2025 BRINGS A GLOOMY START FOR GOVERNMENT BONDS

This week has brought a less positive start to the year than most people were hoping for as government bonds and sterling sold off. Nothing significant has changed since 2024. The pre-Christmas messaging from the Federal Reserve and Bank of England was noticeably cooler on the prospect of rate cuts and inflation had already ticked up. Weak Chinese growth and Donald Trump's view that tariffs are the solution to almost everything have been apparent for some time. So, what has changed to bring about the pessimistic mood in bond markets?

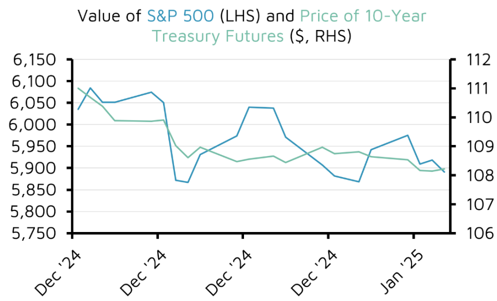
The impact of falling bond yields in the UK is significant for the government as higher bond yields have driven up borrowing costs and mean the government has no real room to move without cutting spending or breaking its pledge not to raise taxes further. But sticky inflation means fewer rates cuts while a drop in government spending reduces the outlook for growth, adding to the negative sentiment. The move up in government bond yields has also been seen in the US. But it's not all gloom this week as UK and US stocks have mostly avoided the negative sentiment.

THE MARKETS THIS WEEK

FTSE 100	S&P 500	Nikkei 225	STOXX 600	Hang Seng	US 10 Yr	UK 10 Yr	Brent Crude	Gold	Copper	GBP USD
+0.98%	-0.69%	-1.51%	+1.39%	-3.40%	+0.10%	+0.25%	+2.65%	+2.55%	+6.39%	-0.97%

US: GOVERNMENT BONDS FALL AND EQUITIES RETREAT

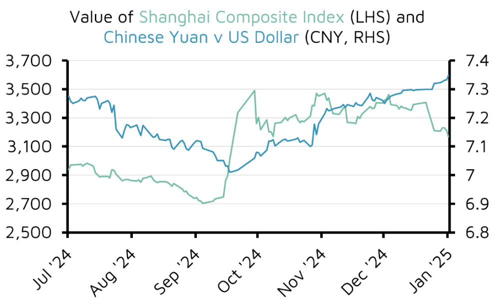
Treasury bonds sold off and US stocks retreated this week as strong economic growth dented hopes of interest rate cuts. The latest monthly Jolts employment data shows more than 250,000 new jobs created, well over expectations. US manufacturing activity also grew more than expected. Meanwhile, the minutes from the latest Federal Reserve meeting revealed officials' concerns about inflation and their desire to be cautious with future rate cuts. Treasury prices fell pushing 10-year yields to 4.7%.



Conversely, the premium paid on corporate debt over safer government bonds is at a two-decade low, meaning investors cannot have enough of them. The narrow spreads have spurred companies to secure funds at relatively low costs. US dollar investment-grade and high-yield bond borrowing surged to $83.4bn this week, the highest year-to-date figure since 1990. Major international banks and manufacturers like Toyota and Caterpillar led the borrowing. Companies need to refinance $1.85tn in maturing debt this year and the next.

CHINA: STOCKS AND CURRENCY DIP OVER GROWTH AND US TARIFFS FEARS

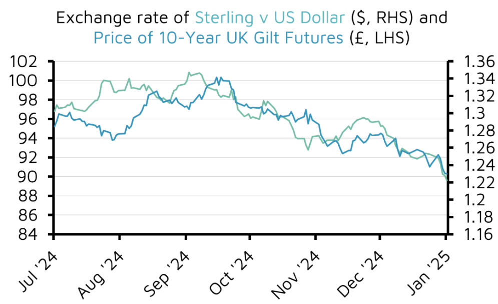
Chinese financial markets started the year under significant pressure. Chinese equities fell significantly in late December as weak economic data combined with concerns about trade policies of US president-elect Donald Trump. Although Chinese equities have stabilised this week, the CSI 300 index of mainland Chinese shares is down more than 5% since 30 December.



China's currency has also come under pressure in recent weeks as investors consider the potential impact of tariffs on Chinese exports to the US. The renminbi has fallen around 1.4% against the dollar in the last month and is below the recent low of $7.33 it briefly touched in mid-2023. As well as concerns about slowing exports, investors are also reflecting on the People's Bank of China's intention to cut rates this year as it attempts to hasten economic growth. Significant additional bond issuance by the Chinese government may support the value of the renminbi but some commentators expect the currency to fall further in 2025.

UK: POOR ECONOMIC DATA DRIVES UP GILT YIELDS AS POUND SLIDES

UK government bonds declined this week pushing yields up to their highest in more than 15 years. The yield on 10-year gilts passed 4.8%, the highest level since the global financial crisis in 2008. The sharp increase in the cost of government borrowing forced chancellor Rachel Reeves to say that the government would cut back spending rather than increase taxes further if it uses up the small £9.9bn of additional headroom it has allowed itself for the next three years. The pound has been losing ground against the dollar since it peaked at $1.34 in September and this decline accelerated this week as it fell from $1.25 to $1.22.



Markets are concerned about low growth in Britain and the gloomy outlook for the economy. So far this year the British Chambers of Commerce, Federation of Small Business and Bank of England have all issued pessimistic forecast as they predict many firms will be forced to put up prices and cut back plans to hire new staff.

Data sourced from Investing.com