BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

19 September 2025

The Headlines

- United States: The Federal Open Market Committee (FOMC) cut rates by 25 basis points (bps) in what Chair Jay Powell described as a risk management cut. Participants' economic and rate projections highlighted a highly uncertain outlook offering an important reminder to investors that expectations for five additional rate cuts over the next 18 months might be excessively optimistic.
- China: Economic data from China fell short of expectations for a second consecutive month with particularly weak results related to fixed asset investment and property investment.
- Japan: The Bank of Japan (BoJ) voted 7-2 to hold rates constant but announced it will commence selling ETFs and J-REITs at a measured pace. Japanese Consumer Price Index (CPI) inflation fell slightly from July year-on-year (y-o-y) levels but was generally in line with expectations.
- United Kingdom: UK CPI inflation generally matched expectations. The Bank of England (BoE) Monetary Policy Committee (MPC) held rates constant and voted to slow the pace of quantitative tightening (QT) to £70 billion per year from the previous £100 billion per year.
- Next week's release schedule is slow with developed market Purchasing Managers' Index (PMI) data and the US Personal Consumption Expenditures (PCE) inflation report on deck.

The Week Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Fed Funds Target Rate	17 September		Level	4.00%–4.25%	4.00%–4.25%	4.25%–4.50%
	Retail Sales (Control Group)	16 September	August	m-o-m	0.4%	0.7%	0.5%
China	Retail Sales	14 September	August	y-o-y	3.8%	3.4%	3.7%
	Industrial Production	14 September	August	y-o-y	5.6%	5.2%	5.7%
	Fixed Asset Investment	14 September	August	YTD y-o-y	1.5%	0.5%	1.6%
	Property Investment	14 September	August	YTD y-o-y	-12.5%	-12.9%	-12.0%
Japan	BoJ Policy Rate	19 September		Level	0.50%	0.50%	0.50%
	Headline CPI	19 September	August	y-o-y	2.8%	2.7%	3.1%
United Kingdom	BoE Bank Rate	18 September		Level	4.00%	4.00%	4.00%
	Headline CPI	17 September	August	y-o-y	3.8%	3.8%	3.8%
	Core CPI	17 September	August	y-o-y	3.6%	3.6%	3.8%
	Services CPI	17 September	August	y-o-y	4.8%	4.7%	5.0%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Headline PCE Inflation	26 September	August	y-o-y	2.7%		2.6%
	Core PCE Inflation	26 September	August	y-o-y	2.9%		2.9%

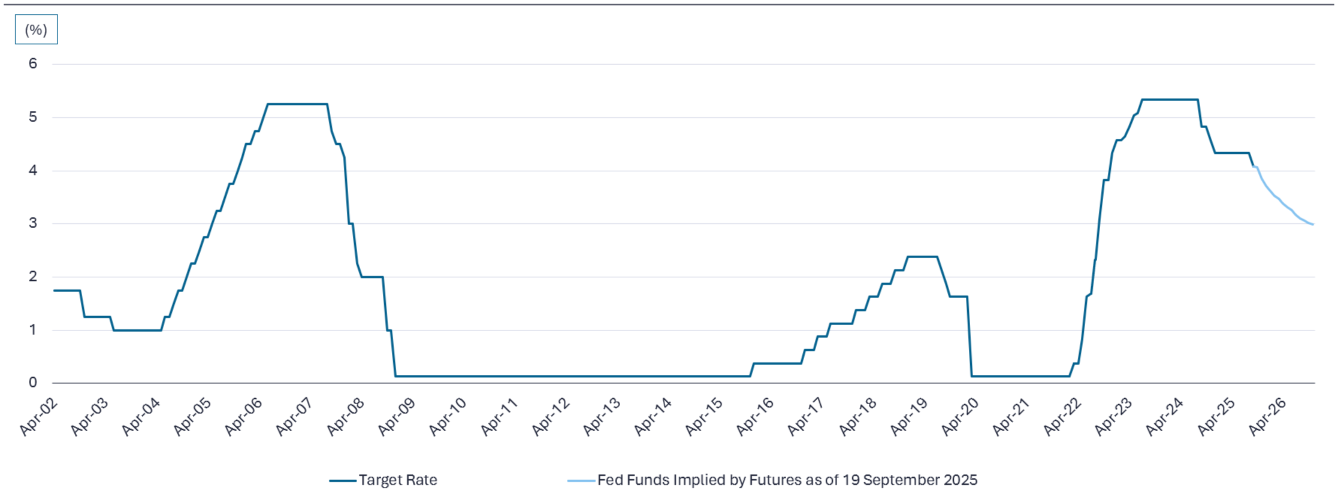
The Week Behind

1. The FOMC cut rates by 25 bps in what Chair Jay Powell described as a "risk management cut."

The outlook: Markets are pricing four rate cuts through the 29 July 2026 FOMC meeting taking the fed funds rate to 3.00%–3.25%. While these expectations could prove correct, I believe the key takeaway from the economic data and this week's Fed communications is that the outlook is highly uncertain and that any near-term rate view should be subject to a high degree of skepticism.

Markets Are Pricing ~100 bps of Fed Easing through July 2026*

Federal Reserve Target Rate and Implied Rate through November 2026



Source: Bloomberg, Chicago Mercantile Exchange, Federal Reserve
Note: As of 19 September 2025
* Markets imply a 91% chance of a 25-bps rate cut through the 29 October meeting and an 80% chance of an additional 25-bps rate reduction through the 10 December meeting.

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For both legs of the Fed's dual mandate, there is significant uncertainty regarding the outlook. I expect core CPI inflation to approach 4% y-o-y over the next six months versus the 3.1% level in July and August. While many economists remain confident that consumers will bear the bulk of tariffs over time, many investors appear to have concluded otherwise. The jury remains out on this question which makes projecting the Fed's policy response to inflation more difficult.

For the employment mandate, there is also a lack of clarity. The labor market has clearly weakened with hiring rates near 2013 levels, unfilled jobs per unemployed worker back below parity for the first time since 2017 (excluding the pandemic), and nonfarm payroll growth down to 27,000 jobs per month since May. But labor supply growth also slowed sharply. On a seasonally adjusted basis from May to August, labor force growth fell to only 268,000 workers in 2025 versus 697,000 in 2024. Despite the sharp slowdown in job creation, the unemployment rate only rose 10 bps from May to August to 4.3%, a level economists would generally describe as full employment.

Looking forward, with sharply lower migrant arrivals into the United States and an administration target to arrest and deport 3,000 people per day, it is difficult to foresee a meaningful acceleration in labor force growth. Hence, even if nonfarm payroll growth remains weak, the unemployment rate might not increase materially. Yet again, this means the outlook for Fed policy is in question.

When I put it all together, I think investors should feel confident that two more rate cuts are likely by mid-2026. My logic is that tariff-induced inflation is likely to peak in the next six months which suggests some unpleasant inflation surprises. By Q2-26, however, inflation should begin to subside as y-o-y figures begin to include tariffs in both the current and prior year. At that point, the Fed will be able to assess whether tariffs have led to price pressures beyond goods. Assuming they have not, additional easing will be warranted, opening the door to reaching a neutral rate on fed funds.

Then the debate will be over the level of the neutral rate. I believe there are credible arguments that in the near term, the neutral rate is above 3%, perhaps as high as 3.50%. If that is the case, current market expectations for an additional four cuts through the July 2026 FOMC and an additional cut through the January 2027 FOMC appear excessive.

<u>The details:</u> The FOMC voted 11-1 to cut rates by 25 bps to 4.00%–4.25%. The sole dissenter was Stephen Miran who joined the Committee the day the FOMC meeting began and advocated for a 50-bps reduction. When comparing the Summary of Economic Projections (SEP) September versus June economic forecasts, an apparent contradiction arose. The September SEP indicated participants expected stronger GDP growth from 2025 through 2027, slightly lower unemployment in 2026 and 2027, and higher headline and core PCE inflation in 2026. Given those expectations, many observers questioned why the policy conclusion was to ease rates when signals from the SEP were for an improved outlook. Powell's response to these questions was to invoke the "risk management cut" terminology.

Approaching the meeting, I was eager to gain five data points from the meeting:

- The vote split: I had expected to potentially have a three-way vote split with perhaps a couple of members voting for no rate change, the majority advocating for a 25-bps cut, and as many as three votes for a 50-bps reduction. The agreement of all members other than Miran was encouraging as it perhaps signals that the voters recognize the importance of avoiding any perception of political influence on rate decisions and the need to act cautiously given the conflicting evidence from economic data.

- Statements from dissenting voters: Unlike at the July meeting, when Michelle Bowman and Chris Waller issued dissenting views separately from the Committee decision, this time no dissenting views have been published.

- The "dot plot": The "dot plot" highlighted the divide within the FOMC with seven of the 19 participants indicating that no additional rate cuts are likely warranted in 2025 (one actually suggested a rate hike by year end). At the same time, two expected one more 25-bps cut and nine expected 50 bps of additional cuts in 2025. The one outlier, presumably Stephen Miran, indicated that 125 bps of additional easing would be appropriate by year end.

- The longer-term neutral rate: I was curious to see if there was any change in the view of where the neutral rate is in the longer term. The median expectation of 3.00% did not change, but the central tendency, which excludes the highest three and lowest three projections narrowed to a range of 2.8%–3.5% from the prior 2.6%–3.6%. I interpret this as signaling higher confidence in the ~3.0% neutral assessment.

- The language used in the press conference: Chair Jay Powell deftly navigated explaining the various crosscurrents affecting voters' views. The most important word choice in my view was his description of the policy move as a "risk management cut" highlighting that the FOMC was taking out an "insurance policy" against growing downside risks.

Overall, the results of the FOMC meeting were better than I had feared in terms of cohesiveness and avoiding the perception of politicization. Importantly, Powell also tempered some expectations for aggressive rate cuts without rattling markets.

2. **US retail sales were better than expected.**

The outlook: Retail sales have remained more resilient than expected given the weakening labor market and weak consumer sentiment. I expect sales growth to weaken later this year as tariffs become more evident in prices and as labor market softening starts to crimp discretionary income.

The details: In the most recent three months, retail sales have been strong, rising at an annualized 9.2% which clearly represents a sizable increase in nominal and real terms.

US August Retail Sales	Consensus	Actual	Prior Month	Revised
Retail Sales m-o-m	0.2%	0.6%	0.5%	0.6%
Retail Sales ex-Auto m-o-m	0.4%	0.7%	0.3%	0.4%
Retail Sales ex-Auto and Gas m-o-m	0.4%	0.7%	0.2%	0.3%
Retail Sales Control Group	0.4%	0.7%	0.5%	

Source: Bloomberg, U.S. Census Bureau

3. **China macro data were weak for the second consecutive month.**

The outlook: I expect China's economic data to remain weak for the foreseeable future as the underlying housing crisis dampening consumer demand remains unaddressed and as export front-loading is behind us. However, from an investor perspective, bad news could be good news if negative economic data leads the central government to announce a large fiscal stimulus program.

The details: All of the key metrics released this week were worse than expected and weakening from the prior month. The most notable negative data point was fixed asset investment (FAI) which fell to the weakest level since mid-2020. Year-to-date (YTD) y-o-y FAI activity rose only 0.5% in August after rising 1.6% YTD y-o-y in July. This implies a meaningful decline on a month-on-month (m-o-m) basis. Infrastructure, property, and manufacturing FAI declined sequentially suggesting broad-based weakness.

Retail sales growth also disappointed in part due to the fading benefits from consumer trade-in subsidy programs. Industrial production fell short of expectations in large part due to a drop-off of demand from overseas after months of front-loading to avoid tariffs.

China August Economic Data		Consensus	Actual	Prior
Industrial Production	y-o-y	5.6%	5.2%	5.7%
	YTD y-o-y	6.2%	6.2%	6.3%
Retail Sales	y-o-y	3.8%	3.4%	3.7%
	YTD y-o-y	4.7%	4.6%	4.8%
Fixed Asset Investment	YTD y-o-y	1.5%	0.5%	1.6%
Property Investment	YTD y-o-y	-12.5%	-12.9%	-12.0%
Residential Property Sales	YTD y-o-y	*	-7.0%	-6.2%
New Home Prices	m-o-m	*	-0.30%	-0.31%
Used Home Prices	m-o-m	*	-0.58%	-0.55%

Source: Bloomberg, National Bureau of Statistics
* No consensus estimate available on Bloomberg.

4. **Japan's CPI inflation was largely in line with expectations.**

The outlook: I expect inflation to continue decelerating in Japan as food price increases normalize. The biggest anomaly for months has been rice prices which peaked in May 2025 at a y-o-y increase of 101.8%. In August, rice prices rose "only" 69.8% y-o-y. While rice is only 0.6% of the CPI basket, this deceleration alone subtracted nearly 0.2 percentage points from total inflation since May. Looking beyond rice, food prices have contributed significantly to overall inflation. The BoJ indicated in its policy statement this week that it expects food inflation including rice prices to wane. I agree with the BoJ that the primary underlying driver of structural inflation is likely to be wages which are likely to continue rising due to labor market tightness.

The details: Headline inflation rose 2.7% y-o-y in August versus 3.1% in July. Lower food inflation contributed to the decline as did a 3.3% y-o-y decline in energy prices (versus -0.3% y-o-y in July). For core and core-core inflation, a slowdown in price increases for consumer durables and everyday necessities also contributed to a deceleration in inflation versus July.

Japan August CPI	Consensus	Actual	Prior Reading
Headline y-o-y	2.8%	2.7%	3.1%
CPI y-o-y ex-fresh food (core)	2.7%	2.7%	3.1%
CPI y-o-y ex-fresh food and energy (core-core)	3.3%	3.3%	3.4%

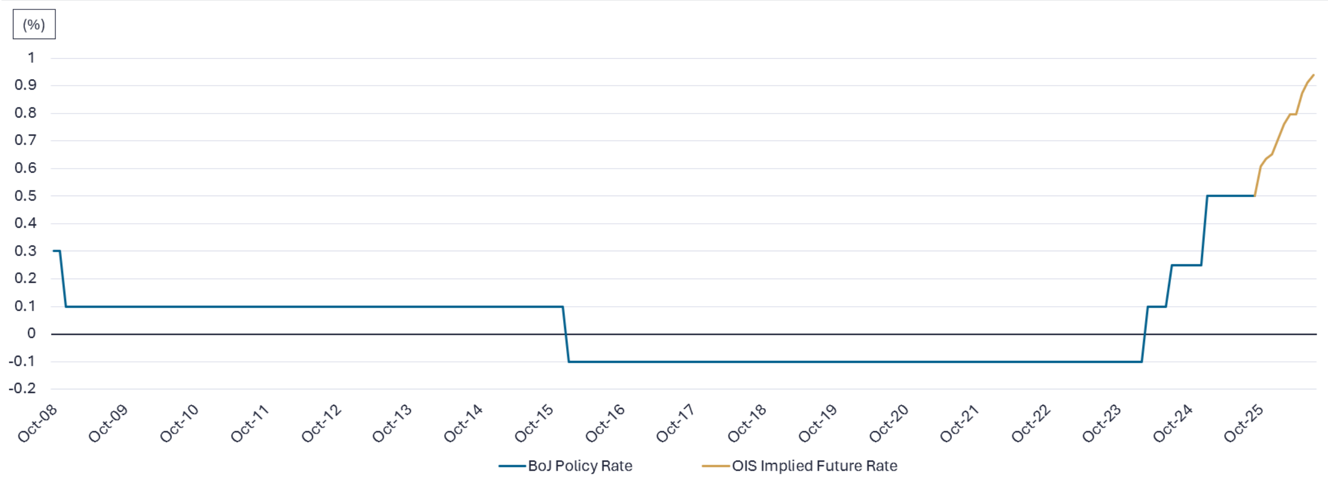
Source: Bloomberg, Japan Ministry of Internal Affairs and Communications

5. **The BoJ held rates constant but surprised markets by announcing sales of ETFs and J-REITs.**

The outlook: The BoJ is likely to continue to pursue a slow process of normalizing monetary policy. Its flexibility continues to be somewhat constrained by political uncertainty as the Liberal Democratic Party (LDP) is in the process of identifying a new leader who will then form a new government. Even without the LDP uncertainty, I believe the BoJ is wise to avoid tightening policy too quickly after such an extended period of no inflation. Markets currently suggest that the BoJ will increase rates by 46 bps though the 31 July 2026 policy meeting with the first of two rate hikes presumed highly likely by the 23 January 2026 meeting. I see downside risk to these rate hike expectations, as a wide array of events and data points could cause the BoJ to delay further.

Markets Suggest ~46 bps of Additional BoJ Rate Hikes through July 2026*

Implied Eurozone Deposit Rate through July 2026



Source: Bloomberg
Note: As of 19 September 2025
* Markets currently imply a 52% chance of a 25-bps hike through the 30 October meeting and a 72% chance of one 25-bps hike through the 19 December meeting.

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The details: The highlights of the BoJ meeting were the dissensions and the asset sale decisions. At this week's meeting, there were two dissenting votes versus the prior four meetings which were all unanimously in favor of holding rates constant. One dissenter, Hajime Takata, noted that, "the price stability target had been more or less achieved," while Naoki Tamura indicated that, "with risks to prices becoming more skewed to the upside, the Bank should set the policy interest rate a little closer to the neutral rate." I see these two dissents as adding to the likelihood of a rate hike at the next few BoJ meetings, but I do not see them as materially raising the chances of an October hike.

The BoJ also announced it will sell ETFs at a pace of ¥620 billion per year on a current market value basis (¥320 billion on a book value basis). It also will sell J-REITs at a pace of ¥5.5 billion per year on a market value and ¥5 billion on a book value basis. The BoJ currently owns more than ¥75 trillion of ETFs which implies that it would take over 100 years to exit its positions at the current pace. With the announced sales representing an average of about 0.05% of daily trading volume, the BoJ is aiming to avoid disrupting markets while exiting this aspect of its pandemic intervention.

6. **UK August CPI inflation was largely in line with expectations.**

The outlook: UK inflation has been more persistent than in most other developed economies. I expect that to continue to be the case, but I also expect price pressures to fade moving into 2026. After a series of negative inflation surprises in recent months, this month's report likely reassured the BoE that it will have the flexibility to cut rates in the not-too-distant future.

The details: Headline inflation remained at 3.8% with food inflation contributing to the undesirably high pace of price increases. Services inflation decelerated by 30 bps versus July with lower transportation, hotel, and package holiday prices contributing to this disinflation after adding materially to inflation in prior months.

UK August CPI

	Consensus	Actual	Prior Reading
Headline m-o-m	0.3%	0.3%	0.1%
Headline y-o-y	3.8%	3.8%	3.8%
Core y-o-y	3.6%	3.6%	3.8%
Services y-o-y	4.8%	4.7%	5.0%

Source: Bloomberg, UK Office for National Statistics

7. **UK retail sales were slightly stronger than expected in August.**

   The outlook: I expect UK retail sales growth to remain sluggish until the BoE can ease policy more aggressively to incentivize consumption. In the interim, BoE policy largely designed to decrease economic demand to drive inflation toward the 2% target.

   The details: The slightly stronger total sales (including and excluding auto fuel) were actually a bit better than they appear on the surface as weaker auto sales depressed the totals. Excluding auto sales, headline sales would have increased 0.8% m-o-m versus the 0.4% consensus. Food stores, non-food stores, and non-store retailers (online) all reported rising sales.

UK August Retail Sales	Consensus	Actual	Prior Month	Revised
Retail Sales including Auto Fuel m-o-m	0.4%	0.5%	0.6%	0.5%
Retail Sales including Auto Fuel y-o-y	0.6%	0.7%	1.1%	0.8%
Retail Sales excluding Auto Fuel m-o-m	0.7%	0.8%	0.5%	0.4%
Retail Sales excluding Auto Fuel y-o-y	1.0%	1.2%	1.3%	1.0%

Source: Bloomberg, UK Office for National Statistics

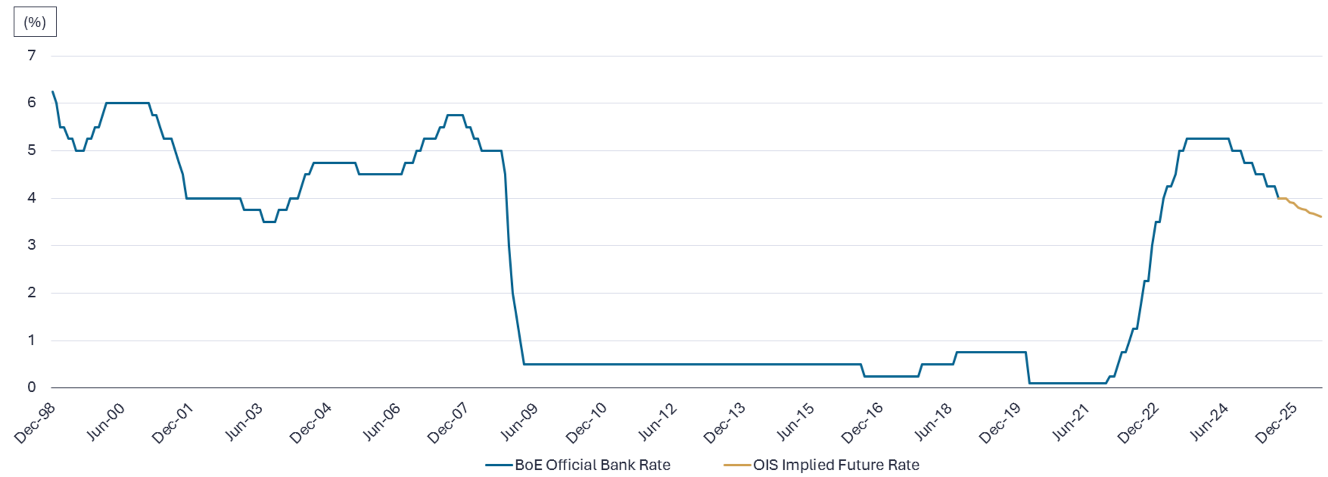
8. **The BoE held rates constant, maintained its commitment to a "gradual and careful" policy normalization, and slowed the pace of QT to £70 billion per year from £100 billion per year.**

   The outlook: Markets are pricing 36 bps of easing through the 30 July 2026 BoE MPC meeting. I believe the BoE will end up cutting twice by mid-2026 as inflation decelerates.

   The details: The MPC voted 7-2 to hold rates constant with the dissenters favoring a 25-bps cut. The £70 billion pace of QT will involve sales of about £20 billion per year with the balance being driven by maturities. The MPC shifted the split of sales to reduce the amount of selling of long-maturity gilts from one-third of sales to one-fifth. The QT decision was supported by seven MPC members with one dissenter supporting cutting the pace of QT to £62 billion per year while another supported maintaining the pace of £100 billion per year.

Markets Suggest ~36 bps of Additional BoE Rate Cuts through July 2026*

Implied Eurozone Deposit Rate through June 2026



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Source: Bloomberg
Note: As of 19 September 2025
* Markets currently imply a 9% chance of a 25-bps cut through the 6 November meeting and a 29% chance of a 25-bps cut through the 18 December meeting.

The Week Ahead

1. **Developed market PMIs will be released on 23 September.**

   The outlook: Consensus expectations are for a slightly softening of the manufacturing and services PMIs in the United States, while UK PMIs are expected to be stable. In the Eurozone, minimal changes are expected with slight softening in France and slight strengthening in Germany.

2. **US PCE inflation for August is expected to be stable.**

   The outlook: US PCE inflation is unlikely to deliver any major surprises given that the key components have largely been reporting already in the CPI and Producer Price Index reports. PCE inflation is expected to be stable in August versus July on a y-o-y basis with slight variations in the headline and core m-o-m figures.

US August PCE Inflation

	Consensus	Prior Reading
Headline m-o-m	0.3%	0.2%
Headline y-o-y	2.7%	2.6%
Core m-o-m	0.2%	0.3%
Core y-o-y	2.9%	2.9%

Source: Bloomberg, UK Office for National Statistics

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