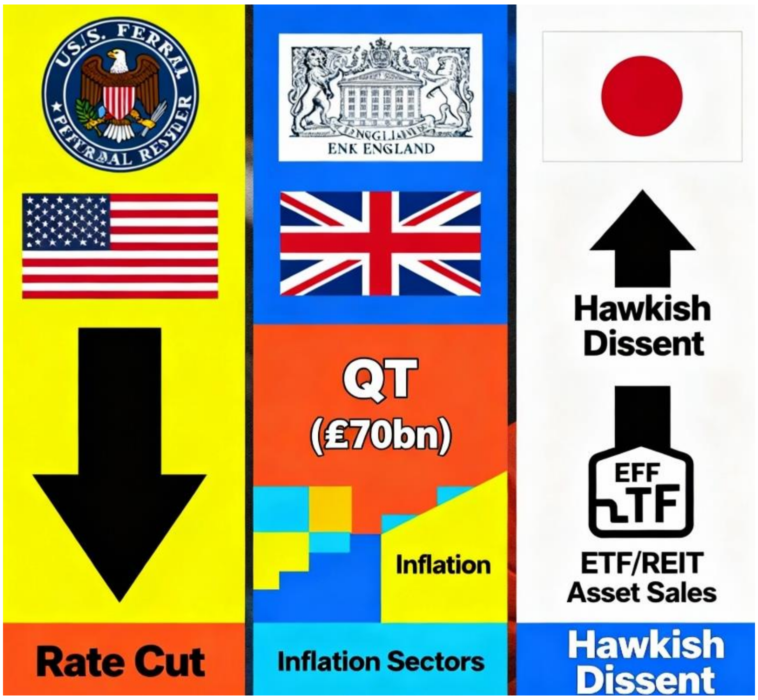
Central Bank Policy Dispersion: Stick, Twist or Fold?



This week's economic focus has been on Central Bank interest rate decisions with the US Federal Open Market Committee ("FOMC"), the UK Monetary Policy Committee ("MPC") and the Policy Board of the Bank of Japan all making their announcements this week.

The most hotly anticipated decision was that from the US, where attempts by Donald Trump to strongarm the FOMC into cutting rates has been plainly evident. Our update from 29th August (see here) set out the political shenanigans around the Trump appointment of Stephen Miran to, and attempted removal of Lisa Cook from, the FOMC.

These manoeuvres gave rise to the possibility of the FOMC not only cutting rates but going for a jumbo rate cut of 0.5% or maybe even more.

As it turned out, the FOMC voted overwhelmingly to cut the Federal Funds Rate by just 0.25%, with only Stephen Miran dissenting in favour of a larger 0.50% cut. Notably, other Trump-appointed MPC members, Michelle Bowman and Christopher Waller, supported the 0.25% cut along with the rest of the committee, demonstrating a unified stance despite earlier speculations that they might do Trump's bidding.

Nonetheless, despite the FOMC Chair, Jay Powell, effectively saying in his speech that the cut was made because the worsening jobs data outweighed the persistent threat of stubborn inflation, it is hard to believe that the decision was anything other than a bow to the intense political pressure heaped upon the committee.

This was broadly demonstrated in both the S&P 500 index, which initially rose to record highs but then experienced volatility and modest pullbacks, while both the 2-year and 10-year Treasury yields rose as expectations for further cuts were tempered and investors reassessed inflation risk.

Trump's immediate reaction to the decision was highly critical—he predictably labelled the cut "too little, too late", and renewed personal and policy pressure on the Fed for much more aggressive rate reductions. Whilst he stopped short of criticising Waller & Bowman it is impossible to see that such restraint will last for any sustained period of time.

Ahead of the Bank of England MPC rate announcement, the UK CPI data released showed annual headline inflation at 3.8% for August, unchanged from July, and still among the highest rates in the G7 nations.

Looking behind the headline rate there are a number of persistently stubborn elements of inflation as follows:

- Food inflation remains elevated at 5.1%, with price pressures seen in fresh meat, butter, and chocolate.
- Housing and Household Services, which includes energy bills and owner occupiers' housing costs, contributed a 6.0% annual rate, reflecting continued high expenses for UK households.
- Alcohol and Tobacco ticked up to 5.9%.
- Core services inflation (such as restaurants, hotels, transport, health, and communications) remains a major concern, with services at 4.9% overall and headline services inflation expected by the Bank of England to stay near 5% through year-end—driven largely by persistent wage growth and sticky labour costs.

Unsurprisingly therefore the MPC voted 7–2 to keep rates unchanged, with two members supporting a 25bps cut. Aside from the headline rate of inflation the key reasons for holding the rate unchanged were that inflation may tick higher in the short-term due to these stubborn elements, even though there is some growing evidence of underlying disinflation in other elements.

In response to the decision, the FTSE 100 Index was steady to slightly higher, while gilt yields across the curve rose modestly.

Whilst the moves at the shorter end of the curve can be attributed to the MPC expectation for stubborn inflation in the short term, the longer date yields, such as the 10-year yield, are more likely to be reflecting ongoing concerns about the fiscal pressures facing the UK.

Meanwhile in Japan the Policy Board of the Bank of Japan kept its benchmark short-term interest rate unchanged at 0.5%, citing continued uncertainty about the impact of US tariffs and domestic political risks.

The decision however was not unanimous with two board members voting for a hike, indicating a growing hawkish sentiment and signalling the possibility of a rate increase as early as October.

They also announced plans to begin selling the BoJ's holdings of Exchange Traded Funds and Japanese Real Estate Investment Trusts, marking a step toward normalising policy and reducing asset purchase support, which had previously sustained equity market valuations.

Both the rate decision and the ETF and REIT sales prompted relatively sharp moves in Japanese equities and the Yen.

The pomp and ceremony surrounding Trump's Sate Visit to the UK dominated the headlines in the mainstream media. Apart from the ego stroking and fawning however, there were some key points about trade between the US and UK.

In particular, the two countries announced over USD10 billion in new economic deals, focused on technology, civil nuclear energy, and defence collaborations, with Microsoft, Nvidia, PayPal and private equity firm, Blackstone all confirming their intention to invest in the UK.

Hopes for an agreement to eliminate tariffs on UK steel exports to the US were dashed however, with the existing 25% tariff remaining in place for now. Whilst this is a lower tariff compared to other countries, which face tariffs of up to 50%, the broader UK industry remains concerned about the indefinite suspension of a zero-tariff deal.

China reached a framework deal with the US to resolve the TikTok controversy, and extended the tariff truce for another 90 days, avoiding a major escalation in US / China tariffs — now capped at 30% on Chinese imports and 10% on US goods.

Whilst this was a welcome step forward in relations, on Wednesday a reverse step became apparent when the Cyberspace Administration of China directed major domestic technology firms, including ByteDance and Alibaba, to halt all purchases, testing, and import of Nvidia's advanced AI chips, specifically the RTX Pro 6000D and H20 processors.

This ban is part of a broader strategy to push national self-sufficiency in semiconductors and reflects a tipping point where China claims its domestic AI chips can now rival or exceed the performance of Nvidia's China-specific chips.

Meanwhile, Japan's tariff negotiator confirmed that with effect from Tuesday, US tariffs on Japanese automobiles and components were reduced to 15%, with further negotiations continuing on the so-called "most-favoured-nation status" for pharmaceuticals and semiconductors.

In return, Japan agreed a substantial $550 billion investment package into US manufacturing, with provisions to buy more US agricultural goods and commercial aircraft, and ease regulatory hurdles for US-made vehicles and equipment sold in Japan.

One final point is the eyebrow raising $5 billion investment by Nvidia in its rival, Intel.

This is billed as part of an expansive partnership to jointly develop custom data centre chips and personal computing products., with the aim of integrating Nvidia's AI and accelerated computing technology with Intel's leading Central Processing Units and Graphics Processing Units, key components in personal computers.

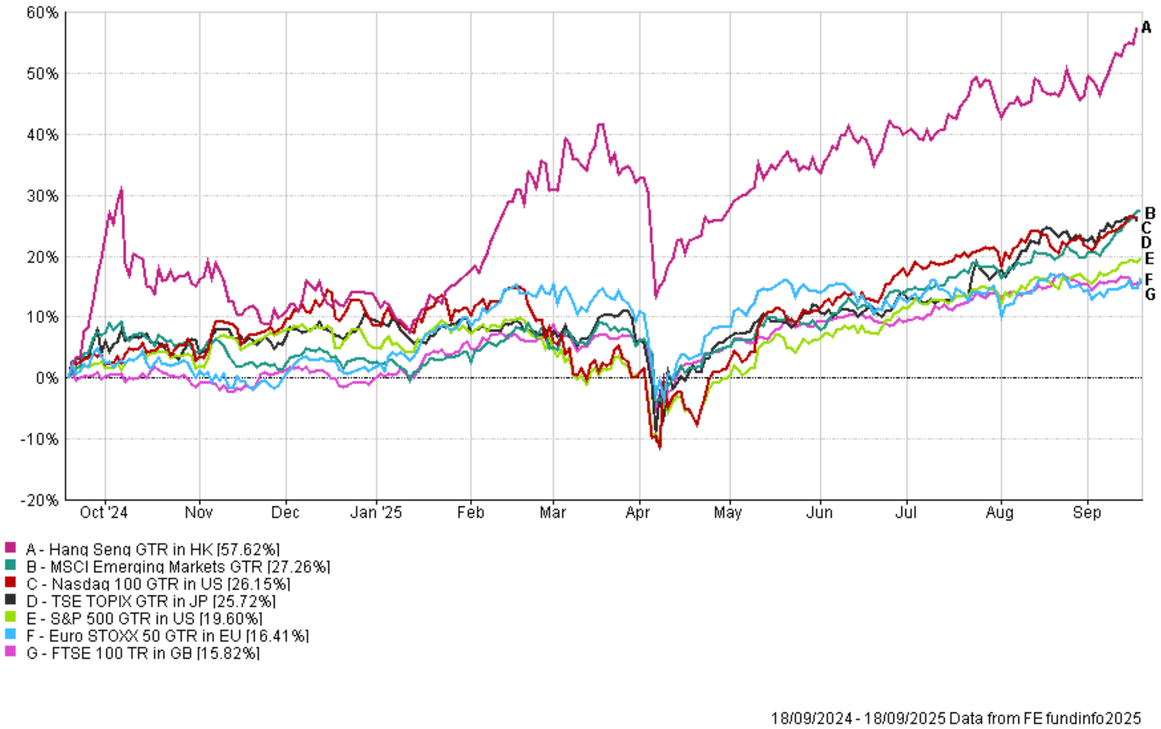
Market perception of the Nvidia / Intel deal has been overwhelmingly positive, with analysts and investors viewing the investment and chip collaboration as both a lifeline for Intel and an industry-defining move for AI and high-performance computing.

Intel's shares soared over 22%, its biggest one-day gain in decades, following the announcement, while Nvidia's shares rose about 3.5%.

On the one hand Nvidia's move may signal confidence in both Intel's future and the long-term growth of AI and PC markets, yet on the other, it does not resolve Intel's key challenge of a lack of advanced manufacturing technology, an issue that is at the root of Intel's relatively poor performance over recent years. This will undoubtedly need to be addressed if the collaboration is to ultimately prove successful.

Where are markets up to?

The rolling 12 month % cumulative returns in local currency from various indices is shown in the following chart:



Where are the portfolios up to?

The portfolio performance, net of fees, to close of business on Thursday is as follows:

	1 week	1 month	3 months	12 months
Cautious	+0.41%	+2.55%	+4.61%	+5.66%
Balanced	+0.68%	+3.22%	+6.84%	+8.23%
Adventurous	+0.80%	+3.70%	+8.02%	+9.94%

As ever, if you would like to discuss any aspect of your portfolio, please do not hesitate to contact us on service@blythefinancial.com.