The Daily Dish

Inflation and the Trump Tariff

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Presidential candidate Donald Trump has proposed a 10 percent across-the-board tariff on all imports into the United States. This $3 trillion (over 10 years) tax increase would have a dramatic impact on households and fallout from its impact on our trading partners. But perhaps one of the most discussed – and misunderstood – aspects of the proposal is the likely impact on inflation. Consider, for example, a recent analysis by the White House Council of Economic Advisers (CEA):

> To begin, these tariffs will raise the prices of imported consumption goods and imported inputs used to produce output that is sold both domestically and internationally. A recent study found that a broad implementation of tariffs would raise the inflation rate by about ¾ percentage point relative to the current baseline (Zandi, Le Cerda, and Begley 2024 and correspondence with author). Clausing and Obstfeld 2024 concur that the inflation impact of an across-the-board tariff would be severe.

To be sure, taxes (and tariffs are simply a tax on imports) are a cost, and those costs will show up as higher prices. So a 10-percent tariff would mean that prices of imported finished goods would be permanently higher (other things being equal) and prices of imported intermediate goods would be passed along as higher prices in the economy.

But inflation is the rate of change of prices, not the level of prices. Imposing the tariff will show up as a one-time jump in costs that will translate into a one-time jump in prices, with no permanent impact on the rate of inflation. So the inflation impacts cited by the CEA must not be a permanent feature, but rather a feature of the transition to new, higher prices.

How much inflation will depend crucially on the Fed. If the Fed reacts to the tariffs with sharply restrictive monetary policy, the higher interest rates may diminish demand enough to keep the inflation impact to a minimum. Yet the combination of a big cost shock and reduced demand would translate into very negative impacts on growth – probably a recession. Still, there is no reason for the Fed to react this way. It will know that the price impacts are a one-time phenomenon that will not boost inflation permanently. It will most likely simply allow the tariffs to produce a one-time burst of (ironically) transitory inflation.

In short, the most likely impact of the tariff proposal will be a transitory detour from the 2 percent target, but no lasting impact on inflation. Prices will go, and remain, higher, just as groceries are now much more expensive even as inflation declines. There are lots of reasons to be unenthusiastic about a $3 trillion tax increase and the distortions this policy would introduce. But higher inflation is not one of them.