Special Commentary — August 18, 2025

Soft-Landing, or No Soft-Landing, That is the Question

Q2 Update

Summary

- In September, we wrote a five-part series of reports that introduced a new toolkit to predict the probability of soft-landing, stagflation and recessionary episodes. The toolkit also predicts the probability of a monetary policy pivot occurring in the next two quarters. In this report, we update our framework with Q2 data.
- In the second quarter, the soft-landing probability remained unchanged at 40%. Meanwhile, the recession probability declined to 25% from 27%, and the stagflation probability remained constant at 28%.
- Although the growth scenarios saw little change this quarter, trade policy has created uncertainty surrounding economic policy, which may create volatility for the probabilities moving forward.

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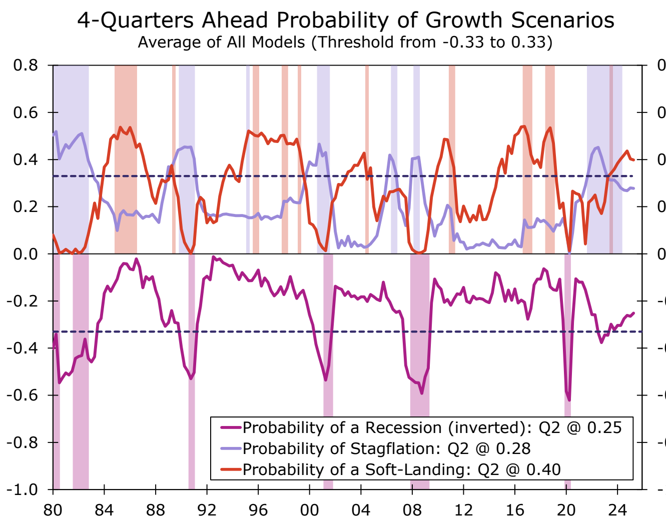
From Pause to Pivot

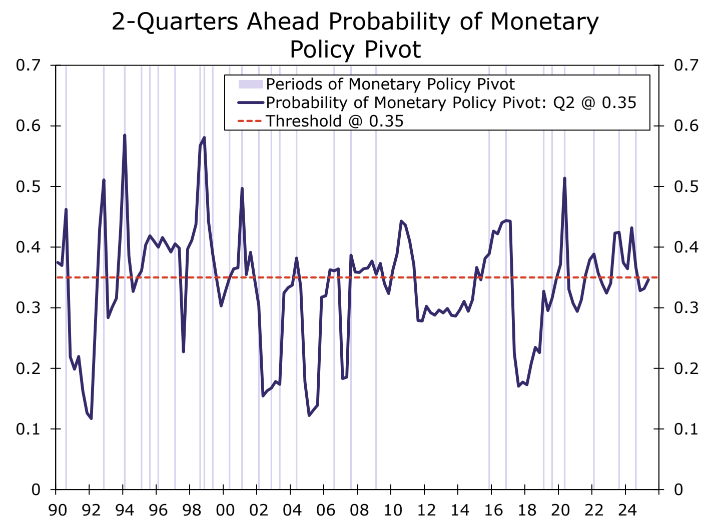
Last September, we wrote a five-part series of reports that introduced a new toolkit to predict the probability of soft-landing, stagflation and recessionary episodes. The series details our methodology, but on a basic level, our framework effectively predicted periods of soft-landing, stagflation and recession using a threshold of 33% in the post-1950 era. It also accurately predicted episodes of policy pivots in the post-1990 era using a threshold of 35%. In this report, we update our framework with Q2 data to predict the probabilities of the three scenarios occurring during the next four quarters. We also predict the probability of a monetary policy pivot occurring in the next two quarters.

In the second quarter, the recession probability continued its downward trend as it dipped to 25% from 27%. Meanwhile, the probability of a stagflationary scenario remains elevated but steady at 28%. Similarly, the soft-landing probability remains unchanged from Q1 at 40%, but it also marks the seventh consecutive quarter as the scenario with the highest probability. However, despite the likelihood of a soft-landing scenario being the highest, the elevated probability of a stagflationary scenario warns decision makers about the potential upside risks to inflation and subdued economic growth in the near term.

While other scenarios saw rather modest changes in probabilities this quarter, the monetary policy pivot probability reached the threshold of 35% in Q2, rising from 33% last quarter. This upward trend aligns with the Federal Open Market Committee's (FOMC) most recent policy decisions. While the Fed decided to hold the federal funds rate steady in July, a persistently elevated soft-landing probability may have increased the likelihood of a policy pivot from holding rates steady to rate cuts in the near future. This is consistent with our expectation for the Fed to start an easing cycle at the September meeting and continue for the rest of the year with a 25 bps cut at each of the remaining meetings of the year.



Source: Wells Fargo Economics



Source: Federal Reserve Board and Wells Fargo Economics

Overall, the growth scenarios showed little to no movement from the previous quarter, and the probability of a soft-landing scenario still remains the highest. However, the volatile nature of current trade policy could complicate the outlook for these growth probabilities. As of now, we estimate that the average effective tariff rate is 18%. Elevated tariff rates can impart a stagflationary shock to the economy and drive inflation upwards while depressing GDP growth. As written in our monthly economic outlook, we expect modest GDP growth for the remainder of the year. Additionally, the price-effects of the current trade policy are more discernibly getting passed to the consumer, and we anticipate inflation rising in the later half of the year. While uncertainty around potential policies continue, our framework may help eliminate some of that uncertainty by predicting potential risks to the economic outlook and utilizing those probabilities to forecast policy pivots. This would help decision makers create effective policy moving forward.

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