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Monday Monetary Thoughts

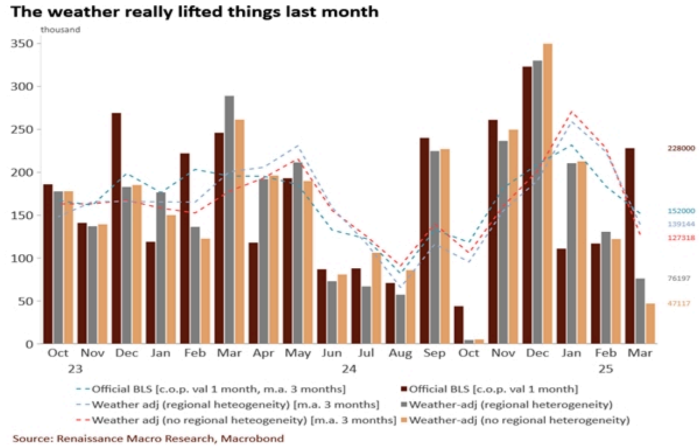
Donald John Tuss

Neil Dutta

There is no buffer

The latest data likely gives policymakers on both ends of Washington DC – fiscal and monetary – the false impression that they are working with an economic buffer.

- Favorable weather conditions likely provided a lift to employment growth in March. Just 87,000 employed non-agricultural workers were not at work due to bad weather, below normal. A formal analysis from the Federal Reserve Bank of San Francisco found that weather lifted payroll growth by roughly 150,000 to 180,000 last month.

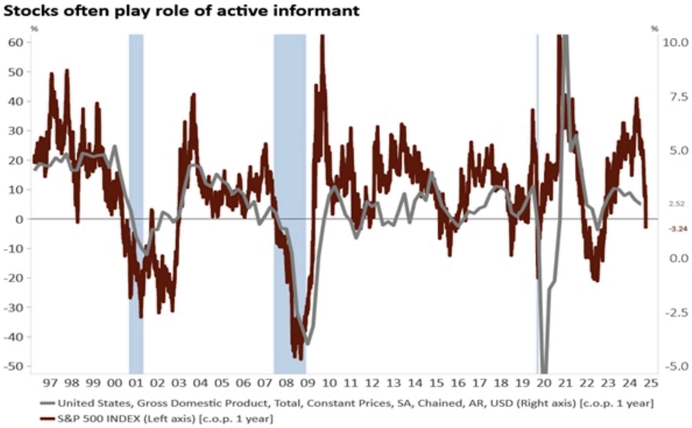


- Even before the latest tightening in financial market conditions, the prime-age employment rate has been contracting. Over the six months ending in March, the prime-age employment to population ratio fell 0.5ppt. It is rare to see a decline of this magnitude outside of recession

In short, the labor market has been getting worse, not better. However, FOMC Chair Powell continues to characterize economic conditions as solid while the Trump administration has fully embraced the economy data as their own with the [President noting that "it's already working"]() following the March release

There is a remarkable level of complacency right now. The Fed is not ready to step in and if the President thinks the economy is fine, he has no reason to change course. Before we even speculate on the outlook for trade policies, investors need to know that the combined strike price on the policy put continues to decline.

Stocks often play role of active informant



Source: Renaissance Macro Research, Macrobond

Stocks can become the economy

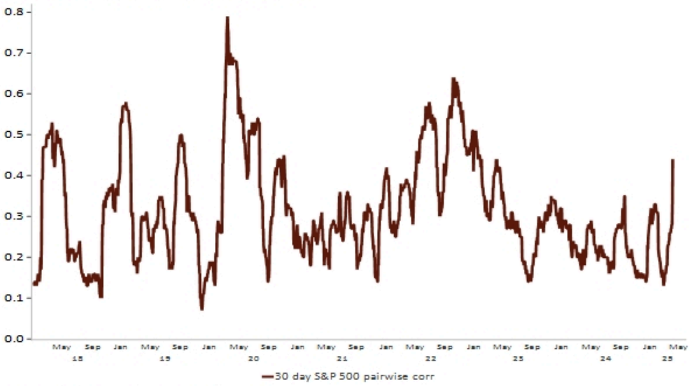
Stocks are not the economy, but stocks are not, not the economy either. A cursory look at our nearby figure shows reflects this insight. Sometimes stocks correlation strongly with economic growth, but sometimes, they don't.

In our view, a firm manager looks at the stock market and asks three questions: (1) Is my stock price reflecting something I already know about my company? (2) Is my stock price reflecting something I do not know about my company? And, (3) Is the broad market informing me of something about the overall economy? The first two questions deal at the firm level while the last question puts the market in the role of aggregating macro views.

I think in normal times, the stock market is a passive informant. Business managers know more about their firms than the outside public. Firms usually do not look at their share prices as a signal to invest. The share price does not tell firm managers something they do not already know. Fundamentals like cash flow and revenue growth say more about the future path of investment than the overall market.

Today, it appears that the stock market is taking on a more active informant role, aggregating beliefs across the marketplace. Individual company valuations matter less while macro risk matters more. Investors may hold macro views on the future affecting share prices across different industries, distorting investment decisions today. If business managers are looking at the stock market as a gauge to assess macro risk, the economy will get into more trouble.

Explosive growth in stock correlations
(Average 30-day S&P500 pairwise correln.)



Source: Renaissance Macro Research, Bloomberg

Indeed, the stock market plays an important role in accelerating financial conditions. Our principal concern is the role the stock market may play in perpetuating uncertainty and financial stress beyond the direct effects on consumption and investment. Now, stock correlations are exploding. If everything is moving together, it means less weigh on valuations and fundamentals and more on macro risk.

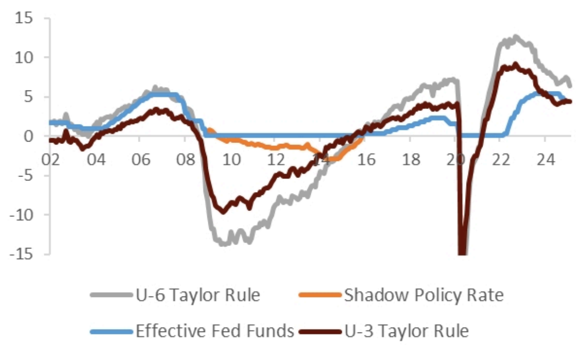
The risk of a negative feedback loop is quite high. Party of the way a feedback loop is broken is by shifting investor attention. That could mean a focus on corporate fundamentals or a policy change. The latter looks quite challenging with both sides of DC digging in. If policy cannot break the negative feedback loop, it will continue. We remain cautious and concerned on the economic outlook.

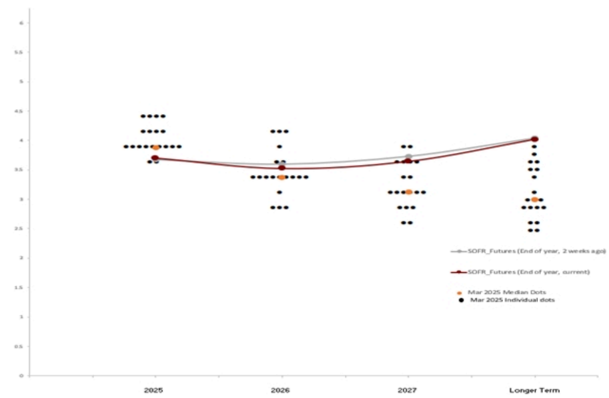
Don’t expect a swift recovery from this

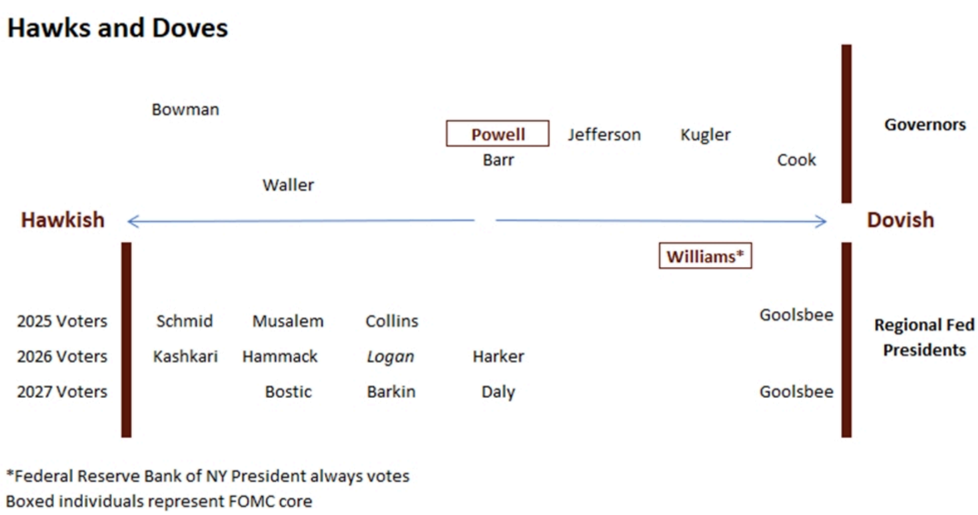
Let’s assume a scenario where Trump backs off his current trade stance (even though doing so this soon would be a major political setback). The markets might welcome that news, but eventually, it will be hard for Trump to stick to that stance. Indeed, it’s possible that a rising stock market might be used an excuse for Trump to turn the trade dial back up. This is and never has been an on-off switch. The uncertainty has become too great.

Looking at the economy, the heightened uncertainty Trump has wrought reminds me a little bit of the early 2000s. Firms were facing a variety of shocks: the aftermath of 9/11, corporate accounting scandals, the run-up to the Iraq War. The 2001 recession was not especially deep, but it did take quite some time to crawl out of it. This feels a little bit like that – muddle through. It’ll be tough to get things going, and while there will be a time to get long on equities, I would not expect a V-shaped recovery.

Monetary metrics

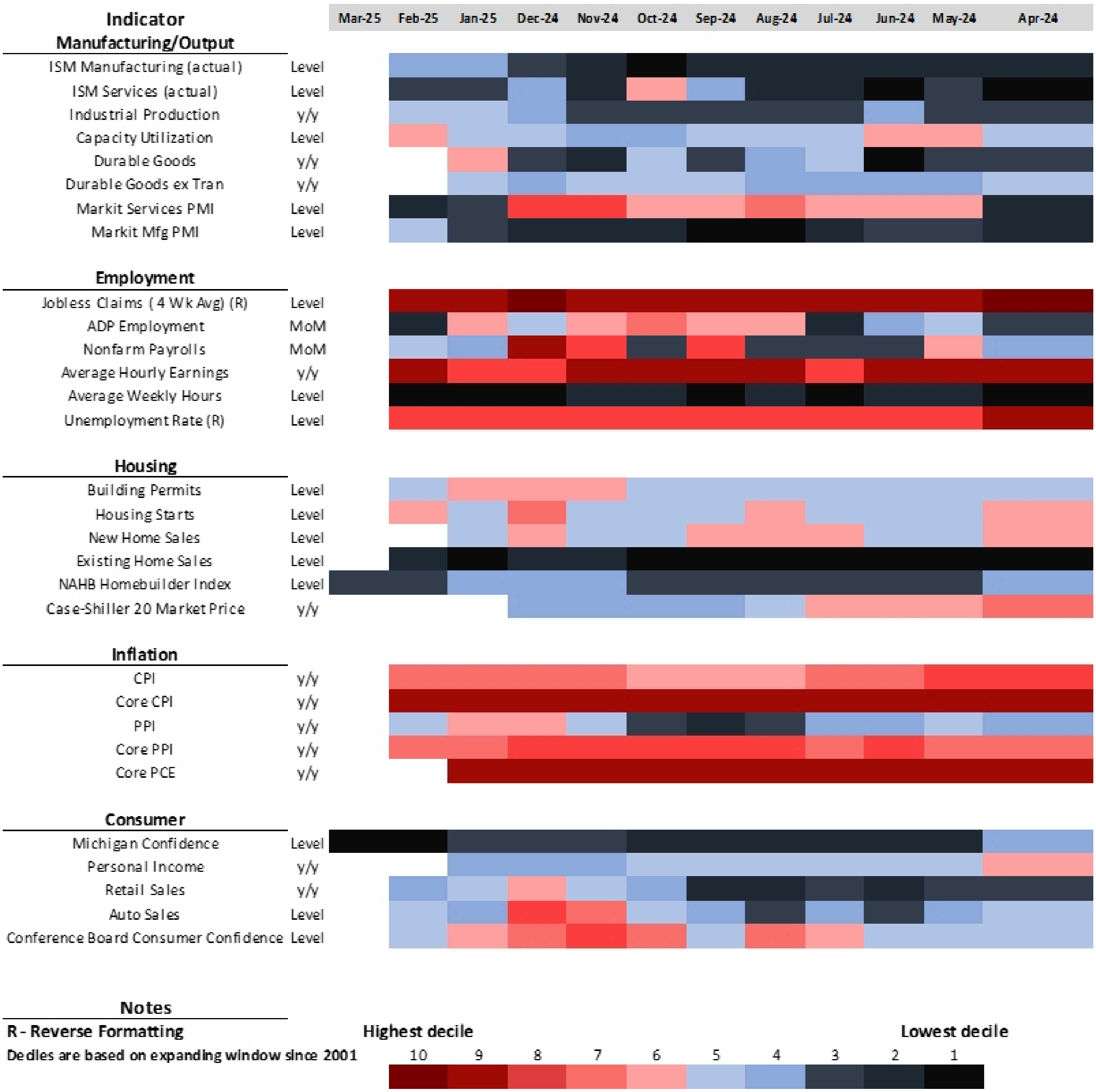




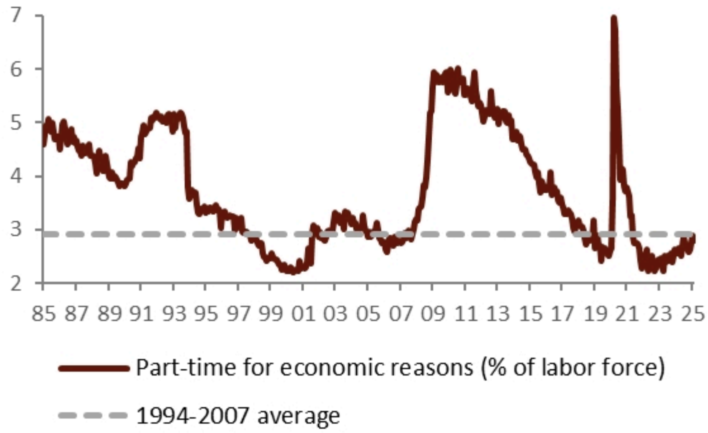


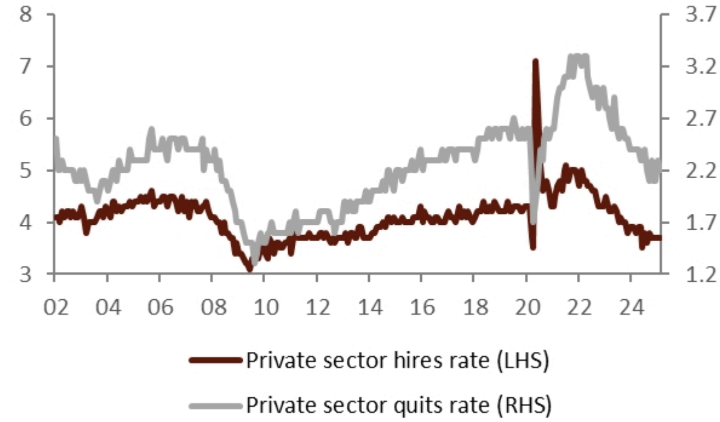
FOMC Forecasts	Median				Central Tendency			
	2025	2026	2027	Longer run	2025	2026	2027	Longer run
Change in real GDP	1.7	1.8	1.8	1.8	1.5–1.9	1.6–1.9	1.6–2.0	1.7–2.0
December projection	2.1	2	1.9	1.8	1.8–2.2	1.9–2.1	1.8–2.0	1.7–2.0
Unemployment rate	4.4	4.3	4.3	4.2	4.3–4.4	4.2–4.5	4.1–4.4	3.9–4.3
December projection	4.3	4.3	4.3	4.2	4.2–4.5	4.1–4.4	4.0–4.4	3.9–4.3
PCE inflation	2.7	2.2	2.0	2.0	2.6–2.9	2.1–2.3	2.0–2.1	2.0
December projection	2.5	2.1	2.0	2.0	2.3–2.6	2.0–2.2	2.0	2.0
Core PCE inflation	2.8	2.2	2.0		2.7–3.0	2.1–2.4	2.0–2.1	
December projection	2.5	2.2	2.0		2.5–2.7	2.0–2.3	2.0	
Projected policy path								
Fed funds rate	3.9	3.4	3.1	3.0	3.9–4.4	3.1–3.9	2.9–3.6	2.6–3.6
December projection	3.9	3.4	3.1	3.0	3.6–4.1	3.1–3.6	2.9–3.6	2.8–3.6

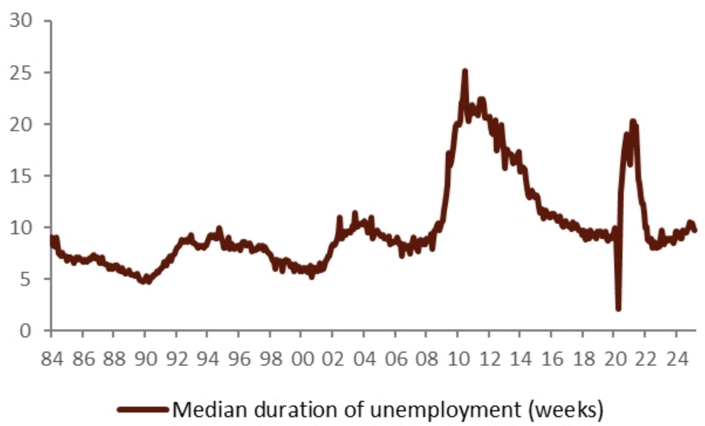
High frequency data heat-map

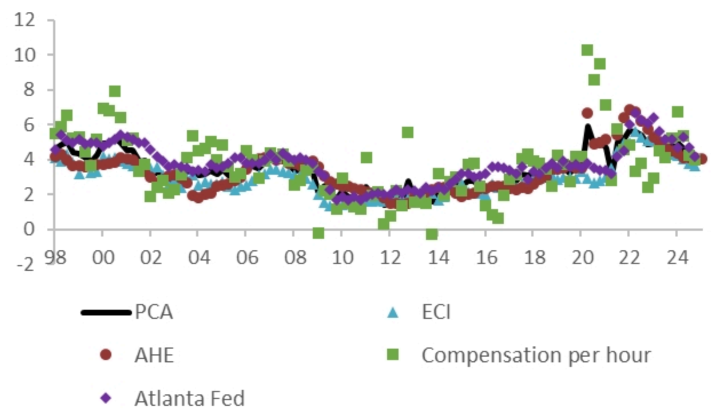


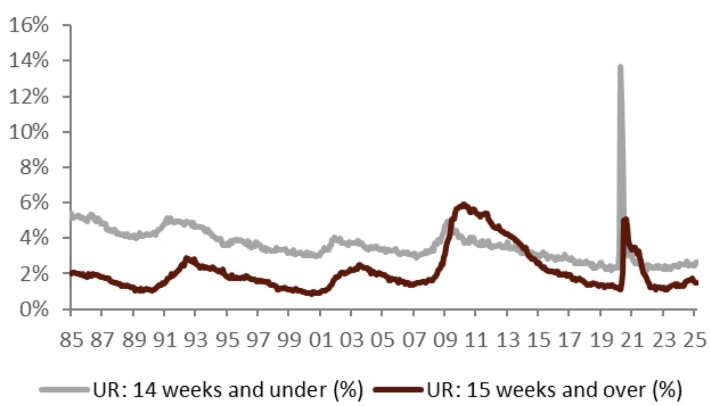
Labor market indicators

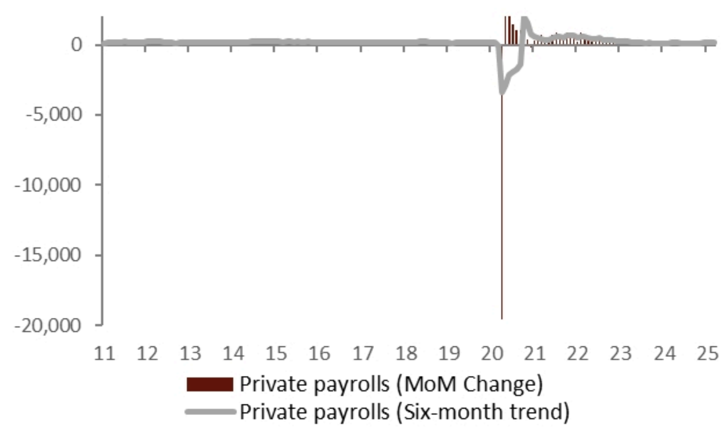












Inflation indicators