Hymans Robertson Investment Services (HRIS)

Bank of England cuts interest rates

August 2024

The Bank of England voted to cut interest rates by 0.25% to 5.0%, the first change in rates for a year. Gilts increased in value on the day while the pound fell on the back of this news.

CPI inflation is back at 2% target, but other measures of inflation are still higher. The Bank of England will therefore likely tread cautiously and cut rates slowly, subject to their not being a meaningful slowdown in economic growth.

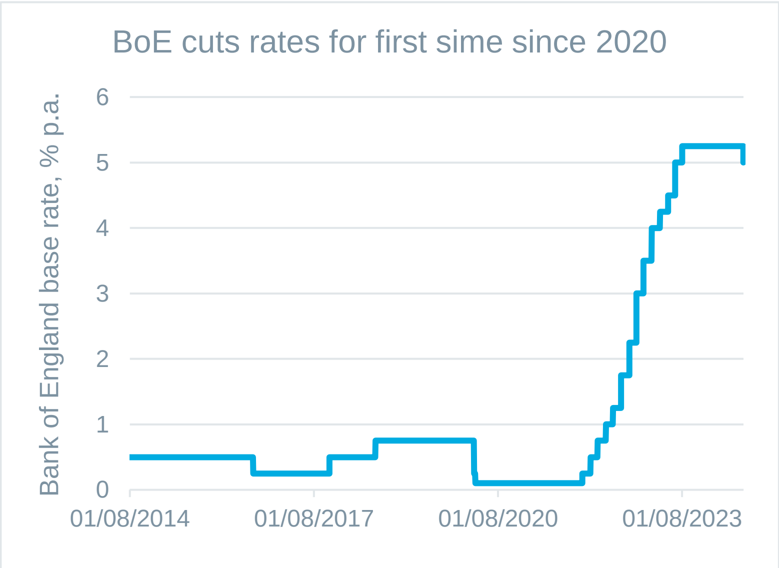
The Bank of England (BoE) voted to cut interest rates by 0.25% to 5.0% on 1st August. The base rate had been at 5.25% since August 2023, following a dramatic increase in interest rates to contain the post-pandemic burst of inflation.

Why did the Bank of England cut in August?

The decision to cut was a close call with five of the nine members of the Monetary Policy Committee (MPC) voting to cut (the other four voted to hold rates at 5.25%). CPI inflation has reached the BoE's 2% target. However, there is still plenty of caution amongst the MPC. This is because, so far, the main reason inflation has fallen from the 11.1% peak has been lower food, energy, and goods prices. Now that energy and food inflation has little left to fall, (energy bills are expected to increase this autumn) the headline figure will likely start to rise over the next few months.

The MPC has been focused on more domestically driven measures of inflation, like core inflation (which excludes volatile items like food and energy) and services inflation. These are still at 3.5% and 5.7% respectively and remained unchanged in the latest June data. The MPC has also been considering key measures of the labour market such as wage growth as wages are an important driver of services inflation. Although there is great deal of uncertainty over the current labour market data, it does seem to show signs of less pressure, as wage growth is slowly but persistently falling - pay rose at 5.7% in May, down from 5.9% in April and 8.6% in July 2023.

The 0.25% cut continues to leave the BoE in restrictive territory – still with its foot touching the economic "brake", but just to a lesser extent than before. This fact helps to justify a small cut to rates without increasing the risk of inflation rising out of control again.



Source: Bank of England

Outlook for interest rates

We expect the MPC to tread cautiously until there is greater certainty that inflation is sustainably around the 2% mark. This probably means getting core inflation below 3%. Therefore, the BoE is likely to cut at a slower pace than they raised interest rates. There will probably be meetings where they keep rates on hold. The MPC meet three more times in 2024 so we can expect 1-2 more 0.25% rate cuts this year. However, if we see a meaningful slowdown in economic growth then the pace of cuts may increase.

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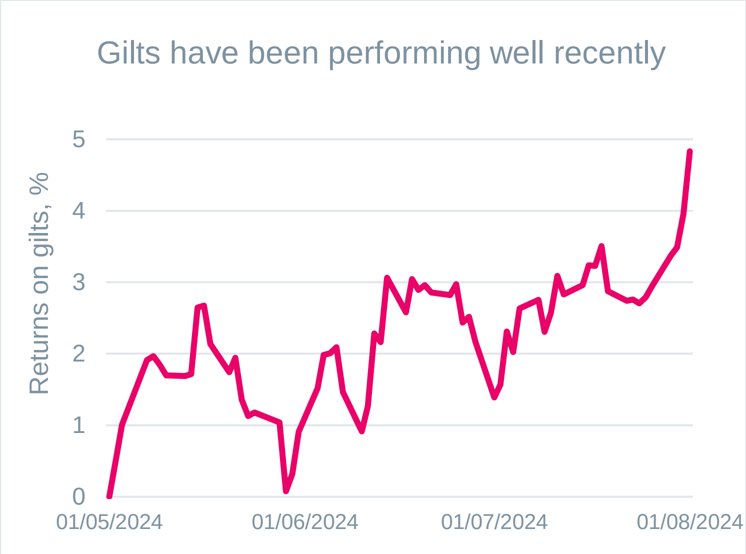
Impact on asset classes

Given the vote to cut was so close, followed by cautious comments from the BoE's Governor Andrew Bailey, markets didn't get too carried away. The immediate impact on assets classes was for gilt yields to fall on the day, pushing up prices (prices rise as yields fall). Gilts had also been rising in the days preceding the meeting in anticipation of BoE action. Sterling also fell against the dollar as lower interest rates tends to weaken the currency. However, it is unclear how much of these moves were down to the BoE's decision or weaker US data released later in the day. The FTSE was mostly unchanged around the interest rate decision but fell slightly later in the day.

As this cycle of high interest rates comes to an end, investors should consider the merits of investing in bonds, where investors can take advantage of a potentially faster lowering of interest rates.



Source: Morningstar, FTSE Actuaries UK Conventional Gilts All Stocks Index

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