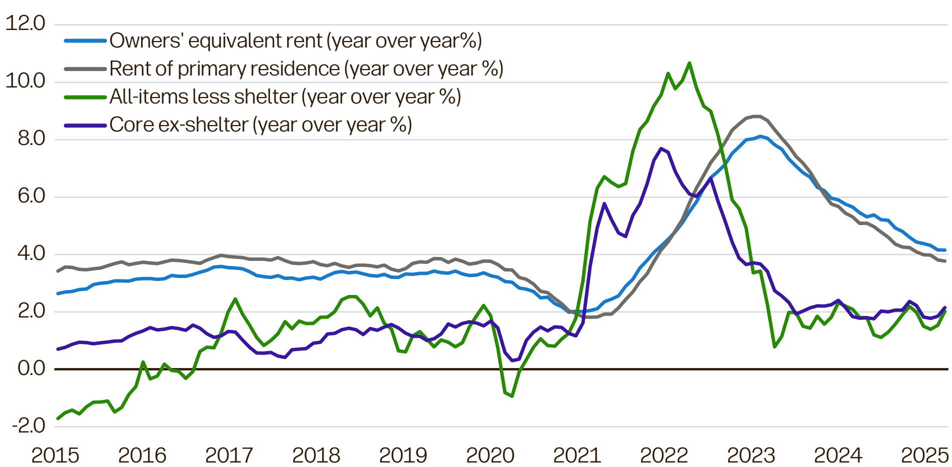
AEGON **INSIGHTS**

The 2x4 CPI

A little context for our international readers: In the US, lumber sizes are nominal dimensions in imperial measurements. One of the more common sizes is 2 inches by 4 inches, colloquially known as the 2-by-4 or 2x4.

We mention this because those 2x4 measurements seem to sum up the recent US consumer price index (CPI) reports quite well. Essentially, you have housing running at a +4% year over year pace and everything else at +2% year over year, a path that is quite similar to the pre-covid rates. Note: Housing has a much smaller weighting in the Fed's preferred inflation measure, the personal consumption expenditures (PCE) price index.

CPI & housing



Sources: Bureau of Labor Statistics, Haver Analytics. Data as of July 2025.

The current pace of inflation is why there have been various comments that the Federal Reserve would be cutting rates if not for the specter of tariffs. But given the circumstances, the Fed puts on its "theta trade" to buy as much optionality as possible.

Later this year the battle royal will occur, which pits inflation from tariff price adjustment (i.e., not surging demand) versus demand destruction. How long will the Fed hold onto the "theta trade" if demand is being quelched? We continue to think the weakening demand signal will lead the Fed to cut interest rates later this year.

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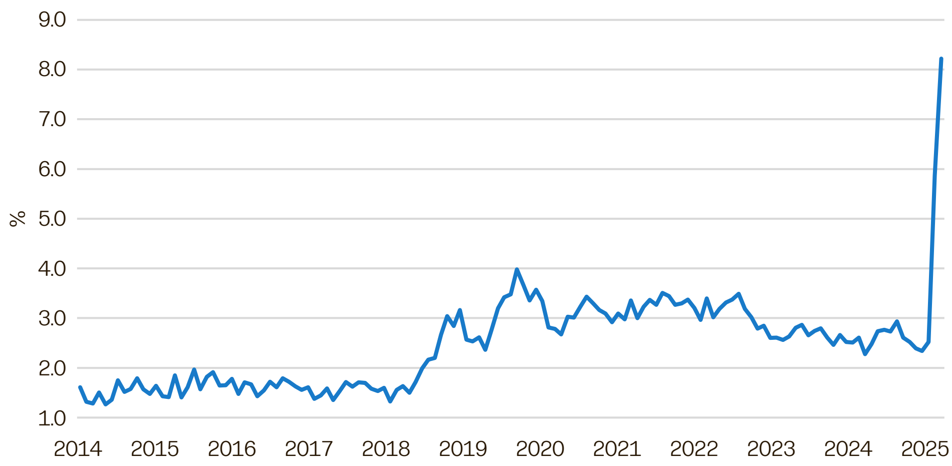
Frank Rybinski, CFA, is head of macro strategy responsible for guiding the firm's global macroeconomic view as it pertains to tactical and strategic asset allocation. This includes analysis of the economy, interest rates, and the relative value between asset classes. In this capacity, Frank frequently appears in leading financial media outlets like Bloomberg, CNBC, Fox Business and the Wall Street Journal. Prior to his current role, Frank was a credit strategist for UBS Investment Bank. Prior to that, he worked as an analyst for ZT Zurich Trust in Zurich, Switzerland. Frank began his career as a trader for Spear, Leeds & Kellogg and held a similar position at The Royal Bank of Scotland. He has been in the industry since 1996 and started with the firm in 2008. Frank received his BA in economics from Boston College. He is a CFA® charterholder.

However, recently we have been exploring whether we need to push our expectation for the next rate cut from September to November/December. The reason being: the tariff "pause" and subsequent "delays" move the bulk of implementation back by three to four months, thus delaying the negative income effect in kind.

Essentially, by the third quarter of 2025 the consumer was supposed to be feeling the full brunt of the tariff impact. But now the tariffs won't be ramping up until midway through the third quarter. For context, the effective tariff was "only" 8% as of May. Compare that to the recent "letters" and "announcements" from President Trump and his administration, which imply the final effective rate will land somewhere in the high-teens or possibly 20% range later this year—that's a big difference to swallow in such a short time. So, stay tuned as this is a moving target.

Effective tariff rate (%)



Source: Haver Analytics. Data as of July 2025.

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