

Special Coverage:

Bank of England looks through the noise and sticks to a gradual approach

Key takeaways

- ◆ It came as no surprise that the BoE's Monetary Policy Committee (MPC) voted to keep the Bank Rate unchanged at 4.75%.
- ◆ The messaging on future rate cuts remains broadly unchanged. The labour market is judged to be "balanced", implying that the policy rates can move more towards "neutral", which we estimate to be close to 3%. Yet there's enough uncertainty around growth, inflation, and potential US tariffs to continue with a data-driven approach. This translates to a gradual 0.25% rate cut at every other meeting for the next few quarters.
- ◆ In our view, the market has become too hawkish on rate expectations. There could be upside risks to our more dovish view, but the broader picture should remain the same. There's an opportunity to invest cash in attractive gilt yields, especially considering cash rates are set to fall significantly. Equities also have a good chance to gain from a weaker GBP and cheap valuations.



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What happened?

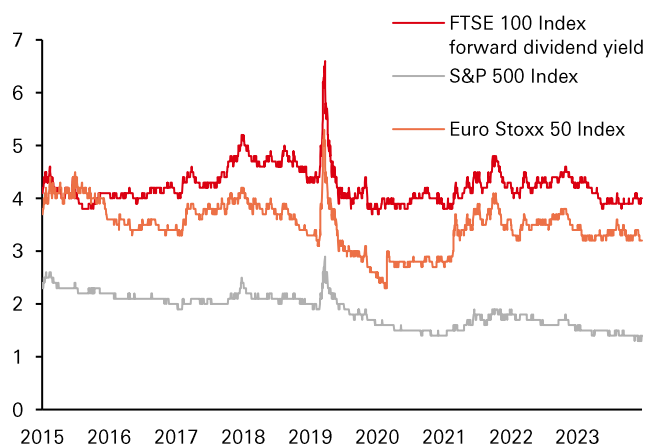
- The Bank of England (BoE)'s MPC voted to keep the Bank Rate unchanged at 4.75%. The 6-3 vote made the decision look more finely balanced than it effectively was. There is a clear difference of opinion within the BoE. For two members to cross over to the more dovish camp, they would have to move away from the "gradual" approach favoured by Governor Bailey, to one that zones in on risks to growth.
- The tone of the BoE minutes reflects our thinking more than the anxiously hawkish market reactions to the recent data. On wage growth, the BoE was more philosophical and didn't want to pin too much on the November Labour Force Survey data that showed an acceleration in wage growth to 5.2% year-on-year. Instead, they pointed to their broader Agents' survey intelligence which suggested wage growth of 3-4% next year.
- Any acknowledgment that inflation was a little higher than expected and that household inflation expectations had increased was offset by the downside risks to growth. The BoE now expects GDP growth to be flat in Q4 and highlighted the apprehension surrounding the National Insurance hike for employers.
- This net impact means that the messaging on future rate cuts remains broadly unchanged. The labour market is judged to be "balanced", implying that the policy rates can move more towards "neutral", which we estimate to be close to 3%. Yet there's enough uncertainty around growth, inflation and potential US tariffs to continue with a data-driven approach.

- This translates to a gradual 0.25% rate cut at every other meeting for the next few quarters. Inflation can pick up a little in the coming months, but by the middle of Q2 next year, we expect it to fall to almost 2%. The BoE may then reason that they can double the pace of cuts to achieve a 3% Bank Rate by early 2026.
- This scenario is most definitely not in the current market pricing, where only 2-3 cuts are priced in by 2025-end. The markets are suggesting that a more “neutral” rate of interest for the UK is closer to 4%. We strongly argue that this is too high and the risks of more rate cuts than the market anticipates are attractively high for a gilt investor.
- In November, house prices in the UK had the sharpest increase in more than two years. The government has reinforced its pledge to build 1.5m homes during the current parliamentary session. We think a rise in annual housebuilding to 370k could add around 2% to GDP over the medium term. Consumer confidence has also shown signs of recovery after dipping due to pre-budget worries.

Investment implications

- UK stocks are anticipated to gain traction by 2025 due to their appealing low valuations and strong shareholder returns.
- Looking ahead to 2025, the market faces uncertainties such as potential trade wars, inflation concerns, and possible US interest rate cuts. These developments may increase the attractiveness of UK companies, especially those in the Defensive and Services sectors.
- UK stocks are significantly undervalued relative to their global peers. They’re resilient as they have large cash reserves and could outperform in challenging times.
- Additionally, global investors are beginning to favour income-focused strategies like dividend payouts, positioning the UK market as a potential beneficiary. The relative geopolitical stability which the UK enjoys in Europe further adds to this allure.

Large caps offer highest dividends globally



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 19 December 2024. Past performance is not a reliable indicator of future performance.

- The FTSE 100 boasts one of the highest dividend yields among developed markets at approximately 4%, surpassing the Euro Stoxx 50 at 3.3% and the S&P 500 at 1.4%. Furthermore, in local currency terms, a weaker GBP would help FTSE 100 earnings as they tend to generally translate 75% of their global earnings back into GBP. With all these factors, we remain optimistic on UK equities and hold a positive view.
- In our view, the market has become too hawkish on rate expectations. There could be upside risks to our more dovish view, but the broader picture should remain the same. There’s an opportunity to invest cash in attractive gilt yields, especially considering cash rates are set to fall significantly.

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