BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

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The Headlines

- United States: The One Big Beautiful Bill (OBBB) was signed, likely increasing fiscal deficits through fiscal year 2034 by over $3.4 trillion. The 90-day pause on reciprocal tariffs ended with the United States announcing significant tariff hikes across multiple countries. Recent labor data showed better-than-expected job growth but falling labor force participation and low hiring rates.
- China: June's Purchasing Managers' Index (PMI) data was slightly better than expected, with improvements for large manufacturers and construction, but small firms and services lagged. Inflation remains weak, with Consumer Price Index (CPI) inflation barely positive and the Producer Price Index (PPI) in deflation for the 33rd consecutive month.
- Eurozone: Inflation matched expectations, standing at the European Central Bank's (ECB) 2% target.
- Japan: Annual *shunto* wage negotiations culminated with the largest pay increases in decades. The Tankan survey reported improved business sentiment, especially among manufacturers.
- Outlook: US inflation is expected to accelerate marginally, and US retail sales are likely to grow modestly. China's GDP report is likely to show growth above the 5% target, but underlying monthly economic data are unlikely to be as positive. Japan's June inflation is expected to slow slightly to 3.3% year-on-year (y-o-y) while UK inflation should remain stable, supporting potential rate cuts.

The Two Weeks Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Change in Nonfarm Payrolls	3 July	June	m-o-m	106k	147k	144k
	Unemployment Rate	3 July	June	Level	4.3%	4.1%	4.2%
	Average Hourly Earnings	3 July	June	y-o-y	3.8%	3.7%	3.8%
Eurozone	Headline CPI	1 July	June	y-o-y	2.0%	2.0%	1.9%
	Core CPI	1 July	June	y-o-y	2.3%	2.3%	2.3%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Headline CPI	15 July	June	y-o-y	2.6%		2.4%
	Core CPI	15 July	June	y-o-y	2.9%		2.8%
	Retail Sales (Advance)	17 July	June	m-o-m	0.1%		-0.9%
China	GDP	14 July	Q2-25	y-o-y	5.1%		5.4%
	Industrial Production	14 July	June	y-o-y	5.6%		5.8%
	Retail Sales	14 July	June	y-o-y	5.2%		6.4%
Japan	Headline CPI	17 July	June	y-o-y	3.3%		3.5%
United Kingdom	Headline CPI	16 July	June	y-o-y	3.4%		3.4%

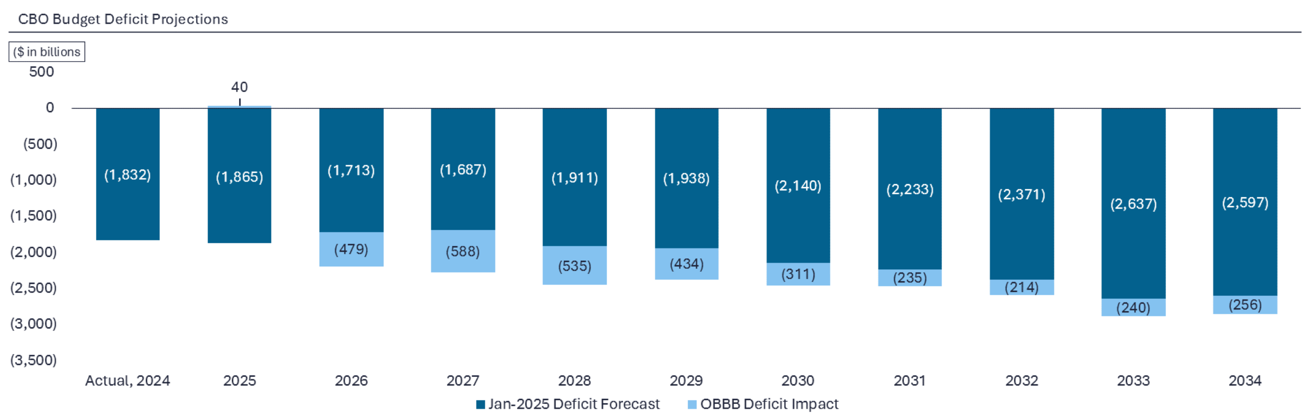
The Two Weeks Behind

1. **The OBBB was signed into law, adding significantly to future fiscal deficits.**

   The outlook: The OBBB fiscal package was signed into law. The legislation reduces federal revenue by ~$4.5 trillion over the next decade by making current personal tax cuts permanent while adding temporary tax breaks for tip income, overtime, and senior citizens, among other measures. Spending reductions total ~$1.2 trillion over the next decade with nearly $900 billion coming from cuts to Medicaid that are scheduled to be imposed after the 2026 mid-term elections. The OBBB also rolls back large portions of the Inflation Reduction Act and slashes higher education funding.

   The Congressional Budget Office estimated that the legislation would add approximately $3.4 trillion to deficits over a 10-year horizon after accounting for macroeconomic effects and increased interest expense on the additions to federal debt. The Committee for a Responsible Federal Budget estimated that the OBBB could add $5 trillion to deficits if temporary tax cuts are made permanent and key Medicaid spending cuts are canceled. Without incorporating potential revenue from imposition of tariffs, US federal deficits are likely to exceed 6.5% of GDP annually from fiscal 2026 through 2034. Put simply, deficits appear likely to remain at unsustainably high levels even assuming no recession for a decade, lower interest rates, and significant tariff revenue.

Deficits Are Likely to Exceed 6.5% of GDP Each Year from FY2026 to FY2034 due to the OBBB



	Actual, 2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Deficit as % of GDP	6.4%	6.1%	7.0%	7.0%	7.2%	6.8%	6.7%	6.5%	6.6%	7.1%	6.7%
Debt held by the public	97.8%	99.8%	103.1%	106.5%	110.1%	112.9%	115.6%	117.8%	120.1%	122.6%	124.8%

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Source: Lazard, Congressional Budget Office, U.S. Treasury Department
Note: OBBB = One Big Beautiful Bill (H.R. 1). Data presented is in fiscal years which end 30 September, e.g., FY2024 ended 30 September 2024.
As of July 2025

2. **The US' 90-day reciprocal tariff pause ended, and tariffs were raised across multiple counterparts.**

   The outlook: With only three agreements reached in principle between the United States and China, the United Kingdom, and Vietnam, the US administration began issuing letters assigning tariff rates to various countries. The tariffs reach as high as 50% for Brazil, but in general are above the 10% universal tariff. On 10 July, President Trump said he might aim for a higher tariff of 15% – 20% for most remaining countries which could mean the weighted average tariff might end up above 20% which increases the risk of triggering a recession if such levels are sustained.

   As a reminder, the three primary tariff "endgame" scenarios initially developed in April 2025 by Lazard Geopolitical Advisory are in the table below. We are currently trending between the "Middle

Case" and "Worse Case" scenarios which could lead to core CPI above 4% with meaningfully negative implications for US real GDP and corporate profit growth.

Three Scenarios Appear Most Likely for an "End Game" Outcome

	Country & US Trade Deficit	Scenario 1: "Best Case" *10% universal tariff and China tariff close to 20%*	Scenario 2: "Middle Case" *10% tariff on most partners, except for cases with high deficits and / or political friction; 40% tariff on China*	Scenario 3: "Worse Case" *10% baseline tariff, but higher rates of 15-35% for other partners, and a 60% tariff on China*
	China (-$295bn)	20%	40%	60%
	EU (-$236bn)	10%	15%	20%
	Mexico (-$172bn)	10%	10%	10%
	Vietnam (-$123bn)	10%	25%	35%
	Japan (-$68bn)	10%	10%	20%
	Canada (-$63bn)	10%	10%	10%
	UK (+$12bn)	10%	10%	10%
	All Others	10%	10%	15%
Potential Impact	**US Avg. Effective Tariff Rate**[1]	**~15%**	**~20%**	**~25%**
	Overview of Potential Impact	*Mildly stagflationary: slower growth with higher inflation, but no recession*	*Recession narrowly averted: growth stagnates and inflation rises*	*Recession likely: growth declines, inflation increases, and the risk of financial stress*

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Note: Tariff rates reflect Lazard estimates.
Assessment initially created in April 2025 with no material revisions through July 2025
1 Lazard estimates based on 2024 trade data. Inclusive of preexisting tariffs and new 2025 rates.

3. US labor reports raised new questions about the trajectory of job creation and unemployment.

The outlook: Based on recent labor data, I am questioning my previous expectation that US unemployment would end the year between 4.5% and 5.0%. The reason I am questioning this view is not due to a change in growth or inflation expectations. Instead, I am contemplating whether the labor force might contract enough due to significantly tighter enforcement of immigration laws to lead to a relatively stable unemployment rate even while total employment stops growing or even declines. Historically, the combination of higher-than-normal birth rates relative to other developed economies plus stronger immigration flows has meant that the United States needed around 150k new jobs per month to maintain a stable unemployment rate—with some anomalies like 2023 and 2024 when this figure was even higher due to the immigration surge.

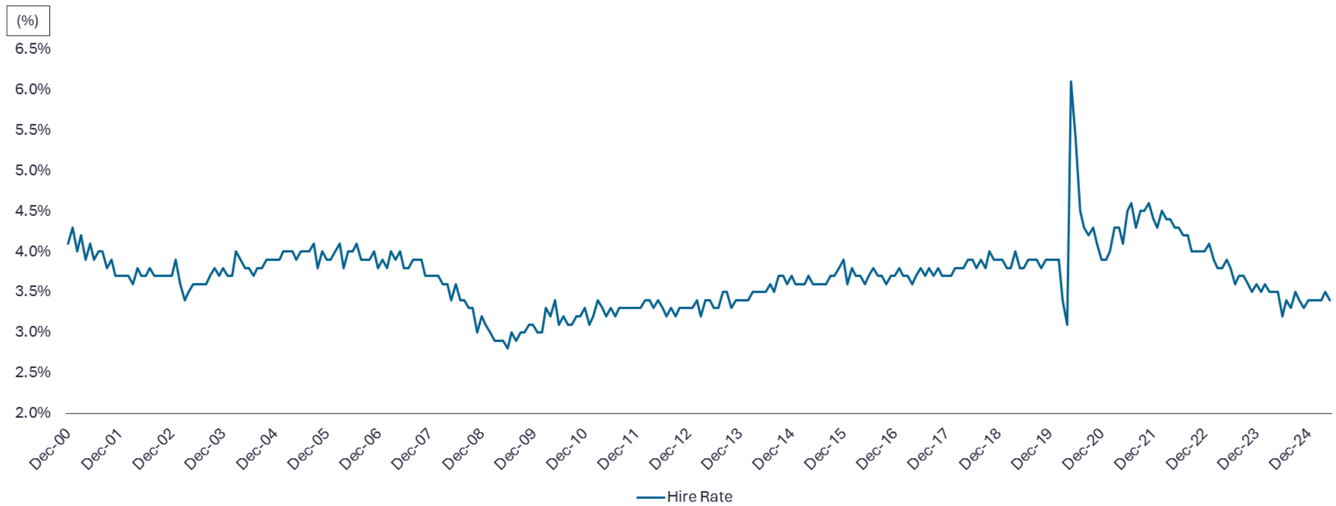
Looking forward, the US "breakeven" rate for stable unemployment could be much lower as labor force growth slows nearly to a halt and GDP growth decelerates while inflation grinds higher due to tariffs. If that scenario plays out, the market's expectations for Federal Reserve rate cuts will prove misplaced as rising inflation with no increase in unemployment would likely preclude any easing.

The details: The Job Openings and Labor Turnover Survey (JOLTS) indicated that job openings rose to 7.8 million from 7.4 million versus an expected decline to 7.3 million. The number of unfilled jobs per unemployed worker edged higher to 1.1 in May from 1.0 the prior two months.

The quit rate nudged higher to 2.1% from 2.0% having reached a low of 1.9% per month in November and December of 2024. The hire rate, however, remained in the doldrums at 3.4%, a level last sustained in 2013 when the unemployment rate was over 6.5%. For roughly the last year, the hire rate has been stubbornly low suggesting employers remain reluctant to add to headcount.

The Hire Rate Is at 2014 Levels when Unemployment Approximated 6.5%

Hire Rate



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

US nonfarm payrolls increased by 147k in June, better than the consensus expectation for 106k, but the quality of the job gains was suspect with state and local governments adding 80k of the new jobs in June with federal job reductions of 7k having little effect on total government employment.

The unemployment rate edged lower to 4.1% in June versus the consensus expectation for a slight increase to 4.3%, but the decline largely reflected a shrinking labor force. Since April, the labor force participation rate declined by 30 basis points (bps) to 62.3%. The labor force has decreased by 755k, and total employment is down 603k in the last two months. Average hourly earnings rose by slightly less than expected in June with a gain of 0.2% month-on-month (m-o-m) and 3.7% y-o-y.

4. **China's June PMI data were slightly better than expected.**

The outlook: China's manufacturing sector is likely to face more challenging circumstances going forward as the trade war cuts into demand from US consumers and other countries attempt to prevent dumping of excess Chinese production.

The details: Despite that negative outlook, this month's PMI data was a bit brighter than expected. The National Bureau of Statistics (NBS) PMI better assesses conditions for large, state-owned enterprises. NBS PMIs improved for large and medium companies to 51.2 and 48.6, respectively, from 50.7 and 47.5, but fell for small manufacturing companies to 47.3 from 49.3. Overall manufacturing PMI figures rose due to stronger output and by a slight increase in new orders. The NBS non-manufacturing PMI rose due to stronger construction activity where the PMI rose to 52.8 from 51.0 while the services reading slipped to 50.1 from 50.2.

The S&P Global (formerly Caixin) PMI also improved for manufacturing but slipped for services. The S&P Global survey captures more companies that are export-oriented and presumably saw a better manufacturing reading after the United States and China agreed to further ease tensions in mid-May. The S&P Global Manufacturing PMI rose to 50.4 from 48.3, well above market expectations. The S&P Global Services PMI, on the other hand, fell below consensus expectations.

June China PMI Data

Release Date		Consensus	Actual	Prior Month
6/29/2025 NBS	Manufacturing	49.6	49.7	49.5
	Non-Manufacturing	50.3	50.5	50.3
	Composite	*	50.7	50.4
6/30/2025 S&P Global	Manufacturing	49.3	50.4	48.3
7/2/2025 (formerly Caixin)	Services	50.9	50.6	51.1
	Composite	*	51.3	49.6

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

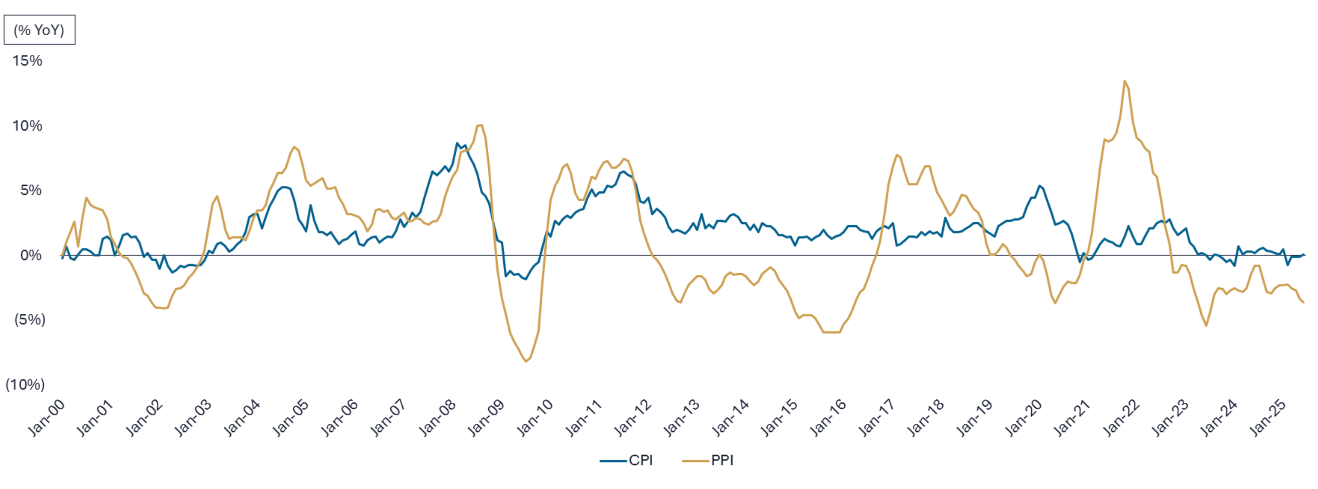
5. China's CPI and PPI inflation remained weak.

The outlook: Absent major fiscal stimulus to lift economic activity in the short term and significant structural reforms to cement a better foundation for long-term growth, I expect China's inflation to remain at undesirably low levels. Unfortunately, I am not optimistic that the Chinese leadership will enact the changes that are needed to retool the growth model but will instead continue to rely on exports to address excess supplies of manufactured goods.

The details: China's CPI was slightly higher than expected at 0.1% y-o-y (versus -0.1% consensus) on the back of non-food goods price rises. The PPI came in at a worse-than-expected -3.6% y-o-y (versus -3.2% consensus). The NBS indicated that PPI was weaker due to lower prices for export items destined for the United States as well as weaker raw materials prices caused by delayed construction projects due to weather conditions.

China's Inflation Is Undesirably Low with PPI Deflation for 33 Months and CPI ≤1% for 29 Months

China CPI and PPI



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Source: Bloomberg, National Bureau of Statistics
Note: As of June 2025

6. **Eurozone June inflation was in line with expectations.**

The outlook: Eurozone inflation is likely to remain at or below the ECB's 2% target through year end. The downside risk largely relates to the potential for larger-than-expected US tariffs on European exports that could dampen demand for those products while China is likely to redirect exports away from the United States to other regions including the Eurozone. Euro strength adds further to the risk of inflation undershooting the ECB target.

Markets currently imply one 25-bps rate cut by year end while I believe two cuts are likely. The key constraint on rate cuts is that increased defense and infrastructure spending could offset the disinflationary drivers noted above and give the ECB pause when considering stimulative moves.

The details: Eurozone headline inflation was slightly higher in June at 2.0% y-o-y versus May at 1.9%. Energy prices declined 2.7% y-o-y in June versus a larger 3.6% decline in April and May. Food prices rose 3.1% y-o-y versus 3.2% in May. Core inflation was stable with non-energy industrial goods prices rising 0.5% y-o-y versus 0.6% in May and services prices up 3.3% y-o-y from 3.2%.

Inflation in Germany and Italy was slightly lower than expected in June on both a m-o-m and y-o-y basis largely due to lower food prices. German services inflation remained elevated at 3.3% y-o-y and 0.3% m-o-m. Italian core inflation remained stable at 1.9% y-o-y while headline figures were slightly lower. Goods prices in Italy rose only 0.5% y-o-y while services prices rose 2.9% y-o-y.

Eurozone Harmonised Index of Consumer Prices 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%	0.9%	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%
6/30/2025	Germany	Headline m-o-m	0.3%	0.2%	0.1%
		Headline y-o-y	2.2%	2.0%	2.1%
6/30/2025	Italy	Headline m-o-m	0.3%	0.2%	-0.1%
		Headline y-o-y	1.8%	1.7%	1.7%
7/1/2025	Eurozone	Headline m-o-m	0.3%	0.3%	0.0%
		Headline y-o-y	2.0%	2.0%	1.9%
		Core y-o-y	2.3%	2.3%	2.3%

Source: Bloomberg
Note: Consensus estimates changed in some cases from what was previewed previously.

7. **Japan's *Shunto* wage negotiations results showed the strongest wage gains in decades.**

The outlook: Wage growth has accelerated to the highest level in decades. The current pace of wage gains is unlikely to be sustained, but the key point is that the inflationary mindset in Japan is changing after nearly four years of inflation exceeding 3% per annum.

The details: The Japanese Trade Union Confederation (JTUC-RENGO) reported a base pay rise of 3.70% and headline wage growth of 5.25%. These figures outpaced the prior year's strong growth of 3.56% and 5.10%, respectively, and should translate to positive real wage gains in 2025 for the first time in four years. Importantly, wage gains agreed to by small and medium enterprises as well as companies in the service sector increased after lagging in prior years suggesting a broader benefit across sectors.

8. **Tankan survey results were stronger than expected for manufacturers and in line for non-manufacturing companies.**

   The outlook: Despite consumer disgruntlement with inflation and the near-term hit to business activity from US tariffs, I remain positive regarding the economic outlook in Japan in 2026. Given the wage gains noted above, consumers will gradually regain confidence that their wage growth can outpace price increases. Japanese companies have extensive experience navigating currency-related competitive pressures as well as a deflationary environment. Moreover, many large Japanese manufacturers have invested heavily in developing global production capacity to help navigate trade challenges. The Tankan survey reaffirmed my cause for optimism with continued labor market shortages, higher-than-expected capex growth expectations, and better results from large and small manufacturers.

   The details: Current conditions and the outlook were better than expected for both large and small manufacturers. Non-manufacturer readings were in line with consensus. Expectations for capex investment are for growth of 11.5% versus a consensus of 10.0%.

The Week Ahead

1. **US CPI inflation is expected to accelerate marginally.**

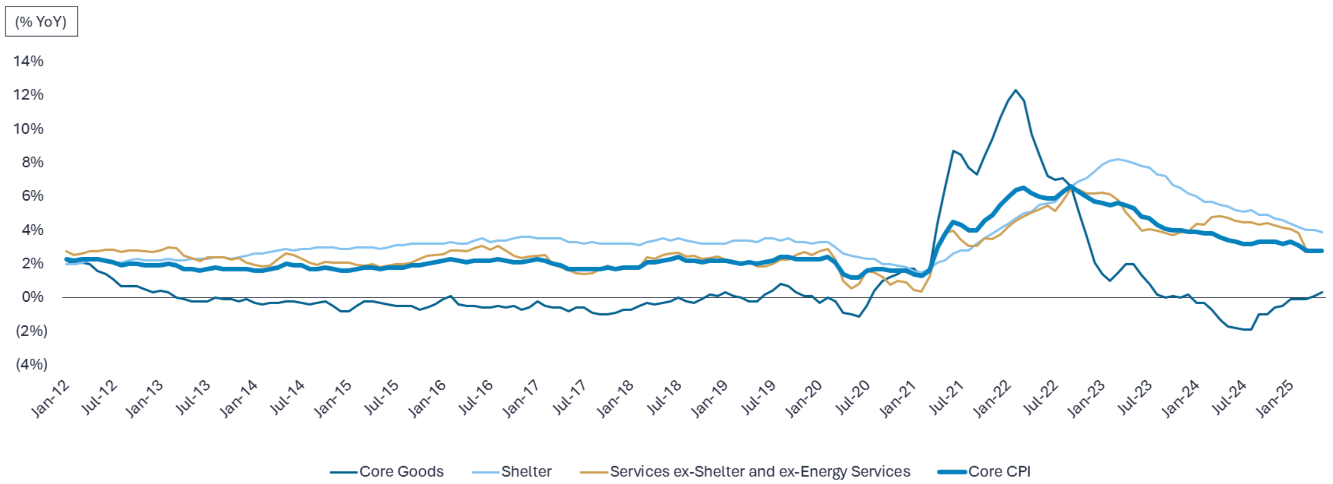
   The outlook: June CPI inflation is expected to reaccelerate to 0.3% m-o-m and 2.6% y-o-y on a headline basis while core CPI is expected to rise 0.3% m-o-m and 2.9% y-o-y.

   I will be particularly eager to see whether core goods prices (all physical goods purchased other than food and energy) begin to show the effects of higher tariffs. Core goods inflation bottomed in August 2024 when prices fell by 1.9% y-o-y but have since stabilized and returned to slightly inflationary levels even before tariffs became a material source of upward pressure.

   Even if core price increases begin to accelerate as I expect, there could be offsets. Core goods represent only 24% of the core CPI basket which means deceleration in the other 76% of the basket could offset tariff-related inflationary pressures. That said, I see little room for downside in rent inflation where the CPI shelter component (44% of core CPI by weight) has largely converged with private metrics such as the Zillow Observed Rent Index. Services ex-shelter represents the other 32% of the index and captures everything from auto insurance to airline fares to dental visits. Inflation for these services has largely stabilized just under a 3% rate in recent months, roughly in line with the average seen from 1999 to 2019.

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

US Consumer Price Index Inflation for Key Categories



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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%.

2. **US retail sales for June are expected to show modest increases with less tariff distortion.**

   The outlook: In May, total retail sales fell due to lower auto purchases after consumers rushed to buy cars before tariffs were imposed. Sales also were down due to lower gasoline prices before the Israeli attacks on Iran. In June, we are likely to see a more normal backdrop for spending. Despite consumer tariff anxiety, I expect modest growth given relatively resilient employment statistics.

June US Retail Sales	Consensus	Prior Month
Retail Sales m-o-m	0.2%	-0.9%
Retail Sales ex-Auto m-o-m	0.3%	-0.3%
Retail Sales ex-Auto and Gas m-o-m	0.4%	-0.1%
Retail Sales Control Group	0.4%	0.4%

Source: Bloomberg, U.S. Census Bureau

3. **China will release its monthly economic data as well as Q2-25 GDP figures.**

   The outlook: While the headline GDP figures are expected to remain at or above the government's 5% growth target, the underlying higher-frequency data are likely to tell a less positive story. Industrial production growth is likely to decelerate slightly while fixed asset and property investment are expected to remain weak. I do not expect but would be encouraged to see signs of improved retail sales growth that might suggest a trough or even inflection in consumer sentiment.

June China Economic Data		Consensus	Prior
Q2-25 GDP	y-o-y	5.1%	5.4%
	YTD y-o-y	5.3%	5.4%
	q-o-q	0.9%	1.2%
Exports	y-o-y	5.2%	4.8%
Imports	y-o-y	1.9%	-3.4%
Industrial Production	y-o-y	5.6%	5.8%
	YTD y-o-y	6.2%	6.3%
Retail Sales	y-o-y	5.1%	6.4%
	YTD y-o-y	5.1%	5.0%
Fixed Asset Investment	YTD y-o-y	3.6%	3.7%
Property Investment	YTD y-o-y	-10.9%	-10.7%
Residential Property Sales	YTD y-o-y	*	-2.8%
New Home Prices	m-o-m	*	-0.22%
Used Home Prices	m-o-m	*	-0.50%

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

4. **Japan is expected to report 3.3% y-o-y inflation.**

The outlook: Japan's inflation report for June is expected to show that inflation has persisted at 3.3% for headline, core, and core-core metrics. (In Japan, core only excludes fresh food while core-core excludes fresh food and energy.) At some point it will be desirable to lower inflation toward the 2% Bank of Japan target, but for now, I would advocate for patience to ensure that the deflationary mindset that plagued Japan for decades is definitively eliminated.

Japan June CPI	Consensus	Prior Reading
Headline y-o-y	3.3%	3.5%
CPI y-o-y ex-fresh food (core)	3.3%	3.7%
CPI y-o-y ex-fresh food and energy (core-core)	3.3%	3.3%

Source: Bloomberg, Japan Ministry of Internal Affairs and Communications

5. **UK CPI inflation is expected to be stable on a y-o-y basis.**

The outlook: UK headline inflation is expected to be stable at 3.4% y-o-y with core inflation at 3.5%. Services inflation is expected to ease slightly to 4.6% y-o-y versus the 4.7% rate in May. After some relatively volatile figures in recent months, resumption of a sustained downward trend would be a positive signal for the Bank of England to lock in a rate cut at the 7 August meeting (currently at an 88% chance according to markets) and to deliver a second rate cut by year end.

Important Information