

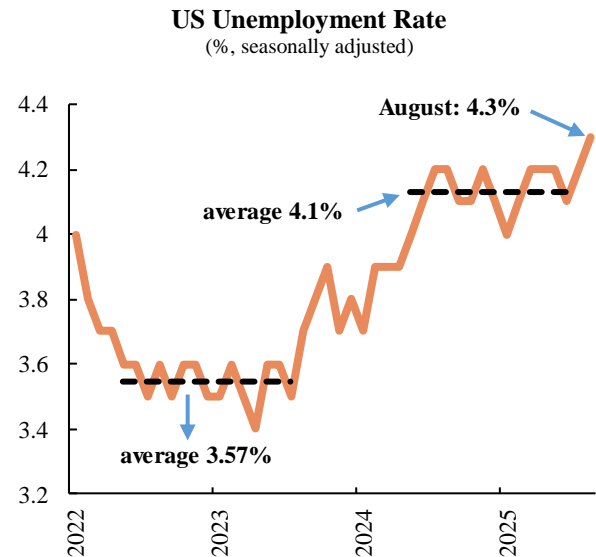
## Federal Reserve cycle of rate cuts likely to be slower than markets expect

Policy rates expectations have swung significantly in recent months, revealing a rather fragile market consensus over the timing and size of easing by the US Federal Reserve (the “Fed”) over the next year. After keeping the rate on hold since the end of 2024, an incipient softening of labour markets began to shift the balance of risks. Unprecedented trade and fiscal policy volatility drove uncertainty measures to record highs, putting policy makers on “wait-and-see” mode as they assessed the major risks to the economy. Finally, the Fed cut the benchmark rate by 25 basis points (b.p.) to 4.25% in September.

The Fed recognizes that near-term risks to inflation are tilted to the upside, with the headline figure fluctuating around 2.9%, markedly above the 2% target of monetary policy, while risks to employment point to the downside. This puts the Fed in a difficult position, as the two targets of the Fed’s mandate, i.e., low inflation and maximum employment, come into direct conflict.

Currently, markets discount close to 125 b.p. in additional rate cuts until end-2026. In our view, although the Fed would eventually bring interest rates to the neutral level close to 3%, there is not an alarming deterioration in the economic growth outlook that would call for a rate cutting cycle of this speed. In this article, we discuss three main factors that support our outlook.

First, labour markets are weakening gradually, in line with a soft-landing of the economy. Labour markets are at the core of monetary policy, explicitly being part of the mandate of the Federal Reserve, and therefore provide guidance regarding the direction of policy rates. Importantly, labour markets are an informative gauge of the state of the overall economy, and a sharp deterioration in employment has historically anticipated a recession. The widely recognized “Sahm Rule” states that a recession is imminent when the unemployment rate increases by 0.5 percentage points (p.p.) relative to the minimum in the last year. This rule has signalled the start of every US recession since the 1970s, but the current progression of the unemployment rate is overly moderate to raise the alarms of a downturn.



Source: Bureau of Labor Statistics, QNB Economics

The August unemployment print of 4.3% still stood in the range that is considered consistent with balanced employment. More importantly, even taking into account the emerging impact of AI on the job market, market consensus points to an unemployment rate of 4.4% by end-2026. Overall, the mild softening of labour markets calls for a more gradual easing of monetary policy than expected by markets.

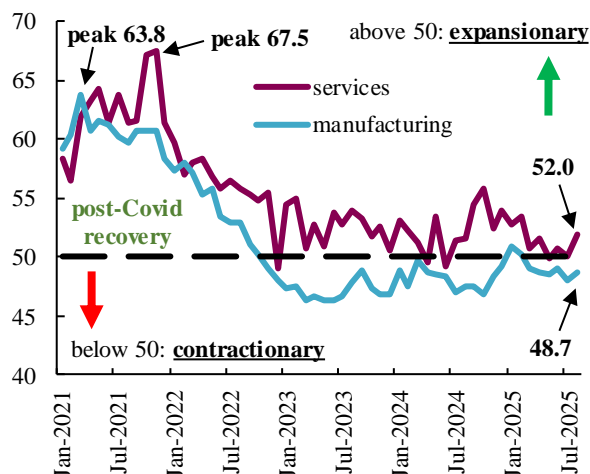
Second, the leading indicators for the services sector still point to positive, even if modest, expansion. The latest prints of the Purchasing Managers Index (PMI) signal that the outlook remains stable for services. The PMI is a reliable survey-based indicator that provides a measurement of improvement or deterioration in economic activity. An index level of 50 serves as a threshold that separates contractionary (below 50) from expansionary (above 50) business conditions. Since early-2023, the PMI for the service sector has fluctuated mostly above the 50-point mark that indicates expansion. In the last three months it has delivered an average of 51 points, indicating this key sector is still expanding at a balanced pace, not justifying aggressive policy rate cuts.

The services sector is key for the performance of the US economy, as it accounts for over 75% of output, and employs over four out of five workers in the private sector. Therefore, a steady services sector

implies that a sharp economic slowdown is less likely.

## PMI Services and Manufacturing Activity Indicators

(50 points: threshold separating contraction from expansions)



Source: Haver Analytics, QNB Economics

Third, the contraction in the manufacturing activity is still contained, showing that the sector remains resilient. Although the manufacturing sector is significantly smaller than services, representing just around 11% of GDP, it is more sensitive to economic shocks and tends to be accurate in anticipating the overall performance of the economy. For example,

the manufacturing PMI has reliably anticipated US recessions when it falls below 45, since the 1950s.

In addition to skilled-labour shortages, manufacturers are facing significant disruptions in their supply chains caused by the sweeping tariffs initially announced by President Trump on “Liberation Day” in early April. Increased uncertainty has placed producers on waiting mode, until there is further clarity on tariffs across sectors and foreign countries and, therefore, on costs of imported inputs. After briefly entering the positive-growth range early this year, the manufacturing PMI has remained below, but close, to the 50-point mark. In other words, in spite of the headwinds and contained contraction, manufacturing activity is also not pointing to a major economic downturn.

All in all, leading indicators from key sectors show that the US economy is heading to a soft-deceleration, with real GDP growth for 2026 expected at 1.7%. A resilient labour market, a still-expanding services sector, and a moderate contraction in manufacturing support this outlook. In our view, given a likely soft-landing scenario rather than a sharp contraction, we expect a less aggressive monetary easing cycle than the market consensus, with the FOMC cutting its policy rate by 25 b.p. twice more this year, and one more time in 2026 to a policy rate of 3.5%.

### QNB Economics Team:

#### Luiz Pinto

Assistant Vice President - Economics  
+974-4453-4642

#### Bernabe Lopez-Martin\*

Senior Manager - Economics  
+974-4453-4643

#### Aisha Khalid Al-Thani

Senior Associate - Economics  
+974-4453-4647

\* Corresponding author

**DISCLAIMER:** The information in this publication (“**Information**”) has been prepared by Qatar National Bank (Q.P.S.C.) (“**QNB**”) which term includes its branches and affiliated companies. The Information is believed to be, and has been obtained from, sources deemed to be reliable; however, QNB makes no guarantee, representation or warranty of any kind, express or implied, as to the Information’s accuracy, completeness or reliability and shall not be held responsible in any way (including in respect of negligence) for any errors in, or omissions from, the Information. QNB expressly disclaims all warranties or merchantability or fitness for a particular purpose with respect to the Information. Any hyperlinks to third party websites are provided for reader convenience only and QNB does not endorse the content of, is not responsible for, nor does it offer the reader any reliance with respect to the accuracy or security controls of these websites. QNB is not acting as a financial adviser, consultant or fiduciary with respect to the Information and is not providing investment, legal, tax or accounting advice. The Information presented is general in nature: it is not advice, an offer, promotion, solicitation or recommendation in respect of any information or products presented in this publication. This publication is provided solely on the basis that the recipient will make an independent evaluation of the Information at the recipient’s sole risk and responsibility. It may not be relied upon to make any investment decision. QNB recommends that the recipient obtains investment, legal, tax or accounting advice from independent professional advisors before making any investment decision. Any opinions expressed in this publication are the opinions of the author as at the date of publication. They do not necessarily reflect the opinions of QNB who reserves the right to amend any Information at any time without notice. QNB, its directors, officers, employees, representatives or agents do not assume any liability for any loss, injury, damages or expenses that may result from or be related in any way to the reliance by any person upon the Information. The publication is distributed on a complementary basis and may not be distributed, modified, published, re-posted, reused, sold, transmitted or reproduced in whole or in part without the permission of QNB. The Information has not, to the best of QNB’s knowledge, been reviewed by Qatar Central Bank, the Qatar Financial Markets Authority, nor any governmental, quasi-governmental, regulatory or advisory authority either in or outside Qatar and no approval has been either solicited or received by QNB in respect of the Information.