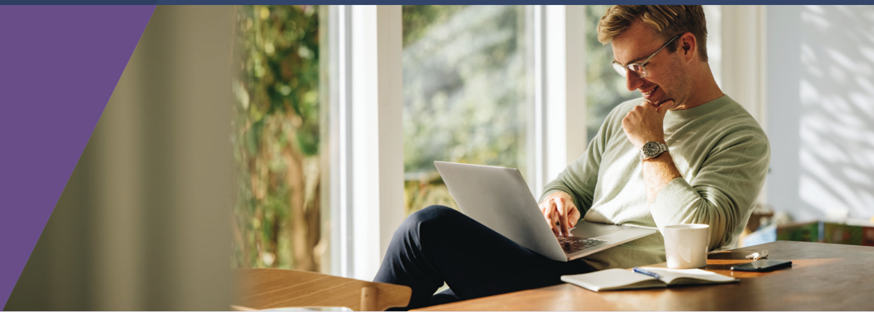
Global markets rally as central banks shift to support growth



A fine balance. Central banks around the world are shifting their focus from controlling inflation to supporting economic growth. The US Federal Reserve (Fed) recently reduced interest rates for the first time in over four years, with a larger than usual cut. Meanwhile, the Bank of England (BoE) and the European Central Bank (ECB) held rates steady, although the general trend is downward.

The US economy remains solid, with inflation falling and the employment market still relatively strong, despite some signs that conditions are weakening. In contrast, the euro area's services and manufacturing sectors have underperformed, underscoring growing challenges for businesses across the region. Meanwhile, China's economy continues to slow, raising concerns that the country may miss its 5% growth target for the year. On the political front, the US presidential race between Vice President Kamala Harris and former President Donald Trump remains tight, with polls showing no clear leader.

Stock markets hit new highs. After a slow start to the month over recession fears, stock markets rose to record highs after the Fed's decision to cut rates. The decision is good news for many companies because lower borrowing costs make it easier for them to borrow and invest. Markets were also bolstered after improved economic data eased fears of a broader slowdown in the US economy.

The FTSE 100 rallied after the Fed's decision, although gains took a slight hit after the BoE announced it was holding rates. Chinese stocks also posted their best week since 2008 after Beijing rolled out further stimulus measures to stem a slowdown in the economy. Meanwhile, European stocks hit record highs, boosted by China's stimulus and a growing conviction that US and European interest rates will fall further in the coming months.

Bank of England holds rates. The BoE decided to hold interest rates at 5% after inflation remained steady in August, but signalled it could cut them at its next meeting in November. UK inflation held at 2.2% in August, far below its peak of more than 11% in 2022. But while inflation is near the Bank's 2% target, services inflation is edging up. The decision to hold interest rates comes after a cut from 5.25% in August — the first reduction since the pandemic started in 2020.

In a worrying development for the new Labour government, data showed the economy has been flatlining, with no growth recorded in either June or July. UK consumer confidence has also fallen amid concerns of a painful Autumn Budget.

Europe's economy contracts. The euro area economy contracted sharply as the bloc's dominant services industry flatlined, while a downturn in manufacturing accelerated. France's output in the private sector slipped back into contraction in September following the Olympics boost. Meanwhile, the downturn in Germany deteriorated to its fastest pace since February, with unemployment in Europe's largest economy reaching its highest level in nearly four years. Other parts of the region grew, although the pace was modest and the slowest since January.

UK house prices in September rose by 3.2% compared with a year ago, which is the fastest rate for nearly two years, according to Nationwide. This increase means that the average price of a UK home is now £266,094.

The European Central Bank (ECB) cut its main interest rate by a quarter percentage point to 3.5%, which is its second reduction this year. The move came after inflation across the euro area fell to 2.2% in August, down from 2.6% in July and near the ECB's 2% target. Cooling inflation opens the door to another interest rate cut in October.

Fed surprises with larger than usual cut. The Fed cut its key lending rate by half a percentage point, kicking off what is expected to be a steady easing of monetary policy. The larger than expected cut will bring relief to borrowers who have been dealing with the highest rates in more than two decades. Fed Chair Jerome Powell has also signalled that more cuts are in the pipeline.

The Fed's decision came after US inflation fell to its lowest level in over three years at 2.5% in the 12 months to August. The US labour market continued to cool at a measured pace. Businesses are still adding to payrolls, but not as indiscriminately, while unemployment dipped slightly in August, reversing the previous month's increase. Consumer confidence also remains strong, with retail sales increasing.

Japan chooses its next prime minister. The yen surged after Shigeru Ishiba won the leadership vote of Japan's ruling Conservative Party, securing his position as prime minister. At its September meeting, the Bank of Japan (BoJ) maintained its key short-term interest rate at around 0.25%, the highest level since 2008. BoJ Governor Kazuo Ueda noted that Japan's economy is progressing as expected, with rising wages boosting consumption and keeping inflation on course to reach the bank's 2% target.

The price of gold hit a record high in September, soaring to $2,685 per ounce. It was driven higher by the Fed's rate cut and China's economic stimulus measures.

Kamala Harris's presidential campaign raised more than three times the amount Donald Trump did in August. The US Vice President and the Democratic National Committee brought in $257 million (£193 million), while the former president's campaign raised $85 million (£64 million).

In August, Japan's core consumer inflation rose for the fourth consecutive month, climbing by 2.8%, which is well above the BoJ's goal. The announcement of China's stimulus also provided a lift to Japanese companies exporting to China. However, Japan's exports and imports grew more slowly than expected due to sluggish domestic activity and weakened demand in its key export markets.

China unveils new stimulus. The Chinese government unveiled a major package of stimulus measures to help lift its floundering economy, including lowering key interest rates and allowing banks to increase their lending. Surveys of Chinese factory managers show the economy weakened further during the month. There has also been a slowdown in retail sales and industrial production.

Property developers have struggled after the government cracked down on excessive borrowing, while house prices have continued to fall. China's youth unemployment has also risen to a new high, amid the economic slowdown and restrictive hiring practices. The country is grappling with the significant problem of weak consumer demand. While exports remain a bright spot, growing at their fastest pace since March 2023, imports grew by less than expected.

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A cautiously optimistic outlook. With US inflation falling, the job market cooling and steady economic growth, the Fed is increasingly confident about achieving a 'soft landing' — when a central bank reduces inflation without triggering a recession. Policymakers are forecasting another half percentage point cut in US interest rates this year, followed by another full percentage point in 2025, and then a final half of a percentage point in 2026.

In a sign that Europe's economic recovery is faltering, the ECB has lowered its growth forecast this year. Meanwhile, UK growth has flatlined, but further rate cuts should be positive for the economy. However, there could be some pain for consumers in October's Budget. While financial markets remain cautiously optimistic about the global outlook, challenges such as geopolitical tensions and China's economic growth remain a concern.

Thank you for reading, until next time.

Ascot Lloyd Investment Team

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