BEHIND THE HEADLINES

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Behind the Headlines in Brief

- The US Court of International Trade ruled that tariffs imposed using the International Emergency Economic Powers Act are illegal, though other statutes allow presidential tariff authority. A universal 10% tariff on most countries—with tariffs on China—remains the likely "end game."
- The US House of Representatives passed a fiscal package expected to add at least $3 trillion to deficits over the next decade.
- US Purchasing Managers' Index and Conference Board Consumer Confidence data improved in May. Next week's US labor market data will be important to gauge tariff effects on employment.
- Chinese economic data deteriorated in April. Next week's PMI data could indicate how materially US tariffs have impacted Chinese corporate sentiment.
- April inflation data for the United Kingdom surprised on the upside. Japanese inflation slightly exceeded expectations. Disinflation continued in key Eurozone countries in preliminary May reports.
- Next week, the European Central Bank is expected to cut rates by 25 basis points.

The Two Weeks Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
China	Industrial Production	19 May	April	y-o-y	5.7%	6.1%	7.7%
	Retail Sales	19 May	April	y-o-y	5.8%	5.1%	5.9%
	Fixed Asset Investment	19 May	April	YTD y-o-y	4.2%	4.0%	4.2%
	Property Investment	19 May	April	YTD y-o-y	-10.0%	-10.3%	-9.9%
	1-Year Loan Prime Rate (LPR)	20 May		Level	3.00%	3.00%	3.10%
	5-Year Loan Prime Rate	20 May		Level	3.50%	3.50%	3.60%
Japan	Headline CPI	23 May	April	y-o-y	3.5%	3.6%	3.6%
	CPI ex-fresh food and energy	23 May	April	y-o-y	3.0%	3.0%	2.9%
United Kingdom	Headline CPI	21 May	April	y-o-y	3.3%	3.5%	2.6%
	Core CPI	21 May	April	y-o-y	3.6%	3.8%	3.4%
	Services CPI	21 May	April	y-o-y	4.8%	5.4%	4.7%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Job Openings	3 June	April	Level	7.1 million		7.2 million
	Unemployment Rate	6 June	May	Level	4.2%		4.2%
	Nonfarm Job Growth	6 June	May	m-o-m	130,000		177,000
Eurozone	Headline HICP	3 June	May	y-o-y	2.0%		2.2%
	Core HICP	3 June	May	y-o-y	2.4%		2.7%
	ECB Deposit Rate	5 June		Level	2.00%		2.25%

The Two Weeks Behind

1. **The US Court of International Trade (CIT) declared that the use of the International Emergency Economic Powers Act (IEEPA) to impose tariffs was illegal.**

   The outlook: While the CIT ruled that IEEPA cannot be used to impose tariffs in the way the Trump administration attempted, the Court noted that there are other legal statutes designed for this purpose including Sections 122 and 338. In other words, the president has the authority to impose tariffs, he just cannot do it using IEEPA. The Court of Appeals allowed the United States to continue collecting tariffs while it considers the US appeal which is likely to end up at the Supreme Court.

   Regardless of the IEEPA outcome, we expect the "end game" to include a universal tariff of 10% applied to all trade counterparts with a materially higher tariff on China and other countries that have served as potential transshipment locations for Chinese goods exports.

   The details: The CIT ruled that IEEPA was used inappropriately to apply tariffs related to fentanyl, illegal immigration, and for "reciprocal tariffs." The ruling has no effect on sectoral tariffs related to autos and auto parts or steel and aluminum which were based on Section 232 (national security).

   The positive aspect of the ruling is that to date President Trump had been using IEEPA on an ad hoc, unpredictable basis. Most other trade authorities require a process that is more predictable and structured which could bring more certainty to countries, companies, and markets.

   One negative aspect of this ruling is that it extends the timeline of uncertainty around the future trajectory of US trade policy. It effectively means that negotiations that were under way to try to beat the 9 July deadline for the 90-day pause on "reciprocal tariffs" are likely to be paused, as trade counterparts have little reason to sacrifice when the Trump administration is awaiting adjudication of its tariff powers. That said, we do not expect an abrupt end to negotiations as trade partners also realize that the Trump administration can use multiple other legal justifications to impose tariffs.

2. **The US House of Representatives passed the "One Big Beautiful Bill Act" fiscal package.**

   The outlook: Based on analysis by the Congressional Budget Office (CBO), the Committee for a Responsible Federal Budget (CRFB) estimates that the fiscal package would add at minimum $3 trillion to deficits that have already been forecast by the CBO to total $21.7 trillion over the next decade. However, the budget is structured to obscure its likely true long-term cost. For example, select tax cuts on tip income and overtime, as well as an increased tax deduction for seniors and deductibility for interest expense on auto loans are scheduled to expire in 2028 to limit their perceived fiscal cost. At the same time, key cost cuts such as reductions in Medicare (program designed to provide healthcare funding for the poor) spending do not begin until 2029, after the current presidential term ends. The reality is that ending tax cuts just before the administration's term ends and starting spending cuts after puts the next president (of either party) in a position where he or she will likely want to eliminate these provisions, hence decreasing revenue and increasing spending and deficits. The CRFB estimates that if these provisions are in fact adjusted to avoid fiscal pain, the deficit impact of the legislation would exceed $5 trillion over a decade.

   With US net federal debt-to-GDP already over 100%, and with GDP growth already slowing materially in 2025, I worry that the United States is pushing the limits of bond market tolerance for perpetually high fiscal deficits that continue to increase the debt-to-GDP ratio. Given the increasing demand for borrowing from European governments that are ramping up defense spending, and from the

Japanese government that appears poised to cut consumptions taxes in the lead up to elections this fall, global demand for funding from developed governments is already rattling long-term bond markets, but the risk of future increases in funding costs is growing.

3. **Developed market Purchasing Managers' Index (PMI) data were better than expected in the United States and mixed elsewhere.**

The outlook: Near-term US PMI readings could be more positive given the Geneva agreement between the United States and China that reduced fears of extremely high tariffs. But non-US PMIs are unlikely to rebound strongly as US rhetoric regarding the European Union has sharpened and as Japan seeks to ensure it concludes a comprehensive deal including the critical auto industry.

The details: Services PMIs weakened in the Eurozone and Japan, while UK and US readings improved. Manufacturing PMIs were generally marginally better except for in the United Kingdom.

May Preliminary PMI Data

Release Date	Country	Index	Consensus	Actual	Prior Month
5/21/2025	Japan	Manufacturing	*	49.0	48.7
	Jibun Bank	Services	*	50.8	52.4
		Composite	*	49.8	51.2
5/22/2025	Eurozone	Manufacturing	49.2	49.4	49.0
	HCOB	Services	50.5	48.9	50.1
		Composite	50.6	49.5	50.4
5/22/2025	France	Manufacturing	48.9	49.5	48.7
	HCOB	Services	47.7	47.4	47.3
		Composite	48.1	48.0	47.8
5/22/2025	Germany	Manufacturing	48.8	48.8	48.4
	HCOB	Services	49.5	47.2	49.0
		Composite	50.3	48.6	50.1
5/22/2025	UK	Manufacturing	46.1	45.1	45.4
	S&P Global/	Services	50.0	50.2	49.0
	CIPS	Composite	49.3	49.4	48.5
5/22/2025	US	Manufacturing	49.9	52.3	50.2
	S&P Global	Services	51.0	52.3	50.8
		Composite	50.3	52.1	50.6

Source: Bloomberg, S&P Global
* No consensus estimate available on Bloomberg.

4. **US Conference Board Consumer Confidence rebounded more sharply than expected in May.**

The outlook: Consumer confidence has been whipsawed year to date (YTD) by volatile trade policies and the expected economic implications thereof. For the previous five months, consumer confidence had declined, and even after this month's historically large surge in expectations, the level remains below 80 which typically predicts recession. I expect volatility to continue in both consumer and corporate sentiment as the trade situation unfolds through the year. With the United States and China already accusing each other of failing to abide by the spirit of the Geneva agreement, and with Treasury Secretary Scott Bessent saying talks have "stalled," I believe that the next phase of trade news is more likely to be negative than positive.

The details: Half of the responses to the May survey were received after the United States and China agreed to sharply reduce their respective tariffs and continue negotiating on 12 May. The press release indicated survey responses were improving before 12 May, but the improvement accelerated thereafter. Despite the improved sentiment, for the fifth consecutive month, consumers indicated that labor market conditions are worsening.

The Conference Board noted, "Write-in responses on what topics are affecting views of the economy revealed that tariffs are still on top of consumers' minds. Notably, consumers continued to express concerns about tariffs increasing prices and having negative impacts on the economy, but some also expressed hopes that the announced and future trade deals could support economic activity. While inflation and high prices remained an important concern for consumers in May, there were also some mentions of easing inflation and lower gas prices."

Conference Board Consumer Confidence

	Consensus	Actual	Prior Reading	Revised
Consumer Confidence	87.1	98.0	86.0	85.7
Current Conditions	*	135.9	133.5	131.1
Expectations	*	72.8	54.4	55.4

Source: Bloomberg, Conference Board

5. **US Personal Consumption Expenditure (PCE) inflation was largely in line with expectations.**

The outlook: As with the Consumer Price Index (CPI) inflation metric, I expect April to represent the cyclical trough in core PCE inflation as tariffs drive prices higher through the rest of the year.

The details: Headline PCE inflation rose 2.1% year-on-year (y-o-y) versus the consensus expectation for a 2.2% increase while the month-on-month (m-o-m) increase was in line with expectations at 0.1%. Core PCE inflation rose 2.5% y-o-y and 0.1% m-o-m, both as expected.

6. **China macro data generally weakened, and the People's Bank of China (PBoC) lowered key lending rates.**

The outlook: We are now entering the phase in which I would expect Chinese macro data to more clearly reflect the negative impact of US tariffs. Previously, Chinese macro data was flattered by front-loading of orders to avoid US tariffs, but those orders have now been filled and customers face higher prices. Additionally, the domestic spillover effects of a more negative global trade backdrop should become more apparent in retail sales and other figures in the months ahead.

It is too early to call a negative inflection point based on the trade war, but the global context certainly is not helping an already negative economic story in China.

The details: Most economic metrics deteriorated from March to April. Industrial production figures beat expectations, but the remaining indicators were marginally weaker than expected. The PBoC's decision to reduce borrowing rates by 10 basis points (bps) for the 1-year and 5-year Loan Prime Rate (LPR) was widely expected. The 1-year LPR is the basis for commercial lending rates while the 5-year LPR is the basis for mortgage lending rates.

April China Economic Data

		Consensus	Actual	Prior
Industrial Production	y-o-y	5.7%	6.1%	7.7%
	YTD y-o-y	6.4%	6.4%	6.5%
Retail Sales	y-o-y	5.8%	5.1%	5.9%
	YTD y-o-y	5.0%	4.7%	4.6%
Fixed Asset Investment	YTD y-o-y	4.2%	4.0%	4.2%
Property Investment	YTD y-o-y	-10.0%	-10.3%	-9.9%
Residential Property Sales	YTD y-o-y	*	-1.9%	-0.4%
New Home Prices	m-o-m	*	-0.12%	-0.08%
Used Home Prices	m-o-m	*	-0.41%	-0.23%

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

7. **Inflation in France, Germany, Italy, and Spain continued to decelerate.**

   <u>The outlook:</u> Inflation in the Eurozone continues to decelerate with falling energy prices and a strengthened euro helping accelerate the process. I expect ongoing disinflation to open the door to further European Central Bank (ECB) rate cuts to 1.5% by year end.

   <u>The details:</u> There were idiosyncratic drivers of disinflation in each country, but the trajectory across all key Eurozone economies is in a good direction as it relates to price pressures. The aggregate Eurozone Harmonized Index of Consumer Prices (HICP) inflation data will be released next week.

Eurozone Harmonized Consumer Price Index for May

Release Date	Country		Consensus	Actual	Prior Reading
5/27/2025	France	Headline m-o-m	0.1%	-0.2%	0.7%
		Headline y-o-y	0.9%	0.6%	0.9%
5/30/2025	Spain	Headline m-o-m	0.0%	-0.1%	0.6%
		Headline y-o-y	2.0%	1.9%	2.2%
5/30/2025	Germany	Headline m-o-m	0.1%	0.2%	0.5%
		Headline y-o-y	2.0%	2.1%	2.2%
5/30/2025	Italy	Headline m-o-m	0.1%	0.1%	0.4%
		Headline y-o-y	1.9%	1.9%	2.0%

Source: Bloomberg

8. **30-year Japanese Government Bond (JGB) yield volatility drew investor attention.**

   <u>The outlook:</u> I could have easily changed this headline to highlight 30-year US Treasuries, but the volatility in Japan was much more extreme relative to recent years' experience. In the span of one week from 14 May to 21 May, yields on 30-year JGBs rose over 30 bps before falling 35 bps in the subsequent seven days after the Ministry of Finance telegraphed it is considering shifting issuance to shorter maturity bonds due to inadequate demand for long-dated debt.

I worry that the absence of sufficient buyers for long-term debt could be a warning sign of things to come given elevated government debt-to-GDP ratios that continue to rise due to unsustainably high fiscal deficits across many developed markets. From 16 May to 22 May, 30-year US Treasury yields also rose 30 bps, suggesting this is not only an issue for Japan.

9. **Japan CPI narrowly topped expectations at the headline and core level.**

The outlook: I expect Japanese inflation to subside from current levels over the next year or two but remain at or near the 2% target level set by the Bank of Japan as normalization continues.

The details: Headline price increases were primarily driven by a 9.3% y-o-y increase in energy prices and a 7.0% increase in food prices. Energy and food accounted for 2.5% of the 3.5% core inflation increase y-o-y. However, services prices rose 1.7% y-o-y versus 1.5% the prior month suggesting a broad-based increase in prices across the economy.

Japan April CPI

	Consensus	Actual	Prior Reading
Headline y-o-y	3.5%	3.6%	3.6%
CPI y-o-y ex-fresh food (core)	3.4%	3.5%	3.2%
CPI y-o-y ex-fresh food and energy (core-core)	3.0%	3.0%	2.9%

Source: Bloomberg, Japan Ministry of Internal Affairs and Communications

10. **UK CPI inflation exceeded expectations.**

The outlook: UK inflation has subsided meaningfully but remains consistently above peer levels. A sizable increase in y-o-y inflation was expected this month due to higher energy bills, water prices, national insurance premium pass-throughs, and the national living wage increase. However, the increase outpaced even the more negative expectations due to higher services inflation. While the increase in prices could be alarming on the surface, a few items drove much of the increase. For example, airfares were measured this year during the Easter holiday which fed into a 27.5% m-o-m increase in airfares. Likewise, water and sewerage prices rose 26.1% m-o-m, the largest increase since February 1988.

The upside surprise combined with the three-way split in voting at the last Bank of England (BoE) Monetary Policy Meeting added to the market's conviction that the BoE will hold policy constant at the June meeting.

The details: The biggest surprise was in services inflation where prices rose 5.4% y-o-y versus the consensus expectation for a 4.8% increase. The upside surprise was driven by larger than expected increases in airfares, package travel prices, and vehicle excise duties.

UK April CPI

	Consensus	Actual	Prior Reading
Headline m-o-m	1.0%	1.2%	0.3%
Headline y-o-y	3.3%	3.5%	2.6%
Core y-o-y	3.6%	3.8%	3.4%
Services y-o-y	4.8%	5.4%	4.7%

Source: Bloomberg, UK Office for National Statistics

11. UK retail sales surprised to the upside largely on the back of stronger food sales.

The outlook: The outlook for UK retail sales is mixed. On the positive side, incomes grew 4% in 2024, and much of that was saved which could allow for pent up demand. Add to that falling interest rates and an early trade deal that could largely immunize the United Kingdom from US tariff risk, and one could argue for a brighter outlook. However, the April inflation report highlighted price increases for necessities such as energy and water that could lead the BoE to be less keen to cut rates and could dampen discretionary spending capacity. On net, I lean more positive than negative but from a low starting point.

The details: The key driver of the better sales figures was a 3.8% m-o-m increase in food store sales that overwhelmed a 0.7% decline in non-food store sales. Warm weather was another important driver of the outperformance in April that has extended into May. To smooth out the bumpiness in such data, if you compare the most recent three months to the preceding three months, retail sales have grown by 1.8%, the strongest pace since mid-2021.

April UK Retail Sales	Consensus	Actual	Prior Month	Revised
Retail Sales including Auto Fuel m-o-m	0.3%	1.2%	0.4%	0.1%
Retail Sales including Auto Fuel y-o-y	4.5%	5.0%	2.6%	1.9%
Retail Sales excluding Auto Fuel m-o-m	0.1%	1.3%	0.5%	0.2%
Retail Sales excluding Auto Fuel y-o-y	4.4%	5.3%	3.3%	2.6%

Source: Bloomberg, UK Office for National Statistics

The Week Ahead

1. US labor market reports are expected to show further weakening.

The outlook: The Job Openings and Labor Turnover Survey (JOLTS) is expected to show a small decline in unfilled positions to 7.1 million in April from 7.2 million in March. I expect a lower quit rate which might suggest increased difficulty for workers to get a new, better job. I will also focus on the hire rate which remains at levels last seen in 2013 when unemployment was at 6.5%–7.0%. The hiring rate has been declining for several years, but any additional declines could reflect elevated uncertainty regarding the economic outlook due to US trade policies.

The Employment Situation report is expected to show a stable 4.2% unemployment rate with nonfarm payroll growth slowing to 130k in May versus 177k in April and 155k per month YTD. Average hourly earnings growth is expected to be muted at 0.3% m-o-m and 3.6% y-o-y versus 0.2% and 3.8% in April.

The May employment report is important as this will be the first month of macroeconomic data that might provide evidence of the effects of the US-initiated trade war. I do not expect a major shift in metrics, but deterioration on the margin could be evidence of the initial damage to confidence and consumption which leads companies to reduce headcount to protect margins.

2. **China PMI data will signal the degree of pain being inflicted on companies by US tariffs.**

   The outlook: The National Bureau of Statistics PMI surveys over 3,000 companies with a focus on large and state-owned enterprises. The Caixin PMI surveys about 650 companies that are typically small- and medium-sized enterprises that are privately owned and often export-oriented. The Caixin PMI tends to be more volatile given its focus.

   I expect to see ongoing weakness in both sets of PMI data series for manufacturing. Presumably, this manufacturing weakness should infect the services and non-manufacturing (which includes services and construction) surveys. The consensus expectation is for each survey to show slightly better results than in April, but my confidence in that improved outlook is very low.

3. **The ECB is expected to reduce rates by 25 bps to 2.00%.**

   The outlook: Markets are pricing almost a 100% probability of a 25-bps rate reduction at the 5 June ECB meeting. With ongoing declines in inflation and consistently dovish language from ECB members, a rate cut appears to be a done deal. The ECB has previously described 1.75%–2.25% as the range that would be considered neutral monetary policy. Any signals of a change in this view would be surprising. I continue to expect rates to be reduced to 1.5% by year end given a more aggressive US trade posture against the European Union. Markets suggest a slightly less dovish outlook with rates ending the year just below 1.6%.

4. **Eurozone June inflation is likely to decelerate further.**

   The outlook: Headline HICP is expected to be flat m-o-m in May versus a rise of 0.6% in April. The y-o-y increase in headline HICP is expected to slow to 2.0% from 2.2% in the prior month. Core HICP is expected to rise 2.4% y-o-y versus the 2.7% increase in April. With inflation for the four major Eurozone economies already reported this week, the aggregate Eurozone figure is unlikely to surprise. Falling energy prices and a strengthening euro should also add to disinflationary momentum in the region. Given market pricing of a near-certain ECB rate reduction, it is unlikely that the inflation report will change the ECB's decision-making calculus.

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