Associated Bank

INTEREST RATE UPDATE

Capital Markets Department
Chicago | Milwaukee | Green Bay
866-524-8836

September 5, 2025
Thomas Toerpe

FEDERAL RESERVE BOXED IN BY "SAG-FLATION" AND POLITICS

With the U.S. economy sagging under the weight of a deteriorating job market and inflation ticking up toward 3%, should the Fed bow to political pressure to cut rates? While we are nowhere near 1970s-style *stagflation*, that episode from 50 years ago highlights the risk of rate cuts in the face of rising inflation, even when the goal is to shore up employment. We saw a similar monetary policy mistake leading up to the 2008 financial crisis, when the Fed's easy monetary policy in a weakening labor market added fuel to the fire of an overheated housing sector.

Right now, interest rate markets are ambivalent. Futures traders are pricing in two or three quarter-point reductions in the Fed funds rate by December with more to come in 2026, driving two-year Treasury yields down 74 bp year to date. Meanwhile, 30-year yields have remained elevated flirting with 5% since May. Gold prices have hit record highs, signaling investor caution over the near-term outlook. The yield curve has steepened too, as the spread between two- and 10-year Treasury yields is near its highest since early 2022.

At the same time, political pressure on the Fed is heating up. Fed Governor Adriana Kugler, whose term expires in January, resigned several months early, clearing the way for a fast-track confirmation of Stephen Miran to the post. Miran is currently chair of the White House Council of Economic Advisers. Trump is also attempting to fire another Biden appointee, Lisa Cook, which would open a long-term seat. With two seats already held by Trump appointees from his first administration, the addition of Miran and a replacement for Cook would give the President a majority on the seven-member Fed Board.

Actual monetary policy is set by a broader group including presidents of the 12 regional Federal Reserve Banks, but with Chairman Jay Powell's term set to expire next May, there's rising concern over the central bank's independence from political influence. The search for Powell's replacement has narrowed down to three candidates, Kevin Hassett, Kevin Warsh and Christopher Waller. All three men have substantial economic policy experience.

Tariff uncertainty flares up again with Appeals Court ruling against Trump Administration. Tariffs enacted this summer under the International Emergency Powers Act (IEEPA) and other laws have raised the average U.S. tariff rate from 2.3% to 16.3%. The full impact has not been felt yet, but the Administration is hoping to generate up to $500 billion in tax revenue from the dramatic increase. The Federal Circuit Court of Appeals last month invalidated the IEEPA tariffs, which would drop the average down to 7% and cut the potential revenue impact by more than half. The Administration has appealed the ruling to the Supreme Court.

Whether the Court upholds or reverses the decision, most tariffs should be able to be reinstated under alternative programs with some limitations and delays. However, the shifting nature of the tariffs, along with the red tape needed to document and comply with the myriad of new rules have thrown sand into the gears of the economy, especially for smaller firms. This is likely to continue to weigh down the sagging job market, keep upward pressure on prices and tamp down interest rates, particularly on the shorter end of the yield curve.

Capital Markets Department
Chicago | Milwaukee | Green Bay
866-524-8836

Key Statistics: Interest Rates, Unemployment and Inflation

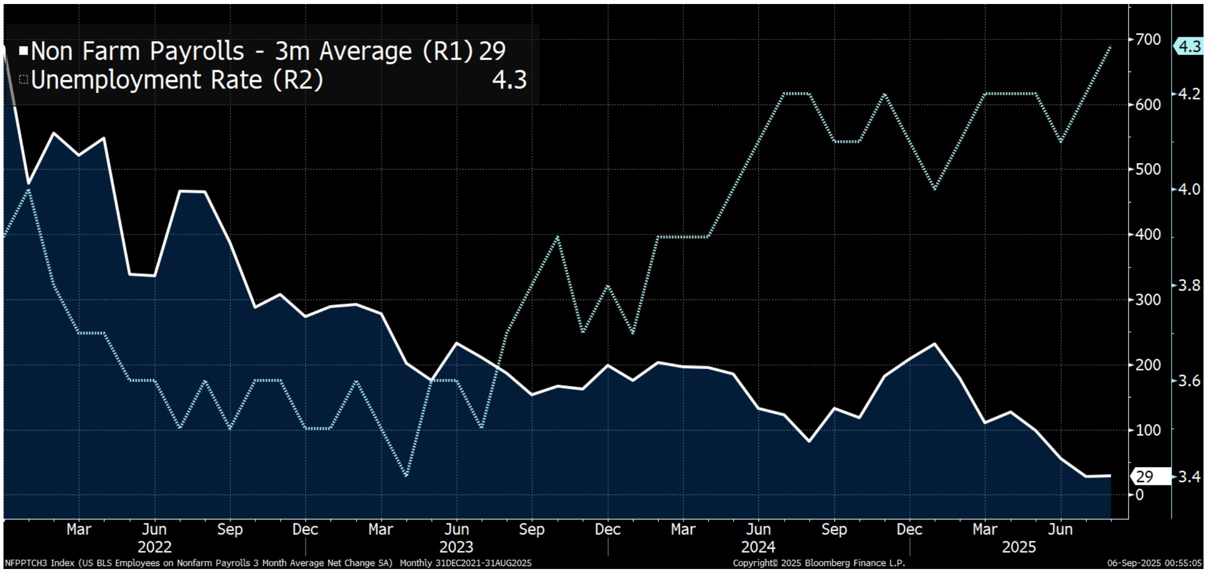
	Year-end 2021	Year-end 2022	Year-end 2023	Year-end 2024	August 29 2025
10-yr Treasury yield	1.51%	3.87%	3.88%	4.57%	4.23%
2-yr Treasury yield	0.73%	4.43%	4.25%	4.24%	3.62%
Spread	0.78%	-0.56%	-0.37%	0.33%	0.61%
Fed Funds Target (mid)	0.125%	4.375%	5.375%	4.375%	4.375%
CME Term SOFR 1-mo	0.055%	4.36%	5.35%	4.33%	4.27%
CPI (y/y change)	7.0%	6.5%	3.1%	2.7%	2.7%
Core PCE (monthly)	4.1%	4.7%	3.16%	2.81%	2.88%
5-yr TIPS (market breakeven)	2.91%	2.38%	2.15%	2.39%	2.52%
U-3 Unemployment	3.9%	3.5%	3.7%	4.1%	4.3%
Real avg weekly earnings	4.7%	-3.1%	0.5%	1.0%	1.4%
Annual change in NFP jobs	+6,451,000	+4,503,000	+2,560,000	+1,450,000	+1,229,000

KEY U.S. INTEREST RATE BENCHMARKS

- One-month Term SOFR (green) was steady for most of 2025 with the Fed on hold, but this key floating index has recently turned downward in anticipation of a September 17 rate cut.
- Two-year Treasury yields (gold) are at their lowest level since September 2022.
- 30-year Treasury yields (white) remain elevated, staying in a 4.75% to 5.0% band since May.

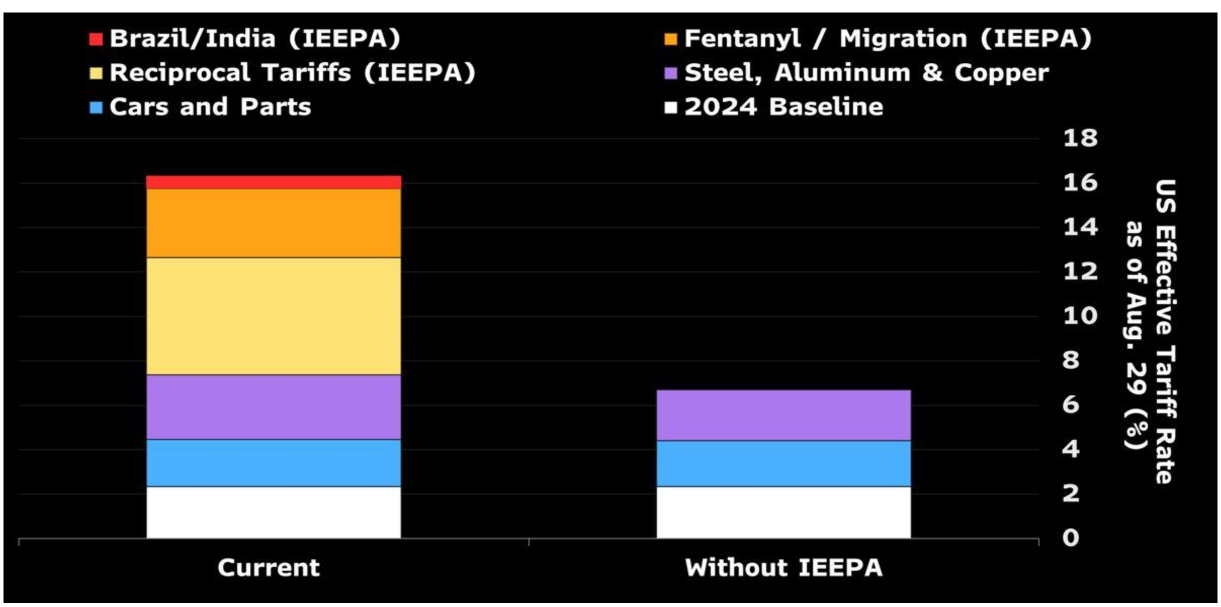
Capital Markets Department
Chicago | Milwaukee | Green Bay
866-524-8836

LABOR MARKET CONTINUES ITS SLOW SLIDE



- Smoothing out month to month fluctuations, 3-month average job creation (white) is currently the slowest it has been since the pandemic.
- Unemployment (blue dotted line) has inched up to 4.3%, now at its highest since October 2021.
- Employment data suggests rate cuts are in order, but inflation has been rising, implying the need for rates to stay high. Inflation, as measured by core personal consumption expenditures (Core PCE) is ticking upward, standing at 2.9% in July. The July producer price index was up 3.3% year over year.
- August figures for PPI and PCE respectively will be released on September 10 and September 26.

TARIFFS ENACTED UNDER IEEPA DERAILED, AT LEAST FOR NOW



Capital Markets Department
Chicago | Milwaukee | Green Bay
866-524-8836

Associated Bank offers a wide range of instruments for hedging interest rate and foreign currency risk, including foreign exchange in more than 75 currencies. Companies interested in learning more about these instruments should contact their Associated Bank Relationship Banker or the bank's Capital Markets Department at 866-524-8836.

All rates shown are indications only and subject to change.