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Market View
Central banks face uncertainty about the path ahead

from Jeremy Sterngold Deputy Chief Investment Officer

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At a glance

- Trade frictions cause uncertainty for central banks
- Federal Reserve holds rates while Bank of England reduces rates
- US/UK announce trade deal framework

Following April's tariff-induced market volatility, investor attention turned to central banks this week, as the Federal Reserve (Fed) and Bank of England (BoE) provided some insight into how their thinking has evolved since President Donald Trump's so-called Liberation Day.

Although the S&P 500 only fell 1% from the Fed's last meeting on 19 March up until 6 May, this does not show the whole picture, given the sharp drawdown and subsequent recovery. Central banks must now grapple with a more complicated landscape and nuanced data that will impact their rate cutting regime going forward. Trump's tariff announcement on 2 April sent global equity markets down abruptly. These tariffs were later rolled back, allowing countries time to reach deals ahead of a revised July deadline, which helped equity markets' subsequent recovery. However, a 10% universal tariff remains in place along with additional levies on steel, aluminium and cars, along with a minimum tariff of 145% on Chinese goods.[1] Ongoing trade friction and uncertainty has increased, which could have a notable effect on prices and overall demand in the global economy.

On Thursday, the UK and US announced the framework of a trade deal in a news conference, the first trade deal since Trump's tariffs were implemented in April. The framework represents a win for both countries, which have long valued close relations, and may give Prime Minister Keir Starmer a much-needed boost in the UK, as he's struggled with sputtering growth and strained public finances. The agreement will leave in place a 10% tariff Trump imposed on 2 April, but will pare back other tariffs on British steel, aluminium and automobiles. In return, Britain will open up access to beef, poultry, ethanol, soft drinks, cereal and other products.[2] Meanwhile, the US and China are set to start talks this weekend to de-escalate trade frictions.[3]

"So much uncertainty"

Unlike other central banks that target inflation, the Fed has a dual mandate, which states it must aim for "maximum employment and stable prices". Last year, job growth slowed down, showing the labour market was becoming more balanced, thereby reducing pressure to raise wages. However, with inflation rates above target, this resulted in the Fed paying more attention towards its inflation objective.

Consequently, President Donald Trump's tariff announcements have the ability to upend this delicate balance. The potential shocks to the US economy from this wide-reaching rewrite of the global trade framework could not only weaken the labour market but result in large increases in costs, making the 2% target inflation rate harder to reach.

During the Fed meeting earlier this week, Chairman Jerome Powell maintained the Fed is not in a hurry to lower interest rates. He stressed the Fed remains "well positioned" to respond in a "timely way to potential economic developments", and said the costs of waiting were still "low". However, he could not yet say "which way things will shake out" in terms of whether the Fed should be more concerned about inflation or growth.[4] "It's really not at all clear what it is we should do," Powell told reporters following the news conference on 7 May. "There's so much uncertainty."[5]

A divided BoE cuts rates

Meanwhile in the UK, the BoE reduced rates to 4.25% at their meeting on 8 May, as the central bank carries on with its quarter-point reduction every quarter since it began lowering rates last year. This latest cut was widely expected, although the decision among policy makers was split, as Trump's tariffs weigh on UK growth. The potential shocks from the Labour government's budgets and ongoing trade fragmentation have not yet been felt in the wider economy, which could lead to the BoE accelerating their rate cuts later this year. While two out of the nine Monetary Policy Committee (MPC) members favoured a larger 0.50% cut, two others voted to keep rates unchanged. This wide range of views tempered expectations on a growing consensus towards faster and deeper rate cuts. The futures market is pricing in two-to-three more cuts this year, representing a modest chance of an acceleration from the current pace.

Bailey echoed Powell's comments about uncertainty, saying, "The past few weeks have shown how unpredictable the global economy can be. During the press conference, Bailey emphasised the bank's flexibility and noted there was no "pre-set path for interest rates." Minutes from the BoE's meeting he also said global trade tensions "should not be overstated", and "uncertainty surrounding global trade policies had intensified" since the tariffs were introduced.[6]

Conclusion

With both the Fed and BoE underscoring rising uncertainty, it appears central banks have taken notes from the recent inflation shock and stand ready to respond in a fast-changing economic environment. They will continue to emphasise their data dependency to allow maximum flexibility. Trade tensions are heightening economic uncertainty, which is challenging central banks' ability to determine the potential growth shock and inflation impact. The Fed has held it cards close, while the BoE appears to be carrying on with gradual rate cuts. The recently announced UK trade deal with the US is good news, but a lot more will depend on the upcoming discussions between the US and China. Until more clarity emerges, we expect central banks will stay away from the limelight. Given the current level of interest rates, there is plenty of room to cut, but for now, a steady hand is welcomed by markets.

[1] NYTimes: https://www.nytimes.com/2025/05/07/business/federal-reserve-may-meeting.html

[2] BBC: https://www.bbc.com/news/articles/c15ng4g5g0eo

[3] BBC: https://www.bbc.com/news/articles/c8rgrejkvmjo

[4] NYTimes: https://www.nytimes.com/2025/05/07/business/federal-reserve-may-meeting.html

[5] BBC: https://www.bbc.com/news/articles/cglxldgx0l5o

[6] Bank of England: https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2025/may-2025