Dutta’s Monetary Thoughts

Arguments I hate

Neil Dutta

Will neutral be enough?

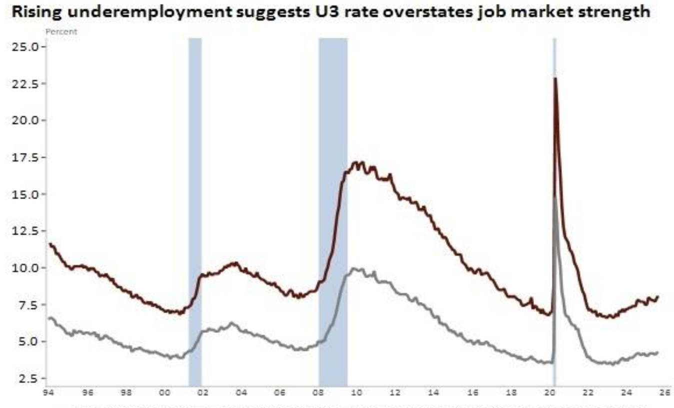
The latest employment data cement at least two rate cuts this year. While I believe growth considerations dominate, I think it will be tough for the consensus on the FOMC to green light a series of cuts with many on the committee still concerned about the inflationary consequences of tariffs. The market sees three cuts this year and three cuts next year. That would essentially take policy to estimates of neutral … a year from now. Nominal wages and salaries appear to already be slowing below three percent over the last few months. I am not sure neutral is going to cut it. Here are some arguments I have heard that I cannot stand.

“The slowing in the labor market is a function of lower breakeven rates due to supply-side considerations. The unemployment rate remains low.”

- First, the unemployment rate has been climbing this year. On average, the unemployment rate has increased 0.03ppt per month over the last eight months. Thus, at the current pace the unemployment rate will be close to 4.5 percent by December.

- Second, U-6 underemployment is rising more quickly than U3 unemployment. Specifically, those not in the labor force that currently want a job has jumped to fresh highs. So, I think the relatively low level of the U3 rate overstates the health of the jobs market.

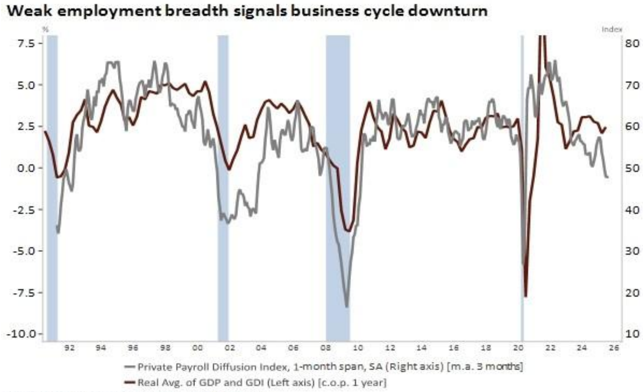
Rising underemployment suggests U3 rate overstates job market strength



Source: Renaissance Macro Research, Macrobond

- Third, unemployment rates for blacks and those with college degrees have been rising. Unless a bunch of black folks and college graduates came across the border in the last few years – unemployment rates for both groups have been rising – it is hard to see why supply-side conditions are the main reason for the slowing in the labor market.

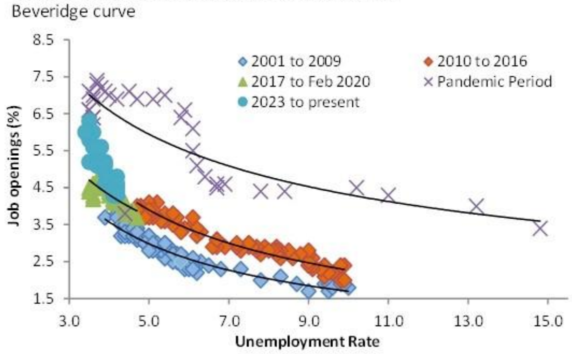
Weak employment breadth signals business cycle downturn



Source: Renaissance Macro Research, Macrobond

- Fourth, the breadth of employment remains very weak. The payroll diffusion index has stood below 50 for the last five months. As our nearby figure shows, this tends to correspond to the broad ups and downs of the business cycle. At any rate, if immigration were a big driver, I would expect supply constraints to slow net jobs growth not necessarily spread job losses.

Weaker demand will mean more unemployment
Beveridge curve



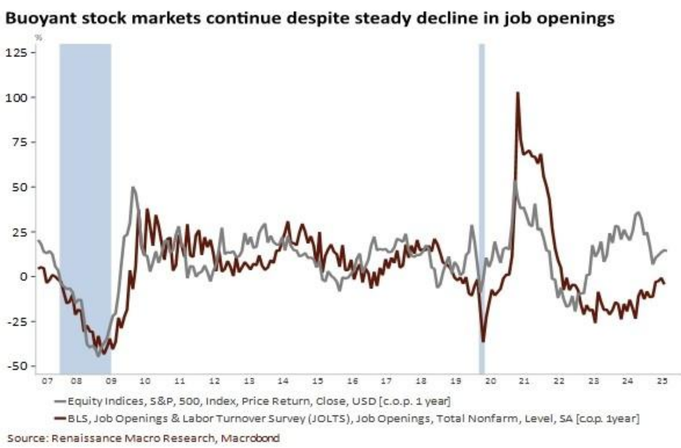
Source: Haver Analytics, Renaissance Macro Research

- This is about demand and excess labor demand continues to cool. Importantly, the labor market appears to be operating along a segment of the Beveridge Curve where ongoing decline in labor demand – as proxied by job vacancies – will coincide with more rapid increases in the unemployment rate.

"The Fed cannot cut because looser financial conditions will lift the economy."

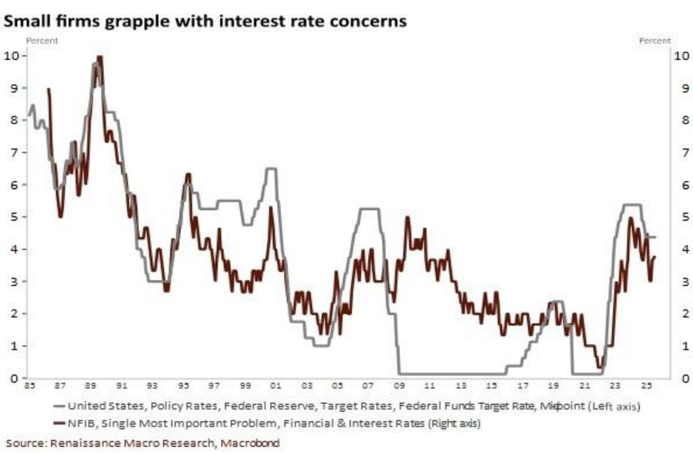
- Forget that the Fed has often cut with stock prices at or near their highs. Is there a statute of limitations on this idea of loose financial conditions lifting the economy? Financial conditions have been loose for a while now: tight corporate credit spreads and rising stock prices. Despite this, economic growth has been cooling, home sales have been sluggish, household net worth has cooled as home prices have eased, and unemployment has been climbing.

See our nearby figures, US equity prices have been buoyant over the few years and yet job vacancies have steadily declined.



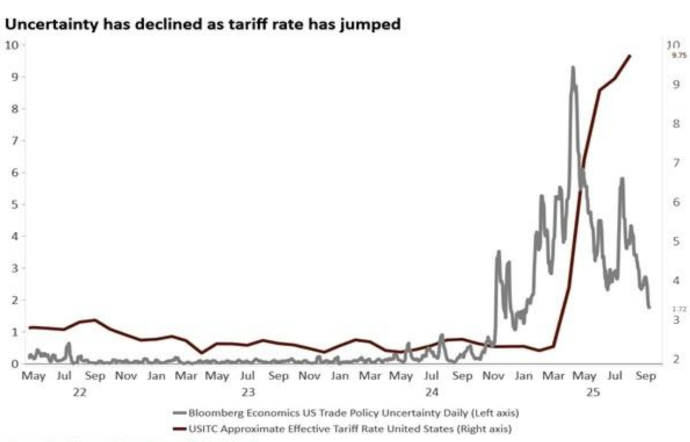
- Next, small firms continue to see interest rates as an important problem at the same rate as they did last September when the Fed began a 100bp easing cycle. There is a difference between financial conditions proxied in the market and financial conditions in the real economy.

Put differently, if financial conditions were this important, why is it that the economy has not reaccelerated already?



The economy is likely to reaccelerate. Here is the WSJ's Greg Ip on the theory: "tariffs, DOGE etc created a q2 confidence shock that tightened financial conditions, depressed activity and, with a lag, labor markets. With that shock dissipating, we could see the same sequence on the recovery side."

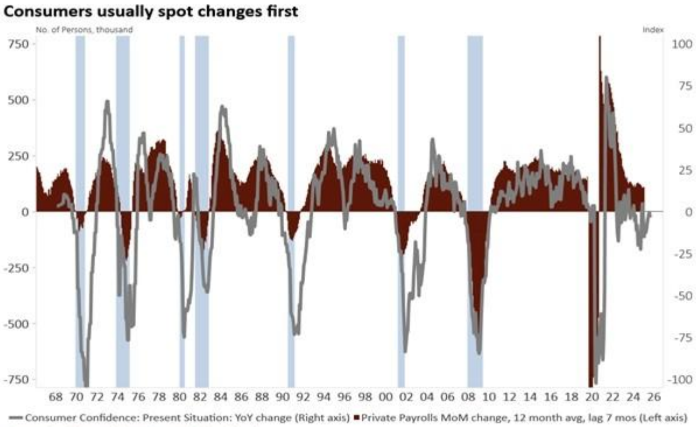
- So, I think there are a few issues with this. First, the argument assumes that uncertainty around the tariffs rather than the tariffs themselves is the issue. The effective tariff rate continues to climb even as the uncertainty around tariffs has declined (though it remains quite elevated).



- Now that the uncertainty has faded, firms may realize what they need to do manage the new cost environment. This would imply some increase in prices and efforts to curb costs – that means, weaker hiring and investment.

- Next there are pretty good reasons to expect growth to slow from here.

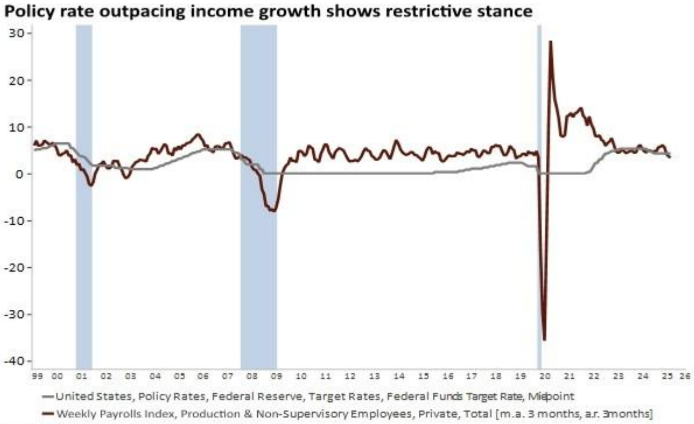
Consumers usually spot changes first



Source: Renaissance Macro Research, Macrobond

__Consumers tend to spot changes in their local economies in front of the published statistics__. So, when consumers tell you labor market conditions are slowing down, believe them. Consumers rate the jobs market as worse than in the same month a year ago. That suggests a labor slowdown is already in train.

Policy rate outpacing income growth shows restrictive stance



Source: Renaissance Macro Research, Macrobond

__Relatedly, consumption will slow as labor markets cool__. Aggregate weekly payrolls, a roughly proxy for *nominal* private wages and salaries, are up less than 3% over the last three months. Given the growth in inflation, this implies flat to negative growth in real incomes ahead. Indeed, the level of the federal funds rate is higher than the growth in aggregate incomes in recent months. Historically, this is a sign of restrictive policy.

Rising housing inventory expected to dampen construction activity

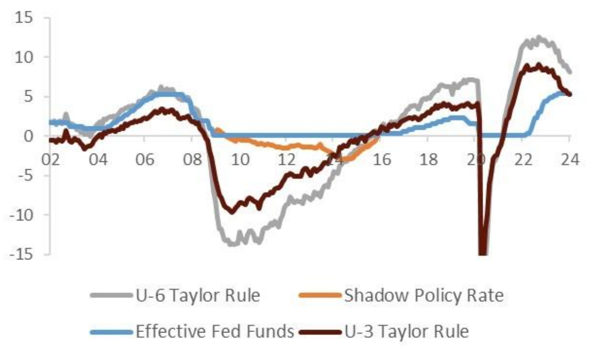
Source: Renaissance Macro Research, Macrobond

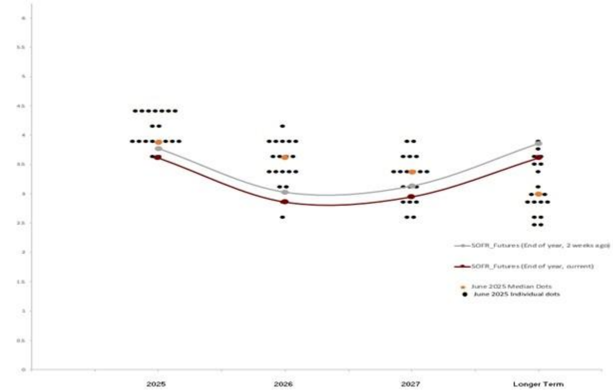
__Residential construction will ease given the increase in unsold new housing inventory__. Thus, it is hard to see why single-family construction picks up anytime soon. The risk with lower mortgage rates is that more activity migrates into the resale market as inventory is unlocked. Builders have enjoyed an unprecedented share of inventory since the pandemic.

State and local governments will be a headwind for GDP growth in H2 after adding 0.25ppt to GDP in H1. As Axios recently reported, states were facing budget shortfalls even before the cuts of the OB3 kicked in.

In short, there are reasons to be skeptical about reacceleration now. I would focus on the slowdown that's here – inertia is an important driver of the short-run outlook – as opposed to maintain optimism over what may happen six-to-nine months from now due to fiscal policy, tax refunds or whatever else.

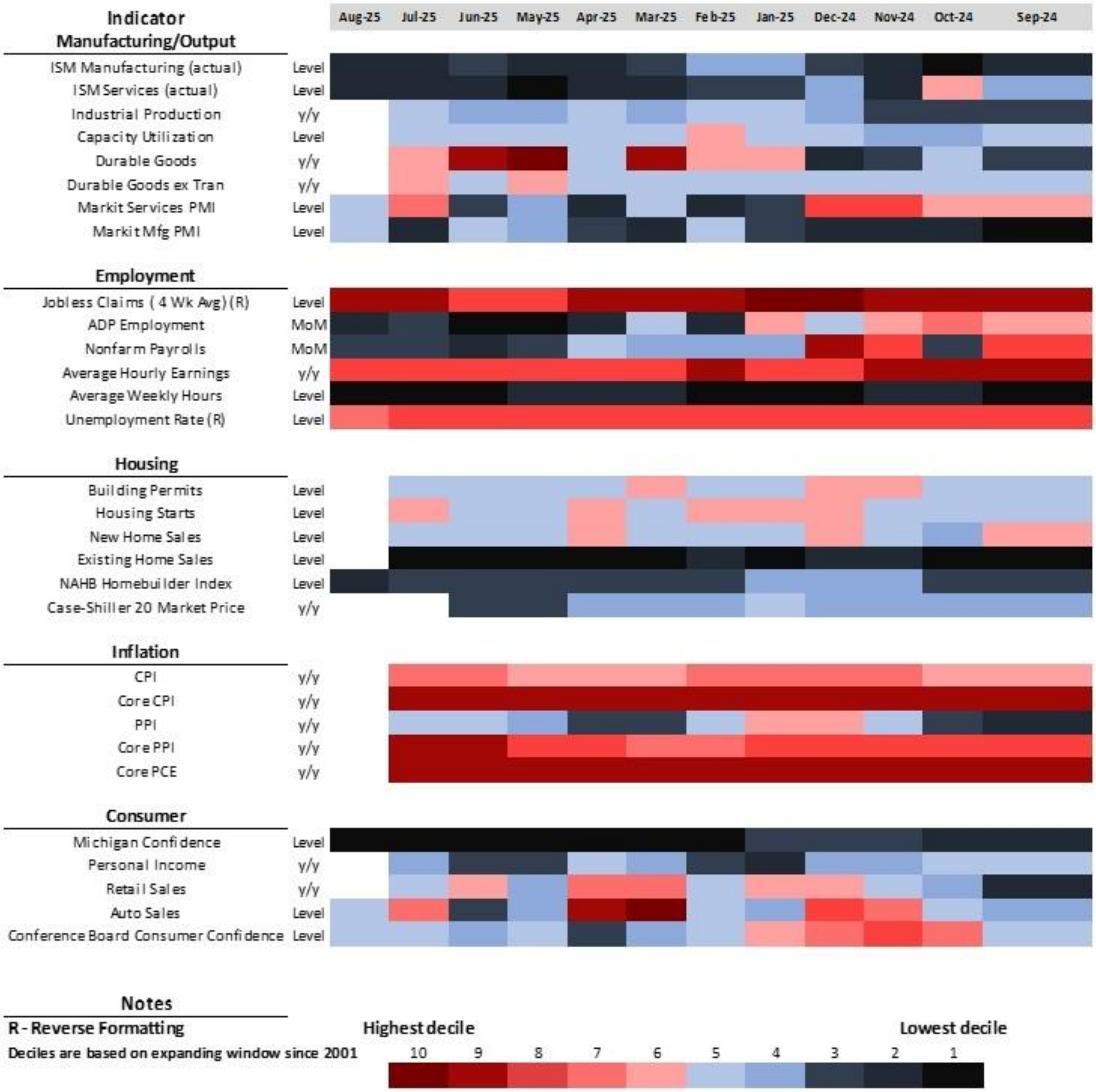
Monetary metrics



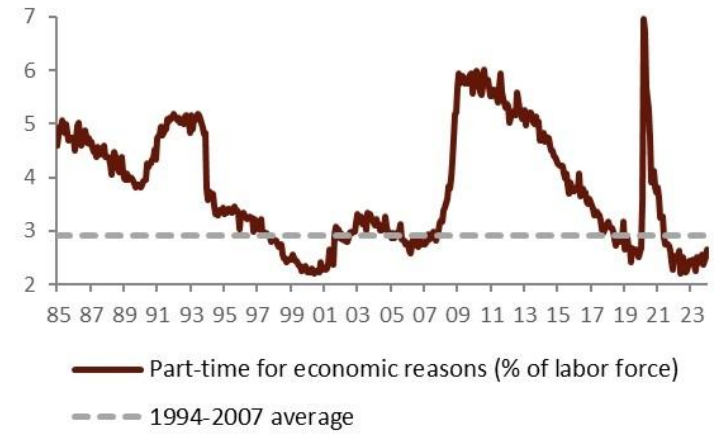


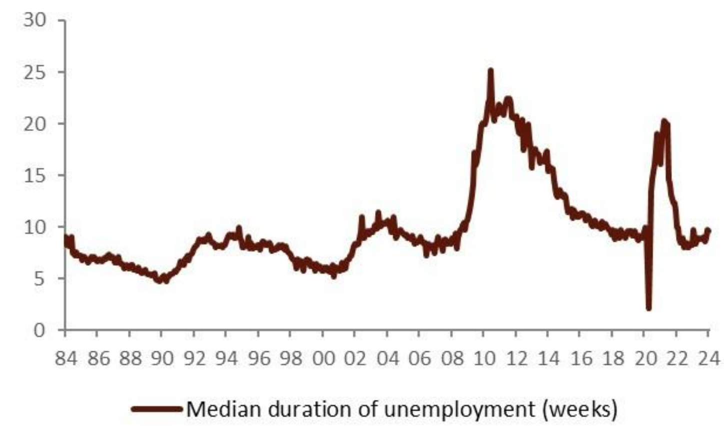
FOMC Forecasts	Median				Central Tendency			
	2025	2026	2027	Longer run	2025	2026	2027	Longer run
Change in real GDP	1.4	1.6	1.8	1.8	1.2–1.5	1.5–1.8	1.7–2.0	1.7–2.0
March projection	1.7	1.8	1.8	1.8	1.5–1.9	1.6–1.9	1.6–2.0	1.7–2.0
Unemployment rate	4.5	4.5	4.4	4.2	4.4–4.5	4.3–4.6	4.2–4.6	4.0–4.3
March projection	4.4	4.3	4.3	4.2	4.3–4.4	4.2–4.5	4.1–4.4	3.9–4.3
PCE inflation	3.0	2.4	2.1	2.0	2.8–3.2	2.3–2.6	2.0–2.2	2.0
March projection	2.7	2.2	2.0	2.0	2.6–2.9	2.1–2.3	2.0–2.1	2.0
Core PCE inflation	3.1	2.4	2.1		2.9–3.4	2.3–2.7	2.0–2.2	
March projection	2.8	2.2	2.0		2.7–3.0	2.1–2.4	2.0–2.1	
Projected policy path								
Fed funds rate	3.9	3.6	3.4	3.0	3.9–4.4	3.1–3.9	2.9–3.6	2.6–3.6
March projection	3.9	3.4	3.1	3.0	3.9–4.4	3.1–3.9	2.9–3.6	2.6–3.6

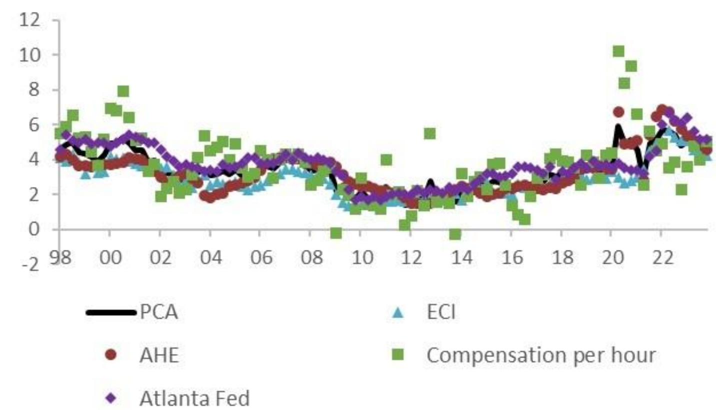
High frequency data heat-map

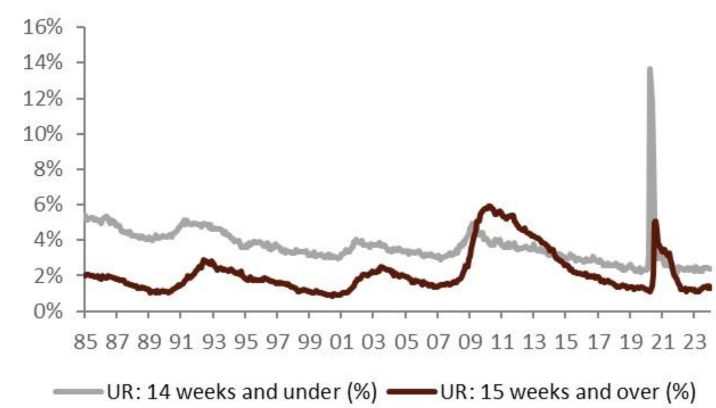


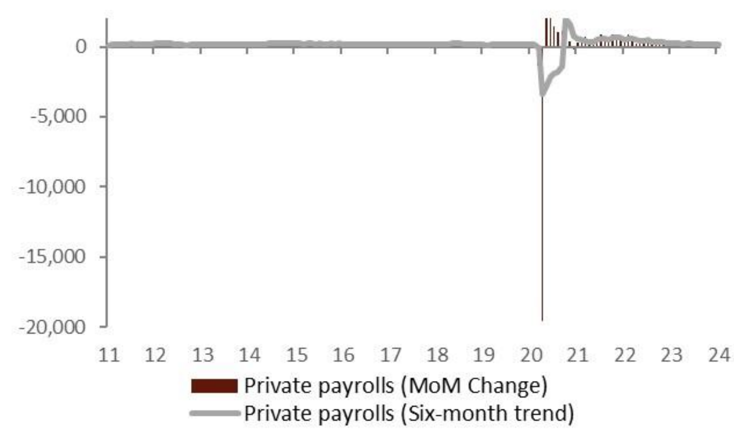
Labor market indicators



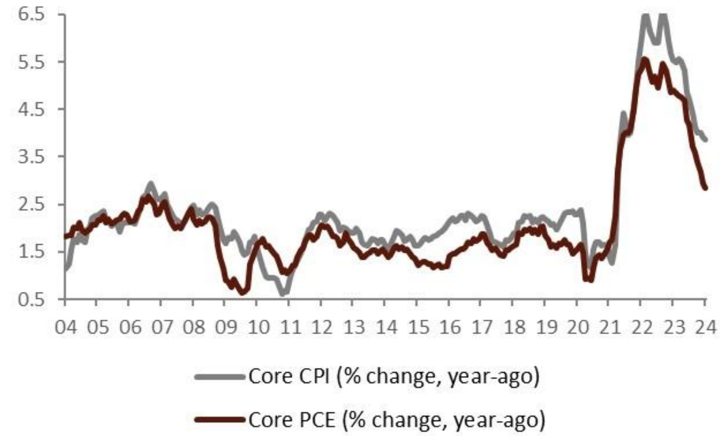


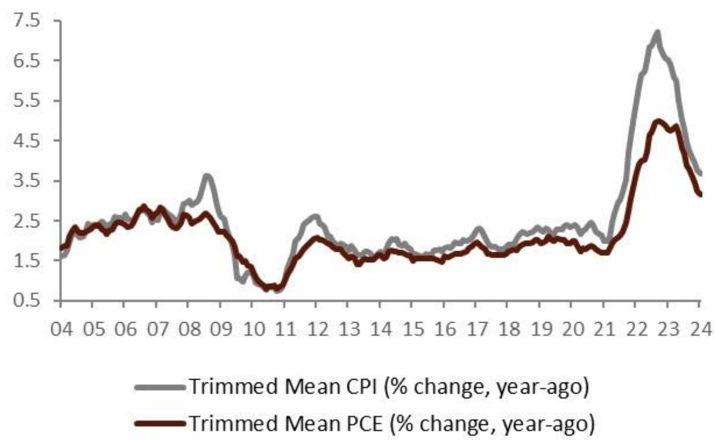


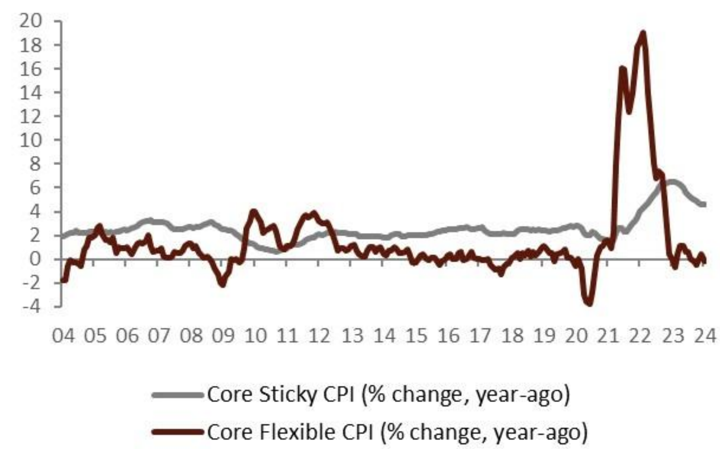


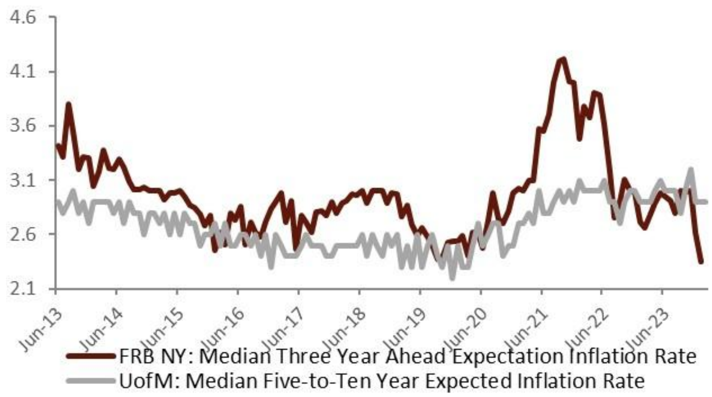


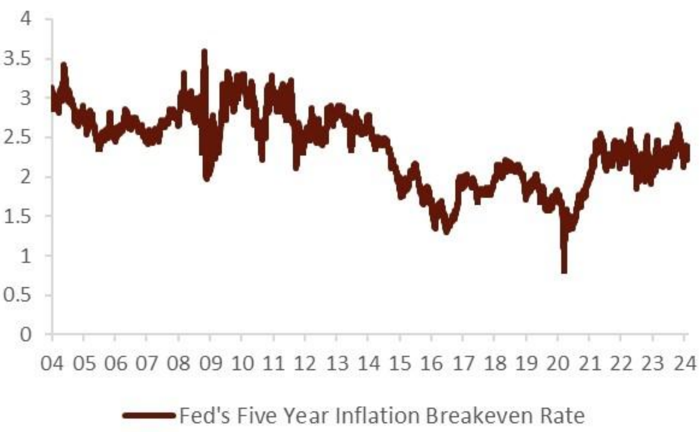
Inflation indicators



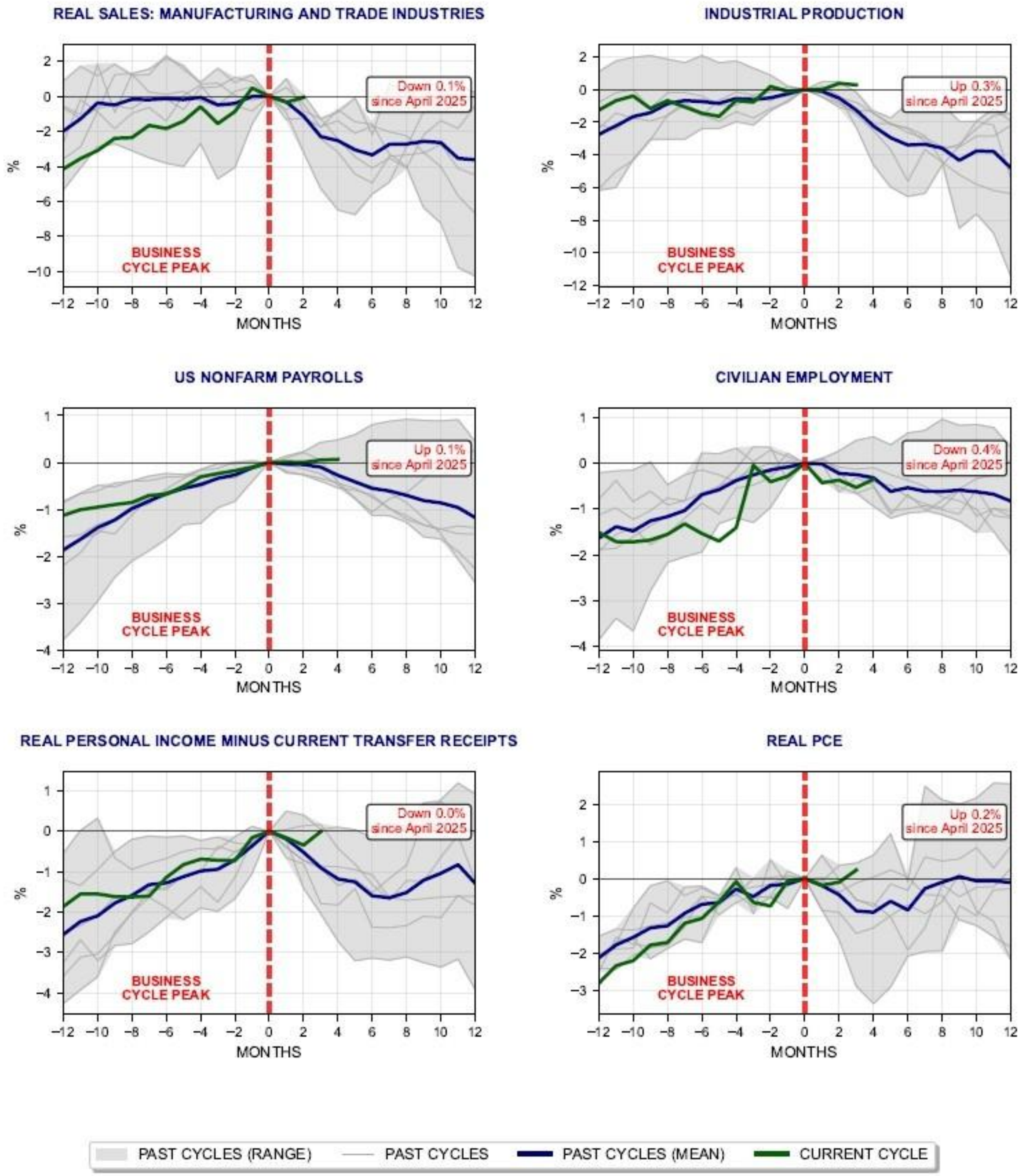





4.6
4.1
3.6
3.1
2.6
2.1
Jun-13
Jun-14
Jun-15
Jun-16
Jun-17
Jun-18
Jun-19
Jun-20
Jun-21
Jun-22
Jun-23
FRB NY: Median Three Year Ahead Expectation Inflation Rate
UofM: Median Five-to-Ten Year Expected Inflation Rate

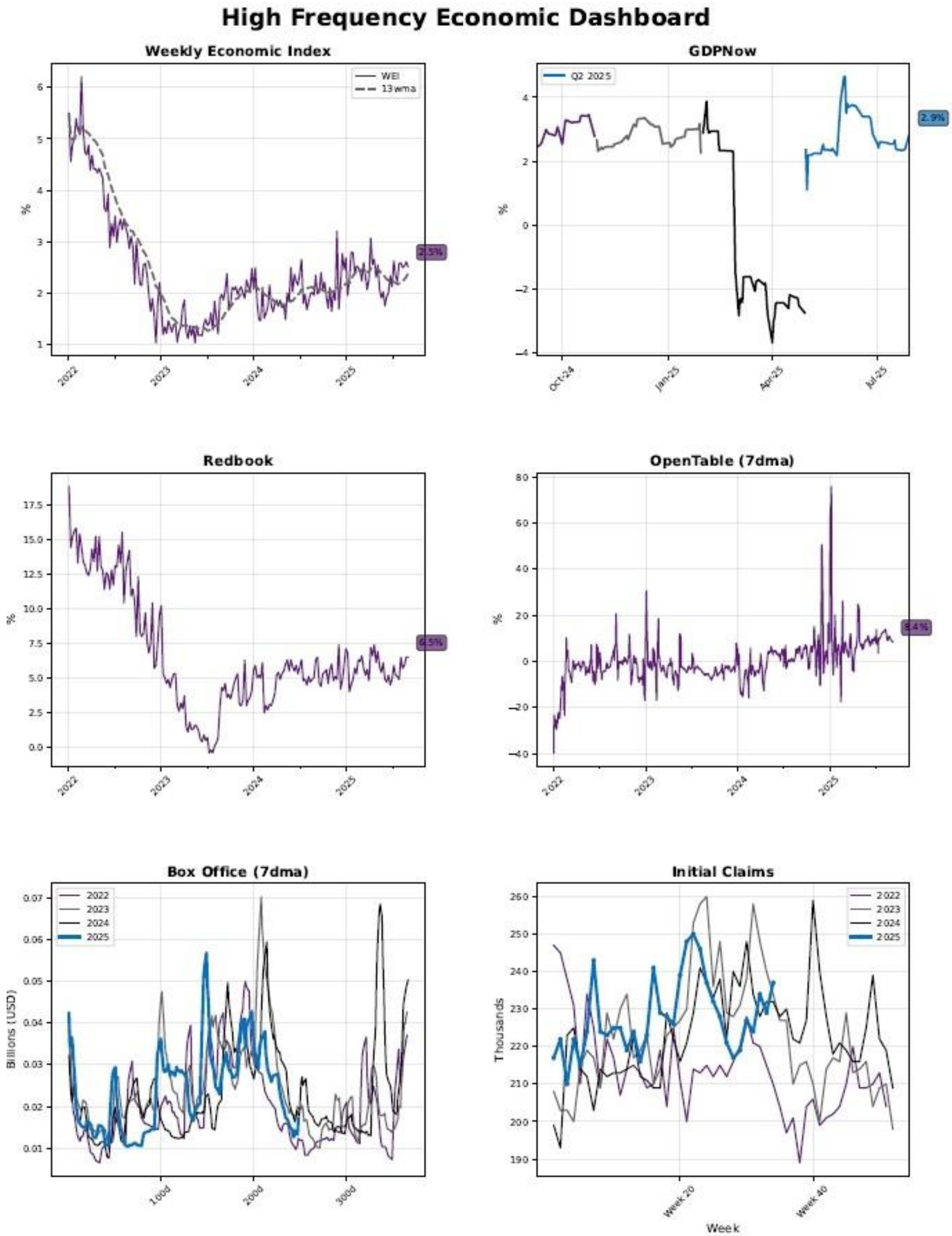

4
3.5
3
2.5
2
1.5
1
0.5
0
04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24
Fed's Five Year Inflation Breakeven Rate

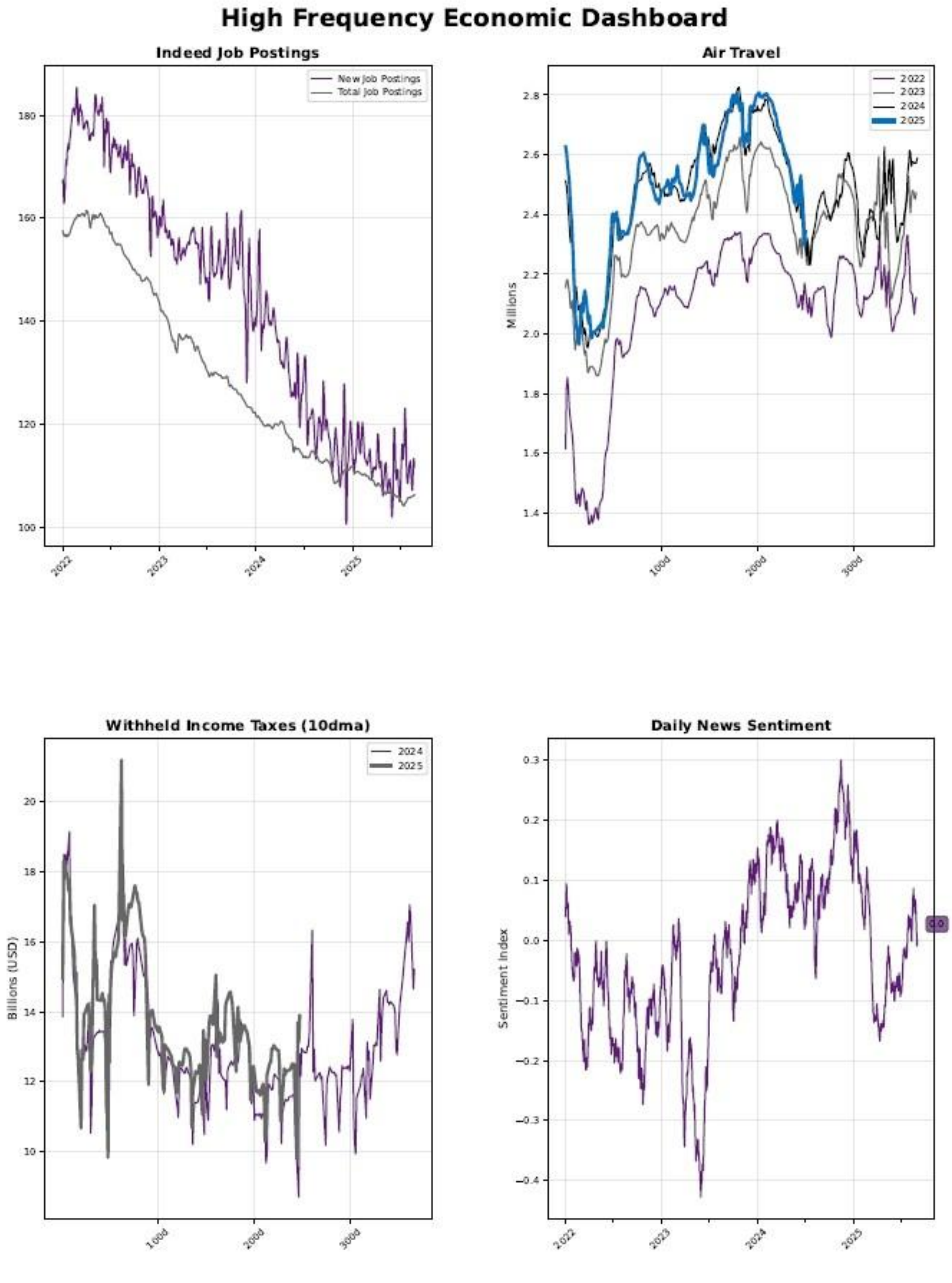
NBER RECESSION INDICATORS DASHBOARD



Past 7 cycles excluding Covid-19 period

09/08/2025


High Frequency Economic Dashboard
Weekly Economic Index
WEI
13wma
2.5%
GDPNow
Q2 2025
2.9%
Redbook
6.5%
OpenTable (7dma)
8.4%
Box Office (7dma)
2022
2023
2024
2025
Billions (USD)
Initial Claims
Thousands
Week


High Frequency Economic Dashboard
Indeed Job Postings
New Job Postings
Total Job Postings
180
160
140
120
100
2022
2023
2024
2025
Air Travel
2022
2023
2024
2025
Millions
2.8
2.6
2.4
2.2
2.0
1.8
1.6
1.4
100d
200d
300d
Withheld Income Taxes (10dma)
2024
2025
Billions (USD)
20
18
16
14
12
10
100d
200d
300d
Daily News Sentiment
Sentiment Index
0.3
0.2
0.1
0.0
-0.1
-0.2
-0.3
-0.4
2022
2023
2024
2025

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