State of Play

Relief rally

16 November 2023

For policymakers, this week represents a nervous ride, praying for reasons to be cheerful. When central banks paused interest rate rises two weeks ago, their decision was based on previous data and expectations of future trends. Does the latest information on employment, wage rises, and inflation back up their expert opinion or warrant a rethink? Simon Durling, from Santander Asset Management, shares his thoughts in this week's State of Play.

Key highlights from this week's State of Play

- Relief rally
- Employment and earnings update
- Inflation latest
- Market update

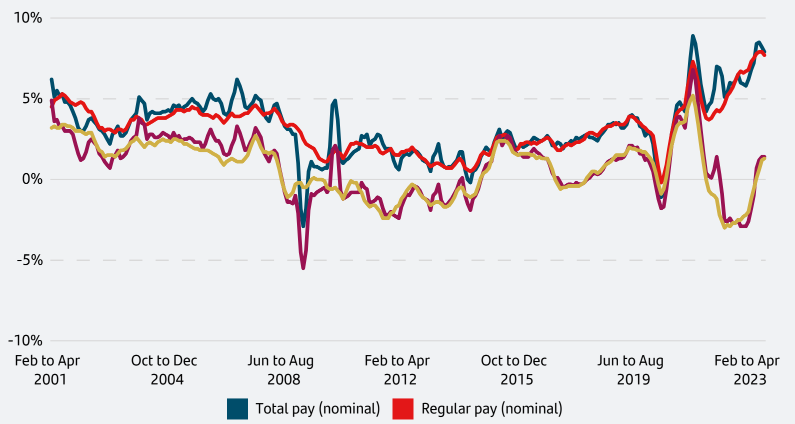
Relief rally

Central banks met two weeks ago and decided to pause interest rate rises after a relentless two years of increasing borrowing costs for individuals and businesses in order to tackle rising prices. Their rationale was that higher interest rates were finally starting to cool consumer spending, which should lead to inflation falling closer to their target of 2%. The remainder of this week's update will explore each of the main data releases, but in short, policymakers will breathe a huge sigh of relief that inflation is starting to fall more sharply and other important measures are trending in the right direction. This immediately fed into a change in investor mood as both share prices and bond values improved as their attention switched from rate rises to the possibility of rate cuts.[1] In investment markets, this sharp bounce is often referred to as a relief rally. The question that will remain unanswered for now is whether this is the beginning of a sustained rise in asset prices leading to something more permanent or simply short-term optimism, which may be dashed should economic data starts to turn gloomy.

Employment and wage growth update

According to the Office for National Statistics (ONS), estimates for July to September 2023 show that the unemployment rate remained unchanged at 4.2%.[2] Annual growth in regular pay (excluding bonuses) was 7.7% in July to September 2023, slightly down on the previous measure, but still one of the highest rates since comparable records began in 2001.[2] Annual growth in employees' average total pay (including bonuses) was 7.9%.[2] This data is affected by the Civil Service one-off payments made between July and August 2023. Both measures were higher than forecast and will remain an ongoing concern for the Bank of England, which has often repeated the impact wage growth will likely have on rising prices. If wages continue to rise more than inflation, it will dilute the impacts of higher interest rates, meaning inflation could become more stubborn and possibly lead to higher interest rates for much longer.

Average weekly earnings annual growth rates in Great Britain, seasonally adjusted, January to March 2001 to July so September



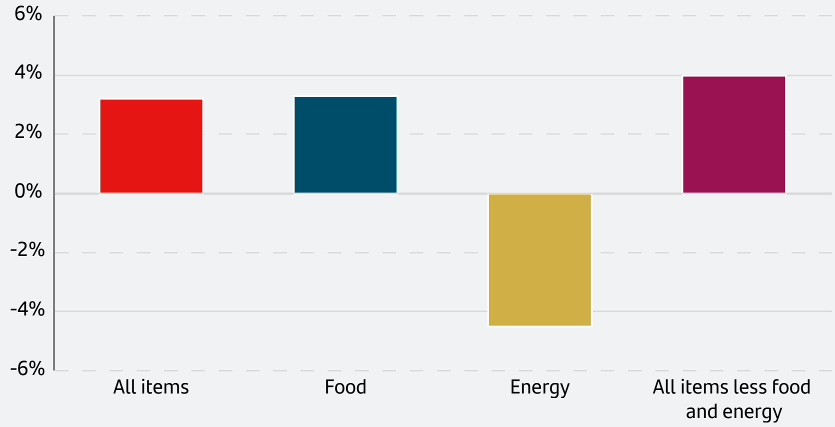
Source: Office for National Statistics
Data as at November 2023.

One silver lining remains the continued reduction in the number of job vacancies, which fell for the 16th consecutive period by 58,000 to 957,000.[2] While industrial action in the public sector has led to intervention by government departments, some elements of the wage growth we have witnessed have been driven by employers struggling to attract the right candidates in a competitive market, leading to increased starting salaries for new recruits. While vacancies remain above the long-term recent average of just above 500,000, the continuing trend supports an expectation by the Bank of England that wage rises may start to fall in the months ahead. The fall in inflation will provide a lower benchmark for employers approaching many year-end pay reviews, allowing for much lower wage rise settlements and taking the pressure off the Bank of England in the months ahead.

Latest US inflation data

The latest inflation data released on Tuesday (14 November) showed the pressure from rising prices starting to ease further in the US. The headline rate slowed to 3.2% from 3.7% and the core rate (which excludes energy and food) moderated to 4.0% from 4.1%.[3] As inflation continues to soften, investors are likely to conclude that central banks have finished with rate rises despite the tough language over the last week warning they would intervene if inflation remained stubborn in the short term.

12-month percentage change, Consumer Price Index, selected categories, October 2023, not seasonally adjusted

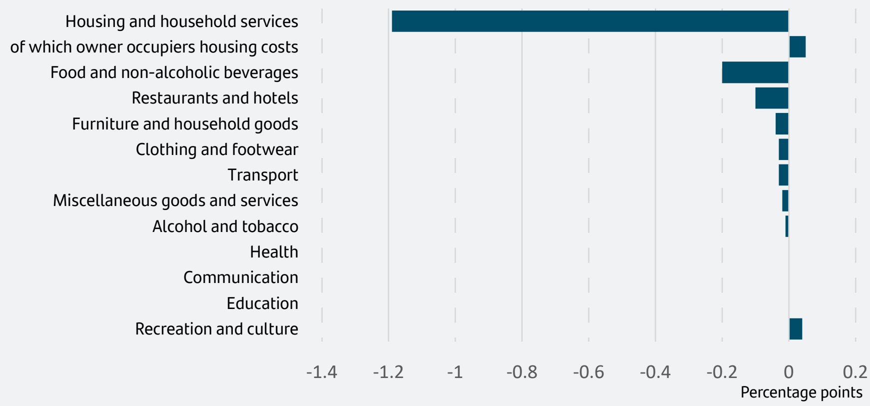


Source: U.S. Bureau of Labor Statistics. Data as at October 2023.

UK inflation

Both the Bank of England and the UK Government will breathe a huge sigh of relief as the expected sharp fall in inflation was even larger than forecast. According to the latest ONS data, the Consumer Price Index (CPI), which is also referred to as the headline rate, fell from 6.7% to 4.6% in the 12 months to October.[4] Core inflation, which ignores energy and food, came in at 5.7%, down from 6.1% the previous month.[4] This significant reduction, as expected, came in the main from a fall in energy prices, as captured by the report from the ONS stating 'Gas costs fell by 31.0% in the year to October 2023, compared with a rise of 1.7% in September.[4] This is the lowest annual rate since records began in January 1989. Electricity costs fell by 15.6% in the year to October 2023, compared with a rise of 6.7% in September.'

Contributions to change in the annual CPIH inflation rate, UK, between September and October 2023

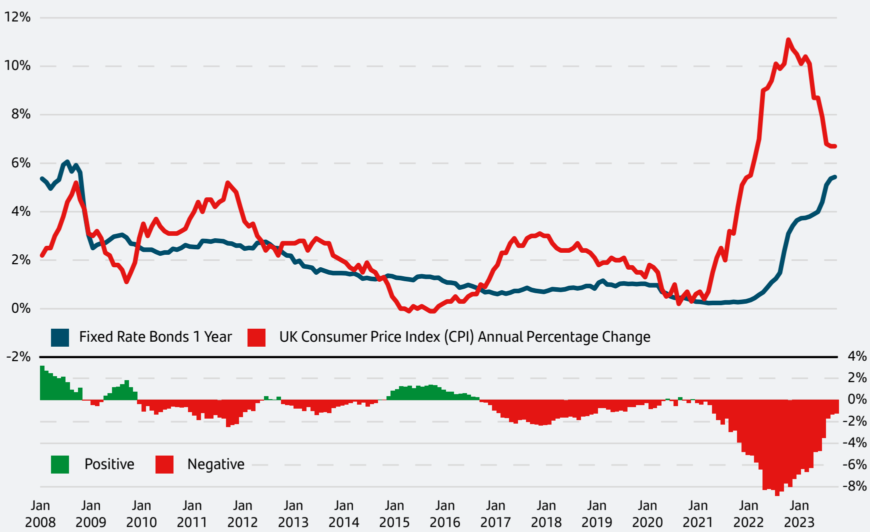


Source: Office for National Statistics
Data as at November 2023.

Beware of the erosion gap

In previous updates, the graph below showed that savers who have benefited from rising savings rates for the first time in a generation may have been lulled into thinking this will help them grow their wealth over the long term. It is true that much higher savings rates will be welcomed by all, as they widen the alternatives available and offer a much better return for short-term cash pots. However, as you can see from the chart, savings rates over time have lagged behind rising prices (as there is more red than green on the bottom chart). What is stark is how much the erosion gap increased in the last two years. Inflation is often referred to as the invisible tax on our long-term wealth, and for good reason. The one thing the chart lacks is the latest inflation data released yesterday. As you can see, the gap has narrowed, and depending on the savings data, it may even cross over into positive territory when the information is released in a few weeks' time. Despite this possibility, the previous 15 years show that even after a sustained period of very low inflation by historical standards, cash was unable to protect against the erosion of wealth.

The erosion gap



Wednesday's inflation data not included due to Building Society Savings Data lag.
Source: Building Societies Association, FE Fundinfo.
Data as at 30 September 2023.

Market update

As you can imagine, the last couple of weeks have been frantic in investment markets as investors adjust to a sustained period of good news. Inflation cooling has lifted confidence and enabled market participants to start assessing when interest rates may be cut in the future rather than if central banks have pressed pause on rate rises. Bonds have risen in value as yields have fallen sharply[5], reflecting expectations for interest rates, especially government bonds. UK 10-year Gilt yields have fallen more than 50 basis points (0.5%) since the most recent high, and at time of writing, were just 4.16%.[6] Stock markets, especially US tech, have bounced significantly, as investors' confidence is boosted by both interest rates and inflation trends. All attention now turns to if and when economic news turns gloomier, prompting central banks to bring forward potential interest rate cuts at some point next year. The all important 'soft landing' they desire, lower inflation through less consumer spending, but without recession – is perhaps a mirage on the horizon. Clearly, as interest rate expectations feed into savings rates we can expect adjustments in the offerings from the savings market with those who were able to capture a more competitive rate in recent weeks starting to think what to do when the offer they have expires.

The value of seeking guidance and advice

It is important to seek advice and guidance from a professional financial adviser who can help to explain how to build an appropriate financial plan to match your time horizons, financial ambitions and risk comfort. If you already have a plan in place or have already invested, it is important to allocate time to review this to ensure this remains on track and appropriate for your needs.

Learn more!

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing here.

Note: Data as at 16 November 2023.

[1] CNBC, 7 November 2023
[2] Office for National Statistics, 14 November 2023
[3] US Bureau for Labor Statistics, 14 November 2023
[4] Office for National Statistics, 15 November 2023
[5] Investing.com, 10 November 2023
[6] Investing.com, 14 November 2023

Asset Management

A Week in the Markets

Performance

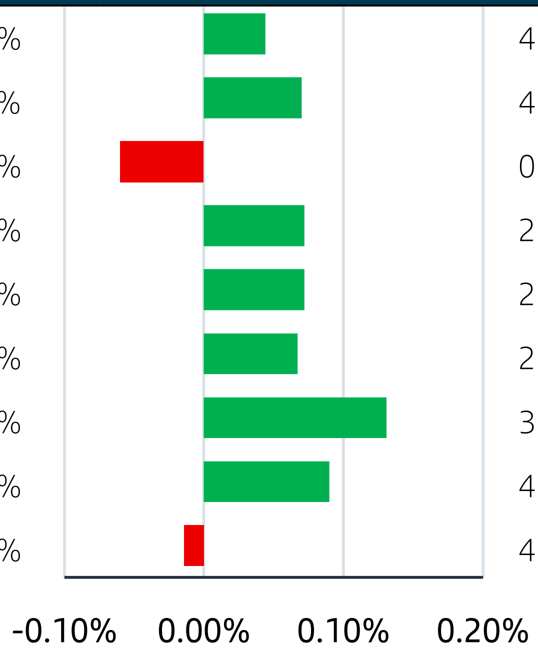
Index	Value	Change	%	12 Month High	12 Month Low
FTSE 100	7,361	**-57.18**	**-0.77%**	8,014	7,257
FTSE 250	17,853	**-130.75**	**-0.73%**	20,615	16,783
Dow Jones Industry	34,283	**221.78**	**0.65%**	35,631	31,819
S&P 500	4,415	**56.90**	**1.31%**	4,589	3,783
NASDAQ	15,529	**429.63**	**2.85%**	15,841	10,679
Hang Seng	17,203	**-460.86**	**-2.61%**	22,689	16,081
Nikkei 225	32,568	**618.22**	**1.93%**	33,753	25,717
CAC 40	7,045	**-2.46**	**-0.03%**	7,577	6,450
DAX	15,234	**45.14**	**0.30%**	16,470	13,885
FTSE Eurofirst 300 Eurozone	2,378	**26.93**	**1.15%**	2,547	2,203
S&P TSX Composite Index	19,654	**-170.38**	**-0.86%**	20,767	18,737
Commodity markets*					
Gold	$1,946.70	**-48.71**	**-2.44%**	$2,047.01	$1,736.85
Crude Oil	$83.90	**-3.43**	**-3.93%**	$97.28	$70.96

Source: Refinitiv Eikon, prices displayed in the local currency.
*Gold Bullion London Bullion Market $ Per Metric Tonne Ounce Delay & Brent Forties and Oseberg Dated Free on Board Northsea Crude used for commodity performance.
Source Data from the 6 November 2023 to 10 November 2023.

Asset Management

10-year bond yields

Country		Variation	12 Month High	12 Month Low
UK	4.34%		4.75%	3.01%
US	4.63%		4.99%	3.29%
Japan	0.86%		0.96%	0.24%
Euro	2.71%		2.97%	1.79%
Germany	2.71%		2.97%	1.79%
France	2.71%		2.97%	1.79%
Italy	3.30%		3.55%	2.24%
Spain	4.58%		4.98%	3.61%
China	3.77%		4.07%	2.77%



Currencies

Currency	Conversion	Price	Change	12 Month High	12 Month Low
Dollar	GBP > USD	$1.22	**-0.02%**	$1.31	$1.17
Euro	GBP > EUR	€ 1.14	**-0.01%**	€ 1.17	€ 1.12
Yen	GBP > YEN	¥185.15	**0.25%**	¥186.51	¥156.32

Source: Refinitiv Eikon.

Source Data from the 6 November 2023 to 10 November 2023.