

## US inflation cools amid tariff uncertainty

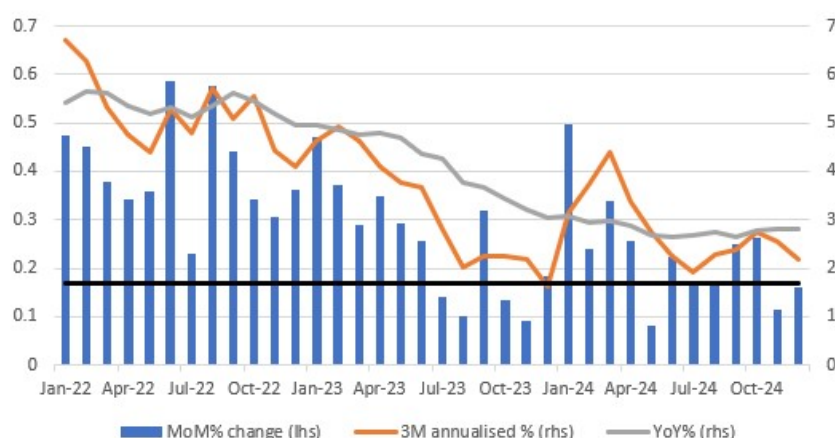
Inflation remains on track for 2% for now with the PCE deflator and employment cost index offering further signs of encouragement. However, President Trump's tariff threats hang heavily on the outlook and means the Fed will remain in a wait-and-see mode



The Fed's favoured inflation measure, core personal consumer expenditure was in line for December

Today's US data suggests that inflation remains on the path towards 2%, but with huge uncertainty over regulatory, tariff, fiscal and immigration policy the central bank can't leave anything to chance and will be keeping monetary policy unchanged until June, we believe. The Federal Reserve's favoured inflation measure – the core personal consumer expenditure price deflator – rose 0.2%MoM/2.8%YoY in December as consensus predicted, but the good news is that to 3 decimal places it is 0.159% so below the 0.17% month-on-month we need to average over 12 months to deliver 2% year-on-year. The chart below shows that we are now seeing as many of the MoM readings (blue bars) coming in below the 0.17% black line as we are seeing above, which offers the Fed the flexibility to respond with further rate cuts this year.

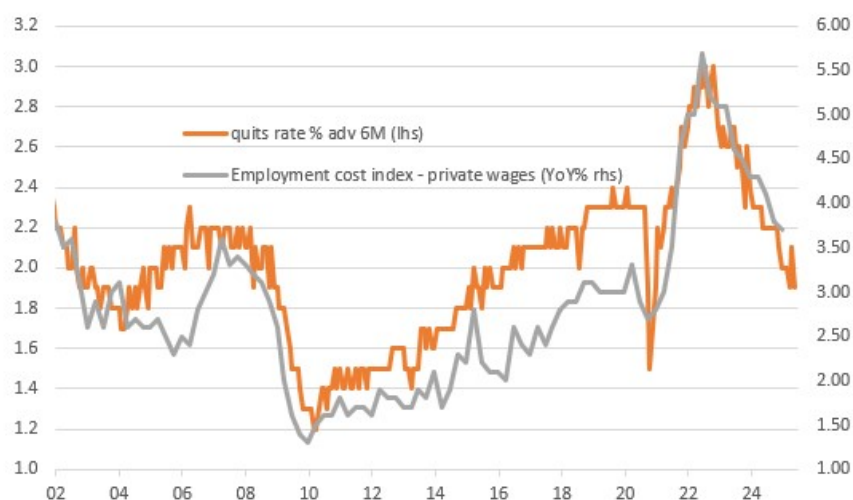
## Core PCE deflator metrics (MoM%, 3M annualised and YoY%)



Source: Macrobond, ING

Meanwhile, the employment cost index for fourth quarter 2024 was also in line with expectations, rising 0.9% QoQ. This is the best measure of overall labour market inflation pressures as it includes all earnings and benefits. The chart below shows how those pressures have been rapidly cooling in the private sector. The best lead indicator for this series is the quits rate (we get an update next week within the JOLTS report). This measures the proportion of the workforce changing jobs each month and this has an excellent lead quality for predicting employment costs. The argument goes that with less job turnover there is less pressure on employers to pay more to retain staff. This should give the Fed added confidence that inflation is on the path to 2%.

## A lower quits rate points to further cooling in employment costs



Source: Macrobond, ING

However, with President Trump indicating he will introduce tariffs on Canadian and Mexico products that enter the US from tomorrow, we believe the Fed will keep rates steady until there is some clarity on the economic implications. The President's team appears to be making the argument that while tariffs will put up prices for imported goods this won't be inflationary because

consumers will have less money to spend on other goods and services. They believe that prices for those items will fall which will leave inflation overall flat. While this may incentivise re-shoring over the medium term, this is not going to be a good scenario for demand for US made goods and services, nor US corporate profits, in the near term.

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