

Bank of England narrowly votes to cut interest rates

Month in brief

The Bank of England cut interest rates to 5% by vote of five to four

The Federal Reserve has strongly hinted at interest rate cuts in September

UK equities were buoyed by a landslide win for Labour in the General Election

UK DB pension scheme funding reduced slightly in July as liabilities outgrew assets

The Bank of England (BOE) voted to cut interest rates by 0.25% at their 31 July meeting in a move widely expected after the UK Consumer Prices Index (CPI) fell to 2% in May and remained there in June.

This is the first time in four years that the BOE has initiated an interest rate cut. Governor Andrew Bailey – who was among the five members of the Monetary Policy Committee to vote for a cut – once again cautioned that the BOE needed “to make sure inflation stays low and be careful not to cut interest rates too quickly or by too much”.

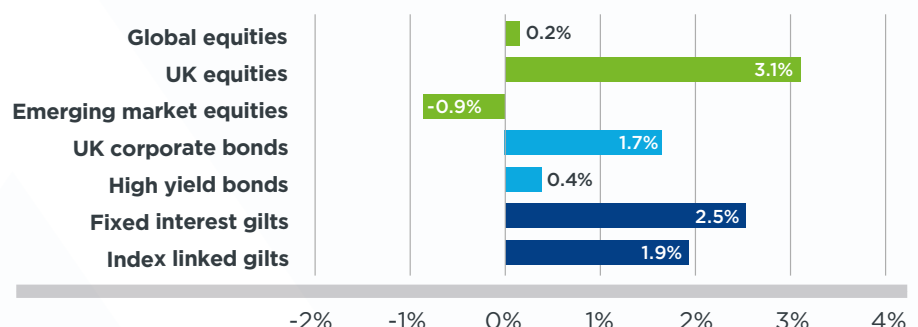
Inflation forecasts published alongside the announcement suggest that inflation is expected to rise later this year before slowing again over the longer term. The effective interest rate on a two-year UK government bond fell to its lowest level in over a year at the end of July suggesting that the market is optimistic that interest rates look set to continue to fall.

An optimistic inflation forecast will come as welcome relief to the new Chancellor of the Exchequer, Rachel Reeves, after the UK’s national debt reached its highest level since 1962 in July. Debt as a percentage of GDP climbed to 99.5%, eclipsing even the highs of the coronavirus pandemic.

Meanwhile, the Federal Reserve (Fed) voted to hold interest rates for the eighth meeting in a row despite much debate at the Federal Open Market Committee meeting in July. The Fed now looks almost certain to implement a 0.25% cut at its September meeting. US economic growth has remained strong and was higher than forecast over the first quarter. Whilst unemployment is currently low, it has risen from 3.7% to 4.1% over the first half of 2024 in a further sign that a softening labour market will encourage the Fed to cut rates sooner rather than later.

UK equities performed strongly over the month

One Month to 31 July 2024



Click to watch Savvas' three-minute video.

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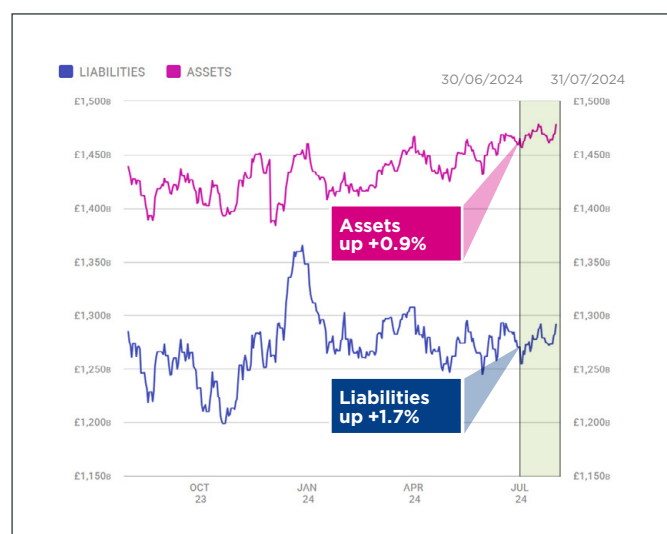


A Labour election landslide was a boost for UK stocks over July as investors warmed to hopes of political stability. Global equities also rose slightly but were hindered by fears that the US could further tighten restrictions on exports of semi-conductor equipment (used in computer chip making) to China which triggered a sell-off in tech stocks. Emerging markets were not immune to the tech sell-off as China's economic struggles return to the headlines. A prolonged property crisis, high government debt, low consumption and elevated unemployment have dragged on the Chinese economy and President Xi outlined plans for fiscal policy reform during a meeting of top Chinese officials in July.

In fixed income markets, both UK investment

grade and global high yield bonds were buoyed by expectations of imminent interest cuts by the UK and US central banks respectively. In the UK, Thames Water's debt was downgraded to sub-investment grade by S&P and Moody's which means it is now in breach of Ofwat's requirement to maintain at least 2 investment grade ratings. This is likely to accelerate a move towards a Special Administrative Regime (SAR) where the running of the business would be passed to insolvency practitioners.

Aggregate UK DB pension scheme funding on a low-risk basis fell slightly over the month. Falling gilt yields saw liabilities grow by more than assets over July. Despite this, aggregate funding continues to remain very healthy overall.



Source: XPS DB:UK www.xpsgroup.com/services/xps-pensions/xps-dbuk-funding-watch

The charts above are based on data from The Pensions Regulator, the PPF 7800 Index and the XPS data pool. The assumptions used in the UK:DB long-term target basis include a discount interest rate of gilt yields plus 0.5%. The assumed asset allocation is 16.9% equities, 20.0% corporate bonds, 6.9% multi-asset, 5.1% property, 3.8% private markets and 47.3% in liability driven investment (LDI) with the LDI overlay providing a 60% hedge on inflation and interest rates.

Find out more

To discuss any of the issues covered in this edition, please get in touch with **Savvas Ioannides**. Alternatively, please speak to your usual XPS contact.



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