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The big question for the Fed is whether tariff inflation is temporary.

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Persistent Inflation, Soft Jobs Data Pull Fed in Two Directions

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Inflation accelerated in August while signs of weakness in the labor market accumulated, illustrating the tightrope the Federal Reserve will walk when officials consider cutting interest rates next week.

Consumer prices were up 2.9% last month from a year earlier, the Labor Department said Thursday, returning to the highest level since the start of the year.

That was up from 2.7% in July and a recent low of 2.3% in April, but in line with expectations from forecasters, who have expected businesses to steadily pass along higher costs from tariffs on imported goods and materials.

Separate data Thursday

showed that the number of people who filed for initial unemployment benefits jumped last week on a seasonally adjusted basis, hitting the highest level since October 2021.

The data can be noisy from one week to the next, particularly during a holiday-shortened workweek.

It comes against the backdrop of a sharp slowdown in payroll growth this summer alongside a slow but steady drift up in the unemployment rate.

A sustained rise in jobless claims would be alarming because it would signal more businesses are shedding workers, ending the slow-to-hire, slow-to-fire labor-market equilibrium of the past two years.

U.S. stocks rose, with all three major indexes setting records. Investors now anticipate the Fed will cut rates at each of its next several meetings.

Investors widely expected a September rate cut after last week's lackluster August jobs report, and Thursday's inflation reading will keep that solidly on track.

But it doesn't neatly answer questions over how aggressively officials will continue to reduce rates without more evidence of weakness in the labor market.

Excluding food and energy categories—the so-called core measure economists watch in an effort to better capture inflation's underlying trend—prices rose 3.1% over the past 12 months, also matching forecasts.

On the whole, price increases this year haven't been as stiff as feared this spring, when President Trump announced large and broad increases in tariffs.

Thursday's reports underscore worries that privatesector and Fed economists have harbored since the beginning of the year over how sweeping trade policy changes could weaken the economy while pushing up prices, delivering a whiff of stagflation. The inflation report showed that the economy might be avoiding a feared "surge" of bigger price hikes as wholesalers and retailers instead spread out cost increases over a longer time horizon.

"The bad news is we're getting these gradual increases in inflation at the same time as we have a series of data points showing a pretty compelling weakening in the labor market," said Daniel Hornung, a policy fellow at the Stanford Institute for Economic Policy Research.

Price increases for tariffrelated products were a mixed bag.

While price increases accelerated for some items such as cars and clothes, others such as tires and furniture were more muted than they had been in recent months.

"Tariffs aren't being passed onto consumer prices all at once," said Sarah House, senior economist at Wells Fargo. "But if you look at the overall trend, you're still seeing goods prices go up."

Meanwhile, the cost of groceries jumped 0.6% month over month in August after falling slightly in July. Over the past year, the grocery items with the biggest price increases include coffee (up 21%), uncooked beef steaks (up 17%) and apples (up 10%).

The big question that has faced the Fed all year is whether firmer inflation because of tariffs will be temporary or whether cost increases will become more persistent—for example, if they lead workers to successfully bargain for higher wages, as occurred in 2021 and 2022.

The answer to that question can't be easily answered until some time next year, which is what makes the Fed's coming policy decisions more difficult.

In recent weeks, more Fed officials, including Chair Jerome Powell, have suggested that softer labor market conditions should give the Fed more comfort that they can assume price increases will be a one-off.

Companies including Hormel Foods, J.M. Smucker and Ace Hardware have said they are raising prices for reasons ranging from higher meat costs to tariffs. At large retailers like Walmart, Target and Best Buy, some tariff-related price increases are already in place and more are on the way.

The Trump administration has said that tariffs won't increase inflation and will make America wealthier.

The Fed's preferred inflation gauge, the personal-consumption expenditures price index, won't be released by the Commerce Department until later this month.

Forecasters expect it could be considerably more mild for August than the CPI. They can predict it reasonably well because it is composed from price data from the CPI and a separate wholesale price index r e l e a s e d Wednesday. "From the Fed's perspective and the fact they care about PCE inflation, this isn't a bad report," said Stephen Juneau, senior U.S. economist at Bank of America.

Persistent inflation could leave consumers feeling gloomier about the economy, especially since they are also facing a weak job market.

“This degree of inflation still pales in comparison to what we saw in the past few years. But it’s coming on the back of that generational surge in prices,” said House. “There’s not as much capacity for consumers to absorb these price increases as they had a few years ago.”

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