

# Dutta's Monetary Thoughts

September is a lock

Neil Dutta

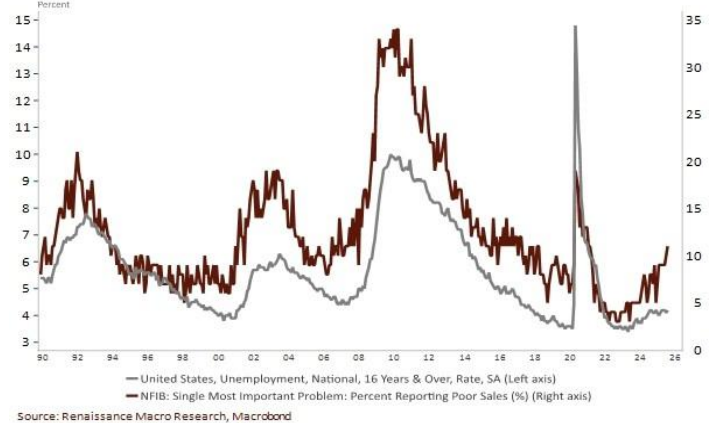
## Small firms complaining about poor sales

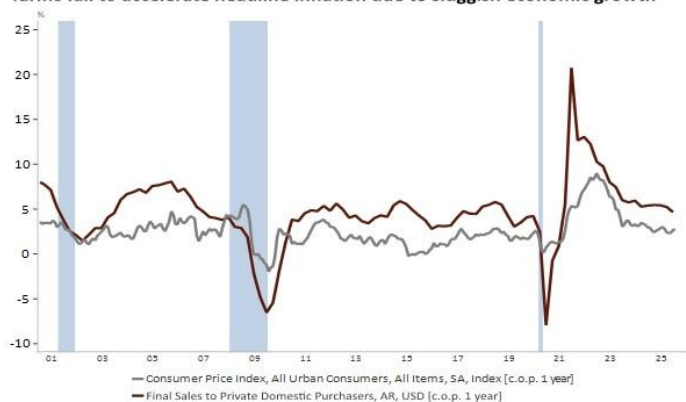
- The NFIB Small Business Optimism Index improved to a five-month high of 100.3 in July. A net 36 percent of small firms expect the economy to improve, the most since February; this series has been positive since the election. However, during this time, the economy has been slowing. There is a gap opening between the perceptions of small firms and reality.
- Interestingly, this year we have seen the ISM Composite PMI sliding with the NFIB rising. The former has a much stronger relationship with growth. If you put the two series in a simple model, ISM is significant, NFIB is not. Perhaps the rise in small business confidence reflects the recent passage of the tax bill.
- Second, while small business sentiment improved in July, more firms are noting "poor sales" as their single most important problem. This series rose to 11 in July, the highest since February 2021. When firms fret about weak sales, unemployment is usually rising.

ISM composite PMI slides while NFIB rises



Poor sales concerns rise, hinting at unemployment trends



**Tariffs fail to accelerate headline inflation due to sluggish economic growth**


Source: Renaissance Macro Research, Macrobond

## September a lock

- If tariffs are causing an inflation problem, then headline inflation rates ought to be accelerating. However, overall inflation is not rising as rapidly as expected likely because nominal growth remains sluggish. In July, headline CPI rose 0.2%. Over the last six months, headline CPI is just 1.9 percent an annual rate, that is the slowest since October 2024. Perhaps this is why surveys of household inflation expectations have been easing recently.

- For the Fed, July's CPI data likely cements a September rate cut. You might be thinking, why not a bigger upfront move? Doves on the FOMC need to fight one battle at a time. There is a wide contingent of folks on the FOMC with tariff derangement syndrome, not seeing cuts at all this year. They won't be able to make the leap from no cuts to a large upfront move overnight.

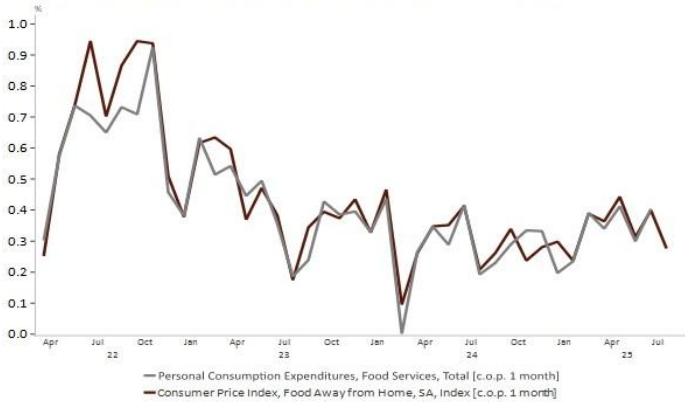
**Dental services not tariffs drove July Core CPI**


Source: Renaissance Macro Research, Macrobond

- Tariffs were not really the proximate cause of the pickup in core CPI in July. Medical care services surged 0.8% over the month led by an unprecedented 2.6% burst in dental services. Had it not been for this rise in dental services, core CPI would have advanced 0.27% over the month instead of 0.3%.

- The most obvious area tariffs are pushing up prices is in core goods, specifically household furnishings, and supplies, which rose 0.7% after a 1% increase in June. Apparel prices rose just 0.1%; while footwear prices are rising, there was a notable offset from men's and boys' apparel. Used car prices rose 0.5% after four consecutive months of decline though latest auction price data implies some cooling ahead.

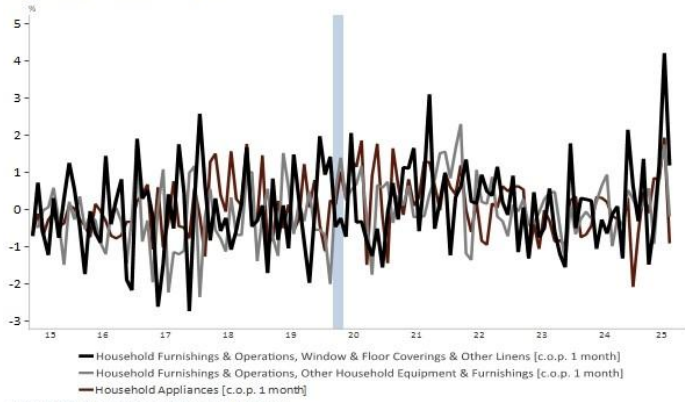
Food away from home CPI shows weakest growth since January



Source: Renaissance Macro Research, Macrobond

- Services continue to ease modestly. A few areas stood out to me. First, food away from home CPI rose 0.3% over the month, the weakest since January. That feeds into core PCE while feeding into headline CPI. Second, the hospitality industry might be under some pressure. Occupancy rates likely ebbing. CPI for hotels and motels has declined for the fifth consecutive month. Over the last six months, prices for this category have contracted 17.3% SAAR. Third, housing rents keep cooling; our blended aggregated rent index is up just 3.3% SAAR over the last three months.
- The market reaction to today's data is surprising. Stocks are rallying because a September cut is a lock; however, if I take the data at face value it implies that tariffs are not being passed onto consumers, which means firms are tolerating a profits margin squeeze. Firms will need to offset the squeeze somehow. That likely implies a continued slowing in employment, hours, cuts to capex or if firms want to roll the dice, a future increase in prices. Perhaps this matters more for economy-wide profits than it does for the firms that trade on the S&P500. Time will tell.
- As an aside, we await tomorrow's Producer Price Index. Dental services will push up core PCE, but we'll get additional details on medical care services from PPI. Portfolio management likely advances given the continued rally in equity prices. On the flip side, airfares are unlikely to rise as rapidly in PCE as they did in CPI today (4% MoM) and food away from home inflation eased somewhat over the month.

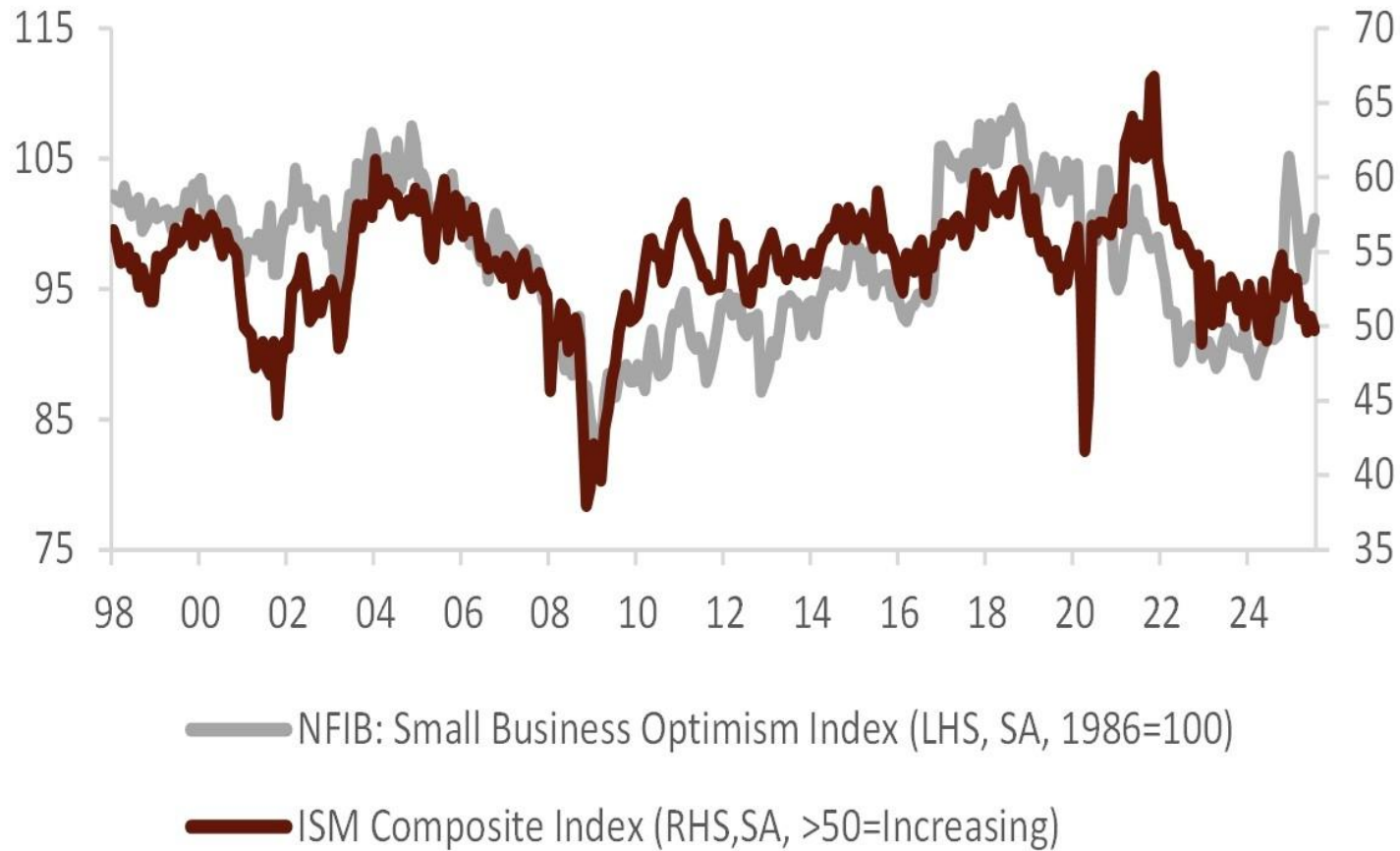
**Big drop in appliance prices**



Source: Renaissance Macro Research, Macrobond

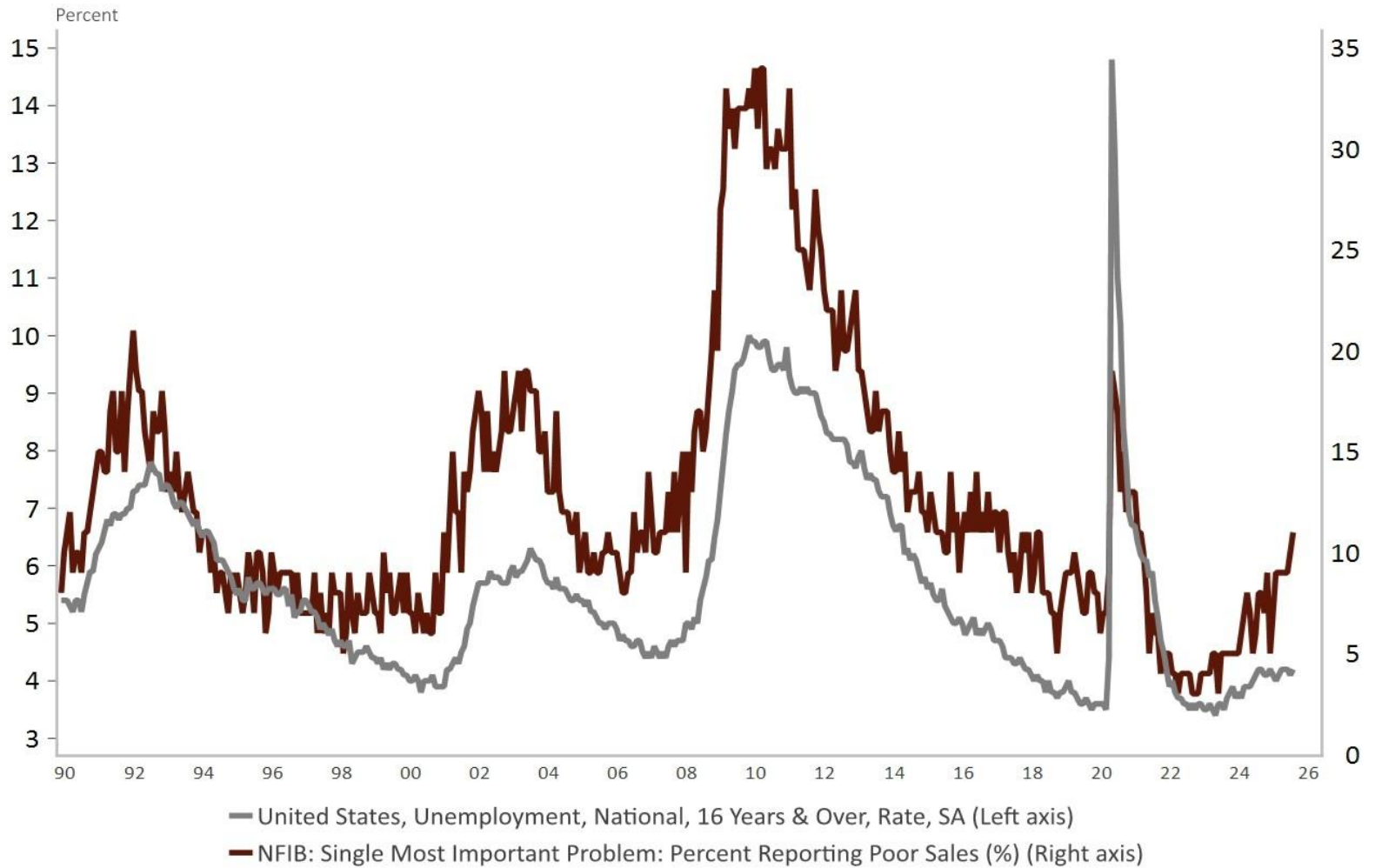
- I am thinking more about the sequential effects. The peak impulse of rising effective tariff rates is now behind us. So, how much more pass through should we plausibly expect? Household appliances actually fell last month while others didn't rise as much. At the margin, today's data indicates somewhat less pass through than anticipated by consensus.

## ISM composite PMI slides while NFIB rises



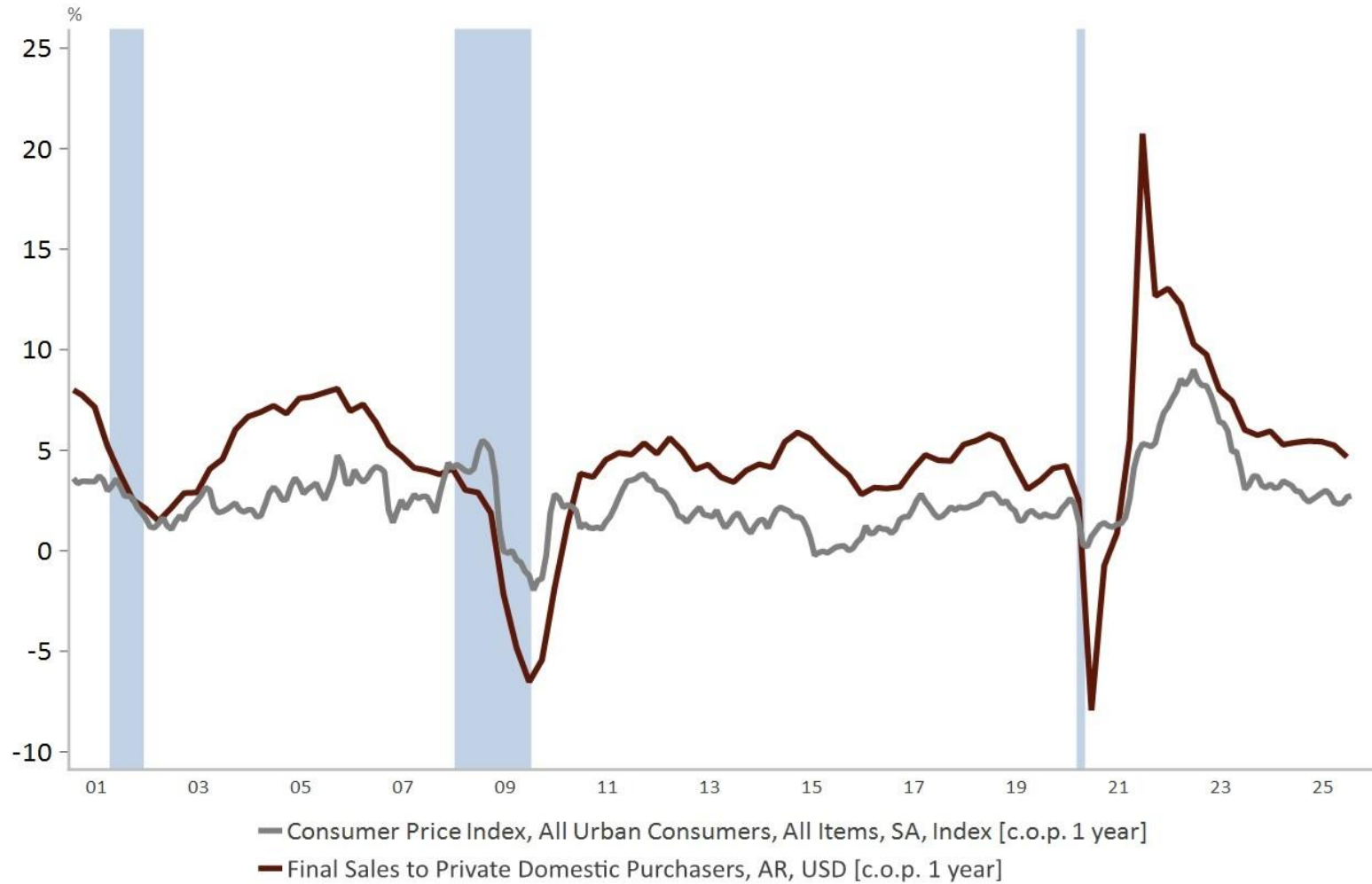
Source: Haver Analytics, Renaissance Macro Research

## Poor sales concerns rise, hinting at unemployment trends



Source: Renaissance Macro Research, Macrobond

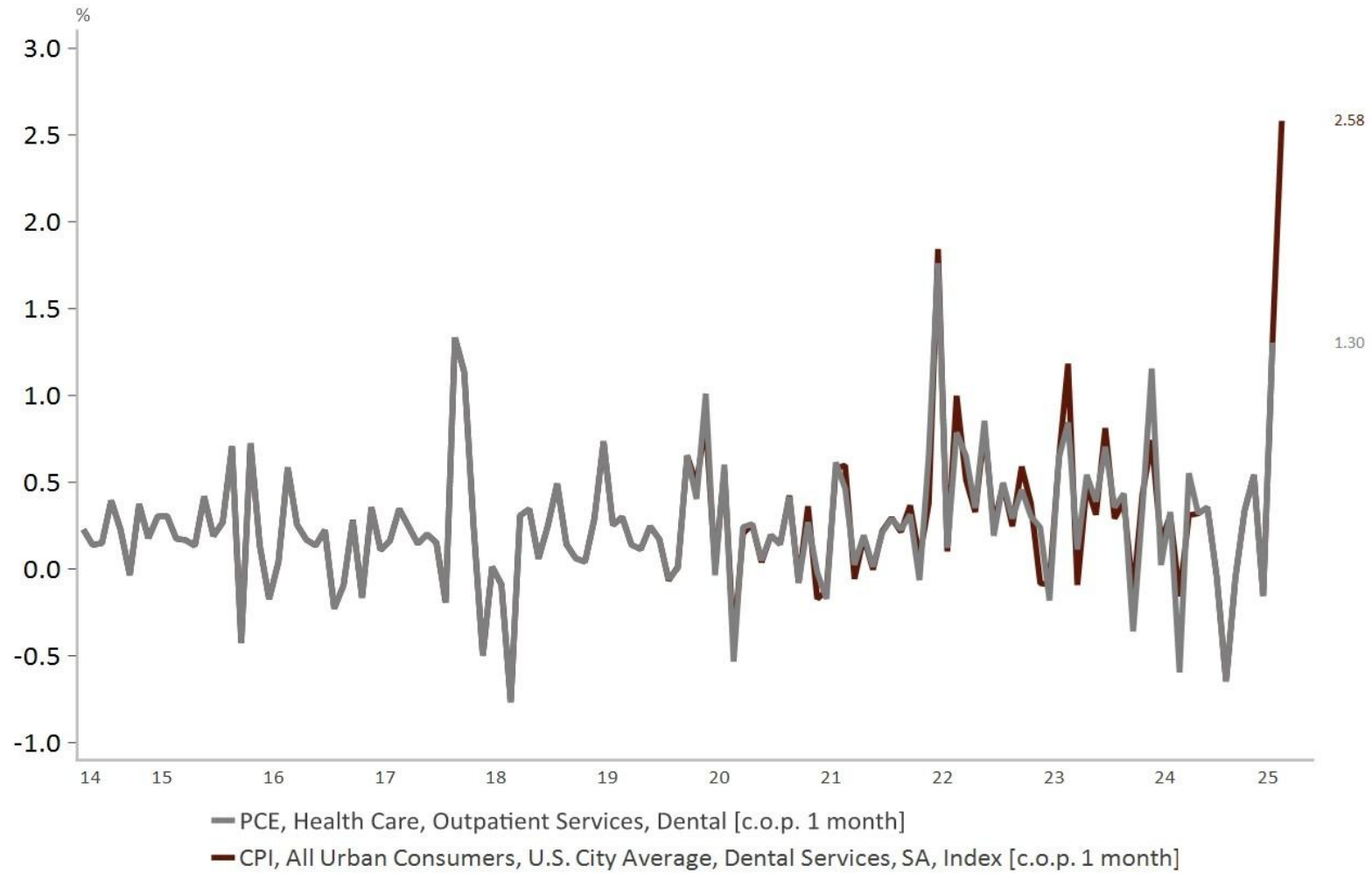
## Tariffs fail to accelerate headline inflation due to sluggish economic growth



Source: Renaissance Macro Research, Macrobond



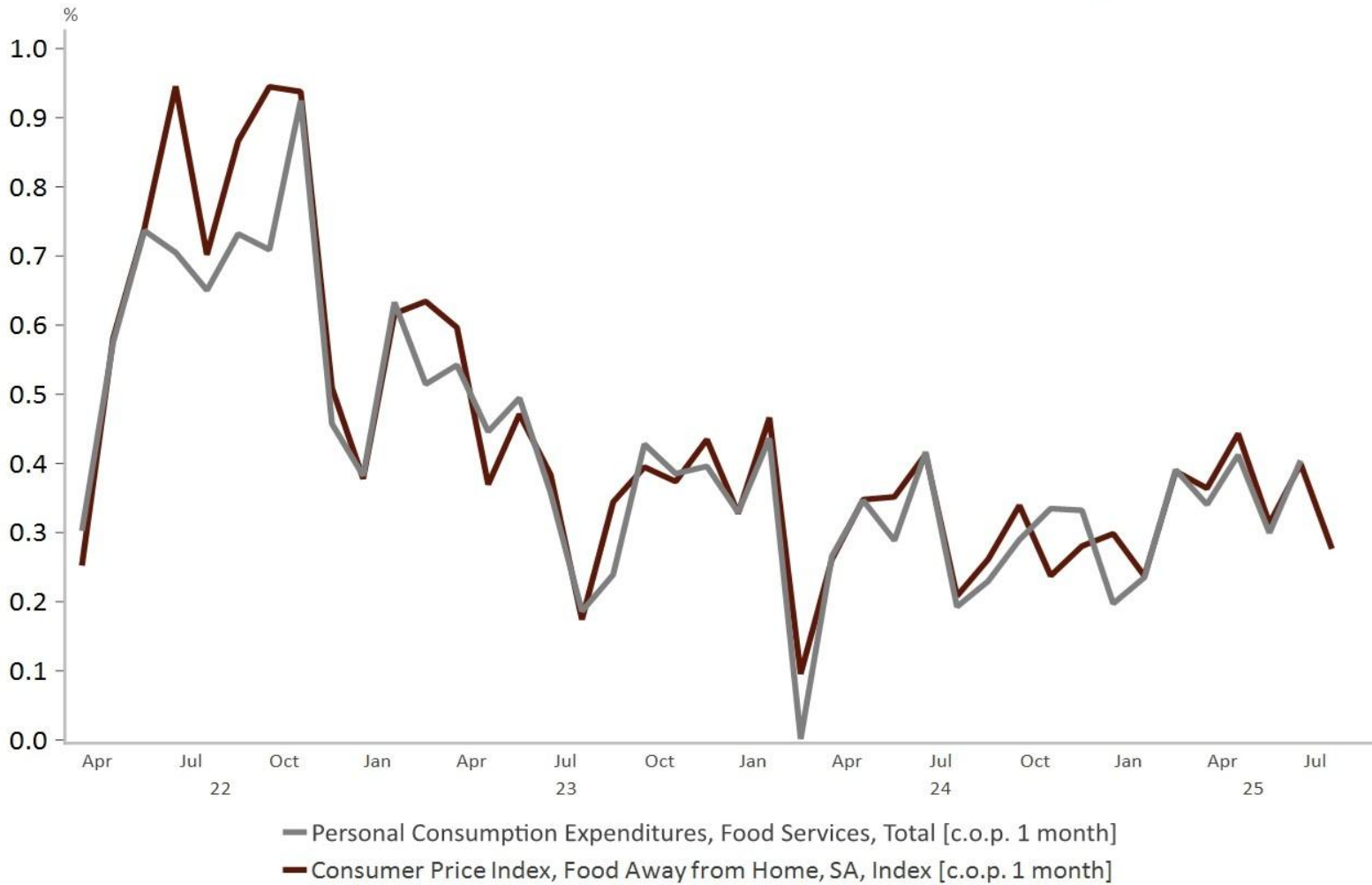
## Dental services not tariffs drove July Core CPI



Source: Renaissance Macro Research, Macrobond

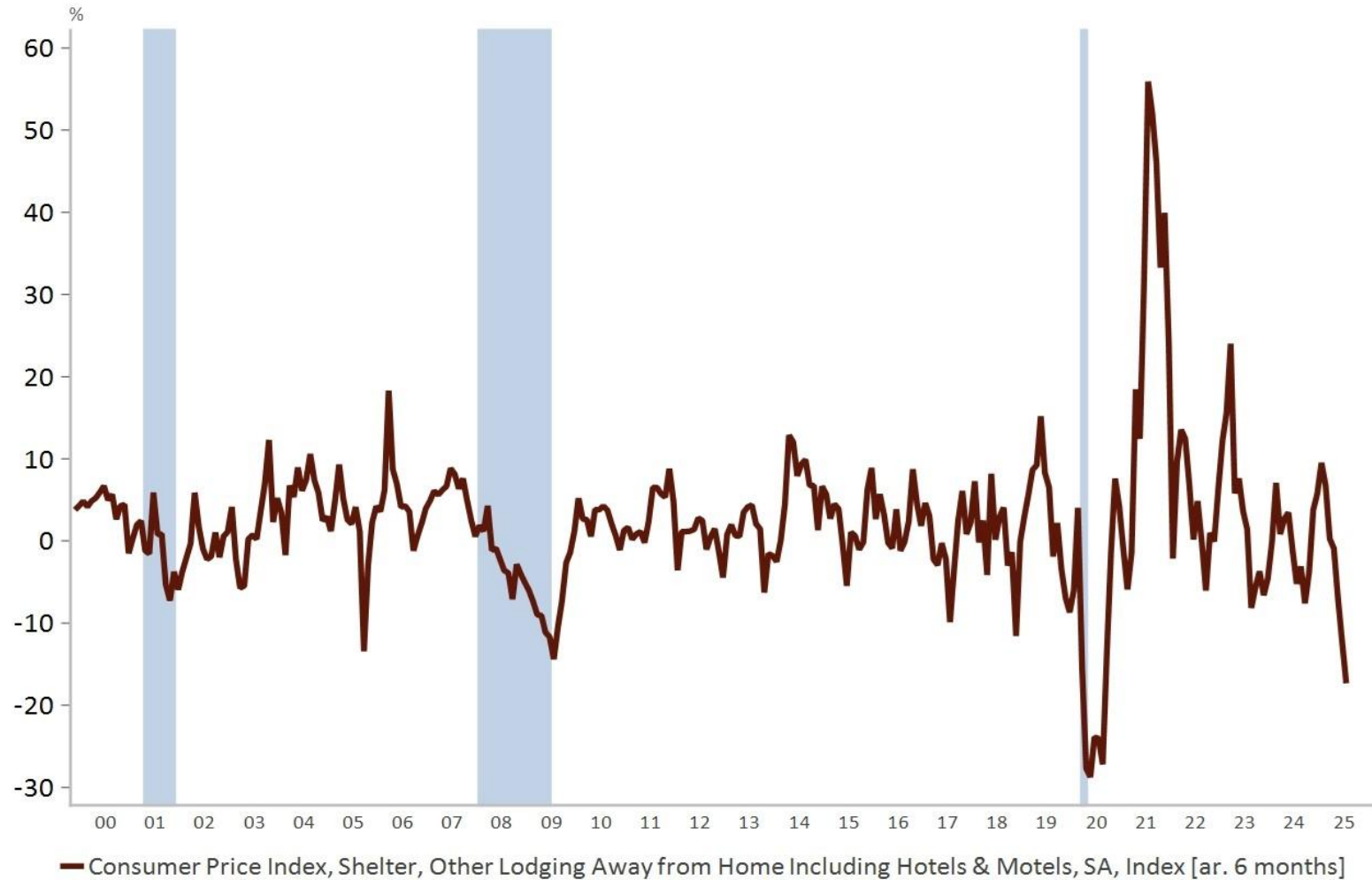


## Food away from home CPI shows weakest growth since January



Source: Renaissance Macro Research, Macrobond

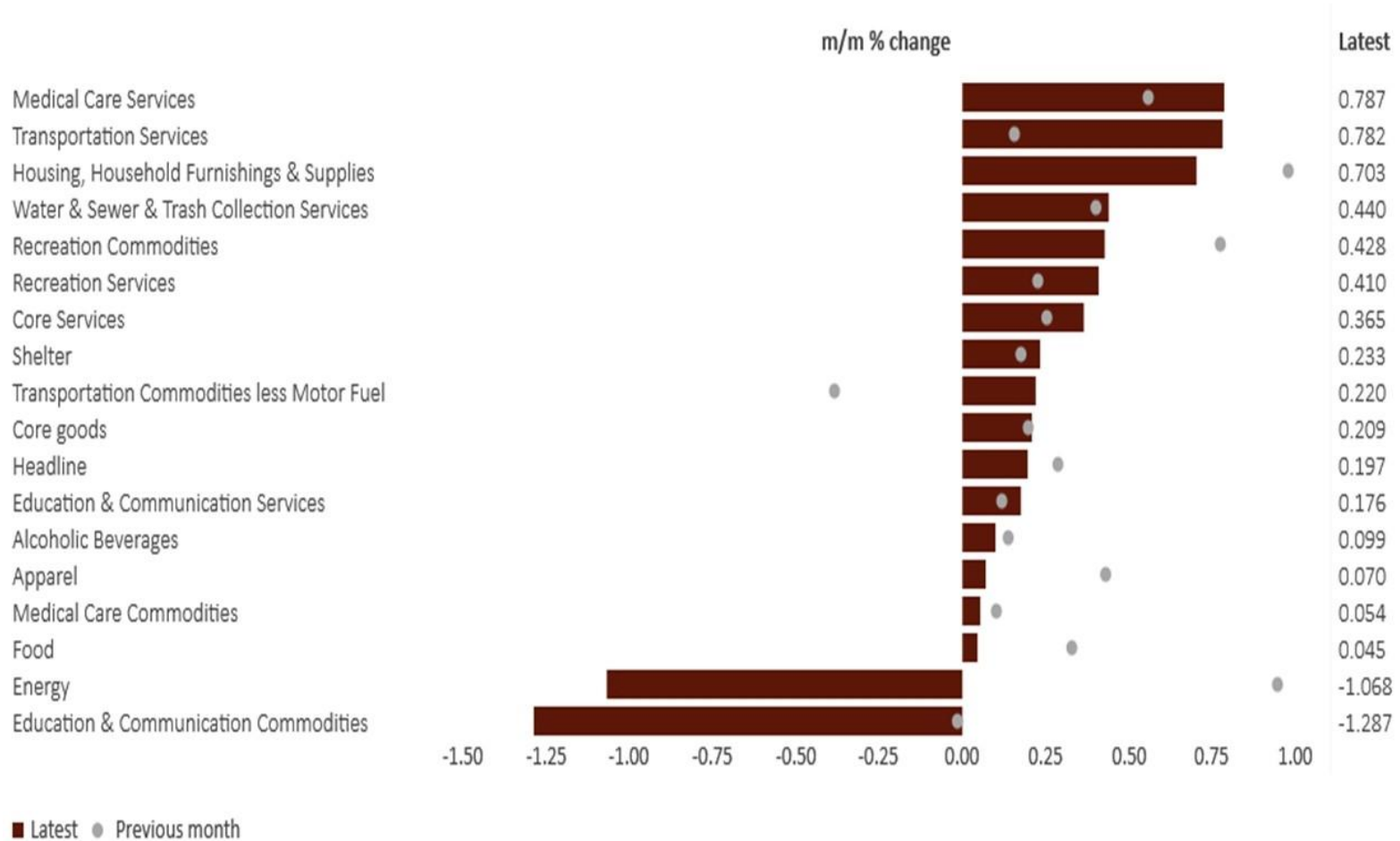
## Hotel and motel CPI declines fifth consecutive month amid occupancy pressure



Source: Renaissance Macro Research, Macrobond

## Monthly change in CPI inflation by category

SA, %; grey dots indicate previous month values



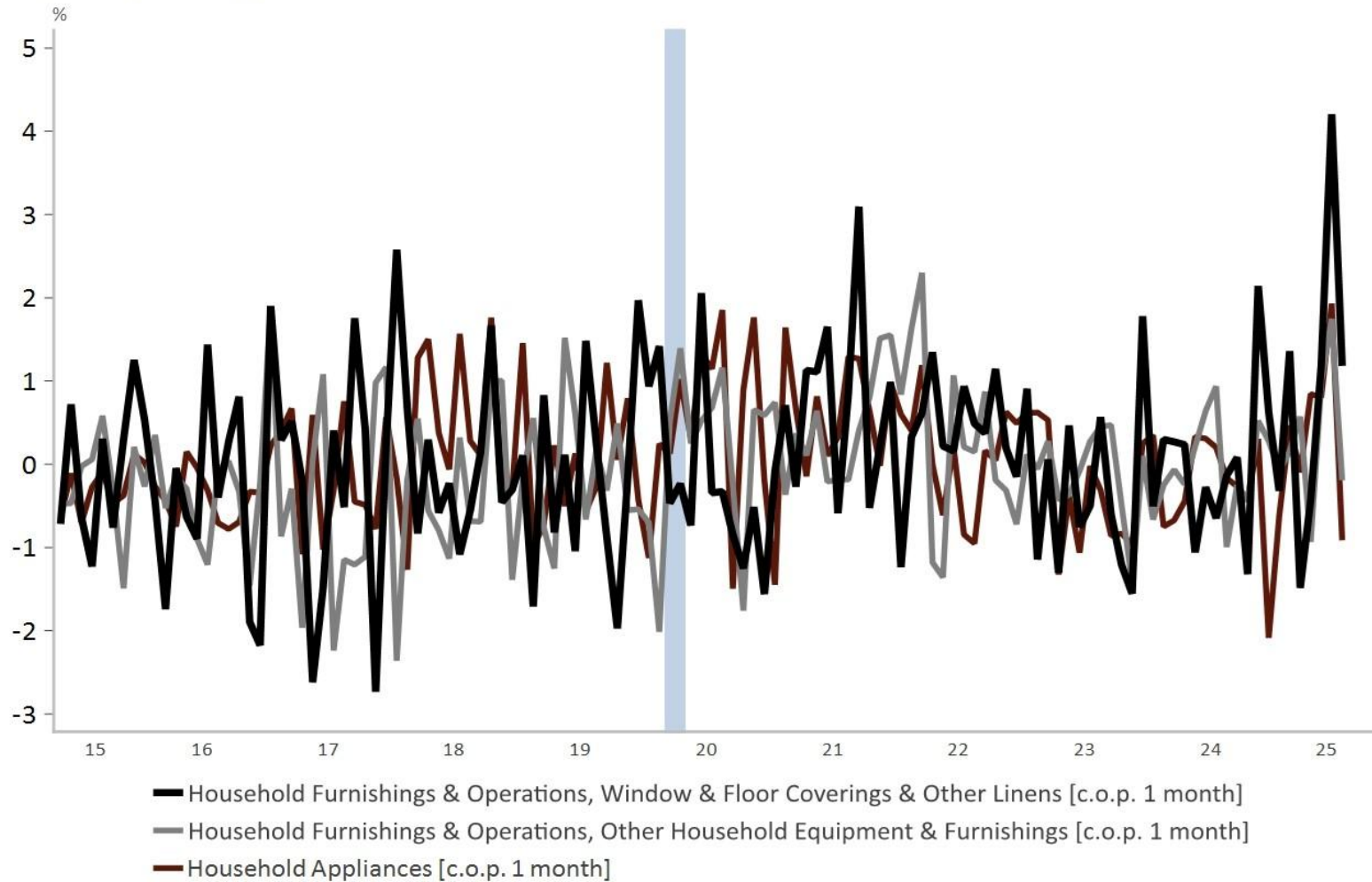
Source: Renaissance Macro Research, Macrobond, BLS

## Housing rental inflation is still cooling



Source: Renaissance Macro Research, Macrobond

## Big drop in appliance prices



Source: Renaissance Macro Research, Macrobond

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