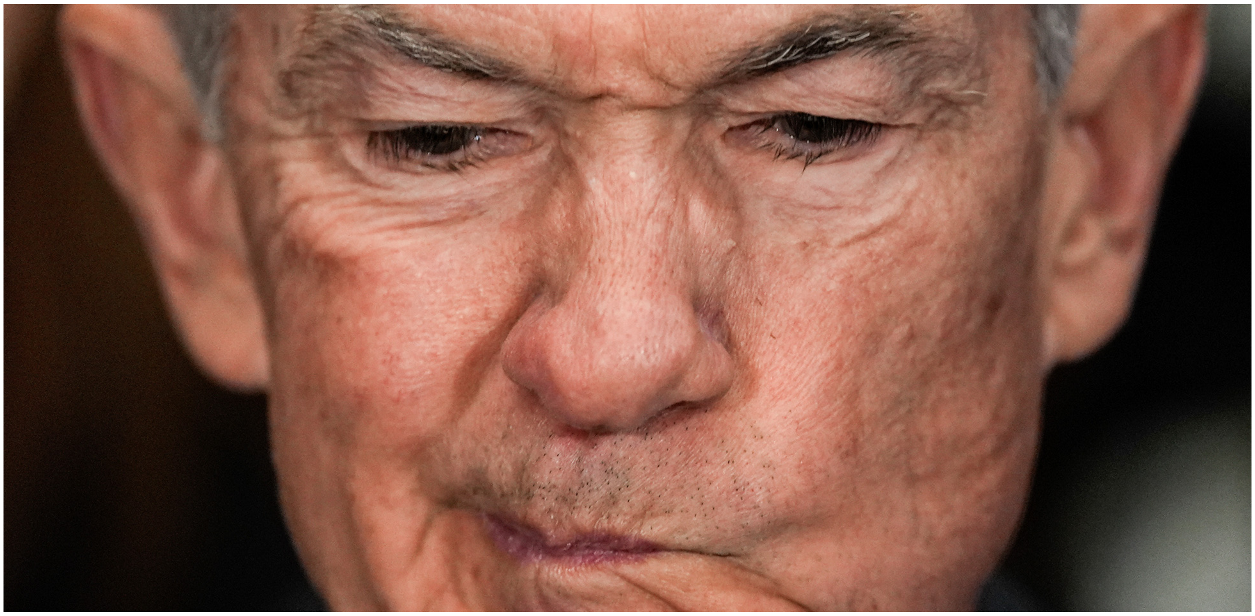
THOUGHTS FROM THE FRONTLINE

Inflationary Confusion

By John Mauldin | July 19, 2025



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If you listen to the media—both MSM and social media—it seems like everyone in the world wants lower interest rates.

Historically low rates were the landscape for most of the last 15 years, and anyone who borrowed money enjoyed it. Savers, not so much, but the idea of going back to low mortgage rates, bank loans, etc. is attractive to many folks.

Unfortunately, the lush financial terrain we enjoyed from 2008 to 2022 was more like artificial turf. It wears out, gets ugly holes, and eventually needs replacement. But how to replace it without causing other problems? That turns out to be a real problem.

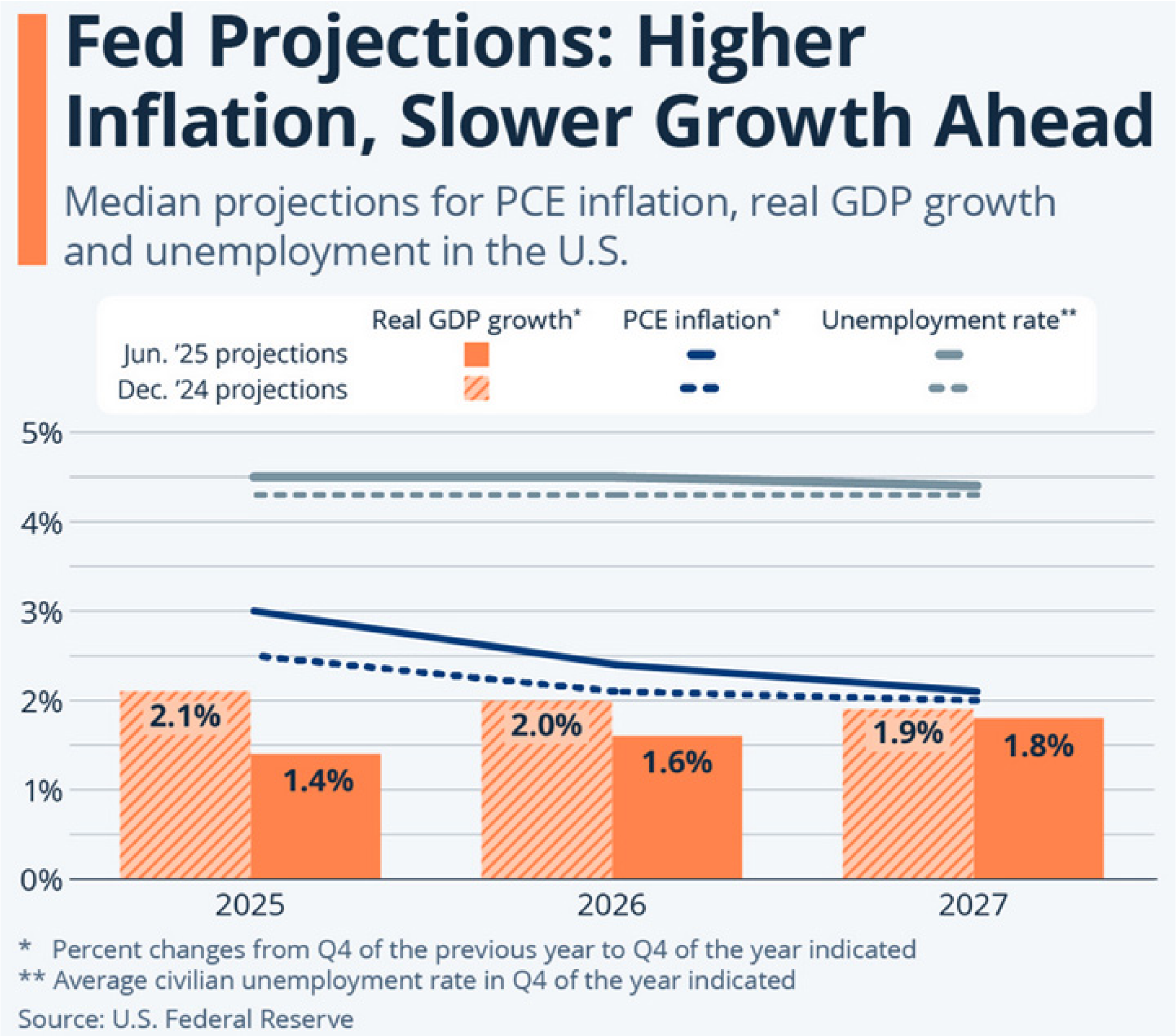
In many minds, the main barrier to lower rates is the Federal Reserve, which they think is unduly worried about inflation. The inflation outlook is key, perhaps the most important key, to interest rates. Getting it right is critical to almost every macro decision. When Fed officials let inflation get out of hand in 2021, even as many of us were screaming for them to lean into clearly rising inflation, it created true problems. We are still living with them.

Today we'll draw on some of my best sources to survey the inflation trends. As you'll see, the direction isn't as clear as either hawks or doves think. And if we have space, I'm going to comment on the Federal Reserve situation and give you a heads up on a tariff decision coming.

The Fed's View

The Federal Open Market Committee is emphatically *not* one of my best sources for any kind of economic projections. I once quipped they were like zero for 300 in their forecast accuracy. It is almost statistically impossible to be as bad as their massive team of PhD economists has proven to be. Nonetheless, we should still look at what FOMC members think. It's a clue to their future decisions.

This handy graphic shows FOMC median projections for PCE inflation, real GDP growth, and the unemployment rate as of December 2024 and June 2025.



Source: Statista

As of last December, the median FOMC member expected 2.5% inflation in calendar 2025. That was enough for them to pause the rate cuts that had begun three months earlier. They subsequently raised their inflation forecast even more to 2.7% in March and 3.0% in June.

While others clamor for rate cuts, the FOMC members (as a group with some notable exceptions!) have been growing *more* concerned about inflation, not less—at least in the near term. They still expect a gradual decline to 2.1% in 2027. But they bumped that estimate up from 2.0% as of March.

The bars at the bottom show confidence in this year's real GDP growth is slipping even further, from 2.1% in December to 1.4% in June, which would normally be a signal for lower rates. Data since then doesn't show much reason to expect any improvement. They're caught between an expectation of persistent inflation and an expectation of slipping growth. The first argues for holding rates high, the other might indicate a need to cut rates.

The deciding factor may be that third line: unemployment. The FOMC thinks the job market will hold about where it is. A 4.5% unemployment rate, while not great, probably isn't enough to demand immediate stimulus.

On Friday morning, Peter Boockvar offered this chart of two-year inflation breakeven rates, up to 2.76%, and as you can see the trend is clearly up from below 2.5% over the last month. The 5-year breakeven has gone from 2.40% to 2.54%. The market is clearly more concerned and less optimistic about inflation than the FOMC. This will be important later.

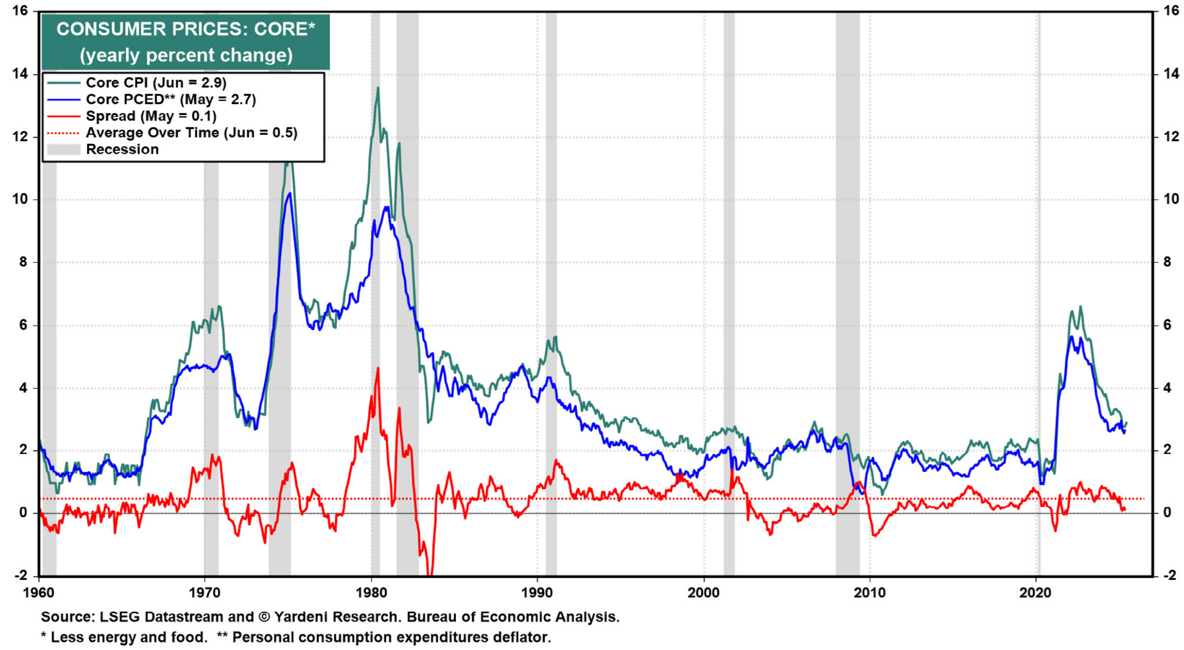
Source: Peter Boockvar

Blaming Tariffs?

Jerome Powell and other FOMC members have been pretty open about their inflation reasoning. It's mostly related to tariffs, which they think will raise consumer prices. They're waiting to see how those effects develop. The trillion dollar question is how long they'll wait. President Trump wants them to move now, but his constant policy changes aren't helping.

This week's June CPI data didn't add much clarity. Here is Ed Yardeni's first impression.

> "Today's CPI report for June suggests that consumer price inflation is no longer declining toward the Fed's 2.0% target. Instead, it might continue to hover around 3.0% for a while as it has recently (chart). Trump's tariffs may be a contributing factor, though their impact remains debated. The core CPI inflation rate upticked to 2.9% last month, hinting that the core PCED inflation rate (at 2.7% in May) might have followed a similar trend.



Source: Yardeni Research

> "President Donald Trump is pushing for the Federal Reserve to cut the federal funds rate (FFR) from 4.33% to 1.00%. This reduction would lower net interest payments on the federal debt, helping to reduce the US budget deficit. A lower FFR could also weaken the dollar, boosting exports and reducing imports. However, Fed Chair Jerome Powell and most Federal Open Market Committee (FOMC) participants are reluctant to cut rates, especially to 1.00%, due to concerns that Trump's tariffs could hinder progress toward the Fed's 2.0% inflation target.

> "The June CPI report reinforces the FOMC's cautious stance. Although Trump's tariffs may not yet be significantly driving inflation, they appear to be contributing to inflation stalling at around 3.0%, supporting the FOMC's hesitation to lower the FFR."

Drilling into the data helps reveal the problem. Before this year, US inflation was concentrated in services, mainly housing. Here's a helpful breakdown.

Annualized Inflation Rates by Product Category

	Food	Energy	Core Goods	Core Services Excluding Housing	Housing	All
2016-19	0.2%	4.2%	-0.6%	2.2%	3.4%	1.7%
2020	3.9%	-7.7%	0.1%	2.0%	2.2%	1.3%
2021	5.6%	30.6%	6.2%	5.3%	3.7%	6.2%
2022	11.1%	6.7%	3.2%	4.9%	7.7%	5.5%
2023	1.5%	-2.0%	0.0%	3.4%	6.3%	2.7%
2024	1.6%	-1.1%	-0.1%	3.5%	4.7%	2.6%

Source: St. Louis Fed

You can see in the "Core Goods" column that non-food, non-energy goods haven't seen much inflation at all since the post-COVID spending spree. Housing and other core services were the main problems in 2023–2024.

If those don't improve, and we add tariff-driven goods price increases on top of them, then inflation starts looking like a bigger worry. But we don't know how long that will take, if it happens. Peter Boockvar thinks we are starting to see early signs.

> "The June CPI figure should put to rest the debate over whether tariffs are consumer inflationary, aka raise the cost of living for the items directly impacted. We saw the equivalent of 12 month gains in prices in just one month in a variety of goods prices and I list the m/o/m increases below. The question instead is how many months of flow through do we get (Helen of Troy said their 7–10% price increases will come over the coming months [Helen of Troy is a multibillion-dollar worldwide marketer of consumer brand-name housewares, health and home, and beauty products that are a bellwether for consumer goods prices]) and whether they are one-time in nature. Theoretically they should be one-time but mucking up global supply chains may lead to more than just a one-time price change.
>
> "Also, on the positive side, I do expect a continued deceleration in services inflation as slower rent growth continues to work its way through the CPI calculation. That said, we are sowing the seeds for an eventual acceleration in rental growth next year as current excess supply gets absorbed and little new multifamily construction is taking place."

Peter then included a list of mostly imported goods and their change in the CPI data from May to June.

- Floor coverings +2.2%
- Window coverings +2.2%
- Other Linens + 5.5%
- Laundry Equipment +1.8%
- Other Appliances +2.0%
- Clocks, lamps, & decorator items +1.6%
- Non-electric cookware & tableware +3.7%
- Tools, hardware, & supplies +1.2%
- Apparel +.4% with men's shirts & sweaters up 4.3%
- Footwear +.7%
- Tires +.9%
- Video & Audio products +.8%
- Sports vehicles including bicycles +1.0%
- Sports equipment +1.8%
- Toys +1.8%

Again, ***those are one-month price changes***. They may or may not continue to climb at these rates. Businesses are trying to figure out how much of the tariff impact they can pass through to customers and how much they'll have to absorb. Choose your poison: Either corporations make less money (impacting valuations and the stock market) or consumers pay more money.

This will likely evolve over time, with more monthly price increases in consumer goods offset by lower service prices. And the tariff rates themselves are often moving targets, too.

Wolf Richter thinks companies will have a hard time raising prices.

> "Companies have lots of room to eat the tariffs, after making gigantic profits as they jacked up consumer prices in 2020–2024 to very high levels. Now they're finding out that consumers have had it, that they're no longer willing to pay whatever, that price increases are a demand killer, and that tariffs are now hard to pass on because consumers reduce their purchases of those products in response."

If he's right, then the tariff impact will manifest mostly as lower corporate profits instead of higher prices. That would suggest the recent inflation pressure will be temporary. You might even call it "transitory." But we don't know this yet. Whether you love or hate the tariffs, I caution everyone not to assume you know how they'll affect the economy. This is a complex situation that could go in many directions.

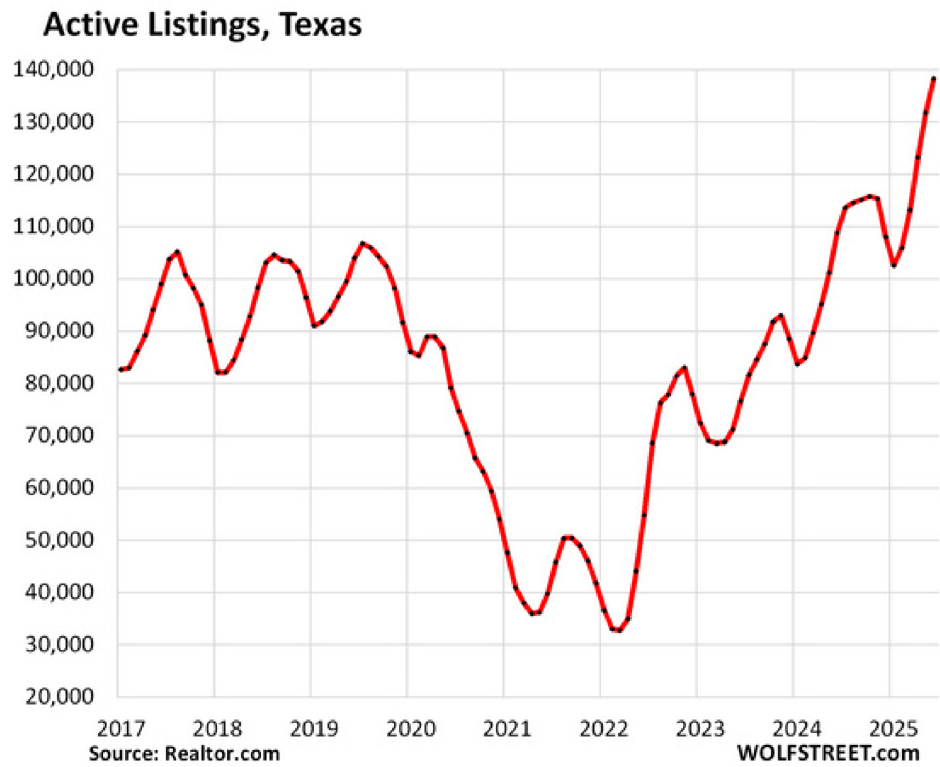
And I should note that consumer spending data this week was actually modestly positive. But that is in the aggregate. Much of the actual positive data was in upper income brackets, which are not as affected by price increases. Lower income spending was challenged.

Wild Card

Real estate is a big wild card in the inflation picture. Housing is the top expense for most households, both renters and homeowners. As noted above, stubbornly persistent price increases have helped keep overall inflation elevated. But we *may* be seeing signs of relief.

All prices are the result of supply and demand. While there's tremendous local variation, the national trend has been lower supply (often due to NIMBY anti-development policies) and higher demand as population grows and people move to places with job opportunities. But it's starting to break.

Here is a chart of active listings in the previously red-hot Texas market.



Source: Wolfstreet

The big 2020–2022 dip in homes for sale is obvious. Recovery took time but now active listings are at an almost 10-year high. This is what needs to happen for prices to fall. It's a slow-moving wave but seems to be picking up speed.

Listings are just listings, though. The growth suggests sellers are getting more motivated but doesn't mean they are accepting lower prices. Many are mentally anchored on getting a certain price. In some cases, they *need* that price to avoid losing money.

If you're underwater on a property and you can't stomach a loss, another option is leasing the property. This is also happening. Here's an Austin-area report.

> "As a result of more inventory, leasing market prices are on the decline, and the leasing options for houses are increasing, Katie Dochen said. For May, median single-family home lease prices in Austin remained flat compared to the previous year, but prices were down 1.8%–2% in both February and April, Unlock MLS data shows.
>
> "'We've had several situations where we haven't been able to get a good enough price for our sellers to sell, and then we put it on the rental market and we've leased it out very quickly,' said Realtor Lindsay Neuren with Compass Real Estate."

Again, this is anecdotal and local. But it makes sense that more rental inventory will bring down rental rates. If it happens widely enough, we should see a helpful effect on the inflation data, even if it takes some time to show up in the data.

Further, these “accidental landlords” may not be able to recover enough from rent to cover their mortgage payments, taxes, insurance, and maintenance expenses. That will affect their spending and investment behavior in a likely disinflationary way.

Cracks are showing in commercial real estate, too. For example, a Chicago-area office park sold in April for a 96% discount to its last sale in 2012. I’ve seen similar stories from other cities. Office space is still quite expensive for top-tier properties in prime locations. Older ones in not-so-hot places are sitting empty for years, I suspect because the owner is carrying the asset marked to an unrealistically high value. Selling it and realizing that loss could mean bankruptcy. Better to hold it and hope for a miracle.

You may recognize this as the “extend and pretend” behavior that caused so much trouble back in 2008. That wasn’t good but it also wasn’t inflationary. More the opposite, in fact.

Stubborn homeowners are only the tip of the iceberg. A great deal of this country’s wealth is in illiquid assets whose actual market value may be much lower than the owners think. When circumstances expose this discrepancy, the result is a kind of negative wealth effect that reduces demand for all kinds of goods and services. Again, not inflationary.

Some Thoughts on Tariffs

President Trump is still throwing out tariff numbers not far from the rates that briefly cratered markets back in April. They may not be permanent, but it is growing clear that we will see broad tariff tax increases to levels higher than the US has had in decades, though the final level is very much “up in the air.” In theory, this should be inflationary, but the data doesn’t yet prove it.

With that said, there is one wild card that could change certain things. A case on the emergency powers Trump is using to impose tariffs is pending at the US Court of Appeals for the Federal Circuit in Washington, DC. Due to its exceptional importance, the entire 11-member court is going to hear the case “en banc” rather than the typical three-judge panel. The hearing is set for July 31.

Some observers think that the Court of Appeals will rule decisively against Trump. But in any case, it will certainly go to the Supreme Court. I think it is possible they will rule against the administration.

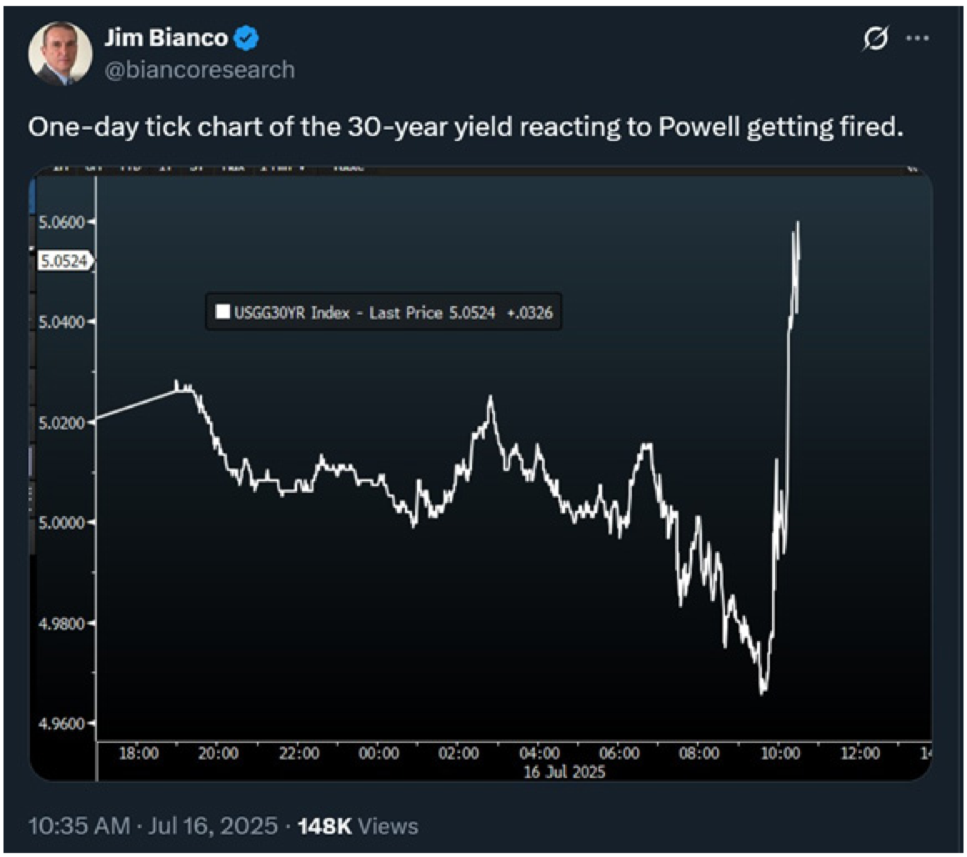
But that wouldn’t mean the tariffs automatically go away. There are multiple other legal avenues that Trump can use to impose tariffs. Some actually have court approval. While I hate the steel and aluminum tariffs (I should point out I hated them under Bush 2 as well), the court ruled that a president can actually do that. And while I want my president of any party to have the ability to strategically impose tariffs and/or anything else in the name of national security, it is possible to disagree on what is actually strategic for the country.

Congress has essentially surrendered its power to impose tariffs to the executive branch (a terrible decision as Congress should be in charge of all taxation) and it is not at all clear what the Supreme Court would do on that particular issue. But if Trump loses the case in question, he will still have other avenues to continue his tariffs—unless the Supreme Court decides to make a very broad ruling, which is not their usual practice.

All this buys Trump time. If, as I suspect, he is using the threat of large tariffs to get trade concessions and other items beneficial to the US from countries, as well as modestly raise revenues, settling the legal questions will help him eventually reach more reasonable tariff rates (whatever that means to anybody).

Now, let's talk about Trump's threat to fire Fed Chair Jerome Powell. This is just me speculating.

Trump clearly wants lower rates. But as noted above, the market is concerned about inflation. When Trump announced that he wanted to fire Powell, the 30-year bond immediately jumped to 5.05%. As of Friday morning, it was still 4.99%.

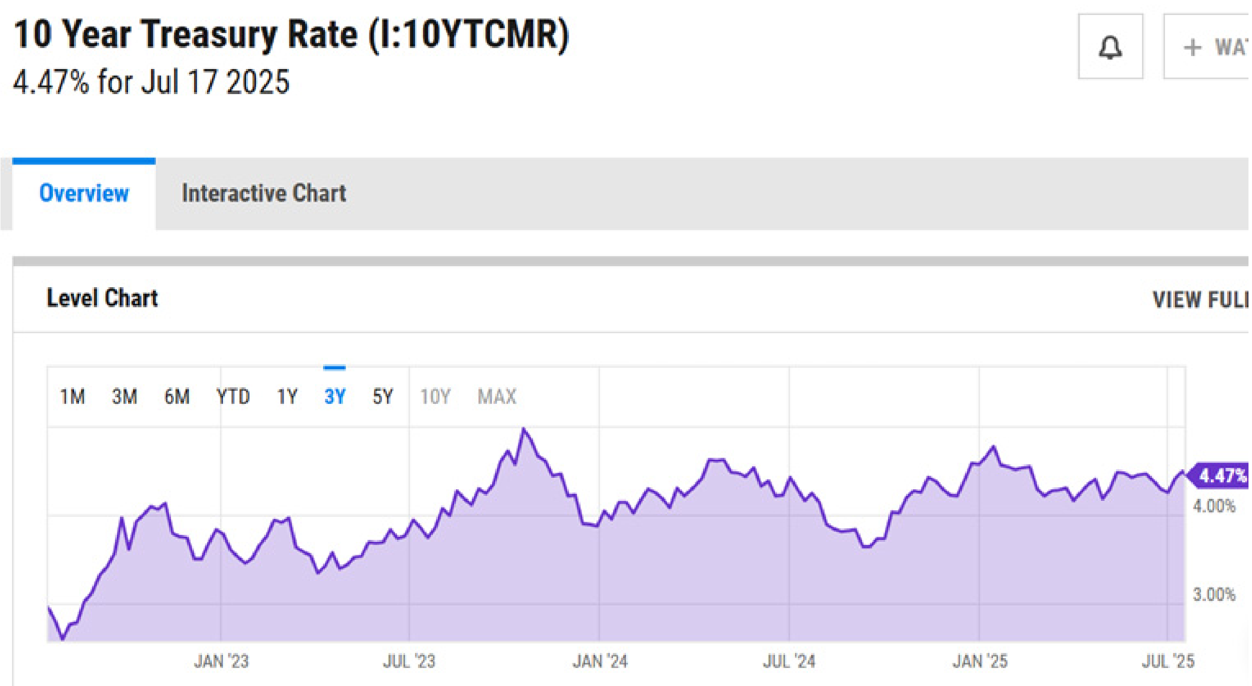


Source: Jim Bianco (H/T Renè Aninao)

Futures prices imply the Fed will cut rates at least twice this year. Firing Powell would mean a confirmation process that would take some time, possibly delaying those cuts. Further, the market actually wants someone with a reputation that says "I am going to pay attention to inflation." No one wants a repeat of 2021, let alone 1976–78. Powell and the Fed really messed that up.

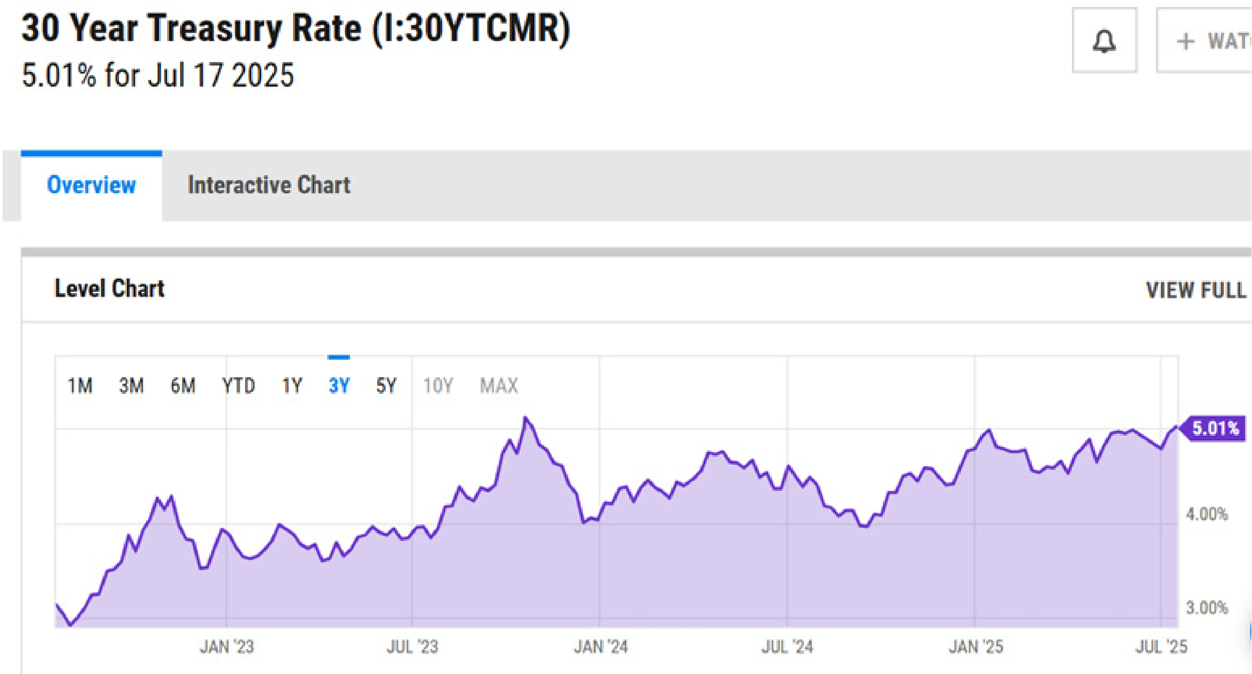
Trump can always blame economic problems on the Fed, but installing a known dove as chairman would not help long-term bond yields. If markets see inflation under control, mortgage and other rates will come down naturally.

Despite the drama, long-term rates are still within the trading range they occupied the past three years. The world didn't come to an end, which to me says that the market doesn't really think Trump will fire Powell.



Source: YCharts

The 30-year rate actually looks the same:



Source: YCharts

I think Powell will finish his term as chair. Right now, betting markets have Kevin Warsh as the odds on favorite, and I think he would be an excellent choice both temperamentally and from a market perspective. (I should note that lately when I write something, Trump has a way of changing things that makes me look less than prescient. I hope I didn't jinx Powell.)

Many conflicting things are happening on the inflation front. We don't know how it will all shake out. There's a lot of confirmation bias happening among investors and economists. If you're convinced inflation is coming, you perk up when you see news that supports your view. Ditto if you think tariffs are awesome and will produce an economic boom.

The truth is more subtle: **We Don't Know Yet.** We live in extraordinarily confusing times. Seemingly impossible things are happening all around us. I myself am pretty confident in the long-term future. But the next year or two? My crystal ball is broken.

New York, Newport Beach, and British Columbia

On Sunday I fly to New York City for three days, having dinners with friends and meeting with my Mauldin Economics partners Olivier Garret and Ed D'Agostino. It is a constant challenge to keep up with the changes in the investment publishing industry, and we work hard to make sure we give you our best. It is likely that I will have at least two Italian meals which is always a good thing in New York.

Monday night will be a dinner with Peter Boockvar and other friends. There is certainly a lot to talk about. Dinner the next night with David Bahnsen, his partner Brian Szytel, and Renè Aninao is one of those special evenings for me. I always come away from dinners like these with a better understanding of how the world is working.

My daughter Tiffani and granddaughter Lively have been with us this week and that has been nice. She will turn 16 in December. It is amazing how fast they grow up.

And with that, I will hit the send button. You have a great week and don't forget to follow me on X!

Your hoping the Fed stays focused on inflation analyst,

John Mauldin
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