

Special Coverage:

Silver linings and gilt-edged opportunities

Key takeaways

- ◆ The Bank of England (BoE) cut the Bank Rate by 0.25% to 4.25%, as expected. The split 5-4 decision did come as a surprise to markets, but with two members supporting a 0.50% cut, this shouldn't be read as a hawkish sign, but rather a reflection of the heightened uncertainty of the geopolitical backdrop. The committee continues to emphasise that they need to remain data dependent.
- ◆ A slew of weaker economic data has led to a broad consensus of cuts to economic growth forecasts and the BoE echoed this trend with a 0.25% cut to its 2026 GDP growth to 1.25%. However, the good news is that plummeting energy prices and a strengthening GBP have pushed inflation forecasts lower, giving the BoE more room to be dovish in the latter half of the year.
- ◆ We prefer to remain selective on equity investments and keep an eye on the data for signs of improvement. Around the 5-10Yr maturities of gilts, real inflation-adjusted yields are fractionally below 2%. This is a great opportunity to lock in near risk-free rates of return that would have seemed well beyond reach only a few years ago. If the base rate falls to 3% in Q3 2026, as we expect, then there is also room for capital gains. The GBP has strengthened largely due to USD weakness.



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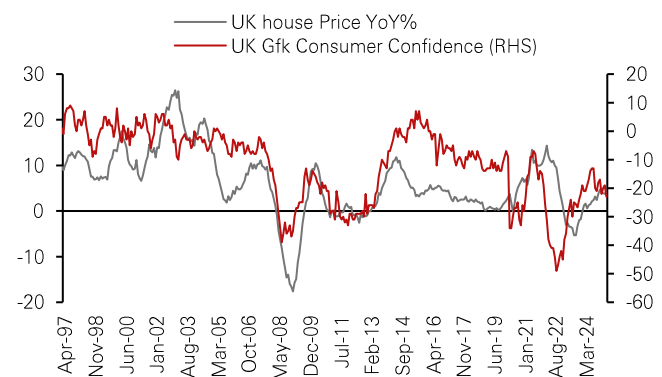
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What happened?

- As expected, the BoE cut the Bank Rate by 0.25% to 4.25%. The committee is weighing up scenarios on the UK economy and continues to emphasise that they need to remain data dependent. Amid heightened uncertainty on economic growth, new trade deals and lower inflation forecasts stand out as silver linings to the gloomy outlook.
- Amid the good trade vibes, one could be tempted to look through the recent poor data. For example, the Services PMI index fell from 52.5 to 49 in April – that's going from a slight expansion to a contraction. The RICS Residential Housing survey also edged down, with surveyors now seeing the housing market edging fractionally lower.
- Consumer confidence continued to slide lower as households cower before the Treasuries' much publicised fiscal restraint and worrying news on tariffs.

UK consumers lack confidence



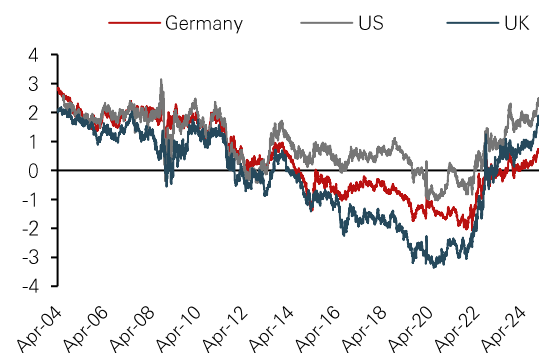
Source: Bloomberg, HSBC Global Private Banking and Wealth, 8 May 2025. Past performance is not a reliable indicator of future performance.

- Because of this broad weakening in economic sentiment, it's no surprise that the BoE cut their 2026 growth forecasts. The broader cuts to growth were already expected and most analysts had already cut their forecasts – over the past 6 months, we slashed our UK 2025 growth forecast to 0.9%, from 1.4% back in October last year.
- While falling short of the comprehensive free trade agreement that the previous government sought, the recent US-UK trade deal should be clearly good news. At the very least, it removes a large chunk of uncertainty and gives the CEOs in the region more confidence to invest. Perhaps the biggest prize of the last few days is the trade deal with India, which positions the UK well with the growth superpower of the East. Let's also not forget the summit with the EU on 19 May, which brings more hope for UK exporters. For the faithful investors who are willing to move before seeing the impact on the economic data, this can be a good opportunity to invest in the UK.
- Inflation has surprised analysts – and to the downside. Six months ago, we saw inflation for 2025 heading towards 3.4%, but we now forecast 2.9% and 2.2% for 2026. Energy prices have plummeted with gas prices down 37% from the early year peak and oil prices down almost a third since mid-January, which means that household energy prices could come down by about 7% by July. About 6-7% of the fall in oil prices can be attributed to USD weakening vs GBP, which helps lower inflation across a broad range of imported goods.
- Furthermore, the BoE expects that Trump's tariffs on Chinese goods will lead to a surplus that should bring down prices for UK importers, creating an additional drag on inflation. However, wages are still too high for the BoE to lean into faster rate cuts, but the job market is cooling, with job vacancies in March falling again.

Investment implications

- Real yields of UK gilts – that're yields after inflation is subtracted – have fallen from their peak but still look attractive. In the 5-10Yr duration, real yields are a fraction below 2%. Amid heightened global uncertainty, it's a comfort to know that your wealth has the potential to grow almost risk free at a rate of nearly 2% in real terms. There is even room for some further returns should the market move more towards our expectations on policy rates.
- We expect that the base rate will reach 3% by Q3 next year, rather than the 3.5% priced in by the markets. If rates indeed fall to 3%, gilt prices would move higher to adjust for lower yields, resulting in capital gains.
- Equities are relatively cheap, but not excessively so. In the coming months, the current outlook is still one of muted growth expectations and we would rather wait to see a turnaround in confidence before moving towards a more positive view on UK equities. For the large caps, which are more global in revenue exposure, we don't think the lower oil prices and weakness in some commodities help their earnings much. That said, the uncertainty has helped the more defensive aspect of the FTSE 100, which is a reminder that some UK equity exposure is warranted. We prefer the banking, healthcare and, helped by the recent trade news, industrials sectors. We remain neutral on UK equities.
- The GBP has strengthened largely due to a falling USD. The narrative of US exceptionalism has been shaken and there is a risk that it falls further from here. While we believe most of the USD weakness is behind us, it is worth kicking the tyres on portfolios, checking for mismatches in currencies and between assets and liabilities.

Real yields for 5-10Yr duration bonds are close to 2%



Source: Bloomberg, HSBC Global Private Banking and Wealth, 8 May 2025. Past performance is not a reliable indicator of future performance.

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