BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

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The Week Behind

1. **The United States announced a 25% tariff on auto and auto parts imports.**

   The outlook: Once fully implemented, this tariff action will translate to an ~2.5 percentage point increase in the weighted average tariff rate on all US goods imports to 10.9% from a rate of only 2.7% before 20 January 2025. Each percentage point of additional average tariff equates to about 10 basis points (bps) of additional core inflation implying over 80 bps of additional inflation pressure in 2025. On 1 April, several reports are due from different government agencies in response to President Trump's "America First Trade Policy." These reports will likely serve in part as a legal basis to impose more tariffs. On 2 April, the United States is expected to announce reciprocal tariffs that could add significantly more to the weighted average US tariff.

   I expect US core Consumer Price Index (CPI) inflation to bottom just below 3.0% in the next two months before exiting 2025 at a run-rate of between 3.5% to 4.0% due to higher tariffs.

   The details: Effective 3 April, auto imports will be subject to a 25% tariff. No later than 3 May, key auto parts such as engines, transmissions, powertrain parts, and electrical components will be added to the tariff regime. No later than 90 days later, all auto parts will be subject to tariffs. The order exempts US content including in autos imported into the United States as part of the United States Mexico Canada Agreement (USMCA). About 50% of autos sold in the United States are imported. Of the 50% that are produced domestically, about 40% is considered US content. This implies ~80% of US auto sales will be subject to the tariff once fully implemented.

   The chart below shows the build-up of the weighted average tariff on US goods imports since 20 January. The chart does not account for the decline in demand for imported goods that is likely to occur in response to tariffs as it is difficult to predict how elastic such purchases will be in the face of higher prices and lack of visibility on specifics regarding each tariff that has been imposed. Despite the absence of demand-response considerations, the ultimate result of the sharp increase in tariff levels will be higher inflation, weaker growth, and compressed corporate profit margins.

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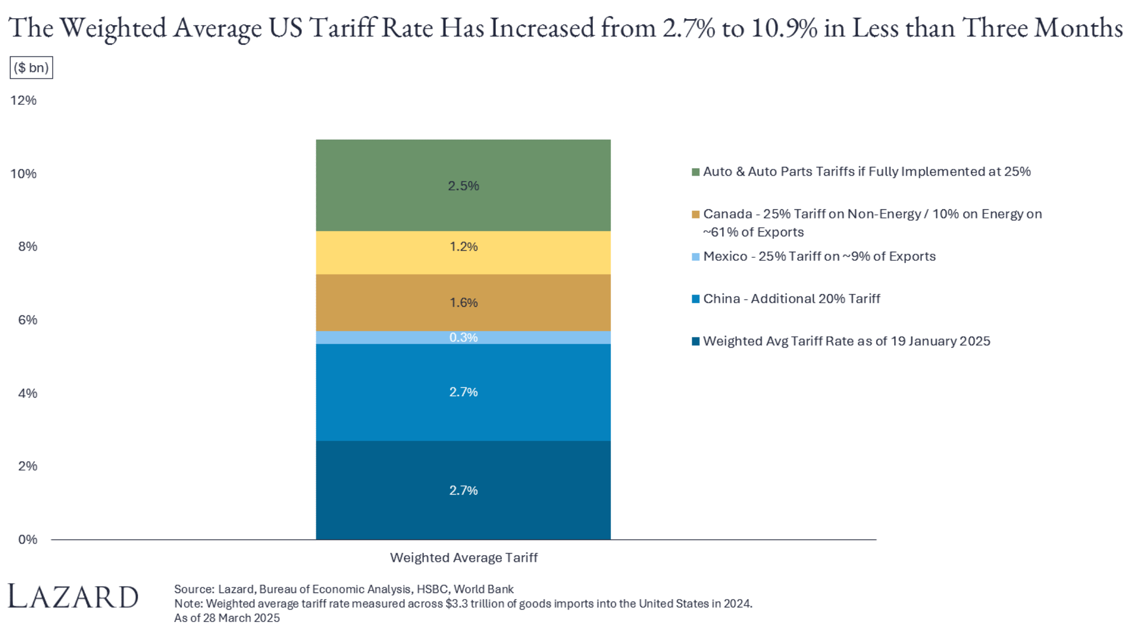


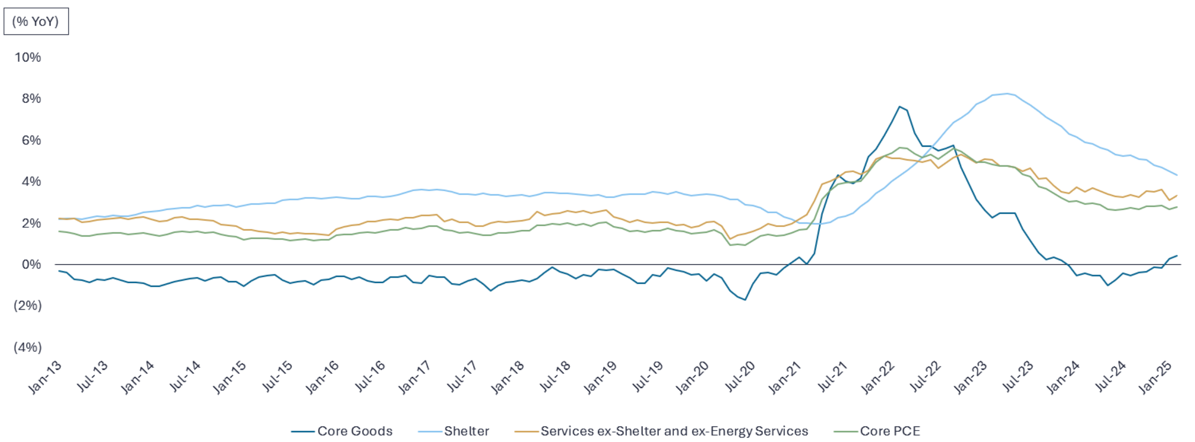
2. **US Personal Consumption Expenditure (PCE) inflation rose more than expected in February.**

   The outlook: I expect core PCE to bottom in the next two months before reaccelerating on the back of higher goods inflation driven by tariffs.

   The details: Headline PCE inflation rose 33 bps month-on-month (m-o-m), in line with expectations. Year-on-year (y-o-y) headline PCE inflation rose 2.5%, also in line with expectations. Core PCE inflation rose 36.5 bps m-o-m versus the consensus expectation for 31 bps. The higher monthly inflation took the y-o-y core PCE inflation up to 2.8% from last month's upwardly revised 2.7%. Shelter inflation continued to subside as expected, core goods inflation was stable at the elevated January run rate, and services ex-shelter inflation accelerated.

Core PCE Inflation Has Stabilized between 2.6% and 2.9% Year-on-Year for the Last 11 Months

Personal Consumption Expenditures Inflation for Key Categories



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Source: Bureau of Labor Statistics, Haver Analytics
Note: As of February 2025
Core goods represent ~25% of core PCE, shelter represents ~19%, and other services ex-shelter and ex-energy services represent ~56%.

3. **US Conference Board Consumer Confidence fell with expectations hitting a 12-year low.**

   The outlook: I expect consumer confidence to continue to slide as tariff increases drive inflation higher and growth lower. There has been a clear, causal correlation between consumer confidence and inflation for several years, and there is no reason to expect that relationship to change. If anything, I believe we could see a more magnified effect on consumer confidence given the impact of tariffs on big ticket items such as autos where prices increased significantly due to pandemic supply chain challenges and have yet to return to pre-pandemic levels. The shock of a 25% tariff on already elevated auto prices is likely to deliver another blow to consumer confidence.

   The details: The reading for present conditions in March fell to 134.5 from an upwardly revised 138.1 in February. The expectations index fell a sizable 9.6 points to 65.2, the lowest reading since March 2013. The composite Conference Board Consumer Confidence Index fell to 92.9 from an upwardly revised 100.1.

   Subsequently, the final University of Michigan Sentiment data for March were released showing an even more negative result than the preliminary figures had presented, reaffirming the negative read from the Conference Board.

4. Purchasing Managers' Index (PMI) data for developed economies were mixed.

The outlook: For Eurozone PMIs, 2025 could be a mixed bag as the immediate negative impact of US tariffs outweighs the benefits from the German fiscal U-turn. In 2026, I would expect that situation to reverse as infrastructure and defense-related spending accelerate significantly. For the United States, I expect more negative manufacturing PMIs looking forward as tariffs on imported inputs raise costs and make final goods less competitive. US services PMIs are also likely to suffer as higher inflation depresses sentiment and demand.

The details: Manufacturing PMIs in the Eurozone surprised on the upside while services PMIs disappointed. Results in the United States and United Kingdom were the reverse of those in the Eurozone with better-than-expected services readings and weaker manufacturing.

March Preliminary PMI Data

Release Date	Country	Index	Consensus	Actual	Prior Month
3/23/2025	Japan	Manufacturing	*	48.3	49.0
	Jibun Bank	Services	*	49.5	53.7
		Composite	*	48.5	52.0
3/24/2025	Eurozone	Manufacturing	48.2	48.7	47.6
	HCOB	Services	51.1	50.4	50.6
		Composite	50.7	50.4	50.2
3/24/2025	France	Manufacturing	46.1	48.9	45.8
	HCOB	Services	46.0	46.6	45.3
		Composite	46.1	47.0	45.1
3/24/2025	Germany	Manufacturing	47.0	48.3	46.5
	HCOB	Services	52.0	50.2	51.1
		Composite	51.1	50.9	50.4
3/24/2025	UK	Manufacturing	47.2	44.6	46.9
	S&P Global/	Services	51.0	53.2	51.0
	CIPS	Composite	50.5	52.0	50.5
3/24/2025	US	Manufacturing	51.7	49.8	52.7
	S&P Global	Services	51.0	54.3	51.0
		Composite	50.9	53.5	51.6

Source: Bloomberg, S&P Global

* No consensus estimate available on Bloomberg.

5. **Inflation in France and Spain was lower than expected in March.**

The outlook: I expect disinflation to continue in the Eurozone which should allow the European Central Bank (ECB) to respond more assertively to the growth headwind from US tariffs. I expect three cuts from the ECB by year end. As of 21 March, the markets were pricing 52 bps of easing by year end, but through the week, that expectation shifted to now price 59 bps.

The details: In both France and Spain, m-o-m and y-o-y inflation figures were modestly below expectations as shown in the table below. French inflation was decreased by lower energy prices and softer manufactured goods inflation which were partially offset by higher insurance and food prices. Spanish inflation benefited from lower electricity and auto fuel costs.

EU HICP for March

Release Date	Country		Consensus	Actual	Prior Reading
3/28/2025	Spain	Headline m-o-m	0.9%	0.7%	0.4%
		Headline y-o-y	2.5%	2.2%	2.9%
3/28/2025	France	Headline m-o-m	0.4%	0.2%	0.1%
		Headline y-o-y	1.1%	0.9%	0.9%

Source: Bloomberg

6. **The UK Spring Statement report revealed plans for further fiscal belt tightening.**

The outlook: The UK government continues to be challenged by the tension between the need for significant productivity-enhancing investment and the simultaneous imperative to demonstrate fiscal discipline. This week's announcement is unlikely to have moved the ball materially down the field in either direction as it was a response to expectations for weaker growth in 2025 than was originally expected. The moves by the United Kingdom and other European governments to ramp up defense spending should benefit growth to the extent the weapons procured are manufactured in Europe. However, defense spending alone will not be sufficient to sustainably lift broader economic growth.

The details: Recognizing that real GDP growth in 2025 is likely to be only 1%, Chancellor of the Exchequer, Rachel Reeves, announced ~£10 billion in total fiscal tightening. Cuts to welfare spending and other less well-defined administrative costs form a key part of the savings to offset a deterioration of around £14 billion in the government's outlook since last fall. At the same time, the UK government announced an increase in defense spending of £2.2 billion funded by cuts in foreign aid and by using Treasury reserves. While this year's growth forecast was reduced, future years' forecasts were increased to what might be excessively optimistic levels, reducing pressure to identify more extensive budget savings. No new tax increases were announced, but the government maintained the freeze on tax bracket thresholds which means inflation will push people into higher tax brackets even though their real incomes might not have increased at all.

7. **UK CPI and retail sales were both better than expected.**

<u>The outlook:</u> The inflation outlook did not change materially as the better-than-expected results were largely attributed to the volatile clothing and footwear category. Services inflation remained sticky and will continue to be the focal point for the Bank of England as it contemplates rate cuts.

The retail sales figures were a positive surprise despite downward revisions to the very strong January numbers. Taken together, the year-to-date figures suggest UK consumers are becoming confident enough to spend more of the savings they accumulated in 2024 and could bode well for economic acceleration in 2025.

<u>The details:</u> The lower-than-expected inflation number was largely attributable to clothing and footwear which reduced headline CPI by 0.14 percentage points. Services inflation was a whisker higher than expected having fallen below 5% in only two of the last 33 months.

Retail sales, which measures quantity bought as opposed to value purchased, rose strongly for a second consecutive month. The January figures were revised downward, but not by enough to offset the upside surprise for February relative to expectations. The Office for National Statistics (ONS) reported that non-food sales rose across all four sub-sectors (department stores, other non-food, clothing, and household goods stores). Sales at household goods stores were strongest, rising 6.8% over the prior month, while online sales rose 3.3% and other non-food stores volume rose 3.1%.

UK February CPI

	Consensus	Actual	Prior Reading
Headline m-o-m	0.5%	0.4%	-0.1%
Headline y-o-y	3.0%	2.8%	3.0%
Core y-o-y	3.6%	3.5%	3.7%
Services y-o-y	4.9%	5.0%	5.0%

Source: Bloomberg, UK Office for National Statistics

February UK Retail Sales	Consensus	Actual	Prior Month	Revised
Retail Sales including Auto Fuel m-o-m	-0.5%	1.0%	2.1%	1.6%
Retail Sales including Auto Fuel y-o-y	0.4%	2.2%	1.2%	0.8%
Retail Sales excluding Auto Fuel m-o-m	-0.4%	1.0%	1.7%	1.4%
Retail Sales excluding Auto Fuel y-o-y	0.6%	2.2%	1.0%	0.6%

Source: Bloomberg, UK Office for National Statistics

The Week Ahead

1. **US labor market reports**

   The outlook: The Job Openings and Labor Turnover Survey (JOLTS) is expected to show a slight decrease in job openings from the prior month's 7.74 million, or 4.6% of all jobs (filled and unfilled) in the United States. I also will be watching the quit and hire rates. The quit rate bounced in January to 2.1% from a recent low of 1.9%, but I expect it to fall further in 2025 as it becomes more difficult to find better jobs with higher pay against an inflationary backdrop caused by tariffs. The hire rate is also important, as we have recently seen new hires fall to the lowest level since 2013 when unemployment was between 6.5% and 7.0%. My concern is that the reluctance to add to staff evidenced by the hire rate could be signaling fragility in the broader labor market.

   The Employment Situation report will also be released next week on Friday. The consensus is that unemployment will be stable at 4.1% while nonfarm payroll growth will ease to 135k from 151k in February. Average hourly earnings are expected to rise 0.3% m-o-m and 3.9% y-o-y versus 0.3% and 4.0% in February. I will be interested to see the underemployment rate (which includes both unemployed people and those working part-time but who want full-time employment) which jumped by 50 bps in February to 8.0%. Historically, employment of temporary workers and part-time workers have been good forward-looking indicators for broader employment data as these positions are created and eliminated more quickly in response to current and expected business conditions.

2. **China PMI data from the National Bureau of Statistics (NBS) and Caixin are expected to be stable.**

   The outlook: The two different PMI data sets are useful given that NBS surveys about 3,000 companies that are typically larger with more representation from state-owned enterprises while the Caixin surveys ~500 companies but focuses more on export-oriented and privately owned companies. In both cases, the results are expected to be stable as shown in the table below.

March China PMI Data

Release Date		Consensus	Prior Month
3/30/2025 NBS	Manufacturing	50.4	50.2
	Non-Manufacturing	50.5	50.4
	Composite	*	51.1
3/31/2025 Caixin	Manufacturing	50.6	50.8
4/2/2025	Services	51.5	51.4
4/2/2025	Composite	*	51.5

Source: Bloomberg, China Federation of Logistics & Purchasing, S&P Global
* No consensus estimate available on Bloomberg.

3. **Inflation readings for the Eurozone, Germany, and Italy are expected to be mixed.**

   The outlook: Harmonized Index of Consumer Prices (HICP) inflation is expected to increase in Italy but be stable at the Eurozone level and in Germany. As noted above related to French and Spanish inflation, absent any major exogenous shocks, I expect ongoing disinflation across the Eurozone.

EU HICP for March

Release Date	Country		Consensus	Actual	Prior Reading
3/28/2025	Spain	Headline m-o-m	0.9%	0.7%	0.4%
		Headline y-o-y	2.5%	2.2%	2.9%
3/28/2025	France	Headline m-o-m	0.4%	0.2%	0.1%
		Headline y-o-y	1.1%	0.9%	0.9%
3/31/2025	Germany	Headline m-o-m	0.5%		0.5%
		Headline y-o-y	2.5%		2.6%
3/31/2025	Italy	Headline m-o-m	1.4%		0.1%
		Headline y-o-y	2.0%		1.7%
4/1/2025	Eurozone	Headline m-o-m	0.7%		0.4%
		Headline y-o-y	2.3%		2.3%
		Core y-o-y	2.5%		2.6%

Source: Bloomberg

4. **Japan's quarterly Tankan survey results are expected to show a modestly weaker outlook.**

   The outlook: The Tankan is a quarterly survey conducted by the Bank of Japan. The survey results to be released next week relate to questions asked in February and March of 2025. The data are in the form of a diffusion index where participants offering negative views of the economy and outlook are subtracted from those with positive views. A positive figure reflects a net positive view. Expectations for the first quarter 2025 Tankan are generally positive except for small manufacturing companies where net results are expected to slip slightly into net negative territory.

   I expect generally positive results from large manufacturers and anticipate labor market metrics will continue to signal the tightest employment situation since the late 1980s and early 1990s.

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