

Monthly Cash Review – GBP

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Persistent UK inflation, Bank of England policy uncertainty and attractive front-end yields continue to shape opportunities for Sterling cash investors.

August offered the Bank of England the rare luxury of not having a policy meeting and therefore no immediate opportunity to be misunderstood. Unfortunately, markets remained perfectly capable of misunderstanding the outlook without assistance. The Monetary Policy Committee, the MPC, entered the month having voted 6–3 to keep the Bank Rate at 3.75%, with three members already favouring an increase to 4.00%. That was enough to preserve a hawkish bias, but not enough to establish when—or whether—the next hike would occur. In other words, policy remained unchanged while the debate surrounding policy became considerably less calm, a familiar arrangement in British public life.

Inflation improves its negotiating position

The principal difficulty was inflation. July CPI, released in August, rose to 2.9% from 2.6% in June, while core inflation held at 2.6% and services inflation eased only modestly to 3.4%. The increase was led by energy and utility costs, with household gas and electricity prices doing what household gas and electricity prices have done with remarkable consistency: creating problems for consumers, politicians and central bankers simultaneously. Inflation expectations also moved higher, leaving the Bank with little incentive to declare victory and several reasons to keep its options open.

The good news was that the labour market continued to soften. Unemployment increased (3 month rolling report) to 4.9%, vacancies declined again, private-sector regular pay growth slowed to 2.8%, and payroll employment remained under pressure. For the MPC, this reduces the immediate risk of a wage-price spiral and makes pre-emptive tightening harder to justify. The bad news is that softer employment conditions are usually considered good news only inside central banks, where the phrase “helpfully weaker labour demand” can be used without anyone being asked to leave the room.

Growth refuses to follow the script

Economic activity was more resilient than the inflation-and-employment combination might have suggested. The economy expanded 0.4% in the second quarter, down from 0.6% in the first quarter but still comfortably positive, while the August flash composite PMI rose to 52.5 from 52.2. Services activity reached a six-month high, offsetting slower manufacturing growth, although the same survey reported renewed cost pressure from fuel, transportation, food and wages. The resulting message was not especially convenient: growth was holding up, inflation pressures were rebuilding, and the labour market was weakening. Central bankers generally prefer their economic signals to arrive in matching sets. August declined to cooperate.

Consumer data were similarly mixed. Retail sales softened in July, while higher-frequency indicators pointed to stronger footfall but also a rise in direct-debit failures. The combination suggested that households were still spending, although not necessarily because financial conditions had become more comfortable. Consumers remained resilient, but resilience should not be confused with enthusiasm, particularly as higher energy bills, borrowing costs and food prices continued to compete for

discretionary spending.

Westminster returns to the bond market's calendar

Fiscal policy became increasingly important as attention turned toward the 28 October Budget. Prime Minister Andy Burnham and Chancellor John Healey reiterated their commitment to the existing fiscal rules while also promising measures covering living costs, infrastructure and regional devolution. Those objectives may all be individually defensible; financing them simultaneously is where the arithmetic develops a sense of humour. Higher inflation has already raised government expenditure, while elevated gilt yields have increased debt-servicing costs and reduced the room available for policy experimentation.

Market participants therefore spent August debating not only what the Bank might do, but how much additional debt the government might issue. A NatWest survey found a consensus expectation for less than £20 billion of additional gilt supply at the Budget, although more than one-third of respondents expected no change to the remit. The DMO continued its regular financing program during the month, including a £4 billion conventional gilt auction and a £900 million index-linked sale. Britain may change prime ministers, chancellors and economic strategies, but the gilt calendar remains reassuringly committed to turning up for work.

Gilts: The front end waits, the long end worries

The gilt curve reflected the tension between monetary policy and fiscal risk and the price moves are reflective of that tension. Two-year yields were bouncing up and down like a sugar-filled 8-year-old in a bouncy house. Two-year yields closed as low as 4.23% and as high as 4.48%. Ten-year yields travelled in a similar channel from 4.89% to 5.16%. Markets priced little chance of a September hike, but approximately one full 25-basis-point increase by December and more by February 2027. The curve's message was essentially that the Bank might wait, but bond investors would prefer not to.

Sterling funding markets remained orderly. SONIA fixed close to 3.73% late in the month, while one-, three- and six-month compounded SONIA rates remained clustered around 3.74–3.76%. That stability was valuable amid the volatility further along the gilt curve. Cash markets were not ignoring the monetary-policy debate; they were simply being paid reasonably well while everyone else continued it at greater volume.

What matters for Sterling cash investors

For Sterling cash investors, August reinforced the value of maintaining liquidity while retaining enough flexibility to use market repricing constructively. Front-end yields remained attractive, the next policy move was uncertain, and the labour market argued against aggressive tightening even as inflation argued against complacency. This is not an environment that rewards oversized directional conviction. It is an environment that favours disciplined maturity ladders, selective extension when term compensation improves, and sufficient liquidity to respond when markets abruptly change their minds. Internal portfolio guidance has consistently emphasized stewardship of liquidity, relative value and avoiding the temptation to chase yield merely because it is available.

Final thoughts

August left the Bank of England in an uncomfortable but manageable position. Inflation has risen, but wage growth and employment are moderating. Growth remains positive, but hardly exuberant. Fiscal policy may support activity, but could also increase gilt supply and keep term premiums elevated. The most likely near-term outcome remains patience, although patience should not be mistaken for

dovishness.

For Sterling cash investors, the conclusion is more straightforward. Income remains attractive, funding markets remain functional, and flexibility remains valuable. Quietly earning carry while Westminster debates the Budget, economists debate the Bank and energy markets debate the Middle East is not the worst strategy available.

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