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TRENDMACRO LIVE!

On the June FOMC

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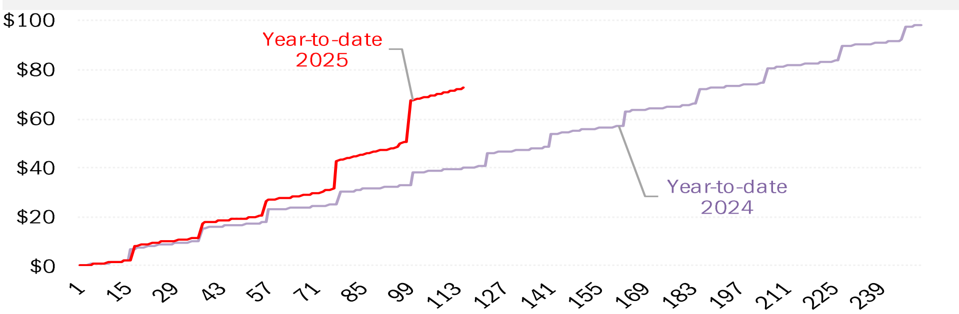
Donald Luskin

The hallucinations continue. Inflation has collapsed, but the Fed sees more of it.

We ducked a bullet. Despite a silly upgrade in inflation forecasts in the Summary of Economic Projections, the "dot plot" for the year-end 2025 funds rate was left at 3-7/8%, where it's been since December, implying two rate cuts still to come this year – despite all the hallucinations about tariff-driven inflation.

Here's reality. *The US Treasury started collecting serious tariff revenues three months ago*. Year-to-date, the take is $72.6 billion, $32.8 billion above this time last year (please see the chart below). You'd think those tariff costs would have started to get passed on to consumers, and that should show up in the Consumer Price Index.

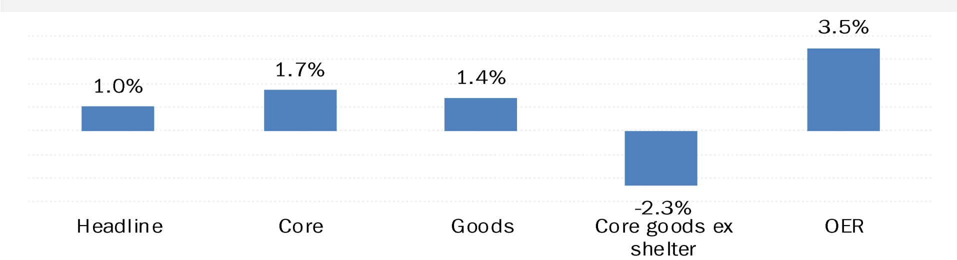
Tariff collections, cumulative year-to-date (USD billions)



Source: US Treasury, TrendMacro calculations

But here's more reality. *Over those same three months, inflation has collapsed* (please see the chart below). Especially goods, the part of the

Consumer Price Index, 3-months at an annual rate



Source: BLS, TrendMacro calculations

Update to strategic view

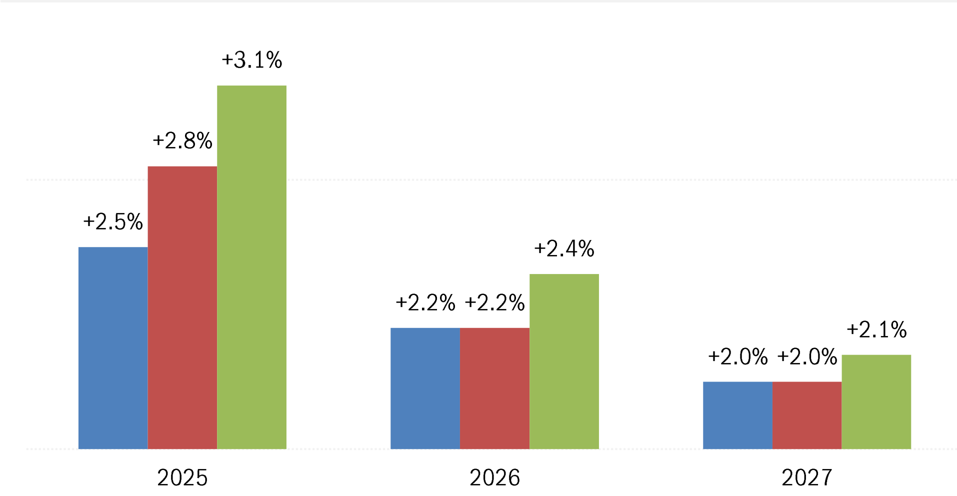
FEDERAL RESERVE, US MACRO: We ducked a bullet. The SEP kept the December 2025 "dot plot" pointing to two rate cuts this year, despite raising inflation forecasts for 2025, 2026 and 2027. Tariffs have begun to be collected at scale now for three months, but over those three months inflation has collapsed. Now the tariffs that were initially surprisingly large, have been put on hold and are likely to be overturned in the courts. At this point the Fed is operating on confirmation bias that tariffs are inflationary (when they haven't been) and for that matter that tariffs will even exist in any significant form. This puts the Fed into cognitive dissonance that it resolves with the theory that inflation expectations will be inflamed by tariffs and become long-lived self-fulfilling prophecies. Yet historical evidence shows that inflation expectations are inversely correlated to future actual inflation.

[Strategy dashboard]

consumption basket that should be most affected by tariffs, which is in outright deflation. Even Fed Chair Jay Powell's beloved "supercore." The only CPI hot-spot is owners' equivalent rent, which is up 3.5% -- must be the tariffs charged on all those homes we are importing from China. But even 3.5% is a new cycle low (see "Data Insights: CPI/PPI" June 11, 2025).

Now here's some hallucinating. Amidst this collapse, core inflation for 2025 anticipated in today's Summary of Economic Projections is *3.1%, up from 2.8% in the March SEP, which was up from 2.5% in the December SEP* (see "Data Insights: Federal Reserve" June 18, 2025 and the chart below). Inflation forecasts have been moved up for all three of the forecast years, out to 2027. In the post-meeting press conference, Powell specifically said this was due to tariffs being larger than expected at the prior SEP.

Core PCE in Summary of Economic Projections



Source: FRB SEP, TrendMacro calculations

So we find it ironic that pretty much the only language change in today's FOMC statement was to point to a diminution in policy risk.

Indeed. Yes, "Liberation Day," on which tariffs on a surprisingly large and sweeping scale were announced (see "Are We Feeling Liberated Yet?" April 2, 2025), is new information for the Committee since the March FOMC. But most of those tariffs are on hold. And the striking down of those tariffs by the Court of International Trade is also new – and offsetting – information (see "You Heard It Here First: Court Strikes Down Trump's Tariffs" May 28, 2025).

So with diminished tariffs – and, by their own admission diminished uncertainty – and with inflation having collapsed over the last three months (a certainty) – we have to infer that the Committee must have more certainty that even reduced and less likely tariffs will lead to more inflation than expected before.

We think that's just plain silly.

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We think what we see in these inflation forecasts in the SEP is a vision based on confirmation-bias that tariffs are everywhere and always inflationary (when they have not been this year – again, see the chart on the previous page – and were not last time in 2018 and 2019 – see "How Much Do Tariffs Matter?" January 28, 2025) *and that there will even be tariffs, once the courts get done with them*.

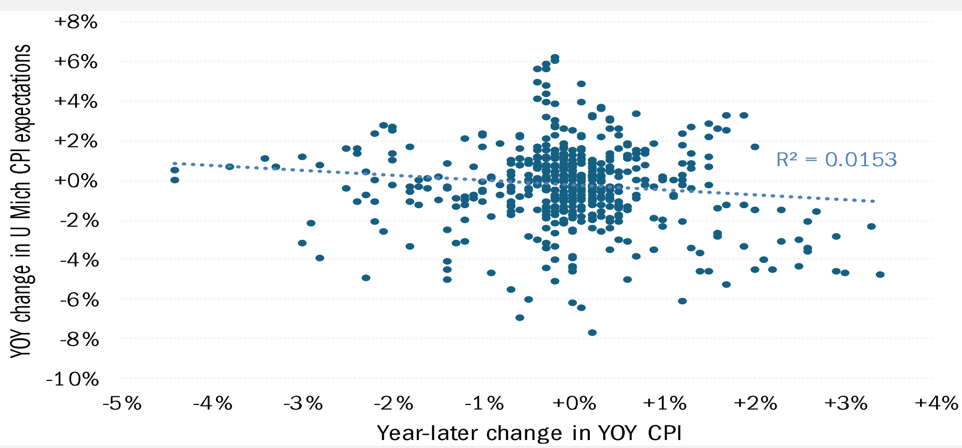
Confirmation bias in the face of the facts leads to cognitive dissonance, and *cognitive dissonance leads to silly rationales. In this case, it's inflation expectations*. Worrying about that means you don't have to consider actual inflation – you just imagine what other people are thinking, and then further imagine that what they are thinking feeds forward into the future of actual prices.

Yesterday's influential *Wall Street Journal* FOMC preview story by our friend Nick Timiraos dealt exclusively with the expected role of inflation expectations in explaining today's policy pronouncements. That's been a staple of Fed discourse all year, and we are surprised that Powell didn't get more questions about it at the post-meeting press conference -- especially after he mentioned it twice in the prepared opening remarks.

Fed officials are worried that inflation has run above target now for 4 years (until three months ago – again, please see the chart on the first page), so there's a risk that expectations could get permanently reset. Going forward, *a one-time inflationary jolt due to tariffs* (if the tariffs even happen, and if the jolt even happens) *will make expectations worse*. Then, they fret, those expectations will become self-fulfilling prophecies, driving the inflation that was expected for no other reason than it was expected.

That storyline never includes an explanation for *how the majority of consumers, who are strictly budget-constrained, could drive the overall price level higher*. Such consumers, when forced to pay more for some goods and services, have to consume less of them, and if they cannot, consume less of something else.

Correlation of inflation expectations with future actual inflation



Source: BLS, University of Michigan, TrendMacro calculations

The proof is in the data – but people with cognitive dissonance don't generally want to look at data. Historically, expectations have worked the opposite of what the Fed seems to think.

Over the entire life of the University of Michigan survey dating to 1978, *changes in CPI inflation expectations have been inversely correlated to year-later inflation* (please see the chart below). Specifically, *when expectations rise year-on-year, one year later inflation has fallen year-on-year*. That correlation is very slight – an r-squared of just 0.15 – so maybe best to say there is no correlation at all. But what little correlation this is, is inverse!

The only FOMC member who seems to have any clue about this is Governor Christopher Waller, who was appointed by President Donald J. Trump during his first term. In a speech early this month, he swallowed without even chewing that tariffs would cause inflation, but then ventured that there was no reason to expect – only to be watchful for – expectations to become unhinged as a result. We assume that small concession to dovishness amounts to a job application for Powell's position.

Check out the op-ed in last week's *Wall Street Journal* by our old friend David Malpass, calling for lower policy rates. Malpass is a conservative stalwart who held positions in the first Trump administration. We haven't heard his name on the short list for Powell's job, but he just threw his hat in the ring and he's more credible a choice for Trump than the names you hear more often (see "Jay Powell: Alien Enemy" April 21, 2025).

Bottom line

We ducked a bullet. The SEP kept the December 2025 "dot plot" pointing to two rate cuts this year, despite raising inflation forecasts for 2025, 2026 and 2027. Tariffs have begun to be collected at scale now for three months, but over those three months inflation has collapsed. Now the tariffs that were initially surprisingly large, have been put on hold and are likely to be overturned in the courts. At this point the Fed is operating on confirmation bias that tariffs are inflationary (when they haven't been) and for that matter that tariffs will even exist in any significant form. This puts the Fed into cognitive dissonance that it resolves with the theory that inflation expectations will be inflamed by tariffs and become long-lived self-fulfilling prophecies. Yet historical evidence shows that inflation expectations are inversely correlated to future actual inflation.