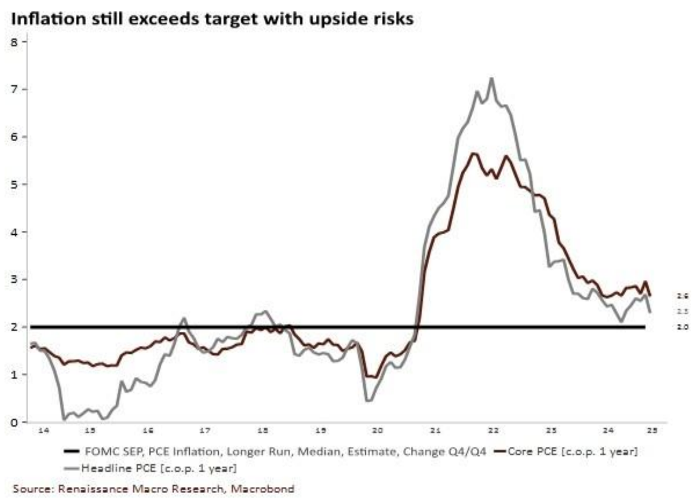
May 5, 2025

Dutta’s Monetary Thoughts

What if labor is getting worse first?

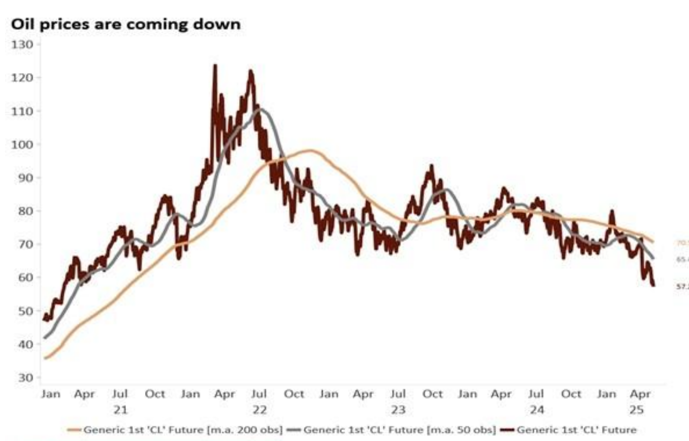
Neil Dutta

Powell still on pause

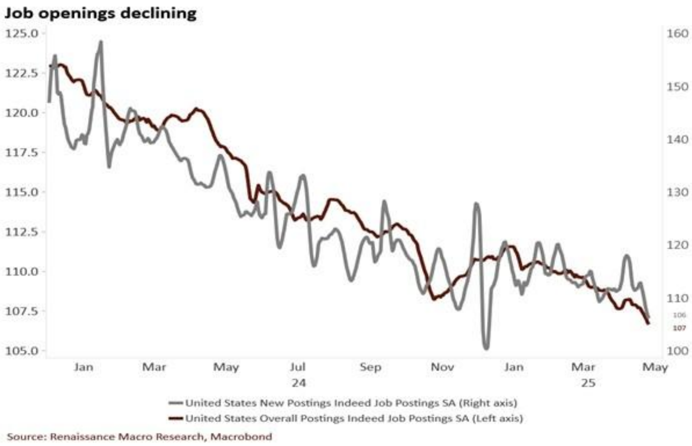


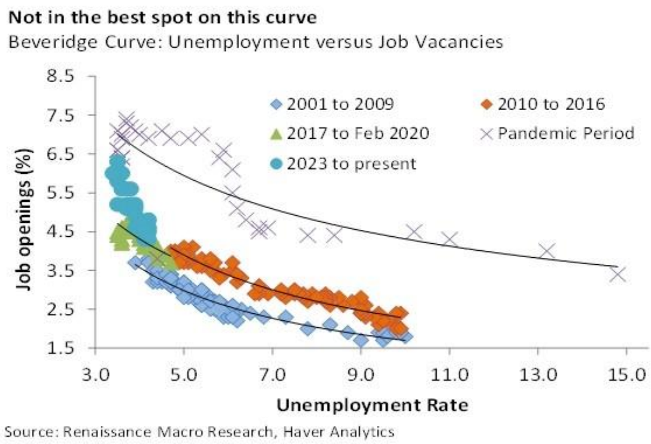
I am not expecting Chairman Powell to deviate from his recent public commentary on the outlook for monetary policy. Here is the main portion of his April 16 speech, ***Our obligation is to keep longer-term inflation expectations well anchored and to make certain that a one-time increase in the price level does not become an ongoing inflation problem****. As we act to meet that obligation, we will balance our maximum employment and price-stability mandates, keeping in mind that, without price stability, we cannot achieve the long periods of strong labor market conditions that benefit all Americans.* ***We may find ourselves in the challenging scenario in which our dual-mandate goals are in tension. If that were to occur, we would consider how far the economy is from each goal, and the potentially different time horizons over which those respective gaps would be anticipated to close****.*

For the time being, this means putting more emphasis on inflation than on unemployment. After all, the unemployment rate is right on the Fed’s longer run estimate of 4.2 percent. By contrast, headline and core PCE inflation remain somewhat above the Fed’s target of two percent and the near-term risks are skewed to the upside.



I don’t think Powell should shut the door on a June rate cut. Keep your options open. First, the risks to the unemployment are to the upside. Second, the recent drop in oil prices is notable. In the short-run, this may blunt the effects of tariffs; after all, energy prices play an outsized role in the month-to-month swings on consumer prices. Moreover, lower energy prices will tend to help keep inflation expectations down, one reason the Fed says its holding off in the first place.





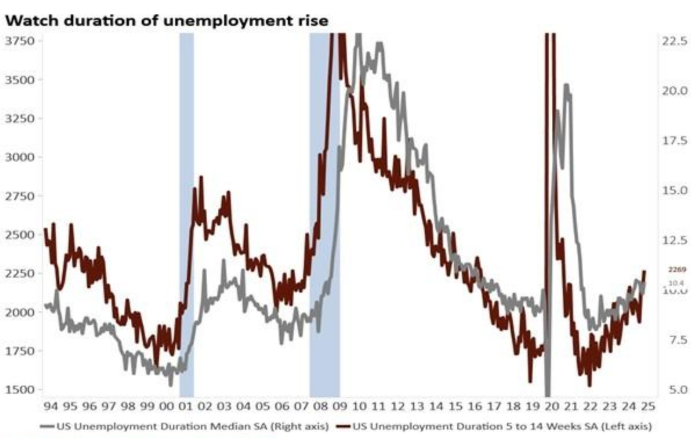
Labor market light is dimming

Under almost no circumstances should investors assume the US labor market is out of the woods. Slack continues to build and the Fed is not yet ready to step in and arrest the loss of labor market momentum.

Here is what stands out to us.

• **Job openings continue to decline.** The latest data from Indeed show job posting sliding to fresh lows, a sign excess labor demand continues to cool. These series do a reasonable job of following the official data from the BLS.

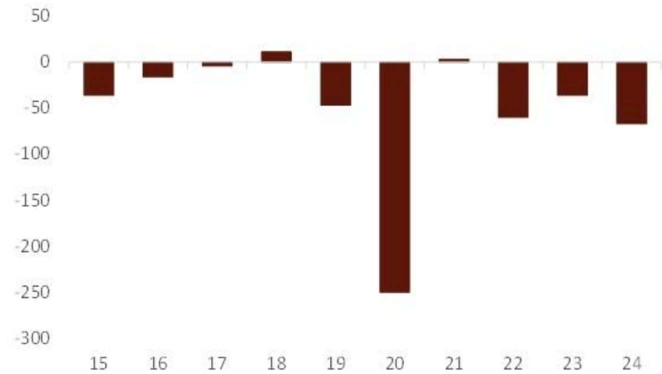
• Importantly, **the labor market is operating at a point along the Beveridge Curve where more weakness in job vacancies will likely result in higher rates of unemployment.**



• **Slack continues to build and wage growth continues to cool**. Notably, we're seeing a rising pool of medium term unemployment, those unemployed between 5 to 14 weeks. **The duration of unemployment likely climbs this summer**. Next, rising slack in the labor market implies slowing wage growth. Indeed, posted wage growth is already making fresh lows, implying realized wage growth will continue to moderate in the months ahead.

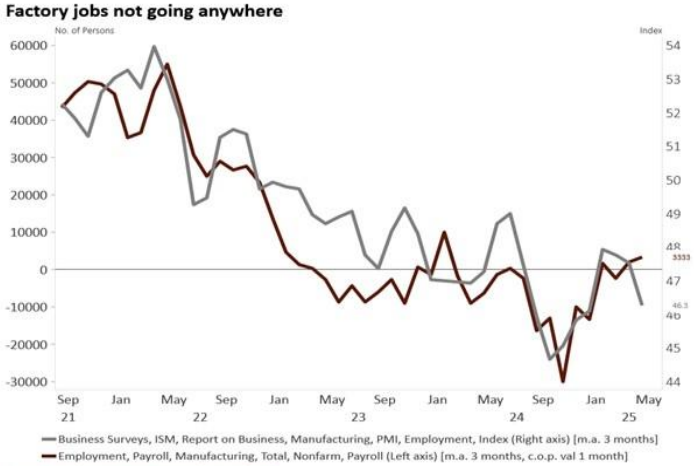
April is usually revised down

Revision to change in NFP: 3rd Estimate less 1st Estimate



Source: Renaissance Macro Research, Haver Analytics

Factory jobs not going anywhere



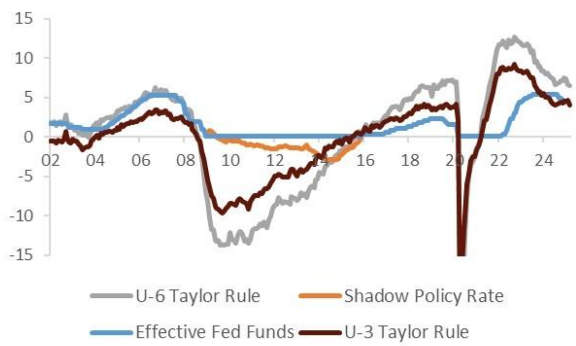
Source: Renaissance Macro Research, Macrobond

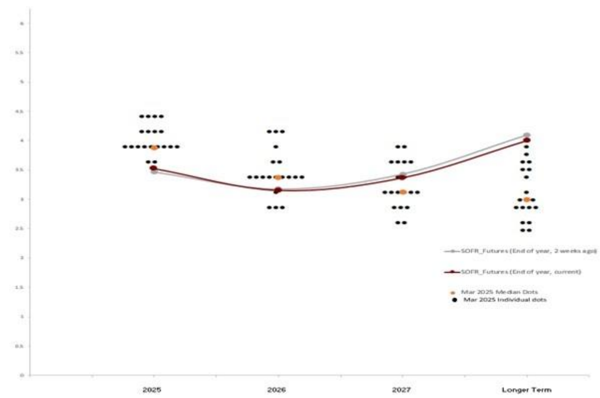
- **The odds of a downward revision to payroll employment growth is high.** Just over half the CES surveys were collected for April, well below normal. While this does not tell you the direction of the revision, it implies that there will be revisions. Another 30 percent of the surveys will likely come in over the next two months. **At any rate, April is historically revised down – that's been the case for 8 of the last 10 years and the average revision since 2022 is roughly -54,000.**

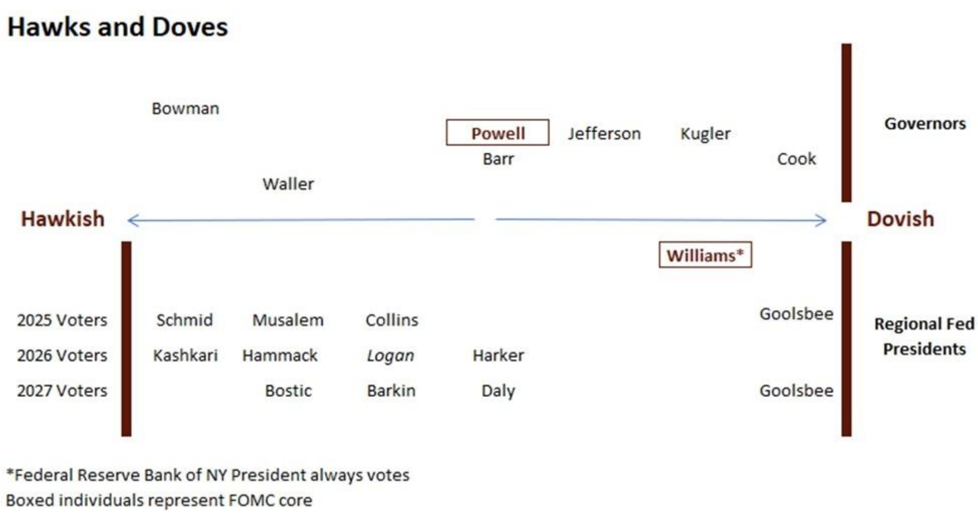
- **Goods producing employment remains sluggish**. For one, residential construction employment has declined over the last six months, which is quite unusual. Given the slack in the single-family housing market, I'd expect this to continue. Next, the recent decline in crude oil prices will weigh on oil and gas extraction jobs. Third, manufacturing employment has more downside over the next few months.

In short, there is very good reason to assume that the tone of the labor market data continues to worsen from here. We also know that the Fed is willing to tolerate this weakness, at least for the time being. If that's the case, those expecting a turnaround in household consumption ought to be concerned.

Monetary metrics

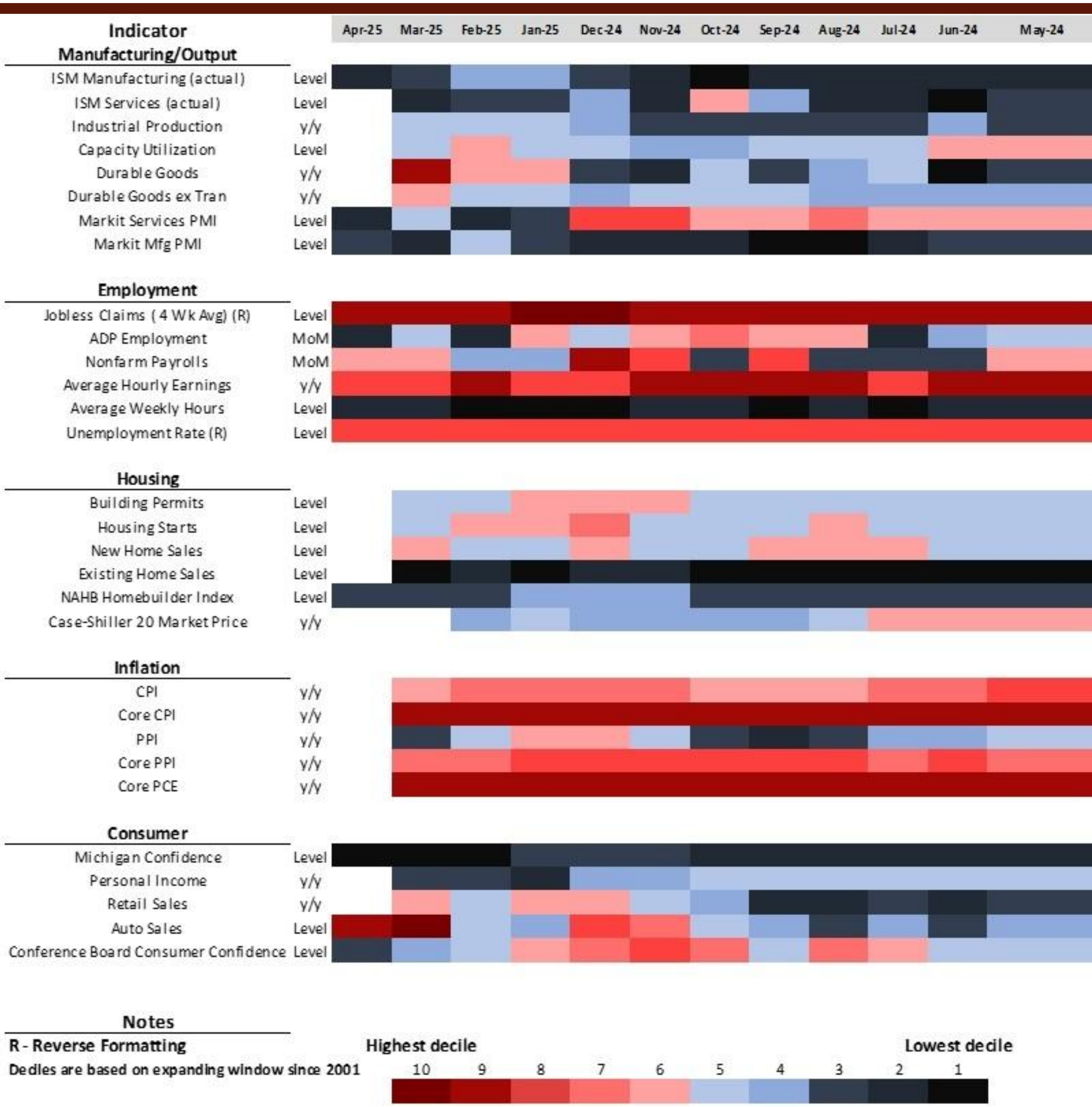




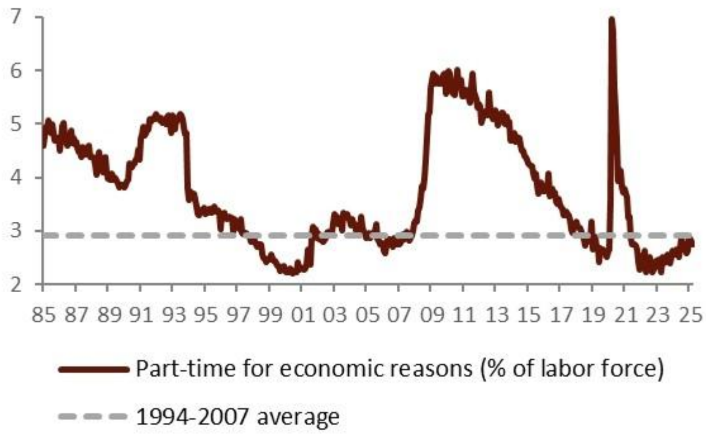


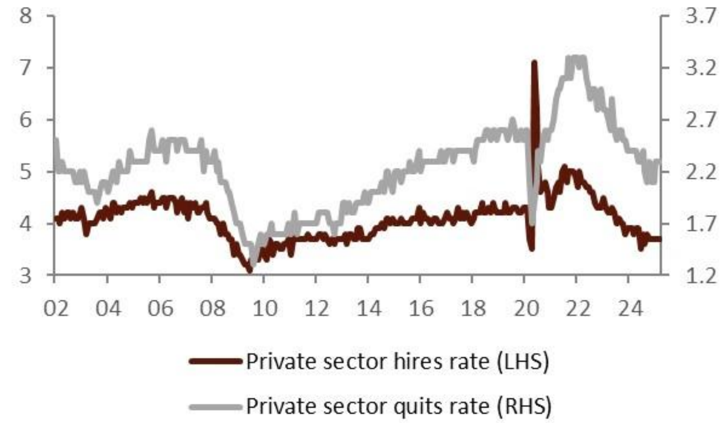
FOMC Forecasts	Median				Central Tendency			
	2025	2026	2027	Longer run	2025	2026	2027	Longer run
Change in real GDP	1.7	1.8	1.8	1.8	1.5–1.9	1.6–1.9	1.6–2.0	1.7–2.0
December projection	2.1	2	1.9	1.8	1.8–2.2	1.9–2.1	1.8–2.0	1.7–2.0
Unemployment rate	4.4	4.3	4.3	4.2	4.3–4.4	4.2–4.5	4.1–4.4	3.9–4.3
December 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

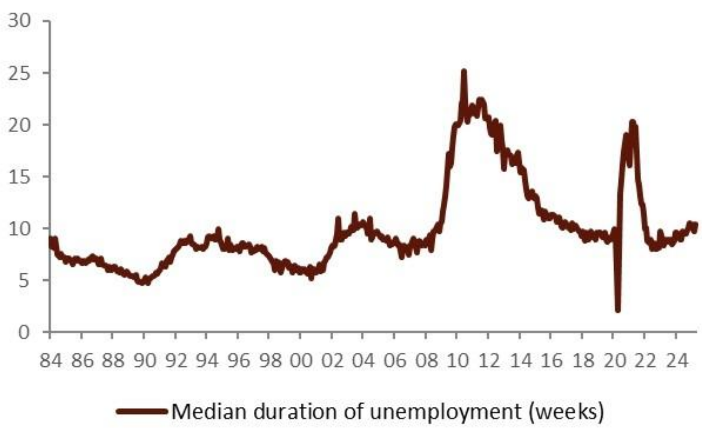
High frequency data heat-map

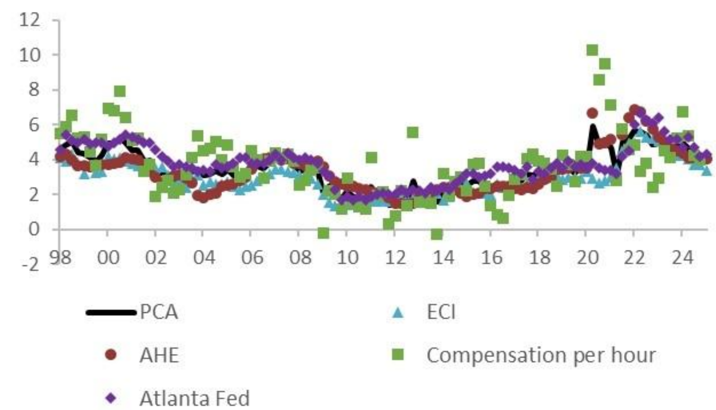


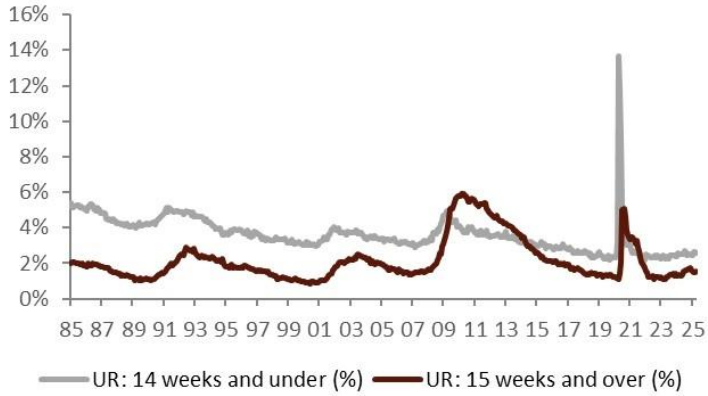
Labor market indicators

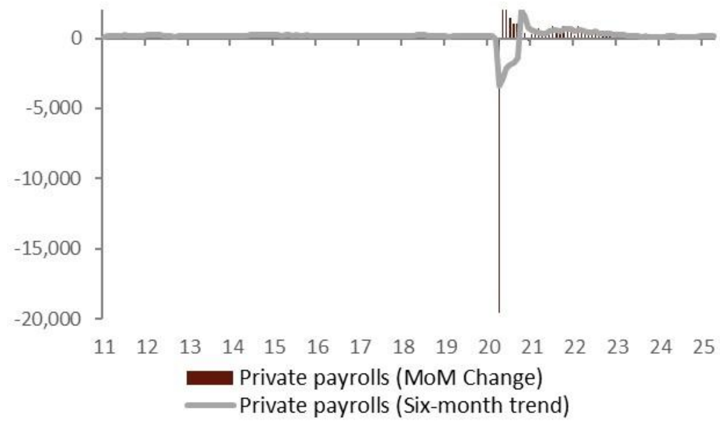




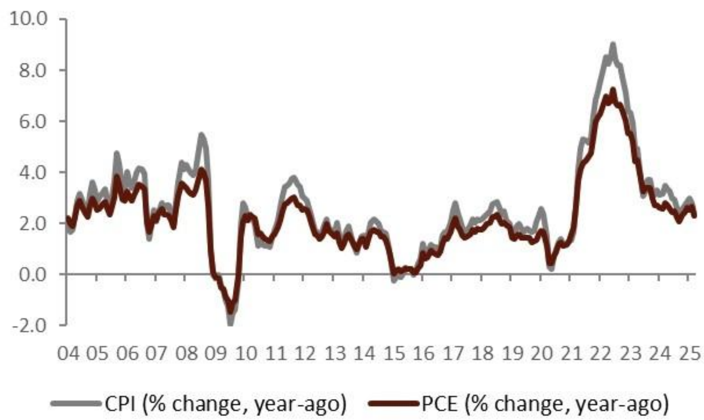


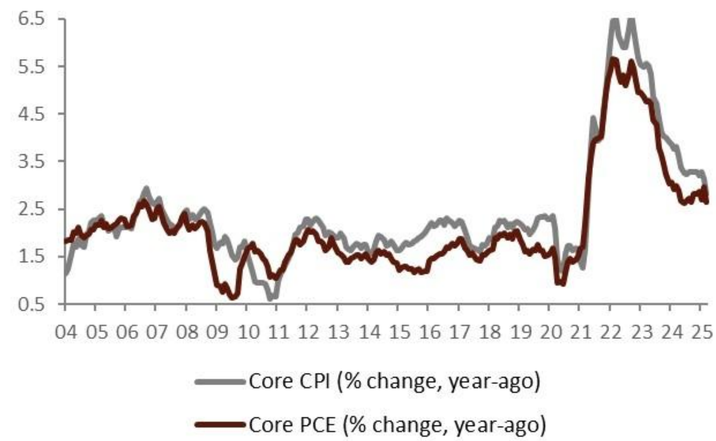


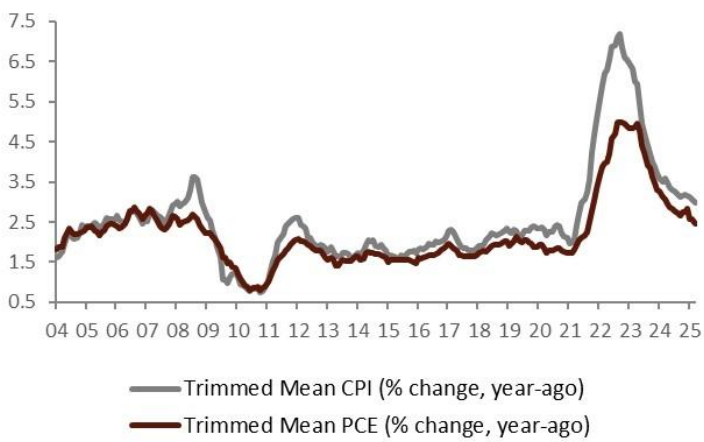


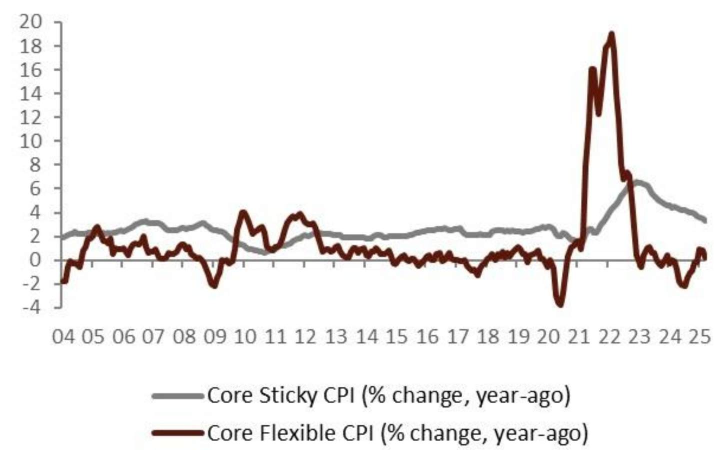


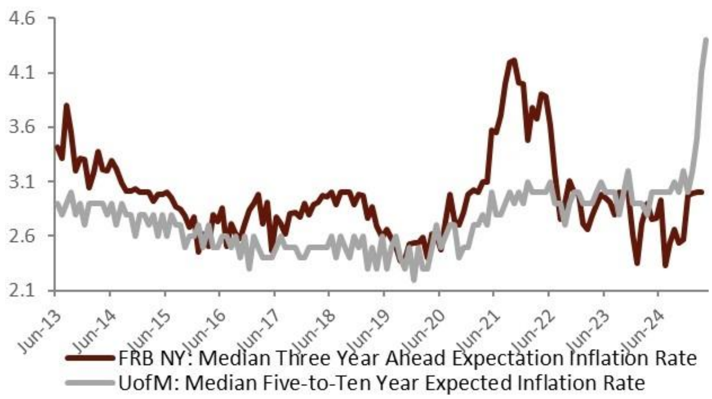
Inflation indicators










4.6
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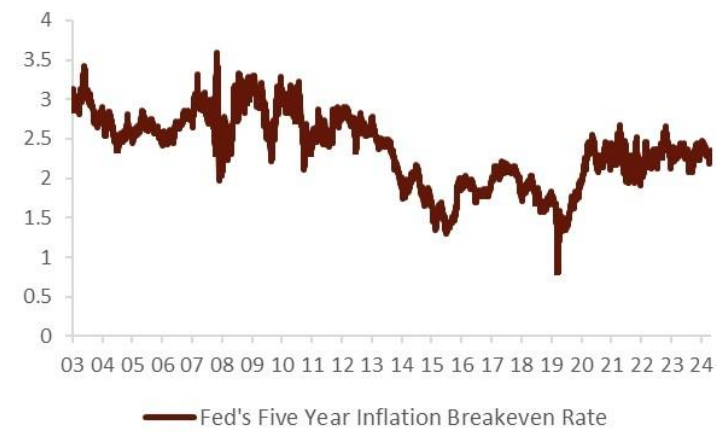
FRB NY: Median Three Year Ahead Expectation Inflation Rate
UofM: Median Five-to-Ten Year Expected Inflation Rate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03 04 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24
Fed's Five Year Inflation Breakeven Rate

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