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AHEAD OF THE FOMC: Can the Fed Justify a Cut Under Its Dual Mandate?

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EXECUTIVE SUMMARY

Markets expect the start of an easing cycle at this week's FOMC meeting. The policy challenge is explaining why policy easing is consistent with the Fed's dual mandate—**maximum employment** and **price stability**—when inflation has not yet returned to the 2% PCE goal.

Inflation progress has become more uneven. **Shelter** components are decelerating, but **non-shelter** core measures have firmed modestly since mid-last year, complicating the case for cuts framed purely as relief from "sticky shelter readings."

The labor market has cooled from 2021–2023 peaks but remains resilient: unemployment (U-3) is still low by historical standards, broader under-employment (U-6) is contained, and reduced churn (lower quits and hires) may suggest normalization rather than deterioration. Recent BLS revisions show job growth over the past two years was slower than initially reported, yet hiring over the past year is still **above Fed economists' estimated breakeven** levels.

Market signals are mixed. A higher long end of the Treasury curve suggests lingering inflation risk or rebuilding term premium, while a **re-steepened 2s/10s curve** tempers hard-landing fears.

Key risk now in focus: a form of *stagflation-lite*—slower growth alongside sticky non-shelter inflation. The Fed must thread the needle: acknowledge disinflation fatigue without loosening financial conditions so much that inflation re-accelerates.

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WHAT IS THE FED'S DUAL MANDATE?

"The Federal Reserve works to promote a strong U.S. economy. Specifically, Congress has assigned the Fed to conduct the nation's monetary policy to support the goals of maximum employment and stable prices. Those two goals are often referred to as the Fed's 'dual mandate.'"[1]

POLICY BACKDROP: THE FED'S MANDATE AND THE TARGET

When the Fed meets this week, markets expect the beginning of a rate cut cycle. The challenge for the Fed, however, will be how to articulate a meaningful policy shift in the context of their dual mandate. In our view, it will be a difficult case to make, and a cut is likely to be framed as managing the balance of risks with greater weight assigned to potential labor market deterioration.

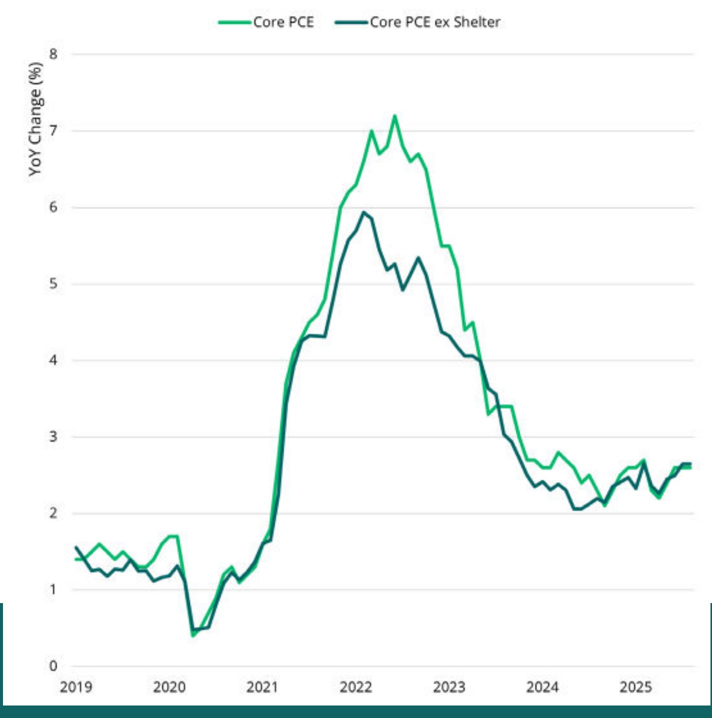
By mandate, the Fed has two objectives in conducting monetary policy: promote maximum employment and price stability. The latter is more clearly defined as a long-term inflation rate of 2 percent as measured by the annual change in PCE.[2]

The problem is that inflation has not reached the Fed's target. In fact, inflation remains higher than the beginning of three of the four previous interest rate hiking cycles.

If the Fed does cut, one of the challenges in abandoning the 2 percent inflation target is that this is no longer a story about sticky, lagging shelter inflation (see below). Core CPI minus housing and Core PCE minus housing show that non-shelter components have moved up a bit since the middle of last year. Meanwhile, shelter components have decelerated.

Core CPI ex Shelter Increasing in Recent Months[3]

Core PCE Readings In-line with Core ex Shelter[4]



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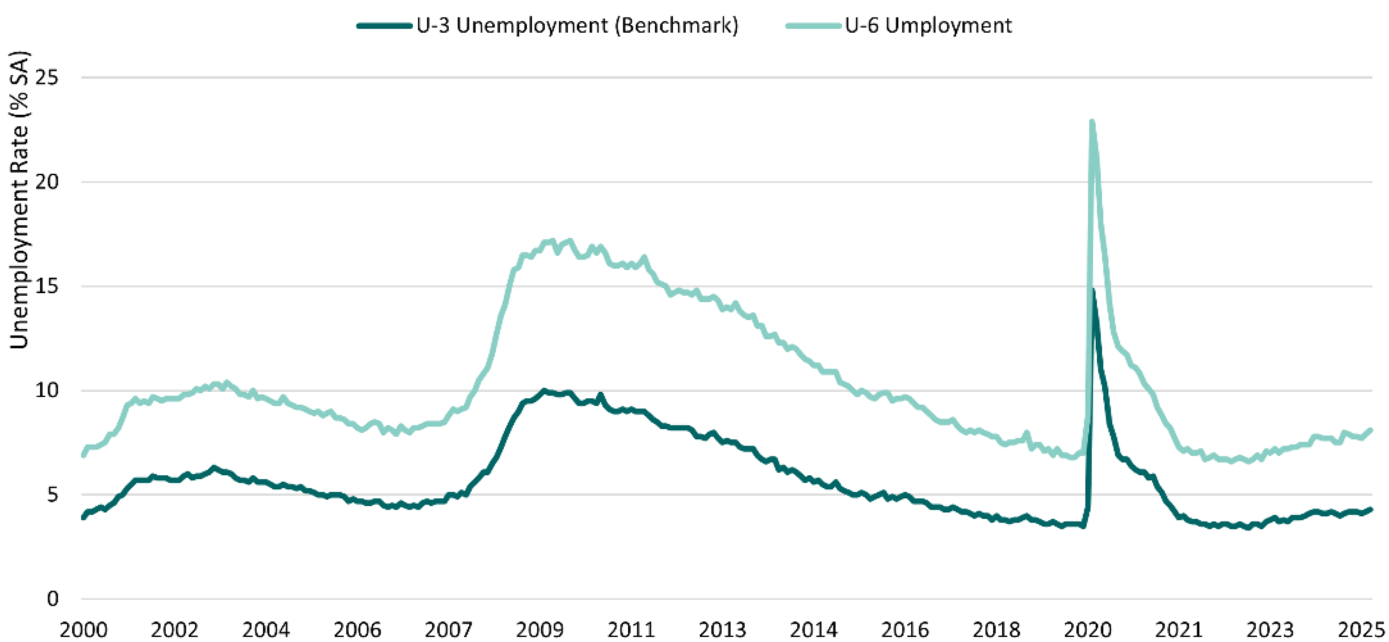
If inflation is no longer the primary target, what does labor market data tell us?

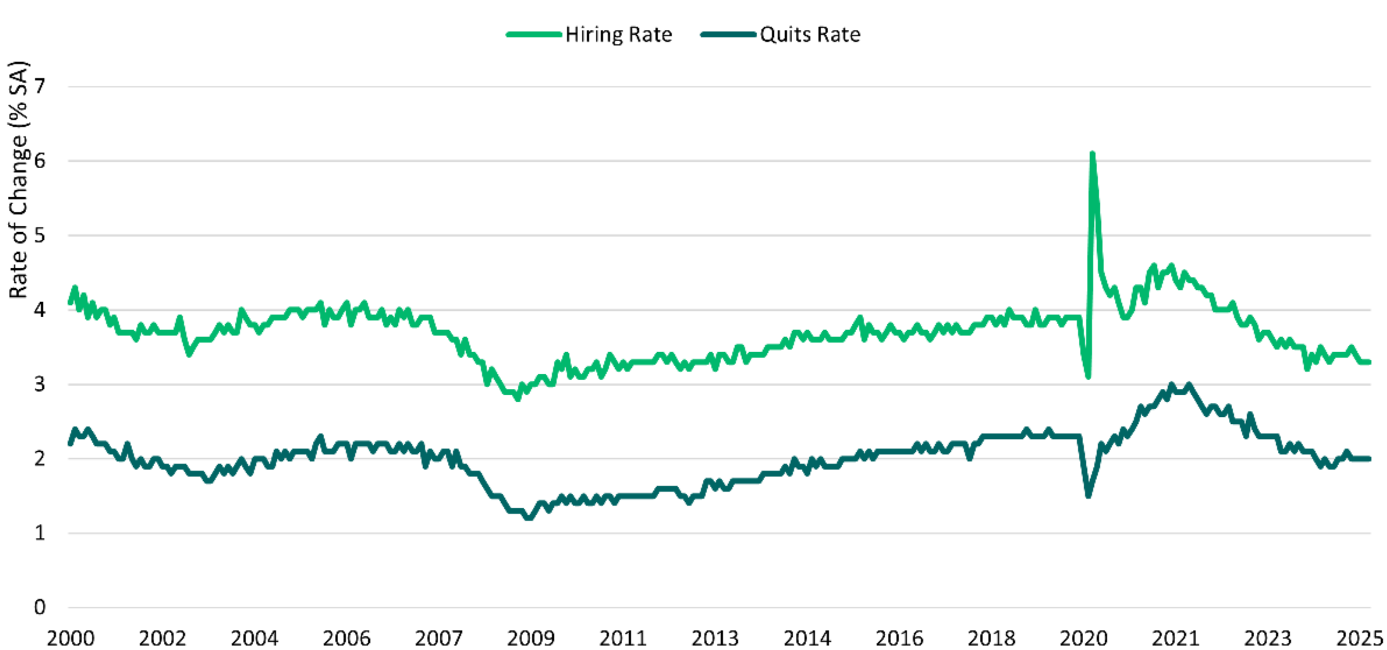
From an unemployment perspective, the standard benchmark, the U-3 level, remains near historically low levels below 5 percent, signaling limited slack. Under-employment (the U-6 measure), which includes unemployed people having difficulty finding a job and involuntary part time workers, also appears contained and near historic lows (see below).

Turning to hiring data from the BLS JOLTS repot ("Job Opening and Labor Turnover Survey"), we see less labor market churn than in recent years (see below). Fewer people are voluntarily leaving their jobs on a monthly basis, and as fewer jobs are required to backfill their departures, we are seeing both the hiring and quits rates decline—arguably that is a measure of labor market stability.

Low Rates for U-3 Unemployment and U-6 (Includes Marginally Attached and Involuntarily Part-Time Workers)[5]



The Churn of "Job Switchers" Has Subsided as Hiring Has Slowed[6]



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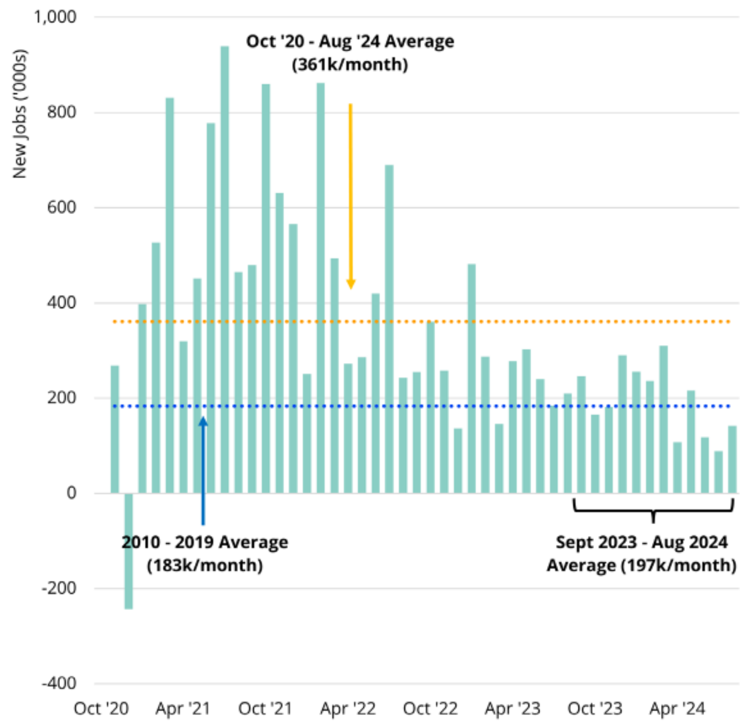
Recent BLS revisions have come into focus as well. The first visual below is employment growth before the September 2024 jumbo-sized downward revision by the BLS. The second includes both the 2024 and 2025 BLS revisions, which shows that job growth after 2020 was less hot than initially believed, and the past year has seen relatively underwhelming job growth figures.

However, it is important to note that underwhelming does not mean that the labor market is losing ground. According to St. Louis Fed economists who analyze the breakeven rate, expected lower immigration this year may have lowered the breakeven rate to somewhere between 32,000 and 82,000 jobs per month on average. Over the past year, we have seen 122,000 jobs per month.

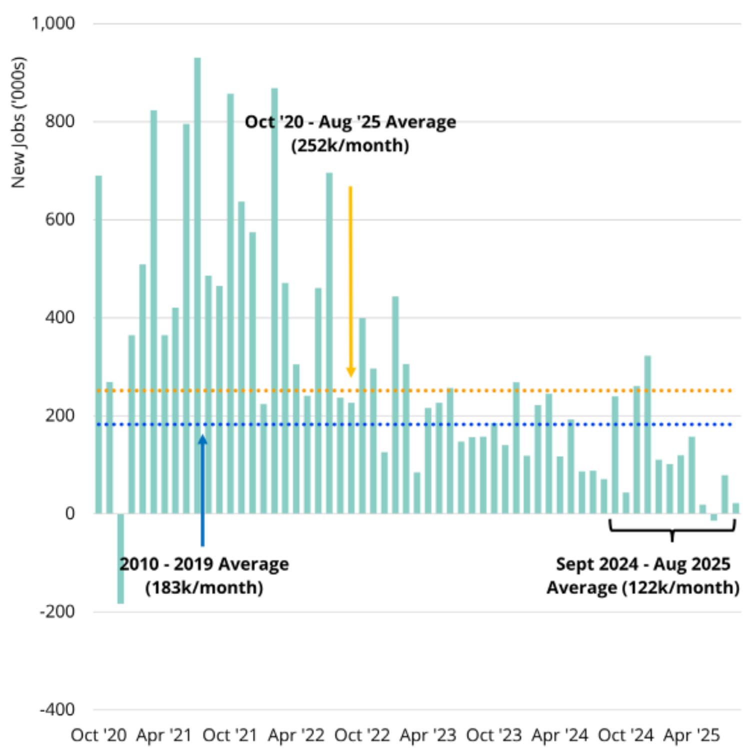
So, what does the market tell us right now? Rising yields on the long end of the curve might suggest a lack of confidence that inflation is under control. At the same time, the 2- and 10-year spread has been in positive territory for over a year following a two-year inversion, which is rare re-steepening without seeing a recession.

It appears that stagflation has emerged as the front running concern that may require the Fed to adjust its policy stance. And since that is outside of the Fed's dual mandate, we will see how they thread the needle on this this week—both with respect to providing an understanding of a policy framework going forward as well as providing assurance to markets.

Nonfarm Employment Growth Prior to September 2024 Revisions[7]



Nonfarm Employment Growth After 2024 and 2025 Revisions[8]



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ENDNOTES

1 Board of Governors of the Federal Reserve System. FAQs: What economic goals does the Federal Reserve seek to achieve through its monetary policy? As of September 12, 2025. Accessed at: https://www.federalreserve.gov/faqs/what-economic-goals-does-federal-reserve-seek-to-achieve-through-monetary-policy.htm
2 Board of Governors of the Federal Reserve System. FAQs: What economic goals does the Federal Reserve seek to achieve through its monetary policy? As of September 12, 2025. Accessed at: https://www.federalreserve.gov/faqs/what-economic-goals-does-federal-reserve-seek-to-achieve-through-monetary-policy.htm
3 Bloomberg as of September 11, 2025.
4 Bloomberg as of September 11, 2025.
5 Bloomberg as of September 11, 2025.
6 Bloomberg as of September 11, 2025.
7 Bloomberg as of September 4, 2024.
8 Bloomberg as of September 11, 2025.
9 Bick, Alexander. August 28, 2025. Lower Immigration Projections Mean Lower Breakeven Employment Growth Estimates. Federal Reserve Bank of St. Louis.

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