Bank of Nassau
SINCE 1982

Economy Week Ahead

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"Economics is not an exact science. It's a combination of an art and elements of science."

Paul Samuelson

Markets ended last week on a positive note despite signs of increased geopolitical tensions (see below). While we have always expected hiccups in the ceasefire, developments this past week call into question whether the two sides can ever reach a lasting agreement. Oil prices have rebounded as tensions rise but remain well below the levels seen during the height of the conflict. Perhaps this is due to lingering optimism that the talks can get back on track, but that optimism will be tested this week.

Geopolitics may overshadow a key week of fundamental news. US inflation and retail sales data should help to better form market expectations for Fed policy. So too should Chair Warsh's testimony before Congress when he delivers the Fed's semi-annual monetary policy report as required by the Full Employment and Balanced Growth Act of 1978 (also known as the Humphrey-Hawkins Act). Overall, the hawkish Fed narrative is likely to harden this week and that's not supportive for further equity market gains.

Geopolitics

Tensions in the Persian Gulf are running high. Iran claimed the Strait of Hormuz was closed "until further notice" after it fired upon and damaged a container ship for not using the approved route. However, the US claimed the strait remains open to all vessels seeking safe transit and ordered a third round of strikes on Iran that targeted its energy sector. Iran launched missile and drone attacks on US bases in the region in response.

Meanwhile, the peace talks are in limbo. President Trump said that the talks would continue despite the collapse of the ceasefire, but Iran demanded the US meet its commitments under the recent ceasefire extension agreement before it would restart talks. With the attacks by both sides continuing, it's hard to see how the talks can continue right now. Markets seem way too sanguine about the rising risks of further disruptions to global shipping.

Americas

The minutes to the June FOMC meeting were hawkish. This should not come as a shock since the decision itself was hawkish. Recall that nine policymakers saw a hike this year.

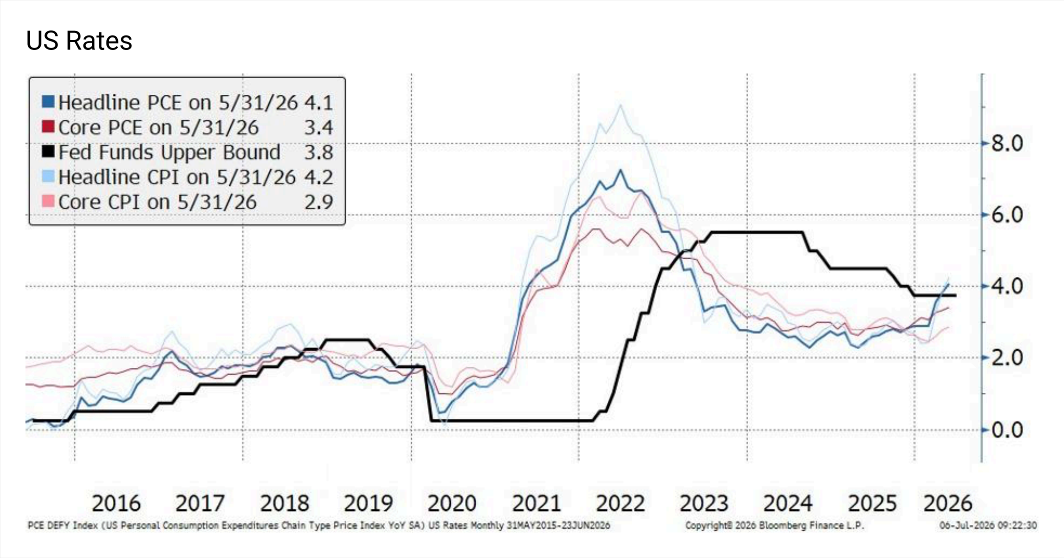
On inflation: "[Participants] observed that both core and total inflation had moved higher and generally attributed these increases to the lingering effects of tariffs, supply chain disruptions related to the closure of the Strait of Hormuz, and strength in demand for some goods and services stemming from robust AI-related investment."

On policy: “Regarding participants’ individual assessments of appropriate monetary policy under what each participant judged to be the most likely scenario for the economy, many participants indicated that the appropriate level of the federal funds rate would be within or slightly below the current target range at the end of this year. Many other participants, however, assessed that the appropriate level of the federal funds rate would be above the current target range at the end of this year. Participants noted that their future policy actions would depend on incoming information.”

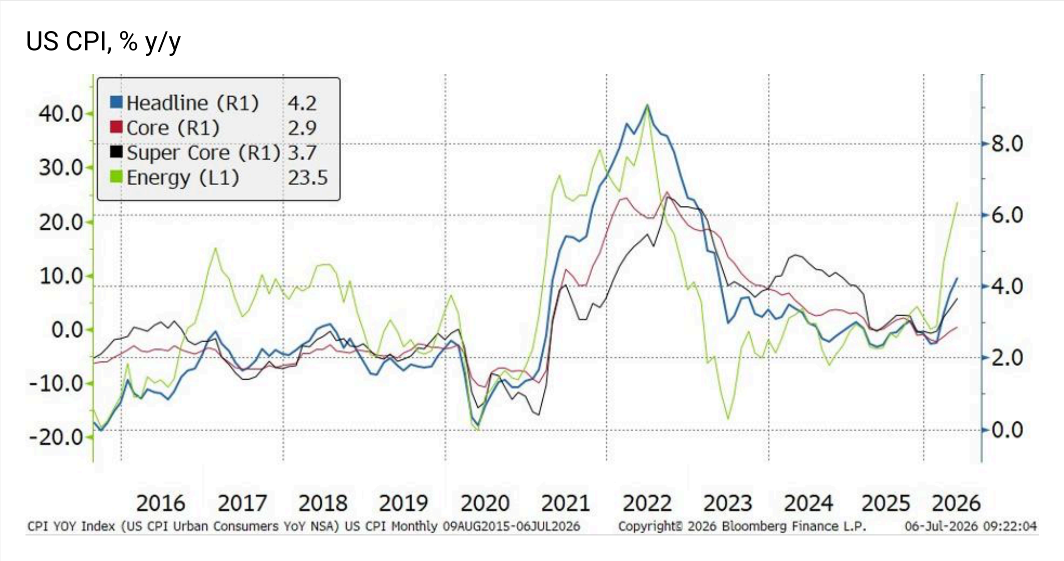
On Fed communications, “A number of participants noted that it was an opportune time to consider significant changes to the FOMC’s post-meeting statement. A majority of participants remarked that they saw advantages in shortening the statement.” We think it’s good that a majority backed a shorter statement as this means it's not something Warsh jammed through unilaterally.

The Fed releases its Beige Book report Wednesday. We expect the report to suggest growth remains moderate. We also expect the report to suggest easing of price pressures, but not by enough to sound the all clear. Lastly, we also expect the report to suggest a stabilizing labor market, but with some risks of slowing in some districts. All in all, the Beige Book should justify the Fed remaining on hold at the July 28-20 FOMC meeting. A September hike is nearly 75% priced in and an October hike is nearly 95% priced in. We do not think the Fed will hike this year but it will all depend on the data.

There are plenty of Fed speakers this week. Bowman and Waller speak Monday. Chair Warsh testifies before the House Financial Services Committee Tuesday and before the Senate Banking Committee Wednesday. Barr, Goolsbee, Cook, and Bowman also speak Tuesday. Williams, Cook, and Musalem speak Wednesday. Logan, Schmid, and Jefferson speak Thursday. At midnight Friday, the communications blackout goes into effect and there will be no Fed speakers until Chair Warsh’s post-decision press conference July 29.

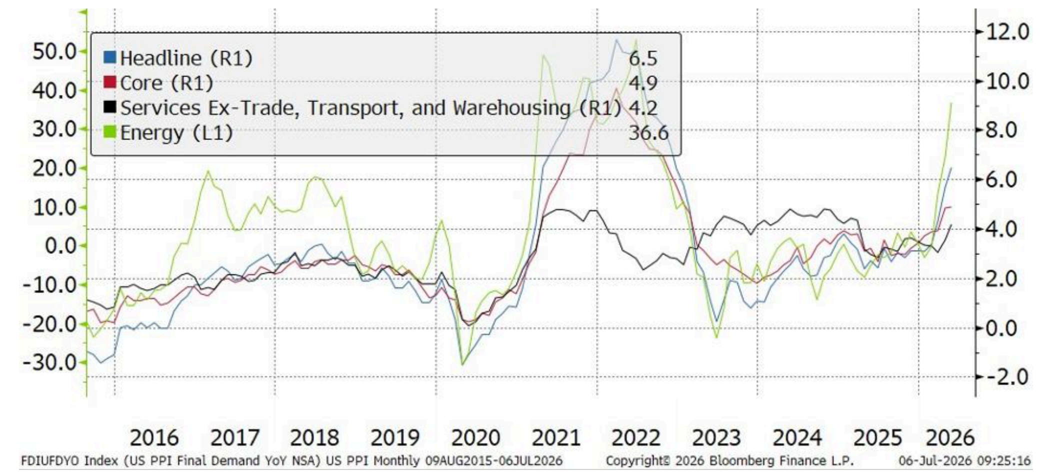


June US inflation data take the spotlight. CPI will be reported Tuesday. Headline is expected to slow four ticks to 3.8% y/y and core is expected to remain steady at 2.9% y/y. If so, headline would decelerate for the first time since January and would suggest inflation peaked in May. The Cleveland Fed Nowcast model estimates June headline at 3.9% and core at 2.9%. Looking ahead, the model estimates July headline at 3.7% and core at 2.8%. While we had become fairly confident that inflation likely peaked in May, the end of the ceasefire complicates matters. Oil prices have not spiked much, which is a good thing.



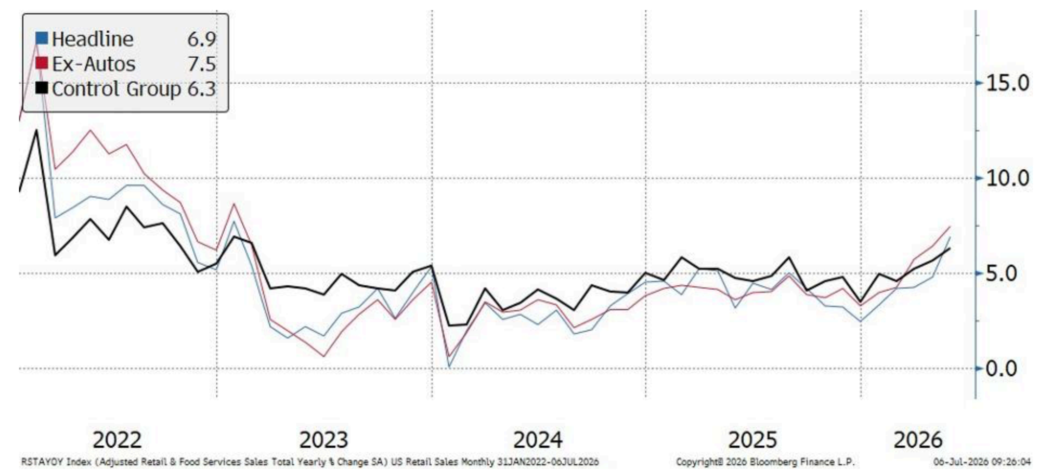
PPI will be reported Wednesday. Headline is expected to fall three ticks to 6.2% y/y and core is expected to rise three ticks to 5.2% y/y. Keep an eye on PPI services ex-trade, transport, and warehousing. This component is used for the PCE calculations and rose to 4.2% y/y in May, the highest since March 2025.

US PPI, % y/y

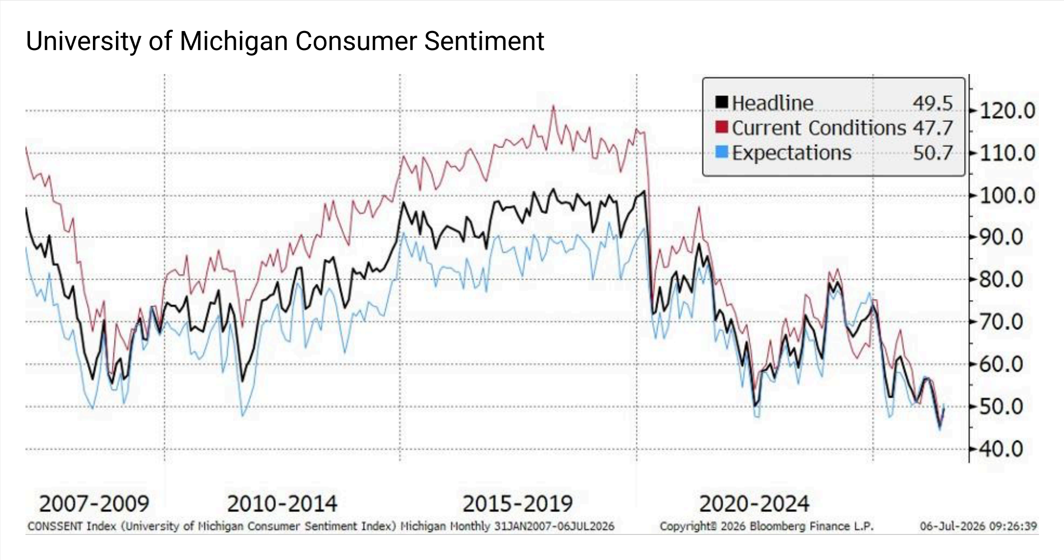


June retail sales data Thursday will be important. Headline is expected at 0.3% m/m vs. 0.9% in May, ex-autos is expected at -0.1% m/m vs. 0.8% in May, and ex-autos and gas is expected to remain steady at 0.5% m/m. Lastly, the so-called control group used for GDP calculations is expected at 0.5% m/m vs. 0.7% in May. The Chicago Fed's CARTS model estimates sales ex-autos at 0.7% m/m in nominal terms and 1.4% m/m in real terms. Real income growth has been flat or negative since March, which is making it harder for households to maintain consumption.

US Retail Sales, % y/y

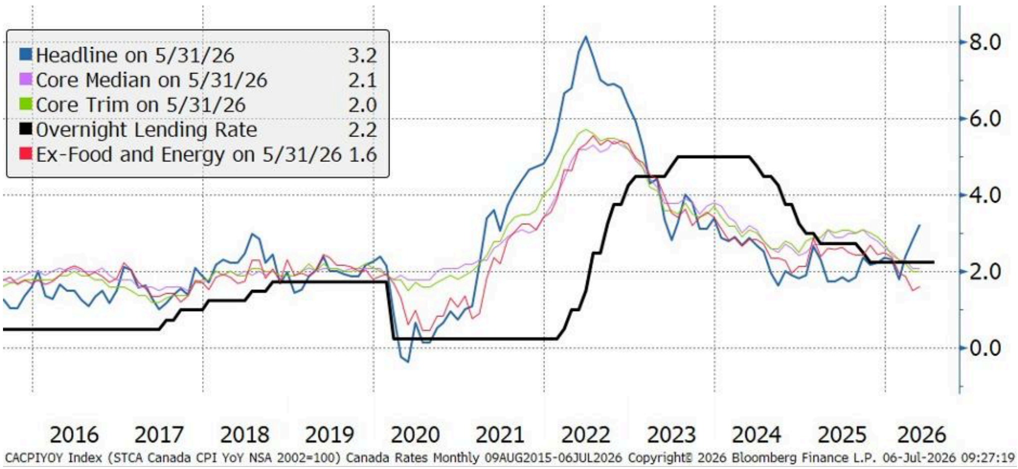


University of Michigan reports preliminary July consumer sentiment Friday. Headline is expected to pick up nearly two points to 51.3, driven by a nearly one point rise in current conditions to 48.5 and more than a point rise in expectations to 52.0. For now, weak consumer sentiment has not really impacted consumption but risks lay ahead. Also keep an eye on inflation expectations, which trended lower in June after peaking in May.



Bank of Canada meets Wednesday and is expected to keep rates steady at 2.25%. At the last meeting June 10, the bank kept rates steady at 2.25% and noted that “Economic activity in Canada has been weak and uncertainty about US trade policy persists. The conflict in the Middle East is ongoing and oil prices remain elevated. Governing Council is continuing to look through the war’s near-term impact on headline inflation, but will not let higher energy prices become persistent inflation.” Governor Macklem acknowledged the policy dilemma and stressed that “For now, holding the policy rate unchanged balances those risks.” The swaps market is still pricing in 50 bp of tightening over the next twelve months, which seems unlikely if the economy continues to soften.

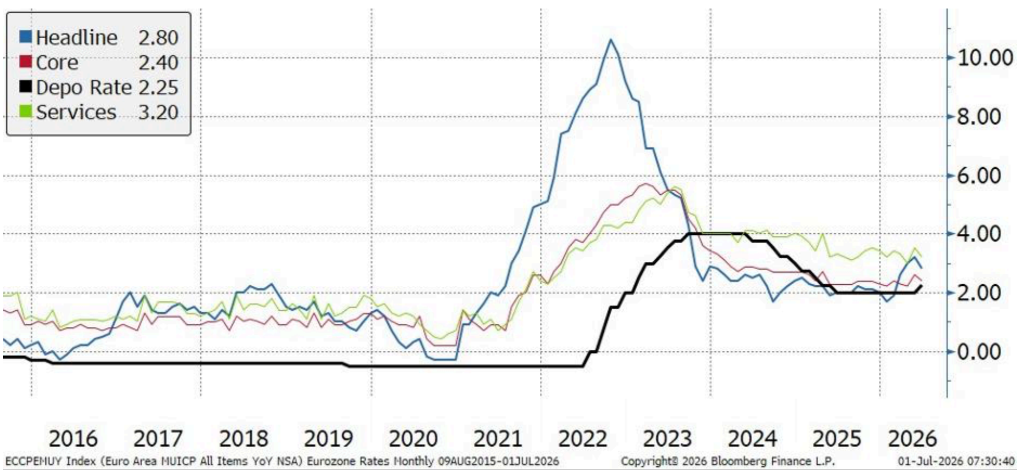
Canada Rates



Europe

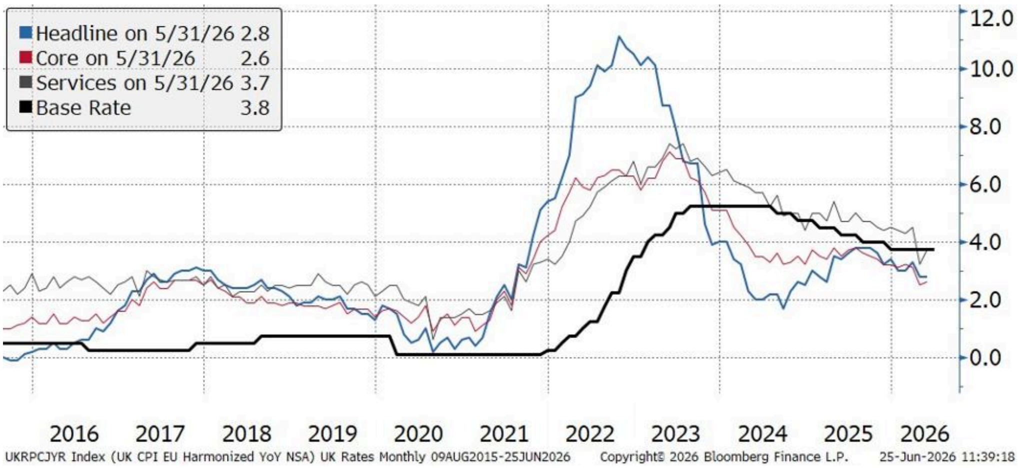
Ahead of the July 22-23 meeting, the European Central Bank enters its pre-decision quiet period Thursday. No change is expected then. Policymakers are caught in a quandary. After lower energy prices led to slower inflation in June, the end of the ceasefire has muddied the outlook. Much will depend on how much energy prices rise and also for how long, but there are clearly still inflation risks ahead. That said, even the staunchest ECB hawks are not beating the rate hike drum as growth risks also remain in play. Looking ahead, the market sees over 80% odds of a hike at the September 10 meeting and becomes fully priced in for the October 29 meeting.

Eurozone Rates

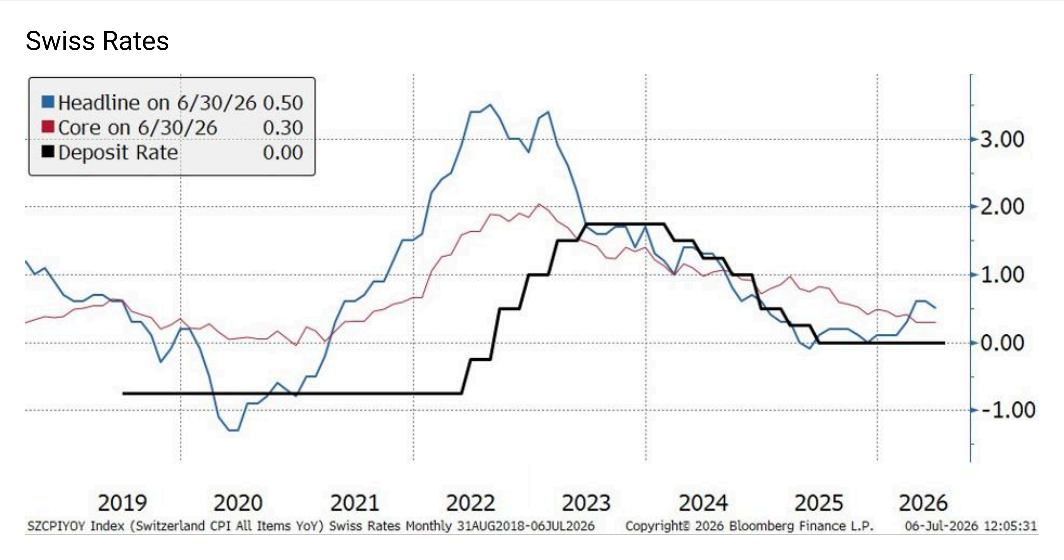


There will be several Bank of England speakers this week. Chief Economist Pill speaks Monday. Governor Bailey speaks Tuesday. The bank remains in wait-and-see mode and is not expected to hike rates at the July 30 meeting. The odds of a hike rise to 45% for the September 17 meeting and nearly 90% for the November 5 meeting. The swaps market is pricing in nearly 50 bp of total tightening over the next twelve months, which we believe overstates the case.

UK Rates

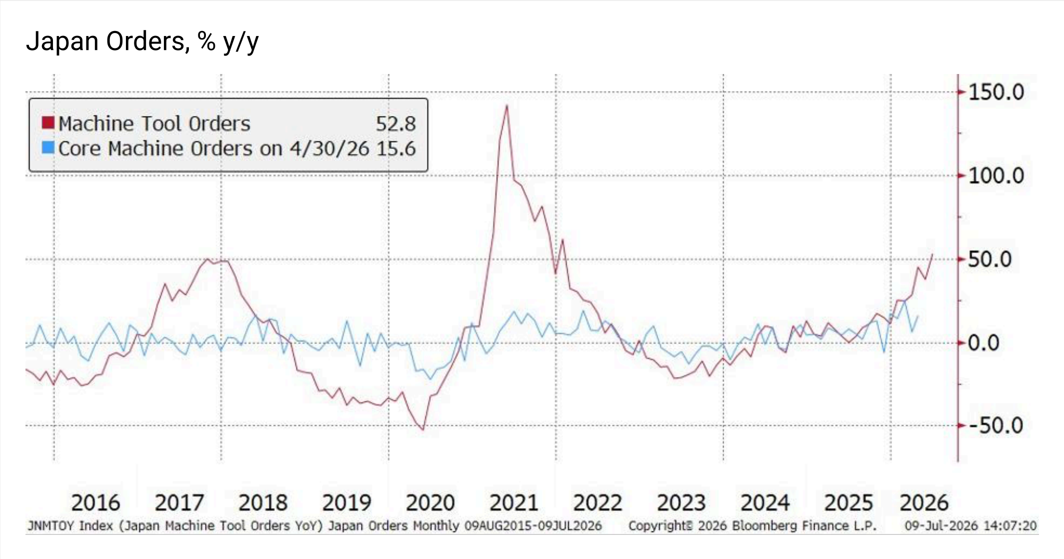


The Swiss National Bank publishes the summary of its June decision Thursday. At the June 18 meeting, the bank kept rates steady at 0.0%. SNB President Schlegel said that "If necessary, we have an increased willingness to intervene in the foreign-exchange market." It revised its inflation forecasts up by just one tick for this year and next, suggesting no urgency to tighten policy. Next meeting is September 24 and no change is expected then. However, the market is pricing in 25 bp of total tightening over the next twelve months.



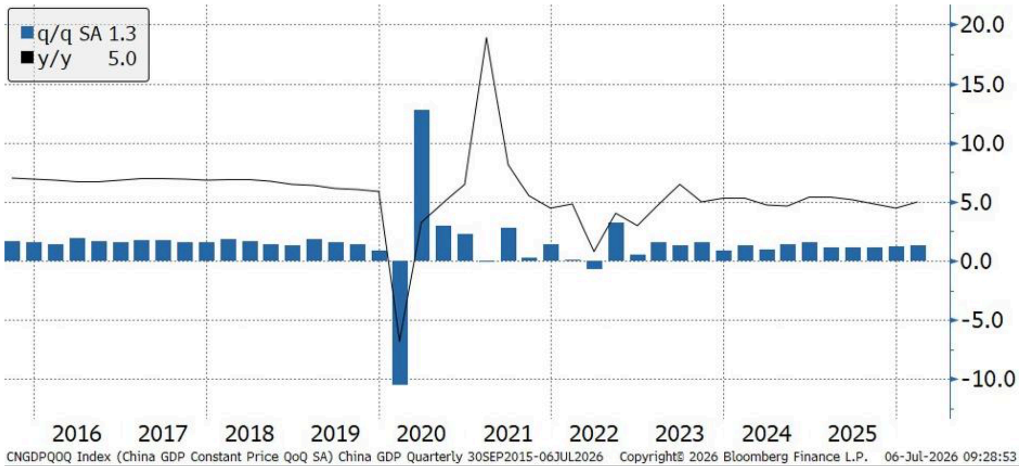
Asia

Japan reports May core machine orders Wednesday. Orders are expected at 12.9% y/y vs. 15.6% in April. Last week, machine tool orders came in at 52.8% y/y in June, the strongest since early 2022. Core machine orders exclude volatile sectors such as ships and electric power, while machine tool orders are much more specific (lathes, drilling and milling machines). However, both are considered to be good leading indicators for the overall Japanese economy. If the economy does continue to hold up, we believe the Bank of Japan may have to hike rates again before December to help support the weak yen.



China reports Q2 GDP and June real sector data Wednesday. GDP growth is expected at 1.0% q/q vs. 1.3% in Q1, while the y/y rate is expected at 4.5% vs. 5.0% in Q1. The mainland economy is holding up relatively well from the Iran conflict but we suspect policymakers are waiting to gauge the full impact before injecting any stimulus.

China GDP Growth, %



Bank of Korea meets Thursday and is expected to hike rates 25 bp to 2.75%. At the last meeting May 28, the bank kept rates steady but it was a split 5-2 decision with the two dissents in favor of a 25 bp hike. The six-month Dot Plot showed 10 of the 21 Dots at 3.0%, suggesting risks of more tightening ahead after this week. The bank noted that growth was stronger than expected due to exports even as the Iran conflict raised inflation pressures and uncertainty. The swaps market is pricing in 100 bp of total tightening over the next twelve months.