BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

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The Week at a Glance

- US labor market data remained resilient, with steady unemployment and moderate job growth. However, job openings declined and wage growth slowed suggesting some fragility.
- US GDP declined 0.3% in Q1-25, but final sales to private domestic purchasers, a better indicator of underlying demand, remained solid at 3.0% quarter-on-quarter (q-o-q) annualized. Economic activity is likely to weaken later in 2025 as US tariffs reduce underlying demand.
- US Core Personal Consumption Expenditure (PCE) inflation was subdued in March, but increased tariffs are likely to cause inflation to reaccelerate, limiting the likelihood of Federal Reserve rate cuts.
- Eurozone inflation surprised on the upside, likely because of the Easter holiday falling in April this year. Eurozone Q1-25 GDP exceeded expectations, but Ireland's GDP, which is subject to frequent revisions, contributed 12 basis points (bps) to the figures.
- The Federal Open Market Committee (FOMC) and Bank of England (BoE) policy meetings will be key events next week. Markets suggest a 3% chance of a Fed rate cut and 100% chance of BoE easing.
- China's reports on Consumer Price Index (CPI) and Producer Price Index (PPI) inflation are likely to show another month of deflation while export and import data are likely to provide evidence of a sharp decline in trade driven by US tariffs.

The Week Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Job Openings	29 Apr	March		7.50 million	7.19 million	7.48 million
	Unemployment	2 May	April		4.2%	4.2%	4.2%
	Nonfarm Payroll Growth	2 May	April		138,000	177,000	185,000
Eurozone	Flash GDP Growth	30 Apr	Q1-24	q-o-q	0.2%	0.4%	0.2%
	Flash GDP Growth	30 Apr	Q1-24	y-o-y	1.1%	1.2%	1.2%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	FOMC Target Rate Range	7 May			4.25% - 4.50%		4.25% - 4.50%
China	Exports	8 May	April	y-o-y	2.0%		12.4%
	Imports	8 May	April	y-o-y	-5.9%		-4.3%
United Kingdom	BoE Target Rate	8 May			4.25%		4.50%

The Week Behind

1. **US employment data were mixed.**

   The outlook: I continue to believe labor markets are likely to be more fragile than suggested by high-level figures like the unemployment rate. However, this month's data did not offer particularly strong evidence to support my view. My expectation is that the effects of US trade policy will become more evident in the data with a lag as companies deplete low-cost inventory and try to wait as long as possible to reduce headcount hoping for better visibility on the ultimate end state of US trade policy. By the time we get to the June and July employment reports, I expect to see meaningful weakening of the labor market assuming tariffs have not been reduced meaningfully.

   The details: The Job Openings and Labor Turnover Survey (JOLTS) showed that the number of open jobs fell by a larger-than-expected 288,000 from February to March leaving 4.3% of positions in the United States unfilled. The quit rate nudged higher to 2.1% from 2.0% signaling that the labor market is strong enough to offer workers opportunities to increase their compensation or the quality or their work. The hire rate was stable at 3.4%, in line with levels seen in 2013 when unemployment was between 6.5% and 7.0%.

   The Employment Cost Index showed total compensation for all civilian workers in Q1-25 rose 0.9% q-o-q and 3.6% year-on-year (y-o-y) versus 0.9% and 3.8% in the prior quarter. Wage growth was slightly slower but benefit costs accelerated in the quarter.

   The Employment Situation report signaled ongoing strength in the labor market with nonfarm payroll growth averaging 155,000 per month year-to-date and the unemployment rate holding steady at 4.2%. The underemployment rate eased 10 bps lower again in April to 7.8% after jumping 50 bps in February to 8.0%, also suggesting that the labor market remained resilient before the United States imposed the bulk of the tariffs on goods imports.

   Average hourly earnings rose by 0.2% month-on-month (m-o-m) and 3.8% y-o-y. In both cases, the increase in average hourly earnings was 10 bps less than the consensus expectation.

2. **US GDP declined 0.3% annualized in Q1-25, but underlying demand is stronger than this suggests.**

   The outlook: While headline GDP was weak, final sales to private domestic purchasers remained solid at 3.0% q-o-q annualized in Q1-25. Remember, though, that a significant majority of tariff increases were implemented in Q2-25. Going forward, I expect a meaningful drag on US GDP from higher prices for imported goods and decreased availability thereof.

   The details: US GDP fell 0.3% q-o-q annualized as a near-record 41.3% q-o-q annualized import surged reduced GDP by 4.8 percentage points. The metric I watch to get a clearer sense of economic resilience is final sales to private domestic purchasers as it excludes the volatile trade and government spending categories. Final sales to private domestic purchasers rose 3.0% q-o-q annualized, roughly in line with the quarterly rates of the last two years.

3. **US core PCE inflation rose less than expected in March, but the two prior months' figures were revised upward.**

   The outlook: I expect April's PCE inflation report to represent the trough of the disinflation cycle before price pressures reaccelerate due to tariffs. While the y-o-y PCE inflation has been between 2.6% and 3.0% for the last 14 consecutive months, the three-month annualized core PCE inflation stood at 3.5% in March due to elevated readings in February and January. Even as the Q1-25 price pressures "fall out" of the rolling three-month figures, rising goods prices will make it more difficult for the Fed to justify any monetary policy easing moving forward.

The details: Core PCE inflation was 3 bps in March, the lowest reading since April 2020, versus 50 bps in February and 34 bps in January. Personal income rose 0.5% m-o-m versus a 0.7% gain in February. Personal spending rose 0.7% in March versus 0.5% in February. Spending was boosted by auto and auto parts purchases which rose 8.1% likely as people pulled demand forward to avoid tariffs.

4. **China's Purchasing Managers' Index (PMI) data were weaker than expected.**

The outlook: US tariffs on imports from China are being felt now across the Chinese manufacturing sector. Bloomberg data show a nearly 50% decline in container volume leaving China for the United States in the second half of April suggesting the real pain of the trade war is now being inflicted. If this is correct, future manufacturing PMI data will likely weaken further while the services PMIs will also likely reflect negative spillover effects from reduced manufacturing employment and falling consumer confidence.

The details: The National Bureau of Statistics (NBS) manufacturing PMI and Caixin manufacturing PMI both fell more than expected in April. The NBS PMI focuses more on large, state-owned companies while the Caixin survey captures more privately owned, export-oriented companies. Unsurprisingly, both were weak given the impact of the trade war on new export orders and broader implications for consumer and corporate confidence. In fact, within the NBS manufacturing PMI, the largest drops among sub-indexes were for new export orders (44.7 in April versus 49.0 in March) and total output (49.8 versus 52.6 the prior month).

April China PMI Data

Release Date		Consensus	Actual	Prior Month
4/29/2025 NBS	Manufacturing	49.7	49.0	50.5
	Non-Manufacturing	50.6	50.4	50.8
	Composite	*	50.2	51.4
4/29/2025 Caixin	Manufacturing	49.7	50.4	51.2
5/5/2025	Services	51.8		51.9
5/5/2025	Composite	*		51.8

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

5. **Eurozone inflation was stable from March to April at levels close to the ECB's 2.0% target.**

The outlook: Eurozone disinflation has progressed more smoothly than UK and US inflation. I expect economic deceleration caused by US trade policy to further reduce Eurozone inflation in the months ahead, allowing the ECB to cut rates to levels at or below 1.5% by year end.

The details: Timing of the Easter holiday appears to have played a role in the modest upside surprise in inflation across the Eurozone as the entire holiday period was in April this year. For example, in Germany, package tour prices rose 5.5% m-o-m reflecting higher demand in April 2025 versus the holiday demand that would have occurred in March 2024.

One worry is that inflation expectations from the ECB Consumer Survey have increased to 2.9% for the next year from 2.6% previously, while the three-year expectation has risen to 2.5% from 2.4%. If inflation expectations rise materially further, not my base case, then the ECB could ease less than my current expectation for the target deposit rate to fall to 1.5% by year end from 2.25% today.

Eurozone Harmonized Consumer Price Index for April

Release Date	Country		Consensus	Actual	Prior Reading
4/29/2025	Spain	Headline m-o-m	0.3%	0.6%	0.7%
		Headline y-o-y	2.0%	2.2%	2.2%
4/30/2025	France	Headline m-o-m	0.4%	0.6%	0.2%
		Headline y-o-y	0.7%	0.8%	0.9%
4/30/2025	Germany	Headline m-o-m	0.4%	0.5%	0.4%
		Headline y-o-y	2.1%	2.2%	2.3%
4/30/2025	Italy	Headline m-o-m	0.6%	0.5%	1.6%
		Headline y-o-y	2.3%	2.1%	2.1%
5/2/2025	Eurozone	Headline m-o-m	0.5%	0.6%	0.6%
		Headline y-o-y	2.1%	2.2%	2.2%
		Core y-o-y	2.5%	2.7%	2.4%

Source: Bloomberg

6. **Eurozone GDP surprised on the upside in Q1-25.**

The outlook: Investors should discount near-term positive surprises related to Eurozone economic activity, as the negative implications of the US trade dispute are likely to materially reduce growth in H2-25. In 2026, however, I expect much higher defense spending to lift growth materially.

The details: GDP rose by 0.4% q-o-q versus the consensus expectation for 0.2% growth, but the sequential outperformance was largely due to an upside surprise in Ireland's GDP which is frequently revised. A 3.2% q-o-q increase in Ireland's GDP contributed 12 bps to the Eurozone figure.

Eurozone Q1-25 GDP		Consensus	Actual	Prior
Eurozone	q-o-q	0.2%	0.4%	0.2%
	y-o-y	1.1%	1.2%	1.2%
France	q-o-q	0.1%	0.1%	-0.1%
	y-o-y	0.7%	0.8%	0.8%
Germany	q-o-q	0.2%	0.2%	-0.2%
	y-o-y	-0.4%	-0.4%	-0.4%
	y-o-y WDA*	-0.2%	-0.2%	-0.2%
Italy	q-o-q WDA*	0.2%	0.3%	0.2%
	y-o-y WDA*	0.4%	0.6%	0.5%
Spain	q-o-q	0.7%	0.6%	0.7%
	y-o-y	3.1%	2.8%	3.3%

* WDA = working day adjusted
Source: Bloomberg, Eurostat, National Statistical Organizations

7. **The Bank of Japan (BoJ) held rates constant and materially lowered its growth forecasts.**

   The outlook: Prospects for material additional tightening of BoJ policy have dimmed significantly in recent weeks due to US trade decisions. Markets now suggest only 8 bps of tightening by year end versus an expectation for over 30 bps of tightening as recently as late March. I expect no further rate increases from the BoJ this year, as Japan is likely to suffer slower growth due to the US imposition of a 10% universal import duty and could be vulnerable to even higher tariffs depending on the outcome of trade negotiations with the United States.

   The details: The BoJ held its target policy rate at 0.5% but lowered its forecasts for growth and inflation reflecting the trade-related pressure on the Japanese economy. The BoJ forecast for GDP growth in fiscal 2025 (year ending 31 March 2026) was reduced to 0.5% from 1.1% in the January forecast while the FY2026 forecast fell to 0.7% from 1.0%. The BoJ's "New Core CPI" forecast (CPI excluding fresh food and energy) was increased to 2.3% for FY2025 from 2.1% in the January outlook while the FY2026 forecast was reduced to 1.8% from 2.1%.

   During the press conference after the Monetary Policy Meeting, BoJ Governor Kazuo Ueda explained that while the BoJ remains confident that it will achieve its inflation objectives over time, the risks to the forecasts have increased and revisions could occur either on the positive or negative side. He acknowledged that Japanese growth is likely to suffer from a fall in exports due to trade tensions, but he also indicated that he is confident that wage growth and price increases will resume given Japan's severe labor shortage. In effect, Governor Ueda appeared to be reaffirming the desire to normalize monetary policy over time, but also gave the BoJ time to delay any further hikes until the outlook related to US-Japan trade relations has become clearer.

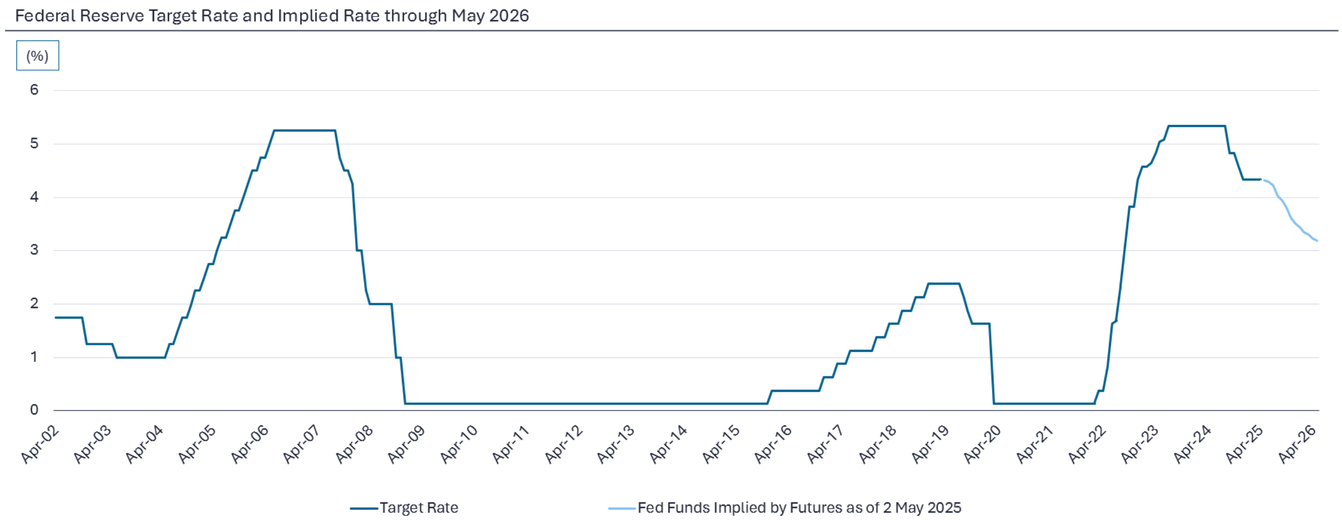
The Week Ahead

1. **The FOMC is expected to hold policy constant.**

   The outlook: Fed funds futures markets are ascribing a 3% probability to a 25-bps rate reduction at the FOMC meeting ending on 7 May with the chances of easing rising to 48% at the 18 June meeting. I continue to expect no Fed rate cuts in 2025 due to the reacceleration of inflation that is likely to result from US tariffs. Markets currently suggest 85 bps of rate cuts by year end.

   With every one percentage point increase in the weighted average US tariff on goods equating to about 10 bps of additional core inflation, the current level of tariffs could add 175 bps to core inflation by year end assuming no further policy changes. While the "no further policy changes" assumption will certainly prove to be incorrect, it is important to remember that future tariff announcements are likely to increase reductions in tariffs for some countries but also increases in tariffs for some sectors such as semiconductors, pharmaceuticals, copper, and lumber.

Markets Are Pricing ~85 bps of Additional Fed Easing through 2025*



Source: Bloomberg, Chicago Mercantile Exchange, Federal Reserve
Note: As of 2 May 2025
* Markets imply a 3% chance of a 25-bps rate cut at the May meeting and an 48% chance of an additional 25-bps cut at the June meeting.

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New projections for economic activity and policy will not be released at next week's meeting, so investors are likely to focus on any language Fed Chair Jay Powell will use at the press conference to explain how the Fed members are thinking about the risk of inflation expectations becoming de-anchored due to tariffs. Powell has spoken about the likely scenario in which the Fed's two mandates of price stability and maximum employment end up being "in tension" against each other. New comments regarding this tension will also be scrutinized carefully.

2. **China export and import data could confirm the sharp slowdown in trade resulting from tariffs.**

   The outlook: After significant front-loading of US demand for Chinese goods exports in anticipation of higher tariffs, export volume is likely to decelerate sharply in April. The consensus expectation is for export growth to slow to 2.0% y-o-y in April from 12.4% y-o-y in March. Imports are also expected to shrink materially as demand for raw materials and other inputs into the manufacturing process decline. Imports are expected to shrink by 5.9% y-o-y in April versus a decline of 4.3% in March.

3. **The BoE is expected to cut rates by 25 bps.**

   The outlook: UK economic data has signaled more clearly of late that labor market tightness is easing and price pressures are declining. This should allow the BoE to ease rates by 25 bps next week, in line with market expectations. While one or two BoE members might vote for a larger 50-bps cut, that outcome appears unlikely. Markets are pricing 97 bps of easing by year end.

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