Economic Commentary

QNB Economics
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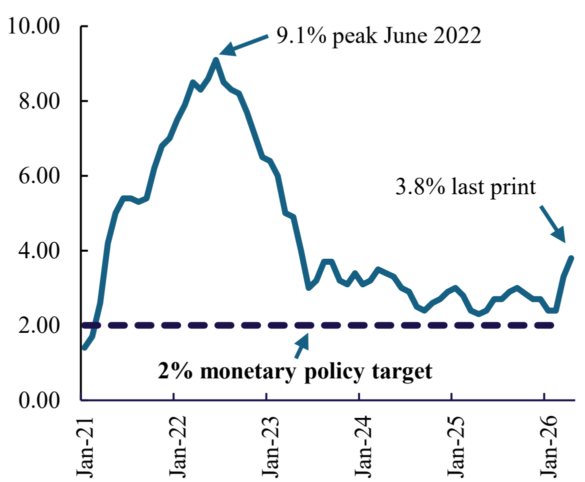
Rising inflation pressures cloud the path of US monetary policy

At the beginning of the year, the US economy was on a path of steady growth and moderating inflation. Price pressures continued to ease from their post-Covid pandemic peak, with consumer inflation declining from around 9% in mid-2022, steadily converging back to the 2% target of the Federal Reserve. However, this trajectory was abruptly disrupted by the escalation of the conflict between Israel and the US with Iran in late February.

Following the US-Israeli military campaign against Iran, launched on February 28th, Tehran retaliated by effectively closing the Strait of Hormuz – the waterway through which approximately 20% of the world's oil and liquefied natural gas (LNG) normally flows. The resulting surge in energy prices has partially reversed the disinflation process, raising inflation to close to 4%, nearly double the 2% target of monetary policy, triggering a reassessment of the outlook. Furthermore, the consensus forecasts for inflation for this year have increased significantly, from 2.6% in February before the conflict, to 3.3% in recent estimates, signalling a renewed phase of price pressures.

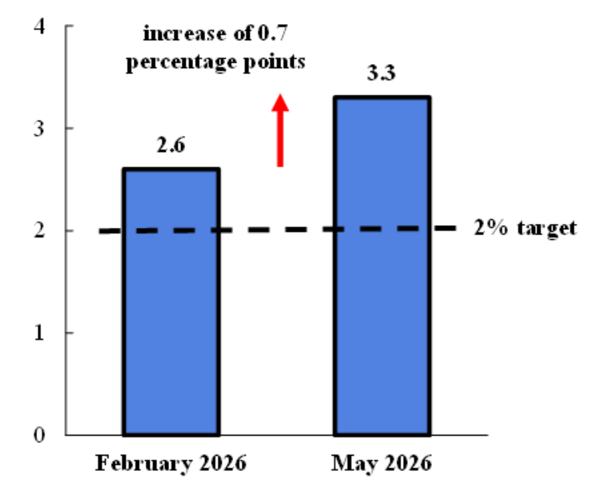
Consumer Price Inflation
(%, year-over-year)



Source: Bureau of Labor Statistics, QNB Economics

What had previously been shaping up as a year of gradual easing by the Federal Reserve is now clouded by heightened uncertainty, as policymakers reassess the persistence and depth of the new price pressures. Furthermore, the leadership transition at the Federal Reserve, with Kevin Warsh as the new Chair for the central bank creates further complexity. Warsh has previously emphasized the role of structural forces, including AI-led productivity gains that could lower production costs and prices faced by consumers, suggesting room for interest rate cuts. But the current environment presents a more challenging scenario. In this article, we discuss the key factors pushing inflation higher in the US and the risks they present for monetary policy.

Consumer Inflation Consensus Forecasts for 2026
(%, year-over-year, annual)



Source: Bloomberg, QNB Economics

First, the primary driver of the recent increase in inflation has been the sharp rise in energy prices following the escalation of the conflict. Brent crude prices surged by more than 25% in the weeks that followed the onset of hostilities, reaching above USD 120 per barrel at their peak, before moderating to still-elevated levels, while gasoline prices rose above USD 4 per gallon from around USD 3 per gallon previous to the conflict. The increase in oil and gas prices has rapidly translated into higher gasoline, electricity, and transportation costs, exerting upward pressure on overall inflation. The energy component of consumer prices rose by 17.9% year-over-year in April. Beyond this direct impact, the shock is propagating through second-round effects as higher energy costs feed into production, logistics, and distribution expenses, lifting prices across a broader range of goods and services. The transmission of cost pressures raises the risk of more persistent inflation, posing a challenge for monetary policy.

Second, trade policy has emerged as an important source of inflationary pressure. Higher tariffs imposed by the US since 2025 have increased the cost of imported goods, reversing part of the disinflation observed over the past year. Average effective tariff rates have increased from 2.3% in 2024 to the current level of 9.4%, with imports accounting for roughly 12% of US GDP. Estimates from the Federal Reserve Bank of Dallas suggest that tariffs have added close to 1 percentage point to inflation, reflecting both direct price effects and indirect spillovers through domestic supply chains. This indicates that trade policy is now acting as an important source of inflationary pressures.

Third, domestic demand conditions remain firm, reinforcing underlying price pressures. Private consumption continues to expand at a solid pace, supported by real income growth and elevated household wealth. US household net worth remains near record highs, at around USD 180 trillion, supported by strong equity market performance and resilient house prices. The labour market, while gradually cooling, remains tight by historical standards, with the unemployment rate still close to 4.5%. In addition, fiscal policy remains broadly supportive, with large deficits and ongoing public spending sustaining demand. Together, these factors are contributing to inflationary pressures, particularly in the services sector, where inflation tends to be more persistent.

All in all, the US inflation outlook has become more challenging, shaped by the recent increase in energy prices, ongoing tariff pressures, and resilient domestic demand. Taken together, these dynamics suggest that inflation is likely to remain above target for longer, complicating the Federal Reserve's path toward policy normalization. Reflecting this, market expectations have adjusted, with investors now anticipating policy rates to remain unchanged this year at around 3.75%, in contrast to pre-conflict expectations of two 25 basis point cuts.

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