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Markets in a Minute

Guy Foster, Chief Strategist, discusses UK and U.S. inflation figures and the potential impact of President Trump's trade, migration and energy production policies on the economy. Plus, Janet Mui, Head of Market Analysis, analyses the latest Chinese economic data.

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There was something quite abstract about having a big week of economic data in the final run-up to the inauguration of a U.S. president who's promised to shake things up.

Analytically, we can go through the motions, identify the outliers and the seasonal discrepancies, and take a view on the likely trajectory of the economy going forward. But we also need to appreciate that some things are likely to change with the new administration.

Returning to the here and now, inflation was the major focus last week, with the U.S. reporting producer and consumer prices data. The UK also reported its inflation data on the same day. This would normally be of only local interest, but with UK bonds having underperformed, and a measure of political pressure building on the UK government over its handling of the economy, gilts have threatened a return to infamy.

And what did the data tell us?

UK inflation was below expectations, which was very well received by the market, and likely very welcome in the halls of government. The decline in the headline inflation rate was marginal, but it's core inflation, which strips out the volatile food and energy prices, that's been the thorn in the UK economy's side. It slowed from 3.5% to 3.2% per annum.

This was excellent news, and enough to see UK government bonds rallying. However, there was a fairly hefty caveat. Although food and energy prices are stripped out, other volatile prices aren't.

A good example of these would be airline fares, which fluctuate wildly – not just from month to month, but even from day to day. They typically rise as the Christmas holidays begin but drop sharply on Christmas Eve and New Years Eve when few people want to travel. These dates were used to measure return flights for European and long-haul flights and would therefore have depressed the overall figures. It means that air fare inflation seemed to rise less than previous years.

Despite this, measures we like to follow continue to point to further disinflation. The rise in the median consumer price index (CPI) category was lower than last month, and services inflation had already slowed in recent months. Overall, core inflation may have been a little flattered by the measurement of air fares, at 3.2% per annum. It remains too far above target, but has been coming down, and should continue to do so.

The UK differs from the U.S. in an important regard. Persistent U.S. inflation could be ascribed to the strength of the country's economy. Strong retail sales growth indicates that growth is likely to be at an annual rate of around 3% in the final quarter. In the UK, Thursday's quarterly gross domestic product (GDP) data and Friday's retail sales data were both very weak.

The strength of the U.S. economy, and the ensuing rise in U.S. and global bond yields, meant there was a lot of anticipation for higher U.S. inflation data. Indeed, prices rose faster in the U.S. over December, reflecting the rise in oil prices. But the core measure of inflation slowed without any of the irritating statistical gremlins that plagued UK inflation figures. The market reaction has been surprisingly strong to a modest undershoot of one measure of inflation. This is an indication of how nervous investors had been about the prospect of a re-acceleration in prices.

There's been room for optimism as far as inflation data is concerned but that, as economists like to say, is ceteris paribus (all other things being equal). But we know that all other things won't be equal.

How will a second Trump presidency differ from the first?

On Monday, Donald Trump was sworn in as the 47th President of the United States, and it's looking like he'll hit the ground running with early policy measures.

During his first term, Trump was politically intuitive but inexperienced and unconnected. He struggled to build a team to implement his policies and ended up relying on the Republican Party establishment to suggest colleagues and advisers. These included members of the administration such as Steven Mnuchin (Secretary of the Treasury), Gary Cohn (Chief Economic Adviser) and Rob Porter (White House Staff Secretary), who didn't share the president's agenda and worked against it. Consequently, it was a year before any tariffs were actually announced.

This time around, the Trump administration has prepared better, and Trump himself has built a team around him who are ideologically aligned (mostly). There are differences, but those are more likely to be evident later in the presidency.

Some members of President Trump's administration, such as Scott Bessent, who's been nominated as Treasury Secretary, see tariffs as more of a bargaining chip. Imposing tariffs now enables the administration to seek concessions in other policy areas. The most obvious example is encouraging other NATO members to invest in defence (U.S.-made defence) on pain of tariffs.

Other members of the administration, such as Peter Navarro, one of the few survivors of Trump's original administration, consider tariffs against China at least to be a means of permanently moving away from economic integration with a strategic rival.

The above is an example of the nuance that can exist within a particular policy area amongst an aligned group of individuals. But there are multiple policy areas that have the potential to impact the economy. Tariffs are relatively easy to understand, even if we don't yet know how broad they'll be. Tariffs are also inflationary. They raise prices, albeit only on imported goods. Because goods form a small and declining share of the CPI basket, the impact will be limited, at least initially.

How will Trump's policies impact the U.S. labour market?

The greater question is about the impact of immigration controls on the U.S. labour market. After data released in early January showed strong growth in employment, and with surveys suggesting that companies expect to hire more staff due to greater economic optimism, the availability of staff may become a big issue (as it was during 2022).

Exactly how many undocumented migrants President Trump will be willing and able to deport remains to be seen. It may only need a reduction in migration to start reducing the supply of workers and trigger renewed inflation. This is particularly true in the agriculture sector, which utilises a lot of migrant workers.

This will be amongst the key policy areas to watch out for announcements now that Trump has been inaugurated.

Finally, it's worth mentioning the beginning of earnings season on Wednesday, which saw a buoyant start. As always, it was the banks that marked the unofficial start. Generally, their results were strong. Net interest margins have risen as savers feel less inclined to shuffle their savings around seeking the optimum rate available. Meanwhile, the big investment banks made large profits from trading bonds around the U.S. election, an early benefit of the new president.

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