



By: Şebnem Kalemli-Özcan

Behind persistent inflation lie numerous supply shocks



It was only a few months ago that investors were preoccupied with US tariffs and the closure of the Strait of Hormuz.

But these issues have since receded from the forefront of our concerns, overshadowed by anxiety over the AI boom and possible bust, rising bond yields, and mounting public debt.

That is a mistake. Each of these developments is affected by inflation, which remains stubbornly high in the United States and many other countries, thanks to tariffs and the Hormuz crisis.

The AI buildout, the bond market, and the debt outlook cannot be properly assessed without accounting for the factors driving persistent inflation.

In September, the US Federal Reserve raised **interest rates** for the first time since 2023, owing most obviously to the energy crisis caused by the Hormuz shock.

But, a year and a half after US President Donald Trump announced his “Liberation Day” tariffs, the price pass-through from higher import costs is still visible in the inflation data.

Tariffs move slowly through global production networks, so their effect on prices shows up not as a single jump but as a slow buildup.

Since January 2025, the US price level has risen 0.3% above its pre-2025 trend—the precise cumulative effect implied by a **model** that my colleagues and I built at the Global Linkages Lab and fed with the tariffs actually implemented over the course of 2025.

The same story is true for core goods prices, which, despite not being directly exposed to the Hormuz shock, are 1.8% higher than their December 2024 level and well above a trend that had been flat to falling.

That translates into a contribution of 0.34 percentage points to the aggregate price level, slightly above our model’s 0.3-point prediction.

The reason for persistent inflation is structural

What sets our model apart from others is that it reproduces the steady increase in core inflation that actually occurred, rather than generating a large initial jump that fades quickly—the source of the mistaken “one-time price increase” narrative that took hold in 2025.

In fact, so many supply shocks have hit the global economy since 2021 that each has had a sustained and growing impact over time, ruling out a one-time price jump.

The reason for persistent inflation amid resilient global growth is structural: cost distortions from each supply shock hop from one sector to another, traveling worldwide.

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This goes back to the COVID-19 pandemic, which pushed inflation above major central banks’ 2% targets, where it has stayed since 2022.

After Russia’s invasion of Ukraine, inflation in 2022–23, especially in Europe, was explained by the resulting energy crunch.

But, as we **showed**, the mechanism was the same then as it is now: the inflation of 2021 was caused by the pandemic’s effects on global supply chains and labor markets, and was later intensified by the energy shock that followed the Ukraine war.

Even if every central bank started tightening its monetary policy in 2022, stabilization takes

longer in a protectionist world with frequent supply shocks.

Trade-policy uncertainty

Fed Governor **Christopher Waller** made a similar point in July, cautioning that core inflation “began rising well before the oil price shock” and pointing to “recent signs of continued pressure on goods prices.”

In his account, inflation is being driven by energy prices, tariffs, and spillovers from demand generated by the AI buildout.

In his Jackson Hole speech in August, Fed Chair **Kevin Warsh** also acknowledged the uncertainty about inflation in the face of repeated global supply shocks.



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Now add trade-policy uncertainty to the mix. To quantify its impact on how markets price stocks, bonds, and exchange rates, the **Global Linkages Lab** recently released the TiRADE (Tariff Rates in Announcements, Declarations, and Events) dataset.

The dataset records every US tariff threatened, announced, or signed since January 2025, timed to the minute, with the exact quote and its source, covering speeches, Truth Social posts, executive orders, proclamations, and White House statements.

What is most striking is that about 70% of these threatened or announced tariff rates

were never imposed, but markets reacted to them anyway.

We used this noise to build a measure of **trade-policy uncertainty** that explains a large share of the fluctuations in risky asset prices, including bond yields and the dollar’s sharp depreciation last year.

It turns out that what is said, not what is signed into law, drives uncertainty.

Inflationary world

Of course, markets may have simply adjusted to a world of protectionism, in which tariffs are one of the only tools that the US and other countries can use to stop the rise of China and shield domestic markets from Chinese goods.

But this will be an inflationary world with higher interest rates for all, and firms and households will also need to update their expectations.

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In their preoccupation with high public debt, rising bond yields, and dizzying AI valuations, investors have seemingly forgotten the supply shocks shaping the underlying inflation outlook.

Anyone worried about debt and yields must also concern themselves with the disruptions created in the name of protectionism and self-sufficiency.

Markets may have moved on, but inflation has not.

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