KKR

# Flash Macro Update

**U.S. CPI** | September 2025

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## What You Need to Know

### 1 How are we thinking about the August 2025 U.S. CPI report?

August CPI data indicates core inflation remains steady at +0.3% m/m (and 3.1% y/y), in-line with economists' estimates, while initial unemployment claims picked up to +263k from +237k, their highest level since 2021 and well above the YTD average of +228k.

Inflation uncertainty previously led the Fed to adopt a more neutral stance, despite labor market weakness. **We now anticipate the Fed will do more in 2025, so we are adding an additional rate cut to our forecast, which implies three cuts this year (one every meeting) versus our 'old' forecast of two cuts in 2025. We leave 2026 at three cuts, but our bias is towards either more cuts in 2026 and/or the end of Quantitative Tightening in 2025.**

Though we think the Fed will be doing more in the near term, cutting an additional 25 basis points matters less when their balance sheet is still 22% of GDP, credit spreads are tight, equity markets are robust, and the dollar is weakening. Moreover, the technical picture (or lack of supply) is as good as we have seen in three decades. In this market we still see the 'Glass as Half Full', though we are tilting more towards operational improvement stories in Private Equity (especially corporate-carve outs), collateral-based cash flow (Infra, Real Estate Credit, and Asset-Based Finance), and structured deals (including structured equity with both downside protection and upside equity opportunity). We still see a weaker dollar, which means more money should flow overseas. That said, the U.S. story is not over, given what we are seeing on the productivity front (which should help offset weaker job growth).

## WHAT DO WE THINK YOU NEED TO KNOW?

- **Goods inflation was hot (as expected), but we think sticky core services inflation is settling in a healthier range.** We revise up our 2026 CPI forecast to 2.9% from 2.8% (marking to market for energy-related inflation), but the key signal we take away is that core services inflation looks set to continue moderating, which will make it easier for policymakers to look through tariff-related inflation.
- **Meanwhile, unemployment claims reenforce our view that the labor market is near stall speed.** Claims came in at +263k (which represents an increase of +26k from +237k), not consistent with a recession for private side employment, but clearly showing the impact of slower government hiring on overall job creation.
- **For the Fed, we do not see the bottom falling out of nominal growth, but we do think policymakers will want to deliver more easing at the margins.** We now expect three cuts this fall, up from two previously, and we stick to our forecast of three cuts in 2026. On balance, risks remained skewed to the downside, especially if the labor market slows further from here.
- **Longer-term, we stick to our 3.38% estimate for 'neutral' rates. This slowdown is a 'pause,' not a 'reset' for our *Regime Change* thesis.** The Fed has missed on its inflation target for 53 months in a row, and we expect inflation to remain above mandate through 2026. Meanwhile, we do not expect a major economic/credit cycle like we saw in 2008, and we are sticking to our four percent target for bond yields longer-term. As such, we continue to expect an investing environment where long-end rates are fairly high and financial conditions are easy.

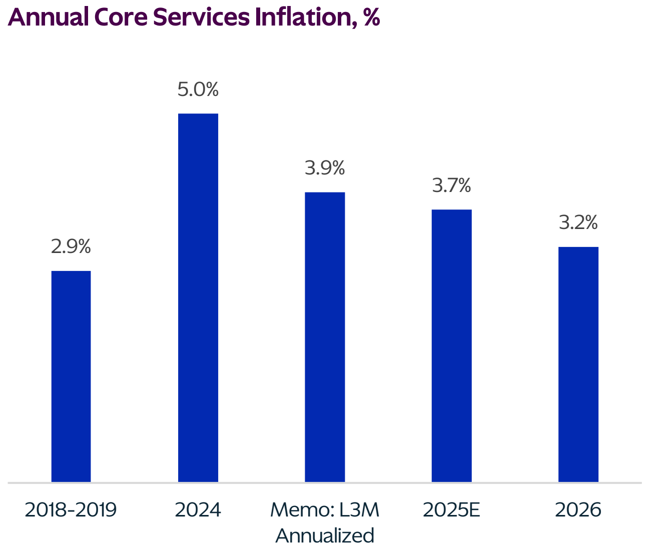
## DETAILS

**Core services inflation slowed in August, particularly in non-housing services (a key pain point for the Fed this cycle).** Core services slowed to +0.3% m/m in August from +0.4% in July, and supercore inflation now looks more 'settled.' On the other hand, we continue to view shelter inflation as a disinflationary input over the medium term given continued softness in key rental/housing markets. Our bottom line is that we see core services remaining well contained from here, despite price pressures on the goods side of the economy *(Exhibit 1)*.

**Core goods prices picked up to +0.3% m/m from +0.2% in July, driven by increases in tariff-exposed categories.** We continue to see auto inflation ratcheting higher as 2026-year models are released, along with continued inflation in small-ticket items like apparel, which coincides with our long-held thesis that tariff inflation will have its biggest impact this fall/1H2026. We actually view this as a somewhat dovish input, as it will enable Fed policymakers to look ahead to a more benign inflation backdrop in 2026 when setting interest rates.

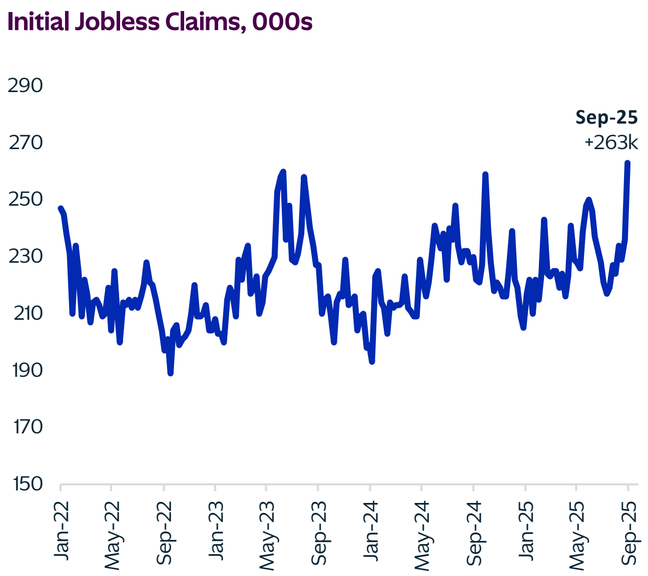
Though we think the Fed will be doing more in the near term, cutting an additional 25 basis points matters less when their balance sheet is still 22% of GDP, credit spreads are tight, equity markets are robust, and the dollar is weakening.

**Exhibit 1:** The Most Important Takeaway From This Month's Report Is That Core Services Is Coming Down, Albeit Quite Slowly




Data as at August 31, 2025. Source: Bloomberg, KKR Global Macro & Asset Allocation analysis.

**Exhibit 2:** That Will Allow the Fed to Focus on the Labor Market, Which Is Near Stall Speed




Data as at September 11, 2025. Source: Bloomberg.

Longer-term, we stick to our 3.38% estimate for 'neutral' rates. This slowdown is a 'pause,' not a 'reset' for our Regime Change thesis. The Fed has missed on its inflation target for 53 months in a row, and we expect inflation to remain above mandate through 2026. Meanwhile, we do not expect a major economic/credit cycle like we saw in 2008, and we are sticking to our four percent target for bond yields longer-term. As such, we continue to expect an investing environment where long-end rates are fairly high and financial conditions are easy.

## Important Information



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