

# Special Coverage:

## Political fog clears and that's good news for investors

### Key takeaways

- ◆ The Bank of England's (BoE) MPC voted 8-1 to cut the Bank Rate by 0.25% to 4.75%. The BoE also cut the borrowing costs for the second time this year but cautioned that the government's recent budget could potentially increase inflation by up to 0.5% while also lifting the GDP growth rate by an additional 0.5%.
- ◆ Governor Bailey emphasised the importance of maintaining inflation within target bounds. Crucially, because the BoE looks at inflation over the "medium term", the 2027 forecast for inflation falling below 2% gives its the licence to carry on cutting rates. This means that the BoE can continue to ease rates and the path for bond yields should be downward from here.
- ◆ With the US election in the rearview mirror, equity volatility has plunged. While obviously this is good for the US markets, it should also be favourable for UK equities. Falling volatility typically leads to less risk aversion and benefits the equity markets. The UK is also less likely to be targeted for trade tariffs as the US runs a current account surplus with the UK. Moreover, the UK is more politically stable than the rest of Europe. Improved investor sentiment and attractive valuations also support our overweight on UK equities.



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### What happened?

- A week after the budget, the stage was set for a less dovish Bank of England (BoE). The Office for Budget Responsibility had revised its 2025 growth forecast 0.5% higher off the back of the budget, leaving it with an estimated GDP growth of 2%, dwarfing the BoE's 1% forecast, which was already comfortably below consensus. This is no longer the case as the BoE in yesterday's meeting added another 0.5% to its 2025 growth because of the budget, contributing to a net upward revision of 0.5% for 2025.
- Strong growth means less economic slack and higher inflation which was reflected in the BoE's revised forecasts, with next year's inflation now revised higher to 2.7% from 2.2%.
- The BoE expects the net effect of the budget will lead to the unemployment rate remaining roughly stable from here, rather than its previous forecast of a peak at 4.7%. As the BoE looks at inflation over the "medium term", the 2027 forecast for inflation falling below 2% gives it the licence to carry on cutting rates.

### Growth forecasts revised higher, thanks to the budget

		2024	2025	2026	2027
CPI (Q4, %yr)	Aug 2024MPR	2.7	2.2	1.6	1.5
	Nov 2024MPR	2.4	2.7	2.2	1.8
	Revision	-0.3	0.5	0.6	0.3
GDP growth	Aug 2024MPR	1.25	1	1.25	
	Nov 2024MPR	1	1.5	1.25	1.25
	Revision	-0.25	0.5	0	

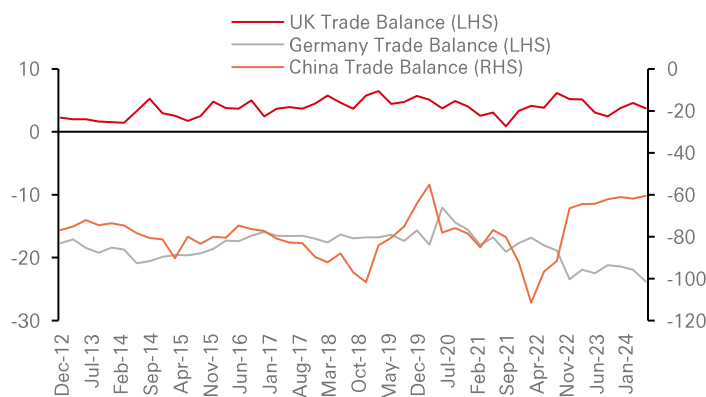
Source: Bank of England, HSBC Global Private Banking and Wealth, as at 7 November 2024. MPR refers to Monetary Policy Rate.

- Markets expect yields to bottom at just under 4%, which is way above our view of rates falling below 3%. Furthermore, gilt yields have moved higher in tandem with the US, as markets priced in fewer rate cuts and more risk to holding US debt amid deficit uncertainty. Currently, an attractive entry point plus underpricing of rate cuts should mean lower yields ahead. The overwhelming opportunities to invest in the UK remain unchanged.
- The US election results announced so far seem positive for the US markets and should also be favourable for UK equities. Recent key political events, such as the US election and the UK budget, had created uncertainty for the markets, which lead to risk aversion. However, as the risk is taken off the table, equities tend to perform well as the “risk premium” falls. Historical data show that the S&P 500 index has risen by 9.4% on average in the 6 months after an election. Hence, we have recently added further to our existing US equity overweight.
- The Trump administration is likely to put forward policies on tax cuts, deregulation and trade tariffs. On trade tariffs, the US has a trade surplus with the UK, ranging between USD1.4 billion and USD6.1 billion over the past 12 years. This is strikingly opposite to the large deficits that the US has with the EU and China.
- The news that German Chancellor Scholz (SPD) dismissed finance minister Lindner (FDP) at the time of writing also adds to uncertainty in the rest of Europe as a total of four ministers from the pro-business FDP will leave the government, and next year’s budget will likely struggle to get through the parliament.

## Investment implications

- **Sentiment:** Our broad measure of sentiment highlights the positive shift, as we are observing a consistent improvement across all the metrics of analyst and investor sentiment. We expect the positive macro surprises and sentiment signals to result in an increased investor positioning in UK equities among global macro funds. The more favourable political backdrop is also supportive.
- **Growth:** The UK remains in a relatively better position in terms of growth and valuations than the rest of Europe. UK equities have outperformed European peers, and the current earnings trend favours the UK on relative terms. UK households have been keen savers since the pandemic, with a savings rate of around 10%. Taken alongside the improving real incomes and a more upbeat housing market, we see a more resilient consumer supporting corporate earnings.
- **Valuations:** UK equities continue to trade near record cheap valuations relative to global peers and hence remain attractively priced.

### UK remains safe in terms of potential tariff changes in the US



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 7 November 2024. Past performance is not a reliable indicator of future performance.

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