UNITED STATES

SLOWDOWN UNDERWAY

Growth in the United States has slowed significantly compared with 2024 and is expected to remain moderate in the coming months, while maintaining some dynamism. Inflation is gradually rising again, mainly due to higher tariffs, while the labour market is already showing clear signs of weakening. These developments are resulting in a rebalancing of risks around the Federal Reserve's (Fed) dual mandate: downside risks to employment are increasing relative to upside risks to inflation. In our view, this should prompt the Fed to make two further cuts to its policy rate between now and the end of 2025, following the September cut. At the same time, fiscal policy is unlikely to stem the rise in the public debt ratio.

SLOWER GROWTH

GDP growth slowed significantly due to uncertainty and inflation fears arising from economic policy decisions, particularly trade policy. Measured as an average over H1 2025 to neutralise the volatility caused by the sharp rise in imports in Q1 (and their decline in Q2), it fell to +0.3% q/q (+0.7% on average in H2 2024). Final sales to private domestic purchasers also slowed (+0.5%, compared with +0.8% previously). At an average of +0.3%, consumption eased sharply (vs. +0.9% in H2 2024). Residential investment contracted during the last two quarters and stood 12% below H2 2021 at the same time. Conversely, business investment picked up, with average growth of +1.9% (+0.1% in H2 2024).

Available data for Q3 are generally encouraging. Retail sales were robust in July and August. At the same time, the two-sided trend in investment continues, with difficulties in housing starts (-8.4% m/m in August) and building permits (monthly contraction in July and August), but core durable goods orders rising in July. According to our forecasts, the average annual growth rate should reach 1.7% in 2025 (+2.8% in 2024), largely helped by the carry-over effect from the previous year (1.0 pp), then 1.5% in 2026.

GROWTH AND INFLATION (YEARLY AVERAGE)

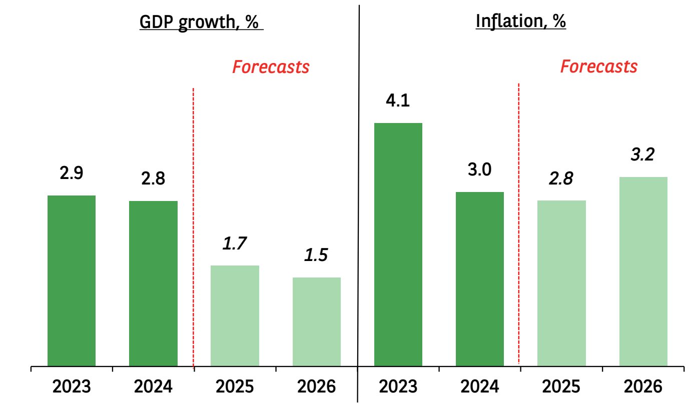

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

FOREIGN TRADE: BEYOND THE SPRING PEAK, A LASTING UNCERTAINTY SHOCK

The United States has been subject to very few tariff retaliations, apart from China, and foreign trade contributed very slightly to growth in H1. In July, exports of goods fell to the same level as in H2 2024, as the boost seen at the end of Q1 2025 gradually faded. Previously, trade tensions had caused volatility in the trade balance for goods, while the balance for services, spared by them, remained stable (+1.0 – +1.1% of GDP). Trade policy uncertainty has receded as a result of the clarification resulting from the trade agreements announced in the summer (covering 60% of imports in 2024), but remains high (Chart 2). Finally, major issues remain unresolved, namely the investigations under Section 232 of the Trade Expansion Act, which could lead to sectoral tariffs on pharmaceuticals, chips and semiconductors, and the appeal on the legality of reciprocal tariffs before the Supreme Court (early November).

LABOUR MARKET: STILL TIGHT, DESPITE A SHARP DROP IN JOB GROWTH

The labour market has been softening since 2024, but this trend is intensifying. This is fuelling fears of a steeper rise in the unemployment rate (4.3% in August, +0.1pp y/y). Nonfarm payrolls fell from +175k in January to +64k in August (6-month moving average). The government sector (+1k monthly average since January) echoed the associated policy, while the leisure and hospitality sector slowed (+8k, +20k annual average in 2024). Manufacturing employment declined (-5k). The weakening was reflected in the BLS's latest annual revision of salaried employment between April 2024 and March 2025, which reached -911k in the preliminary estimate (an all-time high). The labour supply is being penalised by the new and particularly restrictive migration policy, which coincides with a reduction of 1.5 million non-native workers between March and August 2025[1]. At the same time, the labour force participation rate fell by 0.2 pp to 62.3%.

For the time being, the unemployment rate is still within the 4.0% to 4.3% band, in line with or slightly below full employment. Our baseline scenario anticipates stabilisation in the short term, as growth in the available labour force and the pace of payroll growth[2] are slowing simultaneously. The 'curious kind of balance' outlined by Jerome. Powell is reflected in underlying measures of labour market stress. The lack of movement among hires, resignations and dismissals suggests a widespread wait-and-see attitude, while the ratio of job vacancies to unemployed individuals is close to 1 (compared with 2.1 before the start of monetary tightening and an average of 0.6 between 2001 and 2019).

1 The exact scale of this reduction is a matter of debate (due to difficulties in counting and possible carry-over effects in the native population statistics). Nevertheless, it highlights the risk that deportations pose to the US labour market.
2 The 'break-even' unemployment rate corresponds to the number of jobs needed to keep it stable in relation to changes in the labour force. We currently estimate this to be 35k–50k, compared with 70k–100k previously.

INFLATION: NO SECOND-ROUND EFFECTS?

The pass-through of higher tariffs to inflation is becoming more evident. CPI inflation rose in Q3 (+2.9% y/y vs. +2.4% in Q2), driven by core goods (+1.5% y/y in August, vs. an annual average of -1.1% in 2024). This trend is likely to continue. Trends on the prices paid sub-component of the ISM survey, a leading indicator of core inflation, have unprecedented since 2022 (Chart 3). Non-energy services, housing and non-housing, are slowing overall, but remain well above 2%, at +3.3% and +3.6%, respectively. Therefore, we are forecasting inflation to rise to a peak of +3.5% y/y in Q2 2026.

The main risk lies in the likelihood of second-round effects from this tariff-induced inflation, which are unlikely at this stage as long as the economic slowdown continues. Market inflation expectations remain well anchored, although the deterioration in household expectations is a warning to be monitored. Jerome Powell adopted the view of the doves on his board. He felt that wage inflation was 'not [...] likely' due to 'increasing downside risks' in the labour market, and therefore considered a 'one-time shift in the price level' to be a 'reasonable base case'.

FOMC, THE DOVE'S CALL

While tensions intensify on both sides of the Fed's dual mandate, developments and downside risks in the labour market are resulting in a reallocation of risks towards the 'maximum employment' component. Therefore, the Fed cut its target rate by 25 bps in September, to +4.0% – +4.25%, in a 'risk management' effort. According to our forecasts, this is initiating a cycle of monetary easing that will continue until the terminal rate of 3.0% (upper limit) at the end of H1 2026, including two further 25-bp cuts by end-2025. In 2026, the materialisation of inflationary risks and the resilience of the economy should not justify more than two additional rate cuts. However, the further emphasis on employment means that the risks associated with this baseline scenario point to further rate cuts should things worsen. At the same time, the question of the Fed's independence is drawing considerable attention. This is a major issue that carries material risks (increased inflation premium, bond pressures and/or weaker national currency).

DEFICIT STABILISING AT A DANGEROUS LEVEL

The administration's fiscal policy is not expected to get the public accounts in order[3]. The One, Big, Beautiful Act (OBBA) budget reconciliation bill, enacted on 4 July, is expected to have an adverse impact on the federal deficit, which the Congressional Budget Office (CBO) estimates at between USD 4.113 trillion and USD 4.971 trillion over the 2025-2034 period. The CBO also estimates that tariff revenues will reduce the deficit by USD 4 trillion over the same period, which, all other things being equal, would offset most of the impact of the OBBA and limit the increase in the deficit. Under these conditions, we estimate that the federal deficit will stand at -5.5% in 2025, corresponding to a negative fiscal impulse, and between -5.5% and -6.0% of GDP over the2026-2029 (-6.4% in 2024) period. These would be particularly high levels, contributing to an increase in the public debt-to-GDP ratio (97.8% in 2024, rising to 99.9% in 2025 and 101.7% in 2026).

In the meantime, relative bond pressure is emerging: the US 30-year yield approached 5.0% in August (compared with an average of 4.7% in H1 2025), before falling back following disappointing economic data.

UNITED STATES: TRADE POLICY UNCERTAINTY (30-D MMA)

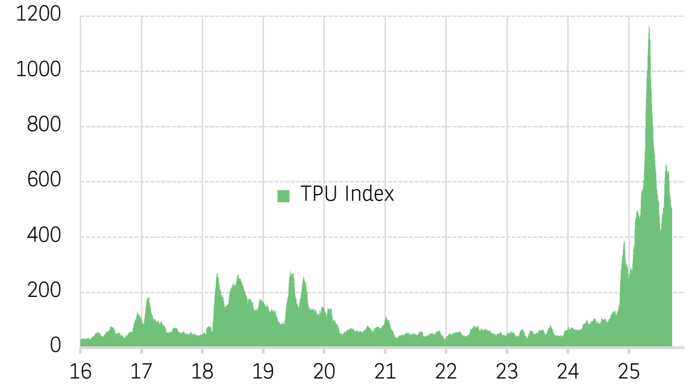

CHART 2 SOURCE: MACROBOND, BNP PARIBAS

UNITED STATES: PRICES PAID AND CORE CPI

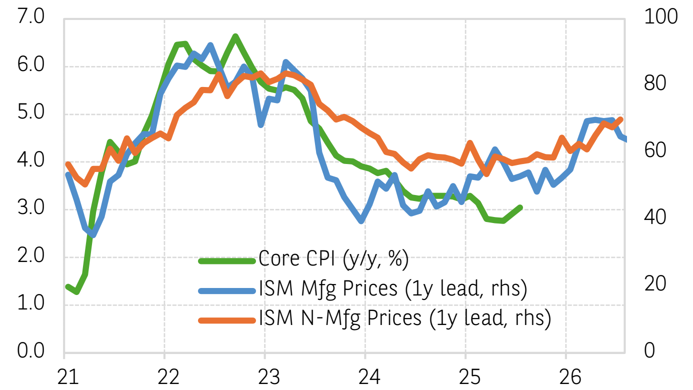

CHART 3 SOURCE: BLS, ISM, BNP PARIBAS

At the same time, the Treasury is stepping up its securities buyback programmes. It has acquired USD 135 billion in securities since 20 January 2025 in order to reduce the interest burden by shortening the average maturity of the debt. However, this practice increases the liquidity risk on short maturities that are in high demand.

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Anis Bensaidani
anis.bensaidani@bnpparibas.com

3 See our EcoInsight: The US Treasuries Market: An Idol with Feet of Clay. US Federal Debt: The Risks of Abundance