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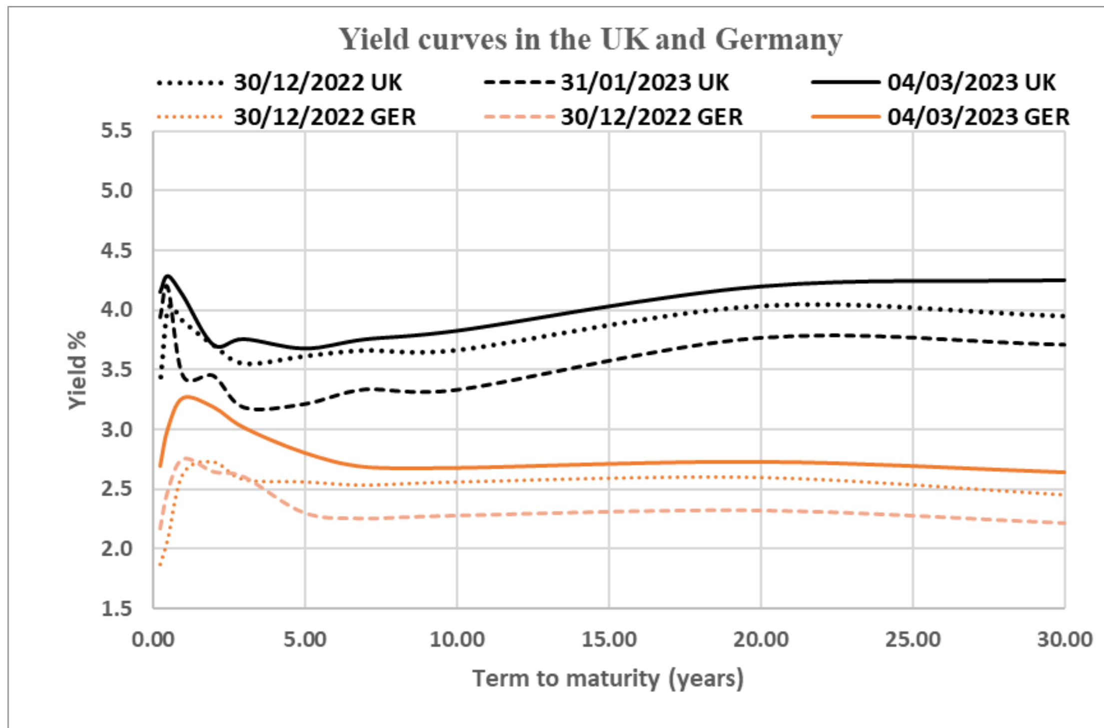
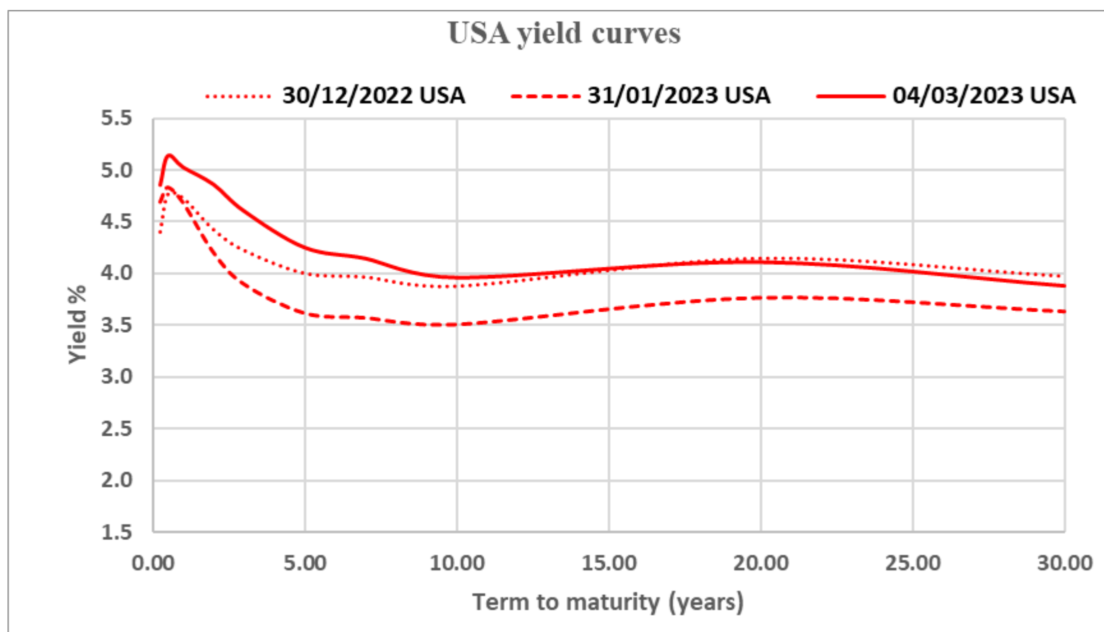
Yields pick up

Synopsis: After a start to the year which saw global bond yields fall, they have returned again to around the highs of last November.

Date published: 07.03.2023





At the start of 2023, markets were expecting that, later in the year, there would be interest rate cuts from the major central banks (other than Japan, which for now is a law unto itself). As the graphs show, across January, Government bond yields

(dashed lines) in the UK, Germany and the USA fell from the end 2022 levels ((dotted lines) at all but the shortest durations. For example, ten-year yields declined by 0.37% in the USA, 0.34% in the UK and 0.28% in Germany.

February saw a change of tack, as inflation and employment data were stronger than anticipated. The markets read that information as an indicator that the interest rate medicine being administered by the central banks was not working as they had hoped. The dosage would have to be increased and the course of treatment extended.

For example, the flash Eurozone inflation figure for February showed inflation running at 8.5%, down just 0.1% from the previous month and 0.3% above the Reuters consensus forecast. Eurozone core inflation (stripping out energy and food) rose 0.3% to 5.6%.

The central bankers' focus is often on core inflation because there is very little they can do to influence energy and food prices. Sticky core inflation numbers (4.7% in the USA on the Fed's favourite measure and 5.8% in the UK) will be the factor to watch in the months ahead. The broader CPI inflation indices are set to fall, thanks to energy price base effects – the surges of last year are not expected to be replicated in 2023.

In the UK, the Bank of England faces an increasingly difficult balancing act. The latest earnings figures (for October-December 2022) show regular pay (excluding bonuses) rising by 6.7% a year while economic growth over the same period was 0.0% and unemployment close to historic lows, at 3.7%. The markets are reading that mix as implying more rate increases to push down earnings growth and increase unemployment.

In a speech at the start of March, Andrew Baily, the Bank's governor, pushed back against that view, saying...

"I would caution against suggesting either that we are done with increasing Bank Rate, or that we will inevitably need to do more. Some further increase in Bank Rate may turn out to be appropriate, but nothing is decided. The incoming data will add to the overall picture of the economy and the outlook for inflation, and that will inform our policy decisions."

Central bankers have given up 'forward guidance' in favour of 'data dependence'. Some commentators read the switch as implying the central bankers do not know what will happen next or, at least, have learned the lessons of the past misguidance.

Comment

The Bank of England makes an interest rate announcement on March 23, eight days after the Federal Reserve reveals its next move and the Chancellor presents his Budget.

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