January 2025 | Market update

Central banks balance inflation with rate cuts

The US Federal Reserve cut rates by another quarter point and indicated a slower pace of easing for 2025

US stock markets steady. After a stellar year, US share prices were mainly steady for much of December. However, they slipped after the US Federal Reserve (Fed) cut interest rates by a quarter of a percentage point. The bank suggested a slower pace of easing in 2025, sending the dollar higher and US stocks lower.

While inflation has fallen from its peak in 2022, it still remains higher than the Fed would like, at 2.7%. The labour market remains robust, with 227,000 jobs added in November. However, in a sign the jobs market is cooling, the unemployment rate ticked up from 4.1% to 4.2%. Yet economic growth is strong, with GDP increasing by 2.8% in the third quarter. Consumer spending, which accounts for more than two-thirds of activity, is growing at a still-brisk 3.5% pace.

UK interest rates held at 4.75%. It was a mixed month for UK shares after the Bank of England (BoE) kept interest rates on hold despite a stalling economy, after inflation rose again. The Bank maintained rates at 4.75% after figures showed inflation increased in November for the second month in a row to 2.6%. Wages are also rising, up by 5.2% in October from 4.4% in September. Unemployment remained steady at 4.3%.

The pound hit its highest level against the euro since the Brexit vote as the European Central Bank (ECB) prepared to cut interest rates. UK government bond yields also rose on the view that the BoE will cut interest rates less aggressively than the ECB. Britain's economy shrank by 0.1% in October, in a blow to the Labour government's economic agenda. It follows a 0.1% contraction in the previous month.

Euro area struggles as ECB cuts rates. European shares came under pressure from ongoing political turmoil in France and Germany, while the euro lost ground against other major currencies. The ECB cut interest rates for the fourth time in 2024 by a quarter percentage point to 3%. The central bank said efforts to return inflation to its 2% target are on track, but the economic recovery is likely to be lower than previous projections.

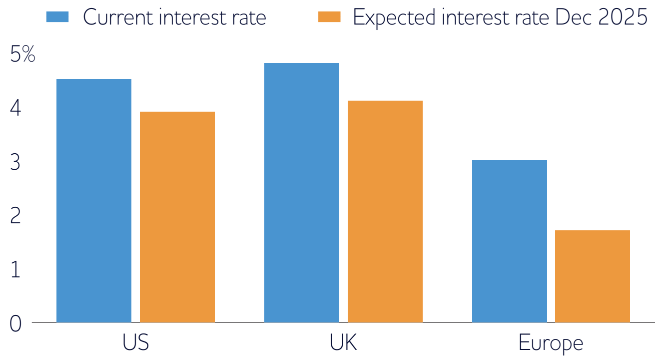
Inflation rose to 2.2% in November, up from 2% the previous month. The euro was also dragged lower by the prospect of Trump's proposed trade tariffs hitting exports. Meanwhile, political turmoil in the bloc's two biggest economies is clouding the outlook for growth. French Prime Minister Michel Barnier resigned following a no-confidence vote, after the collapse of the German government in November.

China's economic struggles deepen. China's economy continues to lose momentum, with data suggesting government efforts to boost activity are struggling to gain traction. Retail sales growth fell sharply in November, rising just 3% year over year compared with October's 4.8% gain.

Property investment dropped 10.4% between January and November compared with the same period in 2023. China's exports also grew at a slower pace than the month before. There is also the risk of a new trade war with the US following Trump's election victory, including potential tariffs of 10% on all Chinese goods.

Figure 1: A fine balance

Interest rates are likely to continue to fall this year but not by as much as expected due to lingering inflationary pressures.



Source Bloomberg

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