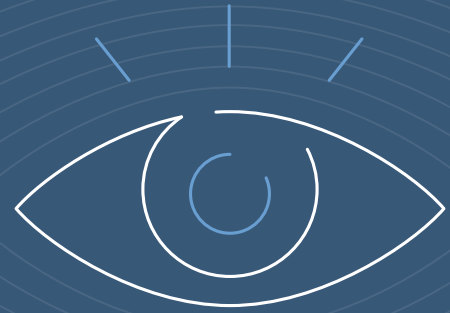


THE VIEW
FROM APOLLO

September 2025



Fed Meeting: Tensions Rising

The Federal Reserve just wrapped its September meeting, and beneath the rate-cut headlines is a story of tension: between growth and inflation, jobs and prices, stability and volatility, and even between points of view of the Fed members themselves. With slowing job gains and sticky inflation, the stakes for every policy move are high as the US economy tries to avoid stagflation.

In this episode, Apollo's **chief economist Torsten Slok** unpacks what these tensions can mean for the economy, for markets, and for portfolios.

Q: What's just your overall take on the Fed's decision to cut 25 basis points and all the considerations that went into it?

A: They did cut 25 basis points, and they signaled that more cuts are coming. The number one conclusion is interest rates are going to go down a little bit more, but there's also a second conclusion, which is that interest rates are only going to go down basically 50 basis points more this year, and then they only have one cut next year. So a very important conclusion for investors is, this is not a situation where the Fed is cutting rates in panic because they're worried about the economy slowing down. They are basically telling us that the level of yields in fixed income is still going to remain relatively elevated for the next several years because they are not foreseeing a recession. They're not predicting a sharp slowdown. They are monitoring very carefully the headwinds to the outlook, but the big picture is they view this as a risk management cut. And I think the markets should be looking at it that way, that this was a cut that is basically now bringing us through more wait-and-see on what the incoming data will show over the coming months. Is the labor market still slowing down? Is inflation going up more? And that will then drive their next decisions.

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Q: They did revise growth up, and at the same time, expectations for inflation are also up. So you've got inflation and growth with rate cuts. How's that all work together?

A: If you tell me that inflation is going to be higher, that tells me I should raise interest rates. If you tell me growth is going to be higher, that also tells me I should be raising interest rates. So why did they cut? This is why Jay Powell justified it by saying, we are doing this out of the worry that the labor market might be slowing down faster. The last print on the employment report was relatively weak, and if we do continue in the direction of more weakness in the labor market, it's probably a good idea to get ahead of that. It was somewhat inconsistent to, on the one hand say, growth is better, inflation is better. And then say, well, we are cutting interest rates. So that's why it was justified as a risk management cut trying to adjust for the risk of the economy indeed slowing more over the coming months.

Q: On that employment picture, 15 FOMC members think their unemployment forecast has upside risk. At the same time, hiring has slowed. How do you see the employment picture right now?

This is a very important debate, and we actually just got another point on that. Neel Kashkari, president of the Minneapolis Fed, said in a speech yesterday that only half of the slowdown in job growth was because of the slowdown in immigration. He thought that immigration slowing down isn't the only reason job growth is slowing. It is also the case that companies are hiring fewer workers. That's a recognition by an important FOMC member that the economy is actually slowing in the background, and the rise we've seen in the unemployment rate confirms that it is a slowdown in the background in the labor market. Combining that with the number of job openings going down, we still have, as Jay Powell also talked about, a very low hiring rate, a very low quits rate. Very few people are quitting their jobs, very few people are getting hired. That is a labor market at a standstill where their worry is that we are at risk of seeing upside to the unemployment rate. But I think that they view this as, just try to do one cut here and then wait a few more months and a few more observations to figure out if this weakening of the labor market is continuing. Because if the unemployment rate does begin to go up more meaningfully, of course then they will have to begin to cut much faster.

Q: At the same time, 12 FOMC members think that their inflation forecast has upside risks. Upside risks to unemployment at the same time as upside risks to inflation points to a stagflationary environment. How are you seeing that?

A: I think investors should be positioned for the potential of stagflation. The forecast they presented indeed has inflation going up and growth slowing. They're essentially telling us that on the one hand, if inflation goes up, the Fed should be hiking. But on the other hand, if growth is slowing down, the Fed should be cutting. This is why their dual mandate is experiencing some tension at the moment, between how much weight they put on inflation going up and how much weight they put on growth slowing down. They're worried about the upside risk to inflation likely because no one quite yet knows exactly how much tariffs will feed through to inflation. We've seen some upward pressure, especially on goods inflation and leading indicators of services inflation. I think the market is more worried that there is some upside risk to inflation that maybe we're not appreciating enough.

At the same time, because of immigration, you're beginning to see wage growth in some of the sectors where unauthorized immigrants are working, namely construction, agriculture, hotels, and restaurants. There's still upside risk pressure on inflation coming from tariffs and from immigration restrictions. And finally, the dollar has been going down almost 10% since the beginning of the year. When the dollar goes down, things we buy abroad become more expensive. That's also an inflationary impulse. I think that they worry about these three forces, and that's the reason why they're saying that there's upside risk to inflation in their forecast.

Q: The amount of conflicting data points could perhaps explain some conflicting points of view among FOMC members. How important is this divergence of viewpoints?

A: If you look at the academic literature that has asked this question, a number of papers have been written have shown that if you have more disagreement among FOMC members – or in the broader context, if you have disagreement among central bankers internally – that begins to raise all kinds of risks for higher volatility. Can we then trust what the dot plot is saying? A unique part of the dot plot that just came out is that there was one member who was saying that they expect a lot of cuts by the end of the year, but there was another member who actually thought that they should be hiking by the end of the year. And the dispersion in views was very dramatic. The fact that there's such a disagreement is indeed telling you that there are some communication challenges ahead and likely going into next year, especially with Jay Powell stepping down on May 15 next year. That's why this discussion around agreement is not just some academic debate. It is something that has significant consequences for volatility. It might also even begin to have consequences for the steepness of the yield curve if people begin to worry about that the new Fed committee essentially is going to accept a higher level of inflation and have an inflation target that's higher than the 2% they have today. And that would be a very, very serious change in the regime.

Q: It's not just the Fed. Yesterday the Bank of England kept rates steady. How are you seeing the environment outside the United States?

A: One very important difference between the economy in the US and many parts of the world is that the US is at the moment engaged in a trade war and raising tariffs on literally every trade partner. That means that imports are now being taxed because of tariffs going up, creating an inflationary impulse specific to the US. That's very different. For example, Germany. In Germany there is a trade war toward the US, but Germany is not in a trade war with France, with Italy, with Spain, with the UK, with Canada, with Australia. For that reason, the inflationary impulse in Germany is not to the same degree to the upside as it is in the US. So for the UK – and also Europe, Canada, Australia – there is some inflationary pressure, but you have more prospect for the central banks cutting rates because they do not face the same inflation problem that we face in the US. That's a very important reason also why we should expect US interest rates to stay higher for longer while we should expect interest rates to begin to go down around the world.

Q: How do you see implications of all of this on asset allocation and portfolios moving forward?

A: The number one takeaway for investors is that, yes, the Fed is indeed cutting interest rates, and it will likely continue. But very importantly, the likelihood of a recession has been going down. The consensus thought a few weeks ago that the probability of recession was 40%, and in the latest data, it is only at 30%. So it's not zero, and that is important, but the view from the consensus – and this is also our view – is that there is a 70% chance we will not have a recession. The nature of the shock that we are experiencing is some headwinds from tariffs, from immigration restrictions, from student loan payments restarting. These are not a shock like Lehman Brothers, not like COVID. These headwinds are somewhat intense, but they are not something that will completely topple the economic outlook.

That brings me to the conclusion that yield levels in the US, especially with this upside pressure on inflation, are going to stay at a higher level than the rest of the world. And then you can still cut coupons in private credit, in public credit, everywhere in fixed income markets, with a level of yields that still looks attractive relative to what you can get in the rest of the world. At this point, where we're sitting today, I still think the conclusion is that the yield level is higher, and fixed income investors are benefiting from that and will still be paying a very nice steady coupon and cash flow over the coming quarters ahead.

Q: What are you looking at now? What's next?

A: When the Fed is telling us that they worry about the upside risk to inflation and the upside risk to unemployment, it is absolutely critical that we in markets now spend time on what exactly they're worrying about. We spend a lot of time here on all the indicators we can look at to have some idea about what's happening to the labor market, what's happening to inflation. The Fed will at its next meeting in late October will again be caught in a situation where they need to choose: Do they want to put more weight on inflation going up, or do they want to put weight on growth slowing down? So it really ends up being a debate around, does the Fed like apples, or do they like oranges? Do they like more inflation? Do they like more of the growth slowdown? And that's why the outlook and the trajectory for the labor market is the number one issue. And the close number two is the outlook for inflation. The different diverging trends in the risk that the labor market might be softening and at the same time inflation may be going up is creating a lot of challenges. I look at the dual mandate, and we need to figure out what could turn out to be worse on the inflation front or worse on the labor market front.

Note: The responses above have been edited for clarity and concision and do not represent a verbatim transcript of the podcast.

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