Macro Outlook

KEEPING OPTIONS OPEN

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We continue to expect the US economy to slow down this year; however, we have lowered the projected likelihood of it entering a recession to 25-30% from 45%, while also characterizing the risks surrounding our growth baseline as skewed to the upside. Solid incoming data, unclear causality between soft and hard data, still ample liquid wealth, and easing trade tensions should reduce the risk that the projected slowdown this year deteriorates into a contraction.

In the EA, our growth baseline remains unchanged. We continue to expect sequential growth to slow down between Q2 and Q3. Lingering trade tensions are likely to weigh on activity via net trade and investment.

In China, we continue to expect GDP growth to decelerate this year, as high tariffs are likely to be only partially offset by further fiscal stimulus. However, we now forecast annual growth to slow down in 2025 to 4.7%, a less severe deceleration than previously expected (4.2%) amid US/China de-escalation efforts.

April's data showed no signs of upward pressure on US inflation. However, we anticipate that tariffs could begin to impact prices in the coming months, reaching their peak over the summer. The easing of US-China tensions was a welcome relief. Nevertheless, the trade-weighted effective tariff rate for the US remains elevated at 14%, compared to 2.5% last year. As a result, we still expect a temporary rise in goods inflation, though we now project a more moderate impact. The annual average for core CPI for 2025 now stands at 3.0% (compared to 3.2% in the previous baseline).

In the EA, core inflation for April rose more than expected, driven by services, but a sustained reacceleration is unlikely. Meanwhile, several signals continue to point to a consolidation of the disinflation trend. Accordingly, our baseline forecast that core inflation will continue to decline towards target by December 2025 remains unchanged.

In China, entrenched deflationary pressures kept inflation subdued in April, while persistent overcapacity contributed to a further decline in producer prices.

Monetary policy wise, we continue to expect the Fed to cut rates twice this year. The risks surrounding our call are that the Fed may cut only once in Q4. For the ECB, we expect three additional rate cuts by the end of the year, though we do not rule out the possibility that the ECB could cut more aggressively if growth and inflation deteriorate further vis-à-vis our baseline. Finally, for the PBoC, we now anticipate 20 basis points in policy rate cuts later this year (vs 40bp previously), but no further RRR cuts before the summer (vs 50bp previously).

GROWTH

US – Testing the X-factor

We continue to expect the US economy to slow down this year; however, we have lowered the projected likelihood of it entering a recession to 25-30% from 45%, while also characterizing the risks surrounding our growth baseline for this year as skewed to the upside. Solid incoming data, unclear causality between soft and hard data, still ample liquid wealth, and easing trade tensions should reduce the risk that the projected slowdown this year deteriorates into a contraction.

We stick to the view that the US economy will slow down in the coming months. We continue to expect that the significantly more aggressive-than-expected trade policy stance adopted by the US administration will weigh on consumer and corporate spending (86% of GDP) going forward.

We also continue to believe that the US economy will avoid a recession this year. Compared to last month, though, we think downside risks surrounding our base case have greatly rebalanced. Accordingly, we lower the likelihood of a recession to 25-30%, down from the previously estimated 45%.

Key, incoming data, which play a key role in our forecasting framework, remain solid. Particularly those related to aggregate private domestic demand.

1) GDP growth slowed in Q1 (-0.3% q/q SAAR from 2.5% in Q4), coming in softer than anticipated in both our forecast (0.8%) and the consensus (-0.2%). However, we are hesitant to interpret the Q1 print at face value as a signal that the US economy is on the brink of collapse.
   For several reasons:

   i. GDP is an expenditure-based estimate of production, which makes it difficult to measure growth accurately in quarters characteries by large swings in components that are inherently challenging to assess, such as inventories and net exports. Indeed, both of these components experienced particularly large fluctuations in Q1. A surge in imported goods ahead of anticipated tariff implementation more than offset a solid increase in gross domestic purchases (C+I+G), resulting in a decline in domestic output in Q1. The surge in imports is also likely to reverse in Q2.

   ii. Consumer spending came in stronger than expected in Q1 (1.8% q/q SAAR vs consensus estimate of 1.2%). However, despite slowing from Q4 (4.3%), it's difficult to reconcile this with the pessimism reflected in consumer sentiment data. The weakness was largely due to a correction in durable goods consumption (-3.4% q/q SAAR) following a surge in Q4 (+12.4%). Meanwhile, spending on services rose a solid 2.4% q/q SAAR, only slightly softer than the strong pace seen in Q4-24 (+3.0 q/q SAAR) - while the saving rate remains low (4.0% in Q1-25 from 3.7% in Q4-24), though it has edged higher. If households had truly become more cautious in line with the consumer sentiment surveys, we would have expected a broader decline in spending across categories, or at the very least, a different spending composition. In our view, if tariff concerns were driving behaviour, it would have made more sense to front-load goods purchases at the expense of services.

iii. Private domestic final purchases (consumer spending + private fixed investment), which is the backbone of the US economy, accounting for 85% of US GDP, rose by 3.0% q/q SAAR, slightly faster than in Q4. Business fixed investment surged to 7.8% q/q SAAR (from -1.0% in Q4-24), driven primarily by a sharp rebound in equipment spending. The surge is clearly unsustainable going forward and is likely in anticipation of tariff implementation; however, it does signal that businesses "see the light at the end of the tariff tunnel", in our view.

Domestic demand likely remained solid heading into Q2. Credit card data indicate ongoing consumer spending. According to BofA, total card spending per household was up 0.9% on a 52-week basis in the six days following Easter. The VISA headline Spending Momentum Index also rose, accelerating to 97.8 in April from 95.9 in March, driven by a notable increase in non-discretionary spending (from 98.0 to 101.2). Similarly, Bloomberg Second Measure of US Consumer Spending showed an upward trend throughout April, largely fueled by increased spending on general merchandise, food services, and health/personal care.

The services sector continues to expand. The ISM Services Index came in higher than expected at 51.6 in April, up from 50.8 in March. Although the exact time window of the ISM survey is not strictly defined, it is typically distributed to Services Business Survey Panel respondents in the early part of the month. Therefore, the April results likely reflect developments such as Liberation Day (2 April) and the 90-day exemptions introduced on 9 April, suggesting that tariff risks have so far had only a limited impact on the non-tradable services sector. Should the US administration follow up on its intention to softening further, it's unclear why the ISM services index should deteriorate remarkable over the coming months (all else equal). Additionally, the underlying composition of the report was mixed-to-strong. The business activity index remained at 53.7, though this marks a slowdown from March's reading of 55.9 (which was the highest since January). Other components contributing to the headline figure came in slightly stronger than last month.

The labour market remains on solid footing. The April NFP report came in stronger than expected at 177k. Although there were downward revisions to February and March data (a cumulative -58k), hiring momentum remained resilient. For the second consecutive month, cyclical sectors made a strong positive contribution, broadly in line with pre-COVID trends. Meanwhile, government sector payrolls edged lower, driven by a third straight monthly decline in federal employment, suggesting that the Department of Government Efficiency (DOGE) may be losing momentum in its efforts to reduce public sector staffing.

We do not deny that Americans are concerned about the economy. However, what truly matters is whether they act on those concerns. While we acknowledge that several soft data points, particularly those related to consumer sentiment, have deteriorated significantly in recent times, we recommend taking these signals with a pinch of salt.

The CESI for US soft data, including consumer confidence, has been weaker than that of its peers in terms of hard data since 2022. At that time, a recession was widely seen as imminent, particularly after the collapse of Silicon Valley Bank. Yet, the US economy grew by 2.9% in 2023 and is projected to expand by 2.8% in 2024.

Whether the period from 2022 to 2024 will mirror 2025 depends on whether the key factors that helped the US economy avoid a recession are still in place. We believe that the exceptional performance of the US economy since the pandemic can largely be attributed to the fact that household finances were in exceptionally good shape. According to our calculations, excess savings reached USD 1.5tn in Q4-22. These unspent dollars accumulated during the lockdowns helped consumers offset the negative real impact on consumption caused by rising inflation and interest rates.

Does the US economy still have the X-factor? To some extent, we believe the X-factor is still present, albeit in a slightly different form. Household finances remain in good, though no longer exceptional, shape. Compared to Q4-22, when excess savings peaked, they have now declined to USD 0.4tn and are increasingly concentrated in the hands of the highest income cohorts.

Aggregate liquid wealth, however, has not diminished. In fact, it has improved. According to our calculations, Americans' liquid wealth (defined as the sum of excess savings and equity assets) reached USD3.8tn in April, roughly USD 1.0tn higher than the level seen in Q4-22. In other words, the liquid wealth currently available to consumers is not much different from the expendable wealth at the end of 2022.

Finally, trade deals continue to emerge. The Trump administration has eased some of its most aggressive tariff policies. After the 90-day pause on the supplementary "reciprocal" tariffs and the exemption of ICT products from China's tariffs, the US recently adjusted the auto parts tariff to prevent it from stacking with steel and aluminum tariffs, as well as to partially reimburse automakers for their increased costs. Following recent agreements with the UK and China, further trade deals may be on the horizon.

Incorporating all these positive developments into our baseline is very challenging. There are simply too many secondary economic effects resulting from past trade uncertainty and political stances on both domestic and external issues. As a result, it is too difficult to integrate these factors with a reasonable degree of confidence into our framework, given all the constructive considerations mentioned above.

However, we believe it would be a mistake not to consider the possibility that US growth will remain resilient and, once again, avoid a recession this year. For now, the balance of these considerations led us to 1) lower the projected likelihood of a recession in the US from 45% to 25-30%, and 2) characterize the risks surrounding our growth baseline for this year as skewed to the upside.

US GROWTH FORECAST TRACKER

Bottom-Line: we have upgraded our projected sequential GDP growth profile for this year. On a SAAR basis – we now forecast GDP growth to rebound 2.0% in Q2-25 (previously: 1.6%) and to expand by 0.8% and 0.8% in Q3 and Q4, respectively (previously: 0.6% and 0.7%). The much weaker than expected print for Q1 (-0.3% q/q vs ANIMA: +0.8%), though, weighs on the annual average which we now project to be 1.5% (1.6% previously).

Drivers of the upgrade:

1) We expect Q1 2025 GDP to be moderately revised upward by 0.1 percentage points to -0.2% q/q SAAR. The second estimate will be released on 29 May. Estimates of the US trade balance for March, published during the first week of May, show a record deficit of $140.5bn, with overall imports surging by $17.8bn (+4.4% m/m), as households and businesses rushed to front-run tariffs. Exports rose a modest $0.5bn (0.2% m/m). The release clarified the distortion caused by gold arbitrage flows, which are included in trade estimates but excluded from GDP accounting. According to March's estimates, gold imports fell to $21 billion, a notable decrease compared to the $30bn monthly figures recorded in January and February. This amount surpasses the expectations set by the BEA in its preliminary Q1 GDP estimate. This implies that non-gold imports were smaller than assumed, all else equal, suggesting an upward revision to Q1 real GDP growth from -0.3% q/q SAAR to -0.2% in the upcoming second estimate (to be released on 29 May)

2) We upgraded our forecast for Q2-25 and now expect growth of 2.0% q/q SAAR, up from 1.6% in the prior baseline. The GDP contraction in Q1-25 was driven by a surge in imports due to front running of tariffs, which subtracted 5.0pp from Q1 growth. In principle, imports shouldn't weigh on growth unless they result in a decline in domestic production. This likely wasn't the case in Q1, as industrial production and spending on domestically produced services remained robust. However, we don't see evidence of a full offset to the import surge from other GDP components. Inventories contributed only 2.3pp to growth.

   We have revised our Q2 forecast to incorporate a reversal of the Q1 import surge. We also anticipate much larger declines in non-residential investment, particularly in equipment spending, which rose an unprecedented 22.5% q/q in Q1 and a stronger positive contribution from inventories, reflecting the absorption of the import spike accumulated in Q1. These adjustments account for the expected payback following the front-loaded demand.

3) We incorporated the latest news on tariffs into our model. For Q2 and Q3-25, we have revised our previous forecasts moderately upwards to 0.8% q/q SAAR in Q3 and 0.8% in Q4-25 (from 0.6% and 0.7%, respectively, in the prior baseline). These revisions reflect the US-UK trade agreement reached on 9th May, which maintains the 10% base tariff rate but lowers the sectoral tariff rate for British cars (up to 100,000 vehicles) from 27.5% to 10% and eliminates tariffs on steel (from 25% to 0%), as well as the preliminary US–China trade agreement. On 12th May, US tariffs on Chinese goods were lowered from 145% to 30% for a 90-day period.

EA – Handle with care

Our growth baseline remains unchanged. We continue to expect sequential growth to slow between Q2 and Q3. Lingering trade tensions are likely to weigh on activity via net trade and investment, despite President Trump's 90-day pause on country-specific reciprocal tariffs.

The underlying growth drivers remain sluggish. Despite stronger-than-expected real GDP growth in Q1, the underlying drivers and the distribution of growth across countries suggest that the overall strength may be overstated.

1) Area-wide GDP came in at 0.3% q/q. Excluding the notoriously volatile Ireland, GDP growth was 0.2% q/q, in line with our baseline and unchanged compared to Q4.

2) There were heterogeneous outcomes among the main EA countries. Core economies showed lackluster growth, with France experiencing a modest sequential increase of 0.1% and Germany a slight rise of 0.2%, maintaining its prolonged trend of underwhelming performance since late 2021. Meanwhile, Spain enjoyed robust expansion with 0.6% q/q growth, while Italy showed resilience with a 0.3% rise.

3) The spending breakdown is not yet available, but country-level details indicate that private consumption and CAPEX spending reported no growth, while trade data up to February suggest that Q1 activity likely benefited from some front-loading of exports to the US, particularly in Ireland's chemicals and pharmaceutical sectors.

In Q2 the picture is bound to weaken. Early soft data for April suggests that headwinds are on the way.

1) The final EA composite PMI fell by 0.4pt to 50.4. The decline was entirely driven by the services sector (-0.9pt to 50.0), while manufacturing output reported a modest uptick (+0.5pt) though it remains in contractionary territory (49.0). Press release commentaries point to the setback in the services sector due to concerns over excessive weakening of domestic demand amid heightened uncertainty, while the manufacturing sector is benefiting from a short-lived boost due to tariff frontloading, which may soon be eroded by the recent tightening of financial conditions.

2) Consumer confidence dropped to -16.7 in April, reaching its lowest level since November 2023. Households have significantly lowered their expectations regarding the general economic outlook by 5.4pt to -33.7 and are now more pessimistic about their current and future financial situation. Additionally, their plans for major purchases in the next 12 months have decreased, which does not bode well for a recovery in private consumption in the coming quarters.

ANIMA baseline. Against this backdrop, our baseline remains unchanged. We continue to expect sequential growth to slow between Q2 (0.1% q/q) and Q3 (0.1% q/q), with an uptick in Q4 (0.2% q/q). Ongoing trade tensions are likely to weigh significantly on activity through weaker net trade and investment, despite President Trump's 90-day pause on country-specific reciprocal tariffs. Additionally, we expect weaker global growth to put pressure on exports.

Incorporating Q1-25 data and maintaining our sequential growth path, our annual average growth forecast for 2025 is now 0.9%.

China – Talks limit (not erase) trade war hit

China's economy started 2025 on a strong note, with Q1 GDP growing by 5.4% y/y, supported by robust exports and policy easing. March data showed solid gains in industrial output, services, and retail sales, aided by trade-in subsidies, while the real estate sector remained weak. April exports proved resilient due to base effects and trade rerouting from the US to ASEAN countries, as US tariffs began to bite. We continue to expect GDP growth to decelerate this year, as high tariffs are likely to be only partially offset by further fiscal stimulus. However, we now anticipate that US/China de-escalation efforts will allow Chinese exports to decline less than previously forecasted, reducing their negative contribution to GDP for the year. Accordingly, we now forecast annual growth to slow down in 2025 to 4.7%, a less severe deceleration than previously expected (up from 4.2%).

The Q1 GDP reading proved better than expected. China's economy started 2025 strongly, with a solid 5.4% y/y expansion in Q1, driven by robust export activity-partly due to tariff-related front-loading and increased domestic policy support. March activity data showed stronger than expected industrial production and service sector growth, while retail sales rose 5.9% y/y, boosted by expanded trade-in subsidies and fiscal measures. Sales of autos, electronics, and furniture were particularly strong. Fixed asset investment (FAI) grew by 4.2% y/y in Q1, led by manufacturing and infrastructure, although real estate remained a major drag, falling 10% y/y in Q1 amid declining home sales, prices, and new housing starts. The labour market also improved slightly, with unemployment dropping to 5.2%. Despite external risks, particularly from US tariffs and concerns about global slowdown, the strong Q1 performance may give policymakers confidence to maintain supportive domestic policies throughout the year.

China's export remained strong in April, as the trade surplus was still slightly affected by tariffs. Exports rose by 9.3% y/y, beating expectations despite the harsh impact of reciprocal US tariffs. Imports also outperformed, increasing by 0.8% y/y. The resilient export performance partly reflects a low base from last year and also results from China's successful trade rerouting through third countries. Regionally, exports to the US plunged, while shipments to ASEAN rose sharply. By product category, exports of housing-related goods declined, but chip exports surged. China's trade surplus reached USD 96.2 billion, slightly below March's level.

Despite US/China bilateral talks sounding encouraging, we continue to expect the trade war to shave up to 0.6% off China's GDP this year. Following the tit-for-tat tariff escalation between the US and China during March and April, the effective US tariff rate on Chinese goods has risen from 64% to 104%. However, after a meeting in Switzerland, the US and China agreed to significantly lower tariffs during a 90-day cooling-off period. Against this backdrop, estimating the economic impact remains non-linear and we revise upward the net export contribution to GDP to -0.6 percentage points, from an earlier estimate of -1.1 percentage points, which means we upgrade our growth baseline for China accordingly.

ANIMA Baseline. Against this backdrop, we fine-tune our 2025 baseline. We expect GDP growth to slow down to 4.9% y/y in Q2-25, to 4.0% in Q3-25 and to bottom out to 4.5% y/y in Q4-25. Taking into account the stronger than expected Q1 reading, we now forecast annual growth in 2025 to slow less than previously expected, to 4.7% (revised up from 4.2%).

INFLATION

US – No tough tariff yet

April's data showed no signs of upward pressure on prices, as tariff-sensitive components have not yet increased. However, we anticipate that tariffs could begin to impact prices in the coming months, reaching their peak over the summer. The easing of US-China tensions, following the 90-days tariff suspension agreement announced on Monday 12 May, was a welcome relief, lowering the risk of inventory shortages and empty shelves. Nevertheless, the trade-weighted effective tariff rate for the US remains elevated at 14%, compared to 2.5% last year, and is likely to affect goods prices. As a result, we still expect a temporary rise in goods inflation, though we now project a more moderate impact. The annual average for core CPI for 2025 now stands at 3.0% (compared to 3.2% in the previous baseline).

A benign print. The April core CPI print fell short of consensus expectations, but in line with our profile, showing reasonably benign price pressures. Core inflation rose by 0.24% m/m (2.8% y/y), following an unusually soft 0.06% m/m increase in March. This shift reflects reduced deflation in some of the more volatile categories.

Tariff-sensitive components haven't picked up yet. Core goods CPI rose by 0.1% m/m in April, up from -0.1% in March. This modest increase was largely driven by used cars, which decelerated less sharply than in the previous month (from -0.7% m/m in March to -0.5% in April). Excluding volatile used cars prices, core goods inflation stood at 0.2% m/m, an increase of 0.2 percentage points from March. We believe this rise is not linked to tariff-related pressures. Indeed, CPI categories with a high share of Chinese imports (such as new vehicles, miscellaneous personal goods, appliances, footwear, clothing, music instruments, sporting goods and personal care items) remained broadly stable compared to the previous month. Our index of tariff-sensitive core goods CPI was flat at 0.0% m/m, down from 0.1% in March.

Shelter, slow softening. Core shelter inflation (RPR+OER) edged slightly lower in April, easing from 0.38% m/m in March to 0.35%. This moderation was driven by a decline in OER inflation, partially offset by a modest rise in RPR. A closer look at the RPR increase suggests that April's resilience was likely influenced by seasonal adjustment effects, which provided a temporary boost, and that the uptick was mainly concentrated in the Northeast region. Core shelter prices have now broadly returned to pre-COVID norms, although their disinflation path has remained volatile month to month. Despite some persistence over the past two months, we continue to expect further disinflation, as market rents, which tend to lead CPI rents by around three quarters, continue to show weak prints. Overall, the trend continues to point downward, with the three-month moving average at 0.3%, down from 0.5% in Q1 2024.

Supercore normalized. Supercore CPI (core services excluding shelter) rose by 0.2% m/m in April, following a -0.1% decline in March. Despite this modest increase, supercore inflation continues to track close to its pre-COVID average. April's rise was largely driven by still-negative but less steep declines in airfares and lodging prices, both highly volatile categories, and a small increase in motor vehicle insurance, which remains broadly in line with its pre-pandemic norm.

Meanwhile, most re-opening-sensitive categories, such as recreation services and personal care, remained well contained.

Tracking PCE with CPI and PPI inputs. Incorporating inputs from CPI+PPI, we now forecast core PCE inflation to 0.15% m/m in April (only with CPI inputs we had expected 0.23%) from 0.03% in March. The year-over-year inflation rate should be set at 2.6%, unchanged from March. Our downward revision (compared to the forecast made with preliminary CPI data only) is mainly explained by weaker than expected PPI airfares and financial services and insurance. However, we flag that for the March print there could be minor upward revisions to core PCE in January (+3bp) and March (+7bp) due to changes in PPI hospitals, physicians, and insurance.

ANIMA baseline. Overall, the April data showed no clear signs of upward pressure on prices. Although the sweeping 'Liberation Day' tariffs came into effect in early April, exemptions were applied to goods shipped before the announcement, and firms appear to have front-loaded imports significantly, as reflected in Q1 GDP figures. Notably, apparel prices, typically among the most exposed to trade tensions, recorded outright deflation. Similarly, the "other goods" CPI category experienced relatively mild inflation, while recreation commodities, another tariff-sensitive group, rebounded mechanically after a seasonally weak March. Looking ahead, we expect tariffs to begin exerting price pressure in the coming months, with the impact likely peaking over the summer. The 90-day suspension of tariffs, announced on Monday 12 May, as part of easing US–China tensions, provided welcome relief by reducing the risk of inventory shortages and empty shelves. Still, the current trade-weighted effective tariff rate of 14% remains well above last year's 2.5% and is likely to put upward pressure on goods prices. As a result, we continue to anticipate a temporary pickup in goods inflation, though now expect a more modest impact.

We have adjusted our inflation baseline, as with our GDP projections, to incorporate the latest developments on tariffs into our model. We now forecast core inflation at 2.9% in Q2 2025 (compared to 3.1% in the prior baseline), 3.1% in Q3 2025 (vs 3.2% previously), and 3.0% in Q4 2025 (unchanged from prior baseline). The annual average for 2025 is now projected at 3.0% (compared to 3.2% in the previous baseline).

EA – An Easter related blip

Core inflation for April rose more than expected, driven by services, but a sustained reacceleration is unlikely. Meanwhile, several signals continue to point to a consolidation of the disinflation trend. Accordingly, our baseline forecast that core inflation will continue to decline towards target by December 2025 remains unchanged.

Core inflation in April halted the downward trend it had been following for the past five consecutive months. The year-over-year rate in April was at 2.7%, up from 2.4% in March.

Easter contributed to the rise. Core goods inflation ticked down to 0.5% y/y, remaining well in line with its pre-COVID pace. However, core services inflation rose to 3.9% y/y, returning to the January 2025 level. We have reason to believe that this was a temporary jump related to the Easter effect, which will likely reverse from May onwards. While the Easter-related increase was stronger than our initially expected, country-level details show that it was primarily a re-acceleration concentrated on volatile items (airfares, package holidays and recreation services), and thus not the resumption of a widespread re-accelerating trend. Excluding volatile services, the print was broadly in line with recent prints and our baseline, suggesting that the disinflationary in non-tradables inflation trend emerged since January remains on track.

Multiple signals continue to point to a consolidation of the disinflation trend:

1) Measures of wage growth continue to cool. Our tracker for negotiated wage growth (one of the ECB's preferred measures) in Q1-25 stands at 3.2%, down from 4.1% in Q4.24. Moreover, the Indeed wage measure is now running at 2.8%, and the ECB's various wage surveys suggest wage growth will be clearly below 3% next year.

2) Secondly, the recent appreciation of the Euro and the drop in energy prices point to disinflationary pressures ahead. Several academic studies support the rule of thumb that a 1% appreciation of the Euro typically reduces headline HICP by about 0.1% over 6/8 quarters. Furthermore, our composite energy price index (a weighted average of oil and gas prices) has declined by approximately 15% since early March, indicating a headline inflation drag of around 0.4pp over the next year.

ANIMA baseline. Our baseline remains largely unchanged, and we have mechanically adjusted our profile by incorporating the April print. For 2025, we project core HICP at 2.5% in Q2-25 (up from 2.4% previously), 2.3% in Q3-25 (up from 2.2% previously), and 2.2% in Q4-25 (up from 2.1% previously). Our full-year core HICP projection for 2025 stands at 2.4% (up from 2.3% previously).

China – Baseline unchanged

Entrenched deflationary pressures in China kept inflation subdued in April, while persistent overcapacity contributed to a further decline in producer prices. Escalating trade tensions have dampened business sentiment, and domestic prices are expected to remain soft due to continued manufacturing overcapacity and limited support from redirected exports.

Our baseline outlook remains unchanged, as deflationary pressures have yet to abate. In April, inflation remained negative (headline CPI at -0.1%, core at 0.3% y/y), while PPI deflation deepened to -2.7% y/y from -2.5% y/y, reflecting weakening business sentiment amid intensifying trade tensions between China and the US. Persistently subdued domestic demand, coupled with external headwinds from elevated US tariffs and weaker demand from non-US markets, continues to weigh on inflation momentum. Over the first four months of the year, headline inflation averaged -0.1% y/y (vs 0.1% y/y in 2024), while core CPI averaged 0.2% y/y (vs 0.7% y/y in 2024).

Looking ahead, we expect domestic prices to remain subdued. Export diversion from the US to other markets should help to stabilize falling domestic prices; however, we remain doubtful that it will significantly alleviate China's growing manufacturing overcapacity, as we expect downward pressure on prices to persist throughout 2025. US/China bilateral talks aimed at de-escalating the trade war could introduce an upside risk to export growth, which may help absorb excessive industrial capacity and partially mitigate China's demand/supply imbalance.

ANIMA Baseline. Against this backdrop, we maintain our baseline and expect full-year inflation for 2025 to accelerate to 0.4% from 0.2% y/y in 2024. On a sequential basis, we anticipate headline inflation to unfold as follows: 0.0% y/y in Q2-25, 0.4% in Q3-25 and 1.4% in Q4-25.

MONETARY POLICY

FED – Stay and pray

Caught between a still healthy economy and rising risks on both sides of its dual mandate, yet with no clear understanding of the impact of tariffs on the US economy, the Fed remains stuck in a wait-and-see mode. Against this backdrop, we continue to expect the Fed to cut rates twice this year. The risks surrounding our call are that the Fed may cut only once in Q4.

No change in monetary policy stance, but uncertainty is rising. As widely expected, the Fed kept policy rates unchanged at 4.25-4.50%. The statement noted that the FOMC believes the risks of higher unemployment and higher inflation have increased, reflecting an increasingly challenging macroeconomic outlook.

Current macro conditions remain healthy. Both the statement and Chair Powell suggested that the FOMC continues to view the current economic conditions as solid. The Chair noted that underlying domestic demand remains robust, the labour market is on solid footing, and services inflation continues to ease.

Matthew 23:3. During the press conference, Chair Powell also touched on soft data. The FOMC appears to believe that it is better to "observe whatever they tell

(...), but not the works they do", given the limited tested causality between soft and hard data. That said, the Chair also noted that the sharp deterioration in confidence data is unprecedented and warrants close attention.

Easing bias with a "but". During the press conference, Chair Powell gave the impression that the FOMC's bias remains orientated towards easing. However, although Chair Powell acknowledged progress on inflation and wage growth, we believe that by introducing stagflation risks into their reaction functions, the FOMC aimed to signal that the timing and manner of future rate cuts remain uncertain. At this stage, the uncertainty around the timing of the next easing move sets the hawkish bar for the Fed, in our view.

Carry on. Against this backdrop, Chair Powell repeated his mantra that monetary policy is well placed to respond to both risks to its dual mandate, reiterating the wait-and-see approach, and going as far as saying that the costs of being patient at this stage are fairly low. The Committee is unanimously aligned with this stance, with everyone voting to hold rates at current levels.

Our take. Consistent with the "conditional" easing bias we identified, we believe that the Fed will 1) continue to be driven by hard data, 2) rely on the current "somewhat restrictive" monetary policy stance, and 3) prefer to err on the side of growth, as jump-starting growth would be easier than combating any tariff-induced inflation.

Accordingly, we stick to our baseline. We continue to expect the Fed to cut rates twice this year (ANIMA: 50bp; market: 80bp). In terms of timing, we do not expect the Fed to act before Q3, unless there is a sudden and sharp deterioration in hard economic data (which is not in our baseline scenario).

ECB - Turning tides

The ECB cut rates by 25bp, reducing the deposit rate to 2.25%. The ECB sounded more dovish than in the past regarding inflation and introduced, for the first time, the notion that tariffs tensions and increased uncertainty have led to a deterioration in its growth outlook. Given the rising uncertainty, the ECB reiterated that it will remain data-dependent and will continue with a meeting-by-meeting approach. Against this backdrop, we now expect three additional rate cuts by the end of the year (up from two previously), though we do not rule out the possibility that the ECB could cut more aggressively if growth and inflation deteriorate further vis-à-vis our baseline.

A dovish cut. The ECB cut rates by 25bp, taking the deposit rate to 2.25%. The decision to cut rates by 25bp was unanimous, with no members of the Governing Council (GC) advocating for a 50bp cut, although they did not rule out this possibility. That said, the ECB's rhetoric turned more dovish than last month on at least three fronts: 1) the assessment of inflation, 2) the impact of tariffs and tariff-related uncertainty on the EA growth outlook, and 3) the degree of restrictiveness of monetary policy.

Inflation is finally declining, and downside risks are mounting. In the statement, in addition to reiterating that the disinflation process is well on track, the ECB noted for the first time that services inflation has eased markedly over recent months. Furthermore, falling energy prices and the appreciation of the EUR are now seen by the ECB as potential downside risks to the inflation outlook.

Trade tensions have made their way into the ECB's reaction function. For the first time, the ECB introduced a paragraph on tariffs and tariff-related uncertainty in its statement, and President Lagarde elaborated on this topic during the press conference. Trade tensions have led to a deterioration in the growth outlook due to reduced confidence among households and firms, while the volatile market response is contributing to tighter financing conditions, further exacerbating downside risks to growth.

Remaining agile among shocks. The ECB removed the entire paragraph on the degree of restrictiveness of monetary policy from the statement. Faced with extreme uncertainty, the ECB judges that it is no longer appropriate to consider the monetary policy stance in terms of its distance from neutral, as the concept of a neutral rate has never been as unclear as it is now. In this context, the ECB's reaction function is now entirely focused on achieving and maintaining price stability. For this reason, President Lagarde reiterated that the ECB will maintain a data-dependent, meeting-by-meeting approach.

We now expect three additional rate cuts in 2025. Against this backdrop, we expect the ECB to implement at least three further rate cuts by year-end, with the possibility that more cuts could be delivered if growth and inflation deteriorate further compared to our baseline (annual GDP at 0.8%, annual core inflation at 2.3%). This is slightly more dovish than market pricing, which anticipates 70bps of cuts by year-end.

PBoC – Ready to do more (if needed)

For the PBoC, we now anticipate another 20 basis points in policy rate cuts later this year (vs 40bp previously), but no further RRR cuts before the summer (vs. 50bp previously).

The PBoC eased monetary policy in response to tariffs. The People's Bank of China (PBoC) cut the reserve requirement ratio (RRR) by 50 basis points, from 9.5% to 9.0%, in early May, and reduced the policy rate by 10 basis points, from 1.5% to 1.4%. This marks a clear first step by Chinese authorities to offset the impact of US tariffs with more monetary stimulus. The move was slightly larger than we had expected. Looking ahead, we still anticipate another 20 basis points in policy rate cuts later this year (vs 40bp previously), but no further RRR cuts before the summer. The size and timing of additional cuts will depend on how the economy responds to the tariffs. Furthermore, the 90-day US/China de-escalation effort should reduce the PBoC's urgency to introduce further stimulus. Against this backdrop, we also expect additional fiscal stimulus in H2, once the economic impact of the tariffs becomes clearer.

The currency is set to remain weak in 2025. The PBoC's dovish policy stance is likely to exert continued downward pressure on the yuan throughout the year. With persistent pressure from tariffs, we believe the central bank will have little option but to maintain an accommodative approach. As a result, we expect it to allow further depreciation of the currency, in the7.50-7.60 range.

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