

Dutta's Monetary Thoughts

Reacceleration looks liffy

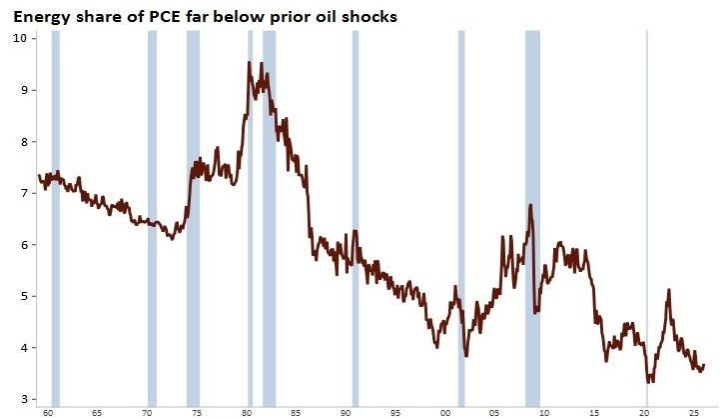
Neil Dutta

Buffers have been drawn down

When oil prices spike due to supply constraints, as is the case now, two things happen. Consumption slows because the rise in energy prices puts a tax on households, and inflation rises, which can push the Fed to tighten monetary policy.

Whenever oil prices rise, I am reminded of two things.

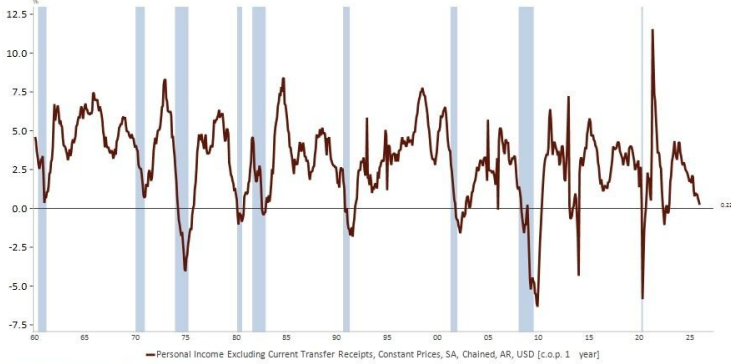
- First, the Fed can amplify oil price shocks. There is some research to suggest that economic downturns associated with an increase in oil prices were not actually caused by the oil price increases themselves, but by the Fed's response to them. This is why inflation expectations are important. A Fed with high credibility can be patient and look through a one-time supply shock.
- Second, equivalent oil shocks that sent the US economy into a deep economic slump previously now result in a much smaller hit to real activity. The US is a large energy producer and energy consumption is a much smaller share of personal consumption expenditures now than was the case in 2022, 2008, or 1990.



Source: Renaissance Macro Research, Macrobond

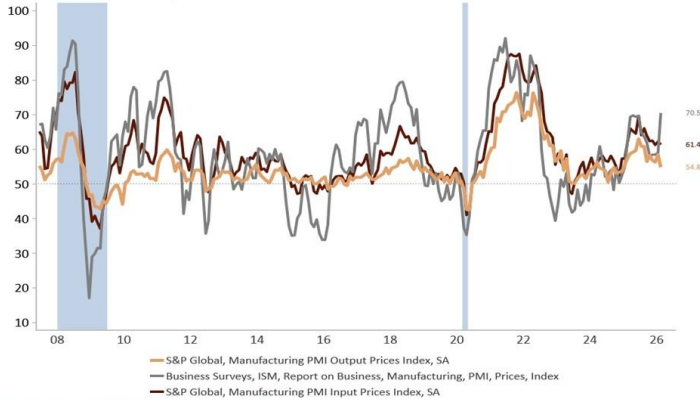
Applying some of this to the present, the latest data indicates that core PCE inflation is at three percent and so, even if I think the outlook for inflation is improving, I think the Fed will be reluctant to elevate growth over inflation risks right now. Cuts have been a close-call as it is; thus, it's tough to look through inflation when you are coming off a period of high inflation. This is probably true overseas too. With natural gas prices surging, there is less chance of cuts from the ECB.

Real incomes excluding transfers are flat leaving little buffer



Source: Renaissance Macro Research, Macrobond

Conflicting news on prices



Source: Renaissance Macro Research, Macrobond

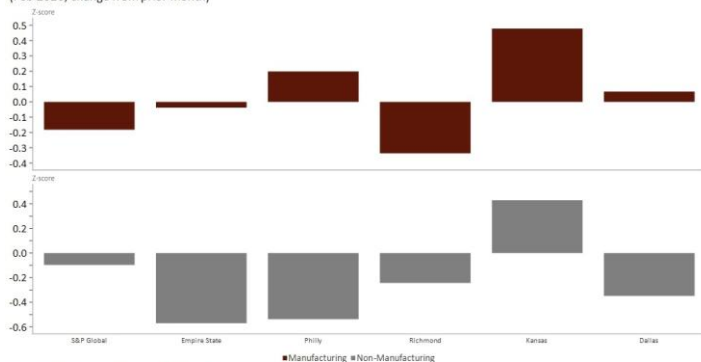
Next, there is not much of a buffer for US households. Real incomes net of government transfers are already flat compared to last year and will likely be squeezed further as pump prices rise with savings buffers already drawn down quite a bit over the last year. The US may be energy independent, but rising prices still pinch consumption and the income that rotates to energy producers is not likely to be spent immediately. A standard economic model will show a fairly muted impact to growth from today's oil move. We are talking about a tenth or two off annualized GDP growth. The risk I'm looking out for is the one that's less linear in nature. How do consumers respond to this when their incomes are already quite weak with limited ability to bring down saving? That will depend on how long the conflict lasts and if there are second effects in energy markets.

ISM Manufacturing remains in expansion

- Manufacturing remains the bright spot in the economy. The ISM Manufacturing PMI eased to 52.4 in February from 52.6 in January, a level that the ISM estimates corresponds to a 1.7% increase in real GDP on an annualized basis. That supports the reacceleration thesis, but is hardly consistent with robust growth. The surprise was in the ISM prices paid component, which surged 11.5pts to 70.5. Interestingly, this was at odds with the S&P Global US Manufacturing PMI, which saw input prices ease to 61.4 and output prices drop to 54.8. Back to ISM, new orders fell 1.3pts to 55.8, a still healthy level. Purchasing managers continue to report their inventory levels as too low, which ought to support ongoing inventory investment. Respondent commentary was generally more upbeat than we have seen in recent months.

March 2, 2026

Regional surveys paint a less optimistic picture, especially services
(Feb-2026, change from prior month)



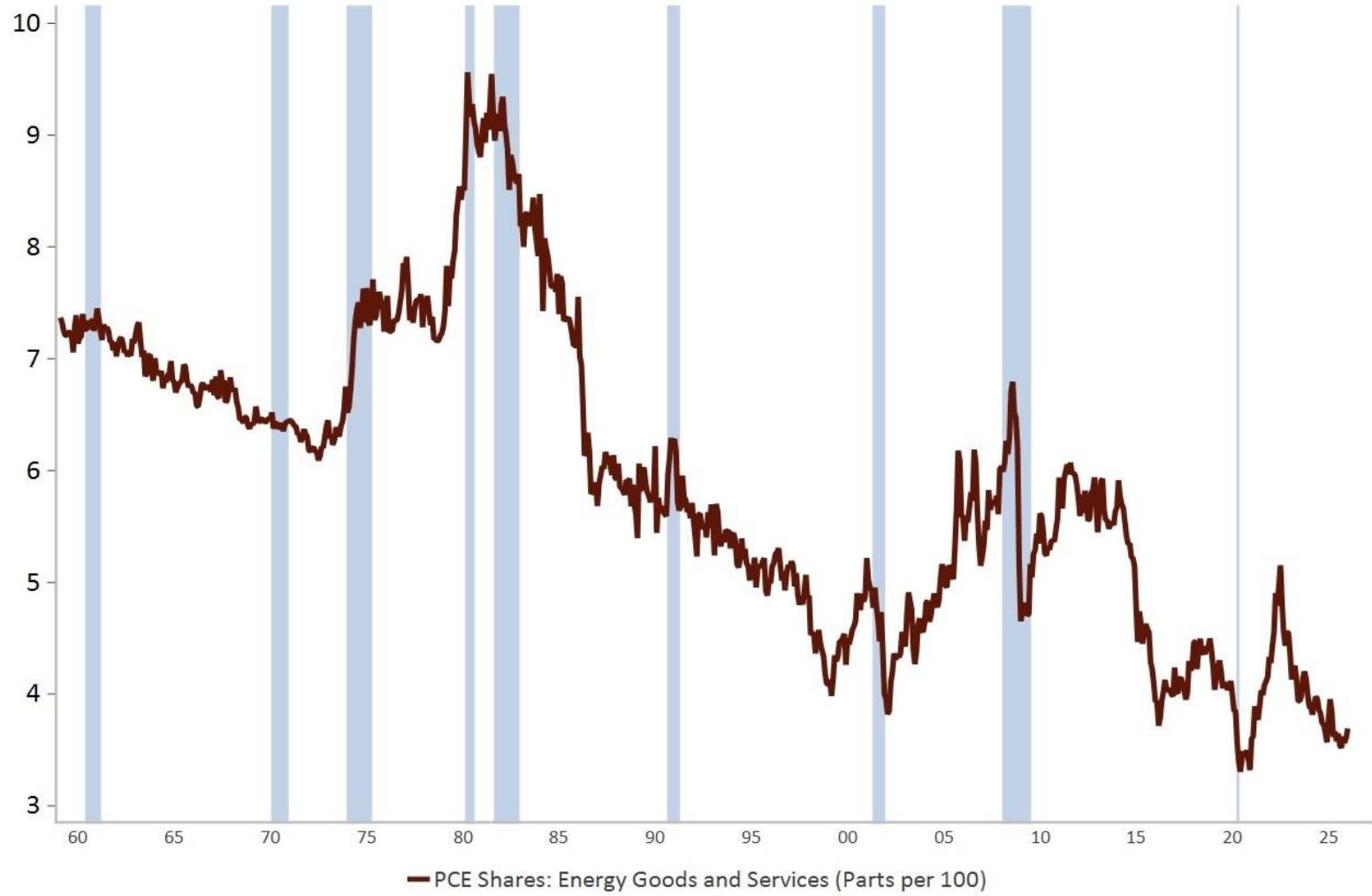
Source: Renaissance Macro Research, Macrobond

- It is worth noting, however, that not all business surveys tell the same story. The S&P Global PMI has eased while a range of regional surveys, particularly on the services side, declined over the month. That's not exactly a bright green light for the reacceleration narrative.

Geopolitical oil shocks and their limited inflation passthrough

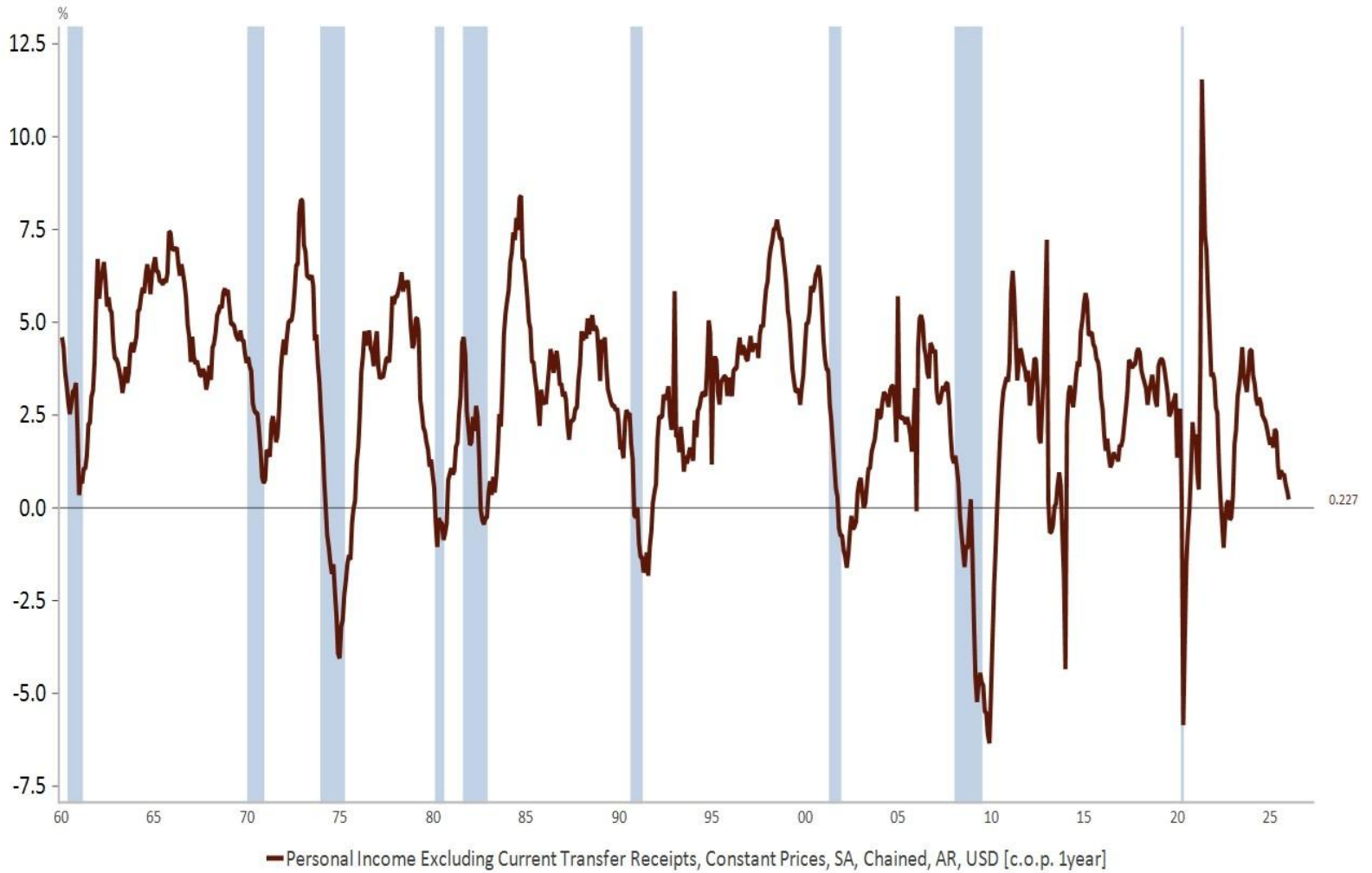
- A [paper](#) published last year by the Dallas Fed, examined how Middle East geopolitical shocks transmit through oil and gasoline prices into U.S. inflation and inflation expectations. Using a structural model estimated on data from 1990 to mid-2025, the study found that even under a severe scenario where WTI crude reaches \$100 per barrel due to a Strait of Hormuz closure, the cumulative effect on annualized headline PCE inflation would be roughly 1.3 percentage points, with core PCE rising only about 0.3 percentage points. Gasoline price shocks shift the price level but the inflationary impulse fades within a few months, and long-term inflation expectations remain essentially anchored.
- That analysis has suddenly become far more than academic. Following the coordinated U.S.-Israeli strikes on Iran on February 28, tanker traffic through the Strait of Hormuz has effectively stalled, with Brent crude surging above \$78 per barrel on Monday — up roughly 8.5% — and WTI jumping over 7% to around \$72. Analysts are flagging the possibility of Brent reaching \$80–\$90 near term, with tail-risk scenarios above \$100 if disruptions persist. The Dallas Fed's framework suggests that even at those elevated levels, the passthrough to core inflation and long-term expectations should remain contained, provided the disruption is temporary. But duration matters enormously — if the Strait remains impaired for weeks, the inflationary arithmetic could start looking more uncomfortable.

Energy share of PCE far below prior oil shocks



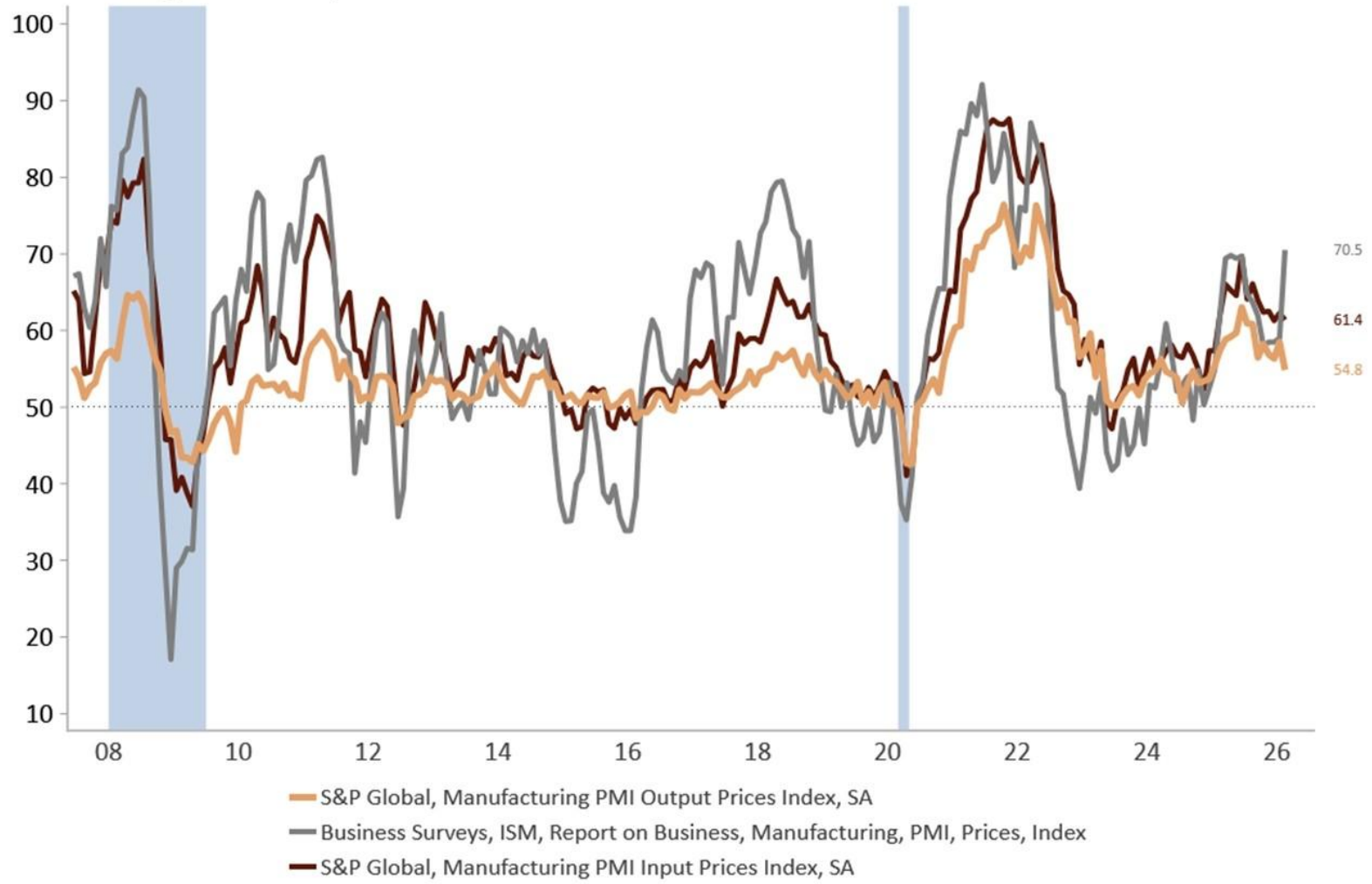
Source: Renaissance Macro Research, Macrobond

Real incomes excluding transfers are flat leaving little buffer



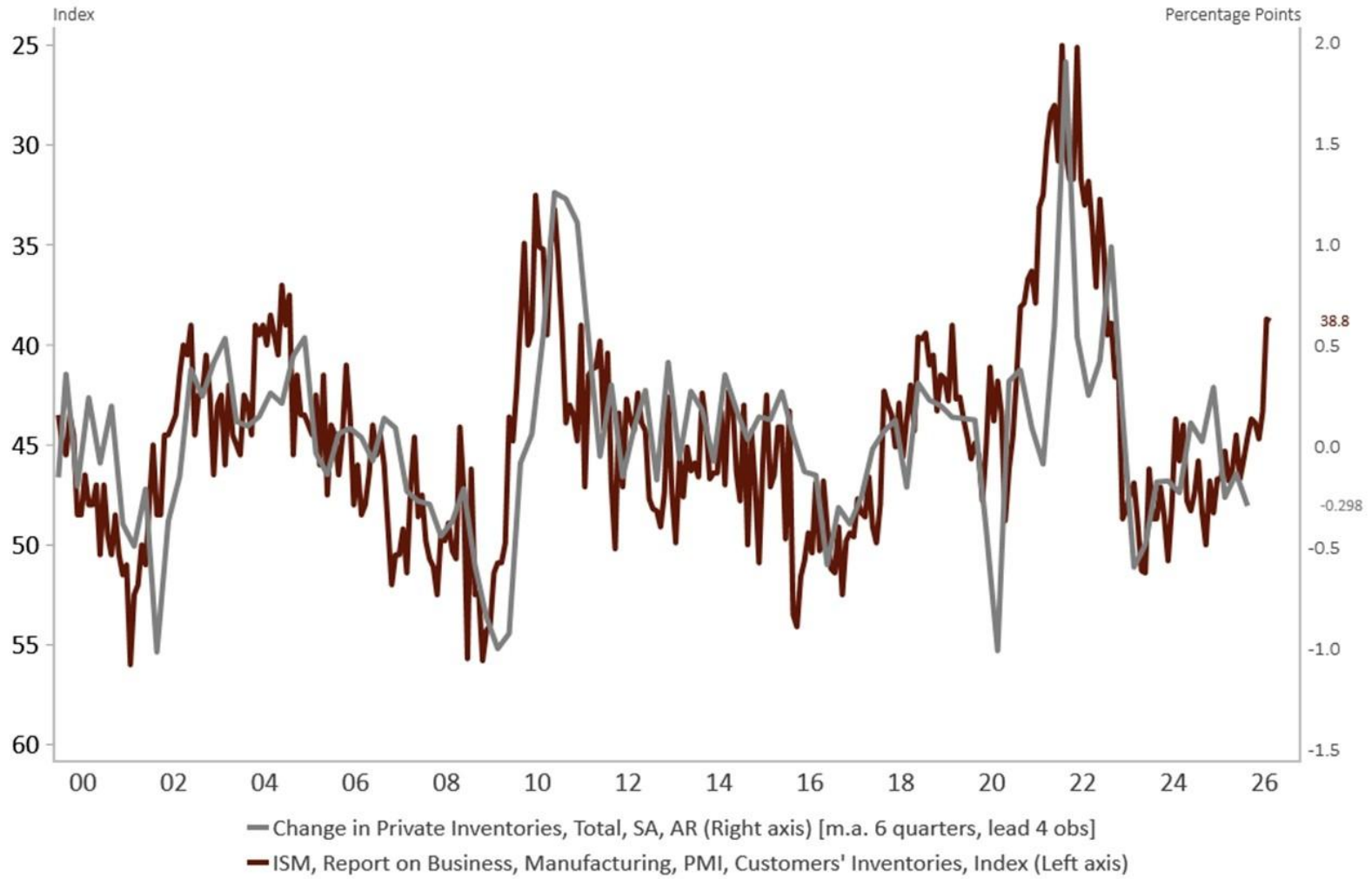
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Inventories to be rebuilt



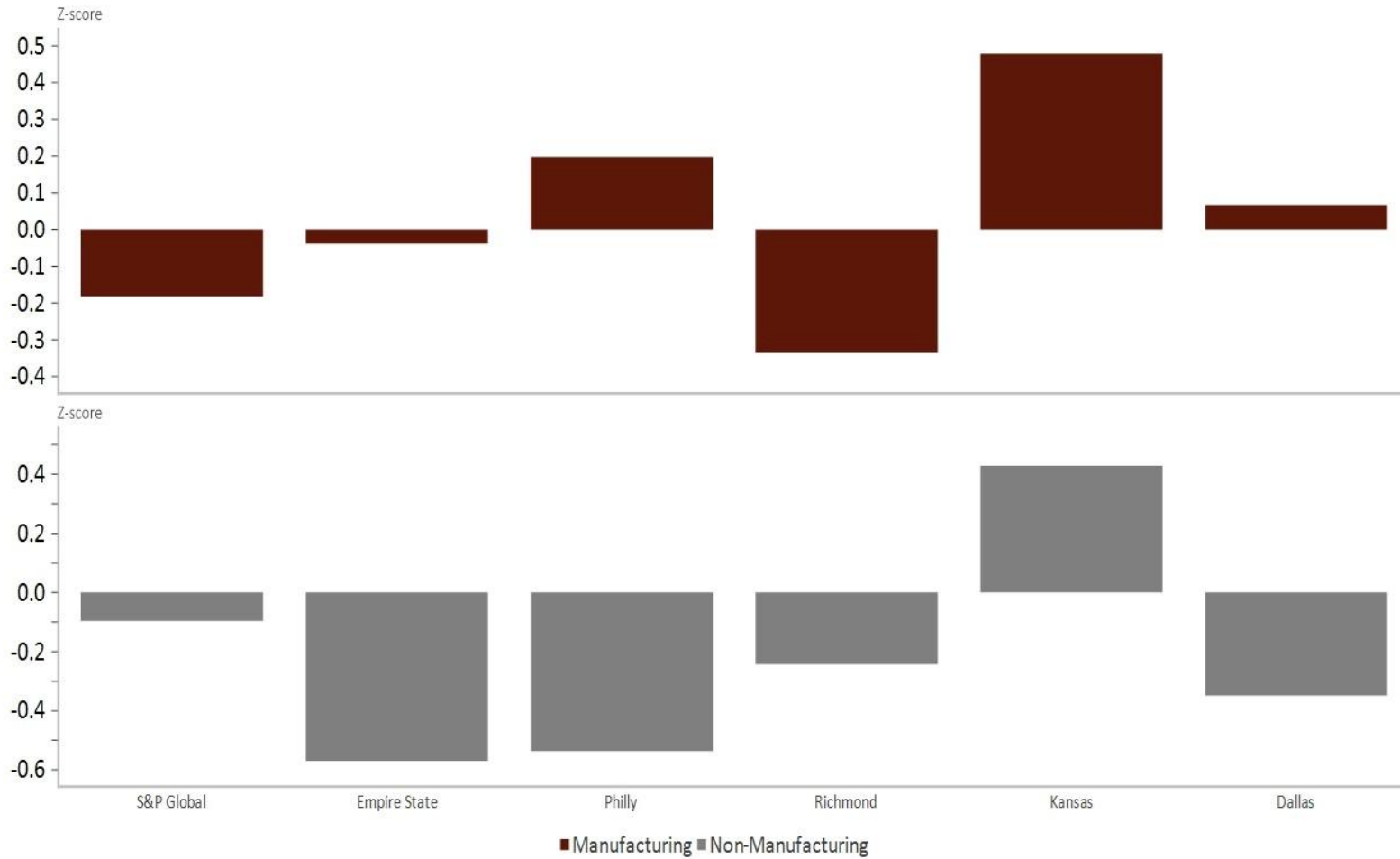
Source: Renaissance Macro Research, Macrobond

WHAT RESPONDENTS ARE SAYING

- “Today, American produced commodities like steel and aluminum are the highest priced in the world, by far. Hence, the Section 232 tariff policy is having the exact opposite effect of their intention on an American manufacturer like us: It is raising prices while lowering demand and profitability.” [Transportation Equipment]
- “Economic activity seems to be also challenging for this year. Some recovery in certain sectors in the economy but still lot of cost pressures and soft demand. Cost discipline is the priority.” [Chemical Products]
- “January sales continued to provide positive indications for growth opportunities. Data center, health care, and food and beverages remain positive growth areas. We continue to receive price increase notifications from suppliers based on unsupported tariff claims and are expanding corporate staff to support sales growth.” [Chemical Products]
- “South American instability has begun to be a factor for our suppliers and inventory management.” [Petroleum & Coal Products]
- “Pricing for outside purchases has stabilized. We are spending significant effort to work with our supply base to mitigate tariff impacts. Backlog is at a healthy level.” [Miscellaneous Manufacturing]
- “Overall orders and supply footprint are improving. As we review customer demand, we are also taking several categories of established materials and supplies out to RFP for review and cost improvements — in particular, printed circuit assemblies, plastics, sheet metal assemblies and motorized assemblies. This will help ease the burden of tariff and customer impacts as we broaden our supplier base to a more regional footprint.” [Computer & Electronic Products]
- “Continue to be impacted by tariffs. Seeing metals prices rise too. Business is steady, but domestic growth is slower than expected.” [Computer & Electronic Products]
- “Business was slow in January. Many orders pulled into end of 2025 to meet revenue goals. Order book is strong going forward.” [Electrical Equipment, Appliances & Components]
- “Tariff policy changes affect total acquisition costs and purchasing source decisions. So far this year, tariff instability still exists. Due to the tariffs, most raw materials used in manufacturing, such as steel and wire, need to be sourced domestically, and the cost keeps going up.” [Machinery]
- “Business is improving by the week. Backlog is growing, and new opportunities are everywhere. Monthly shipments are still lower than planned, but improving. Over the past five years, we spent thousands trying to attract new employees and had almost zero responses. In the last six months, however, we’ve been able to hire experienced engineers, computer numerical control (CNC) operators, and young people wanting to become CNC machinists.” [Fabricated Metal Products]

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