More Cuts Coming – Maintaining Our Bullish view for GBP Fixed Income.

Potential Capital Gains on the Horizon

The Bank of England (BoE) delivered a 25bps cut in July, with another 25bps cut expected by end-2024 and 50bps cut in 2025. These rate cuts should generate capital gains for GBP bond investors. Moreover, a more stable UK government is likely to attract more investment flows.

Despite recent decline in yields, GBP corporate bonds remain more attractive than their USD counterparts. With GBP bond yields still above pre-pandemic levels (see Chart 10), they are an attractive buy, particularly following the strengthening of the MYR against the GBP.

Adding GBP fixed income to your portfolio provides diversification benefits and acts as a partial hedge against negative growth surprises. Risks to our view include: potential UK fiscal indiscipline, a resurgence of UK inflation, possible conflict escalation in Europe, and further MYR strength against the GBP.

Our FTV Framework

Our framework shows three compelling reasons to be bullish on GBP bonds:

Fundamentals: (1) Pockets of weakness still exist in the UK economy, leading to increased likelihood of accelerated rate cuts; Inflation risks are still skewed to the upside, but further BoE easing could occur before inflation reaches the 2% target; Current monetary policy settings are restrictive (see Chart 8).

Technicals: (1) The 10-year UK government bond yield remains in a descending channel; It could rebound to the 3.93%-4.09% resistance levels if inflation and growth data surpass expectations. The market remains cautiously optimistic about further economic recovery.

Valuations: (1) GBP IG corporate bond yields have fallen from post-pandemic highs but are still well above pre-pandemic levels, presenting attractive buying opportunities. These bonds are poised to benefit from the anticipated rate cuts (see Chart 9).

Barbell Strategy for GBP Bonds

A barbell strategy is recommended. This approach involves investing in long-duration (10+ year) GBP investment-grade corporate bonds alongside short-duration (less than 2 years) high-yield GBP corporate bonds.

Long-duration GBP corporate bonds can benefit from potential gains during the anticipated rate cut cycle, as they have historically performed well (see Chart 9).

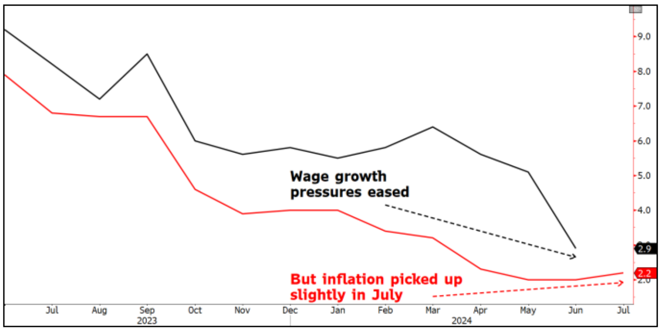
Conversely, short-duration high-yield GBP corporate bonds offer a buffer through high recurring income and provide protection against significant rebound in UK economic growth and inflation.

Top Client Questions:

1. Will the BoE ease aggressively?

Due to the UK's structural economic weaknesses and declining wage growth pressures, the BoE is expected to moderately ease monetary policy despite recent modest growth and inflation. The real policy rate in UK are among the highest and most restrictive among developed markets, hence need to be reduced to alleviate growth restrictions (see Chart 8).

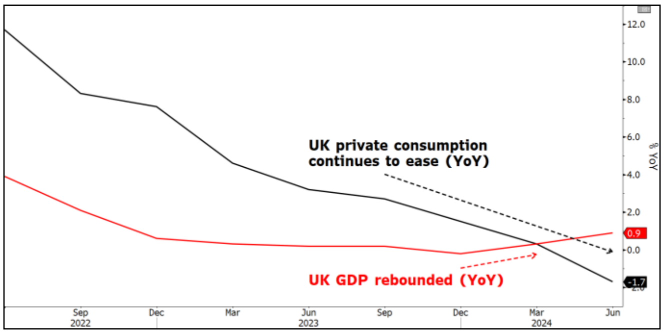
Chart 1: Wage growth pressures continue to ease, but inflation accelerated in July.



Source: Bloomberg, CIMB Chief Investment Office

2Q24 GDP increased marginally by 0.9% YoY, driven by stronger services and utilities production, which offset weaker manufacturing and construction. Household consumption remained lacklustre. The UK's long-term economic growth may face challenges due to weak labour productivity.

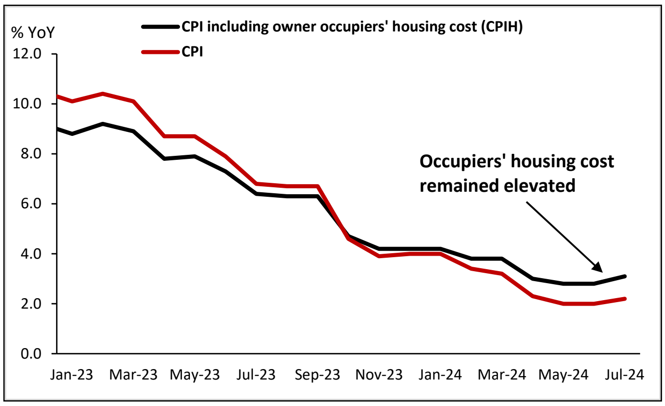
Chart 2: Weak consumer demand remains despite an acceleration in economic activities in 2Q2024.



Source: Office of National Statistics, CIMB Chief Investment Office

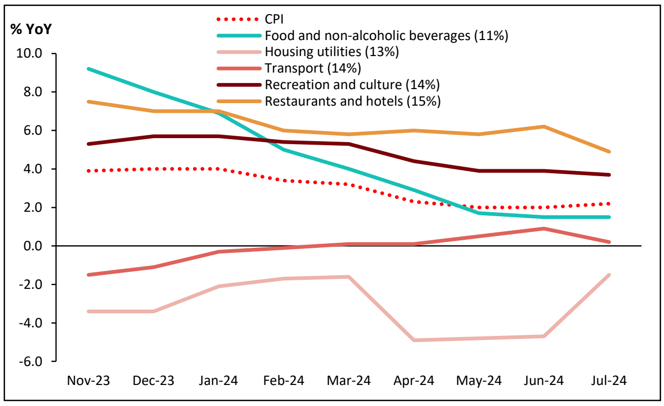
UK inflation has been on a downward trend since early 2023, driven by high interest rates and weaker demand. However, the July CPI saw a sharper increase, mainly due to a rebound in transport and housing costs. This may be temporary, as weak consumer demand will likely push inflation lower in the medium term.

Chart 3: Recent months have seen disinflation progress stall due to persistent housing inflation.



Source: Office of National Statistics, CIMB Chief Investment Office

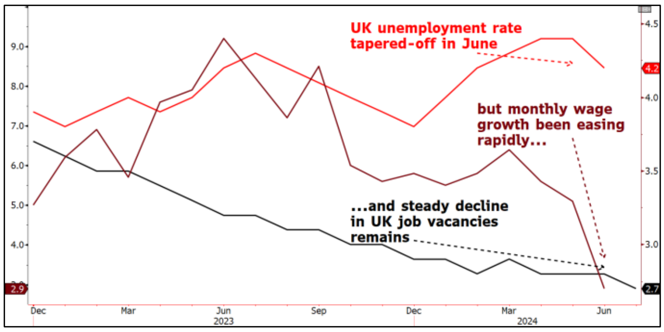
Chart 4: Most CPI components are on downward trend, except for Transport



Source: Office of National Statistics, CIMB Chief Investment Office

The UK labour market remains weak despite the unemployment rate falling to 4.2% in the three months to June. Wage growth and vacancy levels continue to decline, providing the BoE with room to moderately ease monetary policy.

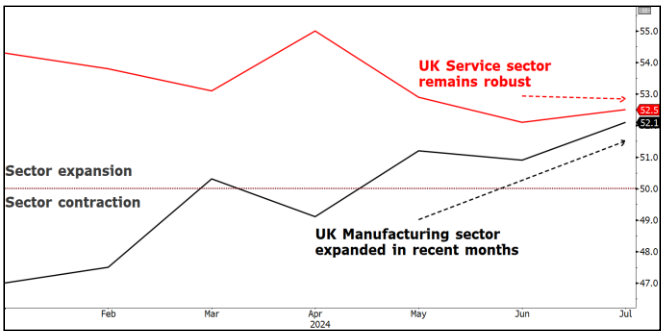
Chart 5: Unemployment rate declined but remains elevated.



Source: Bloomberg, CIMB Chief Investment Office

Manufacturing and service sectors are expanding, showing modest economic growth. This will likely to result in moderate easing by the BoE.

Chart 6: PMIs signal a rebound in economic growth.

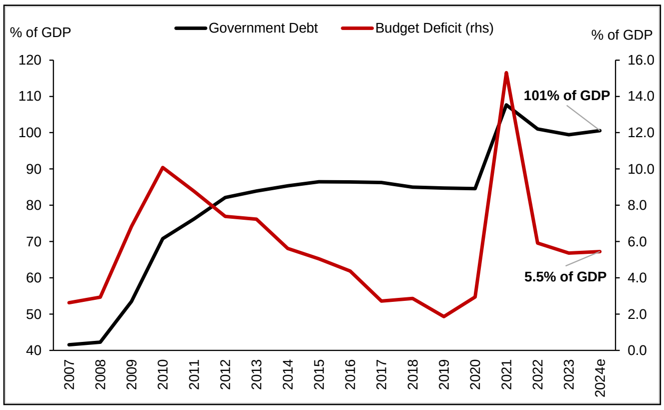


Source: Bloomberg, CIMB Chief Investment Office

2. Are UK fiscal policies supportive of the GBP bond market?

The latest improvements in government debt and fiscal positions are supportive of GBP bonds. However, the outlook depends on the new government's decisions, with the Autumn Budget in October being crucial for direction. Current ratings signal improving prospect: Fitch revised UK credit outlook to stable from negative in March 2024 (AA-), while Moody's (Aa3 stable) and S&P (AA stable) maintain their ratings.

Chart 7: UK fiscal position has become more balanced since 2020; Govt gross Debt-to-GDP ratio improved.



Source: Office for Budget Responsibility, CIMB Chief Investment Office

3. How will GBP currency fare in the medium term?

GBPUSD: Tailwinds – BoE's moderate easing compared to the Fed could boost GBP against USD. **Headwinds** – GBP could weaken against USD in near term due to technical selling, US election risks, and geopolitical tensions. **Action** – Buy GBP via USD at 1.28 and below.

GBPMYR: Tailwinds – GBP could rise in the near term if the BoE slows pace of rate cuts. **Headwinds** – MYR may gain medium-term support from national development initiatives and BNM's decision to maintain the OPR, compared to the BoE's moderate easing. **Action** – Buy GBP via MYR at 5.70 and lower.

Given the projected strength of the MYR against the GBP in 2025 (see Table 1 below), the near-term total return on GBP bonds may be negatively impacted. To mitigate, consider converting from USD or using existing GBP cash to buy GBP bonds. We strongly advocate a long-term perspective.

Table 1: Bloomberg FX Forecast

Consensus Forecast	3Q24	4Q24	1Q25	2Q25	2025	2026	2027	2028
GBPUSD	1.31	1.31	1.31	1.31	1.31	1.30	1.30	1.30
USDMYR	4.37	4.35	4.33	4.32	4.45	4.43	4.47	4.45
GBPMYR	5.72	5.70	5.67	5.66	5.83	5.76	5.81	5.79

Source: Bloomberg, CIMB Chief Investment Office

Actionable Ideas

In the coming months, fixed income instruments are expected to become a central focus of the market. Our selection of GBP corporate bonds (see Table 2 below) offer investors attractive income generation opportunities while serving as a partial hedge against an uncertain economic and geopolitical environment. The recent MYR strength provides an opportunity to invest into GBP bonds for attractive long-term returns.

Table 2: Our high conviction GBP bond ideas

Issuer	Bond Type	Currency	Coupon	Rating	Maturity / Call	Indicative Yield
Credit Agricole	Perpetual AT1*	GBP	7.500%	BBB-	23-Jun-26	6.83%
HSBC Holdings	Perpetual AT1*	GBP	5.875%	Baa3	28-Sep-26	6.81%
Nationwide Building Society	Perpetual AT1*	GBP	5.750%	BB+	20-Jun-27	7.29%
Phoenix Group	Perpetual RT1**	GBP	5.750%	BBB	26-Apr-28	8.13%
Rothesay Life	Perpetual RT1**	GBP	6.875%	BBB-	12-Sep-28	7.58%
Legal & General Group	Perpetual RT1**	GBP	5.625%	Baa2	24-Mar-31	7.30%
Aviva	Perpetual RT1**	GBP	6.875%	Baa2	15-Dec-31	7.33%
Phoenix Group	Tier-2 Subdebt	GBP	7.750%	BBB+	06-Jun-33	6.79%
Pension Insurance	Tier-2 Subdebt	GBP	6.875%	BBB+	15-May-34	6.67%
Rothesay Life	Tier-2 Subdebt	GBP	7.019%	BBB+	10-Jun-34	6.62%

Source: CIMB Chief Investment Office

*Notes: *Additional Tier-1 (AT1) bonds help banks in meeting regulatory capital requirements and absorbing losses. If a bank's financial health and capital decline, these bonds can be converted into shares or written off, resulting in principal loss. **Restricted Tier-1 (RT1) bonds, while similar to AT1 bonds, are issued by insurance companies. Both AT1 and RT1 bonds are subject to risk of coupon cancellation and principal loss, typically offering higher returns to compensate investors for taking on these risks.*

Appendix

Table 3: Consensus forecasts.

Indicator	2023a	2024f	2025f	2026f
Real GDP Growth	0.1%	1.0%	1.3%	1.5%
CPI YoY	7.4%	2.6%	2.2%	2.0%
Unemployment Rate	4.0%	4.4%	4.5%	4.5%
Debt-to-GDP*	100.6%	102.5%	103.6%	103.8%
Fiscal Balance*	-5.5%	-3.9%	-3.1%	-2.9%
GBP/USD	1.27	1.31	1.31	1.30

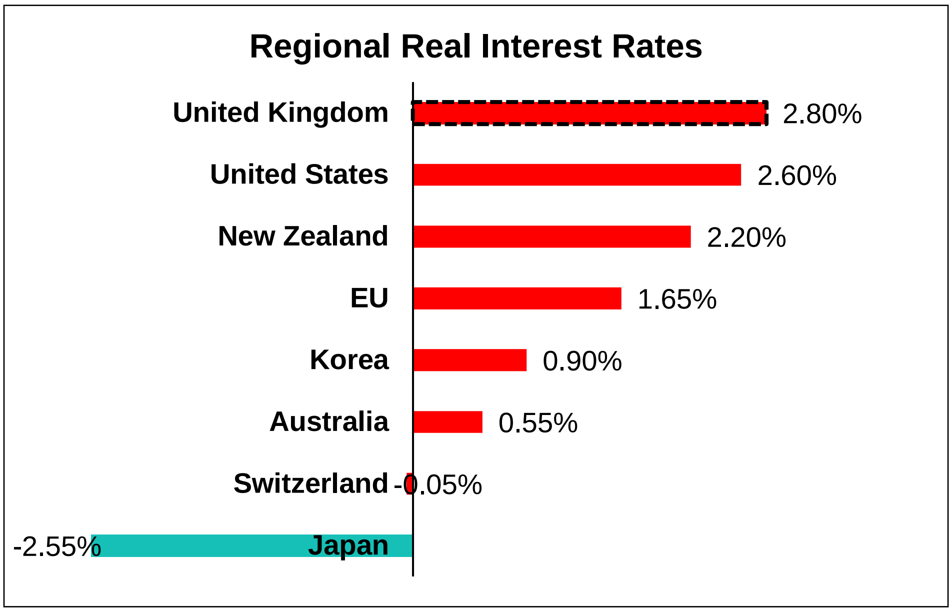
Source: Bloomberg, UK Office for Budget Responsibility
**Note: UK Office for Budget Responsibility projections.*

Table 4: Implied policy rate path by the GBP swaps market; More bullish than our prudent expectations of 4.75% by end-2024 and 4.25% by end-2025.

Policy Rate	3Q24	4Q24	1Q25	2Q25
BoE Bank Rate	4.88%	4.52%	4.20%	3.93%

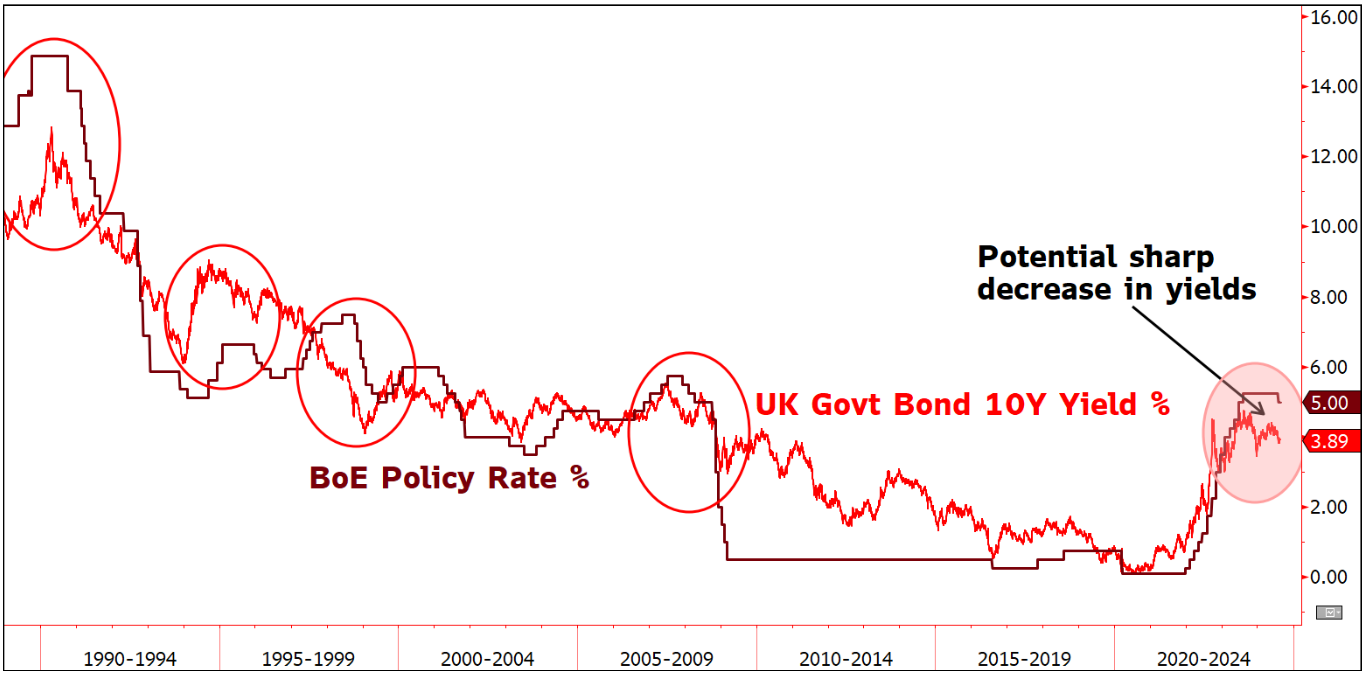
Source: Bloomberg, CIMB Chief Investment Office

Chart 8: The UK enforces one of the most restrictive monetary policy settings among developed economies.



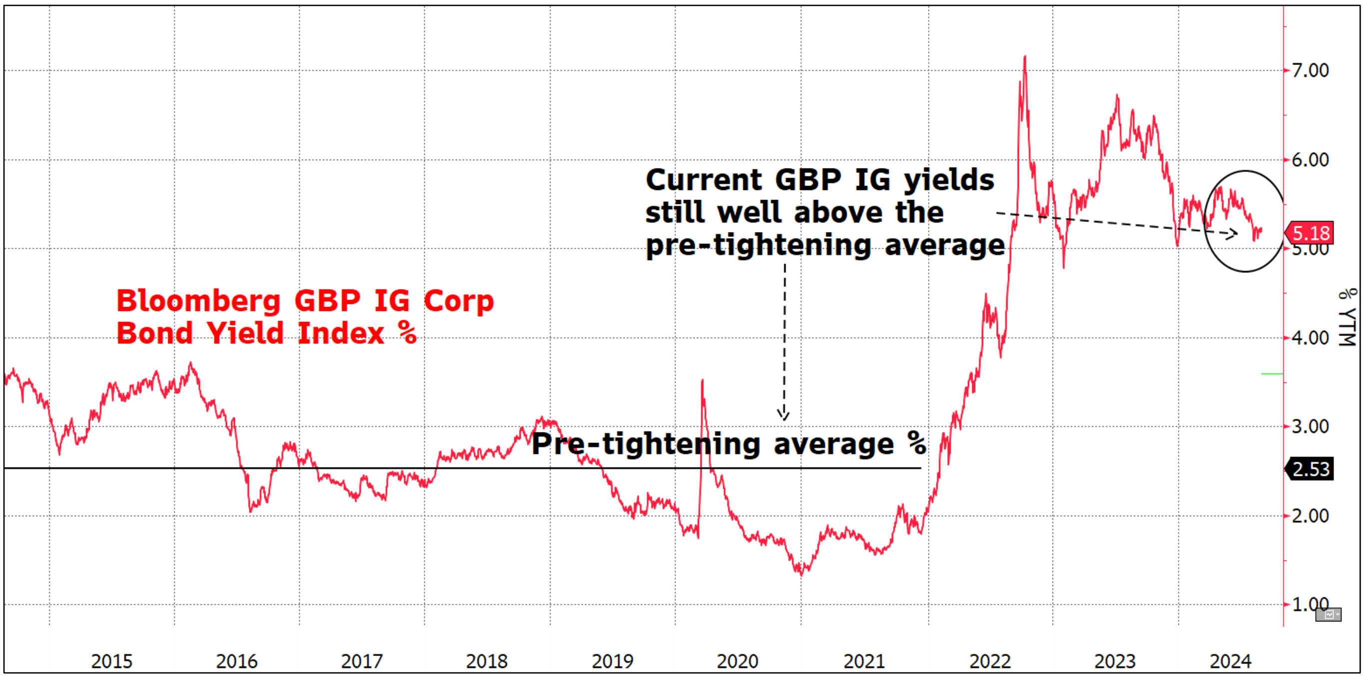
Source: Trading Economics, various national department of statistics, CIMB Chief Investment Office

Chart 9: UK Gilts have historically anticipated and moved ahead of BoE easing cycles.



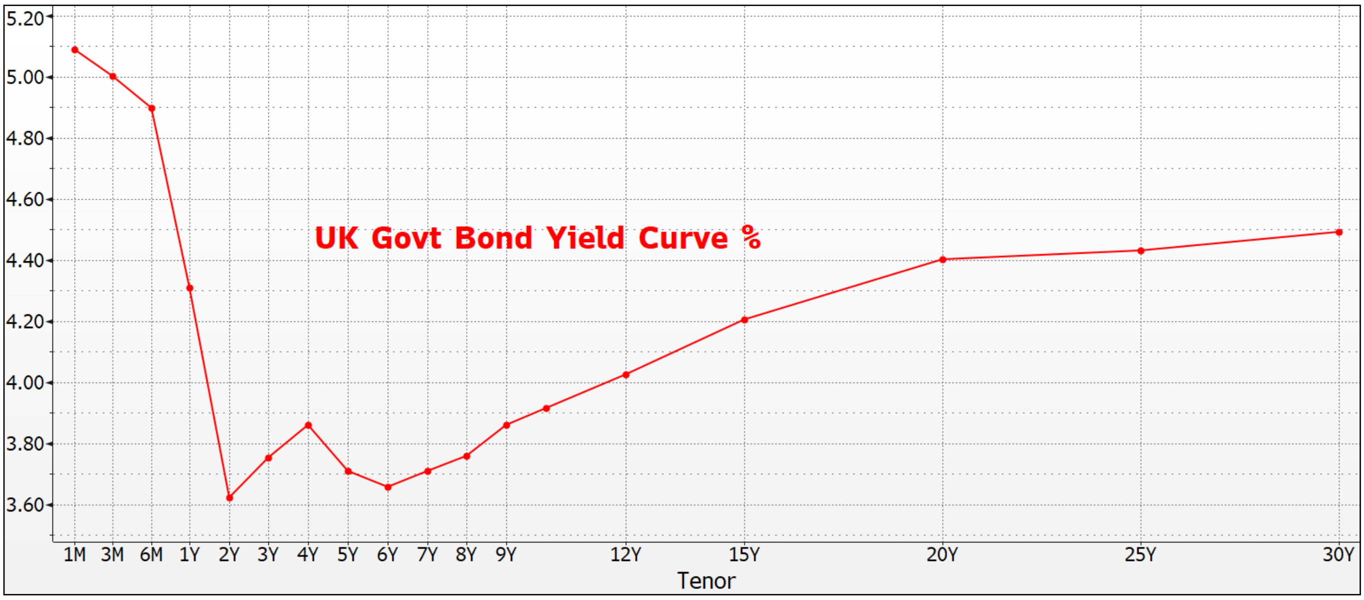
Source: Bloomberg, CIMB Chief Investment Office

Chart 10: GBP corporate bond yields have fallen from post-tightening peaks but still well above the average.



Source: Bloomberg, CIMB Chief Investment Office

Chart 11: The partially inverted UK yield curve and uncertain economic outlook favour a barbell strategy.



Source: Bloomberg, CIMB Chief Investment Office

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