BANK OF ENGLAND HOLDS FIRM AS ECONOMY SLOWS

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The Bank of England's (BoE) Monetary Policy Committee (MPC) kept interest rates at 5.25% on Thursday 21st September as the economy slows.

The decision was approved by a majority of five to four, with four members supporting a 0.25% increase to 5.5%, and sent the pound to its lowest level against the dollar in 6 months, due to investors expecting further rate rises. The pause in the hiking cycle comes after fourteen consecutive rises from 0.1% in December 2021 and remains the highest rate in 15 years. Swap markets still suggest a roughly 70% chance of a final 25bps increase before next March. The committee voted unanimously to reduce the stock of UK government bond purchases over the next year by £100 billion, greater than the £80 billion reduction over the past year.

The latest UK inflation data for the twelve months to August surprised to the upside, coming in lower than economists' predictions at 6.7%, down from 6.8% in July. Most economists expected inflation to rise slightly due to an increase in the cost of petrol and diesel, however a reduction in the cost of certain food items like milk, cheese, and vegetables as well as hotel prices and airfares offset that rise. Inflation is expected to continue falling, with the next Ofgem price cap coming into force from 1st October, when energy bills will see a c.7% reduction, falling below £2,000 a year. In the BoE's latest Market Participants Survey, the expectation is that inflation will return to the 2% target by Q2 2025.

The UK economy contracted more than expected in July with GDP estimated to have fallen by 0.5%, offsetting the growth of 0.5% seen in June. The drag on the economy for July was largely attributed to a fall in the services sector from strike action and a fall in retail sales over the summer, considered to be due to poor weather conditions. Taking a broader view, GDP increased by 0.2% in the three months to July, however growth is predicted to be weaker than previously thought with GDP growth forecast at 0.4% in 2023 and 0.3% in 2024.

With the weaker economic backdrop and inflation falling, albeit still slowly, swap rates have been tightening from the June highs. As a result, we are beginning to see lenders reducing their mortgage rates. For an average 75% LTV mortgage, high street lenders are now offering two-year fixed rate products from 5.48% and five-year fixed rate products from 4.99%, the lowest rates we have seen since June of this year when they increased dramatically.

The UK labour market has started to show signs of weakening, with unemployment rising to 4.3% in the three months to July. The number of people unemployed and the number of vacancies have both been falling, with the latter decreasing for the 14th consecutive period. Wages, however, have continued to grow and have outstripped inflation for the first time in two years. Growth in regular pay, not including bonuses, was up by 7.8% in the three months to July, the highest growth rate since comparable records began in 2001.

	Forecast in rates					
Effective Rate	**1mth time**	**3mth time**	**6mth time**	**12mth time**	**2yrs time**	**3yrs time**
Bank of England Base Rate*	5.25%	5.33%	5.37%	4.91%	4.13%	3.90%
2yr Fixed Rate**	4.96%	4.86%	4.71%	4.42%	4.02%	3.84%
3yr Fixed Rate**	4.68%	4.60%	4.48%	4.24%	3.94%	3.79%
5yr Fixed Rate**	4.34%	4.29%	4.20%	4.04%	3.84%	3.76%
10yr Fixed Rate**	4.05%	4.03%	4.00%	3.93%	3.86%	3.84%

* Using OIS Curve **Based on the swap curve

The two-year swap rate is expected to slowly decline over the next three years, with three- and five-year swap rates predicted to follow the same pattern. All are falling at a far slower pace than previously thought. The curve has flattened slightly with the ten-year swap rate anticipated to stay relatively flat over the next year, decreasing by 21bps over the next three years.

UK Securitisation Market

The UK securitisation market re-opened at the start of September with a flurry of new deals post the summer break, with three transactions from Prime issuers, three from the specialist market, and two legacy deals. The syndication process saw the specialist lenders de-risk a large portion of their AAA before announcing their transactions publicly to provide transaction certainty. The key concerns of market participants continue to be the potential for deterioration of credit performance and higher than anticipated prepayments.

This year so far, there has been just over £13.5 billion of UK RMBS paper placed into the market compared to approximately £20.5 billion at this time last year, although c.£12 billion of that was legacy paper.

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