

Macro Outlook

DIDN'T MISS MUCH

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In the US, with the end of the government shutdown, data flow has resumed, albeit slowly. The data received so far does not alter our baseline forecast. We remain of the view that the US economy will re-accelerate in Q1 after pausing in Q4 amid the shutdown. We continue to expect the Fed's inflation target to be within reach by the end of next year.

In the EA, we stick to the view that EA growth momentum will accelerate next year led by expansionary fiscal policy in Germany. However, while the balance of risks remains to the downside amid poor growth quality and implementation risks, incoming data suggest that Spain outperformance provides a solid floor for EA growth going forward. We continue to expect real GDP growth in 2026 at 1.0% (versus 1.1% consensus). On inflation, we believe the broader core downward trend is likely to remain in place as the annual reset mechanism comes into play and wage growth continues to ease.

In China, economic data show widespread weakness in October, even if certain technical factors have excessively amplified the weakness. Accordingly, we have moderately lowered our real GDP growth forecast for Q4-25 to 4.2% y/y (from 4.4% in the prior baseline). Heading into 2026, we continue to expect GDP to stabilise at 5.0% over 2026. However, based on the revision of the 2025 figures, we have mechanically revised the full-year forecast for 2026 to 5.0% for 2026 from 5.2%. Our expectation of consolidated growth for next year is linked to the fact that recent government announcements indicate that policymakers may have already started making arrangements to accelerate growth. We maintain our view that China's inflation will remain well below the PBoC target through the forecast horizon.

Monetary policy wise, the Fed cut rates by 25bp, as widely expected, taking the Fed fund rate range to 3.50-3.75%. While Chair Powell started out hawkish, he soon revealed the true dovish nature of the FOMC's stance, shifting the Fed's reaction function from passive to aggressive with respect to labour market risks. Against this backdrop, we continue to expect the Fed to cut rates in March, June and September, by more than the market currently expects. However, consistent with our baseline, which envisages potential cycle and policy-driven overheating pressures, we now believe that the risks point to a lower number of rate cuts.

The ECB's rhetoric continues to lean towards the hawkish side, and we do not expect the 2028 forecasts (to be published in December) to show inflation falling meaningfully below target, given technical, exogenous support related to the unusual incorporation of ETS2 impact into their forecast outlook.

Against this backdrop, we stick to our view that the ECB will stay on hold in December, and cut rates one more time in March, taking the deposit rate to 1.75%. Beyond March, we expect the ECB to remain on hold until the end of 2026, with risks skewed towards the possibility of one additional rate cut.

As we expected, the PBoC held the policy unchanged at its meeting on 20 November. Given that we forecast growth in 2025 to be moderately below the 5.0% target threshold (4.8% according to our forecast), we remain of the view that a rate cut by year-end (22 December) to lay the groundwork for solid growth in 2026 is still on the table.

GROWTH & INFLATION

US – (Data) fog starts lifting

With the end of the government shutdown, data flow has resumed, albeit slowly. The data received so far does not alter our baseline forecast. We remain of the view that the US economy will re-accelerate in Q1 after pausing in Q4 amid the shutdown.

We continue to expect the Fed's inflation target to be within reach by the end of next year.

Consumers stand still on their feet. Between the end of summer and the fall season, consumers were able to remain resilient. High-frequency credit card data show that consumers are showing up for the holidays: according to BAC data (BofA) spending on holiday items in the penultimate week of November was up a robust 4.5% vs the same period 52 weeks ago.

September retail sales figures mask a spending pattern that remains robust. We believe that the retail sales figures for September should be taken with a pinch of salt. Indeed, control group sales (which feed directly into PCE data from the BEA) came in a touch softer than expected at -0.1% m/m compared with 0.6% in August. From a top-down perspective, despite the decline in the month's control group sales, strong spending over the summer suggests real consumer spending rose at a robust 3.2% annualised pace in Q3, up from 2.5% in Q2. From a bottom-up perspective, the September slowdown in control group sales - which excludes cars, gas, food services and building materials - came amid a pullback in nominal sales at clothing stores, sporting goods and hobby stores, and in online purchases. These categories of spending, which were weak in September, saw strong gains in both July and August. It is therefore likely that September saw a pullback effect after two months (July and August) of strong back-to-school spending. Moreover, we note that sales for food service and drinking places (the only services spending category in the retail sales report) remained resilient at 0.7% m/m (from an upwardly revised 1.0% previously), maintaining solid momentum amid a warmer-than-usual September.

Further supporting our constructive take on US consumers, labour markets and labour income remain supportive. Headline NFP employment posted an unexpectedly robust 119k gain in September, even though this was accompanied by downward revisions that, on net, reduced the pace in August (-4k) and July (72k). On the household survey, the unemployment rate (U3) rose to 4.44% from 4.32% in August, the highest since October 2021. However, we note that September's increase in U3 was driven by gains in the labour force (+497k) that exceeded those in household employment (+251k): this suggests that these numbers reflect more good news about participation than bad news about jobholding. Furthermore, payroll income estimates within the September report indicate that labour income remains strongly supportive. Job gains have strengthened, and with June's weak figures rolling out of the three-month window, private payroll income growth accelerated to 4.4% on a 3-month SAAR basis, up from 2.8% in August. Although this pace remains below the expansion's earlier average, it is still robust enough to support real income growth and sustain purchasing power, helping to ease concerns over the resilience of consumer spending among income-sensitive households.

Low-fire, low-hire equilibrium remains in place. While awaiting the NFP reports for October and November (both due to be released by the BLS on 16 December), the indications from claims data which is the most reliable measure for assessing the strength of the labour market in real time, are benign. Initial jobless claims fell by 6k to 216k in the week ended November 22, somewhat below expectations. These are

roughly the same level as they were in 2023 and 2024. The four-week moving average of claims edged down by 1k to 224k. Continuing claims for unemployment insurance remain broadly in line with the trajectory seen over the past two years.

Capex activity remains buoyant. Orders data for September came in rather strong. New orders for durable goods increased by 0.5% m/m, in line with expectations. The increase largely reflected the second consecutive month of higher defence aircraft orders. Durable goods orders excluding transportation (+0.6%), core capital goods orders (+0.9%) and core capital goods shipments (+0.9%) all increased above expectations. August growth was revised up for durable goods orders (+0.1pp to +3.0%), durable goods orders excluding transportation (+0.2pp to +0.5%), core capital goods orders (+0.5pp to +0.9%) and core capital goods shipments (+0.3pp to +0.1%).

Durable goods orders have been consistently strong in recent months, with total orders often boosted by orders of aircraft with orders of durable goods excluding transportation also rising. We note that some strength could reflect increased investment demand from tax incentives included in the fiscal package over the summer as well as AI-related investment demand: for instance, shipments for electronic components (with an average run rate of 9.0% in 6m% chg SAAR terms over the last 3 months, compared to an average of 4.2% in 2024) and computer peripheral equipment (with an average run rate of 49% in 6m% chg SAAR terms over the last 3 months, compared to an average of 10.2% in 2024) are riding a remarkably robust trend.

All of this remains consistent with our economic outlook for 2026. Indeed, a key pillar of our constructive macro baseline through 2026 is the assumption that the US economy is undergoing a structural transformation (see Macro Outlook - STRESS TEST - September 2025).

No relevant news on the inflation front. Core PCE inflation for September came in unchanged from August at 0.2% m/m, in line with expectations. An uptick in core goods PCE inflation was partly offset by softer services inflation. Indeed, a moderate tariff pass-through effect on core goods prices — in line with what we saw in the CPI space — was reported in October, with core goods PCE rising to 0.2% m/m (+0.1pp from August). The run-up here was led by categories such as furniture, clothing and other nondurable goods. In the meanwhile, supercore PCE inflation — core services excluding housing — slowed to 0.22% (vs 0.32% prior) amid a slowdown in financial-service cost increases.

We continue to expect the Fed's inflation target to be within reach by the end of next year. The assumptions behind our baseline remain valid:

- 1) We remain of the view that the tariff shock will be temporary. Incoming data along the goods and services price chain continue to suggest that tariff pressures are gradually easing. To us, this is consistent with businesses struggling to fully pass tariffs on to consumers.
- 2) We expect the services sector to remain on a disinflationary trend. That includes both housing and non-housing components, as wage growth is unlikely to re-accelerate amid a balanced labour market.

ANIMA baseline. On growth, we continue to track Q3 GDP at 2.7% q/q SAAR. For Q4-25, we expect growth to decelerate to 1.4% q/q SAAR, reflecting a mild payback in equipment investment after three consecutive quarters of above-average growth and some impact related to the government shutdown. This is consistent with an annual growth rate of 1.9%. For 2026, we now expect growth of 1.7% q/q SAAR in Q1-26, 1.8% in Q2-26, 2.0% in Q3-26 and 2.1% in Q4-26. This is consistent with an annual growth rate of 2.0%.

The inflation baseline remains unchanged. We expect core CPI to be 3.1% in Q4 2025. This remains consistent with an annual average core CPI of 3.0%. For H1-26 we expect core CPI to average 2.8%, and 2.4% in H2-26. This is consistent with an annual average of 2.6%. We expect the y/y rate to reach 2% at the end of Q3-26. 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%. For H1-26 we expect core PCE to average 2.6%, and 2.3% in H2-26. This is consistent with an annual average of 2.5%.

EA – Looking for inflection

We stick to the view that EA growth momentum will accelerate next year led by expansionary fiscal policy in Germany. However, while the balance of risks remains to the downside amid poor growth quality and implementation risks, incoming data suggest that Spain outperformance provides a solid floor for EA growth going forward. We continue to expect real GDP growth in 2026 at 1.0% (versus 1.1% consensus).

On inflation, we believe the broader core downward trend is likely to remain in place as the annual reset mechanism comes into play and wage growth continues to ease.

Area-wide GDP figures for Q3 came were slightly revised up in Q3 to 0.3% q/q.

Although the expenditure breakdown shows that the largest contribution to growth came from investments (+0.2pp), we remain of the view that the growth remains of poor quality and unbalanced.

The reason is threefold:

- 1) Excluding investments, the second largest contributor to growth was government spending.
- 2) Excluding Spain, private consumption was weak.
- 3) Investments and private consumption boost was largely concentrated in Spain.

Two-speed economy continues. Imbalances between sectors remain pronounced. As evident from quarterly GVA data and timely soft data, the services sector continues to expand, while manufacturing remains a drag, with subcomponents suggesting that the strong gains in the first half of the year were largely the result of US demand front-loading, rather than a self-sustainable recovery.

Our two cents remains on the table. Heading into 2026, we continue to expect EA growth momentum to improve. However, compared to the consensus, we remain moderately more cautious about the strength of the recovery: we forecast economic activity to expand by 0.3% for H1 2026 and 0.4% in H2 2026 (quarter-on-quarter average), with an annual growth rate of 1.0% (versus 1.1% consensus).

Fiscal awakening begins to take shape. In our baseline, Germany's fiscal expansion is behind most of the pickup in activity momentum we forecast. Despite implementation risks still running high, we believe that incoming Federal budget execution data support this view. According to October fiscal data, the German government is slightly behind schedule in terms of its investment and defence spending plans from the core budget (core budget investment reached EUR43.8bn in October, around 70% of this year's target). However, spending momentum has picked up remarkably. Our live fiscal stance tracker, a tool that helps navigate the execution of the German government's spending plans, rose by 0.9pp from August to October and shows that October's spending pickup was mainly driven by food, agriculture, energy & trade services (this item includes energy subsidies to businesses) and infrastructure. Moreover, construction orders data for public structures that we track indicates that there was an uptick in civil engineering orders in September (road construction orders, commercial civil engineering orders, and public civil engineering).

This may possibly be one of the first hard data points responding to the passing of the federal budget.

Believe it until you may not. Even if we maintain the view that German growth momentum will re-accelerate, downside risks remain. Signs that fiscal spending is accelerating are encouraging, but the quality of spending and supply-side bottlenecks cast a long shadow.

Disinflation continues. We continue to believe that in 2026, downward pressures on inflation are likely to dominate. Services inflation between October and November experienced some volatility, but we note that this was caused by HICP components known to be typically noisy (e.g., airfares). The overall trend continues to point downward.

The slowdown will be supported by two factors:

1) **The annual reset mechanism is about to come into play.** Items in the HICP services basket that undergo a mechanical price reset account for 49.5% of EA HICP services. They include housing services, canteens, education services, social protection, health services, insurance and financial services. Typically, January is the month when most resets are implemented. We continue to expect strong downward resets in January 2026, as past inflation has weakened, wages continue to ease progressively, and energy prices remain soft.

2) **The normalisation of wage growth is proceeding smoothly.** The ECB's indicator of negotiated wages for Q3 decelerated to 1.9% y/y, a sharp slowdown from the 4.0% y/y growth in Q2. This decline largely reflected favourable base effects in Germany, driven by the timing of base pay increases and one-off payments occurring in different years due to differentiated tax treatment. However, even if we exclude the German mechanical amplifier effect, the direction of negotiated wage growth remains soft. Moreover, surveys and trackers suggest nominal wage growth will step down from 4.5% in 2024 to around 3% in 2025, and towards 2.5% by end-2026. Evidence of slack in the labour market points to limited pro-cyclical wage drift, even with modest strengthening in growth.

ANIMA baseline. We continue to forecast Q4-25 real GDP growth at 0.2% q/q. This results in an annual 2025 forecast of 1.4%. For 2026, we have left our baseline unchanged. We project growth of 0.3% for H1 2026 (quarter-on-quarter average) and 0.4% for H2 2026. This results in an annual 2026 forecast of 1.0%, slightly below the consensus of 1.1%.

Mechanically, we include in our inflation baseline the results of the October and November HICP prints, which were moderately higher than expected due to some noise on typical volatile components (e.g., airfares/package holidays). We now track core HICP for Q4-25 at 2.3% y/y (vs 2.1% prior baseline). Our forecast for the 2025 annual average stands now at 2.4% (vs 2.3% prior baseline). Mechanically, we have also lifted up the 2026 forecast profile: we now expect core inflation of 2.0% in H1 (vs 1.9% prior) and 1.9% in H2 (vs 1.8% prior), consistent with an annual average of 1.9% (vs 1.8% prior).

CHINA – Downsides under control

Economic data show widespread weakness in October, even if certain technical factors have excessively amplified the weakness. Accordingly, we have moderately lowered our real GDP growth forecast for Q4-25 to 4.2% y/y (from 4.4% in the prior baseline). Heading into 2026, we continue to expect GDP to stabilise at 5.0% over 2026. However, based on the revision of the 2025 figures, we have mechanically revised the full-year forecast for 2026 to 5.0% for 2026 from 5.2%. Our expectation of consolidated growth for

next year is linked to the fact that recent government announcements indicate that policymakers may have already started making arrangements to accelerate growth. We maintain our view that China's inflation will remain well below the PBoC target through the forecast horizon.

China's October economic data showed widespread weakness, especially in property and investment. Most major indicators grew by less than 5% year-on-year, while new property starts fell by nearly 30% y/y. Moreover, the sharp decline in fixed asset investment (FAI) over the past few months was unprecedented, comparable only to Q1-20 during the initial nationwide Covid lockdown. However, we believe that certain technical factors have excessively amplified the weakness in the October data. These include: 1) a high base in last October; 2) fewer working days this October; 3) a potential payback effect after production was front-loaded into September to boost Q3 GDP.

Against this backdrop, we have only moderately lowered our real GDP growth forecast for Q4-25 to 4.2% y/y (from 4.4% in the prior baseline). Our full-year forecast for 2025 now stands at 4.8% (versus 4.9% prior baseline).

Heading into 2026, we continue to expect GDP to stabilise at 5.0% over the year. However, based on the revision of the 2025 figures, we have mechanically revised the full-year forecast for 2026: we now expect real GDP growth of 5.0% for 2026 (down from 5.2% in prior baseline).

Policy in the spotlight. Our expectation of consolidated growth for next year is linked to the fact that recent government announcements indicate that policymakers may have already started making arrangements to accelerate growth in Q1-26. On 31 October, the National Development and Reform Commission (NDRC) announced that RMB 700 billion (including RMB 200bn local government special bond quota and RMB 500bn from a "new financing tool") has been allocated to local governments and infrastructure projects. At the State Council meeting on 14 November, chaired by Premier Li Qiang, construction work on "Two Majors" (referring to major strategic projects and major strategic areas) was discussed. In an interview published on 14 November, Minister of Finance Lan Fo'an stated that fiscal policy will be strengthened to support the economy as the 15th Five-Year Plan begins. Also on 14 November, National Health Commission officials announced that local governments have started distributing national childcare subsidies.

If these measures lead to increased consumption and investment in Q1, they will support our baseline forecast for sequential real GDP growth to rise from 4.2% y/y in Q4-25 to 4.6% in Q1-26, paving the way for our projected 5.0% full-year real GDP growth next year. Otherwise, downside risks to domestic demand and our headline forecast for 2026 would increase.

Persistent weak inflation. We maintain our view that China's inflation will remain low over the next year. We expect CPI inflation to increase only gradually, from 0% in 2025 to 0.8% in 2026. We believe PPI inflation may not turn positive year-over-year until late 2026 or early 2027.

ANIMA baseline. We have moderately lowered our real GDP growth forecast for Q4-25 to 4.2% y/y (from 4.4% in the prior baseline). Our full-year forecast for 2025 now stands at 4.8% (versus 4.9% prior baseline). For 2026 we now expect growth of 5.0% (down from 5.2% prior baseline).

On inflation, we anticipate full-year CPI to settle at zero in 2025, down from +0.1% in 2024. On a sequential basis, we expect headline inflation to evolve as follows: -0.3% y/y in Q3, 0.3% in Q4 2025, and 0.8% in Q1 2026. Headline inflation is expected to recover to 0.8% next year, primarily due to favourable base effects.

MONETARY POLICY

FED - From passive to aggressive dovishness

The Fed cut rates by 25bp, as widely expected, taking the Fed fund rate range to 3.50-3.75%. While Chair Powell started out hawkish, he soon revealed the true dovish nature of the FOMC's stance, shifting the Fed's reaction function from passive to aggressive with respect to labour market risks. Against this backdrop, we continue to expect the Fed to cut rates in March, June and September, by more than the market currently expects. However, consistent with our baseline, which envisages potential cycle and policy-driven overheating pressures, we now believe that the risks point to a lower number of rate cuts.

The Fed cut rates by 25bp, as widely expected, taking the Fed fund rate range to 3.50-3.75%. While there were a few hawkish elements in the Fed's decision, it was not a hawkish cut to the extend many expected. On the contrary, the Fed has retained its dovish bias, in our view.

Hawkish wish vs dovish reality. The December meeting started on a hawkish note:

1) There were three dissenters, one more than in October: Miran, who supported a 50bp rate cut (in line with October), Schmid, who supported no change in policy (in line with October) and Goolsbee, who supported no change in policy, but favoured a rate cut in October.

2) The SEP included few changes to projections for this year, but a significant upward revision to growth in 2026. Indeed, real GDP growth was revised up from 1.8% q4/q4 to 2.3% (versus 2.0% for ANIMA and the consensus). Meanwhile, inflation projections were revised down only slightly suggesting that the Fed still believes tariffs have the potential to push goods inflation up materially from here. The core PCE forecast for 2026 was revised down by 0.1pp to 2.5% q4/q4 (versus 2.0% for ANIMA and 2.5% for the consensus). The unemployment rate forecast for next year was left unchanged at 4.4%. The combination of faster growth, slightly slower inflation and unchanged unemployment rate suggests, in our view, that some members must have assumed faster productivity growth in their forecasts rather than pointing to a less sanguine, tariff-related perception of inflation risks.

3) In line with September, the dot plot signalled only one rate cut in 2026 and a further one in 2027.

4) Chair Powell argued on several occasions that the Fed is well positioned to wait and see how the economy evolves. By inserting language such as "the extent and timing of additional [rate] adjustments", we believe the Fed is signalling a pause in January.

A live dovish turn. As the press conference progressed, though, Chair Powell turned decisively more dovish, for the following reasons:

1) Chair Powell's read-through of labour market conditions has turned much more proactive. Back in August, when Chair Powell hinted for the first time that the Fed was going to resume rate cuts, the Chair argued that the U-turn (compared to July) was due to deteriorating labour market conditions, noting that the August downward revision to NFPs was a clear indication that the labour market was weakening. This represented a classic passive monetary policy approach to past macro developments. In December, instead, the Fed attitude changed remarkably. It moved from reacting to NFP revisions to expecting further revisions ahead. The Chair went as far as disclosing the FOMC's estimates of the upward bias embedded in the employment statistics (50-70k per

month). This represents a much more aggressive monetary policy stance than that held in September, in our view. For several reasons, two of which are particularly noteworthy, in our view. Firstly, it is well known that preliminary labour market data tend to overestimate the state of the labour market. Secondly, against the backdrop of an economy that has remained resilient despite the reported downward revisions to labour market statistics, Powell did not offer any discussion of the role played by productivity. This wavering approach was exacerbated by the fact that the FOMC did not revise either inflation or unemployment rate forecasts, despite the significant upward revision to growth projections.

2) While risks to inflation remain to the upside, Chair Powell specified that this is entirely due to tariffs, and that he does not see a strong case for inflationary pressures coming from elsewhere. Once the expected (by the Fed) peak in tariff-driven inflation in Q1 2026 is behind us, inflation will converge towards target, as services inflation is already not far from 2.0%, according to the Chair.

3) Powell argued that the Fed fund rate has reached the higher end of the range of neutral-rate estimates, thereby suggesting that there is more room to cut rates, if/as needed.

4) Asked about the asymmetric social costs of inflation, Chair Powell said that a strong labour market is key to addressing the unfair real impact of inflation.

5) Chair Powell pushed back strongly against the possibility of rate hikes further down the road.

We stick to our call of three rate cuts in 2026. Against this backdrop, we maintain our view that the Fed will cut rates three times in 2026, in March, June and September, taking the Fed fund rate range to 2.75-3.00%. Our view remains more dovish than that of Fed participants and the markets.

For the following reasons:

1) Compared to the SEP, we forecast lower growth in 2026 (2.0% q4/q4 versus 2.3% in the SEP) and faster disinflationary progress (our core PCE forecast for 2026 is 2% q4/q4 versus 2.5% in the SEP) than the Fed currently does.

2) The Fed retains a clear dovish bias. Even after reaching the upper end of the neutral-rate estimates, the majority of FOMC members are still placing greater weight on downside risks to the labour market than on upside risks to inflation.

3) Politics matter. We still believe that, whoever the next Fed Chair will be, the dovish bias will remain, if not be strengthened, amid likely political pressures ahead of the mid-term elections.

Risks are skewed towards fewer cuts. Risks to our baseline are skewed towards fewer rate cuts in the event that the economy overheats. A Supreme Court ruling striking down tariffs under IEEPA and/or larger-than-expected fiscal easing compared with that already included in our baseline could support private consumption more than we currently expect. Moreover, amid a structural lack of labour supply, stronger-than-expected domestic demand could put pressure on labour demand, pushing up wage growth. We believe that, in this scenario, even a dovish-leaning Fed will have to take into account upside risks to inflation.

A front-loaded increase in the Fed's assets to manage reserves. The Fed announced that it will start to buy USD 40bn per month in Treasury bills to maintain an ample level of reserves. This decision follows the announcement of the end of QT, due to a quicker-than-expected decline in the level of reserves and it is in no way related to the monetary policy stance.

The monthly purchases of T-bills will come from two sources:

- 1) Reinvestments from maturing MBS on the Fed's balance sheet.
- 2) The physiological growth of liabilities on the Fed's balance sheet.

The amount of monthly T-bills purchases is higher than our estimate (around USD 25bn). However, the Fed explained that it will front-load the purchases in the coming months to offset the expected large increase in non-reserve liabilities in April due to seasonal tax payments. After that, the pace of total purchases will likely be reduced significantly.

No change to our asset-class allocation. Following the December Fed meeting, our tactical and strategic positioning in rates, equities and EUR/USD is unchanged.

ECB – Still leaning to the hawkish side

We maintain the view that the EA economy requires further support amid strong services disinflation and uncertain macro spillovers from the German package. That said, the ECB's rhetoric continues to lean towards the hawkish side, and we do not expect the 2028 forecasts (to be published in December) to show inflation falling meaningfully below target, given technical, exogenous support related to the unusual incorporation of ETS2 impact into their forecast outlook. Against this backdrop, we stick to our view that the ECB will stay on hold in December, and cut rates one more time in March, taking the deposit rate to 1.75%. Beyond March, we expect the ECB to remain on hold until the end of 2026, with risks skewed towards the possibility of one additional rate cut.

The EA economy needs further support. We maintain the view that the EA economy requires further support, for two main reasons:

- 1) Risks to the growth and inflation outlook remain tilted to the downside. Alongside the well-known threats of tariffs, high saving rates, and signs of labour-market softening, increasing political instability in France introduces an extra headwind that may weigh on future euro area expansion.
- 2) The German package will only begin to lift growth from H2 2026 at best. If the implementation of the package disappoints, growth will likely fall below potential in 2026.

Consensus in the Governing Council is still leaning towards the hawkish side. While some in the Governing Council (GC) argue that it is important to remain open to the possible need for a further rate cut, we remain under the impression that the majority in the GC believes that the ECB is still in a good place, for the following reasons:

- 1) Up until Q3, euro area growth has surprised the ECB on the upside.
- 2) Downside risks to growth are gradually fading.
- 3) Inflation risks remain broadly balanced overall, with fading upside risks.
- 4) Somewhat in contrast to Philip Lane's view, President Lagarde believes that the transmission of easier monetary policy is effective and timely.
- 5) Holding rates steady at this stage leaves greater room for manoeuvre in case of future disinflationary shocks to which monetary policy has to respond decisively.

Inflation forecasts to remain near target even in 2028. At the December meeting, the ECB will publish the updated staff forecasts, which will include 2028 projections for the first time. Given the upside surprise in EA Q3 GDP growth, 2025 GDP growth forecasts are likely to be revised upwards. Moreover, due to a delay in the implementation of Emission Trading System 2 (ETS2) regulation, inflation forecasts for 2027 and 2028 may show inflation slightly below target, but only moderately, supporting the hawks' argument that the risk of inflation falling permanently below target is limited.

Why do we expect ETS2 regulation schedule delay to keep inflation near target in 2028? The reason why HICP inflation is projected to rise from 1.7% to 1.9% y/y in 2027 in the ECB staff projections is related to the implementation of the ETS2 regulation, which the ECB has unusually included in its forecasts since December 2024, even though the system is not yet fully legislated at country level. According to the ECB's December 2024 staff projections, its impact on inflation could range from 0 to 0.4pp. Given that the implementation of the regulation has been delayed and, according to President Lagarde, its impact will now likely be spread across 2027 and 2028, we expect the ECB to slightly reduce its inflation forecast for 2027 and raise the inflation forecast for 2028 accordingly in the December staff projections. Against this background, we expect inflation forecasts for 2027 and 2028 to be just moderately below target (around 1.7 - 1.8% y/y). However, had ETS2 not been (unusually) incorporated into the outlook, the forecasts could have been up to 0.4pp lower in cumulative terms, risking signalling a more pronounced disinflation.

We stick to our view. Against this backdrop, we stick to our view that the ECB will stay on hold in December, and cut rates one more time in March, taking the deposit rate to 1.75%.

Our 2026 call remains unchanged. Beyond March, we expect the ECB to remain on hold until the end of 2026, with risks skewed towards the possibility of one additional rate cut.

PBoC – Support is needed

As we expected, the PBoC held the policy unchanged at its meeting on 20 November. Given that we forecast growth in 2025 to be moderately below the 5.0% target threshold (4.8% according to our forecast), we remain of the view that a rate cut by year-end (22 December) to lay the groundwork for solid growth in 2026 is still on the table.

The next policy window to watch? We believe the next policy window will be post-Central Economic Work Conference (CEWC). The year-end policy meeting (held on 11-12 December last year) would set the policy tone for next year. It could hint at keeping the growth target at "around 5%" for a steady transition into the new FYP, in our view, and policymakers could again try to engineer a strong start in 2026 to hit the target. We anticipate about 40bps of rate cuts and possibly one RRR reduction to support 2026 growth on a firm foundation.

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IMPORTANT DISCLOSURES

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