

# GBP Rates Report

Andrew Benito

2025-09-04

## Table of contents

<b>Market developments</b>	<b>2</b>
Latest developments: the past three months . . . . .	2
Spreads . . . . .	3
<b>Evolving market pricing and OIS curves</b>	<b>6</b>
<b>International spillovers in sovereign bond markets</b>	<b>8</b>
<b>Fiscal risks</b>	<b>8</b>
The (international) risk of fiscal fatigue . . . . .	8
Macro and fiscal news at UK fiscal events . . . . .	9
<b>Market reactions and macro news at recent BoE policy events</b>	<b>9</b>
Analysing monetary policy shocks . . . . .	9
<b>Evolving macro forecasts and macro news</b>	<b>9</b>
Evolving inflation forecasts . . . . .	11
<b>MPC Voting: increased disagreement</b>	<b>11</b>
<b>Views</b>	<b>13</b>

## Market developments

### Latest developments: the past three months

Summarising some key developments in Sterling markets in the past 3 months:

- **OIS rates** have seen a 'round-trip', rallying in June by 25bp and subsequently reversing that move.
- **Sterling** strengthened against the US Dollar in June (while OIS rallied), and then reversed that (as OIS rates sold-off).
- **Gilt yields** rallied (by less than OIS) in June, and that decline has been more than reversed since then and especially at the long-end. 25y Gilt yields end the period a full 40bp higher.
- **Equities** rallied strongly by a cumulative 5% over the period, and concentrated in the period from July to mid-August.

This pattern points to greater fiscal risks creeping into market pricing, especially in the past 2 months. While fiscal slippage boosts aggregate demand directly, some crowding-out from these interest rate responses should also be expected. Fewer rate cuts have been priced in the past month to take place over the next year, and this has tended to weigh on Equity prices. Internationally, these interest rate effects appear to have emanated from the US and UK more than from Japan or Germany.

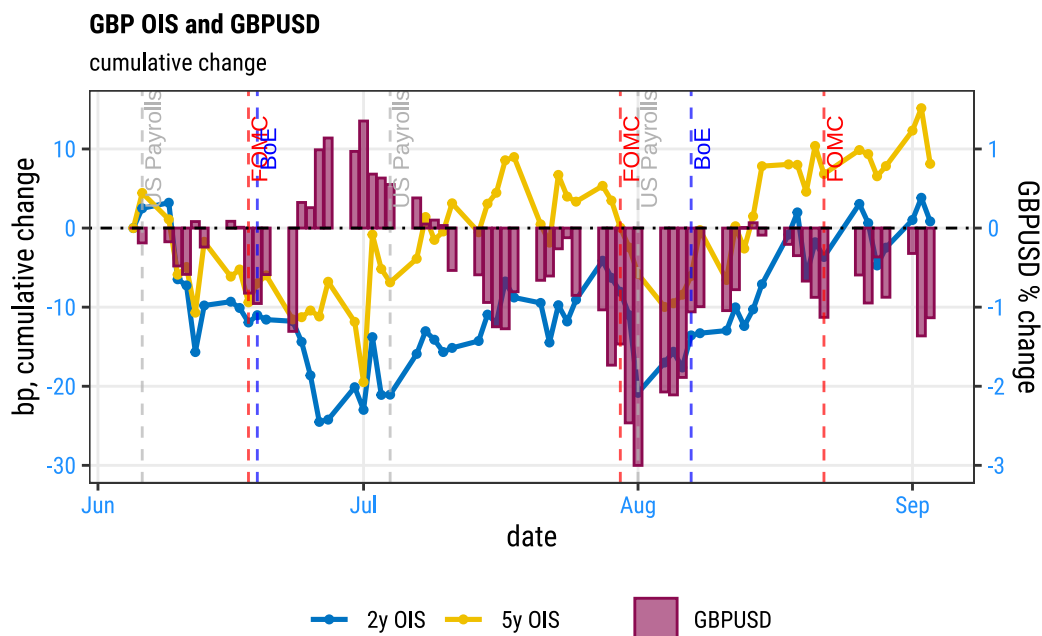


Figure 1: OIS and Sterling

## Spreads

**Term spreads** Setting some historical context for the recent spread of 10y Gilt yields relative to 2y Gilts yields is Figure 3. This shows how a term spread has been restored relative to different periods over the past 10 years and can distinguish several phases over that period.

The 10s25s term spread has widened in recent weeks, and by more than the 2s5s and 5s10s spreads (Figure 4).

**Swap spreads** shed light on potential effects from bond supply in different markets. Swap spreads have moved more deeply negative in recent weeks and by more in the UK than in the US or Germany.

Fiscal developments have likely played a role in the rise in term spreads and widening of swap spreads. @fig\_swsp shows 5y swap spreads (see here for a discussion).

[contribution from OIS and bond yields to changes in swap spreads in UK, US, GER since 2022-01-01]

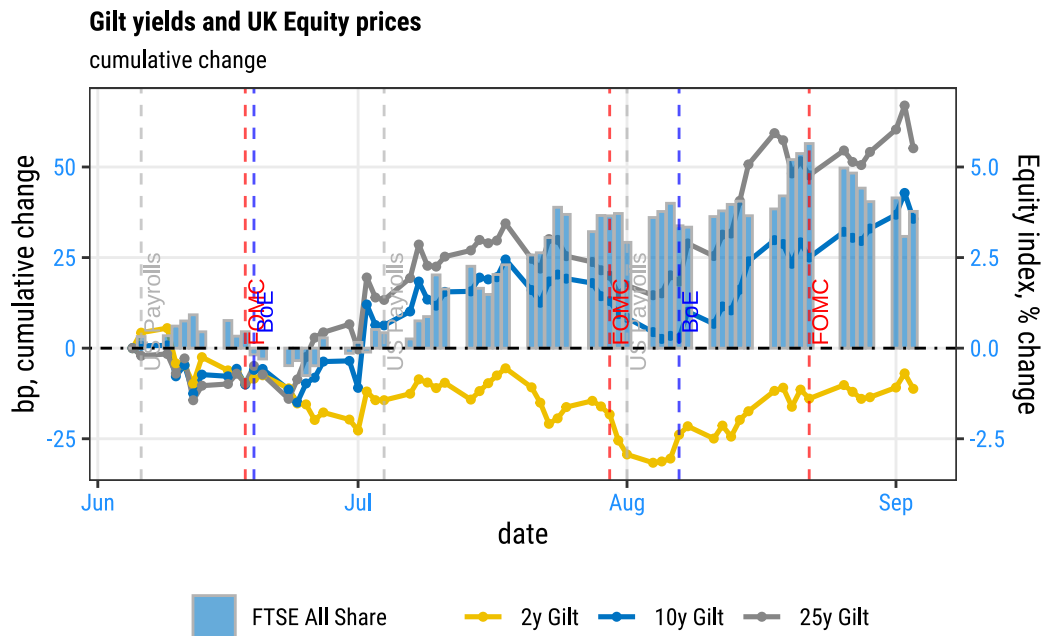


Figure 2: Gilts and Equities

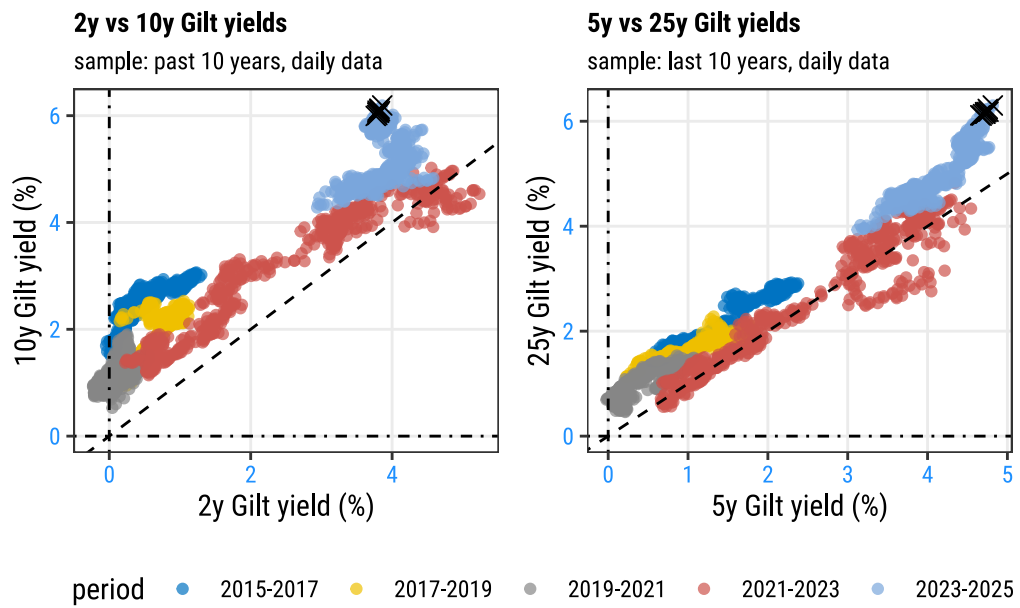


Figure 3: Gilt yields

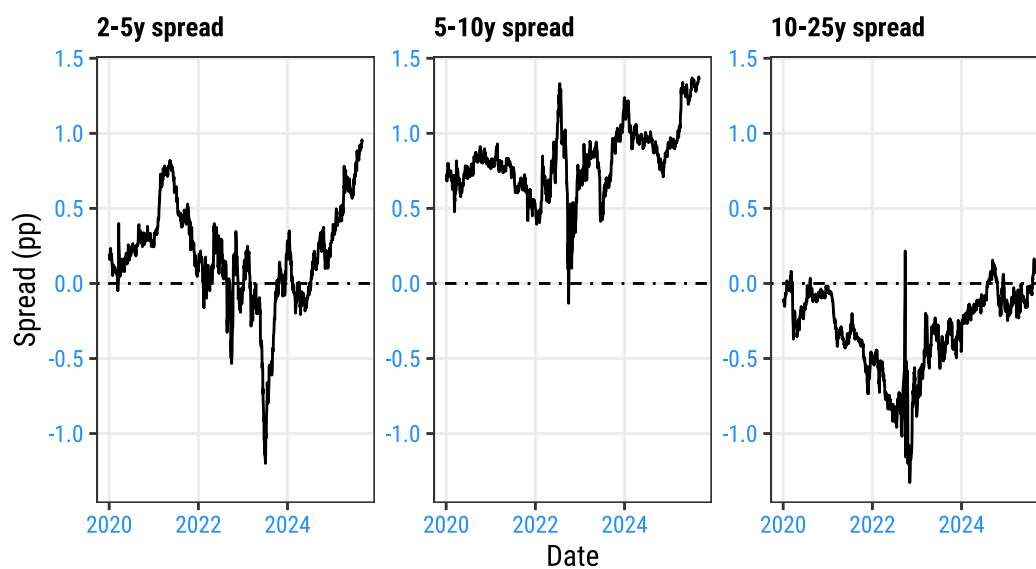


Figure 4: Term spreads in Gilt yields

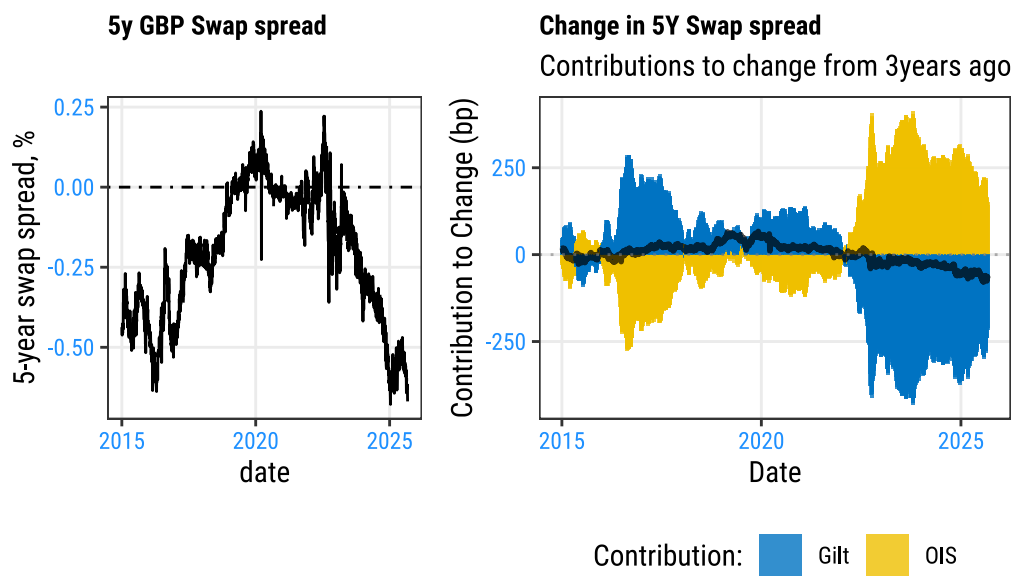


Figure 5: 5y swap spreads

## Evolving market pricing and OIS curves

Reflecting related developments over a longer period, Figure 6 shows how GBP OIS curves have evolved over time, alongside the MPC's Bank Rate decisions. Research has shown how the persistent forecast errors shown in this chart reflect a gradual process of learning about slow-moving, medium-term factors such as the neutral and trend productivity growth.

Figure 7 zooms-in on how OIS curves and Bank Rate have evolved over the past year. [check this chart]

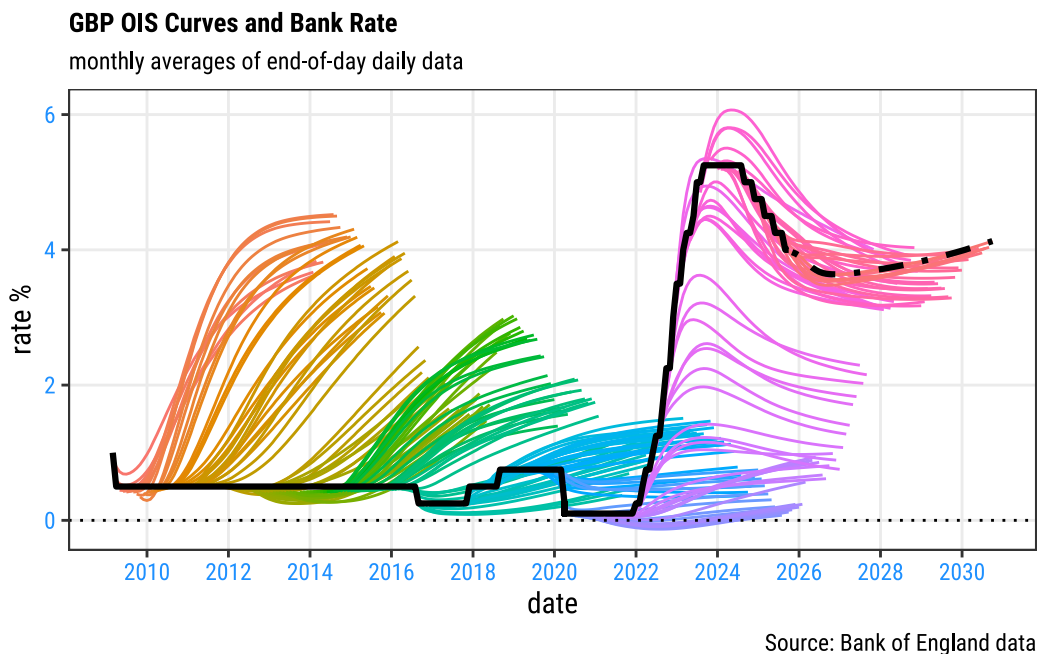


Figure 6: Evolution of GBP OIS curves

**Neutral rates** We limit our discussion of neutral rates. Figure 8 shows estimates since the pandemic based on a survey of market participants in Sterling markets. In principle, this survey should embody informed assessments of the impact on neutral rates from a broad set of influences. I simulate individual responses based on the reported summary statistics published by the BoE in its Market Participants Survey (MaPS).

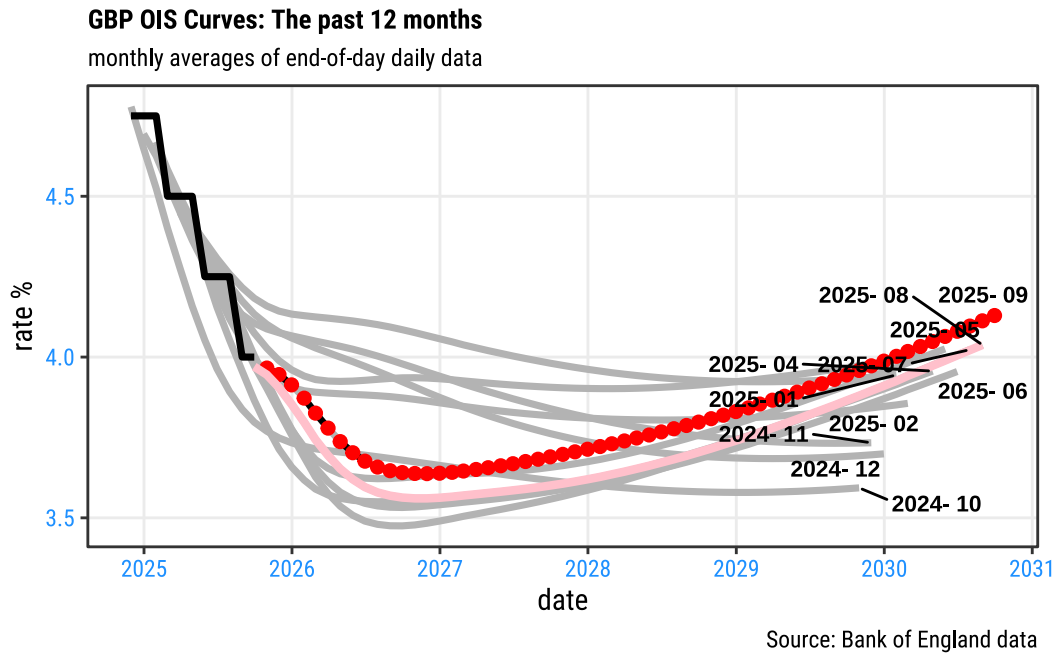


Figure 7: More Recent Evolution of GBP OIS curves

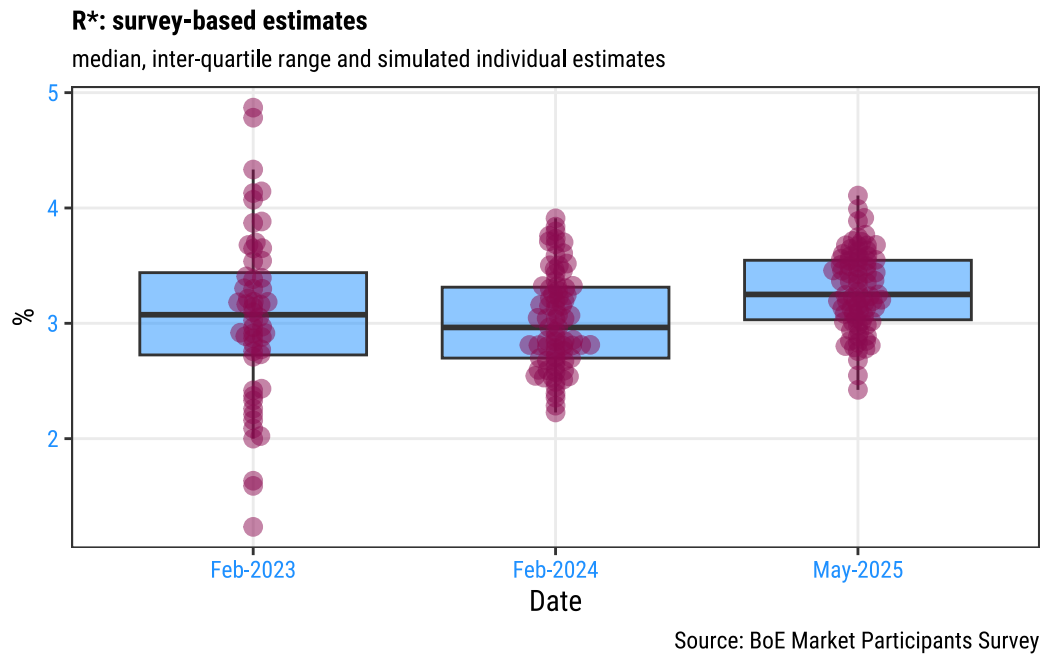


Figure 8: Market Participants Survey: Neutral rate estimates

## International spillovers in sovereign bond markets

What of international spillovers? Using the Rigobon (2003) methodology, we can estimate the extent to which international spillovers have contributed to fluctuations in 10y Gilt yields.

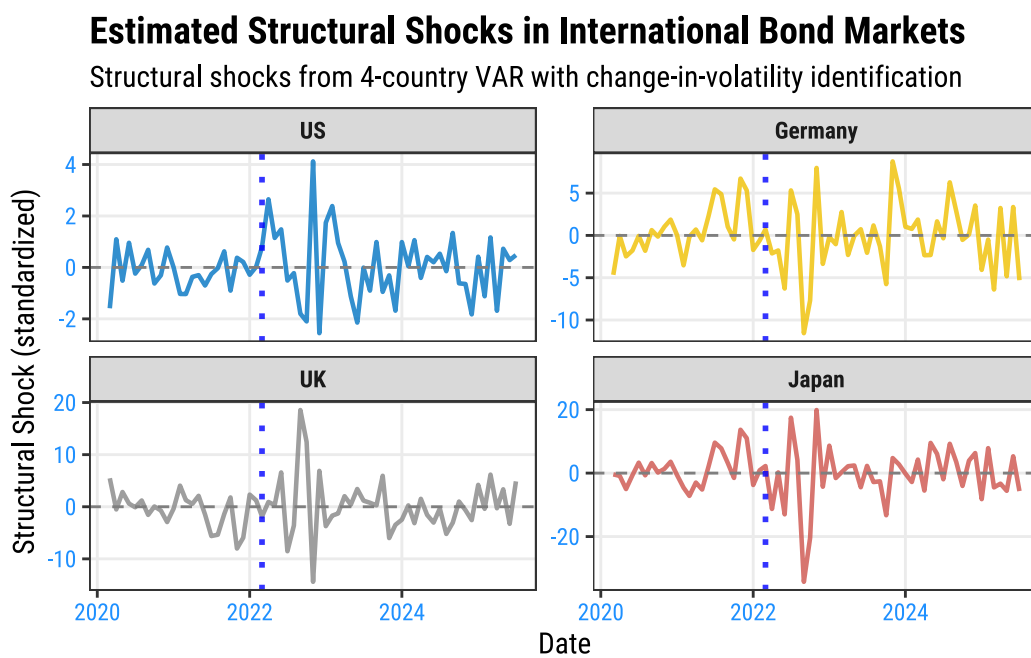


Figure 9: International spillovers

## Fiscal risks

### The (international) risk of fiscal fatigue

Fiscal fatigue occurs where a further fiscal effort is needed to stabilise public debt-to-GDP, but the political will to implement the necessary tax rises or restraint in public spending wanes.

We estimate the UK still has a required fiscal effort of 3% of GDP to stabilise its Debt-to-GDP ratio. Uncertainty in this estimate means it is worth showing the debt-stabilising primary balance for different combinations of 'r' (effective nominal interest rate on government debt) and 'g' (expected



nominal growth rate). Estimates in @tab-dspb suggest the debt-stabilising primary balance would be around 0.5-1.0% of GDP, compared with a primary balance at -2.0% in 2024.

By international standards, this is xxx. [France stands out.]

Figure xxx shows

## Macro and fiscal news at UK fiscal events

A fiscal downgrade of 30bn would, based on this relationship, point to tightening of A key issue in the Budget will be how front-loaded is that tightening.

## Market reactions and macro news at recent BoE policy events

### Analysing monetary policy shocks

We now review how financial markets – OIS, Gilts, Foreign exchange and Equities – reacted to news at BoE policy events. These reactions are summarised in Figure 10.

## Evolving macro forecasts and macro news

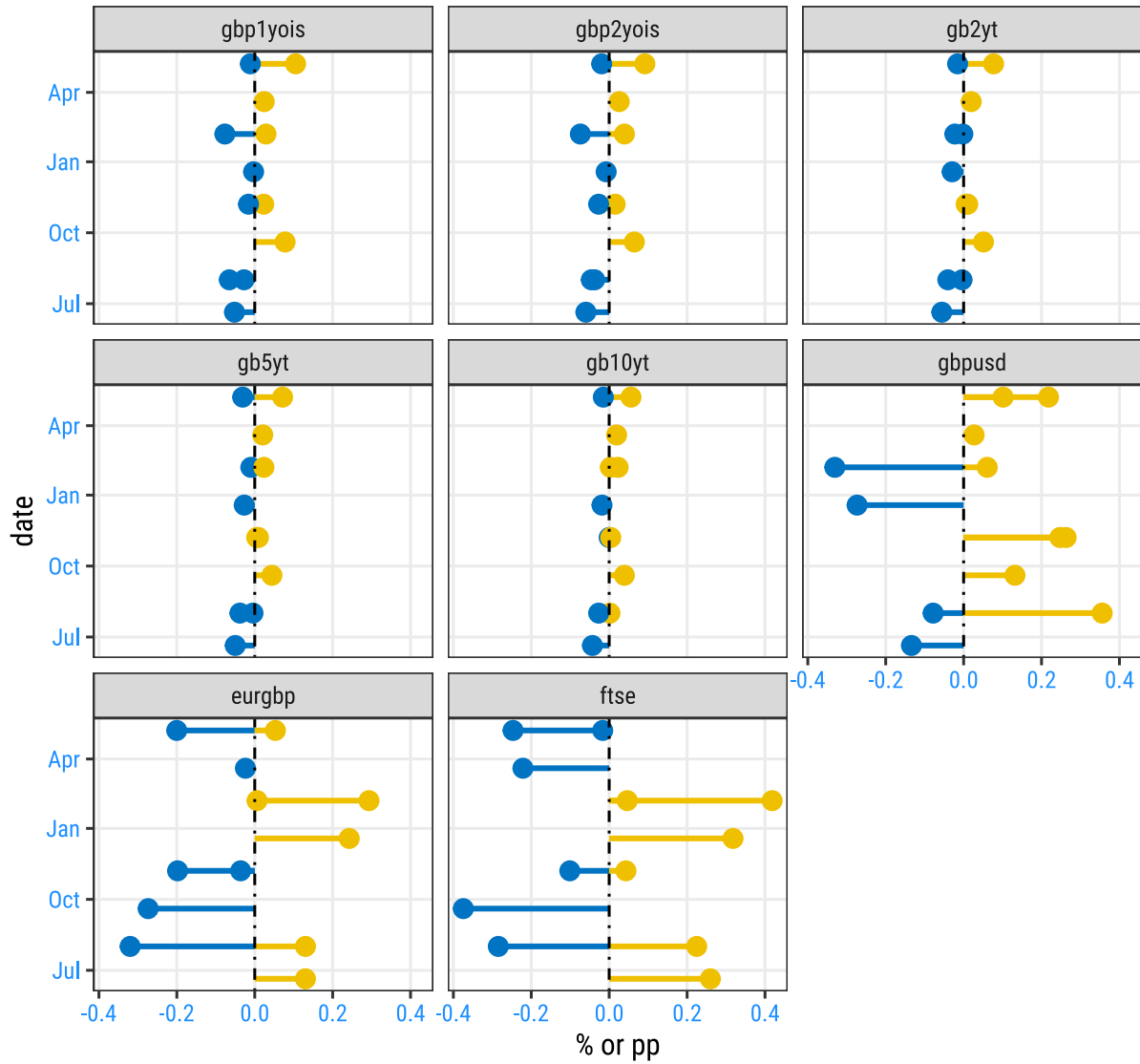
How has the MPC's own assessment of the UK macro outlook evolved?

**Medium-term** Over the past decade or more, the MPC has tended to revise higher its forecasts for inflation, revise its outlook for unemployment lower, without an obvious bias in its forecasts for GDP growth. This points to a pattern of the BoE having had to respond to negative supply shocks, updating its assessments in the light of that repeated pattern.

The weakness of productivity growth, negative terms of trade shocks (e.g. Brexit, pandemic, Ukraine), and the impact of these on real incomes, have all contributed to this pattern of revisions and evolving macro forecasts.

**Recent updates** Looking over the past six MPC forecasts...

### Asset price reactions at MPC meetings



Sources: Braun et al (2025) and own calculations

Figure 10: Asset price reactions at MPC announcements

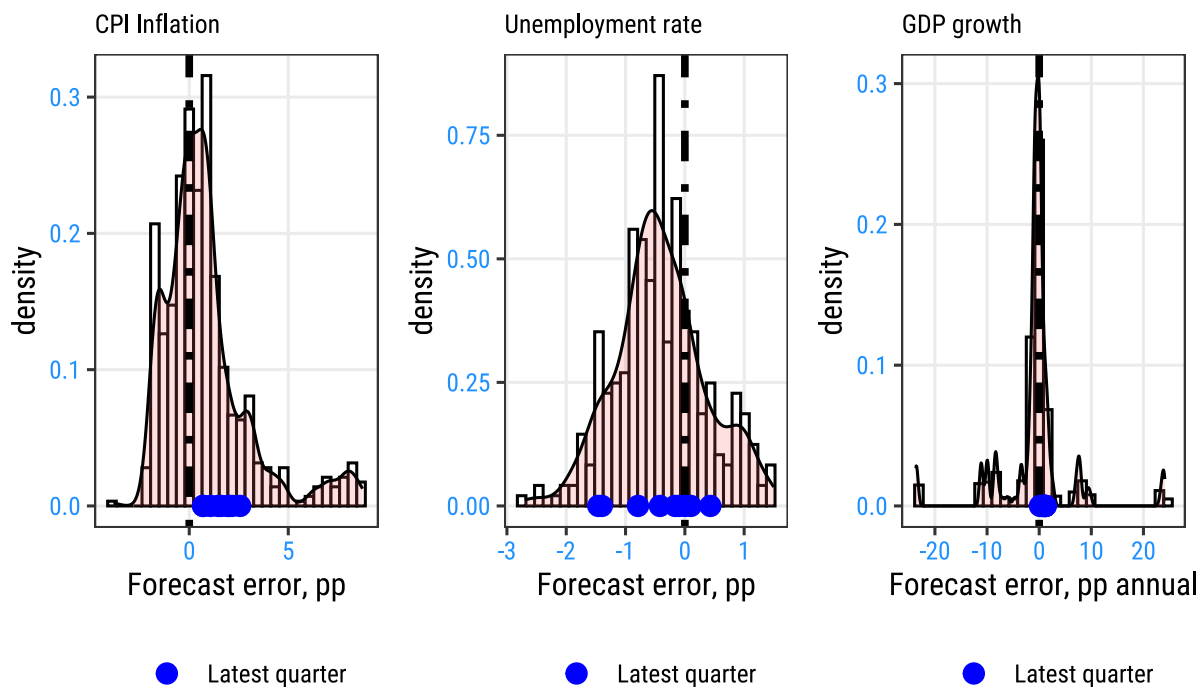


Figure 11: Distribution of BoE Forecast errors

### Evolving inflation forecasts

Based on the pattern of past BoE forecast errors, a realistic path to overshooting the 2% inflation target, is that the MPC produces too optimistic inflation forecasts and retaining too little policy restriction to complete the disinflation.

### MPC Voting: increased disagreement

We inspect MPC voting patterns to illustrate two points. First, the rising extent of disagreement among MPC members. Second, how current MPC member voting compares with that of past members.

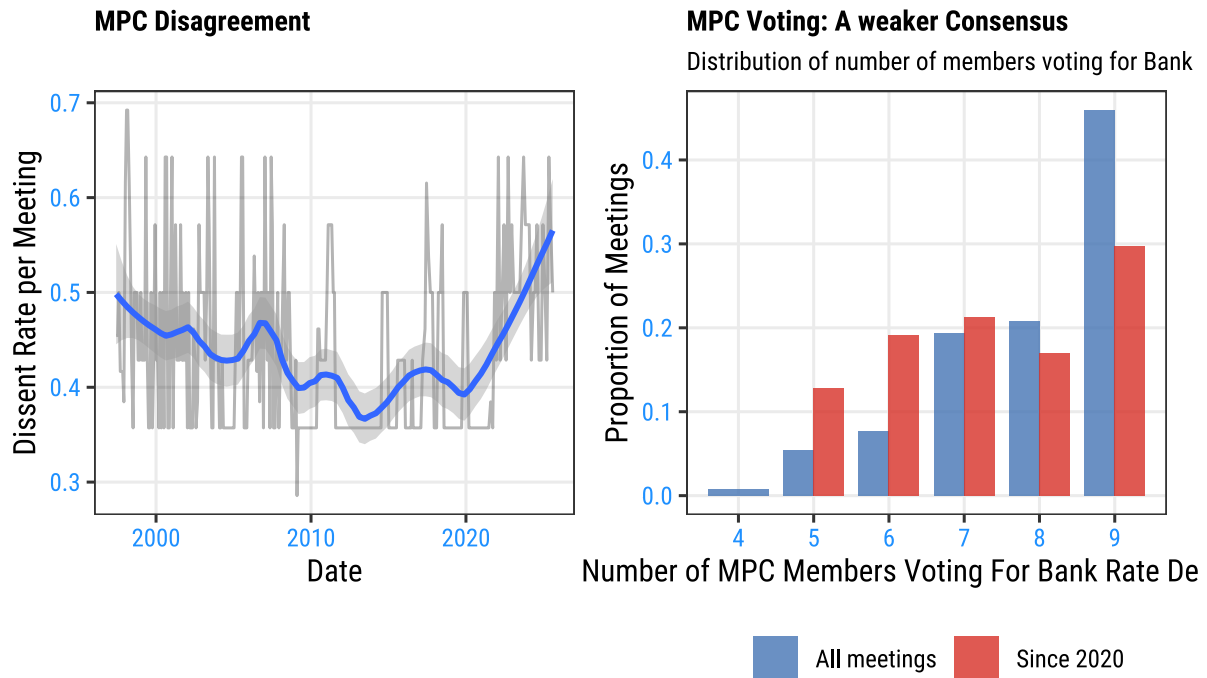


Figure 12: A weaker Consensus in MPC rate decisions

Rising disagreement among MPC members culminated in the August 2025 MPC vote requiring a second vote among Committee members in order to secure a clear majority for the rate cut decision.

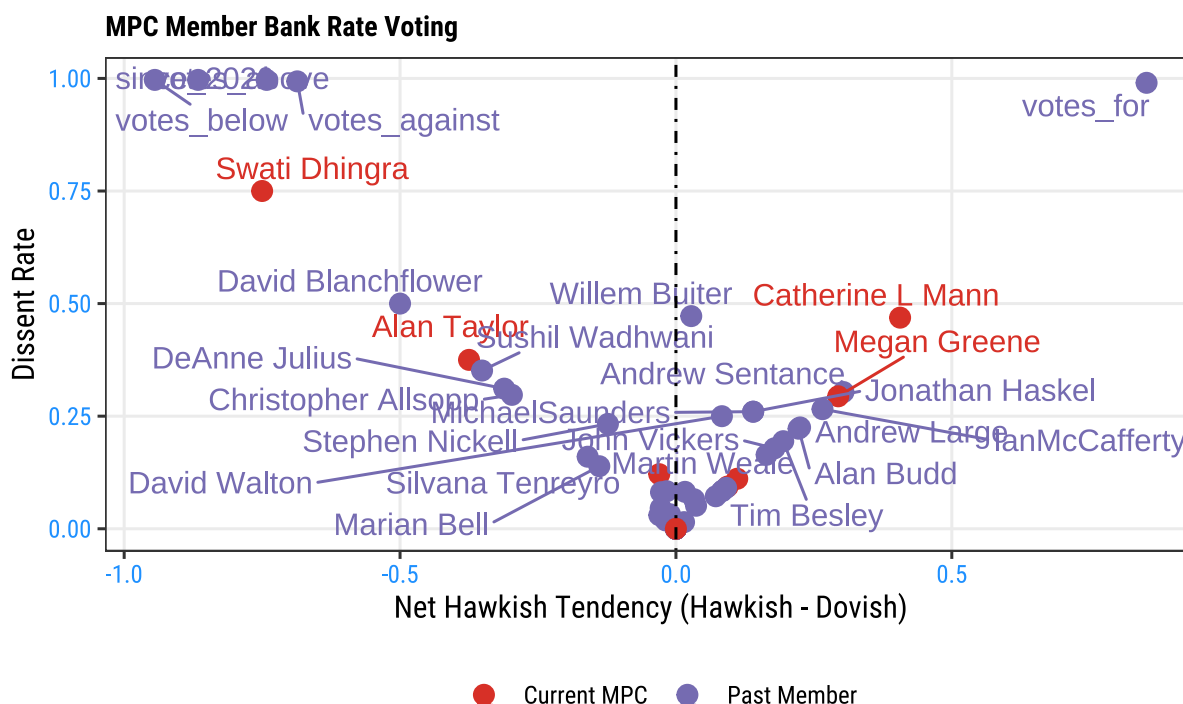


Figure 13: MPC disagreement and preferences

Increasingly nuanced macroeconomic assessments are producing more closely contested votes and heightened disagreement among MPC members. This development places greater emphasis on the quality of macroeconomic analysis and forecasts that underpin MPC decisions. While such complex judgements reinforce the importance of maintaining independence from political pressures, the forecast errors documented earlier pose a risk to both the credibility of the MPC's analytical process and public confidence in its institutional independence. This may leave Sterling markets more sensitive to international spillovers and to political and fiscal news.

## Views

1. Government bonds provide less effective portfolio hedging against equity weakness when negative supply shocks become more frequent. In supply-shock driven downturns, both equities and bonds can decline simultaneously, reducing the traditional negative correlation that makes bonds effective diversifiers.

2. Historical forecast error patterns suggest the MPC faces material upside inflation risks if it maintains current policy settings. The Bank's tendency to overestimate the pace of disinflation, combined with insufficient recognition of the UK's structural supply-side constraints, creates conditions where inflation could persistently exceed the 2% target despite current monetary restriction.
3. Fiscal sustainability concerns amplify bond market volatility, particularly during data-sensitive periods when investors reassess inflation trajectories. This creates a feedback loop where disappointing economic data simultaneously raises questions about fiscal capacity and inflation persistence.
4. The authorities can mitigate yield curve steepening through active debt maturity management, specifically by reducing the average maturity of new issuance. This approach offers lower implementation risk compared to broader fiscal consolidation measures and can provide more immediate relief to long-term borrowing costs while maintaining market confidence.