BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

January 24, 2025

The Week Behind

1. **Manufacturing Purchasing Managers' Indices (PMIs) beat expectations across most economies.**

   While remaining in contractionary territory in each case, the manufacturing PMIs improved substantially and beat expectations across the Eurozone, France, Germany, Japan, and United Kingdom. Services PMIs were mixed with stronger-than-expected results in Germany and a substantial improvement in Japan while the Eurozone, France, and United Kingdom figures were closer to expectations and the prior month's figures. The US PMIs diverged with manufacturing increasing slightly to 50.1 from 49.8 while the services PMI fell materially to 52.8 from 56.5.

January PMI Data

Country	Index	Consensus	Actual	Prior Month
Japan	Manufacturing	*	48.8	49.6
Jibun Bank	Services	*	52.7	50.9
	Composite	*	51.1	50.5
Eurozone	Manufacturing	45.4	46.1	45.1
HCOB	Services	51.5	51.4	51.6
	Composite	49.7	50.2	49.6
France	Manufacturing	42.5	45.3	41.9
HCOB	Services	49.4	48.9	49.3
	Composite	47.7	48.3	47.5
Germany	Manufacturing	42.7	44.1	42.5
HCOB	Services	51.0	52.5	51.2
	Composite	48.3	50.1	48.0
UK	Manufacturing	47.0	48.2	47.0
S&P Global/	Services	50.8	51.2	51.1
CIPS	Composite	50.1	50.9	50.4
US	Manufacturing	49.8	50.1	49.4
S&P Global	Services	56.5	52.8	56.8
	Composite	55.6	52.4	55.4

Source: Bloomberg, S&P Global
* No consensus estimate available on Bloomberg.

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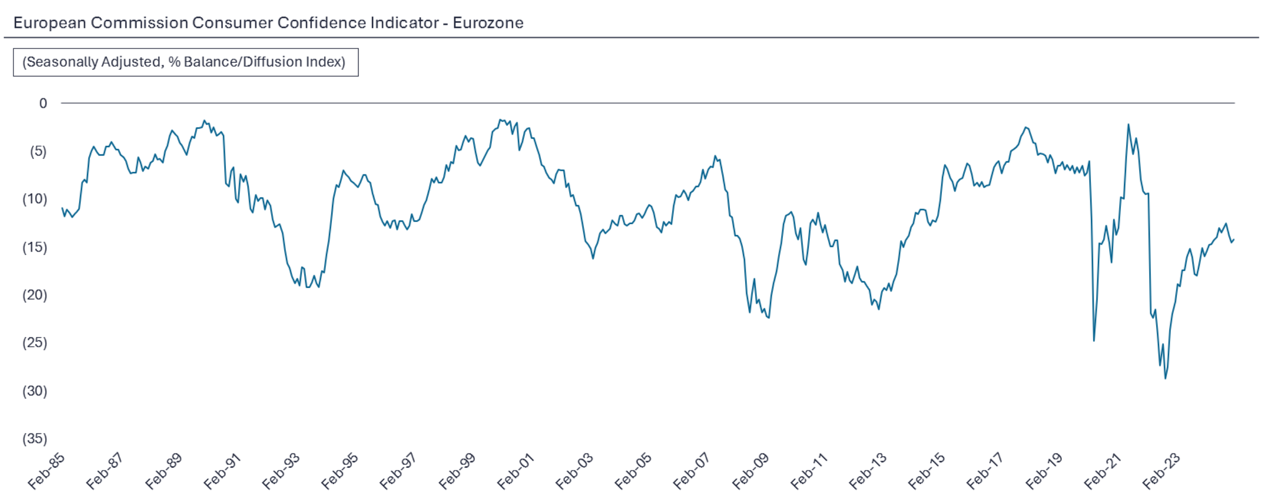
2. **Eurozone consumer confidence nudged higher to -14.2 from -14.5.**

   European consumer confidence has improved significantly from the post-Ukraine invasion record low in October 2022. The conditions are in place for continued improvement as unemployment is at the lowest level since the founding of the euro in 1999, real wages are increasing, and the European Central Bank (ECB) is cutting rates. The biggest risk to this healing narrative is that the United States increases tariffs on imports from Europe triggering a trade war that further weakens Europe's manufacturing sector.

European Consumer Confidence Is Likely to Continue Improving in 2025 Absent a Trade War



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Source: Bloomberg, European Commission
Note: As of January 2025

3. **The Bank of Japan (BoJ) hiked interest rates by 25 basis points (bps) as expected.**

   The BoJ voted 8-to-1 to raise rates by 25 bps as anticipated on 24 January. The shift toward favoring tightening had been clear in recent weeks with the market pricing the rate increase as a near certainty.

   The BoJ's expectations for growth were relatively stable at 1.1% for fiscal year 2025 (FY2025) and 1.0% for FY2026. However, inflation expectations for FY2025 were increased substantially to 2.4% from 1.9% due to higher rice prices, higher import prices due to yen weakness, and the removal of government gas and electricity subsidies.

   In the press conference after this week's policy meeting, BoJ Governor Kazuo Ueda indicated that if the economy remains on the forecasted trajectory, further rate normalization would likely be appropriate. Markets are now pricing one additional 25-bps hike with a 33% chance of a second equal-sized increase by year end.

4. **Japan's headline Consumer Price Index (CPI) rose more than expected while core figures were in line with consensus.**

   Headline CPI rose 3.6% y-o-y versus the consensus expectation for an increase of 3.4% (and November's 2.9% rise). CPI ex-fresh food rose 3.0%, as expected, versus the 2.7% increase the prior month. CPI ex-fresh food and energy rose 2.4%, in line with expectations and the prior month.

   Inflation had been expected to increase due to the removal of government subsidies for gas and electricity, but headline price pressures were further lifted by food prices which rose 6.4% year-on-year (y-o-y) in December versus an increase of only 2.9% as recently as July. Fresh food prices rose 17.3% y-o-y largely due to weather disruptions. Services inflation remained moderate at only 1.5% y-o-y but will likely see upward pressure from the spring wage negotiations currently in progress.

The Week Ahead

1. **The Federal Open Market Committee (FOMC) is likely to hold policy constant.**

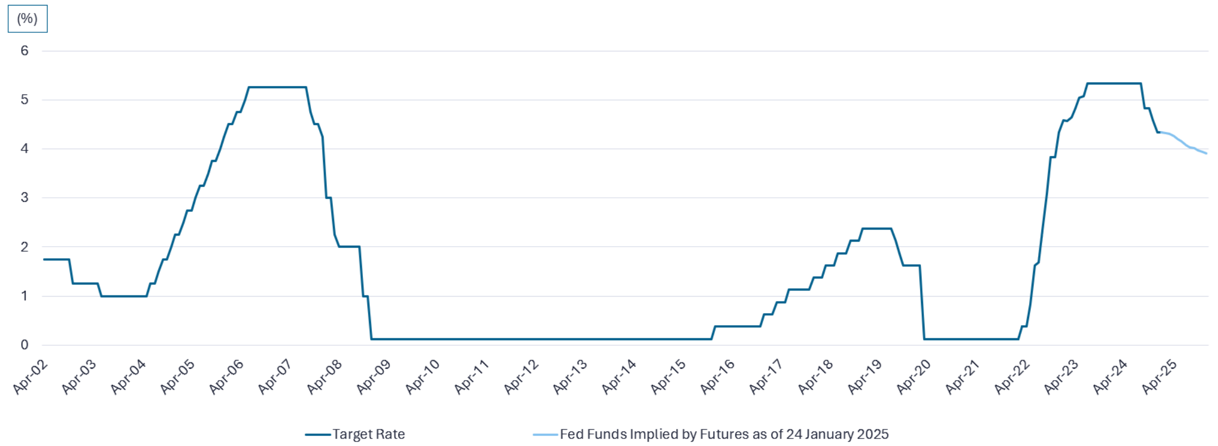
   Markets currently imply a less than 1% probability of a rate cut next week with a 97% chance of one 25-bps rate cut through the 18 June FOMC meeting and 42 bps of total easing expected by year end.

   In the press conference, I expect Chair Jay Powell to continue trying to avoid any appearance of being politically motivated related to monetary policy although it is highly likely he will be questioned about recent presidential pronouncements regarding the optimal level of interest rates.

   I do not believe that the new administration will attempt to end Jay Powell's term as Fed Chair early. However, in the lead up to the end of Powell's chairmanship in May of 2026, I expect Treasury markets to become much more sensitized to the risk of erosion of Fed independence depending on who is nominated to fill the position as Fed Chair.

Markets Are Pricing ~25 bps of Fed Easing through June 2025*

Federal Reserve Target Rate and Implied Rate through December 2025



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Source: Bloomberg, Chicago Mercantile Exchange, Federal Reserve
Note: As of 24 January 2025
* Markets imply <1% chance of a 25-bps reduction at the January meeting and a 28% chance of a 25-bps cut at the March meeting.

2. **The US headline Personal Consumption Expenditure (PCE) inflation is expected to rise 2.5% y-o-y while core PCE inflation is expected to increase 2.8% y-o-y.**

   Most key PCE inflation drivers are already known, so a surprise is unlikely in next Friday's release. The month-on-month (m-o-m) increase in headline PCE inflation is expected at 0.3% while core PCE is expected to increase 0.2%. Growth in personal income and spending are expected to inch upward to 0.4% m-o-m and 0.5% m-o-m, respectively from the November increases of 0.3% and 0.4%.

3. **US Q4-24 GDP is expected to have grown at an annualized rate of 2.6% in the quarter.**

   US GDP growth is expected to decelerate in 2025 to 2.2% from 2.8% in 2024 and 2.9% in 2023. While the advance estimate of GDP is subject to revision, the figure will be closely watched for signs of decelerating momentum as evidence mounts of weakening in the labor market and increasing financial stress for lower- and middle-income households.

4. **China's National Bureau of Statistics (NBS) PMI figures are expected to be stable.**

   The NBS PMI focuses more on large, state-owned companies and is expected to show stable conditions. The manufacturing PMI is expected to remain a whisker above the dividing line between expansion and contraction at 50.1 while the non-manufacturing PMI is expected to be stable at 52.2.

5. **The ECB is likely to cut rates by 25 bps.**

   ECB President Christine Lagarde indicated in December that the neutral rate is likely between 1.75% and 2.5% versus the current 3.0% deposit rate, suggesting meaningful room for easing. Given ongoing sluggish economic activity and lower-than-expected inflation figures in December, markets are pricing a 97% chance of a 25-bps rate cut on 30 January with total easing of ~73 bps by the end of June and ~88 bps by year end.

   Recent commentary from key ECB officials reaffirm the expectation for rate cuts with Vice President Luis de Guindos indicating that the "focus of concern has shifted to low growth from high inflation" and Chief Economist Philip Lane warning of the risks of "too-low inflation if interest rates stay high." Markets currently expect the deposit rate to end the year at ~2.0%. I expect more aggressive easing with the deposit rate approaching 1.5% by year end if US tariffs are imposed on meaningful amounts of European exports.

Markets Suggest ~73 bps of Additional ECB Rate Cuts through June 2025*

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Source: Bloomberg
Note: As of 24 January 2025
* Markets imply a 97% chance of a 25-bps rate cut and an 82% chance of a 25-bps cut at the March meeting.

6. **Preliminary Q4-24 GDP figures will be released for the Eurozone and key economies.**

   Growth is expected to remain sluggish across the Eurozone, France, Germany, and Italy. The consensus expectation for Eurozone GDP growth is only 0.1% quarter-on-quarter (q-o-q) with growth of 1.0% y-o-y. German GDP is expected to contract 0.1% q-o-q while French GDP is expected to be unchanged, and Italian GDP is expected to grow 0.1% q-o-q. Spain is expected to be the standout performer again with q-o-q growth of 0.6% (not annualized) driven in part by population growth but also by strong consumption (with a significant boost from government spending).

7. **Preliminary January inflation for France, Germany, and Spain will be reported.**

   Inflation is expected to remain contained for three of the four largest Eurozone economies. Italian and Eurozone figures will be released the following week.

EU Harmonized HICP for January

Release Date	Country		Consensus	Prior Reading
1/30/2025	Spain	Headline m-o-m	-0.2%	0.4%
		Headline y-o-y	2.8%	2.8%
1/31/2025	Germany	Headline m-o-m	-0.2%	0.7%
		Headline y-o-y	2.8%	2.8%
1/31/2025	France	Headline m-o-m	0.0%	0.2%
		Headline y-o-y	1.9%	1.8%

Source: Bloomberg

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