

# ***Why The Inflation Playbook Will Fail You In 2025***

**Francois Trahan**

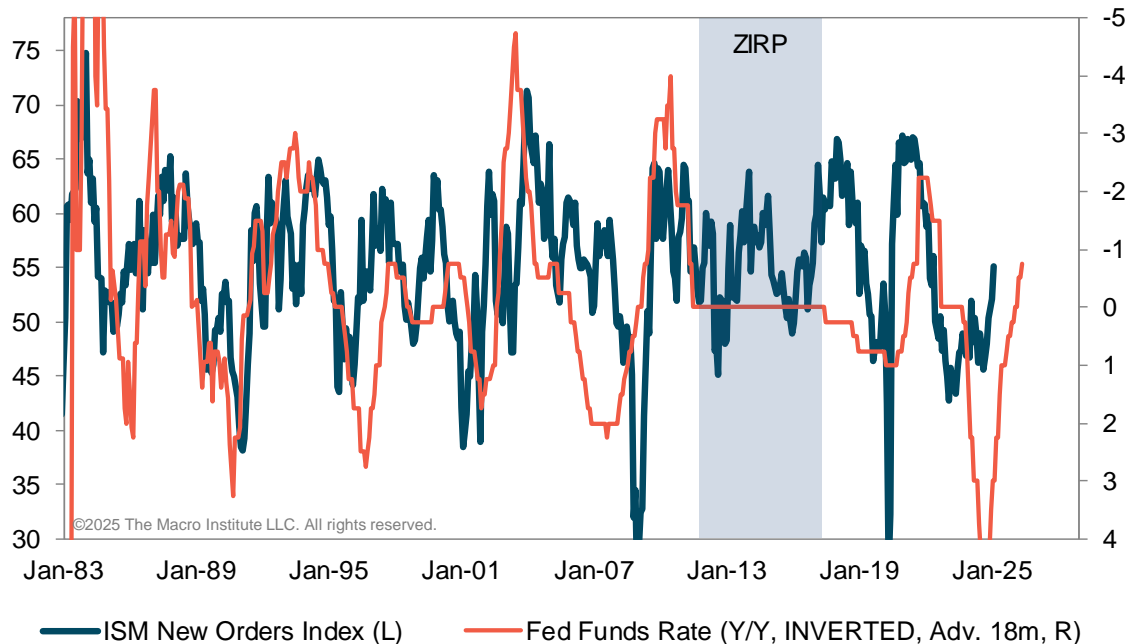
[ftarahan@themacroinstitute.com](mailto:ftarahan@themacroinstitute.com)

**February 2025**

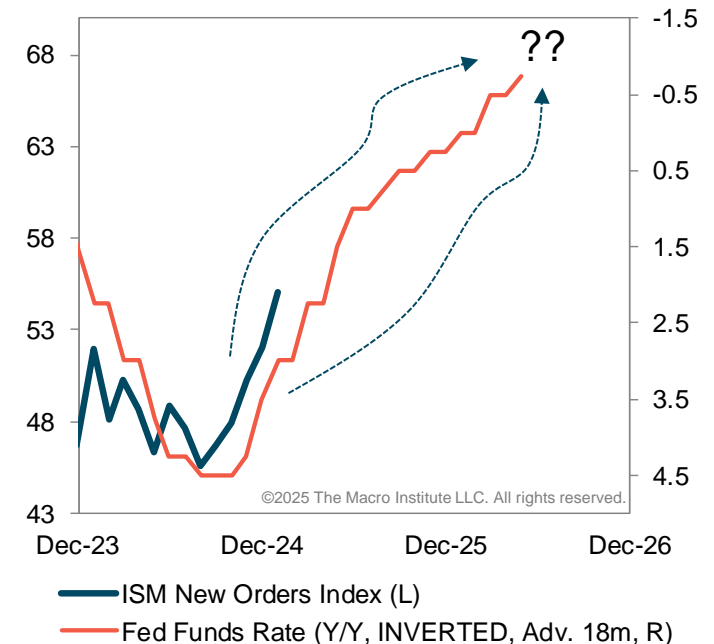
## An Inflationary Recovery In The Making

### Monetary Policy: Already A Tailwind For Economic Prospects (LEIs)

#### LEIs Usually Start To Recover ~18 Months After Last Rate Hike



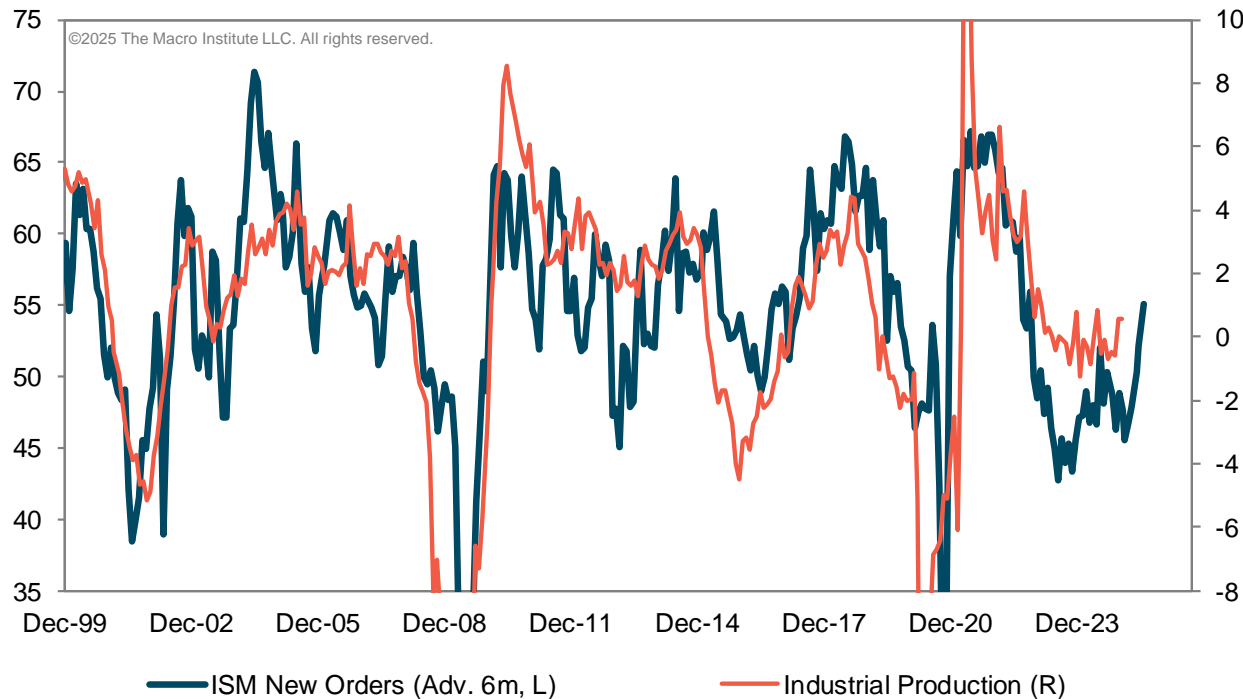
#### Higher LEIs In 2025?!?



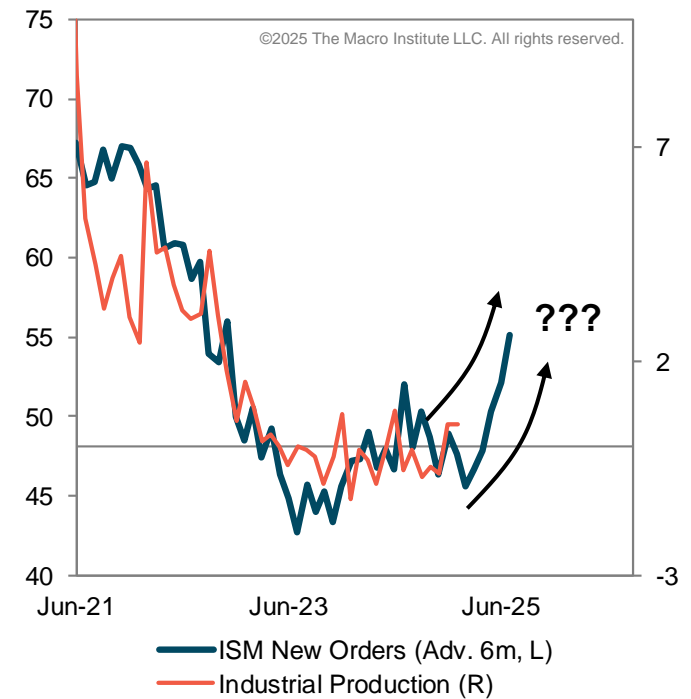
## An Inflationary Recovery In The Making

### Monetary Policy: Set To Become A Tailwind For Broader Economy In 2025

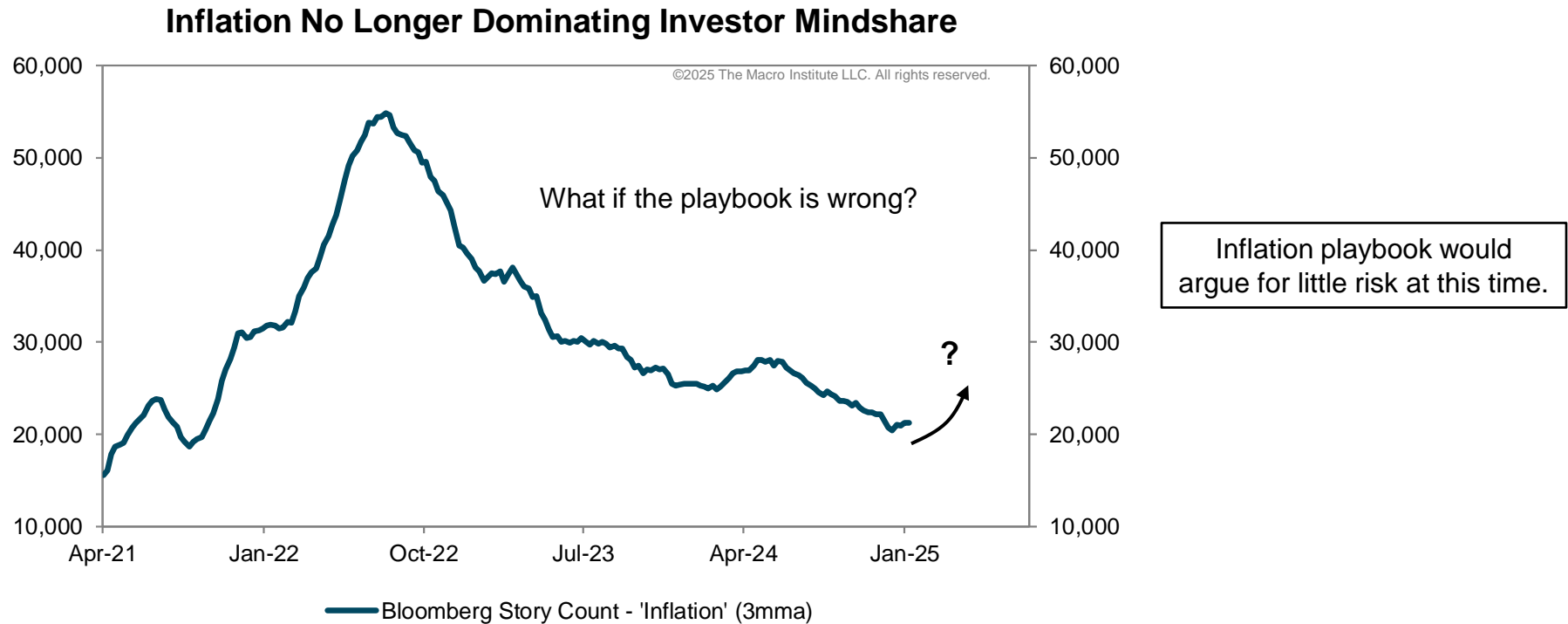
#### Where Leading Indicators Go ... Economic Activity Follows!



#### Q2 Liftoff For The Economy?



## There's Less Concern About Inflation Today Than At Any Point Since 2021



## An Inflationary Recovery In The Making

### Inflation Playbook: Only Problematic In Extended Expansions

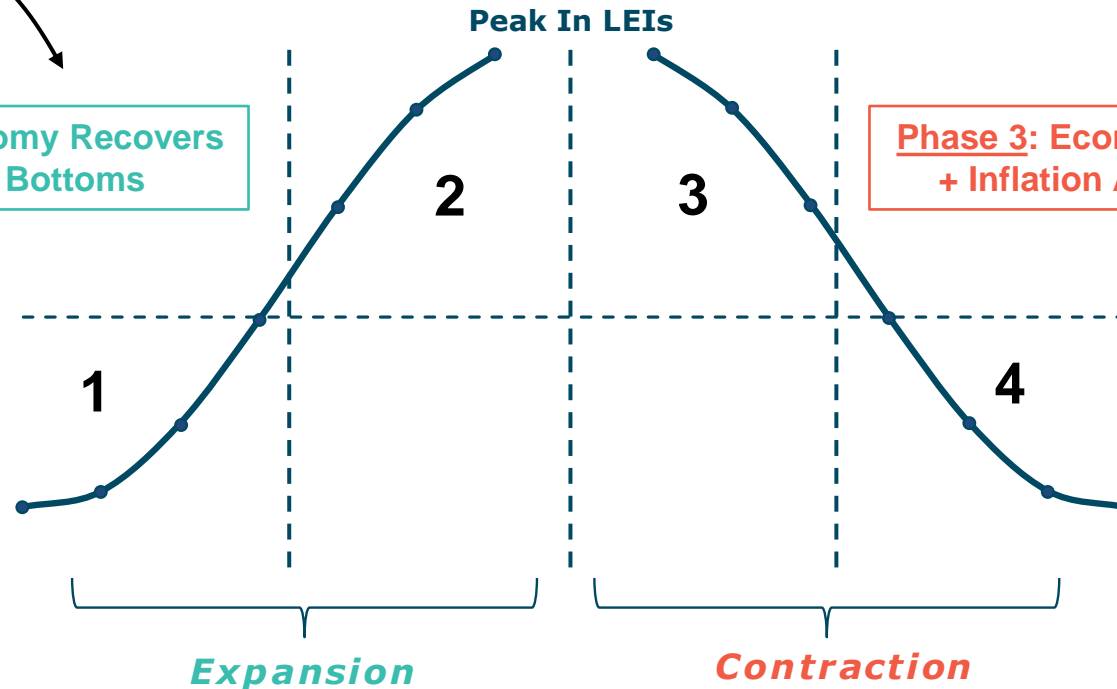
We are here where  
inflation rarely matters.

Phase 2: Economy Recovers  
+ Inflation Bottoms

Phase 1: LEIs Recover +  
No Inflation

Phase 3: Economy Matures  
+ Inflation Accelerates

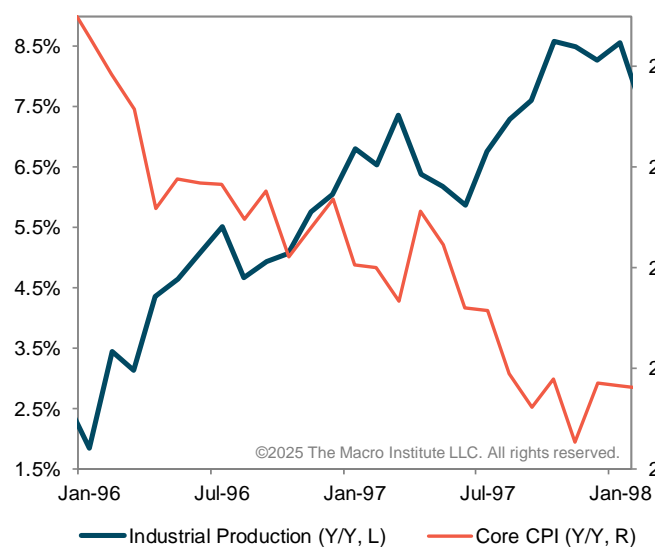
Phase 4: Economy Falters  
+ Inflation Craters



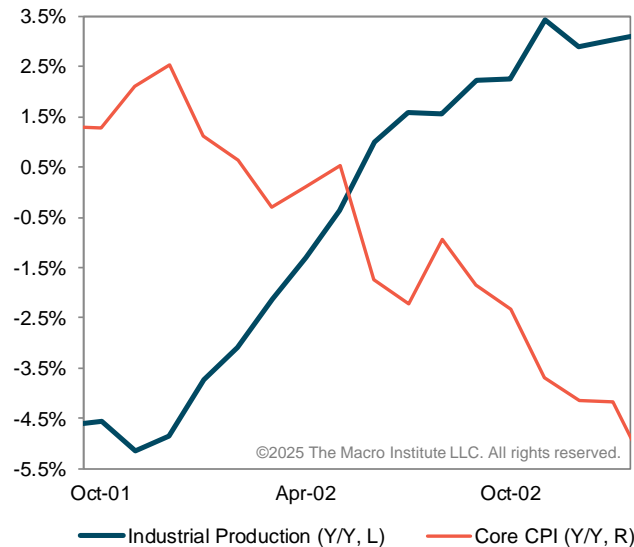
## An Inflationary Recovery In The Making

### Inflation Usually Keeps Slowing Even As Economy Recovers (Phase 2)

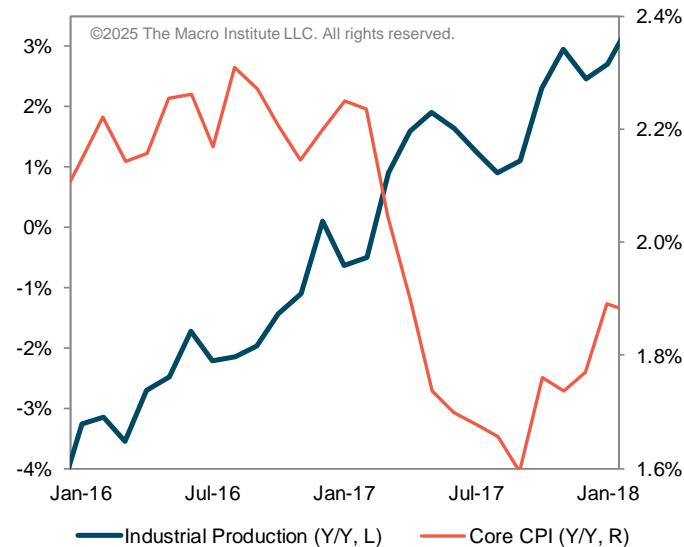
**96/97: Inflation Close In Phase 2**



**01/02: Inflation Close In Phase 2**



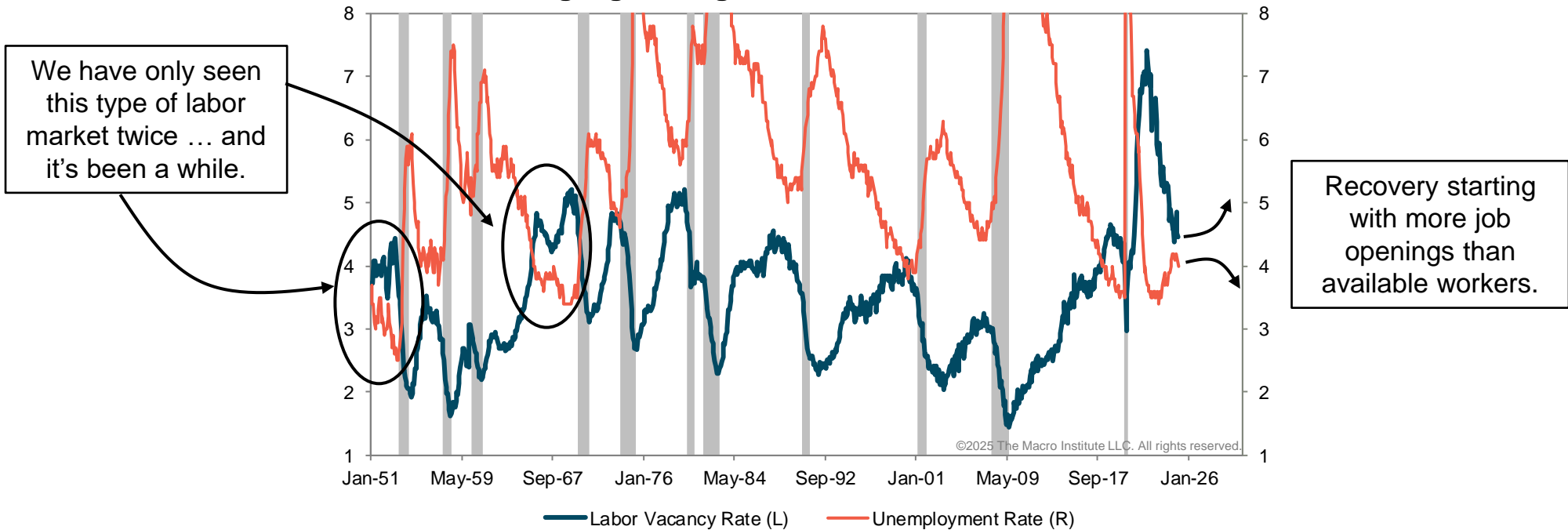
**16/17: Inflation Close In Phase 2**



## An Inflationary Recovery In The Making

### Today's Reality: This Is NOT Your Parents' Labor Market

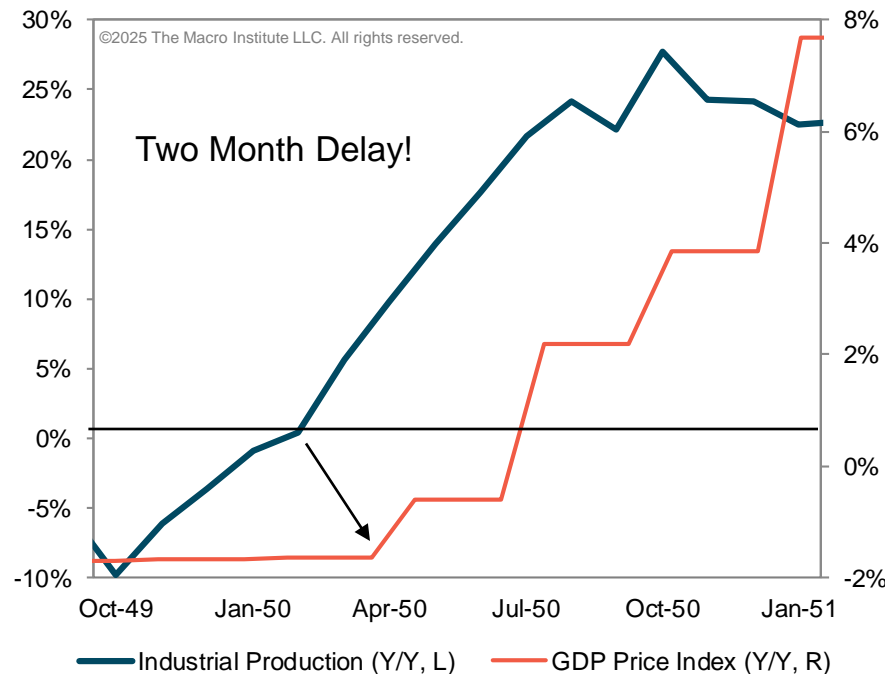
**Labor Marketing Tightening From Levels Last Seen In The 1960s**



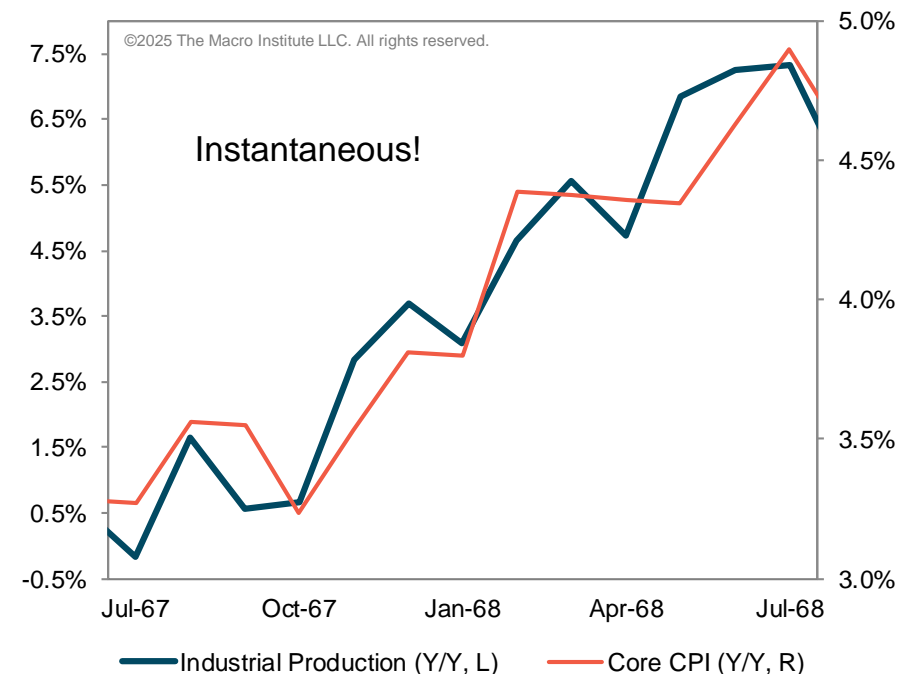
## An Inflationary Recovery In The Making

### Inflation Rebounded Quickly When We Last Faced This Type Of Labor Market

#### 1950: A Quick Recovery In Inflation



#### 1967/68: An Even Quicker Recovery In Inflation





## An Inflationary Recovery In The Making

### Unusual Labor Markets Set To Derail The Inflation Playbook

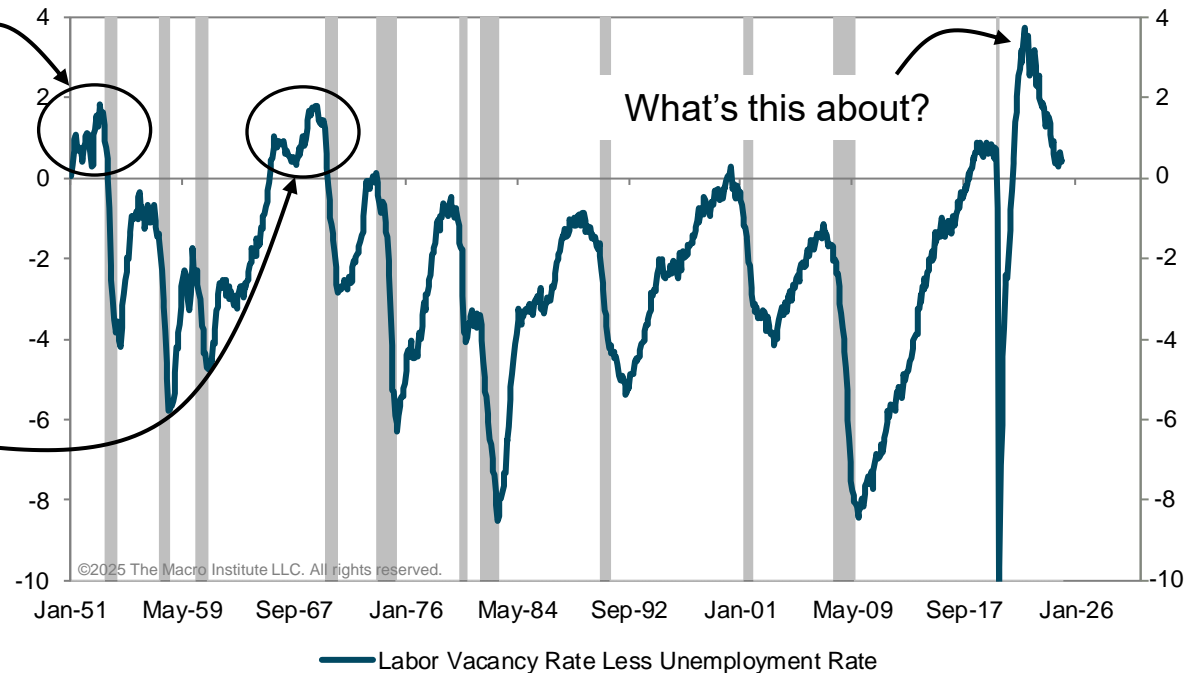
#### Labor Markets Are Different This Time For Today's Investors

"The period spanning the aftermath of World War II and the duration of the Korean War, from 1947 to 1954 ... was characterized by pent-up consumer demand, war-induced uncertainty, and a Fed policy moving from offsetting a national crisis to offsetting inflation."

- Council On Foreign Relations, 5/26/2022

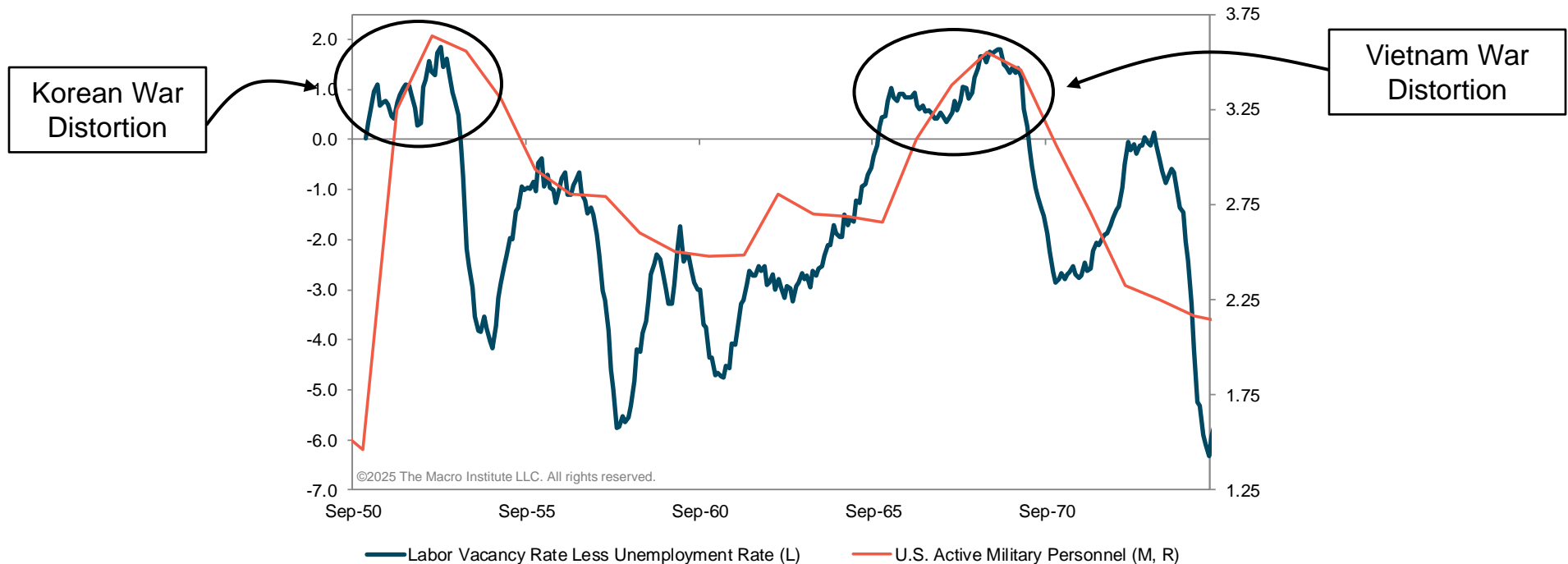
"The expenditures related to the Vietnam war, added to the near full-employment economy that existed in mid-1965, have generated severe inflationary pressures."

- Louis Lundborg, Bank of America Chairman Of The Board, 4/15/1970



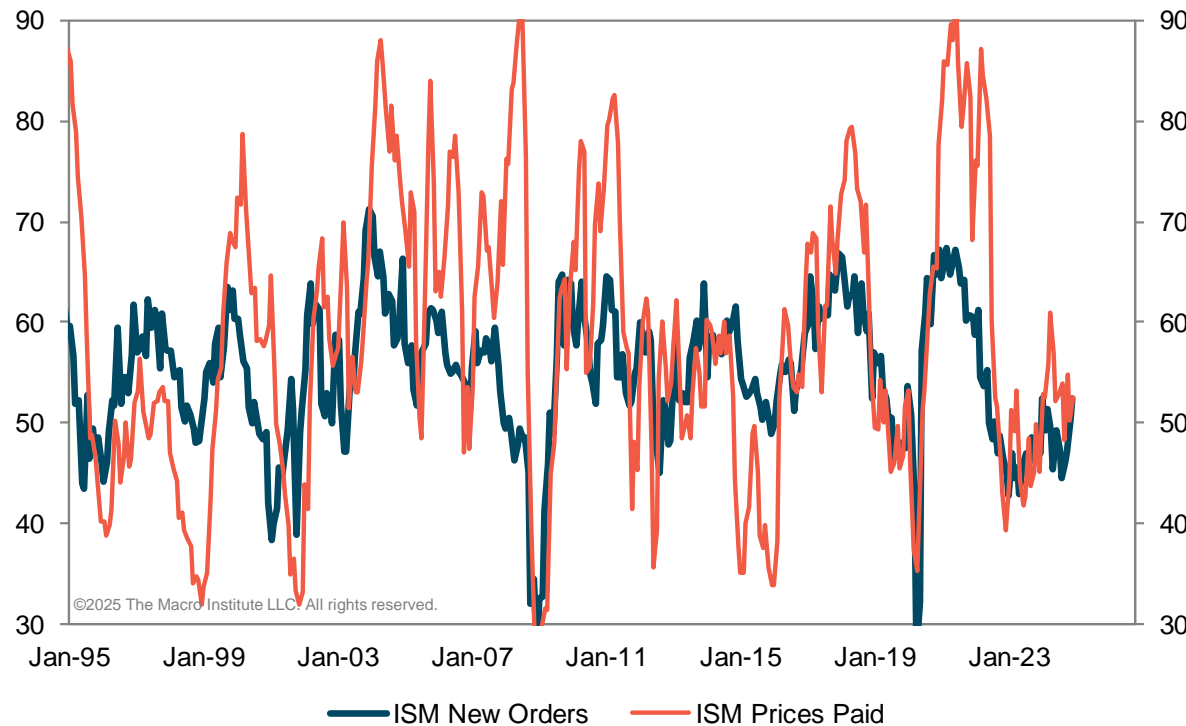
## Unusual Circumstances Have Led To Unusual Labor Markets At Times

### Military Conflicts Have Distorted Pool Of Available Labor In The Past

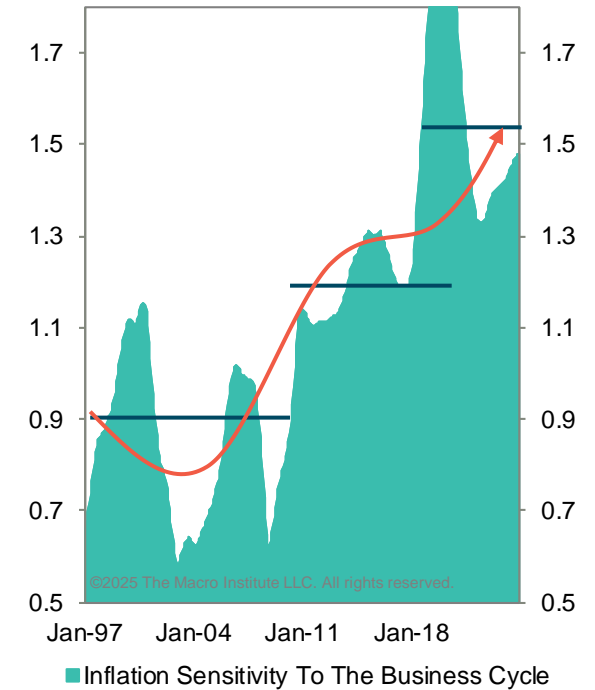


## U.S. Economy Structurally Different When It Comes To Inflation

Inflation Sensitivity Of The Economy Evolves Across Time ...



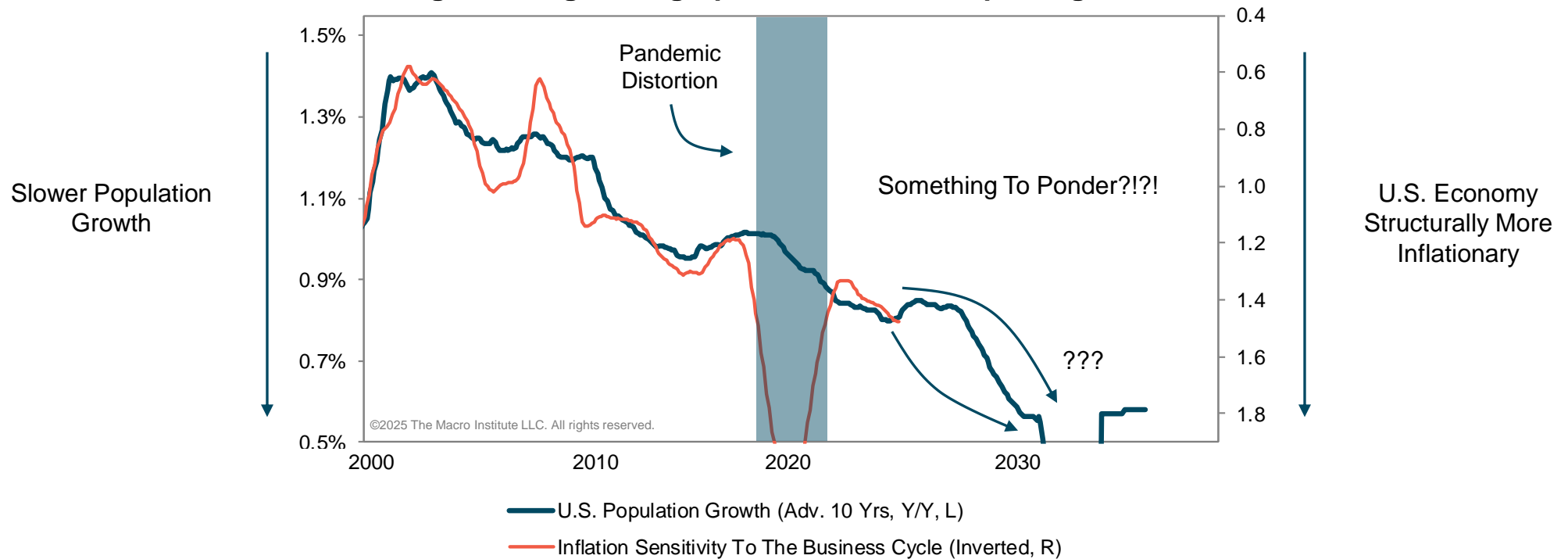
... Now Near Generational Highs



## An Inflationary Recovery In The Making

### Today's Labor Market Issues About Demographics Not War

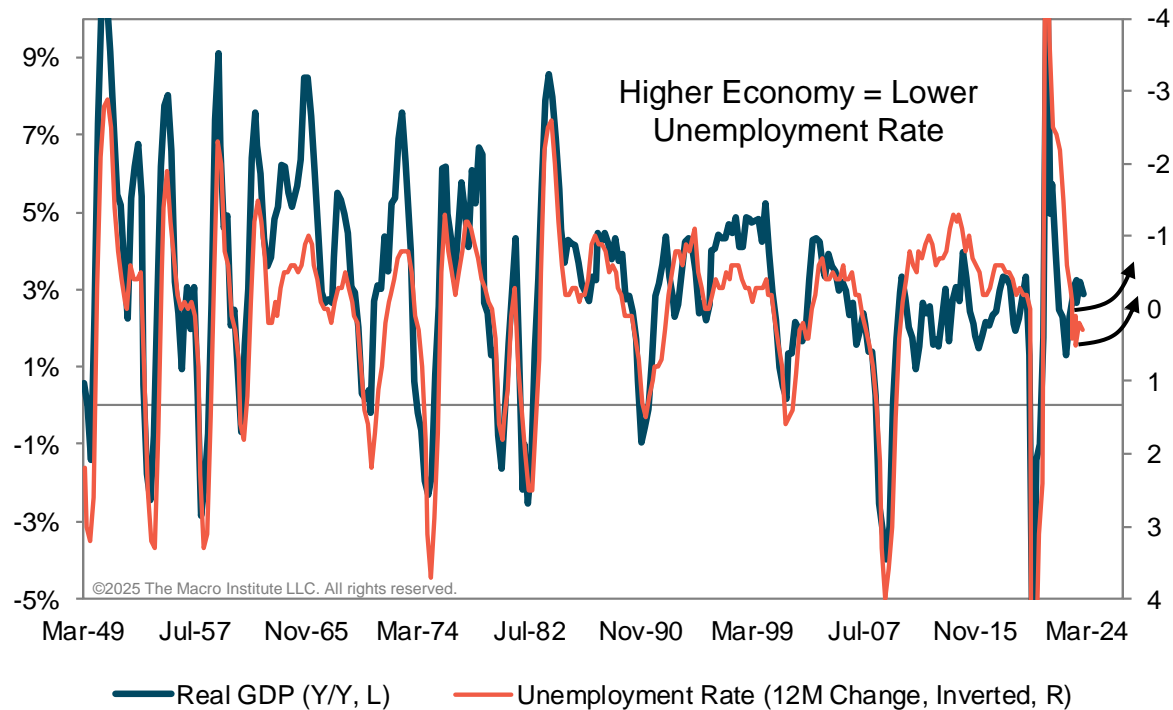
#### Long Standing Demographic Issues Now Impacting Inflation



## Lower Unemployment And Higher Core Inflation Ahead?

### Labor Market Recovery And Stronger GDP Growth One And The Same

#### Hard To Separate Labor Markets From Trends In The Economy

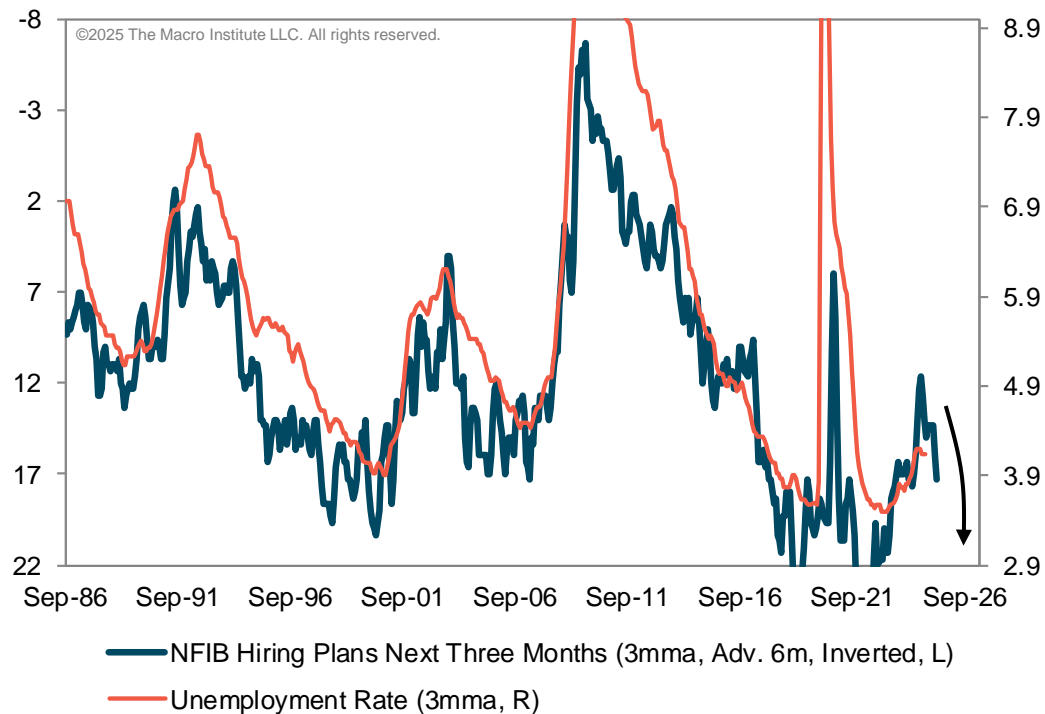


Tighter labor markets an inevitable byproduct of stimulus.

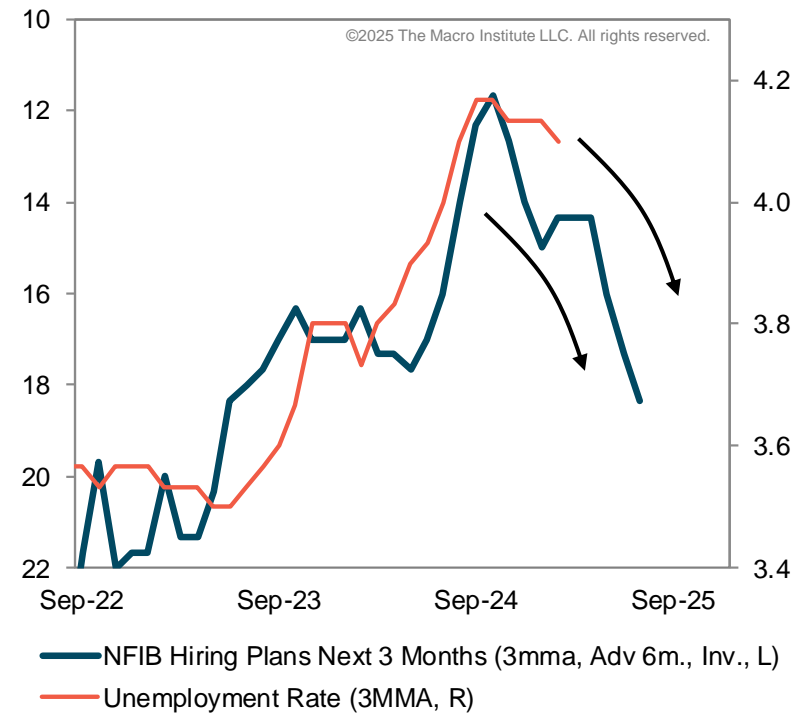
## Lower Unemployment And Higher Core Inflation Ahead?

### Small Business NFIB Survey Points To Even Tighter Labor Markets Ahead

#### Hiring Intentions On The Rise ...



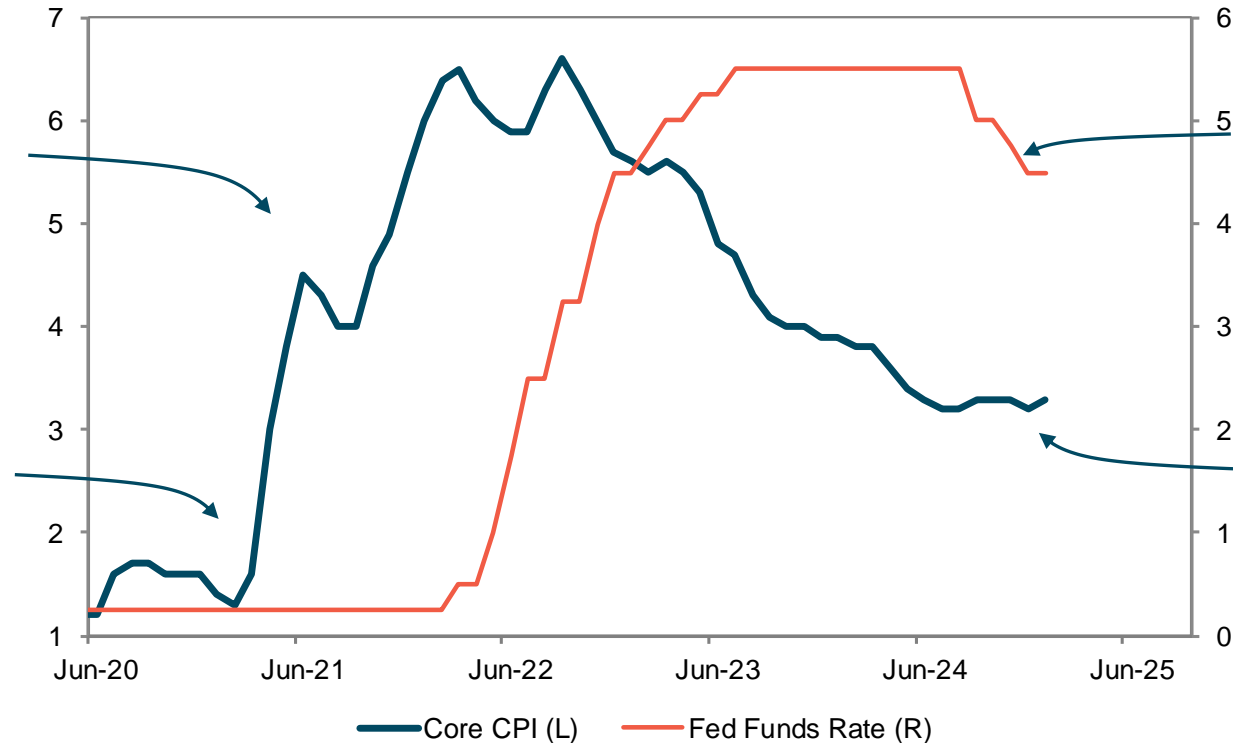
#### ... Unemployment Set To Dwindle Further



## Lower Unemployment And Higher Core Inflation Ahead?

### Are Tariffs The Supply-Chain Issue Of 2025 For The Fed?

#### Fed Too Focused On Tariffs, Not Enough On Unemployment!



"I expect that as price reversals and short-run imbalances from the economy reopening play out, inflation will come down from around 3% this year to close to 2% near year and in 2023."

- John Williams (June 2021)

"These one-time increases in prices are likely to have only transitory effects on inflation."

- Jerome Powell (April 2021)

"We don't know what will happen with tariffs ... not be in a hurry to understanding what our policy response should be until we see it play out."

- Jerome Powell (January 2025)

"We've never said we need to be all the way at target (inflation) to reduce rates ... we think that our policy stance is restrictive. Meaningfully restrictive."

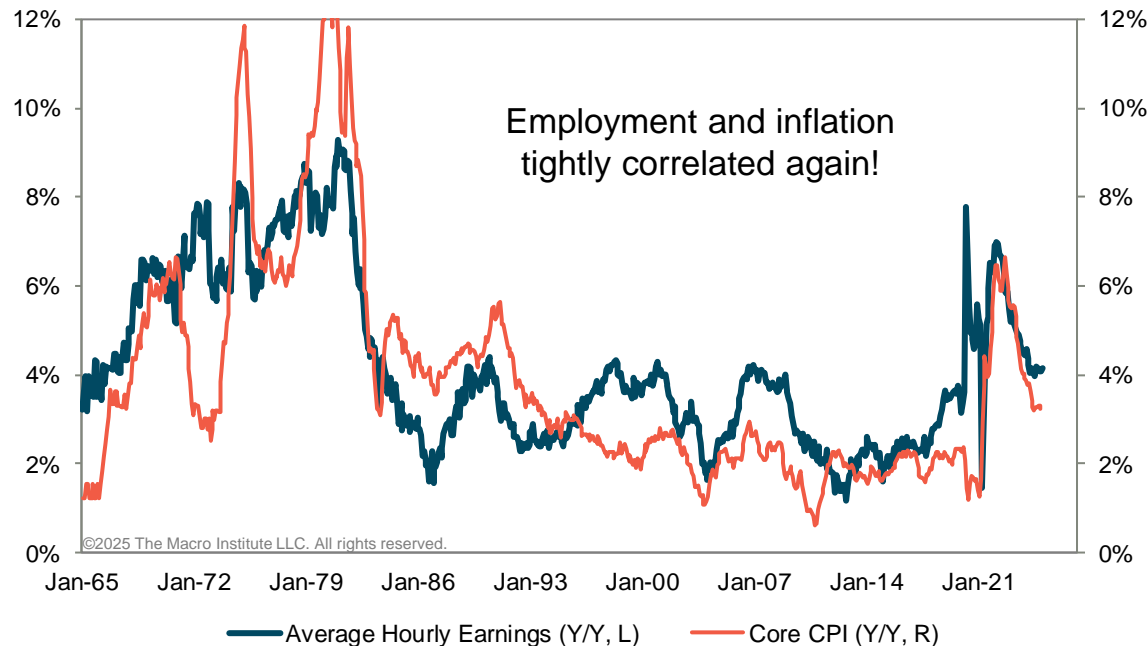
- Jerome Powell (January 2025)

**Wow!!!**

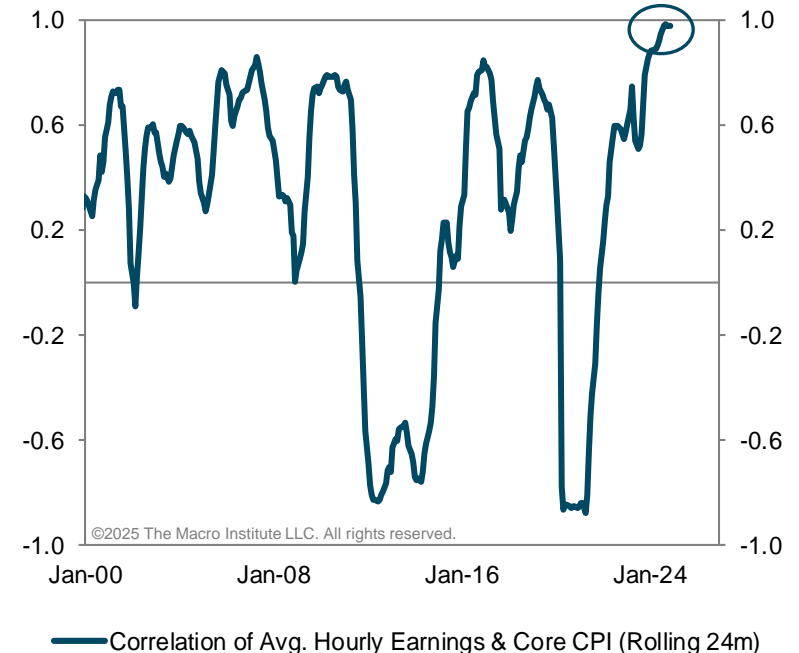
# Lower Unemployment And Higher Core Inflation Ahead?

## Fed Staff Should Probably Revisit The Phillips Curve

### Labor Markets Largest Influence For Core Inflation Trends



### Highest Correlation In Decades

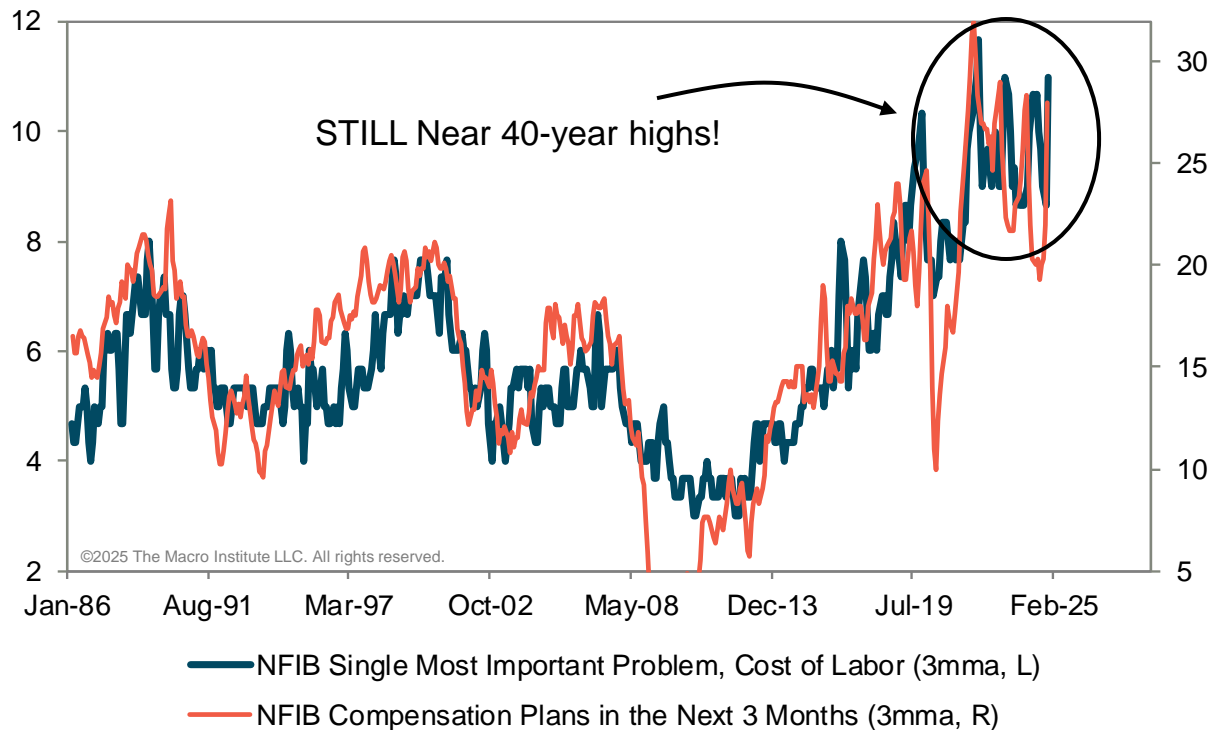




## Lower Unemployment And Higher Core Inflation Ahead?

### U.S. Companies Already Understand What The Fed Is Clearly Missing

#### Labor Markets Tightening From Levels Last Seen In The 1960s



#### Lagging Economic Index (LAG)

- Duration Of Unemployment
- Inventories To Sales
- Services Inflation (77% of Core CPI)
- Labor Costs (i.e., Wage Inflation)
- Commercial And Industrial Loans
- Consumer Credit To Personal Income
- Average Prime Rate

Both are official LAGs

## The Three High-Level Implications Of Higher Inflation



**#1 Fed Tightening**



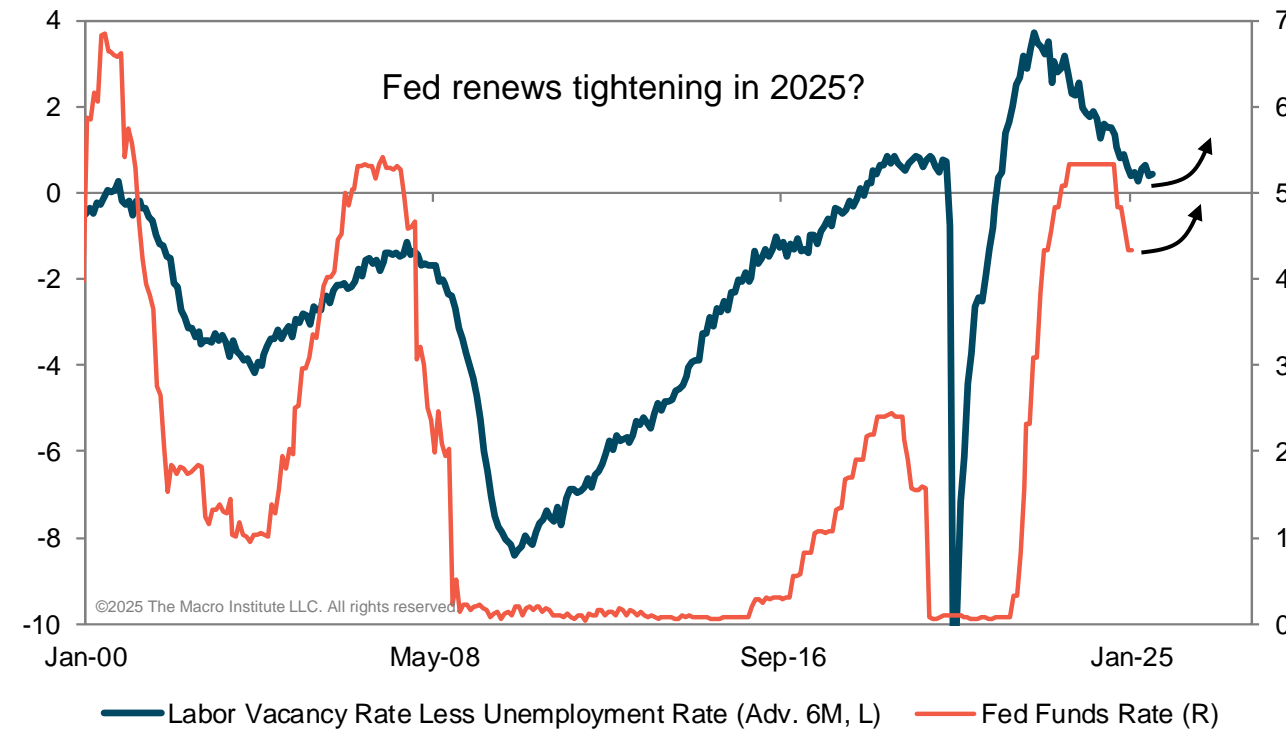
**#2 P/E Compression**



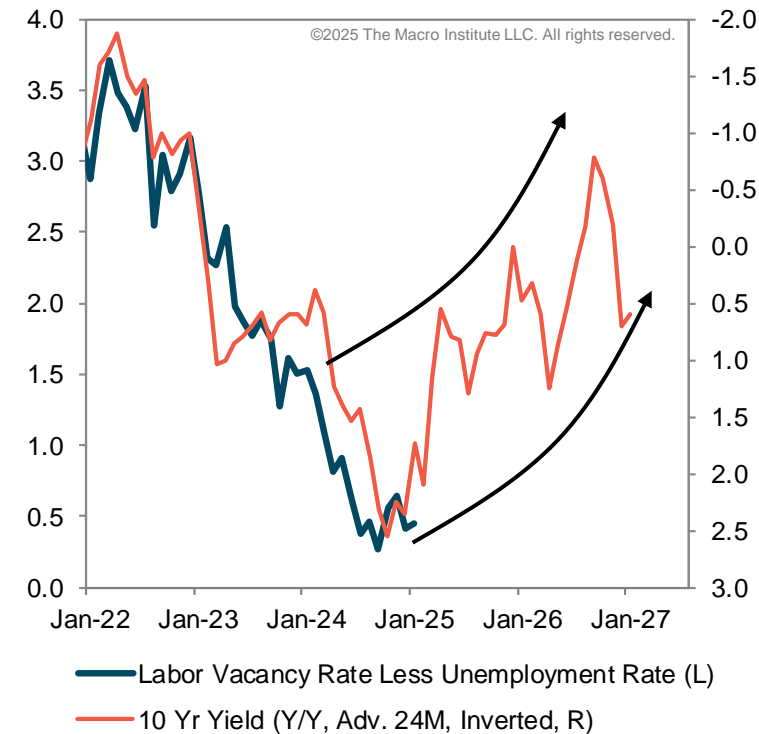
**#3 Pricing Power**

## #1 Fed Tightening: Countdown To The Fed's Change In Policy Stance

### Lack Of Labor Ushers In A Different World For The Fed



### Only Getting Worse From Here?



## Macro/Micro Implications Of A Renewed Inflation Surge

### #2 P/E Compression: A Staple Of Past Fed Tightening Cycles

P/Es Have Contracted During 13 Of The Past 15 Fed Tightening Cycles

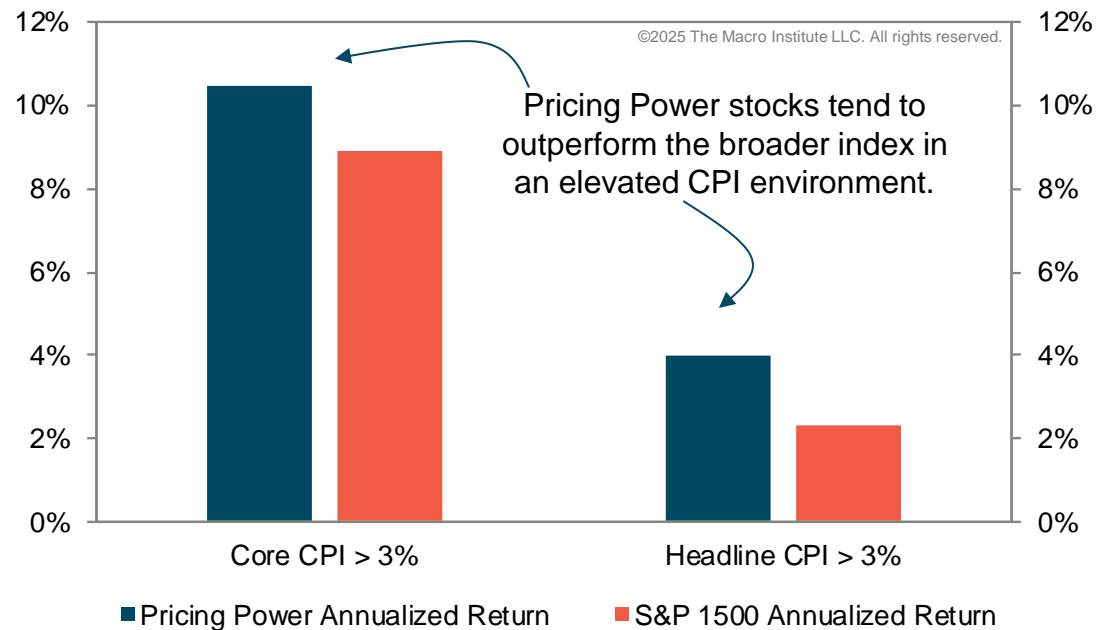
Rate Hike Cycle	Start	Nov-54	Jul-58	Jul-61	Oct-67	Feb-71	Feb-72	Feb-74	Nov-76	Mar-81	Apr-83	Nov-86	Jan-94	May-99	May-04	Dec-15	Up
	Stop	Oct-57	Nov-59	Nov-66	Aug-69	Aug-71	Aug-73	Jul-74	Apr-80	May-81	Aug-84	Feb-89	Feb-95	May-00	Jun-06	Dec-18	
Policy Rates	Start	0.83	0.68	1.17	3.88	3.50	3.50	9.00	4.75	16.00	8.50	5.88	3.00	4.75	1.00	0.50	15/15
	Stop	3.50	4.00	5.76	9.19	5.75	11.00	9.25	11.50	20.00	11.75	9.75	6.00	6.50	5.25	2.50	
	Chg Rates	2.67	3.32	4.59	5.31	2.25	7.50	0.25	6.75	4.00	3.25	3.88	3.00	1.75	4.25	2.00	
Oil Prices	Start	2.8	3.1	3.0	3.1	3.6	3.6	10.1	13.9	38.0	30.6	15.2	15.0	17.8	40.3	37.0	13/15
	Stop	3.1	3.0	3.0	3.4	3.6	4.3	10.1	39.5	38.0	29.3	17.8	18.5	28.8	71.0	45.4	
	Chg Oil	8.9%	-3.3%	0.0%	9.1%	0.0%	21.1%	0.0%	184.2%	0.0%	-4.4%	17.2%	23.5%	62.1%	76.2%	22.6%	
Stock Market	Start	34	47	67	94	97	107	96	102	136	164	249	482	1302	1121	2044	12/15
	Stop	41	58	80	96	99	104	79	106	133	167	289	487	1421	1270	2507	
	Chg Stocks	19.9%	23.5%	20.5%	1.7%	2.4%	-2.2%	-17.6%	4.1%	-2.5%	1.4%	15.9%	1.2%	9.1%	13.3%	22.6%	
P/Es	Start	12.6	14.8	21.4	17.9	18.1	19.4	12.2	11.0	9.0	12.5	12.5	14.9	23.5	16.5	16.2	2/15
	Stop	12.4	17.2	14.4	16.4	18.6	15.1	9.9	7.0	8.9	10.7	10.1	12.6	22.2	14.0	14.7	
	Chg P/E	(0.25)	2.31	(7.07)	(1.53)	0.42	(4.29)	(2.30)	(4.06)	(0.14)	(1.85)	(2.38)	(2.36)	(1.31)	(2.48)	(1.57)	
	% Chg P/E	-2.0%	15.6%	-33.0%	-8.5%	2.3%	-22.1%	-18.9%	-36.8%	-1.6%	-14.8%	-19.1%	-15.8%	-5.6%	-15.0%	-9.7%	4/13
U.S. Dollar	Start				99.9	100.3	90.6	85.9	88.6	80.7	102.1	88.3	79.7	85.3	74.2	82.3	
	Stop				103.0	97.1	79.9	83.9	73.5	87.5	117.0	79.2	71.7	90.7	71.0	80.2	
	Chg USD %				3.1%	-3.2%	-11.9%	-2.4%	-17.0%	8.5%	14.7%	-10.4%	-10.1%	6.3%	-4.2%	-2.5%	

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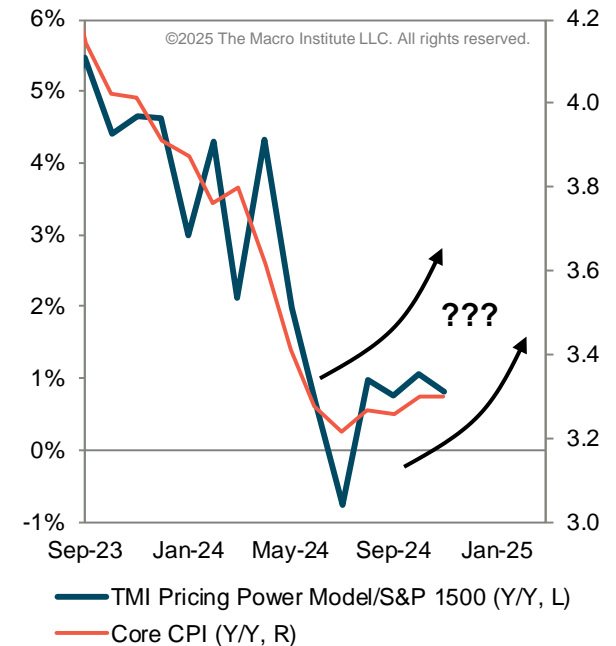
## Macro/Micro Implications Of A Renewed Inflation Surge

### #3 Pricing Power: A Key Factor As Inflation Stages A Comeback

#### Pricing Power Key To Performance In An Inflationary Backdrop



#### Inflation Set To Reaccelerate



#### Strong Pricing Power:

$\Delta$  Gross Margins +  $\Delta$  Market Share  
 Higher Gross Margins (Y/Y) Higher Market Share (Over Past 2 Years)

Why The Inflation Playbook Will Fail You In 2025

DO NOT REDISTRIBUTE. INTENDED FOR USE ONLY BY THE RECIPIENT.

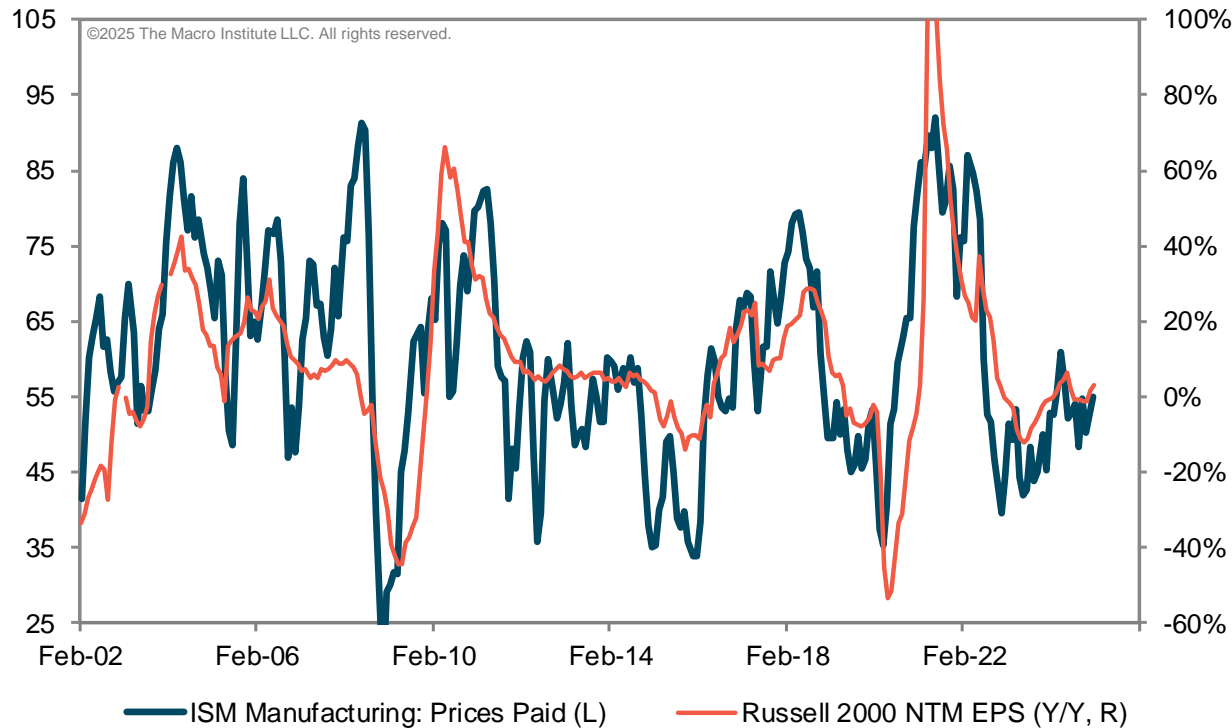
## In Conclusion ... A Strange Recovery At Hand

Good News →

← Bad News

**Better Earnings Inevitably Come With Greater Inflationary Pressures**

### Earnings Trends And Inflation Intrinsically Linked



Learn Why We Think  
Rates Are Headed Higher  
In 2025 By Reading  
[Last Week's Report Here.](#)

## In Conclusion ... A Strange Recovery At Hand

### A Few Inflation Metrics To Keep An Eye On In 2025

	6/22	8/22	10/22	12/22	2/23	4/23	6/23	8/23	10/23	12/23	2/24	4/24	6/24	8/24	10/24	12/24	1/25	2/25
CPI	9.0%	8.2%	7.8%	6.4%	6.0%	4.9%	3.1%	3.7%	3.2%	3.3%	3.2%	3.4%	3.0%	2.6%	2.6%	2.9%	3.0%	
PPI	11.1%	8.7%	8.2%	6.4%	4.7%	2.3%	0.3%	1.9%	1.1%	1.1%	1.6%	2.3%	3.0%	2.1%	2.7%	3.5%	3.5%	
Import Prices	10.7%	7.7%	4.2%	3.2%	-1.1%	-4.9%	-6.1%	-3.0%	-1.8%	-2.4%	-0.9%	1.0%	1.5%	0.8%	0.6%	2.3%	1.9%	
ISM - Mfg. Prices	78.5	52.5	46.6	39.4	51.3	53.2	41.8	48.4	45.1	45.2	52.5	60.9	52.1	54	54.8	52.5	54.9	
ISM - Serv. Prices	80.3	72.6	70.7	67.4	64.4	59.6	55.2	59.2	58.5	56.7	57.8	58.8	56.8	57.7	58.6	64.4	60.4	
UofM - 1 Yr Infl Exp.	5.3	4.8	5	4.3	4.2	4.7	3.3	3.5	4.2	3.1	3	3.2	3	2.8	2.7	2.8	3.3	4.3

Seeing more orange and less green lately!

**TMI CLIENT CONFERENCE CALL ANNOUNCEMENT**

Tuesday, February 25<sup>th</sup>  
10:30 ET

***The Failure Of The Inflation Playbook In 2025***

Host: Francois Trahan

Registration is required for attendance:

[Register](#)



## In Conclusion ... A Strange Recovery At Hand

For any additional questions:  
[research@themacroinstitute.com](mailto:research@themacroinstitute.com)