GBP Rates Report

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Market developments

Latest developments: the past three months

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

- **OIS rates** have seen a 'round-trip', rallying in June by 20bp 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 similar to OIS in June, but that has been more than reversed since then and especially at the long-end. 10y and 30y Gilt yields end the period significantly higher.
- **Equities** rallied strongly by a cumulative 6% over the period, and concentrated in the period since July.

This combination points towards positive foreign growth shocks predominating in the past 3 months. While other shocks, including domestic shocks have likely applied, positive global growth sentiment has been the predominant driver based on a standard macro interpretation. A dovish monetary policy impulse in June was subsequently reversed yet was accompanied by a rally in equities thanks to a belief in stronger growth.

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 distingsuish severa 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 have also widened in recent weeks, as shown in **?@fig-swap-spreads**. This reflects both the rise in Gilt yields, and a fall in swap rates. Swap spreads have been volatile over the past decade or more, reflecting changes in market liquidity, risk premia, and other factors.

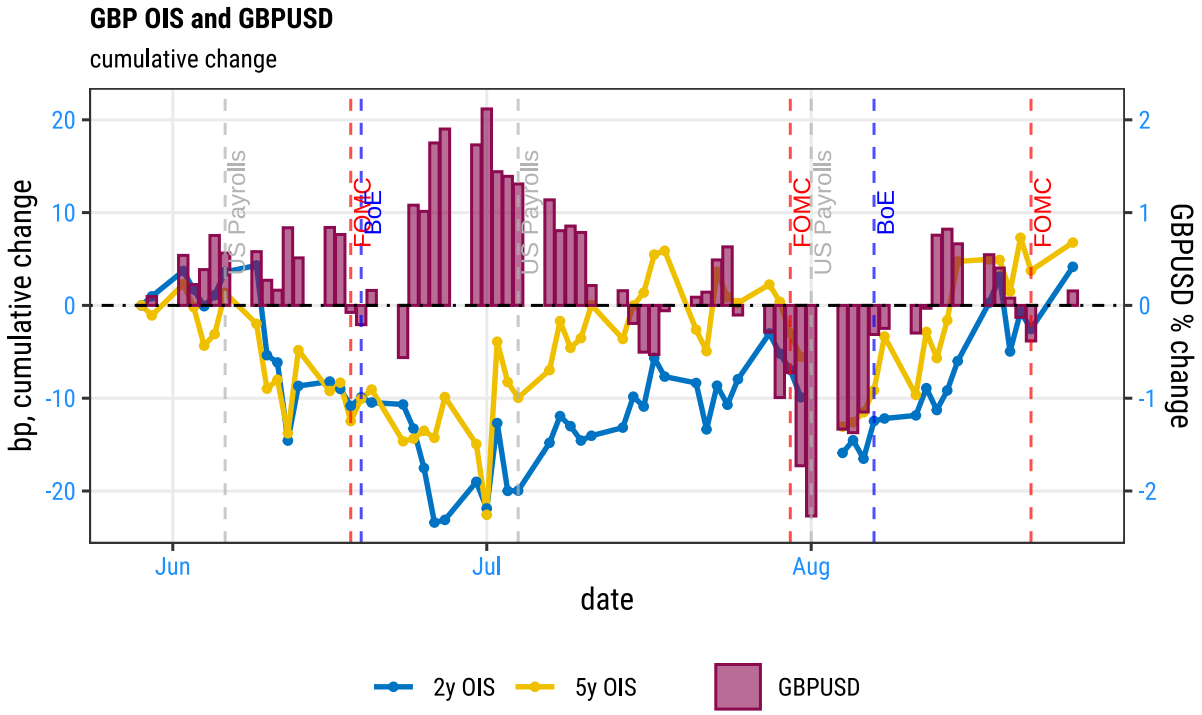

Figure 1: OIS and Sterling

Fiscal developments have likely played a role in the rise in term spreads and widening of swap spreads (see here for a discussio).

Evolving market pricing and OIS curves

Reflecting related developments over a longer period, Figure 5 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 6 zooms-in on how OIS curves and Bank Rate have evolved over the past year. [check this chart]

Neutral rates We limit our discussion of neutral rates. Figure 7 shows estimates since the pandemic based on a survey of market participants in Sterling markets. In principle, this survey should em-

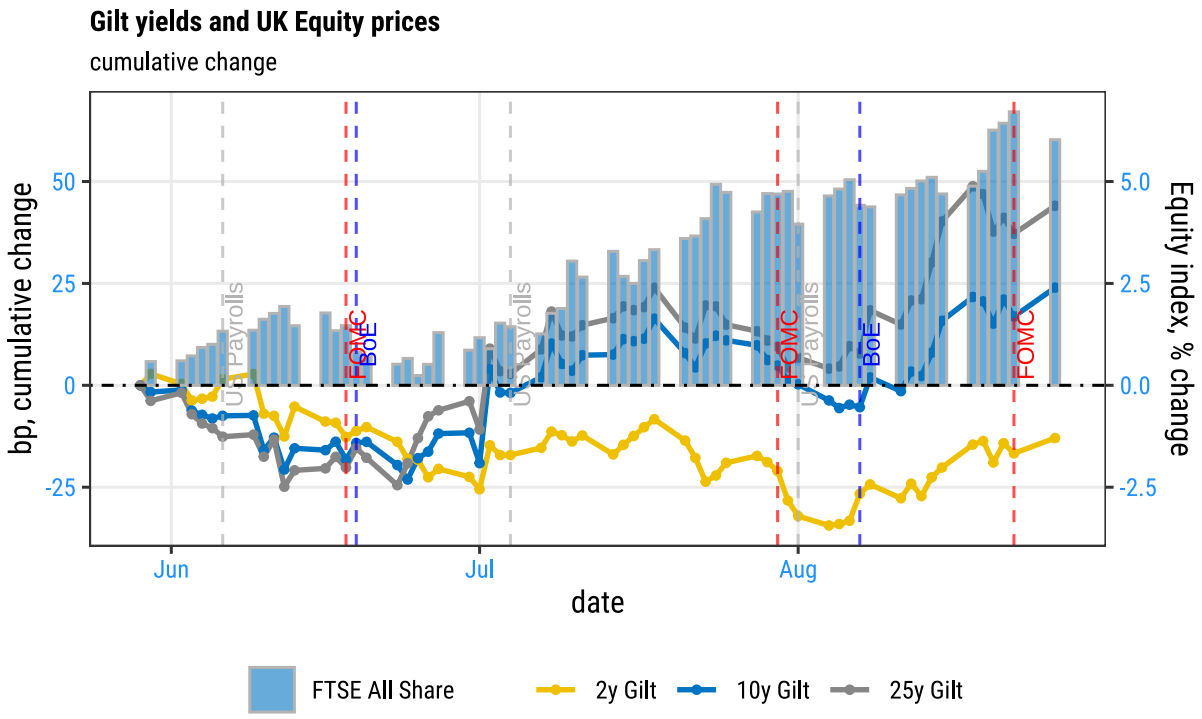

Figure 2: Gilts and Equities

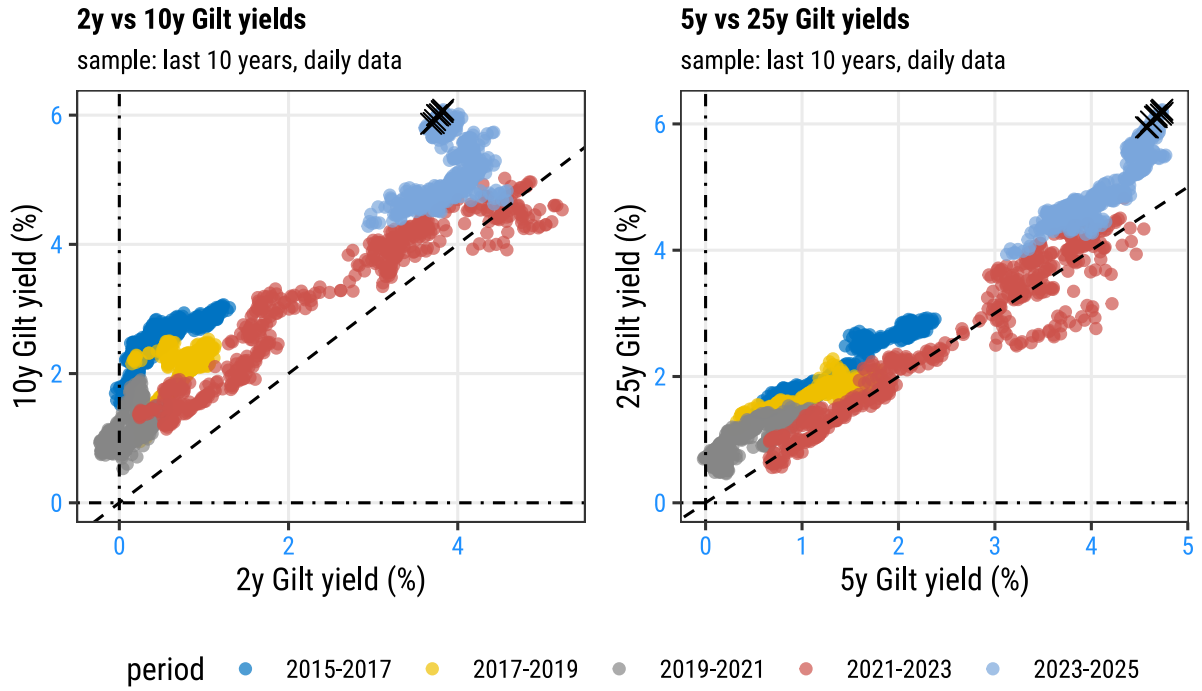

Figure 3: Gilt yields (daily data)

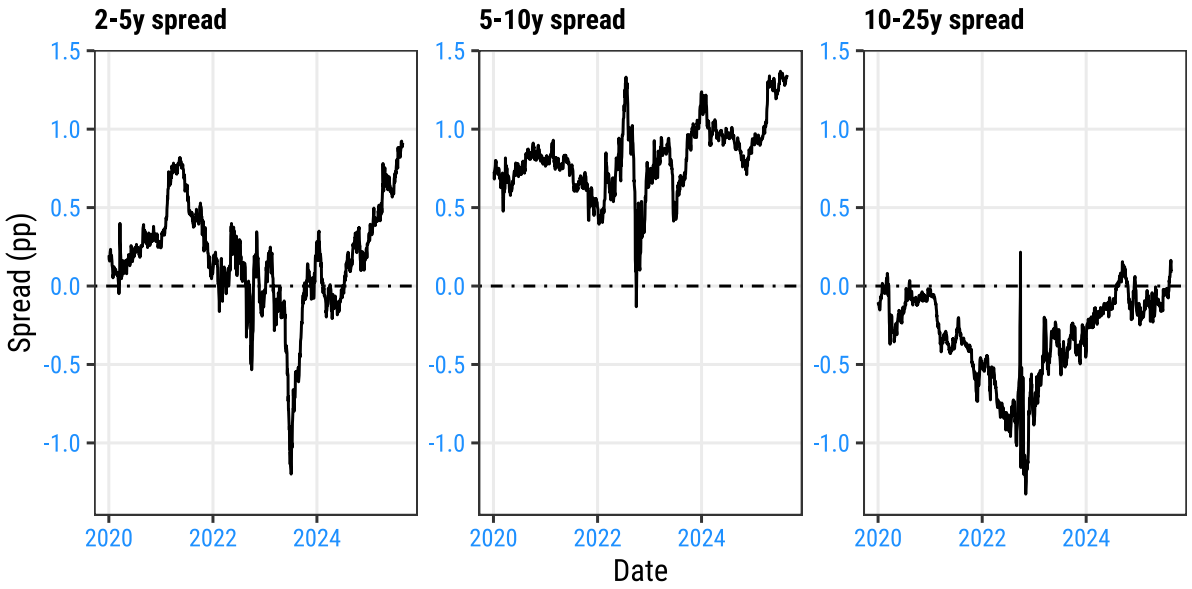

Figure 4: Term spreads in Gilt yields

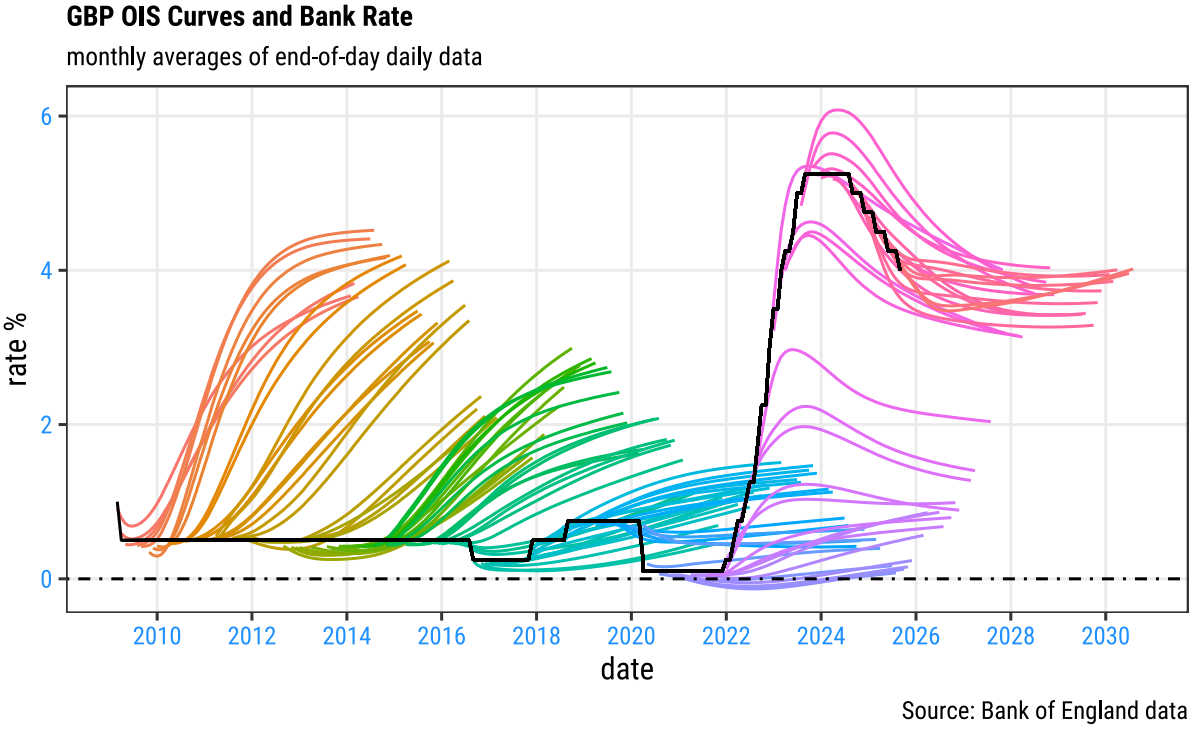

Figure 5: Evolution of GBP OIS curves

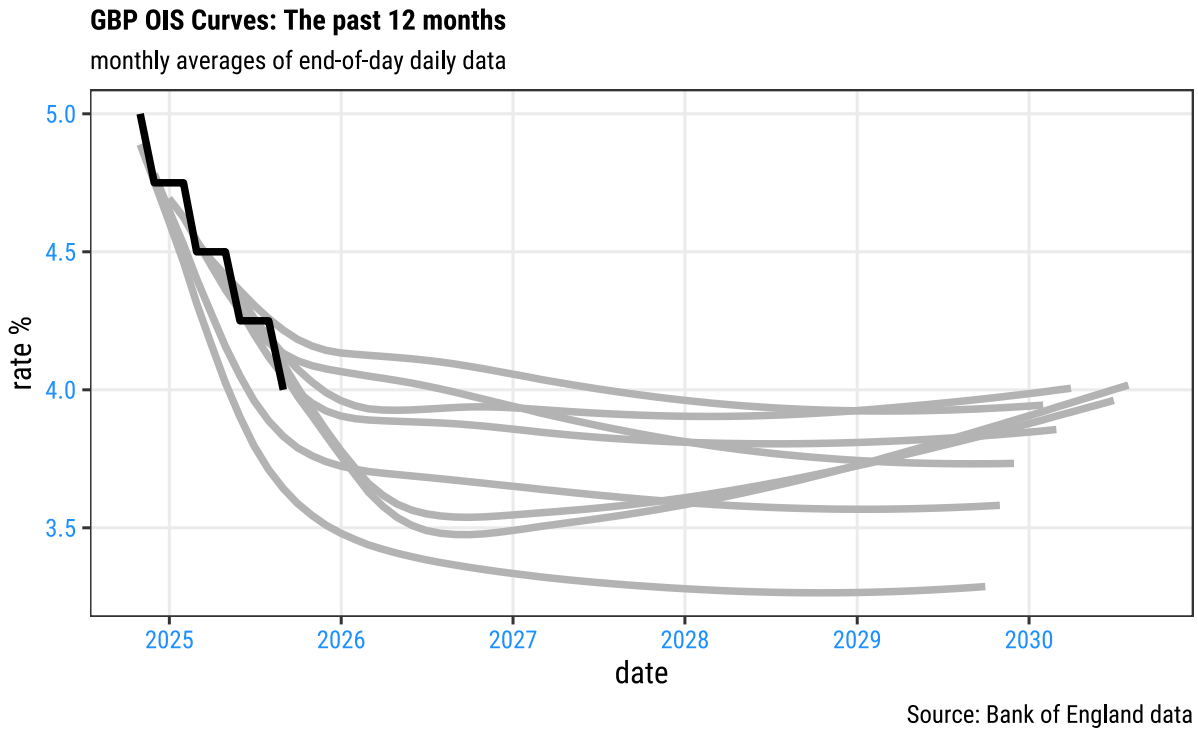

Figure 6: More Recent Evolution of GBP OIS curves

body 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).

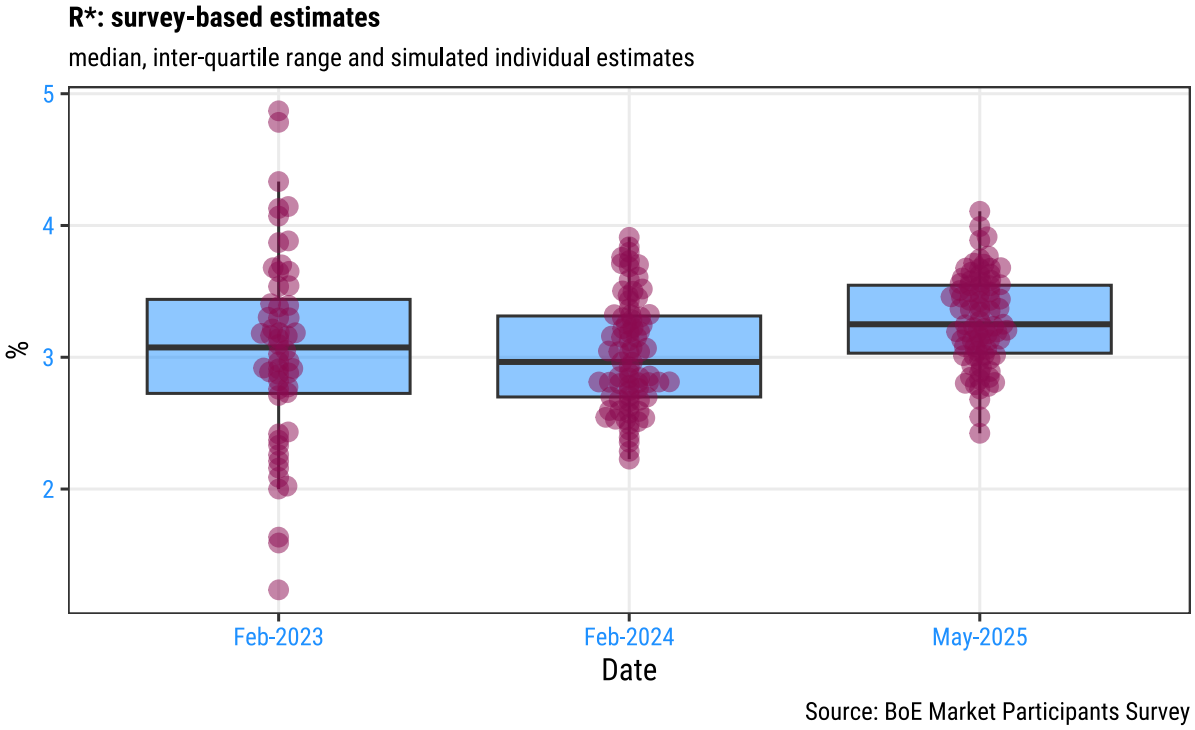

Figure 7: Market Participants Survey: Neutral rate estimates

International spillovers

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.

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Identification Results
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Method: Changes in Volatility
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Sample size: 125
Log-Likelihood: 463.6628
AIC: -805.3255
Structural Break: At Observation Number 63
Number of GLS estimations: 5
Number of Restrictions: 0

Estimated unconditional Heteroscedasticity Matrix (Lambda):
            [,1]     [,2]     [,3]     [,4]
US      1.221149 0.000000 0.000000 0.000000
Germany 0.000000 5.190437 0.000000 0.000000
UK      0.000000 0.000000 3.783752 0.000000
Japan   0.000000 0.000000 0.000000 4.427623

Standard Errors of Lambda:
             [,1]     [,2]     [,3]     [,4]
US      0.3088946 0.000000 0.000000 0.000000
Germany 0.0000000 1.371708 0.000000 0.000000
UK      0.0000000 0.000000 1.255382 0.000000
Japan   0.0000000 0.000000 0.000000 1.360255

Estimated B Matrix (unique decomposition of the covariance matrix):
              [,1]          [,2]          [,3]        [,4]
US      0.12759141  0.061805779 -0.008550644  0.02087056
Germany 0.09618057  0.048858825  0.020438144 -0.04264929
UK      0.05990447  0.088624320 -0.024659891 -0.03676633
Japan   0.04943671 -0.005871381 -0.027446588 -0.01669416

Standard Errors of B:
               [,1]       [,2]       [,3]       [,4]
US      0.017056349 0.03023620 0.04355925 0.08943527
```

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Germany 0.015932425 0.05048225 0.05053044 0.05452573
UK      0.019441577 0.04464160 0.05051845 0.13087779
Japan   0.008795167 0.02348404 0.01927939 0.02541314

Identification Wald Test of equal Eigenvalues:
[1] 5.190437 4.427623 3.783752 1.221149
                                      Test statistic dof p-value
lambda_ 1 =lambda_2                          0.11470   2 0.94427
lambda_ 1 =lambda_2=lambda_3                 0.45325   5 0.99374
lambda_ 1 =lambda_2=lambda_3=lambda_4        9.45199   9 0.39664
lambda_ 2 =lambda_3                          0.11210   2 0.94549
lambda_ 2 =lambda_3=lambda_4                 7.60302   5 0.17951
lambda_ 3 =lambda_4                          5.52632   2 0.06309 .
---
Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
=== Rigobon Structural VAR Results ===
Structural break date: 2020-03-01
Pre-break observations: 63
Post-break observations: -31.25
Number of variables: 4
VAR lag order selected: 2

Structural coefficients (Lambda matrix):
          [,1]   [,2]   [,3]   [,4]
US      1.2211 0.0000 0.0000 0.0000
Germany 0.0000 5.1904 0.0000 0.0000
UK      0.0000 0.0000 3.7838 0.0000
Japan   0.0000 0.0000 0.0000 4.4276

Forecast Error Variance Decomposition at 12-month horizon:
       US Germany    UK Japan
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12 72.788  21.752 3.093 2.367
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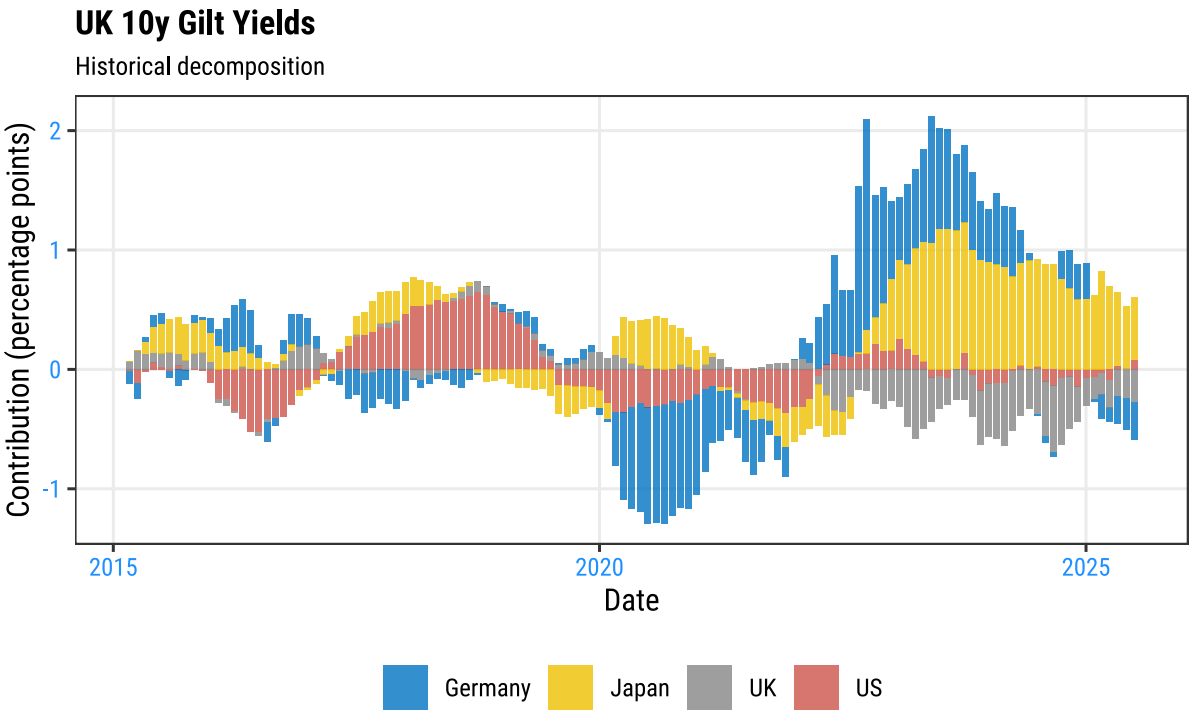


Figure 8: International spillovers to 10y Gilts yields

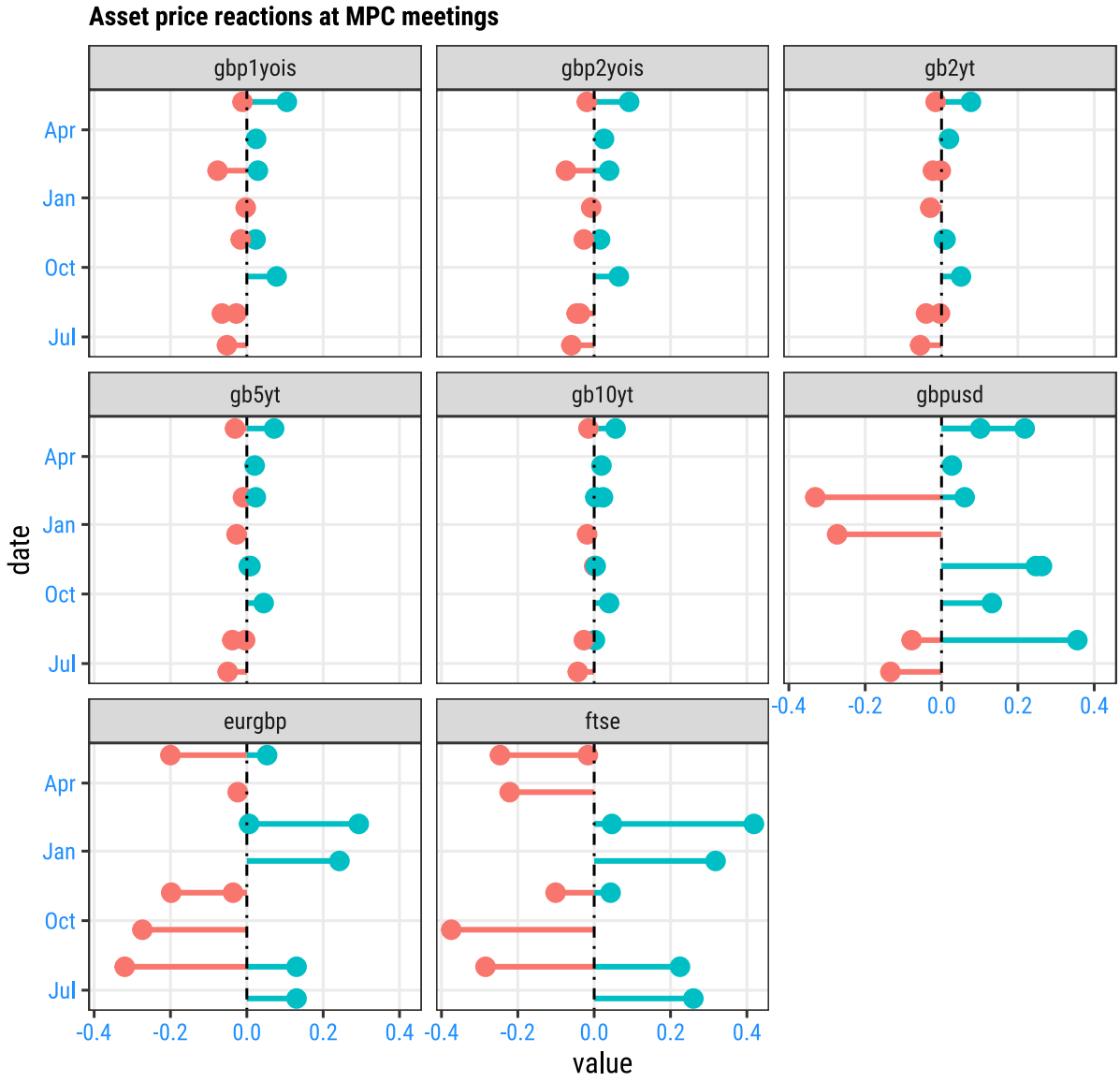
Market reactions and macro news at BoE policy events

Analysing monetary policy shocks

In this section, we review how a range of financial markets has reacted to BoE policy events. The relate the combination of reactions to macro news as digested by markets at those BoE policy events.

Evolving macro forecasts and macro news

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



Sources: Braun et al (2025) and own calculations

Figure 9: Asset price reactions at MPC announcements

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 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…

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.

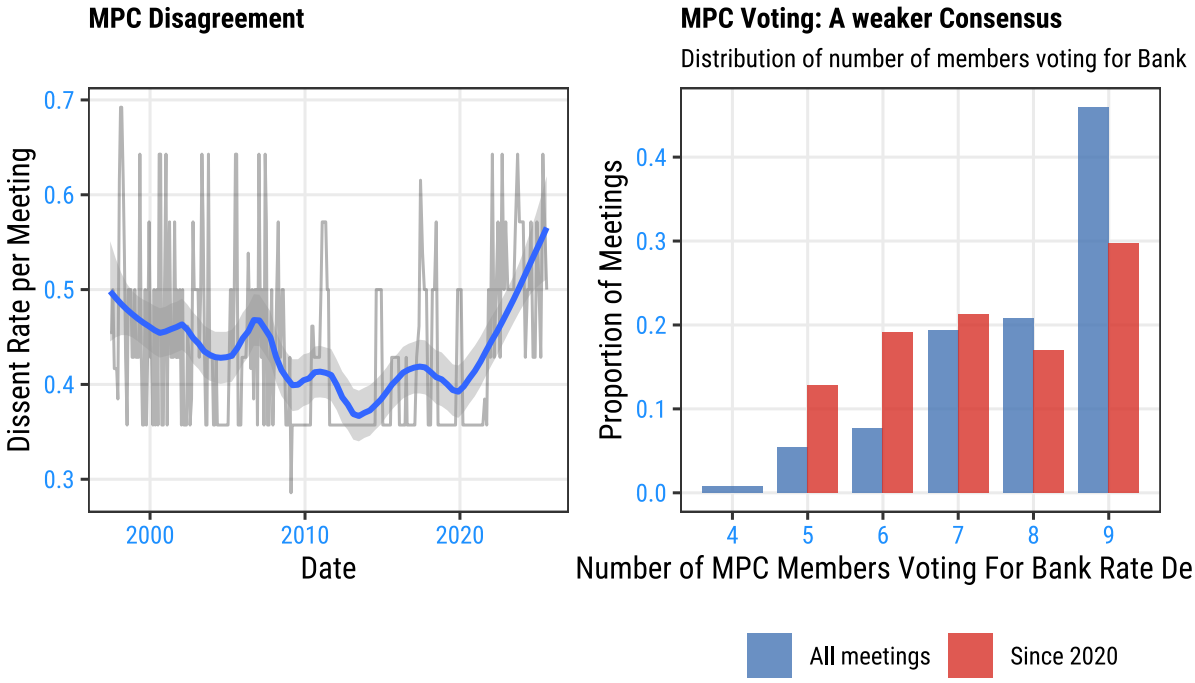


Figure 10: A weaker Consensus in MPC rate decisions

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.

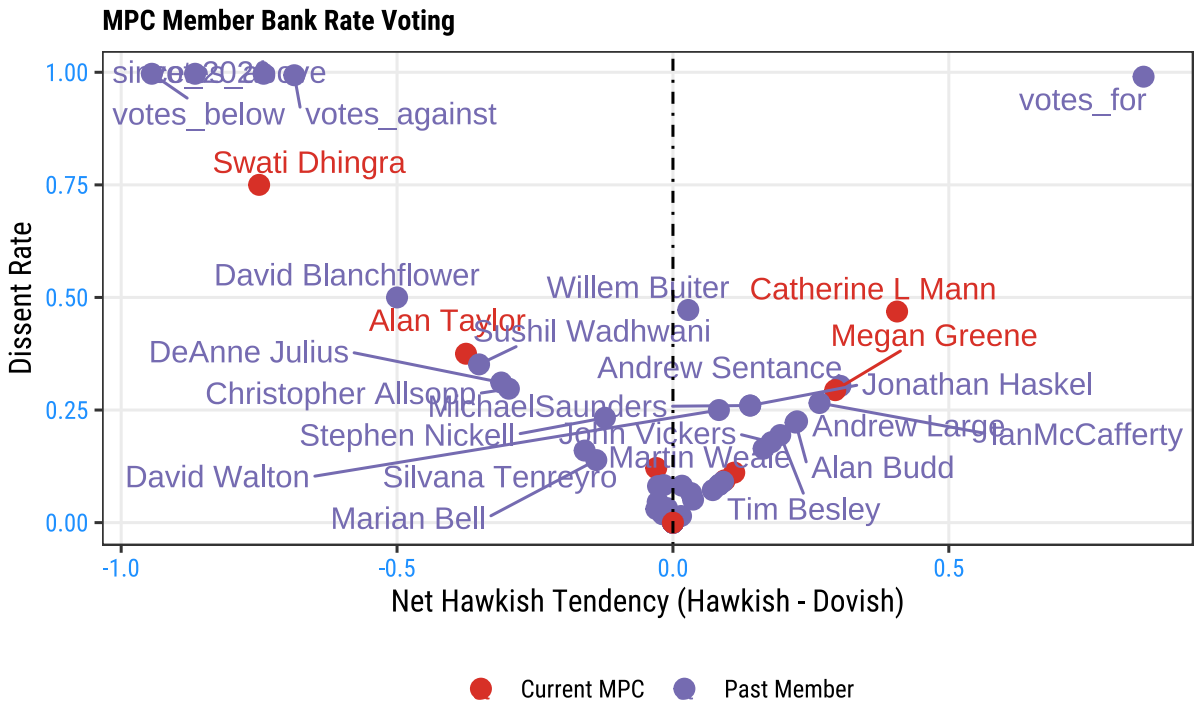


Figure 11: MPC disagreement and preferences

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.