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Mind on the Markets Quarterly

2 THEMES SHAPING Q4 MARKETS

2025 Fourth Quarter Outlook

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Safety first for the US Fed

Insights from Elias Haddad

Concern about a faltering US labor market and sluggish economic growth levels encouraged the US Federal Reserve to make a cautious interest rate cut in September. Could more cuts soon lie ahead?

At the September meeting, the US Federal Reserve (Fed) opted for a "risk-management cut", not a sharp policy unwind.

As was widely expected, the Federal Open Market Committee (FOMC) cut the target range for the Fed funds rate 25bps to 4.00-4.25% after keeping them on hold since January. The biggest dovish take from the FOMC was that "The Committee...judges that downside risks to employment have risen." This suggests more easing is expected if the US labor market shows ongoing weakness.

Indeed, the updated FOMC 2025 median Fed funds rate projection implies two more 25bps rate reductions by year-end to a target range of 3.50-3.75% (3.625%), largely in line with futures pricing (**Chart 1)**. Unsurprisingly, there was one dissent in favor of a 50bps cut (Fed Governor Stephen Miran) and no dissent for keeping rates unchanged.

Everything else points to a shallow, gradual easing cycle. Firstly, the FOMC median funds rate projection still implies one cut in both 2026 and 2027 and the longer run rate is unchanged at 3.0%. Secondly, real GDP growth was revised higher across the forecast horizon, the unemployment rate was adjusted a tick lower for 2026 and 2027, and inflation was tweaked two ticks higher for 2026 **(Chart 2)**. Thirdly, Fed Chair Jay Powell sounded cautious on the scope for further easing.

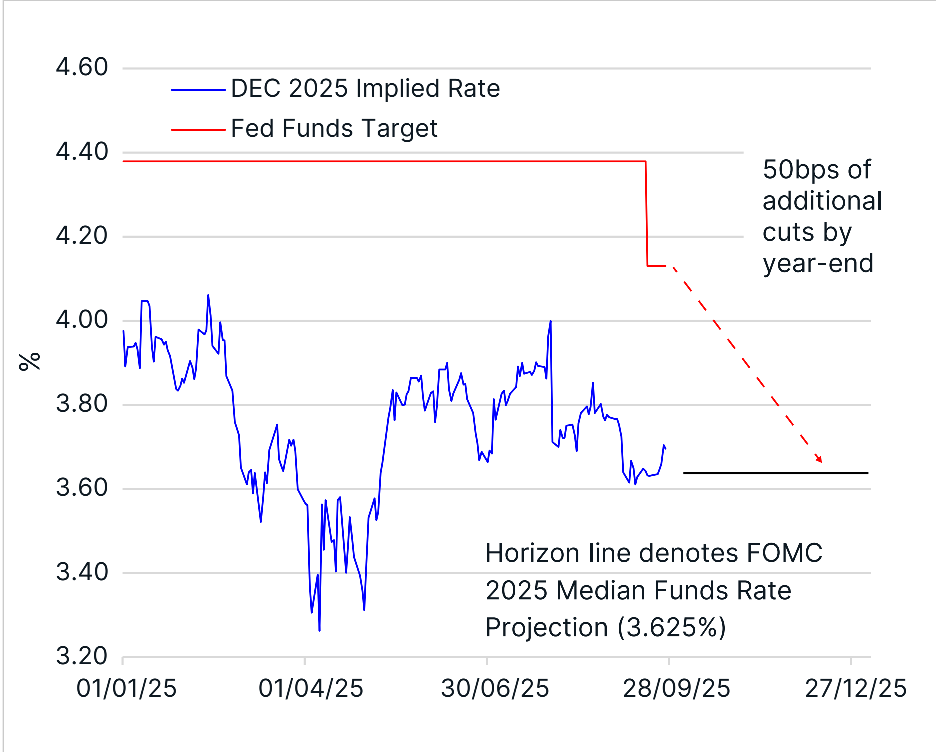

Chart 1 Source: Bloomberg

Variable	Median[1] 2025	2026	2027	2028	Longer run
Change in real GDP	1.6	1.8	1.9	1.8	1.8
June projection	1.4	1.6	1.8		1.8
Unemployment rate	4.5	4.4	4.3	4.2	4.2
June projection	4.5	4.5	4.4		4.2
PCE inflation	3.0	2.6	2.1	2.0	2.0
June projection	3.0	2.4	2.1		2.0
Core PCE inflation[4]	3.1	2.6	2.1	2.0	
June projection	3.1	2.4	2.1		
Memo: Projected appropriate policy path					
Federal funds rate	3.6	3.4	3.1	3.1	3.0
June projection	3.9	3.6	3.4		3.0

Chart 2 - Summary of Economic Projections

Source: https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20250917.pdf

In our view, the risk is the Fed turns more dovish by the December 9-10 FOMC meeting because restrictive monetary policy can worsen the employment backdrop and upside risks to inflation are not materializing

Three indicators flashing yellow

Three of the six monthly economic indicators used by the National Bureau of Economic Research (NBER) to date on recessions are flashing weakness consistent with a policy stance that is too tight.

1. Real personal income excluding transfers is barely growing **(Chart 3)**. The decline in job openings to unemployed workers points to softer wage growth ahead **(Chart 4)**.

2. Real personal consumption spending is growing above trend **(Chart 5)**. However, the pick-up in consumer spending looks fragile given subdued real wage growth, while rising job insecurity could prompt households to save more, further restraining demand **(Chart 6)**.

3. Real manufacturing and trade industries sales recovered towards trend growth **(Chart 7)**. Nonetheless, the ISM manufacturing exports orders index remains below the 50 boom/bust level indicative of renewed weakness in this sector.

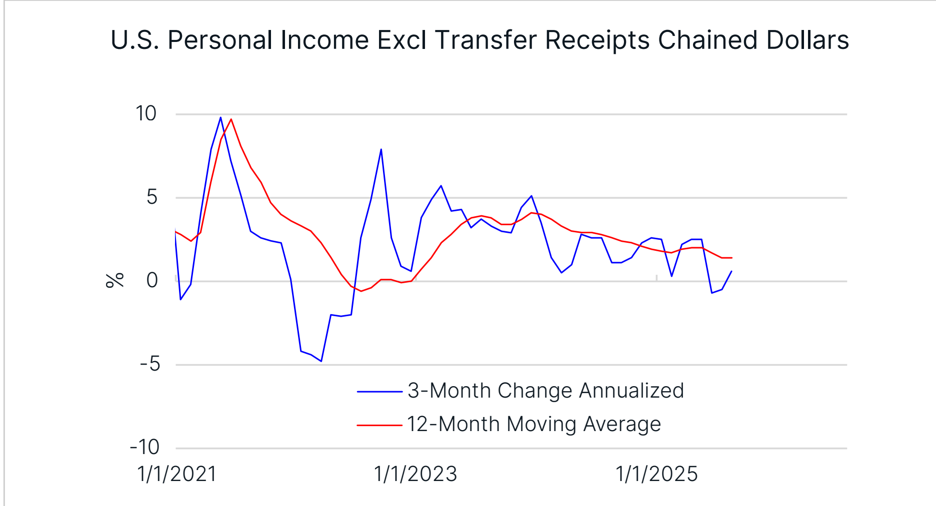

Chart 3 Source: Bloomberg

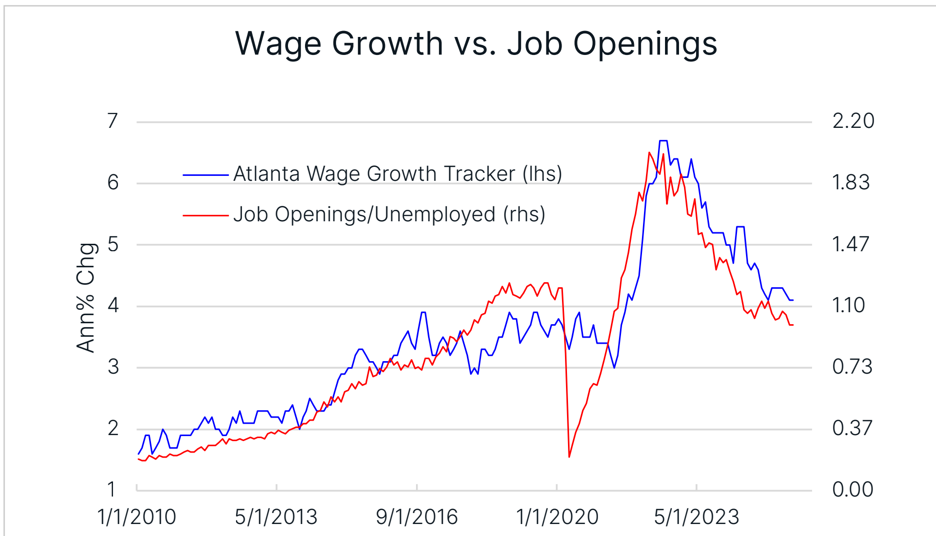

Chart 4 Source: Bloomberg

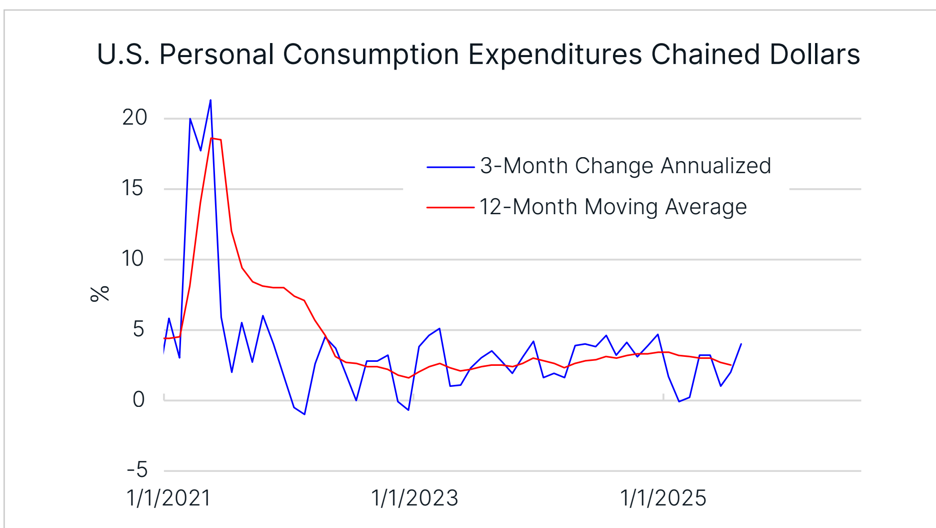

Chart 5 Source: Bloomberg

4. Industrial production is growing at trend and the outlook is encouraging **(Chart 8)**. The rising ISM manufacturing new orders-to-inventories ratio suggest firms may need to ramp-up production as demand is outpacing supply.

5. Monthly payroll gains are close to zero growth **(Chart 9)**. In fact, the economy added just 29k jobs on average in June, July, and August, well below the breakeven number for keeping the unemployment rate steady - estimated to be between 80k and 100k.

6. Labor force growth is virtually flat **(Chart 10)**. Lower immigration and lower labor force participation can further restrict labor supply growth. Fewer workers entering the market reduces potential GDP growth, which in turn dampens demand for goods and services. Firms may respond by curbing hiring, feeding into a self-reinforcing downturn.

The labor market data is the most important driver for the Fed and the most critical data for monitoring downside risks to the economy. As such, the pace of decline in the Fed funds rate will be driven by the three remaining monthly non-farm payrolls reports for the year (due out on October 3, November 7, and December 5).

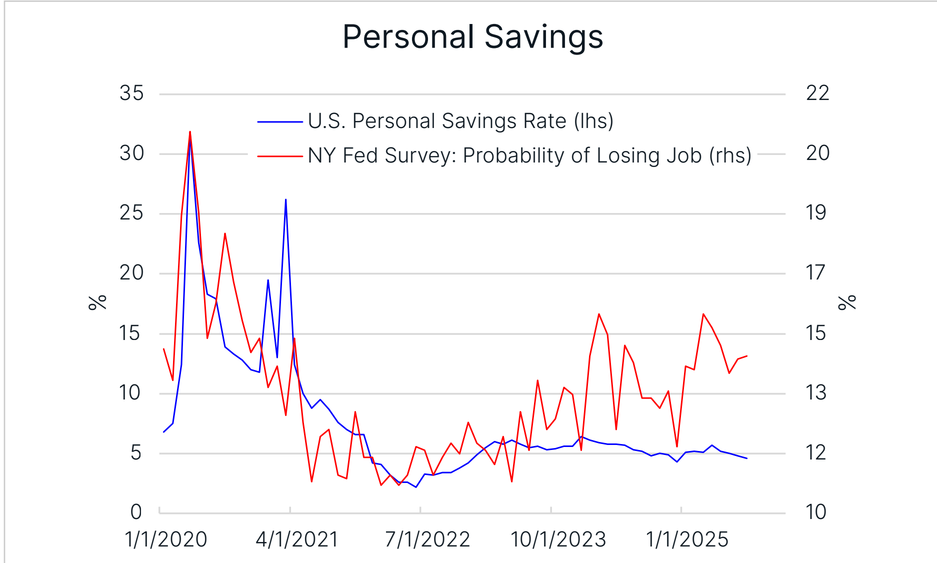

Chart 6 Source: Bloomberg

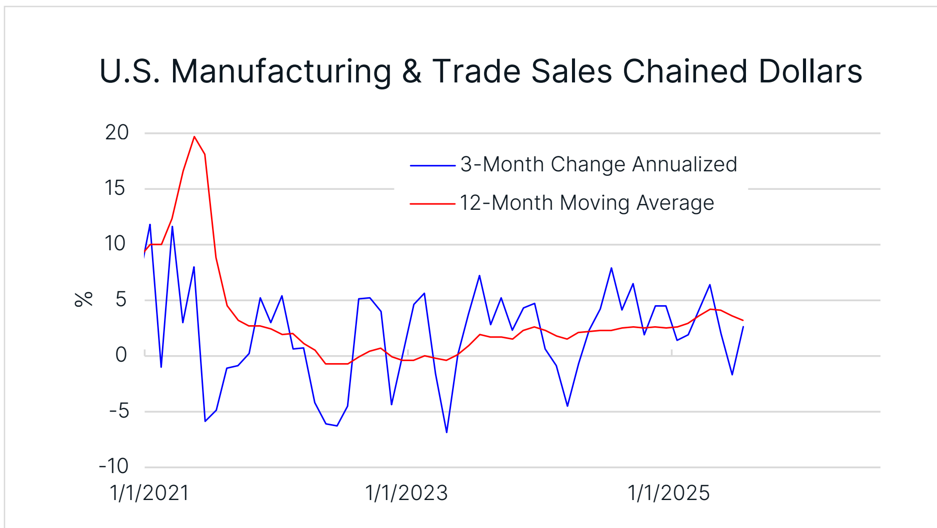

Chart 7 Source: Bloomberg

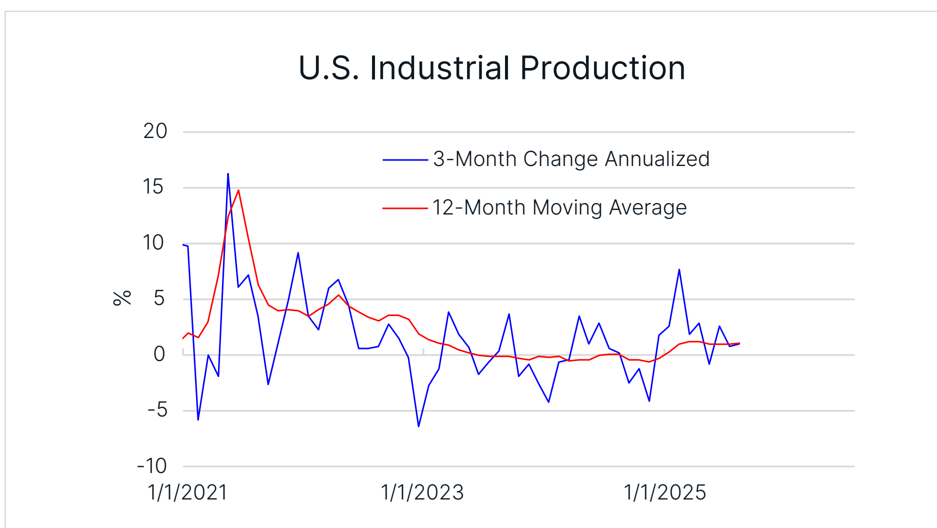

Chart 8 Source: Bloomberg

Inflation contained

Progress towards the Fed's 2% inflation goal may be stalling, but upside risks to prices are not materializing. The policy-relevant headline PCE deflator has yet to reflect the rise seen in the ISM prices paid indexes, which may now be topping-out **(Chart 11)**. More importantly, wage growth is running around sustainable rates consistent with the Fed's 2% inflation goal given annual non-farm productivity growth of around 2%.

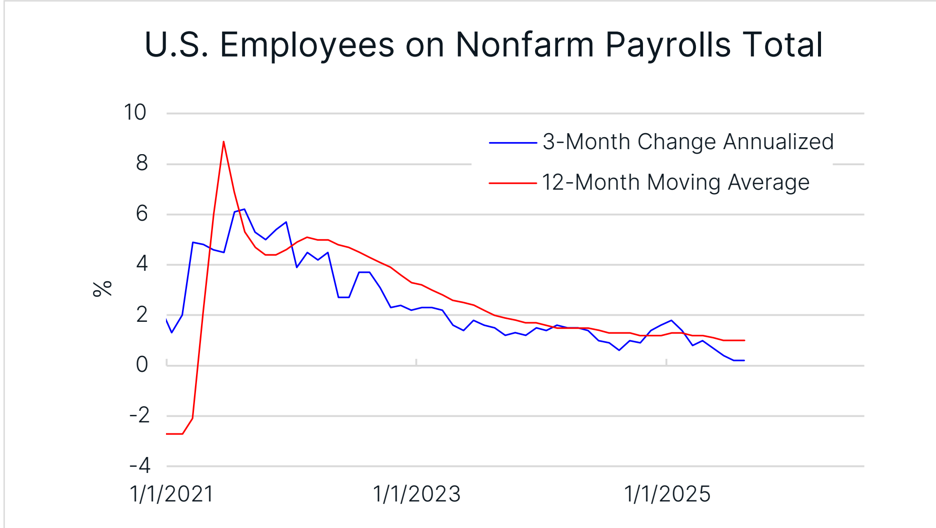

Chart 9 Source: Bloomberg

Bottom line

Our base case is for the Fed to pivot to a more dovish position by year-end, which will weigh on the US dollar and further fuel the rally in equity markets.

Two risk scenarios could keep the Fed anchored to its patient easing guidance: US inflation quickens, or the economy enters a Goldilocks phase. The first scenario is dollar-negative, implying higher likelihood of stagflation. The second scenario is dollar positive. We see the first risk scenario as more likely.

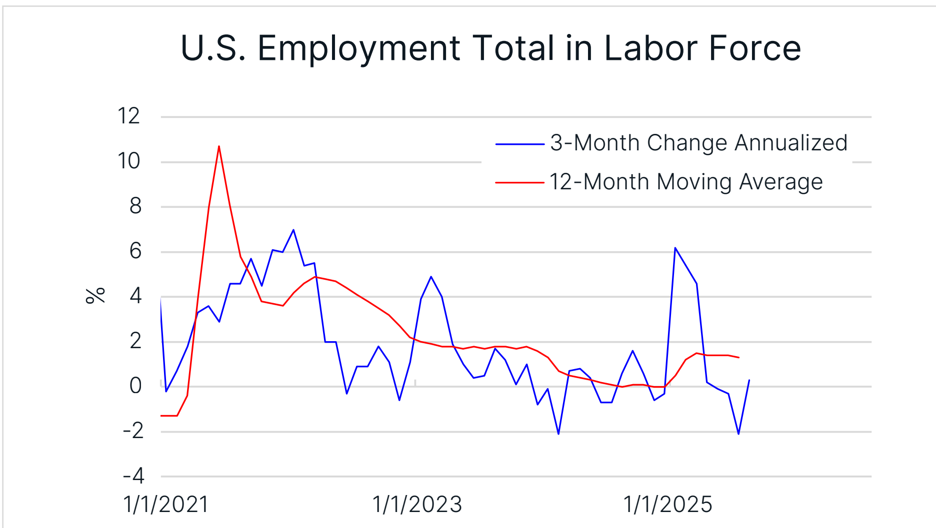

Chart 10 Source: Bloomberg

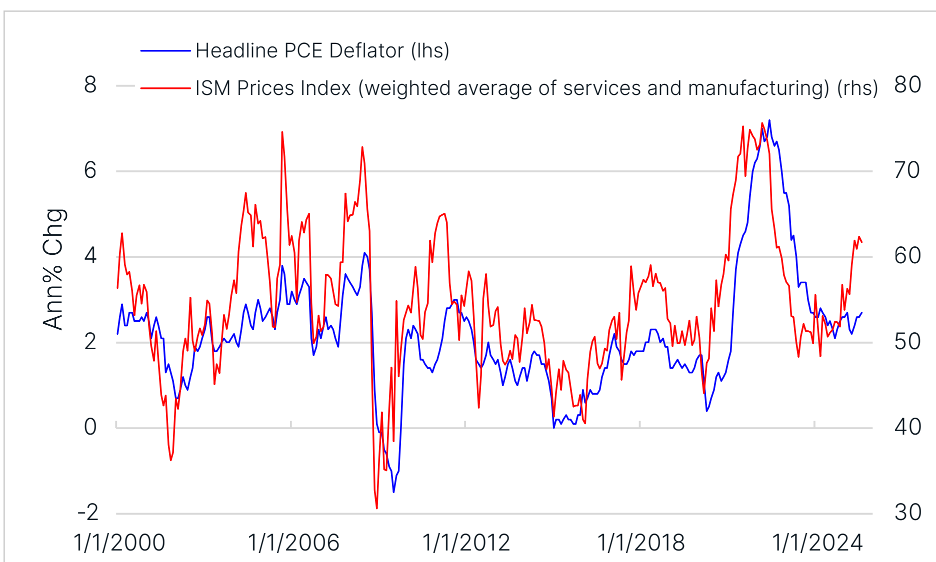

Chart 11 Source: Bloomberg

Stablecoins gain new momentum

Insights from Elias Haddad

With stablecoins expected to play a growing role in global finance, what implications do they hold for the US dollar and Treasury markets?

Stablecoins are a type of cryptocurrency designed to maintain a stable value by being pegged on a one-to-one basis to a traditional reserve asset, most commonly the US dollar. Almost all (99%) of stablecoins are pegged to the US dollar.

Stablecoins are predominantly issued by private firms, with Tether (USDT) and Circle (USDC) the two largest players in the market **(Chart 1)**. USDT and USDC account for 68% and 28% of total stablecoin supply, respectively.

Following July's passage of the Guiding and Establishing National Innovation for US Stablecoins Act (GENIUS), stablecoins are expected to play a growing role in global finance as they provide efficient tools for payments, remittances, and as a store of value within the digital asset ecosystem.

The entire US stablecoin supply is forecast to balloon from roughly $300 billion currently to as much as $2 trillion by the end of 2028. US Treasury Secretary Scott Bessent even stressed "I think that two trillion is a very, very reasonable number, and I could see it greatly exceeding that."

According to the White House, the aim of the GENIUS Act is to ensure continued global dominance of the US dollar as the world's reserve currency "by driving demand for US Treasuries", since dollar-backed stablecoins must maintain 100% reserve backing with liquid assets like short-term US Treasuries (with a maturity of 93 days or less).

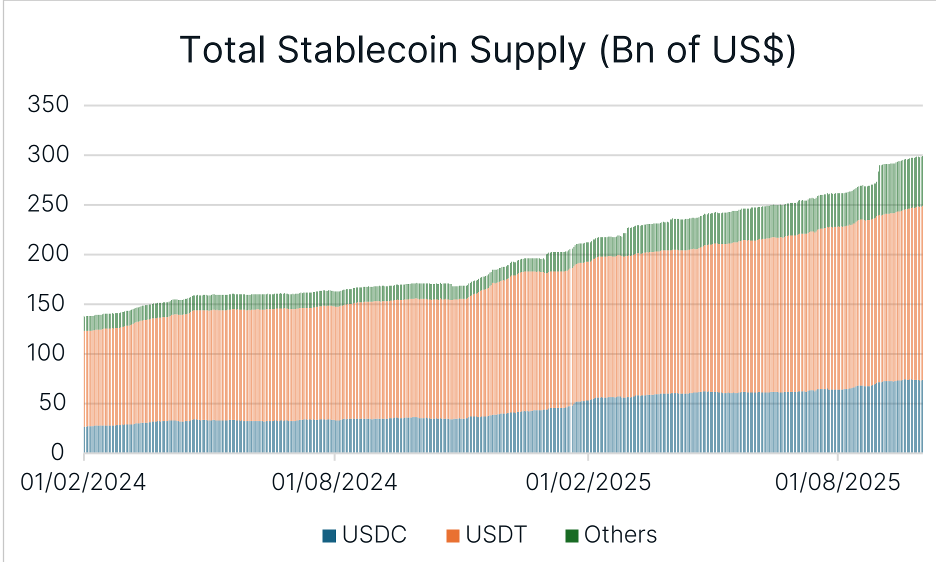

Chart 1

Source: Bloomberg

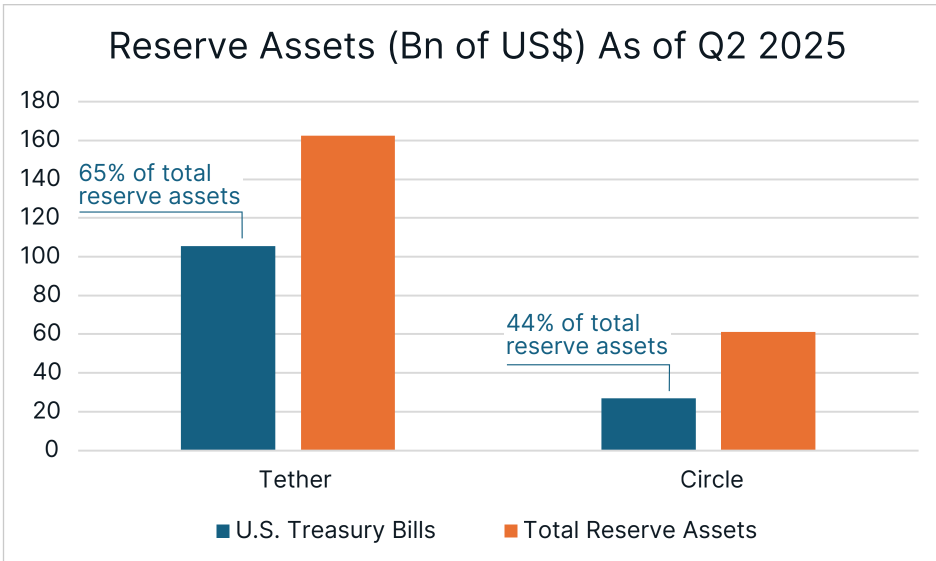

Chart 2

Source: https://tether.to/en/transparency/?tab=reports and https://www.circle.com/transparency

For instance, as of Q2 2025, Treasury bills accounted for 65% of reserve backing for Tether and 42% for Circle **(Chart 2)**. The rest of the assets in reserves are split between repurchase agreements, cash and bank deposits, Bitcoin, and precious metals.

In our view, the potential growth in stablecoins will not have a meaningful impact on the US dollar or Treasuries for the following reasons:

Firstly, stablecoins capitalization will remain relatively small. Even under the overly optimistic scenario of a $2 trillion market in stablecoins, it is still dwarfed by the $9.6 trillion in daily foreign exchange turnover, nearly $6 trillion in outstanding Treasury bills, and over $28.4 trillion of total supply of Treasury securities. Moreover, the Treasury market will only get bigger as the Congressional Budget Office projects US debt to swell by roughly $23 trillion by 2035 to $52 trillion.

Secondly, stablecoins inflow will likely be recycled money, not fresh capital. Stablecoins are prohibited from paying any interest or yield (whether in cash, tokens, or other consideration) and do not benefit from Federal Deposit Insurance Corporation (FDIC) protection - which insures deposits up to $250,000 per depositor, per ownership category at FDIC-insured banks. As a result, stablecoins offer limited incentives for new investors to move bank deposits or physical cash into them.

Instead, stablecoin inflows will largely be dependent on funds being shifted from existing money market funds given their overlapping characteristics. Like stablecoins, money market funds are not covered by the FDIC and are largely backed by Treasury bills.

As of Q2 2025, money market funds held over $1.9 trillion in Treasury bills, accounting for 33% of all bills outstanding **(Chart 3)** – the largest share among Treasury bill holders. Foreigner investors hold the second largest share at 24%.

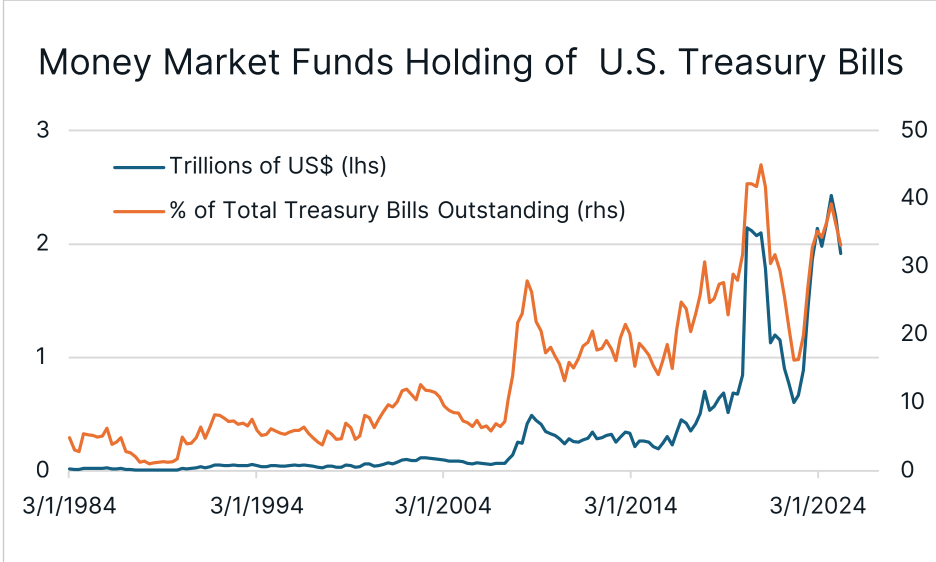

Chart 3 Source: Bloomberg

It is true that money market funds pay interest while stablecoins do not. However, many cryptocurrency exchanges allow users to earn yield or rewards on their stablecoin holdings, eroding money market funds' edge. The implication is that if the source of stablecoin inflows is funded by outflows from money market funds, then net demand for Treasury bills will remain unchanged.

Thirdly, central bank digital currencies (CBDC) can limit the growth of stablecoins. CBDCs are government-issued digital forms of national currency. This can make them more attractive than privately issued stablecoins, which remain exposed to private credit or liquidity risk. Additionally, CBDCs offer broad integration into the backing and payment systems giving them far broader distribution than stablecoins, which mainly stay within crypto platforms.

US government policies support dollar-backed stablecoins rather than CBDCs. In contrast, most other major economies are rolling out their own CBDCs. This limits the global growth opportunity of US dollar-based stablecoins, as foreign users have little reason to adopt them when their domestic CBDCs meet the same payment and liquidity needs. That should restrict the ability of stablecoins to scale internationally and reduce the incremental demand for Treasury bills that would otherwise come from cross-border stablecoin holdings.

Bottom line

In our view, stablecoins are no silver bullet to reverse the dollar's declining role as the primary reserve currency. Instead, US protectionist trade policies, political interference with the Fed's independence, and doubts about the impartiality of key economic data following the sacking of the Bureau of Labor Statistics (BLS) head undermine the dollar's global role.

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