February 2023

XPS Investment News

Bringing you our market round-up and the latest news affecting UK pension scheme investments

Month in brief

- Government borrowing in December was £27.4bn – the highest December level since records began in 1993
- The Bank of England hinted that inflation could fall rapidly in 2023 signalling "a corner has been turned"
- The US economy grew by more than expected in the final quarter of 2022 as unemployment also fell by 0.1%
- UK DB pension scheme funding was down as gilt yields dropped in January

James Stewart
Investment Consultant

Click to watch
James' February update

Government borrowing on the rise but inflation begins to ease

The cost of supporting household energy bills has driven an increase in public sector spending.

The Office for National Statistics estimates that the cost of energy bill support added £7bn to December borrowing alone. Chancellor of the Exchequer, Jeremy Hunt, has already warned that "eye watering" public spending cuts will be needed to get public finances back on track.

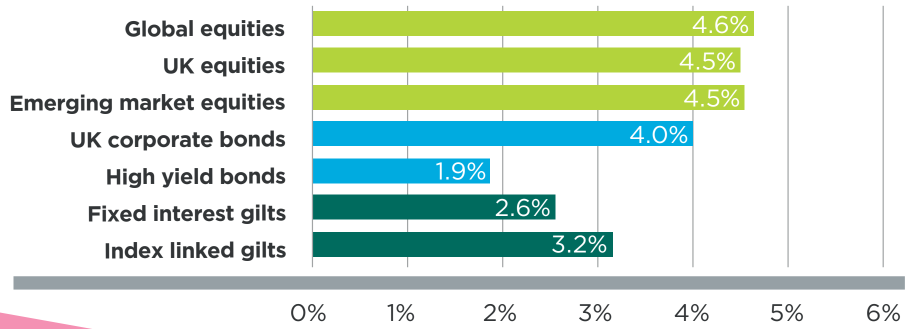
Bank of England Governor Andrew Bailey was optimistic on inflation falling over the year to come but added that the Bank was not trying to change market expectations that interest rates will peak at 4.5%. The Bank has lowered its forecast expecting that inflation will fall to 4% by the end of 2023, down from 10.5% in December 2022. Wholesale energy prices have fallen recently but Russia's continued invasion of Ukraine remains an unpredictable driver of energy costs. On 2 February, the Bank of England voted to raise the base rate by 0.5% in line with expectations.

Rising interest rates continue to bear heavy on the UK housing market as house prices fell for a fifth month in a row in January. Mortgage approvals are at their lowest level since 2009 (excluding the pandemic) with borrowing costs set to rise further.

There was unexpected economic growth in the US over the final quarter of 2022, propped up by consumer spending. Jobs growth remained strong too but there are still worrying signs that the world's largest economy is teetering on the brink of recession. Housing-related investment fell by almost 27% in the fourth quarter and business-related investment rose by just 0.7% but the Federal Reserve continues to maintain that the US economy can avoid a recession, raising rates by just 0.25% in early February – a move away from the more substantial increases seen in the second half of 2022.

Equities and bonds delivered positive performance over the month

One Month to 31 January 2023



Source: Refinitiv Datastream

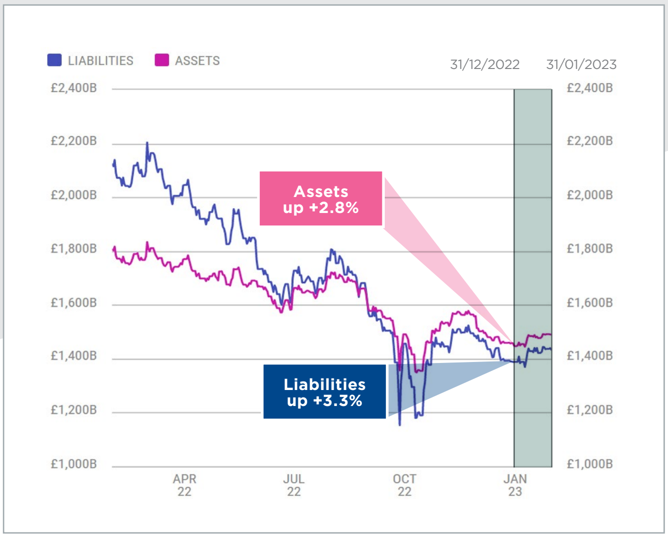
In Asia, Japanese inflation reached a 40-year high of 4% in December as the Bank of Japan came under increasing pressure to raise interest rates. The Yen weakened in the aftermath of the central bank's announcement towards the end of the month that it would not raise rates from near zero levels.

China's economic growth over 2022 was 3%, 2.5% below the government's 5.5% target as the effect of strict coronavirus regulations showed. Annual growth was at its weakest since 1976 but was still stronger than many analysts had expected. The Chinese property market also suffered over the year with house prices falling by 0.2% in December – the fifth consecutive monthly decline.

Overall, January was a strong month for equities and bonds.

Emerging market equities kept pace with global developed equities over the month and similar returns were achieved by UK shares. UK corporate bonds also fared well on the back of a slight fall in long-term inflation expectations and falling credit spreads. Spreads remain elevated however with firms expected to continue to struggle in 2023 with rising costs and falling consumer demand. High yield bonds were also up but not by as much. Falling long-term fixed and index-linked gilt yields saw both asset classes post strong returns.

Despite positive performance from growth markets, aggregate UK DB pension scheme funding was down slightly over January driven by rising long-term liabilities as yields fell. Schemes remain in surplus on a low risk position in aggregate.



Source: XPS DB:UK www.xpsgroup.com/services/xps-pensions/xps-dbuk-funding-watch

The charts above are based on data from The Pensions Regulator, the PPF 7800 Index and the XPS data pool. The assumptions used in the UK:DB long-term target basis include a discount interest rate of gilt yields plus 0.5%. The assumed asset allocation is 16.9% equities, 20.0% corporate bonds, 6.9% multi-asset, 5.1% property, 3.8% private markets and 47.3% in liability driven investment (LDI) with the LDI overlay providing a 60% hedge on inflation and interest rates.

To discuss any of the issues covered in this edition, please get in touch with James Stewart.

James Stewart
Investment Consultant

t 0121 752 6626   e james.stewart@xpsgroup.com

Alternatively, please speak to your usual XPS Investment contact.

XPS Investment