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Economic Briefing

US inflation too high for Fed

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U.S. consumer prices rose significantly in August, up 0.4% from the previous month. This was not only due to noticeably higher gasoline prices. Even more important is the excessive underlying price pressure, as evidenced by the core inflation rate—excluding energy and food—which came in at 0.3%, exceeding expectations. The Federal Reserve has already signaled that it could raise interest rates if the inflation trend does not ease quickly. Now it needs to take action. At its meeting on Wednesday, we now expect the Fed to raise the target range for the Fed Funds rate by 25 basis points.

The data

U.S. consumer prices rose 0.4% in August compared with the previous month. Excluding energy and food, they rose 0.3%, a tenth of a percentage point more than we and the consensus had expected. In year-over-year terms, the headline rate—which covers all goods and services—remained at 3.4%, while the core rate edged down from 2.5% to 2.4%.

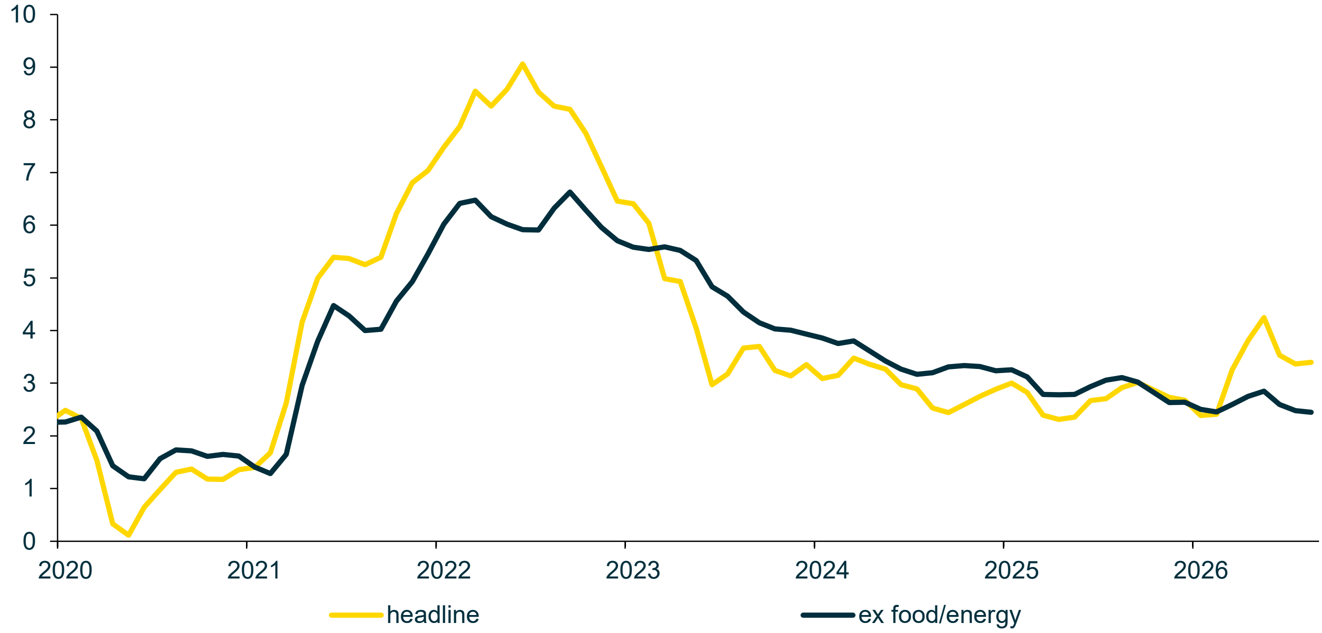
The background

Inflationary pressure in the U.S. remains quite high. In terms of the overall rate, this comes as little surprise given the sharp rise in oil and gasoline prices. However, the more important core rate—which excludes energy and food—also came in high at 0.3% compared to the previous month (0.29% when rounded to two decimal places). Projected over a year, this amounts to 3.5%.

Within the core rate, goods prices rose by 0.1% and services prices by 0.3%. Both are slightly higher than when inflation was fluctuating around 2%.

With a bit of goodwill, one could at least identify a downward trend in the core inflation rate (Chart 1). However, this trend has been less pronounced recently. Furthermore, the latest surge in energy prices is likely to soon drive up the prices of non-energy goods as well, for example due to rising transportation costs. And finally, inflation has been too high for more than five years. The central bank's hopes for a sustained decline to 2% have never materialized. All in all, the inflation problem remains unresolved and calls for a response from the central bank.

Chart 1 - Inflation too high since 2021
US consumer price index, year-on-year change in %. October 2025: missing value interpolated



Source: BLS, S&P Global, Commerzbank Research

Now the Fed will likely have to act

For the Fed to hold steady at next week's meeting, it would have needed better—that is, lower—inflation data. Fed Governor Waller recently stated that the Fed would likely have to respond if the trend of slowing inflation did not continue in August. And that is exactly what has happened. Against this backdrop, further inaction by the Fed would entail the risk of another negative reaction from the bond markets. Fed Chairman Warsh already learned this lesson early in his tenure, when the markets reacted to his remarks with a spike in yields.

In any case, the Fed is likely keeping a very close eye on the bond market at the moment; after all, Treasury Secretary Bessent's efforts to curb the rise in yields on longer-term bonds have not been successful. It would therefore be highly undesirable if the markets were to price in even higher inflation expectations due to a lack of response from the Fed to the inflation data. An interest rate hike would thus likely be the lesser of two evils, even from Bessent's perspective. The Fed will have to weather the wrath of President Trump, who had warned against a rate hike.

We had previously assumed a close call in favor of keeping interest rates unchanged. However, following today's figures, a 25-basis-point rate hike is now more likely on Wednesday.

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