

Job worries push the US Fed into action

Trade swings are masking a cooling of US economic growth, but nothing can disguise the obvious weakening of the jobs market. There is a growing confidence that tariffs will not boost inflation more permanently, so the Fed appears ready to embark on a series of interest rate cuts that will swiftly move monetary policy to a neutral setting



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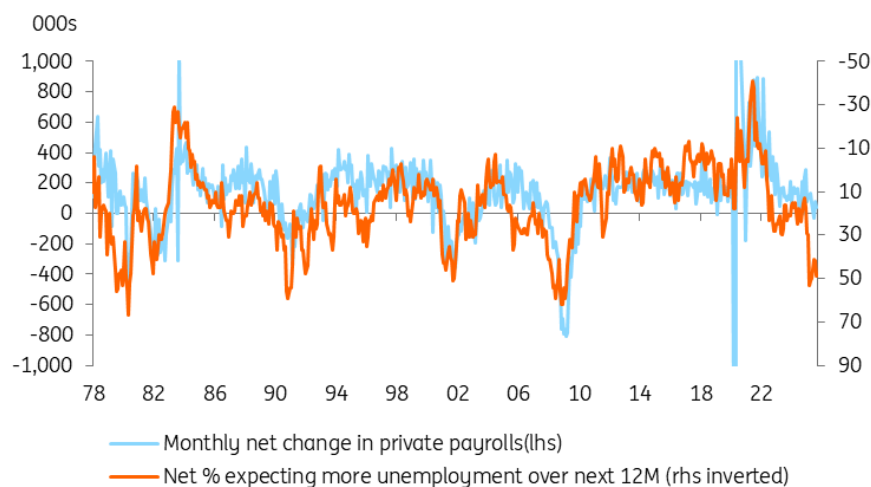
Job weakness becoming the priority

Second-quarter GDP growth was revised up to 3.3%, but given the trade volatility brought about by President Trump's tariff policy, we should take an average of the first two quarters, which means annualised growth of around 1.5% for the first half of the year. The second half is likely to expand at a similar rate. There appears to be a modest consumer revival in the third quarter, offset by weaker construction and investment and a drag from trade. In the fourth quarter, we suspect growing fears about the jobs market and the squeeze on disposable incomes from tariff-induced price hikes mean consumer spending growth slows again.

Weakness in the jobs market is becoming more apparent after yet another disappointing payrolls figure for August and a rise in the unemployment rate to 4.3%. It remains a story of slowing hiring with limited evidence of firings right now, but the deterioration in sentiment towards the jobs

market among workers is very concerning. The fear of losing one's job has only been greater on four occasions in the past 50 years.

Households fear that unemployment could climb



Source: Macrobond, ING

Inflation fears start to ease

As for inflation, we continue to expect tariffs to lift prices for goods, but the impact on overall CPI shouldn't be overplayed. Admittedly, it is a big supply shock, but three factors that amplified and extended the post-Covid inflation surge to above 9% in 2022 are absent this time around.

First, oil prices tripled between 2021-22, but they are falling today. Second, house prices rising 50% and a doubling of mortgage rates contributed to CPI measures of rent rising 8% year-on-year nationally by 2023. Today, house prices have fallen for four consecutive months and are set to fall further, with rents already cooling. Third, the weakening jobs market means wage growth is slowing towards 3% rather than rising towards 6% as in 2022. Remember too that the core goods (ex food and energy) – where tariffs have most influence – are only around 19% of the CPI basket by weight. By way of contrast, housing is 33%.

So with growth remaining below trend, the jobs market clearly cooling and tariffs set to mean a one-off step change in some goods prices rather than something more permanent on inflation, the Federal Reserve has scope to restart moving policy from 'restrictive' territory to closer to neutral. We continue to forecast three 25bp rate cuts this year with a further 50bp of cuts across the two early 2026 meetings. The recent data flow has prompted markets to move in line with our view.

The housing market needs to be watched closely

For next year, the balance of risks, we suspect, is skewed toward the Fed moving policy below neutral, i.e. the Fed cutting interest rates more than we are forecasting rather than implementing fewer cuts. This is largely because the housing market is looking increasingly vulnerable to a potential correction.

Demand remains weak due to a lack of affordability, but the limited housing supply has kept prices supported. That situation is changing with the number of homes for sale rising consistently over

the past year. Factors that are prompting this include employers being less willing to accommodate remote working, family circumstances changing, plus higher property taxes and adjustable mortgage rate resets, meaning an increasing number of people are struggling financially.

The result is that the demand-supply rebalance has prompted four consecutive monthly price falls already, with the prospect that more are on their way, especially if the jobs market cools further. Property is the largest reserve of wealth for most Americans, and any erosion of that will intensify consumer angst.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

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