CENTRAL BANK WATCH

The Fed's dilemma

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Recent inflation numbers are in line with a short pause in the path towards the Fed's target, yet bond yields have moved sharply higher since the Fed's big cut. Medium-term inflation expectations – including FOMC member expectations – have moved higher (see chart), but **most of the increase in ten-year yields since the election reflects a rise in real rates.**

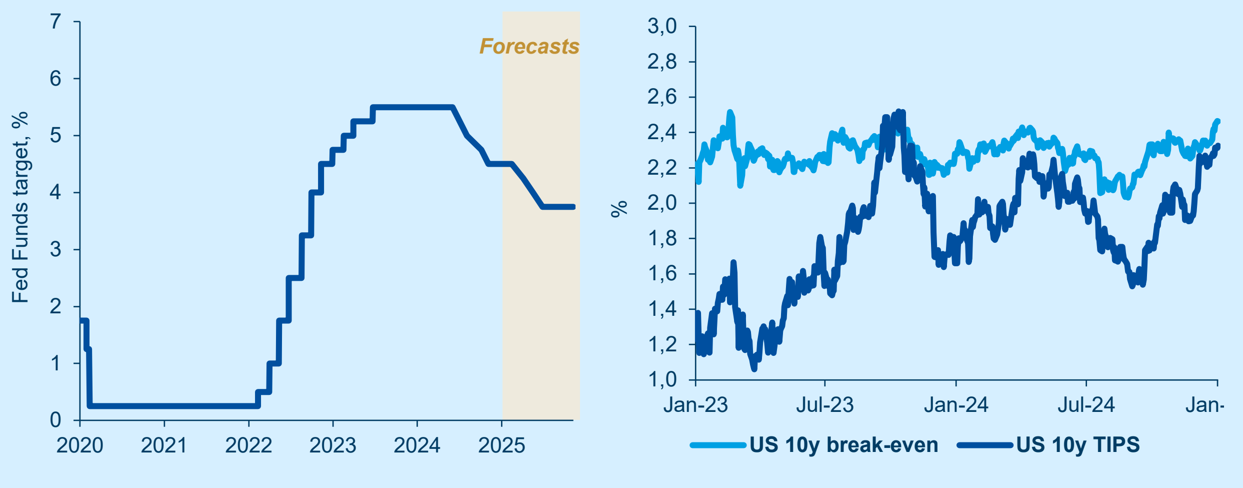
The Fed expects inflation about 30bp higher at the end of 2025 (at 2.5%), which implicitly incorporates some changes in policy under Trump, especially tariffs and fiscal easing. Market pricing is volatile and sensitive to monthly inflation outcomes. **We expect three cuts to take the policy rate to 3.75% by the end of this year**, as we believe the US economy will slow towards potential growth just below 2%, with higher real rates and tariffs weighing on growth.

The US labour market is gradually rebalancing and wage growth does not pose a risk to inflation. Labour demand has been weakening, with fewer openings, lower quit rates, and an increase in temporary jobs. Labour cost indicators – hours worked, wages of new hires – are also moderating. And aggregate wage growth of 4 percent supported by productivity growth.

"We expect three 25bp cuts by the end of this year, taking the policy rate to 3.75%."

Higher real bond yields, will be a key headwind to growth and asset prices. **The fiscal deficit – expected to be 6% of GDP this year – and associated debt issuance is the more likely reason for higher real rates, and higher term premia** – the additional compensation investors require both for holding more debt and for higher inflation uncertainty. Breakeven inflation rates have moved marginally higher (inflation swaps indicate similarly). But real rates and term premia have moved more, with the latter at 10-year highs. This is more worrying.

CHARTS: AII expectations on Fed Funds; 10y TIPS and inflation break-evens



Source: Amundi Investment Institute (AII), Bloomberg. Data is as of 16 January 2025. Forecasts are by AII and are as of 16 January 2025.

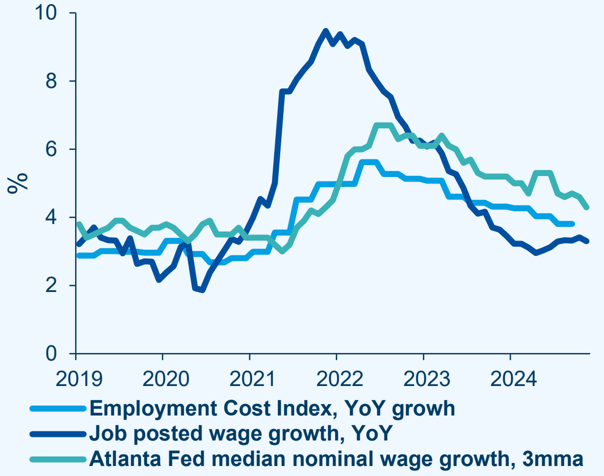
INFOGRAPHIC

A slower US disinflationary process moving ahead

Cooling labour market

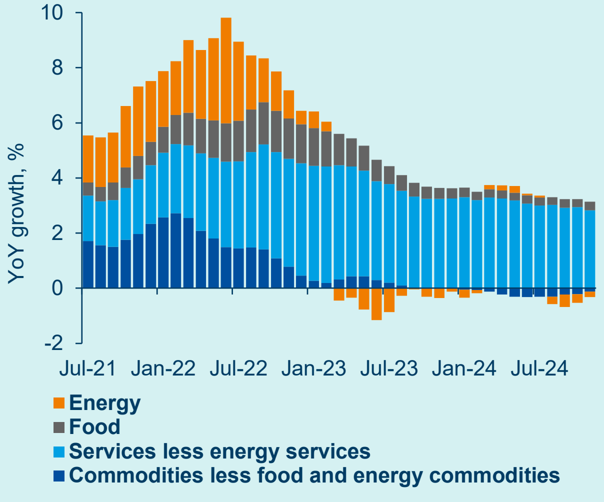
- While there has been an uptick in job openings, hiring remains on a downward trend.
- Workers are increasingly finding it more difficult to switch jobs and, consequently, the quit rate has been declining.

Slower wage growth and labour costs



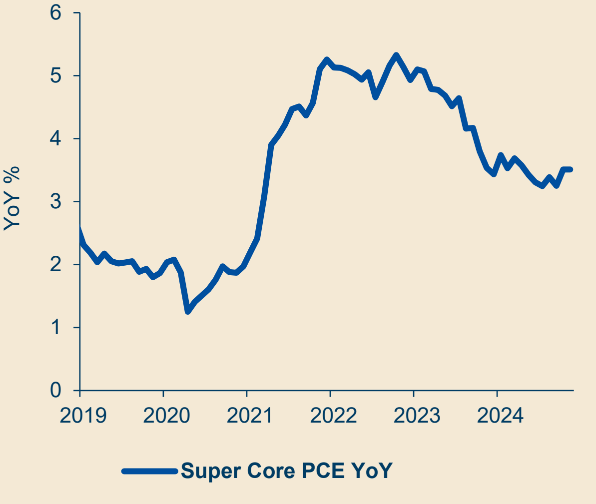
- The declining quit rate is an indicator of wage growth moderation ahead.
- Wage growth measures are on a downward trend and the index of new jobs posted shows there is room for moderation, although its stabilisation hints at a slower pace of decline.

Inflation trends key to watch for Fed's outlook in 2025



- Future disinflation will mainly be driven by services inflation, which is currently the stickier component.
- As such, future disinflation may be slower than in the past.
- Core goods' disinflationary contribution may be challenged in the future by likely tariffs.

Sticky inflation components on a downward trend



- Most of the persistent hot inflation items are services-oriented.
- Core services inflation has negative base effects for Q1 2025.

Source: Amundi Investment Institute on Bloomberg, Datastream. Data is as of 14 January 2025.

Main and alternative scenarios

	Probability 70% **MAIN SCENARIO** Resilient multi-speed growth	Probability 20% **DOWNSIDE SCENARIO** Renewed stagflationary pressure	Probability 10% **UPSIDE SCENARIO** More disinflation with productivity gains
GEOPOLITICS	▪ Rising tensions and geo-economic fragmentation, including protectionism and sanctions. ▪ Disruptive trade policies and re-routing of global supply chains as a reaction to tariffs. ▪ Ukraine-Russia: ongoing fighting, but ceasefire odds increase. ▪ Middle East: talks and conflicts likely. ▪ China-US: decline of relations. ▪ US-Europe relations under pressure.	▪ Autarchical new alliances challenge advanced economy democracies: new & escalating conflicts. ▪ Countries forced to choose between US vs China. Global trade begins to decline.	▪ Geopolitical risk subsides as conflicts come to a close. ▪ Shifting power dynamic reshapes global trade, fostering balanced growth and prosperity.
INFLATION & POLICY MIX	▪ Disinflation trend still intact, but upside risk in the US and EM. ▪ Developed Market central banks reaching their neutral rates in 2025. ▪ Most EM CBs at peak rates. ▪ Fiscal divergence: US might be under scrutiny with a second Trump presidency; EU consolidating; China expansionary.	▪ Adverse geopolitical trends halt progress on inflation advocate and stall rate cuts. ▪ Ballooning fiscal debt elevates the cost.	▪ Stabilisation of inflation around central banks' targets (and not an issue if slightly above as inflation expectations remain anchored).
GROWTH PATH	▪ Back to potential growth. ▪ Resilient multi-speed growth: subdued recovery in Europe, mild US deceleration but higher short term potential growth. ▪ Growth gap still favours EM. ▪ India's growth potential revised up.	▪ Lower output, sharp reduction in migration into advanced economies lowers labour supply and growth. ▪ Economic unbalances persist, further lowering potential growth (China, EU,...).	▪ Growth enhancing reforms lifting medium term growth potential. ▪ Industrial / trade policies boosting investment and activity.
CLIMATE CHANGE	▪ Climate change hampers growth and exacerbates stagflationary trends. ▪ Chinese dominance in processing and supply of critical minerals; US trying to catch up.	▪ Further policy delays imply more adverse climate events, hampering economic dynamism.	▪ From zero to hero in the net zero transition: geo-engineering, globally coordinated policies.

Risks to main scenario

LOW — Probability — HIGH

	10%	15%	15%	20%
	Central banks quantitative tightening combined with structural shift in US Treasury buyers	Geopolitical crisis with global spill-overs	Market volatility rises sharply to reflect higher geo-economic uncertainty	Reacceleration of DM inflation, due to trade/geopolitical tensions
MARKET IMPACT	Positive for cash and gold. Negative for govies and expensive equities.	Positive for DM govies, cash, gold, USD, volatility, defensive assets and oil. Negative for credit, equities and EM.	Positive for cash and gold. Negative for risk assets.	Positive for TIPS, gold, commodity FX and real assets. Negative for bonds, equities, DM FX and EM assets.

Source: Amundi Investment Institute as of 7 January 2025. DM: developed markets. EM: emerging markets. CB: central banks. USD: US dollar. TIPS: Treasury inflation-protected securities. FX: foreign exchange markets.

FORECASTS

Macroeconomic forecasts

Macroeconomic forecasts						
Annual averages, %	Real GDP growth, YoY, %			Inflation (CPI), YoY, %		
	2024	2025	2026	2024	2025	2026
Developed countries	**1.6**	**1.6**	**1.6**	**2.6**	**2.2**	**2.1**
United States	2.7	2.1	2.0	2.9	2.3	2.2
Eurozone	0.8	1.0	1.2	2.3	2.0	1.9
Germany	*-0.1*	*0.6*	*0.9*	*2.4*	*1.9*	*1.9*
France	*1.1*	*0.7*	*0.9*	*2.3*	*1.7*	*1.8*
Italy	*0.5*	*0.7*	*0.9*	*1.1*	*1.8*	*1.7*
Spain	*3.1*	*2.2*	*1.8*	*2.9*	*2.4*	*2.0*
United Kingdom	1.1	1.6	1.4	2.5	2.1	2.2
Japan	-0.2	1.4	0.7	2.6	2.3	2.4
Emerging countries	**4.1**	**3.9**	**3.8**	**5.3**	**4.0**	**3.4**
China	4.8	4.1	3.6	0.3	0.4	0.6
India	6.4	6.5	6.3	5.0	5.4	4.9
Indonesia	5.0	5.2	5.0	2.3	2.6	3.8
Brazil	3.1	2.3	2.4	4.4	4.9	4.1
Mexico	1.5	1.2	1.5	4.7	3.8	3.9
Russia	3.7	1.0	1.5	8.4	7.0	5.0
South Africa	0.5	1.2	1.3	4.5	3.8	4.7
Turkey	3.0	2.9	3.4	60.0	30.5	19.3
World	**3.1**	**3.0**	**3.0**	**4.3**	**3.3**	**2.9**

Central Banks' official rates forecasts, %					
	17 January 2025	Amundi Q2 2025	Consensus Q2 2025	Amundi Q4 2025	Consensus Q4 2025
United States*	4.50	4.00	4.05	3.75	3.80
Eurozone**	3.00	2.00	2.15	1.75	2.15
United Kingdom	4.75	4.00	4.15	3.75	3.70
Japan	0.25	0.50	0.50	0.75	0.80
China***	1.50	1.00	1.30	1.00	1.20
India	6.50	6.00	5.95	6.00	5.75
Brazil	12.25	14.75	14.62	14.75	14.00
Russia	21.00	19.00	21.35	16.00	16.90

Source: Amundi Investment Institute. Forecasts are as of 17 January 2025. CPI: consumer price index. *: Upper Fed Funds target range. **: Deposit rate. ***People's Bank of China Reverse Repurchase Notes 7 Day Rate. Q2 2025 indicates end of June 2025; Q4 2025 indicates end of December 2025. Current rates and Consensus are from Bloomberg.

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Amundi Investment Institute

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