

# BEHIND THE HEADLINES

with Ronald Temple, Chief Market Strategist

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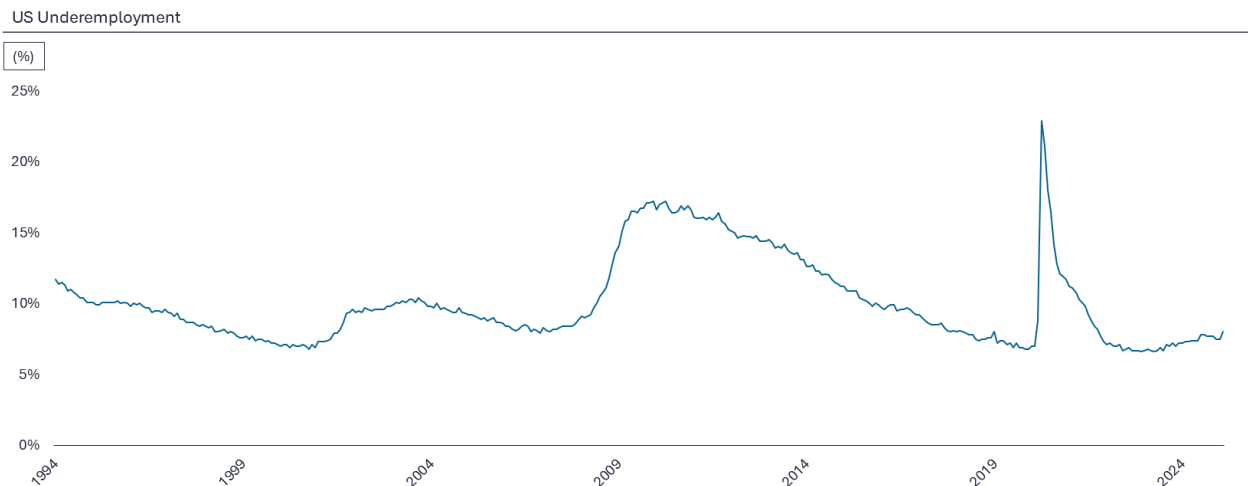
## The Week Behind

### 1. US nonfarm payrolls grew roughly in line with expectations, but the underemployment rate jumped.

The United States created 151k new jobs in February versus consensus expectations for 160k. The unemployment rate nudged higher to 4.1% from 4.0% while the labor force participation rate eased to 62.4% from 62.6%. Month-on-month (m-o-m) average hourly earnings rose in line with expectations while the year-on-year (y-o-y) increase was slightly less than expected at 4.0%.

A more worrying aspect of the report was a 10% increase in the number of part-time workers who want full-time employment. The rise took the underemployment rate up to 8.0% from 7.5%. Historically, part-time and temporary positions can offer an early glimpse into future employment trends. The number of people in temporary positions has declined over the last year. These metrics add to my growing concerns related to the falling hire and quit rates that will be updated next week that could signal increasing fragility in the US labor market.

The US Labor Market Appears to Be at Full Employment, but There Are Cracks beneath the Surface



LAZARD

Source: Bureau of Labor Statistics, Bloomberg  
Note: As of February 2025

LAZARD

**2. The United States increased tariffs on imports from China to 20% from 10% and imposed tariffs on imports from Canada and Mexico before extending an exemption for all goods covered by the United States-Mexico-Canada-Agreement (USMCA) until 2 April.**

This week, the United States imposed additional tariffs that could increase the effective average tariff rate on all imports into the country from ~2.7% before the Trump administration returned to power to between 6.9% to 8.4% depending on the percentage of items that can be shifted to tariff-free access under USMCA rules. As a simple rule of thumb, for every 100 basis points (bps) the average tariff rate on imports increases, the US Core Personal Consumption Expenditure (PCE) inflation rises by 10 bps. This would imply that the tariffs put into place since the inauguration on 20 January could raise US core PCE inflation by ~40 to 60 bps.

The tariff on imports from China doubled to 20%. As it relates to Canada and Mexico, however, the details of what will be covered by the new tariffs and what will be exempt are not yet clear. Initially, President Trump declared that the 30-day delay in tariffs on imports from Canada and Mexico was ending on 4 March, but within 48 hours, he reversed course and indicated that goods that are exempt from tariffs under the USMCA would be given another 30-day reprieve until 2 April. Subsequently, Bloomberg reported that the White House was indicating that 62% of imports from Canada would still be subject to a tariff of 10% for energy-related products and 25% for all non-energy products. For Mexico, 49% of imports in 2024 were exempt from tariffs and would presumably remain tariff-free until April. Of the remaining 51% of imports from Mexico, just over 80% arrived duty-free last year under the World Trade Organization Most Favored Nation rules. Assuming these products comply with USMCA content and wage rules, they could presumably be shipped under USMCA guidelines and remain duty-free. That would imply that ~10% of Mexican exports to the United States will end up being subject to the 25% tariff for now.

Overall, the confusion and unpredictability of tariffs being imposed and then withdrawn on a seemingly daily basis rattled the stock market. By the close of business on Thursday, 6 March, the S&P 500 Index had declined by 6.7% from the mid-February all-time high. I expect more tariffs to be imposed across a range of industries and countries, taking the average US tariff rate to over 10%, a level last seen in the early 1950s, from the 2.7% level before the new administration took office.

As a reminder, the next tariffs scheduled for implementation are:

12 March	Steel and aluminum
2 April	Reciprocal tariffs
2 April	Autos

It is also notable that 1 April is the deadline for the American First Trade Policy Executive Order investigations report from the US Department of Commerce, US Department of the Treasury, US Trade Representative, and the Office of Management and Budget. This report has one objective in my view which is to lay the legal groundwork for more expansive US tariffs and protectionism.

### 3. US Institute for Supply Managers (ISM) manufacturing data were negative with higher prices paid and lower new orders while services figures were more encouraging.

The ISM Manufacturing Index fell slightly short of expectations, but the sub-indices were more negative with the ISM Prices Paid jumping significantly and the ISM New Orders falling materially.

The ISM Services Index was more encouraging with a stronger-than-expected headline figure and better employment and new orders. However, as with manufacturing, the prices paid index rose more than expected from an already elevated level.

ISM Manufacturing	Consensus	Actual	Prior Reading
ISM Manufacturing	50.7	50.3	50.9
ISM Prices Paid	56.0	62.4	54.9
ISM New Orders	54.6	48.6	55.1
ISM Employment	50.1	47.6	50.3

#### ISM Services

ISM Services	52.5	53.5	52.8
ISM Prices Paid	60.4	62.6	60.4
ISM New Orders	51.5	52.2	51.3
ISM Employment	51.6	53.9	52.3

Source: Bloomberg, Institute for Supply Management

### 4. China's National People's Congress (NPC) meeting failed to deliver sufficient fiscal stimulus.

At the NPC, Premier Li Qiang delivered the Government Work Report and announced key economic goals as well as measures the government plans to help achieve them. The 2025 GDP growth target was set, as expected, at "around 5%" while the inflation target was set at "around 2%," down from "around 3%" in previous years. The inflation change was also expected as multiple provinces had already lowered their targets and as inflation has been below 1% for over two years now.

More importantly, though, the stimulus measures that investors have been expecting for months were not delivered. Late in 2024, investors had been anticipating as much as RMB1 trillion for trade-in subsidies, RMB1 trillion for bank recapitalization, and RMB1 trillion for purchases of unsold homes to be used as public housing. The NPC delivered RMB300 billion for trade-in subsidies, RMB500 billion for recapitalization, and no specific funds for housing purchases (though local governments

can use some of the proceeds from RMB4.4 trillion of debt issuance to buy land and homes). The total size of the formal fiscal deficit target was increased to accommodate these measures and other unspecified spending, but the incremental amount remains short of what most economists believe is necessary to stimulate near-term demand.

I believe the longer China waits to address weak consumer confidence and stagnating domestic demand, the higher the probability that China could slip into an extended economic downturn. To avoid this, China needs not only short-term fiscal stimulus, but also significant structural reforms to resolve the multi-decade imbalance between consumption and savings caused by the inadequate social safety net and government funding models that depend excessively on property development.

To put a finer point on the social safety net point, as part of the NPC meeting, policymakers pledged to raise the minimum standard for the basic pension by RMB20 per month relative to the current level of RMB200 per month. A basic pension of less than US\$30 per month is woefully inadequate even in the least expensive areas of China, and an increase of less than US\$3 does not move the needle.

#### **5. China Purchasing Managers' Index (PMI) data showed modest improvement.**

The National Bureau of Statistics (NBS) PMI, which has greater representation of large, state-owned companies in its survey, modestly beat expectations for manufacturing while non-manufacturing activity matched consensus. In both cases, the PMI reading was slightly above 50 indicating modest growth. It is notable that the PMI improvement in February could also have been affected by the timing of Lunar New Year celebrations that had depressed January figures. Encouragingly, within the manufacturing sub-indices, new orders and production strengthened materially, rising to 51.1 from 49.2 and to 52.5 from 49.8, respectively. In the non-manufacturing sub-indices, services activity weakened while construction strengthened.

The Caixin PMI, which better reflects the results of smaller, privately owned companies improved, with the manufacturing index being lifted by a sharp improvement in the employment sub-index. The services index was boosted by stronger employment and new business.

## February China PMI Data

Release Date		Consensus	Actual	Prior Month
2/28/2025 NBS	Manufacturing	49.9	50.2	49.1
	Non-Manufacturing	50.4	50.4	50.2
	Composite	*	51.1	50.1
3/2/2025 Caixin	Manufacturing	50.4	50.8	50.1
3/4/2025	Services	50.7	51.4	51.0
	Composite	*	51.5	51.1

Source: Bloomberg, China Federation of Logistics & Purchasing, S&P Global

\* No consensus estimate available on Bloomberg.

### 6. China trade data for January and February were materially below expectations.

Due to the Lunar New Year holidays, China reports combined January and February data for key economic metrics. China's imports in the first two months of the year fell 8.4% y-o-y versus consensus expectations for an increase of 1.0%. Exports grew 2.3% versus expectations for growth of 5.9%. The trade surplus rose to \$170.5 billion versus consensus for a surplus of \$147.5 billion.

The decline in trade was broad based across countries and industries. Trade with emerging economies decelerated more than with developed economies. While exports to the United States had surged late in 2024 to avoid tariffs, the decline suggests that the slowdown is not simply a hangover from front-loaded demand, but is instead reflecting a downshift in broader activity levels.

### 7. European Commission (EC) President Ursula von der Leyen's proposed ReArm Europe plan could represent a watershed moment for Europe.

EC President von der Leyen's ReArm Europe plan aims to encourage Europe to significantly increase defense spending through key policy changes that could lead to an additional €800 billion of additional defense spending. The Commission would allow European governments to trigger fiscal escape clauses to the Stability and Growth Pact to increase defense spending. The Commission estimates that if defense spending is increased by 1.5% of GDP, the total incremental spending could equal €650 billion over the next four years. The European Union would create a lending facility with €150 billion of capacity to fund national investment in defense with a priority on common projects and procurement. Additionally, a plan would be developed to allow the use of unused Cohesion funds for defense. Finally, policies would be implemented to encourage private sector investment in defense, including through funding via the European Investment Bank.

**8. Germany's next government announced plans to significantly increase investment in defense and infrastructure and will advance a vote on the necessary constitutional changes next week.**

Incoming Chancellor Friedrich Merz proposed a constitutional change that has gained significant momentum to change the function of the "debt brake." In an announcement explicitly described as a "whatever it takes" moment, the government committed to "rearm completely" and invest in growth. The new rules would exclude all defense spending above 1% of GDP from calculations related to the debt brake. Merz also proposed a new €500 billion government investment fund to be used over the next decade primarily on infrastructure and other growth-enhancing purposes including education, decarbonization, transportation, and housing. Finally, the debt brake would be reformed to allow states in Germany to run deficits of up to 0.35% of GDP versus the current zero limit.

There are various interactions between German and European Union rules that could limit the use of the investment fund, but it appears to me that Europe and Germany might be at a critical moment where policymakers finally act to enhance national security, and in the course of doing so, also lift growth rates meaningfully. In fact, some estimates suggest that the new proposals from Merz could be as substantial as the spending on reunification with East Germany over 30 years ago.

European bond markets sold off sharply with the 10-year German bund yield rising nearly 30 bps, the most since German reunification in 1990. The euro surged on the prospects of stronger growth and higher sustained interest rates. Equity markets rallied as investors began to recognize the shift in Germany's approach to fiscal issues as a potentially seismic reorientation that could lead to less stringent rules across the Eurozone which could then lead to accelerated growth. Even though the DAX Index has rallied over 15% year to date to a new all-time high, I believe the announcements from Europe this week could be the beginning of a more sustained rotation of capital away from US into non-US equities. I had previously expected US outperformance to extend longer, but the unpredictable nature of US trade policy and the striking shift of direction in Europe could accelerate the rotation. However, I would caution about getting too enthusiastic regarding equities that are likely to be affected by US tariffs which I expect to be extended and increased in the months ahead.

**9. The European Central Bank (ECB) cut interest rates by 25 bps as expected.**

The messaging from the ECB and President Christine Lagarde remained dovish in my view. Lagarde highlighted three key messages: a) disinflation is on track, b) policy is meaningfully less restrictive than it had been after 150 bps of rate cuts, and c) uncertainty is extremely high. That said, she also reiterated more than once that the ECB is a) not pre-committed to any course of action, b) as data dependent as ever, and c) making decisions on a meeting-by-meeting basis.

All said, the direction of travel remains for further easing, but recent developments in terms of changes to European fiscal constraints could mean more government investment in infrastructure and more spending on defense, both of which could add to growth momentum and reduce the need for ECB rate cuts. I have been of the view that the ECB would end 2025 with the deposit rate at 1.25% or 1.5%. I maintain that dovish base case, but the risk to my view might be shifting upward if we see a significant shift in fiscal policy across the region.

## 10. Aggregate Eurozone inflation was slightly higher than expected.

With the four largest countries' results out in the prior week, there was little excitement regarding the Eurozone aggregate figures. The ECB forecasts that Eurozone headline inflation will average 2.3% in 2025, 1.9% in 2026, and 2.0% in 2027 while core inflation is expected at 2.2%, 2.0%, and 1.9%, respectively. The Harmonized Index of Consumer Price (HICP) data are summarized below.

### EU HICP for February

Release Date	Country		Consensus	Actual	Prior Reading
2/27/2025	Spain	Headline m-o-m	0.4%	0.4%	-0.1%
		Headline y-o-y	2.9%	2.9%	2.9%
2/28/2025	France	Headline m-o-m	0.2%	0.0%	-0.2%
		Headline y-o-y	1.1%	0.9%	1.8%
2/28/2025	Germany	Headline m-o-m	0.5%	0.6%	-0.2%
		Headline y-o-y	2.7%	2.8%	2.8%
2/28/2025	Italy	Headline m-o-m	0.1%	0.1%	-0.8%
		Headline y-o-y	1.8%	1.7%	1.7%
3/3/2025	Eurozone	Headline m-o-m	0.4%	0.5%	-0.3%
		Headline y-o-y	2.3%	2.4%	2.5%
		Core y-o-y	2.5%	2.6%	2.7%

Source: Bloomberg

Note: Consensus estimates changed in some cases from what was previewed previously.

## The Week Ahead

### 1. The US Job Opening and Labor Turnover Survey (JOLTS) will be released.

While I have historically focused primarily on the job openings and quit rates, I will also be eager this month to see the hiring rate. Job openings are likely to continue falling with the number of unemployed workers per unfilled job heading toward parity from the current 1.1 level. The quit rate



has declined from a peak of 3.0% per month to 2.0% in December, and I expect further declines in 2025 as workers find it more difficult to increase their compensation by switching jobs in a weakening labor market. Finally, the hire rate has declined to levels comparable to 2013 when the unemployment rate was between 6.5% and 7.0%. Any further declines would add to my worries that the US economy might be weaker than it appears, and that consumer demand might fade as a result.

**2. The US Consumer Price Index (CPI) for February is expected to show core inflation remained in the 3.2% to 3.3% range of the ninth consecutive month on a y-o-y basis in February.**

Headline inflation is expected to rise 0.3% m-o-m and 2.9% y-o-y in February versus 0.5% and 3.0%, respectively in January. Core inflation is expected to rise 0.3% m-o-m and 3.2% y-o-y versus the January gains of 0.4% and 3.3%. I expect core goods prices to remain in positive inflation territory while shelter and services inflation should continue their slow grind downward. It remains too early to see any meaningful impact from tariffs in the CPI, but I expect to see those effects in the next few months given that the first 10% tariff increase on imports from China was imposed early in February. Assuming most importers front-loaded demand to avoid tariffs, it could take three or more months to see any meaningful inflation impact.

**3. US tariffs on steel and aluminum are scheduled to be imposed on 12 March.**

Imports of steel and aluminum in 2024 were approximately \$54 billion out of total imports of ~\$3.3 trillion. While the size of steel and aluminum imports is relatively small, the impact on key industrial sectors could be meaningfully negative, especially for companies competing with non-US peers that will not be subject to the same tariffs on their inputs.

**4. University of Michigan Sentiment could offer a valuable signal regarding inflation concerns.**

Last month, long-term inflation expectations (5- to 10-year) jumped to 3.5%, the highest level since 1995 while one-year expectations hit 4.3%. Against this backdrop, next week's preliminary reading for March could offer a valuable signal regarding consumer inflation worries.

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

China's PPI has been in deflation for 28 consecutive months while CPI inflation has been below 1% for 24 months. It appears unlikely that either metric will increase materially in February given ongoing weakness in Chinese demand and the weak trade figures this week. The consensus expectation is for CPI to dip to -0.4% y-o-y while PPI is expected to remain in deflation at -2.1% y-o-y in February.



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