

Dutta's Monetary Thoughts

A House Divided

Neil Dutta

FOMC Preview: A house divided ...

The FOMC remains divided heading into this week's meeting. I think the doves have the upper hand heading into the meeting and thereafter, but let's give the hawks their due and review both sides of the policy debate.

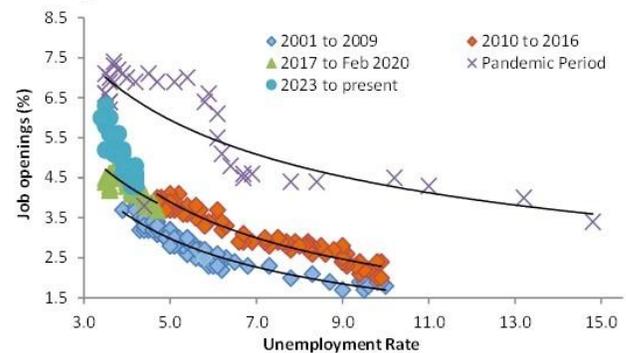
The doves

The labor markets are cooling off. The unemployment rate has already jumped to a fresh high of 4.44 percent. While the latest data from the BLS is stale, from September, private measures of employment point to an ongoing deterioration. We are probably still running below the breakeven rate necessary to hold the unemployment rate flat.

Importantly, the distribution of risks is shifting. The labor market is operating along a point in the Beveridge Curve where declines in job openings will likely result in a higher jobless rate. So, as labor demand continues to cool off, there is a risk we experience more of an outsized increase in the unemployment rate.

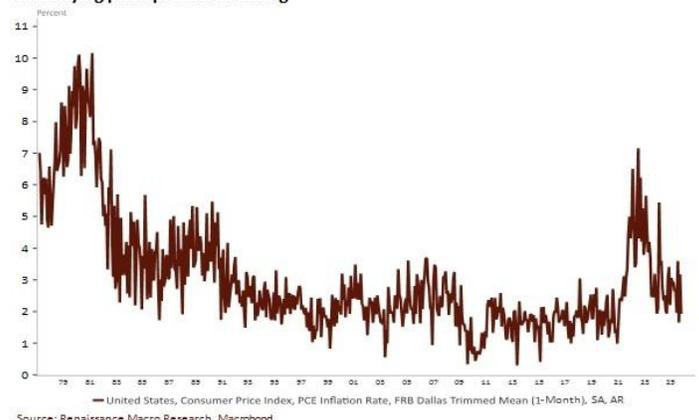
Despite tariffs, underlying inflation appears to be fading to close out the year. Trimmed-mean inflation, a favorite measure of the hawks, has run below 2.0 percent for three of the last five months ending in September. The University of Michigan's longer-run inflation expectations measure, another favorite of the policy hawks, is no higher now than it was last November.

Weaker demand will mean more unemployment
Beveridge curve



Source: Haver Analytics, Renaissance Macro Research

Underlying price pressures easing



Source: Renaissance Macro Research, Macrobond

In short, unemployment is deteriorating and inflation has been improving; the doves have the ammunition they need to press through a cut.

The hawks

The hawks are resistant to green-lighting addition rate cuts.

First, stock prices are at records and corporate credit spreads are tight. Thus, they conclude that policy can't be all that restrictive to begin with.

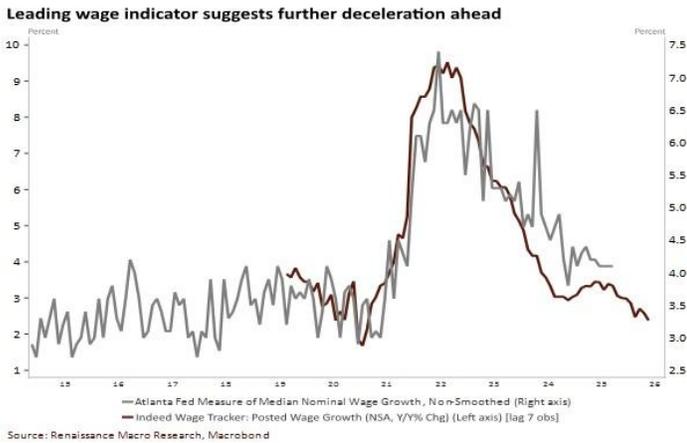
Second, GDP growth has been strong for the last two quarters and with fiscal expansion on the horizon, there is reason to expect GDP growth to remain solid into next year.

Third, wage growth might be stabilizing at an elevated rate. Average hourly earnings has advanced 3.8 percent over the last year while the Atlanta Fed's Wage Growth Tracker, which controls for compositional issues unlike average hourly earnings, has stood at 4.1 percent all year.

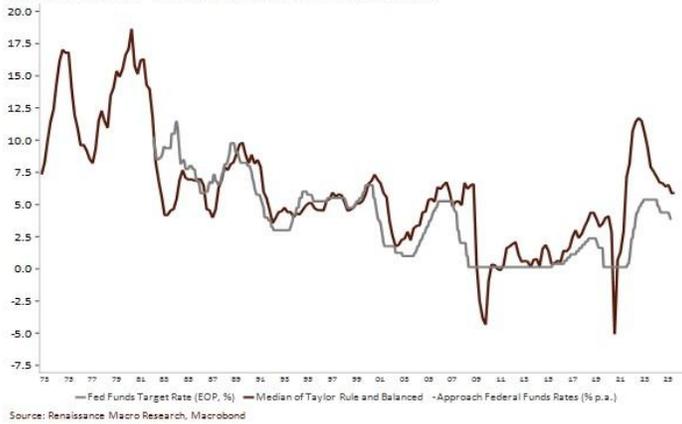
I've argued why I don't find these arguments especially persuasive, but right now, the hawks will not be convinced in the absence of more data. I think this creates a risk where its hard to pull the trigger on another cut until March, at the earliest.

Use the job market to push for cuts, not productivity

Members of the Trump administration have argued that Fed policy can allow the economy to run because we're on the verge of an epic productivity boom. Because productivity is strong, inflation is a non-issue, or so the thinking goes. Be like former Chairman Greenspan! I am not sure anyone on the Fed is going to be convinced of this.



Fed policy closely tracked taylor rule in Greenspan era



First, monetary policy at the time largely followed a Taylor Rule type framework. The Fed saw the data and responded in kind. If policy rates were largely moving sideways at the time, it was largely because the data were saying rates should not really move. Declines in unemployment were offset by a decline in the inflation rate.

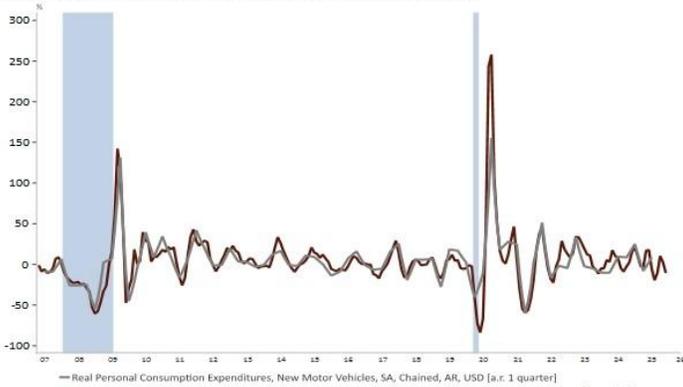
Second, it is true that Greenspan resisted the temptation to raise rates. Back in September 1996, Janet Yellen said this around the FOMC table” The probability of an increase in inflation is clearly higher when labor market slack is lower. For that reason, I conclude that the risk of an increase in inflation has definitely risen, and I would characterize the economy as operating in an inflationary danger zone.” The FOMC left rates unchanged at the time. The context here is important. Greenspan resisted the temptation to raise rates when inflation slowed after a period of having already slowed while unemployment kept sliding. Today, the economy is coming off a period of high inflation. Inflation is coming down with unemployment rate rising. So, current conditions are different than they were back then.

Moreover, by the late 90s, the Federal Reserve was aggressively *hiking* interest rates to deal with a red-hot jobs market. This came even as core inflation ran below 2.0 percent for most of that period amidst strong productivity growth.

Naturally, it is difficult to convince people of new-economy type dynamics. Most will take a show-me the evidence approach. Thus, I would advise against clamoring for upfront rate cuts because of a coming supply-side boom. Indeed, the latest data on productivity shows it rising inline with its historical average. Productivity growth usually comes after the adoption of the technology not alongside it.

Get back to the basics.

Auto sales slow as EV credits expire dampening consumption



Source: Renaissance Macro Research, Macrobond

Real spending slows to close Q3

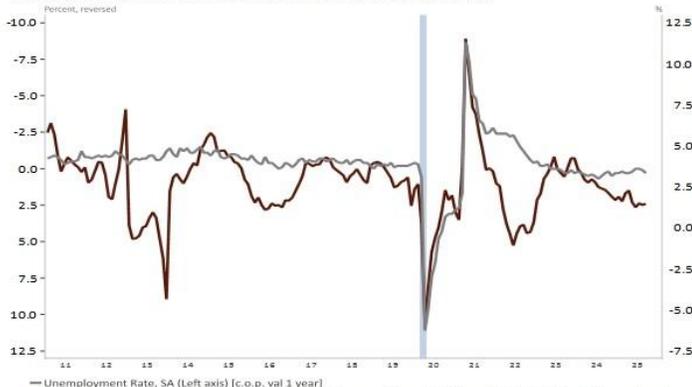
In September, real consumption was flat after being revised down 0.2ppt in August. If the level of September holds, real consumption will rise just 0.4% SAAR in Q4. In October, unit auto sales slowed as EV credits expired. Thus, there was less momentum heading into Q4 and so far, the data for October have been soft. This combination will likely weigh on tracking estimates for Q4 GDP.

PCE excluding Healthcare (Y/Y%)
YY%: y-axis truncated



Two things worth highlighting. First, over the last year, real PCE ex-healthcare has advanced just 1.9%. Historically, that's not consistent with a strong economy.

Cooling labor markets set to weaken real income growth



Source: Renaissance Macro Research, Macrobond

Second, as of September, real incomes net of transfers has been flat since April and only up 1.1% SAAR so far this year. With the labor markets cooling, I would assume an ongoing slowing in real income growth. Weaker income growth ought to weigh on household consumption in the months ahead.

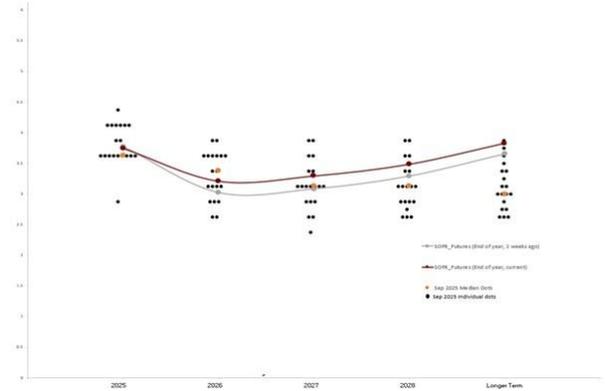
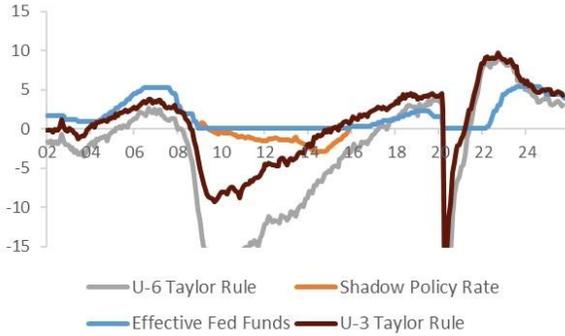
Heavy truck sales slump reveals non-tech investment weakness



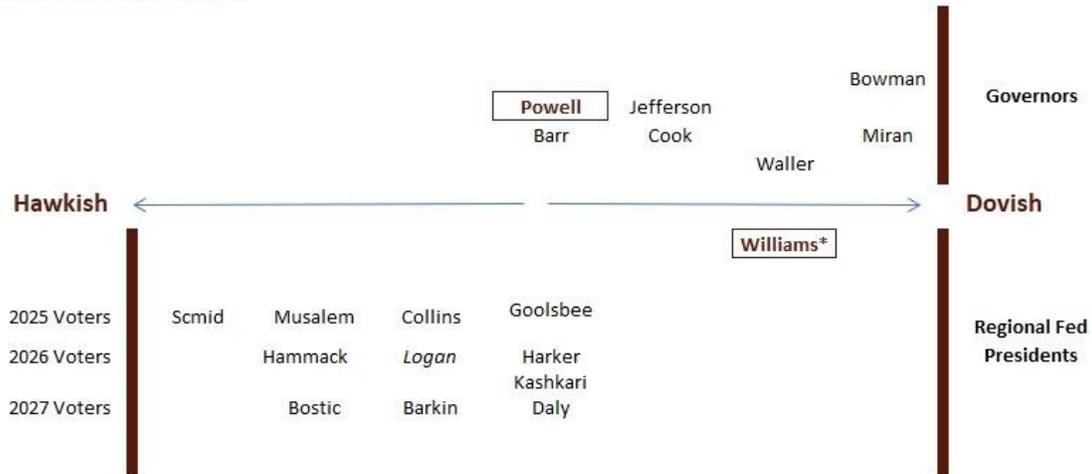
Class III and IV truck sales weak

Medium and heavy-duty truck sales (box trucks, step vans, larger walk in and city delivery trucks) tumbled sharply for four consecutive months before recovering slightly in November. As our nearby figure shows, this series feeds into private fixed investment in transportation equipment. The 3m/3m % SAAR is down 47.1%, as of November. Thus, this area is a drag on GDP growth in H2 2025 and serves as a reminder that outside of technology-related business investment, capex is not particularly strong now.

Monetary metrics



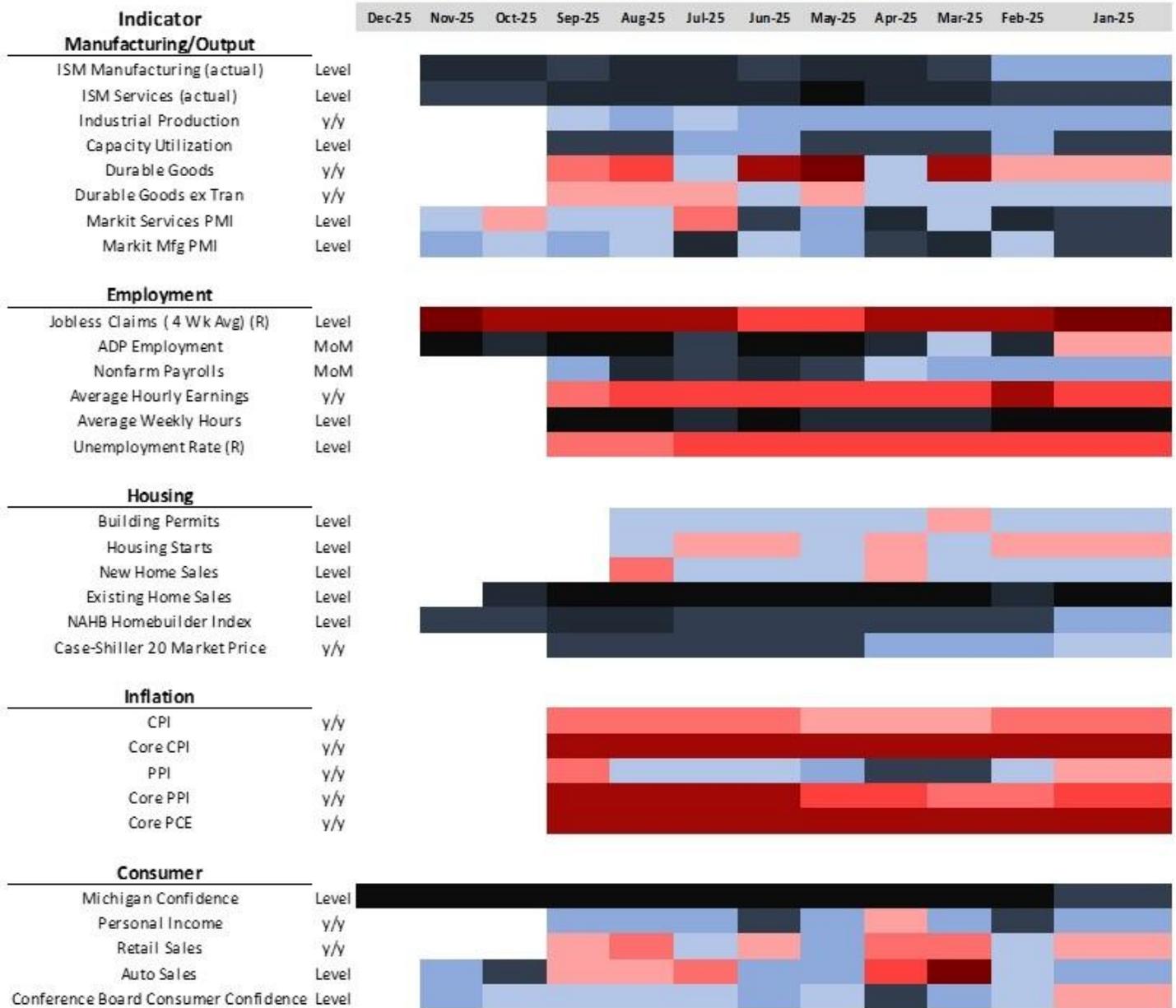
Hawks and Doves



*Federal Reserve Bank of NY President always votes
Boxed individuals represent FOMC core

FOMC Forecasts	Median					Central Tendency				
	2025	2026	2027	2028	Longer run	2025	2026	2027	2028	Longer run
Change in real GDP										
June projection	1.6	1.8	1.9	1.8	1.8	1.4-1.7	1.7-2.1	1.8-2.0	1.7-2.0	1.7-2.0
Unemployment rate										
June projection	4.5	4.4	4.3	4.2	4.2	4.4-4.5	4.4-4.5	4.2-4.4	4.0-4.3	4.0-4.3
PCE inflation										
June projection	3.0	2.6	2.1	2.0	2.0	2.9-3.0	2.4-2.7	2.0-2.2	2.0	2.0
Core PCE inflation										
June projection	3.1	2.6	2.1	2.0	2.0	2.8-3.2	2.3-2.6	2.0-2.2	2.0	2.0
Projected policy path										
Fed funds rate										
June projection	3.6	3.4	3.1	3.1	3.0	3.6-4.1	2.9-3.6	2.9-3.6	2.8-3.6	2.8-3.5
	3.9	3.6	3.4		3.0	3.9-4.4	3.1-3.9	2.9-3.6		2.6-3.6

High frequency data heat-map

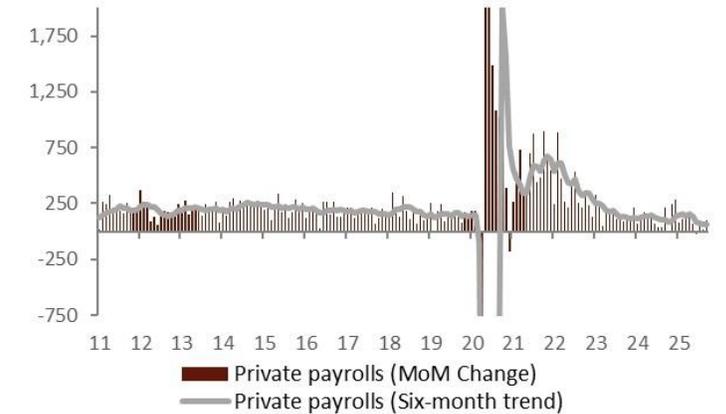
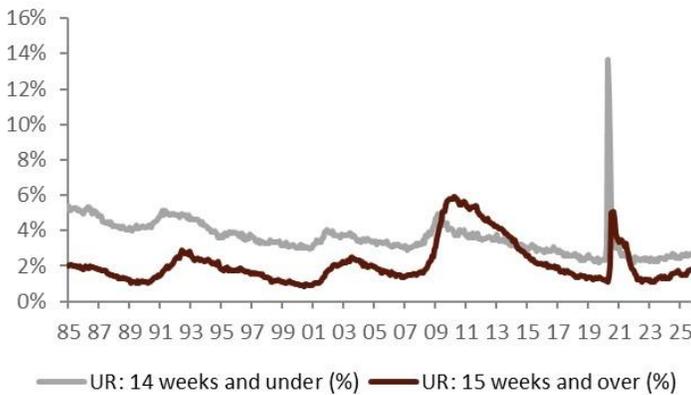
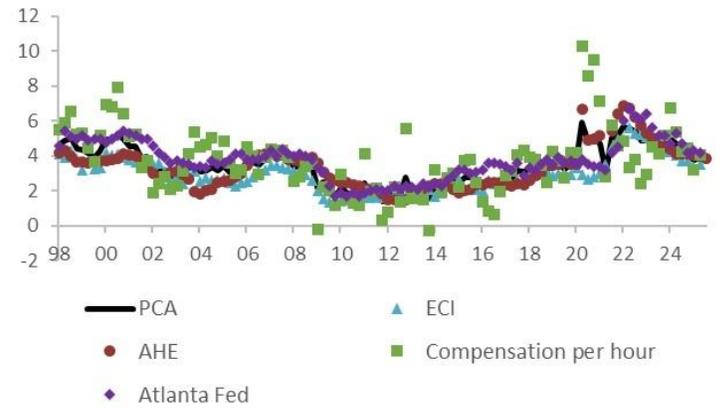
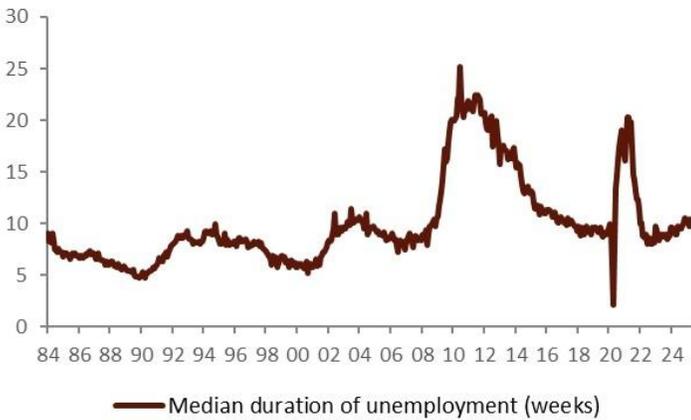
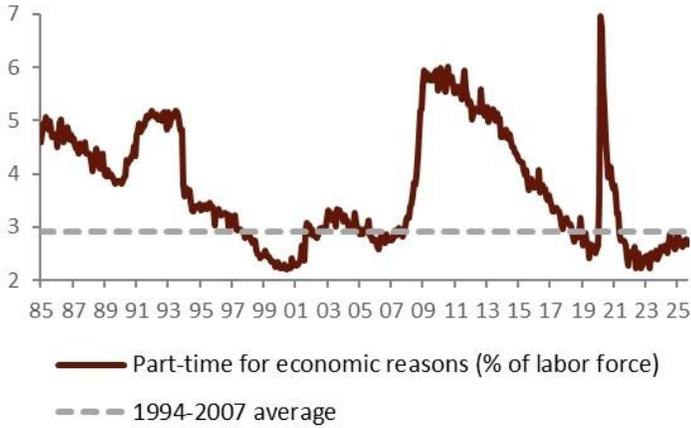


Notes

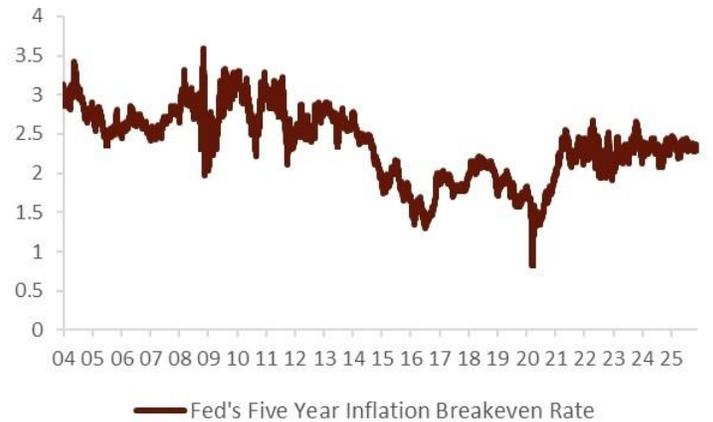
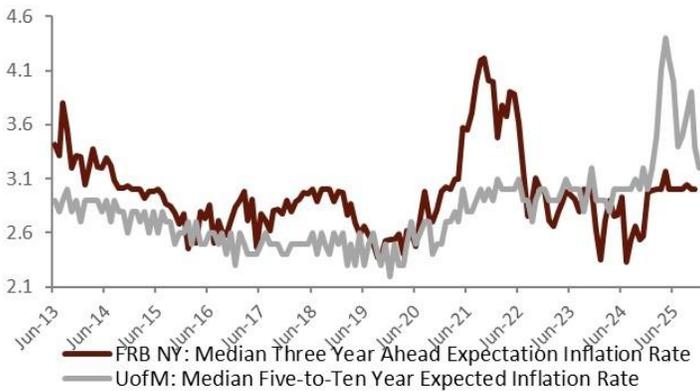
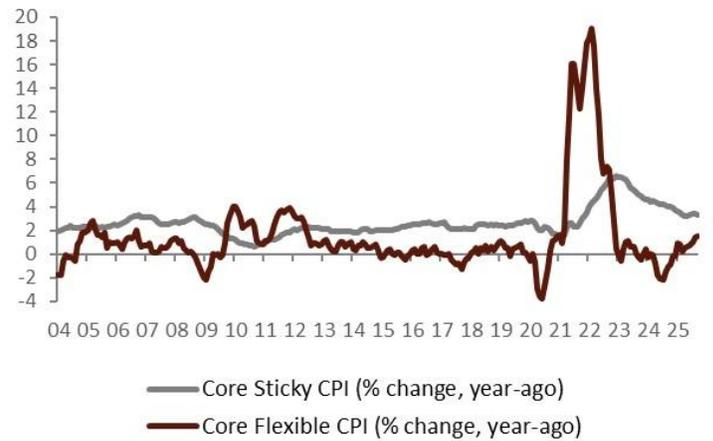
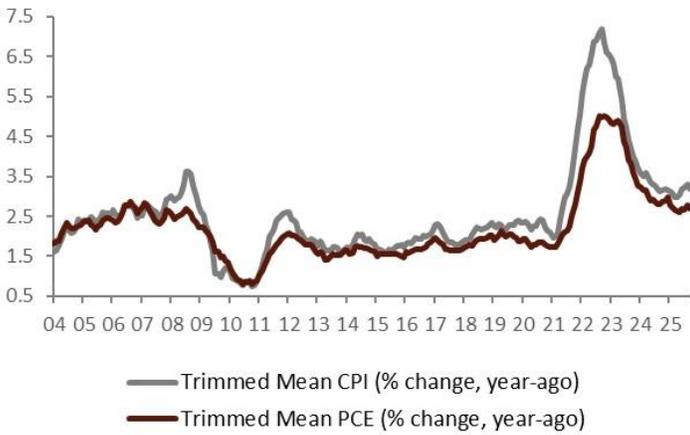
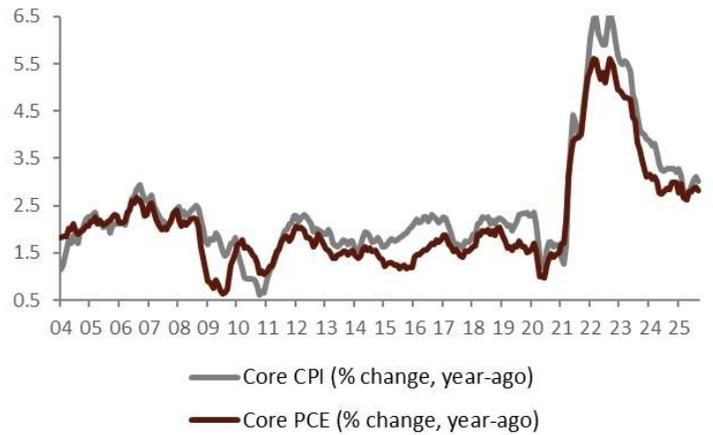
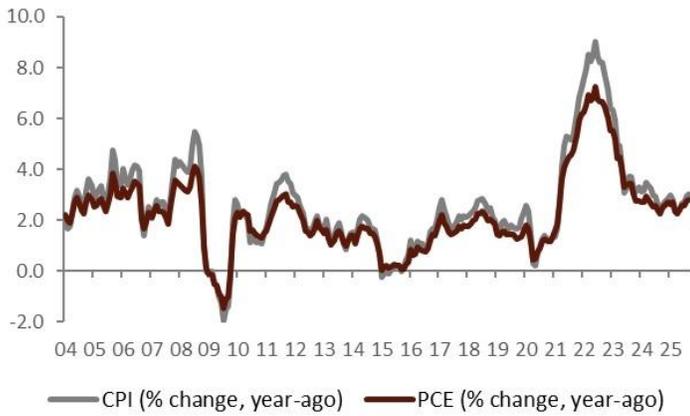
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Deciles are based on expanding window since 2001



Labor market indicators

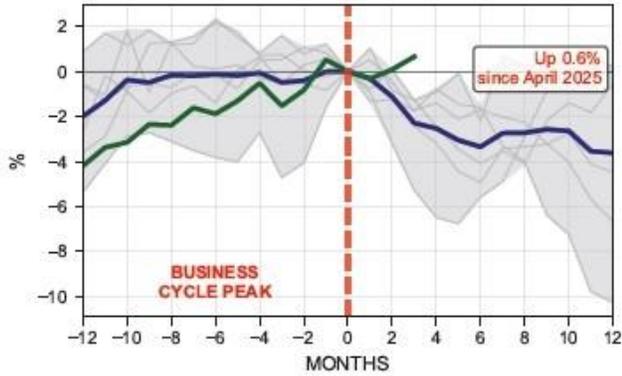


Inflation indicators

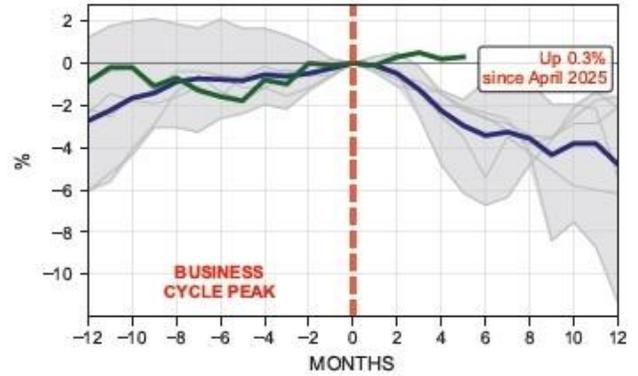


NBER RECESSION INDICATORS DASHBOARD

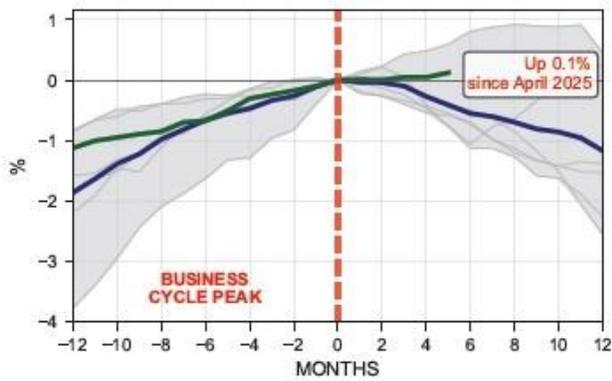
REAL SALES: MANUFACTURING AND TRADE INDUSTRIES



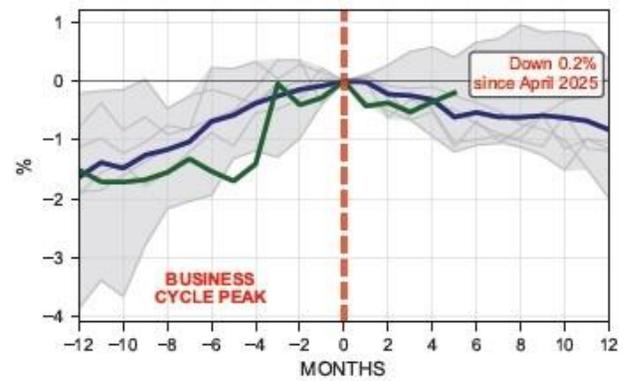
INDUSTRIAL PRODUCTION



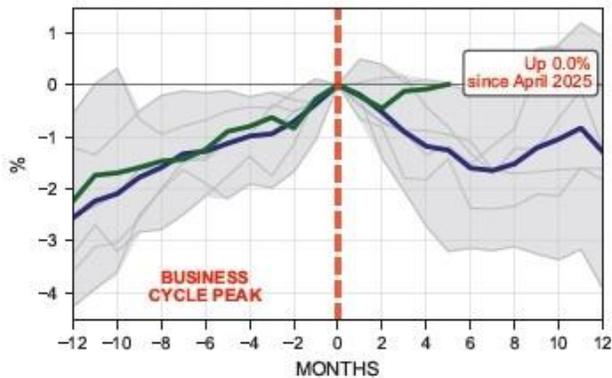
US NONFARM PAYROLLS



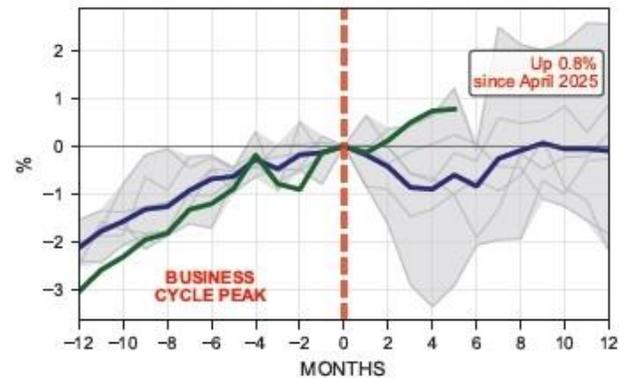
CIVILIAN EMPLOYMENT



REAL PERSONAL INCOME MINUS CURRENT TRANSFER RECEIPTS



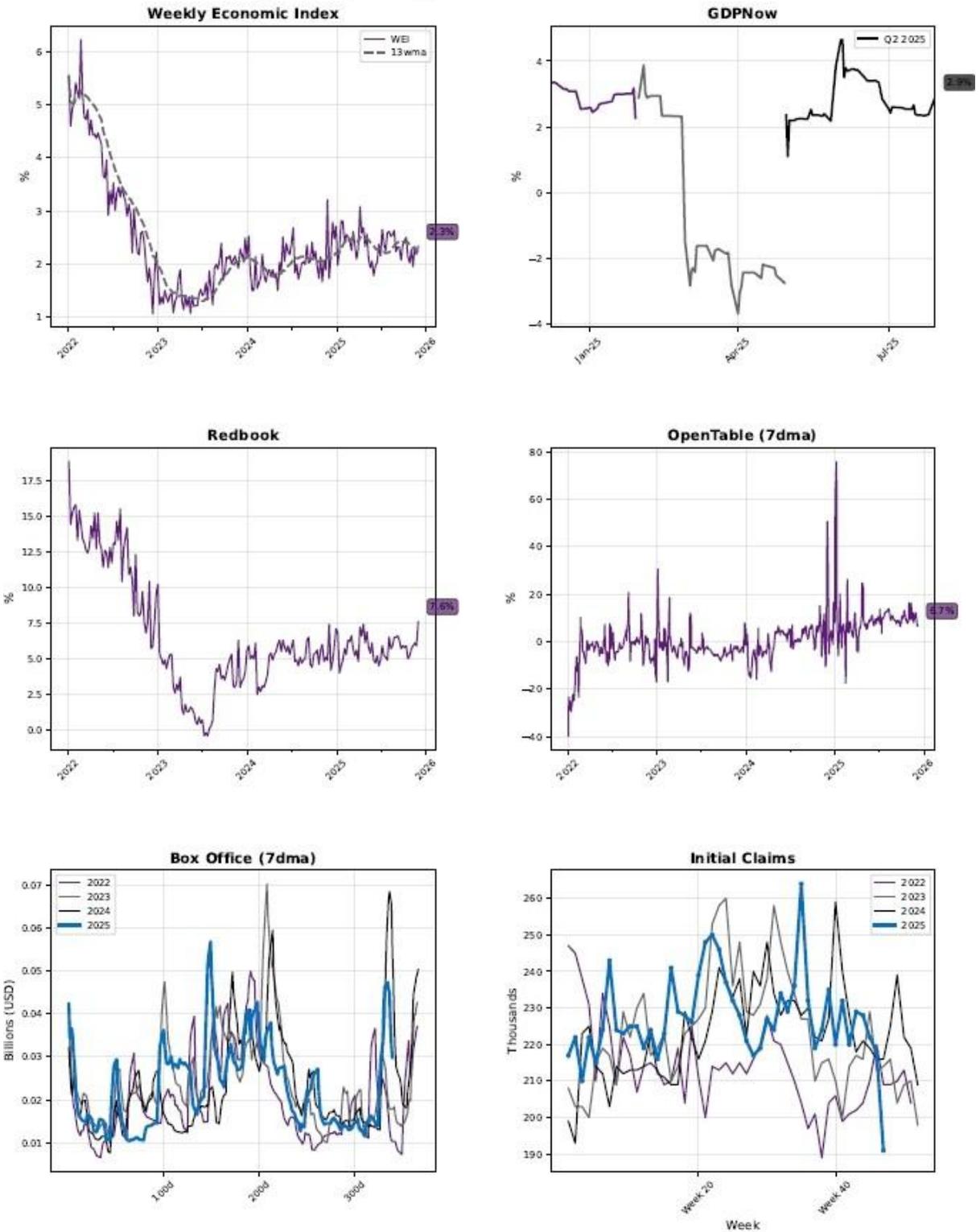
REAL PCE



PAST CYCLES (RANGE)
 PAST CYCLES
 PAST CYCLES (MEAN)
 CURRENT CYCLE

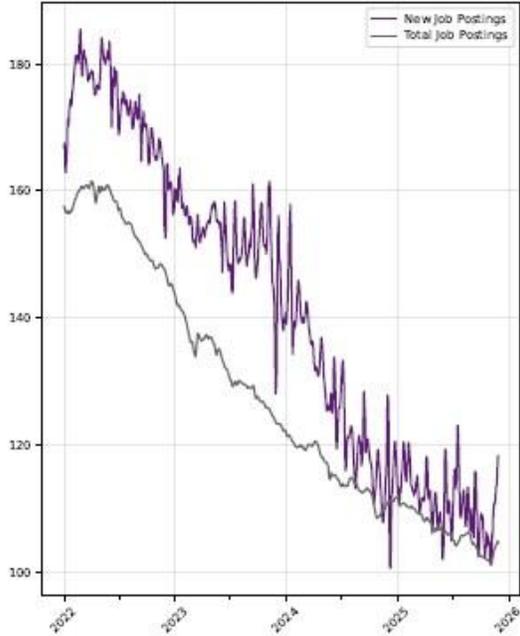
Past 7 cycles excluding Covid-19 period

High Frequency Economic Dashboard

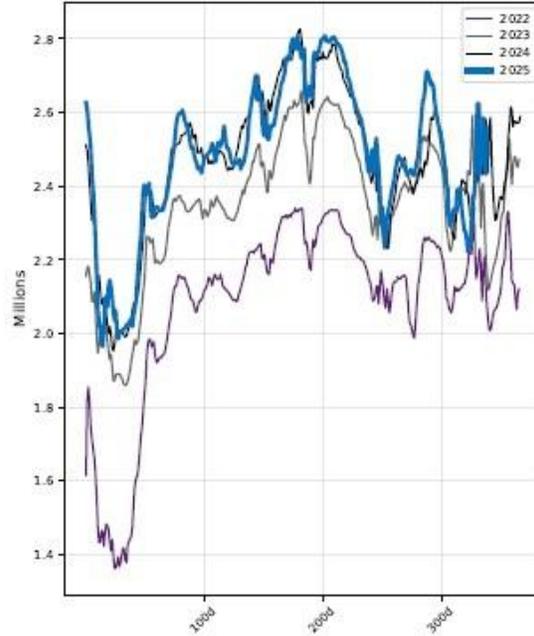


High Frequency Economic Dashboard

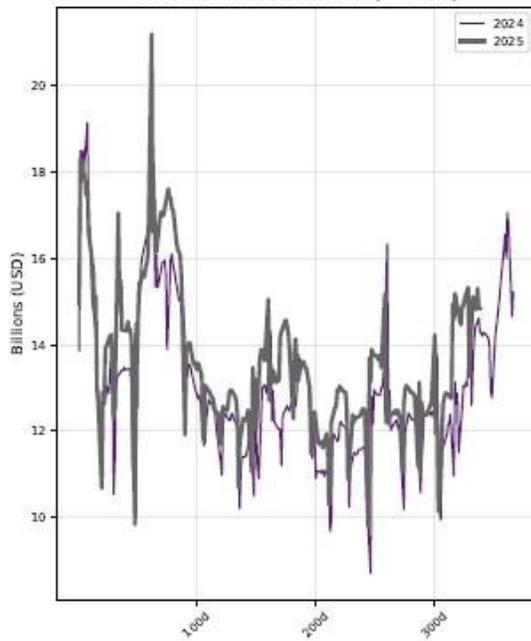
Indeed Job Postings



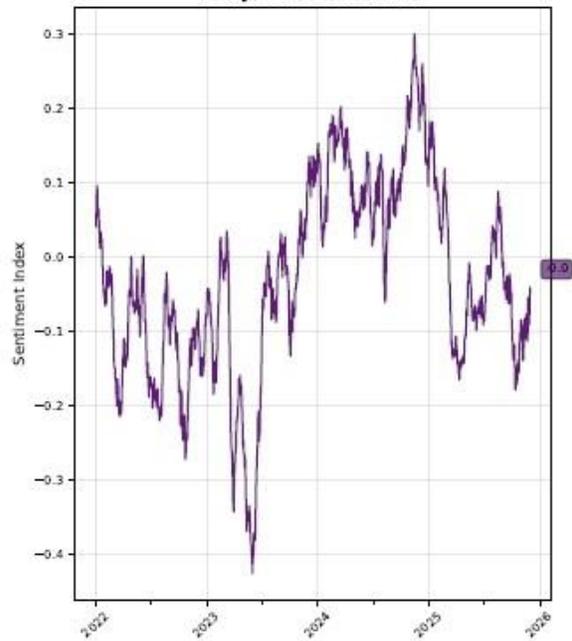
Air Travel



Withheld Income Taxes (10dma)



Daily News Sentiment



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