

Economics

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US CPI (Dec): Fed has time to wait, but not much

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Consumer Price Index (monthly change, %)	Dec 2025	Nov 2025	Oct 2025	Sep 2025	Aug 2025	July 2025	Dec NSA YoY%
All items	0.3	N/A	N/A	0.3	0.4	0.2	2.7
Ex-food/energy	0.2	N/A	N/A	0.2	0.3	0.3	2.6
• Ex-food	0.2	N/A	N/A	0.3	0.4	0.2	2.6
• Ex-energy	0.3	N/A	N/A	0.2	0.4	0.3	2.7
Energy	0.3	N/A	N/A	1.5	0.7	-1.1	2.3
Services	0.3	N/A	N/A	0.2	0.3	0.3	3.3
Housing	0.4	N/A	N/A	0.2	0.4	0.2	3.6
Fuels & util.	0.8	N/A	N/A	-0.5	-0.1	-0.1	6.7
Food/beverages	0.7	N/A	N/A	0.2	0.5	0.0	3.0
• Food	0.7	N/A	N/A	0.2	0.5	0.0	3.1
Apparel	0.6	N/A	N/A	0.7	0.5	0.1	0.6
Transportation	0.0	N/A	N/A	0.8	0.9	0.0	0.4
Medical care	0.4	N/A	N/A	0.2	-0.2	0.7	3.2
Recreation	1.2	N/A	N/A	0.4	-0.1	0.4	3.0
Education, comm.	-1.0	N/A	N/A	0.0	0.0	0.0	0.5
Other good, serv.	0.3	N/A	N/A	0.5	0.2	0.4	4.2
Commodities	0.2	N/A	N/A	0.5	0.5	0.0	1.7

Source: Haver Analytics.

- Yet another downside surprise on U.S. inflation. Core CPI came in below expectations in December, at 0.2% m/m, vs. 0.3% expected. Headline CPI matched expectations at 0.3% m/m, boosted by a sharp rise in food prices. On an annual basis, core and headline inflation rates remained unchanged at 2.6% and 2.7%, respectively. Core goods prices were flat on the month, despite concerns about lingering November survey distortions and the risk of greater tariff pass-through. A significant part of the softness in goods prices reflected declines in both new and used vehicle prices. Services inflation was moderate, with shelter costs rising on a pickup in OER and hotel prices, while non-housing services were subdued during the month. After three consecutive cuts and some noisy Q4 data, the Fed is likely to pause later this month, but we expect it to resume easing in March.
- Many (including us) did not expect annual inflation to be where it is today. Even if the price level is somewhat biased down due to distortions, at the very least, annual inflation would not be far from where it sat on Liberation Day. How did we get here? As always, the answer isn't entirely clear, but there are a few competing and complementary theories. First, the tariff shock is likely not as bad as it appears on paper. While the effective tariff rate is estimated at around 18–20%, a patchwork of exemptions, substitution away from higher-tariff countries, and large front-loading have meant that the actual tariff rate is closer to 10% (as measured by tariff revenue). That roughly halves the estimated price impact. We estimate the long-run impact of a 10% tariff on the level of core PCE at around 0.5–0.6%.

That's manageable, and many major retailers and automakers are absorbing a material share of tariffs to remain competitive, helped by the fact that they have been able to improve margins and already passed through large post-COVID cost increases. Recent research suggests 94–95% of tariffs were borne by U.S. importers (Gopinath and Neiman, 2025).

- The other explanations relate to the state of the economy and productivity. Uncertainty about how steady tariff policy is, tightening immigration policy and a softening job market might be causing some businesses (particularly small and medium-size firms) to wait before fully passing through tariffs. Lower-income consumers too may be more reluctant to be as spendthrift. At the same time, productivity looks strong as large firms are optimizing and reaping the benefits of past capital investment in supply chain management and digitalization, allowing them to manage externally induced cost increases. These businesses also have confidence to continue investing because they see wealthy consumers continuing to double click on "proceed to checkout" at the same pace as before tariffs were put into place.
- In any case, that inflation ended 2025 where it did is indeed surprise. And the path ahead may not be as worrisome as feared, vindicating team "price level shock" in the FOMC. Adding to this, the downward trend in shelter costs means that, by this time next year, it's reasonable to assume inflation is will not be far from target, especially if IEEPA is canceled and replaced with an even looser patchwork of tariffs.
- The Fed does gave some time to wait, but not much. Their price stability mandate looks far less worrisome than it did even in Q3, and we expect the Fed will judge it prudent to bring policy more firmly into neutral territory with a cut in March and then again in June, leaning more into its employment mandate.

Implications & actions

Re: Economic forecast — We expect the Fed will be on hold in January but resume rate cuts in March and June.

Re: Markets — Bond yields were lower following today's release while the broad US\$ index initially dipped before moving higher. Market pricing for the Fed path this year is little changed relative to yesterday.

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