MARKET SIGHT LINES

Inflation Firms a Little, but Softening Job Market Data May Still Lead to Fed Cuts

By Michael O'Keeffe, *Chief Investment Officer*

Since inflation surged in the wake of the pandemic opening and the Federal Reserve (Fed) hiked its funds rate, investors have been closely monitoring for signs of cooler inflation. In the last year or so, inflation fell in some months to levels consistent with the Fed's target, most recently during the four months ending in May. Some June inflation reports are in, showing a modest firming of inflation, but not as much as expected. Further, recent labor market reports show a strong job market, but with some signs of softening. All this considered, these dynamics support the market expectation that the Fed will begin cutting rates later this year. In this week's Sight|Lines, we unpack the recent inflation and job market reports, which provide the Fed a foundation for 2025 rate cuts.

THE TAKEAWAY: MODEST INFLATION FIRMING AND JOB MARKET SOFTENING MAY WELL MEAN FED RATE CUTS

Data related to the Fed's dual mandate – inflation and jobs – give the Fed a reason to cut rates later this year. In summary:

- June headline and core consumer price index (CPI) levels increased at a rate slightly above the Fed's 2% target, with many blaming tariffs for the move.
- Producer price index (PPI) levels, both headline and core, were unchanged.
- Job growth remained strong but are showing signs of softening.
- The unemployment rate is also in a good place, but some of this strength relates to people leaving the job market.
- The Job Openings and Labor Turnover Survey (JOLTS) quits rate remains lower than the last couple of years, signaling a still less confident worker.
- The Fed has made note of tariff uncertainty and a softening labor market, and the consensus view is for two quarter-point cuts, one in September and another in December.
- We also expect one to two Fed rate cuts later this year.
- A corresponding drop in the cost of debt would prove positive for borrowers.

IN-DEPTH: INFLATION IS FIRMING SLIGHTLY, A STRONG JOB MARKET IS SHOWING MODEST SIGNS OF SOFTENING, AND FED CUTS ARE EXPECTED

The Fed is focused on its dual mandate – reasonable prices and maximized jobs – and recent inflation and job markets data give the Fed room to cut rates later this year. Going deeper:

- June CPI levels came in slightly above the Fed's 2% target, with many blaming tariffs for the move:
  - Headline CPI was up 0.3%, above the 0.17% monthly equivalent of the Fed's 2% target and in line the consensus forecast of 0.3%.
  - Core CPI, which excludes food and energy, was up 0.2%, below the consensus forecast of 0.3%.
- PPI levels have yet to pass on higher costs from tariffs:
  - Headline PPI was unchanged in June, rising 1.4% so far in 2025, annualized.
  - Core PPI was also unchanged, rising 2.1% in 2025, annualized.
- Job growth remains strong but are showing signs of softening:
  - June non-farm payrolls rose by 147,000 in with a three-month average of 150,000.
  - The December report showed growth of 323,000.
  - This compares to 183,000 for the 10 years ended December 2019.
- The unemployment rate remains in a good place:
  - The current level is 4.1%, compared to a pre-pandemic 10-year average of 6.2%.
  - 130,000 people left the workforce, though, a higher level than normal.
- The JOLTs quits rate has risen modestly since December:
  - The quits was at 2.1% in May, below a peak of 3% in March 2022.
  - This signals a still less confident worker
- The Fed has made note of tariff uncertainty and a softening labor market:
  - In the most recent Fed meeting minutes: "In their outlook for the labor market, most participants suggested that higher tariffs or heightened policy uncertainty would weigh on labor demand, and many participants expected a gradual softening of conditions."
  - Fed funds futures are showing two quarter-point cuts, one each in September and December.
  - This aligns with our view of one to two Fed rate cuts later this year.
- A corresponding drop in the cost of debt would prove positive for borrowers.

CONCLUSION

All borrowers, like consumers, businesses, and government, care about the level of interest rates. So many keep an eye on Fed policy, as the Fed funds rate serves as a base reference level influencing the cost of debt for these borrowers in our economy. We've all been waiting for inflation to stabilize near the Fed's 2% target. While that happened recently for a number of months, investors and borrowers are worried that tariffs may reignite inflation, and a modest increase in June inflation data may reflect that. Even still, the strong job market is showing some signs of softening. As the Fed balances these issues around their dual mandate – prices and jobs – we align with the consensus and see a strong potential for one to two quarter-point Fed cuts later this year.

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