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US Daily: Lower Oil Prices Won't Offset Much of the Effects of Tariffs on Inflation, Inflation Expectations, and Growth (Rindels)

- Oil prices have fallen by $20 since mid-January, reflecting OPEC supply increases and expectations for softer demand on the back of the weaker growth outlook, and our commodities strategists expect prices to decline further over the rest of 2025 and 2026. We assess the impact of lower oil prices and their scope for dampening the effects of tariffs on inflation, inflation expectations, and GDP growth.
- Lower oil prices will weigh on consumer energy prices, which will slow headline inflation and offset a small share of the inflationary impact of tariffs. The contribution of energy prices to year-over-year headline PCE inflation has already fallen from roughly 0.05pp in January to -0.2pp in March, and under our energy strategists' forecasts, we expect it to remain at about -0.2pp over the rest of 2025.
- Consumer inflation expectations tend to be very sensitive to changes in gasoline prices. However, tariff anxieties have recently driven a large surge in consumer inflation expectations despite the modest offsetting downward pressure from the decline in gasoline prices so far, and we expect that the further decline in gasoline prices that our energy strategists forecast would offset only a bit more of it.
- Lower gasoline prices will offset some of the tax-like hit to real disposable income growth from tariffs, which will in turn boost consumption growth. However, lower oil prices will also weigh on energy capex. While energy capex has become less sensitive to changes in oil prices than during the shale boom last cycle, the net effect of the consumption boost and the capex drag will still likely be only a modest boost to GDP growth.

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Lower Oil Prices Won't Offset Much of the Effects of Tariffs on Inflation, Inflation Expectations, and Growth

Oil prices have fallen by $20 since mid-January, reflecting expectations for softer demand on the back of the weaker growth outlook and supply increases from both OPEC and non-OPEC ex-US shale projects, and our commodities strategists expect prices to decline further over the rest of 2025 and 2026.[1] We assess the impact of lower oil prices and their scope for dampening the effects of tariffs on inflation, inflation expectations, and GDP growth.

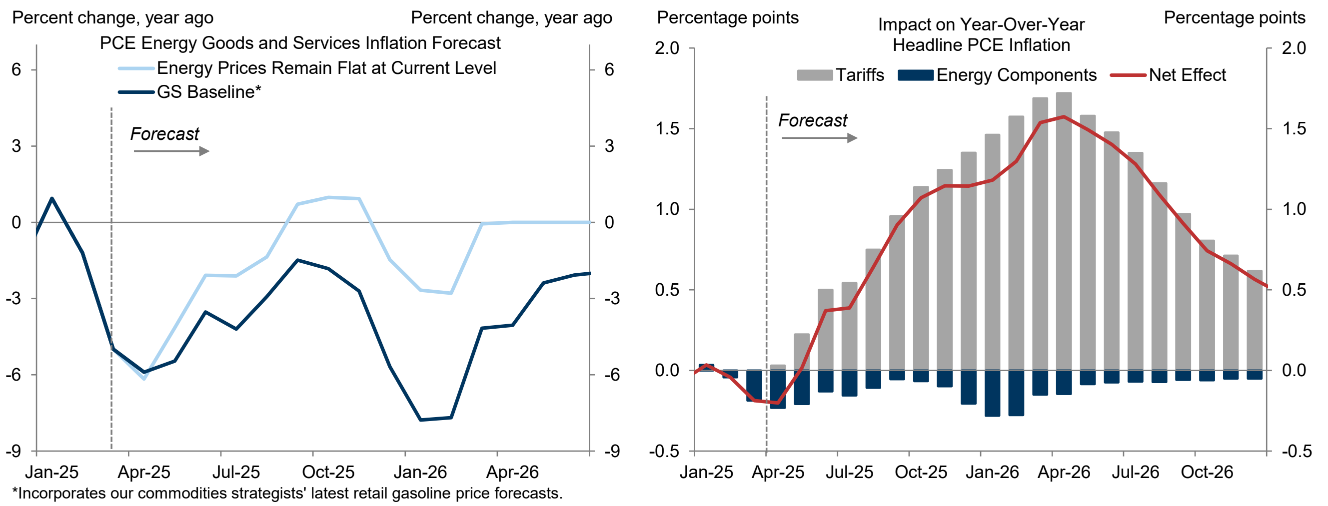
Lower oil prices will weigh on consumer energy prices, which will slow headline inflation and offset some of the inflationary impact of tariffs. As shown in the left panel of Exhibit 1, after combining the decline in oil prices that has already happened with our energy strategists' latest forecasts, we expect year-over-year PCE energy inflation to average roughly -3.5% over the rest of 2025.

The right panel of Exhibit 1 shows that the contribution of energy prices to year-over-year headline PCE inflation has already fallen from roughly 0.05pp in January to -0.2pp in March, and under our energy strategists' forecasts, we expect it to remain about -0.2pp over the rest of 2025. But this drag is much smaller than the boost from tariffs, and we therefore expect year-over-year headline PCE inflation to rise from 2.3% currently to 3.3% in December 2025 and 2.7% in December 2026.

Although core prices exclude energy components, lower oil prices still spill over to several non-energy categories. Our latest update of our commodity passthrough model suggests that the impact of commodity prices on year-over-year core PCE inflation would range between -0.05pp to -0.10pp through the end of this year if oil prices remained around current levels. Accounting for our strategists' forecast of further declines in oil prices, we would expect the impulse on core inflation to fall by another 0.03-0.05pp (corresponding to a rule of thumb of a roughly 4bp drag on core PCE per 10% decline in oil prices).

[1] Our commodity strategists expect Brent/WTI oil prices to decline to $60/56 for the remainder of 2025 and $56/52 in 2026.

Exhibit 1: Lower Oil Prices Will Weigh on Consumer Energy Prices, Though This Will Only Offset a Small Share of the Inflationary Impact of Tariffs

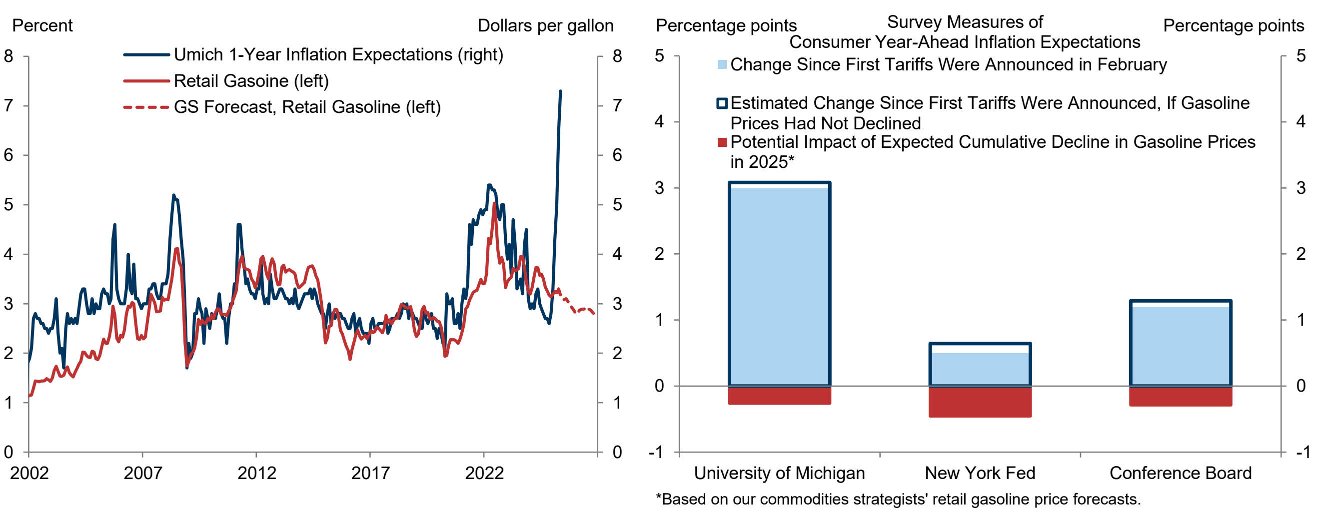


Source: Goldman Sachs Global Investment Research, Bureau of Economic Analysis

Consumer inflation expectations tend to be very sensitive to changes in gasoline prices, which have declined modestly in recent weeks. However, tariff anxieties have recently driven a large surge in consumer inflation expectations despite the modest offsetting downward pressure from the decline in gasoline prices so far, and we expect that the further decline in gasoline prices that our energy strategists expect would offset only a bit more of it.

We use simple regressions to estimate the sensitivity of short-term inflation expectations to changes in retail gasoline prices. The results suggest that the recent decline in gasoline prices could have weighed on short-term expectations by about 0.1pp on average, and that the size of the drag could grow to roughly 0.3pp on average this year if gasoline prices follow our strategists' forecast.

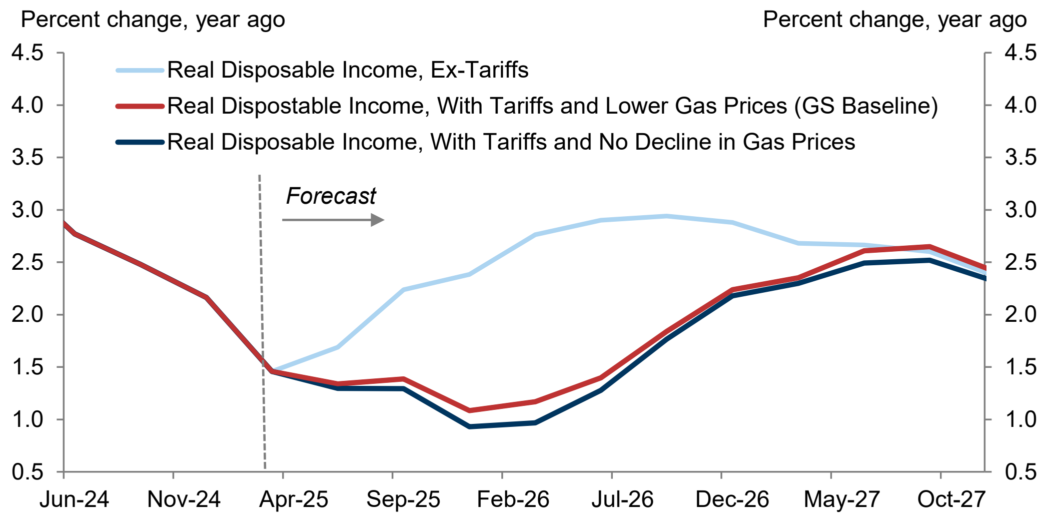
Exhibit 2: Lower Gasoline Prices Could Offset Some of the Rise in Short-Term Inflation Expectations from Tariffs



Source: Goldman Sachs Global Investment Research, Energy Information Administration, University of Michigan, Federal Reserve, The Conference Board

Lower gasoline prices will offset some of the tax-like hit to real disposable income growth and consumption growth from tariffs. Assuming prices decline in line with our strategists' forecasts, our oil consumption model suggests that the oil impulse on consumption growth would average roughly +0.1pp over the next year. We expect real consumption growth of +1.2% on a Q4/Q4 basis in 2025 and +1.9% Q4/Q4 in 2026.

Exhibit 3: Lower Gasoline Prices Will Offset Only a Small Part of the Tax-Like Hit to Real Disposable Income Growth from Tariffs

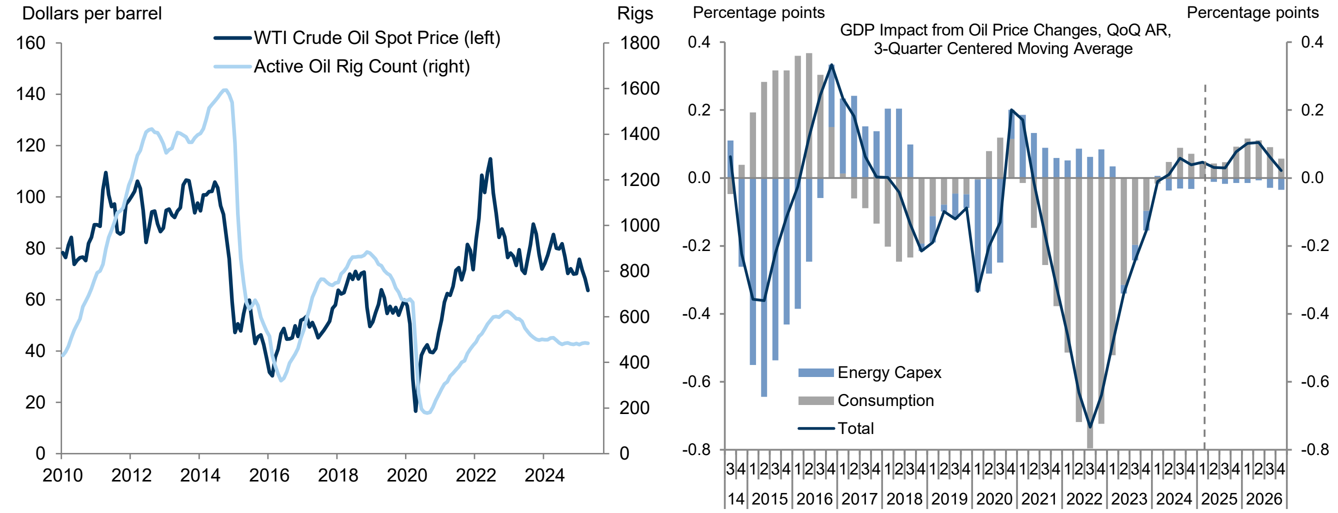


Source: Goldman Sachs Global Investment Research, Bureau of Economic Analysis

While lower oil prices will boost real disposable income and real consumer spending, they will also weigh on energy capital expenditures from lower oil prices. As we discussed previously, the recent shift toward publicly traded producers and heightened focus on investor returns has led to reduced sensitivity of energy capex to oil prices (left panel of Exhibit 4), and we estimate that a $10/barrel decline weighs on GDP growth over the next year via energy capex by 0.05pp today vs. 0.15pp a decade ago.

We estimate that the oil impulse to capex growth will be a roughly 0.05pp drag on average over the rest of 2025, reflecting our energy equity analysts' expectations for a small decline in capex this year driven by the recent oil price volatility and a slower pace of final investment decisions. While both effects are small, we estimate that the net impulse from lower oil prices via consumption and capex will be a roughly 0.1pp boost to GDP growth over the rest of 2025 (right panel of Exhibit 4).

Exhibit 4: Energy Capex Has Become Less Sensitive to Changes in Oil Prices, but the Modest Hit from Lower Prices Will Offset a Bit of the GDP Boost via Consumption



Source: Goldman Sachs Global Investment Research, Energy Information Administration, Baker Hughes

Jessica Rindels

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