

AART Inflation Quarterly Q4 2025

Tariffs pass-through makes its way to consumers

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Key takeaways

- We estimate that the pass-through from tariffs has picked up steam, with tariff-sensitive categories, including apparel, vehicles, auto parts, TVs, and seafood up strongly month-over-month.
- With the trade-policy landscape unsettled, it's difficult to estimate how much more inflation remains in the pipeline.
- Yet overall inflation is becoming slightly less “sticky,” with persistent measures of inflation declining, possibly leading to a lower inflation rate in 2026.
- The market appears too sanguine on the inflation risks, which could justify positions in Treasury Inflation-Protected Securities relative to U.S. Treasuries.

Tariff pass-through appears to be making its way to consumers, based on the August Consumer Price Index (CPI) data, with goods inflation rising 46 basis points month-over-month, and to an annualized 3% quarterly.

We're seeing tariff-sensitive categories, including apparel (+50 bps), vehicles (+35 bps), auto parts (+56 bps), TVs (+246 bps) and seafood (+65 bps), all up strongly compared with July.

Who are tariffs affecting?

Our estimate is that we saw significantly more tariff impact on inflation over the past quarter than during the prior one. With only four to five months of data post-tariffs thus far—and so much unsettled about ongoing trade negotiations, lawsuits, and other potential changes—it's difficult to estimate how much more inflation remains in the pipeline.

Our estimates about the breakdown among the groups affected by the tariffs has also changed significantly, with consumers bearing 59% of the total tariff burden, importers 31%, and exporters only 10%. These results are nearly in line with our original estimates (Exhibit 1).

Exhibit 1: AART Tariff Trackers as of September 22, 2025

	AART Initial Estimate	Absorption Rate	Tariffs Share
Exporter	10%	7%	10%
Importer	30%	22%	31%
Consumer	60%	42%	59%
Total	100%	72%	100%

Source: Fidelity Investments (AART) estimates, as of 9/22/25.

High U.S. tariff rates pose a moderate stagflationary risk to the U.S. economy. Our central scenario assumes that the current tariff regime remains for a prolonged duration. If this were to happen, we estimate a 1% annual hit to U.S. gross domestic product and a 1% increase in the inflation rate. Scenarios where tariffs are negotiated down or ruled illegal would lead to a lower effective tariff rate, with milder impacts on growth and inflation.

Legal update

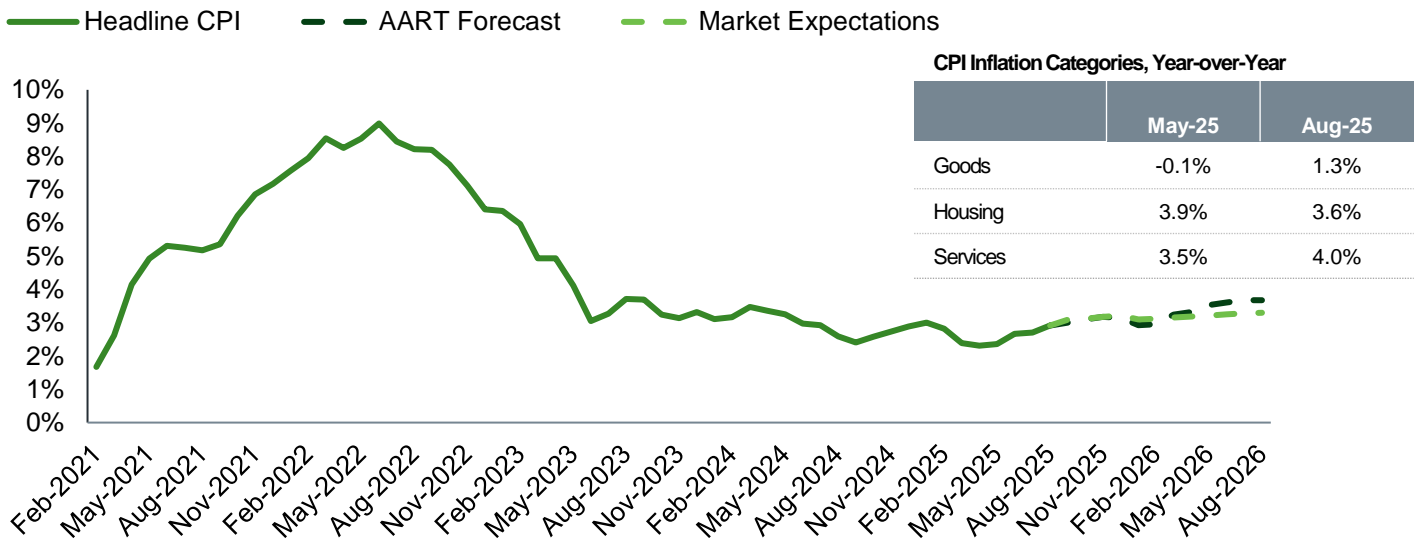
On November 5, the U.S. Supreme Court will hear an appeal on the legality of using the International Emergency Economic Powers Act to continue to impose existing tariffs. This raises the possibility of a ruling by year's end. Although a federal trade court and appellate court both ruled against the administration on this issue, the appellate court vote was 7-4 with 4 Republican appointees. Therefore, the Supreme Court case is not a foregone conclusion.

Even if the Supreme Court were to rule against the administration, substantially equivalent tariffs to those now in place today could still be reconstituted.

Forecast/positioning

The AART team's forecast for headline inflation over the next year reflects expectations of headline CPI inflation peaking in the mid 3% range in mid-2026 (Exhibit 2). This is in line with expectations from the inflation swaps market over the next year, but above 1-year inflation breakevens, which have been trading around 2.8%.

Exhibit 2: AART inflation estimates vs. market expectations



CPI: Consumer Price Index. Market expectations: inflation swaps. Source: Bureau of Labor Statistics, Bloomberg, Haver Analytics, Fidelity Investments (AART), as of 8/31/25.

As for the Fed's preferred inflation measure—core personal consumption expenditures (PCE)—we saw less evidence of tariff pass-through. The AART team expects core PCE to trade slightly above 3% for most of 2026.

Inflation looks slightly less sticky

AART's measure of persistent inflation is declining as inflation becomes more goods-driven, as opposed to services-driven. This may provide benefits in lowering inflation in 2026 as the tariff impact fades—assuming expectations stay anchored, new tariff hikes don't occur, and softer services inflation isn't simply due to an income effect from more expensive goods.

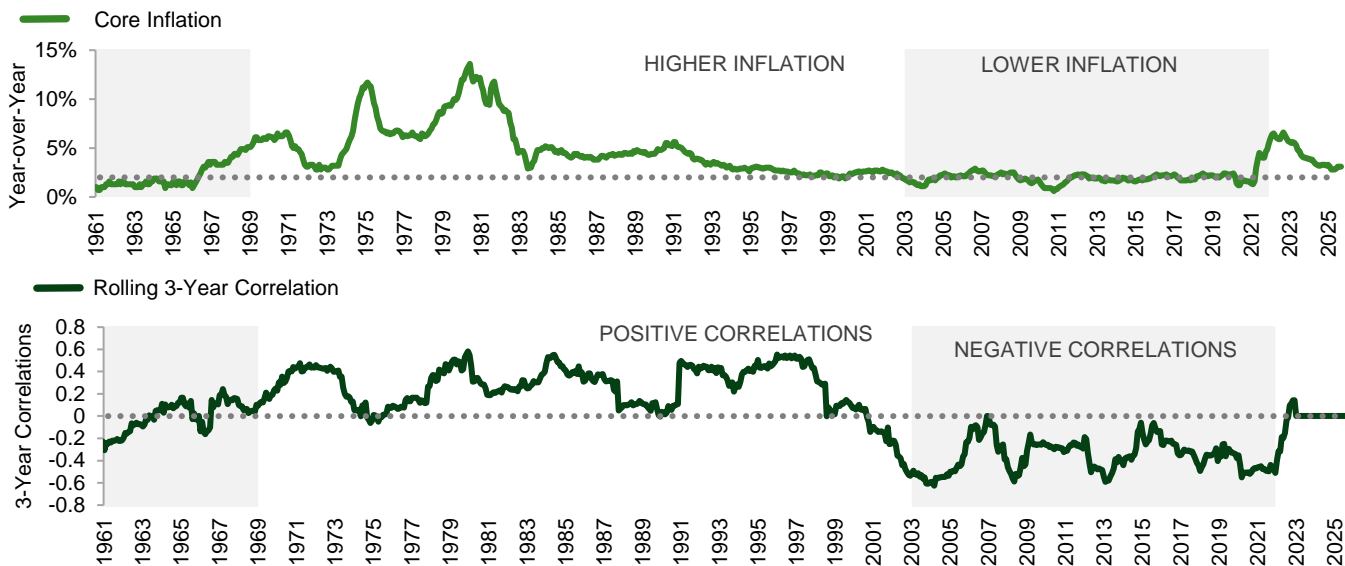
What about housing?

Even with the expected lag between housing prices and CPI inflation, we found it surprising to see an increase in owner-equivalent rent in the latest data (the amount a homeowner would have to pay to rent their own home on the open market). This data point highlights the lengthy process of normalizing CPI housing inflation.

Looking ahead

The next inflation data release, initially scheduled for October 15, will take place on October 24. We see inflation rising slightly again month over month, and up slightly year-over-year as well. Softer labor data could be offset by stronger inflation expectations and looming pass-through from both tariffs and a weaker dollar.

Exhibit 3: U.S. stocks and Treasury bond correlations vs. inflation



Correlation is a statistical measure that reflects the extent to which two variables are linearly related. Positive correlations indicate the variables move in the same direction, whereas negative correlations indicate they move in opposite directions. **Past performance is no guarantee of future results.** Diversification does not ensure a profit or guarantee against a loss. Fidelity Investments' proprietary analysis of historical asset class performance is not indicative of future performance. Stocks measured by the Dow Jones U.S. Total Stock Market Index (Total Return). U.S. Treasuries measured by the Bloomberg U.S. Intermediate Treasury Bond Index (Total Return). Source: Bureau of Labor Statistics, Macrobond, Bloomberg Finance L.P., Fidelity Investments (AART), as of 6/30/25.

Investor considerations

As we noted the previous quarter, core inflation has contributed to the environment of positive correlations between U.S. stocks and U.S. Treasuries (Exhibit 3). This raises implications for asset class diversification.

In an environment in which it may be difficult to return to the Fed's 2% inflation target rate, investors might consider positions in Treasury Inflation-Protected Securities relative to U.S. Treasuries. We believe diversified portfolios that incorporate this type of inflation protection may help investors better manage their finances in periods of market volatility and rising stock-bond correlations.

Other types of inflation-resistant assets include commodities and commodity-producer equities, which have helped hedge against high and rising inflation while also providing potential for capital appreciation in a strong growth environment.

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Collin conducts fundamental and quantitative research for Fidelity's portfolio managers and investment teams. In this role, he provides insights on macroeconomic, policy, and financial market trends.



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