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Markets in a Minute

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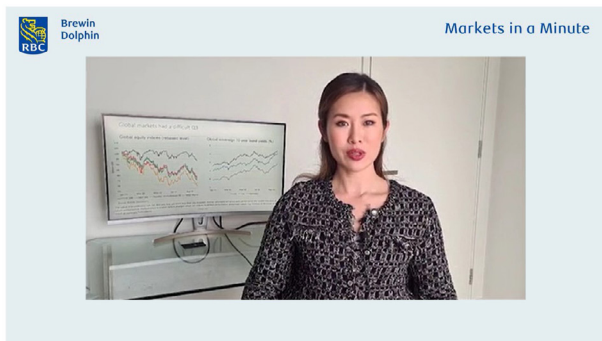
Janet Mui, Head of Market Analysis, discusses the effect of central bank monetary policy and earnings results on markets, and what this and new US jobs data could mean for interest rates.



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We had two big central bank meetings last week, with the Federal Reserve announcing policy on Wednesday evening and the Bank of England doing so on Thursday lunchtime. As expected, neither made any changes, but it was an opportunity to hear the tone being used and to determine the likelihood of an interest rate cut, possibly as soon as (late) March.

The Federal Reserve chairman, Jay Powell, took the first opportunity to set that tone. Data had been supportive of a continuation of economic growth momentum, alongside weakening inflation. Although job openings increased slightly, suggesting the labour market was tight, fewer people had been quitting their jobs, suggesting diminished confidence amongst workers. That matters because wage growth tends to be faster amongst those switching jobs than those staying within the same job.

Blowout jobs growth

On Friday afternoon, more light was shed on the employment position with the monthly non-farm payroll report, which gets pulses racing across the investment world despite a tendency to be heavily revised in the following months.

The Bureau of Labor Statistics estimates that a huge 353,000 new jobs were taken in January, which was almost double the average forecasted figure, and well above even the highest of those forecasts. Not only that, but previous healthy jobs growth numbers were revised higher. Now, an important caveat here is that the headline jobs growth number comes from surveying companies and asking how many jobs they have filled. An alternative measure of ostensibly the same thing surveys households and asks how many of them are in work. This second measure sometimes (often) conflicts with the first and did so again on Friday. But it is accepted that this household survey is not as reliable as the main non-farm payroll report, so this data suggests the labour market is strong.

The second most shocking part of the report was the wage data. In recent weeks, we have seen some more lagged but better-quality data indicating a slowdown in wage growth, but January's wage gains seem, provisionally, to have also exceeded any forecaster's expectations. Wage growth accelerated to 4.5% per annum. Stronger jobs and wage growth is a potent combination which will imply strong growth in consumer spending as well as more money flowing into pensions, and, by implication, into the stock market.

At the same time, though, stronger wage growth will suggest higher costs for firms and therefore higher prices being charged for their goods and services.

Interest rates

This obviously has serious implications for the Federal Reserve. On Wednesday evening, chairman Powell disappointed some investors, saying he doesn't expect to have sufficient confidence that he could cut interest rates by March.

There was clear disappointment reflected in the equity and bond markets, with investors at some stage thinking there was a 60% chance of a rate cut; this dropped to less than 40% after Powell spoke. And now, following the release of this strong employment report, at the time of writing, the chances

of a rate cut seem to have fallen to around 20% (although, chances are still higher than this for subsequent meetings).

Powell's comments felt like they were designed to calm investors down after he struck a decidedly dovish tone in December. The Bank of England (BoE) was expected to do the opposite.

The BoE has been keen to avoid declaring victory in the battle against inflation. At this meeting, the most obvious relaxation of that stance was evident in the voting. In December, three members had voted for a further increase. In January, that was just two, while one had even started by voting for an interest rate cut.

Economic forecasts for the UK have been downbeat and inflation has been high. The elevated level of inflation has weighed on growth (which tends to be measured after adjusting for price increases). However, consumer confidence has improved, the housing market has stabilised, and business surveys show growing confidence.

Unlike the US, there is clear evidence of the UK labour market weakening, which ought to be enough to keep the two hawks on the BoE's Monetary Policy Committee in the minority. It doesn't currently seem sufficient to trigger the cuts the market is expecting.

Earnings season

Earnings season continues with the oh-so-predictable beats-to-misses ratio of 80%. So far, around 40% of companies have reported, but that understates the progression through this earnings season as Tesla, Apple, Alphabet, Microsoft, Amazon and Meta have all reported. So, that just leaves Nvidia to complete the so-called 'Magnificent Seven' when it reports on 21 February.

Of these big companies, Amazon and Meta dazzled, Microsoft was mixed, Google and Apple underwhelmed, and Tesla was received particularly badly by the market when the numbers landed last week. Any disgruntled investors may have felt relieved to know that last week, a judge ruled that Musk's extraordinary record-breaking $56bn compensation should be cancelled.

US stocks seemed set to finish the week little changed overall, after mixed performance from the Magnificent Seven stocks. Despite their size, they contributed an even greater share of the market's earnings growth. But the rest of the US market, while growing more slowly, did at least seem to surprise analysts more favourably when their earnings were released.

One of the major controversies within the market at the moment is whether, after a strong year of outperformance by the Magnificent Seven, expectations could have become difficult to meet. In the short term some companies showed signs of that, but we still see some of these exceptional stocks as offering tremendous value.

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