Outlook for the U.S. Economy

Rebecca Zarutskie
Senior Vice President, Research Department

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Federal Reserve Bank of Dallas

The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.

Federal Open Market Committee (FOMC)

- **Monetary policymaking body of the Federal Reserve**
  - Responsible for open market operations decisions.
  - This includes setting target range for federal funds rate.
- **Twelve members**
  - Seven Board of Governors members.
  - NY Fed president + four rotating Reserve Bank presidents.
- **Eight regularly scheduled meetings per year**
  - Assess economic and financial conditions and the economic outlook, including risks, and determine appropriate stance of monetary policy.

FOMC's Dual Mandate: Maximum employment and stable prices

- From the Federal Reserve Reform Act of 1977

"to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates"

- Stable prices ← defined by the FOMC as 2 percent inflation
  - Personal Consumption Expenditure (PCE) price index is primary gauge.

- Maximum employment ← harder to measure
  - Lowest level of unemployment at which inflation is stable
  - Changes with demographics and other non-monetary forces

- Long-term interest rates moderate in stable economic environment.

Current Economic Conditions

Overview of Current Economic Conditions

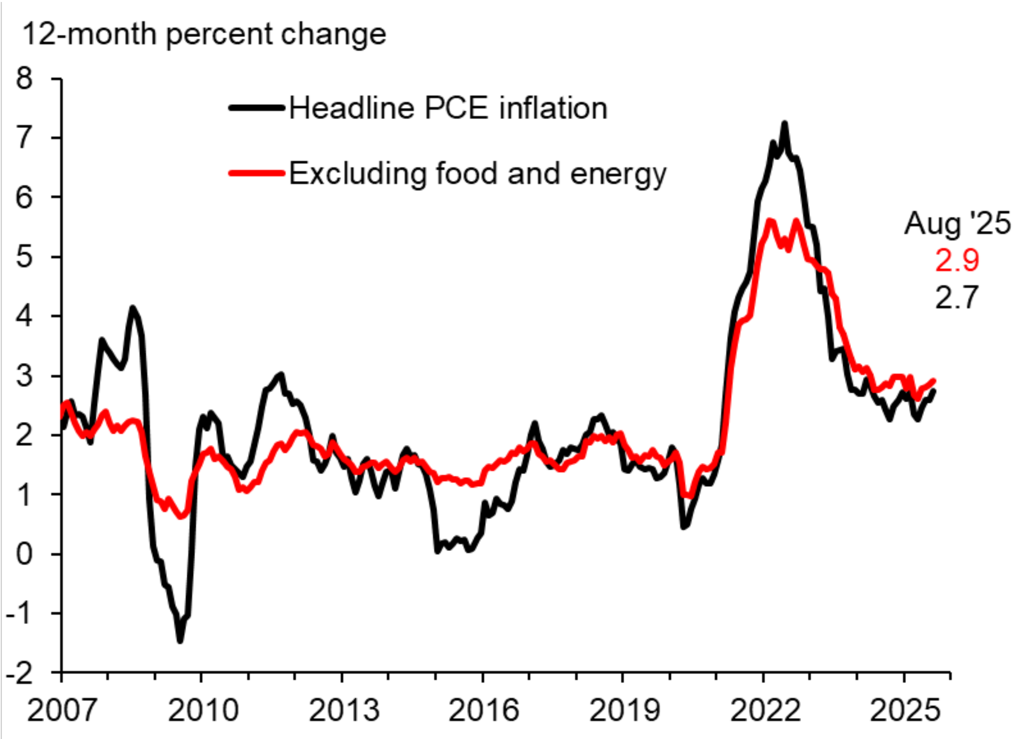
- Inflation still above 2 percent target
  - Goods inflation has increased due in part to tariffs, but services inflation is also elevated.

- Slowing labor market
  - Due in part to slowing population growth.
  - Low hiring, low firing environment has uneven impacts.

- Resilient aggregate growth (GDP)
  - Supported by consumption, business investment (particularly AI-related), and financial conditions.

Inflation Still Above Target

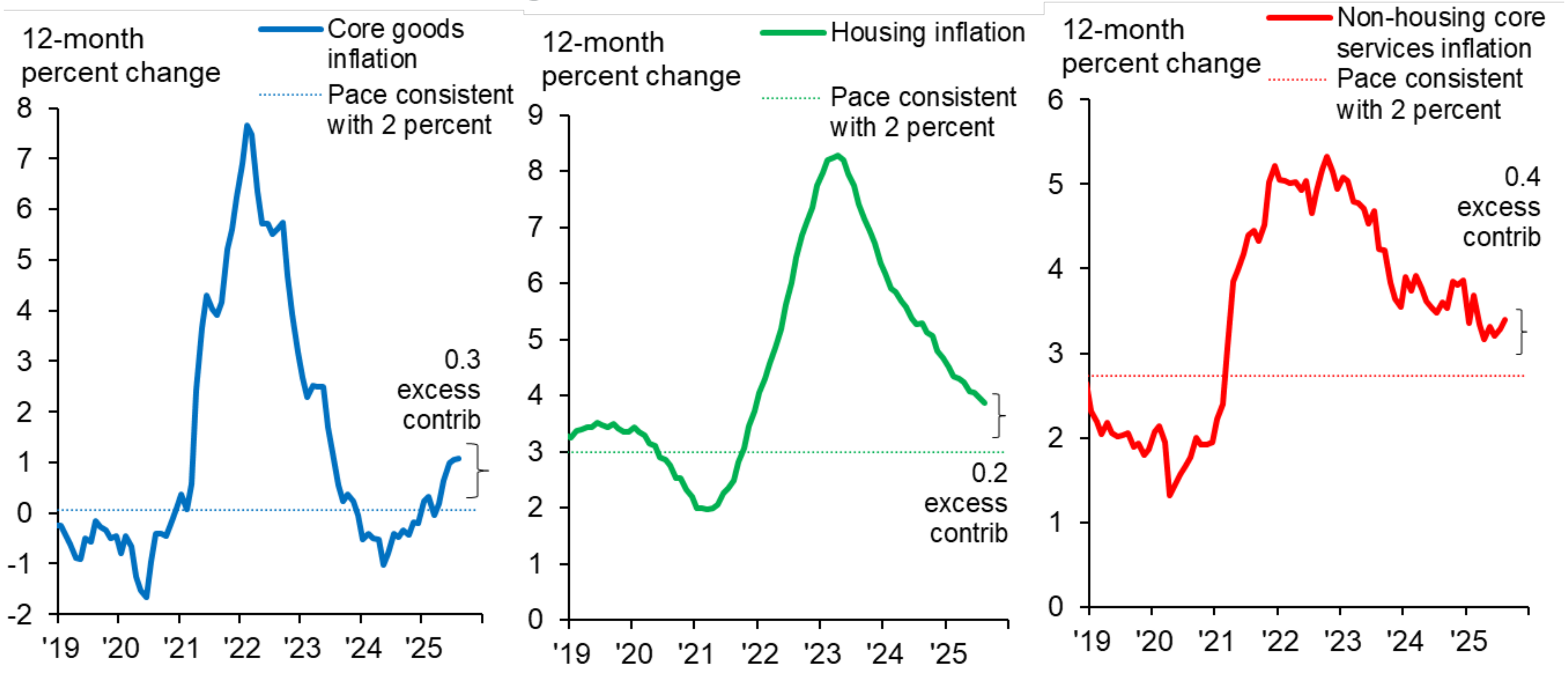
Inflation Remains Above 2 Percent



SOURCE: Bureau of Economic Analysis.

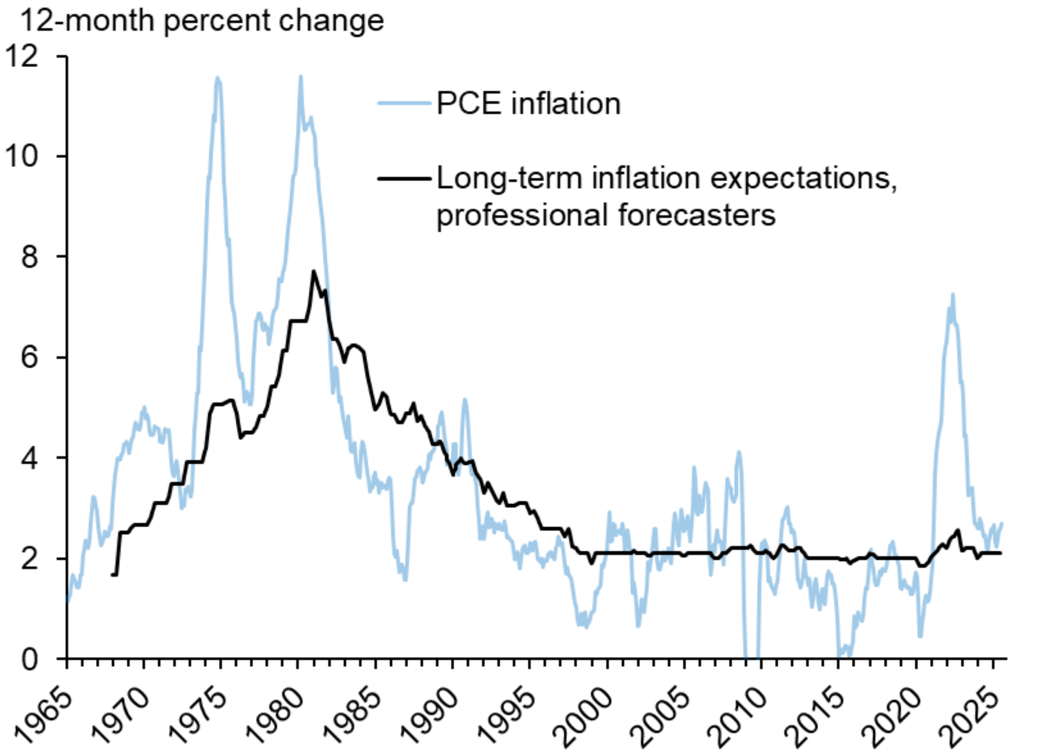
- Inflation has declined from high levels, but still above 2 percent, not shown much progress in over a year.
- Core inflation, which excludes volatile food and energy prices, is a measure of underlying inflation and is close to 3 percent.

What is Keeping Core Inflation Above 2 Percent?



SOURCES: Bureau of Economic Analysis; Dallas Fed staff calculations.

Inflation Expectations Appear Anchored at 2 Percent



SOURCES: Bureau of Economic Analysis; Federal Reserve Board of Governors.

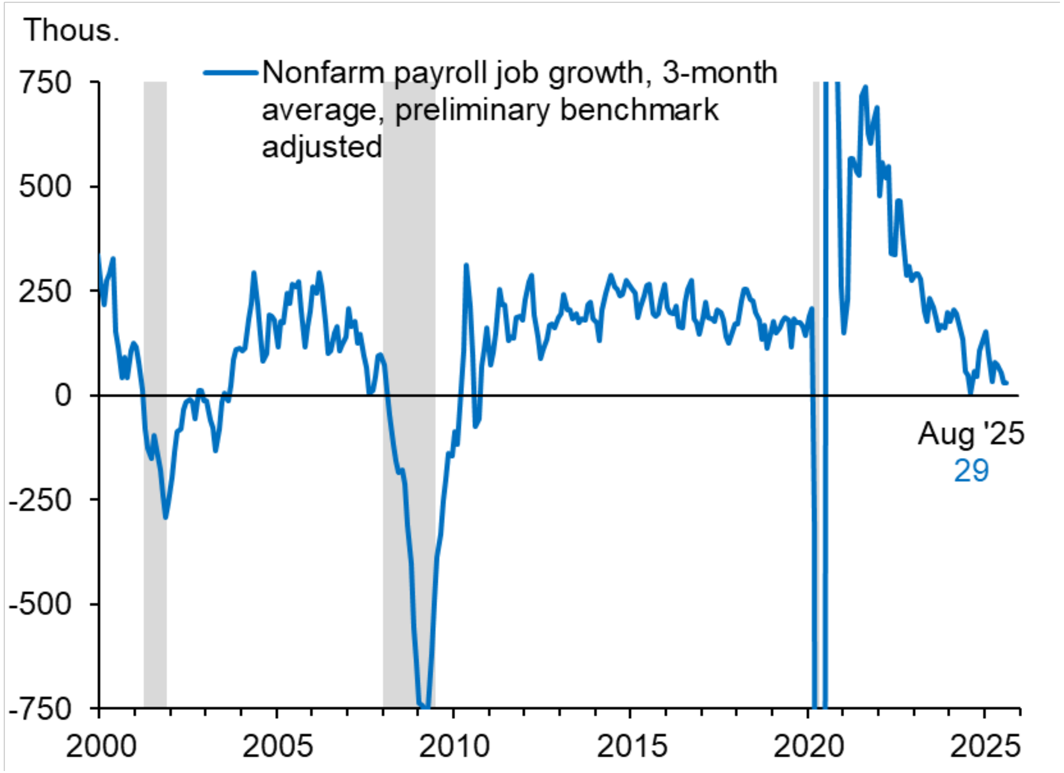
- Anchored inflation expectations help deliver good macroeconomic outcomes.
  - Sign of credible central bank

- If inflation expectations move up, typically so does actual inflation.

- 1970s are a cautionary tale for how unanchored expectations can make lowering inflation harder.

Slowing Labor Market

Job Growth Has Slowed to Near Zero



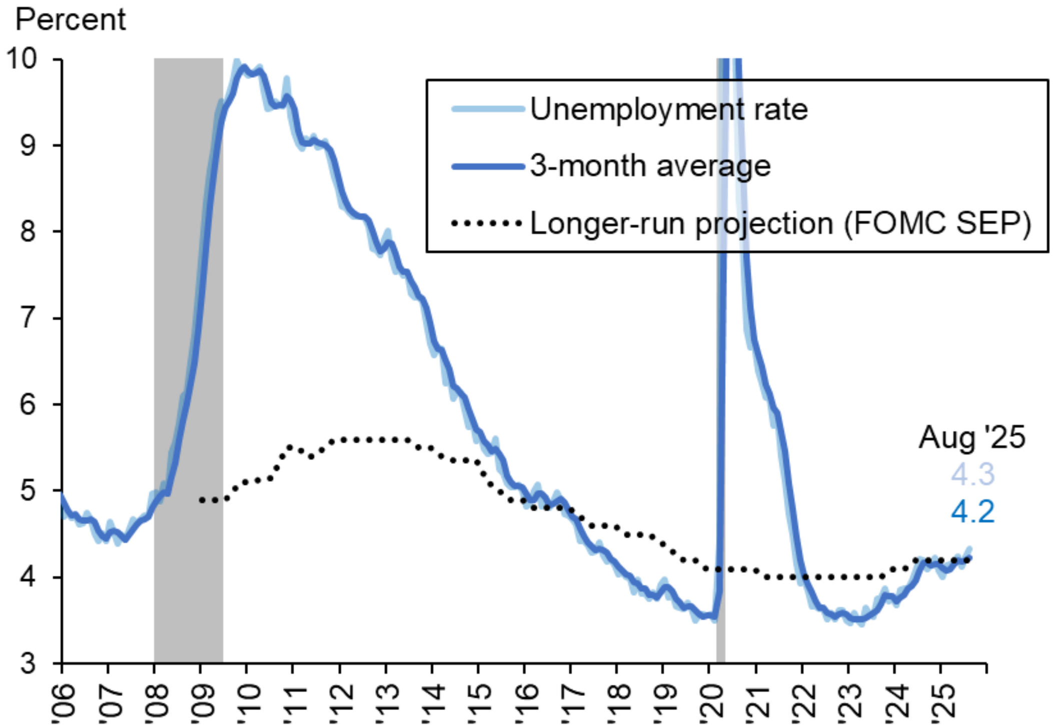
SOURCES: Bureau of Labor Statistics; Haver Analytics.

- Job growth slowed to only around 30K/month.
- Downward revisions possible, recent months could end up with negative job growth.
- Some of the slowing is likely due to a slower population growth.

Does Slower Job Growth Indicate an Increase in "Slack"?

- Slack: underutilization of economic resources, like idle workers or equipment
- Monetary policy can stimulate aggregate demand to reduce slack but cannot affect supply shifts.
- Some of the slowing in job growth may reflect changes in labor supply in addition to changes in labor demand.

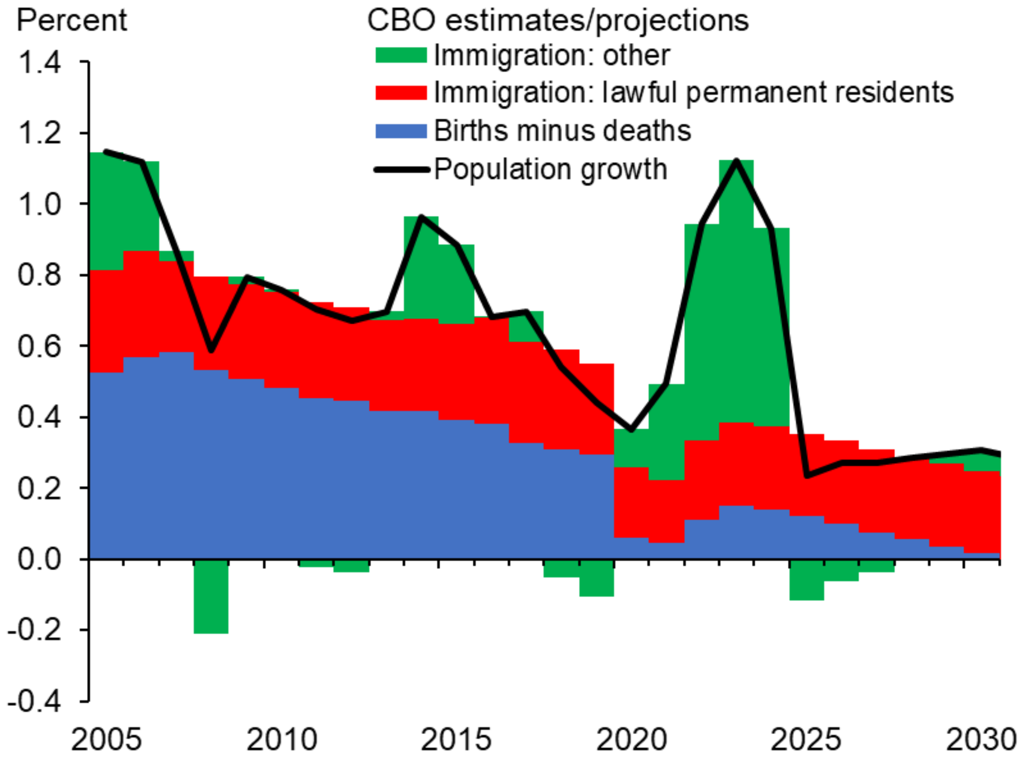
Unemployment Rate Has Been More Reliable Indicator of Labor Market Slack



SOURCES: Bureau of Labor Statistics; Federal Reserve Board of Governors.

- Unemployment rate is less impacted by changes in labor supply, more directly tied to slack, not subject to large revisions.
- In recent months, unemployment has ticked up, signaling gradual increase in slack, but level not far from full employment.

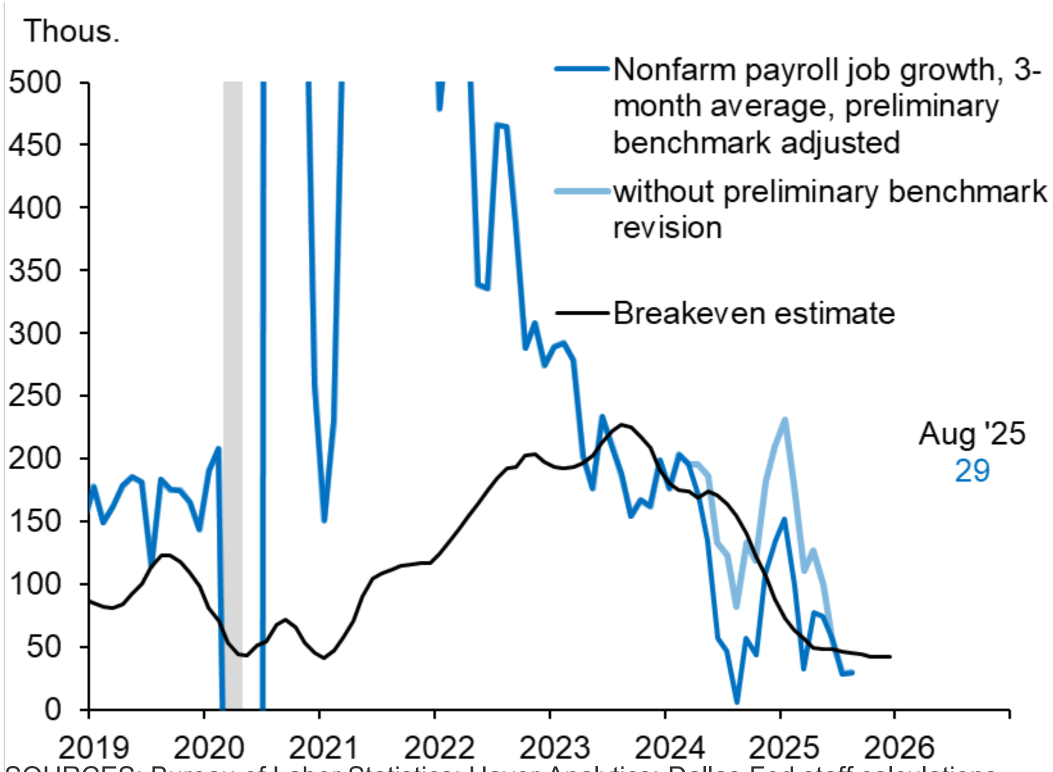
The Rise and Fall of Population Growth



SOURCE: Congressional Budget Office.

- Population growth was around 1% in 2022-24, driven by a surge in immigration.
- In 2025, inflows of other foreign nationals have slowed to near zero, with some outflows (although degree is uncertain).
- Population growth slower than pre-pandemic.

Job Growth Has Slowed, Roughly Keeping Pace with Slower Labor Force Growth



SOURCES: Bureau of Labor Statistics; Haver Analytics; Dallas Fed staff calculations.

- Slower population growth means lower job growth is needed to keep up with labor force.
- Estimates of “breakeven” number of jobs needed to keep unemployment rate steady slowed from about 200K/month to 50k.
    - Estimates are uncertain and vary based on methodology.
- Unemployment should be rising slightly.

Firms Aren't Hiring, But Also Holding onto Workers

- So far, layoffs have been stable near pre-COVID levels, while hiring and job-finding rates have declined, keeping the labor market cooling gradual.

- But the low hiring-low firing labor market is challenging for workers who are looking for a job.
    - Unemployment of labor market entrants is elevated, as is long-term unemployment.
    - If you don't already have a job, difficult labor market.

- Downside risks to labor market have increased – once unemployment rate begins to rise, often does so rapidly.

Government Shutdown Has Delayed Official Data Releases

With delayed official data, we must turn to private data where available and private/Regional Federal Reserve Bank surveys

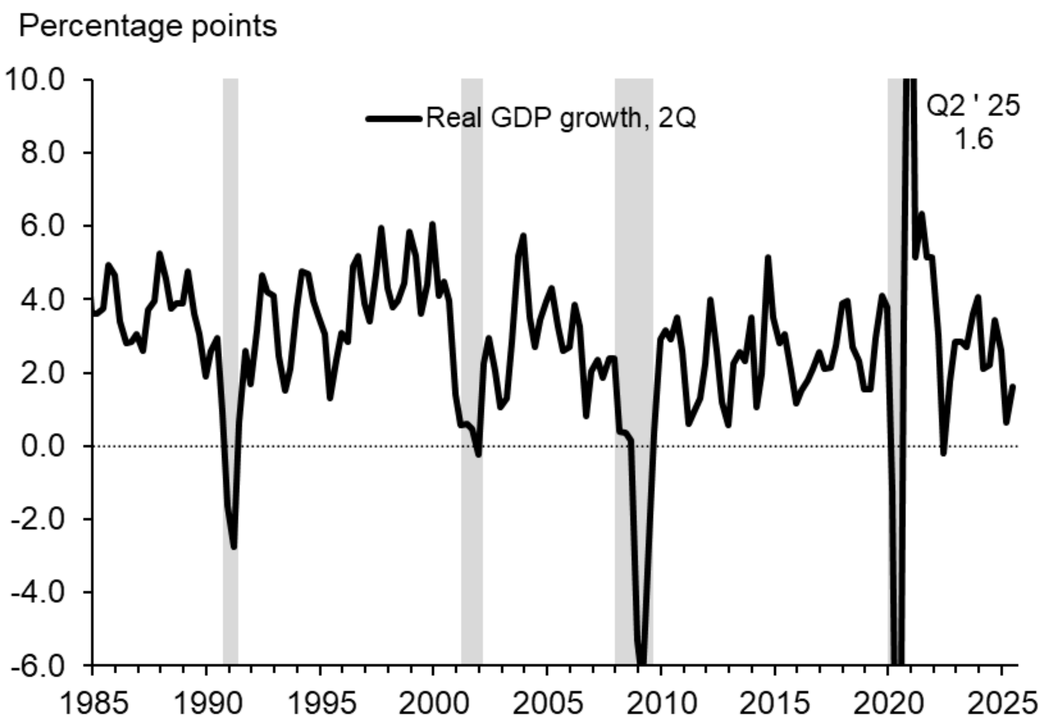
- ADP and Revelio Labs provide private data on job growth.
- Predicting official payroll employment growth from these sources is noisy with wide forecast errors but provides an estimate.
- These sources indicate slow payroll growth in September that is consistent with a roughly stable unemployment rate.

The Federal Reserve Bank of Chicago forecasts unemployment releases given other data sources

- Their final forecast for the September unemployment release shows the unemployment rate remaining at 4.3 percent.

Resilient Growth

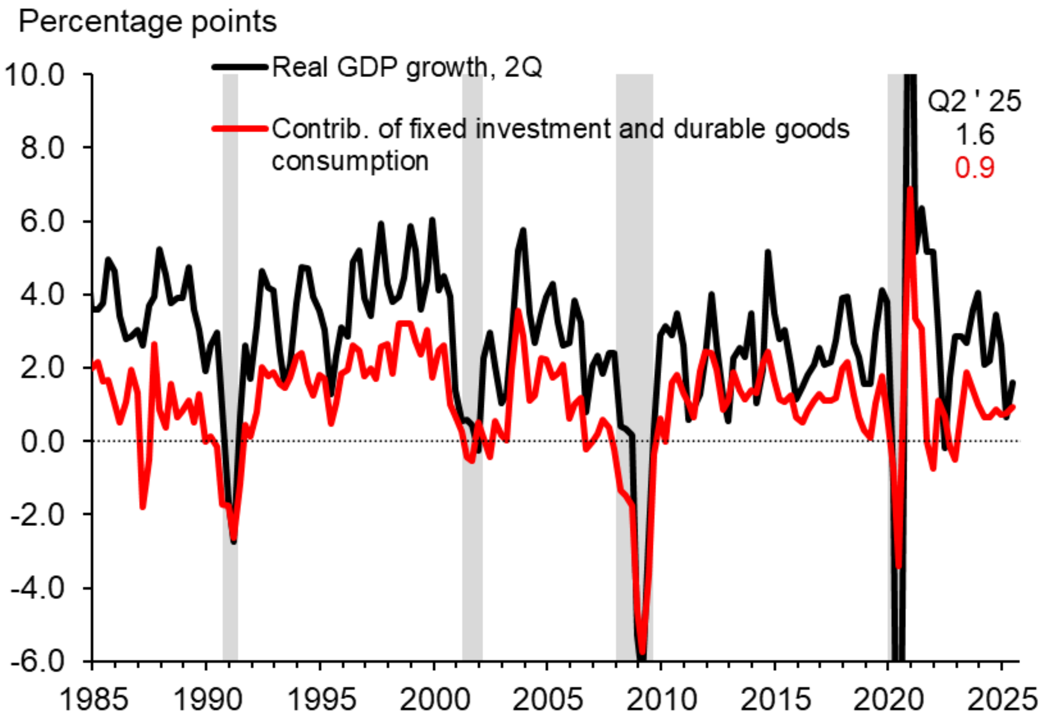
GDP Growth Has Been Resilient



SOURCES: Bureau of Economic Analysis; Dallas Fed staff calculations.

- Real GDP growth slowed to 1.6%in the first half of 2025, slower than 2.4% in 2024.
    - But some slowing to be expected due to slower population growth.

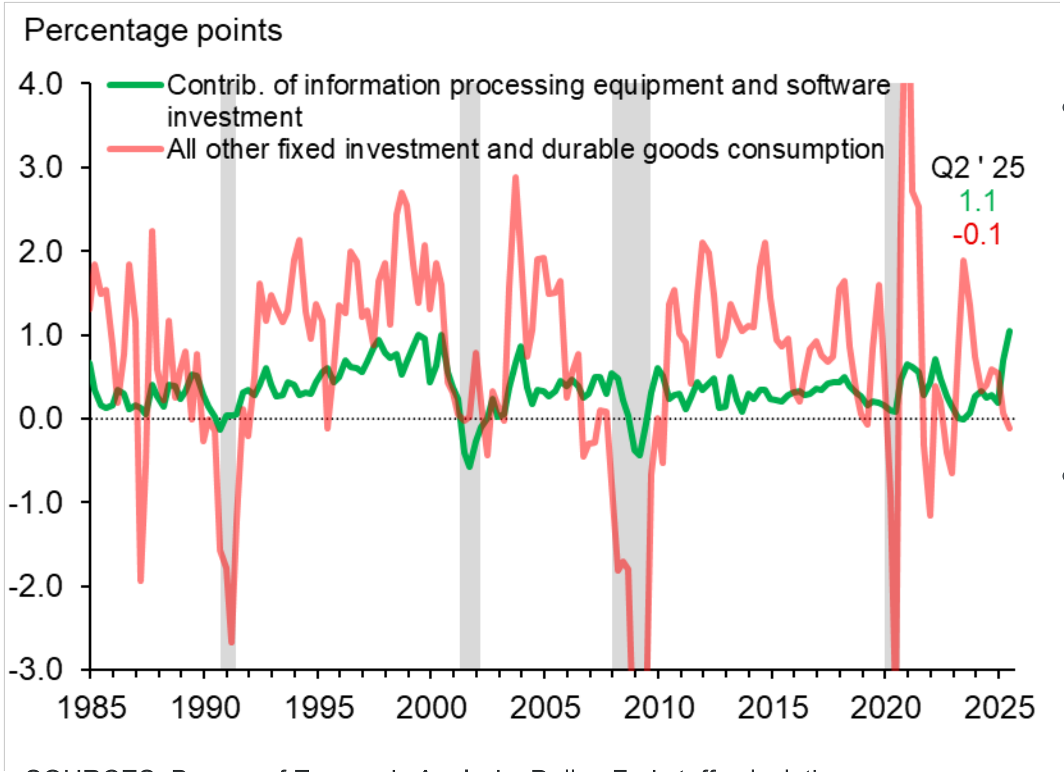
GDP Growth Has Been Resilient



- Investment and durable goods consumption, which is more interest rate sensitive and often drives the business cycle, has been remarkably steady.

SOURCES: Bureau of Economic Analysis; Dallas Fed staff calculations.

GDP Growth Has Been Resilient

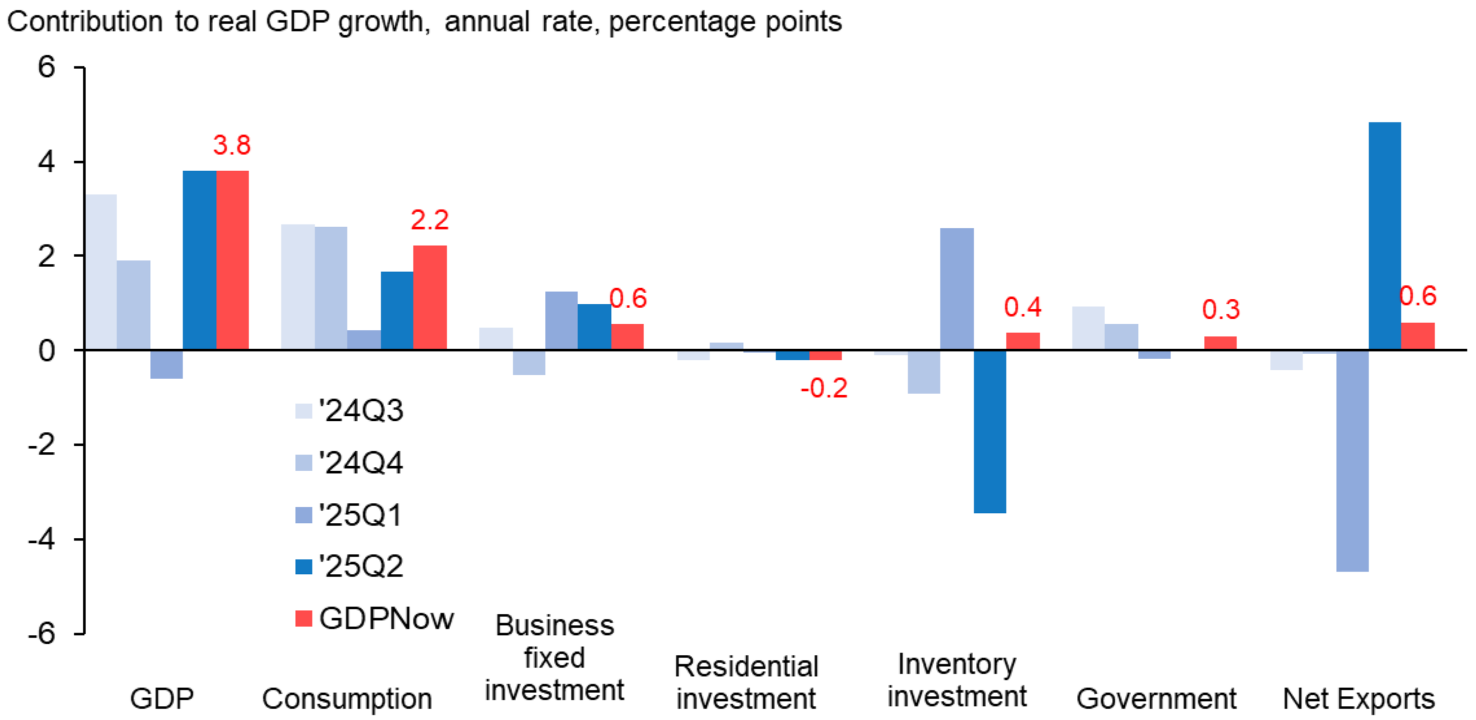


SOURCES: Bureau of Economic Analysis; Dallas Fed staff calculations.

- Investment and durable goods consumption, which is more interest-rate sensitive and often drives the business cycle, has been remarkably steady.

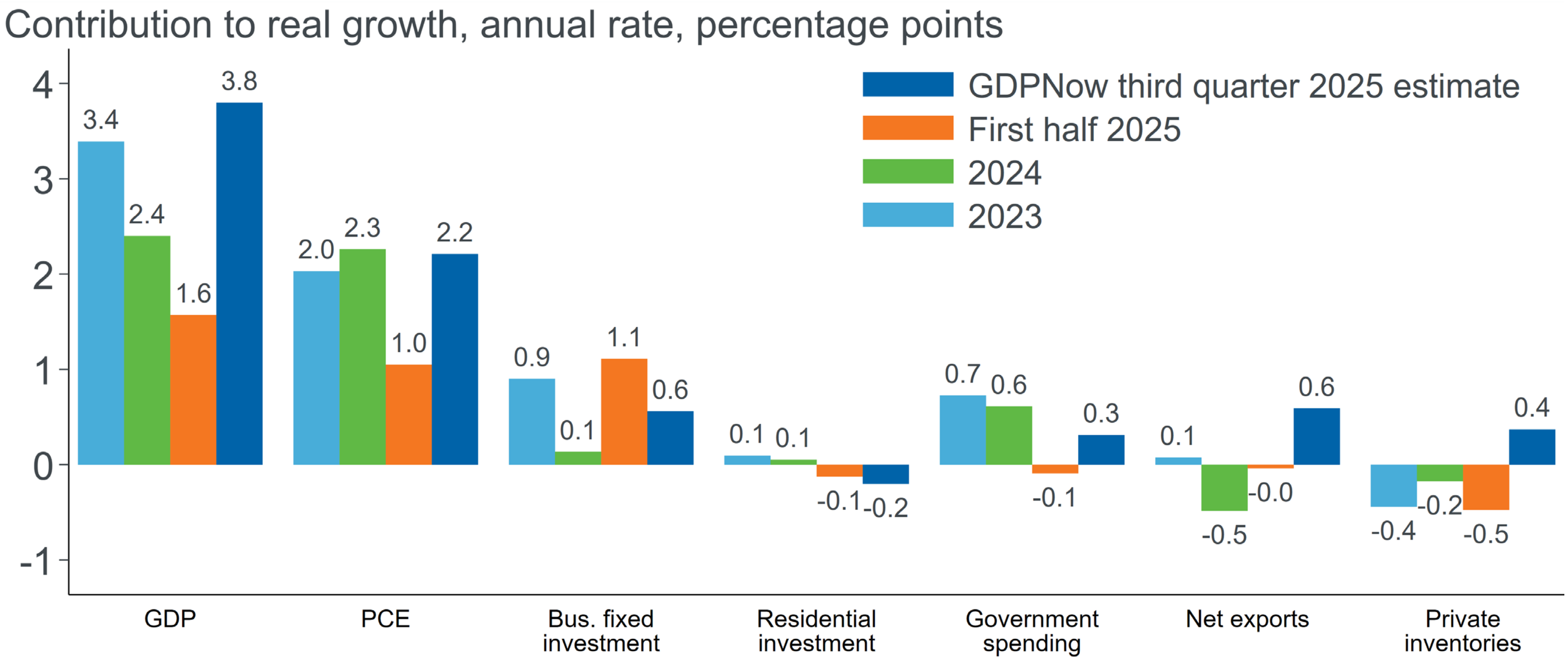
- This has been driven by AI investment, while other forms of investment are declining slightly.

Third Quarter 2025 GDP Growth Tracking to be Strong, Driven by Consumption and Business Fixed Investment



SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Atlanta.

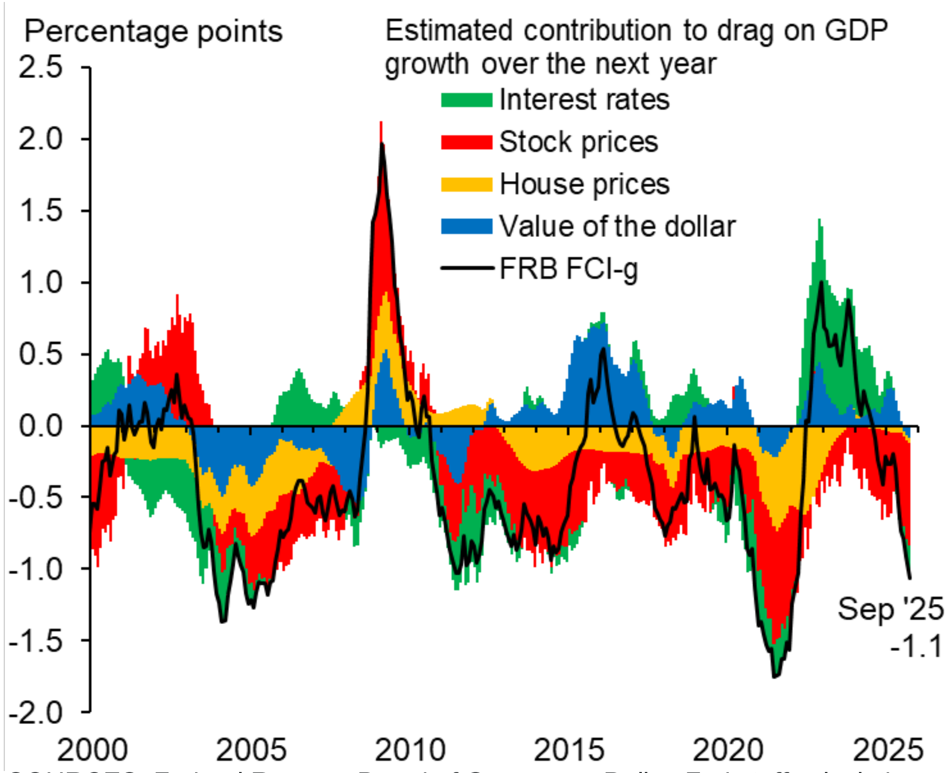
Third Quarter 2025 GDP Growth Tracking to be Strong, Driven by Consumption and Business Fixed Investment



SOURCES: Federal Reserve Bank of Atlanta; Bureau of Economic Analysis; author's calculations.

Supportive Financial Conditions

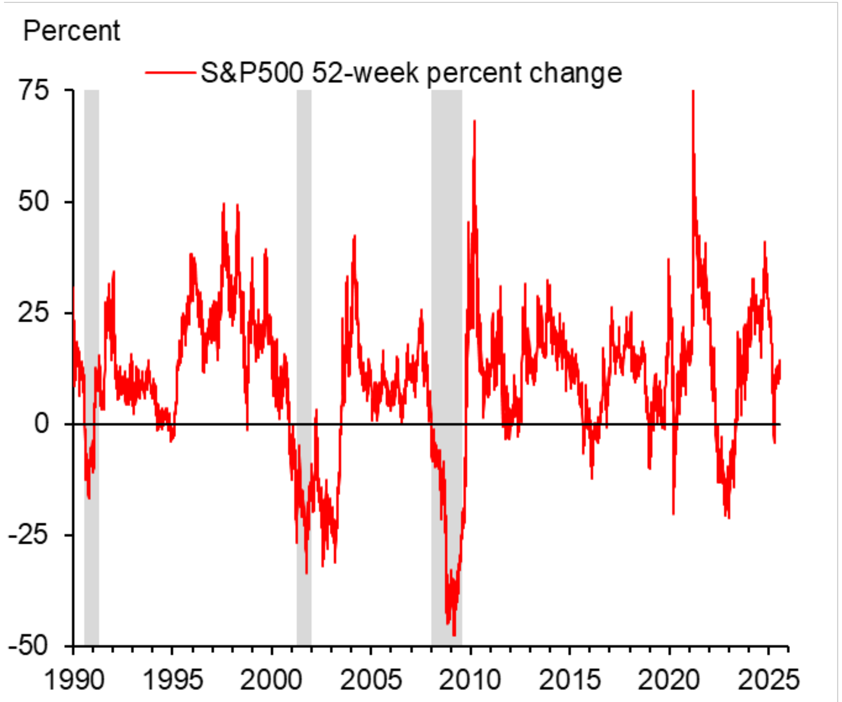
Financial Conditions Appear Supportive of Growth

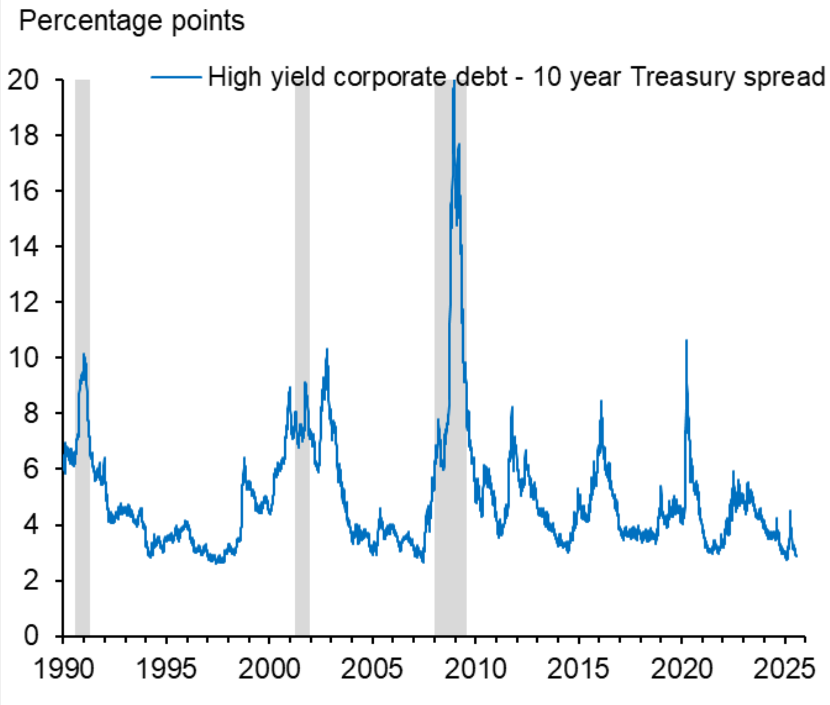


SOURCES: Federal Reserve Board of Governors; Dallas Fed staff calculations.

- Federal Reserve Board FCI-g estimates impact on future GDP growth from changes in financial indicators.
- Driven mainly by equities, currently suggests meaningful tailwind to growth.
- If AI disappoints, financial conditions could flip to a headwind.

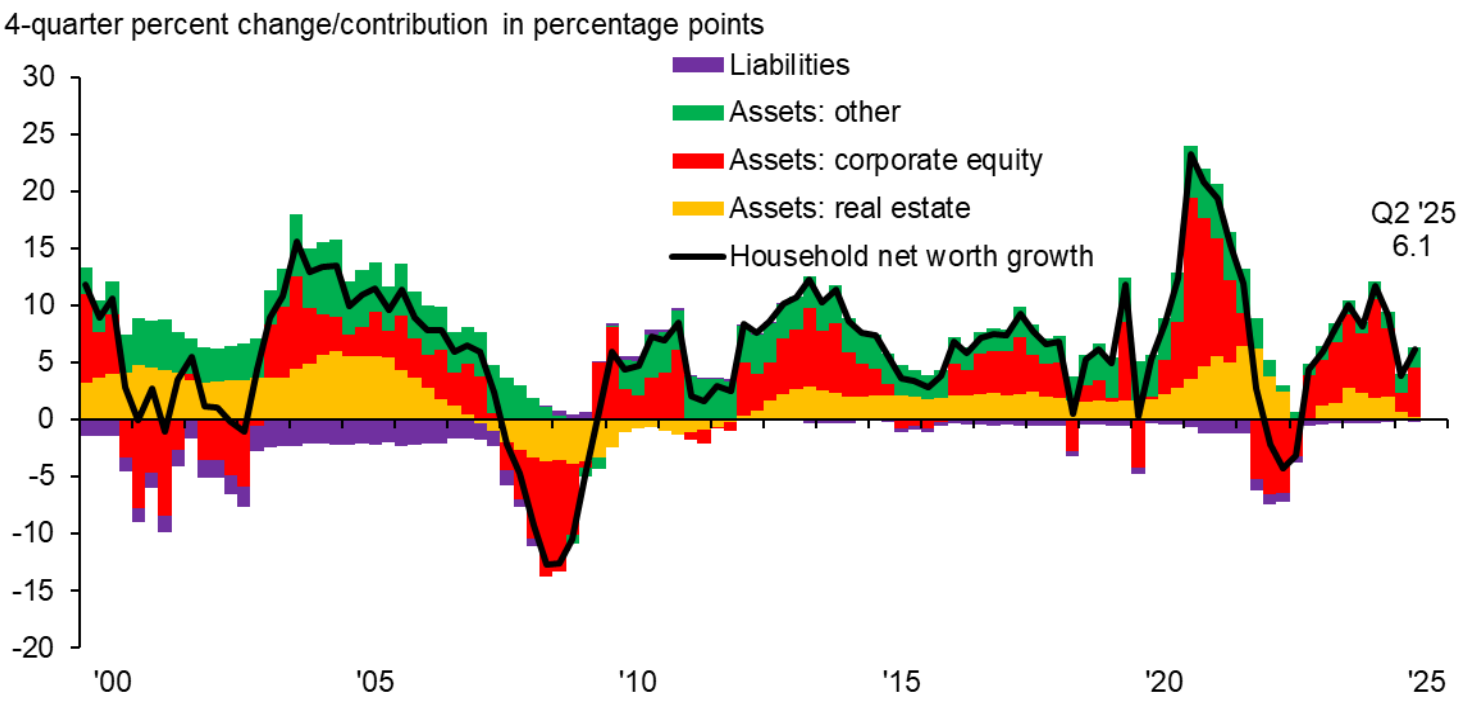
Stock Prices Are High, Credit Spreads Are Near Historic Lows





SOURCES: Standard and Poor's; ICE/Bank of America Merrill Lynch; Federal Reserve Board of Governors.

Household Wealth Accumulation Has Been Strong



SOURCES: Federal Reserve Board of Governors; Dallas Fed staff calculations.

Summary of Current Conditions

Summary of Current Conditions

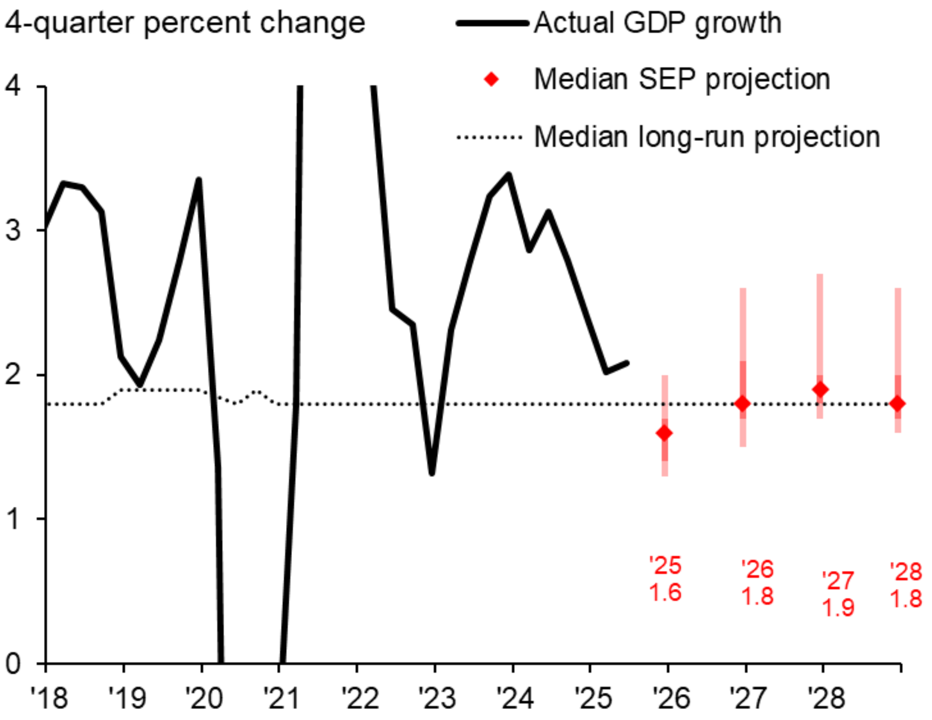
- Inflation above 2 percent for several years, but inflation expectations appear to be anchored.
  - Some temporary factors are boosting inflation (e.g., tariffs), but also some underlying concerns (non-housing services).

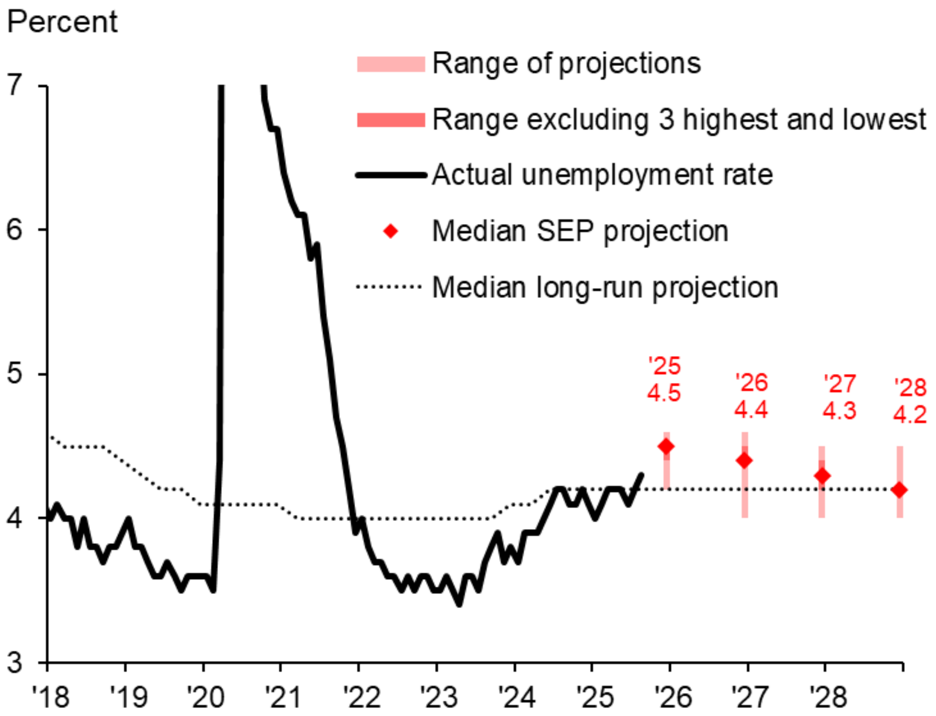
- Labor market—Unemployment rate consistent with full employment but gradually increasing.
  - Low hiring-low firing environment difficult for job seekers.

- GDP growth slowed from pace in 2024 but still resilient and near trend
  - Supported by booming AI investment
  - Will productivity pick up, meaning more output per worker? Or will job growth? What role will AI play in the labor market?

Near-term Outlook:
Summary of Economic Projections (SEP)

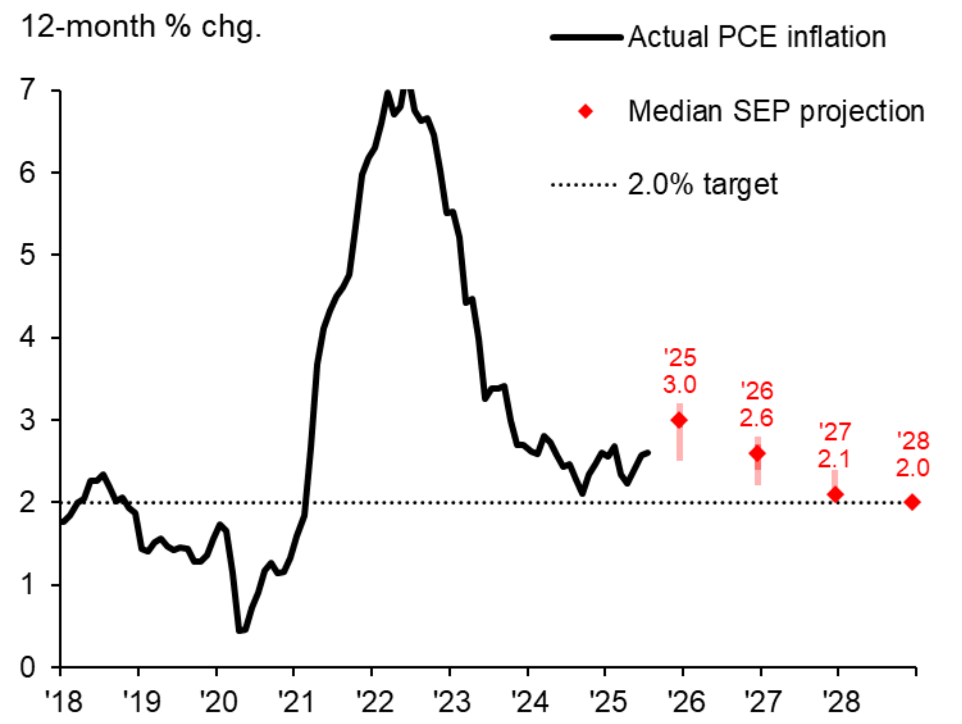
Growth Expected to Slow But Not Far Below Trend, Unemployment to Increase Then Stabilize

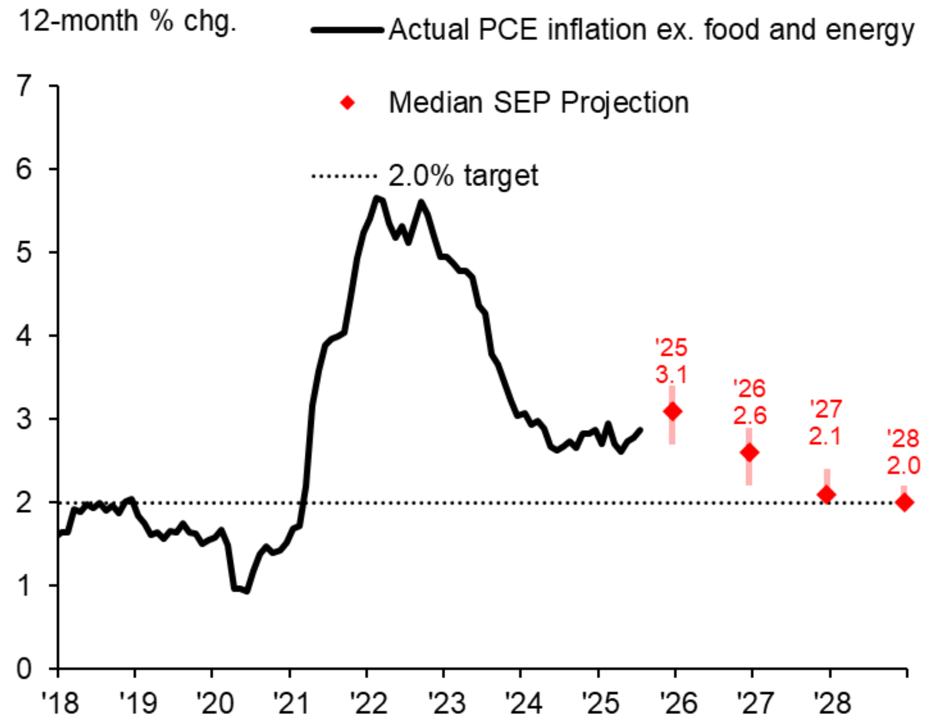




SOURCES: Federal Reserve Board of Governors; Bureau of Economic Analysis; Bureau of Labor Statistics.

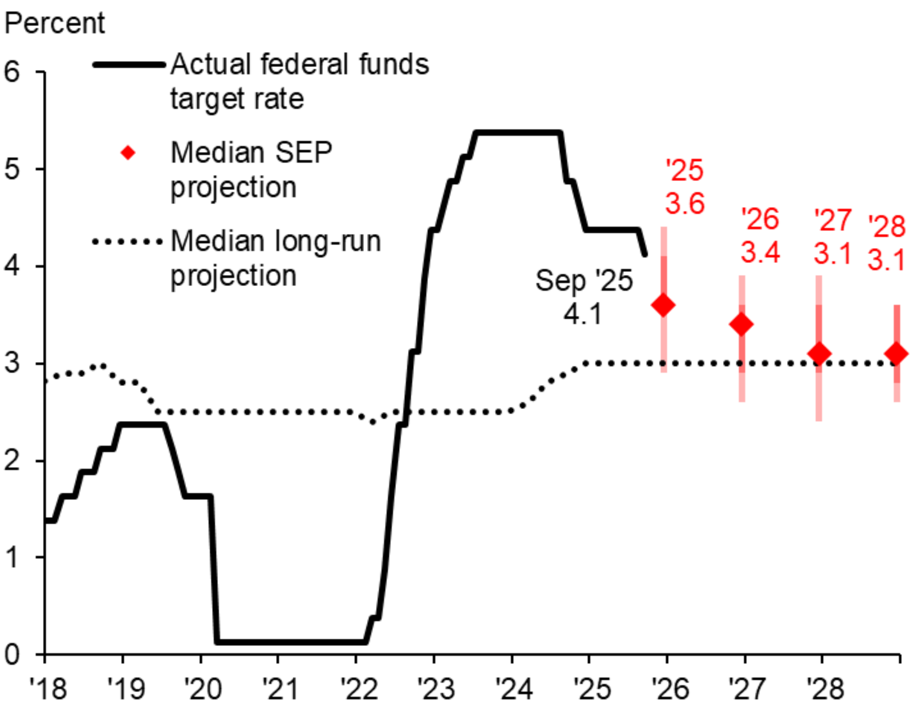
Progress on Reaching 2 Percent Inflation Delayed, Still Headed There Under Appropriate Monetary Policy





SOURCES: Federal Reserve Board of Governors; Bureau of Economic Analysis.

FOMC Cut Rates in September Given Increase in Downside Risks to Employment.



SOURCE: Federal Reserve Board of Governors.

- Range of views on the appropriate number and timing of future rate cuts.

- September FOMC statement:

  "The Committee is attentive to the risks to both sides of its dual mandate and judges that downside risks to employment have risen.

  In support of its goals and in light of the shift in the balance of risks, the Committee decided to lower the target range for the federal funds rate"

- "In considering additional adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks."

Risks to the Outlook

		Risks to inflation	
		Upside	**Downside**
Risks to activity	**Upside**	• Easy financial conditions, boost from fiscal policy, could overly stimulate demand next year	• Productivity boom from AI or other sources
	Downside	• Tariff price pass-through could pick up or be more disruptive. • Inflation expectations could move up.	• Gradual labor marketing softening could accelerate. • Financial conditions could tighten (e.g., AI boom could turn to bust)

Federal Reserve Bank of Dallas

Building a strong economy together