

Macro Outlook

NOT SO FAST

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In the US, we stick to the view that the economy will slow down in Q3 before beginning to reaccelerate in Q4. In aggregate, incoming data remain consistent with our baseline that final private domestic demand is on a gentle slowdown, which will likely flatten entering Q4 as inflation peaks and fiscal policy's support to investment starts to kick in, preventing the US economy from entering recession this year.

In the EA, incoming data point to anaemic, growth momentum, and we have left our baseline unchanged. Manufacturing activity has returned to contraction, while services are proving to be a weak offsetting force. Meanwhile, employment growth continues to advance on its downward trend, leaving productivity per worker nearly flat in Q2.

In China, policymakers launched targeted interest subsidies for households and service sectors in order to further stimulate an activity pick up in those sectors. We expect a positive, albeit limited, impact on GDP as we stick to our current GDP baseline: structural imbalances and deflationary pressures are set to persist. We continue to expect GDP growth to gradually pick up throughout the rest of the year.

In the US, incoming inflation data along the price chain are under the spotlight as they report mounting pressure (or the lack thereof) where we and the market least expect it. In a nutshell, they point to little evidence of tariff pass-through on goods, while showing a pick-up in services momentum. We take both unexpected dynamics with a grain of salt. On the goods side, yes, tariff-related pressures have been coming in slower than we anticipated, but we think they have room to increase further over the coming months. Meanwhile, on the services side, we expect the July increase in consumer prices momentum to be short-lived, but unexpected developments at PPI level warrant close attention. Against this backdrop, the projected shape of our baseline is unchanged.

In the EA, headline and core HICP inflation were unchanged in July. Beneath the surface of core dynamics, services inflation eased markedly, but this was offset by firmness in core goods. We see some evidence that firmness in core goods might have been driven by seasonal volatility, while softness in services might be more structural, suggesting that underlying core disinflation dynamics are here to stay. We maintain our baseline for a disinflation process that will continue throughout the year.

China's inflation stalled in July, with CPI flat and core prices slightly higher. Deflationary pressures are set to persist into 2025 amid ongoing domestic demand weakness.

We stick to our view that the Fed will cut rates twice this year, in September and in December. The Fed is now overweighting downside risks to the labor market and underweighting upside risks to inflation. Pending finalisation of our 2026 outlook, we expect the Fed to take the Fed fund rates to 3.00-3.25% next year.

As the ECB seems 1) content with growth momentum hovering close to zero this year and 2) willing to run the risk of undershooting its inflation target so as not to find itself in the position of having to chase inflation in case German fiscal expansion turns out to be inflationary, we now expect the Governing Council to cut rates only once this year (in December) as opposed to twice (September and December) as we previously projected.

We expect the PBoC to pause easing this summer, resuming in early Q4 with 40 bps of rate cuts and possibly one more RRR reduction, as growth concerns persist. The yuan should stay weak amid a dovish stance and sustained pressure from high US tariffs.

GROWTH

US - Sunshower

We stick to the view that the US economy will slow down in Q3 before beginning to reaccelerate in Q4. In aggregate, incoming data remain consistent with our baseline that final private domestic demand is on a gentle slowdown that will likely flatten entering Q4 as inflation peaks and fiscal policy's support for investment starts to kick in, preventing the US economy from entering recession this year.

Growth volatility continues – Part 1: Q2. Real GDP growth bounced back 3.0% in Q2 after contracting by -0.5% in Q1. As in the case of Q1, though, we think that the Q2 print overstates the strength in activity in the same way as the prior quarter's decline exaggerated the weakness. After imports surged in Q1 in anticipation of tariff increases (subtracting 4.7pp from growth), they plunged in Q2, contributing more than 5pp to the reported GDP expansion.

The spending core that matters. Therefore, we remain of the view that the best indicator to look at to understand how the US economy is performing beneath the surface is private domestic final purchases (PDFFP), which combines consumer spending and private fixed investment. In aggregate, the measure slowed to 1.2% q/q SAAR in Q2 from 1.9% in Q1. The moderation was driven by a sharp payback in business fixed investment, which grew by just 0.4% after rising 7.6% in Q1, while consumer spending accelerated to 1.4% in Q2 after rising 0.5% q/q SAAR in Q1.

Don't get carried away. While some commentators downplayed the faster growth in private consumption relative to Q1 arguing the acceleration was merely an artefact of a strong consumption growth in March, which arithmetically contributes to a significant carry-over effect in Q2, we remain of the view that household spending will continue to support growth, albeit remaining on a gentle slowdown trajectory.

The reason is twofold:

1) While it's true that real personal goods spending declined by -2.9% SAAR in the three-month period that ended in June, we believe the slowdown was more of a payback after the surge in goods spending in March (+1.5% m/m) which was likely due to tariff anticipation. Indeed, 0.5pp of that rise was concentrated in durable goods spending.

Recent retail sales data appear to validate this approach. The strong increase in the control group reported for July (0.5% m/m) came on the heels of sizeable upward revisions to May and June data (+0.4pp cumulative), implying a stronger trajectory of goods spending in Q2 and a stronger carryover effect for Q3. We do not rule out that either in the second or in the third GDP estimate, preliminary household spending estimates might be revised up.

2) Although services spending has slowed compared to the 2024 trend, it remains positive. This is consistent with indications from the ISM services index which remains in expansionary territory but has now hovered for four consecutive months close to the non-expansionary zone and to the low end of the range seen over the post-lockdown period.

Growth volatility continues – Part 2: Q3. Against this backdrop, going into Q3, we maintain our call that consumer spending will continue to show decent positive contribution to growth. This should be consistent with the GDP growth pace that is likely to have eased to 1.0% q/q SAAR.

Contrasting signals from the labour market help feed alternative narratives. On the one hand, the July increase in employment creation (although small), combined with low and declining jobless claims, support the view of those believing that the state of the labour market remains consistent with an economy that is on a gentle slowdown. As we discuss in greater detail below, we find ourselves in this camp. In our view, the relatively low unemployment rate and stable JOLTS data show little labour market slack, explaining why low payroll job gains can be consistent with full employment, given the deceleration in the labour force from policy-related changes in immigration policy.

On the other hand, however, the substantial revision to the prior two months has provided more confidence to those focusing on the slowdown in labour markets to infer downside risks to economic activity.

A possible way out. Without the ambition to solve the dilemma and while suspending judgement over the quality of the data - the 258k downward revision to May and June NFP data cannot go unnoticed, as it was 4-5x larger than the median absolute revision since 1979 - we tried to quantify empirically the importance carried by front-month versus revised data in isolation.

We have reason to believe that we are not on the brink of a contraction. Our econometric analysis shows that payroll revisions carry only limited information about recession risk, with current-month employment changes proving more telling. A probit regression of payroll revisions on expansion versus recession shows that the 258k downward revision corresponds to a 9pp increase in recession probability (all else equal). However, when the current month's payroll gain is included as an additional explanatory variable, the statistical significance of revisions disappears.

Our bottom line. July's payroll increase of +73k likely sends a stronger macro signal than the unusually large downward revisions. In short, if the question is which signal matters more between the signal from July employment (+73k) or the revisions to the June and May employment data (-258k); the answer is the former.

Could this time be different? Possibly. But historically, sharp slowdowns in the initial NFP estimate have shown a stronger correlation with recession risk than revisions to past data. For that reason, we place greater emphasis on July's numbers - a 73k payroll increase, modest wage growth, a rise in hours worked, and a low unemployment rate - than on the unusually large downward revisions.

The shape of our projected profile is unchanged. In all, the latest estimates for activity align with our outlook that real GDP will register at 1.0% q/q SAAR in Q3, similar to the 1.2% SAAR average pace during H1 2025, amid the wild swings in imports and inventories. For Q4, with some fiscal support from the One Big Beautiful Bill Act beginning to be felt, we continue to expect growth to firm to 1.3% q/q SAAR, although the latest rounds of tariff announcements and the weaker pace of payroll employment could introduce some headwinds. The slight upward revision to Q3 and Q4 forecasts (respectively, +0.2pp and +0.3pp) compared to our previous baseline is due to the fact that evidence of tariff pass-through on consumer prices has remained scarce so far.

ANIMA baseline. Our forecast for H2 2025 remains largely unchanged. Considering a slightly stronger Q2 print (3.0% q/q SAAR) than our initial assumptions (2.2% our estimate), and after folding in the latest data, we now expect Q3 GDP growth to slow at 1.0% q/q SAAR (vs 0.8% in the prior forecast) from 3.0% in Q2. For Q4 2025 we forecast 1.3% (vs 1.0% in the prior baseline). This is consistent with an annual growth rate of 1.7%.

EA - On the razor's edge

Incoming data point to anaemic, area-wide growth momentum, and we have left our baseline unchanged. Manufacturing activity has returned to contraction, while services are proving to be a weak, offsetting force. Meanwhile, employment growth continues to advance on its downward trend, leaving productivity per worker nearly flat in Q2.

Nothing exciting. Despite facing expected challenges from increased US tariffs, payback effects, and ongoing uncertainty, the Q2 EA GDP growth print came in slightly higher than expected at 0.1% q/q (vs 0.0% consensus and ANIMA forecast) from the 0.6% increase in Q1, which had been artificially boosted by front-loaded US demand. However, although Eurostat's Q2 spending breakdown is not yet available, from details of some national prints we can deduce that: 1) growth dynamics remained uneven across major EA economies; 2) the underlying growth trajectory points to anaemic yet slightly positive momentum.

More in detail:

1. Both Germany and Italy recorded contractions of -0.1% q/q in Q2.
2. The French economy expanded by 0.3% q/q. However, domestic final sales were soft, contributing only 0.05% pts to the gain, and net exports were a drag of 0.2% pts due to a rise in imports. That left a 0.5% pts contribution from inventory changes explaining the growth of GDP in Q2 2025. According to INSEE, this was related mostly to stock building in aeronautics and, to a lesser extent, in the automotive sector.
3. Spain continues to be the sole outperformer (+0.7% q/q in Q2), keeping aggregate EA growth afloat, but some signs of trouble are emerging. Consumer spending momentum remained solid (+0.8% q/q), though gross fixed investments slowed for the third consecutive quarter (a cumulative decline of 1.8pp since Q4 2024).
4. Finally, Ireland – whose Q1 figures were heavily distorted by front-loaded US import demand – saw a moderate correction, with GDP falling by 1.0% q/q after surging by 7.4% q/q growth in Q1. The unwinding of Q1 front-loading seems to have weighed less on Q2 than we initially expected.

Stripping out the volatility induced by US trade policy developments, the underlying picture points to anaemic activity for Q3. Manufacturing activity - after the notable jump due to front-loading issues from US imports between February and March - has returned to flirting with contraction. Industrial production excluding construction fell by 1.3% m/m in June, after expanding at a lower rate than previously reported in May (1.1% m/m compared to 1.7% previously). This represents a negative carryover for manufacturing activity entering Q3, which aligns with the weak guidance coming from the more timely soft data (PMI, EC). In contrast, the services sector appears broadly stable, likely benefiting from summer hospitality activity. Finally, area-wide hiring showed some further softening. Latest employment growth data for Q2 came in at 0.1% q/q, down from 0.2% q/q in Q1: employment growth continues to advance on its downward trend. Our estimate of productivity per worker is nearly flat in Q2, with a weak +0.1% q/q SAAR growth, significantly below the recent 0.8% average.

Turning the page on tariff impact, we do not alter our H2 2025 baseline. In our view, the reported deal between US and EU is broadly consistent with what we have embedded as part of our existing base case. Granted, our macroeconomic forecasts were conditioned on an assumption of a 10% “baseline” tariff for the EU, rather than 15%, which is the current level set by President Trump against the EU. However, we

estimate that an additional 5pp would have only a marginal impact on the projected cumulative GDP loss over our forecast horizon. In part, this is because the change in the effective tariff rate on the EU would be small – we estimate that under such a deal it would increase to 10.7% from around 9% at present. Also, we believe that more than half of the overall impact arises from trade policy uncertainty and the indirect spillovers from higher tariffs on the rest of the world. Therefore, the GDP impact does not rise one-to-one with the change in the US tariff on the EU.

ANIMA baseline. Our sequential baseline path remains unchanged. We continue to expect EA GDP for Q3 to settle at 0.1% q/q, while for Q4 we continue to forecast a 0.2% gain. Overall, this is consistent with 2025 real GDP at 1.2% (+0.1pp from the prior baseline).

China – Incoming fresh fiscal push amid export resilience

China's trade growth accelerated in July, beating expectations, driven by stronger exports to the EU and emerging markets, while shipments to the US and ASEAN declined. Meanwhile, import growth was broad-based. Export momentum is set to moderate in H2, due to softer global demand, fading US front-loading, and high tariffs. Furthermore, following the July Politburo meeting, policymakers launched targeted interest subsidies for households and the service sector, in order to further stimulate an activity pickup in those sectors. We expect a positive, albeit limited, impact on GDP as we maintain our current GDP baseline: structural imbalances and deflationary pressures are set to persist. We continue to expect GDP growth to gradually pick up towards 5.0% throughout the rest of the year.

External trade accelerated in July. China's trade growth picked up in July, exceeding consensus expectations. The rebound in headline exports was driven mainly by stronger shipments to the EU and emerging markets, while exports to the US and ASEAN declined sequentially. In particular, automobile exports slowed to +18.6% y/y from +23.1% in June, while rare earth ore and mineral exports surged by around 44% (seasonally adjusted). On the other hand, import growth also strengthened on an annual basis, broad-based across major partners and product categories. Looking ahead, we expect exports to remain resilient in H2, but without significant acceleration as global demand softens and US front-loading ends. The effective tariff rate on direct exports to the US is about 41% (11% inherited + 20% fentanyl + 10% reciprocal tariff) and could reach 71% for transshipped goods (11% inherited + 20% fentanyl + 40% transshipment tariff). In our view, narrowing China-RoW tariff differentials and tighter US enforcement reduce the incentive for tariff evasion via transshipment, capping China's export momentum.

Policymakers launched targeted interest subsidies for consumers and service-sector businesses. In August, and following the July Politburo Meeting, policymakers announced two temporary interest subsidy programs, starting in September, for household consumer loans and loans to targeted service sectors (restaurants, tourism, entertainment, childcare, and elderly care). Eligible borrowers will receive a 1pp fiscal interest subsidy, with an estimated cost of up to RMB 80bn over 12 months - likely already budgeted for 2025, and thus not included in our additional easing assumptions. Funding will be split 90% by the central government and 10% by local governments, mirroring the consumer goods trade-in scheme launched in December 2024. While supportive of consumption and services, these piecemeal measures are small and gradual compared to past large-scale easing, so we expect their incremental GDP impact to be limited.

Incremental fiscal push remains unavoidable as structural imbalances persist.

The economy still faces entrenched structural challenges, including imbalances between production, consumption and investment, alongside ongoing deflationary pressures and muted sentiment within the housing sector. We expect continued but measured fiscal support: new initiatives for the housing sector might be in the pipeline as authorities consider asking state-owned enterprises (SOEs) to help digest around 408 million square metres of unsold houses from distressed developers. In our view, we continue to think policymakers are likely to maintain a data-dependent, gradual approach, with no major bazooka-style measures in sight.

ANIMA baseline. We stick to our baseline and project GDP growth to slow to 4.7% y/y in Q3 before edging up to 4.9% in Q4. After stronger-than-expected Q2 growth, we now forecast full-year 2025 GDP at 5.0%, matching 2024's pace.

INFLATION

US – Where you least expect it

Incoming inflation data alongside the price chain are under the spotlight as they report mounting pressure (or the lack thereof) where we and the market least expect it. In a nutshell, they point to little evidence of tariff pass-through on goods, while showing a pick-up in services momentum. We take both unexpected dynamics with a grain of salt. On the goods side, yes, tariff-related pressures have been coming in slower than we anticipated but we think they have room to increase further over the coming months. Meanwhile, on the services side, we expect the July increase in consumer prices momentum to be short-lived, but unexpected developments at PPI level warrant close attention. Against this backdrop, the projected shape of our baseline is unchanged. We remain of the view that inflation will peak this year before heading towards target next year, albeit slightly later than we previously expected on both accounts, amid technical and mechanical considerations.

No news, bad news? Core CPI momentum matched expectations in July (0.3% m/m), broadly in line with the six-month moving average (6mma). The internals of the report, though, were quite interesting. They showed inflationary pressures - or lack thereof - coming from where we were expecting them least.

Limited tariff impact thus far. On the goods front, signs of tariff-driven inflation remain muted. Core goods momentum slowed in July, coming in at 0.21% m/m, a tick above the 6mma. Excluding used cars, core goods inflation deceleration was even more pronounced at 0.17% m/m.

Items facing high tariffs mostly saw a moderate pace of pass-through. Among those consumer goods mostly exposed to duties, *IT items* dropped -1.7% m/m (vs. 3mma of 0.1%), *households appliances* declined -0.9% m/m (vs. 3mma of 1.2%), *households furnishing* eased to -0.7% m/m (vs. 3mma of 0.5%), *apparel* edged down -0.1% m/m (vs. 3mma of -0.1%) and *new vehicle* prices were unchanged (vs. 3mma of -0.2%). Meanwhile, signs of tariff-related pressures were recorded in *hardware & equipment* (+1.6% m/m vs. 3mma of 0.3%) and in *motor vehicles parts & equipment* (+0.3% vs. 3mma of 0.2%).

Along the goods prices chain, indications are of slow yet continued pressure build-up. Excluding food and energy, core goods PPI momentum was 0.4% in July, slightly above the 0.3% average in H1, which was already above the 2024 average. Further supporting the idea that tariffs continue to be passed through, albeit slowly, the surge in aggregate goods PPI momentum (+0.7%) was concentrated in food (+1.6%

vs 6mma of -0.3%) and energy (0.9% vs 6mma of -0.5%), two categories that are notoriously volatile and that have been hit by tariffs less than the remaining core goods items.

The higher up the chain you go, the less clear the pressure becomes. Furthermore, prices for imported capital goods rose 0.1% m/m, and for imported consumer goods (excluding autos) rose 0.4% (vs. 6mma of -0.2% and -0.1% respectively). Although the increase may not be directly related to tariff pass-through as import prices data are reported pre-duties, it still represents a development that speaks in favor of our assumption that more tariff-related inflation is in the pipeline, albeit perhaps indirectly.

The increase in import prices could be driven by two factors. Either it shows that exporters are not materially cutting their prices to offset the increase in tariffs, or that the weak USD (which is anyway a macro-corollary of tariffs) is providing less inflation shelter from foreign price pressures than it usually does.

Too slow to be true. Although tariff evidence within the goods sector has been weaker and slower than even our more conservative than consensus baseline had assumed, we expect tariff-related cost pressures will continue to pass through to consumer prices over the coming months.

Give me a reason. Potential reason(s) for the delay in pass-through so far is likely due to inventory front-running in Q1, and the fact that the effective tariff rate being paid, on aggregate, was still tracking "only" close to 10% through June, due to trade diversion and cautious business pricing strategies amid ongoing uncertainty over the US administration (re)action function on the subject.

That said we retain our call that the impact on core consumer goods price inflation will be limited and temporary. For several reasons:

- 1) Business pricing power is far more limited than during the last inflation crisis (2021-2023) as the economy is far less buoyant than during reopening;
- 2) Corporate margins are much higher than during the first trade war;
- 3) Some trade diversion remains possible;
- 4) Tariff socialism is on the rise. Global businesses reportedly are inclined to spread some of the potential US tariff related prices hike on to their clients across the globe;
- 5) US households spending power is now concentrated in the hands of the wealthier;
- 6) The impulse from US fiscal policy is neutral, and wage growth has normalised.

What does this mean for our goods inflation baseline? Acknowledging a slower-than-anticipated tariff pass-through along the goods prices chain combined with our expectation that we are still far from the peak in the tariff-pass-through, we have slightly postponed the peak in goods inflation we previously anticipated in our baseline. We now expect core goods PCE inflation to peak in October (vs August previously). However, we maintain our view that the tariff shock will be temporary under the assumption arguments listed in the previous paragraph hold and barring catch-up effects from the services sector (see below for more details).

Embrace diversity. If developments within the goods basket were broadly in line with those unfolded since the tariff saga started albeit slightly slower than we had anticipated, the July increase in "supercore" momentum surprised both us and the market to the upside. Non-housing core services momentum surged 0.4% compared to a 3mma of 0.2%.

Don't be scared. We do not believe this is a resumption of an overheating trend. For the following reasons:

1) Most of the “supercore” upside in July was driven by volatile components. Airline fares rose 4.0% m/m, partly reversing a sharp year-to-date decline. Moreover, much of the sequential increase in “supercore” CPI came from *medical services* prices. Here, *dental services* rose by a strong 2.6% m/m, the highest monthly reading in the series’ history. This component tends to have a low response rate, meaning there is limited signal from an upside surprise in July. Excluding these two components, “supercore” CPI inflation was just 0.28% in July, just 0.1pp above the pre-COVID average.

We believe that the notoriously volatile items which boosted “supercore” momentum will mean-revert over the coming months, possibly as early as August. In contrast, some components of inflation more closely linked to consumer demand showed signs of overheating between June and July, such as *recreation services*, which have risen by 0.5pp cumulatively since May, compared to -0.1% over the past 3mma. This, in isolation, could indicate that domestic demand is not slowing down excessively, while not providing a meaningful lift to overall “supercore”.

We do not expect domestic demand to overheat. While consumer spending and investments remain on solid footing, we do not expect them to accelerate in the coming quarters. Nor do we anticipate the labour market tightening, as incoming data show that the current low-hiring-low-firing equilibrium is unlikely to change any time soon. This should prevent wage inflation from re-accelerating.

What does this mean for our services inflation baseline? Nothing. For the reasons listed above, we remain of the view that the state of both domestic demand and the labour market is consistent with a continuation of the core services disinflation trend started in H2 2023, including for the housing services sector. Therefore, we continue to expect non-tradable goods disinflation to retake the lead in core disinflation once the slow and temporary impact of tariffs on goods prices will be exhausted in Q3 this year.

Where is the risk? If we exclude the most obvious, including a re-intensification or broadening of the tariff war via merchant sectors, the main risk we envisage at this stage pertains to a potential, largely unexpected, inflation spillover into goods coming from the services sector PPI.

Our baseline has always been that tariff will mainly hit goods. However, along the prices chain, we detected in the latest PPI report some developments that should not be dismissed simply because it unfolded outside the tariff-sensitive goods box.

Services PPI surge under the microscope. Core services PPI accelerated 1.1% m/m, the largest advance since March 2022, with more than half of this increase attributable to trade margins for wholesalers and retailers. Taken literally, this would imply that merchants’ pricing power was strong in July. The large increase in gross margins (trade services) among wholesalers and retailers could be a sign that the tariff pass-through is still working its way to consumers. Moreover, core services PPI excluding trade, transportation and warehousing - the subcategory that contains most of the inputs relevant for core PCE - also accelerated to 0.7% m/m, amid large gains in financial services. Therefore, we recommend paying particular attention to services PPI data going forward.

ANIMA baseline. The latest CPI inflation data show preliminary and tentative signs of tariff-related price pressures. However, such evidence is emerging in a mixed fashion from month to month. Our fundamental views on inflation remain largely unchanged following July’s data, as we did not learn much from this release. We continue to expect tariff-related cost pressures to show up more materially in goods prices in the coming months (as evidenced in PPI and import prices details), and we maintain the view that the increase in goods inflation will be temporary. We have consistently held the view that tariffs would begin to affect retail prices more materially in H2 2025, although

prior to June's data, we had expected the effect to peak over the summer months. We now have peak effects pencilled in for September–October. Granted, we continue to expect this to be largely offset by a decline in core services inflation, supported by a gradual slowdown in wage growth.

We now expect core CPI momentum to peak at 0.39% m/m in October, led by core goods CPI, which we expect to peak at 0.89% m/m in October. In terms of quarterly profile, we expect core CPI at 3.0% y/y in Q3 2025 (vs 3.1% in the prior baseline) and 3.1% in Q4 2025 (vs 3.0% in the prior baseline). This remains consistent with an annual average of core CPI at 3.0%. In core PCE terms, we expect 3.0% y/y for Q3 2025 and 3.3% for Q4 2025, consistent with an annual average of 2.9% (+0.1pp above the prior forecast). Under our slightly revised baseline, we now expect core PCE to get close to the target in September 2026, compared to June 2026 previously.

EA - The descent continues

Headline and core HICP inflation were unchanged in July at 2.0% y/y and 2.3% y/y, respectively. Beneath the surface of core dynamics, services inflation eased markedly, but this was offset by firmness in core goods. We see some evidence that firmness in core goods might have been driven by seasonal volatility, while softness in services might be more structural, suggesting that underlying core disinflation dynamics are here to stay. We maintain our baseline for a disinflation process that will continue throughout the year.

Headline and core unchanged in July. On the surface, nothing changed in July, with headline euro area HICP inflation stable at 2.0% y/y and core unchanged at 2.3%. Still, we see several interesting takeaways:

- 1) We need to remain cautious about food inflation;
- 2) Goods prices have experienced a temporary uptick, mainly linked to the timing of seasonal sales; and
- 3) Services inflation continues its path towards normalisation.

Within food inflation, pipeline pressures persist. Food, alcohol and tobacco (FAT) inflation continued to climb in July, rising by 0.2pp to 3.3% y/y. The increase was once again largely fueled by unprocessed food, with the annual rate accelerating to 5.4% from 4.6% in June. Processed food inflation also inched higher, ticking up to 2.7% from 2.6% y/y. The monthly momentum remains firmly above historical averages, and we expect this to continue in August, even if we think July looked exceptionally strong. This means that FAT inflation has now accelerated by a cumulative 1.0pp since January, consistent with signals from upstream food prices and EC selling price expectations, which have been pointing to building inflationary pressure for some time. However, we do not believe that the upward trend in food inflation will persist for long. In fact, we note significant heterogeneity across countries and products. Among countries, FAT prices are moderating significantly in Germany, Belgium and the Netherlands, but remain particularly sticky in Italy, Spain and France. Among the products with the strongest momentum, we find meat, milk, cheese and eggs, fruits, sugar products, and non-alcoholic beverages. On the contrary, oils and fats are currently deep in deflation (we estimate -9.0% y/y in July) and vegetables have slipped slightly into negative territory (-1.0% y/y). Consequently, we believe that food inflation is undergoing a process of realignment between countries and products, which will take some time to adjust.

Core goods: temporary upside from sales. NEIG inflation accelerated by 0.3pp to 0.8% y/y due to an increase in sequential momentum by 1.2pp to 2.0% m/m SAAR. This comes after core goods momentum had been broadly stable at below 1.0% m/m SAAR

for more than a year. We suspect that weaker-than-usual summer sales for semi-durable goods contributed to July's acceleration. This aligns with the observation that clothing and footwear prices in NRW, Germany's largest state, fell less sharply than in previous years (-3.1% m/m NSA vs -4.9%/-3.9% in July 2023/24). Consequently, we mark July's NEIG uptick as a temporary, summer-related blip, and expect NEIG inflation to continue to normalise in line with its pre-COVID path over the coming months. In addition, the absence of EU retaliation in the US-EU trade deal removes one upside risk to core goods inflation in the months ahead.

Services inflation fell significantly in July. Services inflation eased by 0.2pp to 3.1% y/y, due to a notable decline in sequential momentum by 2.6pp to 2.0% m/m SAAR. We believe it is crucial to look past the volatility in tourism-related items to gauge the true underlying momentum. Using available CPI data for Germany, Italy, and Belgium, we can track EA package holidays and airfares in July and estimate EA services inflation excluding tourism-related components. Our estimate points to a decline to 3.0% y/y in July from 3.1% in June - a larger drop than the average -5bp seen since December 2024, although it follows a pause in June. This supports our long-standing view that services inflation is gradually easing.

Disinflation in services continues to move in a favourable environment. During the first week of August the ECB released its wage tracker, now up to Q1 2026. From 3.8% y/y in June 2025, the wage tracker is projected to fall to 1.7% in Q1 2026. Despite its numerous flaws, the wage tracker confirms the ongoing downward trend in wages.

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 – Lingering summer deflation

China's inflation stalled in July, with CPI flat and core prices slightly higher. PPI deflation held at -3.6% y/y. Deflationary pressures are set to persist into 2025, amid ongoing domestic demand weakness.

Inflation zeroed in July. Consumer prices remained weak in July, with inflation flat after a brief rise in June. Core CPI inched up to 0.7% y/y from 0.6%, driven by higher services inflation, while core goods prices eased.

PPI deflation took a pause. Producer prices were unchanged in July, as factory gate price deflation steadied at -3.6% y/y, with both consumer and producer goods prices showing little changed.

We expect domestic deflationary pressure to persist into Q3. Sluggish price momentum signals weak household consumption. The Chinese economy's uneven recovery – with supply outpacing demand – has created a demand-supply gap, fuelling deflation. With external demand uncertainties, lingering tariffs, and fading energy price volatility, insufficient domestic demand is likely to remain the main drag on consumer prices, keeping downward pressure through 2025.

ANIMA Baseline. Against this backdrop, we stick to our baseline and expect full-year inflation for 2025 to stabilise at 0.2%, up from 0.1% in 2024. In sequential terms, we anticipate headline inflation to unfold as follows: 0.0% y/y in Q3, 0.2% in Q3-2025 and 0.8% in Q4.

MONETARY POLICY

FED – RESUMING RATE CUTS

We stick to our view that the Fed will cut rates twice this year, in September and in December, taking the Fed funds rates to 3.75-4.00%. While easing financing conditions, the still sound economic growth and upside risks to inflation would justify the Fed remaining on hold in September, Chair Powell's speech at Jackson Hole made it clear that the Fed is now overweighting downside risks to the labor market and underweighting upside risks to inflation in its reaction function. Beyond 2025, and pending finalisation of our 2026 outlook, we expect the Fed to deliver three additional rate cuts and take the Fed fund rates to 3.00-3.25%, the level considered neutral by the Fed. The timing of these cuts is uncertain at this stage. Our call is fairly in line with market expectations in terms of the number of cuts (markets expect the Fed to reach neutral by September 2026).

A dovish shift in rhetoric opens the door to a 25bp rate cut in September. The internal division within the FOMC has gathered momentum in the last month, with more members joining the dovish camp after the unprecedentedly large downward revision to May and June NFP. Chair Powell surprised markets at Jackson Hole, joining the trend and shifting to a much more dovish rhetoric compared to the July FOMC meeting, paving the way for resuming rate cuts in September.

1) In the opening paragraph of his Jackson Hole speech, Chair Powell said, "The balance of risks appears to be shifting".

2) At the conclusion of his speech, he added, "With policy in restrictive territory, the baseline outlook and the shifting balance of risks may warrant adjusting our policy stance".

3) No conditions were mentioned for rate cuts to occur (e.g. weak labour market data), which suggests to us that the bar for not cutting rates in September is very high.

Proceed carefully. While opening the door to rate cuts, Chair Powell conveyed the idea that the Fed will still proceed carefully in delivering further monetary policy easing. For the following reasons: 1) The policy rate is only moderately restrictive. 2) The unemployment rate, as well as other labour market measures are still stable. 3) While the Fed's base case is that the tariff-related inflation increase will just be temporary, the adjustment process could be long, potentially increasing risks of second-round effects. 4) In his speech, Chair Powell admitted clearly that while risks to the labour market are to the downside, risks to inflation are to the upside, with the Fed facing a challenging situation as its two goals conflict.

We stick to our call for 2025. Against this backdrop, we stick to our call and expect the Fed to cut rates twice this year in September and December, taking the Fed funds rates to 3.75-4%. Easing financing conditions, the still sound economic growth and upside risks to inflation would justify the Fed remaining on hold in September. However, Chair Powell's speech at Jackson Hole made it clear that the Fed is now overweighting downside risks to the labour market and underweighting upside risks to inflation in its reaction function.

Beyond 2025, we expect the Fed to continue cutting rates to neutral. Pending finalisation of our 2026 outlook, we expect the Fed to deliver three additional rate cuts in 2026 and take the Fed funds rates to 3-3.25%, the level considered neutral by the Fed. The timing of the rate cuts is highly uncertain at this stage and depends on: 1) Developments in the labour market and inflation outlook. 2) The amount of political pressure on the Fed. 3) Who the next Fed Chair will be. Our call is fairly in line with

market expectations in terms of the number of cuts (markets expect the Fed to reach neutral by September 2026).

ECB – IN DOUBT, MOVE THE GOALPOST (AND YOUR FORECAST)

As the ECB seems 1) content with growth momentum hovering close to zero this year and 2) willing to run the risk of undershooting its inflation target so as not to find itself in the position of having to chase inflation in case German fiscal expansion turns out to be inflationary, we now expect the Governing Council to cut rates only once this year (in December) as opposed to twice (September and December) as we previously projected. We remain of the view that the EA economy needs more support, especially in the face of strong services disinflation and uncertain macro spillover from the German package amid still elevated global uncertainty.

We now expect the ECB to cut rates only once this year (in December). This compares with our previous expectation of two 25bp cuts in September and December.

The reason is twofold:

- 1) The ECB is seemingly becoming less focused on inflation, especially if the trend is downward.
- 2) Although economic activity developments have unfolded broadly in line with our growth baseline, they remain comparatively better than those projected by the ECB, especially for Q3 (in Q3, ECB June staff forecasts project -0.1% q/q GDP growth, while August PMIs are consistent with 0.0-0.1% q/q GDP growth).

It's all relative. We would have expected the ECB to put more weight on the sharp core disinflation process that has unfolded since January, especially in the services sector, rather than on the Governing Council being reassured by a meagre growth outlook simply because it's better than what they had been expecting.

Trying to square the circle. A possible reason for such a passive-aggressive approach by the ECB could be that the Governing Council is, on the one hand, willing to take the risk of undershooting the target amid the prolonged and sizeable overshoot that occurred since reopening and, on the other, is influenced by expectations that fiscal expansion in Germany may cause inflation to re-accelerate.

The jury is still out, yet the verdict is here... for now. Neither these assumptions can be verified at this stage. We can only infer them by resorting to a counterfactual approach. In other words, absent clear and transparent communication from the ECB, we believe that's the only way we can reconcile with a central bank that refuses to keep easing monetary policy despite:

- 1) Growth remaining close to zero amid weak domestic demand
- 2) Headline inflation already at target and surrounded by downside risks as services and wage disinflation continue
- 3) A tariff scenario of 15%, which is, albeit marginally, slightly worse than that assumed by the ECB (10%) initially.

PBoC – Summer rest

We expect the PBoC to pause easing this summer, resuming in early Q4 with 40 bps of rate cuts and possibly one more RRR reduction, as growth concerns persist. The yuan is expected to remain weak amid a dovish stance and sustained pressure from high US tariffs.

Summer rest. After easing in May, the PBoC is expected to hold policy steady through the summer, with the next rate and RRR cuts likely deferred to early Q4, as growth risks resurface. We foresee around 40 bps in rate cuts and possibly one final RRR reduction, with timing dependent on the economy's response to US tariffs.

Yuan set to stay weak. The yuan is likely to remain weak (USDCNY above 7.0) for the rest of 2025, as a dovish stance and high tariffs weigh on growth. The central bank is expected to maintain supportive policies to aid external trade.

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