

Dutta's Monetary Thoughts

Odds and ends about inflation

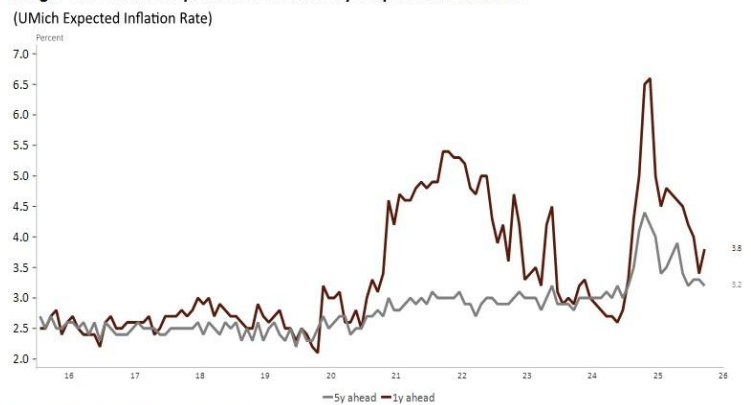
Neil Dutta

Long-run expectations look okay for now

One positive development from last week was that despite the rise in short-run inflation expectations, longer-run inflation expectations were essentially unchanged.

In March, the University of Michigan's Consumer Survey showed the median expected inflation rate for the next year climbing 0.4pts to 3.8 percent. By contrast, the median five-year ahead expected inflation rate slid to a three-month low of 3.2 percent. This is welcome news as it shows that near-term changes in gasoline prices are unlikely to have lasting consequences for underlying household attitudes about prices.

Longer-run inflation expectations hold steady despite near-term rise



Source: Renaissance Macro Research, Macrobond

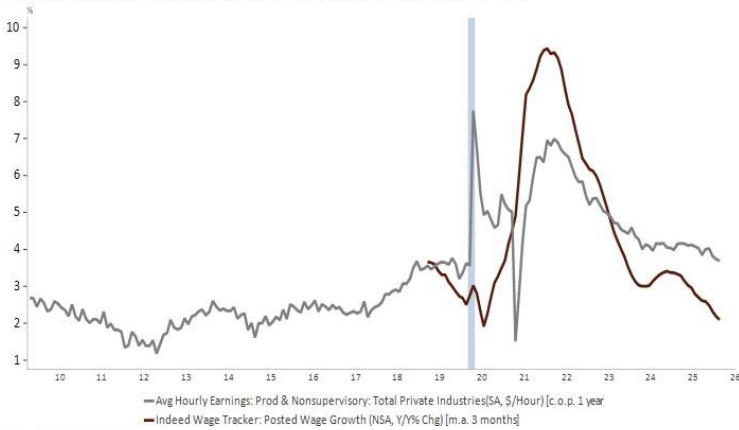
This is one reason to be suspicious of the 1970s analog. Back then, short-run inflation expectations were rising alongside longer-run inflation expectations. That's what happens when the Fed's credibility is under threat. In a sense, the latest month is more relatable to the 1990 Gulf War. Back then, short-run expectations surged almost a full percentage point from June 1990 to December 1990. During that six-month period, longer-run expectations were essentially unchanged.

When it comes to household inflation expectations, so far, so good.

Don't have the same anchor

There is limited evidence that wage growth is poised to perk up in the months ahead; labor market conditions continue to cool off.

Indeed wage growth tracker points to continued cooling in labor costs

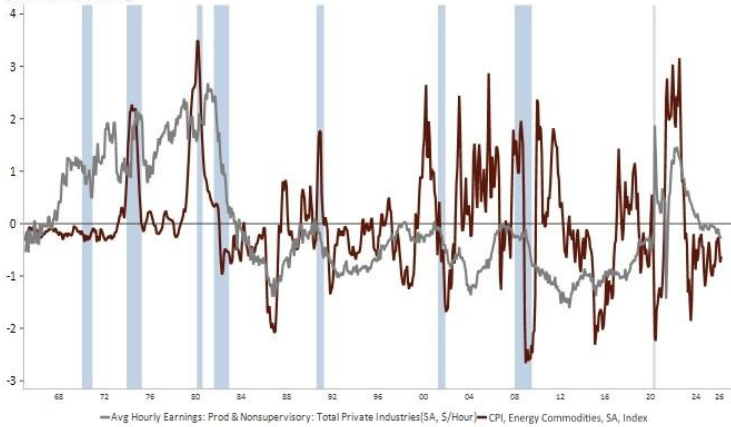


Source: Renaissance Macro Research, Macrobond

According to data from Indeed, as of February, posted wage growth has advanced just 2.1 percent over the last year. The three-month moving average is 2.1 percent, a fresh low. Recall that the Indeed Wage Growth Tracker focuses on wages and salaries published in job postings on Indeed, taking the temperature of jobs market for new hires.

The Wage Tracker leads the ECI by roughly one to two quarters. Recall that the ECI is released on a quarterly basis. At any rate, the slowing in wage growth is important in the context of a rise in oil prices. With labor markets cooling, it is difficult to see how the spike in oil prices bleeds into a broader basket of consumer goods and services. Household budgets are coming under increasing stress.

Wage growth lacks the 1970s momentum to sustain energy pass-through (Z-score of y/y % chg)



Source: Renaissance Macro Research, Macrobond

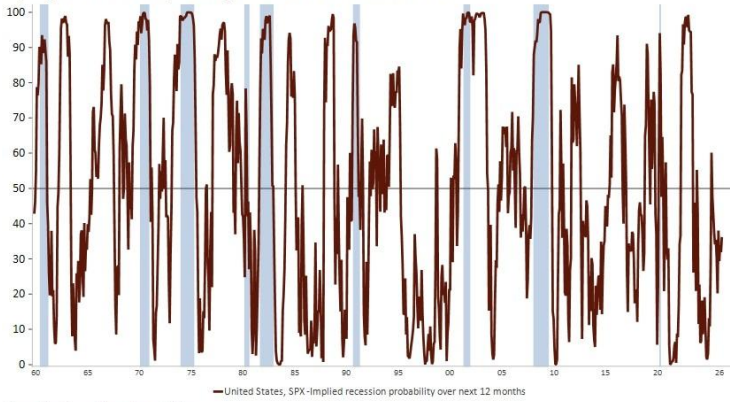
Notice that this is another example of how the current period is not like the 1970s. Consumers lack the wherewithal to absorb higher prices. Average hourly earnings are running less than half the pace in nominal terms today as they were back then. We don't have the same nominal anchor.

Stocks sanguine on recession risk

The US equity market has gone some way into pricing in recession, but is still short of fully pricing one in.

We run the performance of the S&P 500 through a probit model – a statistical tool used to predict the probability of a yes or no outcome based on one or more input variables. In this case, we are estimating the probability of a recession based on the past performance of the S&P500. The probit model uses the shape of a normal distribution to compress predictions into a range of 0 to 100 percent.

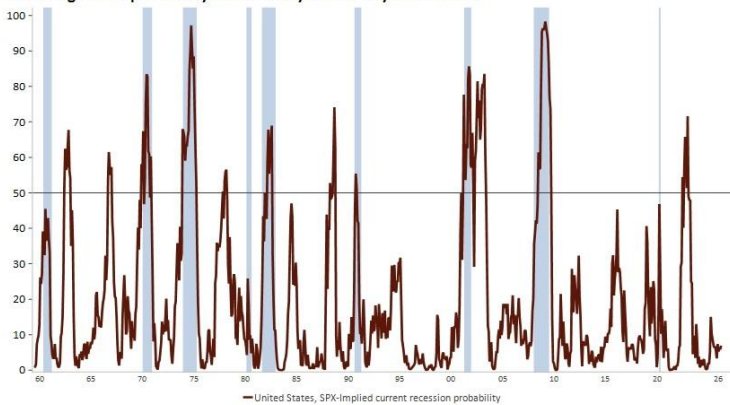
Equity performance implies only modest recession odds ahead



Source: Renaissance Macro Research, Haver

Over the last 12 months, ending March 27, the S&P500 has advanced roughly 14 percent, solid. Historically, this performance implies a one-in-three chance of recession a year from now. This is below the historical norm.

Stocks signal low probability the economy is currently in recession



Source: Renaissance Macro Research, Macrobond

The probability that the US economy is presently in recession based on the performance of stocks over the last year is less than 10 percent. Again, there is historically a one-in-five chance that the economy is in recession – the current performance of the equity market is consistent with something well below that.

In short, US equities remain relatively sanguine on the prospects of a deeper economic slump.

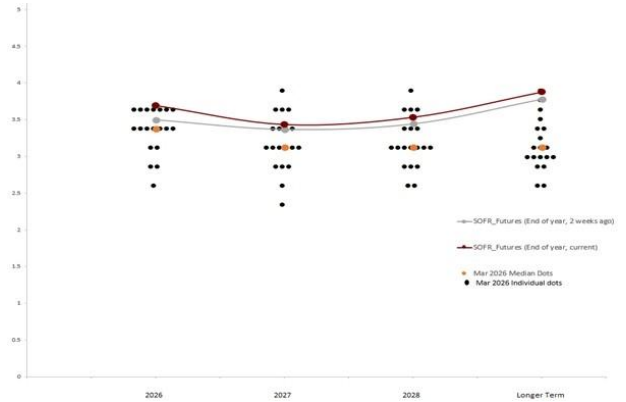
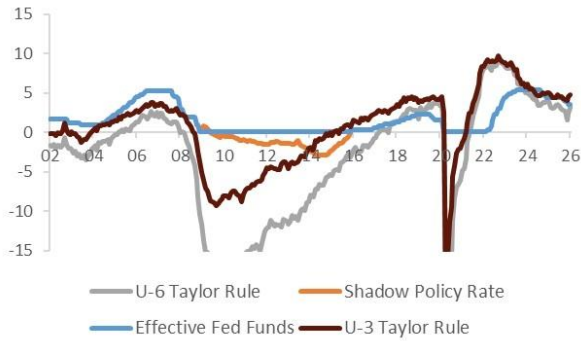
Tight policy bites harder when supply drives inflation

A 2024 [paper](#) by SF Fed investigates the state-dependent effects of monetary policy tightening on financial stress, introducing a novel conditioning dimension: whether prevailing inflation is supply- or demand-driven. Using local projections estimated on high-frequency identified monetary policy surprises and decomposing core PCE inflation into supply and demand components, the authors find a striking asymmetry in the transmission of rate hikes to financial conditions. When inflation is predominantly supply-driven — reflecting adverse costpush or energy shocks — a 25 basis point policy surprise leads to a statistically significant and persistent increase in financial stress, with the amplification effect materializing almost immediately and remaining significant for roughly eighteen months. In contrast, when inflation is demand-driven, the same rate hike leaves financial stress broadly unchanged or even modestly reduces it.

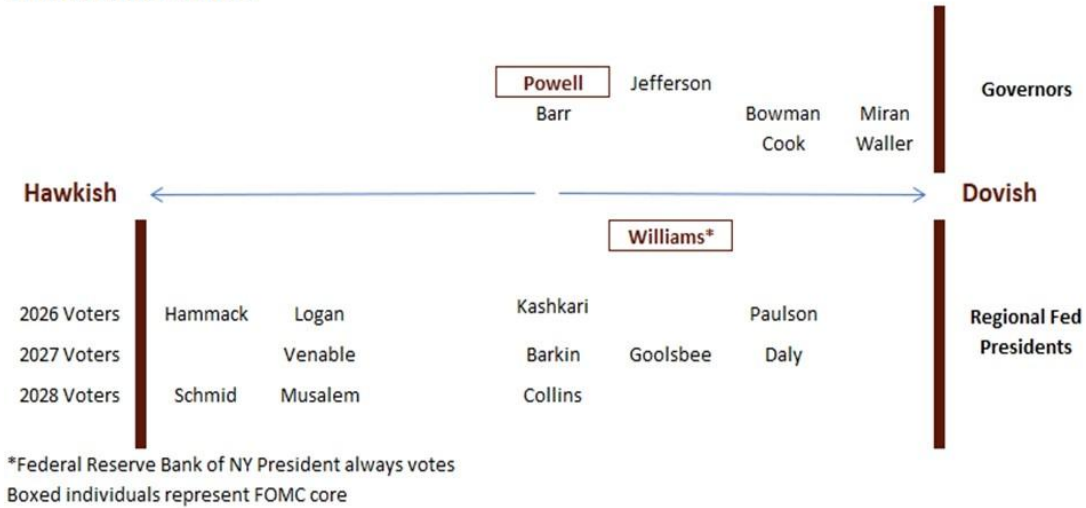
The intuition is straightforward — supply shocks weigh on output and cash flows at the same time borrowing costs are rising, squeezing firms from both sides, while demand-

driven inflation tends to come alongside healthy revenue growth that cushions borrowers against higher rates. Financial stress in the US initially surged in early to mid 2022 as the Fed began hiking rates into what was largely a supply-shock-driven inflation environment — marked by persistent supply chain disruptions and elevated cost-push pressures. By late 2022, however, financial conditions began to ease even as the policy rate continued to climb. The authors argue this shift was not coincidental but rather a predictable consequence of the changing inflation composition: as supply-side pressures dissipated and demand-driven forces became the dominant inflation driver. Through the lens of this paper, the current configuration — where supply-side forces are reasserting themselves while growth is narrowing and the labor market is softening — is precisely the environment in which maintaining restrictive policy carries elevated financial stability risks.

Monetary metrics

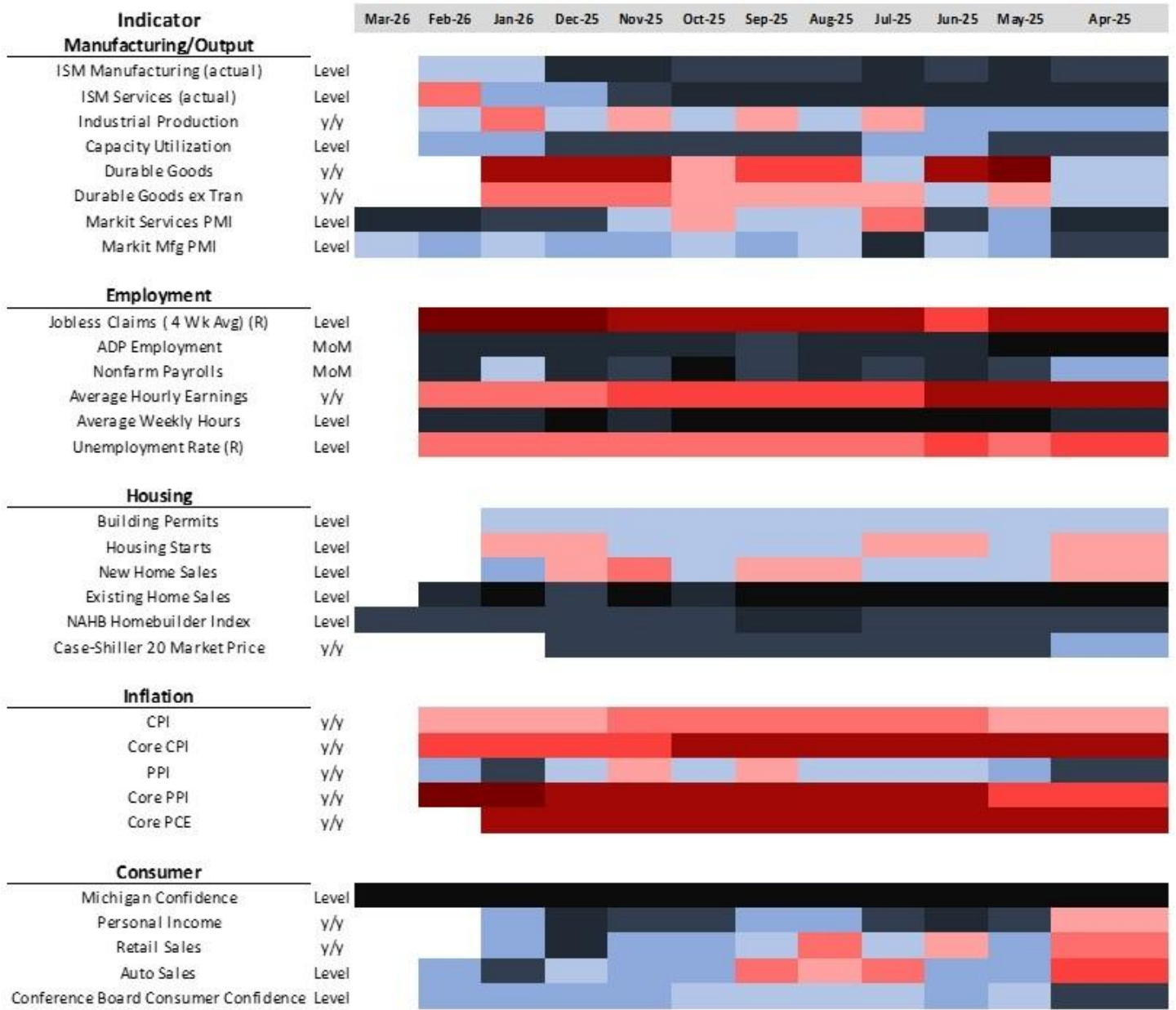


Hawks and Doves



FOMC Forecasts	Median				Central Tendency			
	2026	2027	2028	Longer run	2026	2027	2028	Longer run
Change in real GDP	2.4	2.3	2.1	2.0	2.2-2.5	2.0-2.4	2.0-2.3	1.8-2.0
December projection	2.3	2.0	1.9	1.8	2.1-2.5	1.9-2.3	1.8-2.1	1.8-2.0
Unemployment rate	4.4	4.3	4.2	4.2	4.3-4.5	4.2-4.4	4.0-4.4	4.0-4.3
December projection	4.4	4.2	4.2	4.2	4.3-4.4	4.2-4.3	4.0-4.3	4.0-4.3
PCE inflation	2.7	2.2	2.0	2.0	2.6-3.1	2.0-2.3	2.0	2.0
December projection	2.4	2.1	2.0	2.0	2.3-2.5	2.0-2.2	2.0	2.0
Core PCE inflation	2.7	2.2	2.0		2.5-2.8	2.0-2.4	2.0	
December projection	2.5	2.1	2.0		2.4-2.6	2.0-2.2	2.0	
Projected policy path								
Fed funds rate	3.4	3.1	3.1	3.1	3.1-3.6	2.9-3.6	2.9-3.6	2.9-3.5
December projection	3.4	3.1	3.1	3.0	2.9-3.6	2.9-3.6	2.8-3.6	2.8-3.5

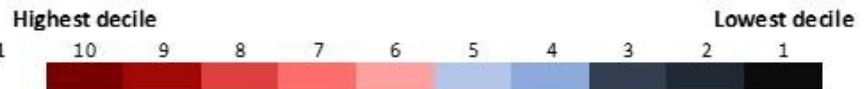
High frequency data heat-map



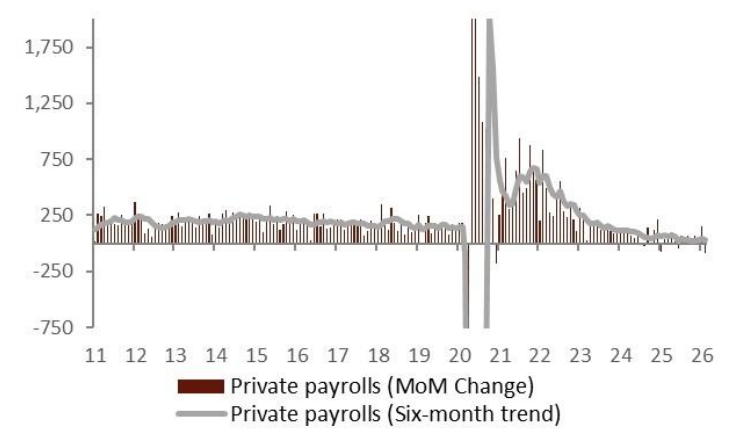
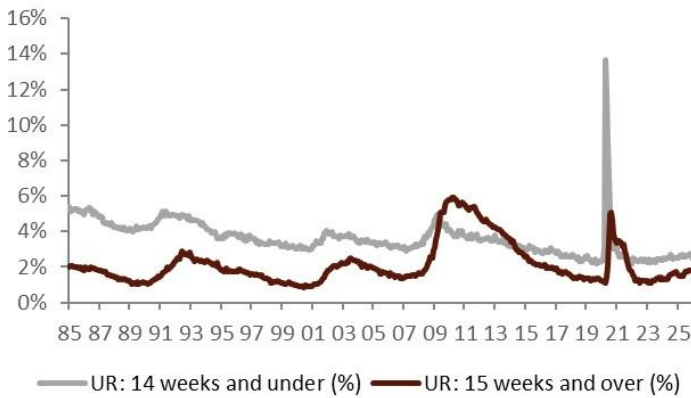
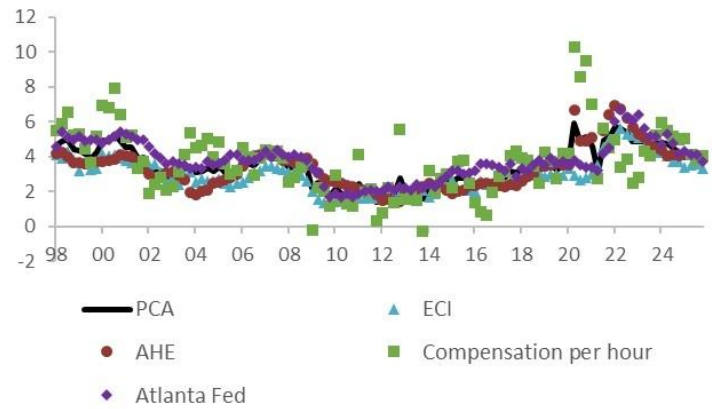
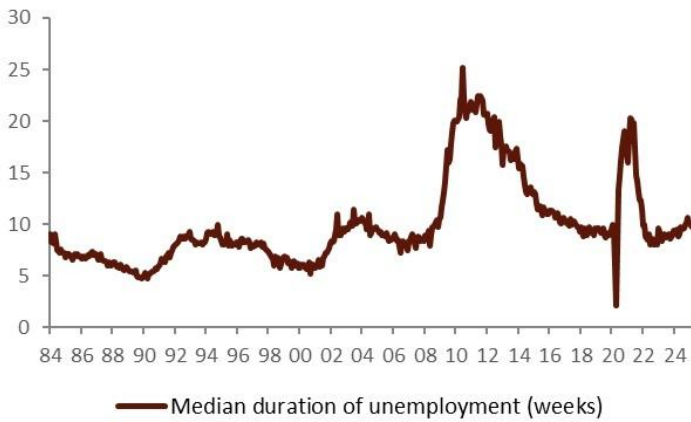
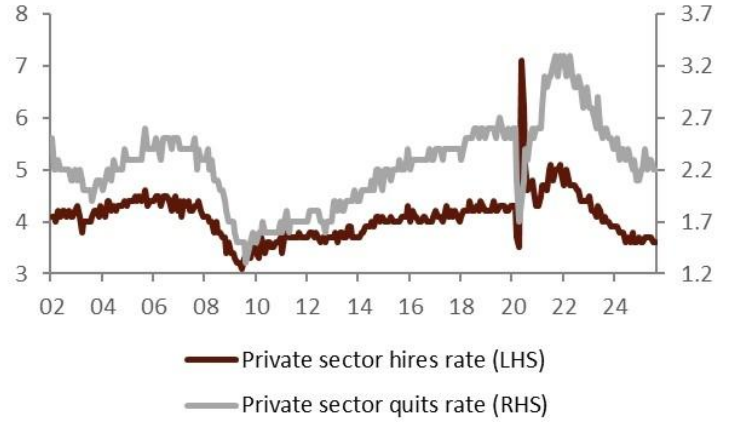
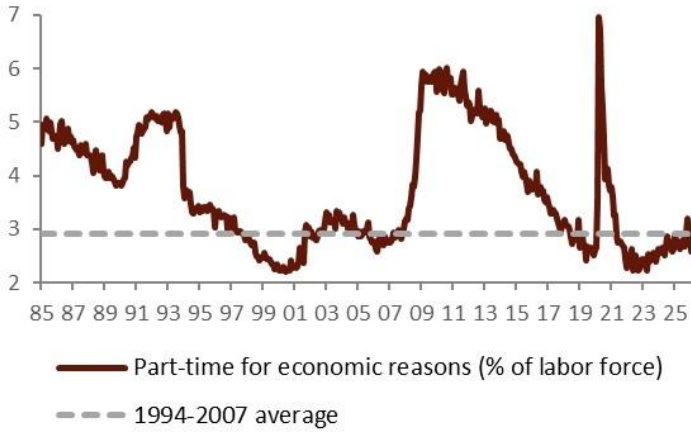
Notes

R - Reverse Formatting

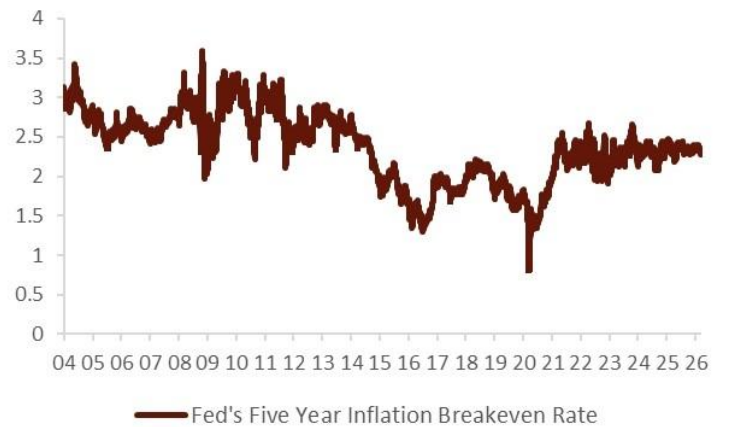
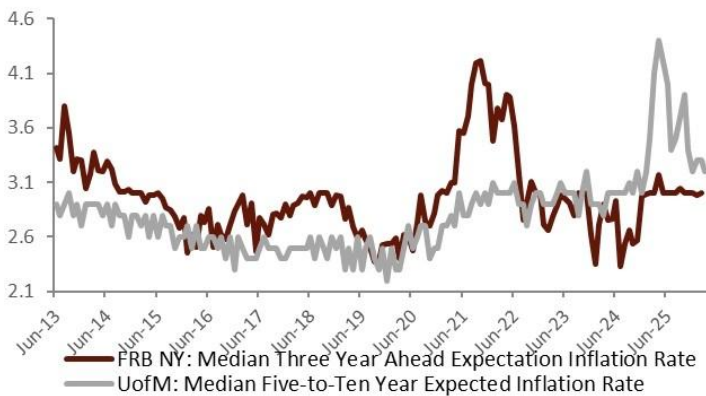
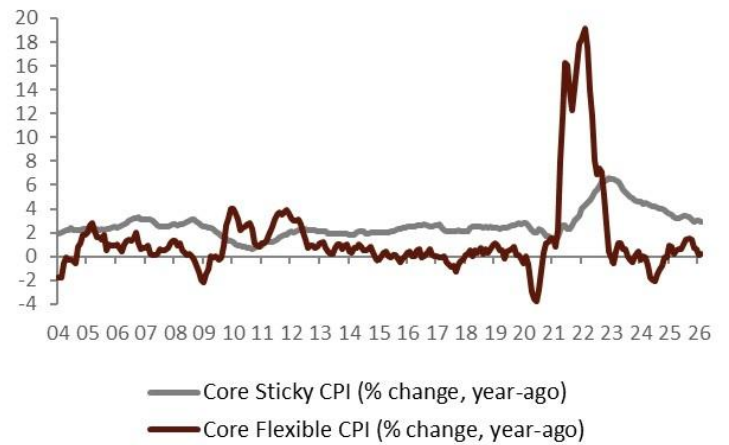
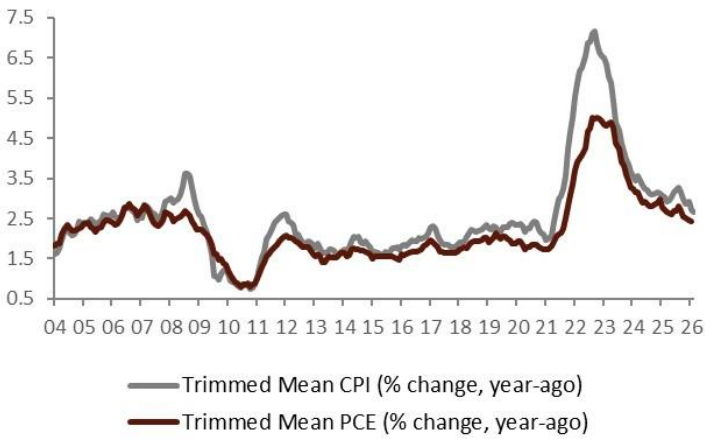
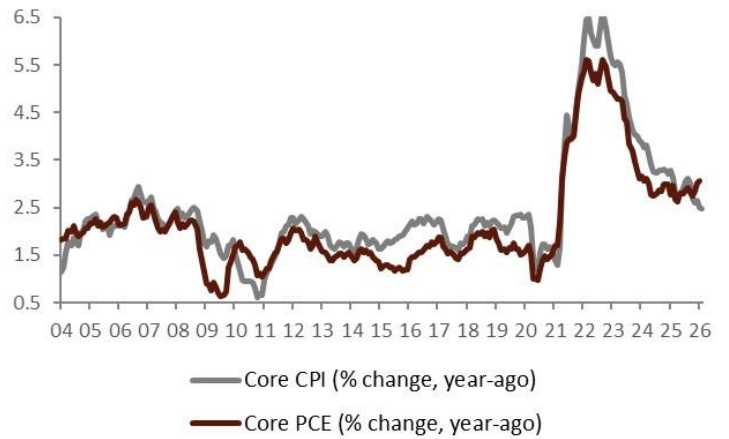
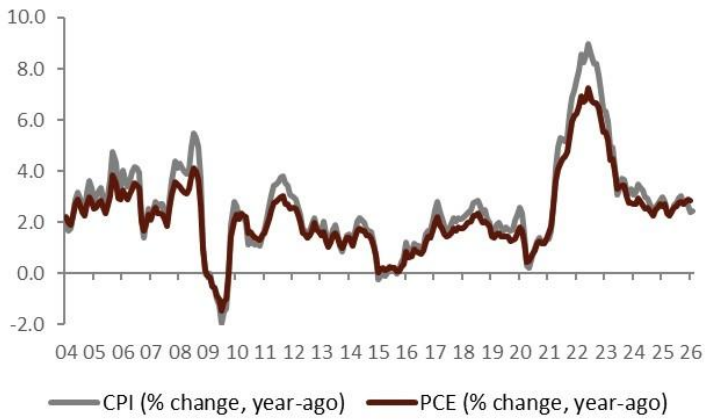
Deciles are based on expanding window since 2001



Labor market indicators

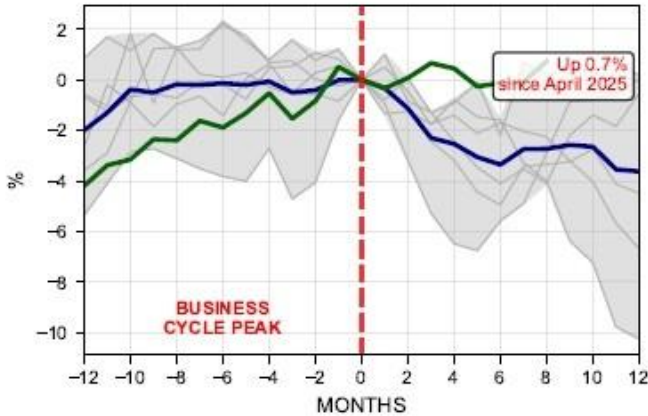


Inflation indicators

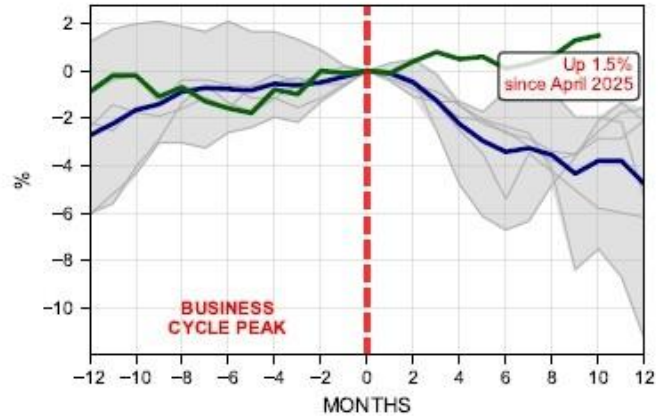


NBER RECESSION INDICATORS DASHBOARD

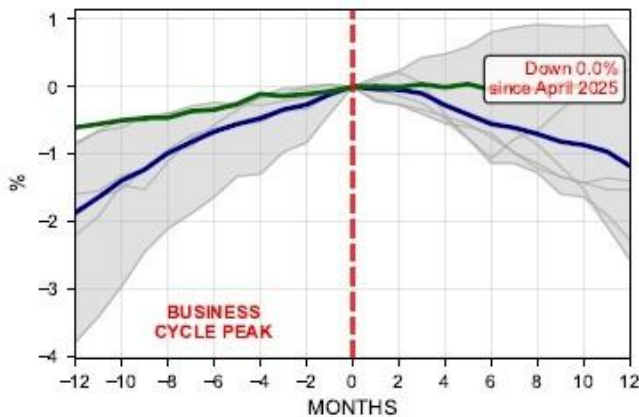
REAL SALES: MANUFACTURING AND TRADE INDUSTRIES



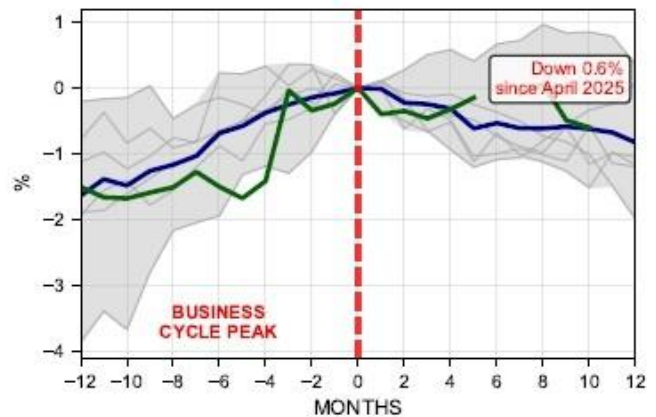
INDUSTRIAL PRODUCTION



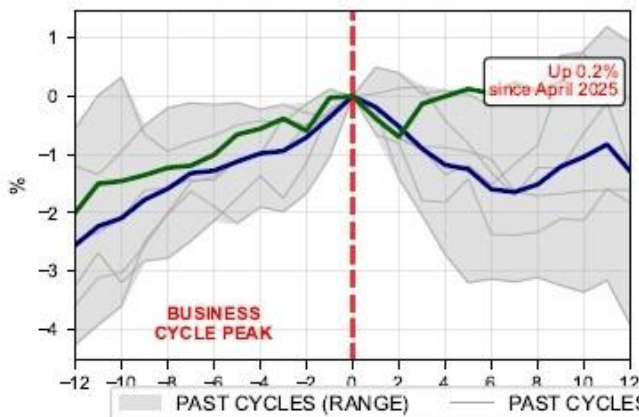
US NONFARM PAYROLLS



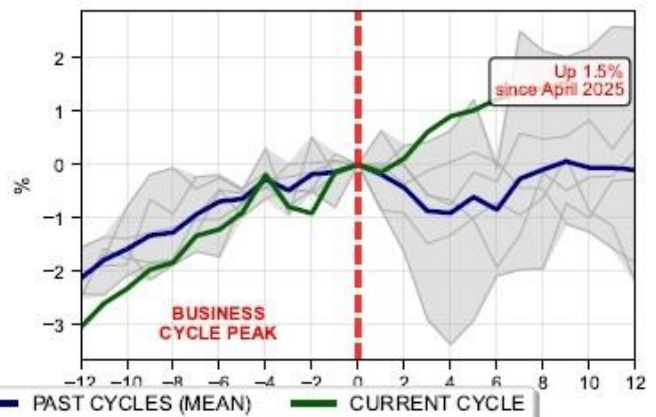
CIVILIAN EMPLOYMENT



REAL PERSONAL INCOME MINUS CURRENT TRANSFER RECEIPTS



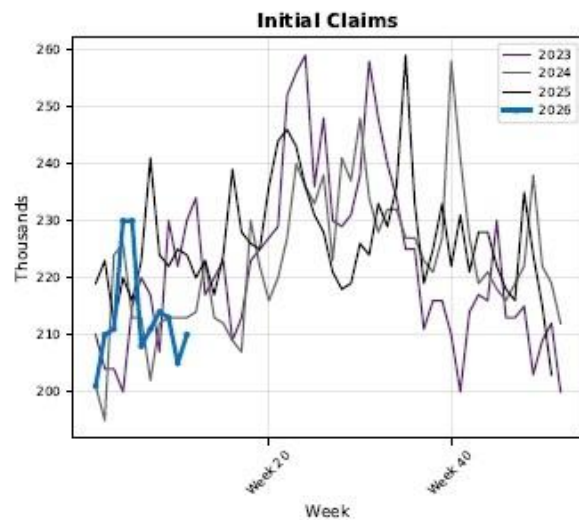
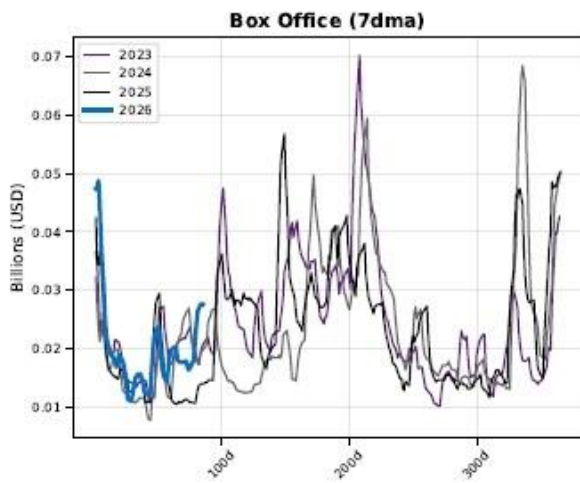
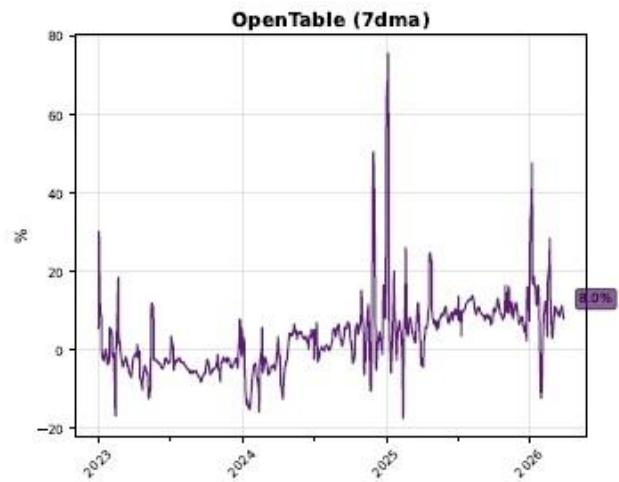
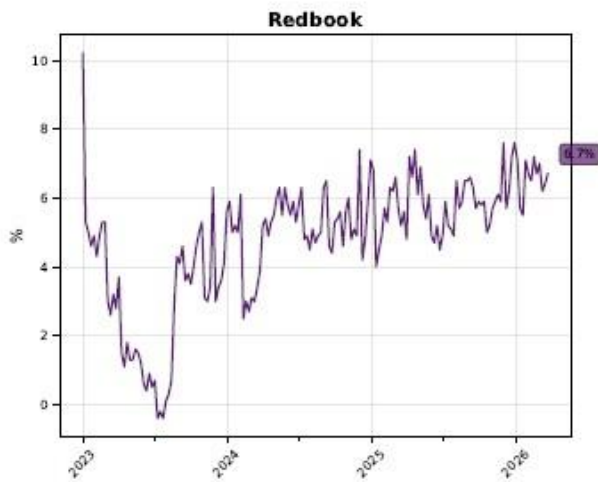
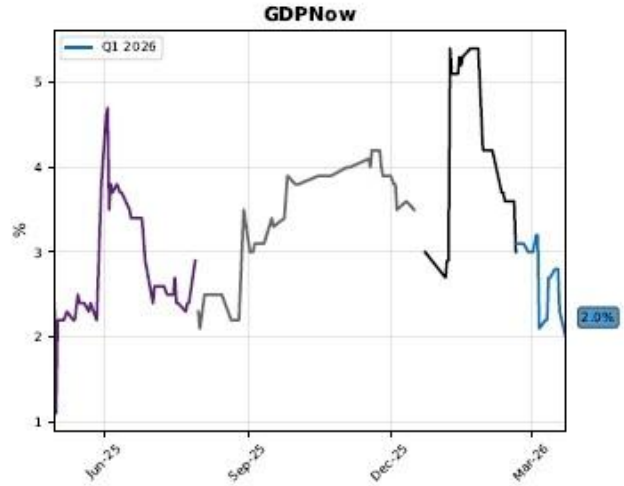
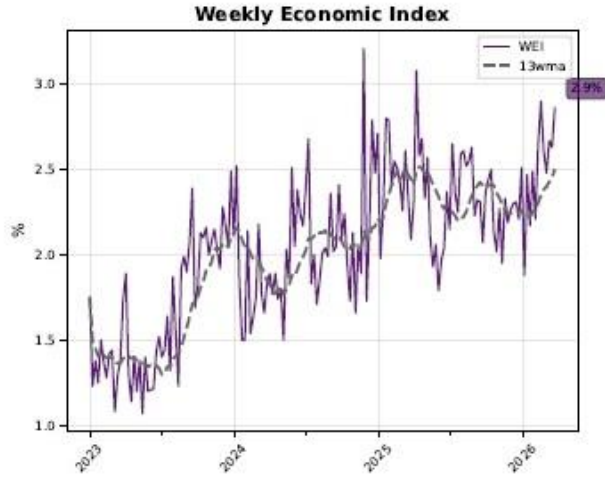
REAL PCE



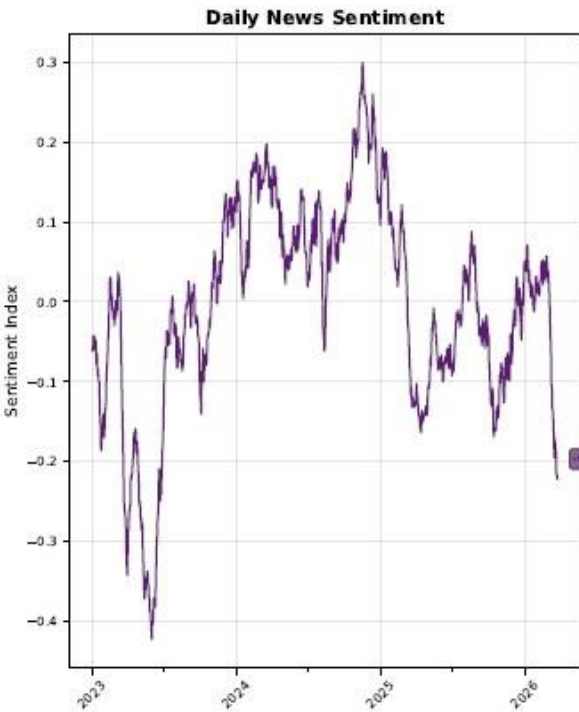
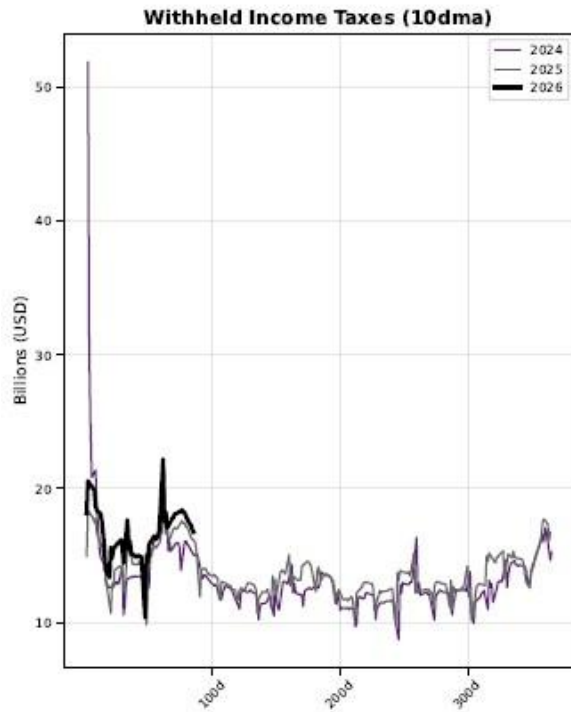
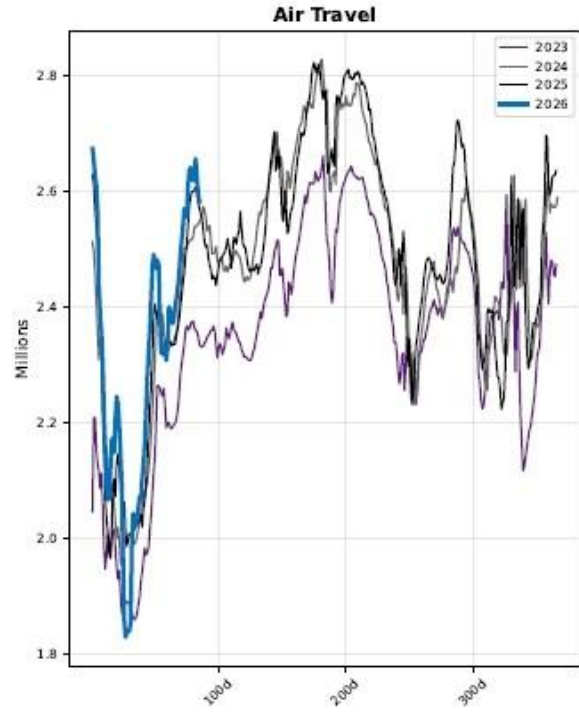
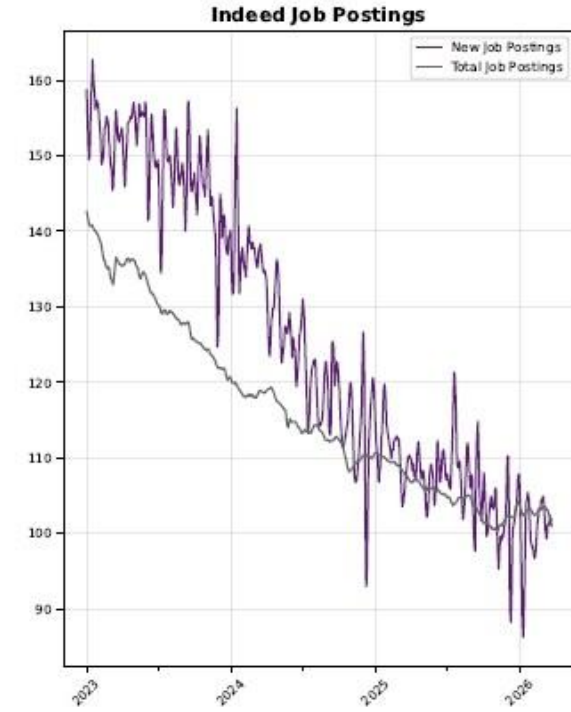
PAST CYCLES (RANGE)
 PAST CYCLES
 PAST CYCLES (MEAN)
 CURRENT CYCLE

Past 7 cycles excluding Covid-19 period

High Frequency Economic Dashboard



High Frequency Economic Dashboard



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