Weekly round up (Week 29)

In our latest overview of key developments in financial markets and economies, we examine the implications of the threat to the independence of the US Federal Reserve. Last week, prices moved relatively sideways. US government bond yields remained broadly unchanged, with UK gilts underperforming and long-term Japanese government bonds outperforming.

Corporate credit markets were also stable, with European credit outperforming slightly.

Commodities traded in a narrow range, while the US dollar posted a third consecutive week of marginal gains, with the DXY index up 1.5% since the start of the month . Equities were mostly in positive territory, with US and Asian markets leading the way with slight gains.

Deflation looms over China

Last week, investors gained a better understanding of the impact of the US administration's tariff policy, thanks to June inflation data, retail sales figures, quarterly results and corporate earnings reports.

Elsewhere, the report on Chinese growth in the second quarter took center stage. Despite a combination of challenges, ranging from the lingering effects of the trade war and the slowdown in the real estate market to persistently weak consumer confidence and outright deflation, the Chinese economy held up. In the first half of 2025, output grew 5.3% year-on-year, with 5.2% growth in the second quarter, exceeding expectations and putting the official target of 5% for the full year within reach.

Interestingly, the main driver of growth was exports, which offset weak domestic demand and may have masked underlying weakness in the economy due to deflation. Looking at growth in terms of nominal GDP, which reflects both real growth and price changes, the economy grew by only 3.9%, the slowest pace since records began in 1993, excluding the pandemic period.

To achieve its 5% growth target for the full year, China faces several major challenges. These include weakening global trade, the waning impact of stimulus measures taken earlier in the year and, above all, the worsening deflationary trend. Deflation is partly due to overcapacity in key sectors such as electric vehicles and solar panels, as well as a widespread decline in real estate prices across the country. Falling prices discourage consumption and investment, with households and businesses postponing purchases in anticipation of better deals.

This cycle erodes corporate profitability, weighs on wages, and further weakens demand and economic confidence.

On the positive side, it is encouraging that Beijing's message has changed significantly in recent weeks. President Xi Jinping and other senior officials have delivered unusually blunt assessments of the “fierce” price competition that is weighing heavily on all sectors.

On the monetary policy front, credit is growing more steadily. In June, total financing, a broad measure of credit, rose by 4.2 trillion yuan ($585.7 billion), according to Bloomberg calculations, exceeding economists' median estimate of 3.8 trillion yuan. At the same time, M2 money supply, a key indicator of liquidity and purchasing power in the economy, saw its strongest growth in more than 12 months, rising 8.3% year-on-year and exceeding consensus forecasts. [6]

Rate cuts may be on the way...

In an interview with The Sunday Times, Bank of England Governor Andrew Bailey suggested that further rate cuts could be considered if the job market deteriorates faster than the central bank currently expects.

The latest consumer price data confirmed Mr. Bailey's concerns, with inflation accelerating unexpectedly in June, a reminder that the fight to control price pressures in the UK is not yet over. Headline inflation rose sharply to its highest level since January 2024, with the consumer price index rising from 3.4% in May to 3.6% in June. Excluding volatile components such as airline tickets, package holidays, and education, a measure the Bank of England has previously referred to as “core” services inflation, inflation rose slightly from 5.0% in May to 5.1% in June.

Employment data also failed to bring good news, reinforcing the impression of a weakening UK labor market. The unemployment rate rose to 4.7% in the three months to May, up from 4.6% in the previous period, reaching its highest level in four years. In addition, tax data showed that the number of people in employment fell by more than 41,000 in June, a larger decline than the 35,000 job losses forecast by economists.

The OIS market now prices in a 90% probability of a 25 basis point rate cut in August, which is now the only monetary easing measure fully priced in for 2025.

In the spotlight

In the US, the administration's tariff and immigration policies were once again in the spotlight. The Federal Reserve's June Beige Book painted a picture of overall economic stability across the 12 districts. Prices rose at a moderate pace, driven by input costs related to tariffs and higher insurance premiums. Economic activity expanded slightly, reflecting a moderate improvement from the previous report. At the same time, labor markets remained tight but stable.

Consumer and producer price reports released in June were weaker than expected. Underlying inflation rose less than expected for the fifth consecutive month, even though companies increasingly passed on tariff-related costs to consumers. Lower vehicle prices helped to limit headline inflation, although goods exposed to tariffs, such as toys and household appliances, recorded their strongest increases in years. The monthly core CPI rose 0.23%, up from 0.13% in May, while the year-over-year core CPI rose slightly from 2.8% to 2.9%.

Despite this slight rise in prices, US consumers remained resilient: retail sales rose 0.6% in June, well above expectations, with increases in 10 of the 13 categories. However, as these figures are not adjusted for inflation, this increase could reflect higher prices rather than higher sales volumes.

While policy mistakes may be contributing to the economic slump in China and the UK, at the end of June, the US economy appeared to be absorbing the administration's aggressive policy measures effectively, as highlighted in the Beige Book. Improved financial conditions, combined with accommodative fiscal policy, are supporting both consumption and investment. At the same time, the Federal Reserve's independence and long experience in controlling inflation are helping to contain inflation expectations.

Tensions between the Fed and Trump intensify

However, tensions between President Trump and Fed Chairman Jerome Powell intensified further last week. A White House official told CNBC that Trump was preparing to fire Powell, while a New York Times article reported that the president had even drafted a letter announcing Powell's dismissal . Although Trump denied that Powell's dismissal was imminent, he did not rule it out .

In our view, firing Federal Reserve Chair Jerome Powell would be a serious political mistake. Central bank independence is a pillar of national sovereignty and good governance. Undermining it could have immediate and serious consequences, including a sharp depreciation of the US dollar and destabilization of inflation expectations. Stripping the Federal Reserve of its autonomy could lead to the appointment of a successor influenced by the political establishment, who would be forced to lower interest rates at the president's discretion, seriously damaging the credibility of monetary policy.

Rating agencies would likely respond with rapid downgrades, while investors could demand significantly higher risk premiums, leading to a steepening of the government bond yield curve, increasing the cost of public borrowing and worsening the country's fiscal situation. At the same time, consumption and investment would be at risk of contracting due to international capital flight and deteriorating domestic sentiment.

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