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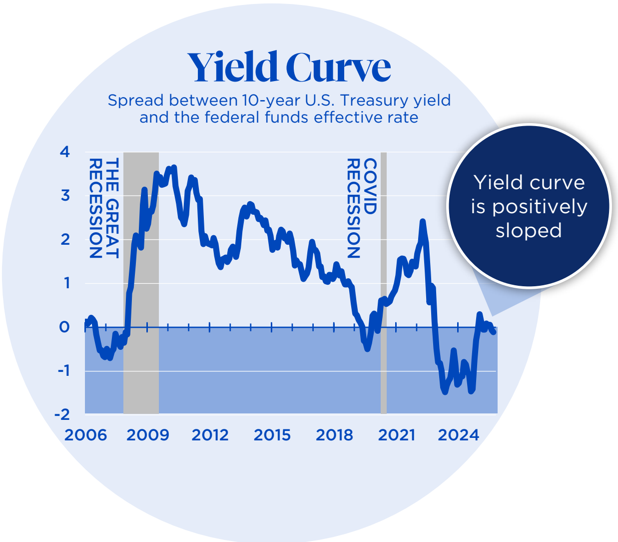
Economic & Financial Markets Monthly Review | October 2025

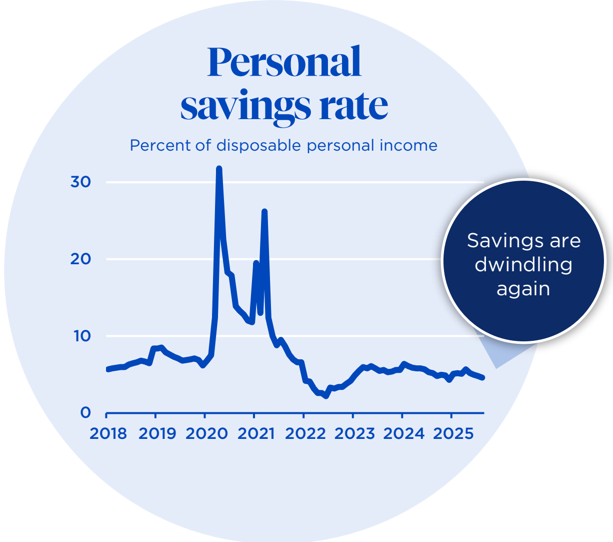
Steady growth despite weak hiring

Economic Overview

Where is the economy now?

Concerns about the sharp slowdown in hiring have shifted the Fed back into easing mode but reported spending activity was resilient through the third quarter. Still, a near-term moderation in economic growth appears likely as inflation and income concerns build for many households while business investment outside of AI remains sluggish given lingering policy uncertainty. The continued government shutdown and layoffs of federal workers tempers Q4 activity.





Where we are this month

Growth has been resilient

Activity through the third quarter was stronger than expected with consumer activity still solid despite the sharp drop in hiring. The government shutdown and possible federal worker layoffs represent downside drags.

Yield curve turns positive

Interest rates have shifted lower on increased expectations for Fed easing for the remainder of 2025 and into 2026. The yield curve remains positively sloped and corporate bond spreads remain very tight.

Consumers tap into savings to spend

The personal saving rate hit a year-low of 4.6 percent of disposable personal income in August, helping to fuel continued solid consumer spending.

What does this mean

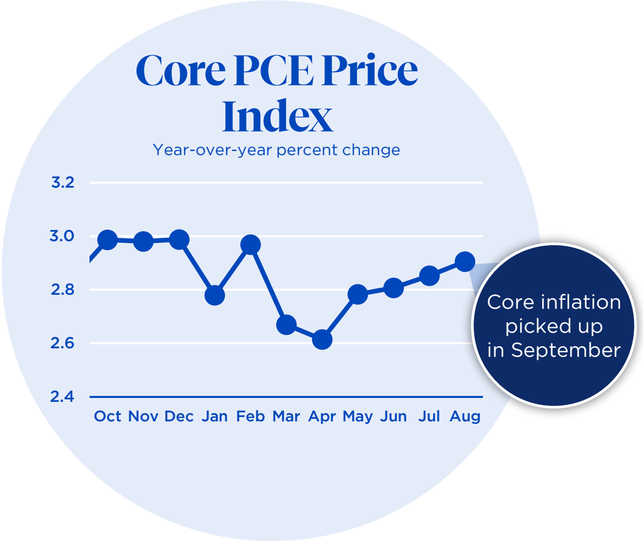
- Given the income pressure from slowing job growth, we expect a softer end to 2025 as consumers pull back a bit on their spending reins. Recession odds remain low with any slowing for the economy likely to be more modest and temporary.
- Interest rate cuts combined with lower tax burdens and enhanced business incentives in 2026 as well as reduced uncertainty, should revive overall business spending and hiring next year.

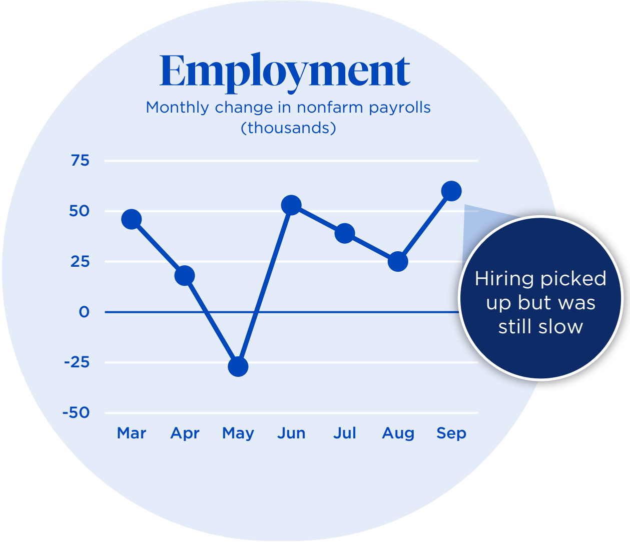
- Yields on 10-year Treasury notes have settled near 4.10 percent. But we look for a steeper yield curve to re-emerge as the Fed engineers a series of rate cuts in the coming months, while the positive term premium should keep long-term rates higher.
- We expect the Fed to cut rates further at the final two meetings of 2025 (late October and mid-December) and the odds of additional easing in 2026 are rising as the makeup of the FOMC changes.

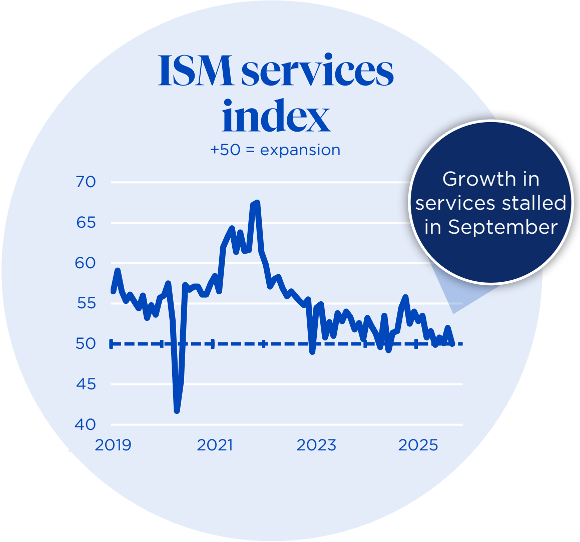
- After boosting savings earlier this year in response to the elevated economic and tariff uncertainty, households have been tapping into savings to maintain spending. A wealth effect for more affluent consumers after the strong rebound in equity markets has also led to reduced perceived need for savings.
- The lack of savings represents a downside risk for consumer spending if a drop in aggregate income unfolds due to a weakening labor market.

Hiring remains slow while the services sector stalls

The government shutdown has delayed many data releases, but private sector updates indicate that hiring remained weak in September. Consumer price inflation readings continued to tick moderately higher through August, but this is unlikely to dissuade the Fed from cutting rates further at the end of October. Supporting the case for further easing, service sector growth slowed sharply in September and may be on the brink of contraction.







Where we are this month

Inflation is rising slowly but steadily

Headline PCE inflation climbed to 2.7 percent in August, while the core rate held steady at an elevated 2.9 percent rate. Both readings were the highest since February.

Private sector data show tepid job growth

With the data release from the BLS delayed by the government shutdown, a private sector source, Revelio Labs, estimated 60,000 in job gains during September.

Service sector is nearing contraction

The ISM services index fell in September to a reading of 50, pulling the index to the brink of contraction amid slowing demand for services.

What does this mean

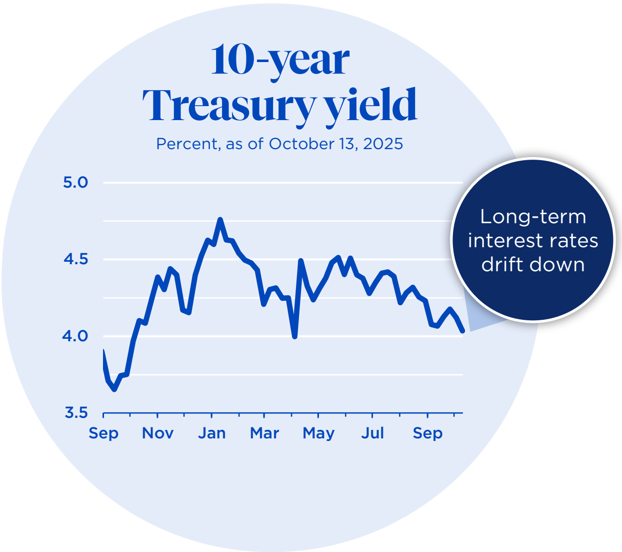
- The climb in inflation has been modest and tariff impacts have been limited outside of a handful of categories (e.g., auto repairs, appliances, furnishings, and some apparel).
- We believe the Fed will continue to look past the slow-but-clear rise in inflation as upward pressure on prices from tariffs should be temporary. With Fed officials focused more on the weak labor market, we expect the policy rate to be cut another 50 bps by year end..

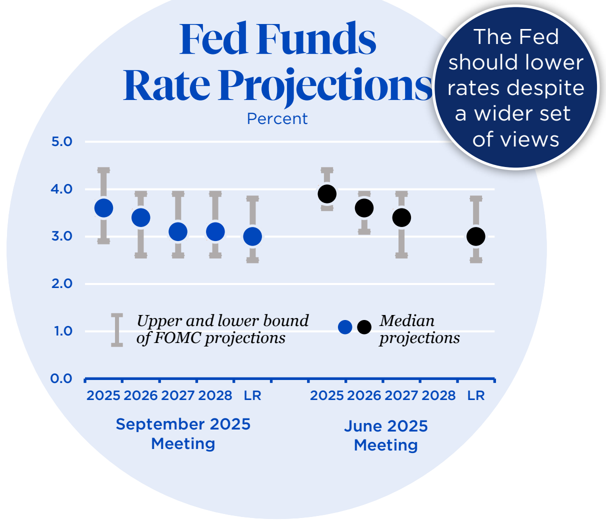
- According to Revelio Labs' methodology which has a strong correlation to the BLS data, job growth in September was the fastest since December 2024. Still, after another month of subpar hiring, the six-month moving average for gains came to an anemic 28,000.
- Low jobless claims indicate that most firms are preferring hiring freezes to layoffs. With little relief for businesses facing rising costs, we expect the soft pace of hiring to continue through the end of the year.

- Slowing demand for services — seen in lower readings for both business activity and new orders — is another sign that households are tightening their spending heading into the fourth quarter.
- The service sector, which has provided a steady source of growth for the economy in 2025, is trending down and could soon join manufacturing in contraction territory. Looking forward, fiscal stimulus and lower interest rates should help to boost activity in 2026.

Euphoric rally in risk assets, new tariff threats provide a check

Risky assets have advanced on an ebullient track with equities making all-time highs and corporate credit spreads staying very tight as the economy appears resilient to policy headwinds. Resilient growth and encouraging corporate financial performance should keep equities on a rising trajectory and lead to a steeper Treasury yield curve as the Fed lowers interest rates. However, recent trade tensions with China inject some increased volatility.





Where we are this month

Equities make fresh new highs

Stocks have been persisting along a steep upward path, underpinned by resilient economic data, solid corporate earnings, ebullience over AI, and expectations of looser Fed policy. Recent China trade tensions revive volatility.

Gradually falling long-term yields

Treasury yields are maintaining their gradual descent, especially in the short-end of the curve, in response to labor market softness and worries over a potential derailment of upbeat investor sentiment.

Data fog shouldn't prevent Fed rate cuts

Fed officials' public remarks since the September FOMC meeting are in line with our forecast for additional Fed easing as policymakers seem eager to stem further weakening in the labor market.

What does this mean

Equities

- The S&P 500 index made a new all-time high in early October and now stands more than 30 percent above its April 8th low. Continued modest tariff impacts and ample market liquidity relative to history are reinforcing positive market trends.
- Outperforming cyclical stocks relative to defensives – a gauge of market attitudes – have indicated very cheerful investor sentiment.

Yields

- We do not see much room for further yield declines as Fed rate cuts are already well-priced into the market. However, a renewed flare-up in trade disputes with China could prompt a downward trend in yields.
- Fundamentally, upward pressure on the term premium for the 10-year U.S. Treasury will limit declines in yields amid increased debt issuance stemming from the "One Big Beautiful Bill."

Fed

- While there is some dispersion in the views of Fed officials, overall policymakers remain more worried about the soft employment picture than inflation. We expect 25bps of easing at both the October and December policy meetings.
- The shutdown has stopped the flow of government economic data, but we expect Fed officials to rely on private sector data and lower interest rates even if the shutdown lasts until the October meeting.

Outlook

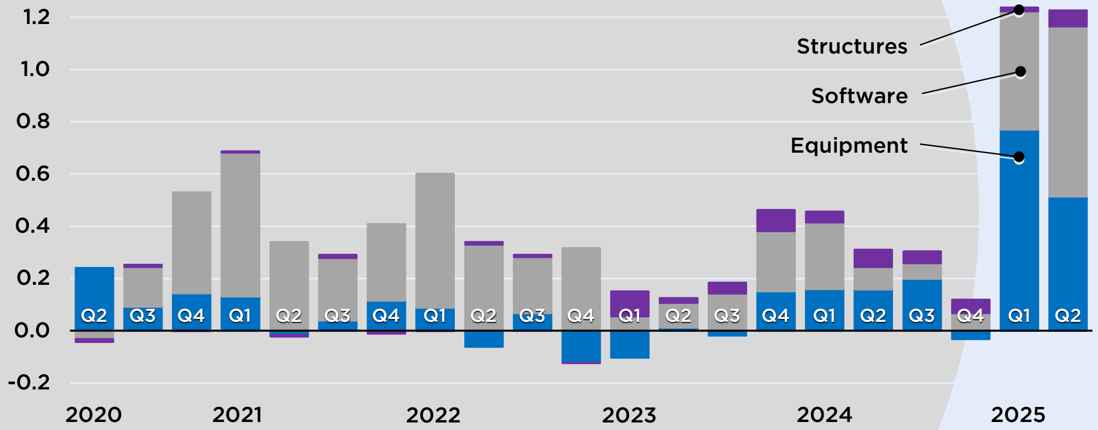
AI investment is providing an outsized boost

Besides driving the strong performance for the equity market, investment in artificial intelligence (AI) also offered a significant positive contribution to GDP growth in the first half of 2025. According to Nationwide Economics' calculations, business investment in software, IT equipment and structures that consists significantly of artificial intelligence and data centers was responsible for an outsized 30 percent of real GDP growth in Q2 2025 and 20 percent of the economy's expansion in Q1. These large contributions are striking but not surprising given that capital expenditures by hyperscalers' (large cloud computing service companies) represented more than 50 percent of their operating cash flow in Q2, an all-time high.

Investment in AI and data centers accounts for a growing share of U.S. economic growth, corporate spending plans, and equity market performance. While impressive, this also means that the economy's topline growth and stock market gains are heavily reliant on the persistence of enthusiasm about this emerging technology. Looking ahead, returns on this AI investment are expected to have a profound impact on productivity growth and the broad economy.

Data centers/AI contribution to GDP growth

Percentage Points



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Forecast

Data as of October 2025

	2024 ACTUAL	2025 ESTIMATE	2026 FORECAST	2027 FORECAST	2028 FORECAST
REAL GDP	2.8%	**2.0%**	**2.0%**	2.3%	2.3%
UNEMPLOYMENT RATE	4.0%	4.3%	4.4%	4.2%	4.2%
INFLATION [1] (CPI)	2.7%	3.1%	2.5%	2.0%	2.0%
TOTAL HOME SALES	4.75	4.71	5.00	5.82	5.95
S&P/COTALITY HOME PRICE INDEX	3.7%	2.1%	3.0%	3.1%	3.0%
LIGHT VEHICLE SALES	15.8	16.2	16.4	16.5	16.5
FEDERAL FUNDS RATE [2]	4.25%	3.50%	3.00%	3.00%	3.00%
5-YEAR TREASURY NOTE [2]	4.38%	3.65%	3.55%	3.55%	3.55%
10-YEAR TREASURY NOTE [2]	4.58%	4.10%	4.10%	4.00%	4.00%
30-YEAR FIXED-RATE MORTGAGE [2]	6.91%	**6.30%**	**5.60%**	5.00%	5.00%
MONEY MARKET FUNDS	4.96%	4.03%	3.22%	3.03%	3.03%

Growth is surpassing expectations in 2025

Consumer spending has remained solid despite the slowdown in the labor market, driving an expected 3.0 percent annualized growth pace for the third quarter. The economy should still downshift in the near term but the upside for growth in 2026 is building.

Mortgage rates to fall further in 2026

Mortgage rates, which hit the lowest levels in a year during September, should decline further over the next year, albeit likely unevenly. Still, a more sustained recovery for housing activity may be delayed until 2027 when the 30-year fixed rate mortgage moves closer to 5.0 percent.

[1] *Percent change Q4-to-Q4*
[2] *Year end*
[a] *Actual*

Contributors

Kathy Bostjancic
SVP & Chief Economist

Ben Ayers, MS
AVP, Senior Economist

Oren Klachkin
AVP, Financial Market Economist

Daniel Vielhaber, MA
Economist

Brendan Taggart
Economics Specialist

Brian Kirk
Communications Consultant

Sources

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