

# Special Coverage:
# BoE sets the scene for an August cut

## Key takeaways

- The Bank of England (BoE) left interest rates unchanged at 4.25% at its June meeting with a more dovish-than-expected 6-3 vote split. The decision reflects the MPC's growing acknowledgement of a cooling UK labour market, easing pay pressures, and weak underlying growth, despite sticky services inflation and heightened uncertainty. Markets now price in a higher probability of a rate cut in August.
- The recent UK equity rally has been led by defensives and energy names amid geopolitical hedging and uplifting of consumer sentiment. However, earnings revisions have not materially improved, and the housing market remains a drag on the domestic cycle. Consumer confidence rebounded in May but from historically low levels, driven more by the rate outlook than actual income gains.


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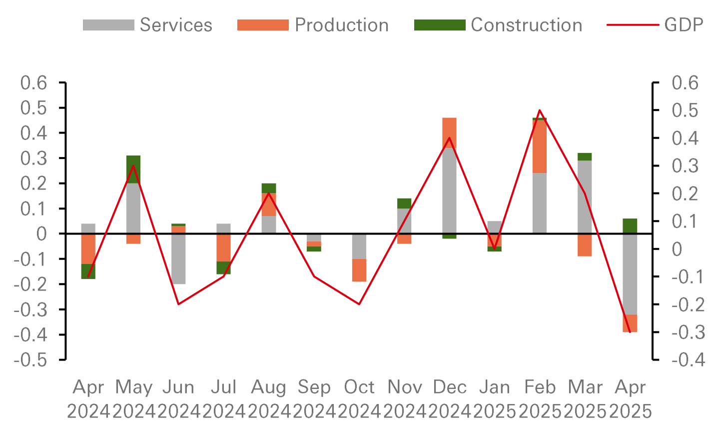
- We remain neutral on UK equities, which have recently rallied on sentiment rather than earnings strength. Given the disinflation trend, a dovish policy pivot and attractive valuations across the curve, we overweight UK gilts, which remain one of the most attractive sovereign bond markets in developed economies, offering positive real yields with policy likely to turn supportive in the second half.

## What happened?

- The BoE maintained its Bank Rate at 4.25%, as six MPC members voted for a hold while three called for a 0.25% cut. The emphasis was still on a "gradual and cautious" approach, but there was an acknowledgement that the conflict in the Middle East has clouded the outlook.
- Despite the BoE once again stressing that monetary policy is not on a pre-set path, they are on route to continue their pace of cutting rates every other meeting – that works out as a 0.25% each quarter. Essentially, current rates are still seen as restrictive and there is a growing confidence that wage growth is heading significantly lower.
- One only has to look at the decline in job vacancies to see where wages are likely heading. Of course, there have been one-off impacts through the National Living Wage, and prices may need to go up to absorb the increase in National Insurance contributions, but we argue that this means in the BoE's medium-term view, there should be some pay-back in softer wage growth.

### Services and production dragged GDP lower in April




Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 19 June 2025. Past performance is not a reliable indicator of future performance.

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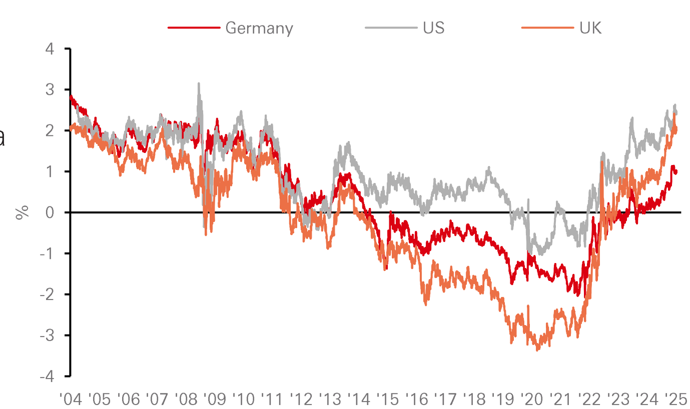
- The BoE will also focus on the domestic growth. UK GDP shrank by 0.3% m-o-m in April, reversing some of the strength seen in Q1. This decline was largely driven by broad-based weakness in services (–0.4%) and manufacturing (–0.9%), with housing-related services and car production hit particularly hard. While some of this softness was due to one-off effects such as the end of stamp duty discounts and the frontloading of activity ahead of new tariffs, the data still point to a broader loss of momentum.
- Although some of these distortions may unwind in the May data, April's decline reinforces our view that the economy is likely to decelerate through Q2. We think that Q2 GDP print could be slightly negative, consistent with the BoE's 0.0%–0.1% growth forecast. Overall, while April's drop shouldn't be seen as a signal of recession risk, it marks a clear turning point after a strong Q1. The balance of risks calls for a more neutral policy. This opens the door for continued quarterly reduction in rates, with the next cut expected in August.
- The GfK survey highlights that UK consumer confidence rose modestly in May, not due to income growth or corporate performance, but rather due to hopes pinned on a new UK-US trade deal. Sentiment has rebounded from April lows, but the consumer outlook remains historically weak, with inflation concerns lingering. The UK housing market isn't exactly booming, as prices have started to give up recent strength as the window for beating stamp duty changes is now a thing of the past. We're not quite sure yet what the catalyst will be to lift this gloom.
- Combined with a lackluster earnings trajectory across several non-energy sectors, this undermines the durability of the recent equity gains.

## Investment implications

- Despite the recent strength in UK equities, the rally appears more sentiment-driven rather than the underlying earnings growth. With fiscal risks also rising, particularly around the £350bn cost of defence plans, we believe upside in equities may be limited. We stay neutral on UK equities, awaiting better earnings visibility and clearer macro inflections.
- Having said that, UK stocks are increasingly seen as a geopolitical hedge, owing to their heavy weighting in energy and traditional defensive sectors like pharmaceuticals and consumer staples. This has allowed the FTSE 100 to keep pace with the broader European indices amid heightened tensions in the Middle East.
- With economic momentum weakening, as reflected by April's 0.3% GDP contraction and over 250,000 job losses since the Autumn budget, the market is increasingly pricing in a more aggressive easing path. Consensus now sees the terminal rate falling to 3.5% by mid-2025, and possibly to 3.25% by 2026–2027. This implies significant room for gilt yields to decline from current levels, offering strong capital appreciation potential for duration-sensitive investors.
- Moreover, with inflation falling back in line with the BoE's projections and wage pressures showing early signs of moderation, we think the real yields on gilts remain attractive, particularly versus peers in the US where fiscal concerns linger, and the Eurozone where the easing cycle has likely reached its end.

### Gilts offer attractive real yields in the 5-10-year maturity range




Note: Yields above are calculated as the 5-year, 5-year forward government bond yields minus the 5-year, 5-year forward inflation swap.
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