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FEBRUARY 2025

Macro Matters

Macro Matters provides a concise, comprehensive look at macroeconomic themes that matter to clients.

Ahead: How long will the Fed hold last?

RUSHABH AMIN

Portfolio Manager, Multi-Asset Solutions

MATTHIAS SCHEIBER, PH.D., CFA

Head of Multi-Asset Solutions

Key takeaways

01 **Growth: Strong in the U.S. but weaker internationally.** U.S. labor and income data indicate healthy consumption, and we expect real growth will remain a robust 3%. Outside the U.S., the U.K. and European economies remain weak and China's consumption data are considerably below average. Any major tariffs implemented would negatively affect international growth.

02 **Inflation: Sticky in the U.S. but near target elsewhere.** U.S. inflation remains sticky, and services do as well. Rents momentum is negative, though, and could provide the Federal Reserve (Fed) with some relief later this year. Implementation of trade tariffs, however, could push U.S. inflation upward. We expect the Fed will watch very closely. While Europe's seasonal volatility has affected inflation, it's still trending down.

03 **Rates: Wait-and-see for the Fed while international central banks stay active.** We believe the Fed will stay paused on rate cuts until May at the earliest, and we see Europe's more aggressive cuts continuing in 2025. In contrast, China needs both monetary and fiscal stimulus.

Growth: How long will the U.S. outpace international markets?

The U.S.'s post-election growth boost lost some steam in early 2025, but our outlook remains positive. The Fed's late-2024 easing and fiscal stimulus expectations have already benefited the economy. Manufacturing data have somewhat improved, and the labor market remains healthy. Looking ahead, labor risks seem skewed downward, especially since the government sector has helped drive jobs growth for the past two years. A stronger U.S. dollar (USD) and higher real yields may dampen growth in 2025, making fiscal stimulus counterproductive.

Internationally, the growth picture is less favorable. Europe's central bank continued cutting rates in December, though the latest cuts haven't affected growth much yet. In Germany, growth shrank in 2024 for the second straight year. Europe's latest data showed some improvement in manufacturing and services. The U.K.'s recent growth has disappointed, but the Bank of England has been more cautious with monetary stimulus due to higher inflation. China's growth policy has shown some stabilization, but not the hoped-for rebound. International growth should benefit from recent weakness in currencies relative to the USD, which favors heavily export-driven international markets. However, potential U.S. trade tariffs pose challenges for both the eurozone and China—although significant negative sentiment is already priced in and we expect an ultimately milder, more targeted U.S. approach.

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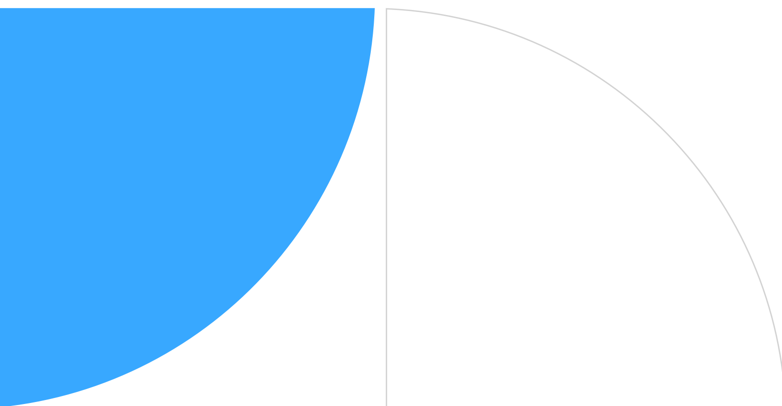
Inflation: Is 2% in the U.S. realistic this year?

The latest U.S. inflation for January was worse than expected, driven by the rise in commodity prices and sticky services inflation. Currently, the preferred consumer-based core price measure is 2.8% year over year—still elevated but progressing toward target. Higher real yields and a stronger USD can help bring inflation down further, although any meaningful fiscal stimulus could offset that. Trade tariffs will likely increase inflation because importers who pay tariffs generally pass those costs on to consumers via higher prices. The Fed will likely remain data-dependent, easing just enough to keep growth going and inflation drifting toward 2%.

Internationally, recent seasonally driven higher inflation readings in Europe and the U.K. indicate lower inflation ahead, driven by weak growth and cautious consumers. Eurozone inflation will likely dip substantially below 2% in 2025. China's inflation outlook remains negative for now.

Rates: Divergence continues between the U.S. and other developed markets

Looking at U.S. real yields, one might think there haven't been any rate cuts yet—since the first cut in September 2024, nominal and real yields have risen. The good news is that inflation expectations have remained anchored, showing the Fed's success at supporting a slowing economy without causing higher prices. It also indicates the Fed's flexibility for cuts in 2025. Fiscal policy will likely get a short-term boost from President Trump's various executive orders. The Fed initially will stay on the sidelines and not cut interest rates in the first quarter and possibly in the second quarter, but a stronger USD and higher interest rates should ultimately bring inflation and short-term interest rates further down.

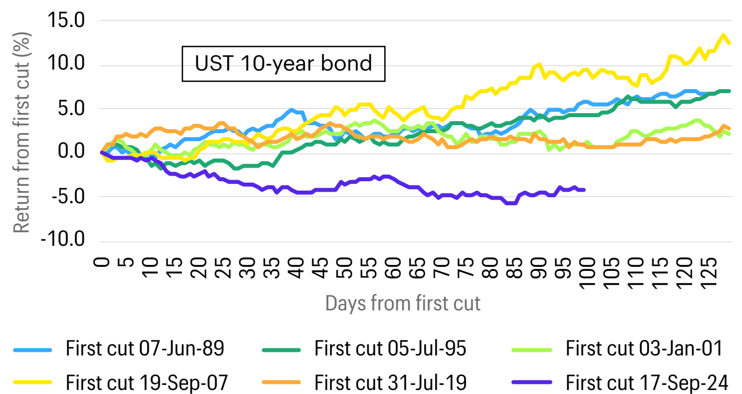


Outside the U.S., the situation is much clearer. Europe and China will need to continue reasonably aggressive easing. Even the U.K.'s weaker growth numbers will likely lead to more rate cuts—possibly up to four, instead of the currently priced-in two. That said, lower productivity, a tight labor market, and robust real incomes make the job a little harder in Europe—though it's unlikely to stop the easing cycle.

Implications for fixed income

Fixed income conditions generally remain very favorable despite the disappointing start to this interest rate cutting cycle, as seen in the chart. Spreads are at historical lows, but all-in yields remain attractive. Given robust U.S. growth, we believe higher-yielding bonds should remain supported and earn the carry. Interest rates will likely continue falling on the short end of the curve, though probably not before the third quarter of 2025. Farther out on the curve, there's likely more interest rate volatility ahead. The interest rate curve should continue steepening in the second half of 2025 as the market starts rebuilding a term premium into long-maturity bonds. We favor higher-quality U.S. bonds with low- to medium-term durations that are less affected by interest rate volatility.

NOT YOUR TYPICAL CUTTING CYCLE: PREVIOUS CYCLES GENERALLY WERE GROWTH-LED SHOCKS



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Past performance is not a reliable indicator of future results.

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International bonds remain supported by lower growth and inflation. Aggressive rate actions by European central banks have kept their bonds attractive, and emerging market bonds could benefit from more attractive real yields and stabilizing currencies in 2025. Any negative impact on growth from trade tariffs may support higher-quality bonds. We need to monitor whether existing weaknesses in international currencies continue—and their potential positive impact on growth but negative impact on inflation.

Implications for equities

We remain constructive on equities and acknowledge there might be a short-term shift away from U.S. equities toward international equities. The fourth quarter 2024 earnings season started strongly for U.S. equities, with plenty of optimism priced in. At such high valuations for the largest companies, hitting expectations must be accompanied by strong forward guidance. A stronger USD combined with higher rates could increase volatility. We expect international earnings to benefit from loose monetary policy, weaker currencies, and lower real yields. That said, trade tariffs could meaningfully affect international equities—more specific tariff details are needed, however, to fully assess the degree of impact. Overall, absolute equity performance should be supported by the prospects of gradual monetary easing, fiscal stimulus through corporate tax cuts, and less aggressive tariff measures.

We expect the rally to broaden into international equities—including emerging markets supported by cheaper valuations, lower real rates, and weaker currencies. Focusing on quality and valuation remains a prudent approach for us.

Implications for multi-asset portfolios

We've recently moved to a more neutral stance on equities versus bonds. The sharp rise in yields has made higher-quality bonds more attractive. Recent sanctions around Russian oil and gas exports combined with a less certain inflation outlook might outweigh the modest outlook for global energy demand. Within bonds, we favor shorter maturities because we expect a steepening yield curve. We also prefer European bonds over U.S. Treasuries given weaker growth and inflation in the U.K. and eurozone. We've trimmed our USD overweight back to neutral as a Fed on hold might lead to lower U.S. growth.

Potential allocations based on today's environment

The table below depicts our views on short-term trends. These perspectives are developed using quantitative analysis of data over the past 30 years overlaid with qualitative analysis by Allspring investment professionals. The positioning of each bar in the table shows the direction and magnitude of an overweight.

For illustrative purposes only.
Source: Allspring Systematic Edge–Multi-Asset, based on the team's analysis of current data and trends for each category of assets

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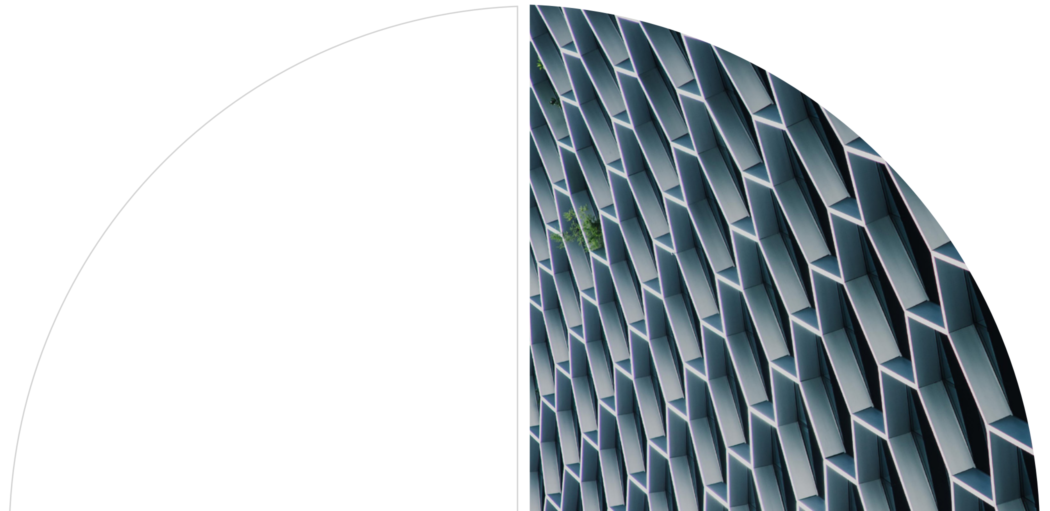
For further information

We're committed to thoughtful investing, purposeful planning, and the desire to deliver outcomes that expand above and beyond financial gains. Check out Allspring's insights:



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