THOUGHTS FROM THE FRONTLINE

Inflation Standoff

By John Mauldin | May 24, 2025

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Dallas, East Palm Beach, and DC

The Strategic Investment Conference is over. I'm now in my annual recovery period, during which I try to absorb the informational firehose I (with thousands of others) just experienced.

I often find SIC's key insights come from unexpected directions. I spend months organizing the agenda in what I think is a comprehensible way. But once we get going, it takes on a life of its own. I've learned not to draw quick conclusions. This post-event consolidation period is just as important as the event itself.

I find that reviewing the transcripts thematically really helps get some perspective. For instance, various speakers said something about inflation or geopolitics or the markets almost every day. Putting them together makes it much easier to come to my own conclusions or at least understand the nuances.

My next few letters will share some initial thoughts from SIC organized around the major topics. Today we'll start with inflation, and specifically the sharply different views of David Rosenberg and Jim Bianco, then balance them with some thoughts from other speakers. David and Jim are good friends whose analysis I've found very useful over the years. It's hard to see how both are right this time, but the contrast between them is enlightening.

First, let me remind everyone you can still join me for SIC and get all the benefits. Our online portal has videos, transcripts, and slide decks for every session. You can listen to the sessions on your walks or in your workout. It's not live but is the next best thing. Click here to get instant access.

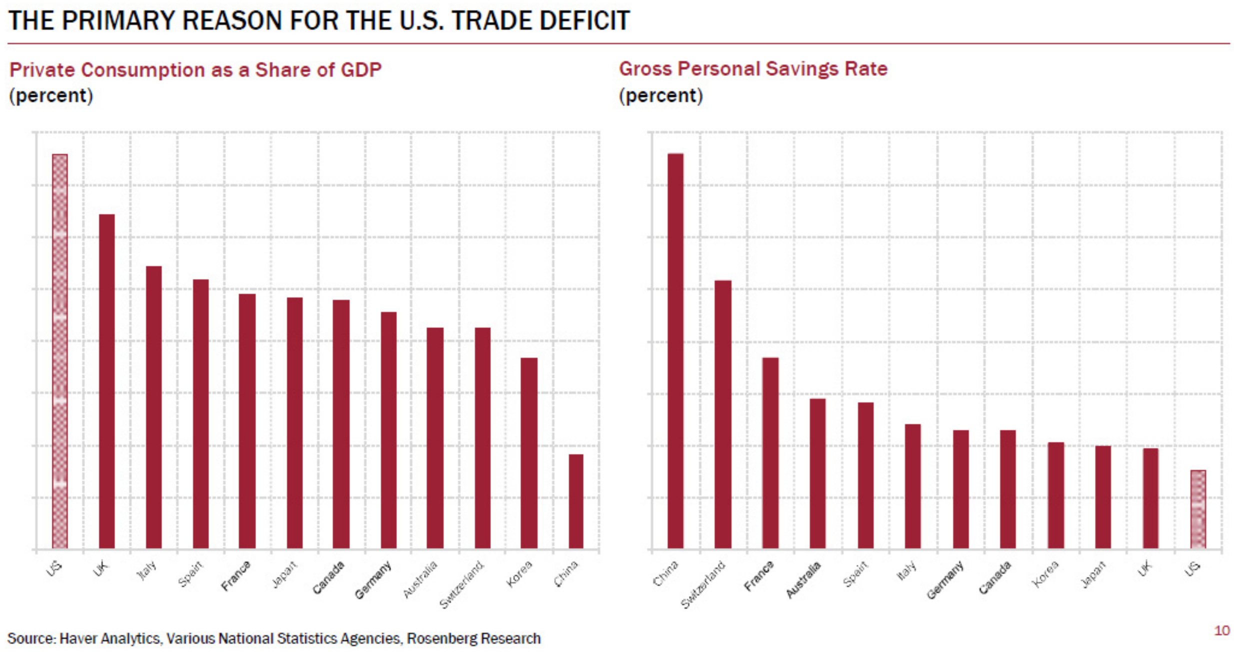
Now, let's talk about inflation.

Dave Rosenberg: Still on Team Transitory

The near-term US economic forecast hinges mostly on trade and tariff questions, along with uncertainty over how everyone will react. Generally, views fall into three categories: recession, inflation and a "stagflation" scenario in between.

David Rosenberg is firmly in the recession camp. In fact, he was already expecting a recession even before Trump launched the current trade war. Now he thinks the trade war's impact on consumers will be the final straw.

The US is uniquely vulnerable because our economy is the most dependent on consumer spending and has the lowest personal savings:



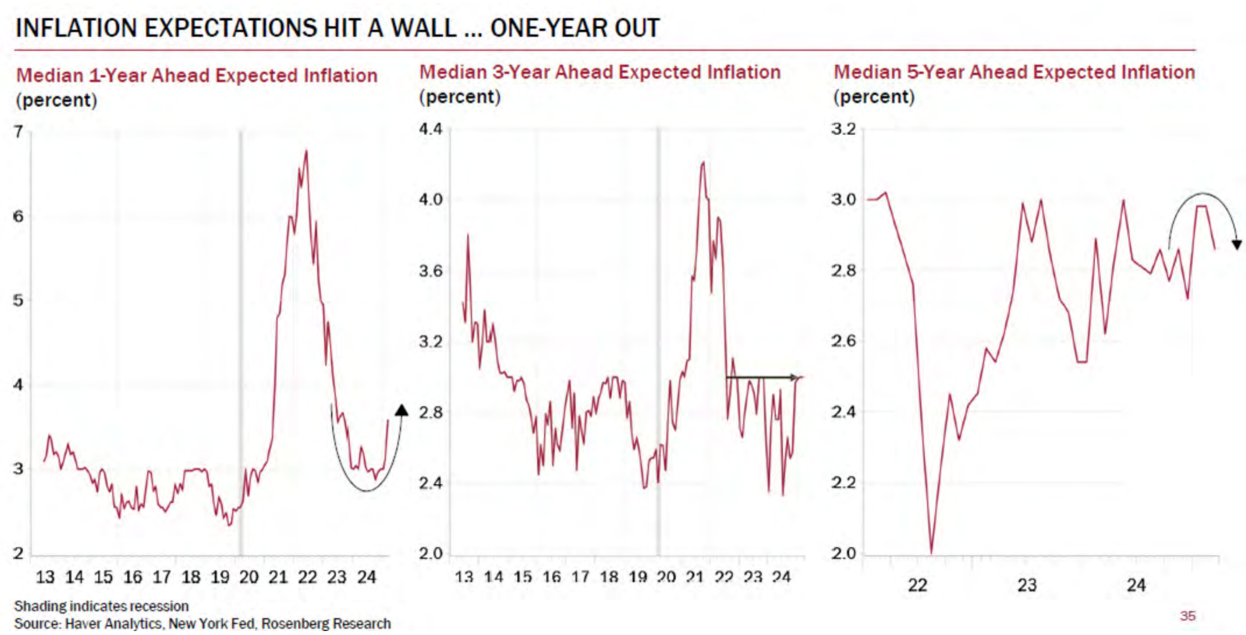
Source: Rosenberg Research

Here's how Dave explained it (from the transcript).

> "It's the structure of the US economy. I mean, take a look at this chart. For anybody that's saying, 'Oh, well, the United States is being ripped off,' no. It's simply because the United States is run on consumer spending. There's no country in the world where consumer spending as a share of GDP is as high…

> "Most countries have actually a national sales tax [VAT]. You would never get that passed through the United States. You can't put a sales tax on the consumer. The consumer runs the economy. Not investment, the consumer.
>
> "What country has a lower savings rate? What country has as much a consumption share of GDP? And there's a 95% correlation between consumer spending and imports. So, for the people that support this view that we have to eliminate all these trade deficits the United States runs, well, then maybe we have to basically take the US economy and make it more European or Asian in nature, embrace frugality, and that way we'll have less consumption and fewer imports."

As Dave sees it, we're about to have a collision between already-weakening consumer spending and tariff-induced price increases. The former points to recession, the latter to inflation. How will this develop? Dave expects inflation first, which will be transitory for a specific reason.



Source: Rosenberg Research

Again, from the transcript:

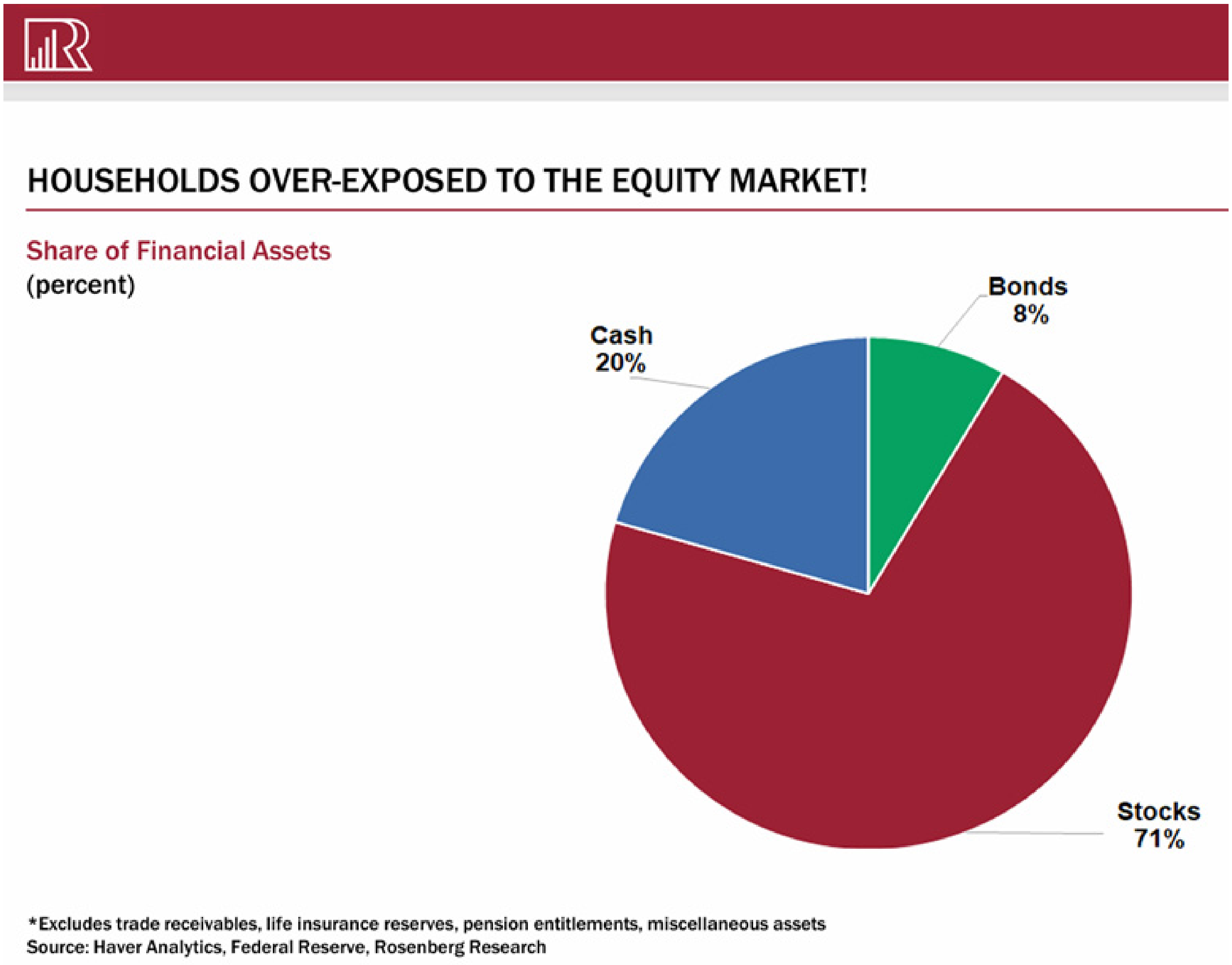
> "Take a look at the latest New York Fed report. Only the one-year inflation expectation measure is hooked up. The three year is moving sideways. The five years hooked down, and everybody's selling their bonds. Inflation. Inflation. Tariffs are inflation. It's a price shock. It's a price shock. And I know people will laugh at transitory, but there's a reason why it wasn't transitory back in 2021 and 2022. There's a reason.

> "And the reason why it will be transitory, I'm not ashamed to use that word again, even though Jay Powell won't, is because of the labor market. The reason why the inflation lasted longer than we all thought, certainly than I thought, was because it triggered at least an 18-month wage and price spiral because the labor market was tightening. And because people are getting paid to stay out of work and not work because of the gigantic mismatch in labor demand and supply, the price shock, supply price shock from COVID transmitted into wages.
>
> "I got news for you. It ain't going to happen this time around. It's not about the 4.2% lagging unemployment rate. Beneath the surface you're seeing a big drop in labor demand, job openings down, hiring rates down, job hopping way down. Totally different complexion to the job market today."

The difference now, as Dave sees it, is that workers are *far less confident* than they were in 2021-2023. This is evident in surveys showing much higher fear of job loss and lower wage expectations. These conditions won't produce a wage-price spiral, without which it will be hard for inflation to gain a foothold. Regardless of tariff rates, Dave expects significantly lower inflation 12 months from now.

Unfortunately, the inflation will give way to recession, and here's why. **Read this quote carefully.**

> "… The household sector of America has never before had $50 trillion of exposure of equities on their balance sheet. Nobody this cycle has rebalanced. Diversification became a dirty 15 letter word - buy every dip.
>
> "Take a look at what the equity ownership was going into the tech wreck. Barely more than $10 trillion. Going into the financial crisis, $15 trillion. Now we're at $50 trillion so there's a lot at stake here…
>
> "71% of the household financial assets is in stocks. Who wants bonds? 8% in bonds. Bonds are for losers. Who shows up at the cocktail party talking about the belly of the curve? No one will talk to you. No. We'll talk about Bitcoin and the Nasdaq-100.



Source: Rosenberg Research

"But what's most important is the boomers… The median boomer is now age 70. It's not 45 or 50 or 55 as it was going into the Great Financial Crisis. And over 60% of the boomers' portfolio is in the equity market. It should be 30 to 40%. Time is not on their side. And I shudder to think what happens if this ever shrinks when you're taking a look at the biggest exposures to equities are in the wrong demographic. Nobody talks about what the future consequences are going to be, especially on the labor market.

"Because when they can see that their retirement plans with their golden goose is not going to be coming to fruition, they might be lining up at Walmart for a job only to find out that robots taking that over. So this is what a recession looks like for those that actually believe in the LEI, for those that believe in the New York Fed model. We're not out of the woods. By the way, I think that the best that I can say is that there will not be a bad recession at this point. It could have been, but I do think that we're going to be seeing at least two or three quarters of mild negative GDP."

Baby Boomers, generally speaking (you may be an exception), are deeply overexposed to the kind of equity bear market that usually accompanies even mild recessions. Many will be fine anyway, but a significant number could see their retirement plans dashed. Some will re-enter the workforce, further depressing wages and raising the unemployment rate.

This is problematic because broad stock market indexes always fall during a recession. Rosie gave us this chart:

WHAT "IF" WE GET A RECESSION?

United States: S&P 500

		Peak to Recession Start		Recession Start to Recession Trough		Peak to Recession Trough	
Expansion Date		Months	% Decline	Months	% Decline	Months	% Decline
Oct-49	Jul-53	6	-7.2	2	-8.2	8	-14.8
May-54	Aug-57	12	-9.1	2	-13.8	14	-21.6
Apr-58	Apr-60	8	-10.4	6	-3.8	14	-13.9
Feb-61	Dec-69	13	-15.1	5	-24.7	18	-36.1
Nov-70	Nov-73	10	-20.2	11	-35.1	21	-48.2
Mar-75	Jan-80	0	-0.9	2	-14.0	2	-14.7
Jul-80	Jul-81	8	-6.8	13	-21.8	21	-27.1
Nov-82	Jul-90	0	-3.5	3	-17.0	3	-19.9
Mar-91	Mar-01	12	-24.0	6	-16.8	18	-36.8
Nov-01	Dec-07	2	-6.2	15	-53.9	17	-56.8
Jul-09	Feb-20	0	-12.8	0	-24.3	1	-33.9
Average		**6.5**	**-10.6**	**5.9**	**-21.2**	**12.5**	**-29.4**

Source: Rosenberg Research

Dave made a compelling case for this scenario. But hold that thought until you consider a different view.

Jim Bianco: Murder Weapons

Jim Bianco looks at the cycle differently. To him, recessions are not a natural phenomenon. What's natural in a capitalist economy is for growth to continue **until something stops it**.

When bad companies are allowed to fail and new ideas are free to develop, the economy *changes* but doesn't have to shrink. Jim quotes the MIT economist who famously said in the 1970s, "Economic expansions don't die of old age, they are murdered."

Economic expansions do not die of old age, they are murdered - Rudi Dornbusch

Post WW2 Recessions and Their Triggers

Start	End	"Murder Weapon"
Feb 1945	Oct 1945	Dramatic Drop in Military Spending (End of WW2)
Nov 1948	Oct 1949	Demobilization of the WW2 Economy
Jul 1953	May 1954	Dramatic Drop in Military Spending (End of Korean War)
Aug 1957	Apr 1958	Suez Crisis/Sputnik
Apr 1960	Feb 1961	Tight Monetary Policy
Dec 1969	Nov 1970	Vietnam War
Nov 1973	Mar 1975	Arab Oil Embargo
Jan 1980	Jul 1980	Highest Inflation of the Century
Jul 1981	Nov 1982	Punishing Interest Rates (15% 10-year)
Jul 1990	Mar 1991	Iraq Invades Kuwait (~200% rise in Crude Oil)
Mar 2001	Nov 2001	Tech Bubble Popping/September 11
Dec 2007	Jun 2009	Housing Crash/$145 Crude (July 2008)
Feb 2020	Apr 2020	COVID-19

May 19, 2025 Bianco Research L.L.C 12

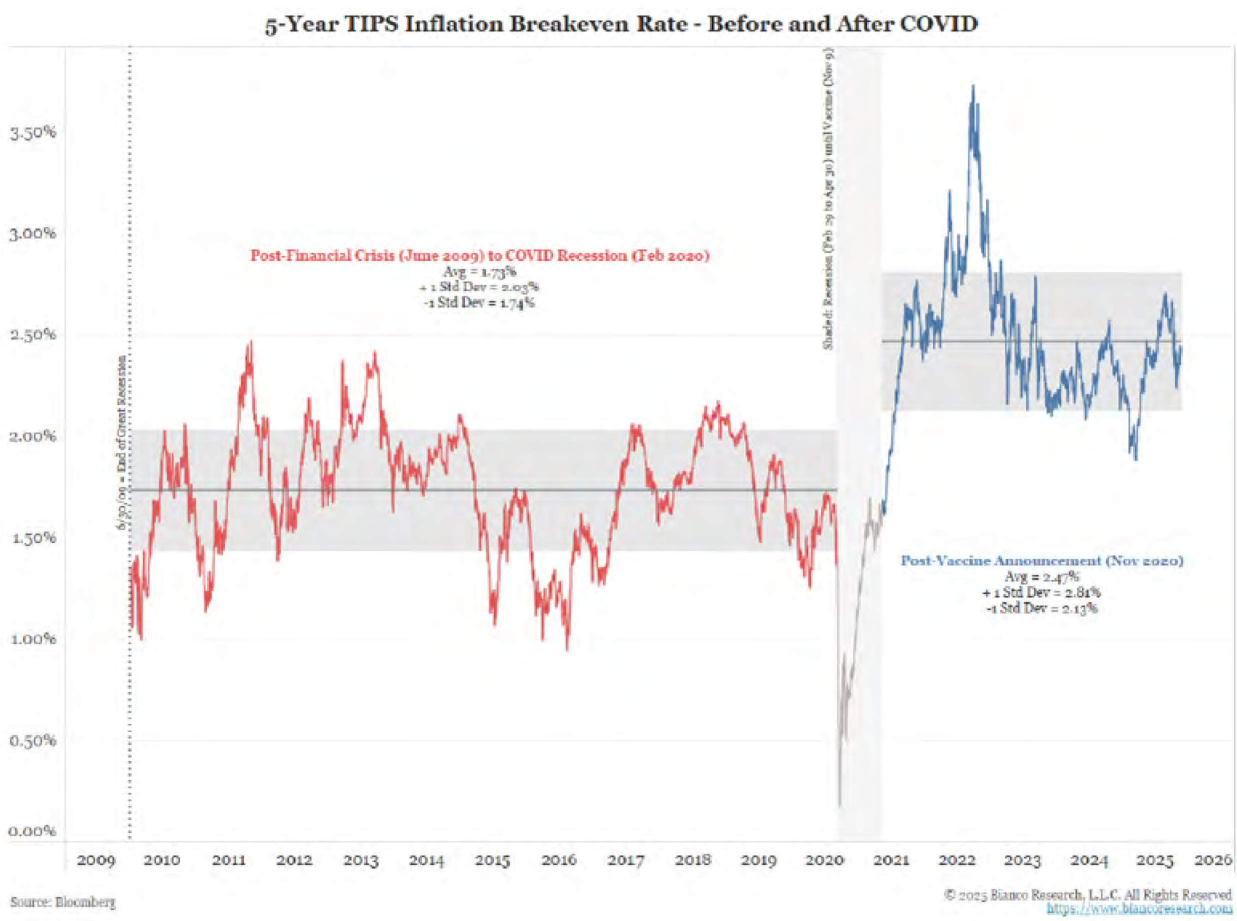
Source: Bianco Research

If recession is looming, what will the murder weapon be this time? At SIC, Jim went through a series of high-frequency indicators like retail sales and weekly jobless claims. This "hard data" doesn't show much cause for concern. Of course it could change, and the "soft data" says change may be coming. But it's not here yet.

What *is* here, according to Jim, is inflation, and it's not transitory at all. It's more like a new normal. He thinks the post-COVID inflation marked a major change.

> "I would postulate that inflation moves in big cycles. The inflationary cycle started in 1965. It ended in 1991, although it peaked in 1981, but it ended in 1991 with the fall of the Soviet Union. We went into a long disinflationary period. That ended with COVID, and I would argue to you that most economists and most people don't recognize that we're in Year 5 of a new inflation cycle, and that they still think we're in the Red era [see chart below].
>
> "When you have a recession or a financial crisis, and we had both, the economy changes. Change does not mean worse. It means different. It changed. The economy changed post-COVID."

Jim shared this chart illustrating his point. The “normal” inflation range clearly shifted higher after 2020.



Source: Bianco Research

I’ve talked about this before. The COVID pandemic and all the events around it changed the economy in ways we still don’t fully understand. Jim thinks it pushed us into a new inflation cycle, which was already underway before Trump started imposing tariffs. But the tariffs won’t help. Here’s Jim again.

> “Tariffs mean higher prices. Who's going to eat those prices? If Trump is right and if some of Wall Street are right that we have no increase in inflation coming because of tariffs, then let's pick up the chisels and start putting Trump on Mount Rushmore right now…
>
> “If he could pull that off, if we find out that they're slapping all these tariffs on and billions and billions and billions of dollars are flowing into this country and prices aren't going up, then the Chinese are paying for it and maybe Walmart's eating a little bit of it, and Trump found a way to raise taxes on somebody who's not the rich or is not Americans, he should go right up on the Mount Rushmore. ‘Don't tax me, tax the man behind the tree. The man behind the tree is Chinese, and he found a way to tax them.

> "I don't think that's the case. I think we're going to find that prices go up and inflation is going to go up, and in this environment when inflation goes up, that means that the Fed holds. So, the path of least resistance on bond yields is going to be higher, and I think that it's going to be problematic for markets."

Baseline inflation is now close to 3%. The "neutral" inflation rate (what the Fed calls "r-star") is around 1 percentage point higher, so 4%, just below the current federal funds range. That means the Fed's current policy is neither loose nor tight. If inflation forces them to get restrictive, we're looking at 5% or more at the short end and even higher at the long end, unless the yield curve stays flat.

Higher interest rates might well trigger a recession. Jim isn't sure about that. But he's very sure inflation won't go back to 2% any time soon. He went through a series of market-based expectations charts showing inflation remaining high until 2030.

A 10-year inflation wave (if this one started in 2020 and lasts until 2030) is not "transitory" by any definition. But Jim doesn't see it as disastrous. Older readers will recall 7% or even 8% mortgages were normal in the 1990s. We'll get through it.

Ugly Combination

Considering both the Rosenberg and Bianco views, the key question is when, if ever, will the pessimism seen in the "soft data" become consistently clear in the hard data? That might mean recession is getting closer.

Keep in mind, however, these aren't either/or conditions. People can reduce spending by a little or a lot. Businesses can freeze hiring but not announce layoffs. There's a lot of open territory between boom and bust.

This all gets much more troubling when I consider Lacy Hunt, who noted at SIC (as he has for years) that growing federal debt suppresses GDP growth. The latest news from Capitol Hill isn't hopeful about making a dent in the debt.

This points toward the ugly combination of near-zero growth, if not outright recession, at the same time inflation stays elevated in ways most Americans haven't experienced as adults. As Jim Bianco said, many of us are still mentally "anchored" in the near-ZIRP years when the Fed struggled to get inflation *up* to 2%. A severe recession could push inflation back down to those levels, but we wouldn't like that, either.

Other Insights on Inflation

Of course, other SIC speakers talked about inflation, too. Let’s start with Barry Habib. Barry has won four out of the last seven Crystal Ball awards from Zillow for the most accurate mortgage interest rate predictions out of 150 economists and has always been in the top five. We should pay attention to what he has to say. Quoting:

> “It's also interesting to understand Jerome Powell's take [on inflation]. So, Jerome Powell recently said that ‘…without price stability, we cannot achieve the long-term periods of strong labor market conditions that benefit all Americans.’ What's the translation? That the Fed has two mandates. Both mandates are very important and while if one gets extremely out of control just like an unruly child… You're going to reprimand that child, that's what the Fed will probably look at. But all things created equal…it appears that the Fed is currently thinking that inflation is more important than labor, at least for now. So, driving more Fed decisions will be inflation data as opposed to labor data, although both are critically important unless the labor data gets really out of control.
>
> “The odds are that there's a chance that we should see inflation decline. I know that there's a lot of tariff stuff in between, but we should see inflation decline, ***although slowly***, and that should mean that rates should decline [over time], and that should give us some clues on the housing market. Now that said, I think the core PCE inflation is going to be stubborn and it's going to be stubborn because the replacement values that we saw in the middle and second half of 2024 were pretty modest. So as new data comes out, it's going to replace the 2024 data and it will be hard to make year-over year progress in a very meaningful way. Probably hover around the 2.5-ish range. It's kind of where we see things on core PCE inflation, which will still be above the Fed's target.
>
> “But one of the things they look at is that three-month and six-month run rate. And currently, the bad news is that the three-month and six-month run rates that the Fed looks at so carefully are running above the annual rates. So that's [the bad comparisons] got to get through the snake and that will make progress on year-over-year inflation stubborn, although the markets will respond favorably if we get good low month-over-month readings or monthly readings.”

That being said, Barry believes the Fed will cut rates two or three times this year even in the face of stubborn inflation. Barry has been very critical of Powell (as I have been) for several years for letting inflation get out of control. Powell is concerned about his legacy and seems afraid to let inflation come back. Barry thinks he is overestimating the strength of the labor market (he sees the labor market data similarly to David Rosenberg and Danielle DiMartino) and will soon have to react:

> “Now, I think the Fed's going to get religion and get sober later…Maybe it's 2 cuts, maybe one's 50, one's 25, or maybe it's three 25 bp cuts, but second half of the year, as that unemployment rate rises, we get past some of the tariff uncertainty. There's going to be no cover for Jerome Powell. They're going to have to address the fact that the economy is not as strong as he thinks.”

That is why Barry thinks mortgage rates will also come down, closer to the 6% range. He spent a great deal of time going through his rationale on that.

Let me quickly summarize Peter Boockvar's inflation view. Peter listens to over 100 earnings calls every quarter. Nearly every company is talking about raising prices. They are trying to find out how much of the tariffs they can pass through. Even if they eat some of the tax, prices are still going up to the end consumer. To the extent companies absorb the tariffs, it means lower earnings, capital investment or employment. Peter thinks this will start to show in the third quarter. And then we'll see. And he points out that a falling dollar is inherently inflationary. The USD is down almost 10% since the beginning of the year.

I wish I had more space, but it's time to wrap up. Next week we'll stay with SIC, shifting our attention to another important topic.

Dallas, East Palm Beach, and DC

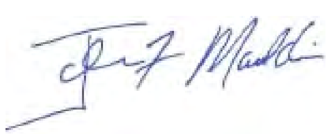
It now looks like I will be in Dallas the first week of June as we open our longevity clinic there. The next week I expect to fly to East Palm Beach and the DC area for a few days, visiting our new clinics as they open.

With the SIC over, my publishers will be glad to know I'm giving more attention to finishing my book on cycles and what I feel will be a coming crisis. Felix Zulauf agrees with me and, like me, thinks it will be manageable if you properly prepare.

Shane is such an optimist. We have this small "dead spot" just to the right of our front door overshadowed by palm trees, bushes and our garage. She has been trying to grow grass there for six years. There are workers yet once again outside my window as I finish this letter. I asked her why she thinks this time will be different. We have a really top-notch contractor and he believes he has a new type of grass that will work here. I am skeptical, but I am not going to deny that look of childlike hope in my wife's face. And I'm old and wise enough to not even whisper, "The definition of insanity is to try something over and over expecting a difference." Happy wife, happy life.

And with that I will hit the send button and wish you a great week.

Your needing a clone or two busy analyst,



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