State of Play

Taking stock

2 November 2023

The bitter and painful pill prescribed by policymakers to combat inflation has been much higher interest rates. Higher borrowing costs for both individuals and businesses take time to filter into the economy to tackle rising prices. Nearly two years and fourteen rate rises later, the Bank of England meets to decide whether the medicine has finally worked. 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

- Taking stock
- Hot US economic numbers
- Bank of England rate decision
- Market update

Taking stock

When inflation returned following the disruption to supply chains during the pandemic, nearly all central banks misjudged what was going to happen next. What was seen as temporary, quickly became embedded, exacerbated by the war in Ukraine and the subsequent rises in commodity and energy prices. Despite the aggressive approach taken, especially by the Federal Reserve (the Fed) in the US, the cooling of global economies has proved to be much harder than rate setters had anticipated. Consumers have been supported by the fastest rise in wages in a generation, and as highlighted in last week's update, the cushion of savings squirrelled away when they were forced to stay at home to slow the spread of the virus. The last two years have seen the fastest and most continuous rise in interest rates on record, yet last week saw very strong economic numbers in the latest quarterly Gross Domestic Product (GDP) released in the US.

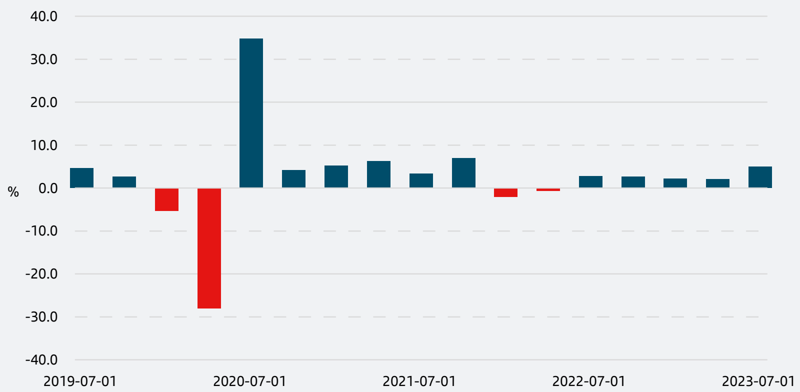
Investors and policymakers have been transfixed on each new data point, trying to judge how this may influence future economic growth (or contraction) and the likely path for interest rates. Raising rates alone isn't the most effective brake to place on an economy, as it takes time to affect consumers and businesses. This is the case in the US, where most mortgage borrowers borrow over typically 30 years, and here in the UK, where much of the mortgages borrowed in recent years have been fixed for two, three, five or even ten years. Individual data points in isolation cannot tell the whole story as to whether higher rates are starting to work. They are short-term signals used by central banks to build a picture and make decisions.

They have always been trying to pull off the impossible: increase rates sufficient to cool the economy but not enough to drag it into a deep recession. This is often referred to as a 'soft landing', with the runway both short and narrow, leaving experts to judge cross winds, which make the task even more difficult. As we approach the end of rate hikes, it appears policymakers are taking stock to try and establish the aftermath of unprecedented financial tightening (higher rates and less money in the financial system). So, with the European Central Bank (ECB) choosing to pause rates last week following the 0.25% rise the month before, will the US and the UK follow suit?

Hot US economic numbers

The US economy grew more than had been predicted at 4.9% versus 4.3% forecast in the latest quarterly GDP released from the Bureau of Economic Analysis (BEA) in the US.[1] If you compare these numbers with the previous quarters, your first reaction is probably that higher rates have been unable to cool consumer spending sufficiently and that the Fed may consider raising rates. However, when you look beyond the headline number and assess the contributions from different parts of the economy, you begin to sense that this may be an anomaly bucking the longer-term trend. Wage rises and the savings buffer have helped consumers counter higher prices and continue spending. However, other data points to a slowdown, which creates doubt as to whether additional rate rises are required. Last time round, when the Fed met to decide, it said it wanted to see how the data evolves in the short term before raising rates once again. So, what did they decide?

US GDP



Source: Bureau of Economic Analysis. Data as at October 2023.

As expected, the Fed decided to keep interest rates on hold following a pause in September. They cited the need to further assess the evolution of economic data in the weeks ahead before considering whether further rate rises are necessary. They suspect that the battle with rising prices is finally being won, but cautioned against complacency, promising to take whatever steps are necessary to ensure inflation over time comes back to their long-term target of 2%.[2]

Bank of England rate decision

The Monetary Policy Committee (MPC) at the Bank of England met today to decide on interest rates. Much like their US and European counterparts, they decided to press pause once again, wanting to see how the economy progresses, especially given their expectations that when this month's inflation numbers are released, they will show a significant fall during October. The data at present is mixed but appears to be trending towards a slowdown or even a recession. While wage rises remain elevated, which is the primary concern for the committee, the vast majority of other measures support a pause in rate rises.

Market update

The US stock market, as measured by the S&P 500 index, fell into correction territory last week.[3] A correction is when share values fall by more than 10% from their previous high, and a bear market is when they fall by more than 20%. A combination of factors contributed to the fall in values over the last few weeks, with growing concerns about the conflict in the Middle East. While the US economy and company earnings appear resilient, investors are increasingly concerned about a low growth future and the risk reward trade-off from shares versus that of bonds and cash. Investing has always been about a trade-off between risk and reward. If you are prepared to take greater risks, then you are expected to be compensated with higher potential returns. This adjustment in share prices may take some time, but the expected pause in interest rate rises by central banks and inflation continuing to fall closer to the policymaker's target will help. Once market participants begin to look ahead with a sense that eventually rates may be cut, this will reflect in both bond yields, which in turn will filter to the saving rates available.

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 2 November 2023.

[1] Bureau of Economic Analysis (BEA), 26 October 2023
[2] Federal Reserve, 2 November 2023
[3] CNBC, 30 October 2023

Asset Management

Performance

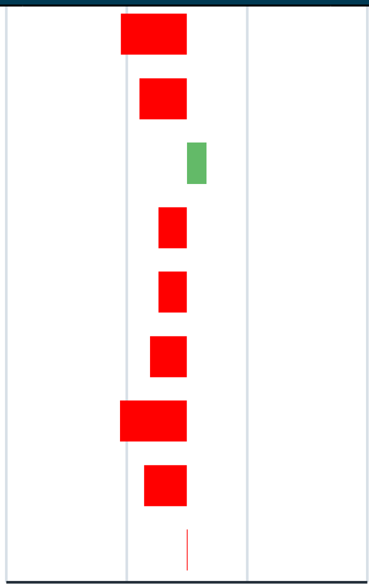
Index	Value	Change	%	12 Month High	12 Month Low
FTSE 100	7,291	-110.86	-1.50%	8,014	7,048
FTSE 250	16,866	-166.50	-0.98%	20,615	16,783
Dow Jones Industry	32,418	-709.69	-2.14%	35,631	31,819
S&P 500	4,117	-106.79	-2.53%	4,589	3,720
NASDAQ	14,180	-380.46	-2.61%	15,841	10,679
Hang Seng	17,399	226.60	1.32%	22,689	14,687
Nikkei 225	30,992	-267.67	-0.86%	33,753	25,717
CAC 40	6,795	-20.84	-0.31%	7,577	6,243
DAX	14,687	-111.06	-0.75%	16,470	13,130
FTSE Eurofirst 300 Eurozone	2,272	-5.11	-0.22%	2,547	2,074
S&P TSX Composite Index	18,737	-378.25	-1.98%	20,767	18,737
Commodity markets*					
Gold	$1,981.90	-11.95	-0.60%	$2,047.01	$1,628.00
Crude Oil	$90.79	-3.31	-3.52%	$99.93	$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 23 October 2023 to 27 October 2023.

Asset Management

10-year bond yields

Country		Variation	12 Month High	12 Month Low
UK	4.55%		4.75%	3.01%
US	4.85%		4.99%	3.29%
Japan	0.87%		0.89%	0.24%
Euro	2.84%		2.97%	1.79%
Germany	2.84%		2.97%	1.79%
France	2.84%		2.97%	1.79%
Italy	3.45%		3.55%	2.24%
Spain	4.81%		4.98%	3.61%
China	3.93%		4.07%	2.77%



Currencies

Currency	Conversion	Price	Change	12 Month High	12 Month Low
Dollar	GBP > USD	$1.21	0.00%	$1.31	$1.12
Euro	GBP > EUR	€ 1.15	0.00%	€ 1.17	€ 1.12
Yen	GBP > YEN	¥181.38	-0.81%	¥186.51	¥156.32

Source: Refinitiv Eikon.

Source Data from the 23 October 2023 to 27 October 2023.

Important Information

For retail distribution.

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