BANK RATE JUMPS 50BPS AS INFLATION HOLDS FIRM

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The Bank of England's (BoE) Monetary Policy Committee (MPC) raised interest rates by 0.5% to 5% on Thursday 22nd June.

This was a higher increase than expected by most economists, which exposed a lack of understanding among markets of the BoE's outlook. The decision was approved by a majority of seven to two, with the minority, in stark contrast, preferring to maintain the rate at 4.5%. The MPC said that further rate rises could be necessary to bring inflation back under control.

This is the 13th consecutive hike to the base rate, which has risen from 0.1% in December 2021, and is the highest rate in 15 years. Due to persistent high inflation, the market is pricing in further hikes this year, with a likely 25bps-hike in August and a projected terminal rate of 5.75% in November, up from 5% previously. Nevertheless, further data surprises on inflation could lead to another 50bps hike in August.

The latest UK inflation data for the 12 months to May was flat from the April print at 8.7%, with overall inflation falling at a far slower rate than anticipated. Services inflation jumped 0.5% in May to 7.4% with airfares and package holidays contributing to the increase. Core goods price inflation was much stronger than anticipated, although this is expected to decrease as supply chain costs fall over the course of the year. Similarly, food price inflation has started to decline and is expected to drop further in Q2 of this year. Wage inflation and a tight labour market are also having a significant impact on the results.

In the MPC's latest Market Participants Survey, predictions are that inflation will decline to just over 2.2% in three years' time.

UK GDP for Q2 of this year is expected to be moderately stronger than previously predicted, following a slightly weaker than anticipated Q1 result, with current estimates expecting growth of 0.1%. Taking a broader view, UK GDP is predicted to increase around 0.25% in 2023.

Due to the sharp rise in rates, new mortgage rates have rocketed with high street lenders offering an average 75% LTV, two-year fixed rate product from 5.6%, and similar five-year fixed product from 5.1% (all rates are dependent on LTV and product fees). Due to the latest hike from the BoE, we expect these rates to increase further.

The UK labour market continues to be very tight, with the unemployment rate remaining broadly flat at 3.8% in the three months to April. The number of people in employment increased to a record high in the latest quarter with increases in both the number of employees and self-employed workers. Labour demand has continued to ease with the number of vacancies falling over the quarter for the eleventh consecutive period. Growth in regular pay, not including bonuses, was up by 7.2% in the three months to April. Although this is a 1.3% decline once adjusted for inflation, it is the largest growth rate seen outside of the coronavirus pandemic.

	Forecast in rates					
Effective Rate	**1mth time**	**3mth time**	**6mth time**	**12mth time**	**2yrs time**	**3yrs time**
Bank of England Base Rate*	5.00%	5.53%	5.91%	5.69%	4.76%	4.25%
2yr Fixed Rate**	5.55%	5.53%	5.41%	5.12%	4.50%	4.06%
3yr Fixed Rate**	5.28%	5.23%	5.11%	4.83%	4.29%	3.91%
5yr Fixed Rate**	4.78%	4.73%	4.63%	4.40%	4.00%	3.74%
10yr Fixed Rate**	4.15%	4.13%	4.08%	3.96%	3.78%	3.67%

* 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 steepened slightly with the ten-year swap rate anticipated to stay relatively flat over the next year, decreasing by 48bps over the next three years.

UK Securitisation Market

The UK securitisation market has been quieter over the last few weeks in the lead up to the Global ABS conference, with the majority of the market attending last week. The conference was the busiest yet with over 5,000 market participants attending. The key concern of market participants is the potential for deterioration of credit performance. On the back of the positive general mood of the conference, two transactions decided to access the market this week, an owner-occupied only first lien transaction from Paratus (Foundation Home Loans) and a mixed owner-occupied & buy to let transaction of first lien loans from Together.

This year so far, there has been just over £8 billion of UK RMBS paper placed into the market compared to approximately £16 billion at this time last year, although c.£10 billion of that was legacy paper. Due to wider market spreads, we have seen more prime issuances than specialist so far this year and only 40% of the specialist volumes we saw at this time last year.

This article was originally published on https://www.mortgagesolutions.co.uk on 27/06/2023

K M ART 0048 JUL23