7th June 2025

Why the US could see disinflation

The big theme in the market is stagflation and how tariffs are inflationary. Yet, all historic evidence points to either deflation (Smoot-Hawley tariffs) or low inflation (Fordney-McCumber tariffs), whilst all historic stagflationary periods were caused by energy shocks (1973 OPEC oil embargo, 1979 Iranian revolution, 2022 Ukraine war). Year-to-date oil, gas and thermal coal, which make up 77% of the world's energy mix as of 2023[1], are down -15% (oil), unchanged in the U.S. & -30% in Europe (gas), and -30% (thermal coal). Out of 13 major central banks, only Brazil and Japan hiked rates year-to-date, all other central banks cut rates between -0.1% and -1%, only the Fed kept rates stable. Now, looking at tariffs, Trump's election pledge was 10-20% universal tariff and 60% tariffs on China. The impetus is clear: Either make your product in the U.S. or face a tariff. Since then, Trump has been clear that certain items, like clothes, should not be made in the US[2]. Home-shoring will take years, as the factories first need to be built. The table below looks at all categories where imports to the U.S. exceed $50bn.

Largest U.S. imports by category (2024) (>$50bn)

Category	US$ million
Pharmaceutical preparations	246,849
Passenger cars	213,590
Crude oil	167,326
Other automotive parts and accessories	145,660
Computers	116,732
Cell phones and other household goods	111,879
Electric apparatus	102,684
Computer accessories	100,660
Other industrial machinery	84,921
Telecommunications equipment	84,611
Semiconductors	81,943
Trucks, buses, and special purpose vehicles	63,388
Medical equipment	62,706
Other textile apparel and household goods	53,731
Finished metal shapes	51,806

Source: Bureau of Economic Analysis

[1] https://ourworldindata.org/energy-mix
[2] https://www.reuters.com/world/us/trump-says-us-wants-make-tanks-not-t-shirts-2025-05-25/

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US May CPI expectations vs. prior

US CPI YoY		
-	2.5%	2.3%
US CPI MoM		
-	0.2%	0.2%
US Core CPI YoY		
-	2.9%	2.8%
US Core CPI MoM		
-	0.3%	0.2%

Source: Financialjuice.com

Central Banks key interest rates

Country	Central Bank	1 Jan 2025 Rate	7 Jun 2025 Rate	Delta
Eurozone	European Central Bank (ECB)	3.00%	2.00%	-1.00%
United Kingdom	Bank of England (BoE)	4.75%	4.25%	-0.50%
Canada	Bank of Canada (BoC)	3.25%	2.75%	-0.50%
Australia	Reserve Bank of Australia (RBA)	4.75%	3.85%	-0.90%
New Zealand	Reserve Bank of New Zealand (RBNZ)	4.25%	3.25%	-1.00%
South Korea	Bank of Korea (BoK)	3.00%	2.50%	-0.50%
China	People's Bank of China (PBoC)	3.10%	3.00%	-0.10%
India	Reserve Bank of India (RBI)	6.50%	5.50%	-1.00%
Russia	Central Bank of Russia (CBR)	21.00%	20.00%	-1.00%
Brazil	Central Bank of Brazil (BCB)	12.25%	14.75%	2.50%
South Africa	South African Reserve Bank (SARB)	7.75%	7.25%	-0.50%
Japan	Bank of Japan (BoJ)	0.25%	0.50%	0.25%
United States	Federal Reserve (Fed)	4.50%	4.50%	0.00%

Source: Tradingeconomics.com

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Pharmaceutical preparations ($247bn imports)

As discussed in a prior note, whilst China and India account nearly 60% of pharmaceutical imports by volume, they only account for less than 10% by value. Ireland, Germany, Switzerland and Netherlands, on the other hand, account for less than 15% of pharmaceutical imports by volume, but nearly 50% by value. The executive order on delivering most-favoured-nation prescription drug pricing to American patients lays the groundwork to establish lower prescription drug prices with first results to be heard by 12th June, i.e. 30 days after executive order was given[3]. The key to this executive order is the following section:

My Administration will take immediate steps to end global freeloading and, should drug manufacturers fail to offer American consumers the most-favored-nation lowest price, my Administration will take additional aggressive action. [...] The Commissioner of Food and Drugs shall take action under section 804(j)(2)(B) of the FDCA to describe circumstances under which waivers will be consistently granted to import prescription drugs on a case-by-case basis from developed nations with low-cost prescription drugs.

We have heard about plans from Roche, Pfizer, Novartis, Eli Lilly, Johnson & Johnson, Merck and AstraZeneca to build new manufacturing sites in the U.S. totalling $150bn[4], which will likely lead to the elimination of most of the nearly $250bn imports of pharmaceutical preparations over time. Tariffs are a bit harder to use as a tool against pharmaceuticals, because it can involve death for the patients and oftentimes the prescription drugs have no competition due to patents. Overall, I'd expect pharmaceutical prices to come down, but would use 0% for the purpose of modelling.

[3] https://www.whitehouse.gov/presidential-actions/2025/05/delivering-most-favored-nation-prescription-drug-pricing-to-american-patients/
[4] https://www.biospace.com/job-trends/massive-investment-in-us-manufacturing-triggers-wave-of-career-opportunities, https://www.thechemicalengineer.com/news/pharma-s-us-150bn-investment-in-us-sparks-exodus-fears-web/

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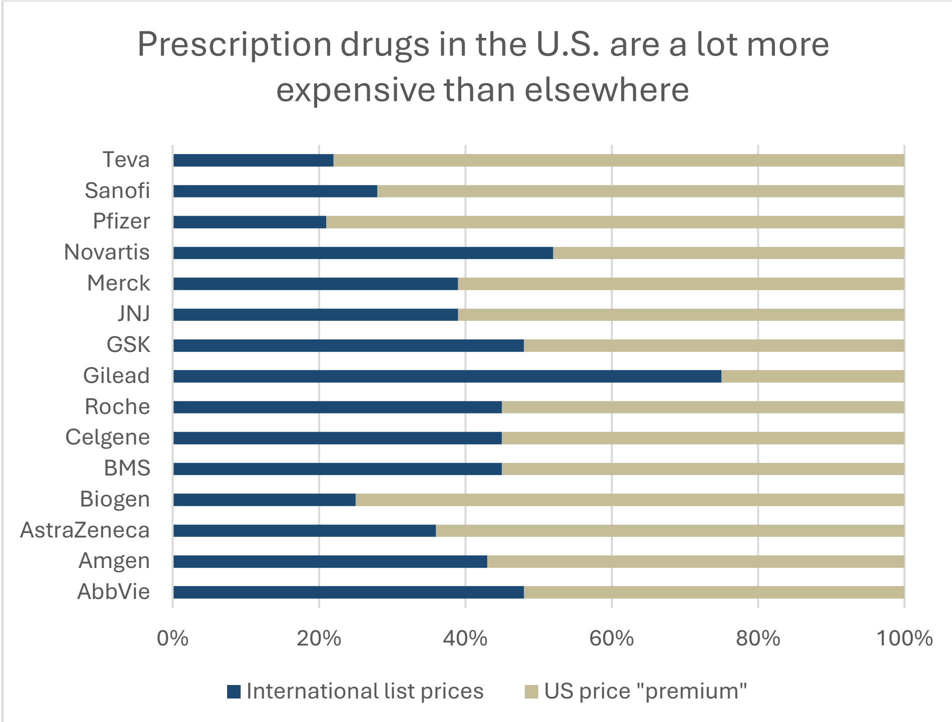

Source: https://www.vox.com/future-perfect/368538/medicare-drug-prices-pharma-negotiations-innovation

Passenger cars & automotive parts ($360bn imports)

Passenger cars and parts currently make up around $360bn in annual imports to the US. Passenger cars currently face a 25% tariff when imported into the U.S. (apart from UK imports, where the first 100k cars only face a 10% tariff)[5]. Around 50% of the 16m annual vehicle sales are imported to the US and, of those manufactured in the US, only 40% have domestic content, which means around 25% are only made in America[6]. However, the United Auto Workers Union estimates that there is plenty of excess capacity to increase production in the US from 10.2m vehicles to 14.7m vehicles[7]. In particular, the Detroit Three (Stellantis, Ford, GM) have the most room to expand existing capacity[8]. Given the deal with the UK and a likely deal with Japan, South Korea and Europe, actual passenger

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[5] https://www.gov.uk/government/news/landmark-economic-deal-with-united-states-saves-thousands-of-jobs-for-british-car-makers-and-steel-industry
[6] https://www.whitehouse.gov/fact-sheets/2025/03/fact-sheet-president-donald-j-trump-adjusts-imports-of-automobiles-and-automobile-parts-into-the-united-states/
[7] https://uaw.org/wp-content/uploads/2025/04/2025-UAW-extra-capacity-white-paper-A1FINAL-1.pdf?source=na
[8] https://www.cbtnews.com/unused-capacity-at-u-s-auto-plants-highlights-complex-tariff-challenges/

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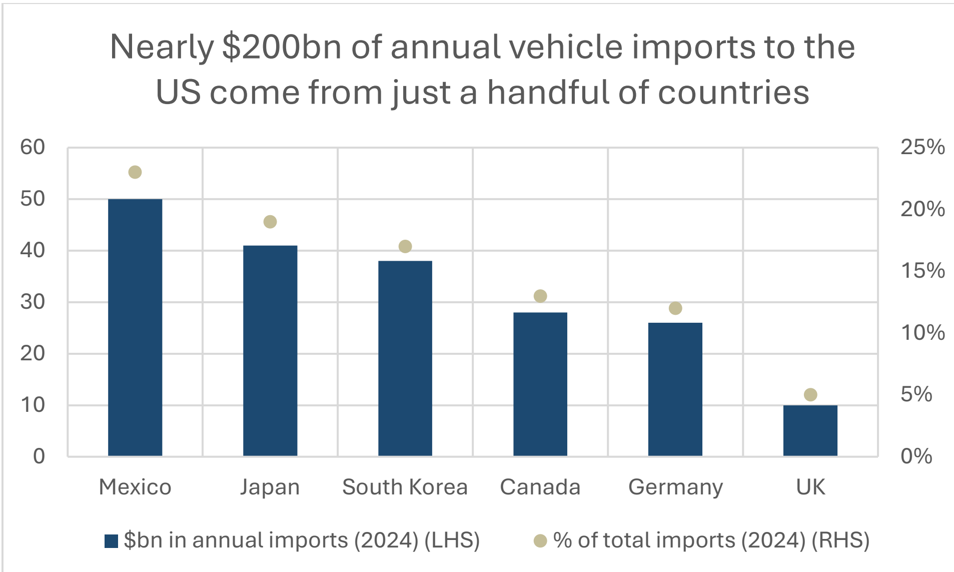
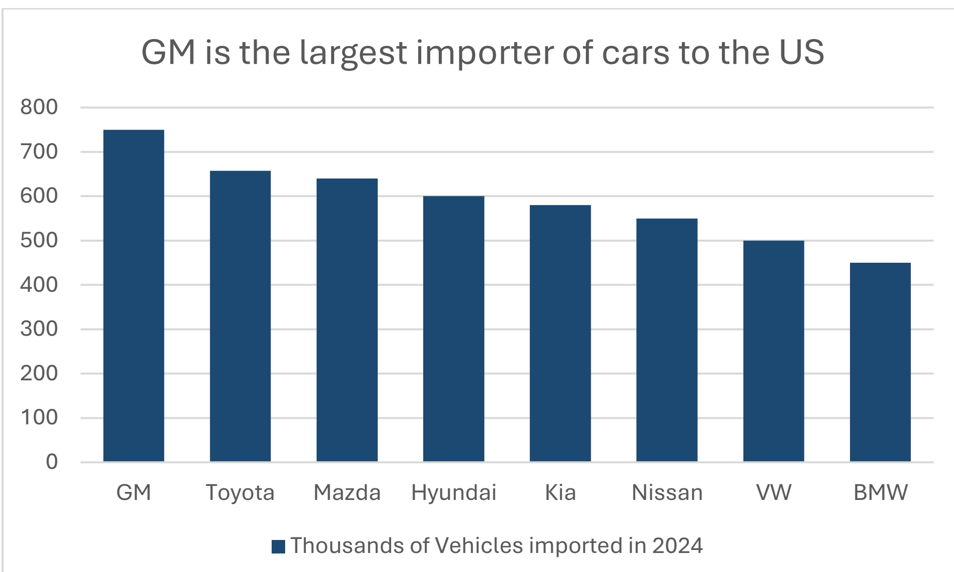
car tariffs might end up at 15%, and amidst the possible capacity expansion, the inflation from these tariffs could end up being at maximum 10%, which could still be way too high. Hyundai, for example, is considering a meagre 1% price hike on US vehicle to counter the hit from tariffs[9].



Source: https://www.usimportdata.com/blogs/top-us-car-imports-by-country-in-2024



Source: https://www.usimportdata.com/blogs/top-us-car-imports-by-country-in-2024

[9] https://www.reuters.com/business/autos-transportation/hyundai-considering-1-price-hike-us-vehicles-counter-tariff-hit-bloomberg-news-2025-05-29/

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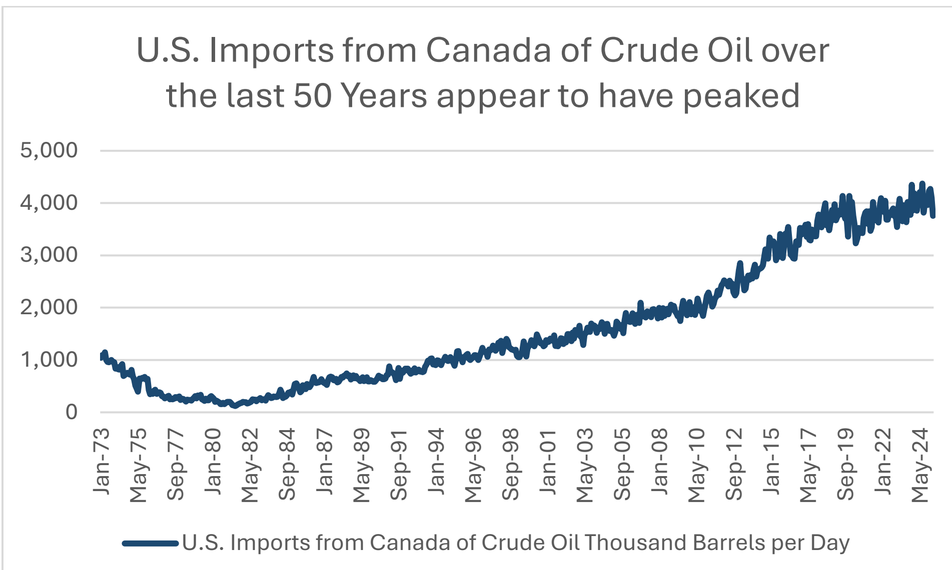
Crude oil ($167bn imports)

The US is importing 76% of its crude oil as of 2023, but remains a net exporter of crude oil overall[10]. This is mostly due to the mix of refineries, as the light shale oil is not suitable for 70% of the refineries built, which are more suitable to handle heavy crude oil, such as the Canadian heavy oil sands[11]. The 10% tariff on Canadian crude oil[12] has not impacted prices[13]. US crude oil imports from Canada have seen a dip in March, but most recent data suggest that more crude oil is flowing from Canada to China instead of the US[14]. Given the general downturn in crude oil, natural gas and thermal coal prices, I apply a 10% decline in energy prices in the model.



Source: EIA

[10] https://www.eia.gov/tools/faqs/faq.php?id=727&t=6
[11] https://www.afpm.org/newsroom/blog/whats-difference-between-heavy-and-light-crude-oils-and-why-do-american-refineries
[12] https://www.whitehouse.gov/fact-sheets/2025/02/fact-sheet-president-donald-j-trump-imposes-tariffs-on-imports-from-canada-mexico-and-china/
[13] https://www.eia.gov/petroleum/gasdiesel/
[14] https://www.reuters.com/markets/commodities/canadas-crude-oil-shift-china-schools-trump-unintended-consequences-russell-2025-05-22/

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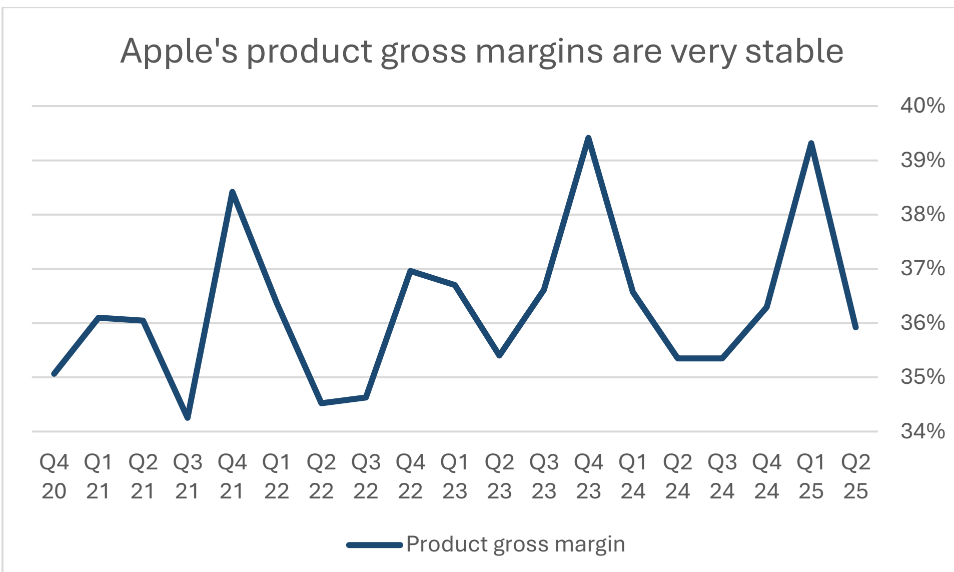
Computers, machinery, cell phones & electrical, telecommunication, medical equipment ($664bn imports)

This category includes mainly imports from China and to some degree imports from American companies that shifted their production abroad, such as Apple. China currently faces a 30% tariff, of which 20% is due to fentanyl and 10% of reciprocal tariff. This deal runs out on 12th August[15] with some products extended deadline of 31st August[16]. This type of equipment oftentimes has >30% gross margins, meaning that the cost of logistics, storage, retail lease and labour costs add significant cost to the end price for the consumer. Apple, for instance, generates 37% gross margins from hardware sales[17]. Tariffs, however, are levied on the landed value of the products. A 30% tariff could therefore end up costing the end consumer only 20% more. For other products, such as furniture, the impact of tariffs on prices will be even lower. However, given that imports compete against domestic production, companies might choose to not pass on the full tariff on its products to customers. Therefore, I'm applying a 20% increase in prices of such equipment, which is similar to car price assumptions, very likely much too high, but considers that tariffs could go back up.



Source: Apple quarterly results

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[15] https://www.whitehouse.gov/fact-sheets/2025/05/fact-sheet-president-donald-j-trump-secures-a-historic-trade-win-for-the-united-states/
[16] https://ustr.gov/about/policy-offices/press-office/press-releases/2025/may/ustr-extends-certain-exclusions-china-section-301-tariffs
[17] https://s2.q4cdn.com/470004039/files/doc_earnings/2024/q4/filing/10-Q4-2024-As-Filed.pdf

Walmart's Q1 earnings call & the inflation model

Walmart's Q1 earnings call has been the most insightful when it comes to tariffs. The key takeaways are listed below and can be summarised as little flexibility on food price inflation and the need to take a loss on excessive tariffs, i.e. 20% price hikes is the highest Walmart thinks certain products can be marked up. At the same time, general merchandise, which is mostly coming from China, has been deflationary for over a year. Hence, some deflationary impact could overall lower potential price hikes from tariffs. Overall, Walmart seem to present a message that price hikes in May have accelerated and that they expect further price hikes through the year. Therefore, if the May and June CPI come in lower than expected, it will be hard for the Fed to keep the current narrative of higher rates for longer. Below is the final US CPI model, coming at right at around 2%. This is by applying 5% food price inflation, -10% energy, -5% transportation services, 10% on vehicles and apparel and 20% on household furnishings, while keeping the rest between 0% and 2%.

US CPI model

Category	Weight	Inflation expectation	Inflation * weight
Food	13.7%	5%	0.68%
Energy	6.3%	-10%	-0.63%
Energy services	3.1%	-10%	-0.31%
New vehicles	4.4%	10%	0.44%
Used cars and trucks	2.4%	10%	0.24%
Apparel	2.6%	10%	0.26%
Tobacco & alcohol & others	2.1%	2%	0.04%
Medical care commodities	1.5%	0%	0.00%
Recreation and education commodities	2.6%	2%	0.05%
Household furnishings	3.4%	20%	0.68%
Shelter	35.4%	2%	0.71%
Water, sewage and trash collection	1.1%	1%	0.01%
Transportation services	6.3%	-5%	-0.32%
Medical care services	6.7%	1%	0.07%
Recreation services	3.5%	1%	0.04%
Education and communication services	5.0%	1%	0.05%
Subtotal	**100.0%**		**1.99%**

Source: Bureau of Labor Statistics, own assumptions

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2/3 of Walmart's products are from the U.S.

It's helpful that more than two-thirds of what we sell in the US is made, assembled, or grown here. In recent years, our US percentage has grown. Last year, we purchased $296 billion in the United States, and we made a commitment back in 2021 to add another $350 billion in incremental US volume over the following 10 years.

Source:

https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 4

China is their largest country of import and cost pressure accelerated in May

The merchandise that we import comes from all over the world from dozens of countries. Other than the US, the other large markets are China, Mexico, Vietnam, India, and Canada. China, in particular, represents a lot of volume in certain categories like electronics and toys. All of the tariffs create cost pressure for us, but the larger tariffs on China have the biggest impact. The cost pressure from all the tariff impacted markets started in late April, and it accelerated in May.

Source:

https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 5

Main struggle is to keep food prices as low as possible

Let me describe how we think about that, and what we're doing about it. First, we want to keep our food and consumables prices as low as we can. Food prices in the US have gone up in recent years and our customers have been feeling that all along. We won't let tariff-related cost pressure on some general merchandise items put pressure on food prices. But as it relates to food, tariffs on countries like Costa Rica, Peru, and Colombia, are pressuring imported items like bananas, avocados, coffee, and roses. We'll do our best to control what we can control in order to keep food prices as low as possible.

Source:

https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 5

Some costs will need to be absorbed by Walmart and tariff to non-tariffed product switching

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In some cases, we'll absorb costs within a category or department and not simply pass on a tariff cost attributable to each item individually. We'll be managing mix across items, categories and businesses.

We also have suppliers shifting materials from tariff-impacted components like aluminum to fiberglass, where there is no tariff. Our merchants, sourcing team and suppliers are being creative. It's been impressive to watch our team identify opportunities and adjust.

Source: https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 5

Tariffs will lead to higher prices, but it will play out through the year

And three, we're positioned to manage the cost pressure from tariffs as well or better than anyone. But even at the reduced levels, the higher tariffs will result in higher prices. The timing of the tariffs and our inventory receipts matters as you interpret our results by quarter. John David will say more about how retail accounting and timing will play out through the year.

Source: https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 5

30% China tariffs are still too high for Walmart

In terms of the first part of your question, what I was referring to is, where the level of tariffs that were announced at the beginning of April. Keep in mind, a week ago, we were at 145% tariffs in China. And certainly, you know as well as anyone the preparation that goes into this day for us. And so when we started the preparation around earnings, that's the construct that we were working under. And 145% tariff environment, and tariffs at a level that are approaching 50% for other countries, is not a good outcome for retailers, it's not a good outcome for the economy.

We're very pleased and appreciative of the progress that's been made by the administration to bring tariffs down to this level. And the guidance that we gave today, the affirmation of our full-year guidance, is with tariffs at this level. But let me emphasize, we still think that's too high. There are certain items, certain categories of merchandise that we're dependent upon to import from other countries, and prices of those things are likely going to go up, and that's not good for consumers.

Source: https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 15

General merchandise has been deflationary for over a year now

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Robby, thanks for the question. I'll start, and some of the others may want to jump in. General merchandise has been deflationary for over a year right now, and we've seen the impact of that. And think of it as deflationary in low single-digits in the quarter. Importantly, though, we grew units in the quarter.

Source:

https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 18

Customers don't want any more food inflation & General merchandise will be more costly

Yeah. Greg, it happens gradually. And as we mentioned earlier, we started to see increases happen in April and through May. We've been really focused on back-to-school receipts. When you have an imported item, you pay the tariff at the time it comes through customs.

And so the cost is higher, even if the tariff rate comes down later, the cost has been elevated. So I wouldn't think of this as a moment in time necessarily, except when you think about seasonal things like back-to-school.

So I think it will feel more gradual. And as we've been saying to everyone, the first thing that goes through my mind is food inflation. We've been through a number of years here where prices have gone up on food, and our customers have felt that, and they don't want any more food inflation.

And so what we hope happens is that there are changes from a policy point of view that help us get prices back, ex tariffs on bananas and things that we don't grow here. So food inflation is very much on our mind.

And as it relates to GM, it will vary by category, which country is it? If it's from China, obviously, it will have a higher amount. And this reset of costs will play out through the year. We'll have seasonal items. It will be higher than they would have been otherwise. So I think what we're looking at is upward pressure that began in April and plays through the entire year on things that are imported.

Source:

https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_management_call/Q1+2026+Earnings+Call.pdf p. 21

Excessive tariffs will lead to losses for Walmart

And that's also a case where I said yesterday we may not pass on the entirety of that cost increase. Like, if you use an extreme example and you take--were to assume the 145% tariff, which is where we were a week ago, the patio furniture that sells for $2,000 at Sam's is now, you know, almost $3,500. You're not going to sell units at that, at $3,500.

So, in that example, maybe we mark it up hypothetically 20% and we absorb a loss on that. But that's where merchant--or the mix of our business really comes into effect, where we might need to price some other things that may be don't even have tariffs applied to them to try to manage this and it be least impactful on the consumer.

Source:

https://stock.walmart.com/_assets/_fd2070d53220eed6fac33d073cf0a0e6/walmart/db/938/9953/transcript_buy_side_follow_up_call/Q1+FY26+Buyside+Investor+Call.pdf p. 5

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