Goldman Sachs Exchanges

The Fed's Tightrope: Inflation, Labor, and the Path Ahead

Rob Kaplan, Vice Chairman, Goldman Sachs

Allison Nathan, Senior Strategist, Goldman Sachs Research

Date of recording: November 12, 2025

Allison Nathan: The US economy is navigating some tricky waters right now with still high inflation, a weakening labor market, and an evolving policy landscape making the outlook and the Fed's next steps quite uncertain.

My guest today is Robert Kaplan, vice chairman of Goldman Sachs and former president of the Dallas Fed. Rob, welcome back to Exchanges.

Rob Kaplan: Good to be with you.

Allison Nathan: So, Rob, let's start right in with the Fed. Chair Powell made some pretty hawkish comments after the last FOMC about the prospect of a December rate cut. It surprised some people. We in Goldman Sachs Research are still expecting a cut in December. The market seems somewhat less convinced. What's your read on those comments?

Rob Kaplan: So, you may know, going into the October meeting, I had been saying that the market expectation of a further rate cut in December, the probabilities of that rate cut were, to my eye, way too high. It doesn't mean the Fed won't cut rates in December. But I think it's a much tougher decision. And so, I was glad that Jay in the press conference balanced the decision a little bit more and left the Fed more time to really debate this out. And you see more articles about a split in the committee. It's understandable.

So, what's the split about? The labor market is weak. We know that. And Jan Hatzius has very eloquently explained that weakness. And hiring is down to stall speed. And why is that? There are three big headwinds that are creating that weakness. One, tariffs in the near term, at least in my opinion, are slowing growth. And we could go through much more detail. But for the purpose of this call, they're having the effect of causing big businesses to do somewhat less. They're having a more pronounced effect on small businesses. And we're seeing that.

In addition, it's not just the cutoff of lax immigration, which I think is probably a very constructive thing, there are 12 to 15 million workers in this country who make up a big chunk of construction, agriculture, services who are here on provisional status. They're not here illegally, the great bulk of them, but they're on some kind of temporary status. And many of them are unsure whether they're going to be allowed to stay. Many of them, I hear from employers, we hear, are not showing up at work. They're not sending their kids to school. They're definitely not shopping at the mall. That's a loss of income. So, those two things are headwinds.

And then we've got a new headwind over the last 45 days which was the government shutdown, which obviously reduces incomes, reduces growth. And so, it's understandable that you see a lot of sluggishness.

At the same time, we've got three tailwinds coming into 2026. One is tax incentives. Tax on tips. Tax on overtime. Accelerated depreciation kicking in early next year. You've got regulatory reform, which has started but hasn't reached full throttle. That will help growth. You have the obvious AI data center power boom, that we've talked so much about, it's fueling growth. And now one of the headwinds which is the government shutdown is going to fortunately go away. That may not become a tailwind, but it will reduce that headwind.

So, it's unclear to me how weak the labor market actually is versus these headwinds and tailwinds. We might see a firming into next year. And so, that's on the other hand.

On the other hand, to put it in short, inflation's running 75 - 100 basis points above target, 2.75 to 3. There's an enormous amount of debate as to whether inflation is already embedded in some of that. Maybe it's temporary. Maybe it will elapse over time. But I can tell you talking to businesses, there's a lot of disagreement on that issue. And many businesses I talk to think that a lot of the tariffs won't actually be felt in terms of price until 2026.

So, the Fed's got to debate both sides of this. Both are unclear. And they're getting close to neutral, which is why the urgency of this debate heightens.

Allison Nathan: And ultimately, Powell gave more room, basically, in those comments to wait and see how some of this evolves.

Rob Kaplan: Yeah. And I would actually add one thing. There are times where the views of the group matter and he's got to reflect those. I think when you go into an agonizing decision like we're heading into December where there are pro and con arguments, and they're legitimate arguments on both sides, what Chair Powell wants to do will have outsized influence in that there are many people on the committee that will vote. It might be 55/45, 60/40. And if he feels strongly one way or the other, they'll be inclined to back him. And my guess is it wouldn't surprise me if he hasn't decided yet what he wants to do. It's going to be a game time decision right up until December 9th and 10th.

Allison Nathan: There's a lot to unpack there, Rob. And I want to ask you some follow-up questions about many things you just said. But let's just take a step back. As you mentioned, the government shutdown, it's been the longest shutdown on record. It's come to an end this week. But in the meantime, there has been this vacuum of data. And so, that in itself must be complicating the Fed's decision-making process. Talk to us a little bit from your experience as a former President of the Fed, how does the Fed even go about navigating this lack of data amid these headwinds and tailwinds, as you just pointed out?

Rob Kaplan: So, the Fed loves data. The Fed is led by, predominantly, PhD economists. Just a few businesspeople. And they like data because they can fit it into models. And that data is very valuable. And it confirms what you're hearing from business and what you're seeing in your own work. And they don't have that.

My guess is when we do get data, it wouldn't surprise me if that data confirms the sluggishness I talked about earlier. But they don't know. And so, that makes their job harder.

That means they've got to do more. Look at private sources. They've got to talk to businesses more. That's anecdotes. It would sure help to get more comprehensive data to confirm those anecdotes.

Allison Nathan: Let me just ask you a bit more about the labor market, which you've mentioned. But ultimately, as I hear you talk about it, are you thinking that this is mostly cyclical factors or more structural? I've heard both, Rob, entering into your comments--

Rob Kaplan: That's right. You did hear both.

Allison Nathan: -- As you're thinking into 2026.

Rob Kaplan: You heard both because I think it's unclear. It's unclear to me which it is. It really is. And I think it's unclear to many others that I speak with. I don't hear businesses tell me that business has fallen off the cliff. I hear it's sluggish. But almost every business I talk to and check-ins I do suggest that business is okay. Not great.

And so, it doesn't feel like a cyclical slowing. I do hear lots of matching issues. I.e., college graduates are struggling to find jobs. But also, I hear lots of open jobs that businesses can't fill. The problem is the people that are looking for jobs don't want-- they don't want to be window installers. So, we do have a matching problem.

And so, to me, if it turns out that a lot of this weakness is matching related, I don't know that monetary policy is the tool to deal with a matching issue. I think some of the weakness is slowing and the shutdown has further exacerbated that. But again, the shutdown is a temporary factor that's going to recede. And then you've got these tailwinds going into next year. So, it's confusing.

And the short answer to your question is I don't know. And that's the problem. I don't think there's great conviction. So, then it becomes a risk management exercise.

Allison Nathan: Understood. And to your point, we are now a fair way into the third quarter earnings season. Earnings have been quite good. So, there aren't too many signs that companies are falling off the cliff. And that's true, not just in the US but globally.

Rob Kaplan: Yeah, and just to further reinforce that, in the prominent cases of large layoffs announced, a number of them have been accompanied by solid sales. Okay? I won't mention names of companies for this purpose. But you can think of some of the examples. It's belt tightening. Other things. Not a cyclical slowing.

Allison Nathan: Understood. But even as we think about those earnings, when we think about the inflation question that you've already begun speaking about, ultimately it's our impression that companies have largely so far been absorbing some costs like the tariff costs that, you know, have been such a big concern this year.

Rob Kaplan: Yes, I agree.

Allison Nathan: But is there a point at which the companies start passing those costs onto consumers? And is that a reason to be more concerned than maybe we are, the markets are, about inflation ahead? It seems like the market really wants to put inflation concerns on the back burner at this point. But is that too premature?

Rob Kaplan: Most of the CEOs I talk to, yes, many have said they're taking it out of margin and they're going to try to get it back in price. In the near time, they're doing belt tightening. For some of the small businesses, it's probably more dire than that in that they don't have the option to take it out of margin and they're struggling with whether they're going to stay in business for the next year or two.

Many other businesses explained to me that there was a restocking pre-tariff implementation. We're now in the destocking phase. But we're getting through destocking. And many businesses have talked to me about the fact that they believe into 2026, that's when you'll see more tariff impact.

Our own economists have a view that maybe we're half or 60 percent of the way through. And that's another one, the honest answer is I don't know. I'm also seeing service sector businesses telling me that some of these cost increases are bleeding into their business. Also, it's bleeding into services.

So, you may remember services have been running about mid threes, 3.5 percent and is sticky. A lot of the improvement in inflation the last few years has been goods disinflation. The tariffs have interrupted that goods disinflation. And so, that's the reason why we're going sideways. And we're going to go sideways probably for a while.

And many argue that the latter half of next year you'll start to see disinflation kick in. But in fairness, that's a leap. That's a leap of faith. And I think there's uncertainty about that.

Allison Nathan: So, yeah. So, it seems like you are maybe not as convinced that inflation is something we should be less worried about.

Rob Kaplan: I'm not. I'm not. And so, here's why all this, I mentioned earlier, gets heightened. If we were at 5 ¼ - 5 ½, you know, we've got lots of room to cut. My own view, and you've heard me say this before, is the neutral, nominal Fed Funds Rate - it's inflation plus a real Fed Funds Rate, there's pretty good consensus that the real neutral Fed Funds Rate is somewhere between ¾ a percent and 1 percent. And I haven't heard a lot of counter arguments to that.

So, then the question is what's the underlying inflation rate? Those who say the neutral rate is closer to 2 ¾, they're assuming inflation gets to 2 percent. The problem is it's not at 2 percent right now. It hasn't been for a few years. It's at 2 ¾ to 3. And so, that makes me believe that currently the nominal neutral rate is about 3 ½ - 3 ¾.

The Fed is at 3 ¾ to 4 right now. Do you really want to be at neutral with inflation running this much above target? And I think that that would, in my former seat, make me very uncomfortable and would make me really want to be confident, more confident than I am right now about what's going on in the labor market.

Allison Nathan: So, Goldman Research is expecting a couple more cuts in 2026. The market, I think if I checked my screen correctly, is expecting three more cuts in 2026. Given all this, I mean, where do you think the risk lies relative to those expectations?

Rob Kaplan: So, you may know, I've been saying for the last couple of months I don't know, but I would take the under. And the reason I would take the under is the only way that I see the Fed doing or should be doing two to three more cuts, the only reason I would be willing to do those is if I were convinced that we were in the midst of a very severe labor market weakening, more severe even than it appears to me today. That would cause me to cut more.

Or over the horizon we're going to make real improvement on the inflation rate, so this 2 ¾ to 3 is going to come down. I've got to be convinced about one of those or both.

And at the moment I'm not. Which is why I've been arguing be careful, I think the market is overestimating the probability of rate cuts.

Allison Nathan: Interesting. Let me take a second, Rob, and ask you about a very topical subject at this point in time, Fed independence. Obviously, this administration has a clear preference for lower interest rates. Has that had any bearing on the decision-making process the Fed at this point from what you can observe?

Rob Kaplan: It probably has had a little bit of impact on the margin. I know around the table at the Fed people are doing their level best to screen out political pressure or political influence. And I think they've done that. I think this is all coming to a head though in December in that, that pressure, I think they're going to do their level best to screen it out. But this is a tough decision, even without that pressure I would find the December decision, if I were in my-- this is an agonizing decision. And so, for me, what they're going to struggle with is from a risk management point of view, one argument would be skip December. If it turns out the labor market, I'm wrong and the labor market is weaker, then we'll act in January. However, the backlash and the tension will escalate. Obviously, I think they've got to screen that out.

The problem is, if you do cut in December, which I still think, I agree, is more likely than not that they will, the problem is now I'm at neutral in my opinion. And if it turns out that we get a firming in the labor market next year and inflation turns out to be stickier, I'm out a position. I don't want to be at neutral. I want to be at least modestly restrictive. So, that's why I say it's an agonizing decision.

Allison Nathan: And as you said, the politics are on their minds. But certainly not the driving factor behind--

Rob Kaplan: In the back of their minds. Not the front of their minds.

Allison Nathan: Right. But we will have new Fed leadership soon. And so, at that point are concerns about Fed independence likely to grow? Should they grow? Are you concerned at all looking ahead at Fed decision making from that perspective?

Rob Kaplan: Listen, I think concerns-- when I talk to capital allocators, investors globally, there's no question the concerns about Fed independence have grown. It may be one of the reasons why gold has rallied 50 percent. Plus, it may explain some of the things that we're seeing.

You've heard me say before, even with a new chair, the culture of independence inside the Fed on setting monetary policy decisions is very strong. And so, I think it would take a lot to change that culture, I mean, a lot of personnel changes. I do believe regulation is not politically independent and it hasn't been for many years. And so, that makes sense. And I don't think there's going to be a big issue there.

I think you may see some changes on the way the balance sheet is managed. And that it would not shock me with a new Fed chair there'll be more active discussion about extending the average maturity of the Fed portfolio. In other words, owning less short. Buying more long. The Fed is not going that way at all so far right now. But with a new Fed chair, I would guess that would be revisited. I'm not troubled by that. I think that might actually be a constructive debate. But on setting monetary policy, you would need meaningful changes in personnel in order to change the independence that I think is still actively there.

Allison Nathan: So, Rob, just to conclude, you've talked a lot about cross currents, different forces pulling different directions. What are you watching most closely over the next couple of months that will be important for the Fed's decision making?

Rob Kaplan: So, I'm going to really be trying to get a feel for the end of the shutdown. Government workers starting to get paid. Flight disruptions starting to calm down. What's the impact and how long is the imprint of that likely-- is it going to take for that to resolve? And I'm expecting it means that maybe the next couple of months are going to be on the weak side. But I'm expecting that. So, I'm watching that.

Talking actively to business, what I'm watching for also is business and consumer spending getting weaker? Is business weakening? Understanding there are two groups of consumers: low/moderate income and more affluent. And they're spending in different ways. Watching that.

And then I'm going to watch very carefully and talk to businesses, what are they seeing, not only in goods, but in services more because that's the bulk of the economy? What are they seeing in terms of costs? And what is their thinking on prices? And so, those are the kinds of things, at least in regard to monetary policy, I'm going to be looking at.

Allison Nathan: Thank you so much, Rob. We have lots of conversations, you and I, and every single time I learn not just one thing, but several things. Thanks so much for joining us again.

Rob Kaplan: Good to talk to you, Allison. Thank you.

Allison Nathan: Thanks for listening to this episode of Goldman Sachs Exchanges which was recorded on Wednesday, November 12th, 2025. I'm Allison Nathan.

Sachs entity to take any particular action, or an offer or solicitation to purchase or sell any securities or financial products. This material may contain forward-looking statements. Past performance is not indicative of future results. Neither Goldman Sachs nor any of its affiliates make any representations or warranties, express or implied, as to the accuracy or completeness of the statements or information contained herein and disclaim any liability whatsoever for reliance on such information for any purpose. Each name of a third-party organization mentioned is the property of the company to which it relates, is used here strictly for informational and identification purposes only and is not used to imply any ownership or license rights between any such company and Goldman Sachs.

A transcript is provided for convenience and may differ from the original video or audio content. Goldman Sachs is not responsible for any errors in the transcript. This material should not be copied, distributed, published, or reproduced in whole or in part or disclosed by any recipient to any other person without the express written consent of Goldman Sachs.

Disclosures applicable to research with respect to issuers, if any, mentioned herein are available through your Goldman Sachs representative or at http://www.gs.com/research/hedge.html

Goldman Sachs does not endorse any candidate or any political party.