*Anima*Insight

MACRO OUTLOOK

Cruise control

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Incoming data suggest that the US economy remains on a soft-landing path driven by deteriorating quality of spending. Indeed, a gradually moderating labor market is setting the stage for a slowdown in income growth, likely causing consumers to be more cautious in their spending behaviors. This is consistent with our view that growth will continue to gently ease in through the forecast horizon, but without taking the economy into recession.

In the EA, area-wide GDP was revised moderately downward in Q2, on the back of weaker domestic demand. Guidance from soft data does not hint at near-term acceleration into Q3. We left our 2024 baseline unchanged, consistent with activity levels remaining below potential for the remainder of the year. Looking further ahead, we believe that our two main recovery drivers (positive real income + improving credit conditions) remain valid. As a result, we expect growth to improve close to potential in 2025.

In China, we continue to expect growth to stay at potential; weak momentum suggests downside risks to our baseline have increased, though.

In the US, idiosyncratic factors largely drove the step-up in August core CPI. Though this report was not as encouraging as previous months' reports, we think that the data still support our outlook for gradual disinflation.

In the EA, the August inflation print showed a stronger-than-expected slowdown in core goods and marginally stickier services. Our view on the inflation outlook remains largely in place, as the current relatively firm underlying services inflation dynamics are offset to weaken amid softening activity data and subsiding wage pressures.

In China, structural factors will continue to keep consumer prices in check over the next few quarters as inflation will stay below 1% in 2024.

We stick to our view that the Fed will deliver 25bp of rate cuts at the upcoming September meeting and 25bp at the December meeting, with the risk of a further cut in November. Beyond 2024, we expect the Fed to continue cutting rates gradually by 25bp on a quarterly basis until it reaches the level of neutral rate (3-3.50%).

The ECB cut the deposit rate by 25bp to 3.50%, as widely expected. The tone of the statement and of the press conference was largely unchanged compared to recent meetings and indicate that the ECB remains data-dependent and maintains a gradual approach to rate cuts. We stick to our forecasts of 25bp rate cut at the December meeting followed by 100bp of rate cuts in 2025, one per quarter, with the depo rate ending 2025 at 2.25%, roughly in line with neutral.

We continue to anticipate that the People's Bank of China (PBoC) will remain cautious, as the economy is expected to improve very moderately after the summer, raising odds that further fiscal stimulus is on the pipeline.

GROWTH

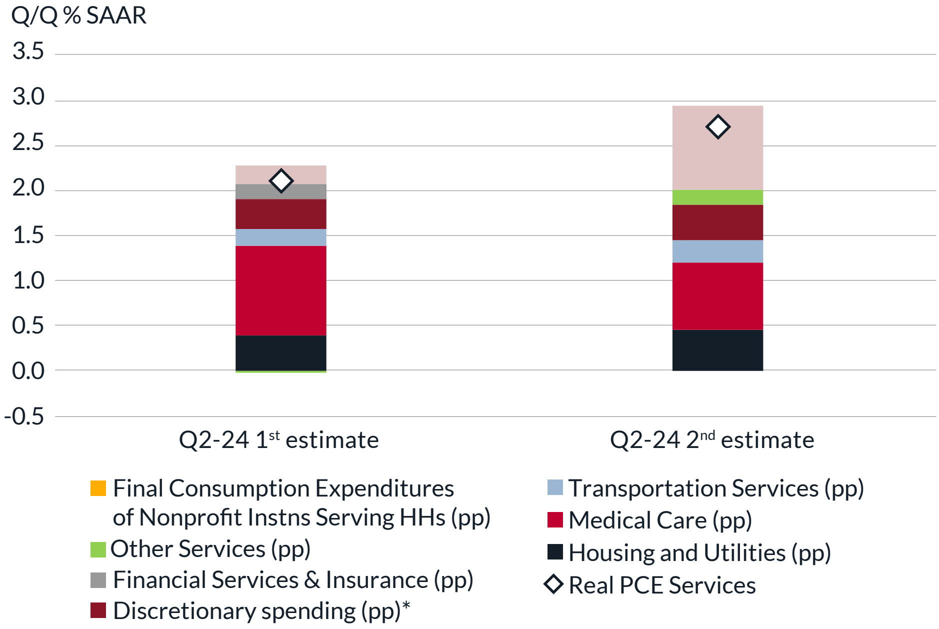
US – Slow and steady still holds true

Incoming data suggest that the US economy remains on a soft-landing path driven by deteriorating quality of spending. Indeed, a gradually moderating labor market is setting the stage for a slowdown in income growth, likely causing consumers to be more cautious in their spending behaviors. This is consistent with our view that growth will continue to gently ease in through the forecast horizon, but without taking the economy into recession.

Quality of spending keeps deteriorating. Real GDP for Q2-24 was revised up by 0.2pp to 3.0% q/q SAAR. An upward revision to consumer spending was partly offset by downward revisions to non-residential fixed investment, exports, inventories and government spending. Granted, we don't read too much into the strength in personal-spending numbers. Despite a large part of the revision came on the back of services spending, we note that the services-component that was revised upward is related to a portion of PCE that represents the services that are provided to households by nonprofit institutions without explicit charge. Meanwhile, the dynamics of spending in discretionary services continues to travel roughly unchanged.

Consumer fatigue extends into Q3. Though the headline figures in the July personal spending data were mostly rosy, the details of the report reveal aspects of a potentially fragile economy. Spending growth was largely supported by a one-off recovery in car sales, while services spending shows only signs of stabilization, and consumers are cutting back on saving while they still can. (**Figure 1**)

FIGURE 1
Quality of spending keeps deteriorating



** Discretionary spending = Recreation svs + Food svs and accomodation*
Source: Haver Analytics, ANIMA Research

Labor market weakening still orderly. August payrolls data adds to evidence that employment growth is cooling, although not at an alarming pace. Improvement in the pace of job creation in construction and leisure/hospitality speaks to the point. Moreover, the unemployment rate ticked down. Temporary layoffs had boosted unemployment in July but those mostly reversed. Beyond monthly volatility, we note that systematic downward revisions are outlining the bulk of the labor supply slowdown.

Weaker manufacturing, stronger services. Although the ISM manufacturing index improved mildly in August, it remained in contractionary territory. The outcome is broadly consistent with a theme that has been in place for the better part of the past year: the economy is still expanding even if the factory sector is not. Meanwhile, services activity is merely moderating rather than declining, quelling for now concerns about stalling growth.

ANIMA baseline. Our sequential path for 2024 remains broadly unchanged. We project GDP for Q3-24 at 2.3% q/q SAAR (vs 2.5% prior estimate), and 2.1% for Q4-24 (unchanged from previous estimate). This was consistent with an annual growth rate of 2.7% (unchanged from previous estimate). For H1 2025, on average, we expect growth at 1.9% q/q SAAR and 1.7% for H2-25 (unchanged from previous estimate) – consistent with an annual growth rate of 2.1% (unchanged from previous estimate). (**Table 1**)

EA – Muddling through

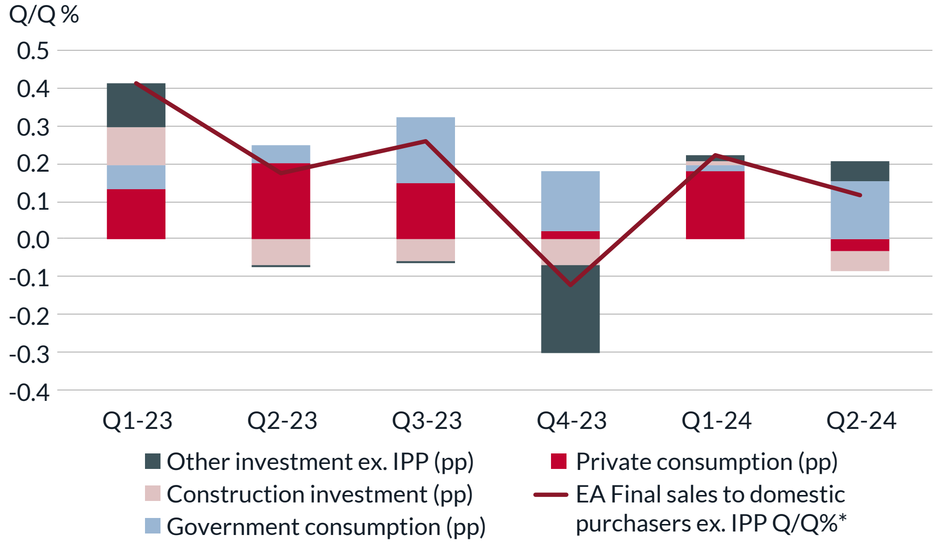
Area-wide GDP was revised moderately downward in Q2, on the back of weaker domestic demand. Guidance from soft data does not hint at near-term acceleration into Q3. We left our 2024 baseline unchanged, consistent with activity levels remaining below potential for the remainder of the year. Looking further ahead, we believe that our two main recovery drivers (positive real income + improving credit conditions) remain valid. As a result, we expect growth to improve close to potential in 2025.

Weak underlying domestic demand. Area-wide Q2 GDP was revised to 0.2% q/q (vs 0.3% initially reported) with a weak composition, given declines in consumption and investment spending. Supply side details shown that cross-sectoral divergences remain salient, as the Q2 expansion was once again services-driven. In the meantime, soft data do not hint at near-term acceleration drivers into Q3.

Resilience in a gradually softening labor market. The area-wide unemployment rate reported a new all-time low in July at 6.4%. Meanwhile, employment growth keeps being accommodated by an increase in the labor force through a mix of rising participation and a recovery in immigration. On the other hand, labor demand is gradually easing: shortages and vacancies are falling quickly to pre-pandemic levels. (**Figure 2**)

FIGURE 2

Growth revised down in Q2 as domestic demand loses steam



**IPP= Intellectual Property Products*
Source: Haver Analytics, ANIMA Research

More confidence ahead. Despite the current uninspiring economic outlook, we still predict a modest improvement in 2025. We believe that a gradual increase in households' real disposable income and a resilience in employment, coupled with a shift from a restrictive to a neutral/slightly accommodative monetary policy stance, should lead to a recovery in private consumption and a modest revival in business investment. This is expected as the prospects for both demand and corporate profits become more favorable.

ANIMA baseline. For 2024, we have left our growth baseline unchanged, consistent with activity levels remaining below potential for the remainder of the year. In sequential terms, we forecast growth at 0.3% q/q for Q3-24, (unchanged from the previous baseline), while for Q4-24 we expect another 0.3% q/q (unchanged from the previous baseline). This is consistent with an annual growth rate for 2024 at 0.8%. For 2025, we expect growth at 0.3% on average in H1-24, and 0.4% in H2-24 – consistent with an annual growth rate of 1.3%. (**Table 1**)

China – Growth at potential, but downside risks increase

We continue to expect the Chinese economy will grow at a rate of around 5% this year and next, a level considered adequate by the Communist Party to meet its global strategic objectives. Nonetheless, downside risks to our baseline increased.

Growth is expected to advance slightly around potential in the second half of the year. After a predicted slowdown in Q2 due to weakening supply and demand conditions, we foresee a modest economic recovery in the latter half, which should keep growth at potential in the coming quarter owing to fresh stimulus from authorities.

Foreign trade should remain a positive factor. Exports are likely to stay afloat, buoyed by shipments to the US, Eurozone, and Japan, while imports are expected to remain resilient in Q3/Q4, benefiting from a favorable base effect.

The housing sector remains weak. Despite new policy interventions, the housing market is expected to take several quarters to stabilize, continuing to act as drag for overall growth.

ANIMA Baseline. We slightly downgrade our baseline owing to a balancing act between weaker-than-expected momentum and fresh stimulus injection, and we expect GDP growth to unfold as follows: 4.8% q/q in Q3 and 4.9% q/q in Q4 (annual growth at 4.9% vs 5.0% before). For 2025 we expect growth to continue to expand at a 5% annual pace. (**Table 1**)

INFLATION

US – August as an acceptable report

Idiosyncratic factors largely drove the step-up in August core CPI. Though this report was not as encouraging as previous months' reports, we think that the data still support our outlook for gradual disinflation.

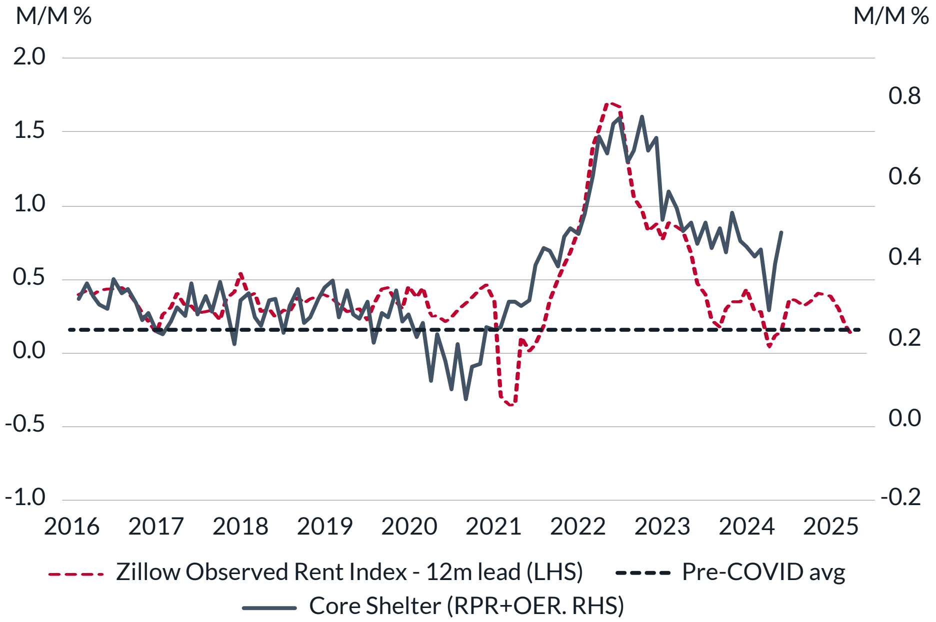
Slightly stronger than expected but not worrisome. The August CPI report was stronger than expected at the core level. The bulk of the firming in core CPI came from core services inflation, which rose by 0.1pp to 0.4% m/m and accounted for a swing of +8bp from July.

The positives: goods deflation, breadth, and volatile items. First, core goods prices fell more than expected, and the decline was not just due to weakness in used car prices. Second, the breadth of disinflation in recent months continues to improve. Third, a couple of small and volatile components - airfares and lodging - explained the uptick in supercore (+0.1pp to 0.3% m/m), after being extremely weak in the past months. Fourth, MV insurance prices continue to normalize - a sign that the period of abnormally strong insurance increases is ending. Fifth, two major macro-reopening sensitive categories (food away from home and recreation services) remain in line with the pre-COVID norm.

The negatives: OER! The bad news is that shelter inflation accelerated. Along with the details, we note two mutually offsetting forces: 1) rent of primary residence (RPR) partially reversed July's jump, 2) OER inflation accelerated. Considering that OER has more than twice the weight inside core shelter (i.e., RPR+OER), OER's strength failed to offset RPR's weakness. (**Figure 3**)

FIGURE 3

Leading indicators continue to point south



Source: Haver Analytics, ANIMA Research

Shelter fundamentals still point to further cooling. Regional-wise, this time, we do not notice relevant drivers that could explain the OER spike. However, we do note that the bulk of this acceleration came mainly from the grouping of smaller cities. Overall, we believe that core shelter has entered a range of gradual, albeit volatile, moderation consistent with some volatility. In this regard, leading indicators continue to point toward further cooling.

Core PCE is on track for another favorable print in August. With CPI inputs, we track core PCE for August at 0.19% m/m - roughly unchanged from July (0.16%). We will update our forecasts tomorrow with the PPI release.

ANIMA baseline. For Q3-24 we expect headline/core CPI at 2.6/3.2% (unchanged from previous baseline) and for Q4-24 we project 2.4/3.2% y/y (vs 2.5/3.1% prior) – consistent with an annual rate for 2024 at 2.9/3.4% (unchanged from previous baseline). In H1-25 we forecast 2.1/2.8% (vs 2.1/2.6% prior estimate), while for H2-25 we project 2.3/2.7% (vs 2.3/2.6% prior estimate) – consistent with an annual rate for 2024 at 2.2/2.8% (vs 2.2/2.6% prior baseline). (**Table 2**)

EA – Disinflation continues in earnest

The August print showed a stronger-than-expected slowdown in core goods and marginally stickier services. Our view on the inflation outlook remains largely in place, as the current relatively firm underlying services inflation dynamics are set to weaken amid softening activity data and subsiding wage pressures.

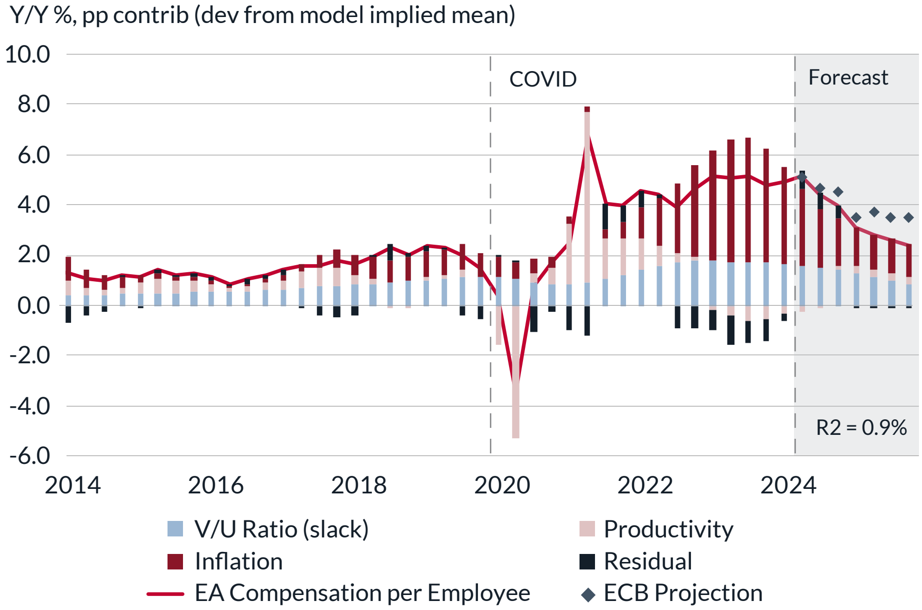
Is backing off. Headline inflation for August slowed to 2.2% y/y from 2.6% in July. This marks the weakest reading since June 2021 and is the third print in line with expectations this year.

Core mixed, but with encouraging signs. The August print shows a stronger-than-expected slowdown in core goods and marginally stickier services. However, we think both those dynamics are overstated.

1. The break lower in core goods may well be due to the volatile and highly seasonal semi-durables. We think the easing in core goods in August may overstate the softness on a forward-looking basis, and we would need to see more data to truly challenge the narrative that core goods inflation is normalizing from low rates.
2. The tick-up in services might also be partly explained by the volatile components (i.e. German package holidays). In addition, we note that about 75% of the August sequential acceleration in euro area services inflation was caused by France, where services were at least partly boosted by base effects and possibly by the Olympics, though we saw no evidence of that in July. In this regard, we do think the data point to continued persistence in services inflation, which has made no disinflationary progress in nine months. However, we would need stronger evidence to conclude that underlying services momentum is actually accelerating. (**Figure 4**)

FIGURE 4

No underlying reacceleration in sight



Model based on a augmented Phillips curve that relate sequential growth in compensation per employee to measures of labor market slack, inflation catch-up and other factors (including lagged wage growth, trend labour productivity and country-specific effects).
Source: Haver Analytics, ANIMA Research

Cooling wage growth. Pay growth indicators have slowed more than anticipated in Q2, including the ECB's measure of negotiated wages and compensation per employee. The ECB's wage surveys, our wage model and the continued drop in vacancy rates all point to further cooling in wage growth ahead.

Profit margins continue to absorb the rise in unit labor costs. On the profit side, the GDP deflator decomposition for Q2 shows that margins are declining as firms partially absorb the increase in input costs.

ANIMA baseline. Altogether, this leaves our view on the inflation outlook largely in place, as the current relatively firm underlying inflation dynamics are offset by softer activity data and subsiding wage pressures. More in detail, for Q3 2024 we expect headline/core HICP at 2.3/2.8% (unchanged from previous baseline) and 2.3/2.7% for Q4 2024 (previously 2.3/2.6%) – consistent with an annual growth rate for 2024 of 2.4/2.9% (previously 2.4/2.8%). For 2025, we expect headline/core HICP at 2.2/2.4% in H1 2025 (vs 2.2/2.3% previously) and 2.1/2.3% in H2 2025 (vs 2.1/2.2% previously) – consistent with an annual growth rate of 2.1/2.3% (vs 2.1/2.2% previously). (**Table 2**)

China – The zero-inflation environment set to dissipate in 2025

Our inflation outlook remains unchanged as structural factors will continue to keep consumer prices in check over the next few quarters. We expect inflation to stay way below the central bank's 3% target in 2024, with inflation picking up in the first half of 2025, driven by base effects that should push prices above 1% next year.

In August, headline inflation rose while core inflation declined. Overall inflation increased by 0.1pp to 0.8% y/y, owing to higher food prices, but core inflation declined for the third month in a row to 0.1% y/y, reaching a new minimum this year, as service prices slowed.

The zero-inflation environment seen in the first half of the year is expected to gradually fade in the coming months. Inflation averaged just 0.1% in H1, with a slight uptick in Q2, mainly due to higher pork prices. However, inflation is likely to remain below 1% overall.

ANIMA baseline. Against this backdrop, our inflation baseline is unchanged. We expect headline inflation to unfold as follows: 0.6% q/q in Q3 and 1.0% q/q in Q4 (annual average at 0.5%). As per 2025, we expect inflation to continue to mildly reaccelerate above 1% on annual average owing to favorable base effect. (**Table 2**)

TABLE 1 AND 2

ANIMA's growth and core inflation baseline

Growth	US Q/Q %, SAAR	EA Q/Q %	China Y/Y %
2023	**2.5%**	**0.5%**	**5.2%**
Q1 24	1.4%	0.3%	5.3%
Q2 24	3.0%	0.2%	4.7%
Q3 24	2.3%	0.3%	4.8%
Q4 24	2.1%	0.3%	4.9%
2024	**2.7%**	**0.7%**	**4.9%** ↓
2025	**2.0%**	**1.3%**	**4.7%** ↓

Core Inflation	US CPI Y/Y %	US PCE Y/Y %	EA Y/Y %	China Y/Y %
2023	**4.8%**	**4.1%**	**4.9%**	**0.2%**
Q1 24	3.8%	2.9%	3.1%	0.0%
Q2 24	3.4%	2.7%	2.8%	0.3%
Q3 24	3.2%	2.6%	2.8%	0.7%
Q4 24	3.1%	2.6%	2.7%	1.2%
2024	**3.2%**	**2.7%**	**2.9%** ↑	0.6%
2025	**2.8%** ↑	**2.2%**	**2.3%** ↑	1.2%

Source: Haver Analytics, ANIMA Research

MONETARY POLICY

ECB – Nothing new under the sun

The ECB cut the deposit rate by 25bp to 3.50%, as widely expected. The tone of the statement and of the press conference was largely unchanged compared to recent meetings and indicate that the ECB remains data-dependent and maintains a gradual approach to rate cuts. We stick to our forecasts of 25bp rate cut at the December meeting followed by 100bp of rate cuts in 2025, one per quarter, with the depo rate ending 2025 at 2.25%, roughly in line with neutral.

Little change at the ECB's meeting beyond the deposit rate cut. The ECB cut the deposit rate by 25bp to 3.50%, as widely anticipated by consensus and markets. There was basically no change in the statement, no change in the tone at the press conference and little change in the staff forecasts. The ECB upgraded by 0.1pp core inflation in 2024 and 2025, while it downgraded growth by 0.1pp across the forecast horizon (Table 1). Even after this revision, risks to growth forecasts remain tilted to the downside.

Inflation will converge to target. The ECB continued to sound confident that inflation will converge to target over the forecasting horizon for the following reasons:
1. For the 5th consecutive round, staff projections saw inflation declining towards 2% towards the end of 2025.
2. President Lagarde explained in great details that the stickiness of services inflation is linked to wage growth that will still be high and volatile in the final part of 2024 and first part of 2025, but that beyond H1 2025 is expected to decline.
3. While wage growth is still positive, profit margins are declining, indicating that firms are absorbing the increase in labor costs.
4. Financing conditions continue to be restrictive.
5. The decision to cut rates was unanimous.

But rates need to stay restrictive for the time being. That said, the ECB also acknowledged that rates need to stay sufficiently restrictive for a while to ensure that inflation will ultimately converge to target. In this respect, President Lagarde went as far as saying that domestic inflation is not satisfactory. This is why the ECB will continue to adopt a meeting-by-meeting approach and look at the totality of data, not just at a data point. Moreover, the ECB continues not to pre-commit to any path of rate cuts.

We stick to our baseline. Against this backdrop, we continue to believe that the ECB will proceed gradually with rate cuts. We stick to our forecasts of 25bp rate cut at the December meeting followed by 100bp of rate cuts in 2025, one per quarter, with the depo rate ending 2025 at 2.25%, roughly in line with neutral.

PBoC – Struggling economy increases odds of intervention

We continue to anticipate that the People's Bank of China (PBoC) will remain cautious, as the economy is expected to improve very moderately after the summer, raising odds that further fiscal stimulus is on the pipeline.

We expect the trade-off between the economy's uneven recovery and the government's gradual interventions to persist in the second half of the year. We believe policymakers will maintain their focus on the housing sector, introducing new measures to address unsold properties, though a full real estate recovery is expected to be limited. Although we now expect further fiscal stimulus to support growth in Q3/Q4, we continue to think the PBoC is likely to adopt a prudent approach, with only minor policy adjustments expected by the end of the year. We stick to our forecast of a 50bp cut in the reserve requirement ratio (RRR) and a 10bp policy rate cut by year-end. Risks remain skewed towards additional monetary easing, particularly if the Federal Reserve begins cutting its federal funds rates.