AIER Research Reports

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Research Reports

AIER publishes over 100 articles per month that are distributed in digital form. Research Reports contains Business Conditions Monthly plus 8 of the most representative, chosen here for popularity, variety, and relevance. These articles are often reprinted in venues around the web, including Seeking Alpha, Intellectual Takeout, Mises Brasil, and dozens of other outlets. To read all of them, go to www.aier.org

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September 2026

From the Senior Director of Research

Peter C. Earle

Senior Director of Research

The latest US-Canada trade fight begins with a political premise: Canada is "taking advantage" of the United States. But that framing gets the economics backward. Countries do not trade in the way governments negotiate treaties or armies contest territory. People and firms trade. American manufacturers purchase Canadian inputs because they need them; American households buy Canadian products because they prefer them to alternatives. Canadians make the same calculations about American goods and services. What politicians describe as a contest between nations is overwhelmingly the aggregation of millions of voluntary commercial decisions.

Trade in US goods and services trade with Canada approached $900 billion in 2025. The United States exported roughly $426 billion to Canada and imported about $444 billion. There was a US goods deficit, but also a substantial services surplus. None of this begins to establish that anybody has been "ripped off." A bilateral trade deficit is an accounting result, not an invoice presented by one country to another. I run a bilateral trade deficit with my supermarket because it has things I want to buy while I have little it wants from me. I have not been exploited.

That does not place Canadian trade policy beyond criticism. Canada maintains protectionist dairy policies, and our two countries have fought over softwood lumber for decades. Provincial restrictions, procurement rules, autos, alcohol, and other products have generated disputes. But specific barriers should be identified and addressed uniquely, not transformed into evidence that an entire nation is 'victimizing' another. The United States maintains formidable barriers of its own, including tariffs of up to **155 percent** on certain Canadian peanuts and restrictions on sugar. Protectionism does not become economically sound when the flag fluttering over it changes.

This distinction matters when governments claim to be "defending companies." A US lumber producer may want protection from Canadian competition. American homebuilders and homebuyers may prefer cheaper Canadian lumber. A US dairy producer may want greater Canadian market access while a manufacturer depends upon inexpensive Canadian components. The economic interests of a producer are not synonymous with the national interest. When Washington adopts one company's commercial grievance as a national cause, it transfers the resulting costs to other Americans.

Note that consumers are absent from these discussions. The factory competing against imports is visible, organized, and politically influential. The millions of households paying less for automobiles, food, appliances, and construction materials are dispersed. So are thousands of businesses benefiting from less expensive intermediate inputs. Protectionism counts the gains to protected producers loudly while treating losses imposed elsewhere as background noise.

The administration's latest tariff hijinks illustrate the problem. New **50 percent** tariffs cover roughly $20 billion of Canadian exports, while President Trump is threatening **50 percent** tariffs on Canadian cars, trucks, and auto parts beginning January 1. Canada is preparing retaliation. What begins as an attempt to protect particular producers quickly draws steel, dairy, appliances, agricultural equipment, pulp and paper, electronics, and other industries into a dispute they did not start.

Autos demonstrate how obsolete the nationalistic model of trade has become. There is no hermetically-sealed American automobile industry competing against a Canadian one. There is a North American automotive production system. Components can cross the border several times before a finished vehicle leaves an assembly plant. A tariff on a Canadian auto part therefore does not magically cause an identical supplier to materialize in Michigan. It raises the cost of an input needed by an American factory.

Supply chains are not light switches. Replacing them requires factories, machinery, specialized workers, financing, regulatory approvals, and most of all: time. And in those places where Canadian production is more efficient, forcing production into the United States at greater cost is not an economic victory. It means consuming more resources to produce the same output.

The greatest danger is not that Canada will somehow "beat" America. It is that two governments will deliberately degrade an extraordinarily productive continental division of labor. Companies compete with companies. Countries do not compete in the same sense. When governments transform commercial disagreements among firms into contests between nations, they socialize those disputes, spreading the costs among millions of consumers and businesses that had nothing to do with them.

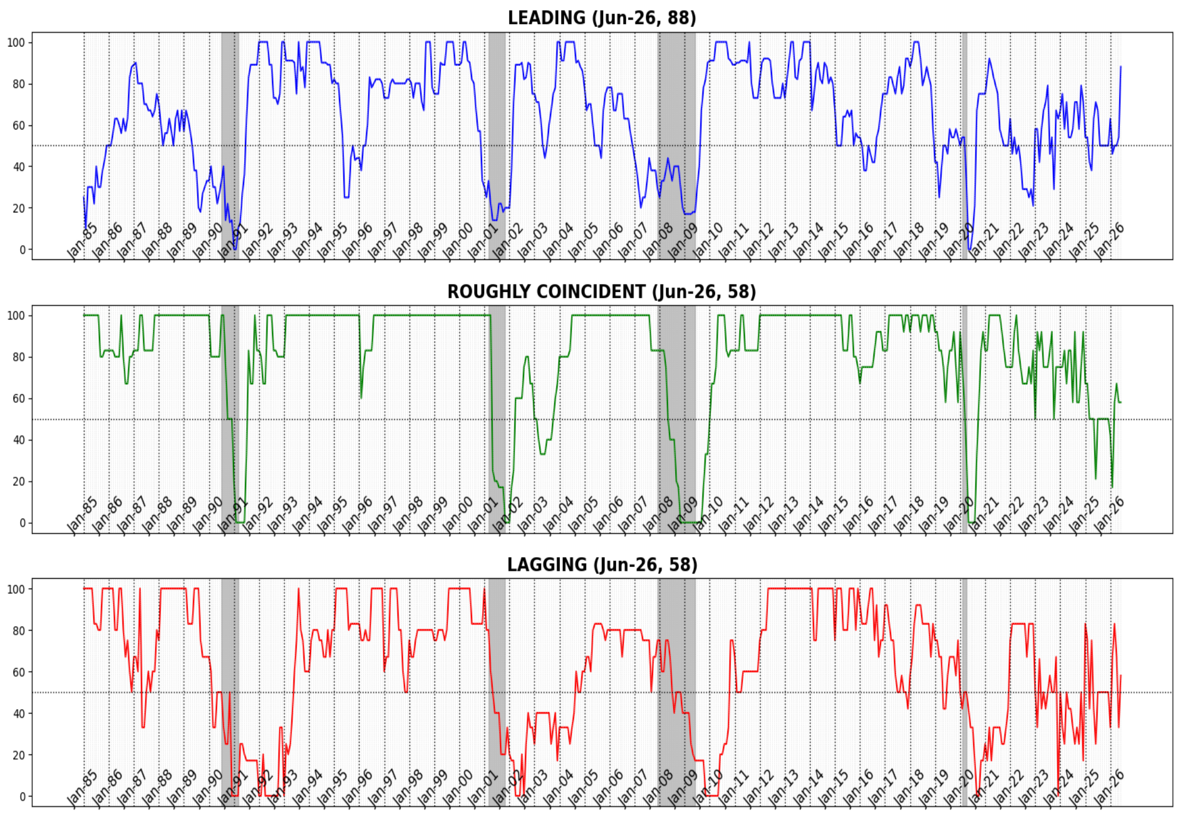
Nearly $900 billion in annual commerce did not arise because bureaucrats designed a continental economy. It arose because hundreds of millions of people discovered gains from trading across a border. The objective should be to remove government-created impediments to those exchanges, not manufacture new ones. The best trade policy would recognize that achievement and get out of its way.

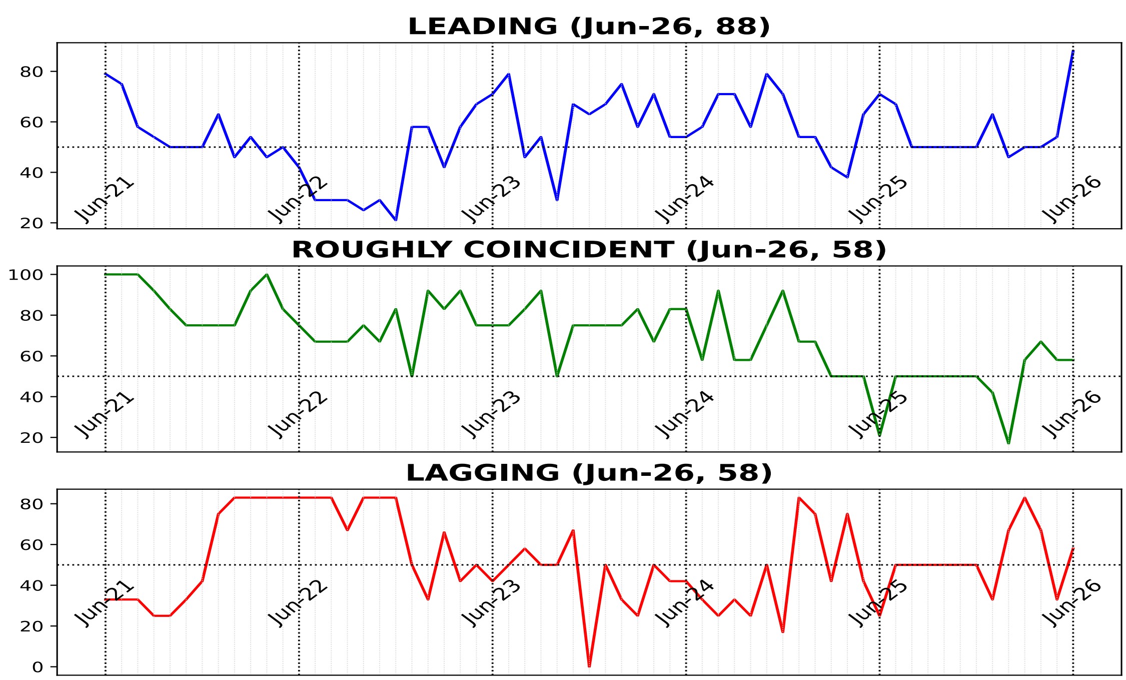
Peter C. Earle, Ph.D
Managing Editor, *AIER Research Reports*

September 2026

Business Conditions Monthly June 2026

Peter C. Earle
Senior Director of Research


LEADING (Jun-26, 88)
ROUGHLY COINCIDENT (Jun-26, 58)
LAGGING (Jun-26, 58)
0
20
40
60
80
100
Jan-85 Jan-86 Jan-87 Jan-88 Jan-89 Jan-90 Jan-91 Jan-92 Jan-93 Jan-94 Jan-95 Jan-96 Jan-97 Jan-98 Jan-99 Jan-00 Jan-01 Jan-02 Jan-03 Jan-04 Jan-05 Jan-06 Jan-07 Jan-08 Jan-09 Jan-10 Jan-11 Jan-12 Jan-13 Jan-14 Jan-15 Jan-16 Jan-17 Jan-18 Jan-19 Jan-20 Jan-21 Jan-22 Jan-23 Jan-24 Jan-25 Jan-26


LEADING (Jun-26, 88)
ROUGHLY COINCIDENT (Jun-26, 58)
LAGGING (Jun-26, 58)
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The June 2026 AIER Business Conditions Monthly (BCM) shows a pronounced improvement in forward-looking conditions, while measures of current and trailing activity remained considerably more subdued. The Leading Indicator surged to **88** from **54** in May, with gains extending across consumer expectations, financial markets, housing, retail activity, transportation, and capital-goods orders. The Roughly Coincident Indicator held at **58**, suggesting that current economic activity continued to expand, but without the breadth evident in the leading data. The Lagging Indicator recovered to **58** from **33**, reversing much of May's deterioration as several credit, labor-market, inventory, and construction measures improved.

LEADING INDICATOR (88)

The Leading Indicator rose sharply to **88**, with ten of twelve components improving, one essentially unchanged, and only one declining.

The improvement was unusually broad. The University of Michigan Consumer Expectations Index rose **15.0 percent**, reversing some of the weakness in household expectations seen previously. Initial jobless claims declined **3.6 percent** and, because lower claims represent an improvement in labor-market conditions, contributed positively after inversion. The Conference Board US Leading Index Stock Prices 500 Common Stocks increased **0.5 percent**, while Conference Board US Manufacturers New Orders Nondefense Capital Goods Ex Aircraft rose **1.1 percent**.

Housing and other demand-sensitive measures were also supportive. US New Privately Owned Housing Units Started by Structure Total SAAR jumped **19.7 percent**, the Inventory-to-Sales Ratio Total Business increased **1.6 percent**, and Adjusted Retail and Food Services Sales Total SA advanced **0.3 percent**. United States Heavy Trucks Sales SAAR rose **13.4 percent**, while Debit Balances in Customers' Securities Margin Accounts increased another **6.1 percent**. The 1-Year to 10-Year US Treasury Yield Spread narrowed substantially, falling **27.8 percent**, but was scored positively under the BCM's inverted treatment of that measure. US Average Weekly Hours All Employees Manufacturing SA was unchanged at 40.4 hours and therefore contributed neutrally.

The principal exception to the broad improvement was Conference Board US Leading Index Manufacturers' New Orders Consumer Goods and Materials, which declined **0.3 percent**.

Taken together, June's leading data represent a marked strengthening from May. The rise from **54** to **88** was not driven by one or two unusually strong components, but by improvement across a wide range of forward-looking measures. Consumer expectations, jobless claims, equities, capital-goods orders, housing starts, inventories, retail sales, heavy truck sales, margin debt, and the yield-spread signal all contributed positively. Although one month of stronger leading data does not establish a durable acceleration, the June reading points to substantially greater forward-looking breadth than was evident during the spring.

ROUGHLY COINCIDENT INDICATOR (58)

The Roughly Coincident Indicator remained at **58**, with three of six components improving, one essentially unchanged, and two declining.

Measures of income, sales, and production continued to advance. Conference Board Coincident Manufacturing and Trade Sales increased **0.3 percent**, reversing May's decline, while Conference Board Coincident Personal Income Less Transfer Payments rose **0.2 percent**. US Industrial Production SA increased **0.3 percent**. US Employees on Nonfarm Payrolls Total SA was essentially unchanged, rising just **0.01 percent**, and therefore contributed neutrally under the BCM scoring methodology.

The weaker components were concentrated in confidence and labor-force participation. Conference Board Consumer Confidence Present Situation SA declined **0.8 percent**, indicating some further softening in households' assessment of current conditions. The US Labor Force Participation Rate SA fell from **61.8 percent** to **61.5 percent**, a **0.5 percent** decline.

Overall, the coincident measures continue to describe an economy expanding at a modest and uneven pace. The unchanged reading of 58 masks some rotation among the underlying components: manufacturing and trade sales improved after weakening in May, while labor-force participation deteriorated and present-situation confidence remained soft. Income and industrial production continued to provide support, but the current-conditions picture remains substantially less vigorous than June's leading indicators suggest.

LAGGING INDICATOR (58)

The Lagging Indicator rebounded to **58** from **33**, with three of six components improving, one essentially unchanged, and two declining.

Several measures that weakened in May turned more favorable in June. US Commercial Paper Placed Top 30 Day Yield increased **0.8 percent**. Conference

Board US Lagging Average Duration of Unemployment declined **1.9 percent** and, after inversion, contributed positively. Census Bureau US Private Construction Spending Nonresidential SA edged **0.1 percent** higher. US Manufacturing and Trade Inventories Total SA increased only **0.04 percent**, leaving the measure effectively unchanged and contributing neutrally.

Two components restrained the index. US CPI Urban Consumers Less Food and Energy Year over Year NSA declined from **2.85 percent** to **2.59 percent**, a **9.1 percent** decrease under the BCM's month-to-month scoring calculation. Conference Board US Lagging Commercial and Industrial Loans declined **0.5 percent**, extending weakness in that measure.

The recovery in the Lagging Indicator from **33** to **58** indicates that May's sharp deterioration in trailing conditions did not continue into June. Short-term commercial paper yields, unemployment duration, and nonresidential construction shifted into the positive column, while inventories were essentially unchanged. At the same time, declining commercial and industrial lending remained a source of weakness, and the core inflation measure also scored negatively. The result is a considerably more balanced lagging picture than in May, though not one signaling uniformly strong conditions.

June's BCM results therefore present a notably different configuration from May. Forward-looking conditions strengthened dramatically, with the Leading Indicator climbing from **54** to **88** and positive signals appearing across nearly every major category. Current conditions were steadier: the Roughly Coincident Indicator remained at **58** as gains in income, sales, and production were offset by weaker confidence and labor-force participation. Lagging conditions improved substantially, with the index recovering from **33** to **58**. Taken together, the June readings suggest an economy whose forward-looking breadth improved considerably even as current activity remained moderate — an encouraging shift, but one that will require confirmation in subsequent months before it can be characterized as a sustained acceleration.

DISCUSSION, JULY— AUGUST 2026

The July CPI rose just **0.07 percent**, lowering the year-over-year rate to **3.4 percent**, while core CPI increased **0.22 percent** and slowed to **2.48 percent** from a year earlier, matching its five-year low. Lower gasoline prices again provided substantial relief, food inflation moderated, and earlier supply pressures in food and metals showed signs of reversing, while the fading World Cup-related tourism boost contributed to declines in lodging, vehicle rentals, and recreational services. Services inflation rebounded modestly from June's unusually soft reading, however, and the share of core CPI components rising at annualized rates above two percent increased to **53 percent** from a second-quarter average of **42 percent**. Producer prices were more reassuring: headline PPI was unchanged in July and core PPI rose only **0.2 percent**, both below expectations, as falling energy and transportation costs offset firmer services prices. June's PCE report similarly showed improvement, with headline prices falling **0.11 percent** and core inflation slowing to **0.13 percent**, even as real consumer spending remained solid at **0.4 percent**. That spending increasingly appears to be outrunning household resources, however, as income rose only **0.2 percent** and the saving rate slipped to **2.7 percent**. Taken together, inflation continues to cool without a collapse in demand, but persistent services pressures and broader July price increases argue against declaring victory. With employment also weakening, the data provide little justification for renewed tightening while allowing the Federal Reserve to remain comfortably on hold.

July 2026 also marked a significant deterioration in US hiring, with payrolls declining 23,000 and revisions to May and June removing another 103,000 jobs from previously reported totals. The three-month average has consequently collapsed from more than 100,000 during the spring to only 20,000, while private employers added just 30,000 positions. Weakness was concentrated in local-government education, leisure and hospitality, retail, and financial services, with the post-World Cup reversal likely explaining some of the losses in restaurants and entertainment. Healthcare, normally an important source of employment growth, also slowed sharply, while construction added 22,000 jobs. The drop in unemployment from 4.2 to **4.1 percent** provides little reassurance: household employment fell by 87,000, but a 264,000 contraction in the labor force mechanically reduced the number counted as unemployed and pushed participation down to **61.4 percent**. June JOLTS data provide additional evidence of diminished labor demand, with openings falling to 7.36 million and workers continuing to quit at historically subdued rates, although layoffs remain low. ADP similarly reported just 44,000 new private-sector jobs in July, its weakest result this year, even as pay growth for job-switchers accelerated to seven percent. With average hourly earnings in the government report rising only **0.1 percent** and aggregate labor-income growth slowing markedly, employment conditions are becoming a greater constraint on household spending while posing progressively less inflationary risk. The emerging pattern is therefore one of fewer opportunities and reduced labor-market mobility rather than widespread firing, adding another reason for the Fed to leave rates unchanged in September.

July's ISM surveys showed a notable strengthening in demand and output, particularly in manufacturing, even as supply constraints, weak hiring, and elevated costs complicated the picture. The manufacturing PMI climbed from **53.3** to **55.6**, its strongest reading of the current expansion, as factories increased production sharply in response to faster orders, growing backlogs, and renewed export demand. Employment returned to expansion for the first time since February, while inventories grew more slowly as strong demand absorbed existing stocks. Some caution is warranted because lengthening supplier delivery times mechanically boosted the index and may increasingly constrain actual factory output if access to raw materials becomes more difficult. Input costs continued to rise, although price pressures were less widespread than in June. Services presented a different mix: the headline PMI barely moved, rising to **54.1**, but business activity jumped to **59.1** and new orders reached **57.2**, with exports and imports also returning to expansion. That resurgence in demand did not translate into additional hiring, as the services employment index fell sharply to **47.4** amid reports that firms are relying on AI, restrained staffing, and relocation to meet higher demand without adding workers. Services prices also accelerated, with the prices-paid index exceeding **70** for the fourth time in five months.

The July surveys therefore depict an economy in which demand remains considerably stronger than the weakening labor data alone would imply, with manufacturers expanding production and services activity accelerating, but supply bottlenecks and persistent service-sector cost pressures posing increasingly important constraints.

US households and small businesses sent increasingly divergent signals about the economic outlook in the latest surveys. Preliminary University of Michigan data showed consumer sentiment falling sharply in August to **51.0** from **55.2**, with most of the deterioration concentrated in expectations rather than assessments of current conditions. Concerns about purchasing power appear increasingly important: only eight percent of respondents expect their incomes to rise faster than inflation over the coming year, while short-term inflation expectations edged up to **4.3 percent** and longer-term expectations remained elevated at **3.3 percent**. Small businesses, by contrast, became more optimistic in July, with the NFIB index rising to 99.8 as hiring and capital-spending plans strengthened considerably. A net **20 percent** of firms planned to hire, the highest share since October 2022, and investment intentions reached their strongest level since late 2024. Actual hiring remained weak, however, with more than half of businesses seeking workers reporting difficulty finding qualified applicants, suggesting that labor-market softness may partly reflect matching problems rather than simply disappearing demand. Pricing indicators also improved as fewer firms reported raising or planning to raise prices, although actual sales remained weak. The contrast between increasingly cautious households and more expansion-minded small businesses leaves a mixed outlook for domestic demand, particularly as consumers become more concerned about real incomes while firms continue to signal an appetite for workers and investment.

Consumer spending lost some momentum in July following a strong second quarter, although the details suggest moderation rather than a broad pullback by households. Headline retail sales fell **0.6 percent**, substantially below expectations, while the control group used in calculating GDP declined **0.4 percent**, its weakest performance since January 2025. Some of the deterioration reflected temporary factors: online sales dropped **2.2 percent** following the boost from Amazon's June Prime Day, while declining gasoline and motor-vehicle sales accounted for a significant portion of the headline decrease. Spending elsewhere was considerably firmer, with seven of thirteen retail categories advancing and clothing, health and personal care, general merchandise, furniture, and building materials all recording gains. Restaurant and bar sales increased another **0.5 percent**, potentially benefiting from the final weeks of the World Cup, while light-vehicle sales remained above both their second-quarter and 2025 averages despite easing slightly to a 16.33 million annualized rate. The combination suggests that consumers remain willing to spend on discretionary services and large purchases, but the unusually strong pace of consumption earlier in the year is beginning to normalize as temporary supports fade and labor-market conditions soften.

Industrial production data also reinforced the increasingly uneven character of US growth, with investment-related manufacturing strengthening even as consumer-facing output weakened. Industrial production and manufacturing output each rose **0.2 percent** in July, while upward revisions to June left the recent trajectory of factory activity somewhat stronger than previously reported. The composition was notably divided: consumer-goods production fell **0.4 percent** and consumer durables declined **1.4 percent**, consistent with softer retail and employment data, while business-equipment production increased **0.8 percent** alongside further gains in computers, electronics, machinery, and electrical equipment. Eleven of eighteen major manufacturing industries expanded during the month, suggesting that strength was not confined to a single category, although capacity utilization remained well below its historical average. Continued spending on technology, artificial intelligence infrastructure, and other capital equipment is therefore providing an important counterweight to weakening household-related production, but the concentration of strength in investment-oriented industries still falls short of a broad industrial acceleration.

Second-quarter GDP presented a considerably stronger picture of the US economy than the headline growth rate initially suggests. Real GDP expanded at a **1.5 percent** annualized rate, down from **2.1 percent** in the first quarter, but the slowdown largely reflected drags from inventories and net exports rather than deterioration in domestic demand. Real final sales to private domestic purchasers accelerated sharply to **3.9 percent**, as consumer spending rebounded to **3.2 percent** and durable-goods purchases rose **6.8 percent**. Business investment also remained robust, with equipment spending increasing more than **15 percent** and gains extending across industrial, transportation, and information-processing equipment rather than being confined to artificial intelligence. Software and R&D investment provided additional support, although spending on structures continued to decline. The principal concern was inflation: the GDP deflator accelerated to **6.2 percent**, underscoring the persistence of price pressures despite slower headline output growth. Overall, the report depicts an economy with substantially greater underlying momentum than the **1.5 percent** GDP figure implies, but with enough inflationary pressure to reinforce the case for the Federal Reserve to remain cautious rather than respond to the headline slowdown with easier policy.

Monetary and fiscal policy are increasingly intersecting as persistent inflation constrains the Federal Reserve while heavy federal borrowing puts pressure on longer-term interest rates. Minutes from the July FOMC meeting showed that most officials favored holding rates steady, although several supported a 25-basis-point increase and many remained concerned that prolonged above-target inflation could become embedded in expectations and price-setting behavior. At the same time, policymakers and Fed staff identified growing downside risks associated with AI financing, asset valuations, and weaker economic data, reinforcing the case for leaving rates unchanged in September.

Fiscal conditions present a different challenge. With the 2026 deficit now on track to approach $2.1 trillion amid higher interest costs, tariff refunds, and war-related spending, Treasury faces unusually heavy financing requirements and increasing sensitivity at the long end of the yield curve. Secretary Scott Bessent's decision to at least double long-dated Treasury buybacks briefly reduced 10- and 30-year term premiums by roughly six and ten basis points, respectively, an unusually large response given the modest scale of the intervention, but much of the decline quickly reversed. The episode illustrates the limits of debt-management policy: altering the maturity composition of outstanding debt can temporarily reduce the duration absorbed by private investors, but cannot eliminate the underlying supply created by persistent deficits. With the Fed reluctant to ease while inflation remains elevated and Treasury increasingly focused on containing long-term borrowing costs, the interaction between monetary policy, debt management, and fiscal policy is becoming more consequential, particularly if continued upward pressure on yields eventually generates demands for greater coordination between the Fed and Treasury.

As this report goes to publication, several consequential but highly fluid developments in US trade policy are unfolding, with potentially significant implications for supply chains, inflation, and relations with major trading partners.

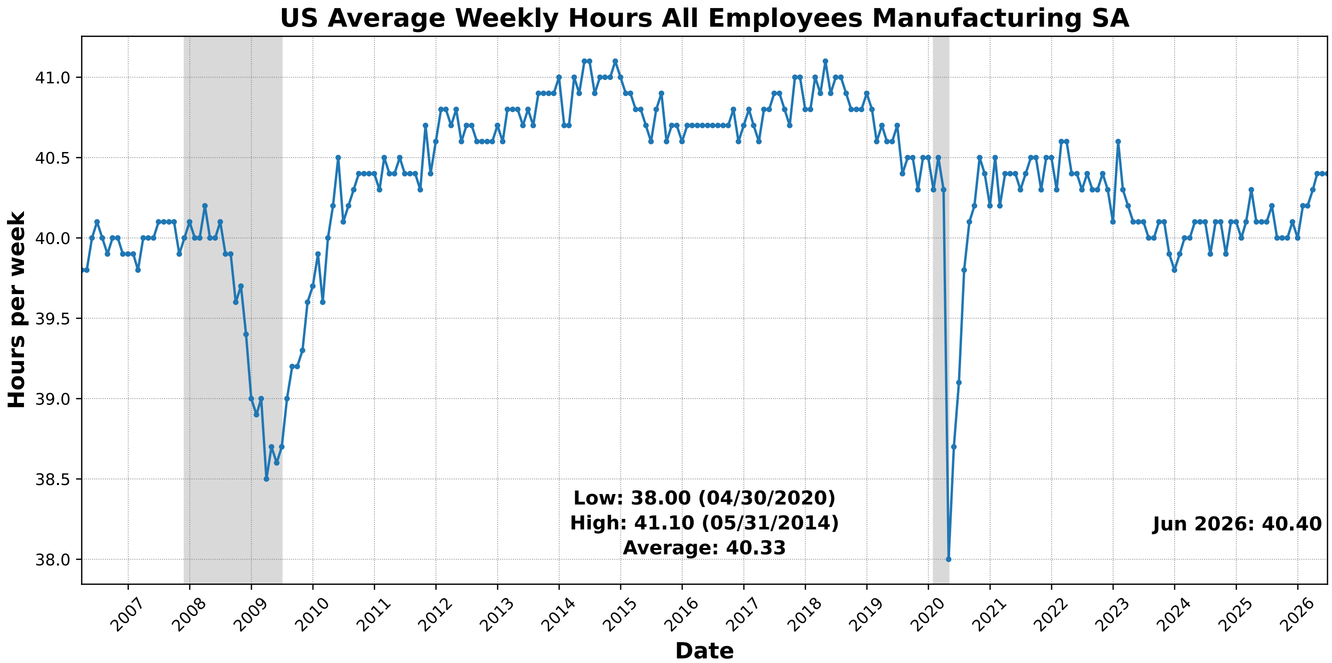
The administration's promised "economic D-Day" against Iran has so far produced sanctions on more than 70 Iran-related entities and threats of secondary penalties against countries maintaining economic or financial ties with Tehran, but the more consequential question is whether enforcement will ultimately fall most heavily on China, which purchases roughly **80 percent** of Iranian oil; 26 of the initial sanctions targets are based in mainland China or Hong Kong, and broader action against major Chinese banks, refiners, or energy companies could quickly jeopardize the fragile US-China trade truce.

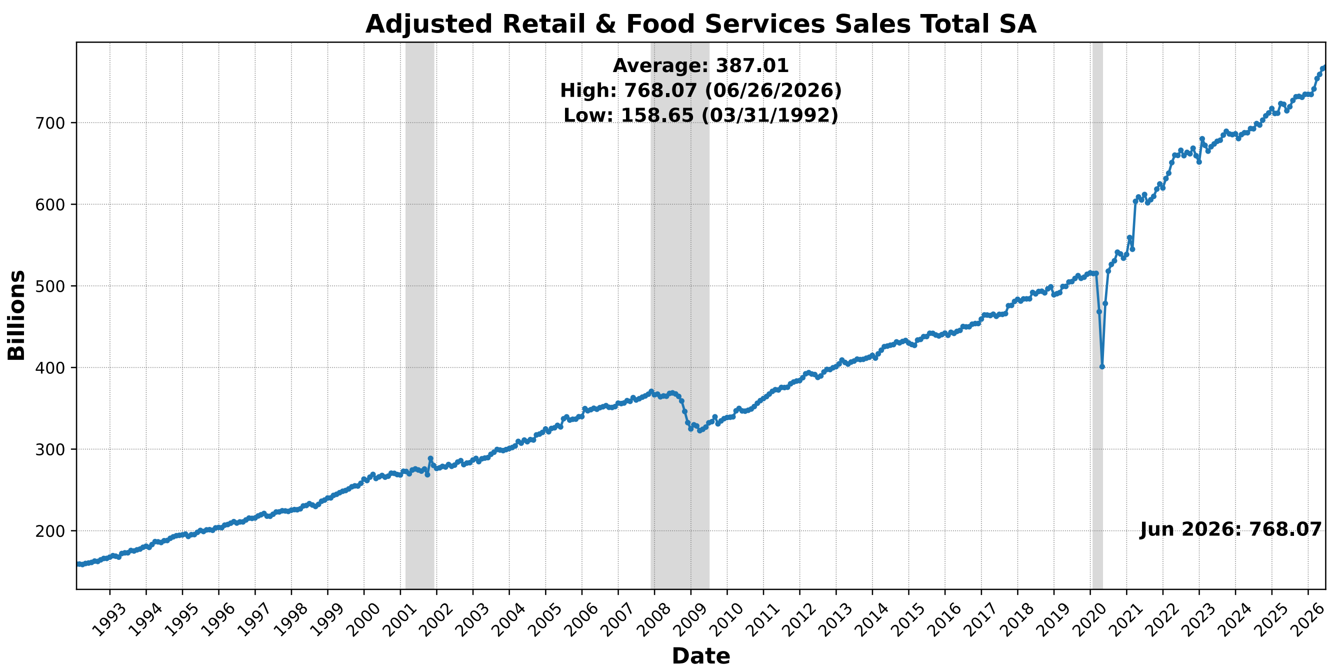
Simultaneously, trade relations with Canada have deteriorated sharply following the collapse of bilateral negotiations, with **50 percent** US tariffs taking effect on roughly $20 billion of Canadian exports and President Trump threatening to raise tariffs on Canadian automobiles and parts to **50 percent** beginning January 1, 2027. Ottawa is preparing retaliatory tariffs and domestic assistance for affected workers and businesses, while both governments continue to leave open the possibility of renewed negotiations. Taken together, the two disputes introduce substantial uncertainty into the outlook: measures nominally directed at Iran could reopen a broader confrontation with China, while escalating US-Canada tariffs threaten deeply integrated North American automotive, steel, and manufacturing supply chains, potentially creating renewed upward pressure on costs even as recent domestic inflation data have been improving.

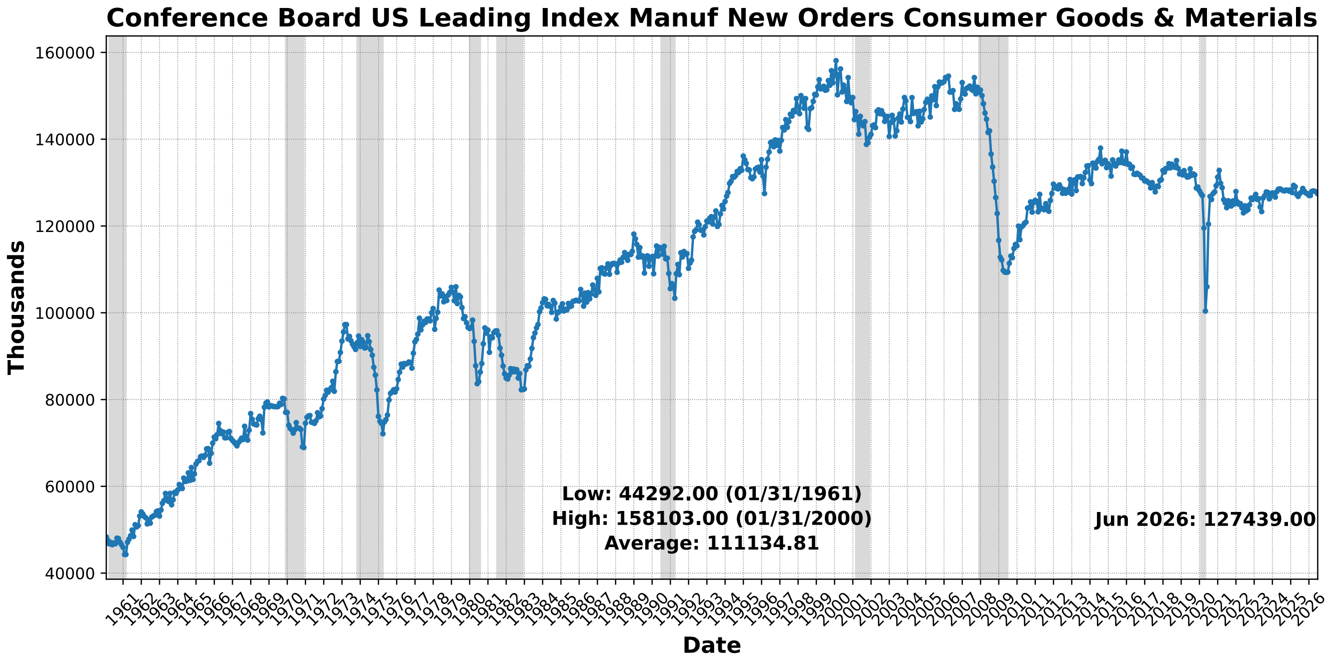
The economic signals entering late summer are unusually difficult to reduce to a single characterization. Second-quarter domestic demand was substantially stronger than the **1.5 percent** headline GDP growth rate implies, and July data show continued strength in capital investment, manufacturing orders, business equipment, and services activity. Yet that strength is increasingly disconnected from conditions facing households. Payrolls contracted in July, previous employment estimates were revised sharply lower, labor-force participation declined, retail spending weakened, consumer confidence fell, and income growth has failed to keep pace with consumption. Businesses, meanwhile, continue to report ambitious hiring and investment plans despite difficulty translating those intentions into actual employment. Inflation provides some relief: core CPI has returned to a five-year low, producer prices were softer than expected, and recent PCE readings have moderated. But services costs and inflation expectations remain sufficiently elevated that renewed tightening cannot be dismissed entirely. For now, weaker employment alongside improving inflation makes unchanged rates the most defensible course for the Fed.

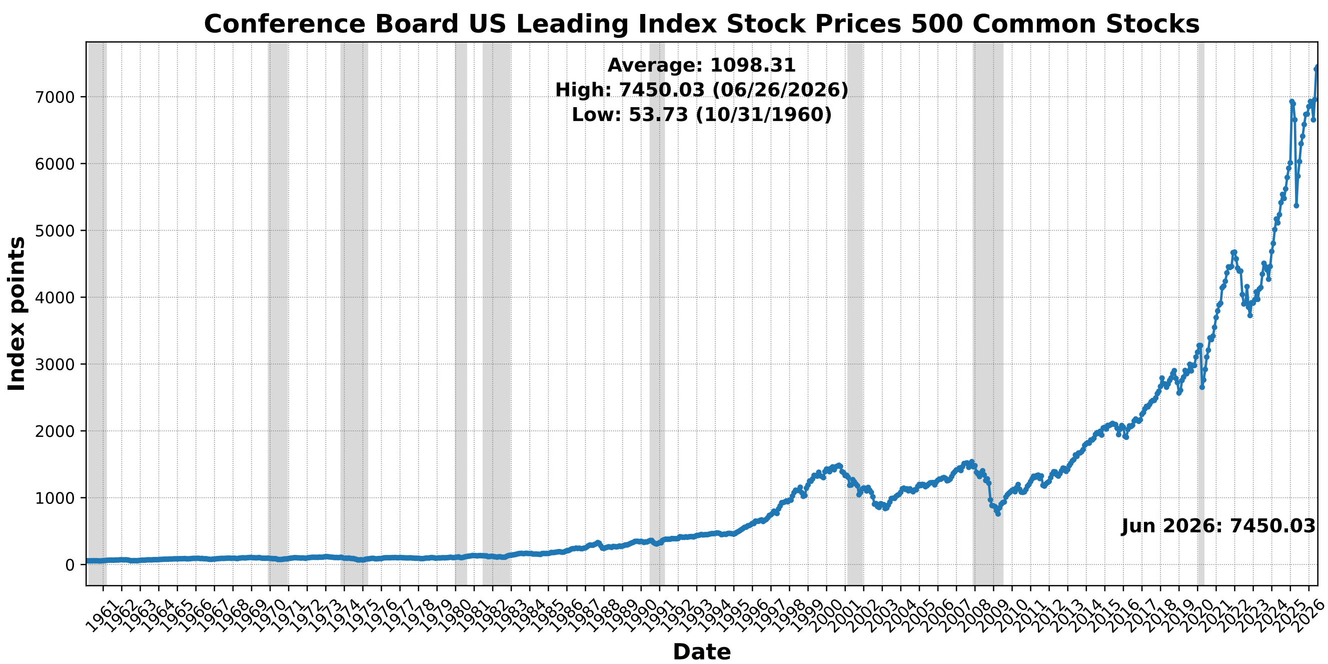
An increasingly important source of uncertainty lies outside the conventional business cycle. Federal borrowing requirements continue to expand, long-term Treasury yields remain sensitive to enormous prospective debt supply, and Treasury's decision to enlarge long-duration buybacks produced an initially powerful but largely temporary reduction in term premiums. At the same time, Washington is escalating economic pressure abroad on two fronts. Sanctions intended to economically isolate Iran increasingly implicate Chinese refiners, financial institutions, and other entities, creating a potential collision with the tentative US-China trade *détente*, while the rapidly deteriorating dispute with Canada threatens tariffs and retaliation across automobiles, steel, agriculture, and other deeply integrated North American industries. Thus the central risk over the coming months may be less that private economic activity is spontaneously rolling over than that an already less-balanced expansion encounters additional shocks generated by fiscal stress, trade restrictions, geopolitical conflict, or some combination of the three.

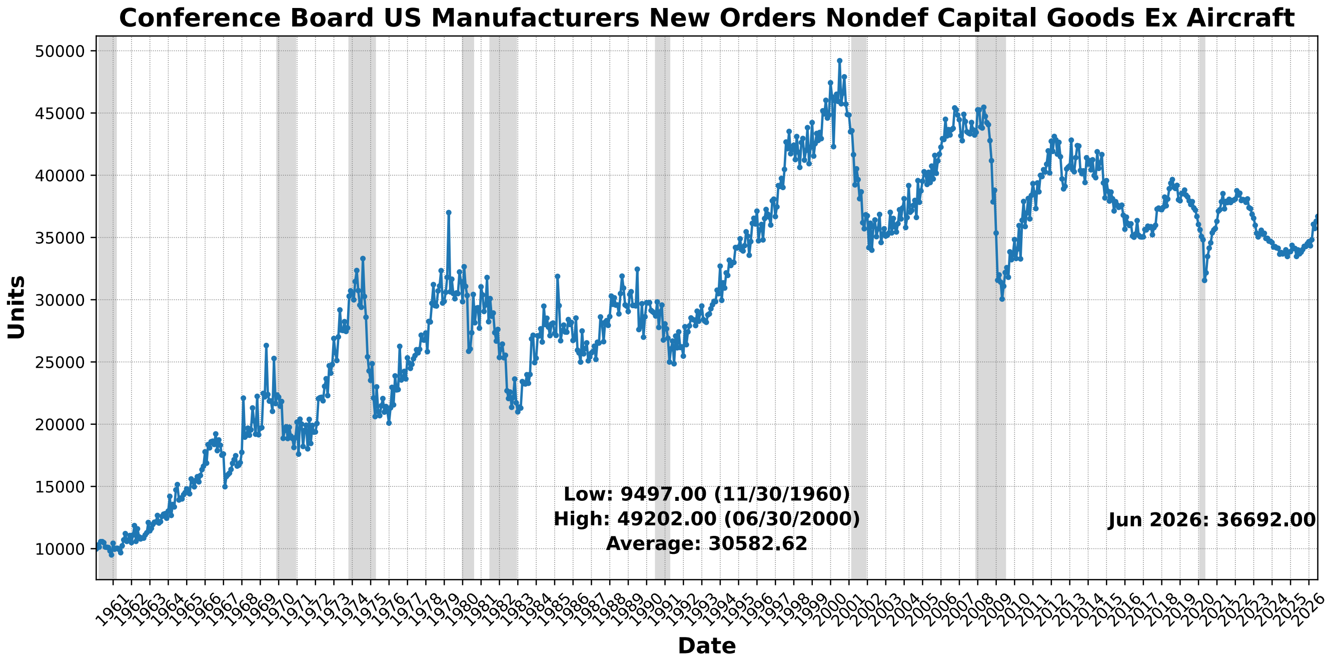
LEADING INDICATORS

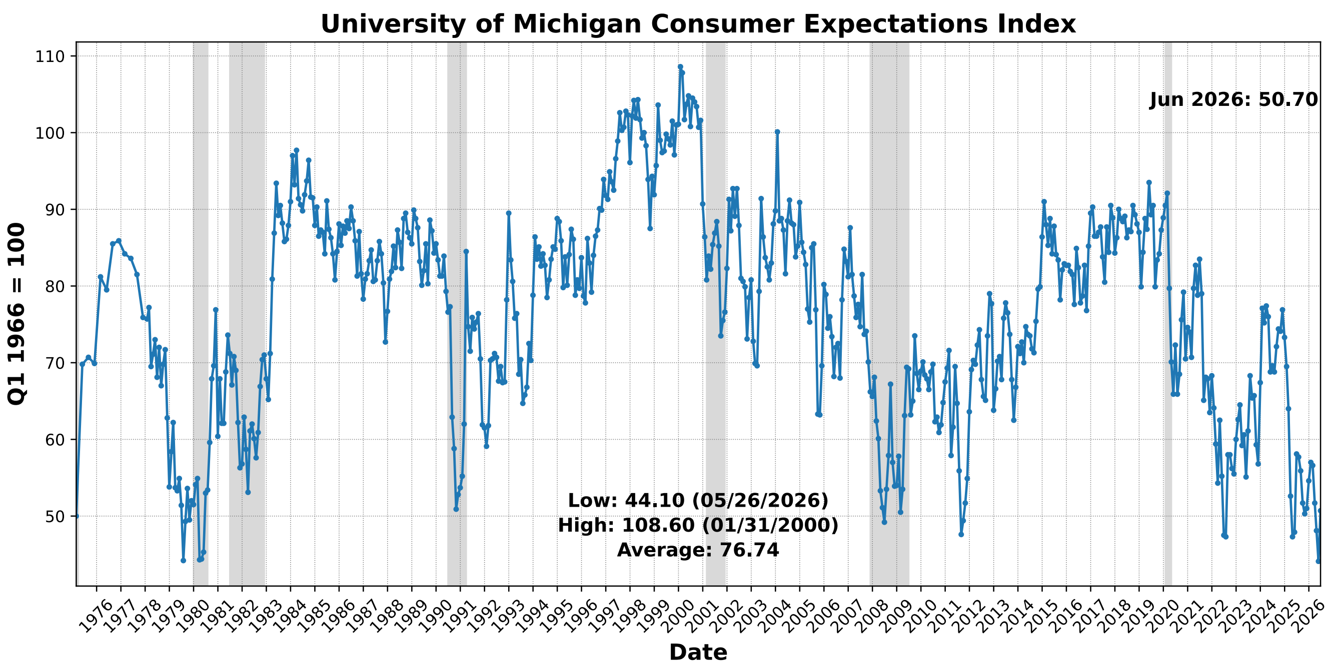


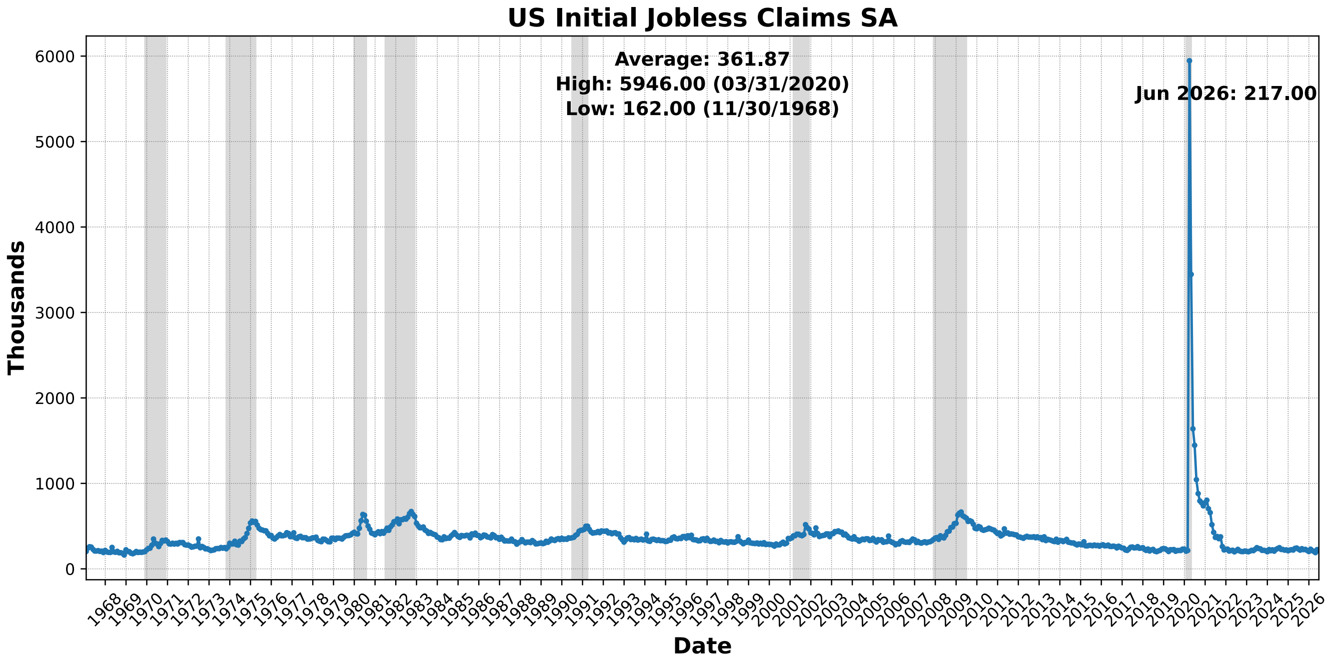


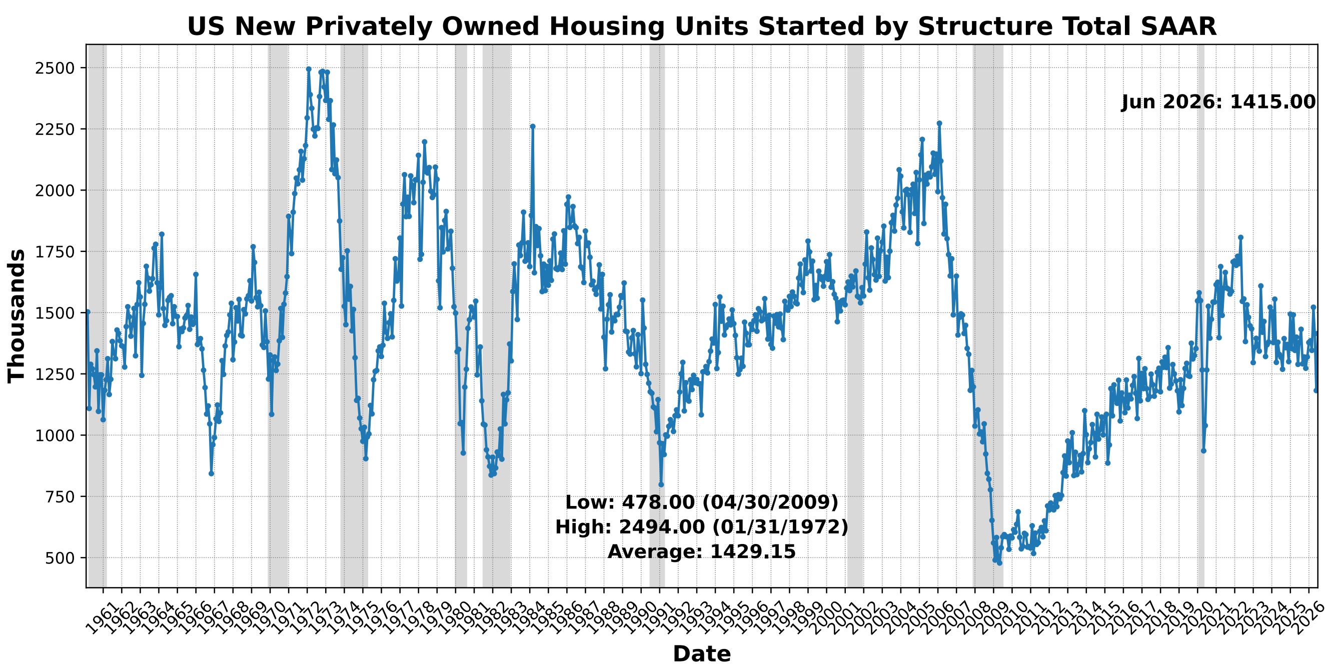

Conference Board US Leading Index Manuf New Orders Consumer Goods & Materials
Thousands
Low: 44292.00 (01/31/1961)
High: 158103.00 (01/31/2000)
Average: 111134.81
Jun 2026: 127439.00
Date

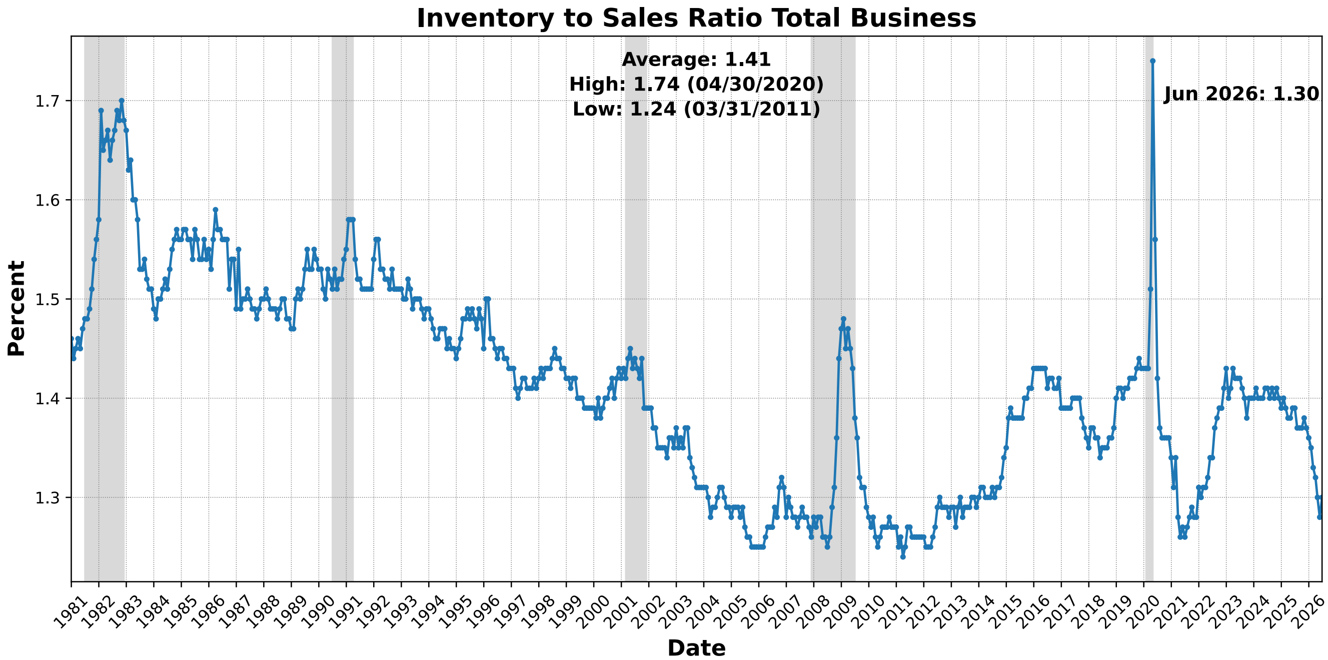

Conference Board US Leading Index Stock Prices 500 Common Stocks
Index points
Average: 1098.31
High: 7450.03 (06/26/2026)
Low: 53.73 (10/31/1960)
Jun 2026: 7450.03
Date

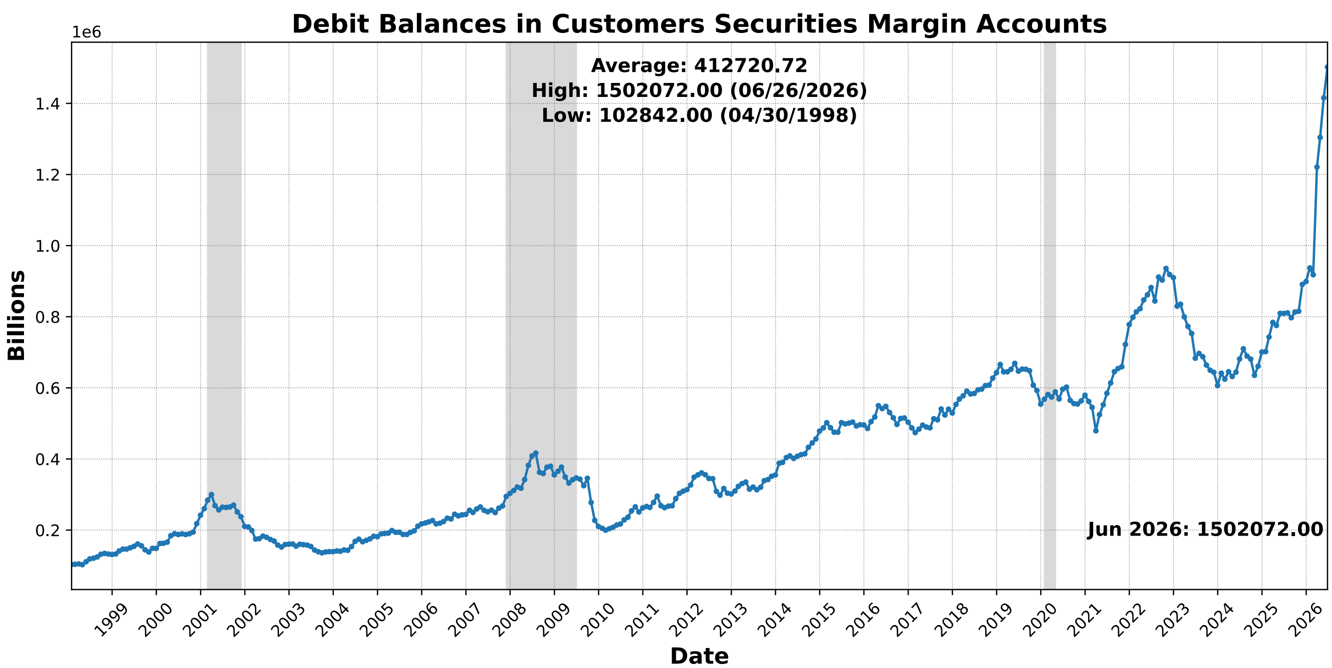

Conference Board US Manufacturers New Orders Nondef Capital Goods Ex Aircraft
Units
Date
Low: 9497.00 (11/30/1960)
High: 49202.00 (06/30/2000)
Average: 30582.62
Jun 2026: 36692.00

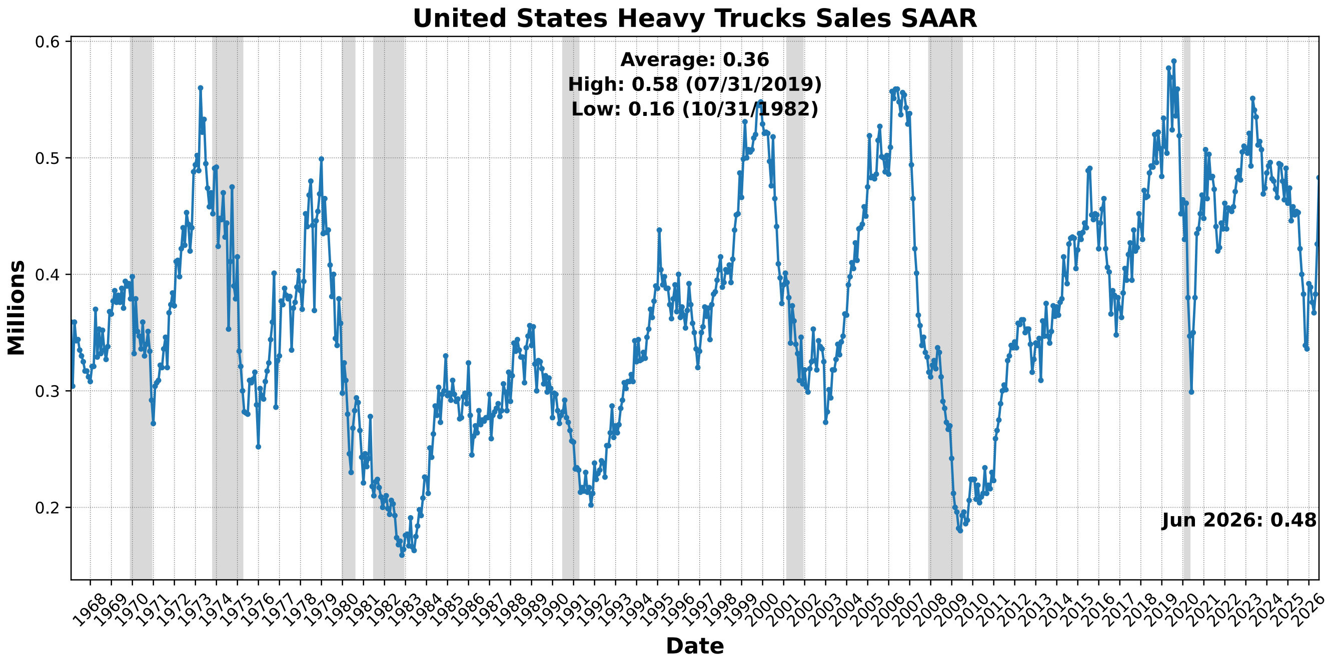

University of Michigan Consumer Expectations Index
Q1 1966 = 100
Date
Jun 2026: 50.70
Low: 44.10 (05/26/2026)
High: 108.60 (01/31/2000)
Average: 76.74

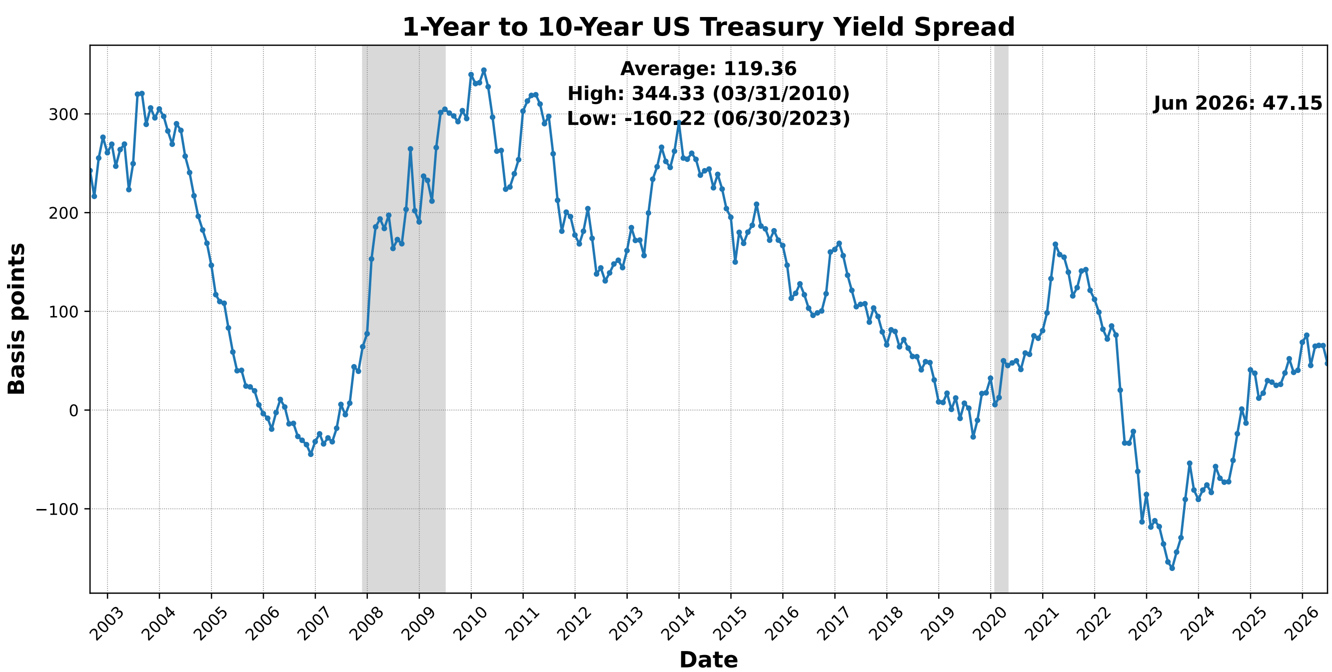

US Initial Jobless Claims SA
Average: 361.87
High: 5946.00 (03/31/2020)
Low: 162.00 (11/30/1968)
Jun 2026: 217.00
Thousands
Date


US New Privately Owned Housing Units Started by Structure Total SAAR
Jun 2026: 1415.00
Low: 478.00 (04/30/2009)
High: 2494.00 (01/31/1972)
Average: 1429.15
Thousands
Date

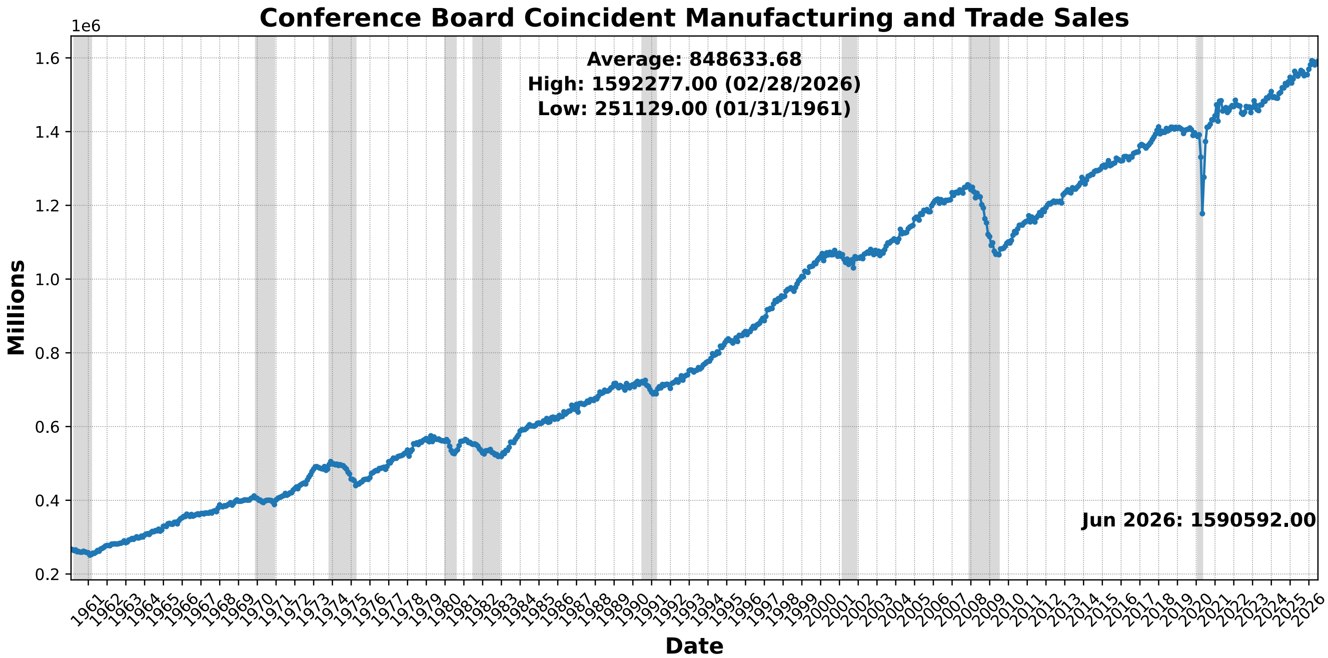

Inventory to Sales Ratio Total Business
Average: 1.41
High: 1.74 (04/30/2020)
Low: 1.24 (03/31/2011)
Jun 2026: 1.30
Percent
Date

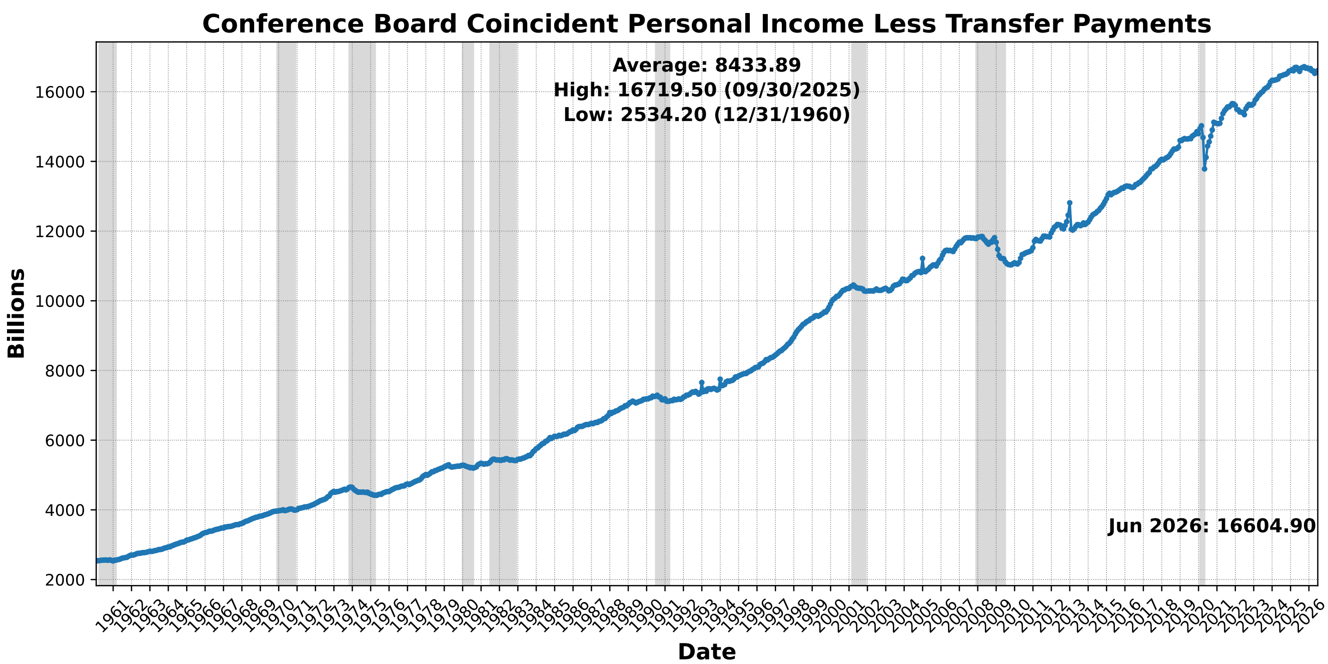

Debit Balances in Customers Securities Margin Accounts
Average: 412720.72
High: 1502072.00 (06/26/2026)
Low: 102842.00 (04/30/1998)
Jun 2026: 1502072.00
1e6
Billions
Date

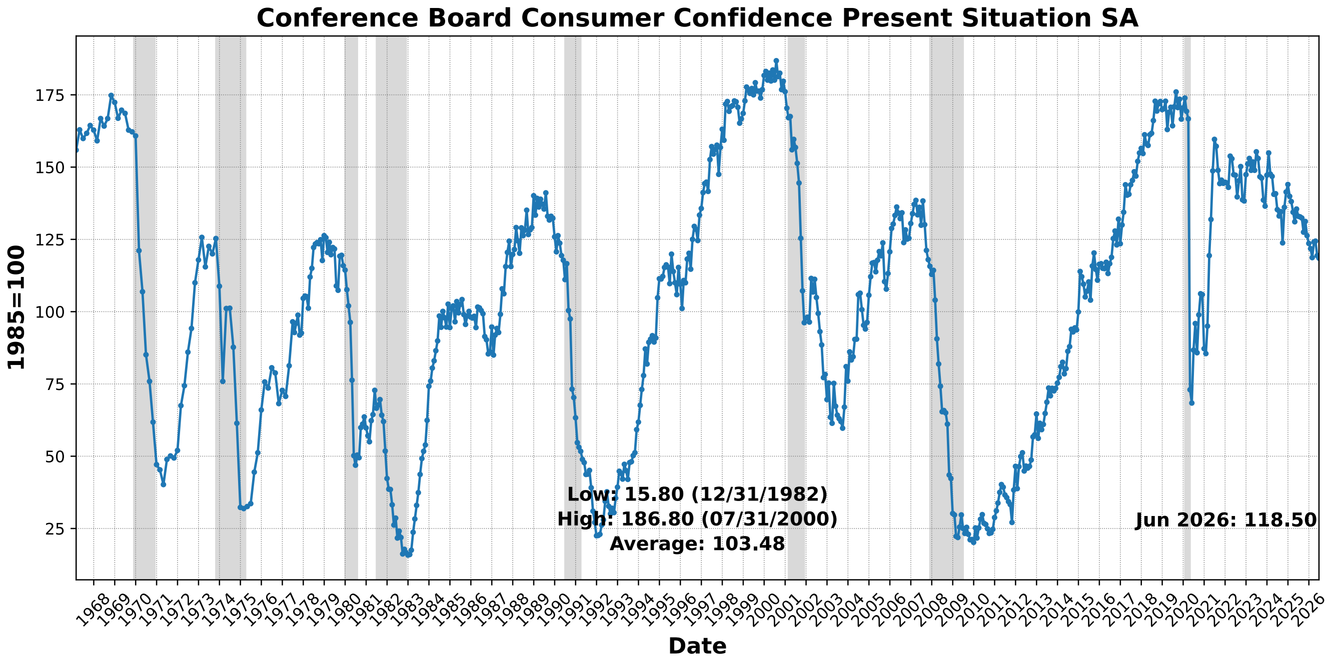

United States Heavy Trucks Sales SAAR
Average: 0.36
High: 0.58 (07/31/2019)
Low: 0.16 (10/31/1982)
Jun 2026: 0.48
Millions
Date


1-Year to 10-Year US Treasury Yield Spread
Average: 119.36
High: 344.33 (03/31/2010)
Low: -160.22 (06/30/2023)
Jun 2026: 47.15
Basis points
Date

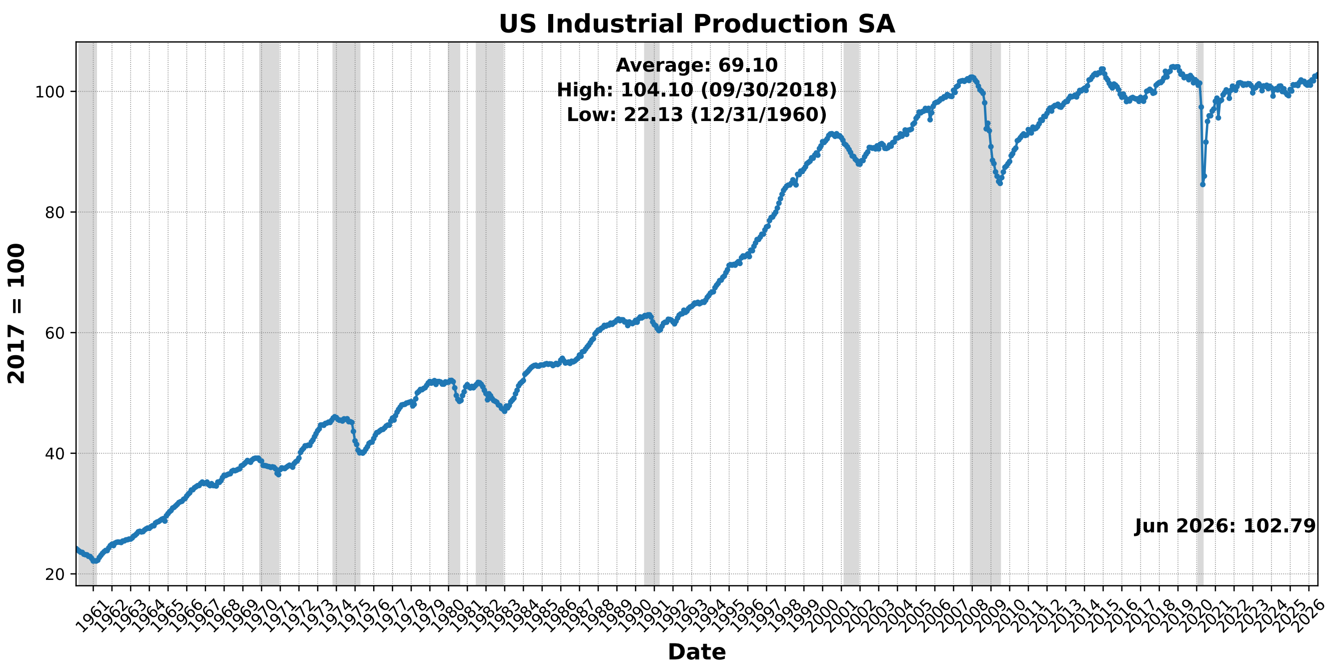
ROUGHLY COINCIDENT INDICATORS



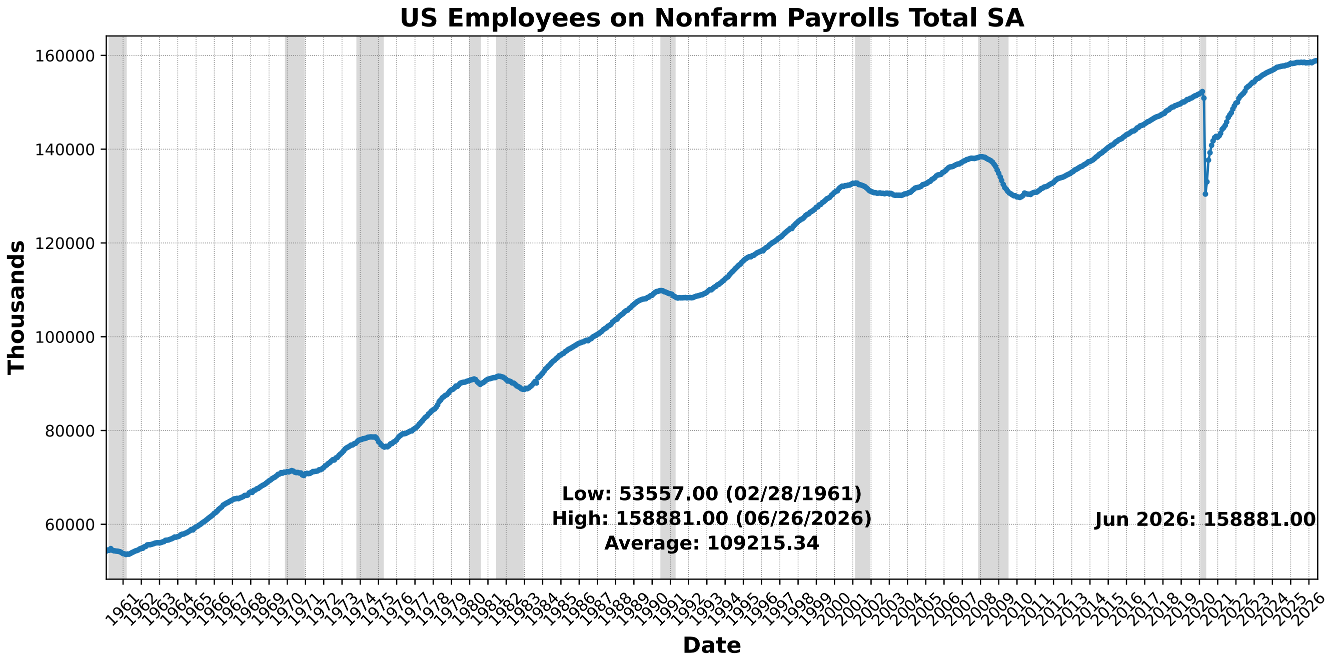


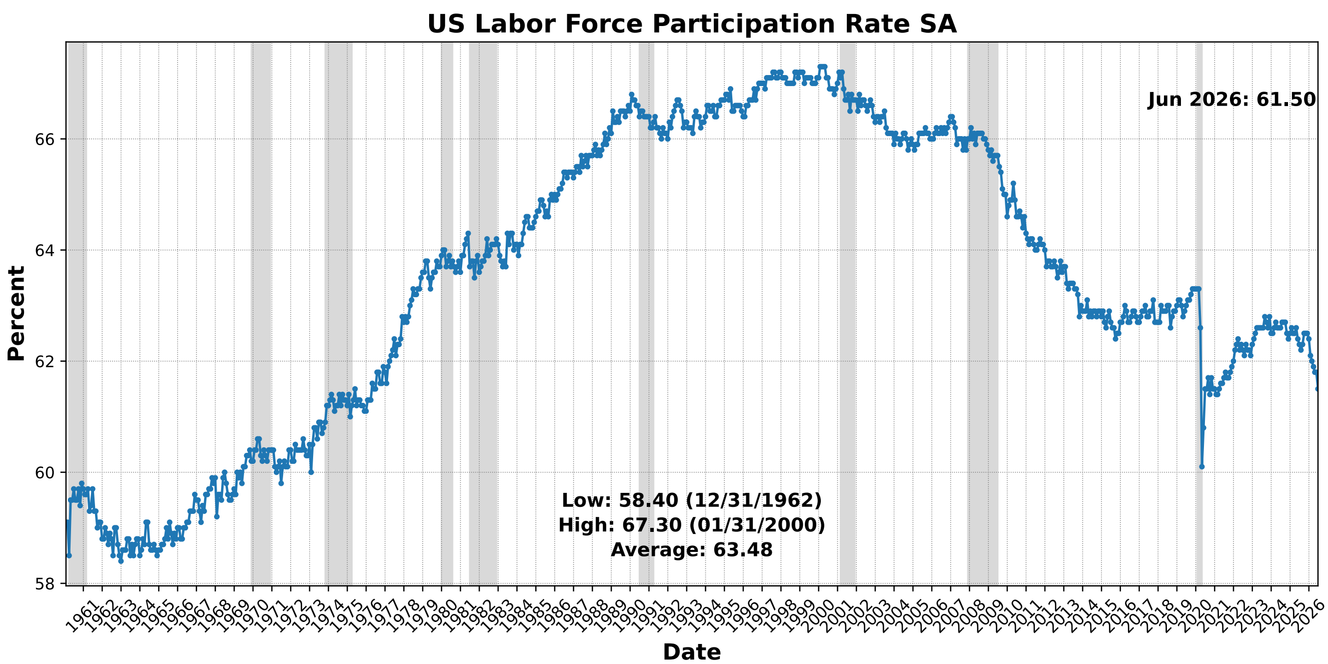


Conference Board Consumer Confidence Present Situation SA
1985=100
Low: 15.80 (12/31/1982)
High: 186.80 (07/31/2000)
Average: 103.48
Jun 2026: 118.50
Date

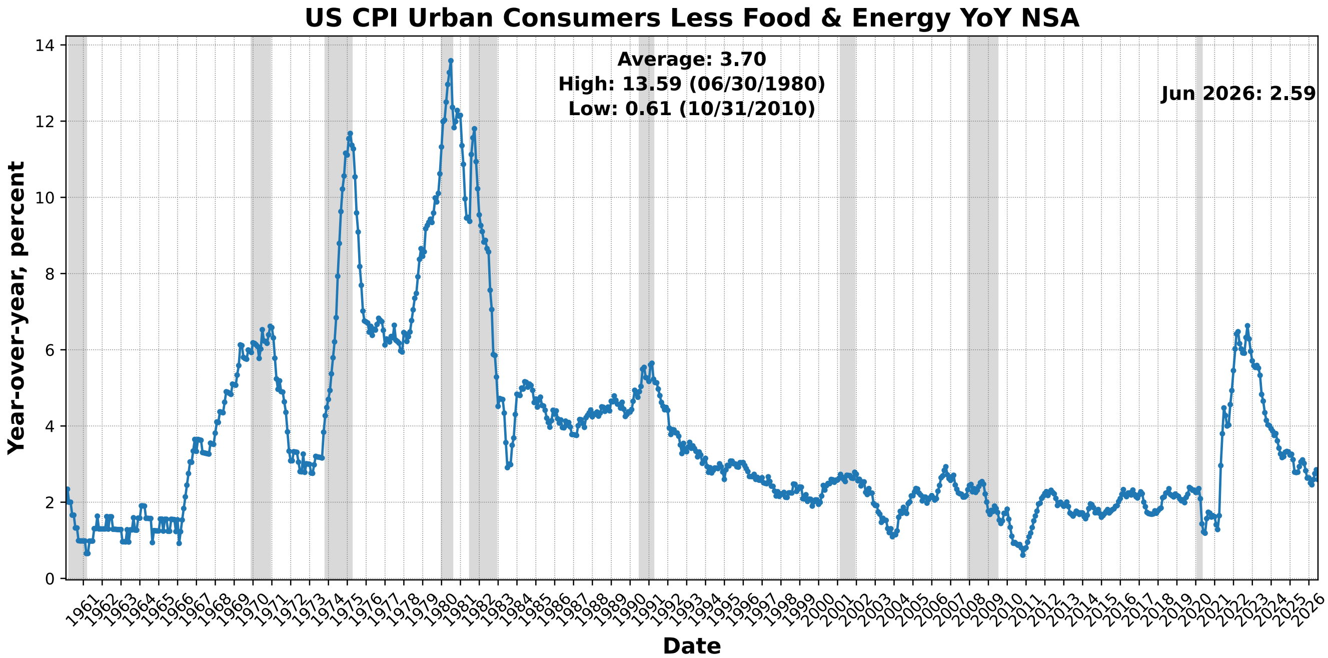


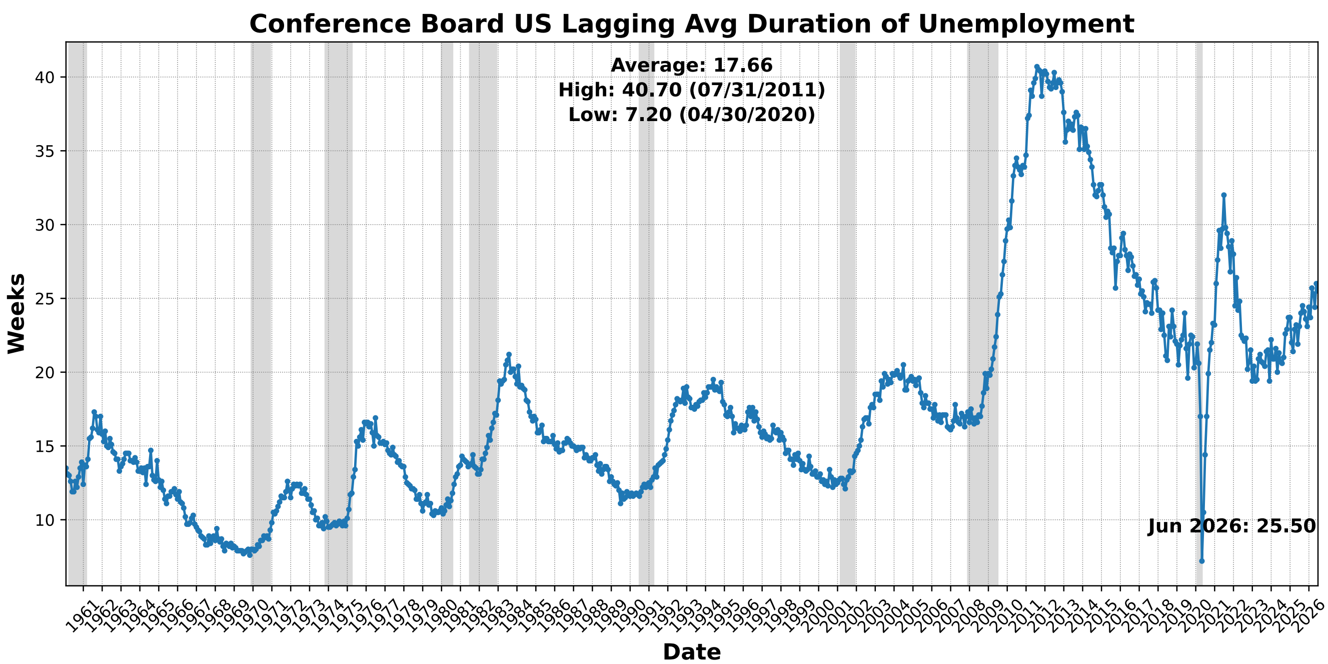
US Industrial Production SA
2017 = 100
Average: 69.10
High: 104.10 (09/30/2018)
Low: 22.13 (12/31/1960)
Jun 2026: 102.79
Date

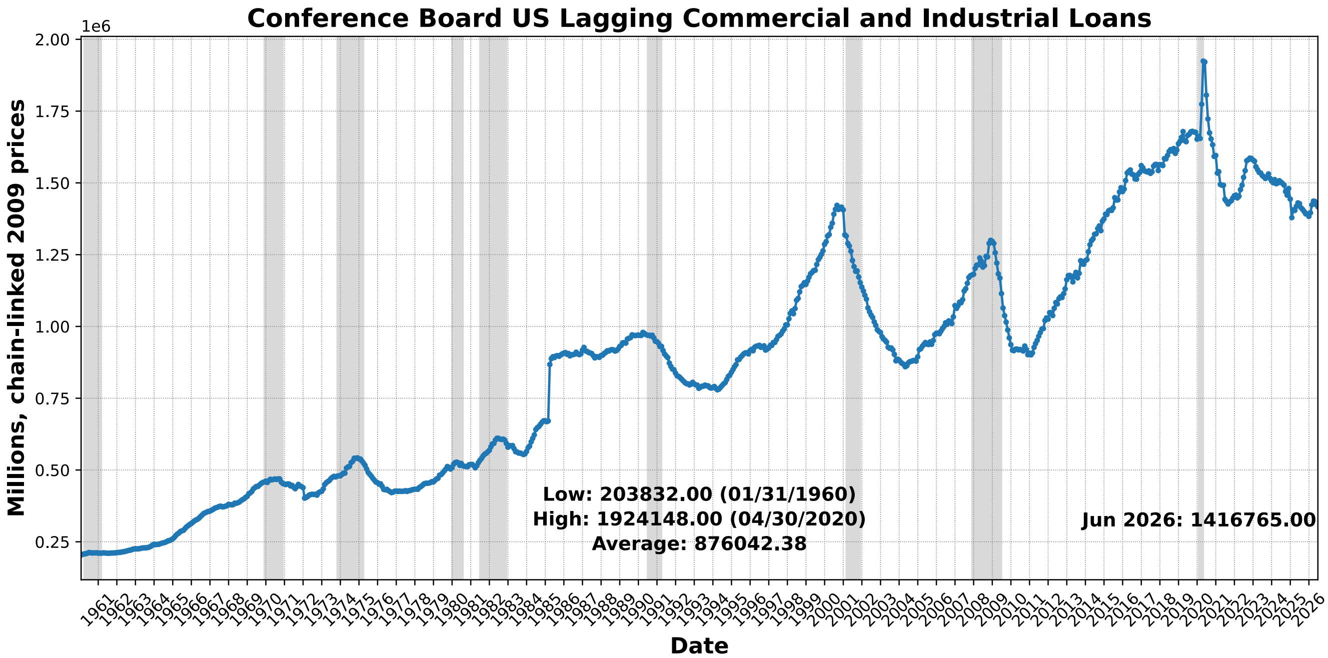

US Employees on Nonfarm Payrolls Total SA
Thousands
Date
Low: 53557.00 (02/28/1961)
High: 158881.00 (06/26/2026)
Average: 109215.34
Jun 2026: 158881.00

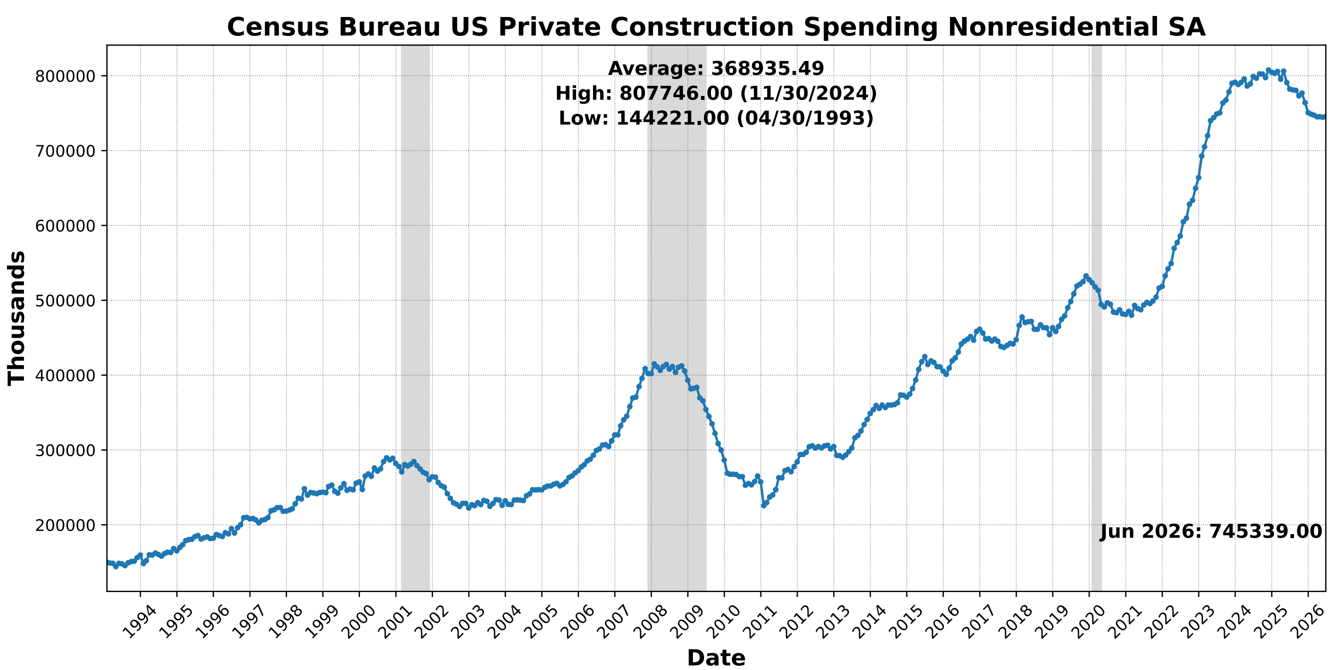

US Labor Force Participation Rate SA
Percent
Date
Jun 2026: 61.50
Low: 58.40 (12/31/1962)
High: 67.30 (01/31/2000)
Average: 63.48

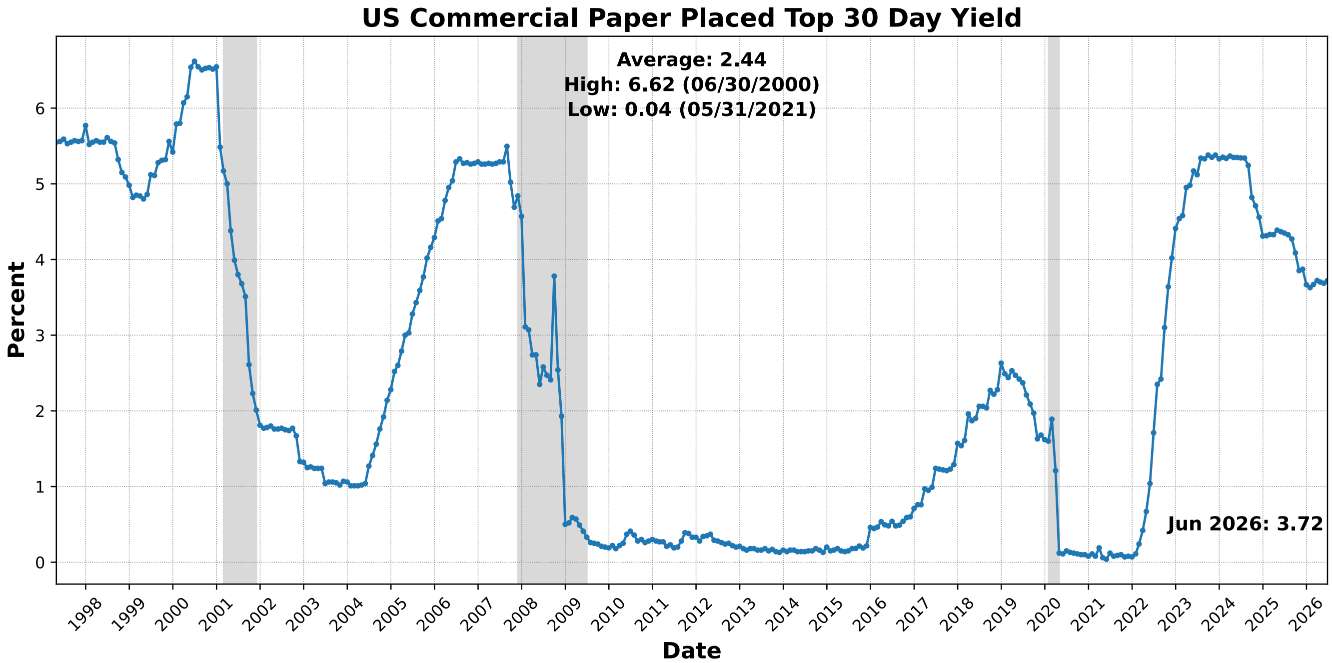
LAGGING INDICATORS

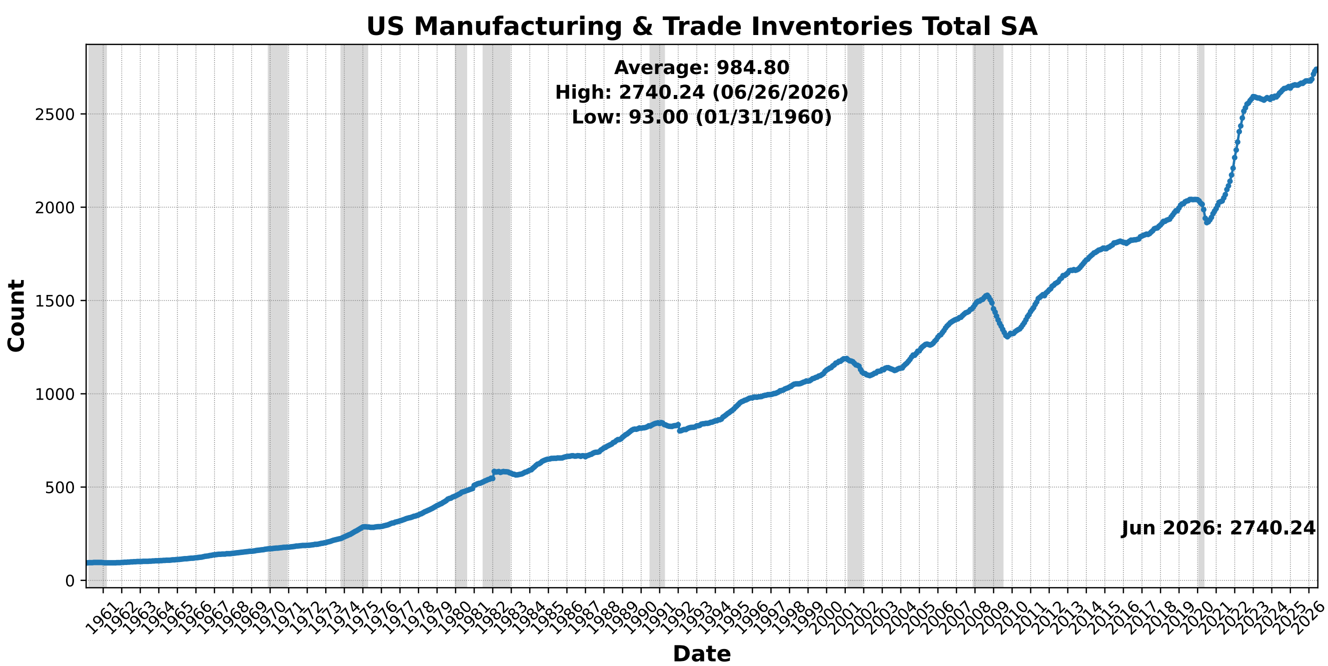





Conference Board US Lagging Commercial and Industrial Loans
1e6
Millions, chain-linked 2009 prices
Low: 203832.00 (01/31/1960)
High: 1924148.00 (04/30/2020)
Average: 876042.38
Jun 2026: 1416765.00
Date


Census Bureau US Private Construction Spending Nonresidential SA
Average: 368935.49
High: 807746.00 (11/30/2024)
Low: 144221.00 (04/30/1993)
Thousands
Jun 2026: 745339.00
Date


US Commercial Paper Placed Top 30 Day Yield
Average: 2.44
High: 6.62 (06/30/2000)
Low: 0.04 (05/31/2021)
Jun 2026: 3.72
Percent
Date


US Manufacturing & Trade Inventories Total SA
Average: 984.80
High: 2740.24 (06/26/2026)
Low: 93.00 (01/31/1960)
Jun 2026: 2740.24
Count
Date

Capital Market Performance

Ticker		Short Name	%1M	%3M	%1YR	3 Year Annualized Total	5 Year Annualized Total	10 Year Annualized Total
SPR	d	S&P 1500 Composite Index	+3.05%	+2.56%	+18.39%	21.4557	12.7816	14.6872
SPXT	d	S&P 500 Total Return	+3.35%	+2.68%	+19.74%	21.9594	13.1529	15.0635
SPX	d	S&P 500 INDEX	+3.25%	+2.40%	+18.34%	21.9335	13.1306	15.0467
MID	d	S&P 400 MIDCAP INDEX	+.46%	+3.48%	+16.75%	15.7459	9.0563	10.8730
RTY	d	RUSSELL 2000 INDEX	+2.22%	+4.39%	+26.81%	19.2053	8.3063	10.6127
SXXP	d	STXE 600 (EUR) Pr	+1.51%	+3.57%	+17.07%	17.2001	10.5270	10.1969
TLT US	d	ISHARES 20+YR TR	-.83%	-2.50%	-5.16%	.1993	-8.2929	-2.5863
QLTA US	d	ISHARES AAA - A	-.05%	-1.66%	-3.23%	4.9042	-.5761	1.6237
CRY	d	TR/CC CRB ER Index	+1.82%	+2.60%	+34.30%	13.9113	14.4236	7.8326
XAU		Gold Spot $/Oz	+15.19%	+2.73%	+39.50%			
XAG		Silver Spot $/Oz	+19.25%	-10.86%	+80.44%			
ILM3NAVG		Bankrate 30Y Mortgage Rates Na	+.90%	+2.91%	+1.05%			
ILM1NAVG		Bankrate 15Y Mortgage Rates Na	+.83%	+3.21%	+3.91%			
MB301ARM		5 Year ARM	+3.30%	+4.21%	-1.16%			
ILA3NAVG		Bankrate 30Y Fixe Mtg Refis Na	+.14%	+.29%	-2.92%			

(Source: Bloomberg Finance, LP. Data subject to shutdown limitations.)

September 2026

The Nixon Shock 55 Years Later: Three Impossible Promises

Jeffery L. Degner
Research Fellow

Economist Thomas Sowell once quipped, “The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.” And, on Sunday evening, August 15, 1971, President Richard Nixon and his Camp David advisors curated a museum-grade artifact of the second lesson for all the world to see and suffer its consequences.

While economic in nature, the speech was titled, “The Challenge of Peace” in reference to the US troop drawdowns in Vietnam. Its central focus was to explain Nixon’s “New Economic Policy.” In the aftermath of the speech and the policy choices that followed, the plans were more aptly named, “The Nixon Shock.” In the weeks following the speech, the administration unleashed a tidal wave of new government intervention into the economy. These measures have become a masterclass in the consequences of governing officials ignoring the lessons of economics, throwing off the restraints of market discipline, and crafting political promises that defy the laws of economics.

THE CONTEXT

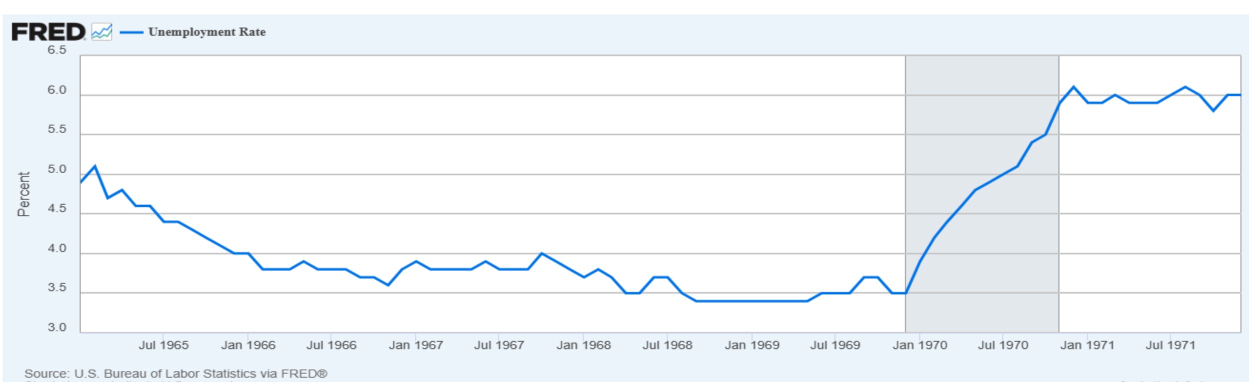
A title like, “The Challenge of Peace” implies that economies fare better in the fog of war. This sentiment has been called, “Military Keynesianism” and refers to the idea that with elevated spending on armaments comes increased employment along with rising laborer income, followed by a surge in consumer spending. The outcome is a buoyed economy.

The administration had imbibed this view of war spending as Nixon implied the end of the conflict would give way to the so-called “Challenge of Peace.” He clearly articulated this Keynesian doctrine declaring, “America today has the best opportunity in this century to achieve two of its greatest ideals: to bring about a full generation of peace, and to create a new prosperity without war.” This raises an obvious question: Why is war associated with prosperity? Further, one may ask: How did peace come to be viewed as a threat to wealth?

The answers lie with Keynes himself who noted that the path to improving economic conditions didn’t require a novel approach, but could be learned from the lessons of old. In his 1936 *General Theory of Employment, Interest, and Money* he pointed his readers to the virtues of public expenditure, recounting that “Pyramid-building, earthquakes, even wars may serve to increase wealth, if the education of our statesmen in the principles of the classical economics stands in the way of anything better.” Some of his disciples protest the use of this quote, downplaying the big-spending implications of Keynes’s statement. But, the point here isn’t ever-growing government expenditure. Rather, it’s the inordinate emphasis on aggregate demand and consumption as the driver of healthy, growing economies, eschewing the positive role that thrift, saving, investment, and capital accumulation play that is at the core of this sentiment. For Keynes and for Nixon, the point is that government expenditure, intervention, and policymaking are required to truly ensure a growing economy.

THREE PROMISES

Nixon’s address quickly moved to describe his aims. “We must create more and better jobs; we must stop the rise in the cost of living; we must protect the dollar from the attacks of international money speculators.” In one sense, the assertion that these three goals can be met through political means is nothing unusual. They sound like the campaign promises of every person either running for or already in office. What is noteworthy is that the context presumes that these will be more difficult in a peacetime economy and that more, not less, government interference is the pathway to achieving these goals after the cannons have gone silent. Nevertheless, Nixon’s administration would give it their all. Of course, the “we” he referenced wasn’t the American public, but rather his own administration, attempting to engineer their desired outcomes through the levers of government power.



Each of Nixon's promises was tied to a policy lever. Jobs would be improved via fiscal measures, regulatory moves would apply to prices in the market, and monetary policy would be used to rescue the dollar. What Nixon didn't say, and perhaps didn't grasp, is that these interventions work against one another. Fiscal spending on favored projects drives up prices and wages in those markets, inviting calls for price controls. Those controls, in turn, were thrown into further disarray when the US dollar was unmoored from gold.

It's a classic case of one intervention breeding the conditions and calls for another.

THREE POLICY INTERVENTIONS

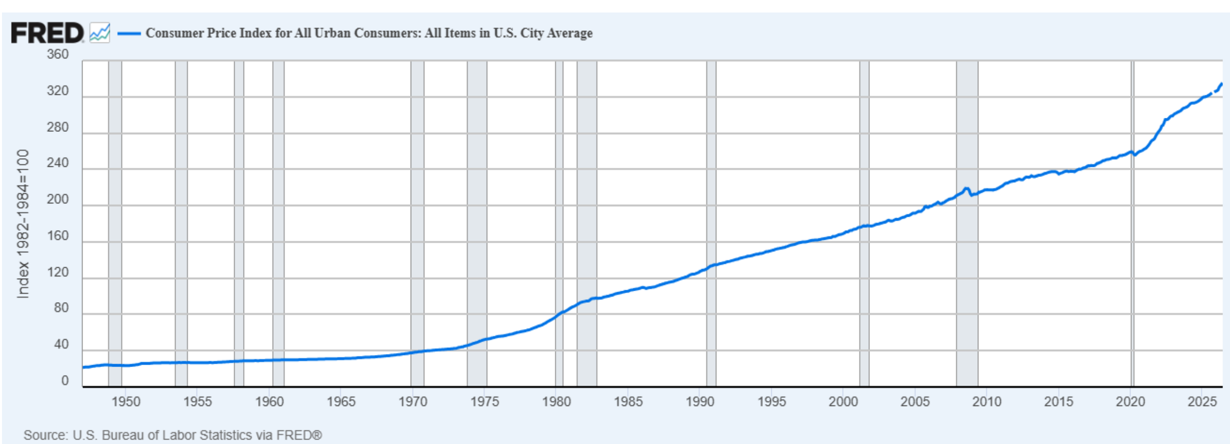
The August 15 speech provided an overview of several policy interventions and the days ahead would reveal even more. To better understand the nature of the interference, it's useful to categorize the measures into fiscal, regulatory, and especially monetary policy.

Nixon would first issue fiscal policy decrees in the broadcast. Chief among them was "a 10-percent Job Development Credit for one year, effective as of today, with a five-percent credit after August 15, 1972." Further, he proposed a repeal of the seven-percent excise tax on automobiles. Nixon's stated goal mattered more than the mechanics: higher aggregate consumption. This is a rationale right out of Keynes's framework, which he reiterated: "This increase in consumer spending power will provide a strong boost to the economy in general and to employment in particular." To what extent the Camp David meeting discussed the ways in which this additional spending would drive prices higher isn't completely clear. If they did, the regulatory channel was the blunt instrument they planned to use. And use it, they did.

With the regulatory interventions of wage and price controls, Nixon proclaimed the content of Executive Order 11615: "I am today ordering a freeze on all prices and wages throughout the United States for a period of 90 days." In the Camp David meeting that preceded the announcement, both Paul Volcker and George Shultz voiced concerns about these moves. Regardless, they were overruled by both Nixon and Fed Chair Arthur Burns. Burns, it is said, desired the President's approval and enthusiastically supported the New Economic Plan. The swaggering Texan, John Connally, was personally admired by Nixon and was largely responsible for pushing the plan through. Given these interpersonal dynamics, wage and price controls went into the speech and into effect. Later phases created a Pay Board and a Price Commission that would assign prices to be controlled. While the price freeze enjoyed initial popular support, it wouldn't take long before the laws of economics would reverse that sentiment.

Despite these dramatic policy initiatives, it was Nixon's directive to Treasury Secretary John Connally to suspend "temporarily" the convertibility of US dollars into gold that earned the announcement's greatest infamy. Foreign governments had been able, under the Bretton Woods agreement of 1944, to present dollars and redeem them at $35 for an ounce of gold.

On the fiftieth anniversary of the address, economist Alex Pollock neatly summarized the speech and its impact. He lamented that Americans responded to the seismic shift in the global economic landscape with complacency and apathy. Standing in stark contrast to Pollock is Jeffrey Garten, who regarded the radical departure from the Bretton Woods system and the closing of the gold window as necessary and wise.



Yet even he recognized that while “It was a good political move by Nixon; it was really bad for the Fed’s reputation.” While the central bank’s reputation may have been sullied in the intervening years, those harmed by the positive, persistent inflation it is responsible for have fared even worse.

THE IMMEDIATE REACTIONS

The reaction to Nixon’s speech was swift, and some of the most prominent voices directed their ire toward the introduction of wage and price controls. Writing for *The New York Times* on September 4, Murray Rothbard fumed, “On Aug. 15, 1971” he announced, “fascism came to America. And everyone cheered.”

His concern was over the relative silence on the topic of price controls as much as the policy itself, exclaiming, “The main horror of the wage-price freeze is that this is totalitarianism, and nobody seems to care.”

That October, Manuel Klausner of *Reason* raised his voice in protest. Speaking of the wage and price controls, he remarked, “In the application of this ‘wishful thinking’ approach to public policy, Americans of all political complexions are supporting the President in his wage-price freeze. They do so because Nixon has done something bold, without regard to whether the action will help or aggravate the problem.”

In the same piece, Klausner exposed “the real source of inflation” as “monetary expansion, pursued by the Federal Reserve Board in issuing new, unbacked dollars into the economy.” Ludwig von Mises’s view on the matter from his *Theory of Money and Credit* explained that “Inflation is the fiscal complement of statism and arbitrary government…a cog in the complex of policies and institutions which gradually lead towards totalitarianism.”

THE LEGACY OF THE NIXON SHOCK

Fifty-five years is long enough to grade all three promises. Unemployment stood at **6.1 percent** when Nixon spoke and hit nine percent in May 1975. Inflation was not tamed either. By March 1975, consumer prices were rising at **10.3 percent** while unemployment sat at **8.6 percent**, a combination the prevailing Keynesian macroeconomics had ruled out and that Milton Friedman had warned was coming. The wage and price freeze didn’t prevent rising prices. Instead, these interventions hid and postponed them. When the controls expired at midnight on April 30, 1974, the suppressed increases arrived at once, and Blinder and Newton later concluded that decontrol accounted for most of that year’s double-digit surge. Only the third promise was kept, and that has been the most damaging legacy of the Nixon Shock.

Nixon’s third promise — to save the dollar from attack — failed spectacularly, though the US Federal Reserve system (not “international speculators”) became its primary assailant. The requirement to convert gold imposed a technical restraint on federal spending and limited inflation, because foreign official holders could demand gold. That constraint died with the dollar’s convertibility. Among its long-run consequences are a shift toward fiscal dominance and endless national debt, both of which are now permanent features of the US economy. No political will appears prepared to change course.

Critics rightly regard the temporary-turned-permanent suspension of the dollar’s convertibility into gold as a ruinous decision. They’ve taken note of the dramatic ethical, economic, and cultural shifts that policy choice induced, not to mention the loss of purchasing power over time that stemmed from the announcement and its execution.

Thomas Sowell’s second lesson has held true for five and a half decades. Nixon disregarded the laws of economics, and in the short run, it won him 49 states in the 1972 election. The politics worked perfectly; the economy fared less well. What remains in the long shadow of the Nixon Shock is a monetary order that enables massive federal and consumer debt and a lost national imagination of what sound money even looks like.

While the situation is dire, hope remains. Calls for a return to sound money haven’t fallen completely silent, and as the monetary crisis deepens, something has to give. If past events are any guide, political ambitions will eventually collide with the laws of economics.

September 2026

Economists Are Not Blind to the Full Range of Human Motivations

Donald J. Boudreaux

Associate Senior Research Fellow

Writing recently at *National Affairs*, Yale University political philosopher Gregory Collins leveled serious charges against modern economics. Because Collins is an accomplished scholar of the works of Edmund Burke and Adam Smith (among others) — and because he harbors toward the market order none of the knee-jerk hostility that today motivates so many progressives and postliberals — his criticisms deserve to be taken seriously.

Among the economists whose work Collins criticizes is me. Specifically, he criticizes my distinction between consumption and production. My respect for Collins and his work fortified me to contemplate his criticisms with an open mind. I nevertheless believe that Collins misses my point. And so while I'll devote the first part of this essay to addressing some of Collins's criticisms of other economists, I'll devote most of this essay to a defense of my distinction between consumption and production.

AN OVERLY BROAD-BRUSH CRITICISM OF ECONOMICS

Collins argues that modern economics rests on an impoverished understanding of human nature — one that compresses human beings into creatures seeking to maximize utility by satisfying as many material preferences as possible. Economics, in his view, reduces "the spice and variety of life to the vapid premises of preference satisfaction, utility maximization, and rational-choice theory." This impoverished understanding, Collins argues, stems from economists' failure to draw sufficiently on pre-Enlightenment wisdom, especially the insights of Aristotle and St. Thomas.

The best pre-Enlightenment thinkers, Collins argues, understood that human existence involves more than mere preference satisfaction. They recognized that each of us — or at least those striving to live a worthy life — "seeks," in Collins's words, "moral purpose and spiritual transcendence." By ignoring this reality, modern economics misunderstands humanity and, with it, social activity.

I have no interest in defending every tenet of neoclassical economics. Much economic analysis is carried out with too narrow an understanding of human nature. In addition, many economists, focused as they are on quantitative measurement, overlook economically relevant phenomena that cannot be captured in numerical data. But I know of no such flaw in economics that has not been identified and challenged by economists themselves. Although not all of these arguments and discoveries appear in textbooks, they are prominent enough within the discipline to make Collins's portrayal of economics itself ironically reductionist.

Consider two examples.

The typical neoclassical economist assumes that self-interest encourages individuals to capture as much of the gains from trade as possible, leaving their trading partners with as little as possible. Yet in laboratory experiments of what is called "the ultimatum game," individuals typically exhibit a sense of fairness and will knowingly sacrifice material gain in order to enforce that sense of fairness.

It's true that changing the rules of the 'game' often changes the outcomes. Indeed, it's possible to arrange, by changing the rules, for each player to behave more like a narrow-minded *homo economicus*. But this latter experimental finding itself reveals that narrow-minded *homo economicus* is, under certain circumstances, an empirical reality — and, thus, attention to both formal and informal institutions is important if we wish to prevent society from being dominated by narrow-minded *homines economici* pursuing only their short-run material interests.

Another example of work that belies Collins's description of modern economics is that of the late Nobel laureate Elinor Ostrom. Through extensive fieldwork, Ostrom discovered that individuals in communities often solve collective-action problems, such as creating and sustaining communal irrigation systems, that would never be solved by narrow-minded *homines economici*.

Of course, one can attempt to describe these behaviors in utility-maximizing terms. But the fact that prominent economic research recognizes human purposes as complex, layered, and often nonmaterial is powerful evidence that Collins's critique paints economics with too broad a brush.

ON PRODUCTION AND CONSUMPTION

Collins explicitly rejects my attempt to distinguish production from consumption. He writes:

> *Many economists today believe that maximizing consumption should be the aim of political economy. Donald Boudreaux asserts as much in an essay published last summer by the American Institute for Economic Research. Powered by the logic of Ludwig von Mises, Boudreaux insists that "consumption is the end, and production is the means" of economic activity, and that all productive activities are "means to the end of achieving maximum-possible consumption satisfaction."*

> *Boudreaux's view represents the first commandment of the economic mind today: Thou shalt study the satisfaction of subjective preferences. This assumption, like the philosopher's stone, transmutes the complexities of human behavior into the hallowed touchstone of economic analysis, effectively chilling serious reflection of the social and moral dimensions of man's natural constitution.*

Collins misunderstands my point because he overlooks the purpose of my essay. That purpose is not the normative claim that "maximizing consumption should be the aim of political economy." Rather, my purpose is to expose an analytical error committed by many interventionists, especially protectionists such as Oren Cass and Robert Lighthizer.

Protectionists typically justify their policies by pointing to the particular jobs they save. Economists respond that protectionism also destroys particular jobs. They also note that protectionism reduces the spending power of domestic consumers. In public debates, protectionists often ignore the first point while eagerly seizing on the second to make what they believe is a "gotcha" argument against economists.

"Aha!" protectionists cry. "Economists' view of humanity is absurdly narrow! Unlike us protectionists, who understand that people are not only consumers but also producers, economists think people are only consumers. How silly! We can therefore ignore economists."

If economists were guilty as charged, then policy recommendations rooted in our positive analysis would indeed be worthless. But we're innocent.

To see why requires that the analytical distinction between "consumption" and "production" be made clear. "Consumption" is a label for ends; "production" is a label for means. The particular content of the ends (and of the means) isn't specified. "Consumption" can refer to the wise pursuit and embrace of the true and the beautiful as defined by Aristotle or Aquinas (or by Adrian Vermeule, Pope Leo, the Dalai Lama, Hasan Piker, Nick Fuentes, whoever) no less than to myopic attempts to gratify the most fleeting desires of the flesh.

When economists say that individuals act to satisfy as many consumption desires as possible, we describe a category of human action; we prescribe nothing. We simply mean that individuals act to achieve as many of their ends as possible. When challenging protectionist policies and other government interventions, we explain that such policies increase some individuals' ability to achieve their ends only by reducing the ability of others to achieve theirs. Economics imposes no restrictions on what those ends are or ought to be, and it makes no value judgment about one set of ends compared with another.

Nor do economists elevate consumption over production. Rather, we point out that production is a means to consumption, whatever the particular consumption desires might be. To argue for policies that treat production as an end in itself is therefore to commit a category error.

It is akin, for example, to mistaking an emergency appendectomy for an end on par with the patient's goal of good health. The successful performance of the surgery has genuine value, and the surgeon may rightly take satisfaction in performing her craft with skill and care. Yet no sensible person would wish to protect the surgeon's job by opposing a pharmaceutical breakthrough that ensures appendixes never again rupture. The dignity and satisfaction the surgeon derives from her work come from restoring patients to health. If patients are already healthy, the surgeon would be perverse — and most undignified — to insist on performing unnecessary operations.

No competent economist denies that work has dignity or that individuals find satisfaction and meaning in their work beyond the incomes they earn. What economists deny is the practical possibility of using government to protect some individuals' pursuit of dignity and other nonmaterial goals without obstructing other individuals' pursuit of the same.

Similar reasoning applies to the values people attach to their families, communities, churches, and countless other non-monetary aspects of life. Perhaps "consumption" is an imperfect word to describe the pursuit of both material and higher ends. I am open to suggestions for a better term. But until such a term gains currency, scholars should avoid concluding from economists' description of "consumption" as the goal of human action that economists either deny or dismiss the human pursuit of truth, beauty, and transcendence.

Warsh Wants the Federal Reserve to Rethink the Rules

Thomas L. Hogan
Associate Senior Research Fellow

At its most recent meeting, the Federal Reserve held rates constant, as most investors were expecting. Prior to the meeting, which resulted in a split 9-3 vote, there were rumblings of discontent among members of the Federal Open Market Committee (FOMC), mostly over Chairman Warsh's controversial views on inflation, interest rates, and the Fed's balance sheet.

What do we know about Warsh's views? In a 2018 paper, he argued that "the central bank and the academic community should engage in a fundamental rethinking of the Fed's strategy, tools, governance, and communications." In this article, I discuss three points made by Warsh as well as the evidence from economic research.

THE TYRANNY OF FORWARD GUIDANCE

Fed officials try to make their future plans clear to the public, a policy known as forward guidance. Setting the public's expectations can, at least in theory, improve the efficiency of monetary policy. One problem, however, is that the more specific Fed officials are about their plans, the harder it is to change them.

This was a major problem in the post-pandemic period. Chair Powell promised "ample warning" before any changes in policy, but when it became clear in late 2021 that loose monetary policy was driving the highest inflation in 40 years, Powell was reluctant to change course. His failure to act made inflation worse, which eroded the value of the dollar and reduced the real incomes of average Americans.

To prevent the lock-in effect of forward guidance, Warsh has argued that the Federal Open Market Committee (FOMC) should have a long-term strategy that is not altered by fluctuations in short-run economic conditions. "It would scarcely require Fed speakers to rush to update their guidance to market participants," allowing them the flexibility to adopt the best policy in the face of a changing economy.

GROUPTHINK AT THE FED

The FOMC relies on discussion and debate to formulate its monetary policy decisions. At each meeting, the members share their opinions about the state of the economy and are briefed by Fed staff economists who share their economic forecasts. According to Warsh, however, the staff presentations may lead to excessive conformity among FOMC members. "The most common forecasting error," he says, "is groupthink."

"There is a tendency to try to find an anchor," Warsh describes, "and FRB/US — the dynamic, stochastic, general equilibrium model that has served at the core of the Fed's thinking for decades — ends up being the leading device through which a lot of discussions are conducted in formulating policy."

The problem of groupthink is evident from the FOMC's Summary of Economic Projections. Four times per year, the FOMC members publish projections of what they expect in the coming years for the rates of inflation, unemployment, and GDP growth. Despite some recent dissent, Warsh rightly notes that their projections have historically tightly converged on the economic forecasts presented by the Fed staff. "The dot forecasts from members of the FOMC are nearly on top of one another."

Indeed, groupthink has become a serious problem at the FOMC. Research confirms that the projections by FOMC members conform closely to the forecasts of the FRB/US model. The lack of intellectual diversity has likely led to suboptimal monetary policy decisions. In addition, the FOMC's forecasts have been very wrong, which may also have led to policy mistakes.

RETHINKING THE FED'S TOOLS

Warsh wants to reconsider the Fed's use of its monetary policy tools, especially its large balance sheet. The payment of interest on reserves that banks hold at the Fed and the rate on overnight reverse repurchase agreements have caused the Fed's total assets to explode from less than $900 billion in 2007 to almost $9 trillion in 2022, which Warsh notes is "markedly different than projected" when this policy was first proposed.

Warsh has argued that the Fed's "bloated" balance sheet gives it an outsized footprint in financial markets, which inhibits financial intermediation and distorts market prices. "We should not encourage the financial markets to be the handmaiden of the central bank," he said. "We should allow asset prices to be an independent source of economic insight and discipline."

Overall, Warsh seems correct on all three points. It is refreshing to see a Fed Chairman take an objective look not only at Fed policy but at the institutional arrangements that hinder good policy decisions. Warsh's criticisms are fair and supported by evidence from economic research. Now, we will see if those insights will translate to better policy.

The Real Cost of $40 Trillion in Debt

Thomas Savidge
Research Fellow

I was only a few days into my role at AIER when Pete Earle penned "$34 Trillion and Climbing" in January 2024. Six months later, he published "$35 Trillion—and Counting" on July 31, 2024. Now, just two years and 18 days later, gross federal debt passed the $40 trillion mark on August 18, 2026. Although the debt held by the public (gross federal debt minus intragovernmental holdings) is "only" about $32.3 trillion, both measures indicate a clear warning: America's fiscal institutions need serious reform.

Perhaps more concerning than the number itself is how little attention the milestone received outside those already interested in the subject. That indifference is perhaps unsurprising. For the average American, daily life appears (at least on the surface) to have changed relatively little, despite doomsday predictions that frequently accompany national debt headlines. Historic debt markers come and go, and somehow the sky has yet to fall and we all must still get up and go to work in the morning.

The rising debt nevertheless deserves attention, because the underlying fiscal trajectory threatens our standard of living and is compounding the affordability pressures Americans already face. Those who care about the national debt, however, should avoid the doomsday rhetoric. Every uneventful milestone we pass makes exaggerated warnings easier to dismiss and the case for serious reform harder to sustain.

APOCALYPSE NOW?

Nothing economically decisive happened when the gross debt moved from $39.99 trillion to $40 trillion. There is no magic number at which the US suddenly becomes insolvent. The Congressional Budget Office has long acknowledged that no identifiable debt-to-GDP "tipping point" can reliably predict whether or when a fiscal crisis will occur.

Debunking an imminent catastrophe should not be confused with defending the *status quo*. The relevant question is whether current policy leaves the country more prosperous and financially capable a decade from now. CBO projects that debt held by the public will rise from **101 percent** of GDP in 2026 to **120 percent** in 2036, exceeding the postwar record. Over the same period, the annual federal deficit is projected to grow from $1.9 trillion to $3.1 trillion.

Those figures reflect a structural imbalance. Under current law, federal spending is projected to remain persistently higher than federal revenue. Economic growth may narrow that gap, but CBO does not project growth sufficient to close it.

This is a very different concern from imminent bankruptcy. A fiscal crisis might never arrive on a predictable schedule. The more probable danger is a gradual erosion of economic growth, household purchasing power, and the government's freedom to respond to future challenges.

As Pete himself wrote back in the halcyon days of 2024 and a $34 trillion national debt, "Too much credibility has been squandered on the futile endeavor of predicting fiscal tipping points." Instead, he recommends, and I concur, that the better strategy is explaining the effects of unsustainable debt on the average person.

WHAT $40 TRILLION ACTUALLY MEANS FOR YOU

The national debt did not single-handedly make housing, cars, groceries, or healthcare expensive. Prices and borrowing costs reflect monetary policy, relative price changes, and productivity among other factors.

Still, persistent federal borrowing can intensify affordability problems through several channels.

First, the federal government competes with private borrowers for capital. When the Treasury issues more debt, some savings that might otherwise finance homes or business expansion instead are crowded out to finance government spending. As Nobel Prize-winning economist James M. Buchanan stated, this is "in effect chopping up the apple trees for firewood, thereby reducing the yield of the orchard forever." Greater federal borrowing can put upward pressure on interest rates, although it is only one of many forces affecting credit markets.

Recent events illustrate both the connection and its complexity. On August 19, the Treasury announced that it would at least double the size of its buybacks of 10- to 30-year securities, from $2 billion to $4 billion per operation. The announcement was followed by a decline in long-term Treasury yields, temporarily relieving some of the pressure that high government borrowing costs place on mortgages and other private credit.

The buybacks did not reduce the national debt because that was not the goal. They were intended to improve liquidity in parts of the Treasury market, but they may also complicate monetary policy. If Treasury actions push down long-term borrowing costs while the Federal Reserve is trying to restrain inflation, fiscal debt management and monetary policy can work at cross-purposes.

At the margin, higher government borrowing can make mortgages, car loans, and business credit more expensive. For families already struggling to purchase a home or replace a vehicle, even a modest increase in financing costs matters.

Second, weaker private investment can slow wage growth. Businesses increase worker productivity by investing in technology, properties, and employees. When less capital flows toward those investments, workers produce less than they otherwise would and their compensation grows more slowly. That cost is nearly impossible to observe directly. It appears as a business that does not expand, a job that is never created, or a raise that never materializes.

Third, persistent deficits can add inflationary pressure under some economic conditions. Debt does not automatically produce inflation, and $40 trillion does not mean hyperinflation is around the corner. It does, however, increase the temptation for Congress and the White House (regardless of which party is in power) to pressure the Fed to accommodate expansive fiscal policy by purchasing Treasury debt.

The debt's clearest present cost, however, appears right in the federal budget. Net interest payments cost taxpayers more than $970 billion in fiscal year 2025. Put another way, for every dollar the federal government spent in FY 2025, 13.5 cents went to net interest payments. That's more than defense spending (5.5 cents) or income security programs (12 cents).

Those interest payments highlight a serious budgetary trade-off. A dollar spent servicing past debt cannot simultaneously finance an agency, reduce a tax, or prepare for the next emergency.

For the average American, that does not mean receiving a bill labeled "national debt." It means future lawmakers will have less room to fund core services of government, reduce taxes, or respond to new priorities. They will eventually have to choose between spending cuts, higher taxes, higher inflation, or some combination of the three. They arrive through a slightly more expensive mortgage, slower wage growth, higher taxes, or a weaker dollar. None resembles an apocalypse. Together, however, they can materially lower Americans' living standards.

PAIN DELAYED IS PAIN MULTIPLIED

Government must be able to borrow during wars, recessions, and genuine emergencies. The problem becomes financing recurring regular commitments and structural deficits with debt.

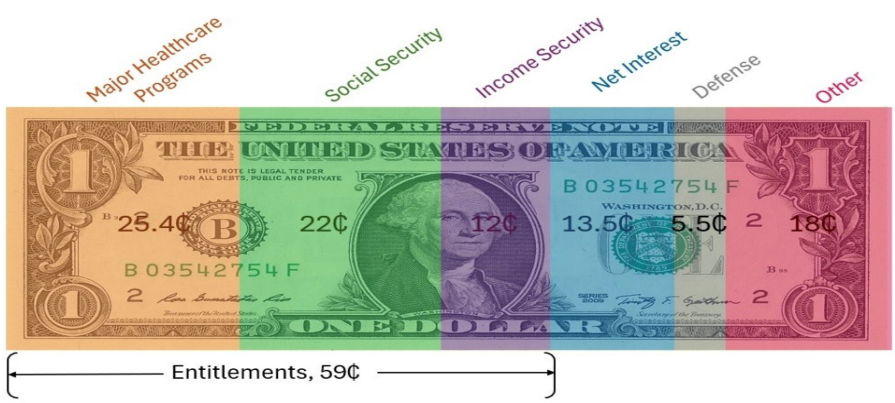
The unprecedented level of debt does not automatically prevent the government from responding to another crisis, but it makes any response more expensive and adds to an already large net interest burden. Lawmakers and financial markets might also become less tolerant of aggressive emergency borrowing.

Fiscal space matters most when the country suddenly needs it. Using that space to finance routine deficits leaves less room for the unexpected.

Delay also changes who bears the cost. Current voters receive the benefits of government spending and tax reductions while future taxpayers, whether ourselves in the future or future generations, inherit the obligation to restore balance.

The longer policymakers wait to stabilize the debt, the larger the eventual tax increases and spending cuts must be. The consequences of delay will also fall disproportionately on younger and lower-income Americans.

Interest compounds financially and delays compound politically. Every year without reform creates new beneficiaries, new expectations, and new commitments. Policies that could have been adjusted gradually become more difficult to change.



Early reforms can be phased in while late reforms are more likely to be abrupt. They arrive when interest costs have already narrowed the available choices and when households have less time to prepare.

Early reforms can be phased in while late reforms are more likely to be abrupt. They arrive when interest costs have already narrowed the available choices and when households have less time to prepare.

The longer reform is postponed, the more disruptive it is likely to become.

TOWARD A NEW AMERICAN FISCAL CONSTITUTION

A new fiscal constitution means durable rules governing how government makes financial commitments, pays for them, departs from ordinary constraints during genuine emergencies, and then returns to them once the emergency subsides.

The *status quo* divorces those decisions. Congress authorizes spending and taxes first, then confronts the resulting borrowing through conflicts over the statutory debt ceiling. This limit, however, fails to control fiscal policy. Elected officials threatening to not raise the debt limit merely risks default, rather than affecting commitments already made.

An effective fiscal constitution starves the beast of both revenue and responsibility. Fiscal rules such as a Taxpayer Bill of Rights (TABOR), Swiss Debt Brake, or a BRAC-style commission for federal spending could help constrain how much a government taxes and spends. Limiting the government’s scope of authority helps prevent policymakers from finding workarounds to budget rules through regulation or accounting gimmicks.

Pessimism, however understandable, is unproductive. Americans went to work the morning after the debt crossed the $40 trillion mark. We will probably do the same when it reaches the current $41.1 trillion limit. The costs will instead emerge gradually through higher interest expenses, tighter budgets, weaker investment, and less capacity to respond to crises.

The danger is that every uneventful milestone will make the next trillion dollars seem normal. The sky does not need to fall for the debt to matter.

‘A Deal Written in Pencil’: Tariffs Are Erasing America’s Credibility

David Hebert
Director of Economics and Economic Freedom

Hours after the trade negotiations collapsed and the United States imposed a 50-percent tariff on roughly $20 billion worth of Canadian goods on August 22, Canada's prime minister, Mark Carney, stood before reporters and told them what lesson Canada had drawn from 18 months of dealing with Washington. In his words, Canada understood that America "would put a series of tariffs on its closest allies and use economic integration as a weapon. That its signature was written in pencil."

Canada will match US tariffs dollar for dollar, starting on September 8.

For a man who delivered a rousing speech at Davos calling for the "middle powers" to stand up to "hegemons" and be "at the table," not "on the menu," the "written in pencil" line might just be the most powerful line in his tenure as prime minister to date. Tariff rates can be haggled over and retaliation can be unwound, but a signature written in pencil means that there is no real reason for anyone to negotiate, because there is no commitment. Canada did not arrive at this position quickly. It got there the hard way, by giving Washington what it asked for three times and watching a trade deal spearheaded by the very same man evaporate and be replaced by new tariffs.

Start with fentanyl, the original stated justification for tariffs on Canada. Despite the fact that less than one percent of the fentanyl seized at American borders comes from the northern border, Canadian officials took the complaint seriously. They implemented a $1.3 billion border security plan, appointed a fentanyl czar, and designated drug cartels as terrorist organizations. In response, Washington paused tariffs in February 2025 only to impose them anyway in March. The border was hardened, but the tariffs still came.

In September of 2025, Canada unilaterally dropped its retaliatory tariffs on USMCA-compliant American goods, removing these countermeasures as a gesture of good faith. Shortly thereafter, the US imposed tariffs on Canadian softwood lumber and other wood products such as upholstered furniture, kitchen cabinets, and vanities. In these most recent talks, Canada extended a second olive branch, offering to drop their remaining steel, aluminum, and automotive retaliatory tariffs if the US would reciprocate.

Last October, Ontario ran a television commercial during the baseball World Series in which Ronald Reagan, in his own voice from his famous 1987 radio address, explained why tariffs cost American jobs. The president called the ad "FAKE" and terminated trade talks over it. Ontario then pulled the ad to let negotiations resume, complying with the president's demands, but was then met with an extra 10-percent tariff — all for pointing out that President Reagan, who at the time Trump had been comparing himself to, was against the use of tariffs.

So really, what Canadian trade officials learned over the last 18 months is that if they concede, they get a tariff. If they offer an olive branch, they get a tariff. And if they point out the hypocrisy, try to appeal to the American people, and still pull the ad when feathers get ruffled, they get tariffs. On top of all of that, they were then accused of lax enforcement against forced labor practices, making them subject to additional Section 301 tariffs. And now, they face **50 percent** tariffs on a wide range of products. At this point, no one should be surprised that US trade policy has pushed away one of our closest allies.

Trade agreements are valuable not just because of the rates they set over certain products. They are valuable precisely because they are binding commitments. If a signature can be undone whenever one party imagines a new slight, then the value of any agreement plummets. Certainty is exactly what trade agreements like the USMCA are supposed to provide. But, as Canada, Mexico, and the rest of the world has learned, even a deal that President Trump himself negotiated and heralded as "the fairest, most balanced, and beneficial trade agreement we have ever signed into law. It's the best agreement we've ever made," was signed in pencil.

Canada is our closest ally and one of our largest trading partners. Supply chains between the US and Canada — especially in Michigan, a state that the president has visited several times and promised to revitalize — are so tight that a car part can cross the border seven times before it becomes a car. If any country could reasonably expect its own concessions to matter and its agreements to hold, it was Canada.

Every government now negotiating with Washington, including Tokyo, Brussels, New Delhi, and Beijing, has seen these developments. If a full trade agreement passed by Congress and signed by this president couldn't protect Canada from tariffs, the "frameworks of a deal" that other countries around the world have are even less secure.

Tariffs that can be predicted can be survived, priced in, and in some cases, engineered around. Unpredictable tariffs and trade agreements that expire at whim cannot be. Carney's point about America's signature being written in pencil is a powerful one. Canada has stopped negotiating for promises and started building new trade deals to work around us. And the rest of the world is increasingly following.

What Payroll Revisions Reveal about the Economy

Peter C. Earle
Senior Director of Research

The July employment report offered an unusually good occasion to revisit something I wrote about almost exactly a year ago: the widespread misunderstanding of revisions to the monthly jobs numbers. On August 7, the Bureau of Labor Statistics reported that nonfarm payroll employment fell by 23,000 jobs in July, while the unemployment rate edged down to **4.1 percent**. At the same time, May payroll growth was revised from +129,000 to +63,000 and June from +57,000 to +20,000: a combined downward revision of 103,000 jobs.

Those numbers certainly suggest that the labor market has weakened. The three-month average payroll gain is now only about 20,000. But before turning a disappointing jobs report into either a recession call or another round of accusations that government statisticians are cooking the books, it is worth remembering what these numbers actually are.

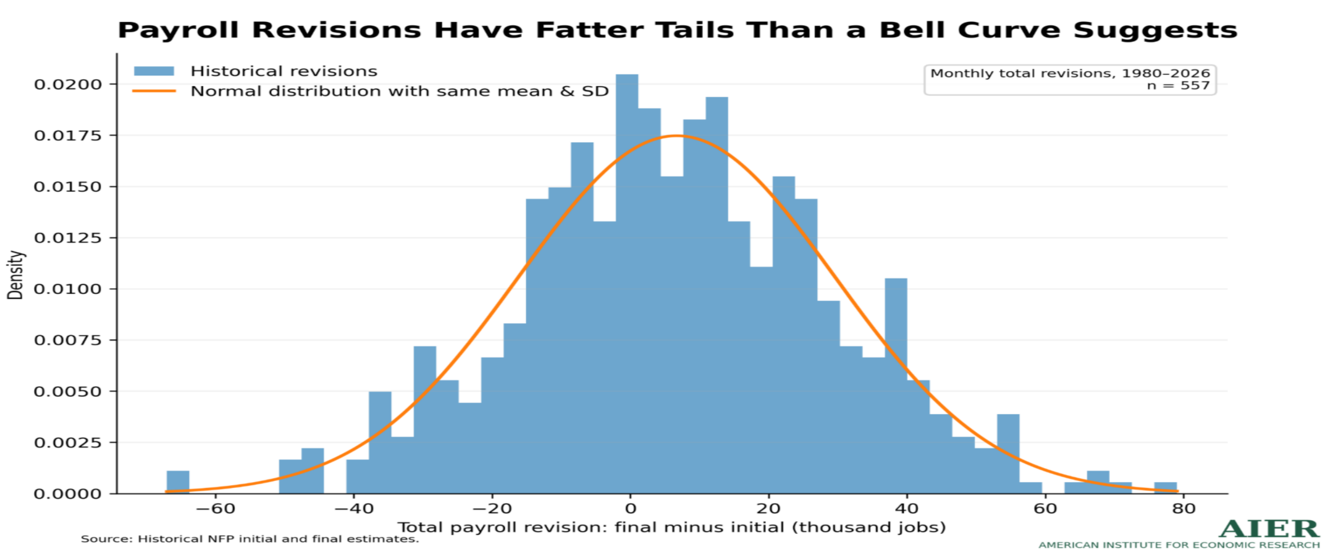
They are estimates. The headline payroll number comes from the Current Employment Statistics survey, in which BLS collects payroll information from roughly 119,000 businesses and government agencies representing about 622,000 worksites. That is an enormous sample, covering about one-quarter of American payroll employment. It is nevertheless still a sample. Not every establishment responds immediately, seasonal factors are continually recalculated, businesses are born and disappear, and additional information arrives after the first release. Consequently, revisions are not corrections of “mistakes” in the ordinary sense. They are updates to an estimate as information improves. BLS explicitly notes that the two preceding months are routinely revised as additional survey responses arrive and seasonal factors are recalculated. After two revisions, when nearly all reports have been received, the estimate is considered final.

This distinction matters particularly for July’s negative first print. The reported loss of 23,000 jobs sounds very precise. It is not. BLS estimates that the 90-percent confidence interval surrounding a monthly payroll change is roughly plus or minus 122,000 jobs. Applied mechanically to July, that means a first estimate of –23,000 is consistent with an underlying change somewhere in the neighborhood of –145,000 to +99,000. That does not make the estimate useless. It means that the proper way to read it is as one observation in an evolving stream of evidence rather than as a perfectly measured head count.

That was also the point of my analysis following the extraordinary revisions in the July 2025 report. At the time, May and June 2025 were revised downward by a combined 258,000 jobs. I examined the historical distribution of payroll revisions and found that it was decidedly unlike the neat bell-shaped distribution people often have in mind when they hear that something is “three standard deviations” from normal. Payroll revisions have fat tails: unusually large observations occur considerably more often than a normal distribution would imply.

Since then, I have substantially expanded that dataset and asked a more practical question: do revisions themselves tell us something about the business cycle? The answer is yes — but considerably less than headlines sometimes imply.

Among 484 observations in my sample where the economy remained in a National Bureau for Economic Research (NBER) expansion from the initial estimate through the final release, nearly **40 percent** were revised downward. Downward revisions, in other words, are perfectly ordinary during good economic times. And during stable contractions, upward revisions were actually much more common than downward ones.



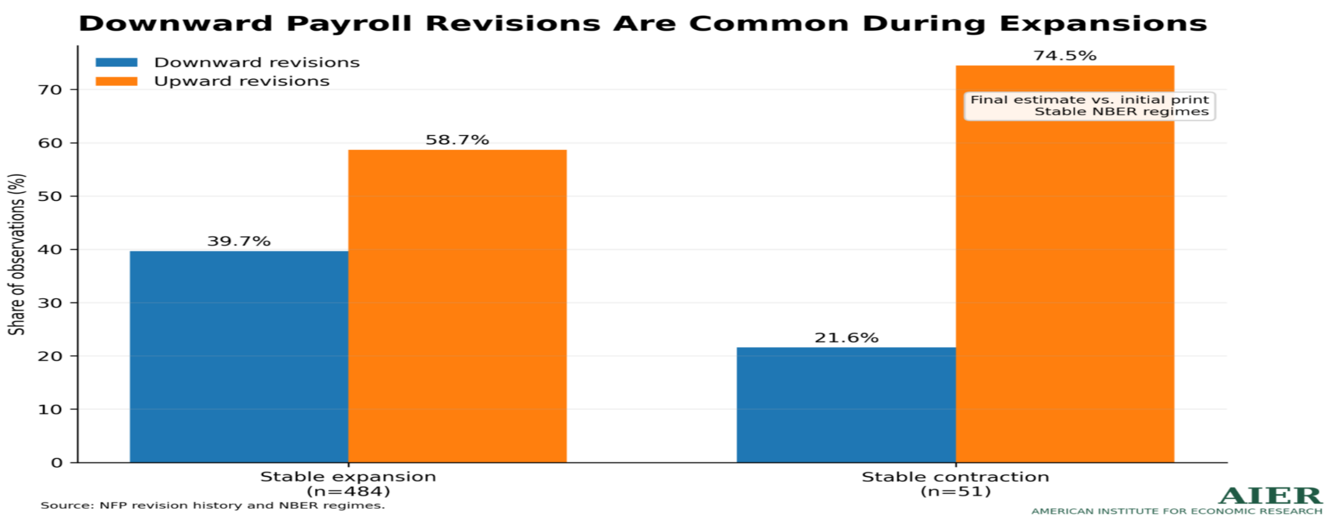
A single negative revision is correspondingly weak as a recession signal. When an expansion is underway, the historical probability of entering recession within the next 12 months in my sample is about **12.2 percent**. After one negative payroll revision, it is **11.0 percent**: essentially no warning at all.

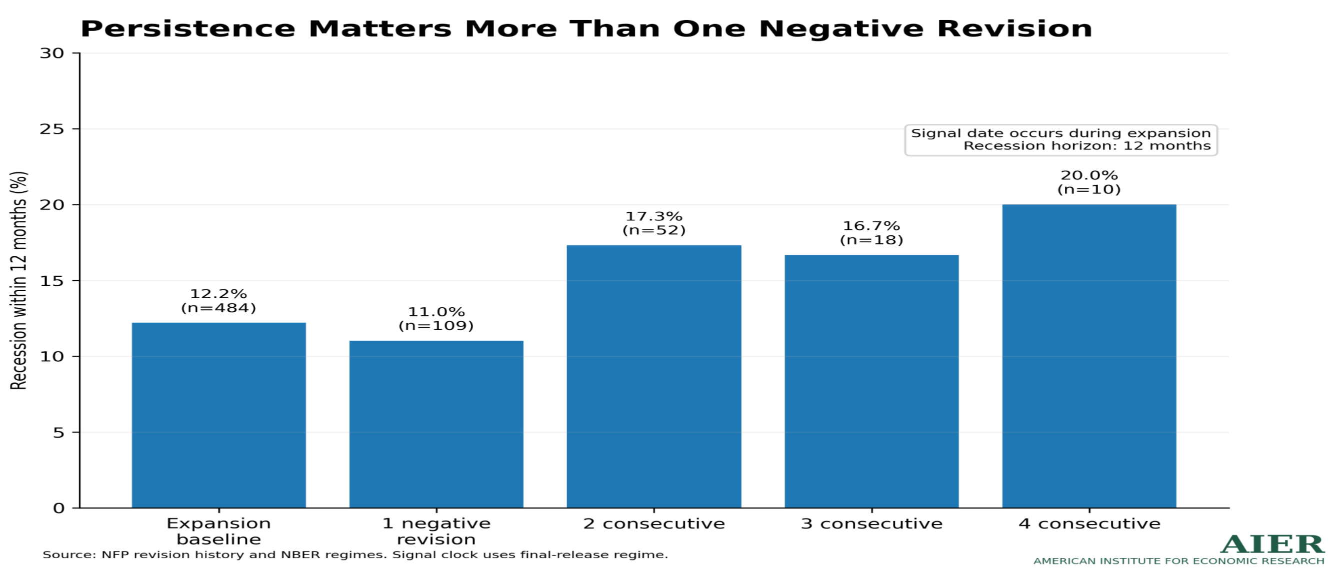
Persistence is somewhat more informative. After two consecutive negative revisions, the 12-month recession probability rises to **17.3 percent**; after three, **16.7 percent**; and after four, **20 percent**. The strongest signal appears when repeated downward revisions also acquire meaningful size. Once an ongoing string of negative revisions accumulates to approximately 30,000 to 40,000 jobs, subsequent recession risk rises noticeably. At a cumulative −40,000, the historical 12-month probability reaches roughly **26 percent**, more than twice the expansion baseline.

That is interesting, but it is not a recession alarm.

The samples become small quickly, the relationship is not perfectly linear, and extremely large revisions are not automatically more informative than moderately large ones. The sensible conclusion is narrower: one disappointing number tells us little; persistent deterioration across successive estimates deserves considerably more attention.

I also subjected the data to some simple forensic tests because accusations that BLS numbers are politically manipulated have become routine. I looked for suspicious rounding and unusual final-digit patterns, calendar effects, election-year behavior, campaign-season anomalies, and partisan differences in revisions. The initial estimates and total revisions showed no suspicious digit patterns.

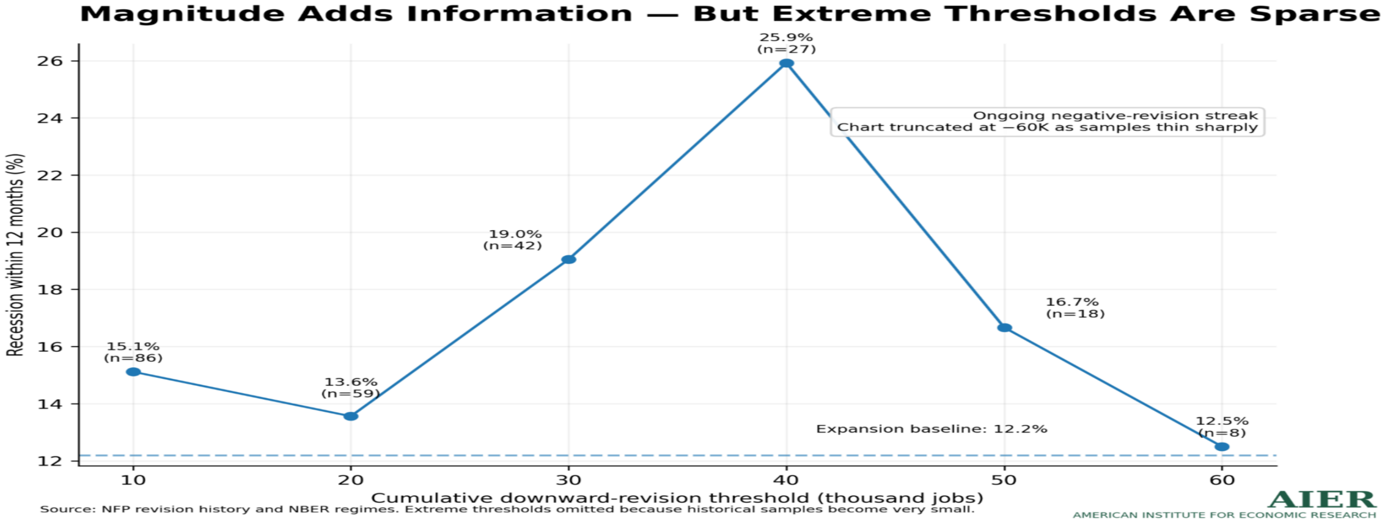




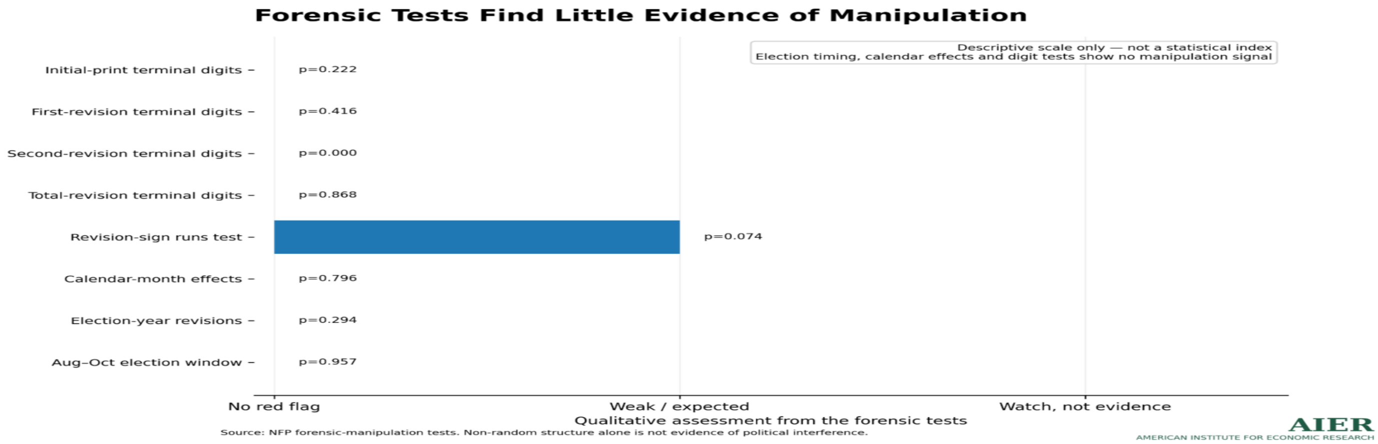
Average revisions did not vary meaningfully by calendar month. Presidential election years showed no statistically meaningful revision bias, and during August through October of presidential-election years — the period when political incentives ought to be greatest if manipulation were occurring — average revisions were virtually identical to those in other months.

There are patterns in the data. Economic statistics are not random numbers generated by a roulette wheel. Revisions cluster, business conditions change, reporting arrives unevenly, and turning points are particularly difficult to measure. Non-randomness is not evidence of fraud.

July's −23,000 nonfarm payrolls number deserves attention, particularly alongside the weaker May and June estimates. But the lesson from nearly half a century of revisions is not that the latest number should be ignored. It is that we should resist giving any single first estimate more authority than it demonstrably possesses. The monthly jobs report is best understood not as a final measurement of the economy, but as a successive attempt to see something enormous, complicated, and constantly changing with necessarily incomplete information.



(The above chart should be read as a measure of how the warning signal changes as downward revisions accumulate. **During an ordinary expansion, the historical probability of entering recession within the next 12 months is about 12.2 percent. But among the 27 observations in which an ongoing sequence of downward payroll revisions accumulated to at least 40,000 jobs, 25.9 percent were followed by recession within a year: roughly twice the baseline rate.** That does not mean a cumulative 40,000 job revision predicts recession, much less causes one; roughly three-quarters of those observations were not followed by recession. Rather, it suggests that once downward revisions become both persistent and sizable, they contain more information about deteriorating economic conditions than a single negative revision does.)



(The forensic tests look for statistical fingerprints that might suggest systematic distortion. Terminal-digit tests find no suspicious heaping in initial prints, first revisions, or total revisions; the unusual pattern in second revisions is consistent with later adjustments clustering near zero. A runs test finds mild persistence in the direction of revisions, but nothing inconsistent with changing economic conditions, while calendar-month tests find no recurring seasonal pattern. Most importantly, revisions in presidential election years and during the politically sensitive August–October campaign window are statistically indistinguishable from other periods. None of these tests can rule out manipulation categorically, but together they provide no statistical evidence of systematic political interference.)

July Inflation Rises, But Weakening Labor Complicates Fed’s Choice

Nicolas Cachanosky
Senior Fellow, Sound Money Project

Inflation crept back up in July, though not by much. The Consumer Price Index (CPI) rose **0.1 percent** last month, a modest reversal after June's **0.4 percent** decline. The year-over-year rate eased slightly, to **3.4 percent** from **3.5 percent**.

Core inflation, which excludes food and energy, told a similar story. Core CPI rose **0.2 percent** in July after being flat in June. The year-over-year core rate ticked down to **2.5 percent** from **2.6 percent** — another small move.

Last month's headline decline was almost entirely an energy story, as oil prices moderated with the anticipated reopening of the Strait of Hormuz. In July, housing took over as the main driver. Shelter rose **0.1 percent** over the month, accounting for roughly two-thirds of the monthly increase in the headline index. Energy fell **1.5 percent**, with gasoline down **2.9 percent**, continuing the retreat that began in June. The shift matters: energy moves are volatile and often reverse quickly, while shelter tends to be stickier.

Price increases in July were broad. Medical care, airline fares, communication, education, and recreation all rose, with airline fares up **2.2 percent** on the month, driven by higher prices for jet fuel. Motor vehicle insurance was one of the major categories contributing to a decline in the index, down **0.3 percent**, although less than its **2.0 percent** drop in June.

THE THREE-MONTH POINT OF VIEW

The three-month trend annualized, which can help filter out some of the monthly noise, tells a cooler story than either the monthly or annual figures suggest. Headline CPI rose at roughly a **0.8 percent** annualized rate over the three months through July, well below the **3.4 percent** year-over-year figure. Core, which strips out energy, rose faster over the same stretch, at roughly **1.6 percent** annualized — still below its **2.5 percent** year-over-year pace but a smaller gap. The wider gap on the headline number shows that a few volatile months of energy prices can lead to huge swings.

Markets are more confident that the Fed will hold rates steady. The CME Group's FedWatch tool puts the odds of a hold around **65 percent** in September and **50 percent** in October, following yesterday's steady PPI print.

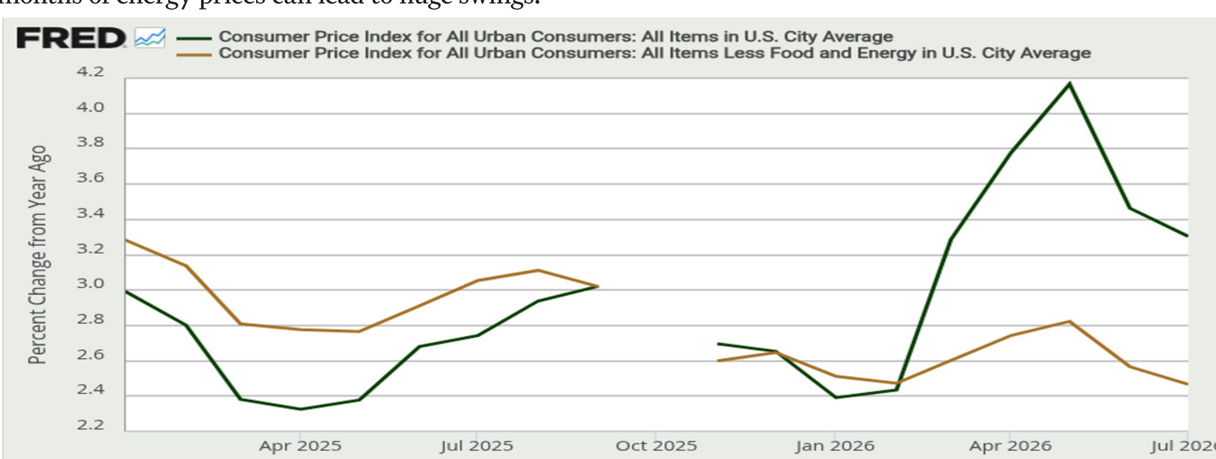
The labor market gave the Fed more reasons to lean that way. The latest data indicate nonfarm payrolls fell by 23,000 in July, and May and June were revised down by a combined 103,000. The unemployment rate fell slightly from **4.2 percent** to **4.1 percent**, but the participation rate has now declined **0.7 percent**age points since January. Year-over-year average hourly earnings decelerated from **3.5 percent** in June to **3.2 percent** in July. This is not a labor market showing acute stress, but it is no longer the source of comfort it was earlier this year.

THE NOMINAL INCOME POINT OF VIEW

Inflation can react to either nominal or real shocks, which makes it an indirect measure of where monetary policy actually stands. Nominal income, by contrast, is a direct measure of whether policy is loose, about right, or restrictive, since it isolates the nominal side of the economy from the real shock noise that CPI can't filter out on its own.

Between Q2 2025 and Q2 2026, nominal GDP grew **6.5 percent**, a significant increase compared to the **4.6 percent** growth between Q1 2025 and Q1 2026. That elevated trend sits uncomfortably above the roughly four-percent pace that prevailed before the pandemic.

Despite signs of a weakening labor market and a three-month CPI trend below **2 percent** annualized, the Fed faces a dilemma. CPI and payroll data reflect the current state of prices and hiring, both of which show signs of deceleration. Meanwhile, nominal spending indicates demand is still robust, and this demand hasn't slowed sufficiently to suggest that the recent cooling is anything but temporary. If nominal spending remains strong, the softer CPI and employment figures are more likely indicators of a lag rather than a true shift in trend.



Source: U.S. Bureau of Labor Statistics via FRED®
Shaded areas indicate U.S. recessions.
myf.red/g/1XSfW

JULY 2026 CPI AT A GLANCE

Category	Month-over-Month (July)	3-Month Annualized	Year-over-Year
All items	**0.1%**	**0.8%**	**3.4%**
All items less food and energy	**0.2%**	**1.6%**	**2.5%**
Food	**0.1%**	**2.0%**	**3.0%**
Energy	**-1.5%**	**-13.3%**	**14.7%**
Shelter	**0.1%**	**2.0%**	**3.2%**
Transportation services	**0.3%**	**-2.4%**	**2.9%**
Medical care services	**0.6%**	**4.1%**	**2.7%**

September 2026

Univ. of Michigan's Hidden Grades Will Backfire on Students

Julia R. Cartwright
Senior Research Fellow in Law & Economics

Starting in fall 2027, the University of Michigan's College of Literature, Science, and the Arts, the largest of its 19 colleges, will hide letter grades from first-semester transcripts. Freshmen will still earn grades and receive feedback, but outsiders will see only a "P" for pass or "NC" for no credit. Note the euphemism: not Pass/Fail, but Pass/No Credit, presumably to cushion even the vocabulary of falling short. The university says the policy will help students acclimate and "curb the mental health crisis" among college students. The intention sounds noble, but the economics suggest it will backfire on the very students it aims to protect.

The trouble becomes clear through a concept economists call signaling. In any market where one side knows something the other side can't observe, transactions depend on credible signals. A job applicant knows whether she is diligent, capable, and quick to learn, but an employer cannot see any of that directly. A college degree has always served multiple purposes. It is, we hope, an education. But it is also a signal: a costly, hard-to-fake indicator of ability and work ethic. The reputation of the institution, the rigor of the major, and yes, the GPA all transmit information that employers cannot gather any other way at reasonable cost.

Cost is the operative word here, because the flip side of signaling is what economists call search costs — the time, effort, and money buyers and sellers spend finding each other and identifying good matches. Employers sifting through thousands of applications are desperate to lower those costs. This is why so many firms concentrate recruiting on a short list of campuses. Oracle's celebrated "Class Of" sales program, for example, built its pipeline around nonstop recruiting at a core group of roughly 30 universities, big state schools like Ohio State and North Carolina alongside privates like Georgetown and Baylor.

Is that because Oracle dislikes students everywhere else? Of course not. It's because past hires from those schools performed well, alumni networks make outreach efficient, and a known curriculum makes credentials easy to interpret. Target-school recruiting is search-cost economics in action. A reliable signal lets employers find talent cheaply, which benefits the students who carry that signal.

The whole point of a transcript is differentiation. When employers can distinguish exceptional students from adequate ones, they can hire the best fit, and the credential retains value for everyone who earned it. Michigan's policy deliberately degrades that signal. And here is the crucial insight the policy's designers seem to have missed: when you muddy a signal, the demand for information doesn't disappear. It migrates — usually to proxies that are far less meritocratic than grades.

Medicine has already run this experiment and seen the perverse results. In 2022, the US Medical Licensing Exam Step 1, long the great equalizer of residency applications, switched to pass/fail reporting. Surveys of residency program directors across specialties found that most opposed the change and expected to lean more heavily on medical school prestige, research output, letters, and personal connections to sort applicants. Researchers warned the shift could paradoxically disadvantage students from less prestigious and less wealthy institutions, precisely the students the change was supposed to help. Diligent medical students naturally responded to the new environment, reporting that they now needed more research publications and extracurricular credentials to stand out.

When one signal is stripped away, students rationally invest in costlier and less accessible ones. A test score can be earned by anyone with a library card and some discipline. A research pipeline and a well-connected mentor require a lot more than just raw knowledge.

The timing makes Michigan's move stranger still. A's are already the most common grade in American higher education, and some elite universities award A-range grades roughly **80 percent** of the time. The grading signal is compressed enough as it is. Compress it further, and employers will simply continue to shift to their own assessments, referral networks, and raw school brand, making the Michigan degree itself worth less — for high performers and strugglers alike.

We don't have to speculate about how this ends. Johns Hopkins ran a "covered grades" policy for first-semester freshmen from 1971 until it abandoned the experiment with the class entering in 2017. Its own deans explained why: faculty found that covered grades "delay development of study skills and adaptation to college-level work." Worse, the policy penalized students who performed well, and employers and graduate schools neither understood it nor welcomed it. The university ended nearly five decades of experimentation based on its own assessment of the evidence. The wave of schools that unceremoniously retired COVID-era pass/fail grading reached the same conclusion.

None of this dismisses the mental health struggles of today's students. But the answer to a crisis of fragility is not to blur the mirror; it is to teach students to metabolize honest feedback while the stakes are still low.

Grades that differentiate are not the enemy of student wellbeing. They help make a degree worth earning and give a talented kid from anywhere a way to signal what he can do.

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