



October 27, 2025

Morning Briefing

Inflation: 3.0% Is The New 2.0%

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

Executive Summary: The Fed Put is back. Given the likelihood of two more reductions in the federal funds rate before year-end, we're reducing the odds of our bullish base-case Roaring 2020s scenario from 55% to 50% and raising the odds of an even more bullish stock market meltup from 25% to 30%. Indeed, the stock market jumped Friday in reaction to a cooler-than-expected inflation report, since it buoys the case for Fed ease. Today, Dr Ed explains why further rate cuts are not needed now with both parts of the Fed's dual mandate, unemployment and inflation, close to Nirvana. The Fed's attempt to achieve the "neutral" FFR rate by easing is more likely to drive stock prices higher than to help the labor market. ... Also: Dr Ed pans "The Woman In Cabin 10" (- - -).

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Inflation I: Fed Set To Lower Rates Again. We're tweaking the odds we assign subjectively to various stock market scenarios: We are raising our odds of a very bullish stock market meltup from 25% to 30%. We are lowering our bullish base-case scenario's odds from 55% to 50%. We are keeping our bearish scenario at 20%.

We are doing so because the Fed has been signaling that more rate cuts are likely before the end of this year. September's cooler-than-expected CPI inflation report, released on Friday, increases the odds of two cuts in the federal funds rate (FFR) before the end of this year. The major stock market indexes rose to new record highs after the CPI report.

Also on Friday, we learned that the economy doesn't really need more monetary stimulus. That's why we are increasing the odds of a meltup. Consider the following:

(1) According to the October S&P Global [report](#) on the US flash PMI, the Composite PMI Output Index rose slightly to 54.3 in October, up from 54.0 in September, indicating a solid and sustained expansion in private-sector business activity. The latest reading is the

highest since July and signals an acceleration of growth to a pace just above the Q3 average. Output has risen continually for 33 months now.

The services sector continued to lead growth, with the Services PMI Business Activity Index at 55.2 in October, according to the flash estimate, up from 53.9 in September ([Fig. 1](#)). The service sector continued to report especially robust growth, posting the fastest expansion since July and the second strongest increase so far this year.

The Manufacturing PMI improved to 52.2, up from 52.0 last month, signaling modest growth in factory activity. Production volumes rose for a fifth consecutive month. The expansion of factory output was the second steepest since February, buoyed by the sharpest influx of new orders in just over a year and a half. Orders increased at the fastest pace in three months, driven by stronger domestic demand.

Employment rose for the tenth time in the past 11 months, with the rate of job creation improving on September's recent low and broadly in line with the average for the year to date. An upturn in service-sector job creation, albeit modest, was accompanied by slower job gains in manufacturing.

(2) On Thursday after the markets closed, Bloomberg reported: "Initial claims increased to about 227,000 in the week ended Oct. 18 from a revised 220,000 in the prior week, according to a Bloomberg News analysis of the figures. Goldman Sachs Group Inc. economists also estimated 227,000 applications for last week." The Labor Department hasn't issued its weekly report since September 25 because of the government shutdown, but it did make [downloadable data](#) available for most states. Bloomberg News adjusted those raw numbers using pre-released weekly [seasonal factors](#) from the Bureau of Labor Statistics.

(3) On Friday afternoon, the Fed released its latest weekly data report on commercial banks' balance sheets. It showed a solid 4.9% increase ([Fig. 2](#)).

(4) During the week of October 23, the S&P 500's weekly forward earnings per share rose to yet another record high ([Fig. 3](#)). It is highly correlated with The Conference Board's Index of Coincident Economic Indicators.

So given the above signs of strength, why is the Fed suddenly in a rush to lower the FFR now when there was no rush to do so earlier this year?

True, the labor market has weakened in recent months. To be more exact, both the demand for labor and the supply of labor have edged down, leaving the unemployment rate very low at 4.3% ([Fig. 4](#) and [Fig. 5](#)). The pace of hiring has slowed, but so has the pace of separations, which is the sum of quits and layoffs ([Fig. 6](#)). Half of the Fed's dual mandate is to keep unemployment low. At 4.3%, the unemployment rate is almost equal to the Federal Open Market Committee's (FOMC) longer-run unemployment rate average estimate of 4.2% ([Fig. 7](#)). So, again we ask: Why the rush to lower the FFR?

According to the FOMC's September [Summary of Economic Projections](#) (SEP), the jobless rate is expected to rise to 4.5% by December, then fall to 4.4% in 2026 and 4.3% in 2027. Presumably, the committee believes that the FFR must be lowered to keep the unemployment rate from rising higher than 4.5% and to bring it back down to 4.2%, which must be the FOMC's estimate of full employment.

We don't see how the problems causing the weakness in both labor demand and supply can be solved by lowering interest rates. The supply problem is related to the retirement of Baby Boomers, who are hard to replace with inexperienced younger workers. Deportations and stricter immigration policies are also weighing on the labor supply. On the demand side, many employers are assessing whether AI technologies can reduce their headcounts while boosting their workers' productivity. These are issues that won't be resolved by increasing demand for goods and services by lowering interest rates.

Before the government shutdown, we learned that real GDP rose 3.8% during Q2 (saar) and was tracking at 3.9% during Q3 according to the Atlanta Fed's [GDPNow](#). Consumer spending rose 2.5% during Q2 and was tracking at 3.3% during Q3. These numbers suggest that the economy doesn't need to be stimulated by easing monetary policy. They also suggest that productivity growth is very strong.

Meanwhile, the other half of the Fed's dual mandate remains troublesome for now. As we discuss below, on Friday we learned that September's headline and core CPI inflation rates rose 3.0% ([Fig. 8](#)). That's 100bps above the Fed's 2.0% inflation target ([Fig. 9](#)).

According to the SEP, the FOMC is projecting that the inflation rate will fall to 2.1% by 2027, nearly its stated 2.0% target. That's a head-scratcher given that the committee expects to be lowering the FFR to 3.1% by 2027 ([Fig. 10](#)).

In other words, the Fed is fine with the inflation rate at the current 3.0% y/y, which apparently is the new 2.0% for now. Let's see if the Bond Vigilantes agree. The Fed may be

making the same mistake as it did last year, when a 100bps cut in the FFR prompted a 100bps rise in the 10-year yield (along with mortgage rates) ([Fig. 11](#)).

Stock investors love that the Fed Put is back, especially if it isn't needed. The Fed Put came back late last year because of widespread hysteria that the Sahm Rule was about to predict a jump in the unemployment rate, which never happened. The S&P 500 is up 18.6% y/y.

Inflation II: We Dissent. The Fed will almost certainly cut the FFR by 25bps on Wednesday. It will probably do it again on December 10. Apparently, Fed officials believe that the current 4.00% reading of the FFR is restrictive. That's because they are collectively convinced that the long-run FFR is 3.00% ([Fig. 12](#)). This rate is also often called the "neutral FFR" or "r-star" (a.k.a. "r*"), which is deemed to be the interest rate that achieves the Fed's dual mandate of maximum employment with price stability.

The neutral FFR concept is a bad joke, if you'd like to know what we really think. Here's why:

(1) For starters, the so-called dot-plot in September's SEP shows that 3.00% is just the average of the opinions of the 19 FOMC participants. They range between 2.50% and 4.00%. Only four of their projections are at 3.00%, nine are higher, and six are lower ([Fig. 13](#)).

(2) Moreover, why would a rate that supposedly indicates ideal economic conditions be the one used as an overnight rate for bank reserves? Maybe simply because the Fed can control the FFR but not interest rates that would be more suitable measures of the neutral rate, like the 10-year US Treasury bond yield. If so, that rate should be at 4.00% not at 3.00%. That's what the bond market is currently telegraphing.

(3) Another drawback of the concept: Everyone agrees that the neutral rate can't be measured. Furthermore, it is extremely unlikely to be a constant. It will move around as the economy changes.

(4) What we do know is that dual-mandate conditions are close to Nirvana right now: The unemployment rate is only 4.3%, and the inflation rate is at 3.0%, which is apparently fine by the Fed given its intent to lower interest rates ([Fig. 14](#)). If so, then the current levels of interest rates *are* at neutral already.

Lowering the FFR isn't likely to "fix" the labor market. Instead, it is likely to boost inflation. It

may not boost consumer price inflation given our Roaring 2020s scenario in which productivity growth keeps a lid on unit labor costs inflation ([Fig. 15](#)). Instead, it is likely to boost asset price inflation, particularly in the stock market.

Trump administration officials must have been pleased with Friday's CPI report for September. It confirms their view that Trump's tariffs haven't boosted inflation. However, the tariffs have kept inflation from falling from 3.0% to 2.0%, in our opinion. That's because the tariffs did in fact boost the CPI's durable goods inflation rate from last year's low of -4.2% y/y during August to 1.8% y/y in September ([Fig. 16](#)). This rate tended to be slightly negative in the years prior to the 2021-22 inflation spike. Then it was negative again in 2023-24. Now it is slightly positive thanks to the tariffs ([Fig. 17](#), [Fig. 18](#), and [Fig. 19](#)).

Inflation III: Running Warm. Fed officials seem to agree that the impact of the tariffs on inflation will be transitory. They are betting that consumer durable goods inflation will fall again in 2026. They will probably be right about that. But they should remain concerned that inflation remains relatively hot in services despite the decline in shelter inflation:

(1) The CPI services inflation rate was 3.6% y/y during September. It has stalled around this pace for the past seven months ([Fig. 20](#)). That's about a percentage point higher than in the years between the Great Financial Crisis and the Great Virus Crisis.

(2) The CPI rent of shelter inflation rate has fallen sharply since it peaked at 8.2% y/y during March 2023 ([Fig. 21](#)). It was down to 3.5% in September. However, the CPI services less rent of shelter has been stuck around 3.5% recently ([Fig. 22](#)).

Movie. "The Woman In Cabin 10" (- - -), 2025, is a very unthrilling thriller. It stars Keira Knightley, who does her best with the flimsy film plot. The real star of the show is the amazing yacht that functions as the set of this murder mystery. So who is the murderer? It isn't everyone on board, as might be expected if Agatha Christie wrote the script. It also isn't anyone on the crew working below deck. The likely villain is easy to identify all too early in this who-done-it. (See our movie reviews [archive](#).)

Calendars

US: Mon: Dallas Fed Manufacturing Survey. **Tues:** Consumer Confidence 94.0; Richmond Fed Manufacturing Index -14; Atlanta Fed GDPNow 3.9%; S&P Case-Shiller Home Price Index 0.1%/m, 1.9%/y. (Source: FX Street)

Global: Mon: Germany Ifo Business Climate Index 87.8; Elderson; Bullock; Balz; Tuominen. **Tues:** Germany Gfk Consumer Confidence -22; Italy Business & Consumer Confidence; ECB Bank Lending Survey. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US\$ Performance) ([link](#)): The US MSCI index rose 1.9% during the October 24 week to its first record high since October 8. The AC World ex-US underperformed with a gain of 1.5% for the week to its first record high since October 6. The AC World ex-US has been hitting new record highs since May 14--the first time it's had such a long streak of successive record highs since June 15, 2021. Despite its strength in recent weeks, the US MSCI outperformed the AC World ex-US in only 15 of the past 39 weeks. EM Asia was the best performing region last week, with a gain of 2.3%, followed by EM (2.0%), EM Latin America (1.5), and the AC World ex-US. EMEA was the worst regional performer, albeit with a gain of 0.8%, followed by EMU (1.1), Europe (1.2), and EAFE (1.2). The China MSCI index, with a gain of 3.9%, performed the best among country indexes, ahead of Korea (3.7), Sweden (3.0), Brazil (3.0), and Hong Kong (2.7). The Mexico MSCI index was the worst performer w/w, with a decline of 0.9%, followed by Switzerland (-0.6), South Africa (0.1), Taiwan (0.3), and France (0.3). In terms of ytd performance rankings, the 15.6% gain for the US MSCI index ranks as the third worst country performer and trails the 25.8% 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 35.9%, followed by EMU (32.7), EM Asia (29.3), EM (29.2), Europe (27.2), and the AC World ex-US. EAFE is the worst ytd performer, albeit with a gain of 24.3%, followed by EMEA (24.7). Korea is the best ytd performer, with a gain of 77.6%, followed by Spain (59.3), South Africa (55.5), Mexico (39.9), and China (35.4). The worst performing countries ytd: India (3.9), Australia (12.6), the US (15.6), Japan (20.2), and Switzerland (23.7).

US Stock Indexes ([link](#)): Forty-five of the 48 major US stock indexes that we follow rose during the week ended October 24, down slightly from all 48 rising a week earlier. The S&P 400 MidCap Pure Growth index was the best performer for the week, rising 4.4%, ahead of S&P 600 SmallCap Pure Value (4.0%), S&P 600 SmallCap Value (3.7), S&P 600 SmallCap Equal Weighted (3.1), and S&P 600 SmallCap (3.0). The Dow Jones 20 Transports index was the worst performer, with a decline of 1.4%, followed by S&P 500 Transportation (-0.6), Dow Jones 15 Utilities (-0.5), Dow Jones 65 Composite (1.1), and Nasdaq Industrials (1.3). All but one of the 48 indexes are higher ytd. With a gain of 20.8%, the S&P 500 LargeCap

Growth index is in the top spot as the best performer so far in 2025, ahead of Nasdaq 100 (20.7), Nasdaq Composite (20.2), Russell 1000 Growth (17.8), and Russell 3000 Growth (17.8). The worst performing major US stock indexes ytd: Dow Jones 20 Transports (-2.8), S&P 600 SmallCap Equal Weighted (3.3), S&P 600 SmallCap Value (4.3), S&P 400 MidCap Value (4.8), and S&P 600 SmallCap (4.9).

S&P 500 Sectors Performance ([link](#)): Nine of the 11 S&P 500 sectors rose during the week ended October 24, and four were ahead of the S&P 500's 1.7% gain. That compares to 10 S&P 500 sectors rising a week earlier, when five were ahead of the S&P 500's 1.7% gain. The outperformers last week: Information Technology (2.7%), Energy (2.4), Industrials (2.1), and Consumer Discretionary (1.9). The underperformers last week: Consumer Staples (-0.6), Utilities (-0.2), Materials (0.6), Communication Services (1.0), Real Estate (1.4), Financials (1.8), and Health Care (1.9). The S&P 500 is now up 15.5% ytd, with all 11 sectors positive ytd and four 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. Information Technology now wears the crown as the best ytd performer with a gain of 25.6%, followed by Communication Services (25.1), Utilities (20.5), and Industrials (17.5). These seven sectors are lagging the S&P 500 so far in 2025: Energy (3.0), Consumer Staples (3.2), Consumer Discretionary (4.3), Real Estate (4.8), Health Care (6.0), Materials (6.2), and Financials (9.8).

US Economic Indicators

Consumer Price Index ([link](#)): The *headline CPI* rose 0.3% in September, a tick below August's 0.4% and matching the average monthly gain from June through August. Energy prices climbed 1.5%, with gasoline prices (4.1%) posting the largest monthly gain; food prices ticked up 0.2%, with the *food at home* index rising 0.3% and *food away from home* edging up 0.1%. *Excluding food and energy*, core prices edged up 0.2% after gains of 0.3% the prior two months. *Looking at the yearly rates*, the *headline* rate accelerated for the fifth consecutive month from a four-year low of 2.3% in April to 3.0% in September, a tick below the consensus estimate of 3.1%. The core rate held relatively stable at 3.0%, fluctuating between 2.9% and 3.1% the past four months. The *headline* rate peaked at 9.0% during June 2022, while the *core* rate peaked at 6.6% during September 2022. The *shelter index* was 3.6% above a year ago. *Other categories showing noticeable increases* over the past 12 months include: used cars and trucks (5.1% y/y), household furnishings and operations (4.1), household furnishings & operations (3.9), medical care (3.3), and recreation (3.0).

Consumer Sentiment Index ([link](#)): Consumer sentiment slipped in October, as a modest increase in sentiment among younger consumers was offset by decreases among middle-aged and older consumers. *Consumer sentiment* sank from 55.1 in September to a five-month low of 53.6 in October; sentiment was at 70.5 a year ago. *Current conditions* fell for the third month, from 68.0 in July to 58.6 this month, while the expectations component fell from 58.1 in June to 50.3 in October. The report noted: “Inflation and high prices remain at the forefront of consumers’ minds,” while there is little evidence this month that consumers “connect the federal government shutdown to the economy.” The report said only about 2% of consumers referenced the shutdown during this month’s interviews, compared with 10% of consumers who did so in January 2019 during that 35-day shutdown. *Turning to inflation*, year-ahead inflation expectations eased again this month to 4.6%, from 4.7% in September and 4.8% in August, though remained stubbornly high; long-run inflation expectations moved up for the third straight month to 3.9%, though is lower than the 4.4% spike recorded in April.

Existing Home Sales ([link](#)): “As anticipated, falling mortgage rates are lifting home sales. Improving housing affordability is also contributing to the increase in sales,” noted Lawrence Yun, chief economist of NAR. *Existing home sales* climbed 1.5% in September to a seven-month high of 4.06mu (saar), in line with expectations. *Single-family* home sales climbed 1.7% to 3.69mu, while *condominium and co-op* sales were once again flat at 370,000 units. The former rose 4.5% versus a year ago, while the latter was flat versus a year ago. *Regionally*, existing home sales were a mixed bag: Sales in the *West* (5.5% m/m & 0.0% y/y) recorded the largest monthly gain during September, while sales in the South (1.6 & 6.9) posted the largest yearly gain. Meanwhile, sales in the *Northeast* (2.1 & 4.3) and *Midwest* (2.1 & 2.2) showed identical monthly gains, while the Northeast’s yearly gain was double that of the Midwest. The *inventory of unsold existing homes* at the end of September was at 1.55 million units, up 1.3% m/m and 14.0% y/y. Unsold inventory was at a 4.6 months’ supply at the current sales pace for the third straight month.

Global Economic Indicators

US PMI Flash Estimates ([link](#)): “Flash US PMI signals strong start to fourth quarter,” was the headline of the October report, posting its second fastest reading so far this year, according to the flash estimate, and accompanied by the “largest rise in new business seen in 2025 to date.” Output has now risen continually for 33 months. October’s *C-PMI* (to 54.8 from 53.9) climbed to a three-month high, with the *NM-PMI* (55.2 from 54.2) also at a three-month high, while both the *M-PMI* (52.2 from 552.0) and *M-PMI Output* (52.8 from 55.4)

measures were at two-month highs. Meanwhile, expectations for the year ahead slipped a bit this month from September's four-month high, with manufacturing optimism falling to its lowest reading since June 2024, while optimism in the service sector also deteriorated—well below the survey's long-run average. According to the report, outlook concerns remain centered on the detrimental impact of government policies, noticeably tariffs, and broader political uncertainty, though some manufacturers again cited tariffs as a “possible stimulus to domestic production.” Meanwhile, both sectors also saw business growth expectations “supported by lower interest rate policies.” Turning to pricing, input cost inflation remains elevated this month, though is below rates seen earlier this year, while output cost inflation has cooled to the lowest levels since April.

Eurozone PMI Flash Estimates ([link](#)): Activity in the Eurozone continued to rise during October, continuing the trend seen since the start of 2025. The Eurozone C-PMI (to 52.2 from 51.2) reached a 17-month high this month, according to flash estimates, with the NM-PMI (52.6 from 51.3) reaching a 14-month high. Meanwhile, the M-PMI (50.0 from 49.8) rose to the breakeven point of 50.0, while the M-PMI Output (51.1 from 50.9) measure climbed further into expansion territory. Turning to the Eurozone's two largest economies, Germany saw its C-PMI (to 53.8 from 52.0) climb to a 29-month high, led by the NM-PMI (54.5 from 51.5), which also reached a 29-month high. Meanwhile, the M-PMI (49.6 from 49.5) remains just below the breakeven point of 50.0, while the M-PMI Output (52.3 from 53.0) gauge continued to grow, though at a slower pace. Economic activity in France deteriorated, falling at its fastest pace since February. The C-PMI (46.8 from 48.1) sank to an eight-month low, with the NM-PMI (47.1 from 48.5) and M-PMI Output (45.3 from 45.8) measures both dropping to eight-month lows. The M-PMI (48.3 from 48.2) shows activity continue to contract, though the measure edged up to a two-month high. The report noted that excluding Germany and France, the rest of the Eurozone posted the fastest rise in activity in two-and-a-half years. Turning to pricing, the ECB pays close attention to prices in the service sector. According to the report, the rate of inflation for sales prices has risen slightly but remains close to its long-term average, while cost increases were slightly lower during the month—so there is little danger from the services side over the short term.

Japan PMI Flash Estimates ([link](#)): “Japanese business activity increases at slowest rate in five months amid renewed drop in sales,” according to the report. The C-PMI (to 50.9 from 51.3) moved down closer to the breakeven point of 50.0, with both the M-PMI Output (48.1 from 47.4) and M-PMI (48.3 from 48.5) measures continuing to contract. The NM-PMI (52.4 from 53.3) held fairly steady above the breakeven point of 50.0. The report notes that Japanese companies remained generally confident that output will increase over the next 12 months, though the degree of optimism edged down from September and was below the

survey's long-run average. The sectors were at odds, with services companies less upbeat about the year ahead and manufacturers more confident.

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