BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

March 14, 2025

The Week Behind

1. **US Consumer Price Index (CPI) inflation was slightly better than expected, but the outlook is negative.**

   <u>The outlook:</u> I expect US core CPI to trough in H1-25 slightly below 3.0% before reaccelerating. Depending on the scope and scale of tariffs, core CPI could rise to 3.5% to 4.0% by the end of 2025.

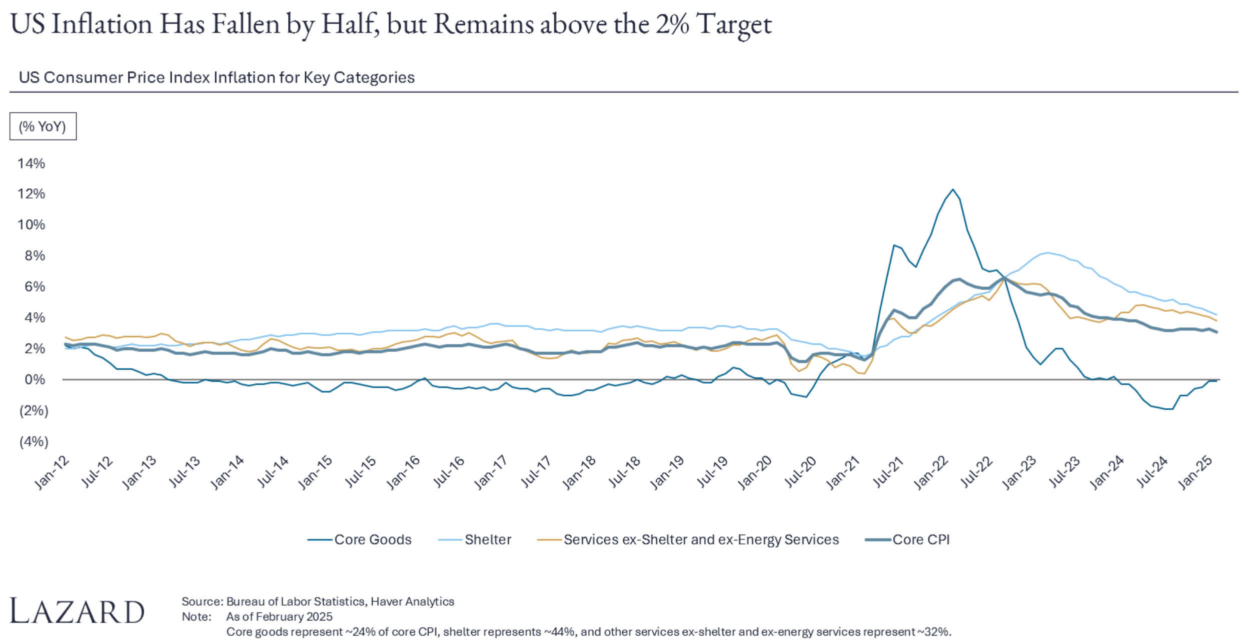
   If I am correct, the Federal Reserve is unlikely to cut rates in 2025, in contrast with the 70 basis points (bps) of easing implied by Fed Funds futures. While I do not expect rate cuts, I also do not expect any hikes. Tariff-driven inflation is generally a one-time event, i.e., prices go up once to reflect the tariff, but one year later, absent additional tariffs, the inflation subsides. The challenge for the Fed is likely to be a combination of rising inflation and increasing unemployment. Given the dual mandate for price stability and maximum employment, the Fed is likely to be criticized, but if it remains true to its mantra of the last four years that price stability is a precondition for full employment, it will have to prioritize inflation over jobs and hold policy steady.

   <u>The details:</u> Headline CPI rose 22 bps month-on-month (m-o-m) and 2.8% year-on-year (y-o-y). Core CPI rose 23 bps m-o-m and 3.1% y-o-y after rising 3.2% or 3.3% y-o-y each of the prior eight months. Both core and headline inflation were 0.1% lower than expected (on both m-o-m and y-o-y bases) due largely to falling airline fares, a notoriously volatile price series.

   As anticipated, shelter inflation continued to decelerate with the y-o-y increase falling to 4.2% from 5.2% six months earlier. While there could be some additional downside for shelter inflation, I believe we have seen the bulk of the improvement in this metric that accounts for 44% of core CPI by weight.

   Services inflation ex-shelter slowed to 3.8% y-o-y, its lowest level since late 2023. Core goods inflation remained at -0.1% y-o-y for the second month but is up from -1.9% y-o-y six months ago.

LAZARD



February 2025 Core CPI Details	Weight in Core CPI	Contribution/ Detraction (bps)
Key Categories:		
Shelter (OER, rent of primary residence, other accommodation)	44.3%	12.5
Services ex-Shelter	31.5%	6.5
Core goods	24.2%	5.2
Total Core CPI (from sum of key categories)		24.2
All Items Ex-Food and Energy (reported)		22.6
Contributors:		
Owners' equivalent rent of a primary residence	32.7%	9.1
Rent of Primary Residence	9.3%	2.6
Recreation services	4.3%	3.5
Used cars and trucks	3.0%	2.6
Detractors:		
Airline fares	1.2%	(4.7)
Source: Lazard, Bureau of Labor Statistics		
As of Febuary 2025		

2. **The United States imposed tariffs on ~$150 billion of steel, aluminum, and related imports.**

   <u>The outlook:</u> More tariffs are likely to be imposed across a broadening array of goods and countries. Retaliatory measures are also likely to expand as trade partners respond to US measures. The most significant divergence between my views and the market is that I believe the administration fully

intends to deliver on its trade rhetoric. I expect significant additional tariffs to be imposed and to stay in place long enough to materially raise US inflation, lower US (and non-US) GDP, and squeeze corporate profit margins.

The details: US imports of steel and aluminum totaled approximately $60 billion in 2024, but the new tariffs were imposed on approximately $150 billion of the commodities themselves and goods with substantial steel and aluminum content ranging from beverage cans to frying pans to auto parts.

The next major scheduled tariff dates are 1 April for the America First Trade Policy Executive Order investigations from key US government agencies regarding global trade practices and 2 April for the imposition of reciprocal tariffs and auto tariffs.

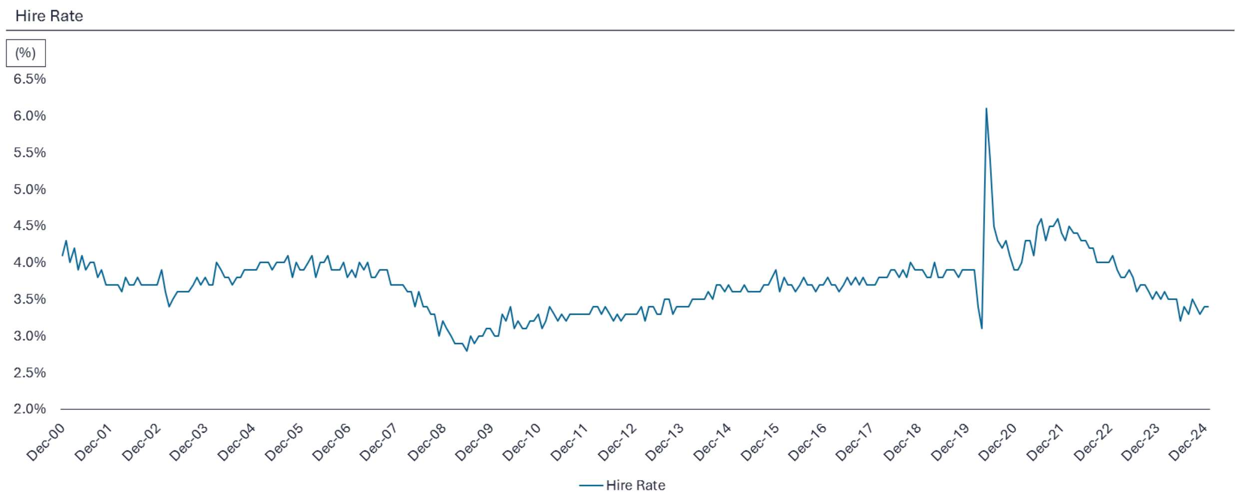
3. **The Job Openings and Labor Turnover Survey (JOLTS) delivered mixed signals regarding the US labor market.**

   The outlook: I expect the US labor market to soften through 2025 as companies struggle to find cost cuts to offset tariff-driven cost increases while also protecting profit margins. Data over the last two weeks was neutral relative to my expectations with job opening and quit rates signaling strength while the hire rate and the underemployment rate both suggest softening.

   The details: Job openings in January rose to 7.7 million from a downwardly revised 7.5 million. (JOLTS is reported with a one-month lag relative to the Employment Situation report.) The openings rate of 4.6% of all jobs approximates the levels of 2019 just before the pandemic when the US economy was at what most economists would describe as full employment. The quit rate jumped to 2.1% from a downwardly revised 1.9% in December. The quit rate is now at levels last seen (before the pandemic) in 2017 when unemployment was marginally higher at about 4.5%.

   The hire rate remained weak (number of hires divided by total employment) at a 3.4% rate; a level consistent with 2013 when unemployment was between 6.5% to 7.0%. Taken alongside rising underemployment which jumped 50 bps to 8.0% in February and falling employment of temporary workers, a leading indicator of labor market conditions, I believe the data are signaling future increases in unemployment.

The Hire Rate Is at 2013 Levels when Unemployment Stood at 6.5% to 7.0%



LAZARD Source: Bureau of Labor Statistics, Haver Analytics
Note: As of January 2025

4. **University of Michigan Sentiment figures fell sharply while inflation expectations rose materially.**

   The outlook: I expect the building trade war to continue to dampen consumer and corporate sentiment as price pressures build and labor markets weaken.

   The details: The University of Michigan readings were materially worse than expected across the board. While current conditions sentiment held up to some degree, expectations fell sharply while inflation expectations on a 1-year and 5- to 10-year horizon both rose sharply. The results are unsurprising as the constant drumbeat of tariff increases and the highly volatile US trade policy continue to unnerve companies and consumers.

University of Michigan Sentiment

	Consensus	Actual	Prior Reading
University of Michigan Sentiment	63.0	57.9	64.7
Current Conditions	64.4	63.5	65.7
Expectations	63.0	54.2	64.0
1 Year Inflation Expectations	4.3%	4.9%	4.3%
5-10 Year Inflation Expectations	3.4%	3.9%	3.5%

Source: Bloomberg, University of Michigan

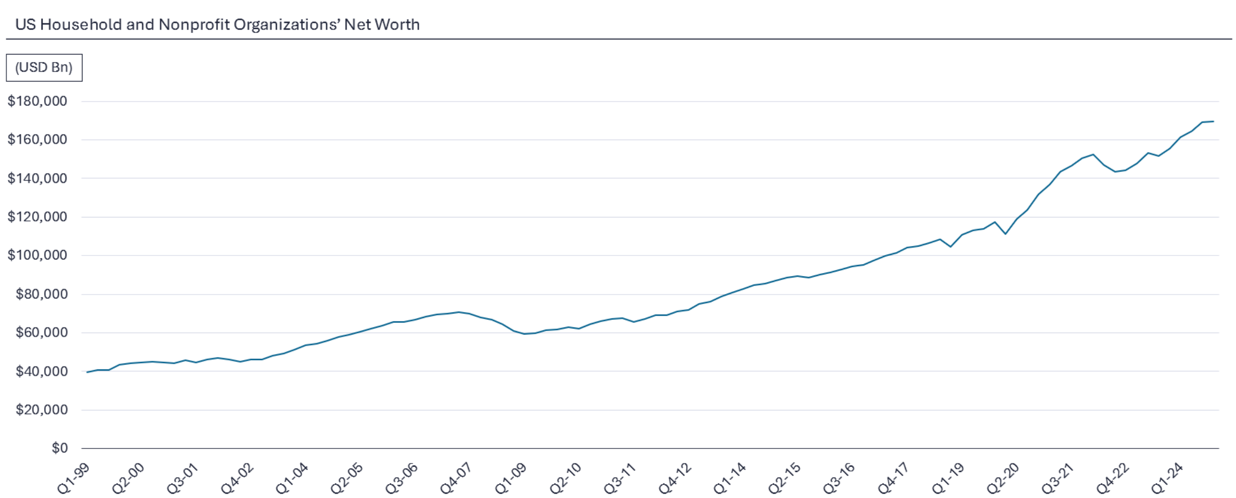
5. **The Q4-24 net worth of US households and nonprofit organizations reached $169.4 trillion.**

   The details: Given current equity market levels, household new worth is likely to decline in Q1-25 which is extremely high by historical standards at over 770% of disposable personal income. Historically, the Fed combined household and nonprofit balance sheets due to data gathering limitations, but recently the Fed has provided more granularity. Of total net worth, households are estimated to hold $160.3 trillion with the residual being owned by nonprofits.

   Household assets total $179.7 trillion of which nonfinancial assets account for $56.2 trillion (86% real estate with remainder being other consumer durables such as autos) and financial assets $123.5trn. Financial assets include the following holdings from largest to smallest:

$46.8 trillion	Corporate equities and mutual fund shares
$32.2	Pension entitlements
$18.4	Bank deposits, money market funds, and time deposits
$15.5	Other corporate equity (e.g., privately owned businesses, etc.)
$10.6	All other assets

US Household and Nonprofit Organizations' Net Worth Reached a Record High of $169 Trillion



LAZARD Source: Federal Reserve, Haver Analytics
Note: As of December 2024

6. China CPI and Producer Price Index (PPI) inflation fell short of expectations.

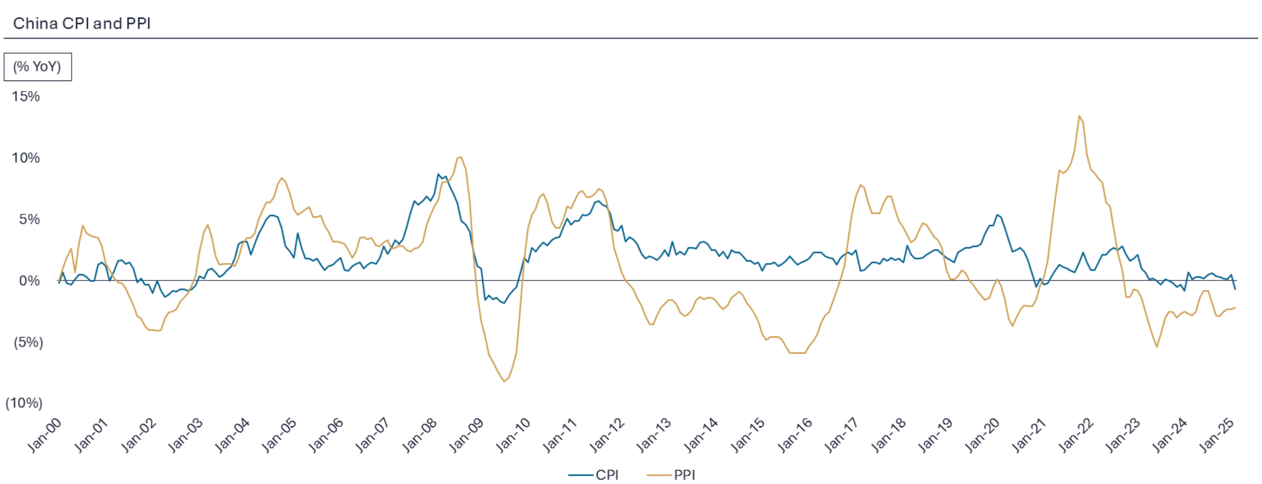
The outlook: China continues to suffer from supply-demand imbalances leading to downward pressure on prices. The government strategy of exporting excess production is increasingly unviable as trading counterparts defend their own producers from Chinese dumping.

I am concerned that the failure of the central government to act aggressively enough to restructure the Chinese economy is increasingly likely to result in a long-term stagnation and is raising the risk of entrenching deflationary expectations into the Chinese corporate and consumer mindset. The implications could be very negative in an economy that is as leveraged as that of China.

The details: CPI fell into deflation with a 0.7% decline in prices on a y-o-y basis versus consensus expectations for a decline of 0.4%. This marked the 25th month of CPI inflation below 1% in China. It is likely that the earlier than usual Lunar New Year holiday contributed meaningfully to the negative CPI reading in February with much of the weakness arising from lower food prices and tourism-related services. Food prices fell 3.3% y-o-y after rising 0.4% y-o-y in January. Non-food prices fell 0.1% y-o-y after rising 0.5% y-o-y in January.

PPI deflation was sustained for the 29th month with prices falling 2.2% y-o-y versus consensus expectations for a decline of 2.1%.

China Inflation Is Undesirably Low with PPI Deflation for 29 Months and CPI ≤1% for 25 Months



LAZARD

Source: Bloomberg, National Bureau of Statistics
Note: As of February 2025

7. **Early readings on Japan's spring wage increases topped last year's very strong levels.**

   The outlook: Early *shunto* data bode well for the ongoing normalization of inflation in Japan and my positive thesis on the capital optimization process for Japanese companies.

   The details: The first reports on Japan's *shunto* (with translates to "spring wage offensive") indicate that wage gains are running at a rate of 5.46% versus Bloomberg consensus of 5.1% and last year's 5.28% first report. The base salary increases also are running ahead of expectations which is important as the wage gains are typically divided between the "base-up" which can be thought of purely as inflation, versus compensation increases driven by seniority and other factors.

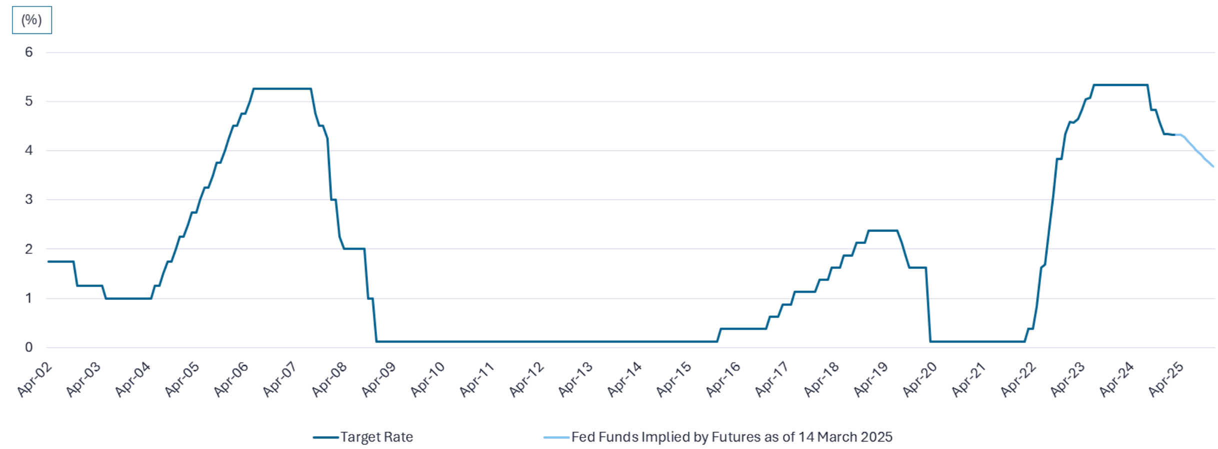
The Week Ahead

1. **The Federal Open Market Committee (FOMC) is expected to hold monetary policy constant.**

   The outlook: I continue to expect no rate cuts from the Fed through the rest of 2025 versus the Fed Funds futures market which implies 70 bps of easing by year end. My out-of-consensus view is driven by my expectation that US tariffs will broaden in scope and scale raising inflation through 2025 (see CPI in paragraph one in The Week Behind). While a reacceleration of inflation will not necessarily lead to rate hikes, I expect rising price pressures to preclude the Fed from easing policy even as unemployment rises.

Markets Are Pricing ~70 bps of Additional Fed Easing through 2025*

Federal Reserve Target Rate and Implied Rate through December 2025



LAZARD

Source: Bloomberg, Chicago Mercantile Exchange, Federal Reserve
Note: As of 14 March 2025
* Markets imply a 4% chance of a 25-bps rate cut at the March meeting and a 33% chance of a 25-bps cut at the May meeting.

2. **February US retail sales are expected to have risen strongly after a very weak January report.**

   The outlook: The consensus expectation is for a headline increase of 0.7% m-o-m (versus -0.9% in January) and for the control group to rise by 0.3% m-o-m (versus -0.8% in January). On the back of the very weak University of Michigan Sentiment data, there could be downside risk to retail sales figures if consumers are spending in line with their economic outlook. However, we could also see a countervailing force of people trying to make purchases before tariffs increase.

3. **China will release February economic data after the Lunar New Year quiet period.**

   The outlook: China did not release data for January due to Lunar New Year holidays. As a result, this month's macro data will only include YTD figures and prior month data will not be available. Overall, the February YTD data is expected to remain relatively stable compared to Q4-24 run rates, but there is risk to the downside as anecdotal evidence from China suggests that auto sales and household appliance sales volume growth has fallen materially early this year. Markets will be keen to see whether the government is falling further behind the curve in terms of the need for demand stimulus.

February China Economic Data		Consensus
Industrial Production	YTD y-o-y	5.3%
Retail Sales	YTD y-o-y	3.8%
Fixed Asset Investment	YTD y-o-y	3.2%
Property Investment	YTD y-o-y	-8.9%
Residential Property Sales	YTD y-o-y	*
New Home Prices	m-o-m	*
Used Home Prices	m-o-m	*

Source: Bloomberg, National Bureau of Statistics
* No consensus estimate available on Bloomberg.

4. **The German Bundestag is scheduled to vote on Tuesday 18 March on constitutional reforms.**

   On Friday 14 March, the Christian Democratic Union (CDU)/Christian Social Union (CSU) and the Social Democratic Party of Germany (SPD) reached an agreement with The Greens on a broad constitutional reform to allow for substantially higher defense spending and the creation of a €500 billion Infrastructure Fund. The key concession to The Greens was that €100 billion of the Infrastructure Fund will be shifted into the Climate and Transformation Fund targeted at the energy transition.

   The outlook: Passage through the Bundestag is not the end of the story. The reforms have to also pass the Bundesrat and withstand review by the Constitutional Court. I expect the reforms to be implemented with significantly positive implications for German and European growth and security.

5. **Japan's CPI inflation is expected to have decelerated in February to a still elevated rate.**

   The outlook: The consensus is for headline, core, and core-core inflation to decelerate in Japan in February from January on a y-o-y basis. Even with the likely easing of price pressures, core CPI running well above 2% is sufficient to sustain the inflation normalization process in Japan and to feed into the capital optimization process I expect to progress over the years ahead.

Japan February CPI	Consensus	Prior Reading
Headline y-o-y	3.5%	4.0%
CPI y-o-y ex-fresh food (core)	2.9%	3.2%
CPI y-o-y ex-fresh food and energy (core-core)	2.6%	2.5%

Source: Bloomberg, Japan Ministry of Internal Affairs and Communications

6. **The Bank of Japan (BoJ) is expected to hold policy steady.**

   The outlook: Markets are assigning a 2% probability of a 25-bps rate hike from the BoJ next week. The important insight we will gain from the policy statement and press conference will be related to the economic signals the BoJ needs to see to warrant additional rate normalization. Markets currently expect 31 bps of rate hikes by year end.

7. **The Bank of England (BoE) monetary policy committee (MPC) is expected to pause its cutting cycle.**

   The outlook: Markets are pricing a 3% chance of a 25-bps rate cut from the BoE next week with the likelihood of easing rising to 76% at the 8 May meeting. As with the BoJ, the insight we will be looking for relates to any signals of incremental data the BoE is looking for to determine future policy moves. In the case of the BoE, the changing economic and policy backdrop in the European Union could affect future UK growth and inflation expectations as European governments, including the United Kingdom, significantly increase defense spending. I will also be interested to see the divergence of opinion within the MPC after two voters opted to support a 50-bps easing in February versus the other seven who supported the 25-bps cut. Given incremental economic data since February, we could see even more dispersion of views in this decision.

Important Information

This content represents the views of the author, and its conclusions may vary from those held elsewhere within Lazard.

These materials have been prepared by Lazard for general informational purposes only on a non-reliance basis, and they are not intended to be, and should not be construed as, financial, legal, or other advice.

In preparing these materials, Lazard has assumed and relied upon the accuracy and completeness of any publicly available information and of any other information made available to Lazard by any third parties, and Lazard has not assumed any responsibility for any independent verification of any of such information. These materials are based upon economic, monetary, market, and other conditions as in effect on, and the information available to Lazard as of, the date hereof, unless indicated otherwise. Subsequent developments may affect the information set out in this document, and Lazard assumes no responsibility for updating or revising these materials.

These materials may include certain statements regarding future conditions and events. These statements and the conditions and events they describe are inherently subject to uncertainty, and there can be no assurance that any of the future conditions or events described in these materials will be realized. In fact, actual future conditions and events may differ materially from what is described in these materials. Lazard assumes no responsibility for the realization (or lack of realization) of any future conditions or events described in these materials.

No liability whatsoever is accepted, and no representation, warranty, or undertaking, express or implied, is or will be made by Lazard or any of its affiliates for any information contained herein or for any errors, omissions, or misstatements herein. Neither Lazard nor any of its affiliates makes or has authorized to be made any representations or warranties (express or implied) in relation to the matters contained herein or as to the truth, accuracy, or completeness of this document.

Nothing herein shall constitute a commitment or undertaking on the part of Lazard to provide any service. Lazard shall have no duties or obligations to you in respect of these materials or other advice provided to you, except to the extent specifically set forth in an engagement or other written agreement, if any, that is entered into by Lazard and you.

By accepting this document, each recipient agrees to be expressly bound by the foregoing limitations.