

Inflation Focus Q3

19 September 2025



Key Points

- Inflation is well-behaved but increasingly divergent, with tariff pass-through underway
- Tariff headwinds and policy uncertainty will weigh on growth, but a recession is not expected
- Labour market dynamics are weakening, helping to contain wage growth and services inflation
- The global rate cutting cycle has further to run, though central banks need to remain vigilant and focused on inflation

Growth should be resilient despite tariff headwinds

Elevated tariff uncertainty has fallen back as the US has reached tariff agreements with key trading partners. While this is encouraging, US tariffs have risen to the highest level since the 1930s. This is causing disruptions to global trade and is weighing on what had been a robust US and global growth outlook at the start of the year. Front-loading of trade supported global growth in the first half of the year but momentum is now slowing, with falling export volumes and new orders. A key exception is tech-related trade, where demand and shipments remain brisk. Looking forward, we anticipate global growth to settle at a below trend level, but recession risk is likely to be limited.

Inflation is well-behaved, with tariff pass-through underway

Inflation data have been encouraging over the past quarter, broadly matching expectations in most regions. Divergences are on the rise, however, in part reflecting the different impact of tariffs on US prices and those in the rest of the world.

Goods disinflation remains in place outside of the US, bolstered by the low oil price and a weak US dollar. The weak pricing environment reflects sluggish global demand and persistent excess supply from China. Evidence is also gathering that exporters to the US are cutting prices in response to tariffs, leading to downward price pressure in global supply chains and amplifying disinflationary trends globally. This is particularly noticeable in EM Asia, where deflation risk is significant.

By contrast, tariff pass-through is underway in the US, with upward price pressure on a variety of goods, including household appliances, apparel, auto parts and auto prices. So far, pass-through has been broadly in line with expectations, with little evidence of spillover on prices more broadly. We expect to see further pass-through, likely leading to continued stickiness in headline inflation, at an above-target pace. A stronger rebound in inflation is not expected, however, in part reflecting the softening of the labour market that is underway.

The labour market is shifting

The US labour market is weakening, albeit from a very robust level. Payroll growth slumped in the third quarter and unemployment has edged higher. Immigration restrictions play a part by curtailing the pool of available workers, but demand weakness is also visible. While wage growth has been running at a moderate level for a while now, some further downside is now likely given stalling job growth. This matters, particularly on the services side, where further progress on inflation is needed.

Outside of the US, dynamics are changing as well. Most notably, Eurozone wage pressures are quickly subsiding. A tracker of negotiated wage growth has fallen below 2%, compared to a peak of close to 5% in 2024. This reduces risk around sticky services inflation and helps explain why the ECB now projects inflation to fall below the 2% target by 2026. We agree with this assessment.

By contrast, inflation in the UK remains stubbornly high. Wage growth is still too strong at above 4.5%, despite slowing job

growth and a gradual increase in unemployment. This makes the UK somewhat of an outlier globally and calls for a cautious approach by the central bank.

Dollar weakness and low energy prices are helpful

The US dollar has traded broadly sideways in Q3, but remains notably below the level seen at the beginning of the year. This, alongside a still subdued price of oil, is helping to contain price pressures globally, particularly on the goods side. Emerging markets, including in LatAm and EM Asia, stand to gain as these circumstances create space for further policy easing. Going forward, we anticipate the global rate cutting cycle to continue, though scope for further rate cuts is limited.

Central banks need to remain vigilant

A recent key development is that the Federal Reserve has cut rates for the first time this year, though guidance around future rate cuts was relatively cautious. Other central banks are also proceeding very cautiously, despite the better news around inflation.

While we anticipate further policy easing, including from the Fed, it remains critical that central banks keep their focus on inflation. This should provide an anchor point for inflation expectations and ensure that borrowing costs are at an appropriate level to avoid a persistent overshoot (or undershoot) of inflation. Indeed, the ability of central banks to set their policy independently will be a key factor to monitor going forward, amid a changing geopolitical and political landscape.

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| <p>US Core inflation remains significantly above target</p> | <p>Headline CPI inflation accelerated from 2.7% YoY in July to 2.9% YoY in August. While core CPI remained at 3.1% YoY, shorter-term trends are showing an acceleration away from target for core inflation, over both three and six month periods. On a more positive note, trimmed mean inflation measures (which remove volatile components) have remained more muted, and core PCE inflation, the Fed's favoured measure, is likely to see a less substantial pickup, though it still remains significantly above target. Overall, the impact of tariffs has been relatively modest so far while price pressure has continued to be robust in services. The previous tariff-related pickup in prices for some goods has moderated, while other goods are now beginning to reflect a pass-through into prices. We expect to see more of an impact from tariffs on goods inflation going forward.</p> <p>Combined with the ongoing strength in services prices, this will make it more difficult for the Fed to justify aggressive monetary easing in the near term. In addition, households' longer-term inflation expectations have also risen recently, increasing the risk of them becoming unanchored if tariffs hit more substantially in the coming months.</p> |
| <p>UK Service inflation remains too high</p> | <p>Both headline and core inflation accelerated to 0.3% MoM in August from 0.1% MoM in the month before. This resulted in an annual rate of 3.8% for headline inflation, the same as in July, and a slowdown to 3.6% YoY from 3.8% YoY for core inflation. While price dynamics in the goods sector have moderated, helped by falling regulated energy prices, services inflation remains elevated, at 4.7%, which is particularly worrying. A large spike in airfares was a major driver of higher services prices over summer. Given that this is a very volatile series, it is expected to moderate going forward. Another strong driver was catering services, however, which is an important component of the BoE's supercore measure. Since food is a key input to this sector, and food prices remain firm, the risk is that supercore stays elevated, making it more challenging for the BoE to cut rates further in the near term.</p> <p>Economic growth has slowed in Q2 and is expected to soften further in the coming months, which should put more pressure on the labour market. However, while pay growth slowed in the first half of the year, it was still elevated in recent months, therefore not indicating any immediate substantial slowdown in wage costs and service prices.</p> |
| <p>Eurozone Inflation back at target</p> | <p>Headline inflation is close to target, at 2% YoY in August, and it has now been flat at around this level over the past year. While this is encouraging, core CPI is still running slightly higher, at 2.3%, primarily reflecting still robust services inflation, now at 3.1%. Recent trends are encouraging, however, as services inflation has already fallen swiftly from the 4% level where it was tracking in the beginning of the year. Wage growth, moreover, continues to cool, as shown by the ECB's negotiated wage growth tracker, which has fallen below 2% compared to close to 4% one year ago. We therefore expect services inflation to continue to moderate. Goods prices, by contrast, have been slightly firmer than expected recently, in part reflecting rising food prices. The underlying pricing trend on the goods side is one of weakness, however, given fragile external demand, excess supply from China, and tariff-induced downward price pressure in global supply chains. Given this, headline inflation should continue to edge lower in coming quarters, likely leaving it below target in 2026.</p> <p>The ECB continues to signal that they are comfortable with the policy rate at its current level of 2%. However, they now project inflation to be below target in both 2026 and 2027, thus leaving the door open for further rate cuts.</p> |
| <p>Switzerland Inflation turns positive again, but headwinds mount</p> | <p>Annual CPI inflation turned positive in Q3, following a brief dip into negative territory in Q2. Headline inflation is tracking at 0.2% YoY, with weakness continuing to reflect imported deflation, while domestic inflation is stronger at 0.6%. That said, CPI excluding rents is still negative. Rent inflation is also falling, given the rental reference rate cut in March, while a further cut was announced for September. This will weigh on domestic price pressures over the coming year. By contrast, nominal wage growth is holding up, at 2.3% YoY in Q2, suggesting a reacceleration following weak dynamics in 2024. The wage data is highly uncertain, however, and we anticipate wage growth to remain contained.</p> <p>The Swiss franc is strong and the real exchange rate remains close to a historical high. Together with the 39% US tariff rate on Switzerland (ex pharma and gold), this will weigh on exports in coming quarters, and likely sharpen focus on reducing costs and prices more broadly. Deflationary risk has consequently risen, though we maintain our view that inflation is set to remain in positive territory over the coming year. While we do not expect any further SNB rate cuts, it is a close call, with rate risk firmly to the downside, similarly to inflation.</p> |
| <p>Japan Sustained inflation and steady wage gains underpin expectations of BOJ rate hikes</p> | <p>The latest CPI shows underlying inflation remains persistent, with core CPI steady at 3%, although headline CPI has eased due to government energy subsidies. Wage growth has been solid, with base wages up 2.4% YoY and nominal wages rising 4.1%. As a consequence, real wages have turned positive for the first time since December last year, offering some relief to households after a prolonged period of high prices. Q2 GDP growth was also surprisingly strong, underpinned by better than expected household spending. Meanwhile, ongoing labour shortages are likely to structurally support wages, though US tariff pressures could dampen near term developments.</p> <p>Resilient growth, sustained inflation, and steady wage gains should support further BOJ rate hikes, possibly as early as October. Narrowing rate differentials have however strengthened the yen, weighing on import costs, while wage growth may soften due to tariff-related pressure on corporate profits. We therefore expect inflation to ease towards 2% next year. Moreover, transitory factors, such as the recent rice supply crunch caused by weather conditions, should help moderate inflation and inflation expectations going forward.</p> |

China

Supply cuts are unlikely to solve the inflation problem

Producer price data show that deflationary pressures are starting to ease on the supply side, with PPI at -2.9% YoY, up from -3.6% in July. Policymakers have intensified their supply reform, the so called anti-'involution' campaign, targeting overcapacity in steel, coal, EVs, and solar panels through production caps, stricter standards, and reduced subsidies. These reforms are beginning to narrow PPI contractions, particularly in coal and metals.

That said, we believe weak demand sits at the heart of China's stubborn deflation. CPI remains subdued at -0.4% YoY, mainly due to lower food prices. Core inflation is higher at 0.9%, with services showing a slight improvement. July's activity data suggest growth momentum is stalling, which will likely prompt policymakers to ramp up fiscal support. The main challenge now lies in balancing supply cuts with adequate demand-side stimulus. Overly aggressive production cuts without sufficient demand measures could worsen unemployment and sentiment, undermining efforts to reflate the economy. While these reforms may help producer prices find a floor, persistent demand fatigue suggests deflationary pressures could linger in the medium term without broader policy support.

Australia

Easing price pressures allow the RBA to resume its loosening path

Headline and core CPI continued their easing trend in Q2, falling to 2.1% YoY and 2.7% YoY respectively, with both measures now comfortably within the RBA's target range of 2-3%. Services inflation fell to a three-year low of 3.3%, due to easing price rises for rents and insurance, though the rental component at 4.5% YoY remains elevated. Goods inflation slowed to 1.1%, primarily due to falls in automotive fuel prices. Wage growth has been stickier, holding steady at 3.4% YoY in Q2, though lower than the same period last year (4.1%). Overall, the continued easing in pricing pressures allowed the RBA to resume its gradual easing path, lowering the cash rate by 25bps to 3.6% at its August meeting, its third cut this year.

Challenging this Q2 easing trend to some extent, headline CPI for July rose to 2.8% YoY, vs 2.3% expected, in part driven by a mis-timing in the extension of the government's electricity rebate, which may unwind in August. However, the monthly CPI data can be volatile and overall price pressures appear contained. Accordingly, we believe that the RBA will lower the cash rate to 3.35% by year end, with a further cut expected in early 2026.

EM Asia

Mounting deflation risk

ASEAN is facing mounting deflation risks as inflation remains subdued across the region. In Thailand, annual CPI inflation is in negative territory, with prices falling for four consecutive months, reflecting weak growth and fragile sentiment amid persistent political uncertainty. While Vietnam leads the region with inflation at 3% YoY, followed by Indonesia at 2.3%, Malaysia, the Philippines, and Singapore all report CPI below 2%, well below historical trends. As a region deeply integrated into global trade, ASEAN's outlook is clouded by US tariffs and surging Chinese exports, pressuring local industries to cut prices, particularly as China's overcapacity seeks new markets. So far, falling prices have been largely attributed to abundant supply rather than collapsing domestic demand. Stabilising currencies, helped by a weaker USD, provide room for further rate cuts, and we expect more monetary easing across the region this year to support growth. This should limit deflation risk.

In India, CPI inflation is also projected to remain soft in the coming quarters, thanks to lower food prices and the disinflationary effects of the recent sale tax cuts. Accordingly, the RBI forecasts FY26 inflation near 3%, below its 4% target, which should allow for a gradual easing of monetary policy.

Brazil

Brazil's central bank navigates between core inflation persistence and growth headwinds

Brazil's August CPI came in at -0.1% MoM, down from 0.3% in July and slightly above consensus. On a YoY basis, headline inflation eased from 5.4% in Q2 to 5.1%. The decline was mainly driven by the housing category, due to a one-off electricity bill credit, and broad-based deflation in food-at-home prices. Core inflation, however, remained sticky. The CPI ex-energy and food accelerated to 5.1% YoY in August, up from 5.0% in Q2, led by persistent services price pressures. Given this backdrop, the central bank (BCB) is expected to hold its policy rate at 15% in the September meeting, unchanged since the last, and likely final, rate hike in June.

Nonetheless, mounting signs of an economic slowdown —falling industrial output, weak retail sales, and subdued consumer and business sentiment —could pave the way for the start of a gradual easing cycle by year end. Importantly, 12-month inflation expectations have declined steadily from a Q1 peak of 5.9% to 4.2% in September. They are now within the 1.5–4.5% tolerance band, though still above the 3% target, with both the nominal and real Selic rate standing at nearly two-decade highs. That said, the BCB's persistent hawkish tone introduces an upside risk to our year-end Selic forecast of 14.5%.

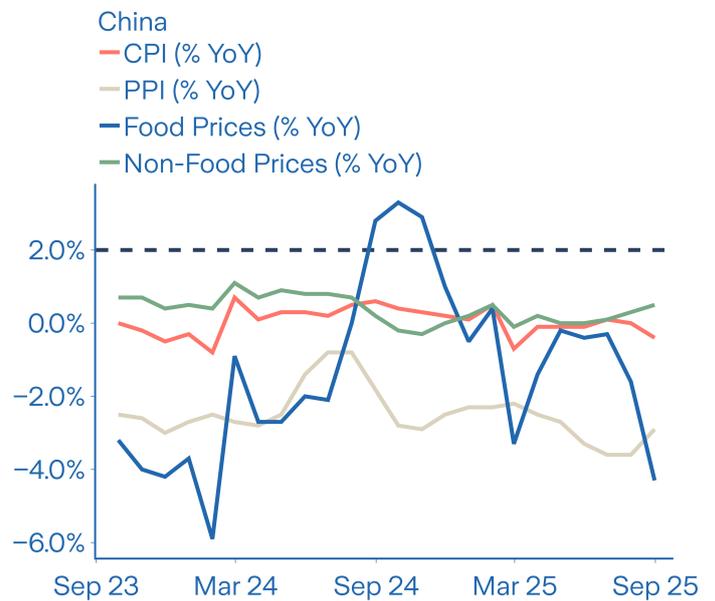
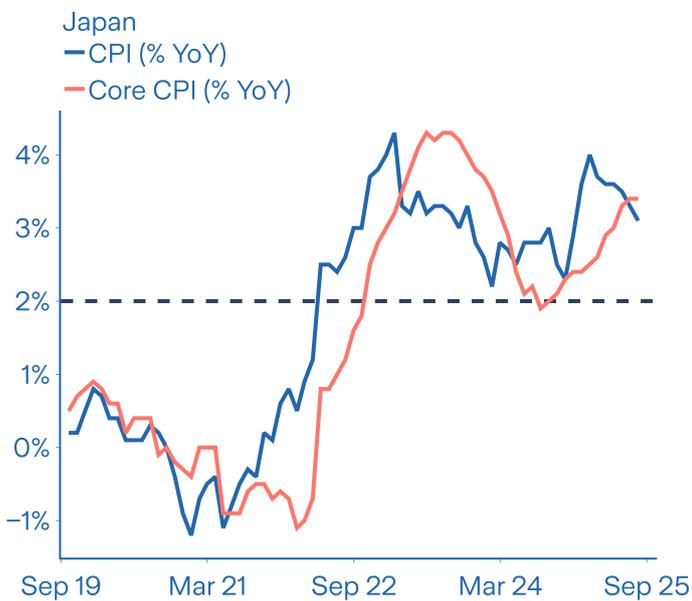
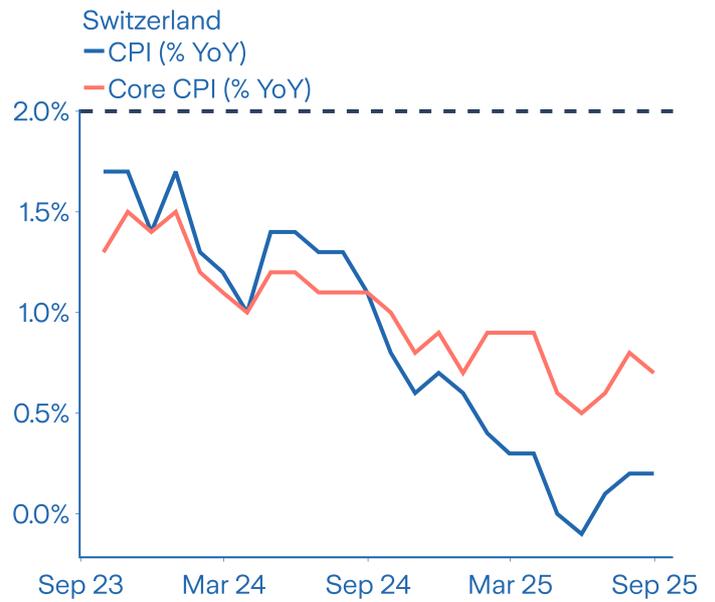
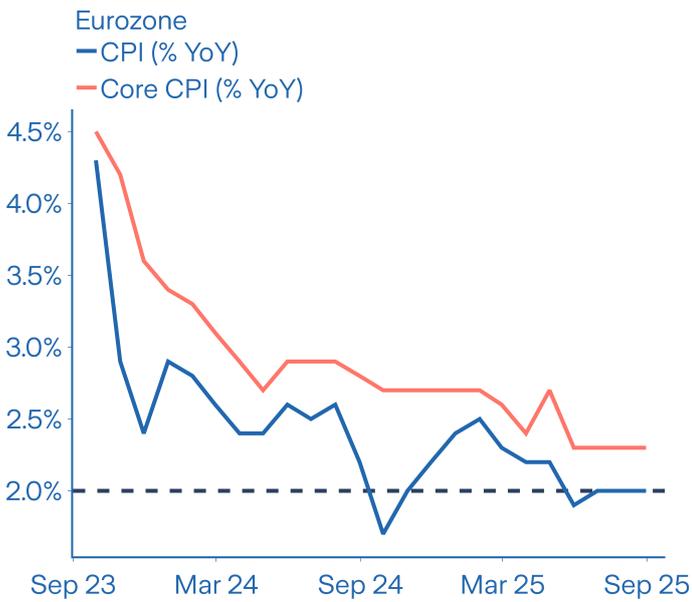
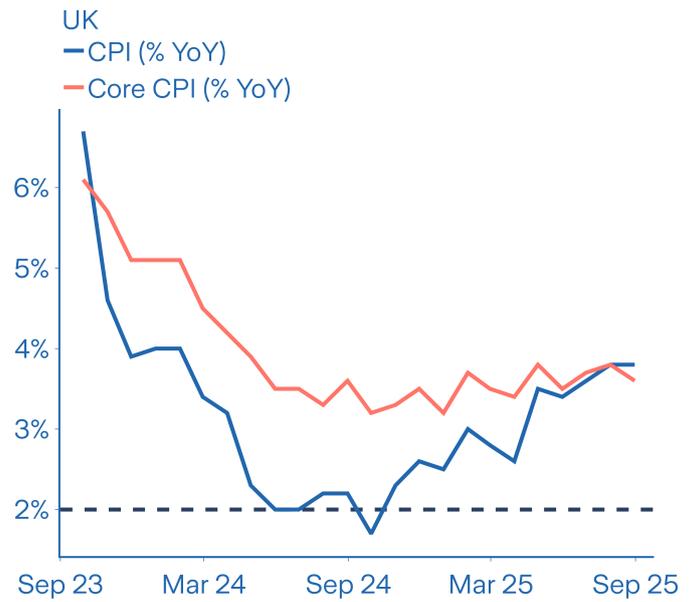
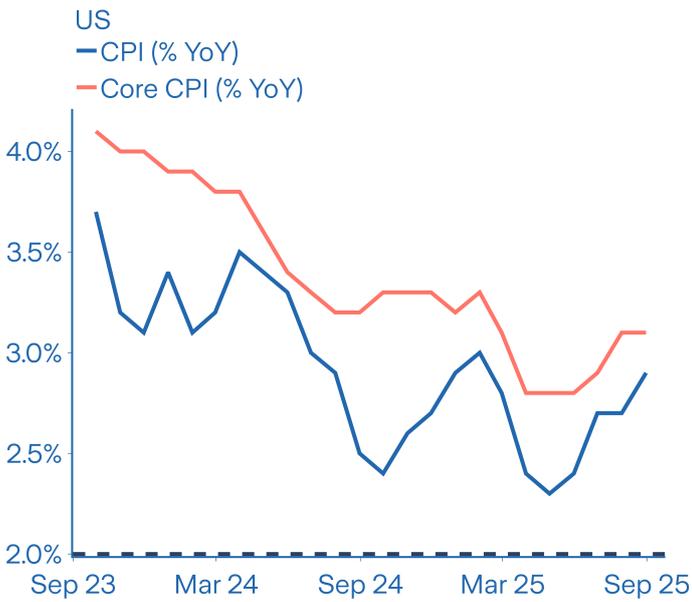
LatAm

Cooling headline inflation opens room for further easing, though core CPI is stickier

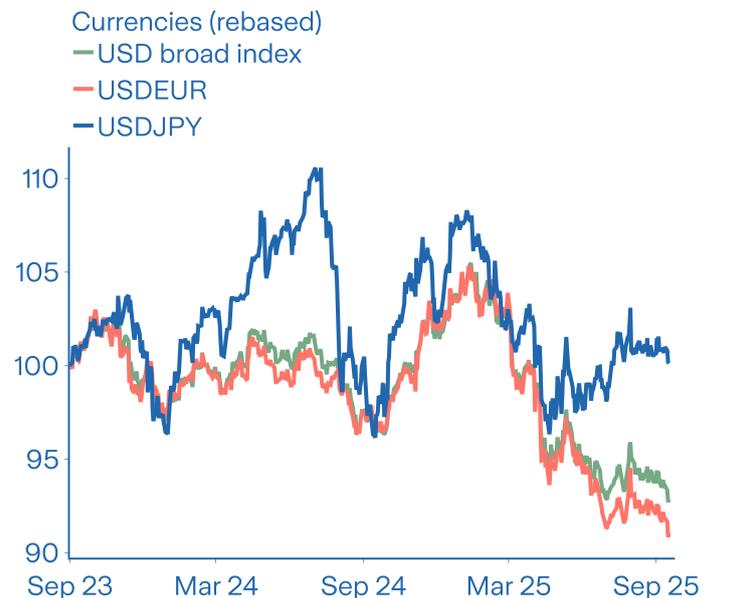
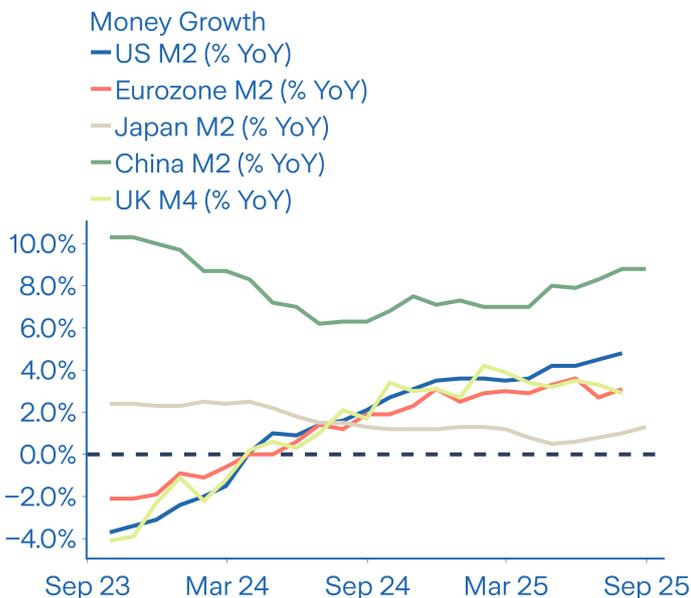
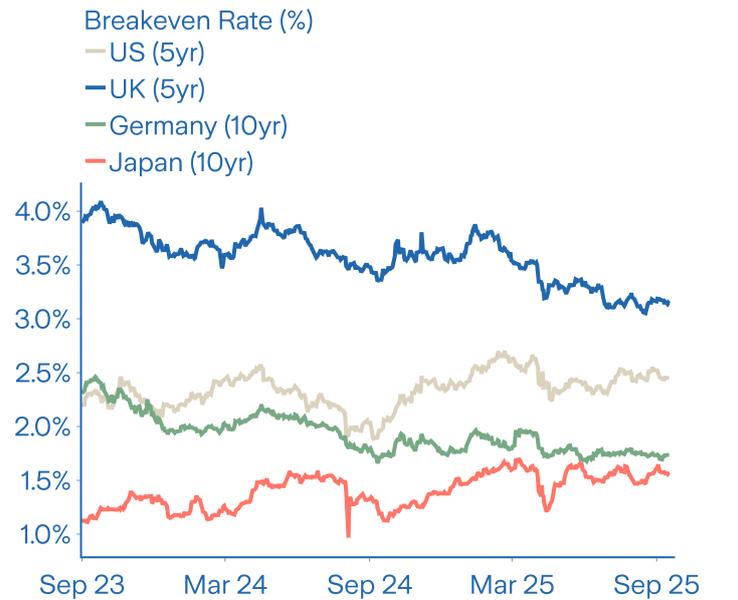
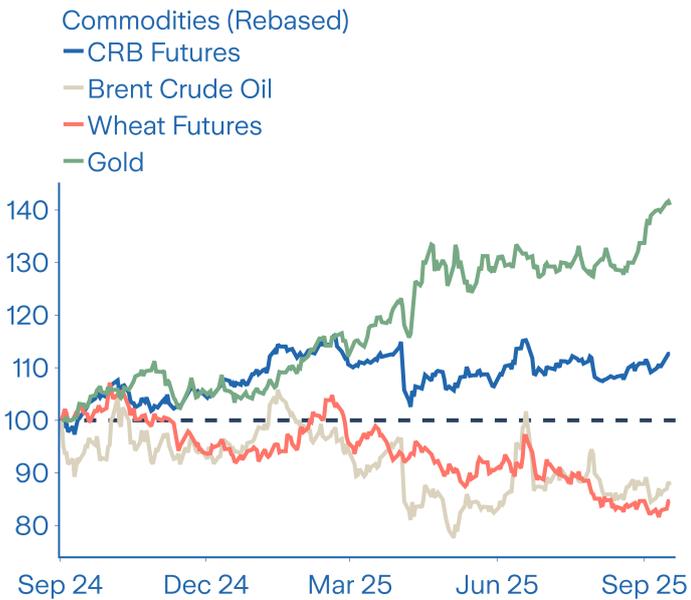
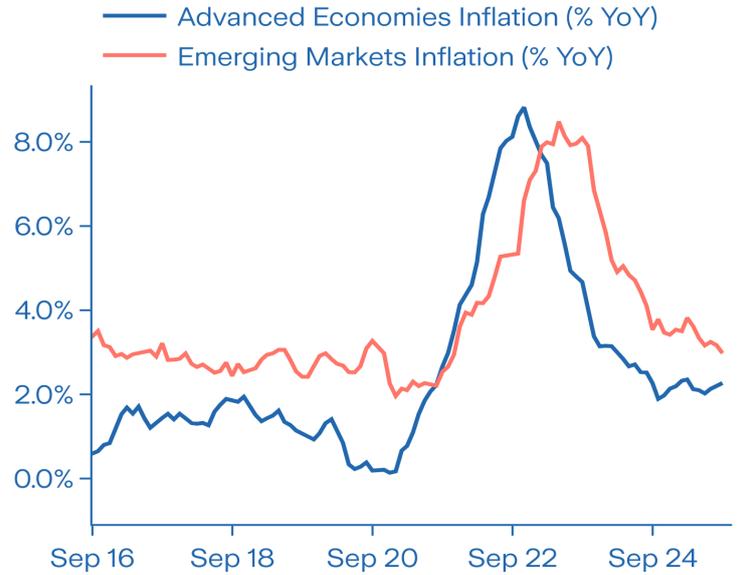
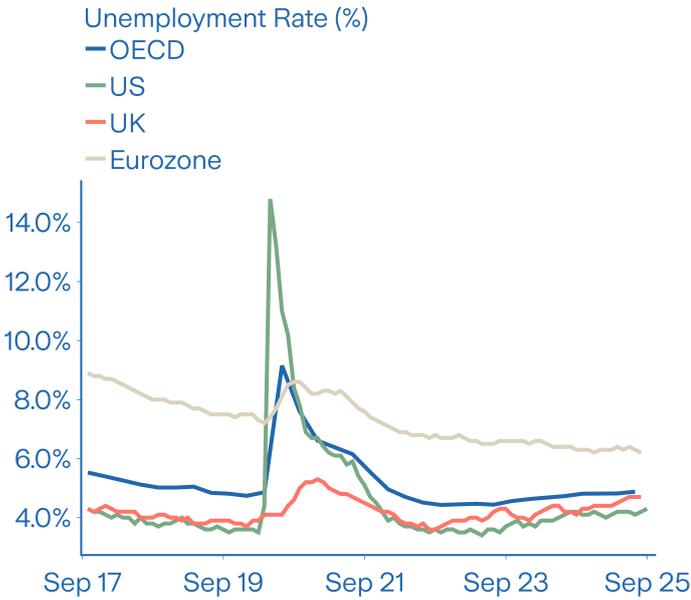
Mexico's inflation eased from 4.4% YoY in May to 3.6% in August, driven mainly by a sharp decline in non-core inflation, which fell from 5.3% to 1.4%, amid the normalisation in agricultural and livestock prices. However, core inflation remained stubbornly high at 4.2% YoY in August, above Banxico's 2-4% tolerance range, led by persistent services inflation. Despite this, we expect the Central Bank to continue its easing cycle at the September meeting, considering the weakening economic backdrop, a still restrictive policy stance, and expectations of upcoming Fed rate cuts.

In Chile, inflation continued to ease in Q3, with August CPI flat versus the 0.2% MoM that has been expected, and down sharply from July's 0.9%. Annual inflation declined to 4.0%, down from 4.3% in July and 4.9% at the end of Q1. Despite this, the Central Bank (BCC) held the policy rate at 4.75% in September, following a 25bp cut in July, while adopting a more cautious tone amid sticky core inflation and effectively ruling out an October cut. We expect inflation to moderate further in Q4, likely to end the year below the 4% threshold, creating room for a final 25bp cut in December, though the BCC's recent hawkish shift has raised upside risks to our 4.5% year-end forecast.

Current and historic inflation



Key Indicators



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