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Analysis of today
Assessment of tomorrow

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Why Tariffs Do Not Cause Inflation

Recent official data shows that prices in the US economy are exceedingly far away from the runaway inflation fears created by Keynesian economists.

Contrary to Keynesian consensus estimates, inflation expectations among consumers are falling, the Consumer Price Index (CPI) remains contained, and the prices of essential goods are not rising.

While tariffs can be criticised for policy and geopolitical reasons, the narrative that they are direct drivers of sustained inflation does not stand up to empirical and theoretical scrutiny.

Consumer inflation expectations in the US have been trending downward. In June 2025, expectations fell to 3.0% from 3.2% in May, with projections suggesting a further decline to 3.0% for 2026.

The CPI year-over-year change stood at 2.7% in June 2025, well below the levels many forecasters feared at the start of new tariff implementations. Monthly core inflation, excluding food and energy, has hovered around 0.1-0.3%, consistent with pre-tariff periods and a far cry from any narrative of spiralling prices.

The USDA projects food-at-home prices to rise 2.2% in 2025, below the 20-year average—while certain categories like eggs and fresh vegetables are experiencing price declines.

Although some imported goods, such as appliances and toys, have recorded modest price increases, these have been counterbalanced by declines in other essentials such as gasoline, rent, and clothing. The all-in basket of essential household goods thus remains well within historic bounds.

Tariffs do not cause inflation—key arguments

1. Costs do not dictate final prices; it is the other way around, as the Menger imputation principle shows.

A key principle of economics, the Menger imputation principle, reminds us that final prices drive costs, rather than the reverse.

The value of factors of production is derived from the value of the final goods they help produce, not from their own intrinsic characteristics or costs.

Sellers can only raise prices to the extent that demand allows; otherwise, costs get absorbed along the supply chain or by exporters themselves.

2. Tariffs do not suppose more units of currency in the system nor higher monetary velocity. Furthermore, they do not impact aggregate prices.

Tariffs, unlike aggressive fiscal policy or monetary expansion, do not inject additional currency into the economy nor accelerate monetary velocity.

> Higher government spending leading to a soaring money supply, not tariffs, played the driving role in the inflation surge that peaked in 2022

True inflation—sustained, cumulative, and annualised rises in the general price level—requires an increase in money supply and/or spending velocity, and tariffs do not drive any of those factors.

Higher government spending leading to a soaring money supply, not tariffs, played the driving role in the inflation surge that peaked in 2022.

3. Supply chains are not a binary producer-buyer chain. They are exceedingly complex, and many of those rivets and links absorb costs.

The US supply chain network has grown nine times more complex since 2009, including a large number of components, partners, and processes.

Such complexity means tariffs on finished goods often see the cost spread widely and absorbed by producers, distributors, and transport or storage and packaging businesses.

Supply chain actors have varied strategies for mitigating cost increases, from technology to efficiency and inventory management, among others.

4. Most exporter nations have overcapacity and working capital challenges and thus prefer to keep prices attractive to sell to the US, the largest and richest market.

Countries like China struggle with industrial overcapacity, particularly in sectors like automobiles, batteries, and electronics.

The EU overcapacity is evident in steel, chemicals, automotive, and machinery as well as agricultural and farming goods.

These exporters face working capital constraints and often choose to keep prices attractive to maintain access to the massive US market, the largest and richest in the world, eating tariff costs.

5. Tariffs do not increase aggregate prices.

If tariffs created a sudden burst of aggregate prices, which is impossible as per the previous points, inflation would plummet in the following month due to declining consumption. Demand is not inelastic.

Only excessive government spending driving money supply and velocity growth create high inflation - Daniel Lacalle

If tariffs were truly inflationary at the aggregate level, economies like the EU or China—both with significant tariffs and trade barriers—would be suffering high inflation.

Instead, the redirection of Chinese goods to Europe is forecasted by ECB economists to reduce European inflation by up to 0.15 percentage points, showing how market competition and surplus supply suppress inflationary effects.

Moreover, demand is never perfectly inelastic; should tariffs sharply increase prices, which is impossible as we have mentioned, US consumers would simply buy less, quickly stabilising any upward pressure.

Inflation expectations are receding; CPI is rising in line with historical trends; and essential goods prices are flat or have fallen.

Only excessive government spending driving money supply and velocity growth create high inflation.