BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

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The Headlines

- The United States launched attacks on Iran's nuclear facilities. Iran and Israel agreed to a ceasefire, but tensions remain high, and the long-term risk of conflict persists. Iran's military capabilities have been degraded, but the degree of damage to its nuclear program is unclear with initial US intelligence reports suggesting Iran's capabilities might have only been delayed by a few months.
- Developed market Purchasing Manager's Indexes (PMIs) were stable or improved, except in France, with US manufacturing output prices rising—possibly reflecting new tariffs.
- US Personal Consumption Expenditure (PCE) inflation rose more than expected in May, suggesting the cyclical low for inflation has passed, with tariffs likely to push prices higher in coming months.
- Inflation in France and Spain accelerated in June, but overall Eurozone inflation is expected to remain near the European Central Bank's (ECB) 2% target when reported next week.
- Looking ahead, US unemployment is projected to rise, with labor market deterioration expected if tariffs persist. China's economic indicators are anticipated to remain weak, and Japan's Tankan survey is expected to show slowing activity, particularly in manufacturing.
- Behind the Headlines will not be published next week in observance of the US Independence Day holiday. The next update will be on 11 July.

The Week Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Headline PCE Inflation	27 June	May	y-o-y	2.3%	2.3%	2.1%
	Core PCE Inflation	27 June	May	y-o-y	2.6%	2.7%	2.5%

The Two Weeks Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Change in Nonfarm Payrolls	3 July	June	m-o-m	120,000		139,000
	Unemployment Rate	3 July	June	Level	4.3%		4.2%
	Average Hourly Earnings	3 July	June	y-o-y	3.9%		3.9%
China	NBS Manufacturing PMI	29 June	June	Level	49.6		49.5
	NBS Non-Manufacturing PMI	29 June	June	Level	50.2		50.3
Eurozone	Headline CPI	1 July	June	y-o-y	2.0%		1.9%
	Core CPI	1 July	June	y-o-y	2.3%		2.3%

The Week Behind

1. **The United States attacked Iran's nuclear facilities. Iran and Israel subsequently agreed to a ceasefire.**

   The outlook: The Israel-Iran crisis is by no means over, despite both sides agreeing to a ceasefire. It appears likely that the Iranian regime was threading a needle of demonstrating a symbolic retaliation against US forces in Qatar (which it forewarned against to avoid escalation) against the risk of being deposed. For now, the regime has remained in control, and nationalist sentiments have been aroused by the attacks, but the situation remains in flux.

   It appears that much of Iran's military capacity to inflict damage on Israel has been degraded. Israel has disabled much of Iran's missile launch capabilities and has established relatively unchallenged air superiority over Iran. Iran does retain substantial short-range missile capabilities, but these weapons would be more relevant for use in the Persian Gulf arena, potentially including against US facilities, than for attacking Israel. It seems highly likely that Iran's immediate priority during a ceasefire is to rebuild its conventional defensive military capabilities.

   The degree to which Iran's nuclear program has been set back is more questionable. A US Defense Intelligence Agency (DIA) assessment concluded that the program might have been delayed by only a few months, but such immediate evaluations are inherently unreliable, as are political statements regarding military success. Until on-the-ground assessments can be attained, we are unlikely to know the true impact on Iran's capabilities.

   Longer-term, Iran's incentives to develop a nuclear weapons capability are likely to have been increased by the June conflict, as its leadership recognizes that such attacks typically do not occur against nuclear-armed states. However, for Israel, Iran's possession of nuclear weapons is an existential threat. This combination of risk-reward calculations makes a lasting peaceful coexistence more difficult to imagine even if the current ceasefire persists.

   Markets have interpreted the ceasefire as a return to the pre-attack status quo. Brent crude prices have returned to levels just before the Israeli strike implying a de-risked situation. Iran's response to the Israeli and US attacks suggests such an optimistic approach might be appropriate given that Iran's retaliation was limited to missile and drone attacks on Israel and US military assets but did not target any Persian Gulf energy infrastructure. However, some degree of risk premium appears appropriate in a region that is far from a lasting peace.

2. **Developed market Purchasing Managers' Index (PMI) data were stable-to-better versus May's.**

   The outlook: It was encouraging to see stable-to-stronger manufacturing PMI readings in all countries other than France. But what might be most notable was the 4.8-point increase in the US manufacturing output prices index to 64.5 versus a relatively stable reading for other developed markets. This could be an early sign of the impact of tariffs on the cost of producing manufactured goods in the United States as well as the greater ease for US manufacturing companies to raise prices when competing imports become more expensive due to tariffs.

   The details: The manufacturing, services, and composite readings by country and economic unit are summarized in the table below.

June Preliminary PMI Data

Release Date	Country	Index	Consensus	Actual	Prior Month
6/22/2025	Japan	Manufacturing	*	50.4	49.4
	Jibun Bank	Services	*	51.5	51.0
		Composite	*	51.4	50.2
6/23/2025	Eurozone	Manufacturing	49.7	49.4	49.4
	HCOB	Services	50.0	50.0	49.7
		Composite	50.4	50.2	50.2
6/23/2025	France	Manufacturing	49.8	47.8	49.8
	HCOB	Services	49.0	48.7	48.9
		Composite	49.3	48.5	49.3
6/23/2025	Germany	Manufacturing	49.0	49.0	48.3
	HCOB	Services	47.8	49.4	47.1
		Composite	49.1	50.4	48.5
6/23/2025	UK	Manufacturing	46.8	47.7	46.4
	S&P Global/	Services	51.3	51.3	50.9
	CIPS	Composite	50.6	50.7	50.3
6/23/2025	US	Manufacturing	51.0	52.0	52.0
	S&P Global	Services	53.0	53.1	53.7
		Composite	52.2	52.8	53.0

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

3. US PCE inflation rose more than expected in May.

<u>The outlook:</u> I believe we have likely seen the cyclical trough for US inflation. Tariffs are likely to begin raising the price of goods in the United States in the months ahead as companies deplete their inventories of products purchased before tariffs were imposed. Over time, companies will face a choice of either raising prices, cutting other costs to offset tariffs, or sacrificing margins. Markets have interpreted benign inflation readings to date as suggesting less impact from tariffs on inflation, but my assessment is that this is all about timing.

<u>The details:</u> The decline in personal income was driven by lower government social benefits. The decline in personal spending was entirely driven by lower auto sales after consumer front-loaded purchases in March and April to avoid tariffs as well as lower gasoline and other energy spending.

US Personal Income and Outlays, May 2025

	Consensus	Actual	Prior Reading	Revised
Personal Income	0.3%	-0.4%	0.8%	0.7%
Personal Spending	0.1%	-0.1%	0.2%	
PCE Price Index (m-o-m)	0.1%	0.1%	0.1%	
PCE Price Index (y-o-y)	2.3%	2.3%	2.1%	2.2%
Core PCE Price Index (m-o-m)	0.1%	0.2%	0.1%	
Core PCE Price Index (y-o-y)	2.6%	2.7%	2.5%	2.6%

Source: Bloomberg, Bureau of Economic Analysis

4. **Speculation increased regarding President Trump potentially naming a successor to Federal Reserve Chair Jay Powell much earlier than usual.**

   The outlook: I continue to see the appointment of Jay Powell's replacement as a meaningful tail-risk for markets. The United States has enjoyed largely unquestioned status as the world's safe haven and reserve currency for decades, but through that time, under a range of political administrations, it has also increasingly taken this status for granted. As US debt-to-GDP continues to escalate, even against a full-employment economic backdrop, and as inflation is likely to reaccelerate due to tariffs and stricter enforcement of immigration laws, it is critical that the next Fed chair be perceived to be independent of presidential influence.

   I do not foresee a situation in which the Fed loses all credibility, but any meaningful slippage could accelerate capital reallocation away from the US dollar and other US assets to the extent investors lose confidence that the Fed's sole priorities are achieving its dual mandate to maintain price stability and maximize employment.

   Were President Trump to announce his nominee to succeed Jay Powell much earlier than usual, it could create a situation where the candidate's commentary could undermine market confidence in the future direction of Fed policy if he or she were to diverge publicly from Fed communications.

5. **In France and Spain, Harmonised Index of Consumer Prices (HICP) inflation rose in June.**

   The outlook: I continue to expect inflation to remain at or even below the ECB's 2% target. To the extent US tariffs on exports from the Eurozone end up being higher than markets currently anticipate, there could be incremental downward pressure on inflation due to the negative effects on Eurozone exports and broader economic activity levels.

   The details: French HICP inflation accelerated to 0.8% year-on-year (y-o-y) versus the consensus expectation of a 0.6% gain with services driving the increase. Service prices rose 2.4% y-o-y 2.1% in May. In Spain, inflation also accelerated in June versus May, but figures were in line with expectations.

Eurozone Harmonised Consumer Price Index for June

Release Date	Country		Consensus	Actual	Prior Reading
6/27/2025	France	Headline m-o-m	0.2%	0.4%	-0.2%
		Headline y-o-y	0.7%	0.8%	0.6%
6/27/2025	Spain	Headline m-o-m	0.6%	0.6%	0.0%
		Headline y-o-y	2.2%	2.2%	2.0%

Source: Bloomberg

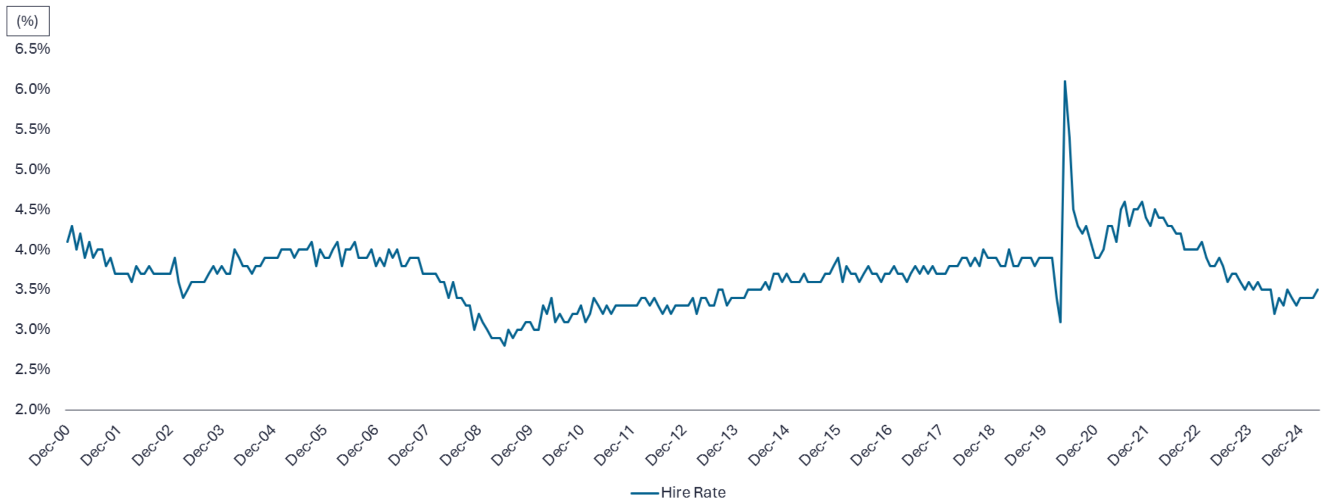
The Two Weeks Ahead

1. **The US unemployment rate is expected to edge higher to 4.3% in June.**

   The outlook: On 1 July, the Job Openings and Labor Turnover Survey report will likely show stable to lower job openings. I will continue to watch the hire rate for signs of improved employer confidence that might be manifested through additions to headcount. The hire rate in recent months has been at levels last seen in 2013 and 2014 when unemployment was 6.0%–7.0% suggesting reluctance to commit to new employees.

The Hire Rate Is at 2014 Levels when Unemployment Stood at 6.0% to 6.5%

Hire Rate



LAZARD Source: Bureau of Labor Statistics, Haver Analytics
Note: As of April 2025

The Employment Situation report will be released on 3 July. Nonfarm payrolls are expected to increase 121k in June versus 139k in May. The unemployment rate is expected to increase to 4.3% from 4.2% with a risk of a larger jump to 4.4%. It is noteworthy that the unrounded unemployment rate in May was 4.24%, so it would only take a rise of 11 basis points (bps) to round up to 4.4%. Average Hourly Earnings are expected to rise 0.3% month-on-month (m-o-m) and 3.9% y-o-y.

I see the June labor market reports as the first that will indicate the degree to which the US trade war has affected employment. Through year end, I expect to see deteriorating labor market conditions with companies cutting headcount to mitigate the cost pressure from higher tariffs from imported goods. If tariffs remain near current levels, i.e., at a weighted average tariff of ~15.6%, I expect unemployment to grind higher toward 4.5%–5.0%. If additional sectoral tariffs and country-specific tariff hikes raise the weighted average tariff toward 20%, unemployment could exceed 5%.

2. **China PMIs for June are likely to be stable-to-weaker.**

   <u>The outlook:</u> The current consensus expectation is for stable PMIs from the National Bureau of Statistics (NBS) which better reflect activity for large and state-owned enterprises. The Caixin figures which better represent conditions for small and medium companies and privately owned companies are expected to improve marginally for manufacturing. The Caixin figures had been more negatively impacted by the trade war and hence could enjoy a slight rebound, but I doubt any recovery will be lasting given the precarious state of US–China trade relations.

3. **China's Consumer Price Index (CPI) and Producer Price Index (PPI) are likely to remain undesirably weak.**

   <u>The outlook:</u> While consensus expectations are not yet available on Bloomberg, it is highly likely that the PPI will remain in deflation for the 33rd consecutive month while CPI will likely be close to 0% representing the 29th month at or below 1.0% on a y-o-y basis.

4. **Eurozone, German, and Italian inflation are expected to accelerate slightly in June versus May.**

   The outlook: With the French and Spanish inflation data already in hand, the consensus expectation is for Eurozone headline inflation to accelerate to 0.3% m-o-m in June from 0% in May. Y-o-y inflation is expected to nudge higher to 2.0% from 1.9% in May.

5. **The quarterly Tankan survey by the Bank of Japan is expected to show weakening activity.**

   The outlook: Companies are expected to report weaker current activity and outlooks. However, non-manufacturing companies are expected to be more resilient than their manufacturing peers.

   I expect labor market conditions to remain near the tightest levels since the early 1990s given ongoing demographic challenges and an already elevated level of female labor force participation which leaves little additional domestic supply of workers to meet demand.

Japan's Labor Market Is the Tightest since 1991

Tankan Survey of Enterprises, Employment Conditions

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Source: Bank of Japan, Haver Analytics
Note: As of March 2025

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