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The CPI report in January showed inflation increasing for a fourth consecutive month to 3.0% year-on-year from 2.9% in December, above analyst expectations of 2.9%. Core inflation (ex. food and energy) increased to 3.3% after slowing in December, and above analyst expectations of a slowdown to 3.1%. On a month-on-month basis, overall inflation picked up by 0.5% vs 0.4% from a month ago and above expectations of a 0.3% increase. Core inflation ticked higher as well, up 0.4% in January vs 0.2% in December and above 0.3% expected by analysts.

The acceleration in the Consumer Price Index and the strong employment data from last week bolster the Fed's decision during their January meeting to hold rates at the current level. Inflation remains stubbornly high and Trump's tariff policies could push inflation even higher. Trump's first days in office show that he is willing to follow through on his campaign promises of putting tariffs on countries that he believes deserve them. He has imposed tariffs on China, threatened to impose tariffs on Mexico and Canada of 25%, though he delayed them until March 1st, is imposing tariffs of 25% on all imports of Aluminum and Steel and is planning reciprocal tariffs against any country that has imposed tariffs on US goods. The Fed should be able to take all of this into account before their next meeting which is set to take place on March 19th. At this meeting, the Fed will update their predictions for rate cuts and other economic indicators.

We had previously expected the Fed to cut rates by 0.50% this year with a cut possible in March, but the very strong economic data out so far this year and the prospects of inflationary government policies mean the March cut is unlikely. In addition, we believe even the 50bps in cuts this year is at risk. As the economy is near full employment, the Fed can focus its attention on the inflation side of its dual mandate. Here, government policies on immigration, tariffs, and the budget could all add to inflationary pressures. This means the Fed will be on pause in its rate cutting cycle for some time and could end the year with just 0 or 1 further rate cut of 0.25%.

Treasury yields have reacted to the higher than expected inflation with a sharp rise, with longer-term bond yields rising faster than shorter-term bond yields. We believe the inflation risks, as well as large ongoing budget deficits and debt issuance, mean this trend can continue. We believe longer-term bond yields could rise further while shorter-term bond yields look more reasonable at current levels. Our preference is for investors to remain in shorter maturity (duration) fixed income as yields levels offer good return potential with less risk of price declines if yields continue rising.

Some details on the CPI report:

- Headline inflation was 3.0% YoY, up from 2.9% in December. Core inflation increased to 3.3% YoY from 3.2%. On a month-on-month basis, headline inflation was 0.5%, and Core was 0.4%. All 4 numbers were higher than what analysts expected.

- Food inflation remained steady at 2.5% YoY for a second consecutive month. The increase was once again driven by the Food at Home category, where eggs rose by 53% from a year ago. The US is currently suffering from a shortage of eggs due to the bird flu.

- Goods prices (ex food and energy) decreased by -0.1% YoY as prices for many goods continue to decline from last year but at a much slower pace than the past few months.

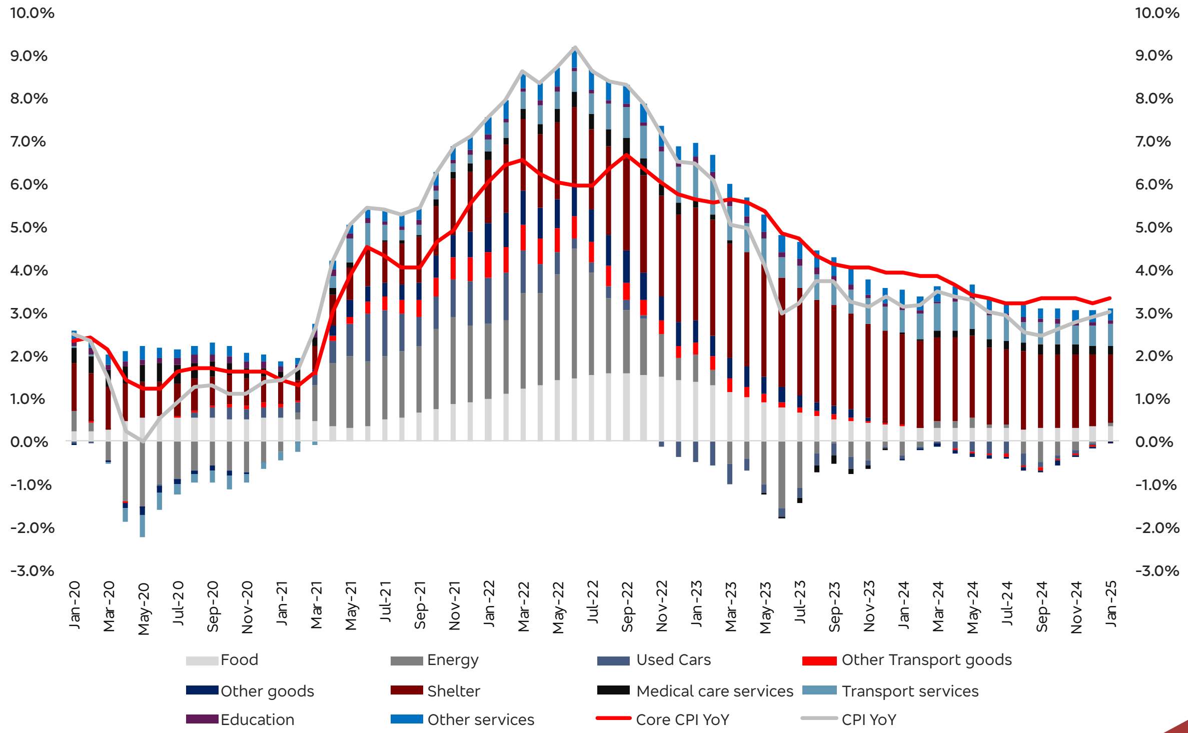
- Medical Care Commodities increased by 2.3% YoY in January up from 0.5% last month mainly driven by an increase of 2.6% in the Medicinal Drugs category as prescription drugs jump 4.5% from a year ago.

- Transportation commodities which includes New and Used Vehicles as well as Motor Vehicle Parts increased for the first time since December 2023 by 0.2% largely in part due to Used Cars and Trucks which increased by 1% from a year ago, increasing for the first time since October 2022.

- Core Services inflation slowed to 4.3% from 4.4% last month as Shelter inflation continues to slow. Shelter inflation slowed to 4.4% from 4.6% helped by Owners' Equivalent Rent (OER) which slowed to 4.6% from 4.8%. Shelter inflation increased on a monthly basis, up 0.4% from 0.3% driven by OER which increased 1.4% after decreasing by 0.5% in December.

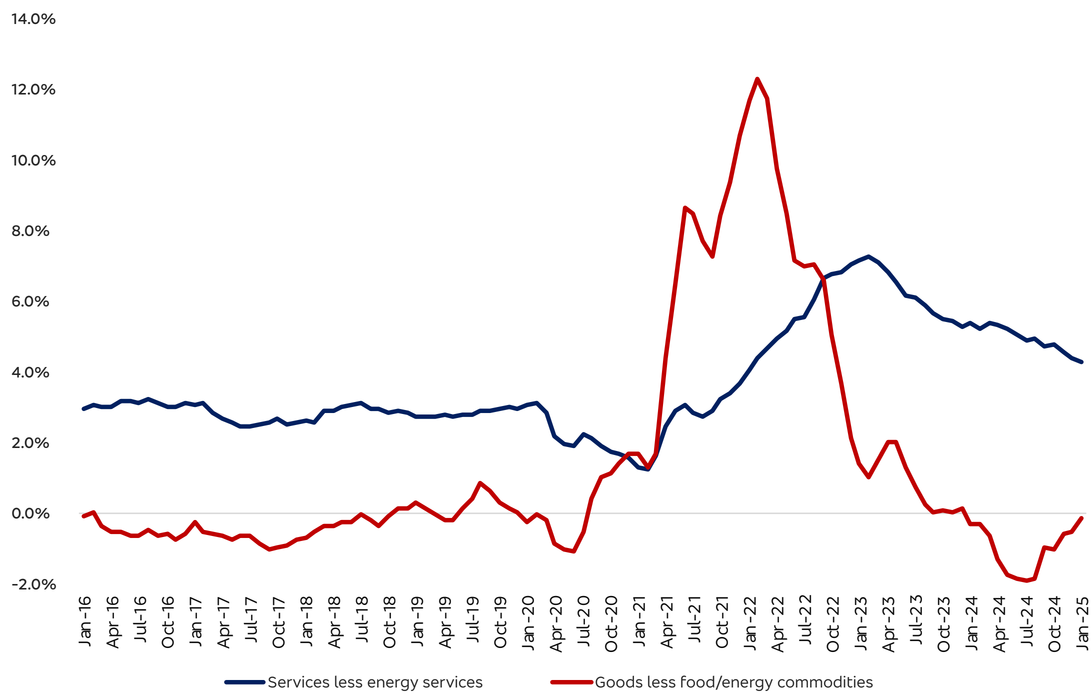
- Energy increased for the first time since July 2024, up 1% from a year ago. The increase was due to the Motor Fuel category which, although it decreased by 0.5% from a year ago, the pace is much faster than the pace of the past few months. Energy Services slowed to 2.5% from 3.3% due to Electricity inflation which slowed to 1.9% from 2.8%.

Inflation rises to 3.0 % YoY while Core inflation ticks up by 3.3%



Source: Bloomberg/Bradesco

Goods prices decrease by just 0.1%YoY, while Services inflation remains elevated at 4.3% YoY



Source: Bloomberg/Bradesco

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