

Flash Macro Update

U.S. FOMC | September 2025



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What You Need to Know

1 How are we thinking about the September FOMC meeting?

On Wednesday, the Fed cut rates by -25 basis points and changed its forward guidance to reflect an additional rate cut this year (bringing their forecast to three cuts this year, in-line with GMAA's outlook). The FOMC also released new economic forecasts that showed higher growth, lower unemployment, and faster inflation (*Exhibit 2*).

Chair Powell's comments endorsed our view that the Fed needs to cut rates faster, given worsening labor risks but still somewhat sticky inflation concerns. We do not see this balance of risks shifting back towards inflation in 2026, which is why we think the Fed will ultimately cut rates more aggressively than policymakers expect over the next twelve months.

To reflect our evolving outlook, we are tweaking our 10-year target to 4.0% from 4.25-4.5% for 2025; longer-term, we maintain our 4.0% outlook for the 10-year.

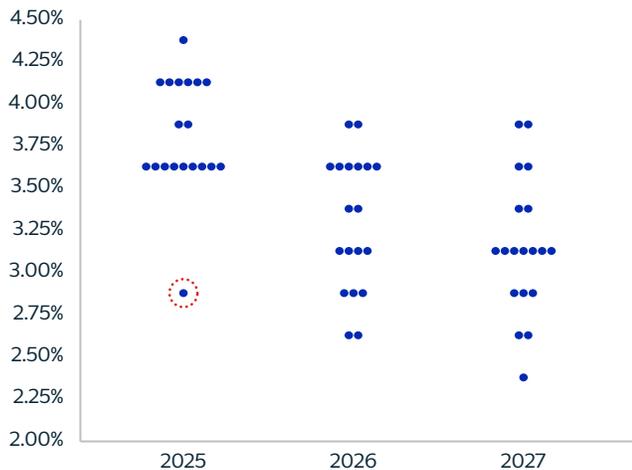
Key points from the committee are as follows:

- **The Fed is starting to recognize downside risks to employment...**Chair Powell acknowledged that “demand for workers has come down sharply,” but that a lack of available workers is helping to prevent layoffs. Keep in mind that unemployment would be closer to five percent if it were not for lower labor market participation, we think, which helps explain why the FOMC's unemployment forecast moved down despite the Chair's more cautious tone (*Exhibit 3*).
- **...And they see fewer upside risks to inflation.** While the FOMC actually marked up its core inflation forecast for 2026 to 2.6% from 2.4%, we believe this revision reflects what Powell described as a “one-time” goods price increase. Meanwhile,

'sticky' inflation components continue to soften (especially housing, as we show in *Exhibit 4*), which we think will help the Fed 'look through' tariff-related inflation when cutting rates.

Exhibit 1: Beneath the Surface, We Now See a Widening 'Bid/Ask' Within the FOMC

September 2025 FOMC Dot Plot



Data as at September 17, 2025. Source: Federal Reserve, Bloomberg, KKR Global Macro & Asset Allocation analysis.

The Fed now plans to cut rates back toward neutral, while keeping real rates around one percent in equilibrium for a weaker job market. In practice, however, we think the Fed will ultimately need to ease rates a bit faster than its dot plot suggests. We expect job growth to remain near zero this year, which would typically call for a zero percent real rate.

Exhibit 2: September 'Dot Plot' Revisions Show Stronger Growth and Inflation, But Also Lower Rates

Fed Forecasts Update Summary Relative to Consensus					
	2025e	2026e	2027e	2028e	Long-Run
Central Tendency of Economic Projections					
Real GDP Growth	1.6%	1.8%	1.9%	1.8%	1.8%
<i>Jun'25 meeting</i>	1.4%	1.6%	1.8%	N/A	1.8%
<i>Memo: Bbg Consensus</i>	1.2%	1.9%	2.0%	N/A	N/A

Unemp. Rate	4.5%	4.4%	4.3%	4.2%	4.2%
<i>Jun'25 meeting</i>	4.5%	4.5%	4.4%	N/A	4.2%
<i>Memo: Bbg Consensus</i>	4.4%	4.4%	4.2%	N/A	N/A

PCE Inflation	3.0%	2.6%	2.1%	2.0%	2.0%
<i>Jun'25 meeting</i>	3.0%	2.4%	2.1%	N/A	2.0%
<i>Memo: Bbg Consensus</i>	3.1%	2.4%	2.2%	N/A	N/A

Core PCE Inflation	3.1%	2.6%	2.1%	2.0%	N/A
<i>Jun'25 meeting</i>	3.1%	2.4%	2.1%	N/A	N/A
<i>Memo: Bbg Consensus</i>	3.2%	2.5%	2.2%	N/A	N/A

Year-End Fed Funds Forecast					
September meeting	3.625%	3.375%	3.125%	3.125%	3.000%
<i>Jun'25 meeting</i>	3.875%	3.625%	3.375%	N/A	3.000%
<i>FF Futures</i>	3.73%	2.92%	3.01%	3.28%	3.70%
<i>GMAA Base Case</i>	3.63%	2.88%	2.88%	3.38%	3.38%

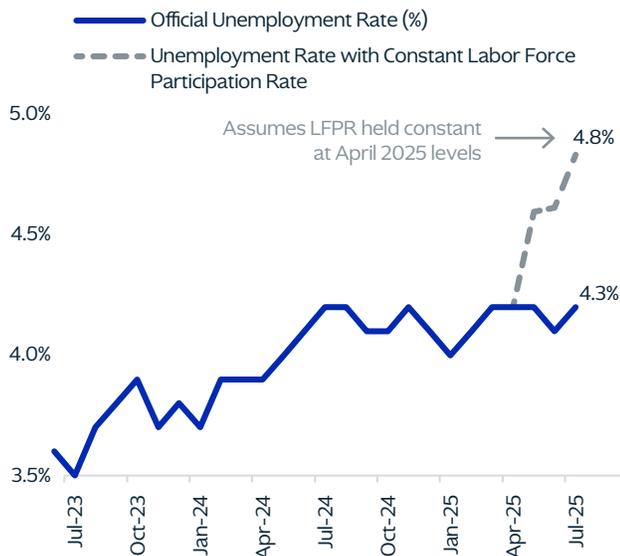
Data as at September 17, 2025. Source: U.S. Bureau of Labor Statistics, Bloomberg, KKR Global Macro & Asset Allocation analysis.

- The Fed now plans to cut rates back towards neutral, while keeping real rates around one percent in equilibrium for a weaker job market.** One can see this in *Exhibit 5*. The Fed's forecast shows cuts each year through 2029, at which point they reach a three percent 'neutral' rate.
- In practice, however, we think the Fed will ultimately need to ease rates a bit faster than its dot plot suggests.** We expect job growth to remain near zero this year, which would typically call for a zero percent real rate (*Exhibit 5*). We expect the Fed to take rates closer to this zip code in 2026 (i.e., rates just below three percent and inflation in the mid-high two percent range) as we think inflation risks will continue to diminish once we move beyond the initial 'shock' of higher tariffs.

- **Importantly, this cutting cycle does not mark a reversal in our Regime Change thesis.** If anything, Fed cuts amid what remains above-target inflation underscores the structural considerations we have been highlighting around deficits, demographics, geopolitics, and the energy transition. Looking at the details, we still see inflation settling in the mid-two percent range long run, with fed funds settling in the low three percent range. We think that reality will keep bond yields from rallying as much this cycle.

Exhibit 3: If Not for Collapsing Labor Force Participation (Lower Immigration and Labor Supply), the Unemployment Rate Would Have Climbed to Nearly 5% in August Instead of 4.3%

U.S. Unemployment Rate

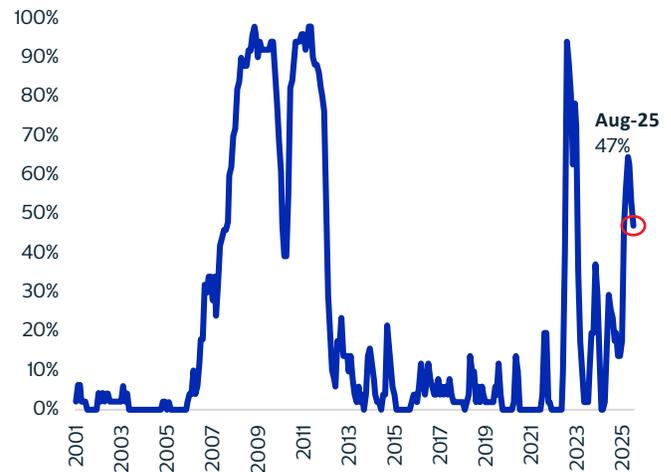


Data as at September 5, 2025 Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Looking at the details, we still see inflation settling in the mid-two percent range long run, with fed funds settling in the low three percent range.

Exhibit 4: Weakness in the Housing Sector Is Contributing to Core Services Moderation, Giving the Fed Leeway to Begin Cutting Again

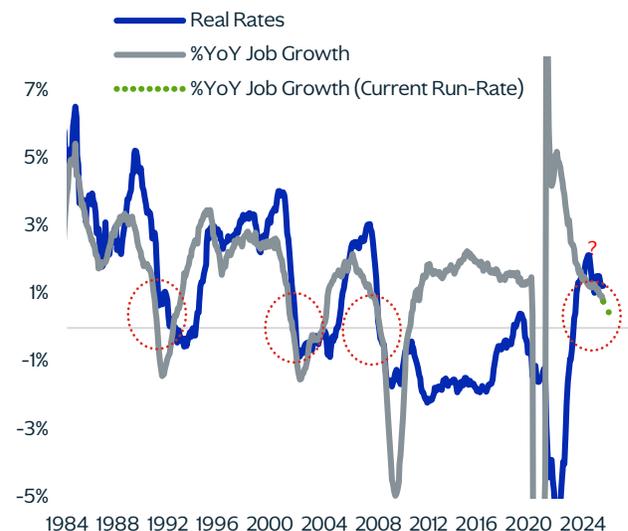
Percent of States With Negative HPA, %chg M/m



Data as at August 31, 2025. Source: Haver Analytics, Bloomberg.

Exhibit 5: Job Growth Is Running Near Stall Speed, Which Would Typically call for Real Rates Near Zero Percent...

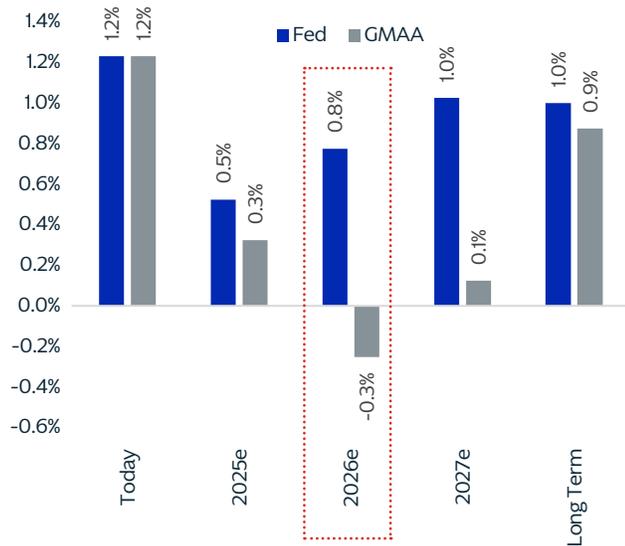
Real Rates vs. Job Growth, %



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

Exhibit 6: ...Which is Why We See a Faster Easing Cycle Playing Out in 2026 vs. the Fed

Real Fed Funds, %



Fed data uses Core PCE inflation vs. Core CPI for GMAA. Data as at September 17, 2025. Source: Bloomberg, Federal Reserve Board, KKR Global Macro & Asset Allocation analysis.

WHAT DO WE THINK THIS MEANS FOR MARKETS?

- The market's focus, along with the Fed's, is now more on employment than inflation.** We had talked previously about the optionality the Fed had earned this cycle to toggle between the importance of growth and inflation in its dual mandate. Powell stated directly that, while there is tension between the two considerations, the threat of "weaker employment" is now winning the day in terms of Fed concerns. Interestingly, though, the Fed emphasized the labor market at a time when it raised its GDP estimate, lowered its unemployment rate, and increased its inflation forecast.
- Our view of the current situation is largely unchanged.** The supply side technical rule remains robust, while earnings and GDP growth are likely to remain solid, albeit unspectacular.
- What does this mean for markets?** Six months from now, equity markets are likely headed higher, the dollar is likely to be headed lower, and the demand for collateral-based cash flows and other forms of inflation protection will remain robust. Longer term, we think the cycle continues until productivity

falters, AI capex spending falls significantly, and/or unemployment ticks up more materially (*Exhibit 8*).

- In terms of asset allocation nuances (and despite lower rates), we think international markets, Asia in particular, will outperform U.S. small caps. As such, we would stay overweight the U.S. with a focus on large-cap stocks. Outside of the U.S., we like Japan, China, India, Germany and Spain. Bigger picture, we think productivity stories across all markets are likely to be re-valued upward, while we see growing strains in the bank loan market of smaller companies that lack scale and/or a technological advantage.

Exhibit 7: Many in Corporate America (ex-Mega-Caps) Believe, Real Interest Rates Remain Too Restrictive

U.S. Equities: NTM Net Profit Margin, %

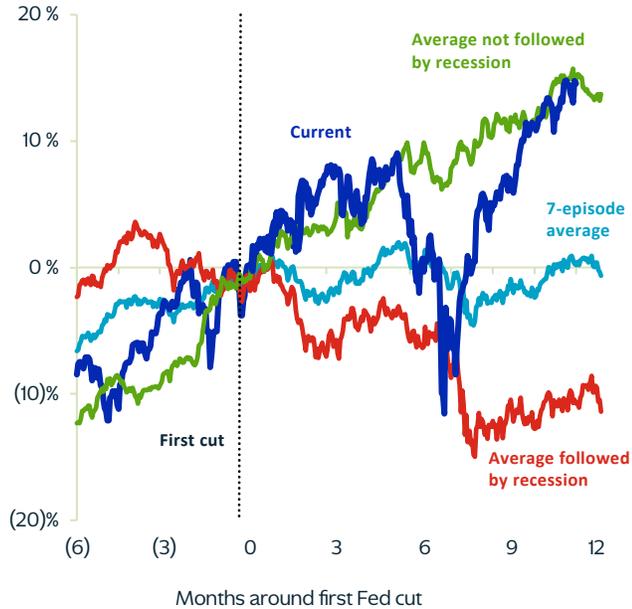


Data as at August 29, 2025. Source: Bloomberg, S&P, KKR Global Macro & Asset Allocation.

Our view of the current situation is largely unchanged. The supply side technical rule remains robust, while earnings and GDP growth are likely to remain solid, albeit unspectacular.

Exhibit 8: Market Performance Will Depend on Whether the Economy Enters Recession This Cycle

S&P 500 Returns Around the Start of Fed Cutting Cycles



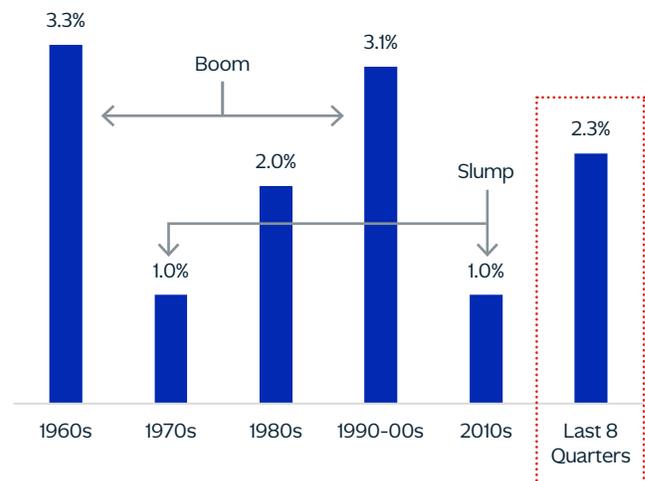
Data as at June 30, 2025. Source: Datastream, Worldscope, Goldman Sachs Global Investment Research.

- **What does this mean for our macro themes, especially as it relates to Private Markets?** All else being equal, lower rates help levered structures, which directly benefit many parts of the private markets. However, just as raising rates by 525 basis points did not derail the economy on the way up, we do not believe that a 25 basis point cut represents nirvana. It is directionally helpful, but we think the Fed needs to cut two more times in 2025 and three more times in 2026 to get closer to a level that will directly benefit the economy.
- From a thematic perspective, we remain bullish on our Capital Heavy to Capital Light thesis. This theme is positively affecting KKR, particularly through corporate carve-outs in Private Equity and Infrastructure, and within Asset-Based Finance in our Credit & Markets business. We also like non-correlated Collateral Based Cash Flows, including Infrastructure, Real Estate Credit, and Insurance as an asset class. Finally, we remain bullish on all things linked to productivity. In a world of

levered governments with big deficits, rising input costs, and slowing labor force growth, we think productivity has emerged as a key differentiator (*Exhibit 9*).

Exhibit 9: Stronger Labor Productivity Is the 'Secret Sauce' to Extending the Business Cycle As Well As Partially Offsetting Higher Deficits

U.S. Labor Productivity Growth, %



1960s refers to 1959-68; 1990s-00s refers to 1995-05; 1970s refers to 1973-79; 2010s refers to 2010-19; 1980s refers to 1980-88. Data as at June 30, 2025. Source: Bloomberg, Federal Reserve Bank of San Francisco.

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