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Market Update - December 2025

The Bank of England cut interest rates to 3.75% in December as inflation eased to 3.2%, signalling the start of a gradual rate-cutting cycle. The FTSE 100 delivered exceptional returns, topping 9,900 and heading towards surpassing pre-Christmas records. However, retail sales disappointed despite early festive spending, with consumer confidence remaining fragile amid economic headwinds and labour market weakness.

Sector performance diversified sharply, with mining and energy stocks leading on the strength of commodities. Retail sectors faced headwinds from squeezed consumers. Globally, the US Federal Reserve cut rates for a third consecutive time but adopted a hawkish tone on future cuts, whilst China reported a record trade surplus amid growing concerns about protectionism. Investors navigated a landscape of monetary policy divergence and geopolitical trade tensions as 2025 drew to a close.

UK policy

The key UK policy development in December was the Bank of England's rate decision on 18 December, when the Monetary Policy Committee voted to cut the base rate by 0.25 percentage points from 4% to 3.75%. This marked the first reduction in four months, ending a pause that began in September.

The decision came after inflation fell unexpectedly sharply to 3.2% in November—marking a notable decline from October's 3.6% and significantly beating expectations of 3.5%. Services inflation also eased to 4.4%, down from 4.5%, whilst food price inflation fell to 4.2% from 4.9%, signalling broad-based disinflationary momentum.

The Committee signalled that further rate cuts are likely, conditional on inflation continuing its downward path and labour market slack materialising. The guidance emphasised a "gradual" approach to future cuts rather than aggressive easing, reflecting policymakers' continued vigilance regarding wage growth and services inflation.

This represents a significant shift in tone from the Chancellor's Autumn Budget in November, which had triggered broader expectations of rate cuts. However, the gradual stance reflects the BoE's desire to ensure that inflation returns sustainably to its 2% target without stoking another bout of price pressures.

The UK economy

The UK's economic picture in December remained mixed, characterised by conflicting signals on growth and employment.

On the positive side, business confidence rebounded sharply in December, with the Lloyds Business Barometer rising to 47%, up five points from November and 10 points higher than at the start of 2025. Optimism towards the broader economy reached a four-month high, with construction sector confidence hitting 61%, its strongest reading of the year, and manufacturing posting a rebound.

Manufacturing PMI data also delivered a timely boost, with activity expanding for the first time in a year in the wake of the Autumn Budget clarity. This suggests that the initial shock of fiscal tightening may be giving way to cautious optimism as businesses adjust their plans.

However, labour market weakness remained pronounced. UK unemployment hit 5.1% in the three months to October, marking a four-year high and signalling material softening in the jobs market. This, combined with the economy's 0.1% contraction in October, underscores underlying fragility despite the brighter December sentiment.

Retail presented a particularly sobering picture. The Confederation of British Industry reported that retail sales volumes fell at an accelerated pace in December, a disappointing outcome given the festive season. Consumers prioritised affordability, with 40% of households planning to use loyalty points and vouchers for Christmas shopping. Barclays' data showed card spending falling 1.1% year-over-year in November, the steepest decline since February 2021, though this likely reflected pre-Christmas caution ahead of the budget.

Christmas spending showed some resilience later in the month, with retailers reporting £20bn in expected total spend (up 2.8% year-over-year), suggesting a bounce-back as budget uncertainty lifted. However, this modest growth reflects a consumer base under significant pressure from extended tax band freezes and rising household costs.

The UK market

The FTSE 100 delivered outstanding performance in December, capping its strongest annual return since 2009. The index closed the month near record highs, approaching 10,000 as investors embraced the rate-cutting cycle and improved business sentiment.

The market rally was broad-based. On 17 December, the FTSE 100 surged 1.7% following the better-than-expected inflation print, with financial stocks rallying on rate-cut expectations. Bank stress test results on 2 December provided additional support, with Lloyds, Barclays and HSBC posting gains of 1%, 0.95% and 0.7%, respectively.

Mining and energy sectors led the broader market, supported by higher commodity prices. Precious metals benefited from geopolitical uncertainty, with Endeavour Mining and Fresnillo rising by 3.1% and 2.8%, respectively. Engineering and defence stocks also performed well, with Rolls-Royce posting gains of 2.7% amid optimism about defence spending.

Consumer discretionary and retail, however, lagged the broader market, reflecting concerns over squeezed household finances and slowing consumer spending. Housebuilders similarly faced headwinds from mortgage rate uncertainty and concerns about housing demand.

Gilt yields reflected the new rate-cutting environment, with longer-dated bonds supported by expectations of a sustained easing cycle in 2026. Sterling also softened modestly, trading near $1.35, as investors priced in the BoE's pivot to a more accommodative stance.

Overall, UK markets balanced relief at clearer monetary policy with caution over persistent labour market weakness and subdued consumer spending. The FTSE 100's annual return of over 21% masks underlying economic sluggishness and highlights the strength of international earnings exposure within the index.

The Global Outlook

Global markets displayed divergent momentum as central banks charted different courses and trade tensions loomed large.

The US Federal Reserve cut rates for a third consecutive time on 10 December, reducing the federal funds rate by 25 basis points to 3.5%-3.75%. However, the decision came with decidedly hawkish signals. The Committee added language about considering "the extent and timing" of future adjustments, signalling that further cuts would be harder to justify.

Fed Chair Jerome Powell indicated the current rate is likely close to neutral, and policymakers showed more optimism about 2026 growth, potentially limiting appetite for further easing.

US inflation and labour market data remained mixed, but the resilience of economic growth (with third-quarter GDP reaching 4.3%) reduced the urgency for aggressive rate cuts. Markets initially sold off slightly before digesting Powell's message of a "wait-and-see" approach to 2026 policy.

The European Central Bank maintained its benchmark rate at 2% in December, continuing its data-dependent approach. The ECB revised growth forecasts upwards to 1.4% for 2025 and 1.2% for 2026, supported by industrial recovery and easing energy costs.

Eurozone inflation remained near the 2% target, leaving little pressure for further cuts in the near term. European equity markets nonetheless performed well, buoyed by expectations of a stable policy environment and earnings resilience.

China's economy sent mixed signals. The nation reported a record trade surplus exceeding $1 trillion in 2025, driven by surging exports to non-US markets following tariff diversification. However, domestic demand remained weak, with imports growing just 0.2% year-over-year, underscoring persistent deflationary pressures and low consumer confidence.

The government signalled reluctance to implement a broad stimulus, instead focusing on infrastructure investment, raising questions about the sustainability of export-led growth amid rising global protectionism.

Geopolitical risks loomed large, with US tariff threats and trade negotiations creating volatility. A ceasefire in the Middle East and progress on US-China trade negotiations provided some relief, yet trade tensions remained a key driver of investor sentiment.

Overall, global investors navigated monetary policy divergence, trade tensions, and uneven growth dynamics, with equity markets supported by lower rates, earnings resilience, and technical factors, yet constrained by macroeconomic uncertainty and geopolitical risk.

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