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ECONOMIC AND MARKET OUTLOOK

January 2025

While some aspects of the new US administration's program could boost investor optimism, others are likely to have a negative impact on the US economy and the rest of the world. The resulting volatility could create investment opportunities to be seized.

Written on 30 January 2025. Opinions subject to change.
Latest available data as of publication date.

Economic outlook

United States: greater political uncertainty

The outcome of the U.S. elections has given the Republicans significant leverage to implement the new president's agenda.

It is based on four main policies: higher tariffs, lower immigration, tax cuts and deregulation.

The new administration's tariffs and immigration policies are likely to have very negative effects on the economy and inflation (figures 1 and 2).

Meanwhile, business-friendly tax cuts and deregulation have already prompted a trump bump in small business optimism (figure 3).

On the fiscal front, the new government plans to make most of the temporary provisions of its 2017 tax law permanent and cut taxes on companies producing in the US.

The narrow Republican majority in Congress could make negotiations long and difficult.

However, the President has considerable discretionary authority to act on trade and immigration.

While it is unclear whether the President will follow through with all his pledges to increase tariffs, an immigration crackdown is highly likely.

In terms of deregulation, the new administration intends to unleash oil drilling in a bid to increase production. Yet the reality is that prices would have to approach USD 90 per barrel to prompt a sharp acceleration in production, and OPEC's high spare capacity is likely to anchor them to the current level of USD 75 per barrel.

If the new government enacts his immigration and trade policies, the inflationary effect could force the Fed to interrupt its rate-cutting cycle.

Figure 1
United States | **Impact of a 25% tariff on Canada and Mexico and an additional 10% tariff on China**
Source: Peterson Institute

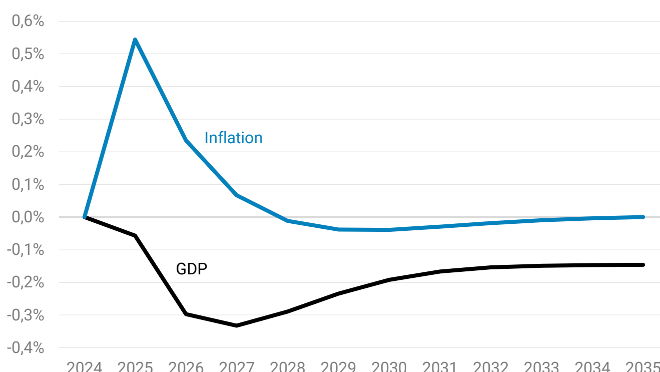


Figure 2
United States | **Impact of deporting 10% of illegal immigrants**
Source: Peterson Institute

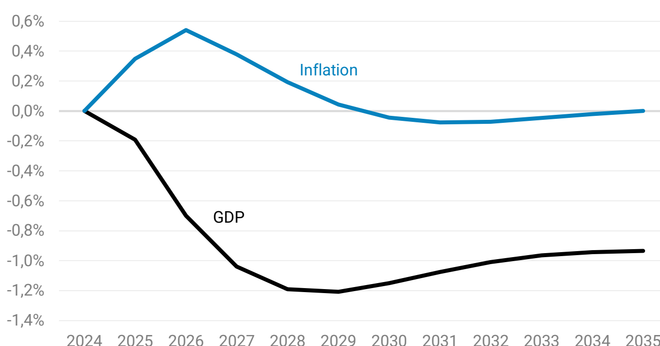


Figure 3
United States | **NFIB Small Business Optimism Index**
Source: Bloomberg

A still-robust economy

The latest economic indicators reveal that the probability of a hard economic landing in the US has declined in recent months.

Robust growth, driven by consumers and the State, has partially offset sluggish investment (figure 4).

Noteworthy is that consumer spending is mainly driven by the most affluent households, underpinned by a very positive wealth effect.

Employment data have improved: December's employment report revealed a healthy labour market and weekly jobless claims remain at reasonable levels (figure 5).

Robust growth and healthy employment raise the question of whether labour markets will tighten and wages will rise, heralding more inflation. While shelter inflation is easing, other services prices are only declining very slowly (figure 6).

Given this backdrop, the Fed sees no urgent need to ease monetary policy and has adopted a cautious approach to further rate cuts.

Productivity gains are the key to strong growth without inflation and although progress has been made, growth falls short of the productivity booms observed the 1960s and early 2000s.

It is still too early to estimate the global impact of artificial intelligence (AI). Recent productivity gains stem mainly from the effects of digital transformation in retail, while the sectors most exposed to AI are not yet visibly accelerating.

Figure 4
United States | **Final domestic demand contributions year-on-year**
Source: Bloomberg

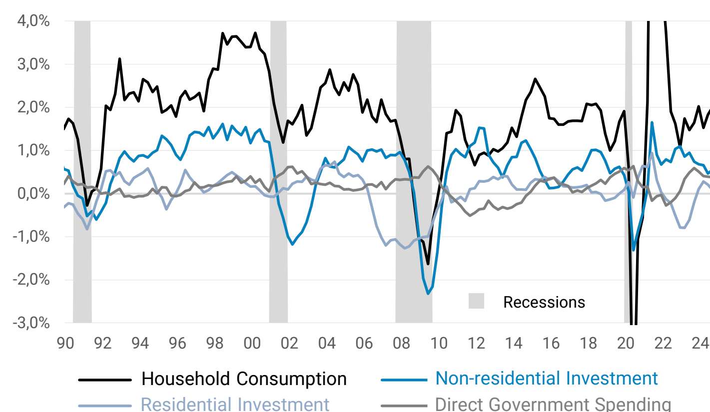
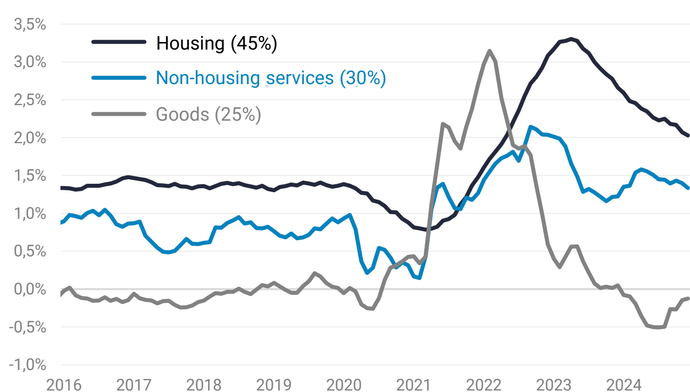


Figure 5
United States | **Weekly jobless claims**
(per week, four-week moving average)
Source: Bloomberg

Figure 6
United States | **Core inflation contributors**
Index weightings in brackets
Source: Bloomberg



What about the rest of the world?

Economic indicators in the eurozone are consistent with moderate growth hampered by industrial challenges and the German economy.

While these difficulties could persist, consumer spending harbours significant potential for growth as household spending has not risen in line with household income (figure 7).

The savings rate has risen sharply such that even stabilisation would be enough to boost consumer spending and support broader growth.

For this to happen, household confidence, which is currently low due to political upheaval in Germany and France, needs to improve. The German elections at the end of February and ongoing French budget negotiations will require close monitoring.

Meanwhile, the economy should benefit from the ECB rate cuts, with falling inflation opening the door to more reductions.

While most models indicate that US tariff increases should have a limited impact on the eurozone (figure 8), China's economy could suffer significantly.

Chinese exports to the US account for just 2% of China's GDP, but a sharp rise in tariffs could prompt them to fall dramatically.

This would deprive the Chinese economy of an essential growth driver: with domestic demand dragged down by the property sector (figure 9), much of China's growth relies on foreign trade.

Against this backdrop, more monetary easing can be expected, although the scale of the support remains an unknown.

Macroeconomic overview

The economic picture is mixed and growth is expected to remain at similar levels to 2024.

- In the US, the surprisingly upbeat job market data could lead to labour market tightness in the quarters ahead.
- In the eurozone, consumer spending could boost the gradual growth recovery.
- In China, question marks hang over an economy that has heavily relied on exports to offset weak domestic demand.

Figure 7
Eurozone | **Spending and income**
Year-on-year growth
Source: Bloomberg

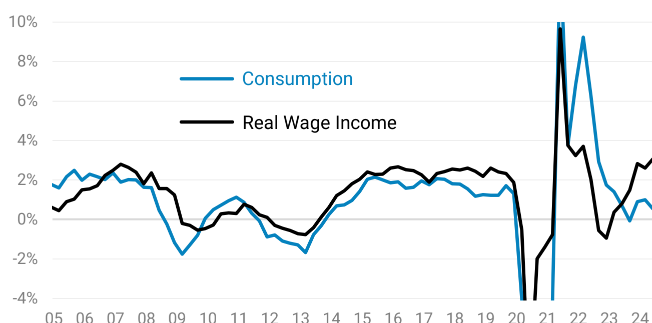
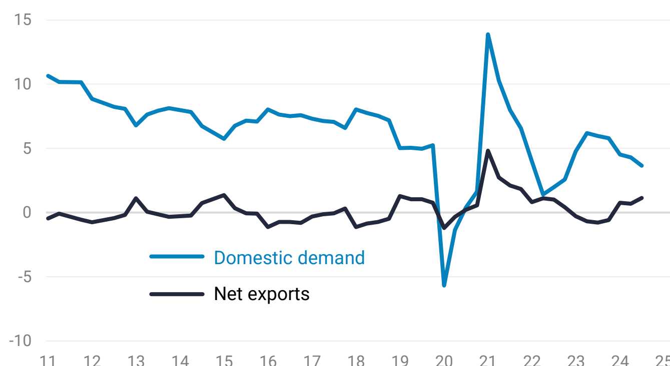


Figure 8
Eurozone | **GDP impact of various scenarios**
Source: CEPII

Figure 9
China | **GDP growth contributions**
In percentage points, year-to-date
Source: Bloomberg



Market outlook

2025: volatility and opportunity

In recent months, markets have upwardly revised their Fed fund target rate expectations. They now sit at around 4%, which is one or two quarter-point rate cuts from the current level (figure 10).

However, the strong US economy and the new government's policy are sowing a great deal of uncertainty over the future of monetary policy. This could stoke volatility in interest rates.

In Europe, the ECB's key rate could sit at around 2% in the summer. In the UK, markets expect short-term rates to remain higher for longer, but its economic momentum is similar to that of the eurozone.

This comes amid an uptick in long-term bond yields. The shift has more to do with the rise in real interest rates than with inflation expectations and boils down to where the neutral rate will settle.

Still-buoyant growth is providing a supportive backdrop for companies in terms of both credit risk and earnings.

However, the markets have already priced in a lot of good news.

While valuations have reverted to more normal levels on most equity markets, they remain high in the US (figure 11), where market valuations are distorted by a handful of heavyweight stocks that dominate the indices.

Meanwhile, expected earnings in the US imply record-high margins, although labour market tightness and rising interest rates could put businesses under pressure.

In addition, earnings growth for the so-called Magnificent Seven companies is decelerating and if this continues, sky-high valuations will be harder to justify. In other markets, earnings expectations are far more reasonable.

Figure 10
United States | Federal funds rate
Source: Bloomberg

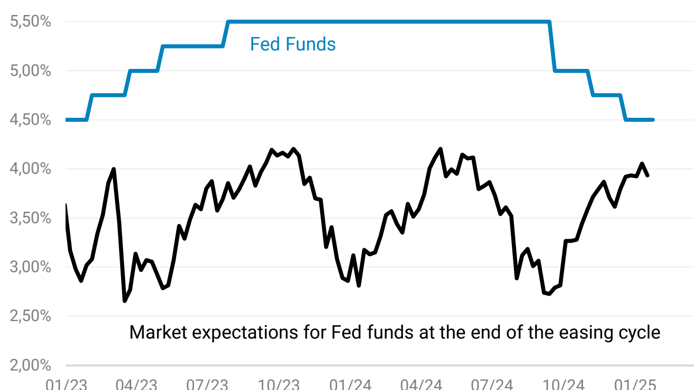


Figure 11
Equity markets | 12-month forward PE ratio
2006–2024
Source: Bloomberg

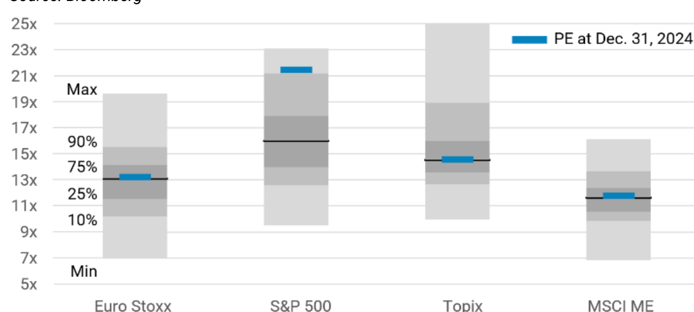
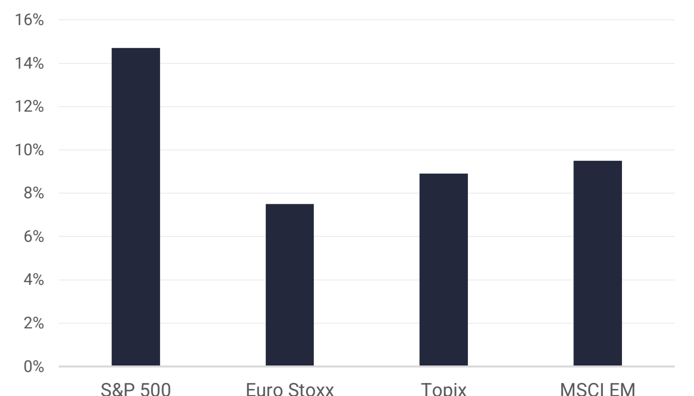


Figure 12
Equity markets | 2025 earnings growth expectations
Source: Bloomberg



Market overview

In the months ahead, as markets adjust to a higher interest-rate backdrop, volatility may increase. However, sustained growth is good news for companies.

While the US stock market remains distorted by a handful of stocks with sky-high valuations, they are more reasonable elsewhere.

The preponderance of the US stock market means that adjustments to valuations and earnings expectations will undoubtedly have global effects. However, a corrective pullback in excessive valuations and earnings expectations may create some attractive entry opportunities.

In fixed income, we remain cautious on sovereign debt and favour yield curve strategies. For example, we see the US yield curve continuing to steepen and a narrowing UK–Germany bond yield spread.

We are positive on corporate bonds: while spreads currently sit at very low levels, carry is attractive.

GLOSSARY

ECB: European Central Bank.

FED: The Federal Reserve, the central bank of the United States.

GDP: Gross domestic product is an economic indicator that quantifies the total value of annual wealth produced by economic agents residing within a territory.

PER (or PE, P/E): The price-to-earnings ratio is the measure of a company's market capitalisation relative to its earnings. This indicator is used in financial analysis to assess a company's valuation. The PER of a stock market index is the average PER of the index constituents.

Spread: The difference in yield between two bonds of the same maturity. The spread is generally used to compare the difference between a bond issued by a "risk-free" issuer and a bond issued by a riskier issuer. The better the perceived creditworthiness of the issuer, the lower the spread.

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