25 March 2025

Markets in a Minute

Key highlights

- **Trade pain and the pain trade:** The so-called 'Trump slump' paused for breath last week, with regional equity market performance becoming generally more uniform.
- **Are U.S. consumers spending less?** U.S. retail sales data showed further declines in food services and drinking establishments. While the U.S. consumer is cutting back, there's plenty of scope for an economic slowdown without it triggering a recession.
- **UK disability reforms:** The UK announced disability benefit reforms that could save £5bn per year. However, independent assessments suggest over a million people could be left without benefits.

Watch the latest Markets in a Minute video

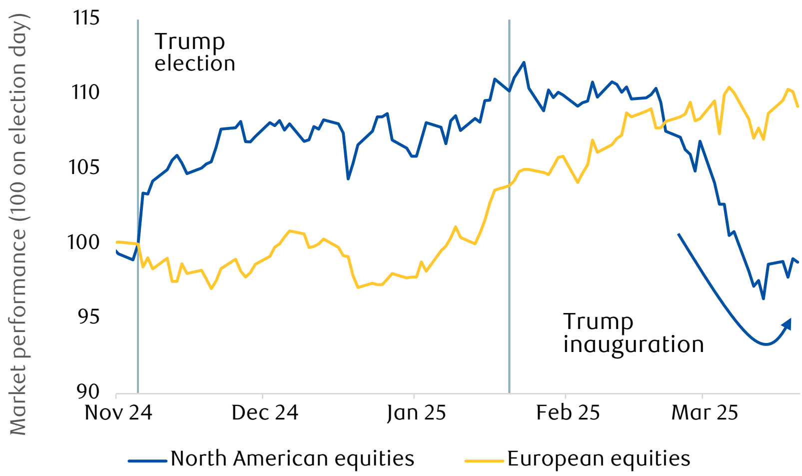
Guy Foster
Chief Strategist

We've seen a fragile recovery in U.S. equity markets. Surveys suggest trade uncertainty has caused wariness. Weak sentiment indicated a potential rebound. However, several factors conspired to slow economic activity in early 2025.

Trade pain and the pain trade

The so-called 'Trump slump' paused for breath last week, and the performance of regional equity markets became generally more uniform.

The Trump slump showed signs of stabilising



Source: LSEG Datastream

> "Data released on Friday showed a continued shortfall in the UK budget – £1.6bn, according to estimates."

Guy Foster, Chief Strategist

Figure of the week

4.5%

Both the U.S. and the UK left interest rates unchanged at 4.5% last week.

The 'pain trade' is the tendency of the market to move in a way that causes the maximum possible pain to the largest possible number of investors. It happens when there's a very widely and strongly held consensus, such as the belief that U.S. President Donald Trump's second term would bring a boost to growth from deregulation and tax cuts, and that the artificial intelligence (AI) boom would continue.

In 2008, the U.S. equity market was around 1.5 times as big as the European equity market. By the end of 2024, it had ballooned to more than five times the size. That means any rebalancing from the U.S. to Europe can have a disproportionate impact on the latter. It pays to be aware of these technical factors in order to distinguish them from fundamentals.

Over the same period, U.S. earnings outpaced European earnings by a similar amount. Fundamentally, U.S. companies continue to be much more profitable than European companies and so demand a premium valuation.

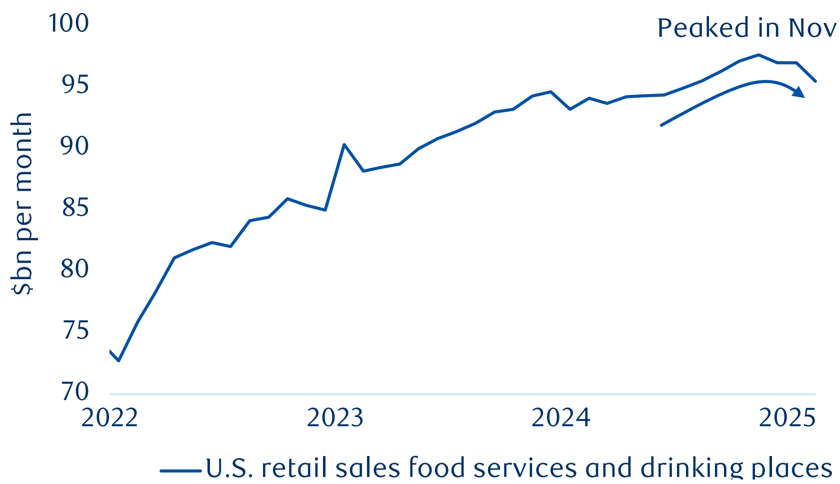
Although there has been some deregulation, the market's focus has been on surprisingly aggressive U.S. trade policy (which seems to have few winners and many losers) and the sudden realisation in Europe that the region would need to re-arm itself.

Are U.S. consumers spending less?

The most obvious rationale for the sell-off in U.S. equities has been the onset of trade tariffs. They seemed to be the trigger, but so far, their impact on the economic data has been restricted to surveys. It will be some time before tariffs show up in the wider economic data, but we can see some evidence of weaker economic activity that pre-dated any tariff announcements.

One example of this is U.S. retail sales data, which suggests a decline in consumer spending.

U.S. food services sales suggest consumers have been saving



Source: LSEG Datastream

U.S. retail sales data has generally underwhelmed, and last week's announcement did show a further decline in sales at food services and drinking establishments. This could suggest that consumers are going out less—although during the winter, we do see occasional lulls in eating out due to adverse weather conditions.

It looks like the U.S. consumer has been cutting back over the last four months or so. The onset of tariffs may cause them to do so more. Certainly, those who might be reliant upon the state for salary or welfare will be anxious over efforts to rein in government spending. But the U.S. economy has been growing comfortably, at more than 2% a year for the last two years, so there's plenty of scope for a slowdown without it triggering a recession.

UK announces public spending reductions

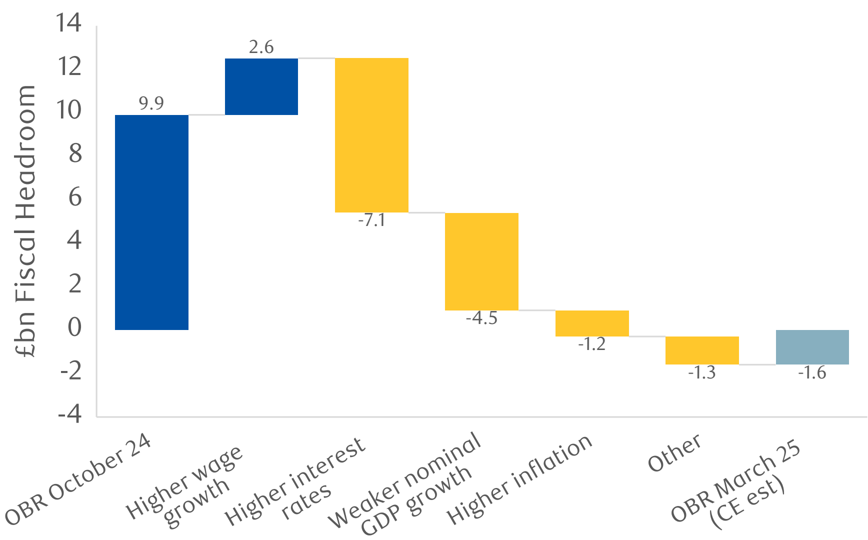
Last week, the UK's Work and Pensions Secretary Liz Kendall announced planned reforms to disability benefits. The government believes the measures will save more than £5bn per year by the end of the decade. The measures are being consulted on but have drawn sharp criticism from Labour backbenchers.

The government hasn't given figures, but independent assessments suggest the reforms could strip over a million people of their benefits. The measures coincide with the UK's pledge to increase defence spending and come ahead of the Spring Statement this Wednesday.

Over the weekend, Chancellor Rachel Reeves announced civil service costs will be cut by 15%. The cuts will come from back office and administrative functions and will be achieved through greater use of technology and productivity tools.

It's expected that the Office for Budget Responsibility (OBR) will reveal that the government is in breach of its fiscal rules due to a combination of factors. Data released on Friday showed a continued shortfall in the UK budget, with borrowing during February exceeding OBR estimates. The shortfall could be £1.6bn according to estimates by Capital Economics.

Several factors have combined to eliminate fiscal headroom



Source: Capital Economics

The government has said that it won't be increasing taxes in the Spring Statement, so it will need to announce more spending cuts (assuming it doesn't loosen the fiscal rules).

The fiscal rules are one constraint but they can be fudged. Cuts in the future can be endlessly deferred, but the chancellor must also convince the lenders (i.e. the bond market) that the government is on a fiscally sustainable track.

The less fungible constraint is the impact that increased borrowing would have on market interest rates. As the UK's fiscal position deteriorated earlier in the year, we saw a sharp rise in bond yields, and the UK remains in the focus of the bond markets.

UK interest rates were kept on hold last week as the Bank of England balanced the competing pressures of too high wages, an apparently slowing jobs market, and the probability of some form of modest fiscal tightening.

Coming up this week

- **UK Spring Statement:** On Wednesday, UK Chancellor Rachel Reeves will deliver the Spring Statement. She's expected to announce further measures to rein in borrowing (but will not, apparently, increase taxes).
- **Inflation reads:** The last of the inflation estimates for February will be released. We'll see UK consumer price index and retail price index numbers, but also the U.S. personal consumption expenditure price index, the Federal Reserve's preferred measure of price growth.
- **More inflation reads:** There's still a week to go until 'Liberation Day' (as President Trump calls it), the day when reciprocal tariffs are announced on an as yet unknown group of countries.

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