

Research @ Citi Podcast, Markets Edition, Featuring Dirk Willer & Adam Pickett: Back to School — Navigating September Macro Headwinds

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Opening Teaser: (00:00)

Research @ Citi, Markets Edition

Dirk Willer (00:03)

Welcome to Research @ Citi, Markets Edition, where we break down global macro in 10 minutes. I'm your host, Dirk Willer, Citi's Global Head of Macro. With me today is Adam Pickett, our Global Macro Head in London.

Welcome to the show, Adam.

Adam Pickett (00:18)

Pleasure to be here, Dirk.

Dirk Willer (00:20)

We are recording this podcast at 9 a.m. on Monday, September 8, 2025.

It's now back to school for investors, after a summer break that has raised many macro questions. What is the state of the U.S. economy and equity markets? What is the state of Fed independence? And where do we stand on the tariff front?

Let me start with the U.S. economy and equity markets. The U.S. economy is doing relatively well. Our Citi U.S. Economic Surprise Index has been rising for some time, and is now solidly in positive territory. The Atlanta GDP estimate is running at around 3%.

The labor market is not overly strong, though. The June number was actually just revised to a negative trend last week. But we would make two points. First, negative trends are often getting revised higher. And secondly, they don't necessarily indicate a severe recessionary slowdown.

There are many false signals where negative job numbers should be faded. With both equities and credit telling us that conditions are far from recessionary, we think that this is one of these times where it pays to not focus too much on the weak job market when it comes to your investment decisions in equities.

Of course, for bonds, it matters tremendously. But when it comes to equity markets, the sluggish labor market could be a good thing, as it will trigger the Fed to cut into an equity market with solid fundamentals. This is in particular true given the CapEx boom, which is already significantly larger than during the dotcom days, and is well above trend.

We also see some evidence for productivity gains in terms of sales per employee and EBITDA per employee, so far mostly driven by the Mag7, but potentially broadening out. Therefore, Fed cuts into a CapEx boom could be leading to an inflating equity bubble.

Adam Pickett (02:24)

But Dirk, that's all well and good, but do you not think that's all in the price?

Dirk Willer (02:28)

Very good point. I think the sentiment is actually surprisingly unenthusiastic. Our Citi Pulse indicator, which tries to measure exuberance, is not really ringing any warning bells. The survey of individual investors is really quite subdued.

What I would say, though, is September could still be a more volatile month. The reason is that seasonals are very poor in September and the liquidity at the Fed is going to shrink due to the TGA rebuild that's going to take place.

And our Bitcoin indicator is also short-term cautious. Overall, we remain overweight U.S. equities in our asset allocation, but we would consider adding additional risk only on a pullback in September.

Now let's move to the next big macro question of the summer: the reconstitution risk for the FOMC, which is key for the rates and FX outlook. Adam, how do you see it?

Adam Pickett (03:25)

It's a fascinating question and moves beyond just, "will Lisa Cook stay or go and who might be their replacement?," but bleeds into the idea that by the end of February, all of the regional Fed chairs need to be reappointed.

And if a Board of Governors for some reason, and if Cook goes, the majority of which will potentially be dovish and potentially also be Trump appointees — if they find reason to not reappoint some of these Fed chair members, then the musical chairs continue. Is there precedence for this? Yes, there is. Waller and Bowman did not vote to confirm Austan Goolsbee.

Now, can we price it? We try to. So, looking at one year, one year dollar rates versus detrended S&P and five-year break-evens as a sort of model for the growth and inflation part of the dual mandate and the residual of which should tell us whether the market is pricing the Fed to be excessively dovish or excessively hawkish.

Now that model is telling us that we're unusually dovish in terms of the market pricing versus fundamentals — about 15 times or so in the last 30 years — but we would also flag that post-2008, post-2020, the Fed have been considerably more reflationary in their starts.

There also is the dynamic of the labor market, i.e. current priced Fed dovishness might catch down to the reality of a weakening labor market or the data sort of might validate this dovish Fed pricing.

So overall, we think there is some FOMC recalibration risk in the price. We don't think it's as excessive as it has been in the past. And we also think the data could continue to validate it as well.

Overall, we think it's good for U.S. curve steepeners, a weaker dollar, as well as gold.

Dirk Willer (05:25)

But Adam, is it not on the price already? I mean, gold is already at all-time highs and the back end of the U.S. curve is certainly not expensive.

Adam Pickett (05:33)

Certainly, the valuation metrics might suggest some excessive moves across those three assets or trades I mentioned, but when we think about the flows on fixed income — we've done a lot of work on the global bond glut, this excessive net safe asset supply that the private sector has to take down, so looking at AAA to A rated sovereign credit and securitized issuance across DM, stripping out what central banks buy, what FX reserve managers buy, what HQLA portfolios buy — and it suggests that the ACM term premia could have another 50 bps to go to the top side.

On the flip side, for gold, if bonds are no longer the ballast in your portfolio and central banks are on the bid, and as term premia rises, we find the correlation between gold and rates actually flips from negative to positive. All of that suggests that the valuation anchor for gold potentially has a little bit less bearing.

And finally, for the dollar, we've done a lot of work around the hedging story. And from our perspective, while it started in places like Canada and Scandies, we see less evidence in Japan and Europe, these big pools of low hedged dollar assets owned by foreigners. And we think as the Fed cuts — potentially cuts more meaningfully, towards the end of the year into next year — that dollar hedging story matters, not just initially, but also longer term for how much foreign capital flows are needed to support the dollar going forwards.

Dirk Willer (07:12)

Great, thanks. And that brings us to the third big macro question, which is really the tariff debate. There has been some legal uncertainty created as the U.S. Court of Appeals for the Federal Circuit ruled that the majority of reciprocal tariffs are illegal, but it allowed

the administration some time for an appeal, and that appeal is of course happening to the Supreme Court.

There is a lot of uncertainty about the timing and the content of that ruling but the question whether there will be a new bout of tariff uncertainty, I think this is not going to happen. And the reason is that the administration has plenty of other legal bases to implement tariffs and will do so if necessary. Section 301 is probably the most likely, but there are others, and while there is an investigation required by the U.S. trade representative, that could happen relatively quickly.

So overall, we doubt that the legal situation will change the overall setup too much. Now, that doesn't mean at all that there's not continued tariff uncertainty, but that tariff uncertainty really has to do much more with the lags in the system and whether we still can expect some of the negative impact of tariffs going forward that was expected to happen already.

Adam, how do you see that?

Adam Pickett (08:33)

There's good and bad reasons to look at this story. So, on the lags, when we look at simply the trend of U.S. imports and the large bump that we got leading into the tariffs being put on, it suggests that the excessive U.S. imports that were built up are maybe, you know, five, at a push six months' worth of excessive imports versus trend.

Now, that suggests to us that the tariffs which, you know, went on around Feb/March time initially, especially for China, you know, we should be starting to feel the impact or at least have run through some of this excess inventory by about September/October time.

So, the rubber should be sort of meeting the road on some of these inflationary impacts. It's curious that they don't show up yet. Which brings me on to the next point, which is if you look at the effective tariff rate, theoretically, given what's been announced, it's about 17, 18 percent.

But if you look at what's coming into the Treasury every month versus U.S. imports, it suggests that we're only running about 9 percent or so. Why could that be? That could be that there's more carve-outs happening behind the scenes than we realize. There was a big story in 2018, in Trade War 1.0. It could also mean there's some transshipment.

On that, we find that while the skew of U.S. imports and Chinese exports has rotated heavily towards ASEAN and Mexico, the overall level of U.S. imports suggests that not everything is being replaced from China, from lower tariff rate countries.

China exports are still reasonably strong but that could also be goods-dumping. So overall, there's probably going to be a lagged goods inflationary impact, but just given you know services hasn't shot up yet, given that there could also be healthier

reasons for the inflation to not be showing up yet in terms of carve outs and transshipment, we think the bar for tariffs to sort of upset our more dovish Fed view, given the labor market, and given the FOMC reconfiguration risks, we think that bar is high.

Dirk Willer (10:53)

Thanks, Adam.

So overall, we are not overly concerned about the soft patch in the U.S. labor market and strategically like U.S. equities, even though we think that September could be more volatile.

We are worried about FOMC reconstitution risk, even though some is already priced. Gold should continue to benefit from this narrative. And we do not expect an increase in tariff uncertainty from the latest legal developments and doubt that the lagged inflationary tariff effect would impact the Fed's stance.

Thank you for joining us today. This episode was recorded on September 8th, 2025, and I am your host, Dirk Willer.

If you enjoyed the podcast, please leave us a review on your favorite podcast platform.

Next week's Research @ Citi Markets Edition will be hosted by Beata Manthey, Citi's Global Head of Equity Strategy.

And be sure to look out for our Research @ Citi podcast, which you will access on the same channel.

The Macro Strategy team will be back in two weeks' time. Stay sharp!

Disclaimer (11:57)

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