



September 8, 2025

Morning Briefing

The Good, The (Not So) Bad & The (Relatively) Ugly

Check out the accompanying [chart collection](#).

Executive Summary: Our Roaring 2020s economic scenario and expectations for inflation and the labor market suggest that the Fed probably shouldn't cut interest rates this year, although one cut might be warranted if upcoming inflation reports are more subdued than we expect. Yet a rate cut next week, after the FOMC meets Wednesday, is practically a foregone conclusion. Stimulating an economy that doesn't need stimulation won't create more workers to address the undersupply that's constraining the demand for labor, Dr Ed explains. Plus, cutting rates when it's not necessary could cause stock prices to melt up and destabilize the broader financial system. ... Plus, a look at the debt crises attracting Bond Vigilantes' attention in the UK, France, and Japan. ... Also: Dr Ed reviews "Happy Face" (+ +).

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available [here](#).

The Good: Accentuating the Positives. Friday's employment report was weaker than we expected. It was weaker than almost everyone expected. Not surprisingly, the [CME FedWatch Tool](#) is now showing 100% odds that the Fed will cut the federal funds rate on September 17, with a 25bps cut at 89.0% odds and a 50bps cut at 11.0%.

We are raising our odds of a 25bps rate cut on September 17 from 40% to 80% in response to Friday's employment numbers. Why not 100%? We think that next week's PPI and CPI inflation rates for August might be hotter than expected.

If these inflation reports are subdued, however, we will change our stance on the number of 25bps rate cuts we think is warranted from none-and-done in 2025 to one-and-done in 2025. Why not more rate cuts before the end of this year? We are sticking to our view that the economy, including consumer spending, remains resilient.

Consider the following:

(1) *The Fed Put*. Interestingly, the odds of a recession in 2025 remained unchanged at just 8% on Friday, according to Polymarkets.com, as the odds of a rate cut have risen ([Fig. 1](#)). However, 2025 will be over soon, and Polymarkets.com doesn't have a similar bet yet for 2026.

The 2026 recession odds would remain low if Friday's employment report triggers a Fed Put—with a rate cut on September 17 and more rate cuts after that to avert a recession. In any case, we continue to believe that by cutting rates this month the Fed would be stimulating an economy that doesn't need easier monetary policy.

(2) *GDP & consumer spending*. Just before Friday's employment report, the Atlanta Fed's [GDPNow](#) model showed Q3 real GDP growth was tracking at 3.0% (saar) ([Fig. 2](#)). That number will likely be lowered on Monday to reflect that personal consumption spending might be held down by personal income, reflecting little job growth in recent months.

However, the Redbook retail sales index rose 6.5% y/y through the week of August 29 ([Fig. 3](#)). Our Earned Income Proxy for private wages and salaries in personal income rose 0.3% m/m to a new record high in August ([Fig. 4](#)). That suggests that retail sales did the same in August.

Also auguring well for August retail sales is the forward revenues of the S&P 500 Retail Composite ([Fig. 5](#)). Retail industry analysts' bullish revenues expectations are based on retail managements' positive guidance on consumer spending.

Auto sales did edge down in August to 16.1 million units ([Fig. 6](#)). But that's a relatively strong pace.

(3) *Productivity*. Q2's productivity growth rate was revised up sharply from 2.4% (saar) to 3.3% as output rose 4.4% (up from a revised 3.7%) and hours worked rose 1.1% (down from 1.3%) ([Fig. 7](#)). This confirms our view that the problem in the labor market is a shortage of labor rather than insufficient demand. Employers are solving this problem by boosting both productivity and real wages. Hourly compensation rose 4.3% (saar) and 2.6% during Q2 in nominal and real terms.

The underlying inflation rate in the labor market, i.e., unit labor costs, rose just 1.0% q/q and 2.5% y/y during Q2.

All this is consistent with our Roaring 2020s economic scenario, which doesn't require the

Fed to cut interest rates. On the contrary, our concern is that lowering interest rates will lead to financial instability, including a meltup/meltdown in the stock market. Solid productivity-led growth in real GDP implies that currently interest rates are just fine where they are.

(4) *CESI*. Despite Friday's weaker-than-expected employment report, the Citigroup Economic Surprise Index remained surprisingly strong at 20.1 ([Fig. 8](#)). That's down slightly from the recent high of 29.9 on September 1.

(5) *S&P 500 Earnings*. The Q2 reporting season delivered lots of positive surprises, as did Q1's season. That's somewhat surprising given Trump's Tariff Turmoil during the first half of the year. Nevertheless, following a brief dip through the April 2 Liberation Day turmoil, analysts' consensus expectations for S&P 500 revenues and earnings in 2025 and 2026 rebounded ([Fig. 9](#) and [Fig. 10](#)). In addition, the index's forward revenues and forward earnings resumed their climbs to record readings.

The same can be said about the S&P 500 forward profit margin ([Fig. 11](#))! Now that is truly surprising given that tariffs, like other taxes, increase the costs of doing business. Of course, some of those costs were absorbed by foreign exporters and domestic consumers. In addition, productivity gains must have played a role in bolstering the profit margin.

In any event, Q2's earnings surprises were relatively broad based among the 11 sectors of the S&P 500 ([Fig. 12](#)). In addition, the three-month percentage changes in both forward revenues and forward earnings soared in recent weeks to 89% and 86% as analysts scrambled to raise their earnings estimates in response to the positive surprises of the latest two reporting seasons ([Fig. 13](#) and [Fig. 14](#)). (Hat tip to our inventive colleague Joe.)

(6) *Business applications and bankruptcies*. Another positive economic development is the recent rebound in business applications to 470,600 during July ([Fig. 15](#)). That's the highest reading since October 2023, and it's a monthly rate (i.e., it isn't annualized). Presumably, almost every new business must be employing at least one new worker. Could it be that the birth/death adjustment applied to the latest monthly payroll employment numbers by the Bureau of Labor Statistics is too low?

(7) *YRI S&P 500 targets*. Notwithstanding Friday's weak employment report, we are reiterating what we wrote in our August 25 [Morning Briefing](#): "We are sticking with our targets for the S&P 500 of 6600 by year-end 2025 and 7700 at the end of next year. That's our base-case scenario with a subjective probability of 55%. We currently assign a 25% subjective probability to a meltup that lifts the S&P 500 to 7000 by year-end 2025 and 20%

odds to a correction in the index by the end of this year.” If the Fed lowers the federal funds rate on September 17 and signals more rate cuts ahead, we will increase the odds of a meltup and decrease the odds of a correction.

The (Not So) Bad: Labor Market Equilibrium. Poor Miss Piggy, the Mae West of the Muppets. They say that you can put lipstick on a pig, but it is still a pig. That’s why her flirtations never attracted Kermit. The same can be said for trying to put a positive spin on August’s employment report. Nevertheless, that’s what we did in Friday’s [QuickTakes](#) titled “US Labor Market Is In Balance.” We noted that while payroll gains averaged just 29,300 per month through August, the unemployment rate only edged up from 4.2% in May to 4.3% in August.

But there is an intrinsic conundrum in the current labor market: The new “breakeven” pace of payroll gains necessary to keep the unemployment rate from rising may be significantly lower now for some reason. If so, the question is why that is.

In our opinion, much of the labor market’s recent weakness is attributable to the diminishing supply of workers resulting from the Trump administration’s success in shutting off illegal immigration and in deporting illegal migrants. On Thursday, 475 mostly South Korean nationals were arrested at a Hyundai facility in Georgia. They will be returned to South Korea on a chartered flight. That kind of news certainly will convince other would-be undocumented immigrants to stay in their home countries or to go back there if they are working illegally here. Also, US employers will be less likely to hire them.

In addition, the Baby Boomers are retiring. They currently account for 48.0% of the population that is not in the labor force, up from 38% in 2011, when the oldest among them turned 65 years old ([Fig. 16](#)). Now, the latter group is 79 years old. The retiring Baby Boomers were highly experienced workers and difficult to replace with younger ones, especially teenagers and recent college graduates, which explains why unemployment rates are rising for younger workers while remaining low for older ones ([Fig. 17](#)).

So the demand for workers is being constrained mostly by the supply of workers. On the demand side, some of the recent weakness may be attributable to less need for social assistance for immigrants. Indeed, two of the weakest job openings series have been for health care & social assistance workers and state & local government workers providing education and other social services ([Fig. 18](#) and [Fig. 19](#)).

Having the Fed cut the federal funds rate isn’t likely to create more workers to meet the

demand for workers. Instead, would-be employers will have no choice but to boost the productivity of their current employees. We think that is exactly what is happening.

If so, then additional monetary easing might boost wage inflation, though that should be offset by higher productivity growth. If the labor market and the economy don't need additional monetary stimulus, then the added liquidity is likely to drive stock prices higher, possibly causing a meltup. We prefer that the Fed avoid causing such financial instability so that the Roaring 2020s will be followed by the Roaring 2030s. To infinity and beyond!

The (Relatively) Ugly: Debt Crises Brewing Abroad. In the US, bond yields have declined in recent weeks in response to weak economic indicators. Concerns that inflation remains about a percentage point above the Fed's 2.0% y/y target and that federal debt is rising too rapidly have vanished. The Bond Vigilantes seem to have vanished. Where have they gone?

The Bond Vigilantes are vacationing in the UK, France, and Japan. They clearly don't like the fiscal excesses they are seeing over there. As fears of an imminent debt crisis have abated in the US, their ranks have increased in these three countries ([Fig. 20](#), [Fig. 21](#), and [Fig. 22](#)). Consider the following:

(1) *United Kingdom*: The UK's debt-to-GDP ratio has surpassed 100%, reaching levels not seen since the early 1960s. Recent posts on X highlight concerns over rising 30-year gilt yields hitting 5.60%, with the annual debt interest bill soaring. The lack of budget discipline and resistance to welfare spending cuts under Prime Minister Keir Starmer's government have raised fears of a looming fiscal crisis.

(2) *France*: France faces a severe debt crisis, with a national debt that equals 114% of GDP and a 2024 budget deficit of 5.8%. Political instability, including a potential government collapse and a confidence vote called by Prime Minister François Bayrou has heightened concerns. Bond investors now view France's risk profile similarly to Italy's, with 10-year yield gaps narrowing significantly. The Interior Minister warned of a "financial abyss," with 54% of debt held by foreign investors, increasing France's vulnerability.

(3) *Japan*: Japan's debt-to-GDP ratio is the highest among developed nations at around 260%, with gross debt at ¥1.3 quadrillion (US\$8.7 trillion). The Bank of Japan (BoJ) holds nearly half of this debt, mitigating some risks due to domestic ownership. However, rising bond yields (30-year at 3.14%, 40-year at 3.6%) and weak bond auction demand signal investor concerns about fiscal sustainability. The BoJ faces a dilemma: Raising rates to

combat inflation or yen weakness could spike debt servicing costs, potentially exceeding ¥30 trillion in 2025; alternatively, keeping rates low risks bond market instability. Japanese Prime Minister Shigeru Ishiba announced his resignation on Sunday.

Movie. “Happy Face” (+ +) is a 2025 Paramount+ series about the chilling true story of Melissa Moore, daughter of serial killer Keith Jesperson, the “Happy Face Killer” (played by Dennis Quaid). This eight-episode drama shifts focus from the killer’s crimes to the ripple effects on his family, with a fictional twist about a ninth victim. Quaid’s creepy charisma steals scenes, but Ashford’s emotional depth as Melissa carries the show. Solid performances make it interesting to watch, though the invented subplot feels forced. It is a compelling watch for true-crime fans, since it fits right in with the serial-killer genre. (See our movie reviews [archive](#).)

Calendars

US: Mon: Consumer Credit Change \$10.1b. **Tues:** NFIB Small Business Optimism Index 101.0; Payrolls Benchmark. (Source: FX Street)

Global: Mon: Germany Industrial Production 1.3%; China Exports & Imports 3% & 4%/y. **Tues:** France Industrial Production -1.2%; Eurogroup Meetings; Japan Machine Tool Orders 3.6%/y; China CPI & PPI -0.2% & -2.9%/y. Nagel. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US\$ Performance) ([link](#)): The US MSCI index rose 0.3% during the September 5 week and closed 0.3% below its August 28 record high. The AC World ex-US rose 0.6% for the week and improved to 0.5% below its August 25 record high. The AC World ex-US has been hitting new record highs since May 14 for the first time since June 15, 2021. Despite its strength in recent weeks, the US MSCI outperformed the AC World ex-US in only 11 of the past 32 weeks. EM Latin America was the best performing region last week, with a gain of 1.7%, followed by EM Asia (1.6%), EM (1.4), and the AC World ex-US. EMU was the worst regional performer, with a decline of 0.3%, followed by EMEA (0.1), Europe (0.2), and EAFE (0.2). The Mexico MSCI index, with a gain of 2.9%, performed the best among country indexes, ahead of China (1.9), Taiwan (1.6), Switzerland (1.6), and India (1.6). The Germany MSCI index was the worst performer w/w, with a decline of 1.3%,

followed by Australia (-1.2), Hong Kong (-1.0), Spain (-0.4), and France (0.0). In terms of ytd performance rankings, the US MSCI index is up 10.3% ytd, but ranks as the second worst country performer and trails the 20.1% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EM Latin America leads with a gain of 31.7%, followed by EMU (26.3), Europe (22.5), EAFE (20.6), and the AC World ex-US. EMEA is now the worst ytd performer, albeit with a gain of 16.5%, followed by EM Asia (17.5) and EM (18.7). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 51.2%, followed by Korea (41.3), South Africa (38.3), Mexico (35.2), and Germany (29.3). The worst performing countries ytd: India (-0.5), the US (10.3), Australia (12.5), Taiwan (15.0), and Japan (17.3).

US Stock Indexes ([link](#)): Thirty-three of the 48 major US stock indexes that we follow rose during the week ended August 29, up from 12 rising a week earlier. The S&P 400 MidCap Growth index was the best performer for the week, rising 1.6%, ahead of S&P 400 MidCap Pure Growth (1.5%), S&P 400 MidCap Pure Value (1.5), S&P 600 SmallCap Value (1.4), and S&P 400 MidCap (1.4). The S&P 500 Transportation index was the worst performer, with a decline of 1.6%, followed by Dow Jones 20 Transports (-1.1), Dow Jones 15 Utilities (-0.9), Dow Jones 65 Composite (-0.6), and S&P 100 Equal Weighted (-0.6). All but one of the 48 indexes are higher ytd. With a gain of 14.1%, the S&P 500 LargeCap Growth index is in the top spot as the best performer so far in 2025, ahead of S&P 500 LargeCap Pure Growth (13.3), Nasdaq 100 (12.6), Nasdaq Composite (12.4), and Russell MidCap Growth (11.8). The worst performing major US stock indexes ytd: Dow Jones 20 Transports (-1.1), S&P 600 SmallCap Value (2.1), S&P 600 SmallCap Equal Weighted (2.6), S&P 600 SmallCap (3.0), and S&P 500 Transportation (3.9).

S&P 500 Sectors Performance ([link](#)): Five of the 11 S&P 500 sectors rose during the week ended September 5, and four were ahead of the S&P 500's 0.3% gain. That compares to three S&P 500 sectors rising a week earlier, when five were ahead of the S&P 500's 0.1% decline. The outperformers last week: Communication Services (5.1%), Consumer Discretionary (1.6), Health Care (0.3), and Consumer Staples (0.3). The underperformers last week: Energy (-3.5), Financials (-1.7), Utilities (-1.1), Industrials (-0.9), Materials (-0.4), Real Estate (-0.3), and Information Technology (0.2). The S&P 500 is now up 10.2% ytd, with 10 of the 11 sectors positive ytd but only three are ahead of the index. During the June 20 week, Consumer Discretionary and Health Care were trailing so far behind ytd that they were the only sectors trailing the index. Communication Services still wears the crown as the best ytd performer with a gain of 23.2%, followed by Industrials (14.1), and Information Technology (13.8). These eight sectors are lagging the S&P 500 so far in 2025: Health Care (-0.1), Energy (1.1), Consumer Discretionary (3.2), Real Estate (3.3), Consumer Staples

(4.3), Financials (9.5), Utilities (9.6), and Materials (9.9).

US Economic Indicators

Employment ([link](#)): Another soft jobs report: The August increase was considerably below expectations, while there was a small upward revision to July payrolls and a downward revision to June jobs. Payroll employment climbed only 22,000 last month, below the consensus estimate of 75,000, while July's (to 79,000 from 73,000) gain was revised upward slightly and June's (-13,000 from +14,000) down, for a net loss of 21,000. Private payroll employment climbed 38,000 in August, while government jobs fell 16,000 during the month. The service-providing sector added 63,000 to payrolls last month, below July's 85,000, while the goods-producing sector lost 25,000 jobs, its fourth straight monthly decline, reflecting losses in manufacturing jobs of 12,000 in August, 2,000 in July, and 17,000 in June—primarily durable goods manufacturing. Within service-producing industries, once again health care led the pack, adding 31,000 in August—below the average monthly gain of 42,000 over the prior 12 months—with ambulatory health care services (13,000) once again leading the gains in this sector, while both nursing & residential care facilities and hospitals added 9,000 to payrolls. Social assistance jobs continued to climb, adding 16,000 jobs last month, driven by individual and family services.

Wages ([link](#)): Average hourly earnings (AHE) for all workers on private payrolls increased 0.3% in August, while the three-month rate increased 3.3% (saar), below the yearly rate of 3.7%. August's yearly rate is down from last November's 4.2% and a couple of ticks below this July's 3.9%. The yearly rate was at 3.6% last July, which was the lowest since May 2021. Service-providing industries showing three-month rates above their yearly rates: utilities (6.9% & 2.4% y/y), transportation & warehousing (4.6 & 3.2), and other services (3.8 & 2.5). Service-providing industries showing three-month rates below their yearly rates: education & health services (1.5 & 2.9), retail trade (1.9 & 3.8), financial services (2.9 & 4.1), and information services (3.2 & 4.6). Service-providing industries showing three-month rates near their yearly rates: professional & business services (5.2 & 5.0), leisure & hospitality (3.9 & 3.7), and wholesale trade (3.5 & 3.3). Within goods-producing industries, the annualized three-month rates were below the yearly rates for both durable goods (2.9 & 4.1) and nondurable goods (2.9 & 3.4) manufacturing.

Earned Income Proxy ([link](#)): Our Earned Income Proxy (EIP), which tracks consumer incomes and spending closely, climbed to yet another a new record high in August, increasing 0.3%. Average hourly earnings advanced 0.3% during the month,

while aggregate weekly hours was unchanged—with both private payroll employment and the average workweek flat.

Unemployment ([link](#)): The number of unemployed rose 148,000 in August to 7.38 million, with the unemployment rate ticking up from 4.2% to 4.3%—moving above the narrow range of 4.0% to 4.2% from last May through this July. Household employment rose 288,000 last month, while the labor force was 436,000 higher. The participation rate edged up from 62.2% in July to 62.3% in August. The unemployment rate climbed for African Americans (to 7.5% from 7.2%) and Hispanics (5.3 from 5.0) during August, fell for Asians (3.6 from 3.9), and was unchanged at 3.7% for Whites. By education: Unemployment rates fell in August for those with a high-school diploma (4.3% from 4.4%) and rose for those with less than a high-school diploma (to 6.7 from 5.5), and some college or an associate's degree (3.2 from 3.0). The unemployment rate for those with a bachelor's degree or higher was unchanged at 2.7%.

US Non-Manufacturing PMI ([link](#)): The US service sector expanded for the third consecutive month in August, with ISM's NM-PMI climbing to 52.0 from 50.1 in July. The business activity/production index (to 55.0 from 52.6) moved further into expansion territory in August—and has not been in contraction territory since May 2020. Meanwhile, the new orders (56.0 from 50.3) measure bounced higher last month after falling close to the breakeven point in July. The inventories (53.2 from 51.8) measure was in expansion for the third straight month. The supplier deliveries (50.3 from 51.8)—gauge was in expansion territory for the ninth successive month, indicating a slower supplier delivery performance. (Supplier deliveries is the only ISM index that is inversed; a reading above 50.0 indicates slower deliveries, which is typical as the economy improves and customer demand increases.) Employment (46.5 from 46.4) was in contraction territory for the third straight month in August and the fifth time in the last six months, though held steady around July's pace. On the inflation front, the price index (to 69.2 from 69.9), exceeded 60 percent for the nine successive months—its longest streak since the 30 consecutive months recorded from October 2020 through March 2023.

Global Economic Indicators

Global Composite PMI ([link](#)): Global economic growth was at a 14-month high in August, but business confidence dipped to one of its lowest readings since the 2020 pandemic. The Global C-PMI Output Index (to 52.9 from 52.5) accelerated for the fourth straight month—at its fastest pace since June 2024—though there's a disparity between the manufacturing and

service sectors, with the service sector outperforming the manufacturing sector for the sixth consecutive month. The global services (53.4 from 51.8) measure posted the strongest growth since December (53.8), with all three sectors—business, consumer, and financial services—increasing, financial services the most and consumer services the least. The global manufacturing (50.9 from 49.7) measure moved back above the breakeven point of 50.0, though has been fluctuating around 50.0 in recent months. Regionally, India recorded the strongest growth overall in August, while the US continued to outperform the major developed economies—despite slowing a bit last month. The report notes faster expansions were signaled in the UK and Japan, as well as further modest growth in the Eurozone. Meanwhile, economic activity in mainland China accelerated, while downturns moderated in both Russia and Brazil. Turning to business confidence, the report notes that surveyed companies “often cited geopolitical uncertainty and/or US trade policy as the main factors stymieing confidence.” Turning to pricing, August data showed a further increase in average input prices, though the rate of inflation was little changed compared to recent months. The rate of increase in average output charges was also broadly unchanged.

Eurozone Retail Sales ([link](#)): Another soft jobs report: The August increase was considerably below expectations, while there was a small upward revision to July payrolls and a downward revision to June jobs. Payroll employment climbed only 22,000 last month, below the consensus estimate of 75,000, while July’s (to 79,000 from 73,000) gain was revised upward slightly and June’s (-13,000 from +14,000) down, for a net loss of 21,000. Private payroll employment climbed 38,000 in August, while government jobs fell 16,000 during the month. The service-providing sector added 63,000 to payrolls last month, below July’s 85,000, while the goods-producing sector lost 25,000 jobs, its fourth straight monthly decline, reflecting losses in manufacturing jobs of 12,000 in August, 2,000 in July, and 17,000 in June—primarily durable goods manufacturing. Within service-producing industries, once again health care led the pack, adding 31,000 in August—below the average monthly gain of 42,000 over the prior 12 months—with ambulatory health care services (13,000) once again leading the gains in this sector, while both nursing & residential care facilities and hospitals added 9,000 to payrolls. Social assistance jobs continued to climb, adding 16,000 jobs last month, driven by individual and family services.

Germany Factory Orders ([link](#)): German factory orders fell for the third straight month in July. Germany factory orders were much weaker than expected in July, sinking 2.9%, missing forecasts of a 0.5% increase, following June’s downwardly revise 0.2% decline. Foreign demand contracted 3.1% in July, with orders from within the Eurozone sinking 3.8% and orders from outside the Eurozone contracting 2.8%. Domestic orders fell by 2.5%. July once again saw a collapse in orders from aircraft, ships, trains, and military vehicles,

plunging 38.6%, while demand was also in the red for electrical equipment orders (-16.8%). Meanwhile, autos (6.5) had a positive effect. By sector, intermediate (-5.3%) and capital (-2.4%) goods orders declined during the month, while consumer goods (4.3) orders rose. Excluding large-scale orders, billings rose 0.7% during the month.

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