

Fed to ease again despite flying blind on key economic data

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With growth holding up but jobs faltering, a cautious Fed could surprise markets and dampen expectations of deep 2026 easing

Despite the government shutdown disrupting official data releases, available activity indicators suggest that underlying momentum likely remains solid. Incoming data released before the shutdown showed that real personal consumption rose by 0.35% m/m in August and was revised up for July (to 0.4% from 0.3%), keeping third-quarter spending on a solid footing. The third estimate of Q2 GDP showed an upward revision to 3.8% (from 3.3%), driven by stronger services spending and intellectual property investment ([Figure 1](#)). With hard data on September's retail sales, industrial production, and international trade missing, the most recent assessment has relied on privately produced indicators, mainly business surveys. The ISM manufacturing index edged up to 49.1 in September, supported by rebounds in production and employment subindices, although new orders softened. The ISM services index sent a more cautious signal, falling to 50.0 as business activity dipped below 50 and new orders also weakened. More recently, the S&P Global Composite PMI rose to 54.8 in October, reaching a three-month high and suggesting that activity continued to expand at a healthy pace. The improvement was led by services, while manufacturing scored a muted gain. Altogether, available data suggest the picture is still one of a resilient economy, but one that is increasingly at odds with signs of labor market deterioration. This divergence raises the question of which side of the economy will adjust: growth to weaker job creation, or employment to resilient growth.

September jobs report's delay clouds visibility into labor market conditions, but alternative data still point to a weak jobs market outlook. The JOLTS report for August, released just before the shutdown, showed job openings holding steady at 7.2 million, with both the hiring and quits rates edging down by 0.1 pp each, to 3.2% and 1.9%, respectively—reflecting lingering caution among firms, which are holding back on hiring, and among workers, who remain hesitant to pursue new opportunities. A source of comfort is the layoffs rate, which held steady at 1.1%, even 0.1 pp below the rate observed in September last year. Earlier this month, the privately sourced ADP employment report showed a 32,000-job decline in September—the sharpest since early 2023 and broad-based across many sectors (except education, health services, information, and mining) and most firm sizes (except those with 500+ employees). The ISM PMI surveys offered mixed signals: manufacturing employment rebounded, while the services employment index remained below 50. On the supply side, the newly announced \$100,000 H-1B visa application fee reinforced the administration's broader

crackdown on (even legal) immigration, which may at the margin help prevent a further deterioration in the unemployment rate. Taken together, these developments still point to a hiring freeze rather than a wave of layoffs. All told, we expect most FOMC participants to conclude that downside risks to the labor market remain firmly in place and to support a second consecutive rate cut this week—dismissing the case for a cautious pause despite the absence of official data.

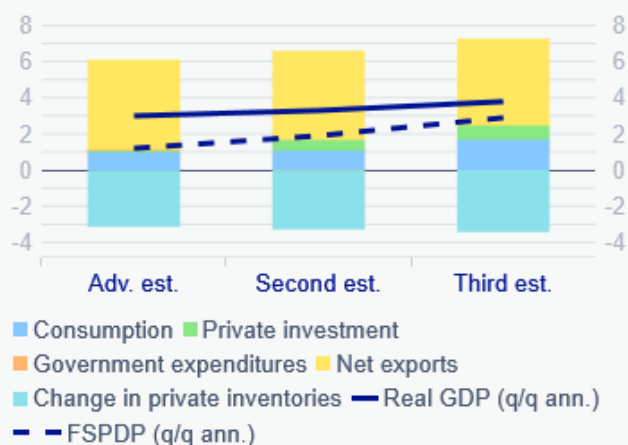
Inflation data continued to suggest that the pass-through from tariffs to consumer prices remains limited for now, despite certain goods still reflecting some effects. The September CPI (originally scheduled for October 15) was released on Friday despite the government shutdown, as required by Social Security-related legal deadlines. It showed that core prices rose by a below-consensus 0.23% m/m, bringing the annual rate down to 3.0% from 3.1% ([Figure 2](#)). The main driver of the downside surprise was a soft 0.13% increase in owners' equivalent rent. Core goods prices rose 0.2% m/m, the fourth consecutive monthly increase (they fell in Q1). Core goods prices showed offsetting dynamics: prices moved up for apparel, furniture, appliances and new vehicle prices—likely reflecting tariff effects—, but declined for used vehicles and medical goods which allowed overall core goods inflation to remain contained. Six months after “Liberation Day,” inflation data have yet to show a sharp pass-through from tariffs, but FOMC participants are likely to still foresee core goods inflation to continue to creep up going forward, keeping core inflation above its target for the foreseeable future. In the very short term though, the latest CPI print significantly reduces the odds of significant dissent around a rate cut this week—and may even prompt a change of view among some of the eight participants who, in September, projected one or no additional cuts this year. With downside risks to employment still more pressing, inflation concerns continue to take a back seat—for now. The question is, for how long?

Markets expect the Fed to keep easing well into next year, but a cautious tone may challenge those expectations and prompt a partial rebound in long-term yields. The September FOMC minutes confirmed the Fed's dovish pivot last month but also revealed lingering divisions. Most participants agreed that downside risks to employment had increased, yet “a majority” continued to emphasize upside inflation risks, and only “a few” acknowledged that labor market conditions had been weakening for longer than previously reported. Some favored a more cautious approach, leaving the door open to either pausing or delivering another cut this week; Friday's CPI print decisively tilted the balance toward the latter. Fed funds futures had already been almost fully pricing in a second consecutive 25bp rate cut since the last FOMC decision, and over the past month they have moved to price in a much deeper easing cycle through 2026, of roughly 100bp of additional easing by end-2026 ([Figure 3](#)). The 2-year Treasury yield declined by roughly 20bp during that period, and the 10-year yield fell below 4% last week for the first time in over a year ([Figure 4](#)). Expectations were likely reinforced by Chair Powell's recent remark that the labor market “may now be at a stage where further declines in job openings might very well show up in unemployment”—a statement that may have sealed the deal for a cut this week, while also boosting market confidence in a prolonged easing path. Markets appear to be downplaying cautionary remarks from even dovish officials like Waller, who has warned against assuming a linear easing trajectory next year, citing the conflicting signals from robust activity data and a softening labor market.

We expect the Fed to deliver a 25bp rate cut, bringing the target range to 3.75-4.00%, while aiming to avoid fueling excessive easing expectations for next year. The decision is likely to be justified as a continued response to the recent “shift in the balance of risks.” Given the ongoing federal government shutdown and the resulting increased uncertainty amid the absence of key economic data, the Fed may also opt for a cautious tone, avoiding strong assessments of current economic activity or labor market conditions as well as strong guidance for upcoming meetings. With both headline and core CPI inflation in year-on-year terms remaining a full percentage point above target, the policy statement will likely continue to describe inflation as “elevated” and highlight ongoing uncertainty around the outlook. With no updated SEP or dot plot this time, all eyes will be on any hints about the Fed’s plans beyond this week’s priced-in move. An overly cautious tone—whether in the statement or during Powell’s press conference—could surprise markets and trigger a partial unwinding of 2026 policy easing expectations and prompt a partial rebound in long-term Treasury yields. Still, absent major surprises, the policy message is likely to remain that while the bar for continued easing has come down, each step will remain data-dependent.

The 3rd estimate of Q2 GDP confirmed activity momentum, with growth revised up to 3.8%

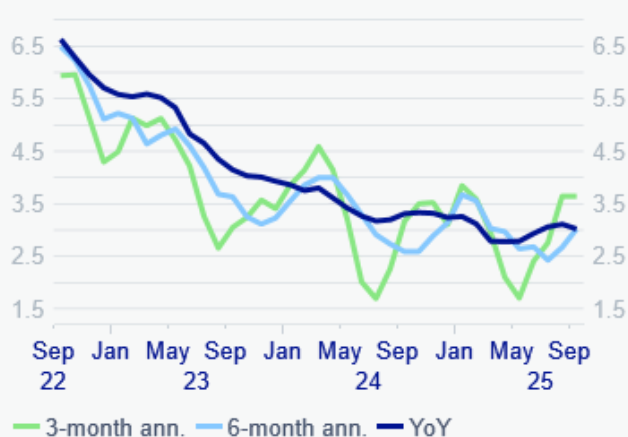
FIGURE 1. 2Q25 REAL GDP GROWTH (%)



Source: BBVA Research / BEA

Core CPI prices rose by 0.23% m/m in Sep, bringing the annual rate down to 3.0%

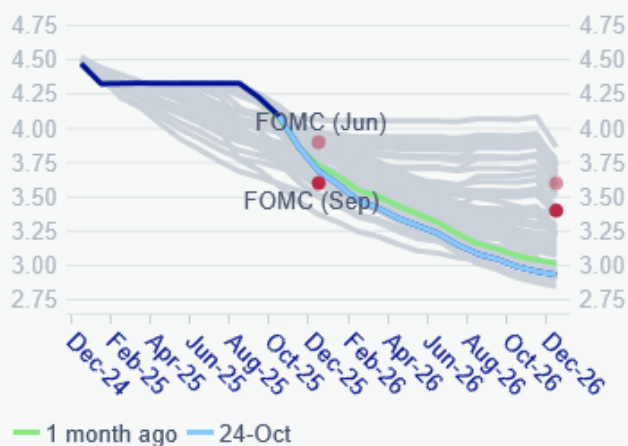
FIGURE 2. CORE CPI INFLATION (%)



Source: BBVA Research / BLS

Fed funds futures moved to price in a much deeper easing cycle for 2026

FIGURE 3. FUTURES-IMPLIED FED FUNDS RATE (%)



The gray lines indicate weekly implied rate paths over the past year. Source: BBVA Research / CME / Fed

The 10-year yield fell below 4% last week for the first time in over a year

FIGURE 4. TREASURY YIELDS (%)



The gray area indicates the fed funds rate target range. Source: BBVA Research / Fed / Treasury Dept.

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