RATHBONES

‘TIS THE SEASON FOR A RATE CUT

REVIEW OF THE WEEK
16 DECEMBER 2024

AS 2024 WINDS DOWN AND WALL STREET IS LIT UP LIKE A CHRISTMAS TREE, THERE’S STILL PLENTY TO KEEP US ON OUR TOES. WILL CENTRAL BANKS BRING GLAD TIDINGS?

It’s a busy week for central banks. The US Federal Reserve (Fed)’s final interest rate decision of the year comes on Wednesday, followed by the Bank of England (BoE) on Thursday. Most investors seem to think that both are generally foregone conclusions, but we’d better not be complacent. And it might not be the rates decisions themselves that are the key driver of markets, but the statements that accompany them.

There’s pretty widespread confidence that the Fed will deliver another quarter-point rate cut. That would amount to one full percentage point in cuts from the Fed in 2024. After that, a majority of economists polled by Bloomberg are predicting just three Fed rate reductions in 2025. That’s a big turnaround from only a few months ago when concerns about a weakening US labour market had many expecting bold Fed rate cuts into 2025. But the slight rise in unemployment earlier this year has reversed and progress on cooling inflation down to the Fed’s 2% target has stalled. Moreover, the incoming Trump administration arguably adds to near-term inflation risks.

Imposing tariffs, especially the very broad ones under consideration, would push inflation up in the short term. Corporate tax cuts (plus the various other tax changes Trump has talked about – extending various personal and business tax reductions, while cutting taxes to tips and overtime pay) could also exacerbate price pressures. Trump’s plans to clamp down on immigration could stoke inflation longer term too. An estimated 10 million people have come into the US in the last four years, expanding the labour pool and contributing to demand. If that flow is reversed, that could raise the risk of labour shortages, driving up wages and fuelling inflation.

Fewer Fed rate cuts than investors were expecting hasn’t stood in the way of decent US equity market returns this year because growth has been stronger than forecast. Nevertheless, markets could be unsettled if the Fed signals it’s planning even fewer and smaller rate cuts next year than they currently expect.

The UK economy shrinks… again

Meanwhile, the UK economy isn’t delivering much festive cheer. The most recent monthly GDP change, published by the Office for National Statistics (ONS) last week, showed the UK economy contracting by 0.1% in October, despite expectations that it would return to growth after a fall of the same magnitude in September. The data points to an anaemic start to the fourth quarter.

That leaves the Bank of England (BoE) in a tight spot. On the one hand, it’s warned that the big spending plans set out in Labour’s first Budget could stoke inflationary pressures and cautioned that rates can’t be cut “too quickly or by too much”. On the other, it recognises that the Budget has rattled business and consumer confidence, increasing uncertainty about the economic outlook in the UK.

The ONS is reporting that it’s the retail, leisure and hospitality sectors that have had a particularly weak few months. These labour-intensive industries have been hit hardest by the Budget increase in the rate of Employers’ National Insurance Contributions and, more importantly, a reduction in the threshold for contributions being made – the latter bringing a lot more lower paid workers into the net. Businesses are warning that the extra costs will have to be absorbed through some combination of higher prices, reduced profits, lower wage increases or lower employment. Many companies have also indicated that they will cut back investment plans. None of this will be helpful to workers or to the UK economy.

The BoE is likely to err on the side of caution in the near term given the uncertainty the Budget has created and keep rates on hold at 4.75% this week. But rate-setters will undoubtedly be paying very close attention to the employment and inflation figures due out on Tuesday and Wednesday respectively before they make their decision.

Thank you for investing with us and for reading our weekly thoughts. We are now taking a Christmas break and will be writing to you once more on 6 January. Happy holidays!

*If you have any questions or comments, or if there’s anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We’d love to hear from you.*

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