

Special Coverage: Bank of England takes a gradual approach to easing

Key takeaways

- ◆ After last month's tight vote to lower rates from a 16-year high, the Bank of England's (BoE) Monetary Policy Committee voted 8-1 to keep the bank rate unchanged at 5% in September, in line with our view.
- ◆ The message is very clear from the BoE that they would like to take a gradual approach as inflation still remains the binding factor. Also, UK wage growth remains higher than the US, and the economy has accelerated of late. We expect one more 0.25% cut in November this year, followed by four 0.25% cuts next year, one at every other meeting, starting in January.
- ◆ The UK market is considered a defensive play and less vulnerable to US policy risks with the upcoming US election. The broader UK market also remains cheap and should benefit from the moderate pace of growth. Hence, we maintain our overweight on UK stocks. We continue to favour investment grade credit and believe that investors should lock in yields ahead of further policy easing. Gilt yields have been trending lower over the summer, and we expect they will continue to fall modestly from here.



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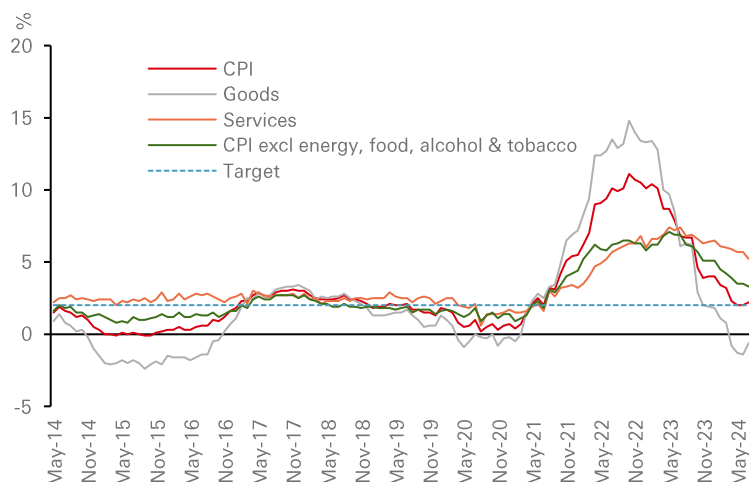


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What happened?

- The Monetary Policy Committee (MPC) voted by a majority of 8-1 to maintain the bank rate at 5%. The minutes highlighted that "In the absence of material developments, a gradual approach to removing policy restraint remains appropriate". It also pointed out that the preference remains for a meeting-by-meeting approach and the need for policy to stay "restrictive for sufficiently long".
- The BoE announced that it now expects inflation to rise to 2.5% by the end of the year, a bit lower than the previous estimate of 2.8% due to forecasts of a slightly weaker economy (0.3% GDP growth for Q3, rather than 0.4%), but weak energy costs and a stronger GBP lowering import costs would have played a part too.
- Though the major contribution to the uptick in services inflation in the latest print was from the volatile airfares, we cannot deny the fact that services inflation, which increased from 5.2% in July to 5.6% in August, along with the higher wage inflation, remains too high for the BoE's liking. A more cautious approach is warranted.

Services inflation remains a bit sticky



Source: Bloomberg, HSBC Global Private Bank and Wealth, as at 19 September 2024.

- The MPC also revealed its plan for quantitative tightening over the upcoming year, maintaining an overall reduction of £100 billion, but with the pace of active bond sales decreasing to just £13 billion. The Office for Budget Responsibility (OBR) had previously expected active sales of £48 billion, so this reduction in bond sales will result in fewer losses for the Treasury.
- Sterling rose to a two-and-a-half-year high against the dollar after the decision. With GBP higher, the FTSE 100 eased back some of the day's gains but (at the time of writing) remained a little over 1% higher for the day, thanks to the Fed's more aggressive cut. The FTSE 250 was over 1% higher on the day as a strong GBP helps lower import costs for more domestically focused businesses and household purchasing power. Gilt yields on the 10-year bonds also moved modestly higher.

Investment implications

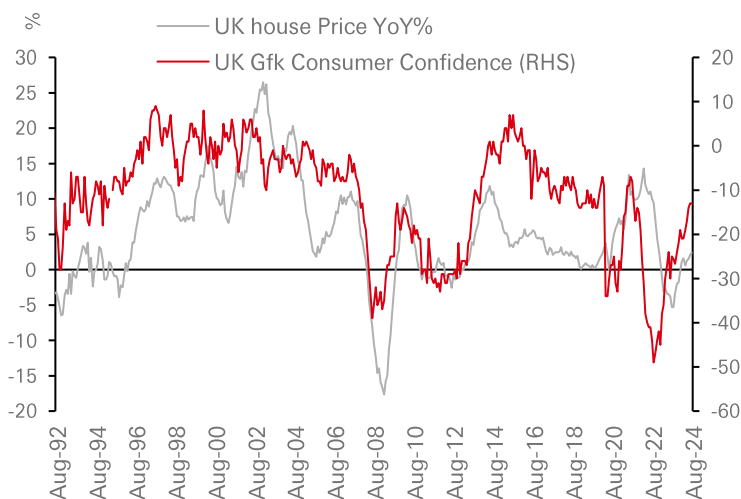
- **We keep our overweight positioning in the UK:** Appetite for UK stocks has been on the rise as the macroeconomic backdrop improves along with consumer confidence. Further easing in the next meeting will help support this backdrop.

- **UK equities are well placed for the US election:** UK equities are "defensive" due to the bias towards consumer staples, which will be welcomed by investors if volatility around the US election rises. The UK is also likely to be less vulnerable to targeted tariffs, as the US has a goods trade surplus of over £7bn with the UK.

- **UK's housing recovery:** The government wants to build more houses, from 170k to 370k per year, via streamlined planning rules, local targets and unlocking the "grey belt". If the government does succeed in significantly ramping up housebuilding, this could add around 2% to GDP over the medium term. In the UK, house prices and consumer sentiment go hand-in-hand, which, in turn, also feeds into consumer spending. Real income growth is strong too. In a consumer-driven economy, this is positive for earnings growth.

- **Valuations:** UK valuations remain attractive both on a relative and absolute basis. While UK stocks are still trading at around a 35% discount relative to their global peers, the FTSE 100 is outpacing the Stoxx 600 index in dollar terms this year. M&A deals are also on the rise as per Bloomberg, underpinning the attractiveness of the domestic market.

Consumer confidence remains stable leading to rising house prices



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 19 September 2024.

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