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America and the Quadrilateral of Inflation

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Oil, customs duties, immigration, budget, inflationary threats are accumulating. But the economic fabric resists, and the market applauds the resilience of companies.

Can the " Iran issue " disrupt the American economic prospects by triggering an inflationary shock ? The military air intervention on June 22, in support of the operations of its Israeli ally, reinforced concerns about a surge in oil prices. But the diagnosis is more complex, and the truth must first be sought in the country's internal economic and political dynamics.

So far, inflation remains contained. Highly anticipated, especially after import taxes have already risen, the Consumer Price Index (CPI), for May, showed a rise of just 0.08%, over one month, coming below expectations. Even more surprising, among the weakest components, automobiles and clothing are on the front line without trade tensions, whose prices have fallen.

This is good news for the Fed, which can afford to wait to gather more information on prices' dynamics, before adjusting its monetary policy stance. For now, there are no concerns about the financing conditions on the American economy, despite some nervousness in long-term interest rates.

But, as Jerome Powell himself pointed out during the June 18 press conference, the level of uncertainty remains very high, and the ongoing escalation between Iran and Israel is a new factor that could change the situation.

✓ **Inflation** – including its part excluding energy and food with a few months' lag – **is indeed very strongly correlated with oil prices.** According to JP Morgan's analysis, a closure of the Strait of Hormuz could lead American light crude prices toward **$120 per barrel, which would mean a risk of raising inflation in the United States to 5%.**

This is consistent with a recent study by the American central bank, which estimates that a $10 increase per barrel has the capacity to raise inflation by 20 Bps.

However, the threat became credible since the Iranian Parliament, on 22 June, in response to the American airstrikes on the same day, authorized the country's executive to close the strait through which more than 20% of the world's oil production and 30% of that of liquefied natural gas transit.

At this stage, caution should be exercised, as any prolonged closure would first have adverse consequences for the initiator itself. Iran would, indeed, be the first country to suffer from an interruption of traffic in this strategic passage. And economic damages would be inflicted on its main partner, China, which, as part of its Belt and Road Initiative, is counting on the ports of Gwadar in Pakistan and Chabahar in Iran to connect Central Asia to Europe and to the Middle East by sea.

✓ **The increase in tariffs is the second inflationary factor to monitor.** The ninety-day "pause" decreed by Donald Trump on April 9, after the global shock caused by "Liberation Day" a week earlier, is nearing to its end. Time is running out.

To date, only one partial agreement has been signed with the United Kingdom. But among the most important trading partners, neither Europe, nor Japan, nor China seem to be able to meet the July 9 deadline.

Paradoxically, the tone of discussions suggests a more quicker and positive outcome with the Chinese strategic rival, rather than with the European or Japanese allies. Despite the uncertainty, regarding the scale and speed of the potential strongest tariff shock since – at least – the 1930s, the conclusion of an agreement with China would allow economic actors to anticipate and smooth out the impacts.

In that case, and if such agreements were also quickly concluded with the main Asian countries, the rise in prices could only be temporary – six to nine months – unless there is an additional shock, particularly in the labor market.

✓ **The labor market is the third inflationary factor** to monitor in the United States, the most structuring in the medium-term. While employment is gradually normalizing, it remains subject to potential tensions, as there is little room to maneuver with an unemployment rate of barely over 4.2%.

However, it is, in fact, the immigrant labor that allows the adjustment of labor supply and demand, particularly in labor-intensive sectors, such as construction, agriculture, or tourism.

In the run-up to Donald Trump's election last November, **several studies had warned of the need to maintain a largely positive net migration balance to avoid disrupting the economy.** In November 2024, the Congressional Budget Office (CBO) then estimated that from 2031 onwards, the birth deficit would mean that only net immigration could balance the demographic equation.

Moreover, immigration is essential for maintaining productivity growth, which, by remaining above that of net wages, enables the promotion of non-inflationary growth.

Donald Trump's ambition to multiply deportations could, therefore, be a disruptive factor for the supply.

✓ **The last subject of concern is that of a massive revival of the demand through a sharp increase in the budget deficit.**

Investors' discomfort has indeed been revived by the vote in the House of Representatives of the major OBBBA law – **One Big Beautiful Bill Act** – which sets the fiscal framework for the federal government. According to the CBO, if the law is approved by the Senate, the overall tax-cutting measures could generate a widening of the projected deficit by over $430 billion in 2025. This massive stimulus, even if it overlooks the most modest households, would be a powerful factor of pressure on prices in the context of the disruption of the supply.

So far, the economy resists and the confidence of SME owners, measured by the NFIB index, which rose sharply in May, testifies the resilience of the economy and adaptability of companies. The market understood it, refusing to give up. **Investors are now waiting for stronger support from the Fed in the face of geopolitical turmoil. Will they keep their nerves in the face of the escalation of the various conflicts?**

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