

# Dutta's Monetary Thoughts

Hawks playing with fire

Neil Dutta

## If we're counting votes, we're losing

Last Friday, New York Fed President Williams sparked optimism for a December rate cut. Meanwhile, in a Bloomberg TV interview, Governor Miran signaled that we would support a 25-basis point rate cut if he was the marginal vote on the FOMC. So, after briefly flirting with no cut, the futures market is now pricing in a three-in-four chance of a cut in December.

This is an encouraging development; however, it's worth noting that the meeting is probably closer to a toss-up than these market-implied probabilities show. Right now, I count 7 officials for a December cut: Powell, Waller, Bowman, Miran, Williams, Cook, Jefferson. I'm not totally sold on Cook and Jefferson; the two have ramped up the hawkish speak of late. On the no cut side, I count 5: Goolsbee, Schmid, Musalem, Collins, Barr. Powell has his work cut out for him heading into this meeting.

Minutes from the last FOMC meeting show that "many participants" see it as "appropriate to keep the target range unchanged for the rest of the year" while only "several participants" see that another cut this year "could well be appropriate." First, in Fed lingo, many is greater than several. Second, this passage shows that the hawks are more hawkish than the doves are dovish – "could well be" is not exactly firm language.

Moreover, the data fog continues. The Fed meets on December 10. However, the next employment report is due December 16 while next inflation report comes December 18. So, policy hawks could clamor for patience, wanting more information before having to make a rates decision. **There is a scenario where the data fog can be used as an excuse to skip December to leave January live.**

The bigger story is that the distribution of risks for the economy has deteriorated while the distribution of outcomes for the December FOMC has shifted in a hawkish direction. If the Fed cuts, it will be challenging to signal more into 2026. Taking a “cautious” approach as the labor market is deteriorating is unwise. Moreover, taking a “meeting by meeting approach” is not going to cut it. This implies waiting for the data to crack and then deciding to move after the subsequent meeting.

**Hawks have a weak case**

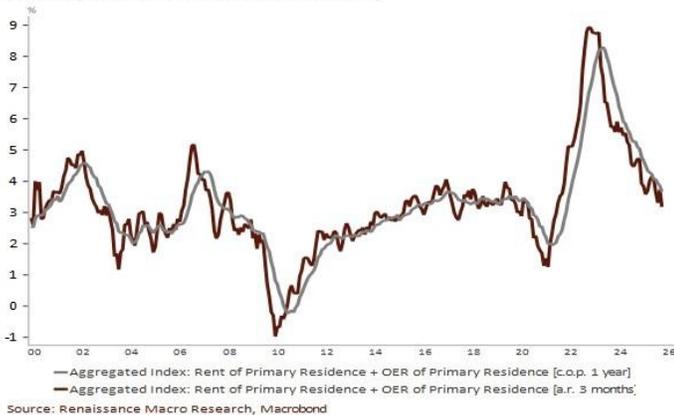
The hawks have a very weak case for holding off. I think a plausible hawkish view is (1) the inflation gap is larger than the unemployment gap, (2) financial conditions are loose and suggest neutral rates above three percent and (3) there is a risk that inflation expectations are becoming unanchored. I don’t find these arguments persuasive.

**Unemployment gap in focus**

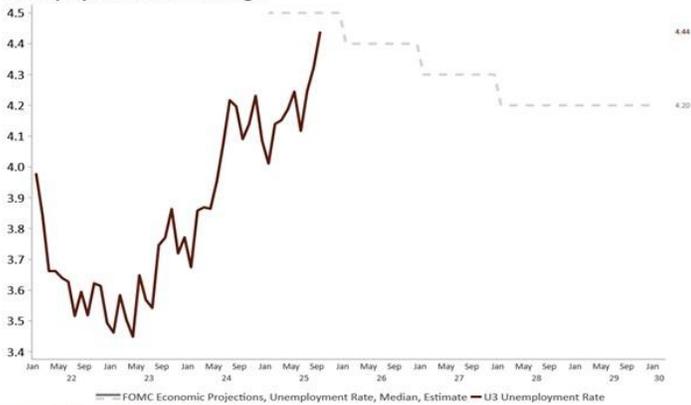
Core inflation appears to be climbing at roughly the same pace as last year. The difference is tariffs are in place now and they were not last year; thus, underlying inflation is likely improving on net. Importantly, the fixation on the inflation gap misses two important points.

- First, the outlook for inflation is improving. It’s tough to see core inflation being a problem with housing rental inflation cooling off.

**Housing rental inflation is still cooling**



Unemployment hits a fresh high



Source: Renaissance Macro Research, Macrobond

- Second, unemployment tends to move in a non-linear fashion while inflation is a slow-moving process outside of commodities. The unemployment rate has been rising 0.1ppt per month on average per month for the last three months, a somewhat faster pace than August 2024, right before the Fed cut 50bps.

**To review, underlying inflation dynamics are improving, and the inflation gap has at a bare minimum not gotten any worse despite tariffs while the unemployment gap is clearly worsening.**

**Financial conditions: Markets vs economy**

Next, I am not sure what to make of neutral rate arguments derived from financial market pricing since financial markets can shift abruptly. But, loose financial conditions for the economy and loose market conditions don't appear to be the same thing.

Despite record high stock prices and tight corporate credit spreads, we've seen an increase in unemployment and tightening credit conditions for households. According to data from the New York Fed, rejection rates are rising for credit applications. Firms see a similar story; despite strong stock prices, lending standards on C&I loans to small, medium and large firms have been tightening on net.

Lending standards tightening despite strong stock prices



Source: Renaissance Macro Research, Macrobond

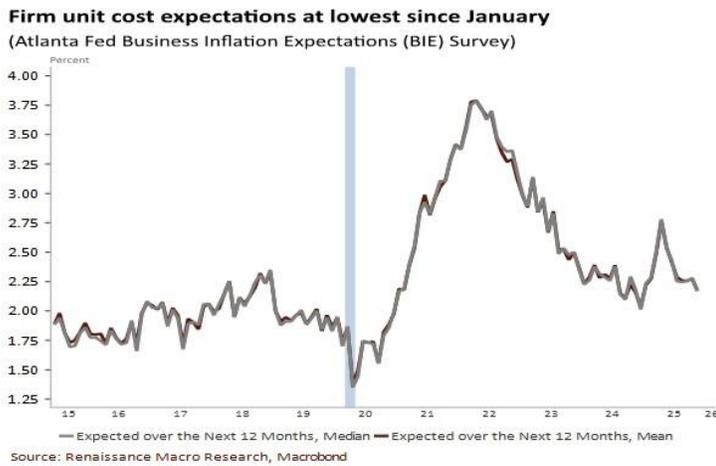
Information technology is putting upward pressure on stock prices, but it is not having as much of an impact on credit-sensitive spending like housing and autos. Thus, I'd be somewhat skeptical of market-derived estimates of neutral rates.

**In short, the neutral rate for the real economy appears to be lower than whatever it presently is for financial markets. The Fed should worry about the former, not the latter.**

**Inflation expectations are fine**

The notion that because inflation has been above target, inflation expectations risk becoming unanchored carries a lot of weight among central bankers. However, the evidence for unanchored expectations is quite thin.

According to the Atlanta Fed Business Inflation Expectations Survey, the median expected change to unit costs over the next 12 months slid to 2.2 percent in November, exactly where it was in January and unchanged from a year ago. Businesses incorporate a much wider range of information when forming their views on inflation. Households, by contrast, tend to set expectations based on those goods and services they purchase frequently.

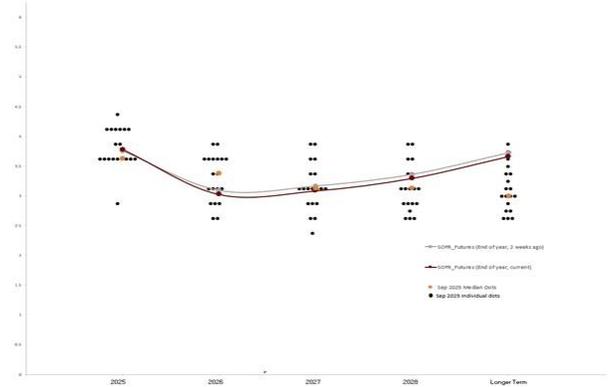
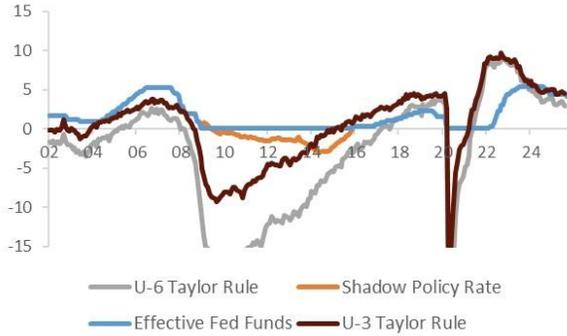


Now, there is quite a bit of fixation of consumer one-year ahead inflation expectations. It's believed that short-run expectations are important to wage setting. However, with the labor markets slackening, I am doubtful anyone is going to be successful negotiating for higher pay. Posted wage growth, as an example, has been steadily cooling off.

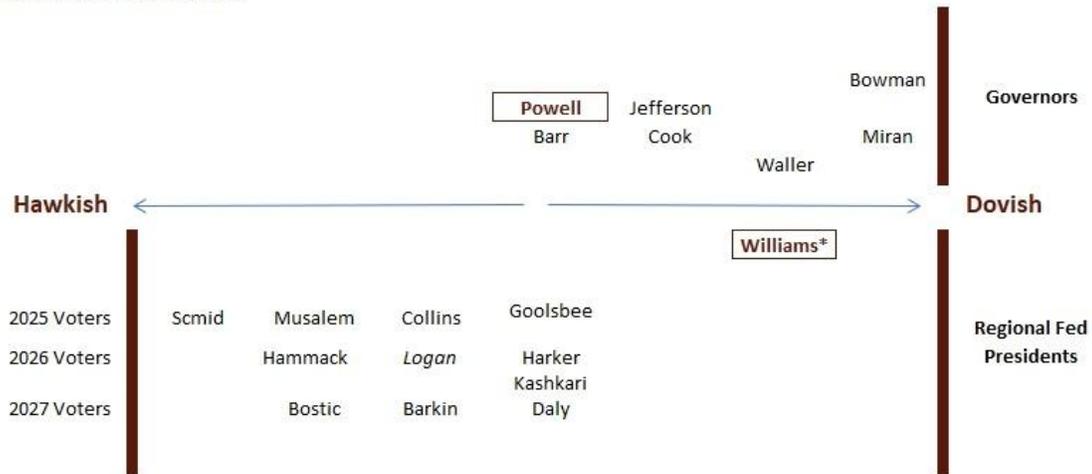
**Not cutting enough until something breaks**

For investors, concerns ought to be growing. It's true that inflation has been running above target for a while. But, it is also true that past performance is no guarantee of future results. The case for higher unemployment is quite a bit stronger than the case for a pick-up in consumer prices. If inflation concerns keep the Fed from signaling an easing path, the deterioration in unemployment will only intensify.

**Monetary metrics**



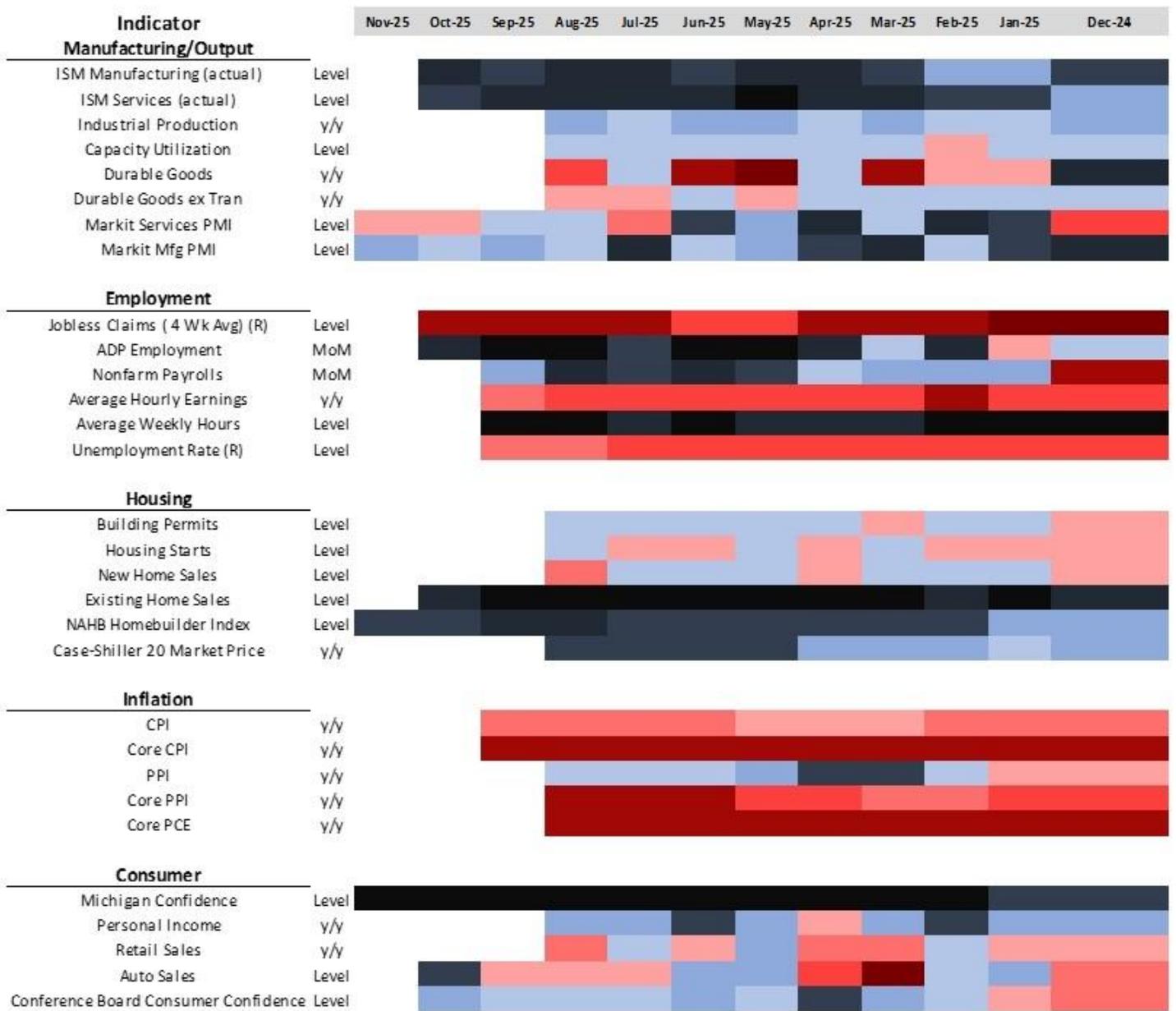
**Hawks and Doves**



\*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
<b>Change in real GDP</b>	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
June projection	1.4	1.6	1.8		1.8	1.2-1.5	1.5-1.8	1.7-2.0		1.7-2.0
<b>Unemployment rate</b>	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
June projection	4.5	4.5	4.4		4.2	4.4-4.5	4.3-4.6	4.2-4.6		4.0-4.3
<b>PCE inflation</b>	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
June projection	3.0	2.4	2.1		2.0	2.8-3.2	2.3-2.6	2.0-2.2		2.0
<b>Core PCE inflation</b>	3.1	2.6	2.1	2.0		3.0-3.2	2.5-2.7	2.0-2.2	2.0	
June projection	3.1	2.4	2.1			2.9-3.4	2.3-2.7	2.0-2.2		
<b>Projected policy path</b>										
<b>Fed funds rate</b>	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
June projection	3.9	3.6	3.4		3.0	3.9-4.4	3.1-3.9	2.9-3.6		2.6-3.6

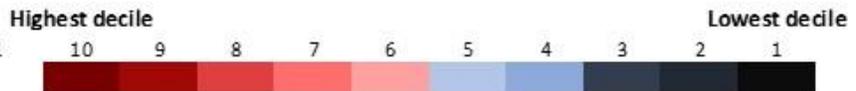
**High frequency data heat-map**



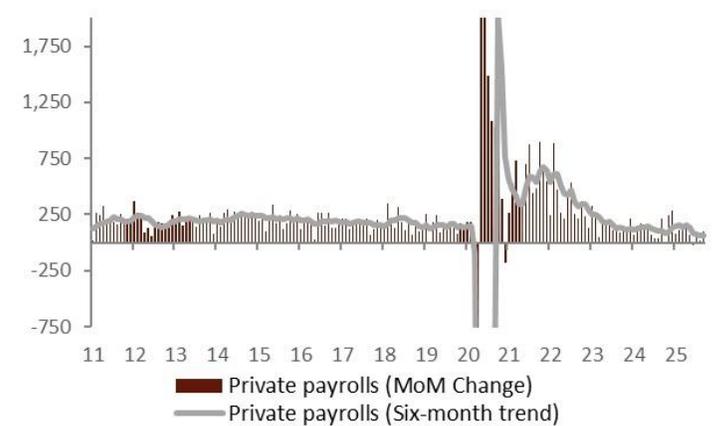
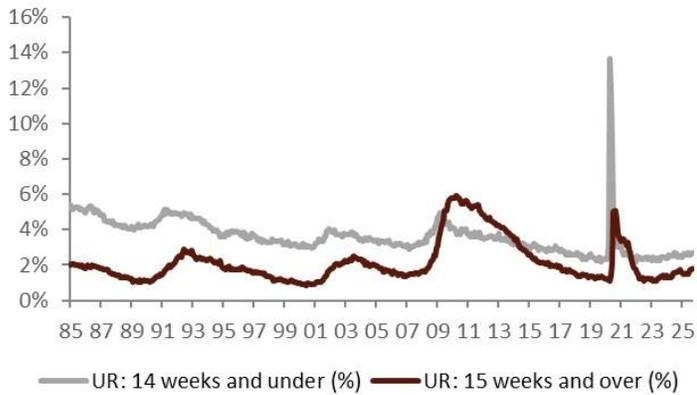
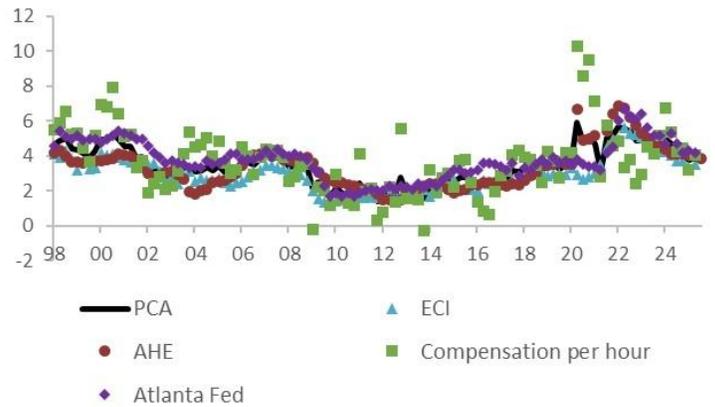
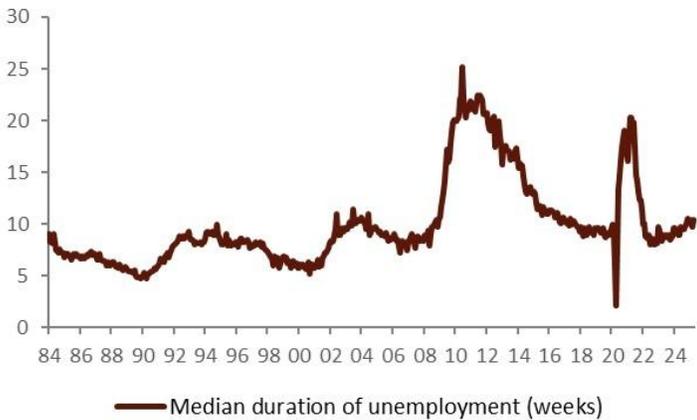
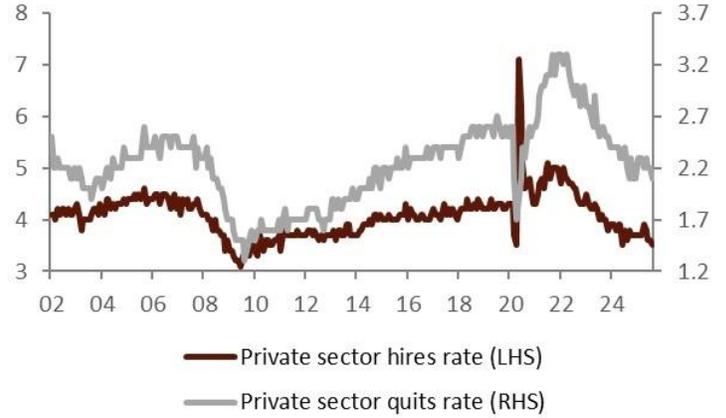
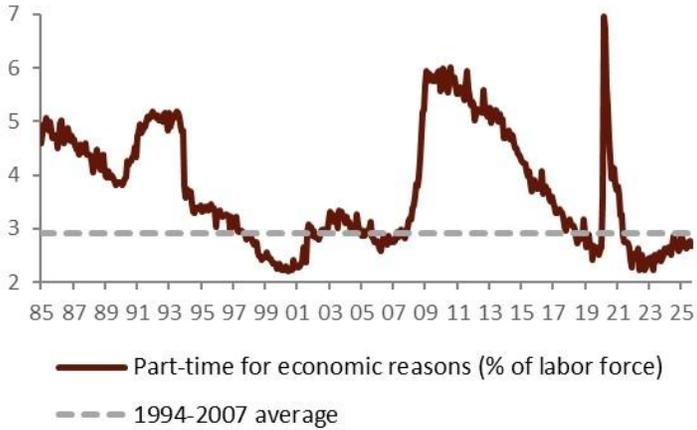
**Notes**

**R - Reverse Formatting**

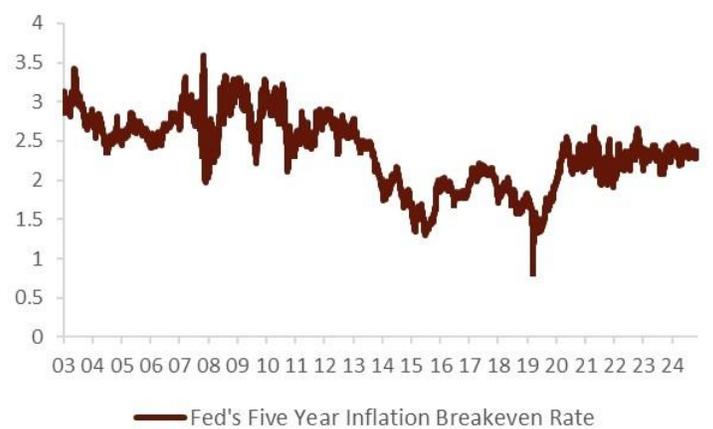
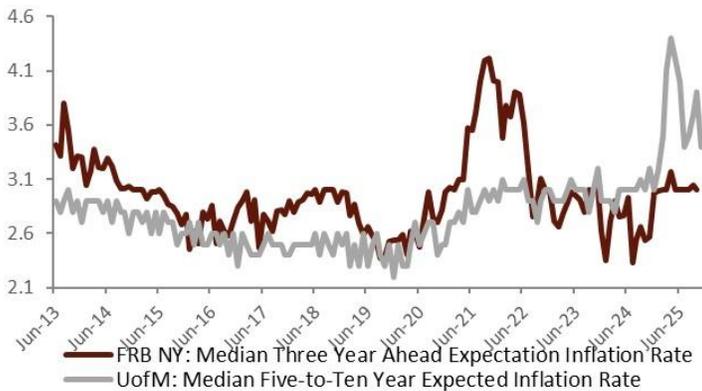
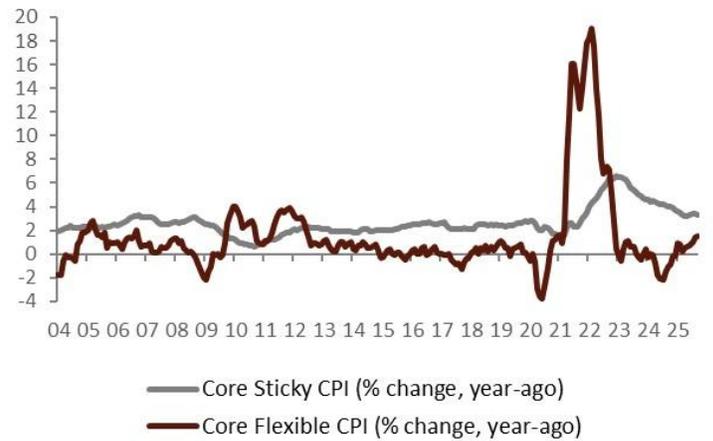
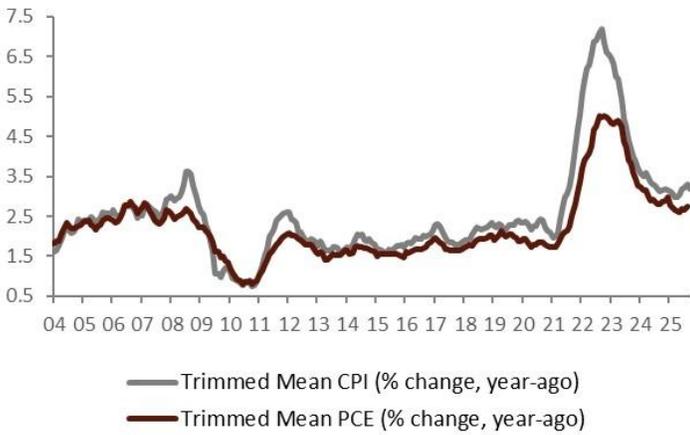
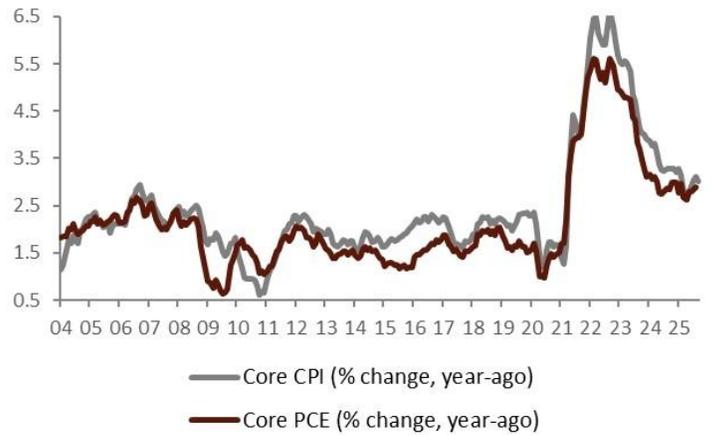
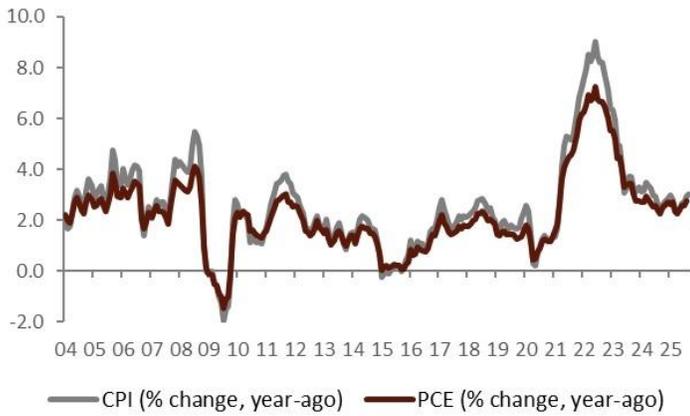
Dedles are based on expanding window since 2001



**Labor market indicators**

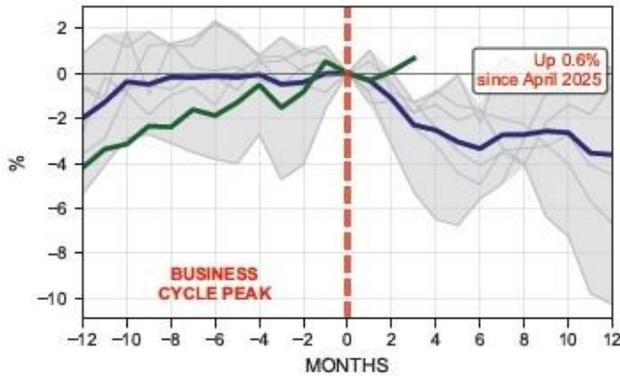


**Inflation indicators**

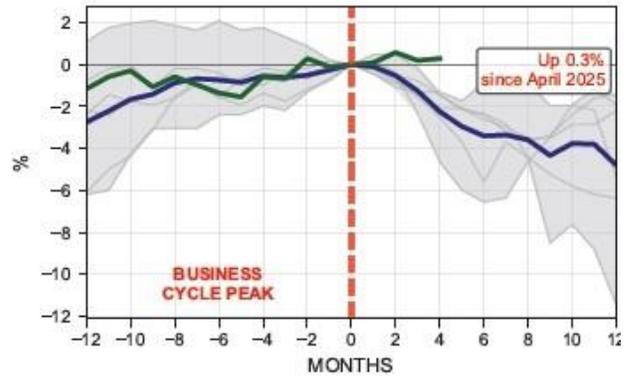


## NBER RECESSION INDICATORS DASHBOARD

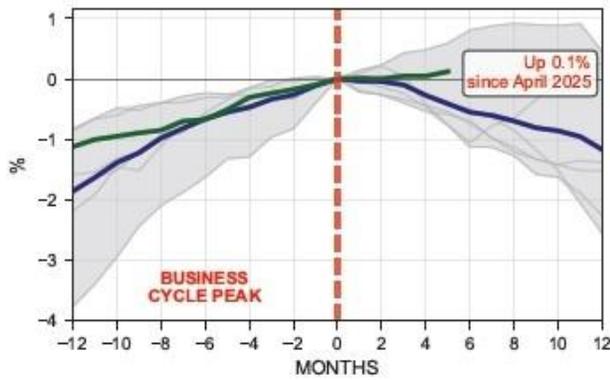
**REAL SALES: MANUFACTURING AND TRADE INDUSTRIES**



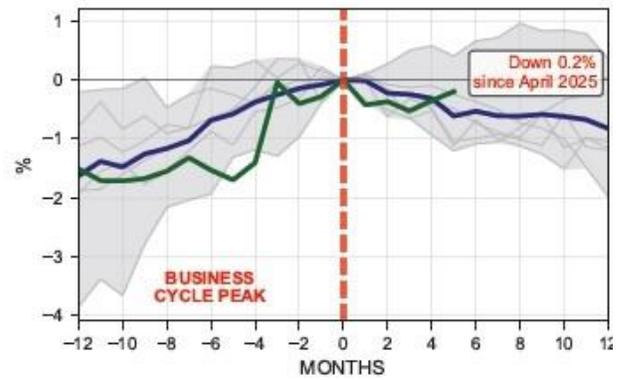
**INDUSTRIAL PRODUCTION**



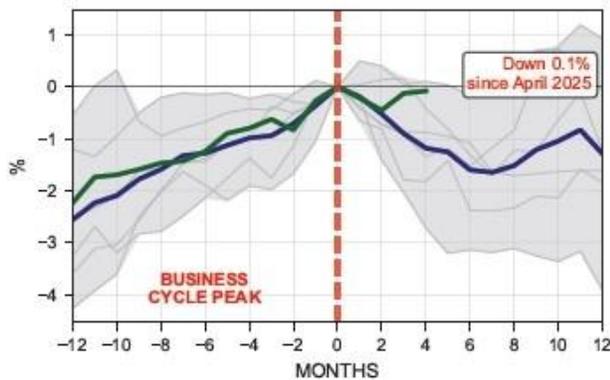
**US NONFARM PAYROLLS**



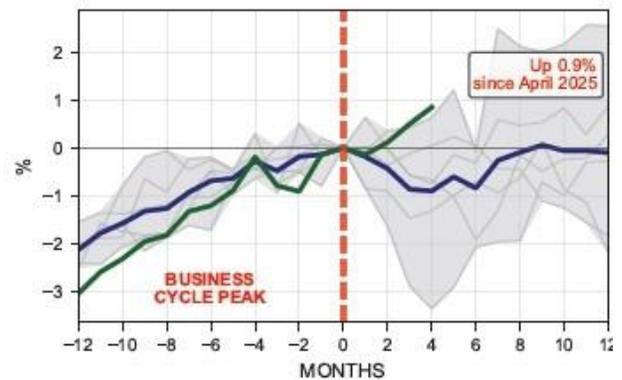
**CIVILIAN EMPLOYMENT**



**REAL PERSONAL INCOME MINUS CURRENT TRANSFER RECEIPTS**



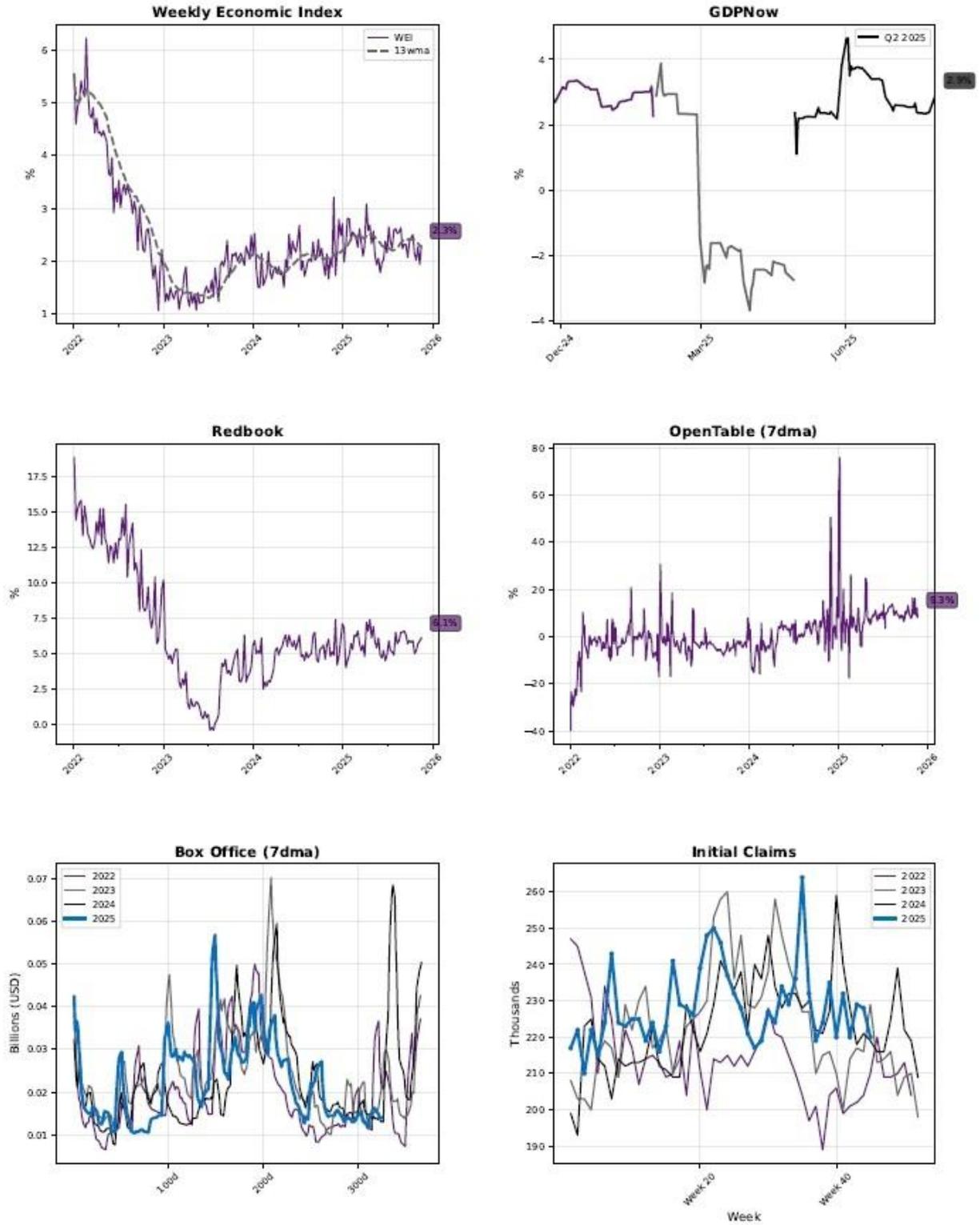
**REAL PCE**



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

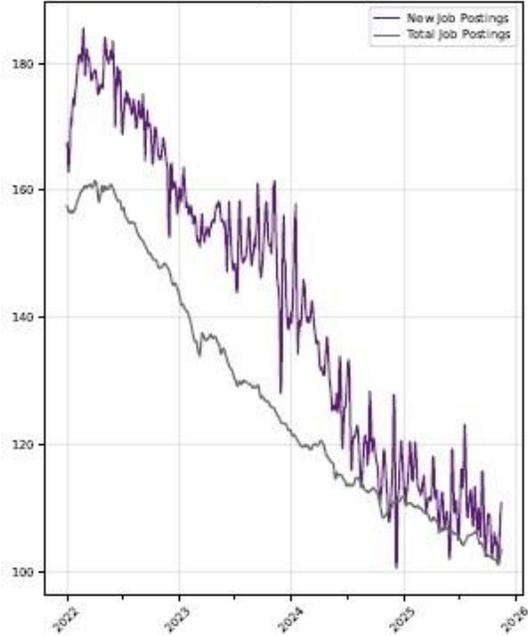
Past 7 cycles excluding Covid-19 period

## High Frequency Economic Dashboard

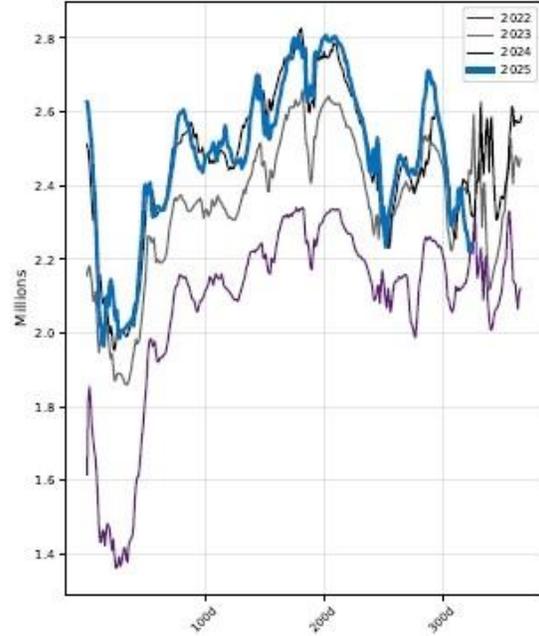


## High Frequency Economic Dashboard

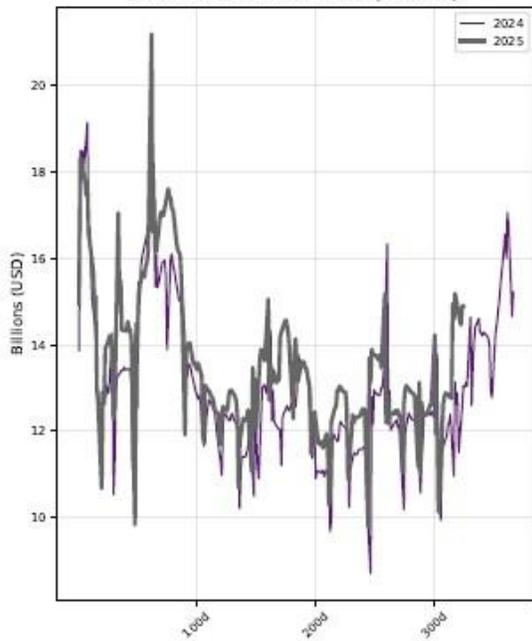
**Indeed Job Postings**



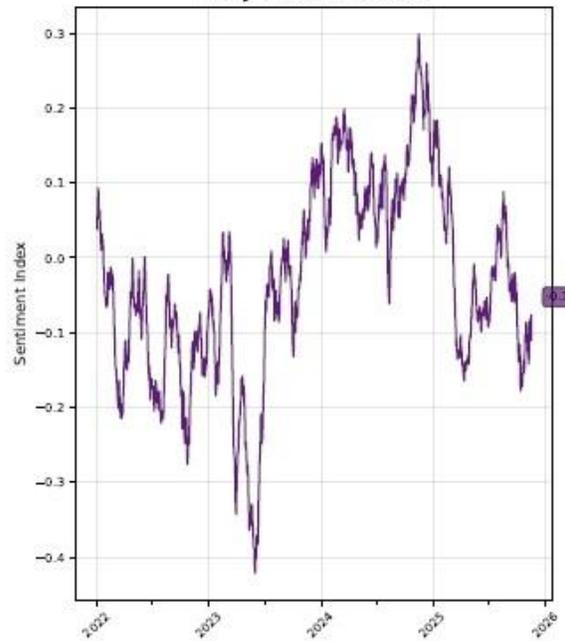
**Air Travel**



**Withheld Income Taxes (10dma)**



**Daily News Sentiment**



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