# DB FX Blog - The dog that didn't bark

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**DB FX Blog - The dog that didn't bark - the surprising case of US inflation**

**USD up on Fed repricing.** The dollar has rallied over 3% in the past five weeks, supported by a hawkish Fed repricing. The US2y is up 40bps, compared to 10-30bps for most peers. The dominant narrative around Fed pricing seems to be “they haven’t hit the inflation target in six years, growth is still robust – more work to do”. We can't argue with that view, except to say it might not be the complete story.

**All things considered, inflation isn't that high.** The other angle we find relevant – core inflation actually appears remarkably *low* given everything that has happened in the past two years. Imagine it’s late 2024 and the coming two years are described to you: “US growth still stay robust – unemployment to stay in the low 4s, strong profit growth, easy financial conditions. Plus, we'll see serious price shocks – a tripling of the US tariff rate on imports, and a doubling of energy costs. What will happen to core PCE?” You’d be forgiven for guessing a 100bp+ acceleration at least. Yet it’s been a minscule*10bps* – core PCE inflation was 2.9%yoy in late 2024, and throughout 2026 it’s been right around 3.0%.

**Surprisingly low.** Figure 1 makes an attempt at illustrating these developments. Z-scores for drivers of growth (unemployment, profit growth, financial conditions) and inflation shocks (gasoline prices, tariff rate, supply chain pressure index) have shot up to a level rivalling the 2022 inflation surge. Yet the rise in core PCE inflation has been minimal. US inflation prints have tended to undershoot consensus forecasts over the past year or so (Figure 2). Quite why this has occurred is up for debate. Perhaps the capex-heavy nature of growth has helped, or there's been a contribution from productivity and/or deregulation.

**The bottom line.** US inflation is certainly too high, hence the need for Fed hikes. But all things considered, it’s surprising inflation isn't higher. The risks seem skewed to a downside surprises and a dovish Fed repricing. Our economists have only 16bps for core CPI this week - about the low in the market (most at 20bps, with some at 30bps). And they see two more Fed hikes, compared to market pricing for more than three. This would work against the

dollar breaking higher (BBDXY is at the top of the 17-month range - Figure 3).

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