~~lower the target range for the federal funds rate ~~at 4~~ by 1/4 percentage point to 4~~-~~ to 4-1/~~2~~4 percent. In considering ~~the extent and timing of~~ additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks. The Committee will continue reducing its holdings of Treasury securities and agency debt and agency mortgage~~-~~-backed securities. The Committee is strongly committed to supporting maximum employment and returning inflation to its 2 percent objective.

The "insurance" nature of the fastest pace of rate cuts appears clearly from the projections. They FOMC has indeed improved its growth and unemployment outlook and edged up the inflation forecast for next year. The faster pace of rate cuts originat-ed from a downward tilt in the balance of risks for activity and the labour market and a somehow lower concern on inflation.

Median Projection

	2025	2026	2027	2028	Longer run
Change in real GDP	1.6	1.8	1.9	1.8	1.8
June projection	1.4	1.6	1.8	-	1.8
Unemployment rate	4.5	4.4	4.3	4.2	4.2
June projection	4.5	4.5	4.4	-	4.2
PCE inflation	3.0	2.6	2.1	2.0	2.0
June projection	3.0	2.4	2.1		2.0
Core PCE inflation	3.1	2.6	2.1	2.0	
June projection	3.1	2.2	2.1	-	
Memo: Projected appropriate policy path					
Federal funds rate	3.6	3.4	3.1	3.1	3.0
June projection	3.9	3.6	3.4		3.0



Source: FRB, GenAM

The distribution of the "dots" remains wide but tilted downwards. In the press conference Powell reiterated that the median pro-jection is not a commitment to a path and that the FOMC is split, but walking back from this powerful signal would destabi-lise markets without any significant macroeconomic benefit.

Distribution of the projected year-end Fed funds rate

Estimate of year-end appropriate rate by each FOMC member, by meeting. Boxed: median

2025		2026		2027		2028		Long term	
Jun-25	Sep-25	Jun-25	Sep-25	Jun-25	Sep-25	Jun-25	Sep-25	Jun-25	Sep-25
4.38	4.38	4.13	3.88	3.88	3.88		3.88	3.88	3.88
4.38	4.13	3.88	3.88	3.88	3.88		3.88	3.75	3.75
4.38	4.13	3.88	3.63	3.63	3.63		3.63	3.63	3.63
4.38	4.13	3.88	3.63	3.63	3.63		3.63	3.63	3.50
4.38	4.13	3.88	3.63	3.63	3.38		3.38	3.50	3.38
4.38	4.13	3.88	3.63	3.38	3.38		3.38	3.50	3.38
4.38	4.13	3.63	3.63	3.38	3.13		3.13	3.38	3.25
4.13	3.88	3.63	3.63	3.38	3.13		3.13	3.13	3.13
4.13	3.88	3.63	3.38	3.38	3.13		3.13	3.00	3.13
3.88	**3.63**	**3.63**	**3.38**	**3.38**	**3.13**		**3.13**	**3.00**	**3.00**
3.88	3.63	3.38	3.13	3.38	3.13		3.13	3.00	3.00
3.88	3.63	3.38	3.13	3.13	3.13		2.88	2.88	3.00
3.88	3.63	3.38	3.13	3.13	2.88		2.88	2.88	3.00
3.88	3.63	3.38	3.13	3.13	2.88		2.88	2.88	2.88
3.88	3.63	3.38	2.88	2.88	2.88		2.88	2.88	2.75
3.88	3.63	3.13	2.88	2.88	2.88		2.75	2.63	2.75
3.88	3.63	3.13	2.88	2.88	2.63		2.63	2.63	2.63
3.63	3.63	2.88	2.63	2.63	2.63		2.63	2.50	2.63
3.63	2.88	2.63	2.63	2.63	2.38		2.63	2.50	2.63

Source: Federal Reserve Board, GenAM

In the press conference, Chair Powell pointed out that activity has slowed due to softer consumption growth, which is not fully offset by strong investment in equipment and intangibles, mostly related to AI. Unemployment edged marginally upward, but slower labour supply conceals the impact of a sharp decrease in job creation. This "curious balance" of soft demand and supply growth makes the labour market less dynamic. With record low levels of the job finding and hiring rates, a spike in fir-ings could trigger a sharp increase in the unemployment rate; the indication of quicker policy easing is meant to reduce the risk of such an outcome.

The still high level of inflation, with core PCE expected to have edged up to 2.9% year-on-year in the three months to August, is the result of a moderation in services offset by stronger goods prices. There is a clear effect of tariffs, as importers are gradually passing through the cost increases to consumers. The FOMC still expects the tariffs to produce a short-lived infla-tion rise and takes comfort from the fact that long-term inflation expectations remain consistent with the 2% goal.

After the recent employment numbers, the FOMC sees the risk of higher unemployment having risen to more or less the same level as that of persistent inflation, and this requires a faster pace of normalisation than that indicated in June. The FOMC faces the highly unusual situation of a two-sided, almost symmetric risk distribution, which implies that “there is no risk-free path,” and prevents the committee from abandoning the meeting-by-meeting decision process on rates.

We had been expecting two rate cuts this year, and we will revise our Fed path after the next employment report. Still, the expected path signalled by the dots (a 100-bps reduction by the end of next year) remains much more hawkish than the 150 bps expected by markets.

Market moves pointed to some disappointment about the small change in the policy stance and the not-so-dovish tone of the communication. The S&P lost 0.15% after rising slightly on the announcement, the trade-weighted dollar was up 0.3%, and yields basically did not move.