



Market Commentary

The last (paper) straw?

By order of Trump, plastic straws are back in business!

Key points:

- Talk of a peace deal with Russia saw hope but also concern at what a bad deal for Ukraine and its European allies could mean.
- In emerging markets, we think that Eastern Europe could benefit from any positive sentiment relating to the Russia/Ukraine conflict.
- The Trump base may feel delighted at the speed and scope of change in the US, which is in stark contrast to countries such as the UK.
- The German election is imminent, although events in the US are overshadowing it somewhat.
- Japanese yields continued to push to new highs over the week, although reduced risk aversion has seen the yen reverse some of last week's gains.

14 February 2025 (London) – Trade policy developments were the focus of market attention over the past week, with President Trump managing to create a degree of havoc in overseas capitals. The threat to tariff Canada and Mexico at 25% raised the possibility of widespread economic disruption, given the interconnectedness of these economies in key sectors such as autos and energy.

A stronger-than-expected US inflation report pushed yields higher in the middle of the week. However, there is something of a sense that current data are being lost amidst the cacophony of noise and policy announcements coming from the new US administration.

News that Trump plans to meet with Putin and seems set to draft a peace deal with Russia saw a mix of both hope and concern. The end to conflict is most definitely desirable. Yet, by agreeing to many of Putin's requirements, there is a danger that this is a bad peace deal for Ukraine and its European allies.

Moreover, by obliging the EU to foot the bill for Ukraine's future security and reconstruction, without even involving its allies in discussions, this risks further fracturing already-broken relationships between the US and EU member states.

Despite howls of protest from the international community and many prominent figures within the US, it is striking that Donald Trump enjoys a strong approval rating from voters, as he seeks to deliver on 'Project 2025'. With financial markets remaining calm, this may mean that the administration feels emboldened to keep pushing on tariffs and doubling down on DOGE efforts to reform the Federal bureaucracy and reshape the apparatus of government, for years to come.

In many respects, the Trump base may feel delighted at the speed and scope of change that is being delivered. Indeed, the US comparison to a country like the UK, where the new Labour government seems to have talked much and delivered very little, nine months since taking the reins of power, is pretty stark. In this regard, even the harshest critics of Trump will nonetheless concede that here is a President who is managing to get things done.

That said, for all the short-term populist satisfaction that measures to date are helping to stymie – illegal immigration, eliminating corruption and bias, and bringing jobs and investment back to America – there is a sense that the true cost of these initiatives is yet to be felt. With respect to trade tariffs, it is hard to accurately

estimate the impact of US growth and inflation over the course of the year ahead, given uncertainty with respect to the eventual outcome, in terms of what is imposed and what countermeasures are adopted.

However, we think that it could be prudent to expect US GDP growth to be at least 0.5% lower this year and inflation 0.5% higher than would be the case were these policies not on the agenda. Indeed, these figures may be at the conservative end of what may come to pass.

Ostensibly speaking, such an outcome on growth and inflation should detract from risk assets and push credit spreads and equities weaker. However, this has not manifested up until this point. In part, this may be down to the fact that markets will only be able to react to data as and when it is released.

Herein, the sheer level of uncertainty around trade policy makes any analysis difficult to incorporate into decision making ahead of the event. Nonetheless, this leads us to think that there may be some level of complacency in the prevailing status quo in market pricing.

In Europe, we are now on countdown to the German elections just over one week from now. However, it does feel like events in Berlin are being overshadowed by what is happening across the Atlantic. We would caution that there is still a long way to go before Trump can claim his 'Big, Beautiful Peace Deal', which will surely, in his mind, guarantee him the Nobel Peace Prize, which he was denied in his first term in office.

That said, with the US President promising to 'unleash hell' if Hamas fails to release Israeli hostages as per the previously agreed timeline, many outside the US might remain highly sceptical of Trump's peace-making credentials. Indeed, with comments suggesting that POTUS is eyeing mega deals for Ukrainian rare earths worth many USD billions, there is a sense that the self-styled CEO of US Inc is as inclined to focus on the economic prize at stake as much as the welfare of those citizens embroiled in the conflict.

In the UK, a downgrade in OBR growth estimates for the economy has negatively impacted the UK Budget position. With GDP stagnant in the second half of 2024 and remaining similarly weak in 2025, this has eliminated the fiscal space that Chancellor Reeves will have been hoping to utilise and may push the government into further tax rises or spending cuts in the months ahead.

Meanwhile, the news on inflation is not looking any better, notwithstanding the weak growth backdrop. The worry is that stagflation risk starts to build, and for the government trying to jump on the growth bandwagon, it seems that all that is being offered are platitudes and empty words by policymakers struggling for ideas.

Politically speaking, it is also interesting to see Reform heading several recent UK opinion polls, and it might be that populist trends see a strong showing for Farage and colleagues at the local government elections in May.

Japanese yields have continued to push to new highs over the course of the week. However, reduced risk aversion has seen the yen reverse some of last week's gains.

In FX more broadly, the euro has benefitted from Ukraine peace hopes, though we would caution against this move, on the view that the euro may quickly reverse gains on a 25% US tariff announcement.

That said, in emerging markets, we think that Eastern Europe could benefit from any positive sentiment relating to Russia/Ukraine. We have also thought this region may benefit from defensive flows within EM, should we see moves by the US administration to step away from the World Bank or IMF.

Although this is not something we are explicitly forecasting, the reality of the US administration at the moment suggests to us that US support for supranational organisations is no longer something that can be taken entirely for granted.

Credit markets have remained relatively quiet, with the early year glut of new issuance fading. A trend we have been witnessing in new issuance has been syndicates delivering artificially cheap initial pricing terms on new issues, so as to build heavily inflated and over-subscribed books when deal pricing is subsequently revised materially tighter.

Although orders may be pulled, those defunct orders are still reported in the official book size, so as to give an impression of very strong demand. This may be questionable practice, though in reality, the main takeaway is to be relatively sceptical around some of this demand data and to appreciate that new issuance, in itself, rarely offers investors much of a free lunch, in the way that may have been the case in the past.

Looking ahead

It is a little difficult to determine when the fog of Trump-driven uncertainty may clear. However, we think we can wait and be patient. We are operating at a time when the risk is to be drawn into trading and chasing headlines, and this is a sure recipe for losing returns.

Instead, we are eager to try and determine levels at which we may want to buy or sell exposure, should the opportunity present itself. In this context, we would highlight levels on US 2-year yields at 4.50% and 4.00% respectively, as areas we might want to trade long or short in rates respectively. Similarly, we think that euro duration could be attractive should yields move up towards 2.60%.

Otherwise, we continue to try to focus on trades that may not be as impacted by Trump and US policy. That said, in the macro space, this is somewhat easier said than done at the moment, given how pivotal changes are in US policy, not just for the US itself, but also for the rest of the world.

Past norms of behaviour are being challenged and it will be interesting to see how things play out in the coming weeks. For example, will Musk and his team cut deep into the bureaucracy and lower the deficit as a result, or will bureaucracy and the courts fight back?

Commentators have looked rather sceptically on the extent of the DOGE transformation up until now, but there is a building sense that we are witnessing things we just haven't seen before. At least, when it comes to McDonald's, the return of plastic straws seems much less likely to do any harm!

Notes to Editors

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