Flash Economics

N° 68
June 17, 2025

Why inflation is set to rise in the United States

Core inflation (excluding energy and food) was 2.8% year-on-year in both April and May 2025 in the United States.

Several mechanisms should lead to a significant rise in US inflation between now and the end of 2025:

- Expansionary fiscal policy at full employment;
- Higher customs duties;
- The depreciation of the US Dollar;
- Weak competition and monopoly rents.

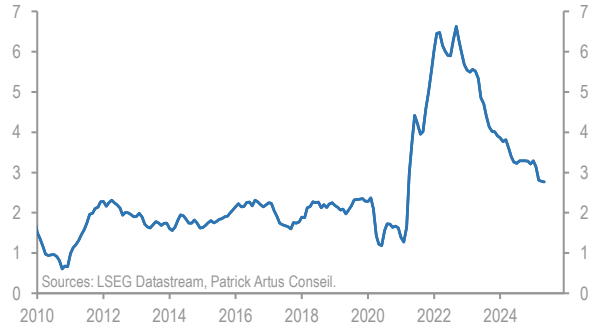
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Underlying inflation remains high in the United States in spring

The Federal Reserve's difficulties in cutting interest rates further are understandable when we look at the trend in **underlying inflation in the United States** (**Chart 1**). Admittedly, its level since March 2025 (2.8%) is lower than its average level for the period May 2024 - February 2025 (3.2%), but it is still well above the 2% target.

Chart 1
United States: Headline inflation and core inflation
(CPI excl. food and energy, Y/Y as %)



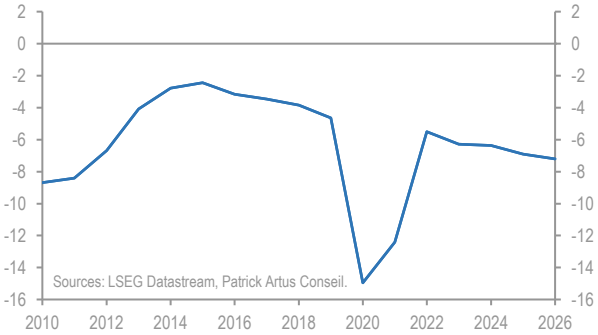
In addition, four mechanisms are very likely to cause underlying inflation to rise again in the future.

Four inflationary mechanisms in the United States

1- Expansionary fiscal policy leading to full employment

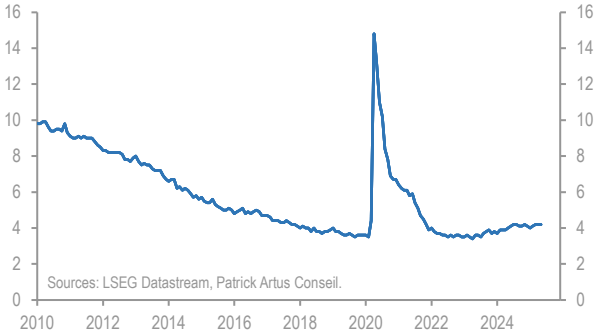
We now know that **fiscal policy in the United States is going to be very expansionary** (**Chart 2**), with the vote in favour of massive tax cuts (renewal of the Tax Cuts and Jobs Act of 2017, exemption for tips and overtime), not at all offset by a similar reduction in spending (Medicaid).

Chart 2
United States: Budget deficit (as % of nominal GDP)



This expansionary fiscal policy is being implemented while **the United States is operating at full employment** (**Chart 3**), which can only result in additional inflation.

Chart 3
United States: Unemployment rate (as %)



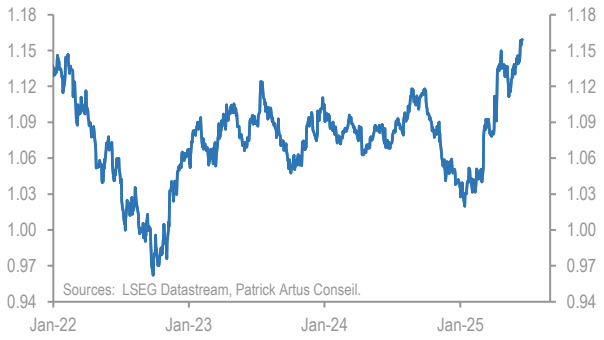
2- The increase in tariffs

At present, the tariffs applied by the United States on its imports stand at 0% for electronics and auto parts, 10% for all other goods (with the exception of automobiles at 25%, and steel and aluminum at 50%). Even if various countries and the United States may, in the future, negotiate agreements to reduce some of these tariffs, it is likely that, compared to the situation at the beginning of 2025, there will remain an average increase of 10 percentage points in tariffs. This will lead to an approximate 10% rise in import prices and, taking into account a reduction in distributors' profit margins**, to an increase of around 0.7 percentage points in core inflation *ceteris paribus***.

3- Depreciation of the US Dollar

The US Dollar has depreciated since the beginning of 2025, for instance against the Euro, from 1.02 to 1.15 (**Chart 4**). Even though a depreciation of the USD Dollar exchange rate is partially offset by lower profit margins among exporters and distributors, it will still lead to additional inflation.

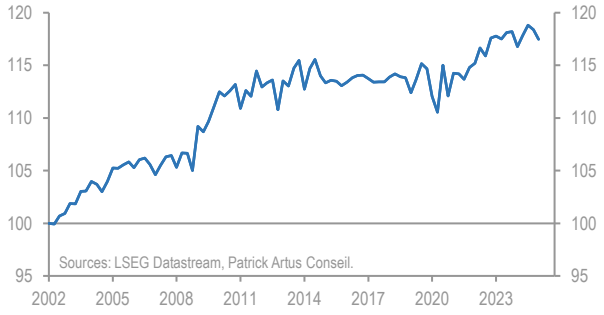
Chart 4
Euro/dollar exchange rate (EUR 1 = USD...)



4- Weak competition

Numerous academic studies (such as those by Thomas Philippon at NYU and Ufuk Akcigit at the University of Chicago) show that the **weakening of competition policy** (anti-trust regulation) in the United States has led to the emergence of **monopoly rents, visible in the rising profit margins of American firms** (**Chart 5**).

Chart 5
United States: Ratio between GDP deflator and unit labour cost (2002.Q1 = 100)



Competitive intensity is likely to decrease further due to tariffs and pressure on other countries to stop penalising American companies for abuse of dominant position (as is the case with the GAFAM) firms in Europe). This should result in a further rise in profit margins in the United States, causing additional inflation.

Summary: Towards stagflation in the United States

It is clear that the American economy is moving towards a stagflationary environment: higher inflation (driven by expansionary fiscal policy at full employment, tariffs, the depreciation of the US Dollar, and the retreat of anti-trust policies) and lower growth (due to the impact of inflation on households' purchasing power and consumption, and the inefficient use of monopoly rents).

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