CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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Strong US data raise spectre of higher-for-longer global rates

An exceptionally strong US payrolls release for December roiled markets at the end of last week, driving the US dollar and bond yields higher, and pushing US equites sharply lower on the week. The payrolls data showed a further fall in US unemployment on the back of a stellar month of jobs growth. On the back of the "Trump trade" of late-2024, markets are now bracing for higher-for-longer interest rates, with investors pricing in just 25 basis points (bps) of interest rate cuts by the US Federal Reserve in 2025, and the US 10-year Treasury yield edging towards 5%. What begins in the US usually permeates the global economy, with bonds across major markets following suit last week, most notably in the UK.

The UK gilt market has garnered much investor and media attention on the back of a sharp sell-off of late, and even spurred a parliamentary statement by a Treasury minister attempting to quell fears of a deterioration in UK debt sustainability. While not based on any new macro data, the move in gilt yields, nonetheless, adds to pressure on the UK Chancellor to meet her already ambitious fiscal rules set down in her first Budget in October.

UK gilts have broadly tracked global bond market moves in recent months, with the 10-year yield up over 60bps since the beginning of December to 4.9%, a similar rise to the 10-year US Treasury, currently at 4.8%. A firming in rate expectations on the back of sticky inflation has been a factor in these moves, but a key catalyst has been the rise in term premia on the back of the US election and expected fiscal stimulus by President Trump. However, the rise in UK gilt yields over the past week has been more rapid, about 27bps for long-dated bonds versus a 15-20bps rise in US Treasuries. Reflecting the negative sentiment around UK assets, sterling was also significantly lower on the week, down by as much as 2.5% against the major currencies, including breaking through a 12-month low against the dollar.

This move may indicate some lingering concerns around the UK's growth prospects and fiscal sustainability post the Autumn Budget. Analyst commentary around the Chancellor's narrowing fiscal headroom to her new targets has also possibly created a negative feedback loop to markets. What hasn't been present are any specific macro drivers to spur the sell-off in gilts - the UK data calendar has been sparse so far this year. Therefore, the market may settle back down in the coming weeks, but the current episode highlights the fragility of the UK Government's fiscal position. With GDP growth remaining muted and markets pricing in a shallow trajectory of rate cuts, this implies a 'stagflationary' outlook amongst investors, which may be amplified by incoming data. If sustained, this could pile pressure on the Chancellor to revisit her fiscal plans in the Spring statement in March, and abandon her commitment to having a single annual fiscal event each Autumn.

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