

Pension schemes better funded than ever following peak in UK borrowing costs

Month in brief

UK gilt yields again pushed to new highs

The Bank of England cuts bank rate but now faces rising inflation

Equity investors rotate out of tech, whilst Japan's TOPIX soars to record highs

Stagnant US inflation data has increased the likelihood of a Fed rate cut next month

Long term UK borrowing costs have hit a new high as the 20 year gilt yield peaked at 5.6% at the end of August. The rise piled pressure on Chancellor Rachel Reeves ahead of her Autumn budget, who needs to find £40bn to fill a fiscal spending gap without undermining her election pledge not to increase mainstream taxes.

Retail investors are now pouring money into UK government debt at a record rate after the wider sell off in the bond market. Despite some volatility, long term inflation expectations ended the month much how they started.

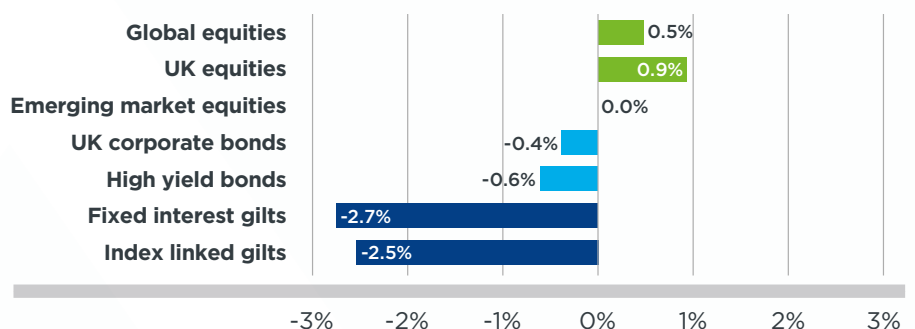
The Bank of England (BOE) cut the bank rate to 4% in early August by a quarter percentage point. Speculation over another rate cut has since been muted by the rise in UK inflation data to 3.8% in July, driven by higher food prices and airfares. This has put price rises in the UK well above that of the Eurozone, whose inflation figures were steady at 2% in July, down from 2.6% a year earlier. Markets are only anticipating a 50% chance of a further rate cut this year.

The credit premium that investment grade companies in the US and Eurozone pay when borrowing dropped to their lowest levels since 1998 and 2018, respectively. The premium is now just 0.75 and 0.76 percentage points above benchmark US and Eurozone government bond yields.

In equity markets, major US tech company shares slipped over August as investors become increasingly concerned over weakened earnings forecasts. A major player of the 'Magnificent Seven' – the semiconductor manufacturer Nvidia – announced a 50% increase in sales but warned that geopolitical tensions between the US and China could impact their growth forecast this year. A jittery response from investors culminated

Major equity markets produced positive returns over the month.

One Month to 31 August 2025



Click to watch Joe's two-minute video.

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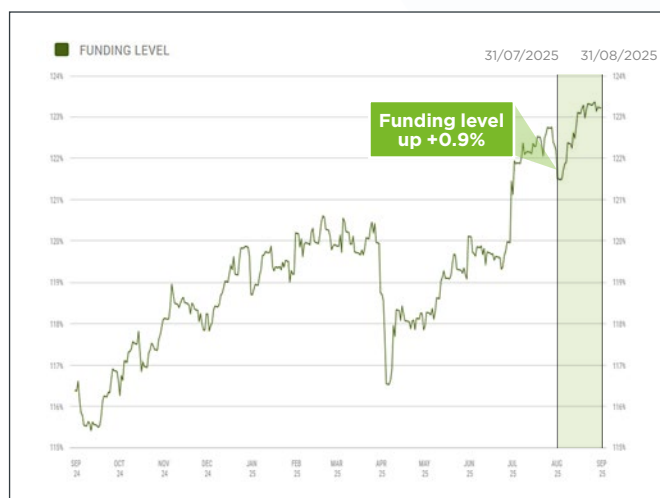
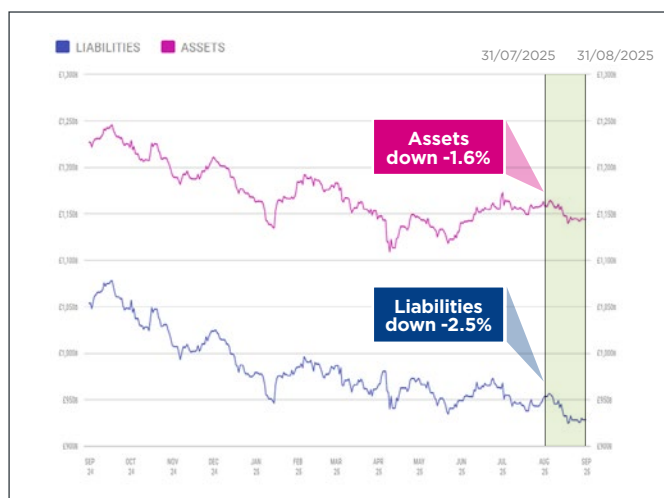
in a share price fall of 3.5% in one day, topping off the company's biggest weekly fall since May. A similar story across the remaining 'Magnificent Seven' has caused speculation on whether the AI boom has become over hyped. Investors have since flocked to the S&P 500's remaining 493 stocks, ensuring the US equity index still gave strong positive returns over the month, up 3.6%. The FTSE 100 index finished 1.5% up over August and the European Stoxx 600 was up 3.0%.

The Fed now faces more pressure to cut rates as the latest US inflation data remains unchanged at 2.7% in July, countering expectations that Trump tariffs would be detrimental to US growth. Subsequently,

the market is now pricing in a 96% chance of a quarter point rate cut in the Fed's September meeting.

Somewhat quietly in the background, Japan's TOPIX equity index has rallied to record highs having surpassed 3,000 points for the first time in August. The rally has been brewing since President Trump's Liberation Day, however a favourable US and Japan trade deal alongside stagnant US inflation data this month has accelerated Japanese equity returns.

The combination of a rise in gilt yields, positive returns for major growth asset classes and contracting credit spreads have boosted aggregate UK DB pension scheme funding to a new high on a low-risk basis over August.



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 **Joe Dempsey**. Alternatively, please speak to your usual XPS contact.



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