December 16, 2025

Dutta's Monetary Thoughts

Skipping class now will mean make up class later

Neil Dutta

A short-lived skip

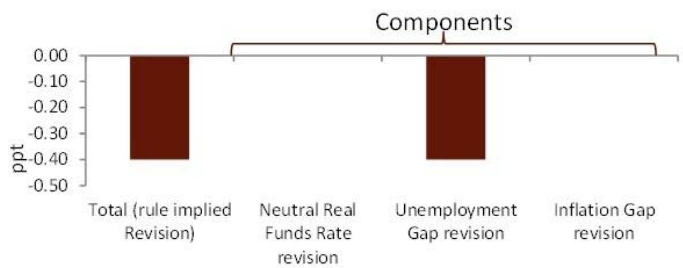
The December FOMC meeting has reset the table to some degree. Rate cuts at upcoming meetings cannot be ruled out but can't be priced in either. The incoming data will dictate what follows. Thus, I think there is a somewhat higher bar for cuts now and a somewhat lower bar for cuts later.

First, the FOMC currently sees the unemployment rate ending the year at 4.4 percent with the median participant penciling in one rate cut. Assume a scenario where the jobless rate climbs to 4.6 percent at the time of the January FOMC. Such a scenario would only imply one more rate cut in a typical Taylor Rule framework.

You could see a situation where the Fed is penciling in another cut for the year, but holding off on pulling the trigger just yet. It's still early in the year and the Fed could guide to a cut without actually doing one.

Taylor rule suggests limited cuts even if unemployment rises

(Rule-implied (Taylor 1999) 2026 funds rate revision assuming 4.6% UR in Jan)



Note: Funds rate revision = neutral_real_rate_revision + 0.5*Core_Inflation_revision + 2*Unemployment_gap_revision

Source: Haver Analytics, Renaissance Macro Research

Early next year, there will be uncertainty around the Chairman and a bunch of serious hawks will circle into the FOMC – Hammack and Logan. Recall that the dots revealed a total of six participants opposed a cut last week. Moreover, many on the FOMC could make the case to hold off on shifting policy since the peak impact of fiscal policy hits in Q2. They'll be reluctant to move in front of that train.

Second, while underlying inflation is cooling, there is some risk that residual seasonality keeps the Fed from easing in Q1. We've seen this play out in each of the last three years. January inflation has generally been firm even after seasonal adjustment. This creates the risk of a head fake. One strong inflation print during Q1 and the hawks may feel ascendant.

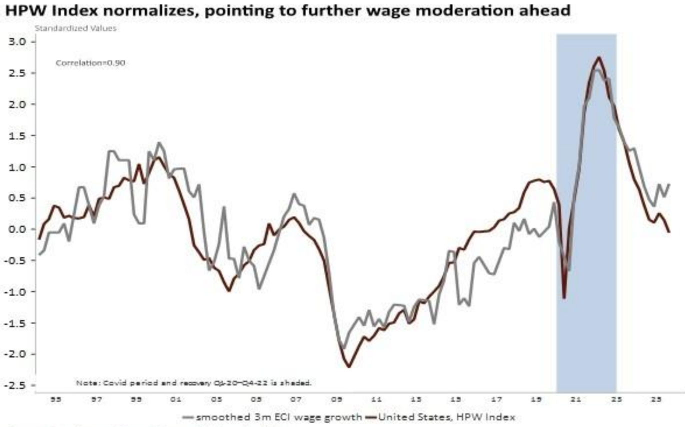
In short, the near-term data-flow might create a tension between softening employment, albeit not softening enough and a pick-up in consumer prices. Thus, I am inclined to think the Fed will skip the first two meetings of 2026.

Wage growth is cooling off

Labor cost pressures will continue to ease in the coming quarters as the balance of power shifts away from workers and to employers.

We extended Heise, Pearce, and Weber's (2024) labor market tightness study by expanding the regression window through Q3-2025, adding five additional quarters beyond their original sample ending in Q2-2024.

HPW Index normalizes, pointing to further wage moderation ahead



Source: Renaissance Macro Research, Haver Analytics

The HPW Index—a composite measure combining the quits rate and vacancies-to-effective-searchers ratio (V/ES)—has declined significantly from its pandemic-era peak of approximately 2.8 in early 2022 to -0.06 in Q3-2025, marking the first negative reading since the pre-pandemic period. This represents a substantial normalization in labor market conditions, with the index now sitting just below historical average of zero (by construction, the standardized index has mean zero over the estimation sample).

The HPW Index's trajectory suggests that labor market tightness has fully unwound its extraordinary postpandemic surge, with conditions now consistent with or slightly below the 1994-2025 average. While there may be some residual momentum in wage pressures, the 0.90 correlation between the HPW Index and smoothed wage growth suggests that wage growth should continue moderating in coming quarters as the lagged effects of reduced labor market tightness work through.

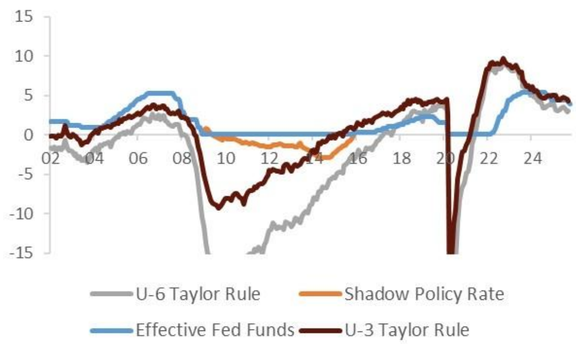
While there is a wide range of views on interest rates next year among Fed officials, there is not much difference of opinion on the unemployment rate. The median for 2026 stands at 4.4 percent with a range of 4.2 to 4.6 percent. This comes as a surprise to us since unemployment has been climbing for the last three months as it is.

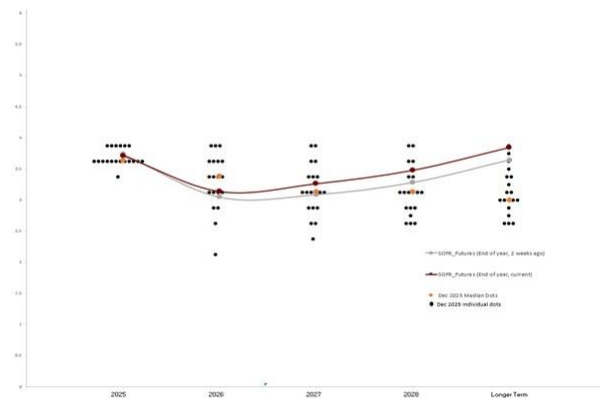
Year	Window Start	UR at Start (%)	UR 12M Later (%)	UR Change 12M (ppt)
1970	1970-02	4.2	5.9	1.7
1973	1973-11	4.8	6.6	1.8
1974	1974-09	5.9	8.4	2.5
1975	1975-03	8.6	7.6	-1.0
1980	1980-04	6.9	7.2	0.3
1981	1981-08	7.4	9.8	2.4
1982	1982-01	8.6	10.4	1.8
1990	1990-07	5.5	6.8	1.3
1991	1991-01	6.4	7.3	0.9
2001	2001-06	4.5	5.8	1.3
2003	2003-04	6.0	5.6	-0.4
2008	2008-05	5.4	9.4	4.0
2009	2009-01	7.8	9.8	2.0
2016	2016-02	4.9	4.6	-0.3
2023	2023-08	3.7	4.2	0.5
2024	2024-05	4.0	4.2	0.2
2025	2025-07	4.2	N/A	N/A

When unemployment starts climbing, it typically keeps climbing. See our nearby table. This analysis identifies years since 1970 where the unemployment rate rose by at least 0.1 percentage point per month for three or more consecutive months — a pattern often signaling recession onset. For each year meeting this criterion, we capture the first such window and measure where unemployment stands 12 months after the window begins.

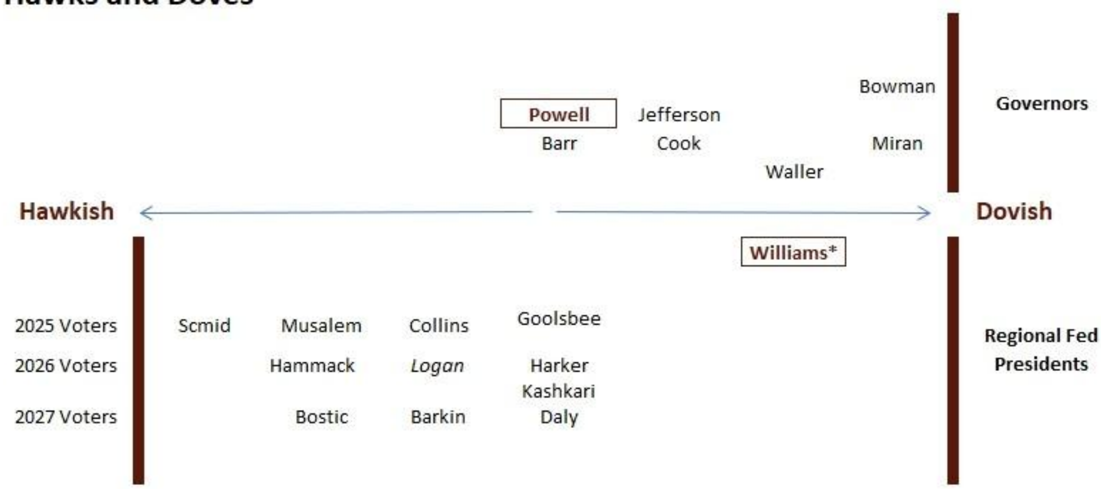
Across 17 episodes, unemployment averaged 1.2 percentage points higher a year later, with a median increase of 1.3 points. Notable examples include the 1981-82 recession (UR jumped from 7.4% to 9.8%) and the 2008-09 financial crisis (from 5.4% to 9.4%). The more severe episodes — six or more consecutive months of rising unemployment — proved even more damaging, with the jobless rate averaging 2.1 points higher after 12 months. However, not every streak leads to disaster: the 2016 and recent 2023-24 episodes saw only modest increases or even declines in unemployment 12 months out. Currently, the streak that began in July 2025 bears watching.

Monetary metrics





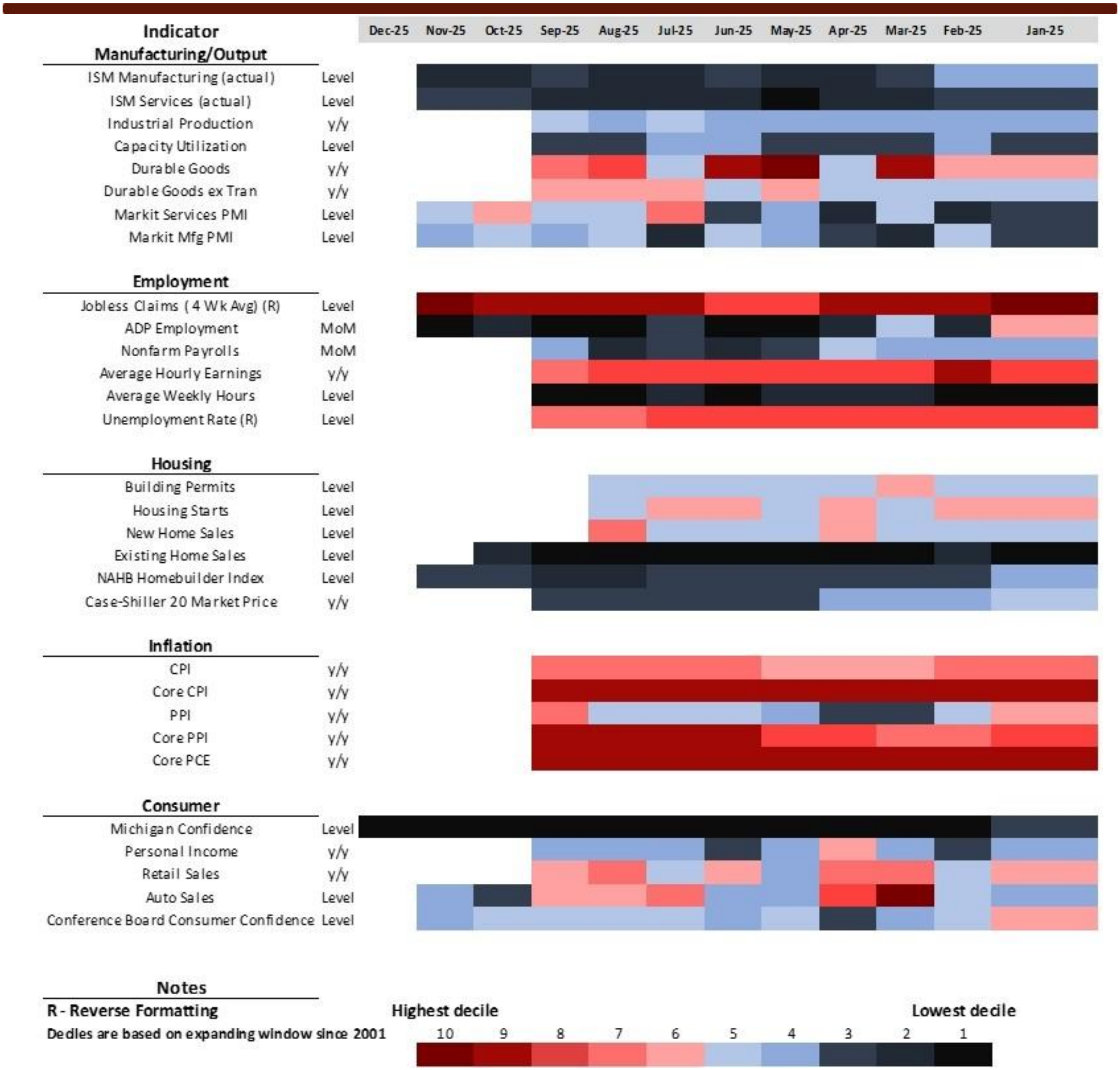
Hawks and Doves



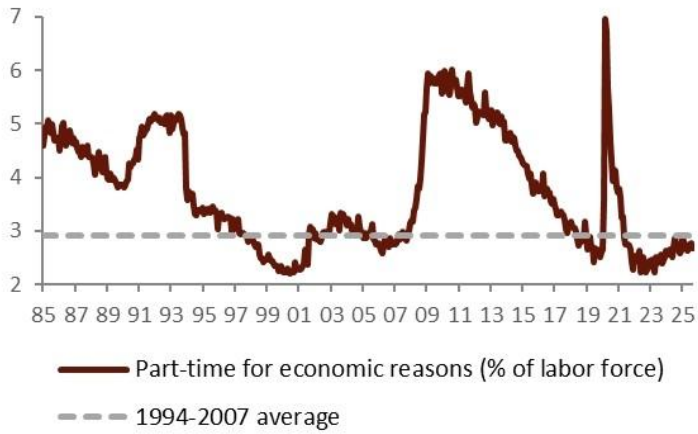
*Federal Reserve Bank of NY President always votes
Boxed individuals represent FOMC core

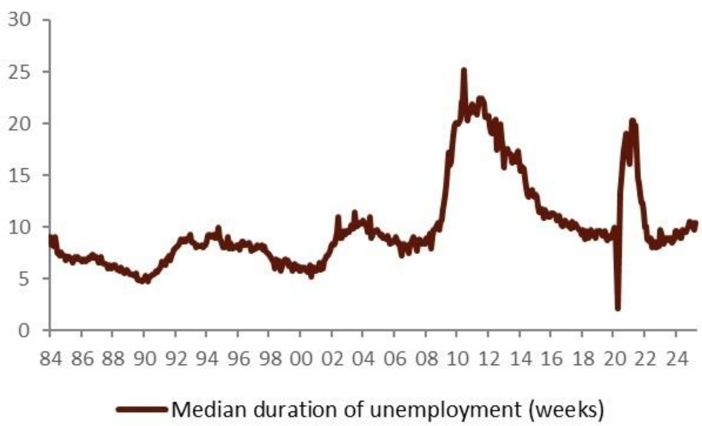
FOMC Forecasts	Median					Central Tendency				
	2025	2026	2027	2028	Longer run	2025	2026	2027	2028	Longer run
Change in real GDP	1.7	2.3	2.0	1.9	1.8	1.6–1.8	2.1–2.5	1.9–2.3	1.8–2.1	1.8–2.0
September projection	1.6	1.8	1.9	1.8	1.8	1.4–1.7	1.7–2.1	1.8–2.0	1.7–2.0	1.7–2.0
Unemployment rate	4.5	4.4	4.2	4.2	4.2	4.5–4.6	4.3–4.4	4.2–4.3	4.0–4.3	4.0–4.3
September 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	2.9	2.4	2.1	2.0	2.0	2.8–2.9	2.3–2.5	2.0–2.2	2.0	2.0
September 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	3.0	2.5	2.1	2.0		2.9–3.0	2.4–2.6	2.0–2.2	2.0	
September projection	3.1	2.6	2.1	2.0		3.0–3.2	2.5–2.7	2.0–2.2	2.0	
Projected policy path										
Fed funds rate	3.6	3.4	3.1	3.1	3.0	3.6–3.9	2.9–3.6	2.9–3.6	2.8–3.6	2.8–3.5
September 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

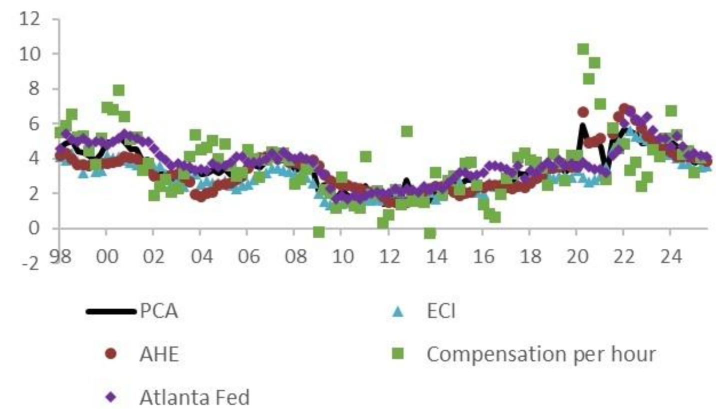
High frequency data heat-map

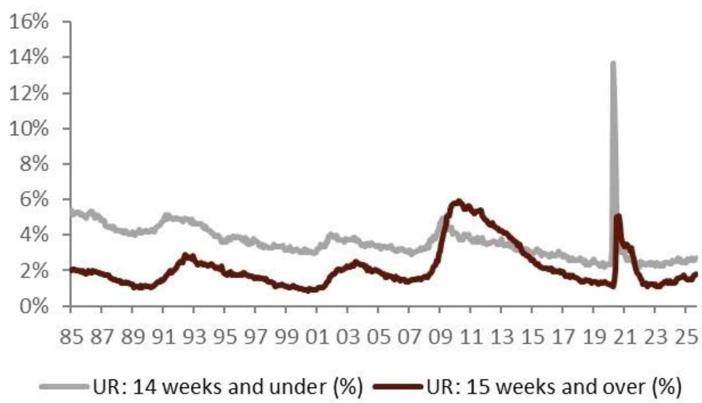


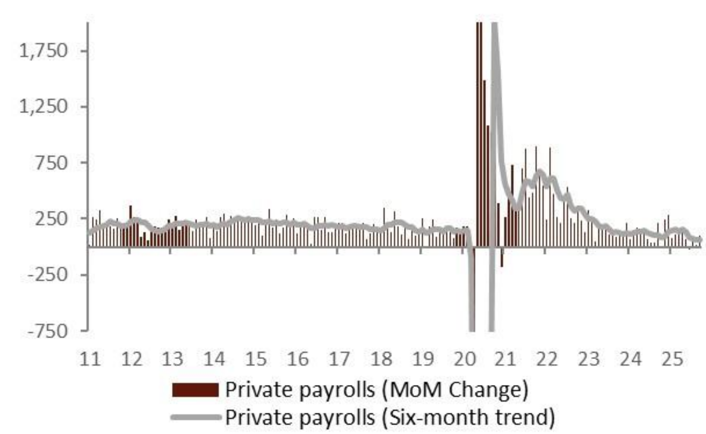
Labor market indicators



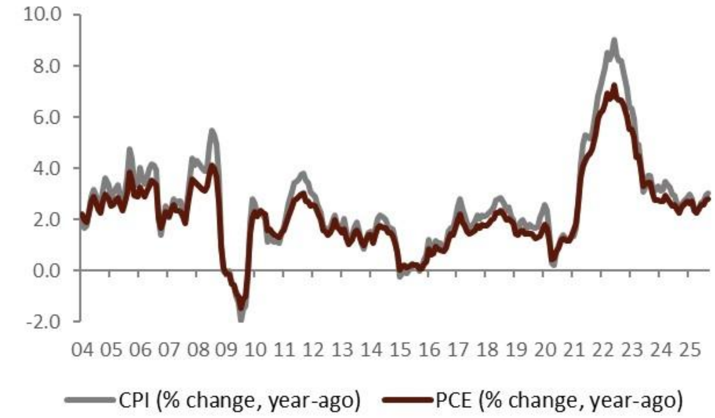


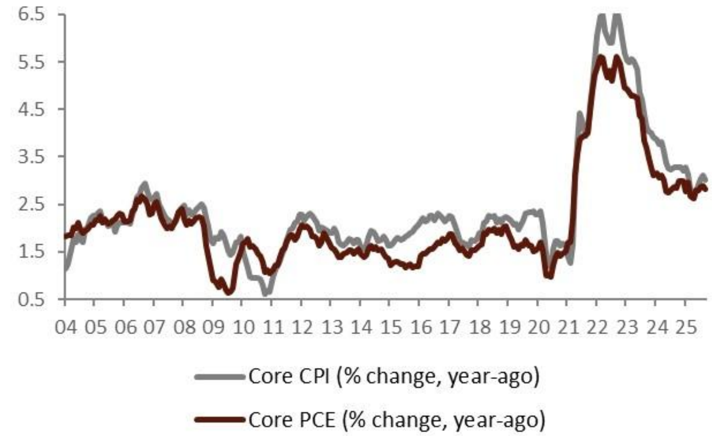


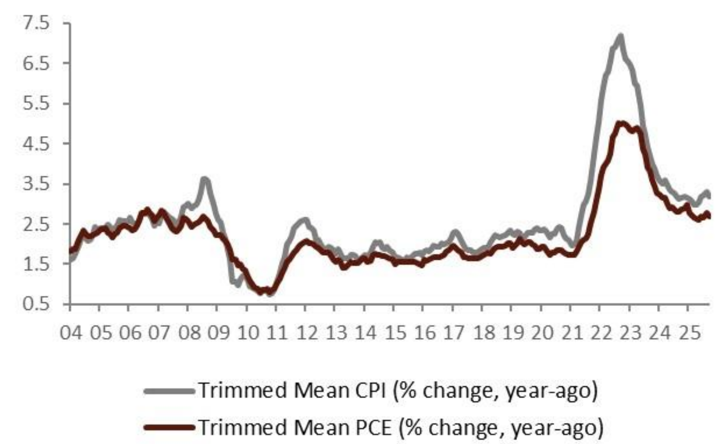


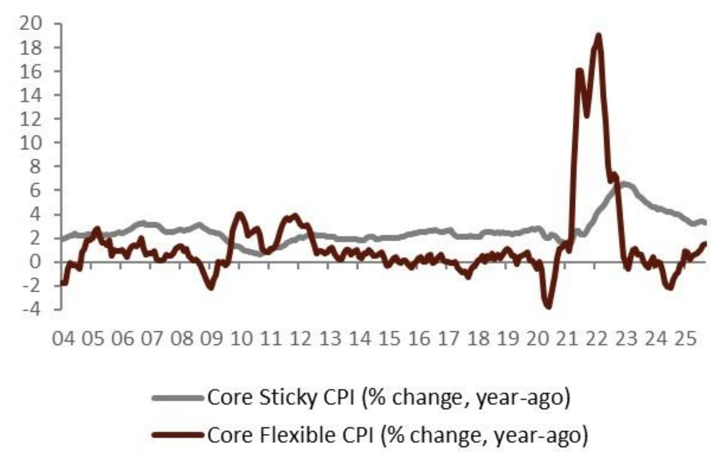


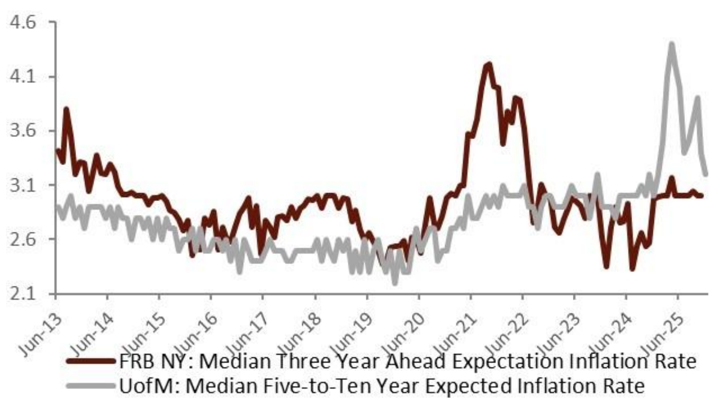
Inflation indicators

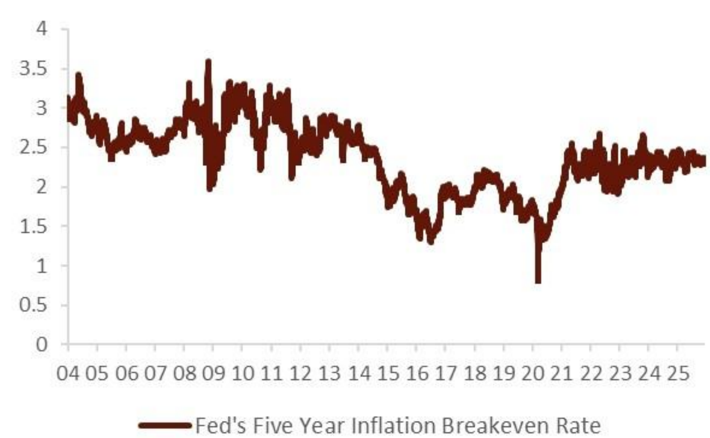




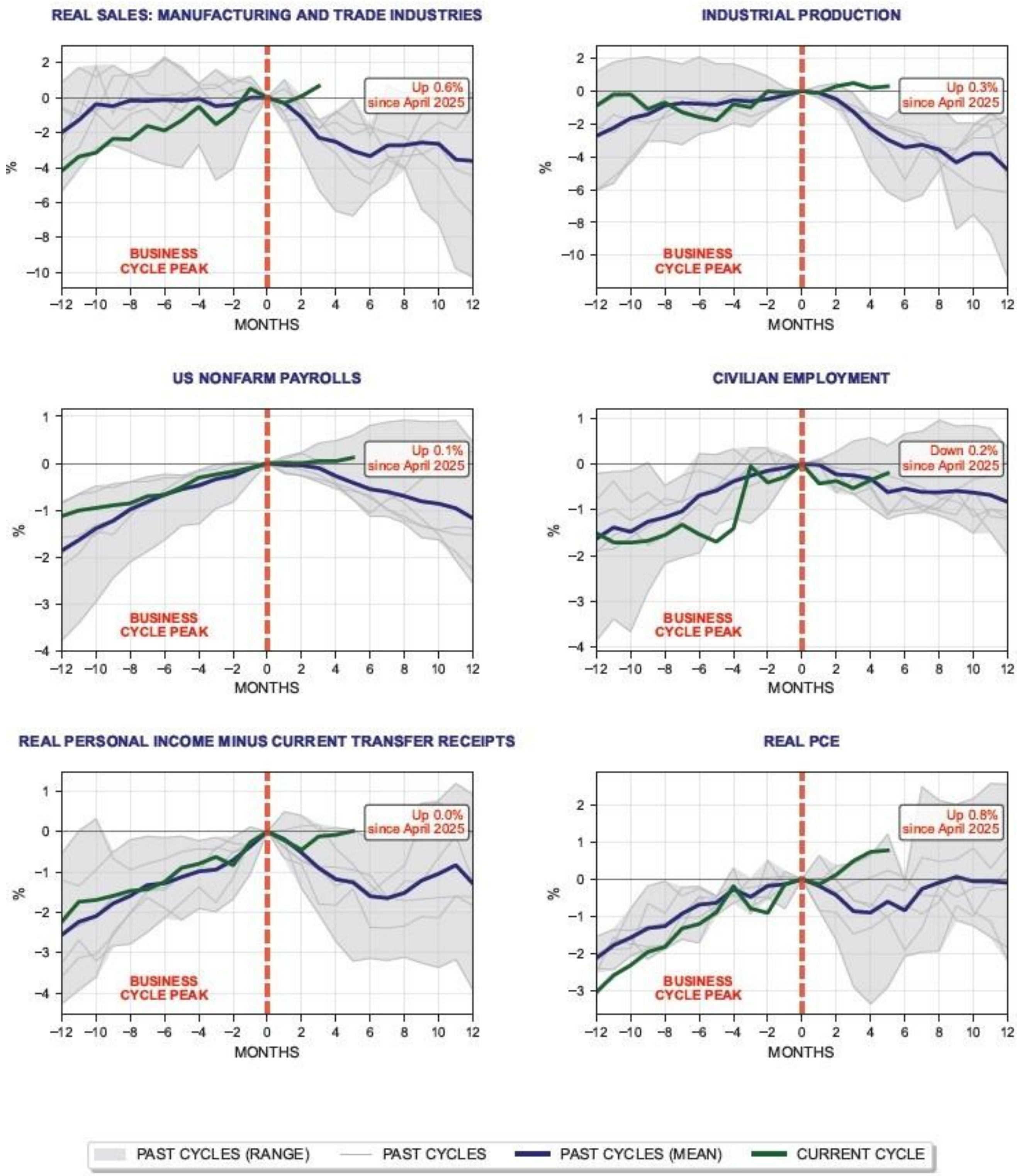






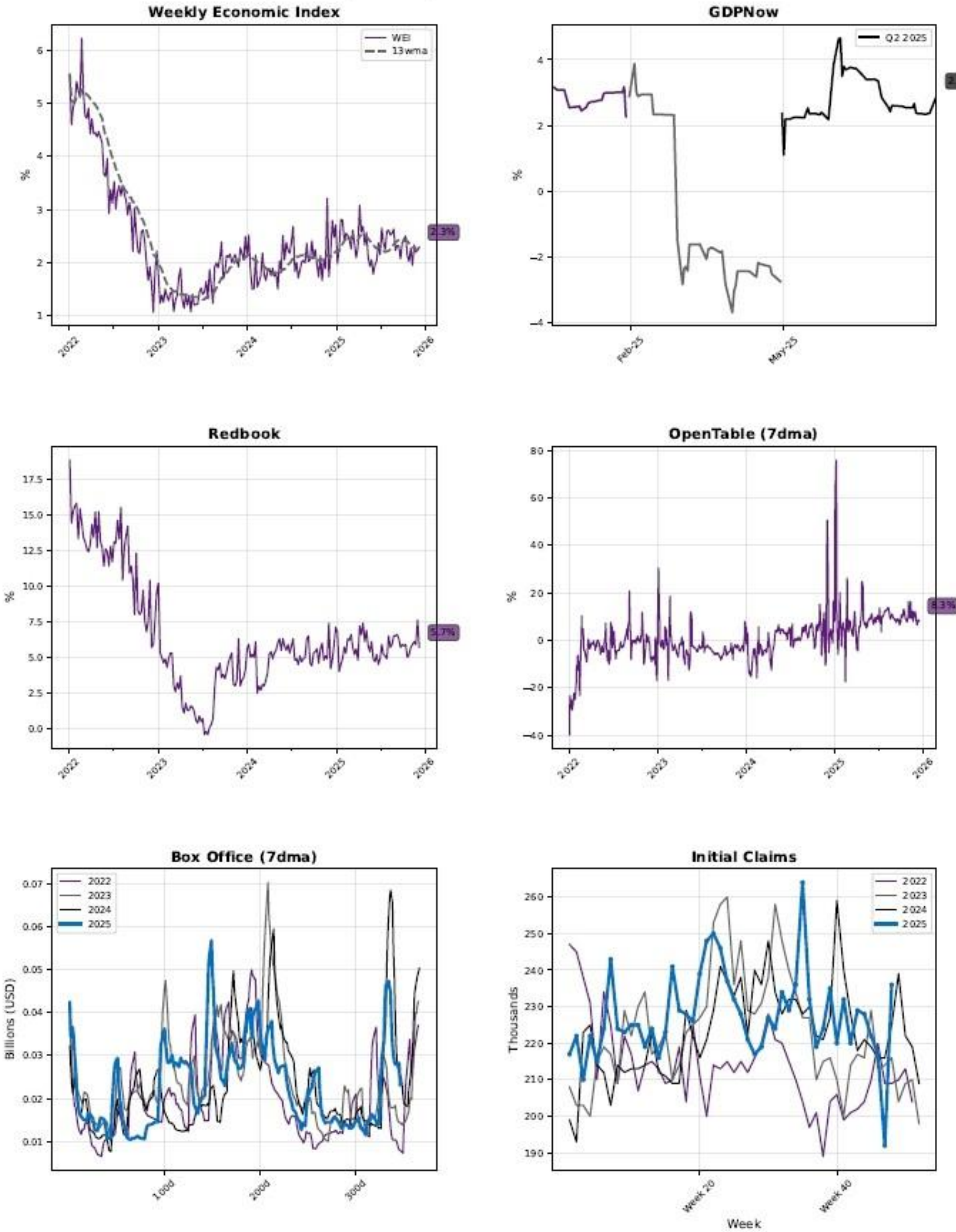


NBER RECESSION INDICATORS DASHBOARD



Past 7 cycles excluding Covid-19 period

High Frequency Economic Dashboard



High Frequency Economic Dashboard