

# WEEKLY ANALYSIS

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## BRITISH BONDS AND REAL ESTATE ARE IN DEMAND

GDP slump. Divided economy. Inflation remains stubborn. BOE still on hold until Q1 2026. High risk premium for bonds and securitized real estate. Potential appreciation of the pound sterling. Growing risks for the FTSE100.

### Key points



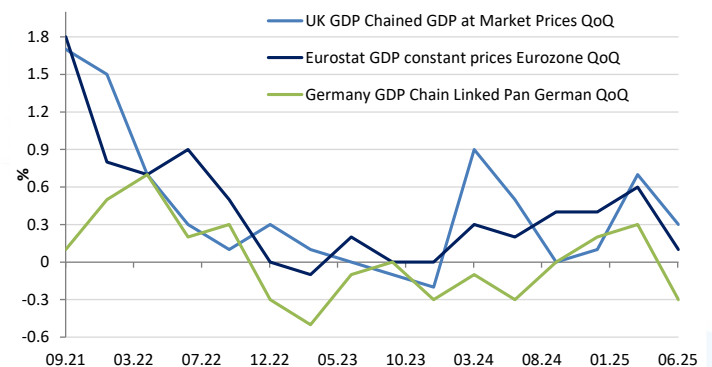
- Growth slows after a robust start to the year
- The UK economy is running out of steam
- Leading indicators point to a divided economy
- The labor market appears to be easing
- Household confidence is eroding
- Inflation is not showing sufficient signs of slowing
- The BoE remains cautious but is reducing its QT program
- The bond market offers attractive yields
- Prospects for pound appreciation
- Securitized real estate remains particularly attractive
- A cautious approach to UK equities

### Growth slows after a strong start to the year

After surprising quarterly growth of +0.7% in the first quarter of 2025, the UK economy slowed down, with gross domestic product (GDP) growth falling to +0.3% in the second quarter. Although modest in historical terms, this performance still places the United Kingdom in an intermediate position compared to the performance of its G7 peers, with growth significantly higher than that of the eurozone (+0.1%) and Germany, which contracted (-0.3%), but significantly lower than that of the United States (+0.8%). This slowdown is mainly due to a 4.0% drop in business investment, completely offsetting the previous quarter's increase, and a near-zero contribution from household consumption (+0.1%). The most recent monthly data for the start of the third quarter indicate that this moderate trend is continuing. In its latest projections, the Bank of England anticipates growth of around +0.4% for Q3, but the risks weighing on the outlook for the end of the year and for 2026 are clearly skewed to the downside. Persistent global trade tensions and slowing external demand are significant headwinds. As a result, growth forecasts for 2025 as a whole have been revised downwards by several

institutes and now range from +1.0% to +1.2%. Our forecasts remain in line with our previous analyses, suggesting growth of +1.1% for the year. The UK economy, while avoiding recession, is on a fragile growth path, facing persistent inflation and an increasingly uncertain global environment. This complex economic climate has led the Bank of England to maintain a restrictive monetary policy, creating a favorable environment for bond yields that offer positive real returns. At the same time, the real estate market is showing signs of stabilization after a period of correction, and the securitized real estate segment is confirming its appeal. Meanwhile, UK equities have reached high levels, suggesting greater selectivity and a cautious approach for the coming months. We maintain a preference for bonds and real estate.

Quarterly GDP growth - United Kingdom



Sources: Bloomberg, BBGI Group SA

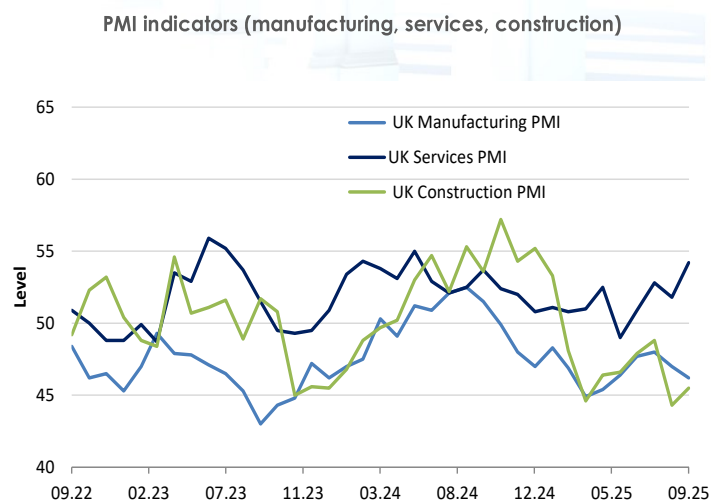
### The British economy is set to run out of steam

The British economy enters the final quarter of 2025 in a state of near stagnation, oscillating between signs of resilience and persistent headwinds. Data from July to September paint a picture of sluggish growth, stubborn inflation, and a labor market showing signs of cooling, pointing to a subdued outlook for the end of the year, with a possible contraction in household consumption.

Recent statistics paint a mixed but not very reassuring picture. On the positive side, the service sector, the cornerstone of the economy, has maintained slight growth, and the unemployment rate, although up slightly to 4.7% according to the latest published data, remains historically low. In addition, wage growth, although slowing, continues to support household purchasing power, which is not being used to increase consumption. On the other hand, the negative indicators are notable. GDP growth stagnated in July after a more robust performance in the second quarter. Inflation, at +3.8% in July and August, remains well above the Bank of England's target, eroding household and business confidence. The industrial production sector declined, and the trade deficit widened, highlighting the difficulties in exports in the tense international context and despite the agreement reached with the United States, which is less restrictive than for European Union countries. The main strength of the British economy lies in the vigor of its services sector, particularly financial and technological services. A robust business investment environment at the start of the year is also an asset. However, structural weaknesses are weighing on overall performance. Persistently low productivity, heavy dependence on imports, and significant regional economic disparities are holding back a more vigorous and widespread recovery. The main risk for the final quarter remains inflation, which could force the BoE to maintain restrictive monetary policy for longer than expected, weighing on investment and consumption. Global geopolitical uncertainties and volatile energy prices also pose significant threats. Nevertheless, opportunities exist. A faster-than-expected deceleration in inflation could boost purchasing power and stimulate domestic demand. In addition, targeted investments in growth sectors such as green technologies and artificial intelligence could lay the foundations for stronger and more sustainable future growth.

### Leading indicators show a divided economy

The latest purchasing managers' index (PMI) surveys for September continue to paint a picture of a divided economy. The service sector remains the main pillar of economic activity, with a PMI index of 54.2 in August, a level indicating robust expansion.



Sources: Bloomberg, BGGI Group SA

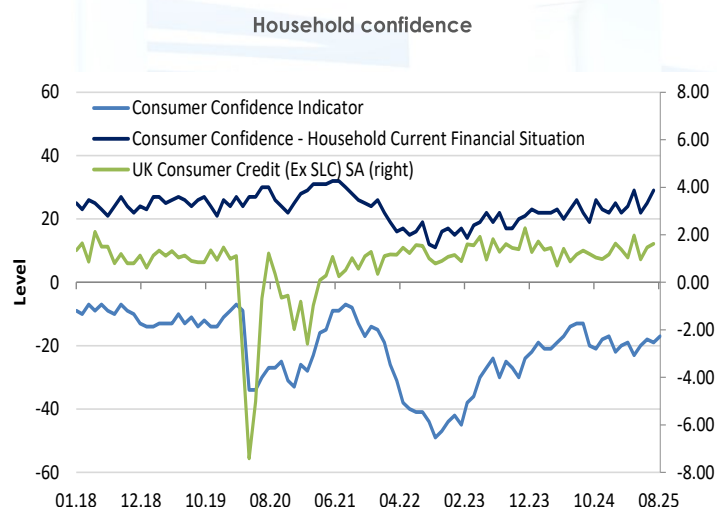
Consumer demand for leisure, travel, and hospitality services remained strong. In contrast, the manufacturing sector remains mired in contraction, with the PMI index at 47.0, its lowest level in several months. The sub-indices for new orders and production are particularly weak, penalized by falling domestic and foreign demand, as well as persistently high energy and raw material costs. The construction sector is also showing signs of weakness, particularly in the residential segment. This pronounced sectoral divergence is a source of concern, as it suggests unbalanced and unsustainable growth, with the weakness of the manufacturing sector likely to weigh on employment and investment in the long term.

### The job market seems to be easing up.

The labor market, which has shown remarkable resilience, is beginning to show signs of easing, a process that the Bank of England considers necessary to control inflation. The unemployment rate rose slightly to 4.7% for the three months ending in July 2025. At the same time, the number of job vacancies, although still high from a historical perspective, continued to decline, indicating easing market tension. Wage growth, a key indicator for the central bank, also began to moderate. Annual average wage growth (excluding bonuses) stood at +4.8% for the period from May to July, down from the peaks seen earlier in the year. However, with inflation at 3.8%, real purchasing power growth is only +1.0%, which explains the continued pressure on household finances. This gradual slowdown is essential to curb services inflation, but if it accelerates, it could weigh heavily on consumption and overall growth.

### Household confidence is eroding

Household confidence eroded in September, reflecting growing concerns about the cost of living and the economic future. The consumer confidence index fell to -19, but unsurprisingly remains close to the low levels recorded since the beginning of the year. It is estimated that the outlook for the general economic situation and personal finances over the next twelve months has deteriorated the most. This gloomy mood is already translating into greater caution in spending. The latest retail sales figures for August showed stagnation, with a notable decline in purchases of non-essential goods.



Sources: Bloomberg, BGGI Group SA



Households are facing a "scissor effect": real wages are rising modestly on the one hand, while fixed costs (mortgages, energy, food) remain high on the other. Anticipation of the fall budget announcements, which could contain austerity measures, adds a layer of uncertainty that is weighing on purchasing intentions. We believe this factor will become increasingly important during the winter and expect private consumption to stagnate or even decline in the coming months. The loss of consumer confidence could also affect business investment and curb spending. These key factors do not bode well for GDP prospects in the coming months.

### Inflation shows insufficient signs of slowing down

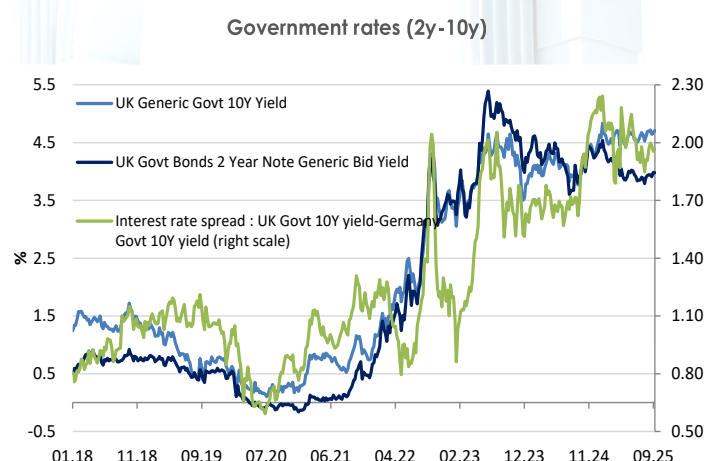
Inflation remains a thorn in the side of the British economy. The consumer price index (CPI) remained at +3.8% year-on-year in August 2025, stable compared to July and nearly twice the Bank of England's target of +2%. While energy prices have contributed to the moderation compared to last year's peaks, food inflation remains particularly high and weighs heavily on low-income households. More worrying for the central bank, measures of core inflation, which exclude volatile items, show persistent domestic pressures. Core inflation has fallen slightly to +3.6%, but inflation in the services sector has only slowed to +4.7%. The latter is directly fueled by wage growth and strong domestic demand, making it more persistent and difficult to curb. The BoE expects inflation to continue to fall slowly, but the path to the +2% target is still long and subject to upside risks, including a further surge in global energy prices.

### The BoE remains cautious but reduces its QT program

Against this backdrop of inflation that unfortunately remains relatively stubborn, the Bank of England's Monetary Policy Committee (MPC) logically decided, by a vote of 7 to 2, to keep its key interest rate at 4.0% at its September meeting. The decision was not unanimous: the two dissenting members voted for a 25 basis point cut, arguing that monetary policy was already sufficiently restrictive to weigh on the economy. However, the majority felt that it was premature to lower its guard in an uncertain international environment. The Central Bank's message is nevertheless nuanced. While the current pause after five cuts since the summer of 2024 this does not necessarily mean the end of the monetary tightening cycle, with the door remaining open to further increases if inflation data, particularly wages and service prices, do not show more convincing signs of moderation. Nor does it rule out easing its policy, in particular by modifying its strategy of reducing the size of its balance sheet. At the same time, the MPC announced a slowdown in its quantitative tightening (QT) program, from £100 billion to £70 billion for the coming year, focusing on short maturities so as not to disrupt the long-term interest rate market. This technical decision aims to reduce disruption in the bond market, but should not be interpreted as an overall easing of monetary policy. The markets are now only anticipating a first rate cut in the second quarter of 2026.

### The bond market offers attractive yields

In this environment, where key interest rates are expected to remain high for an extended period, the UK bond market continues to offer attractive value. The yield on 10-year government bonds (Gilts) is trading at around 4.6%, representing a real yield (after inflation) of around 80 basis points. The yield curve has remained virtually flat, with the two-year yield very close to this level, reflecting market expectations of restrictive monetary policy in the short term. The BoE's decision to focus its government bond sales on the short end of the yield curve will have a positive effect on longer-dated bonds. Compared to other sovereign debt, Gilts offer an attractive premium. The yield spread with the 10-year German Bund remains significant, at nearly 200 basis points. This risk premium, combined with the strength of UK sovereign credit, makes UK government bonds particularly attractive to investors seeking stable income and diversification. They offer not only protection against inflation, but also potential for capital appreciation when the Bank of England begins its cycle of rate cuts.



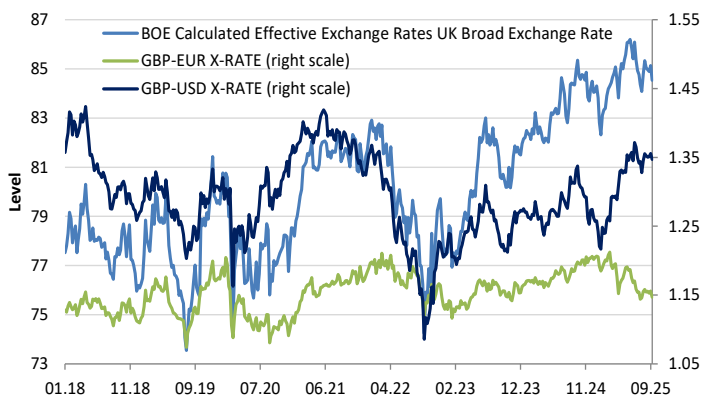
Sources: Bloomberg, BBGI Group SA

### Prospects for appreciation of the pound

The pound sterling has experienced mixed fortunes recently. Against the US dollar, it reached the top of our target range (1.25-1.35), stabilizing around 1.355. This equilibrium reflects more synchronized monetary policies between the BoE and the Federal Reserve until the latter's latest decision to cut its key rates again in September. This synchronization had helped to limit short-term volatility in the USD/GBP pair. However, the expected new path for US key rates, suggesting two more cuts before the end of the year, will not be followed by the Bank of England, which is not expected to take action before the end of the first quarter of 2026. The pound sterling could therefore resume a positive trend against the dollar in the coming months and appreciate by around +5%.

However, performance against the euro has been disappointing. The GBP/EUR exchange rate is around 1.15, below our expectations. This relative weakness could be explained by fears of a more pronounced slowdown in the UK economy compared to the eurozone, which, although fragile, is showing signs of stabilization. Nevertheless, we anticipate a rebound and appreciation of the pound, which could reach our target of 1.18 against the euro.

### Pound effective exchange rates



Sources: Bloomberg, BBGI Group SA

The situation is even more complex with regard to the Swiss franc. Despite an interest rate differential of nearly 400 basis points, the GBP/CHF rate fell to 1.07. The franc's status as a safe haven in a context of geopolitical tensions and global economic uncertainty has outweighed the appeal of yield, temporarily invalidating our scenario of a pound appreciation against the franc. A constructive approach to the future evolution of the British currency seems justified by favorable interest rate differentials and economic resilience that is currently superior to that observed in Europe and Switzerland.

### Securitized real estate remains particularly attractive

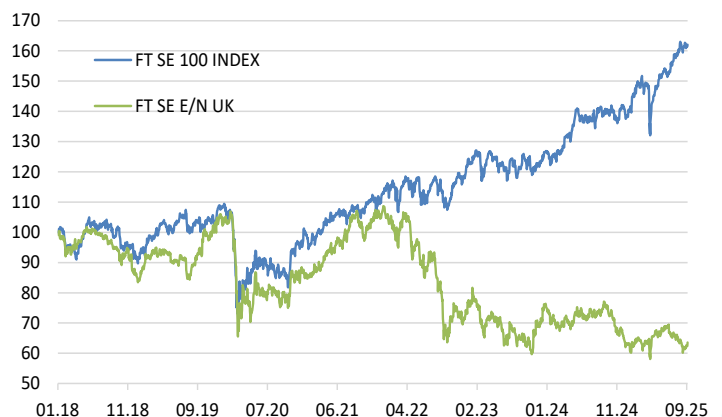
The UK real estate market continues to show signs of stabilization. Annual house price growth stood at +2.8% in July, but transaction volumes remain low and lending conditions have tightened. The commercial market is highly polarized: the logistics and industrial sector remains in high demand, while the office sector, particularly lower-quality assets, is suffering from the widespread adoption of remote working. Against this backdrop, real estate investment trusts (REITs) have posted solid performances since the beginning of the year. Although rising interest rates are increasing their financing costs, the best companies in the sector benefit from strong balance sheets and high-quality asset portfolios, generating stable, inflation-indexed rental income streams. A major opportunity lies in the significant discount to net asset value (NAV), which remains substantial for many REITs. This discount, combined with attractive dividend yields (often above 5% net), offers medium-term appreciation potential, which will materialize as market and financing conditions improve.

The price/net asset ratio of 64% represents a particularly attractive discount for an exceptional stock market return of +7.2%. It is true that competition from high interest rates remains significant and does not encourage investors to take on additional risk for a given yield differential, but the medium-term outlook is particularly attractive and should support growing investor interest in UK securitized real estate.

### Cautious approach to UK equities

The FTSE 100 index has performed extremely well since June, climbing to around 9,200 points, not far from its historic highs. This rise was mainly driven by large international stocks in the energy, commodities, and pharmaceutical sectors, which benefited from the slight weakness of the pound sterling and, in particular, stronger global demand. However, at these levels, we believe the potential for further upside is limited. Although the index's valuation, with a price/earnings (P/E) ratio of around 13.5x for 2026, remains lower than that of the US market (S&P 500), it is no longer as obviously cheap as it was before. Above all, the UK market lacks strong domestic catalysts, with the economy expected to experience weak growth. The FTSE 100's heavy exposure to the global economy also makes it vulnerable to a slowdown in growth in China or the US. Therefore, we recommend a cautious approach and suggest not overweighting UK equities, whose future performance will depend more on global economic conditions than on domestic dynamics.

### UK equities and securitized real estate



Sources: Bloomberg, BBGI Group SA

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