Macro Outlook

DANCING IN THE DARK

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One of the longest government shutdowns is having a severe impact on our read-through of the US economy. Available data suggest, however, that domestic demand and labour markets are holding up. Against this backdrop, we stick to the view that 1) the US economy will re-accelerate in Q1 next year and 2) risk are to the upside.

In the EA, we continue to believe Germany will revive EA's growth momentum going into next year. While evidence is mixed to slightly positive at this stage, downside risks related to quality and implementation of announced spending measures and reforms remain. As incoming data suggest that fiscal and reform optimism remains largely on paper, the jury is still out, in our view. Inflation-wise, we believe the broader core downward trend is likely to remain in place as wage growth continues to ease.

In China, domestic demand remains feeble as we enter Q4. Box-office revenues fell by roughly 30% y/y in October, despite the extended Golden Week holiday. Moreover, export performance in October fell well short of expectations. However, high-frequency shipping data show signs of a rebound in exports in early November - consequently, the October miss in exports could be interpreted as payback after a strong September. Our long-term view remains unchanged. We continue to anticipate policy measures such as targeted subsidies and fiscal easing will provide only marginal support, sufficient to maintain growth momentum throughout 2025–26, amid structural challenges including weak consumption, deflationary pressures, and a sluggish property sector.
Deflation is expected to persist into mid-2026, though favourable base effects may mechanically lift headline inflation towards 1%, helping to stabilise prices throughout 2026.

The Fed cut rates by 25bp in October, taking the policy rate to 3.75-4%. While the FOMC assessment of incoming data, especially inflation, was dovish, the rhetoric about the next move was more hawkish than expected, with Chair Powell arguing that a December cut is far from a foregone conclusion amid limited data visibility. Against this backdrop, the timing of the next rate cut has become more uncertain, and we do not rule that the Fed may choose to wait until January before proceeding. That said, we continue to expect the Fed to deliver four additional 25bp rate cuts by the end of Q3 2026.

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 continues to sound very constructive on the EA growth outlook, and we do not expect the 2028 forecasts (to be published in December) to show inflation falling meaningfully below target, amid 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 cut rates at least one more time over the forecast horizon, taking the depo rate to 1.75%, but we have moved the timing of the cut to March (vs. December/March previously). 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.

After easing in Q2 and pausing in Q3, we expect the PBoC to keep policy unchanged through early Q4, before delivering a rate cut by year-end to lay the groundwork for solid growth in 2026.

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GROWTH & INFLATION

US – Getting blood from a stone

One of the longest government shutdowns is having a severe impact on our read-through of the US economy. Available data suggest, however, that domestic demand and labour markets are holding up. Against this backdrop, we stick to the view that 1) the US economy will re-accelerate in Q1 next year and 2) risk are to the upside.

The federal government shutdown continues. During November, pressures on healthcare premiums from subsidies expiring at year-end may act as a catalyst, with open enrolment season for ACA healthcare plans beginning on state-level exchanges.

Meanwhile, our baseline remains unchanged. We continue to estimate Q3 GDP growth at 2.8% q/q SAAR and Q4 GDP growth at 1.6% q/q SAAR.

We have little evidence to revise our view, but the limited data available do support our baseline.

Activity wise, domestic demand remains steady. The ISM services index surprised to the upside at 52.4 (vs 50.8 consensus) from 50.0 in September. The composition of the report was strong, as the business activity (+4.4pt to 54.3), new orders (+5.8pt to 56.2), and employment (+1.0pt to 48.2) components all increased.

Labor-market indicators suggest employment creation may have stabilised.

1) The labour data landscape has expanded with ADP's launch of a timelier weekly version of its private sector employment report. However, the weekly estimate is subject to high volatility, and we continue to prefer the monthly reading. The October monthly ADP report showed a 42k employment increase between the week of September 13 and October 18.

2) Initial jobless claims (implied from state-level data, so there may be a risk of mismeasurement in the figures) were also reassuring, falling back to 219k for the week ending 25 October, from 232k in the prior week, and tracking in a similar pattern to prior years.

3) The labour market differential in the Conference Board's consumer confidence survey rose slightly to 9.4% in October, up from 8.7% in September. Although this indicator has generally been trending downward since December, the latest uptick may point to some stabilisation in unemployment. However, it's still too early to draw a definitive shift about the trend.

Recent trade agreements have led to a modest decline in the trade-weighted tariff. President Trump announced new deals with China and South Korea, both following a familiar pattern: lowering US tariffs in exchange for concessions. The key element of the China deal is a reduction of the 20% 'fentanyl' tariff to 10%. In return, China has agreed to suspend planned export restrictions on rare earths, resume US soybean purchases between 2025 and 2028 - albeit at slightly below recent average levels - and potentially increase its imports of US energy. A key element of the South Korea deal is the reduction of the US tariff on Korean auto imports from the sectoral rate of 25% to 15%, aligning it more closely with the rates applied to Japanese and EU vehicles. In return, South Korea has committed to purchasing US energy products, making cumulative investments of approximately $350 billion in the United States over an extended period, and cooperating to reduce non-tariff barriers.

After incorporating these various changes, we estimate that the effective tariff rate impact will eventually settle at 12.2% - down from 13.6% previously. However, tariffs on pharmaceutical products, which have been threatened but not yet implemented, could plausibly raise the rate by 1.1pp, bringing the trade-weighted tariff rate to 14.3%.

The most tariff-sensitive items continue to show a mixed-to-weak pass-through. The core CPI print for September came in softer than expected at 0.2% m/m, down from 0.3% in August. Goods inflation moderated slightly (0.2%), a touch softer than the 0.3% increase in August. The pullback was driven by used car prices, which fell 0.4% after a 1% gain in the prior month. New vehicle prices were firmer, rising 0.2%, while apparel prices posted a second consecutive strong reading at 0.7%.

Meanwhile, core services inflation showed clearer signs of moderation. Core services prices rose 0.2%, down from 0.4% in August. The slowdown was led by core shelter, which eased to a 0.15% gain from an unexpectedly strong reading in August. Owners' equivalent rents were particularly soft, rising just 0.1%, the weakest reading since November 2020. Supercore CPI remained steady at 0.3% (roughly in line with the pre-COVID norm), driven by volatile components: airfares (+2.7%) and lodging away from home (+1.3%) increased, but motor vehicle insurance fell (-0.4%). The September CPI data indicate that, during this period of data absence, the inflation outlook remained contained. Inflationary pressures on services continue to moderate, while on the goods front, the impact of tariffs remains limited.

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 (vs 1.6% previously), on the back of a mild payback in equipment investments 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 at 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 at 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 – Believe it until you may not

We continue to believe Germany will revive EA's growth momentum going into next year. While evidence is mixed to slightly positive at this stage, downside risks related to quality and implementation of announced spending measures and reforms remain. As incoming data suggest that fiscal and reform optimism remains largely on paper, the jury is still out, in our view. Inflation-wise, we believe the broader core downward trend is likely to remain in place as wage growth continues to ease.

Make-believe resilience. Preliminary GDP data for Q3 came in better than expected. EA growth expanded by 0.2% q/q, up from 0.1% in Q2 and above the 0.0% expected by consensus.

However, the outcome doesn't change our view that the quality of EA growth remains poor going into year-end. This is for several reasons:

1) Most of the upside surprise came from France, where growth expanded by 0.5% q/q compared to 0.2% projected by consensus. Available data suggest that activity momentum was boosted by net trade (+3.4pp) amid surging exports. We do not expect this external support to continue; neither has foreign demand ever been the backbone of French growth, nor do we expect it to become so from here.

2) Elsewhere in the region, incoming data suggest anaemic underlying growth dynamics alongside sluggish private consumption.

3) Surveys point to modest growth. Flash PMIs for October indicate that economic activity has picked up slightly, but momentum remains close to 0.2% at best once the payback in French growth is factored in.

What to expect. Heading into 2026, we continue to expect growth momentum to improve. We forecast economic activity to expand by 0.3% for H1 2026 and 0.4% in H2 2026 (quarter-on-quarter average).

Our forecast is based on two main assumptions:

1) Spain will continue to outperform. Among the big four, Spanish migration inflows remain the highest in relative terms, supporting robust demographic growth. Productivity has proven resilient - particularly on a per-hour basis - with early signs of AI adoption emerging within the business sector. Moreover, both the supply side and the demand side appear to be well anchored. On the supply side, since the post-COVID period, Spain has seen investment growth (excluding construction) that has been more dynamic than in most of the EA. On the demand side, consumer spending since 2024 has reported an average sequential growth rate of 0.9% compared to a modest 0.3% in the rest of the EA.

2) Germany will deliver on its fiscal and reform plan. However, we acknowledge that some forces could jeopardise the implementation of the German package:

A) Federal spending expansion is ambitious and not entirely growth-friendly. Compared to 2024, public spending is projected to rise by c. EUR 45bn (1.0% of GDP) in 2025 and by over EUR 90bn (1.8% of GDP) in 2026. While substantial in aggregate, the size of spending with the highest multiplier is roughly half of that. Infrastructure investment and energy subsidies for businesses are set to rise by EUR25bn and EUR10bn, respectively. Meanwhile, the largest share of capex spending concerns defence (EUR 40bn) and social spending (EUR 26bn), which tends to have limited impact on growth.

B) Fiscal Implementation risks remain despite some green shoots. Both social spending and subsidies to businesses (largely electricity price subsidies) have already entered the execution phase. The upcoming military procurement acceleration law, expected this autumn, could further support the implementation of defence expenditures. However, infrastructure spending remains, in our view, the area most exposed to under-delivery risks amid evidence of significant under-spending in recent years. Unless supply-side bottlenecks are adequately addressed, slow planning, weak permitting procedures and administrative hurdles may delay the planned infrastructure and regional spending. Similarly, the EUR 10bn rise in regional investment support may not fully translate into higher general government spending.

C) Political uncertainty in Germany remains high. Political disagreements and political noise could hinder the implementation of the budget plan. Austerity debates, even after the debt brake suspension, are diluting confidence. Indeed, economic policy uncertainty remain at all-time highs, well above that of peers, including France. This is likely to weigh on the implementation of supply-side reforms, which are essential to foster growth.

E) Businesses and consumers appear to have little faith in the government's ability to deliver on its budget plan. The German economy seems caught in a paradox. Optimism is rising, but reality is not following. We note that while the IFO expectations index has been on an upward trend since January 2025, current conditions have remained flat. It is a split that sums up Germany's broader struggle: forward-looking sentiment is buoyed by fiscal promises, even as present activity stagnates. Meanwhile, retail sales data show that discretionary spending remains weak: in September, sales in specialised stores (including clothing and footwear) fell to -1.6% m/m from -0.6% in August, while sales for HHs furnishing also declined to -1.4% m/m from 0.0% in August.

Keeping track of promises. To monitor the German government's ability to deliver on its ambitious fiscal plan, we have built a live fiscal stance tracker. This tool helps to navigate the execution of the German government's spending plans, as it monitors both the evolution of the fiscal stance (the change in budget balance as a % of nominal GDP) and the contribution to the fiscal stance from individual categories of expenditure (i.e. federal expenditures by function) on a monthly basis.

On track… for now. Despite the 2025 budget only being approved in September, and with limited data on the SVIK infrastructure fund, incoming numbers overall suggest the government is currently deploying core budget spending swiftly. According to our tracker, the fiscal stance became more expansionary by 0.3pp from August to September, with a positive contribution coming mainly from energy subsidies, infrastructure, and defence spending. We will continue to closely monitor developments in our tracker heading into Q4, to understand how committed the German government remains to its budget plan.

Glass stays half full, for now. Against this backdrop, we maintain the view that German growth momentum will re-accelerate. However, downside risks remain. Signs that fiscal spending is accelerating are encouraging, but the quality of spending and supply-side bottlenecks cast a long shadow.

Inflation-wise, uninterrupted disinflation. The flash report for October showed core inflation at 2.4% y/y, unchanged from September. A downtick in non-energy industrial goods (NEIG) inflation offset the uptick in services. However, preliminary country-level details indicate that the support from services inflation came mainly from volatile categories, essentially airfares. The strong airfares print seems quite broad-based: in Germany, Belgium and Italy (to a lesser extent), - the only three countries providing detailed figures, but also Spain (according to the press release), and likely the Netherlands and Austria. Meanwhile, preliminary indications suggest that underlying services items reported a moderate deceleration.

Within headline HICP space, food inflation (FAT) decreased to 2.5% y/y, marking the third consecutive monthly decline. The slowdown came from both processed food inflation and especially from unprocessed food (3.2% y/y from 4.2% in September): this remains consistent with our view that unprocessed food continues to have room for normalisation in the coming quarters. In support of this view, the EC survey of food and beverage selling price expectations have also been decelerating over recent months.

Despite monthly volatility in the services inflation space, we believe the broader downward trend is likely to remain in place. Wage growth continues to normalise to levels consistent with price stability. Indeed, as evidenced by national accounts data, the contribution from labour costs to domestically generated inflation is moderating, and profit expansion has slowed significantly in recent quarters.

ANIMA baseline. Reflecting the upward surprise in Q3 GDP at 0.2% q/q (+0.2pp compared to our baseline), we have mechanically revised our baseline for 2025. We now forecast Q4-25 real GDP growth at 0.2% q/q (+0.1pp vs prior baseline). This results in an annual 2025 forecast of 1.4% (vs 1.2% prior baseline). 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 consensus of 1.1%.

We continue to expect EA core HICP at 2.1% in Q4 2025. Our forecast for the 2025 annual average remains at 2.3%. For 2026, we expect core inflation of 1.9% in H1 and 1.8% in H2, consistent with an annual average of 1.8%.

CHINA – Q4 off to a bad start

Domestic demand remains feeble as we enter Q4. Box-office revenues fell by roughly 30% y/y in October, despite the extended Golden Week holiday. Moreover, export performance in October fell well short of expectations. However, high-frequency shipping data show signs of a rebound in exports in early November - consequently, the October miss in exports could be interpreted as payback after a strong September. Our long-term view remains unchanged. We continue to anticipate policy measures such as targeted subsidies and fiscal easing will provide only marginal support, sufficient to maintain growth momentum throughout 2025–26, amid structural challenges including weak consumption, deflationary pressures, and a sluggish property sector.
Deflation is expected to persist into mid-2026, though favourable base effects may mechanically lift headline inflation towards 1%, helping to stabilise prices throughout 2026.

Consumption remains weak as we enter Q4. High-frequency indicators point to a deceleration in auto sales growth, which slowed to 6% y/y in October, down from 6.4% in September. This moderation likely reflects tighter implementation of auto trade-in subsidies at the local level. Additionally, the slowdown appears to be a natural correction following strong demand earlier in the year, when auto sales surged by 11% y/y in the first half of 2025. Meanwhile, services consumption shows no signs of recovery. Notably, box-office revenues fell by roughly 30% y/y in October, despite the extended Golden Week holiday. This weakening in consumer activity likely stems from deteriorating labour market conditions, with youth unemployment remaining elevated at around 18%.

The export channel takes a breather. Export performance in October fell well short of expectations, contracting by 1.1% y/y after posting 8.3% growth in September. The sharp 9.4 percentage point drop in headline export growth was broad-based across major trading partners, indicating a widespread loss of momentum. Sequentially, the trend also deteriorated, with seasonally adjusted exports declining by 1.2% over the three months to October, compared with a 0.3% drop in September. Import activity mirrored this weakness, also undershooting forecasts and pointing to a softening in domestic demand.

The sharp deceleration in export growth raises concerns about the sustainability of China’s current economic momentum, particularly given that external demand has played a critical role in offsetting domestic weaknesses. In the first three quarters of 2025, net exports contributed 1.5 percentage points to the overall GDP growth of 5.2%, accounting for nearly 30% of the headline figure. If export strength continues to falter, the economy could face mounting pressure from three fronts: a prolonged downturn in the property sector, subdued private consumption, and weakening external demand - posing a significant challenge to maintain stable growth.

That said, we believe it is too early to reflect this risk in our baseline. High-frequency shipping data show signs of a rebound in exports in early November – consequently, October could be interpreted as a correction after a strong September.

Against this backdrop, we downgrade our expectation for Q4-25 GDP growth to 4.3% y/y (vs 4.9% in the prior baseline) down from 4.8% in Q3.

Our long-term view remains unchanged. The outlook for domestic demand continues to be weak, as per our baseline. Meanwhile, despite some payback in October following a strong September, the trade channel should continue to support growth. Looking ahead, some major exporters in the auto sector have indicated that they remain upbeat about exports in 2026, thanks to the competitiveness of high-tech Chinese products. The China Passenger Car Association (CPCA) estimates that China will export10mn cars per year by 2030, up from the current 6.5mn auto exports.

Fiscal stimulus remains necessary. Over the summer, newly introduced targeted interest subsidies for households and service-sector enterprises likely provided incremental, albeit limited, support to the cooling services sector and consumer spending. Meanwhile, the "*trade-in programme*" launched last year expired in September. Overall, we continue to assess the impact of these measures as modest and insufficient to generate a meaningful acceleration in GDP growth in 2025/26. In our view, fiscal easing will continue to offer only marginal support to domestic demand, helping to sustain economic momentum amid persistent structural challenges: namely, imbalances between production and consumption, ongoing deflationary pressures, and continued weakness in the property sector. To mitigate the housing crisis and improve household sentiment, authorities may further instruct state-owned enterprises to purchase unsold housing inventories from distressed developers.

Headline CPI rose for the first time in October since July. However, we believe that the increase in the headline rate was due to the: 1) the extra-long Golden Week holiday that boosted services demand and inflation (travel, transport) and food inflation, and 2) the continued surge in gold and platinum prices. Despite the unexpected uptick in price indicators, we expect sequential deflationary pressures to intensify in Q4-25 and to remain a drag well into the first half of 2026. This outlook reflects persistently weak household demand, limited pricing power across both goods and services, and substantial excess capacity in the manufacturing sector, all of which are likely to keep inflation subdued next year. However, a favourable base effect is expected to support year-over-year price growth between Q4-25 and Q1-26, gradually lifting headline inflation towards 1% and helping to establish a floor for price levels over the remainder of 2026.

ANIMA baseline. We downgrade our expectation for Q4-25 GDP growth to 4.4% y/y (vs 4.9% in the prior baseline) down from 4.8% in Q3. We anticipate full-year 2025 GDP at 4.9%. In 2026, we continue to expect GDP to stabilize at 5%.

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 – Slowing, not stopping

The Fed cut rates by 25bp in October, taking the policy rate to 3.75-4%. While the FOMC assessment of incoming data, especially inflation, was dovish, the rhetoric about the next move was more hawkish than expected, with Chair Powell arguing that a December cut is far from a foregone conclusion amid limited data visibility. Against this backdrop, the timing of the next rate cut has become more uncertain, and we do not rule that the Fed may choose to wait until January before proceeding. That said, we continue to expect the Fed to deliver four additional 25bp rate cuts by the end of Q3 2026.

The Fed cut rates in October. At the October meeting, the Fed lowered the policy rate by 25bp to 3.75-4%. Within the FOMC, there was broad agreement on the decision, with only two dissenters: Miran, who dissented in favour of a 50bp as he did at the September meeting, and Schmid, who dissented in favour of keeping rates unchanged. The statement was almost unchanged compared with September, echoing a broadly unchanged macro-outlook characterised primarily by downside risks to employment.

A dovish take on inflation. The Fed read-through of incoming data was dovish. While Powell acknowledged that the labour market has somewhat stabilised, the rhetoric on inflation was, in aggregate, softer than in September. We share the FOMC's constructive view on inflation and continue to expect inflation to move towards target throughout 2026, as shelter inflation continues to decline and tariff-related inflation remains a one-off.

December cut is not a given. Despite the dovish tone on inflation, Powell's rhetoric on the next Fed move was more hawkish, and so was the rhetoric of FOMC members post-meeting, with a December cut far from being a foregone conclusion. For the following reasons:

1) December may be another meeting when the availability of macro data is limited due to the prolonged US government shutdown.

2) Within the FOMC, there are markedly different views about how to proceed in December, depending on members' macro forecasts and risk appetites. With the last rate cut, the fed funds rate has entered the neutral territory, which is estimated to be between 3% and 4%, depending on the currently very different FOMC views and their respective risk tolerance regarding inflation overshoots and employment undershoots. **The timing of the next rate cut has become more uncertain**. Against this backdrop, the timing of the next rate cut has become more uncertain, and we do not rule out that the Fed may choose to wait until January before proceeding.

We stick to our call that the Fed will deliver four additional rate cuts by the end of Q3 2026, taking the Fed fund rates to 2.75-3%. While the recent Fed rhetoric raises legitimate doubts about a cut in December, we do not see anything in either the statement or the press conference to suggest that the Fed will deviate from the easing path signalled in September. **We think that for the Fed to stop cutting, economic activity would have to surprise strongly to the upside, pointing to overheating risks.** This is not our baseline, neither in the near- nor in the medium-term. However, we remain of the view that the main risk to our macro narrative is that the US economy does "too" well. Growth momentum moving decisively and consistently above potential could re-ignite wage inflation amid a tight labour market. Some FOMC members may share the same concern, especially amid the current lack of data visibility.

QT will stop in December. The Fed announced that it will end QT at the beginning of December, one month earlier than we expected. While there has been no final decision on the composition of the balance sheet in the long run, starting from December the Fed will reinvest UST redemptions at UST auctions, while it will reinvest expiring agencies and MBS in T-bills in the secondary market. The purpose is two-fold: 1) In the long-run, the Fed's balance sheet will mainly consist of US Treasuries 2) The maturity of USTs held by the Fed will gradually decline and converge to the average maturity of marketable US debt.

As we argued in "UST: Early end of Fed's QT not a game changer", we believe the end of QT is not a game changer in terms of our UST strategic neutral positioning, as the Fed's net new demand for USTs will concentrate at the short-maturities and will not lead to a significant decline in medium to long-term UST supply.

ECB – Pausing (again) in December

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 continues to sound very constructive on the EA growth outlook, and we do not expect the 2028 forecasts (to be published in December) to show inflation falling meaningfully below *target, amid 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 cut rates at least one more time over the forecast horizon, taking the depo rate to 1.75%, but we have moved the timing of the cut to March (vs. December/March previously). 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. Despite a better-than-expected GDP reading in Q3, we maintain the view that the EA economy requires further support, for the following reasons:

1) The solid Q3 GDP reading was mostly due to a better-than-expected outturn in France, with net trade playing a significant role in the upside surprise.

2) Risks to the growth and inflation outlook remain tilted to the downside. In addition to the well-known downside risks - tariffs, historically high saving rates, and emerging weakness in the labour market - the increase in political uncertainty in France presents an additional risk that could weigh on euro area growth going forward.

3) 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 very constructive on the economy. According to President Lagarde, speaking at the October press conference, the ECB is still in a good place for the following reasons:

1) The preliminary GDP growth estimate for Q3 shows the euro area growing at 0.2% q/q, higher than the 0% in the ECB September staff forecasts.

2) Downside risks to growth are gradually fading. In particular, President Lagarde referred to three events that have helped mitigate downside risks: the EU-US trade deal over the summer, the ceasefire in the Middle East, and the recently negotiated trade deal between the US and China.

3) Inflation risks remain broadly balanced overall, with fading upside risks (President Lagarde mentioned the absence of supply chain disruptions due to trade uncertainty).

4) Somewhat in contrast to Philip Lane's view, President Lagarde argued that the transmission of easier monetary policy is effective and timely.

Inflation forecasts to remain near target also 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 might be revised upwards. Moreover, due to a delay in the implementation of Emission Trading System 2 (ETS2) regulation, inflation forecasts for 2027 and 2028 might show inflation slightly below target, but only moderately, supporting the hawks' argument that risks of inflation falling permanently below target are limited.

Why we expect ETS2 regulation schedule delay to keep inflation afloat 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, hence risking signalling a more pronounced disinflation.

We move forward the rate cut from December to March. Against this backdrop, we stick to our view that the ECB will cut rates at least once more, taking the depo rate to 1.75%, but we have moved the cut to March (vs. December/March previously).

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 – 2026 with a dovish stance

After easing in Q2 and pausing in Q3, we expect the PBoC to keep policy unchanged through early Q4, before delivering a rate cut by year-end to lay the groundwork for solid growth in 2026.

Monetary policy is set to remain moderately dovish heading into 2026. After Q2 easing and Q3 pause, we expect the PBoC to maintain its stance through early Q4, with the next policy rate and RRR cuts likely postponed until the end of Q4 as risks to the 2025 growth target have receded. We anticipate about 40bps in rate cuts and possibly one RRR reduction to support 2026 growth on a firm foundation.

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