BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

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The Week Behind

1. **US President Donald Trump imposed tariffs on imports from China. Tariffs on imports from Canada and Mexico were announced and then delayed by 30 days to allow for negotiations.**

   After promising on the campaign trail to address key policy concerns via tariffs, President Trump acted on these pledges by invoking the International Emergency Economic Powers Act (IEEPA) based primarily on allegations of insufficient cooperation to stem the flow of illegal immigrants and fentanyl into the United States. The initial announcement included a 10% increase in tariffs on US imports from China and a 25% tariff on all imports from Mexico and Canada (with an exception for Canadian energy, which would be taxed at a 10% rate).

   In subsequent conversations with Mexican President Claudia Sheinbaum and Canadian Prime Minister Justin Trudeau, the United States agreed to delay imposition of the tariffs 30 days to allow for negotiations. In exchange for the delay, Mexico agreed to deploy 10,000 troops along the US border to tighten controls, while Canada agreed to increased spending on border control and coordination with the United States. The measures agreed by Mexico and Canada have been subject to some debate regarding the magnitude of incremental efforts versus a reaffirmation of already announced plans, but the terms satisfied the US administration for now.

   In the case of China, tariffs were imposed on 4 February across all products with no exceptions. These tariffs are on top of previously existing actions during the first Trump administration and the Biden administration that had already increased the average tariff rate on US imports from China to nearly 20%. China retaliated against the United States by imposing a 15% duty on imports of US coal and liquified natural gas (LNG) and a 10% tariff on crude oil, agricultural machinery, and large-engine vehicles, effective 10 February. China also imposed export controls on certain critical minerals and launched an antitrust investigation into Google while also adding two US companies to the "Unreliable Entity List," which could curtail their operations in China. Finally, China filed a complaint with the World Trade Organization (WTO) accusing the US of discriminatory trade practices.

   It is notable that China's retaliation fell far short of matching the scope of US tariffs. US tariffs apply to over $450 billion per year of imports from China, while the retaliatory measures apply to less than $20 billion of US exports to China. Some interpreted this restrained Chinese response as signaling a desire to avoid escalation and offer a gesture of goodwill toward negotiating a deal.

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Alongside the new tariffs, the United States also eliminated the de minimis rule that had allowed for imports of up to $800 duty-free. US merchants had highlighted the abuse of this system predominantly by Chinese online merchants that ship directly to US customers to avoid paying duties. (US merchants complained because their imports of the same products would be subject to duties when they are ordered in bulk by the retailer and subsequently sold to their customers.) The de minimis exemption will no longer be allowed for any imports from China as of 4 February and could be eliminated for Mexico and Canada at the end of the 30-day delay noted above. The exemption remains in place for all other countries.

I view the events of the last week as a key turning point for investors, many of whom had discounted the likelihood that the new administration would impose tariffs based on inflation and growth concerns. I see these announcements as commencing a potentially extended period of uncertainty around trade policy that will likely command much attention from C-suite executives (and logistics professionals) as well as investors. President Trump confirmed as well that the European Union is likely to be among the next targets of tariffs given certain trade practices the United States contests. While I cannot predict the specific measures that will be introduced or the timing thereof or the reactions of the targeted countries, I can predict significant change and uncertainty.

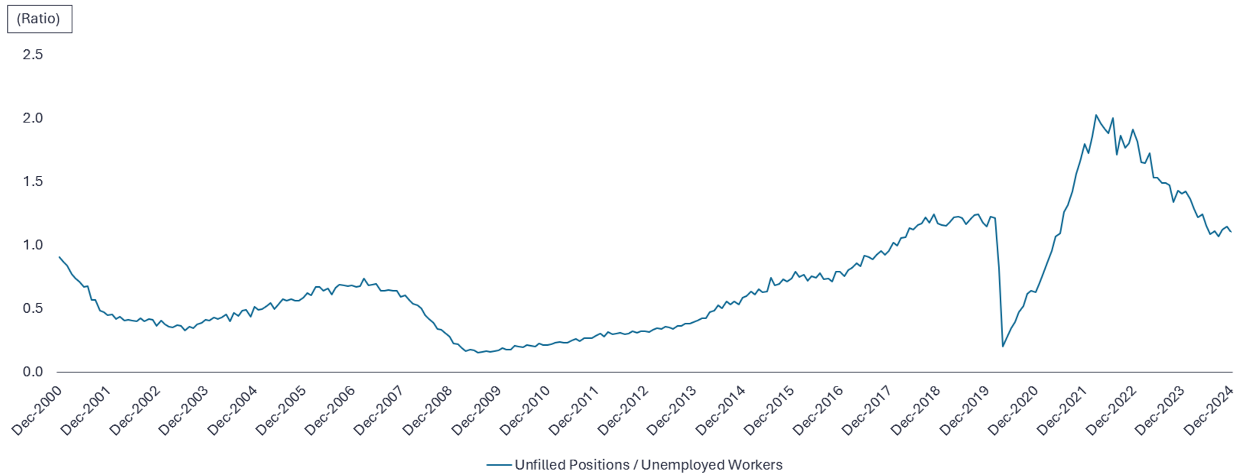
The situation remains very fluid, which makes estimating the effect of the new tariffs against China difficult (as we have no idea how long they might stay in place and whether they might be increased). What is clear is that US inflation will likely be boosted slightly by the tariffs imposed so far, while US GDP might be slightly reduced. That said, a 10% tariff on all Chinese goods is unlikely to be the end of the story. I continue to expect a broader and larger set of tariffs that will likely have a material effect on growth and inflation. Only time will tell if this assumption is correct.

2. **US labor markets remained solid in January.**

   The Job Openings and Labor Turnover Survey (JOLTS) showed a decline in the number of open jobs to 7.6mn (4.5% of all filled and open jobs) from 8.2mn (4.9% openings rate). The job openings rate is now roughly equal to that just before the pandemic in January 2020. The quit rate was unchanged at an upwardly revised 2.0% (previously reported at 1.9%), which equates to levels seen in January 2018 and early 2016. The hire rate of 3.4% was unchanged and remains in line with levels seen at the end of 2013. The number of unfilled positions per unemployed worker peaked at 2.0 in March 2022. It has since fallen to 1.1. While the current ratio of open jobs to unemployed people has declined substantially, it remains high versus the pre-pandemic period when the record high was ~1.24.

US Labor Market Tightness Has Eased Considerably from 2.0 Unfilled Jobs/Unemployed Worker to 1.1

Unfilled Jobs per Unemployed Worker



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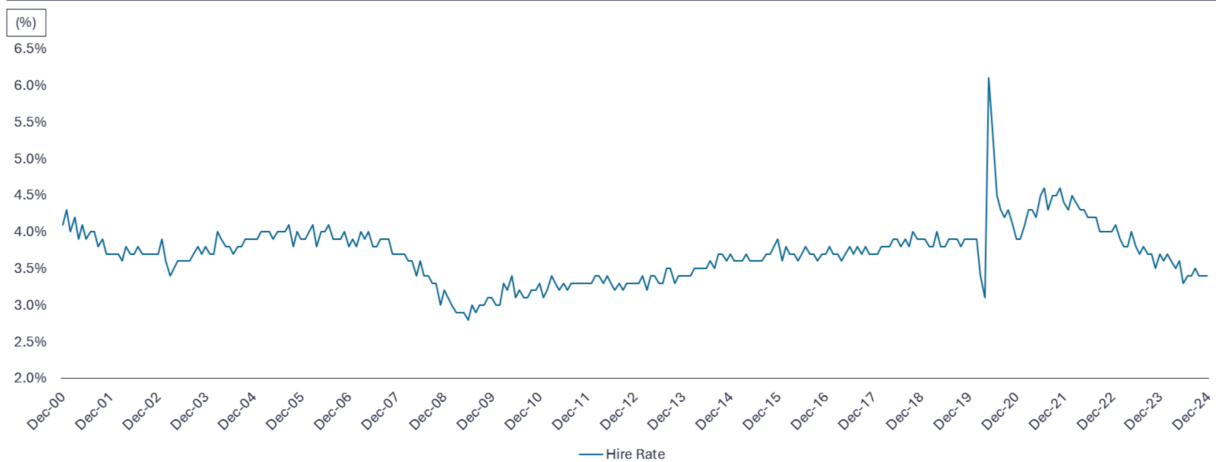
Source: Bureau of Labor Statistics, Haver Analytics
Note: As of December 2024

The Hire Rate Has Fallen to Levels Last Seen in 2013

Hire Rate



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Source: Bureau of Labor Statistics, Haver Analytics
Note: As of December 2024

The Employment Situation report indicated that 143k new non-farm jobs were created in January versus the consensus expectation for 175k new jobs, but the prior two months' figures were revised upward by a total of 100k. The unemployment rate of 4.0% was slightly below expectations that it would remain stable at 4.1%. Average hourly earnings rose 0.5% month-on-month (m-o-m) and 4.1% year-on-year (y-o-y) versus expectations for increases of 0.3% and 3.8%, respectively.

The January figures were affected by recent significant upward revisions to the Census Bureau's estimates of the civilian non-institutionalized population (released in December) from 2020 to 2024. As a result of the higher population figures, the Household Survey was recalibrated with increases in civilian noninstitutionalized population age 16 or over of 2.9 million, the total civilian labor force of 2.1 million, employment of 2.0 million, and unemployment of 0.1 million. The net effect of these adjustments was to increase the unemployment rate, the employment-to-population ratio, and the labor force participation rate by 0.1%. Otherwise, the revisions did not affect nonfarm payroll figures.

I remain concerned that employers could be engaged in "labor hoarding," which could open the door to a surprising acceleration of layoffs if the US economy slows moderately from the current pace of growth. My logic is that employers were scarred by their immediate post-pandemic experience when it was extremely difficult to find good workers. After that time, employers might be tempted to retain surplus workers to ensure they have sufficient labor if activity accelerates. If employers are already operating with some excess supply of workers, and the economy slows, that could trigger larger layoffs than might have been expected without labor hoarding.

3. **China's Caixin Purchasing Managers' Index (PMI) disappointed expectations.**

   One week after the National Bureau of Statistics (NBS) PMIs fell short of expectations, China's Caixin PMI which focuses more on small, privately owned, export-oriented companies also disappointed. Taken together, the PMI data suggest China's economy remains stuck in the doldrums despite nascent signs of optimism that arose after stimulus measures were announced late in 2024.

January China PMI Data

Release Date		Consensus	Actual	Prior Month
1/26/2025 NBS	Manufacturing	50.1	49.1	50.1
	Non-Manufacturing	52.2	50.2	52.2
	Composite	*	50.1	50.5
2/2/2025 Caixin	Manufacturing	50.6	50.1	50.5
2/4/2025	Services	52.4	51.0	52.2
	Composite	*	51.1	51.4

Source: Bloomberg, China Federation of Logistics & Purchasing, S&P Global
* No consensus estimate available on Bloomberg.

4. **Eurozone headline inflation surprised slightly on the upside.**

   The Eurozone headline Consumer Price Index (CPI) slightly exceeded expectations, rising 2.5% y-o-y versus the consensus expectation for a rise of 2.4%, while core CPI rose 2.7% y-o-y versus the consensus of 2.6%. The m-o-m CPI swung to -0.3% in January from 0.4% in December.

   In Italy the Harmonized Index of Consumer Prices inflation rose 1.7% versus the consensus expectation of 1.4% with reduced energy cost deflation adding to overall price pressures. In January energy prices fell 0.7% y-o-y versus a decline of 2.7% in December. Inflation on a m-o-m basis was -0.7% versus the consensus for -1.1%.

5. **The Bank of England (BoE) cut rates by 25 basis points (bps), as expected, to 4.5%.**

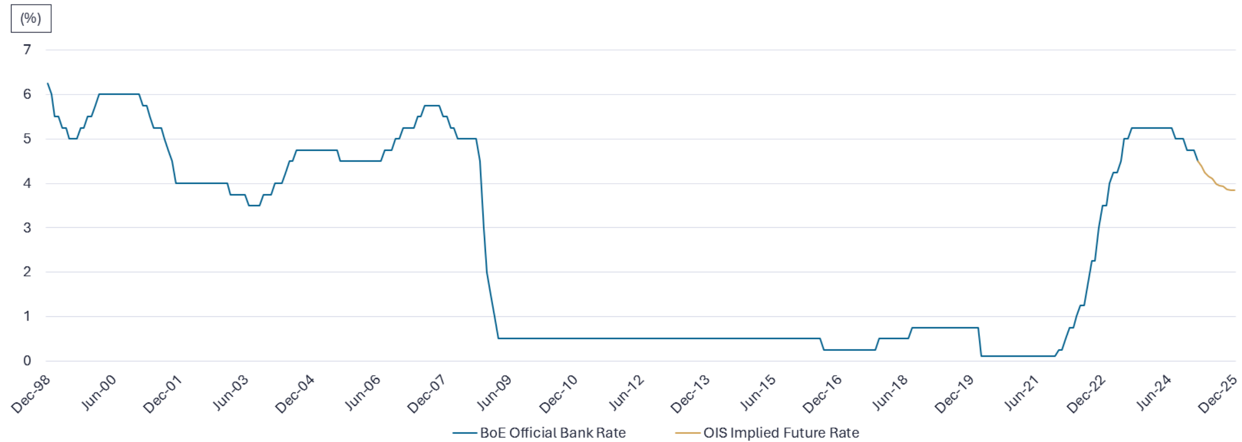
   The BoE voted 7-2 to reduce rates by 25 bps to 4.5%. The two dissenters advocated for a 50-bps reduction with Catherine Mann, typically a more hawkish voter being one of the two. The Monetary Policy Committee (MPC) highlighted the success in reducing headline inflation to 2.5% y-o-y in Q4-24 but noted that, due to energy price base effects, inflation is likely to rise to 3.7% in Q3-25 before decelerating again. The expected peak of 3.7% y-o-y is a full percentage point higher than what the BoE had forecast in November 2024. Despite the energy price effects, the BoE expects underlying domestic inflationary pressures to continue subsiding through 2025.

   The BoE MPC minutes noted that labor market conditions have continued to ease such that pay growth is expected to slow to 3.75% by year-end, but at the same time, productivity growth has been weaker than expected with negative consequences for growth potential.

   Market expectations for future rate cuts did not change materially after the BoE meeting with swap markets suggesting ~61 bps of additional rate reductions by the end of 2025.

Markets Suggest ~61 bps of Additional BoE Rate Cuts through 2025*

Implied Eurozone Deposit Rate through December 2025



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Source: Bloomberg
Note: As of 6 February 2025
* Markets currently imply a 29% chance of a 25-bps cut in February and a 98% chance of a 25-bps cut in May.

The Week Ahead

1. US CPI is expected to remain relatively stable.

Headline CPI inflation is expected at 0.3% m-o-m and 2.9% y-o-y (versus 0.4% and 2.9% in December), while core CPI is expected at 0.3% m-o-m and 3.1% y-o-y (versus 0.2% and 3.2% in December). This report and future inflation readings will be important to determine if disinflation has stalled or if anomalies have distorted our understanding of the level of sustained price pressure.

I will be watching the three key categories within core CPI as usual:

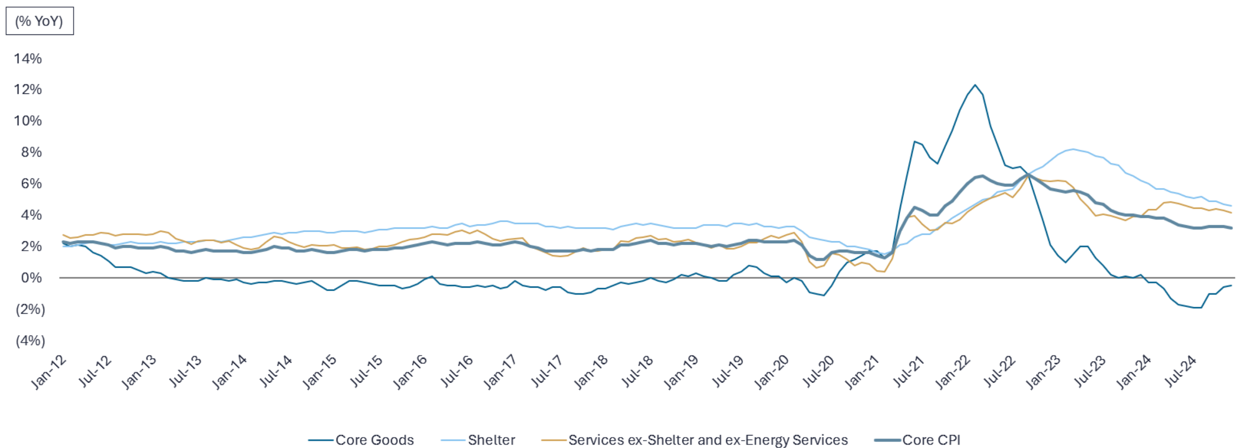
- Shelter inflation (46% of core CPI by weight) has subsided in recent months and is likely to remain at the new lower level of 20 to 40 bps per month, which mathematically implies a continued deceleration in the y-o-y inflation that stood at 4.6% in December.
- Services ex-shelter and ex-energy services inflation (31% of core CPI) has also been decelerating on a y-o-y basis, but the m-o-m variability is a bit more erratic as costs for volatile items like airline tickets can skew the results. The most recent y-o-y figure was 4.2% in December.

- Core goods prices (23% of core CPI) were flat or down on a m-o-m basis for 15 consecutive months until September 2024 when core goods inflation turned positive again, largely on the back of higher car prices. I expect a small positive m-o-m reading to reduce the deflationary y-o-y figure further from December's reading of -0.5%.

The chart below shows each of the three categories above as well as the core CPI on a y-o-y basis.

Shelter and Services Inflation Are Slowly Subsiding, but Core Goods Inflation Is Accelerating

US Consumer Price Index Inflation for Key Categories



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Source: Bureau of Labor Statistics, Haver Analytics
Note: As of December 2024
Core goods represent ~23% of core CPI, shelter represents ~46%, and other services ex-shelter and ex-energy services represent ~31%.

Note that there are three primary reasons to be careful in interpreting next week's release:

- Seasonal adjustment factors will be revised for the years from 2019 to 2024, and new factors and index weights will be released for 2025. These changes could lead to marginal deviations from expectations.

- Typically, about half of the full year price increases for core CPI occur in the first three months of the year in the seasonally unadjusted numbers. In recent years seasonal adjustments have not been as successful as in the past, leading to larger forecasting errors and bigger CPI surprises.

- California wildfires could add to inflation pressures, but I doubt the scale of the related supply and demand effects of this tragedy are large enough to skew national figures. The rebuilding process could add to inflation pressure over time, but that would likely be spread over months and years, reducing its effect on a much larger base of national consumption.

2. **China's CPI and Producer Price Index (PPI) are likely to remain undesirably low.**

   China's CPI is expected to rise 0.4% y-o-y versus 0.1% in January, while PPI is expected at -2.2% versus -2.3%. If realized, these figures would represent the 24th month of CPI below 1% and the 28th month of PPI deflation. As a reminder, the risk of ongoing extremely low inflation is that it leaves China's companies and consumers in a precarious position as any material downward shock to growth could lead to deflation, which makes servicing elevated debt levels more difficult for borrowers. China's private sector companies are among the most highly leveraged in the world, which makes this risk all the more relevant.

3. **UK GDP for Q4-24 is likely to have declined by 0.1%.**

   While no consensus estimate is available yet on Bloomberg, the BoE forecasts a 0.1% decline in Q4-24 GDP based on "a broad-based downturn in business confidence." Recent UK economic reports have featured a troubling combination of signs of sustained stickiness in selected wage and price pressures alongside signs of weakening growth. The less positive perspective also featured in the BoE Monetary Policy Report's section on current economic conditions, where it reduced the outlook for 2025 GDP growth to 0.75% from 1.5% while slightly boosting growth expectations for 2026 and 2027 to 1.5% from 1.25%.

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