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Market View
With September rate cut imminent, the Fed stands at a crossroads

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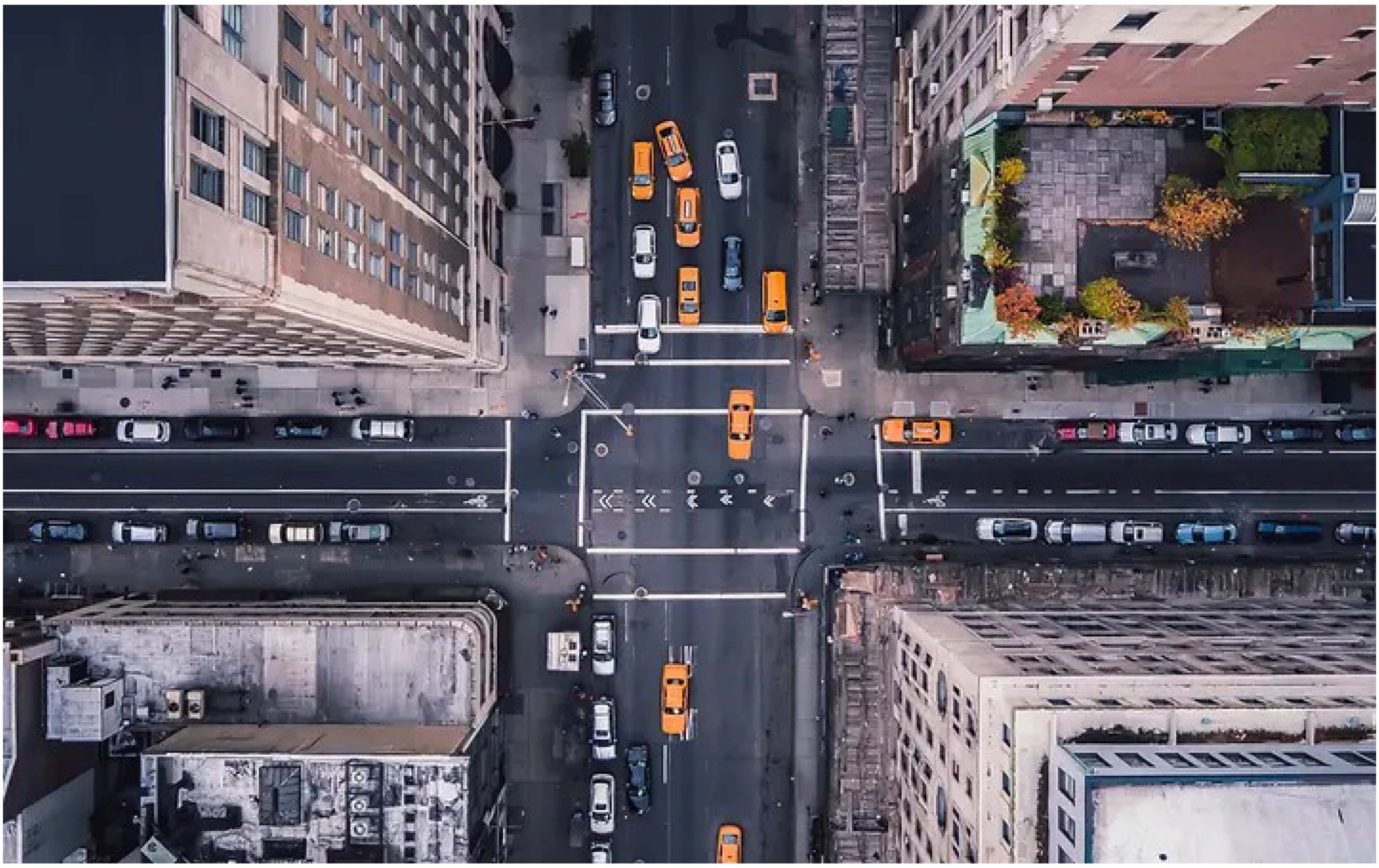

At a glance

- Fed's maximum employment goal showing cracks
- Inflation remains elevated with tariffs pushing prices up
- Opposing objectives making Fed's rate cutting path challenging

Although the Federal Reserve (Fed), the Bank of England (BoE) and the European Central Bank (ECB) are often lumped together when discussing central bank activity, their mandates differ significantly. While the BoE and ECB focus primarily on getting inflation to their 2% target, the Fed faces a more complex task: pursuing maximum employment and stable prices – a dual mandate that requires plenty of balancing and some trade-offs, particularly in turbulent times.

Labour market showing cracks

Recent data indicates the US labour market is weaker than previously thought, which has intensified scrutiny of the Fed's employment mandate. Nonfarm payrolls – the barometer that measures the number of jobs added or lost in the US each month – rose just 22,000 in August, down from 79,000 in July and well below the 75,000 expected.[1]

On top of this, earlier this week, the Bureau of Labor Statistics announced a downward revision of 911,000 in total jobs from April 2024 to March 2025, equivalent to about 75,000 fewer jobs per month over that period.[2] Meanwhile, continuing jobless claims drifted higher, painting a picture of a cooling labour market. The softening in employment conditions puts pressure on the Fed to consider rate cuts even as inflation remains above target.

Tariff headaches and inflation pressures

Tariff-induced price pressures are adding to the Fed's dilemma, as as the effects of these tariffs on prices are showing up more clearly in inflation data. The latest annual Consumer Price Index (CPI) figure published on 11 September rose to 2.9% from 2.7%,[3] illustrating the challenges of getting inflation back to 2%.

Tariffs have historically led to short-term price increases. However, given the high inflation experienced in the aftermath of Covid, there are concerns that this time may be different, as some worry tariffs' impact on inflation will not be short-lived.

With inflation already elevated, some members of the Fed fear that cost pressures caused by tariffs could feed into longer-term inflation expectations, making their job even more difficult.

Tariffs, which raise the cost of goods and squeeze incomes, are effectively a tax on consumers. The impact on inflation depends on whether companies pass higher costs onto consumers or absorb them through cost-cutting, including layoffs. In either case, they have a broad economic effect.

Political pressure and questions about credibility

Complicating the Fed's task is the ongoing political pressure from the Trump administration, which continues to push aggressively for interest rate cuts – on 10 September, Trump posted on Truth Social how "Powell is a total disaster, who doesn't have a clue!!!"[4] As economic conditions weaken, the Fed's decisions are coming under greater scrutiny, particularly from the White House.

If the Fed appears to prioritise the employment mandate while inflation is still running hot, some may view this as yielding to political pressure rather than acting independently. This could undermine the Fed's credibility and blur the lines between policy and politics.

All eyes on the Fed's September meeting

With a quarter-point rate cut fully priced in for the Fed's highly anticipated September meeting next week, markets are trying to determine whether the central bank will only react to weakening fundamentals or whether outside influence has shaped their decision. At the time of writing, markets expect three rate cuts by the end of the year with another three priced in for 2026 taking rates to around 3%. Chairman Jerome Powell will aim to strike a careful balance – restoring confidence in the US economy without sending the signal that the Fed is ignoring its price stability mandate or fears of a recession.

If the Fed is perceived as too soft on inflation, it could have broader consequences, particularly for the term premium, the additional return investors demand for holding long-term bonds. A rising term premium would push up intermediate- and long-term bond yields, tighten financial conditions and negate the impact of rate cuts.

[1] Bureau of Labor Statistics

[2] Deutsche Bank

[3] Bureau of Labor Statistics

[4] Reuters: https://www.reuters.com/world/us/trump-says-fed-chair-powell-should-make-big-rate-cut-now-2025-09-10/

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