NATIONAL BANK OF CANADA FINANCIAL MARKETS

August 2025

Forecast Summary

By Taylor Schleich, Ethan Currie & Warren Lovely

- The July employment report sent shockwaves through financial markets, as the U.S. labour market was cast in an entirely different light in early August. It wasn't so much the modest 73K job gain in July that led to the reassessment (though this was a disappointing print) but it was the massive 258K downward revision to May and June that *really* captured the market's attention. Post-revisions, the monthly pace of job creation over the last three months is a paltry 35K compared to the 150K/month pace reported before the last release. Additional downward revisions may still be in store.
- The timing of the jobs report was unfortunate, coming just two days after the Fed held its policy rate unchanged, in part due to a healthy and well-balanced labour market. Had the data been available earlier, it's likely the decision would've gone differently. Naturally, markets ramped up bets that the Fed would resume its easing cycle in September as more FOMC participants join Governors Waller and Bowman (the two dissenters in July) in angling for a cut. And even though the subsequent July CPI report continued to show that inflation is running well above target, the data wasn't hot enough to rule out a cut. Given that the stance of monetary policy is still "modestly restrictive", policymakers will be able to justify an adjustment to the fed funds target in September. Consistent with market pricing, we judge that a cut next month is all but assured.
- We are, however, tempering our expectations beyond September and are skeptical that the central bank will deliver 3 (or more) consecutive rate reductions as some have suggested. We're also unconvinced that a larger (50 bp) cut will garner enough support next month. Why? First, inflation is still a problem and is likely to hover around 3% for the foreseeable future. That will keep the hawks, of which there were many, on the defensive. Second, employment revisions were undoubtedly disappointing, but it was always clear that hiring would slow quickly given the U.S. immigration stance and the resulting hit to labour supply. It's why Chair Powell, in July, stressed that the unemployment rate would be the key measure to watch. And despite the softer headline job growth, the jobless rate has been range-bound for a year, right around levels consistent with full employment. Yes, risks are tilted towards additional slack, but this is *precisely* what FOMC participants have been expecting. The median unemployment rate forecast in the June *Summary of Economic Projections* (SEP) was 4.5%. The current rate is comfortably below that mark and other labour market data (claims, job openings) are not indicative of *significant* labour market cooling. Against this expected employment backdrop, the median FOMC participant foresaw 50 bps of easing this year (and just 25 bps in 2026). So, recent data may nudge hawkish members closer to the median but we believe they are unlikely to fully abandon their prior stance. In the end, the two cuts projected in June's SEP may be the best reflection of the outlook. It should also be stated that while markets have become somewhat numb to uncertainty (with respect to trade, geopolitics, monetary policy, or otherwise), there remains a heightened risk of abrupt repricing of the Fed rate path and asset prices more generally.
- North of the border, the Bank of Canada leaned against the narrative that their easing cycle was over at the late July rate decision. While the central bank held its policy rate steady for a third straight meeting, it made its dovish bias more explicit by stating "[if inflation is contained] there may be a need for a reduction in the policy interest rate". This language wasn't featured in the June press release, so its inclusion suggests the central bank wants to emphasize that risks are still skewed to the downside. While tariff relief (via USMCA-exemptions) has shielded *most* exporters from significant pain, lingering uncertainty is likely to continue weighing on an economy already grappling with excess supply. Importantly, July's weak employment report validated our skepticism of June's reported strength. Cutting through the volatile month-to-month readings, Canadian employment has risen only ~5K per month in the 'Trump era', sluggishness that should continue. In our view, a lower policy rate is warranted, though the timing of further easing remains uncertain and will hinge on inflation data, with two CPI reports due before the next decision. Our official forecast for a September cut is not of the highest conviction, but we think markets may be underpricing the probability of easing next month.

United States

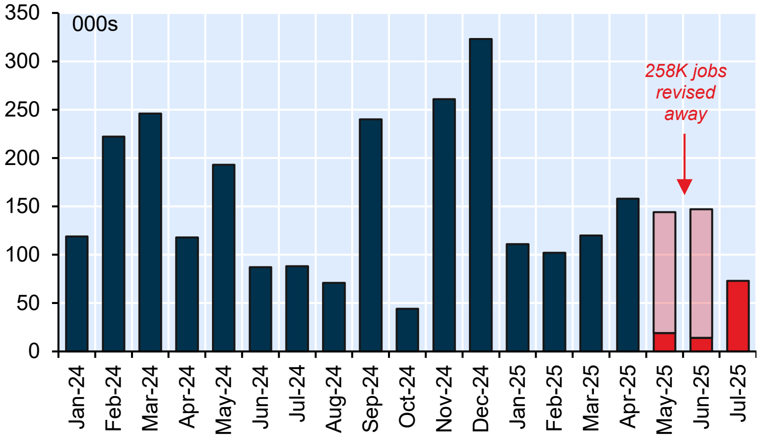
Quarter	Target	3M	2Y	5Y	10Y	30Y
14-Aug-25	**4.50**	**4.10**	**3.67**	**3.74**	**4.21**	**4.80**
Q3:2025	4.25	4.00	3.75	3.85	4.25	4.85
Q4:2025	4.00	3.65	3.65	3.80	4.25	4.85
Q1:2026	3.75	3.40	3.50	3.75	4.20	4.80
Q2:2026	3.50	3.35	3.45	3.70	4.15	4.75
Q3:2026	3.50	3.35	3.35	3.65	4.10	4.75
Q4:2026	3.50	3.35	3.40	3.60	4.15	4.80
Q1:2027	3.50	3.35	3.35	3.55	4.20	4.85
Q2:2027	3.50	3.30	3.30	3.55	4.20	4.85

Canada

Quarter	Target	3M	2Y	5Y	10Y	30Y
14-Aug-25	**2.75**	**2.65**	**2.68**	**2.92**	**3.38**	**3.76**
Q3:2025	2.50	2.40	2.55	2.85	3.35	3.70
Q4:2025	2.25	2.25	2.35	2.75	3.25	3.60
Q1:2026	2.25	2.20	2.30	2.70	3.20	3.55
Q2:2026	2.25	2.20	2.40	2.75	3.25	3.55
Q3:2026	2.25	2.35	2.55	2.80	3.30	3.60
Q4:2026	2.50	2.45	2.65	2.85	3.35	3.60
Q1:2027	2.75	2.60	2.75	2.90	3.40	3.60
Q2:2027	2.75	2.65	2.70	2.95	3.40	3.60

Chart 1: Labour market cast in a new light with revisions

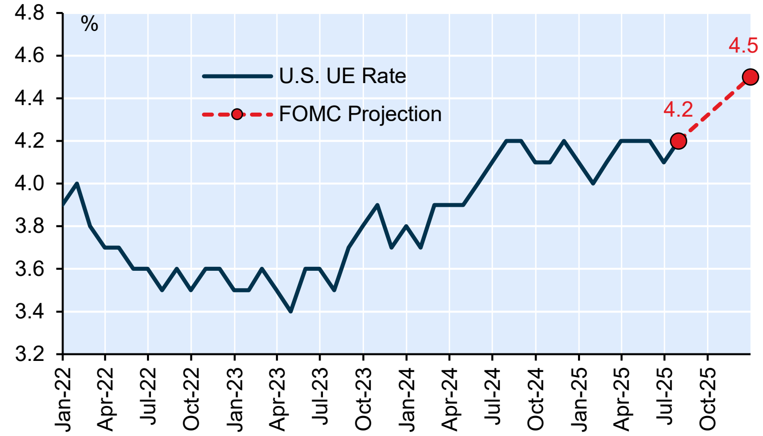
U.S. monthly employment change



Source: NBC, Bloomberg | Note: Translucent bars reflect pre-revision job growth

Chart 2: The jobless rate has held up, below EoY Fed forecast

U.S. unemployment rate and FOMC end-of-2025 projection

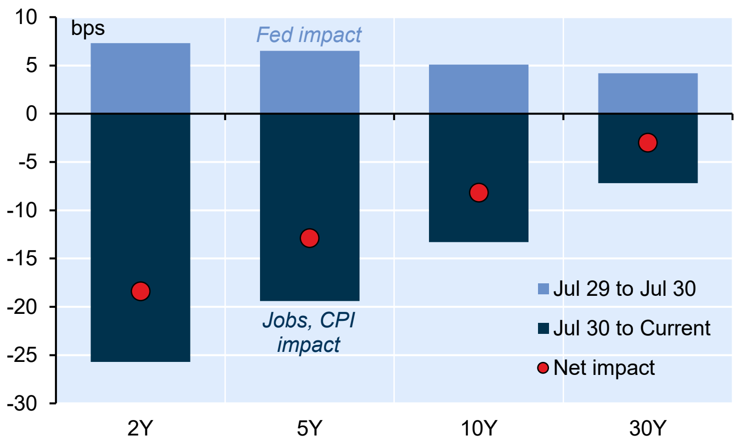


Source: NBC, Bloomberg, FOMC

It's easy to see why labour market anxiety is growing. Job growth hasn't been this soft since COVID (and before that, the GFC). However, hiring was always going to slow given federal policy. Other gauges of job market health aren't *so* bad. Take the unemployment rate, which is still comfortably below the Fed's end-of-year forecast. With a 4.5% jobless rate, the FOMC expected 2 cuts in 2025.

Chart 3: Yields up on hawkish Fed, down more on weak jobs…

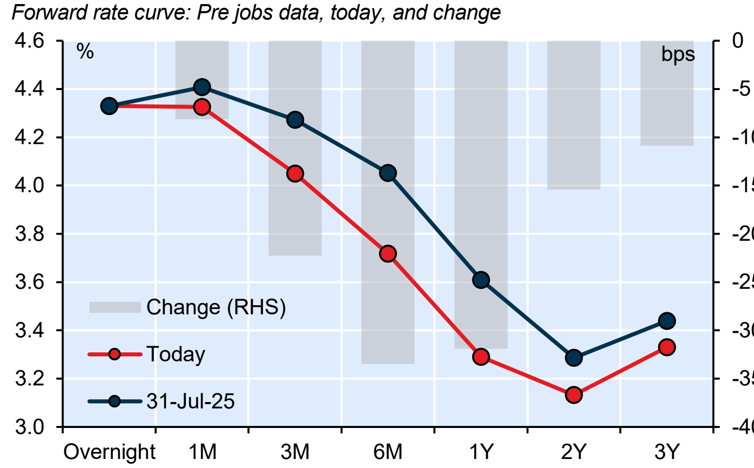
Change in UST benchmark yields: FOMC July decision and onwards



Source: NBC, Bloomberg

Chart 4: …leading to growing bets on near-term Fed easing

Forward rate curve: Pre jobs data, today, and change

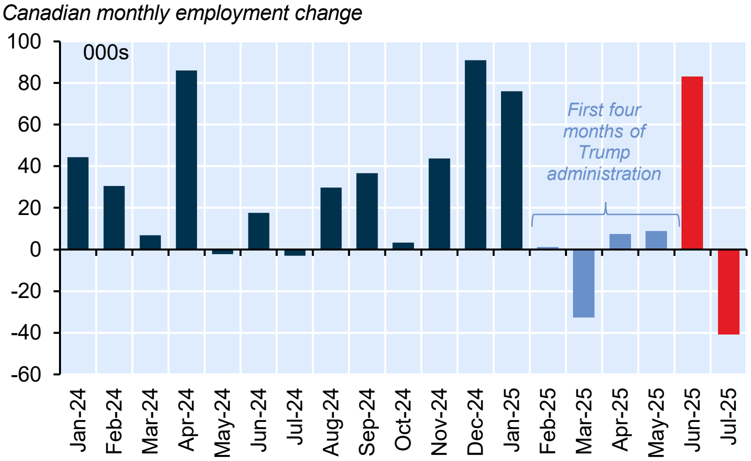


Source: NBC, Bloomberg

Still, the labour market isn't as strong as Powell implied in his July 30th press conference. The market's hawkish reaction to a patient Fed was quickly unwound (and then some) post-jobs data, continuing after a not as hot as fear CPI report. Bets on consecutive and/or large rate cuts have ratcheted up in recent days but we're skeptical the Fed will be frantically cutting throughout the fall.

Chart 5: Hello job growth, goodbye job growth

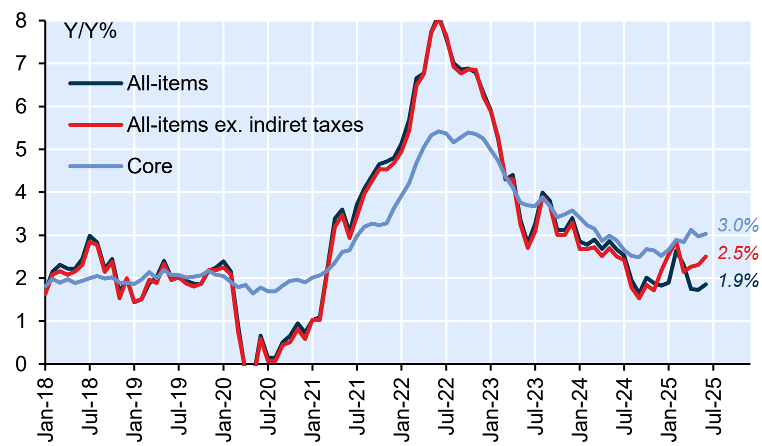
Canadian monthly employment change



Source: NBC, Bloomberg, StatCan

Chart 6: CPI data to dictate September BoC decision

Measures of Canadian inflation



Source: NBC, Bloomberg, StatCan

After June's LFS, momentum was building around the idea the easing cycle was over. July's weaker print recentered expectations, reminding investors the labour market is still weak. We expect job market softness to continue which supports further easing, but really the next decision(s) will be about CPI. Marginal cooling in core inflation is likely a prerequisite for a rate cut.

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