BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

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The Headlines

- In a busy week for central banks, the Federal Reserve, Bank of England (BoE), and Bank of Japan (BoJ) all held policy constant as expected with few meaningful changes in messaging regarding future policies. Each cited trade and other geopolitical uncertainties as driving elevated risk to economic forecasts.
- In China, retail sales materially beat expectations, but most other monthly economic metrics were weaker than anticipated. Fading export volumes likely impacted industrial production while the housing industry remained in the doldrums.
- Japan's Consumer Price Index (CPI) inflation was slightly above expectations while the UK's CPI fell back from the elevated prior month's levels.
- Next week will be relatively quiet on the macroeconomic data front with developed market Purchasing Managers' Index (PMI) data and US Personal Consumption Expenditure (PCE) inflation being two of the limited number of potentially market-moving reports. More importantly, investors will be waiting for a US decision regarding whether it will join Israel in its attacks on Iran with a likely focus on disabling Iran's nuclear program.

The Week Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Retail Sales Control Group	17 June	May	m-o-m	0.3%	0.4%	-0.1%
	FOMC Target Rate	18 June		Level	4.25% – 4.50%	4.25% – 4.50%	4.25% – 4.50%
China	Retail Sales	15 June	May	y-o-y	4.9%	6.4%	5.1%
	Industrial Production	15 June	May	y-o-y	6.0%	5.8%	6.1%
	Property Investment	15 June	YTD May	YTD y-o-y	-10.5%	-10.7%	-10.3%
Japan	Bank of Japan Target Rate	17 June		Level	0.50%	0.50%	0.50%
	CPI	19 June	May	y-o-y	3.5%	3.5%	3.6%
	Core-Core CPI	19 June	May	y-o-y	3.2%	3.3%	3.0%
United Kingdom	CPI	18 June	May	y-o-y	3.3%	3.4%	3.5%
	Core CPI	18 June	May	y-o-y	3.5%	3.5%	3.8%
	Bank of England Bank Rate	19 June		Level	4.25%	4.25%	4.25%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Headline PCE Inflation	27 June	May	y-o-y	2.3%		2.1%
	Core PCE Inflation	27 June	May	y-o-y	2.6%		2.5%

The Week Behind

1. **The Fed held interest rates steady and indicated it can be patient before easing further.**

   The outlook: I continue to expect no Fed rate cuts in 2025, while the fed funds futures suggest ~48 basis points (bps) of cuts by year end.

   The details: During the press conference, Chair Jay Powell noted repeatedly that someone will have to pay for tariffs, and it is likely that consumer prices will rise because of these levies. He also suggested that price increases for goods could trigger a more widespread increase in prices.

   Powell clearly conveyed the Fed's view that there is no rush to cut rates, as the economy and labor market appear solid. Powell repeated his prior statement that price stability is a precondition for achieving maximum employment in the long run. However, he also acknowledged that at some point the Fed's two mandates to achieve price stability and maximum employment could be in conflict. In such a scenario, he said the Fed's decision-making would incorporate an assessment of how far the economic situation is from each objective when weighing which should be prioritized.

   The Summary of Economic Projections showed Fed participants lowered their GDP expectations while they marginally raised forecasts for inflation and unemployment. Despite these changes, the median expectation for the fed funds rate at year end still implied two 25-bps rate cuts.

2. **Headline US retail sales fell more than expected as auto purchases normalized.**

   The outlook: To date, qualitative assessments of consumer confidence have been severely impacted by the US trade war, but hard data measures of actual consumption have been more resilient. As tariffs translate to higher prices and impose cost pressures on companies, I expect retail sales to better align with soft data as the year progresses.

   The details: Total retail sales of $753 billion were worse than expected with a decline of 0.9% month-on-month (m-o-m) versus the consensus expectation for a fall of 0.6%. The shortfall can be explained largely by a 3.5% decline in sales at motor vehicle and parts dealers (which represent 19% of total US retail sales). The control group, which excludes auto dealers, gas stations, and building materials, saw sales increase 0.4% versus consensus for a 0.3% m-o-m gain.

   The only part of the retail sales report that captures the service sector is restaurant and bar sales (categorized as food services and drinking places) where spending fell 0.9% m-o-m perhaps suggesting that consumers are tightening their belts in the service sector for now and prioritizing buying goods before prices rise to reflect tariff increases.

   Overall, the retail sales report was good enough to signal that consumers continue spending despite the psychological roller coaster they have endured this year related to tariffs and the stock market swoon in early April.

May US Retail Sales	Consensus	Actual	Prior Month	Revised
Retail Sales m-o-m	-0.6%	-0.9%	0.1%	-0.1%
Retail Sales ex-Auto m-o-m	0.2%	-0.3%	0.1%	0.0%
Retail Sales ex-Auto and Gas m-o-m	0.3%	-0.1%	0.2%	0.1%
Retail Sales Control Group	0.3%	0.4%	-0.2%	-0.1%

Source: Bloomberg, U.S. Census Bureau

3. China reported better-than-expected May retail sales but other metrics disappointed.

The outlook: I expect China's economy to continue to muddle through the rest of 2025 absent a large fiscal stimulus program. Even if China's central government delivers substantial fiscal stimulus, it will still need meaningful structural reforms to sustainably reinvigorate growth. The longer China waits to deliver the necessary boost to activity, the higher the probability that China slips into a longer-term stagnation.

The details: Retail sales were the bright spot in China's monthly economic data release rising 6.4% year-on-year (y-o-y) versus the consensus expectation for an increase of 4.9%. The increase appears to have been driven by trade-in subsidies that have recently been exhausted in some provinces as well as an earlier than usual "618" shopping festival. In sum, the retail sales figures were good, but they are unlikely to be sustained given the rest of the report.

Most other metrics fell slightly short of expectations. Industrial production suffered from slowing export growth as well as domestic factors. Drags on industrial production included electric machinery and chemical manufacturing. The trajectory was negative across a range of other industrial areas including crude steel, steel products, cement output, and power generation. Auto production was a bright spot with output up 11.3% y-o-y in May versus a gain of 8.5% y-o-y in April.

Fixed asset investment (FAI) disappointed relative to expectations. FAI suffered from slower growth in infrastructure and property investment. Manufacturing investment helped mitigate the downside in FAI rising 7.8% y-o-y in May versus a gain of 8.2% in April.

The National Bureau of Statistics 70-city weighted average home price data showed a decline of 0.22% m-o-m in May. On a year-to-date (YTD) basis, the weighted average new home price is down about 4.0% but note that this figure reflects the listing price rather than the final agreed sale price, and it does not include "shadow discounting" where a property buyer gets a free parking spot, for example. As such, these figures likely understate ongoing pressure on housing prices that is more evident in data regarding previously occupied home prices that are down 5% – 15% y-o-y.

May China Economic Data		Consensus	Actual	Prior
Industrial Production	y-o-y	6.0%	5.8%	6.1%
	YTD y-o-y	6.4%	6.3%	6.4%
Retail Sales	y-o-y	4.9%	6.4%	5.1%
	YTD y-o-y	4.8%	5.0%	4.7%
Fixed Asset Investment	YTD y-o-y	4.0%	3.7%	4.0%
Property Investment	YTD y-o-y	-10.5%	-10.7%	-10.3%
Residential Property Sales	YTD y-o-y	*	-2.8%	-1.9%
New Home Prices	m-o-m	*	-0.22%	-0.12%
Used Home Prices	m-o-m	*	-0.50%	-0.41%

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

4. **The BoJ held policy constant as expected.**

The outlook: Market prices suggest a 54% chance of one 25-bps rate hike by year end from the BoJ, but I am skeptical that we will see any additional rate increases this year. While the target rate of 0.5% is well below inflation and hence is stimulative, I do not believe the BoJ will be willing to risk its progress in normalizing inflation at or above the 2% target level amid significant trade policy and geopolitical uncertainty.

The details: The BoJ's decisions were in line with consensus both in terms of maintaining the target rate at 0.5% and in maintaining the pace at which it is reducing purchases of Japanese Government Bonds (JGBs). The current BoJ plan is to reduce purchases by ¥400 billion per quarter until March 2026, at which point it will slow the pace of reductions to ¥200 billion. By calendar Q1-27, this would mean that the BoJ would be purchasing ~¥2 trillion of JGBs per month.

At the post-meeting press conference, BoJ Governor Kazuo Ueda indicated that the BoJ's economic assessment has not changed since the April meeting with elevated uncertainty remaining a constraint on further policy changes. He also noted that hard data could begin deteriorating after the summer and that risks to the inflation forecast are to the downside. US trade policy is likely to be the key source of uncertainty for the BoJ, but the Israel-Iran conflict also will contribute to fears regarding energy prices in Japan.

5. **Japan's core CPI slightly exceeded expectations.**

The outlook: Japan's inflation is likely to subside due to releases of emergency supplies to lower rice prices. However, I still expect Japan to sustain 2% "new core" inflation (ex-fresh food and energy) into 2026 given wage increases and sustained private service sector inflation.

The details: Across the three CPI metrics, rice contributed at least 60 bps to each despite its small weight in the CPI basket as prices are 101.7% above the prior year. (New core excludes fresh food, but it includes rice.) In headline CPI, energy prices also contributed significantly with an 8.1% y-o-y increase and a weight in the CPI basket of 7.1%.

On a month-on-month basis, new core CPI has posted increases of 20 – 30 bps for nine consecutive months suggesting a sustained run rate for core inflation approximating 3%.

Japan May CPI

	Consensus	Actual	Prior Reading
Headline y-o-y	3.5%	3.5%	3.6%
CPI y-o-y ex-fresh food (core)	3.6%	3.7%	3.5%
CPI y-o-y ex-fresh food and energy (core-core)	3.2%	3.3%	3.0%

Source: Bloomberg, Japan Ministry of Internal Affairs and Communications

6. **UK inflation was largely in line with expectations in May reducing price pressure anxiety.**

The outlook: UK inflation has been stickier than in other regions with UK core CPI still running at 3.5% y-o-y versus US core CPI below 3% and the Eurozone below 2.5%. May's UK CPI readings offered a reassuring signal that prices are gradually returning toward the BoE's 2% inflation target.

The details: As a reminder, the April UK CPI figures had surprised meaningfully on the upside with services being particularly worrisome on the back of the timing of the Easter holiday and its effect on airline fares. In May, inflation returned toward more acceptable levels with services inflation rising 4.7% y-o-y versus 5.4% in April due to airline fares returning to normal non-holiday levels and the Office for National Statistics correcting its Vehicle Excise Duty figures following an overstatement in April.

Headline CPI was slightly above expectations due to a larger-than-expected increase in food prices, but the core and services readings are typically accorded a higher priority by investors as they reflect sustained underlying price trends better in the absence of erratic food and energy prices.

UK May CPI

	Consensus	Actual	Prior Reading
Headline m-o-m	0.2%	0.2%	1.2%
Headline y-o-y	3.3%	3.4%	3.5%
Core y-o-y	3.5%	3.5%	3.8%
Services y-o-y	4.8%	4.7%	5.4%

Source: Bloomberg, UK Office for National Statistics

7. **The BoE held policy steady in a 6-3 vote with the minority advocating a 25-bps rate cut.**

The outlook: Markets are now pricing a 78% chance of a 25-bps rate cut at the 7 August BoE Monetary Policy Committee (MPC) meeting with total rate cuts by year end of 49 bps. My view aligns with the market at this point as the BoE will want to see further progress toward its 2% inflation target before easing policy materially further.

The details: While the consensus expectation was for no change in policy, the 6-3 vote was slightly more dovish than expected as most commentators anticipated two votes to ease rather than three. The BoE maintained its intention to pursue a “gradual and careful approach” to policy easing and reiterated that it is “not on a pre-set path.” The MPC statement indicated that, “more pronounced disinflation was needed to ensure CPI inflation declined back towards the 2% target consistent with the baseline projection in the May Report,” suggesting a patient pace of easing through year end.

8. **UK retail sales fell far short of expectations in May.**

The outlook: I expect UK retail sales to grow at a sluggish pace this year as the BoE’s ability to ease monetary policy is constrained by sticky inflation and geopolitical uncertainties keep a lid on consumer confidence.

The details: Retail sales from January through April had been surprisingly strong relative to sentiment surveys, but the May data appear to have brought the two data series back into line. Some portion of the May sales weakness could be attributed to bad weather, but the magnitude of the decline brings retail sales back to December 2024 levels.

May UK Retail Sales	Consensus	Actual	Prior Month	Revised
Retail Sales including Auto Fuel m-o-m	-0.5%	-2.7%	1.2%	1.3%
Retail Sales including Auto Fuel y-o-y	1.7%	-1.3%	5.0%	
Retail Sales excluding Auto Fuel m-o-m	-0.7%	-2.8%	1.3%	1.4%
Retail Sales excluding Auto Fuel y-o-y	1.8%	-1.3%	5.3%	5.2%

Source: Bloomberg, UK Office for National Statistics

The Week Ahead

1. **Global attention will remain focused on the conflict between Israel and Iran.**

   The outlook: The biggest question looming over the next week is whether the United States will join Israel in attacking Iran with a focus on its underground nuclear facility in Fordow. The most recent information being released by the White House suggests that the President will decide on US involvement within the next two weeks. In the interim, US naval forces are moving toward the region, and it is likely that B-2 bombers are being positioned in a proximate location to enable the use of Massive Ordnance Penetrators, otherwise known as bunker-busting bombs against key nuclear facilities. These 30,000-pound bombs are believed to be the only ones short of nuclear weapons that could penetrate the depth of earth above the Fordow nuclear facility.

2. **PMI data will be released across major developed economies.**

   The outlook: In recent months, most countries have seen their PMI Composite reading converge toward 50 with the Eurozone, France, Japan, and the United Kingdom all reporting readings within one point of the 50 level that demarcates growth from contraction. The only economy materially above 50 is the United States at 53.0 while Germany is the laggard at 48.5. Given the major fiscal changes in Germany and meaningful interest rate reductions by the European Central Bank (ECB), I would expect Germany's PMI figures to improve moving forward. In the United States, on the other hand, depending on the course of trade policy in the weeks and months ahead, there could be material downside to readings especially if the pause on "reciprocal tariffs" ends badly on 9 July.

3. **US PCE inflation for May is expected to be muted.**

   The outlook: US PCE inflation is likely to reach a cyclical trough in May as tariffs begin to increase the cost of goods in future months. The consensus expectation is for headline PCE inflation to rise 0.1% m-o-m with an increase of 2.3% y-o-y. Core PCE inflation is expected to rise 0.1% m-o-m and 2.6% y-o-y. The key components of PCE inflation have largely been released as part of the CPI and Producer Price Index inflation data. Hence, meaningful surprises are unlikely.

   Personal income and spending will also be part of the same release and are expected to increase 0.2% m-o-m in both cases versus an increase of 0.8% for income and 0.2% for spending in April.

4. **France and Spain will release preliminary inflation data for June.**

   The outlook: In May, French CPI rose only 0.6% y-o-y while Spanish CPI increased 2.0%. The June results are expected to be roughly the same on a y-o-y basis in both cases. These reports will offer a preview of the Eurozone aggregate inflation figures to be released the subsequent week. I expect inflation to continue sliding to levels slightly below the ECB's 2% target due in part to the strengthening euro as well as negative demand effects from the US trade war.

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