Bank of England Cuts Rates

Latest views from the investment team

The Bank of England lowered interest rates yesterday, from 5.25% to 5%. This is the first cut since the start of the pandemic in March 2020 and will be welcomed by borrowers. The committee were split on the decision - five members, including Governor Bailey, voted for a cut while four preferred to leave rates unchanged.

Key to this decision is inflation. The Bank of England's Monetary Policy Committee sets interest rates with the aim of meeting the 2% inflation target. Inflation, which peaked at over 11% in October 2022, fell to 2% in May and remained there in June. The decline has largely resulted from reduced pressures on food and imported goods prices. Food inflation has fallen to under 2%, from nearly 20% at its peak, a worrying level driven by the effect of global supply disruptions caused by pandemic lockdowns and the Russian invasion of Ukraine. Some committee members have concerns about the sustainability of low inflation because wage pressures are still elevated. This is supporting services inflation, currently at 5.7%. Recent above inflation pay awards in the public sector will not alleviate these concerns. However, at 5%, policy rates are still viewed to be restrictive and are expected to further dampen some of the more stubborn inflation pressures.

Governor Bailey has cautioned that rates are unlikely to be reduced as rapidly as they were increased between December 2021 and September 2023, when rates rose from 0.1% to 5.25%. The Bank of England are currently forecasting that inflation will increase modestly to 2.75% later this year, largely due to volatile energy prices, before returning to the 2% target in 2025. Any upcoming changes to government spending, due to the UK Budget on 30 October, will be incorporated in the MPC's November projections.

Bottom line

The interest rate cut was not a surprise to investors; expectations for a reduction had heightened over the last three months as inflation hit its target. Nonetheless, alongside political stability following the UK election and improving macroeconomic data, we view this supportive stance from the Bank of England as good news for UK assets.

For more information, please contact your adviser.

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