

Macro Outlook

NEXT, PLEASE

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In the US, incoming data remain broadly consistent with our baseline. We maintain the view that the economy will bounce back in Q2 amid a reversal in net trade contribution. Meanwhile, we continue to expect growth to soften in Q3 before beginning to recover, albeit slowly, in Q4. In a nutshell, we continue to expect significant volatility in growth data, yet not a recession.

In the EA our baseline remains unchanged. Incoming data suggest that activity remained subdued in Q2, due to the reversal of the idiosyncratic factors that supported growth in Q1. Looking ahead, between Q3 and Q4, we expect growth momentum to improve only very modestly after the Q2 payback, supported by the gradual decline in uncertainty and a recovery in foreign demand as adverse tariff effects fade. We continue to expect growth of 1.1% in 2025.

In China, better-than-expected GDP data for Q2 imply that short-term growth fears have subsided somewhat, owing both to strong exports (helped by frontloading) and to early government stimulus. Nonetheless, looking at hard data for June, domestic momentum slowed during the month. Overall, economic headwinds have not dramatically abated in China: on the one hand, trade confrontation with the US has eased; on the other hand, domestic demand continues to struggle.

The June US core CPI report came in softer than expected. Core goods returned to positive territory, driven by a still modest and mixed tariff pass-through effect. Core shelter continues its normalising trend, while supercore inflation remained relatively subdued. We continue to expect tariff-driven inflation momentum to peak over the summer as businesses exhaust inventories built up before the tariffs took effect. That said, we maintain our view that the projected increase in goods inflation will be temporary. However, if the limited pass-through persists into July, we highlight a moderate downside risk to our already low CPI forecast. From Q4 onwards, we expect core services disinflation to regain prominence in shaping the inflation outlook, bringing overall inflation to target by Q2 next year.

The June print confirmed that the EA inflation outlook is broadly on target. The slight increase in services inflation was led by volatile components and was offset by a slight decrease in core goods. Taking into account the decelerating momentum of underlying services, the ongoing normalization of wage growth, and the softening of consumer inflation expectations, we maintain our baseline for a disinflation process that will continue throughout the year.

China's inflation turned slightly positive in June. Deflationary pressures are expected to persist into 2025, amid continued weakness in domestic demand.

Our monetary policy outlook is largely unchanged. In DMs, we continue to expect both the Fed and the ECB to cut rates twice this year. The PBoC is expected to pause monetary easing over the summer, resuming further rate and RRR cuts in early Q4 as growth concerns re-emerge.

GROWTH

US – Ups and downs in reverse

Incoming data remain broadly consistent with our baseline. We maintain the view that the US economy will bounce back in Q2 amid a reversal in net trade contribution. Meanwhile, we continue to expect growth to soften in Q3 before beginning to recover, albeit slowly, in Q4. In a nutshell, we continue to expect significant volatility in growth data, yet not a recession.

We remain of the view that the US economy will bounce back in Q2. After contracting by -0.5% q/q SAAR in Q1, we forecast real GDP to grow by 2.1% in Q2 (with the preliminary estimate to be released on 30th July 2025).

The reason is twofold:

1) Net trade's contribution to growth is set to bounce back. In anticipation of tariffs, imports surged by 38.0% q/q SAAR in Q1. As a result, net exports' contribution to Q1 GDP growth plunged by 4.6pp. Data released thus far suggest that some of this dynamic reversed in Q2, as imports dropped by -48.2% in April-May (average of the 3-month % change) compared to Q1. Despite the unexpected slowdown in exports, we estimate that net trade's contribution to Q2 GDP growth should be +3.5pp.

2) Domestic demand resilience continues:

i) Downward revisions to Q1 services consumption exaggerate the perceived weakness in US consumer spending at the start the year. The BEA reported that services consumption grew by 0.6% q/q SAAR, down from 1.7% in the second estimate and 2.4% in the advance estimate. The downward revision to services spending between the advance and final estimates is substantial and, given its large weight in total consumer spending, means that growth in private consumption was only 0.5% q/q SAAR in the quarter, compared to 1.8% in the advance estimate. Ordinarily, a pronounced slowdown in services spending would be cause for concern, as such outlays tend to be less cyclical than goods. However, several factors likely contributed to the subdued pace of spending early this year. Firstly, households' strong consumption in Q4 2024 made some pullback inevitable. Secondly, spending on non-discretionary services (e.g. housing or healthcare) was high at the turn of the year. Combined with increased spending on durables (such as autos) to front-run tariffs, households may have had less disposal income for discretionary purchases. Finally, residual seasonality, which tends to elevate inflation in Q1, may have artificially suppressed measured real activity.

ii) Incoming data for Q2 indicate a modest pickup in consumer spending.

In particular:

May's personal income data showed continued resilience in labour income, rising 0.4% m/m, in line with the recent trend.

In addition, the June ISM Services Index more than recovered from its May decline. The strength was broad-based: the new orders index rose sharply to 51.3 from 46.4 in May, and business activity regained momentum, with a remarkable increase to 54.2 (+4.2pt).

Consumers are reigniting confidence. The University of Michigan's consumer sentiment index for June climbed to 60.7 - its highest level since February. Moreover, the Survey of Consumer Expectations (NY Fed) for June showed that consumers' confidence in their financial situation was restored; the financial situation index ("much better off" measure) rose to its highest point since February, while the

probability of losing a job over the next 12 months fell to its lowest level since December.

Retail sales for June bounced back, with broad-based gains. Food services and drinking places sales (the only services spending category in the retail sales report) rose 0.6% m/m, signalling that the consumer is not giving up on discretionary spending.

iii) Equipment investment remains solid - In May, a solid 1.7% m/m increase was reported in orders for core capital goods (non-defense capital goods excluding aircraft). This reversed the decline seen in the previous month, returning orders to a level close to that of Q1. Even so, core capital goods orders show a broader slowing following earlier frontrunning, with May's level up 2.4% on a 3-month SAAR basis, compared with 6.9% over the preceding three-months ending in February. We had assumed that, after the unexpected spike in equipment investment in Q1 GDP data (+23.8% q/q SAAR), this component would decline in the following quarter, thereby dragging on overall GDP growth. However, the strength of core capital goods orders data for May suggests that the contribution of equipment in Q2 GDP will be positive once again.

iv) The labour market is holding up - The NFP report for June came in stronger than expected, with payrolls rising by 147k for the month. There were also upward revisions of 16k to prior employment figures. Cyclical sector employment growth was slower, at 74k for the month, but strength in state and local government hiring more than offset this. Employment in goods-producing sectors continues to struggle, increasing by only 6k in June, while the bulk of services hiring remains concentrated in leisure & hospitality and education and health.

We believe that deceleration in cyclically sensitive sectors is a delayed response to the high tariff-related uncertainty. Consequently, we think this may be a temporary pocket of weakness, as the June print on "core" (excluding healthcare) private sector employment suggests a labour market frozen by *Trumpian* uncertainty, rather than one already plunging into recession. Indeed, the solid pace from the latest JOLTS data, along with a non-alarming (i.e. seasonally consistent) level of initial claims over the past two weeks, does not indicate imminent risks of a structural weakening trend in the core-employment US business sectors.

Looking ahead to H2-25, we continue to expect a mild softening of domestic demand, but a recession will be avoided. The primary drivers of the slowdown are the direct effects of tariffs, which act as a tax on consumption and capital investment. We expect the peak of consumer weakness to occur at the end of Q3, when a temporary spike in inflation will weigh on consumer purchasing power. Regarding spending drivers, we anticipate a more significant slowdown in spending on goods versus services, as goods prices bear the brunt of high pass-through from tariffs. Durable goods are the most affected in our forecast, partly due to a pull-forward effect in auto spending that likely front-loaded demand, as well as from higher prices. We assume limited pass-through of higher goods prices into services, but not enough to cause a decline in spending on real services, which remains the backbone of total consumer spending. Regarding capex, after the frontrunning of investments in Q1 and their surprising resilience in Q2, we expect that, amid still high political uncertainty, business spending will slow down in Q3.

ANIMA baseline. Against this backdrop, we now forecast real GDP growth for Q2 2025 at 2.2% q/q SAAR (down from the prior estimate of 2.7%), and we continue to expect growth at 0.8% q/q SAAR in Q3 2025 and 1.0% in Q4 2025. This is consistent with annual GDP growth of 1.5% (compared with the prior estimate of 1.6%).

EA – Payback in motion

Our baseline remains unchanged. Incoming data suggest that activity remained subdued in Q2, due to the reversal of the idiosyncratic factors that supported growth in Q1. Looking ahead, between Q3 and Q4, we expect growth momentum to improve only very modestly after the Q2 payback, supported by the gradual decline in uncertainty and a recovery in foreign demand as adverse tariff effects fade. We continue to expect growth of 1.1% in 2025.

Subdued activity in Q2. After growth was exaggeratedly amplified in Q1 due to strong exports driven by US tariff front-loading, we continue to expect real activity to slow in Q2. This is because the unwinding of the export front-loading in Q1 will be compounded by an elevated level of trade policy uncertainty during April, May, and June. Indeed, the spike in trade policy uncertainty is expected to have dampened exports, especially due to its negative impact on investment in capital goods abroad, as well as on domestic investment and, albeit to a lesser extent, consumption.

Payback in motion. Incoming data show that the payback is materialising. Indeed, real German exports dropped by 1.0% and 1.3% m/m in April and May, respectively. Moreover, German industrial orders decelerated to -1.4% m/m in May, with capital goods orders at -0.9% m/m (a decline of 6.6pp from the previous month). Along the same lines, industrial turnover in France declined by 2.5pp to -1.2% m/m in April, while goods exports (excluding Airbus) dropped to -4.9% m/m in May.

Households spending remains weak. Area-wide retail sales dropped to 0.7% m/m in May. The weakness was broad-based: sales in non-specialised stores declined by 0.4% on the month, while online sales fell by 0.3% m/m for the second consecutive month. This is consistent with consumers continuing to be highly cautious. Consumer confidence declined to -15.7 in Q2 2025, the lowest level since Q4 2023. The saving rate remains higher than its implied trend level, and savings intentions are still extremely elevated.

Labour market is starting to look fragile. The EA unemployment rate edged up to 6.3% in May from 6.2% in April. Among major EA economies, the unemployment rate rose by 0.4pp to 6.5% in Italy, increased by 0.1 percentage points to 6.5% in Belgium, but remained unchanged at 3.7% in Germany and 7.1% in France. Meanwhile, consumer unemployment expectations are on an upward trend, reaching 27.3 in Q2 2025, the highest level since Q1 2021, while business surveys (PMIs) suggest that the momentum of employment creation is gradually easing.

Financial credit remains restrictive. Recent money and credit figures indicate a slowdown in lending activity to both households and businesses in May. Notably, lending flows to the non-financial corporate (NFC) sector weakened substantially, turning negative for the first time since July 2024 – falling to €2 billion from around €10 billion in April. Consequently, the year-over-year growth rate of business loans eased to 2.5%, down slightly from 2.6% in April. This sequential decline was primarily driven by a contraction in short-term loans (with maturities under one year) and a marked deceleration in the growth of long-term loans (with maturities over five years). These patterns continue to suggest that businesses remain cautious in the face of ongoing economic uncertainty.

Looking ahead, between Q3 and Q4 we expect growth momentum to improve very tentatively after the Q2 payback, supported the gradual decline in uncertainty and a recovery in foreign demand as adverse tariff effects fade. Trade talks between the EU and US continue and, despite reported skirmishes on both sides, we expect an equilibrium to be reached that is acceptable to both parties, and that negotiations are approaching a point of resolution. Most recently, there has been

commentary regarding the August deadline. Consequently, we expect that once a deal is formalised, uncertainty will begin to wane. However, we believe that since the recovery starts from a rather depressed level, the regain of confidence will take time to translate into real activity, and the improvement in momentum will prove to be tentative and gradual.

ANIMA baseline. Our baseline remains largely unchanged. For Q2 2025, we project a deceleration to 0.0% q/q, reflecting a more pronounced payback from “excess Q1 growth” than initially anticipated. For Q3 2025 we continue to expect growth of 0.1% q/q and 0.2% q/q in Q4 2025. Our annual forecast for 2025 remains at 1.1%.

China – Better than expected GDP print in Q2, but details matter

Better-than-expected GDP data for Q2 imply that short-term growth fears in China have subsided somewhat, owing both to strong exports (helped by frontloading) and to early government stimulus. Nonetheless, looking at hard data for June, domestic momentum slowed during the month, and the structural imbalance in the economy, especially the imbalance between domestic demand and supply, shows no sign of improvement and has become a pressing issue in the near term. Overall, economic headwinds have not dramatically abated in China: on the one hand, trade confrontation with the US has eased; on the other hand, domestic demand continues to struggle as the economy still requires further fiscal support.

China's GDP report shows the economy decelerated slightly less than expected in Q2. Real GDP growth printed at 5.2% y/y, down from 5.4% y/y, while we were expecting a slightly softer 4.9% y/y print. Nevertheless, economic momentum softened in Q2, in line with our expectations and sentiment indicators, as many businesses were hit by the trade confrontation with the US. Sequential growth decelerated to 1.0% q/q from 1.4% q/q in 1Q. The breakdown of Q2 GDP growth showed that the contribution of consumption to GDP growth jumped to 1.28pp from 0.47pp. Finally, the contribution of net exports to GDP halved to 1.20pp from 2.13pp in Q1. Overall, the contribution of total domestic demand increased to 4.0pp in Q2 from 3.26pp in Q1; however, the underlying data does not support the view of strengthening domestic momentum heading into the summer.

June hard data details suggest domestic momentum is slowing again. The details of June economic hard data turned out to be quite different from expectations, with a positive surprise on the production side (industrial production rose significantly above expectations to 6.8% from 5.8% y/y in May) and a downside surprise on the demand side (retail sales softened to 4.8% y/y from 6.4% y/y in May, and fixed asset investment decelerated to 2.8% y/y from 3.7% y/y). The sequential decline in domestic demand from May to June, combined with the uneven pace of economic development, indicates that:

- 1) economic momentum is weakening again at the start of Q3, and
- 2) structural imbalances between domestic demand and supply persist and remain a key challenge, despite the easing of near-term growth concerns. July's hard data will be important to confirm whether the economy is indeed losing steam heading into H2.

The improvement of housing market conditions stalled in June. Regarding housing market activity, new home sales showed a further decline of -5.0% y/y in June, the same pace as in May; notably, the price decline of Tier 1 cities accelerated, with prices dropping 2.6% y/y compared to 2.1% in May. Meanwhile, home sales growth in value terms fell by 13.6% y/y, compared to 6.8% y/y in May. Overall, the housing market improvement observed since late Q4 2024 now seems to be losing momentum.

A fiscal push is still needed as structural imbalances persist. Economic development continues to face structural challenges, particularly persistent imbalances among production, consumption, and investment, as well as ongoing deflationary pressures. Against this backdrop, we expect continued policy support: in our view, the July Politburo meeting is likely to be a policy non-event from a cyclical perspective, as the probability of additional policy stimulus is low. We expect policymakers will continue to prefer a data-dependent and gradual fiscal push, with limited additional fiscal stimulus for the rest of the year, likely by the end of Q3.

China's June exports remained resilient, rising by 5.8% y/y from 4.8% y/y previously, supported by a 21.9% rebound in shipments to the US. Exports elsewhere were mixed, with declines in exports to the EU and EM Asia, and increases in exports to Japan. The breakdown by product suggests the lift came mainly from exports of mechanical/electrical and high-tech products. We expect China's export momentum to moderate in H2 as external trade policy uncertainties remain high. The pace of the slowdown will depend on ongoing US trade negotiations with China and other trading partners, the extent to which trans-shipments are curtailed, and the resiliency of overall global demand.

ANIMA Baseline. Against this backdrop, we maintain our forecast of a sequential slowdown in Q3: we expect GDP growth to slow down to 4.7% y/y in Q3, before bottoming out at 4.9% y/y in Q4. Given the better-than-expected GDP print in Q2, we now expect annual growth to reach 5.0% in 2025, the same pace as in 2024.

INFLATION

US – Warm but not hot

The June core CPI report came in softer than expected. Core goods returned to positive territory, driven by a still modest and mixed tariff pass-through effect. Core shelter continues its normalising trend, while supercore inflation remained relatively subdued. We continue to expect tariff-driven inflation momentum to peak over the summer as businesses exhaust inventories built up before the tariffs took effect. That said, we maintain our view that the projected increase in goods inflation will be temporary. However, if the limited pass-through persists into July, we highlight a moderate downside risk to our already low CPI forecast. From Q4 onwards, we expect core services disinflation to regain prominence in shaping the inflation outlook, bringing overall inflation to target by Q2 next year.

For the fifth consecutive month, core CPI surprised to the downside relative to consensus expectations. The June core CPI print came in at 0.2% m/m (vs 0.3% consensus) up from 0.1% in May.

Core goods returned to positive territory, supported by a still modest and mixed tariff pass-through effect. Core shelter continues its normalising trend, while supercore remained relatively subdued.

Core goods inflation rose to 0.2% m/m (vs 0.0% previously).

Beneath the surface, used cars remained in negative territory (-0.7% m/m), while the rest of the breakdown was a mixed bag. As a result, it remains difficult to determine how much of the uptick in core goods in June can be attributed to tariff pass-through effects. Indeed, on the one hand, some heavily tariffed goods have yet to show meaningful price pressures, such as new cars (-0.04pp to -0.3% m/m), motor vehicle parts/equipment (-0.3pp to 0.6% m/m), and medical care goods (-0.5pp to 0.1% m/m). On the other hand, certain items may be beginning to reflect tariff effects, for example,

apparel CPI (0.4% m/m from -0.4% in May) and household appliances (1.8% m/m from 0.8% in May).

What casts some doubt on whether the June core goods uptick was actually driven by tariff pressures is that prices for new and used cars, along with motor vehicles equipment, showed no increase, despite this being the sector most affected by tariffs and the one where consumers front-loaded the most in Q1 (in March, PCE spending on motor vehicles and parts rose to +225% m/m).

Core services rose to 0.25% m/m (vs 0.17% previously).

Core shelter (OER+RPR) ticked up slightly to 0.28% m/m from 0.26% in May. Overall, core shelter inflation momentum has largely normalised to pre-COVID levels. Although the deceleration trend tends to be somewhat volatile month to month, and despite some stickiness earlier this year, we anticipate further disinflation. This expectation is supported by market rents, which tend to lead CPI rents by three quarters, continuing to post weak.

Supercore CPI (core services ex shelter) came in at 0.24% m/m from a very weak print in May (0.10%). Excluding the seasonally unusual May print, core services came in a touch softer than its trend over the past 8 months (0.26%). Prices for travel services fell for the fifth consecutive month, as lodging prices plummeted 2.9% m/m and airline fares slipped 0.1%. The remaining macro-reopening categories (recreation services and MV insurance) proceed to travel roughly in line with the pre-COVID average.

ANIMA baseline. This inflation report remains broadly consistent with the gradual disinflationary trend observed in recent months. While the tariffs imposed on Canada, China, and Mexico before June may have contributed to an uptick in a limited number of goods-related subcomponents, the magnitude of these increases is not yet sufficient to significantly alter the overall inflation outlook. We expect a further acceleration over the rest of the summer, with monthly readings likely peaking in August.

Our forecast profile remains unchanged. Indeed, although the June print came in softer than consensus expectations, we are not adjusting our baseline. For the June print, our core CPI forecast was 0.22% m/m (vs 0.23% actual). In terms of subcomponent drivers, we expected 0.12% m/m for core goods (vs 0.19% actual) and 0.27% for core services (vs 0.25% actual). Hence, we were moderately surprised to the upside on core goods CPI, so we have no reason to lower the level of the inflationary peak linked to tariff-induced pressures. However, if the persistence of a very limited pass-through is also observed in July, we highlight a moderate downside risk to our already low CPI path.

We maintain the view that the increase in goods inflation will be temporary. We continue to expect the tariff-related peak to occur in Q3, with core CPI projected to reach a peak of 0.39% m/m in August. This is expected to be largely offset by a decline in core services inflation, supported by a gradual slowdown in wage growth.

EA - Disinflation proceeds

The June print confirmed that the euro area inflation outlook is broadly on target. The slight increase in services inflation was led by volatile components and was offset by a slight decrease in core goods inflation. Taking into account the decelerating momentum of underlying services, the ongoing normalisation of wage growth, and the softening of consumer inflation expectations, we maintain our baseline for a disinflation process that will continue throughout the year.

Headline at target. Headline inflation rose to 2.0% y/y in June up 0.1 percentage points from May, primarily driven by base effects that slowed the rate of energy

deflation. Energy prices remained mostly stable month-on-month, and data from Germany indicates that the brief surge in oil prices had only a limited effect on HICP fuel prices. In contrast, inflation for food, alcohol, and tobacco (FAT) dipped by 0.1 percentage points to 3.1% year-over-year, mainly due to lower processed food inflation. This decline occurred despite unprocessed food inflation remaining seasonally strong.

Unchanged core inflation. In June, the slight increase in services inflation (+0.1pp to 3.3% y/y) was offset by a slight decrease in core goods inflation (-0.1pp to 0.5% y/y).

Sequentially, momentum in core goods inflation eased by 1.4pp to -0.5% m/m SAAR, with the three-month moving average (3mma) remaining stable at 0.3% m/m SAAR. We take this as further confirmation of a full return to the pre-COVID trend for this component, and we believe this path will continue throughout the rest of the year. The only event that could materially derail this view would be a major retaliation by the EU on the tariff front, following the 50% tariffs announced by Donald Trump, but it appears that the EU and the US are moving closer to an agreement.

Sequential momentum in services inflation increased by 5.9pp to 4.8% m/m SAAR, but that was from a very low May reading, which was distorted by several factors. Momentum in 3mma terms increased by a more moderate 0.3pp to 3.2% m/m SAAR. Indeed, as evident from the German inflation details, the June increase was driven mainly by typically volatile items (i.e. package holidays and airfares), rebounding from the significant price drops seen in May. Excluding volatile components, the momentum of underlying services inflation is edging down. This underlying softness should help to reduce some of the uncertainty regarding the true strength of services inflation this year (initially influenced by annual price resets and later distorted by the timing of Easter), and it provides further confirmation that services inflation is indeed moderating. Moreover, in July we account for an additional supportive element for disinflation stemming from the negative base effect of services inflation in France, following the Olympics in July 2024. Looking ahead, we continue to believe that the medium-term outlook for wage growth normalisation remains encouraging, further supporting the disinflationary process in services inflation.

Further encouraging signs of disinflation were seen in the ECB's consumer survey, which reported that median inflation expectations declined in May (12-month ahead: down 0.3pp from April to 2.8%; 3-year ahead: down 0.1pp to 2.4%). This partially reversed the increases observed in April and March, supporting a relatively benign inflation outlook.

ANIMA baseline. Our baseline remains unchanged. We expect core HICP to end 2025 at 2.2%, with an annual average of 2.4%, both unchanged from our prior baseline. On a quarterly basis, we forecast core HICP at 2.2% in Q3 2025 (unchanged) and 2.2% in Q4 2025 (also unchanged).

China – Subdued Inflation, Persistent Deflation

China's inflation turned slightly positive in June, with CPI rising by 0.1% y/y, along with core prices. PPI deflation deepened due to weak demand and seasonal factors. The GDP deflator fell by -1.2% y/y, marking a record fall. Deflationary pressures are expected to persist into 2025, amid continued weakness in domestic demand.

Inflation turned positive in June. China's inflation remained soft in June, as consumer prices inched up to 0.1% y/y after four consecutive months in negative territory, driven by a modest increase in food prices. Core CPI inflation rose slightly to

0.6% y/y from 0.5% y/y, driven by higher core goods prices, while services inflation remained unchanged during the month.

Producer prices deflation deepened. PPI deflation widened more than expected, falling to -3.6% y/y from -3.3% y/y, as consumer goods prices dropped by -1.4% y/y and producer goods declined by -4.4% y/y, with continued easing in producer prices for mining, raw materials, and manufacturing goods. The broader decline, particularly in mining, raw materials, and manufacturing, was partly due to seasonal factors, as high summer temperatures slowed construction activity and weakened demand.

GDP deflator craters. Following the release of Q2 GDP data, the latest figures show the GDP deflator contracted by 1.2% y/y: this represents the ninth consecutive quarter of contraction, breaking the previous record of seven consecutive quarters of negative GDP deflator readings, and also marks the lowest GDP deflator level in this cycle.

Looking ahead, we continue to anticipate that domestic deflationary pressure will persist. The uneven development of the Chinese economy, especially the outperformance of the supply side relative to consumption, has led to a wide demand-supply imbalance which continues to fuel deflationary pressures. As external demand and tariff uncertainties persist and energy price volatilities diminishes, we expect insufficient domestic demand to be the dominant factor affecting consumer prices. We therefore expect downward pressure on prices to continue through 2025.

ANIMA Baseline. Against this backdrop, we stick to our baseline forecast and expect full-year inflation for 2025 to stabilise at 0.2%, the same level as in 2024. In sequential terms, we anticipate headline inflation to unfold as follows: 0.1% y/y in Q3 2025 and 0.8% y/y in Q4 2025.

MONETARY POLICY

ECB – Long story short (of cuts)... for now

The ECB left the depo rate unchanged at 2% in July – the first pause after seven consecutive rate cuts. As incoming data remains broadly in line with the June assessment, President Lagarde reiterated that the ECB is in a good place and can afford to stay on hold to observe how conditions develop, especially regarding tariffs. That said, we maintain our view that the ECB will implement two additional rate cuts by the end of the year, bringing the depo rates to 1.50%, as we anticipate continued weak growth and a faster pace of disinflation than the ECB currently expects. While the German fiscal package may offer some support to the euro area economy, its effects are unlikely to be felt until 2026.

On hold, as expected. The ECB left the depo rate unchanged at 2%, for the first time after seven consecutive rate cuts. The decision was unanimous. The Governing Council (GC) concluded that the inflation outlook is broadly unchanged compared to June, with inflation currently on target and expected to remain on target in the medium term. Against this backdrop, the ECB can stay on hold, at least until there is more clarity on trade policy.

ECB's rhetoric continues to lean on the hawkish side. During the press conference, President Lagarde's rhetoric was very much in line with that of June, again leaning on the hawkish side.

- 1) President Lagarde repeated that the ECB is in a good place and that monetary policy decisions will be taken meeting by meeting, following a data-dependent approach.
- 2) When asked whether she is excluding the possibility of raising rates in the future, she replied that she would not exclude anything.
- 3) President Lagarde played down the decline in inflation below target in 2026 forecasts, arguing that this is a minor deviation that can be disregarded.
- 4) Both in the statement and during the press conference, the EA economy was described as resilient.
- 5) President Lagarde refrained from commenting on the pass-through of the stronger EUR exchange rate to inflation.

We stick to our call. Despite the hawkish-leaning rhetoric, we continue to expect the ECB to deliver two rate cuts by year-end, taking the depo rate to 1.50%, for the following reasons:

- 1) The growth outlook remains weak (even in the ECB's forecasts, despite their constructive rhetoric on growth).
- 2) Risks to the growth outlook remain tilted to the downside.
- 3) While inflation is already at target, wage growth continues to slow down, and tariffs represent an additional downside risk to inflation. Meanwhile, the ECB's current staff forecasts, which already foresee a decline in inflation below target in 2026, are built on the assumption of at least one more rate cut. Against this backdrop, two additional cuts might be needed to avoid an excessive decline in inflation below target.
- 4) While the German fiscal package might lend a helping hand to the EA economy, its impact will only be felt in 2026.

PBoC – On a summer pause

The PBoC is expected to pause monetary easing over the summer, resuming further rate and RRR cuts in early Q4 as growth concerns re-emerge. We forecast 40bps of rate cuts and up to one additional RRR reduction. The yuan is expected to remain weak due to the PBoC's dovish stance and ongoing pressure from elevated US tariffs.

PBoC on summer pause. Following the latest round of monetary easing that began in May, we anticipate the PBoC will remain on hold over the summer months. We anticipate that the next wave of policy rate and RRR cuts will be deferred until Q4, when growth concerns may re-emerge.

We expect new cuts by early Q4. Looking ahead, we expect an additional 40 basis points of policy rate cuts by early Q4, along with up to one final reduction in the reserve requirement ratio (RRR). As we have previously noted, the scale and timing of further easing will largely depend on how the economy absorbs the impact of US tariffs.

We continue to expect the yuan to remain weak for the remainder of the year. The PBoC's dovish stance will likely keep the currency weak (with USDCNY above 7.0), particularly as elevated tariffs continue to weigh on Chinese export channels. Against this backdrop, the central bank is expected to maintain a supportive policy approach to bolster external trade.

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IMPORTANT DISCLOSURES

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