BANK HOLDS RATE AT FIFTEEN-YEAR HIGH

ALEX MADDOX • CAPITAL MARKETS DIRECTOR

The Bank of England's (BoE) Monetary Policy Committee (MPC) kept interest rates at 5.25% on Thursday, 14th December, as the economy continues to slow.

The decision was approved by a majority of six to three, with the dissenting members supporting a 0.25% increase to 5.5%. This is the third pause in the BoE's hiking cycle and comes after fourteen consecutive rises from 0.1% in December 2021. The Bank's current rate remains its highest in fifteen years. The BoE maintained their cautious stance and tightening bias, with markets not anticipating any cuts to the base rate until at least May next year, contrasting sharply with the Federal Reserve opening the door to interest rate cuts in the new year. Sterling rose against the dollar following the announcement.

The latest UK inflation data for the twelve months to October reported a fall to 4.6%, largely attributed to declining energy prices, where the annual rate was the lowest since records began in 1950. The second largest downward contribution was from food and non-alcoholic beverages, which reached their lowest rate since June last year. Core prices, however, were up 0.1% month-on-month (MoM) and services inflation fell more softly than expected at -0.3% MoM. Inflation is anticipated to fall more modestly in the November release, with market participants estimating a 0.2% decline. In the BoE's modal projection, inflation is expected to return to the 2% target by the end of 2025.

UK GDP was flat in Q3 of this year, although MoM saw a fall of 0.3% in October, with services, production, and the construction sector all experiencing a drop in output. GDP is now expected to remain flat in Q4 rather than the slight growth of 0.1% previously anticipated. Based on the latest surveys of bank staff, GDP is expected to see growth of c.0.25% in 2024, weaker than previous predictions.

With inflation falling and the BoE rate believed to have reached the peak of the hiking cycle, swap rates have continued to tighten. As a result, we are seeing lenders reducing their mortgage rates more regularly. For an average 75% LTV mortgage, high street lenders are now offering two-year fixed rate products from 4.77% and five-year fixed rate products from 4.58%, the lowest rates we have seen since May of this year when they increased dramatically.

The UK labour market continues to show signs of weakening, with the number of vacancies decreasing on the quarter for the 17th consecutive period, the longest continuous decline ever recorded. Growth in regular pay, not including bonuses, was up by 7.3% in the three months to October, a fall from the recent highs we have seen. Unemployment, however, was largely unchanged on the quarter at 4.2%.

	Forecast in rates					
Effective Rate	**1mth time**	**3mth time**	**6mth time**	**12mth time**	**2yrs time**	**3yrs time**
Bank of England Base Rate*	5.25%	5.14%	4.84%	3.91%	3.34%	3.21%
2yr Fixed Rate**	4.20%	4.05%	3.83%	3.53%	3.27%	3.18%
3yr Fixed Rate**	3.91%	3.80%	3.65%	3.42%	3.23%	3.18%
5yr Fixed Rate**	3.62%	3.55%	3.46%	3.32%	3.22%	3.22%
10yr Fixed Rate**	3.49%	3.47%	3.43%	3.39%	3.38%	3.42%

* Using OIS Curve **Based on the swap curve

The two-year swap rate is expected to fall far more quickly than previously expected, by just over 100bps over the next three years, with the curve flattening. The three- and five-year swap rates are predicted to fall at a slower rate and stabilise at around 3.2%. This suggests that the market believes rates will stabilise for an extended period. The ten-year swap rate is expected to stay very flat over the next year, decreasing by only 7bps over the next three years.

UK Securitisation Market

The UK securitisation market finished the year busier than usual throughout November with eight transactions pricing from four specialist lenders, two Prime lenders, a legacy transaction, and one from Kensington's own programme, Gemgarto 2023-1. The transactions all experienced strong engagement from investors especially in the mezzanine tranches with significant tightening from IPTs and good coverage levels.

Kensington's Gemgarto 2023-1 transaction, consisting of owner occupied, high-LTV loans, was the first transaction from the issuer in over two years. The reception from markets was strong from the beginning of the process, across all offered tranches, resulting in high coverage levels for the Class B to E notes, respectively 5.1x, 6.8x, 5.0x, and 2.9x oversubscribed at IPTs. Coverage reached on average 4.3x at final terms, and pricing tightened on average by 40bps from IPTs. The final levels across mezzanine notes ended up inside all recent UK RMBS mezzanine notes placed by UK issuers this year.

In 2023, there has been just over £16.5 billion of UK RMBS paper placed into the market compared to approximately £22 billion at this time last year, although c.£12 billion of that was legacy paper.

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