

Andrew Kohl
Chief Investment Officer
Alloya Corporate FCU

Economic Update

SEPTEMBER 2025

Commentary

The long-anticipated Fed rate cut finally arrived this month. Heading into 2025, the market expected the first rate cut to occur in March but instead had to wait an extra six months as inflation has remained elevated. Despite the delay, the stock market was still pleased with the outcome, with the S&P 500 gaining 3% in September and up 13% on the year.

At the Federal Open Market Committee (FOMC) meeting, the participants updated their economic projections for the next three years. The median fed funds rate forecast indicates two more rate cuts this year and further modest declines the next two years until ultimately reaching 3% by the end of 2028 (versus 4.25% today). The post-FOMC press conference provided by Chairman Powell was somewhat hawkish as he considered the 25-basis point cut as more of a “risk-management” move than an indication of a prolonged easing cycle. The Fed’s dual mandate remains in tension as inflation has now been above their target for over four years, yet the labor market is showing signs of weakness. The Fed believes that downside risks to the economy are building, but it will be difficult to take aggressive preemptive action with inflation well above their target.

Last week, Q2 gross domestic product (GDP) was revised upwards from 3.3% to 3.8%, which is the fastest pace in nearly two years. The revision was mainly due to much stronger consumer spending. Importantly, our preferred economic growth measure (final sales to domestic purchasers) was upgraded by one full percentage point to 2.9%. That growth rate is on pace with where we’ve been over the past few years. The updated data also includes more comprehensive annual revisions going back to 2000. The data showed more household income (largely due to dividends) than previously reported, indicating that consumer health is even better than previously believed. With many GDP prediction models pointing to 3%+ growth in Q3, the economy looks to be on solid footing.

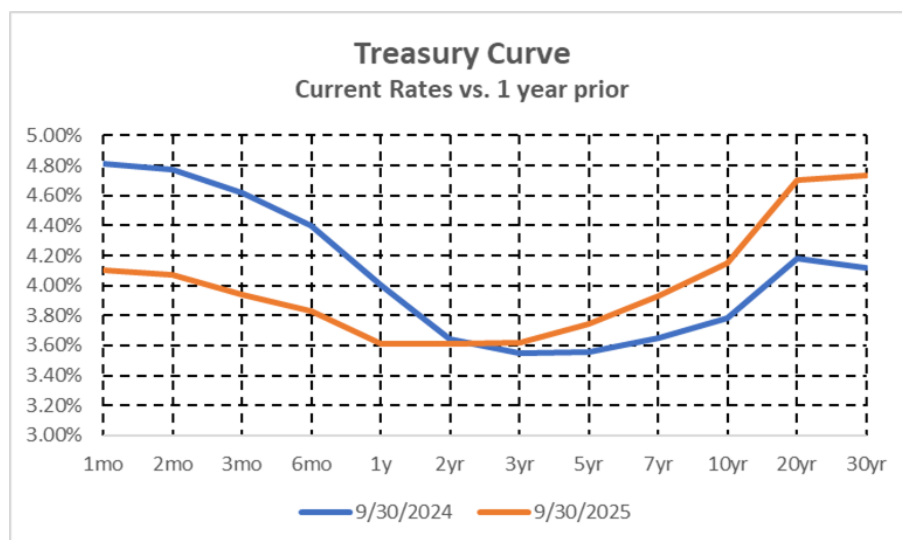
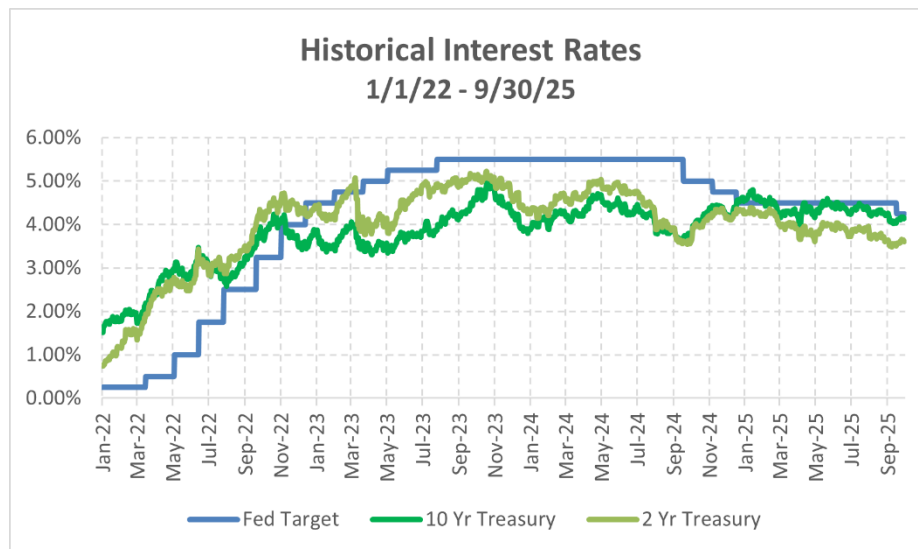
As we head into the end of September, we are experiencing what has now become an annual ritual of an impending government shutdown. This is because September is the last month of the federal government’s fiscal year and because the increasing polarization of the political parties has made it harder to reach a compromise until (and sometimes beyond) the deadline. This year’s process has been even more acrimonious, with President Trump threatening to fire many federal workers rather than just have them furloughed. We have not had a shutdown since 2019. The economic impacts of shutdowns are typically small and short-lived. The longer the shutdown, the greater the possibility of a larger drag on growth. For now, we expect any government shutdown to be short-lived, but it is an added risk to the economy.

THIS MONTH

- COMMENTARY
- FIXED INCOME OUTLOOK
- LABOR READINGS
- INFLATION READINGS
- CONSUMER READINGS

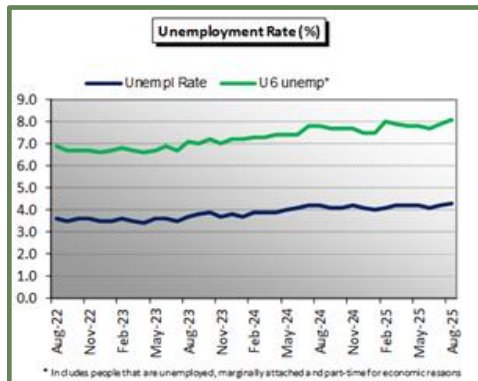
Fixed Income Outlook

Treasury rates steepened in September, with short-term rates declining and the longer end of the curve remaining relatively unchanged. The Fed cut rates by 25 basis points, as expected, at its meeting this month. The economic projections showed a wide range of forecasts, which isn't surprising given the tension between the Fed's dual mandate. The markets have priced in a 97% chance of a rate cut at the October meeting and a 78% chance of another cut in December. Those odds seem a bit high given the current strength in the underlying economy, but all will depend on how the labor market unfolds.



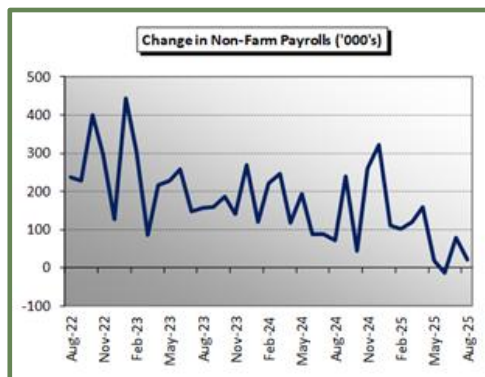
Labor Readings

(Data source: Bloomberg)



Unemployment Rate Moves Higher

The unemployment rate increased from 4.2% to 4.3% in August, in line with expectations. The unemployment rate is now at its highest level since October 2021. The labor market has been weakening, with continuing jobless claims reaching the highest level in four years and more people working part-time for economic reasons.

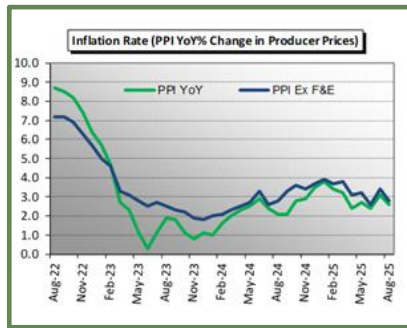


Payroll Growth Remains Weak

Payroll growth for August came in below expectations. There were 22,000 net job gains versus an estimated gain of 75,000 jobs. Payroll growth has come in below 100,000 jobs for four consecutive months and three-month average payroll growth is at a multi-year low.

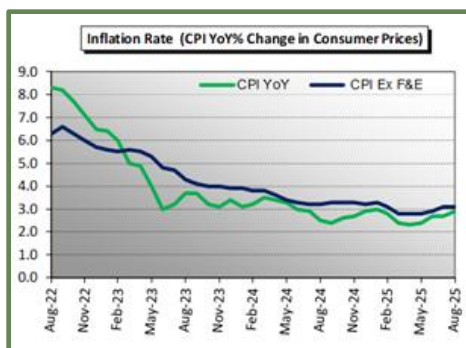
Inflation Readings

(Data source: Bloomberg)



Producer Prices Inflation Cools Off

Producer prices in August were well below expectations. On a month-over-month basis, prices declined for the first time in four months. The year-over-year price change was 2.6% versus an expected increase of 3.3%.



Consumer Inflation as Expected

As expected, consumer inflation in August rose by 2.9% on a year-over-year basis, which was an increase from 2.7% the prior month. Core inflation rose by 3.1%, unchanged from the prior month. On a month-over-month basis, both headline and core inflation rose at the fastest pace since January.

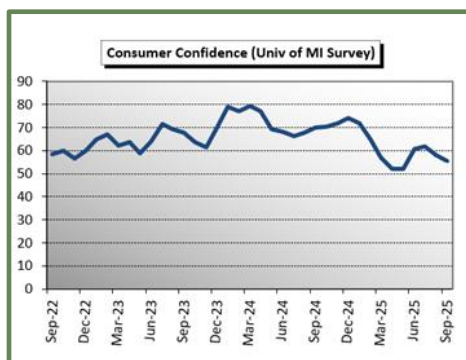
Consumer Readings

(Data source: Bloomberg)



Retail Sales Stronger than Expected

Retail sales advanced by .6% on a month-over-month basis versus an expected gain of .2%. Retail sales have shown strong gains over the past three months. Nine of the 13 sales categories posted monthly gains. Control-group sales, which feed into the GDP calculation, indicate healthy consumer spending in Q3.



Consumer Confidence Decreases

Consumer confidence in September declined by more than expected. Confidence is declining more sharply among lower to middle-income consumers. Many consumers expect rising unemployment and worsening personal finances in the months ahead.