

# Special Coverage: Divided BoE settles on another rate cut

## Key takeaways

- ◆ The Bank of England (BoE) cut interest rates to 4.0%, marking the lowest level in over two years. In a 5-4 vote, the Monetary Policy Committee (MPC) opted for a 0.25% rate cut with four members voting for no change. This re-vote was a rare move in the MPC's 28-year history and underscores the challenging macroeconomic backdrop the UK faces.
- ◆ GBP gained against the dollar following the decision, while gilt yields rose as investors scaled back their expectations. Markets anticipate the Bank Rate could decline to around 3.5% by year-end, assuming inflation stabilises and the labour market remains soft. We forecast the BoE will continue to reduce Bank Rate at a continued 0.25%-per-quarter pace, until it gets to 3.0% in Q3 2026.
- ◆ We maintain an overweight stance on UK gilts as they still offer relatively attractive value compared to global peers, especially as yields are expected to decline further into 2026. In our view, the Bank Rate can fall much closer to 3.0% before the BoE feels comfortable that rates are no longer restrictive. This implies that bond yields can fall from here, making gilts with a 7-10 year duration an attractive investment.



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## What happened?

- The BoE's decision followed an unprecedented re-vote after an initial deadlock among policymakers, highlighting the deep division within the Bank's MPC. Governor Andrew Bailey described the situation as one of 'genuine uncertainty', particularly given the balancing act between persistent inflation, now expected to peak at 4.0% in September, and signs of labour market softening.
- The division comes more down to timing. This year's inflation forecast has been revised higher, thanks to a previous spike in energy prices and higher food inflation. The MPC members have noted that while food inflation is only about 15% of the inflation basket, it can have an outsized influence on households' inflation expectations.
- Even though the BoE forecast have move in a stagflationary direction with higher inflation and lower growth, there's a sense that the BoE sees enough of an economic slowdown to continue in a "gradual and careful" downcycle in rates. There's a much clearer downtrend in falling job vacancies that sunk below the pre-COVID levels a year ago and has since fallen further without any loss in momentum. With less jobs available, wage growth will surely suffer, and the BoE will have less to fear from the more domestically driven services inflation.

## BoE forecasts edge slightly more stagflationary

	2025 Q3	2026 Q3	2027 Q3	2028 Q3
GDP	1.2 (1.1)	1.3 (1.3)	1.5 (1.6)	1.7
CPI Inflation	3.8 (3.5)	2.7 (2.4)	2 (1.9)	2
Unemployment rate	4.8 (4.6)	4.9 (4.9)	4.8 (5)	4.8

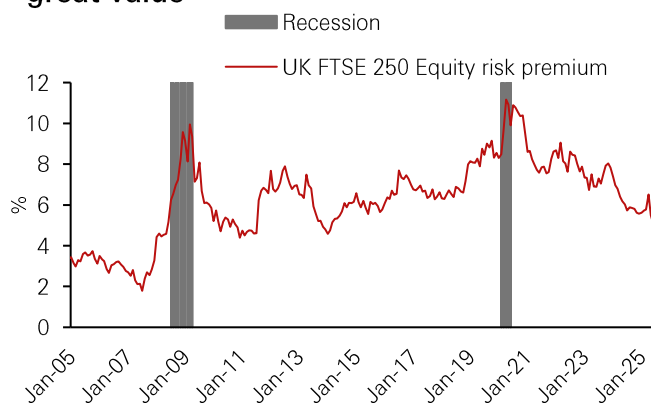
Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 7 August 2025. Forecasts are subject to change.

- As for the US tariffs, the UK government can take some comfort in settling for the “baseline” tariff of 10%. This has helped provide some clarity to the outlook and, notably, the BoE thinks that the US tariffs will weigh only “modestly on GDP. Meanwhile, the inflationary impact is more mixed in the near-term but are “judged to be disinflationary... in the near term”.
- London’s housing squeeze is happening against a backdrop of souring consumer sentiment across the UK. In July, the GfK consumer-confidence index dipped a point to -19, well below its long-run average of -10, as worries over possible tax rises and stubbornly high inflation weighed on households.
- The saving index that tracks whether people feel it’s a good time to save or spend jumped seven points to 34, which is the highest reading since the onset of the financial crisis, underscoring how many UK consumers are bracing for tougher times ahead.
- This slump in confidence comes alongside unexpectedly weak economic data. UK GDP contracted by 0.1% in May, marking the second straight monthly decline. GfK sentiment about the country’s overall economic prospects has plunged to -44, down from -32 a year ago, reflecting growing unease over the fiscal headwinds the UK faces. Consumers are hunkering down, and with buying intentions flat, fewer would-be homeowners are stepping forward, precisely at a moment when London’s builders are already hesitating.
- Historically, there has been a clear link between household mood and property prices. House prices are rising at just 2.4% y-o-y, down from peaks of over 10% y-o-y in recent boom years. This anemic pace mirrors the caution flagged by record-high savings sentiment and soft purchase intentions.

## Investment implications

- There’s a lack of confidence and animal spirits in the UK. While this remains the case, it’s hard to get excited about UK equities, particularly now that they aren’t quite the bargain they once were.
- The rising UK household saving ratio % and with the GfK’s saving index has rose to 34, these signs point to a risk that households would spend less this winter and since consumer spending makes up about 60% of the economy, that’s going to be a big hit.
- At the same time, the official measure of policy uncertainty is as high as it was around Brexit, meaning people and businesses don’t know what to expect next. Put it all together — political surprises, higher saving and low confidence — can lead to Britain’s fragile recovery easily run out of steam.
- This isn’t a fertile backdrop for earnings growth and the best argument for investing in the UK remains its diversifying traits as a “defensive value” play. On this, the FTSE 100 index does have some merit amid the risks that US tariffs and a fractious geopolitical backdrop would drive some investor flows towards the UK.
- The better opportunities in the UK seem to be in the bond market. The market is pricing-in rates hitting 3.5% before returning towards 4.0% in the longer term, which looks very hawkish to us. One can only assume that investors are taking recent inflation trends and extrapolating them too far into the future. Yet the evidence from previous rises in the national living wage point to businesses clawing back the high costs through more muted wage growth in the following years. Therefore, if anything, the recent inflation rise should be seen as a drag on future inflation, rather than a “new normal”.
- We maintain an overweight stance on UK gilts as they still offer relatively attractive value compared to global peers, especially as yields are expected to decline further into 2026. In our view, the Bank Rate can fall much closer to 3% before the BoE feels comfortable that rates are no longer restrictive. This implies that bond yields should fall from here, making gilts with a 7-10-year duration an attractive investment.

### FTSE 250 equity risk premium in no longer great value



Source: Bloomberg, HSBC Private Bank and Premier Wealth as at 7 August 2025. Past performance isn't a reliable indicator of future performance.

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