3Q25 Economic Summary

After a turbulent first half of the year, the U.S. economy entered the third quarter on uneven ground as investors weighed resilient consumer demand against weakening labor market conditions and lingering inflation pressures. Add to the mix rising geopolitical tensions, a looming government shutdown and concerns about Fed independence and you have the recipe for another quarter of heightened economic uncertainty.

Equity markets shrugged off the unknowns and hit new all-time highs during the quarter as AI exuberance, solid corporate earnings and expectations of easing monetary policy overrode concerns about mixed economic data. Fixed income markets also posted solid returns as bond yields fell following the Fed's first rate cut of the year. The yield curve steepened during the quarter as short-term yields, which are more sensitive to rate cut expectations, dropped more dramatically than long-term yields.

Despite the uncertainty, the U.S. economy continued to defy expectations. After a sluggish first quarter, second quarter GDP growth was revised up from 3.3% to 3.8% on stronger than initially reported consumption and business investment. The positive momentum continued in the third quarter as consumers increased spending on goods and services despite sticky inflation and a softening job market. While budget conscious consumers became more discerning in their spending, the same cannot be said for higher net worth individuals whose personal wealth benefited from the summer stock market rally. Business investment was also strong in the third quarter as companies expanded their digital infrastructure through purchases of software and AI-related equipment. Residential investment remained lackluster, however, as still-rising home prices kept homeownership out of reach for many Americans even with falling mortgage rates.

While GDP growth remained solid during the third quarter, labor market conditions began to show clearer signs of cooling. Job growth slowed materially during the summer, with payroll gains averaging a paltry 29,000 for the three months ending in August. The hiring pullbacks were broad-based with healthcare being one of the few sectors where employment remained strong. The unemployment rate ticked up to 4.3% in August, its highest level in nearly four years. Despite the uptick, initial jobless claims remained relatively stable as employers were reluctant to part with workers even though new hiring stalled. This low-hiring, low-firing environment has resulted in a significant decrease in job openings and an increase in continuing claims as people remain unemployed for longer.

With prices gradually rising on both sides of the economy, progress on inflation appears to have plateaued in the third quarter. After moderating for most of the summer, inflation measures came in hotter than expected in August. While inflationary fallout from trade policy has been limited thus far, goods prices continued to creep up, particularly on tariff-sensitive items like furniture, appliances and apparel. In addition, disinflation in services stalled in August as travel prices and shelter costs increased.

Despite inflation remaining stubbornly above its 2% target, the Fed began to shift its stance toward easing monetary policy in the third quarter. After opting to remain on hold at the July meeting, Chair Powell set the stage for a rate cut during his speech at the Jackson Hole symposium in August. He stated that the balance of risks had shifted toward employment, warranting a change in policy as soon as the next meeting. The Fed proceeded to cut rates by 25 basis points at the September meeting, resulting in a target range for the fed funds rate of 4.00-4.25%. Governor Stephen Miran, recently appointed to the Board by President Trump, was the only dissent. He favored a more aggressive 50 basis point cut instead. While Committee members agreed that inflation remained elevated, concern over the state of the labor market outweighed inflation risk and prompted the Fed into action.

Most participants believed further easing would be appropriate, with the dot plot forecasting an additional 50 basis points of cuts by year-end. However, the Committee agreed that policy was not on a preset course and further action would be dependent on incoming data. Unfortunately, partisan gridlock forced the U.S. government to shut down on October 1, delaying many key economic releases, including September employment and inflation reports. The data blackout has further complicated the Fed's policy-making process. It's hard to be data dependent with no data. As such, markets are expecting the Fed to stay the course and cut rates another 25 basis points at the October meeting.