BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

13 June 2025

The Headlines

- US Consumer Price Index (CPI) inflation rose by a less-than-expected 2.4% year-on-year (y-o-y) in May, while core CPI rose 2.8% y-o-y. Shelter inflation decelerated to a multi-year low, helping to mute overall price pressures. Tariff-induced inflation is likely to become more evident in future months.
- In China, trade data disappointed: exports grew just 4.8% and imports fell 3.4% y-o-y, with evidence suggesting some exports are being routed through third countries to avoid US tariffs. China remains in deflation with CPI down 0.1% and PPI down 3.3% y-o-y, reflecting lower commodity prices and persistent excess capacity.
- Looking ahead, US retail sales are expected to remain resilient, and the Federal Reserve is likely to keep rates unchanged. Markets anticipate two Fed rate cuts this year, but I expect zero.
- In Asia, the Bank of Japan (BoJ) is expected to hold rates steady despite inflation remaining above target, while in the United Kingdom, the Bank of England (BoE) is also expected to maintain rates as investors watch for signs of easing inflation after the recent surge in services prices.

The Week Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	CPI	11 June	May	y-o-y	2.5%	2.4%	2.3%
	CPI	11 June	May	m-o-m	0.2%	0.1%	0.2%
	Core CPI	11 June	May	y-o-y	2.9%	2.8%	2.8%
	Core CPI	11 June	May	m-o-m	0.3%	0.1%	0.2%
China	CPI	8 June	May	y-o-y	-0.2%	-0.1%	-0.1%
	PPI	8 June	May	y-o-y	-3.0%	-3.3%	-2.7%
	Exports	8–9 June	May	y-o-y	6.0%	4.8%	8.1%
	Imports	8–9 June	May	y-o-y	-0.8%	-3.4%	-0.2%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Retail Sales Control Group	17 June	May	m-o-m	0.5%		-0.2%
	FOMC Target Rate	18 June		Level	4.25% – 4.50%		4.25% – 4.50%
China	Retail Sales	15 June	May	y-o-y	4.9%		5.1%
	Industrial Production	15 June	May	y-o-y	6.0%		6.1%
	Property Investment	15 June	YTD May	YTD y-o-y	-10.5%		-10.3%
Japan	Bank of Japan Target Rate	17 June		Level	0.50%		0.50%
	CPI	19 June	May	y-o-y	3.5%		3.6%
	Core-Core CPI	19 June	May	y-o-y	3.2%		3.0%
United Kingdom	CPI	18 June	May	y-o-y			3.5%
	Core CPI	18 June	May	y-o-y			3.8%
	Bank of England Bank Rate	19 June		Level	4.25%		4.25%

The Week Behind

1. **US CPI was softer than expected in May.**

   The outlook: Despite the lower-than-expected inflation in May, it is far too early to discount the effect of tariffs on consumer prices. Ultimately, companies will have to raise prices, cut other costs, and/or accept lower profit margins. I do not see evidence at this stage of broad-based price increases, but I do expect higher inflation and unemployment this year as firms recalibrate operations in response to tariffs.

   The details: Headline inflation rose 2.4% y-o-y and 0.1% month-on-month (m-o-m). Core inflation rose 2.8% y-o-y and 0.1% m-o-m. In both cases, the m-o-m reading was below the consensus expectation for 0.2% headline and 0.3% core price increases.

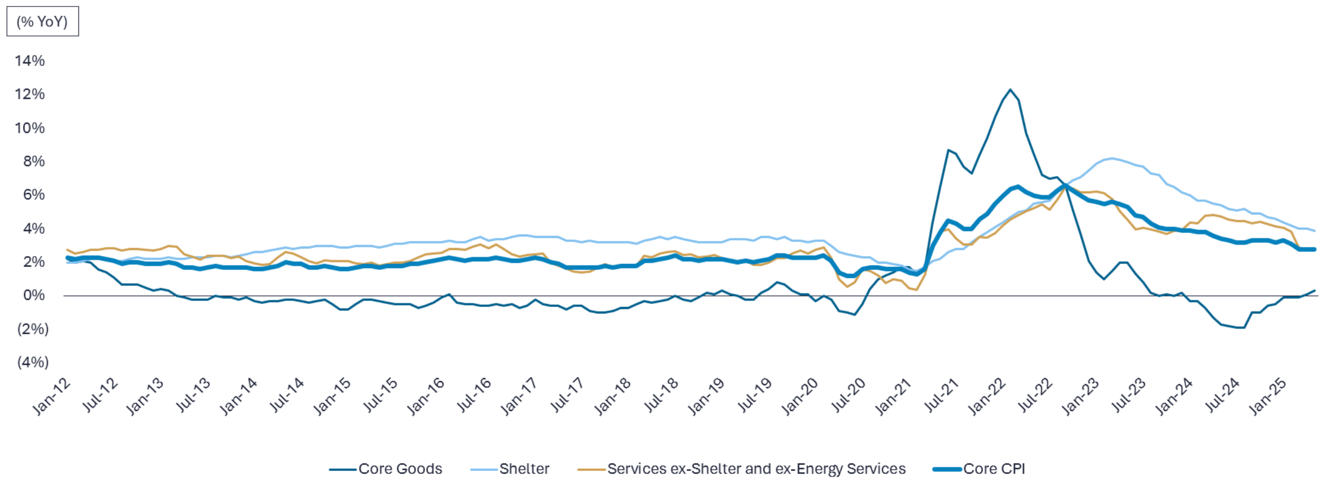
   Examining the data further, inflation for rent of a primary residence fell to the lowest level in four years while owners' equivalent rent inflation was the second-lowest in four years. With a combined weight of 42% of the core CPI basket, these declines helped mute overall price pressures. Core goods prices (all physical items less food and energy) fell slightly during the month against my expectation for a small increase. Goods prices were held down by falling new and used car prices and lower apparel pricing. Given elevated tariffs for autos and auto parts, as well as the universal 10% tariff, I expect prices for these categories of goods to rise in future months.

   Highlights of the inflation report are summarized in the table below while the graph displays the core CPI and the three key categories within it.

May 2025 Core CPI Details	Weight in Core CPI	Contribution/ Detraction (bps)
Key Categories:		
Shelter (owners' equivalent rent, rent of primary residence, other accommodation)	44.3%	11.3
Services ex-Shelter	31.5%	1.8
Core goods	24.2%	(1.0)
Total Core CPI (from sum of key categories)		12.0
All Items Ex-Food and Energy (reported)		13.0
Contributors:		
Owners' equivalent rent of a primary residence	32.7%	9.0
Rent of Primary Residence	9.3%	2.0
Motor vehicle insurance	3.5%	2.3
Hospital and related services	2.9%	1.1
Detractors:		
Airline fares	1.1%	(2.9)
New vehicles	5.4%	(1.6)
Used cars and trucks	3.0%	(1.6)
Admissions (primarily to sporting events)	0.9%	(1.5)
Apparel	3.2%	(1.4)
Source: Lazard, Bureau of Labor Statistics		
As of May 2025		

US Core CPI Inflation Is Likely to Reaccelerate through Year-End 2025

US Consumer Price Index Inflation for Key Categories



Source: Bureau of Labor Statistics, Haver Analytics
Note: As of May 2025
Core goods represent ~24% of core CPI, shelter represents ~44%, and services ex-shelter and ex-energy services represent ~32%.

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2. **China trade data were weaker than expected, but country-level figures tell an interesting story.**

   The outlook: While there is not yet a smoking gun, it appears that some portion of China's exports are being transshipped through third countries to avoid US tariffs. Exports to the United States fell in May to the lowest level since 2012 (except for one month during the pandemic). Meanwhile, exports to ASEAN countries hit a new all-time high in the last three months after rising over 15% versus the same period a year ago. With the pause on "reciprocal tariffs" due to end on 9 July, countries suspected of being transshipment channels could face materially higher US tariffs.

   The details: China's exports rose 4.8% y-o-y versus the consensus expectation for 6.0% growth and the prior month's 8.1% y-o-y increase. Imports fell 3.4% y-o-y versus expectations for a decline of 0.8% and the prior month's contraction of 0.2%. The decline in exports to the United States reduced the US share of total exports to only 9% from 15% in 2024.

   Imports fell in large part due to falling prices for energy and metals. For example, imports of crude oil fell by 22.1% y-o-y by value but only by 0.8% by volume. Other commodities with double-digit y-o-y declines in imports included steel products (-20.0%), unwrought copper and products (-16.9%), and iron ore and concentrates (-12.5%).

   China's trade surplus in the month of May was $103.2 billion versus $96.2 billion in April.

3. **China's consumer and producer prices remained in deflation.**

   The outlook: Deflation in China is driven by both positive and negative factors. The positive factor is falling commodity input prices that lower producer costs. The Producer Price Index (PPI) in China has been in deflation for 32 consecutive months on a y-o-y basis in part due to falling input prices. However, the negative driver of deflation is excess supply which continues to worsen. China's excess industrial capacity relative to domestic demand is likely to be further aggravated by external protectionist measures which could lead to the balance of drivers shifting more negatively.

The details: China's CPI fell 0.1% y-o-y versus expectations for a 0.2% decline and the prior month's fall of 0.1%. Food prices declined by 0.4% y-o-y while non-food prices were flat. Non-food goods prices fell y-o-y while services prices rose marginally. Excluding food and energy, core CPI rose 0.6% y-o-y versus 0.5% in April.

PPI fell by 3.3% versus the consensus expectation for a decline of 3.2% and the prior month's 2.7% fall. PPI for producer goods fell to -4.0% y-o-y in May versus -3.1% in April, while PPI for consumer goods moderated to -1.4% y-o-y versus -1.6% in April.

The Week Ahead

1. **Headline US retail sales are expected to slip, but the less volatile control group is expected to rise.**

The outlook: Despite abysmal readings of consumer confidence from sentiment surveys such as the University of Michigan Sentiment Index, retail sales have continued to grow by about 5% y-o-y. The control group, which excludes food services, gas stations, autos, and building materials, is a less erratic series which has also delivered relatively consistent growth despite volatile sentiment.

I expect retail sales growth to remain resilient until price increases caused by tariffs become more apparent and/or employment begins to weaken due to companies trying to identify cost cuts to offset tariff price pressures. That should translate to a relatively good set of numbers next week for the control group. Headline retail sales, on the other hand, are likely to be weaker as the prior month's figure was inflated by front-loaded auto purchases to avoid tariffs.

May US Retail Sales	Consensus	Prior Month
Retail Sales m-o-m	-0.6%	0.1%
Retail Sales ex-Auto m-o-m	0.2%	0.1%
Retail Sales ex-Auto and Gas m-o-m	0.4%	0.2%
Retail Sales Control Group	0.5%	-0.2%

Source: Bloomberg, U.S. Census Bureau

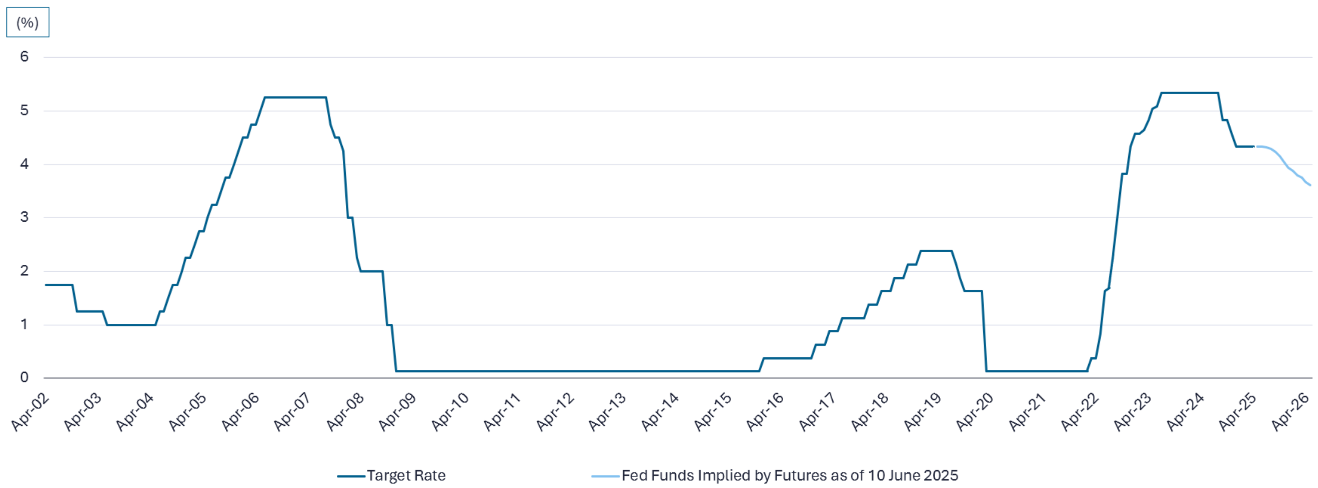
2. **The FOMC is likely to hold rates constant.**

The outlook: Markets have priced a 0% probability of a rate change at next week's FOMC meeting with two 25-basis point (bps) rate cuts expected by year end. I continue to expect no rate cuts in 2025 as inflation reaccelerates due to tariffs and subsequently on the back of increased numbers of deportations.

Investors will carefully examine the Summary of Economic Projections (SEP) for signs of potential policy easing with the dot plot and macro forecasts being focal points. I expect another shift in the dot plot toward fewer rate cuts. In March, when the last SEP was provided, the median expectation was for two rate cuts by year end. The distribution of participant expectations for rate cuts was four for policy staying constant, four for one easing, nine for two cuts, and two for three reductions. In this SEP, I expect the distribution to shift toward fewer cuts even if the median remains a forecast for 50 bps of easing.

Markets Are Pricing ~53 bps of Additional Fed Easing through 2025*

Federal Reserve Target Rate and Implied Rate through May 2026



Source: Bloomberg, Chicago Mercantile Exchange, Federal Reserve
Note: As of 12 June 2025
* Markets imply a 3% chance of a 25-bps rate cut at the June meeting and a 24% chance of an additional 25-bps cut at the July meeting.

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3. **China's monthly economic data are likely to reflect sluggish underlying growth.**

   The outlook: The May economic data from China are likely to show some of the stress created by US tariffs that exceeded 105% until negotiations in Geneva led the United States and China to back away from their most punitive trade measures. I expect domestic retail sales to remain lethargic relative to levels of growth enjoyed in the past while property investment continues to contract meaningfully on a y-o-y basis.

   Absent major structural changes to the Chinese economy, I expect continued weakness as consumers grapple with significant loss of wealth from residential real estate, and as confidence is dampened by increased trade tensions with the United States and other trade counterparts.

May China Economic Data		Consensus	Prior
Industrial Production	y-o-y	6.0%	6.1%
	YTD y-o-y	6.4%	6.4%
Retail Sales	y-o-y	4.9%	5.1%
	YTD y-o-y	4.8%	4.7%
Fixed Asset Investment	YTD y-o-y	4.0%	4.0%
Property Investment	YTD y-o-y	-10.5%	-10.3%
Residential Property Sales	YTD y-o-y	*	-1.9%
New Home Prices	m-o-m	*	-0.12%
Used Home Prices	m-o-m	*	-0.41%

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

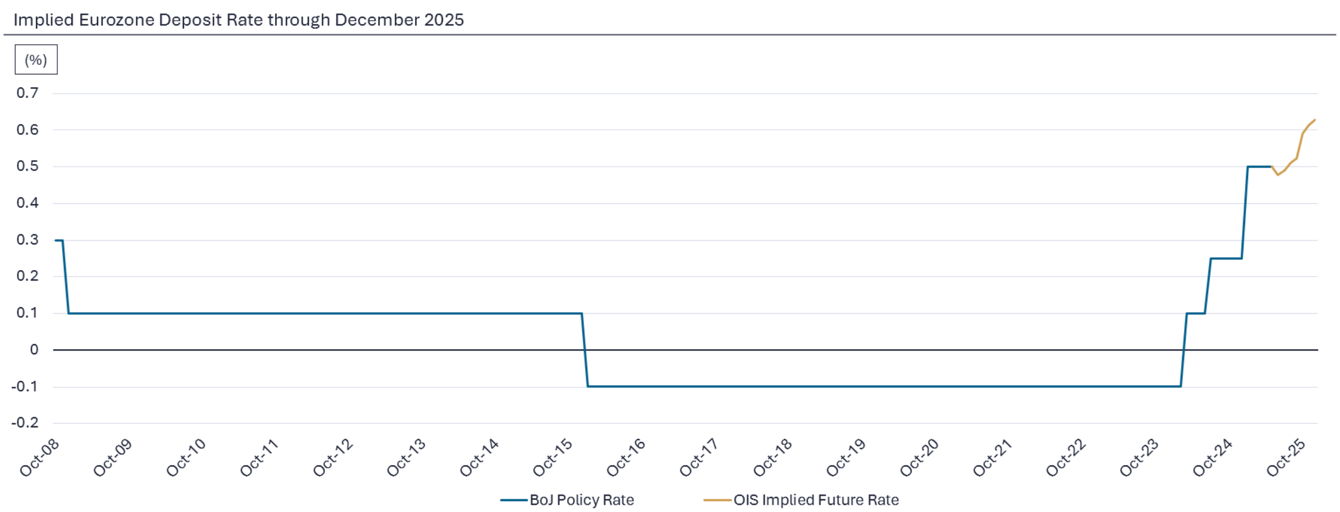
4. **The BoJ is likely to hold rates constant.**

   The outlook: Although headline inflation in Japan has been well above the BoJ's 2% target, a rate hike is unlikely at next week's meeting. Government measures to reduce rice and energy inflation should reassure the BoJ that inflation will be kept under control while also remaining near 2%.

   The BoJ is also scheduled to provide an update on its tapering of quantitative easing. About a year ago, the BoJ announced it would reduce its purchases of Japanese Government Bonds (JGBs) by about JPY400 billion per quarter from a run rate of JPY5.7 trillion per year in July 2024 to JPY3 trillion by March 2026. Investors will be eager to see if the pace of taper is adjusted at this meeting with some advocating a slower pace of tapering to reduce the risk of JGB volatility while others advocate a faster pace to allow markets to function without as much interference from the BoJ.

   While I am optimistic that Japan will be able to sustain its inflation normalization trajectory, I do not believe the BoJ has the latitude yet to further tighten monetary policy. Hence, I expect no 2025 rate hikes from the BoJ in contrast with market pricing of ~15 bps of policy tightening by year end.

Markets Suggest ~15 bps of Additional BoJ Rate Hikes through 2025*



Source: Bloomberg
Note: As of 12 June 2025
* Markets currently imply a 0% chance of a 25-bps hike at the June meeting and a 4% chance of one 25-bps hike through July.

5. **Japan's CPI inflation is expected to remain relatively stable well above the 2% target.**

   The outlook: Food prices, particularly for rice, could have a disproportionate impact on Japanese headline inflation in the months ahead with government measures to reduce consumer prices having a mitigating effect on inflationary pressure. Rice accounts for only 0.6% of the CPI basket, but prices have increased 98.4% from a year ago adding 61 bps to headline CPI and leading the government to announce releases of rice from emergency stockpiles with a goal of cutting prices in half. Energy subsidies have also resumed this summer. In April, electricity, which only accounts for 3.4% of the CPI basket, contributed 46 bps to inflation on the back of a 13.5% y-o-y price increase. A stronger yen is also likely to reduce import prices.

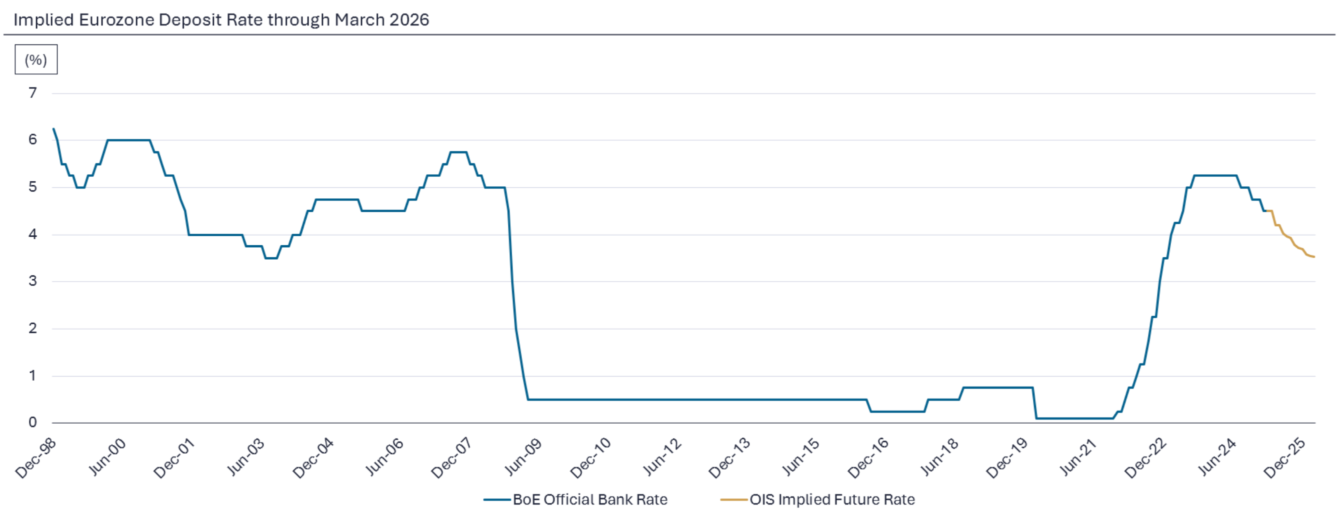
Japan May CPI	Consensus	Prior Reading
Headline y-o-y	3.5%	3.6%
CPI y-o-y ex-fresh food (core)	3.6%	3.5%
CPI y-o-y ex-fresh food and energy (core-core)	3.2%	3.0%

Source: Bloomberg, Japan Ministry of Internal Affairs and Communications

6. **The BoE is likely to hold rates constant.**

   The outlook: Markets are pricing less than a 10% chance of a rate cut from the BoE Monetary Policy Meeting next week. By year end, market prices suggest 53 bps of easing. The BoE will be responding to conflicting economic signals including a weaker-than-expected April GDP reading and sluggish employment metrics while at the same time grappling with surprisingly high inflation. Observers generally expect the BoE to shift to cutting rates at every other meeting with the 19 June meeting offering no policy change.

Markets Suggest ~53 bps of Additional BoE Rate Cuts through 2025*



Source: Bloomberg
Note: As of 12 June 2025
* Markets currently imply a 6% chance of a 25-bps cut in June and a 85% chance of an additional 25-bps cut in August.

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7. **UK CPI inflation will be reported on 18 June.**

   The outlook: While no consensus expectation is yet available on Bloomberg, after the unexpectedly large increase in y-o-y inflation in April, investors will be looking for signs of subsiding price pressures. In April, a confluence of factors led to a surge in inflation with all metrics exceeding expectations. Most worrisome to some was the upside surprise in services inflation which rose 5.4% y-o-y versus the consensus expectation for a 4.8% increase and the March increase of 4.7%.

   As a reminder, in April, UK inflation was exacerbated by a large increase in airline fares (+27.5% m-o-m and water and sewerage services (+26.1% m-o-m). Such large increases are highly unlikely to be repeated which should mitigate the upside in the m-o-m headline and y-o-y services inflation figures.

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