WEEKLY ECONOMICS

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THOUGHTS OF THE WEEK

FOMC Preview: Tariffs Begin to Bite, and the Labor Market Softens

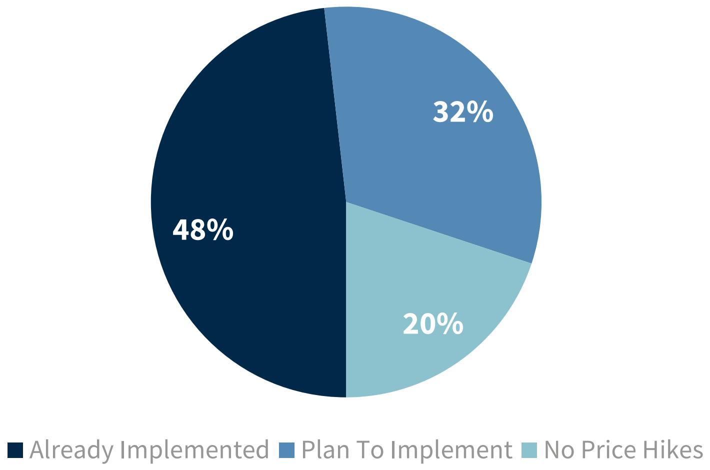
With the Federal Open Market Committee (FOMC) meeting on the horizon, we've taken a closer look at recent economic developments to better understand the landscape Federal Reserve (Fed) officials will be navigating next week.

The August Producer Price Index (PPI) came in softer than anticipated, reflecting a partial reversal of July's sharp gains. Services prices led the decline, while goods prices posted only a modest increase. The July surge had been driven by strong growth in capital equipment purchases, as firms increased purchases due to higher tariffs scheduled to take effect in August, and energy costs, but both categories saw a pullback in August. Lower energy prices and reduced private capital equipment spending, across both government and private sectors, contributed to the overall softness in August. Looking ahead, the inflationary impact of tariffs is expected to become more pronounced, potentially exerting upward pressure on input costs.

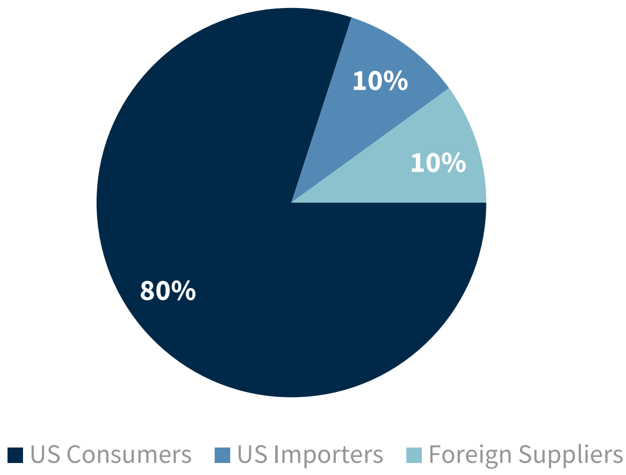
In contrast, the Consumer Price Index (CPI) surprised to the upside in August, largely due to a stronger than expected increase in shelter costs. Food prices rose 0.5%, likely reflecting the early effects of tariffs, with notable increases in tariff-sensitive items such as tomatoes and coffee. Apparel prices also climbed 0.5%, marking the third consecutive monthly increase. Core goods inflation posted its strongest gain since May 2023, rising 0.3%, driven by a 1.0% increase in used vehicle prices and a 0.3% rise in new vehicles. Meanwhile, non-tariffed items like medicinal drugs saw a 0.4% decline.

These developments suggest that tariffs are beginning to influence consumer inflation. While a recent Dallas Fed survey[1] indicates that only 48% of companies have raised prices so far, we estimate that by 2026, up to 80% of tariff costs will be passed on to consumers. Fortunately, goods inflation accounts for just 36% of the CPI basket, suggesting the impact may be contained and transitory, and unlikely to approach the inflation peaks of 2022.

Tariff-Related Price Hikes (Dallas Fed)



Long-Term Tariff Absorption



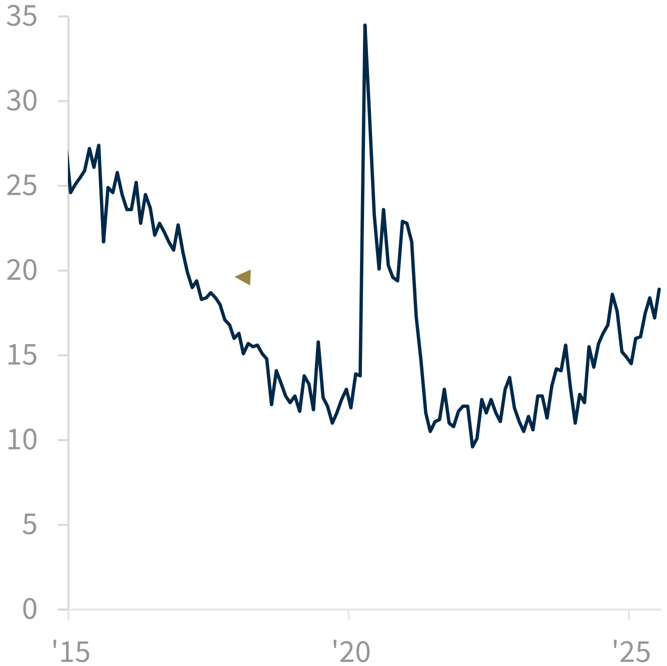
Source: FactSet, Dallas Fed, Investment Strategy

1: https://www.dallasfed.org/research/surveys/tbos/2025/2508q

However, the broad-based rise in consumer prices complicates the Fed's policy outlook. Persistent inflation risks may limit the Fed's ability to pursue aggressive rate cuts. Despite this, we continue to expect a 25 basis point rate cut in September, with at least one additional cut likely before year-end. A larger 50 basis point cut appears increasingly unlikely unless Fed officials perceive a significant recession risk.

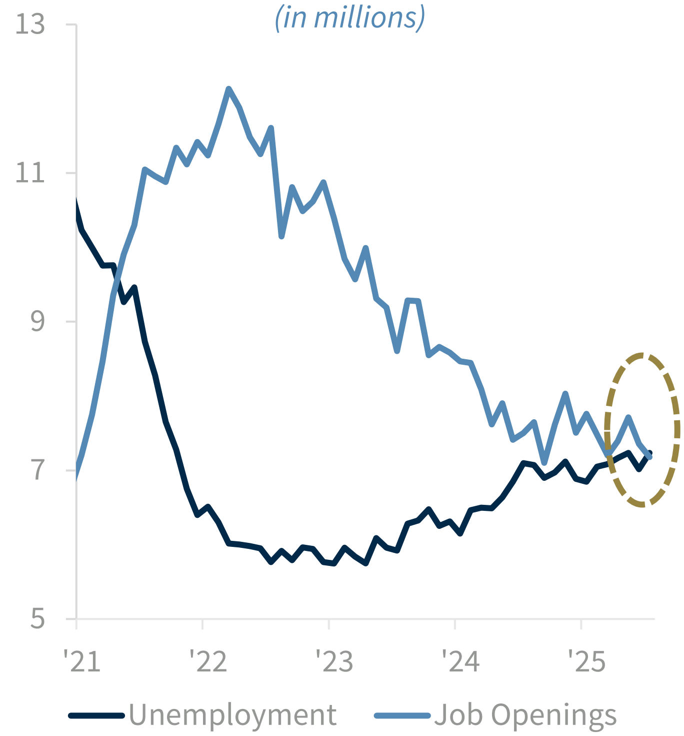
The labor market remains a key concern. Nonfarm payrolls have softened, and recent BLS benchmark revisions underscore this trend. Surveys show weakening hiring plans, the lowest job-finding expectations since 2013, and more unemployed workers than job openings for the first time since 2021. Initial jobless claims recently spiked to their highest level since October 2021. While this jump may be distorted by seasonal factors and a large increase in unadjusted claims in Texas, the underlying trend points to continued labor market deterioration. With small businesses, which are responsible for over half of US employment, facing high single-digit borrowing costs, hiring plans are unlikely to improve.

Consumer Confidence Survey:
Jobs Hard to Get



Source: FactSet, RJ Economics

Unemployed Outnumber
Job Openings
(in millions)



One of the most closely watched indicators ahead of next week's FOMC meeting is Tuesday's retail sales report, which will provide a timely snapshot of consumer spending behavior in the third quarter. July's report showed a solid 0.5% increase in the control group, which feeds directly into GDP calculations, suggesting resilient demand despite elevated borrowing costs and inflationary pressures. However, it's crucial to remember that retail sales are reported in nominal terms, meaning they are not adjusted for inflation. This distinction matters because if prices rise due to tariffs or other cost pressures, the headline retail sales figure could increase even if actual consumption volumes remain flat or decline.

In this context, the August CPI report takes on added significance. With tariff-sensitive categories like food, apparel, and vehicles posting notable price increases, there's a possibility that the retail sales data could be inflated by higher prices rather than stronger demand. A strong nominal print may not necessarily reflect robust real consumption, especially if households are simply paying more for the same goods.

Finally, Wednesday's FOMC meeting and the release of its Summary of Economic Projections (SEP) will be an important moment for markets. This quarterly update offers the Fed's latest forecasts for GDP growth, unemployment, inflation, and the federal funds rate, providing a window into how policymakers interpret recent economic developments. With most tariffs now fully implemented and imports actively taxed, the SEP will likely reflect updated economic projections.

Markets will be watching closely for any upward revisions to the Fed's inflation outlook, especially in the core PCE measure, which excludes volatile food and energy prices. Any shift in the Fed's median dot plot could signal a change in the expected pace or magnitude of rate cuts. If inflation is seen as more persistent due to tariff pass-through or supply chain disruptions, the Fed may opt for a more cautious approach to easing.

Conversely, if the SEP reflects growing concern about labor market deterioration, weakening consumer demand, and tighter credit conditions, the Fed may lean more dovish. The balance between inflation risks and growth concerns will be central to the Fed's messaging, and the SEP will help clarify how officials are weighing these competing forces.

Forecast Table

	Actual						Forecast						Actual	Forecast	
	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26	2024	2025	2026
Real Gross Domestic Product [1]	**1.6**	**3.0**	**3.1**	**2.4**	**-0.5**	**3.3**	**0.6**	**-0.5**	**2.0**	**2.4**	**2.6**	**2.5**	**2.8**	**1.5**	**1.6**
Real Gross Domestic Product [2]	2.9	3.0	2.7	2.5	2.0	2.1	1.4	0.7	1.3	1.1	1.6	2.4	2.5		
Consumer Price Index [2]	**3.2**	**3.2**	**2.7**	**2.7**	**2.7**	**2.5**	**2.9**	**3.4**	**3.4**	**3.7**	**3.5**	**2.9**	**3.0**	**2.9**	**3.4**
Ex-food & energy [2]	3.8	3.4	3.3	3.3	3.1	2.8	3.1	3.4	3.5	3.7	3.4	2.9	3.4	3.1	3.4
PCE Price Index [2]	**2.7**	**2.6**	**2.3**	**2.5**	**2.5**	**2.4**	**2.8**	**3.4**	**3.4**	**3.5**	**3.4**	**2.8**	**2.5**	**2.8**	**3.3**
Ex-food & energy [2]	3.0	2.7	2.7	2.8	2.8	2.7	3.0	3.5	3.5	3.5	3.3	2.7	2.8	3.0	3.3
Unemployment Rate	**3.8**	**4.0**	**4.2**	**4.1**	**4.1**	**4.2**	**4.3**	**4.4**	**4.5**	**4.4**	**4.3**	**4.3**	**4.0**	**4.2**	**4.4**
Fed Funds Rate [3]	4.00	5.50	5.00	4.50	4.50	4.50	4.25	4.00	4.00	3.75	3.75	3.50	5.1	4.3	3.8

1 Annualized Quarter-Over-Quarter Growth

2 Year-Over-Year SA Percentage Change

3 Upper Bound of the Federal Funds Target Range

Economic Releases:

Producer Price Index: Today's Producer Price Index (PPI) report came in softer than expected, with services prices leading the decline. Goods prices posted a modest increase, but the overall tone suggests a partial unwinding of last month's sharp gains. Last month's surge was driven by strong increases in purchased capital equipment and energy. In contrast, this month saw a pullback in both categories. Lower energy prices and a decline in private capital equipment purchases across both government and private sectors contributed to the overall softness. From a policy perspective, this report offers some relief to the Federal Reserve. Expectations had been leaning toward higher input costs, but the data suggests a temporary reprieve. That said, this could simply be a reversal of last month's outsized gains rather than a sustained trend. Looking ahead, we continue to anticipate that the impact of tariffs will begin to surface more clearly in upcoming data. As such, we maintain our view that the Fed will cut rates by 25 basis points in September, with at least one additional cut likely before year-end. The Producer Price Index (PPI) for final demand declined by 0.1% in August, compared to FactSet expectations of a 0.4% increase today, after a downwardly revised increase of 0.7% in July. On a year-over-year basis, the PPI was down to 2.6% in the 12 months ending in August, compared to 3.2% in July. The PPI for final demand services fell 0.2% in August, largely driven by a 1.7% decline in margins for final demand trade services. On the other hand, final demand transportation and warehousing services increased 0.9% in August. The PPI for final demand goods was up 0.1% during the month, making it the fourth consecutive increase. Excluding foods and energy, the index increased 0.3%. The PPI for final demand less foods, energy, and trade services increased 0.3% in August. On a year-over-year basis, the PPI for final demand less foods, energy, and trade services was up by 2.8%. The latest PPI report for final demand goods showed a modest increase, primarily driven by a 1.5% rise in government-purchased foods and a 1.1% gain in finished processed consumer foods. These categories provided upward momentum, even as finished crude consumer foods posted a sharp 13.2% decline, tempering the overall impact. Energy prices edged down by 0.4% during the month, helping to keep headline PPI inflation contained. On the services side, final demand registered a decline, largely due to weakness in capital equipment trade. Private capital equipment trade fell by 3.1%, while government-purchased capital equipment dropped by 3.9%, contributing to the overall softness in services inflation.

Economic Releases:

Consumer Price Index: Headline inflation was higher than expected in August as the increase in shelter prices surprised to the upside. This larger than expected increase is not good news for the Federal Reserve (Fed), the broad base increase in prices during the month will further increase market concerns about future inflation and make the Fed's decision to lower rates more difficult. We still believe that the Fed is going to lower rates by 25 bps in September, but markets may dial down their expectations for almost three rate cuts this year to just two. Furthermore, unless Fed officials believe that the economy is heading into a recession if they don't act more forcefully in September, the possibility of a 50 bps cut in September may be off the table. The headline Consumer Price Index (CPI) increased a more than expected 0.4% in August, while the core CPI increased at an expected 0.3% rate, month-on-month, according to the Bureau of Labor Statistics. On a year-over-year basis, the headline CPI increased by 2.9%, in line with expectations and up from a 2.7% rate in July of this year. The core CPI increased by 3.1% compared to a year earlier and was in line with expectations. Food prices surged by 0.5% in August after being flat in July while energy prices increased by 0.7% after falling by 1.1% in July. The price of gasoline increased by 1.9% in August, month-on-month, but remained down 6.6% compared to a year earlier. Energy services prices declined by 0.2% as utility (piped) gas services were 1.6% lower during the month, while electricity prices were up by 0.2%. Electricity prices were up 6.2% Shelter prices were stronger in August, reversing the recent trend. Since shelter prices represent a third of the CPI basket, this meant that they were the most important reason for the higher than expected increase in inflation during the month. compared to a year earlier, while gas services prices were up 13.8% compared to a year earlier. Core CPI prices were up 0.3% during the month as almost every component increased. The price of commodities less food and energy commodities increased by 0.3% after increasing by 0.2% in July. This was the consequence of a 0.3% increase in new vehicle prices and a 1.0% increase in used cars and trucks' prices. Apparel prices increased by 0.5% while medical care commodities' prices declined by 0.3%. Services less energy services prices were up by 0.3% and shelter prices were up 0.4% while transportation services prices were up by 1.0%. Medical care services' prices were down by 0.1%.

Jobless Claims: Last week's sharp rise in initial jobless claims of 263,000 marked the highest level since the week ending October 23, 2021, and significantly exceeded FactSet's estimate of 231,000. While this spike is notable, it's important to remember that weekly claims data can be highly volatile, and the Labor Day holiday likely distorted seasonal adjustments. Still, the magnitude of the increase warrants close attention. Several leading indicators we monitor point to growing signs of labor market weakness, suggesting this may not be an isolated event. If claims continue to climb, it could signal a broader slowdown in employment conditions. Today's disappointing report, though just one data point, reinforces our expectation that the Federal Reserve will cut rates by 25 basis points at next week's FOMC meeting. We also anticipate at least one additional cut before year-end, especially if elevated claims persist amid the uncertainty created by recent policy shifts. Initial claims for unemployment insurance during the week ending September 6, 2025, jumped by 27,000, compared to claims of 236,000 during the previous week. The four-week moving average was 240,500, an increase of 9,750 compared to last week's four-week moving average. Continuing claims did not change and remained at 1,939,000, while the advanced seasonally adjusted insured unemployment rate was 1.3 percent, unchanged from the previous week. For the week ending August 30, the largest increases in initial jobless claims were reported in Tennessee (+2,870), Connecticut (+2,270), New York (+1,683), Illinois (+1,331), and California (+982). Meanwhile, the biggest declines occurred in Kentucky (-2,833), Pennsylvania (-504), Florida (-456), Texas (-402), and Arizona (-329).

Economic Releases:

ISM Services: The ISM Services PMI was back from the brink in August after being very close to the demarcation point in July. The index was higher than expected and above the demarcation point between expansion and contraction. Twelve of the services industries reported growth in August, while four industries reported contraction. Although the services side of the economy improved in August, employment in the industry remained in contraction, while price pressures remained strong. Production and orders improved, which should keep growth positive. The ISM Services PMI was stronger than FactSet expectations in August, at 52.0 compared to a reading of 50.1 in July, according to the Institute for Supply Management (ISM). The Business Activity/Production Index increased to 55.0 compared to 52.6 in July, while the New Orders Index surged to 56.0 from 50.3 during the previous month. The Employment Index was slightly higher, at 46.5 compared to 46.4 in July, but was still in contraction. The Supplier Deliveries Index was weaker, at 50.3 compared to 51.0 in July. The Inventories Index was higher, at 53.2 compared to a reading of 51.8 in July. The Prices Index eased a bit but remained high, at 69.2 compared to a reading of 69.9 in July, while the Backlog of Orders Index was weaker, at 40.4 compared to a July reading of 44.3. The New Export Orders Index was also slightly weaker, at 47.3 compared to 47.9 in July. The Imports Index was much stronger, at 54.6 compared to 45.9 in July, while the Inventory Sentiment was stronger, at 55.2 compared to 53.2 in July. This was the third consecutive month of expansion for the ISM Services PMI. Commentaries on tariffs and their impact on prices remained top of mind in the release.

ISM Manufacturing: The manufacturing sector continued to contract in August. A notable bright spot was the New Orders Index, which moved into expansion territory after six months of contraction. Still, sentiment remains cautious as for every positive comment on new orders, there were 2.5 expressing concern about near-term demand, largely driven by tariff uncertainty. Prices eased slightly but remain elevated due to ongoing tariff pressures on steel, aluminum, and other imported goods and intermediate materials. Labor market signals were also weak, with four mentions of headcount reductions for every one on hiring, and only two of 18 industries reporting employment growth. These developments align with a broader view of a softening economic environment, one that warrants attention but does not yet point to an imminent recession. The ISM Manufacturing PMI came out below expectations, at 48.7 compared to a reading of 48.0 in July and expectations of 49.0, according to the Institute for Supply Management. The New Orders Index was stronger in August, at 51.4 compared to 47.1 in July, while the Production Index was weaker and fell below the 50-demarcation point, at 47.8 compared to a reading of 51.4 in July. The Employment Index remained almost unchanged, at 43.8 compared to 43.4 in July. Supplier Deliveries bounced back into expansion territory as they strengthened in August to 51.3 from 49.3 in July. The Inventories Index improved slightly but remained below the demarcation point, at 49.4 compared to 48.9 in July. The Customers' Inventories Index was down slightly and still contracting, at 44.6 in August compared to 45.7 in July. The Prices Index softened again to 63.7 in August compared to a reading of 63.7 in July. The Backlog of Orders Index was weaker, at 44.7 in August compared to 46.8 in July. The New Export Orders Index improved from 47.6 in August to 46.1 in July, while the Imports Index deteriorated from 47.6 in July to 46.0 in August. This was the sixth consecutive month in contraction for the ISM Manufacturing PMI. Once again, tariffs as well as uncertainty concerns were mentioned repeatedly by ISM Manufacturing survey respondents. The Institute for Supply Management indicates that an ISM Manufacturing PMI "above 42.3 percent, over a period of time, generally indicates an expansion of the overall economy."

Economic Releases:

Consumer Sentiment: The University of Michigan's preliminary Index of Consumer Sentiment recorded its second consecutive decline, driven primarily by a 7.3% drop in consumer expectations. At the same time, long-term inflation expectations rose for the second month in a row, signaling a shift in public sentiment following the implementation of the August 1 tariffs. Although consumers are no longer bracing for a worst-case scenario—like the surge to 4.4% in inflation expectations seen after Liberation Day—they remain wary. Many anticipate deteriorating conditions in both inflation and the labor market in the coming months. This cautious outlook underscores that consumer resilience is weakening, with inflation poised to rise and unemployment likely to edge higher into year-end. Additionally, it also strengthens the case for a 25 bps rate cut next week, as policymakers aim to preempt further softening in demand and stabilize expectations. The preliminary Index of Consumer Sentiment was lower than expected in September, at 55.4 compared with a print of 58.2 in August, according to the Survey of Consumers from the University of Michigan. Both component indices were lower in September versus August, with the Current Economic Conditions Index at 61.2 compared to 61.7 in August, and the Index of Consumer Expectations at 51.8 compared to 55.9 in August. One year ahead inflation expectations remained unchanged at 4.8% in September, while the more important long-term inflation expectations for the next five years increased to 3.9% in September compared to a print of 3.5% in August. The University of Michigan Consumer Sentiment report stated that "Trade policy remains highly salient to consumers, with about 60% of consumers providing unprompted comments about tariffs during interviews, little changed from last month." This supports our view that consumer sentiment is weakening, and suggests that rising prices, particularly those driven by new tariffs, could pose an additional headwind to household spending.

Disclosures

Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. A value above 100 signals a boost in the consumers’ confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

Employment cost Index: The Employment Cost Index (ECI) measures the change in the hourly labor cost to employers over time. The ECI uses a fixed “basket” of labor to produce a pure cost change, free from the effects of workers moving between occupations and industries and includes both the cost of wages and salaries and the cost of benefits.

US Dollar Index: The US Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

The FHFA HPI is a broad measure of the movement of single-family house prices. The FHFA HPI is a weighted, repeat-sales index, meaning that it measures average price changes in repeat sales or refinancings on the same properties.

Disclosures

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

The ISM Manufacturing Index: The GDP Now Institute of Supply Management (ISM) Manufacturing Measures the health of the manufacturing sector by surveying purchasing managers at manufacturing firms. The survey asks about current business conditions and expectations for the future, including new orders, inventories, employment, and deliveries.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index (PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI New export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

Source: FactSet, data as of 9/12/2025

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