



**Paulina Villanueva**  
[paulina.villanueva@hrratings.com](mailto:paulina.villanueva@hrratings.com)  
Economic Analysis and Sovereign Debt  
Senior Associate



**Edgar González**  
[edgar.gonzalez@hrratings.com](mailto:edgar.gonzalez@hrratings.com)  
Economic Analysis and Sovereign Debt  
Senior Associate



**Ricardo Gallegos**  
[ricardo.gallegos@hrratings.com](mailto:ricardo.gallegos@hrratings.com)  
Deputy Chief Economic Analysis Officer



**Felix Boni**  
[felix.boni@hrratings.com](mailto:felix.boni@hrratings.com)  
Chief Credit and Economic Analysis  
Officer

## The April CPI report strengthens the case for higher long term rates. Warsh inherits a difficult inflation outlook

April's CPI report reinforced the view that inflationary pressures in the U.S. remain significantly above the Federal Reserve's comfort zone, even after nearly two years of restrictive monetary policy. Headline CPI rose 0.64% m/m in April, following a sharp 0.87% increase in March, while annual inflation accelerated to 3.78% from 3.3% previously as shown in Figure 1. Core CPI also surprised to the upside, rising 0.38% m/m and 2.74% y/y.

The inflation release also arrives during a critical transition period for U.S. monetary policy leadership. Jerome Powell's term as Fed Chair is set to expire this Friday, May 15, while Kevin Warsh, President Trump's nominee to replace Powell, still requires final Senate confirmation as Chair after being confirmed to the Fed Board earlier this week.

**Figure 1. CPI Inflation Evolution**

Inflation During:	March-26		April-26		Annualized 3MMA		
	Monthly	Annual	Monthly	Annual	Feb-26	Mar-26	Apr-26
<b>Headline</b>	<b>0.87%</b>	<b>3.29%</b>	<b>0.64%</b>	<b>3.78%</b>	<b>2.54%</b>	<b>3.57%</b>	<b>5.20%</b>
<b>Core</b>	<b>0.20%</b>	<b>2.60%</b>	<b>0.38%</b>	<b>2.74%</b>	<b>2.41%</b>	<b>2.80%</b>	<b>3.03%</b>
Services less Energy	0.37%	3.05%	0.53%	3.27%	2.69%	4.01%	4.81%
Services less Rent	0.33%	3.36%	0.38%	3.52%	3.12%	3.54%	3.83%
Rent of Shelter	0.30%	2.97%	0.63%	3.26%	2.80%	2.91%	3.49%
Non Durable Goods	2.59%	4.90%	1.43%	6.58%	2.75%	5.40%	11.21%
Durable Goods	0.08%	0.05%	-0.15%	-0.10%	-2.64%	-3.94%	-3.68%
Food	-0.01%	2.75%	0.50%	3.22%	3.88%	3.64%	3.65%
Energy	10.87%	12.59%	3.81%	17.54%	1.07%	12.62%	38.06%
Gasoline	21.23%	18.92%	5.44%	28.42%	-3.43%	21.22%	72.66%

Source: HR Ratings with seasonally adjusted information from the U.S. Bureau of Labor Statistics, retrieved from FRED.

A significant portion of the monthly increase continued to be explained by energy prices. The energy component increased 3.8% m/m in April and 17.5% y/y, with gasoline prices rising 5.4% during the month and 28.4% compared to a year earlier. This dynamic reflects the persistence of geopolitical pressures in global commodity markets, particularly after the escalation in Middle East



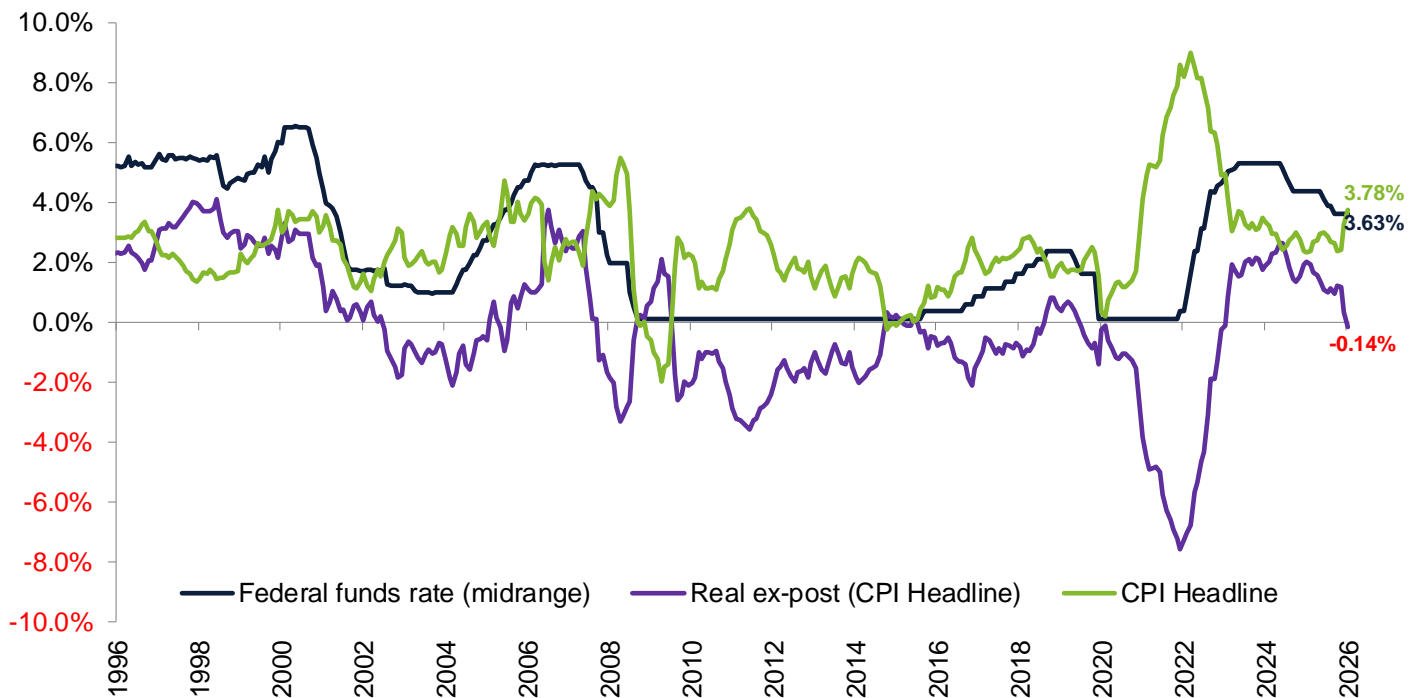
tensions earlier this year with the closure of the Strait of Hormuz. However, the report also showed that inflation pressures remain broad-based beyond energy alone.

Shelter inflation accelerated again, rising 0.6% m/m and 3.3% y/y and services inflation also remained sticky, with transportation services increasing by 4.3% y/y and airline fares surging 20.7% y/y, according to the bureau of labor statistics. Meanwhile, food inflation regained momentum, particularly in food-at-home categories, where prices rose 0.7% m/m. Several agricultural components continued to post sizable increases.

Overall, the April data suggests that inflationary pressures remain broad based across the US economy. While some goods categories such as used vehicles and medical commodities continued to soften, sticky services inflation and renewed energy pressures are complicating the Fed's path back toward its 2.0% inflation target. In annualized terms, the latest three-month rate of headline inflation remains inconsistent with price stability (Figure 1), reinforcing expectations that the Fed may need to maintain restrictive rates for longer than markets anticipated at the beginning of the year.

As shown in Figure 2, although the nominal federal funds rate remains elevated, compared to historical standards, the recent rebound in inflation has driven the real *ex-post* CPI into negative territory, which raises the question of whether the current rate is restrictive enough to address the current inflationary shock.

**Figure 2. Federal Funds Rates in Nominal Terms, Real *ex-post* rate and CPI Headline**



Source: HR Ratings and historic information from the Federal Reserve retrieved from FRED.

For Warsh, the macroeconomic backdrop presents substantial challenges from the start. First, inflation remains materially above target despite policy rates already being restrictive. This limits the opportunity for further rate cuts, even amid political pressure from the White House to ease monetary conditions more rapidly. Second, inflation expectations could become more sensitive



under a new Fed leadership regime, particularly if markets perceive any weakening in central bank independence during the transition away from Powell. Several legislators and market participants have already raised alarms about possible political influence on future monetary policy choices.

Additionally, the broader macroeconomic backdrop may further constrain the Fed's room to ease policy aggressively in the near term. Although labor market conditions have moderated compared to the post-pandemic overheating period, employment dynamics appear to be stabilizing. This reduces the urgency for rapid monetary easing and could make premature rate cuts more difficult to justify amid still elevated inflation readings. At the same time, persistent fiscal deficits are likely to remain an important source of macroeconomic pressure. While tariff revenues may provide temporary support to federal revenues, their medium-term outlook remains uncertain, particularly amid ongoing legal and political disputes surrounding trade policy. Simultaneously, rising defense spending proposals and structurally large fiscal deficits could continue increasing Treasury financing needs. In such an environment, the combination of elevated interest rates and rising debt issuance may place additional upward pressure on federal interest costs over the medium term.



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## Media Contact

[comunicaciones@hrratings.com](mailto:comunicaciones@hrratings.com)

