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Market Update - January 2026

The Bank of England kept interest rates unchanged at 3.75% in February, pausing after several cuts in 2025 as inflation remains above target. Price pressures rose to 3.4% in December, but the BoE expects inflation to ease towards 2% by mid-2026. UK economic conditions remain mixed, with unemployment at a near five-year high and wage growth slowing, though consumer confidence has improved. Equity markets started 2026 strongly, with the FTSE 100 surpassing 10,000 for the first time. Globally, central banks are adopting cautious stances amid uneven growth and persistent geopolitical and trade tensions.

UK policy

The Bank of England (BoE) held interest rates steady at 3.75% at its February policy meeting, marking the first pause in its rate-cutting cycle after multiple reductions in 2025.

The decision came despite inflation rising to 3.4% in December (up from 3.2% in November) driven primarily by tobacco duty increases and higher airfares. However, the BoE expects inflation to fall sharply to around 3% in early 2026, then to around 2% by mid-year.

Deutsche Bank's chief UK economist expects further cuts dependent on forward-looking indicators of price pressures, whilst Bank of America forecasts cuts to 3.25% by autumn. However, the divided 5-4 vote at December's meeting (with four members preferring to hold rates) underscores the Committee's growing caution about the path ahead.

The UK economy

Unemployment held at 5.1% in the three months to November, unchanged from the previous period but marking a near five-year high.

Wage growth continued its gradual deceleration, with annual growth in regular earnings (excluding bonuses) falling to 4.5% in the three months to November from 4.6% previously. Real wage growth, adjusted for inflation, was just 0.6%, underscoring continued pressure on household finances.

Retail sales provided a mixed picture. December saw volumes rise 0.4% month-on-month, the first increase since September, defying expectations of a 0.1% decline. The recovery was driven by strong online shopping. However, over the three months to December, sales volumes fell 0.3% compared with the previous quarter.

Consumer confidence improved modestly in early 2026, rising to its highest level since August 2024 as households became more positive about their finances.

However, the broader economic outlook remains challenging, with Goldman Sachs forecasting 1.4% GDP growth for 2026 and unemployment potentially rising to 5.3% by March before stabilising.

The UK market

The FTSE 100 delivered a historic milestone in early January, breaking through the psychologically significant 10,000-point barrier for the first time in its 42-year history. The index reached 10,004.57 on 5 January before pushing higher to close the month around 10,200, delivering returns of approximately 2.7% for January alone.

The rally built on the index's exceptional 2025 performance, where it returned over 21% - its strongest annual gain since 2009. The breakthrough was driven by broad-based strength across sectors, with banks, mining companies, and defence stocks leading the advance.

Banking stocks provided substantial momentum as investors priced in the impact of higher gilt yields on net interest margins. Lloyds Banking gained 2.5%, NatWest rose 1.8%, Barclays advanced 1.3%, and HSBC Holdings climbed 0.8%. The sector benefited from expectations of stable rates and a steepening yield curve, which supports lending profitability.

Mining and commodities companies rallied on strong metals prices, particularly gold and copper. However, later in January, falling precious metals prices pressured the sector, with Endeavour Mining falling 7%, Fresnillo down nearly 6%, and Antofagasta, Anglo American, Glencore, and Rio Tinto declining between 2% and 3.5%.

The Global Outlook

Global markets navigated divergent monetary policy paths and persistent trade tensions at the start of 2026, with central banks adopting increasingly cautious stances.

The US Federal Reserve held interest rates steady at 3.5%-3.75% at its January meeting, pausing after three consecutive quarter-point cuts in 2025. The decision came amid mixed economic signals, with job growth slowing but inflation remaining above the 2% target at 2.9% in December. Markets now price in at most two rate cuts for 2026, a significant scaling back from earlier expectations.

The European Central Bank maintained its benchmark deposit facility rate at 2.0% in December, holding steady for a fourth consecutive meeting after cutting rates four times in the first half of 2025. President Christine Lagarde emphasised that policy is in a "good place," with eurozone inflation falling to exactly 2% in December from 2.1% in November, meeting the ECB's target.

Economic growth proved more resilient than expected, with the ECB raising its 2025 growth forecast to 1.4% and projecting 1.2% growth in 2026. Core inflation eased to 2.3%, its lowest since August. The ECB's new projections show headline inflation averaging 1.9% in 2026, with market pricing suggesting very limited scope for either cuts or hikes over the year ahead.

China's economy demonstrated remarkable export resilience despite escalating trade tensions. This came despite US exports falling 20% in 2025, with Chinese manufacturers successfully diversifying into markets across Africa (up 26%), Southeast Asia (up 13%), the European Union (up 8%), and Latin America (up 7%).

Geopolitical tensions continued to influence markets, with US-backed regime change in Venezuela creating volatility in energy markets, and ongoing questions about the trajectory of US-China trade relations under the incoming Trump administration.

The World Bank raised its 2026 growth forecast for China to 4.4%, citing anticipated fiscal stimulus and continued export resilience, though economists note structural constraints make a shift away from export-led growth improbable in the near term.

Overall, global investors face a complex landscape characterised by monetary policy divergence, uneven growth dynamics, and heightened geoeconomic competition. Equity markets remain supported by stable-to-lower rates and resilient corporate earnings, yet constrained by persistent inflation concerns, labour market uncertainties, and the ever-present risk of renewed trade tensions.

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