Macro Outlook

APPROPRIATELY SLOW

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In the US, our growth baseline remains largely unchanged. Almost the totality of incoming data point to 1) a technical rebound in growth in Q2, driven primarily by a payback in net trade and 2) solid income growth that should help sustain consumer spending and, in turn, keep the US economy out of recession.

In the EA, although Q1 real GDP growth was revised upwards, we note that distortions from anticipatory effects on US tariffs and idiosyncratic factors (Ireland) were significant. Beneath the surface, domestic demand remains feeble entering Q2. Our baseline remains largely unchanged. We continue to expect sequential growth to slow in the coming quarters.

In China, soft data for May suggest that domestic demand conditions remain challenging, with weak consumption figures and sluggish housing activity expected for the month. Additionally, export-driven manufacturing indicators point to a slowdown in momentum, consistent with disappointing trade figures in May. Overall, we anticipate a broad slowdown in Q2, as economic imbalances persist.

In the US, the May inflation print still shows no significant evidence of tariff pass-through to consumer prices. This aligns with our initial assumptions that the disinflation trend would continue through the summer, supported by Q1 restocking. We continue to expect tariff-driven inflation momentum to pick up in June and peak over the summer as businesses exhaust inventories built before the tariffs took effect. That said, we maintain the view that the projected increase in goods inflation will be temporary. From Q4 onward, we expect core services' disinflation to regain dominance in the inflation outlook, leading overall inflation to reach target by Q2 next year.

Headline EA inflation fell below target in May, with core inflation declining significantly due to weak services, reflecting very soft tourism-related components as well as a broader underlying easing. Multiple indicators continue to suggest that the disinflation trend is consolidating. Accordingly, we maintain our baseline forecast that core inflation will continue to decline toward the target by December 2025.

In China, persistent deflationary pressures kept inflation negative for the fourth consecutive month in May, while overcapacity continued to weigh on producer prices. Prolonged trade tensions have dampened business sentiment, and domestic prices are likely to remain weak amid ongoing excess capacity and limited support from redirected exports.

Monetary-policy wise, we remain of the view that the Fed will cut the rates twice this year starting in Q3.

For the ECB, we maintain our forecast of two additional rate cuts this year, though risks are now balanced (versus potentially three cuts in total previously) given growing divisions within the Governing Council, compared to previously expecting risks skewed toward three cuts.

For the PBoC, we expect another 40bp in policy rate cuts later this year, although no further reserve requirement ratio (RRR) reductions are likely during the summer. The scale and timing of additional easing will depend on how the economy responds to tariffs, as the 90-day US–China de-escalation period should provide the central bank with more time.

GROWTH

US - Puzzle completion

Our baseline remains largely unchanged. Almost the totality of incoming data point to 1) a technical rebound in growth in Q2, driven primarily by a payback in net trade and 2) solid income growth that should help sustain consumer spending and, in turn, keep the US economy out of recession.

Incoming data remain consistent with our baseline view. Accordingly, we maintain the view that the U.S. economy will slow in the coming quarters but avoid a recession.

Technical rebound. We expect real GDP growth to post a technical rebound in Q2, primarily driven by a reversal in net-trade, as imports were significantly affected by tariff front-loading in Q1. Meanwhile, spending data indicate that private domestic demand remains resilient.

This has been confirmed on several fronts.

Real GDP growth was revised up by 0.1pp to -0.2% in the BEA's second estimate. The updated breakdown revealed a slightly larger drag from net trade, only partially offset by a moderately stronger contribution from inventories. Meanwhile, real final sales to private domestic purchasers (the core engine of the U.S. economy) remained solid, growing at 2.5% q/q annualised (SAAR), broadly in line with its recent trend. Within this, fixed investment was modestly revised upward, while private consumption was revised slightly downward to 1.2% q/q SAAR, mainly due to a -0.5pp revision in services spending.

Consumption continues to hold its own. Real consumer spending through April has increased by an average of 0.3% m/m over the past three months, with real services (accounting for 70% of total PCE spending) rising by an average of 0.2%. Both figures are broadly in line with 2024 averages. While Q1 spending was revised downward, it's important to note that the revisions were primarily concentrated in January and February. This suggests that the adjustment mainly reflects a normalisation following the exceptionally strong Q4 2024 spending pace of 4.0% q/q SAAR. Additionally, it implies that consumption regained some momentum toward the end of the quarter, offering a solid starting point for Q2 from a quarterly growth perspective

Personal income posted its strongest sequential increase since January 2024 in the April report. A key driver was a notable surge in transfer payments from the U.S. government. Most of the increase in government social benefits stemmed from higher Social Security payments, largely reflecting disbursements related to the Social Security Fairness Act. This legislation, passed in December, extended benefits to over three million retirees, including teachers, law enforcement officers, and other public sector workers, who had not previously been receiving full benefits for various reasons.

While this component may reverse in the next report, the overall sequential trend in income growth remains robust for three main reasons:

1. The March figure was revised up by 0.2pp to 0.7% m/m.
2. Labour compensation, the core driver of income gains, remained strong at 0.5% m/m in April.
3. Our payroll-income proxy for May points to a healthy 0.5% m/m run rate.

The labour market continues to hold up despite tariff-related headwinds. The May Non-Farm Payroll (NFP) report surprised to the upside, with headline job gains of

139k. Notably, private services-providing industries added 145k jobs, the highest monthly gain since December 2024.

Meanwhile, government sector employment appeared to internally rebalance, federal government payrolls declined by 22k, while local government payrolls rose by 21k. In our view, this may reflect what we previously referred to as the "washing machine effect", where workers laid off at the federal level are reabsorbed at the local level.

Overall, however, government employment remains subdued and continues to lag the pace observed earlier in 2024.**Consumer sentiment remains closely tied to trade policy.** After five consecutive monthly declines, consumer confidence (Conference Board) rebounded in May, coinciding with a temporary cease-fire in the trade dispute. However, despite the uptick, sentiment remains near the lower end of its recent range. Further improvement is likely to hinge on sustained de-escalation of trade tensions.

Domestic trends matter more than international ones. Total overseas travel to the US collapsed in March amid heightened political uncertainty but rebounded above its historical average in April. Given this volatility, forecasting the future trajectory of inbound travel remains challenging. Earlier this year, several airline companies withdrew full-year guidance due to concerns about demand and broader economic uncertainty. Additionally, President Trump's sweeping new travel ban, barring entry to citizens of 12 countries, along with recent policy changes from the new U.S. administration, may further disrupt inbound travel and potentially reduce the flow of international university students.

What might be the implications for the US economy? Our analysis reveals that foreign travel to the US accounts for just 0.8% of nominal PCE spending, and after including medical tourism and education, this figure rises to roughly 1% of nominal PCE. As such, a hypothetical 10% decline in overseas visitors would reduce nominal PCE by only 0.08% (8 basis points), and GDP by even less, approximately 0.05% (5 basis points). In fact, around 90% of spending in the travel and tourism sector comes from **domestic tourists**, and recent data indicate that domestic tourism remains robust. While inbound international travellers are economically significant, their overall impact is relatively modest compared to domestic demand.

Against this constructive readthrough of the data, we highlight the following:

1) Jobless claims are rising. However, we believe that, at this stage, they remain consistent with an economy that is slowing rather than entering a recession. Indeed, our analysis shows that several factors could be behind the recent mild deterioration, including seasonality and idiosyncratic factors. The Department of Labor's (DOL) seasonal adjustments remain questionable due to the significant distortions caused by COVID-19 lockdowns in 2020. To avoid the pandemic-related distortions in seasonal adjustments, we prefer to compare current data with seasonal norms from non-pandemic years. Against that benchmark, last week's NSA move placed initial claims somewhat above the pre-pandemic range and the prior year's reading, but in line with 2023 levels. Idiosyncratic factors include that state-level data showing a reversal of the prior week's jump in Kentucky, which offset moderate increases elsewhere. Continuing claims – a measure that reflects both the number of people laid off and how long it takes them to find a new job - are also rising. However, they remain well below the business-cycle recessionary threshold, which we estimate at approximately 2.7 million. While the level of claims is important, the pace of deterioration also deserves close attention. In that regard, some downside risks have increased, but we prefer to wait for more data before drawing firm conclusions.

2) The ISM Services Index entered contractionary territory in May for the first time since June 2024, with the composite index falling to 49.9 from 51.6 in April. Of the four components that feed into the headline index, two declined (new orders and business activity), while two increased (employment and supplier deliveries). The overall report paints a weak picture of service-sector activity, though much of the softness may reflect a payback effect from demand being pulled forward ahead of tariff. The sharp drop in new orders sentiment is a negative signal for future activity, but it remains too early to determine whether it will be sustained.

It appears that service providers, facing ongoing uncertainty around tariffs, are maintaining current employment levels rather than adjusting their workforce pre-emptively.

While we view the ISM Services Index as a key gauge for the direction of the U.S. economy, we believe that a single month's reading below the contractionary threshold is not sufficient to draw firm conclusions. In recent history, the index has recorded similar temporary dips into contractionary territory, most recently in April and June 2024, without translating into a meaningful deterioration in hard data.

US GROWTH FORECAST TRACKER

We have revised our Q2 GDP tracking estimate upward, from 2.0% q/q to 3.2% SAAR. This adjustment reflects a series of stronger-than-expected macro data releases between May and early June. Notably, core goods shipments exceeded expectations, contributing to an upward revision in our tracker. In addition, the sharp narrowing of the trade deficit in April, driven by higher exports and lower imports, provided a modest boost to net exports, further supporting Q2 growth.

Moreover, April's personal income and spending figures came in above expectations, along with strong control group sales for May, hence, we revised up our PCE estimate for Q2, bringing it to 2.1% q/q SAAR.

Consequently, we expect a technical rebound in real GDP growth to 3.2% q/q SAAR in Q2, led by a recovery in the net-trade component, an uptick in private consumption, and a marginally positive contribution from residential investment. However, inventories and fixed investments are expected to act as a drag, especially fixed investments, which are weighed down by a mechanical correction following the unprecedented 24.7% q/q SAAR surge in equipment investments during Q1 2025.

Looking ahead to H2 2025, we expect growth momentum in domestic demand to weaken once trade and inventory distortions subside. Consumer spending is projected to contract as tariff fears materialise, particularly impacting prices of big-ticket durable goods. However, spending on services is expected to remain resilient, helping to offset sharper declines in goods consumption. Similarly, after a pull-forward in fixed investment activity ahead of tariff threats, the prevailing policy uncertainty is likely to dampen investment spending for the rest of the year.

Against this backdrop, we maintain our growth forecast for Q3-25 at 0.8% q/q SAAR, and we upgrade our projection for Q4-25 to 1.0% (from 0.8% prior baseline). This keeps the full-year 2025 real GDP growth forecast at 1.7%, slightly up from the previous baseline of 1.5%.

EA – Caution in the air

Although Q1 real GDP growth was revised upwards, we note that distortions from anticipatory effects on US tariffs and idiosyncratic factors (Ireland) were significant. Beneath the surface, domestic demand remains feeble entering Q2. Our baseline remains largely unchanged. We continue to expect sequential growth to slow in the coming quarters.

Looking through the Irish fog. Area-wide real GDP growth for Q1 2025 was revised up by 0.3 percentage points to 0.6% q/q in Eurostat's final release. This upward revision was largely driven by a sharp increase in the Irish GDP print, revised up by 6.5pp to 9.7% q/q. However, this surge primarily reflects multinational activity, particularly pharmaceutical exports to the U.S., rather than a broad-based improvement in domestic economic momentum.

Excluding Ireland, signs of weakening domestic demand are more evident. Stripping out the notoriously volatile Irish data, euro area real GDP rose by 0.3% q/q in Q1, up from 0.1% in Q4 2024. The detailed expenditure breakdown confirmed that net exports were the main driver of this improvement, rising by 5.7% q/q. This supports our baseline view that the European trade channel received a temporary boost from the substantial front-loading of US imports.

Household spending and fixed investment under pressure from uncertainty. Private consumption growth slowed notably, with its sequential pace halving from Q4 to Q1, down 0.2pp to 0.2% q/q. Gross fixed capital formation (GFCF) also edged down, though it remained relatively firm at 0.4% q/q. However, a significant portion of this positive contribution stemmed from investment in intellectual property products, which alone added 0.5pp to the GFCF growth rate.

Entering Q2 with a limp. Data released so far continues to indicate a deceleration in economic activity in Q2.

On the demand side, households spending weakened in April. Retail sales excluding gasoline declined by 0.1% month-over-month, a deceleration of 0.5 percentage points. This is consistent with subdued consumer and retail sector sentiment, alongside a contractionary reading of the PMI services index and weak consumer confidence.

On the supply side, the boost from tariff front-loading is beginning to unwind. The weakness in April's industrial production data was broad-based across countries and sectors, but particularly pronounced in Germany's pharmaceutical industry, which contracted by -17.7% m/m, reversing the +19.3% m/m surge recorded in March.

A payback in net trade lies ahead. High-frequency shipping data available as of early June point to a deceleration in export volumes from Europe to the US, following front-loading in March and April. This suggests that exports to the US are returning to more "normal" levels, or potentially falling below them, as front-loading winds down and the negative impact of higher tariffs begins to take effect.

ANIMA baseline. Our sequential forecast path for the EA remains broadly unchanged. For Q2 2025, we now project a deceleration to 0.0% q/q (vs 0.1% previously expected), reflecting a more pronounced payback from "excess Q1 growth" than initially anticipated. Our forecasts for Q3 2025 (0.1% q/q) and Q4 2025 (0.2% q/q) remain unchanged from the previous baseline.
However, annual growth rates place greater weight on the first quarter of the year. As a result, the upward revision to Q1 2025 GDP growth, despite being offset by slower growth in subsequent quarters, raises our annual forecast for 2025 to 1.1%, up from 0.9% previously expected.

China – Trade talks advance as domestic momentum weakens

Soft data for May suggest that domestic demand conditions remain challenging, with weak consumption figures and sluggish housing activity expected for the month. Additionally, export-driven manufacturing indicators point to a slowdown in momentum, consistent with disappointing trade figures in May. Overall, we anticipate *a broad slowdown in Q2, as economic imbalances persist. Finally, the trade truce and the recent US-China talks in London are welcome signs of de-escalation.*

Soft data for May suggest demand conditions remain challenging. China's economy appears to have moderated in the second quarter amid ongoing volatility surrounding U.S. tariff policy. In May, the country's two key manufacturing PMIs diverged: the Caixin manufacturing PMI fell sharply by 2.1 points to 48.3, while the NBS manufacturing PMI edged up slightly to 49.5 from 49.0. This divergence likely reflects differences in survey coverage - the Caixin index focuses more on smaller, export-driven firms, whereas the NBS survey covers a broader industrial base. The increase in the NBS output was driven by robust production in sectors such as food processing, equipment manufacturing, rail, shipbuilding, and aerospace.

Fiscal push still needed as structural imbalances persist. The domestic economy continues to face significant structural challenges, including persistent imbalances between production, consumption, and investment, alongside ongoing deflationary pressures. These factors highlight the need for sustained policy support. We expect domestic demand to remain sluggish, with housing activity weakening further in May.

China's trade performance in May was disappointing. Despite the easing of tariffs agreed in Geneva, trade figures fell short of expectations. Export growth slowed to 4.8% y/y from 8.1% y/y, driven primarily by a sharp decline in shipments to the US, which fell 14.7% m/m seasonally adjusted, or 34.5% y/y. In contrast, exports to other regions remained relatively stable. Imports declined by 3.4% y/y, worsening from the previous month's 0.2% y/y decline, largely due to reduced imports from the US. Nevertheless, the trade surplus continued to widen.

Bilateral trade policy uncertainties are easing, but the trade war is not officially over. The latest round of US-China trade talks, held in London, appears to mark a potentially decisive moment in the ongoing dispute. However, a formal agreement between President Trump and President Xi has yet to be signed. Overall, we view the outcome of the London talks as favorable for China, as it helps mitigate the previously expected negative impact on net exports for the remainder of the year. The agreed tariff level of 55% is close to the 48% rate applied during the earlier 90-day truce and at this stage, we do not rule out the possibility of it being reduced further. Looking ahead, we anticipate a less severe growth drag from China's export sector, with early signs of a recovery in exports to the US expected to become visible by late July.

ANIMA Baseline. Against this backdrop, we fine tune our baseline forecast: GDP is expected to slow to 4.9% y/y in Q2 2025, further easing to 4.5% in Q3 2025 before bottoming out at 4.7% y/y in Q4 2025. We now anticipate annual growth in 2025 to slow less than previously expected, at 4.9% (up from 4.2% previously).

INFLATION

US – Tariff pass-through not yet detected

The May inflation print still shows no significant evidence of tariff pass-through to consumer prices. This aligns with our initial assumptions that the disinflation trend would continue through the summer, supported by Q1 restocking. We continue to expect tariff-driven inflation momentum to pick up in June and peak over the summer as businesses exhaust inventories built before the tariffs took effect. That said, we maintain the view that the projected increase in goods inflation will be temporary.

From Q4 onward, we expect core services' disinflation to regain dominance in the inflation outlook, leading overall inflation to reach target by Q2 next year.

The May CPI report was weaker than market expectations, with both headline and core inflation printing at 0.1% m/m.

The slowdown in core inflation was driven by both goods and services.

Core goods inflation was flat on the month. Although used cars remained in negative territory, as we had expected, the rest of the component showed generally weak readings. Our CPI tariff-sensitive core goods items index dropped to -0.1% m/m, the lowest level since January 2025. This deceleration was primarily driven by new cars and apparel prices, two components with significant weight in the core goods CPI. Some other heavily tariffed categories showed modest increases (e.g. HHs furnishing and recreation commodities) but these were insufficient to offset the overall weakness in core goods CPI, as the rises mostly stayed within the two-standard deviation range.

Core services remained benign, continuing to decelerate by 0.1 percentage points from April to 0.2% m/m, with a broad-based slowdown across components. Core shelter inflation came in well below the pre-COVID average, at 0.2% m/m for Rent of Primary Residence (RPR) and 0.3% for Owner's Equivalent Rent (OER). We continue to expect a softening trend in core shelter, though less pronounced than what unfolded in May. Lodging prices remained flat on the month.

Supercore, supersoft. Supercore CPI (core services excluding shelter) printed weak at 0.1% m/m (with the 3mma down -0.1pp from its pre-COVID pace). Airfares continued their deflationary trend in May for the fourth consecutive month, declining by 2.7% (compared to -2.8% previously). Medical care service inflation also slowed significantly to 0.2% m/m from 0.5% in April, driven by a 0.3% monthly decrease in physician service prices, the largest drop since October 2023. (This component tends to be volatile due to a low survey response rate). Even when excluding the more volatile components (airfares, lodging, and health insurance) from supercore CPI, there was still a 0.2 percentage point deceleration to 0.4% month-over-month in May.

Core PCE tracking with CPI inputs: Using CPI data, we estimate that core PCE inflation for May will be 0.17% m/m, up from 0.11% in April. Although core CPI inflation surprised to the downside, prices for newspapers & magazines and prescription drug (both of which carry a larger weight in the core PCE price index than in core CPI) rose strongly in May.

ANIMA baseline. The May inflation print still shows no relevant evidence of tariff pass-through to consumer prices. Thus, the early-stage tariffs announced in January, February, and March have yet to translate into measurable price effects at the CPI level. This aligns with our initial assumptions that the disinflation trend would continue through the summer. Against this backdrop, we continue to expect tariff-driven inflation momentum to pick up in June, peaking over the summer. We maintain the view that the increase in goods inflation will be temporary and largely offset by a decline in core services inflation, supported by a gradual slowdown in wage growth.

Our baseline remains largely unchanged; we now project core CPI at 2.8% for Q2-25 (vs 2.9% in prior baseline). For Q3-25 we expect core CPI to peak at 3.1% (unchanged from prior baseline), while for Q4-25 we expect 3.0%. Our annual average core CPI forecast for 2025 stands at 3.0% (unchanged from previous baseline).

EA – Services retreat

Headline inflation fell below target in May, with core inflation declining significantly due to weak services, reflecting very soft tourism-related components as well as a broader underlying easing. Multiple indicators continue to suggest that the disinflation *trend is consolidating. Accordingly, we maintain our baseline forecast that core inflation will continue to decline toward the target by December 2025.*

Headline below target. Core at its lowest level since January 2022. In May, HICP data showed further disinflation: headline inflation declined by 0.3 percentage points to 1.9% year-on-year, falling below target, while core inflation dropped by 0.4 percentage points to 2.3%.

Weak energy prices provide relief, but food inflation remains a concern. Energy inflation remained stable at -3.6% y/y in May and is expected to stay in negative territory for the remainder of the year. Our baseline projects EA energy HICP to average -2.4% y/y in 2025, based in part on natural gas and crude oil futures curves. However, food inflation continues to rise. May marked the fifth consecutive monthly increase in food-at-home (FAT) HICP, reaching 3.3% y/y. This broad-based momentum aligns with our relatively firm outlook for FAT inflation through year-end. It is also consistent with the European Commission's survey on food and beverage selling price expectations, which correlates well with HICP data and continues to indicate mounting inflationary pressures in this segment. On balance, we expect headline HICP inflation to end 2025 at 1.8% y/y, with an annual average of 2.0%.

Core, back on the softening track. Core inflation decelerated to 2.3% y/y in May, driven by a notable drop in services inflation, which fell by 0.8 percentage points to 3.2% y/y, its lowest level since March 2022. This more than reversed the April uptick and confirms expectations that the late Easter boost to tourism-related prices (such as airfares and package holidays) would unwind in May. Importantly, the decline in services inflation appears to extend beyond the holiday-related components distorted by Easter timing. Early data suggest a broader softness across services, pointing to a more organic disinflation trend. After averaging 3.9% in 2024, services inflation has declined by 0.7 percentage points between December 2024 and May 2025. This reinforces our view that services disinflation is firmly on track. The ongoing moderation in both profit margins and wage growth should continue to support the downward trend in core inflation.

At the same time, core goods inflation remained steady at 0.6% y/y for the fourth consecutive month. Core goods inflation has been broadly stable since Q4-24, and we expect this trend to continue through the rest of the year. The only factor that could materially disrupt this outlook would be a significant retaliatory tariff response from the EU following the 50% tariffs announced by President Trump, an outcome we currently consider unlikely.

ANIMA baseline. Incorporating the May data, we don't significantly change our outlook on the monthly pace of services and goods prices going forward. On balance, we expect core HICP to end 2025 at 2.2%, with an annual average of 2.4%, unchanged from our prior baseline. Quarterly, we forecast core HICP at 2.4% in Q2 2025 (down slightly from 2.5% previously), 2.2% in Q3 2025 (vs. 2.3% previously), and 2.2% in Q4 2025 (unchanged).

China – Endless deflation

Persistent deflationary pressures kept inflation in China negative for the fourth consecutive month in May, while overcapacity continued to weigh on producer prices. Prolonged trade tensions have dampened business sentiment, and domestic prices are likely to remain weak amid ongoing excess capacity and limited support from redirected exports.

We stick to our baseline, as deflationary pressures persist. In May, headline inflation remained negative at -0.2%, while core inflation rose to 0.5% year-on-year from 0.3%, supported by a temporary boost from trade-in subsidies. Producer price index deflation intensified to -3.3% y/y from -2.7%, reflecting continued weak business sentiment amid ongoing China–US trade talks and a fall in energy prices. Subdued domestic demand and external headwinds, driven by high US tariffs and softer non-US demand, continue to restrain inflation momentum. Over the first five months of the year, headline inflation averaged -0.1% y/y (compared to 0.1% in 2024), while core CPI averaged 0.2% y/y (down from 0.7% in 2024).

Looking ahead, we continue to expect domestic deflationary pressures to persist in the coming months. While export diversion from the US to other markets may help stabilise prices, it is unlikely to meaningfully alleviate China's mounting manufacturing overcapacity. As a result, we anticipate downward pressure on prices to continue throughout 2025.

ANIMA Baseline. Against this backdrop, we maintain our baseline forecast, expecting full-year inflation for 2025 to accelerate modestly to 0.3%, up from 0.2% y/y in 2024. On a sequential basis, we project headline inflation to evolve as follows: -0.1% y/y in Q2 2025, 0.2% in Q3 2025, and 1.2% in Q4 2025.

MONETARY POLICY

FED – Between Scylla and Charybdis

As widely expected, the Fed kept the rates unchanged for the fourth consecutive meeting. On the one hand, Chair Powell gave the impression that the progress with disinflation could be sufficient to justify resuming the cycle of disinflationary rate cuts; on the other, strong expectations within the Committee that tariff inflation is coming seem to be keeping the FOMC up at night. The dot plot validates this polarization. The Committee is divided between zero or two cuts this year with no rush to take sides as the solid economy is providing the time needed to weigh up options for the next move. We remain of the view that the Fed will cut the rates twice this year starting in Q3.

Still in a good place. The Fed kept its fund rates on hold at 4.25-4.5% for the fourth consecutive meeting, as widely expected. While the Fed reinforced its easing bias amidst mounting evidence that inflation is moving in the right direction, there is a strong view that inflation will pick up in the coming months due to tariffs and healthy economic conditions keeping the Fed in wait-and-see mode for yet another meeting.

Past the peak of uncertainty. In its statement, the Fed acknowledged that while uncertainty is still high, it has diminished since April 2. The Fed removed the sentence that "[the FOMC] judges that the risk of higher unemployment and higher inflation have risen" from the statement, suggesting that as of late, stagflation risks have diminished significantly.

Upbeat on growth, labor market and sentiment. Chair Powell sounded optimistic on the economy, indicating that considering swings in net exports, underlying growth momentum remains solid as indicated by final domestic demand in Q1. Moreover, the Chair stressed that labor market conditions remain healthy, with demand and supply of jobs in a good balance, and that sentiment indicators, while still at depressed levels, are picking up.

Dovish on inflation. Chair Powell also sounded highly pleased by the progress made on inflation thus far. He noted that the last three months' readings were favourable and stressed that aggregate services inflation is basically back on target. In our view, without tariffs, this level of confidence in the disinflation progress would probably have pushed the Fed to resume its disinflationary rate cuts' cycle at this meeting.

There is still a but. Amidst ongoing high uncertainty, Chair Powell sounded quite confident that inflation would rise due to the tariffs. Apparently, the only uncertainty the Fed faces is the extent to which the shock will be temporary (which is their baseline at this stage). Chair Powell mentioned several times during the press conference that they will learn a lot more about tariffs and their impact on inflation over the coming months, stressing that the summer will be very important in that regard.

Consistent with the Fed's rhetoric, the updated SEP still highlighted a solid economy and sanguine view of inflation. The revised projections point to slower growth in 2025 and 2026 compared to March, with GDP now expected to rise by 1.4% in 2025 (down 0.3 percentage points from 1.7%) and 1.6% in 2026 (down from 1.8%), while the 2027 forecast remains unchanged at 1.8%. Policymakers continue to foresee a resilient labor market, with only marginal upward revisions to the unemployment rate, which is now expected at 4.5% in both 2025 (+0.1pp) and 2026 (+0.2pp), and 4.4% in 2027 (+0.1pp). Meanwhile, core inflation forecasts were slightly upgraded to 3.1% (Q4/Q4) in 2025 (+0.3pp), 2.4% in 2026 (+0.2pp), and 2.1% in 2027 (+0.1pp).

Dots and signals. The June dot plot continues to indicate two rate cuts this year, while from 2026 the cycle of cuts slows, with only one rate cut in 2026 and another in 2027, keeping the Fed fund rates above neutral in 2027 (3%, unchanged compared to March). Interestingly, the dots also reveal that the Committee is almost split into two camps, calling either for zero or two cuts this year. When asked about the high dispersion in the dots, Chair Powell highlighted that there was no great deal of conviction around the forecasts, given the high level of uncertainty.

We are sticking to our baseline. Against this backdrop, we continue to expect the Fed to cut the rates twice this year, starting in Q3.

ECB – The never-ending end

The ECB cut rates by 25bp, lowering the deposit rate to 2%. While the statement's rhetoric remained largely unchanged and inflation projections were revised downward, President Lagarde emphasized that rates are now at a good level, implying that the current monetary policy cycle may be nearing its end. We believe the ECB is overly optimistic, as incoming data point to downside risks for both growth and inflation, while quality of Q1 growth is questionable. Accordingly, we maintain our forecast of two additional rate cuts this year, though risks are now balanced (versus potentially three cuts in total previously) given growing divisions within the Governing Council, compared to previously expecting risks skewed toward three cuts.

A 25bp rate cut, as expected. The ECB cut rates by 25bp, lowering the depo rate to 2%. The decision was nearly unanimous, with only one dissenter. In the statement, the rhetoric on inflation remained largely unchanged, while the ECB adopted a more constructive tone on growth, noting that eased uncertainty around trade tensions has alleviated concerns about unwarranted tightening of financing conditions.

New macroeconomic forecast revised inflation to the downside, while maintaining growth projections. In the June staff forecast, growth projections for the EA from 2025 to 2027 remain unchanged from March, reflecting a stronger-than-expected Q1 2025 followed by a weaker economic momentum throughout the rest of the year. On the inflation front, headline inflation forecasts have been revised downward to 1.9% in 2025, 1.6% in 2026, and 2.0% in 2027, compared to previous projections of 2.3%, 1.9%, and 2.0%, respectively. Headline inflation is now expected to reach the target in 2025 and to decelerate in 2026, driven by lower energy prices and a stronger euro. Core inflation forecasts were largely unchanged at 2.4% y/y in 2025 (slightly up from 2.2% previously), while the 2026 projection was revised down to 1.9% y/y from 2.0%, reflecting slower support from services inflation and labour costs.

Yet, the tone of the press conference was hawkish. Compared to the more dovish stance at the April meeting, President Lagarde made a notable U-turn, surprising the market by suggesting that the ECB may be approaching the end of its easing cycle.

Several arguments would support this view:

1) Growth has been holding up well recently, driven by private consumption and investments. Looking ahead, the ECB expressed confidence in the region's growth prospects, expecting rising real wages and expansionary fiscal policies, particularly increased investment and defence spending to support momentum.

2) The downward revision to the ECB's headline inflation projections is mainly due to updated assumptions on oil prices and the exchange rate. Core inflation forecasts, however, remain largely unchanged.

3) The ECB appears to have incorporated into its baseline the expectation that the current tariff truce between the US and the EU will be extended beyond July 9th.

We are more cautious than the ECB:

1) Although the EA economy has managed to muddle through recently, growing below potential but avoiding recession, we are less optimistic about both the reasons for this resilience and the prospects ahead. Incoming data, including Q1 GDP, retail sales, and PMIs, indicate that momentum in private consumption and investment remains mixed across the region. The ultra-weak contribution from Q1 net trade, reflecting corporate spending front-loading ahead of tariffs, was largely offset by a surge in inventories. While the positive net trade contribution to growth is likely to reverse in Q2, inventories are expected to contract. Indeed, the ECB itself does not anticipate a solid growth path in the coming quarters. Ironically, although the 2025 growth forecast remains unchanged, the composition has shifted: a stronger Q1 is now offset by weaker growth later in the year, with Q3 expected to contract by 0.1% quarter-on-quarter, compared to the 0.2% expansion projected in March.

2) Over the medium term, we remain in wait-see-mode regarding fiscal policy. It is still unclear whether fiscal policy will become outright expansionary, driven by defence and investment spending. Several implementation risks persist, including the high level of European debt (assuming no recession) and the uncertain political capital of key governments and institutions leading the fiscal expansion, notably Germany and the EU.

3) Two points on inflation: First, given our macroeconomic outlook, the ECB's projection that headline inflation will fall decisively below target while core inflation remains close to target at best raises the risk that the ECB could undershoot its mandate. Second, the sharp decline in services inflation since December last year, from 4.0% to 3.2%, signals genuine easing pressures within the non-tradable sector, rather than just a temporary reversal of Easter-related seasonal effects.

4) Although we believe the US and the EU are motivated to reach a deal on tariffs, the process may take longer than with other jurisdictions due to the fragmented nature of European political capital. Against this backdrop, there is a risk that tariff tensions with the US could persist beyond July 9th, driven by a lack of coordination among EU member states.

5) We maintain the view that the EU will do whatever it can to avoid severe retaliation. Additionally, we see tariffs posing different risks for the US and euro area economies. For the Fed, tariffs are a shock that impacts both inflation and growth, key pillars of its

mandate. For the ECB, tariffs primarily represent a negative shock through the growth channel. Unless the euro area retaliates very aggressively, imposing tariffs on the US that exceed those the US imposes on the euro area, the negative impact on euro area growth is likely to be much larger than the positive impact on inflation, given that the euro area imports less from the US than the US does from the euro area.

6) The neutral rate is no longer considered a key anchor for monetary policy stance, to the extent that the Governing Council did not even discuss it at this meeting. In our view, this signals that monetary policy will remain highly data-dependent, perhaps even more so than in the past.

We (largely) stick to our call and continue to expect the ECB to cut rates twice this year, in September and December, lowering the deposit rate to 1.50%. While we maintain our forecast of two additional rate cuts, we now view the risks as more balanced due to growing divisions within the Governing Council, compared to the previous expectation of two/three cuts (in total).

PBoC – Less tariffs but still on easing mode

PBoC cuts in May… In early May, the People's Bank of China lowered the reserve requirement ratio by 50 basis points and the policy rate by 10 basis points. Since then, trade tensions between China and the US have eased; nonetheless, we continue to expect the Central Bank to maintain its easing bias as domestic demand remains weak.

…and more cuts are coming. Looking ahead, we expect another 40bp in policy rate cuts later this year, although no further reserve requirement ratio (RRR) reductions are likely during the summer. The scale and timing of additional easing will depend on how the economy responds to tariffs, as the 90-day US–China de-escalation period should provide the central bank with more time. We also anticipate increased fiscal stimulus in H2, once the economic impact of tariffs becomes clearer.

We continue to expect the yuan to remain weak throughout the rest of the year. The PBoC's dovish policy stance is likely to keep downward pressure on the currency throughout the year. Despite tariff pressures being somewhat less than previously anticipated, we believe the central bank will have little choice but to maintain an accommodative approach and allow a weaker yuan to support exports.

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