BEHIND THE HEADLINES

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The Headlines

- United States: US inflation showed early signs of reacceleration due to increased tariffs, with core Consumer Price Index (CPI) inflation rising 2.9% year-over-year (y-o-y). The weighted average tariff on US goods imports surged to 20.6%, likely driving core inflation above 4% by year end. Retail sales outperformed expectations for June, but prior months were revised lower; future sales are expected to slow as tariffs impact consumer prices and employment softens.
- China: Q2-25 GDP slightly exceeded expectations, growing 5.2% y-o-y, supported by strong industrial production and export growth following a US–China trade truce. Retail sales and property investment lagged, with the outlook clouded by weaker domestic demand and persistent real estate issues.
- Japan: CPI inflation remained steady, confirming a break from deflation, with nominal wage gains sustaining moderate price increases.
- United Kingdom: CPI surprised to the upside at 3.6% y-o-y, but the Bank of England is still expected to cut rates in August.
- Outlook: Markets anticipate stable European Central Bank (ECB) policy, stable to better Purchasing Managers' Index (PMI) releases for developed markets, and a pivotal Japanese Upper House election that could affect economic direction and trade talks.

The Week Behind

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
United States	Headline CPI	15 July	June	y-o-y	2.6%	2.7%	2.4%
	Core CPI	15 July	June	y-o-y	2.9%	2.9%	2.8%
	Retail Sales (Advance)	17 July	June	m-o-m	0.1%	0.6%	-0.9%
China	GDP	14 July	Q2-25	y-o-y	5.1%	5.2%	5.4%
	Industrial Production	14 July	June	y-o-y	5.6%	6.8%	5.8%
	Retail Sales	14 July	June	y-o-y	5.2%	4.8%	6.4%
Japan	Headline CPI	17 July	June	y-o-y	3.3%	3.3%	3.5%
United Kingdom	Headline CPI	16 July	June	y-o-y	3.4%	3.6%	3.4%

The Week Ahead

Region	Indicator	Date	Period	Comp	Consensus	Actual	Prior Reading
Eurozone	Deposit Rate	24 July		Level	2.00%		2.00%
United Kingdom	Retail Sales ex-Auto Fuel	25 July	June	m-o-m	1.4%		-2.8%
	Retail Sales ex-Auto Fuel	25 July	June	y-o-y	2.0%		-1.3%

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The Week Behind

1. **US CPI inflation showed early signs of reacceleration due to tariffs.**

   The outlook: While the effects of tariffs have taken longer to appear in monthly inflation data, they are beginning to become evident. Given the increase in the weighted average effective tariff on goods imports into the United States from 2.7% at the beginning of the year to 20.6% as of 14 July according to the Yale Budget Lab, it is likely that US core inflation will top 4% by year end versus the 2.9% year-on-year (y-o-y) figure reported this week.

   While my base-case expectation is for materially higher US inflation over the next six-to-twelve months, there are factors that could lessen the increase in price pressures including:

   - Importers could cut enough other costs, such as headcount, to offset part of tariff costs;
   - Companies might take a hit to their profit margins by "eating" some of the tariffs;
   - Exporters to the United States could lower prices to avoid losing market share; and/or
   - Other inflation drivers could soften due to a weaker economy and demand destruction.

   Thus far, the pass through of tariffs to end consumer prices has been limited. Our assessment is that this reflects a) importers having front-loaded inventories in anticipation of tariffs and hence not yet selling higher-priced goods, b) companies being reluctant to raise prices and lose market share when they still do not know how enduring the tariffs will be, and c) weaker demand could be precluding importers from passing through price increases (which implies lower margins).

   With the 1 August deadline for most countries fast approaching, I expect we will see a more meaningful acceleration of price pressures in the August and September CPI and Personal Consumption Expenditure inflation reports. By that time, the full force of the nearly 18-percentage point increase in the weighted average goods tariff will likely begin to be felt.

   The details: Headline inflation in June was 29 basis points (bps) month-on-month (m-o-m) and 2.7% y-o-y. Core inflation was 23 bps m-o-m and 2.9% y-o-y. Each of these metrics was in line with expectations except for the m-o-m core CPI where the consensus was for a 0.3% increase. As usual, there were some noteworthy price categories that moved the needle. For example, lower hotel rates deducted 5 bps from core CPI while lower auto prices also reduced the figure by 4 bps.

   Tariffs were most evident in core goods prices (all physical goods other than food and energy). Household furnishings and supplies prices rose 1.0% in the month (+4 bps to core CPI), the largest increase since January 2022, with a 4.2% m-o-m increase in the cost of window and floor coverings and other linens being the largest single month increase ever. The other core good price that added a notable amount to core CPI was apparel where prices were up 0.4% in the month (on a 3.1% weight in the core CPI) adding 1.4 bps to the figure. There are other items that rose by large amounts, but none of them individually moved the total core CPI figure materially.

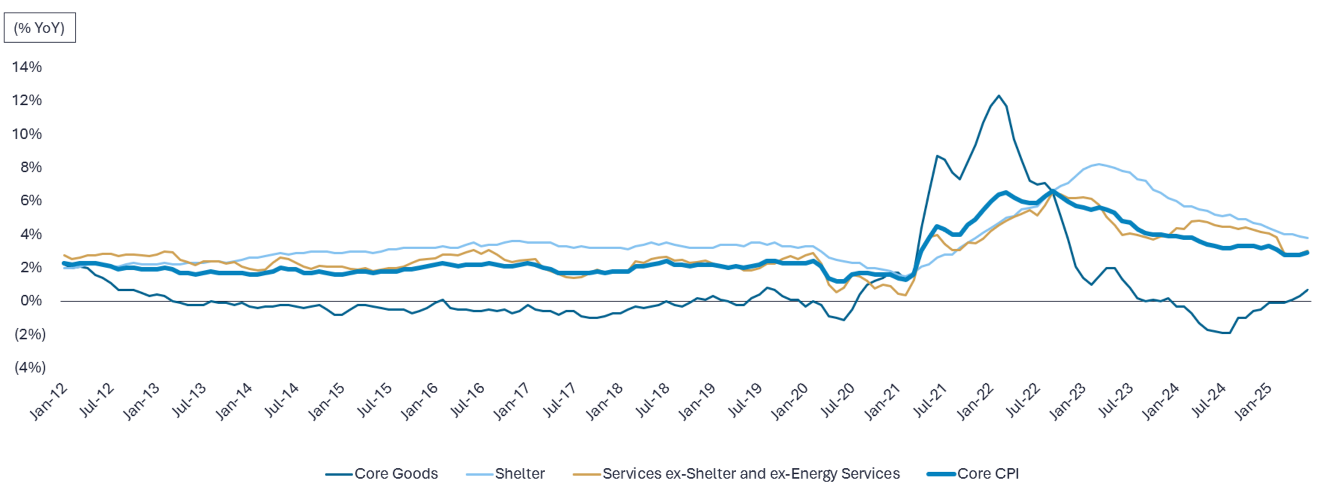
   Key statistics in the monthly report are included in the table below.

June 2025 Core CPI Details	Weight in Core CPI	Contribution/ Detraction (bps)
Key Categories:		
Shelter (owners' equivalent rent, rent of primary residence, other accommodation)	44.4%	7.8
Services ex-Shelter	31.5%	11.5
Core goods	24.1%	4.8
Total Core CPI (from sum of key categories)		24.0
All Items Ex-Food and Energy (reported)		22.9
Contributors:		
Owners' equivalent rent of a primary residence	32.7%	10.0
Rent of Primary Residence	9.3%	2.1
Medical care services	8.4%	4.8
Household furnishings and supplies	4.2%	4.1
Apparel	3.1%	1.4
Detractors:		
Other lodging away from home including hotels and motels	1.5%	(5.0)
Used cars and trucks	3.0%	(2.0)
New vehicles	5.4%	(1.9)
Source: Lazard, Bureau of Labor Statistics		
As of June 2025		

The y-o-y core CPI and three key categories within the index are displayed in the chart below. Note that the lowest line reflects inflation for core goods which have moved from deflation of 1.9% y-o-y in August 2024 to an increase of 0.7% y-o-y in June 2025. Tariffs will be most evident in this line.

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 June 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 were stronger than expected but prior months' figures were revised downward.**

<u>The outlook:</u> This month's data continues a trend of stable growth in retail sales "hard data," - i.e., actual results, versus much weaker "soft data," - i.e., sentiment readings, this year. The core

determinant of the trajectory of retail sales will be employment and wage growth, both of which I expect to weaken in the months ahead. I also expect tariff-induced inflation to affect sales later in 2025 as price adjustments lead consumers to shift spending accordingly. Note that retail sales are not adjusted for inflation. Hence, to the extent inflation reaccelerates, we could see stronger retail sales that are weaker in real terms.

<u>The details:</u> April and May retail sales figures were revised downward, largely offsetting the upside surprise in June figures. Y-o-y sales growth was strongest for health & personal care stores, miscellaneous store retailers, motor vehicle and parts dealers, and food services and drinking places. The weakest y-o-y results were at department stores, building materials providers, and electronics and appliance stores.

June US Retail Sales	Consensus	Actual	Prior Month	Revised
Retail Sales m-o-m	0.1%	0.6%	-0.9%	
Retail Sales ex-Auto m-o-m	0.3%	0.5%	-0.3%	-0.2%
Retail Sales ex-Auto and Gas m-o-m	0.3%	0.6%	-0.1%	0.0%
Retail Sales Control Group	0.3%	0.5%	0.4%	0.2%

Source: Bloomberg, U.S. Census Bureau

3. **China GDP and monthly economic data were mixed, but good economic news in China might be bad news as it decreases the incentives for needed fiscal stimulus and structural reforms.**

<u>The outlook:</u> China continues to deliver resilient economic data despite the trade war and its enduring real estate crisis. The Q2-25 real GDP figure slightly exceeded expectations, but much of the relative strength can be attributed to front-loading of orders by trade partners that boosted exports. Looking forward, payback is likely with weaker economic data in the second half.

The reason good economic news might now be bad is that resilient data decreases the urgency for Chinese leaders to deliver fiscal stimulus to stimulate domestic consumption or to reform the economy to address structural challenges that are likely to limit growth for years to come. In H2-25, economic deceleration could be the catalyst needed to spur these changes, but I am not optimistic.

<u>The details:</u> GDP in Q2-25 rose 5.2% y-o-y versus the consensus expectation for growth of 5.1%. The main event, however, was much stronger-than-expected industrial production growth of 6.8% versus consensus expectations for a 5.6% increase. Industrial production increased across chemical, computer, and equipment manufacturing while rail, ship, and aircraft production growth weakened.

The industrial production outperformance was largely driven by stronger exports after the United States and China reached a trade “truce” in May. Exports rose 5.8% y-o-y versus expectations for 5.0% growth. Imports also grew more than expected rising 1.1% y-o-y versus 0.3% expected.

Retail sales and most investment metrics were weaker than expected. Retail sales rose only 4.8% y-o-y versus the consensus expectation for 5.1% growth. Retail sales were weak across all channels partly reflecting pull-forward of sales caused by the “618” online shopping festival as well as exhaustion of trade-in subsidies in some provinces.

Fixed asset investment, property investment, and residential property sales were all materially weaker, and home price declines accelerated marginally from the pace seen in May.

June China Economic Data		Consensus	Actual	Prior
Q2-25 GDP	y-o-y	5.1%	5.2%	5.4%
	YTD y-o-y	5.3%	5.3%	5.4%
	q-o-q	0.9%	1.1%	1.2%
Exports	y-o-y	5.0%	5.8%	4.8%
Imports	y-o-y	0.3%	1.1%	-3.4%
Industrial Production	y-o-y	5.6%	6.8%	5.8%
	YTD y-o-y	6.2%	6.4%	6.3%
Retail Sales	y-o-y	5.1%	4.8%	6.4%
	YTD y-o-y	5.1%	5.0%	5.0%
Fixed Asset Investment	YTD y-o-y	3.6%	2.8%	3.7%
Property Investment	YTD y-o-y	-10.9%	-11.2%	-10.7%
Residential Property Sales	YTD y-o-y	*	-5.2%	-2.8%
New Home Prices	m-o-m	*	-0.27%	-0.22%
Used Home Prices	m-o-m	*	-0.61%	-0.50%

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

4. **Japan CPI inflation was largely in line with expectations.**

The outlook: Japan has convincingly broken free from decades of price stability and deflationary pressure. Rising nominal wages are likely to translate to ongoing inflation, albeit at a slower pace.

The details: Headline inflation, core, and core-core (see table below) all were in line with or only marginally below or above expectations. Rice prices continued to contribute significantly to all three CPI series. This month, mobile phone charges were a material source of inflation with an increase of over 11% y-o-y on a category that accounts for 3% of the total CPI. Lower water prices, lower durable goods prices, and slower energy inflation helped offset these positive one-offs.

Japan June CPI	Consensus	Actual	Prior Reading
Headline y-o-y	3.3%	3.3%	3.5%
CPI y-o-y ex-fresh food (core)	3.4%	3.3%	3.7%
CPI y-o-y ex-fresh food and energy (core-core)	3.3%	3.4%	3.3%

Source: Bloomberg, Japan Ministry of Internal Affairs and Communications

5. **UK CPI inflation surprised on the upside.**

The outlook: I expect inflation to continue to subside but not on a smooth path. This month's upside surprise is unwelcome but unlikely to deter the Bank of England from cutting rates by 25 bps as markets currently anticipate by the 7 August monetary policy meeting.

The details: The upside inflation surprise was broad based across services, and goods, but volatile components like airline fares and apparel can be partially blamed for adding to price pressures. Within services, housing price increases decelerated but remain high at 6.7% y-o-y. Travel and transport services also contributed to higher inflation at a rate of 6.3% y-o-y. At the headline level, food inflation was strong at 4.5% y-o-y.

UK June CPI

	Consensus	Actual	Prior Reading
Headline m-o-m	0.1%	0.3%	0.2%
Headline y-o-y	3.4%	3.6%	3.4%
Core y-o-y	3.5%	3.7%	3.5%
Services y-o-y	4.5%	4.7%	4.7%

Source: Bloomberg, UK Office for National Statistics

The Week Ahead

1. **Developed markets Purchasing Managers' Index (PMI) data will be released.**

   The outlook: PMIs for the Eurozone are generally expected to strengthen in July, while the United Kingdom is expected to report improvement in manufacturing and a slight softening in services. The US PMIs could indicate whether corporate confidence has recovered from the early policy unpredictability caused by trade policy changes.

2. **The ECB is expected to hold monetary policy constant.**

   The outlook: Markets are ascribing a 1% probability of a 25-bps rate cut at the 24 July ECB meeting. By year end, market prices suggest a 92% chance of one rate cut. I remain in the more dovish camp given my expectation for an aggressive US trade war against the European Union. I believe two rate cuts are likely with one reduction as my bear-case assumption.

3. **Japan will hold Upper House elections on 20 July.**

   The outlook: The election results at this point are being described by Japanese media as too close to call in terms of whether the Liberal Democratic Party (LDP) – Komeito coalition can retain a majority. Of the 248 seats in the Upper House, 125 are up for election. The LDP–Komeito coalition needs to win 50 seats to maintain a majority. If the coalition fails to win enough seats, Prime Minister Shigeru Ishiba could decide to resign which would have significant implications for the US–Japan trade talks. There are multiple permutations we could consider, but the key point is that the election is going to be important to the direction of the Japanese economy and markets.

4. **UK retail sales are expected to have rebounded in June.**

   The outlook: Retail sales have been volatile in recent months with the May decline reflecting a hangover after very strong April sales. Sales growth in May is expected to normalize somewhat with the added benefit of a rebound from April's weakness.

June UK Retail Sales	Consensus	Prior Month
Retail Sales including Auto Fuel m-o-m	1.1%	-2.7%
Retail Sales including Auto Fuel y-o-y	2.2%	-1.3%
Retail Sales excluding Auto Fuel m-o-m	1.2%	-2.8%
Retail Sales excluding Auto Fuel y-o-y	1.5%	-1.3%

Source: Bloomberg, UK Office for National Statistics

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