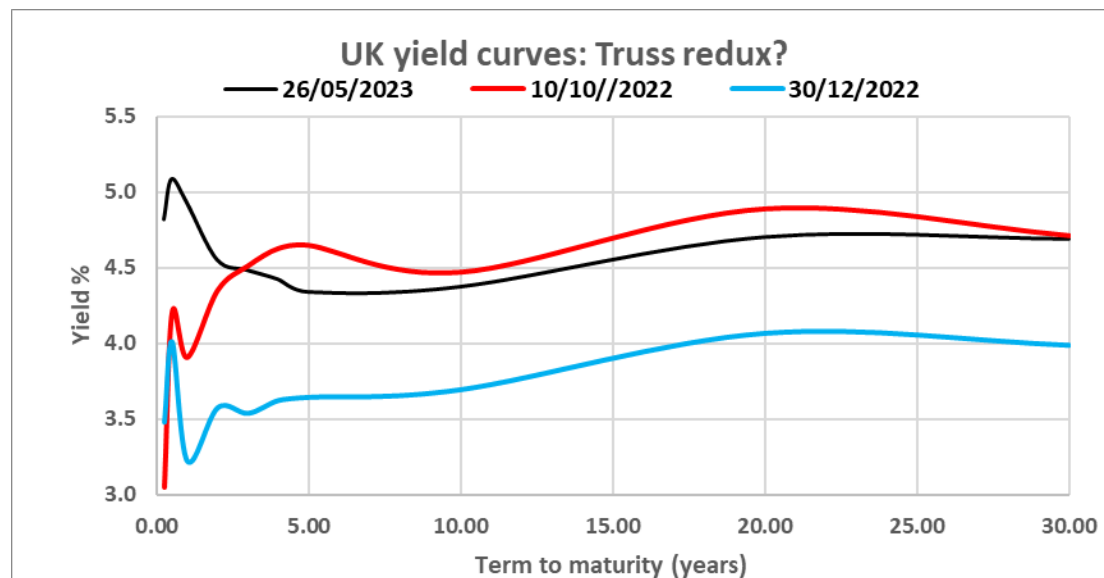


Gilt yields - the Truss redux?

Synopsis: Gilt yields are now almost back to their 'moron premium' peak of 2022.

Date published: 30.05.2023



Last week's UK inflation figures were much worse than expected. The headline rate fall of 1.4% was disappointing, but a more serious concern was the jump of 0.6% to 6.8% in core inflation (CPI ex energy, food, tobacco and alcohol). The rise in the core rate weakened the argument that the inflationary surge was attributable to commodity prices outside the Bank of England's control.

Admittedly the core figure will include secondary effects, e.g. food will influence restaurant prices and fuel impact on transport costs. However, the core is about three quarters of the CPI basket, so if the core is rising, it will limit any benefits from commodity price falls.

It is notable – and often ignored by journalists – that the US Federal Reserve's inflation target is not the CPI, but core Personal Consumer Expenditure (core PCE), data which emerges over a fortnight after the CPI.

The UK inflation numbers prompted a rapid reassessment of the path of UK interest rates. By the end of the week, the consensus for the Bank (Base) Rate was that the Bank of England would be marching it up to around 5.5%, with another 25 basis points to be added at the next Monetary Policy Committee meeting on 22 June. The read across to gilt yields was also swift.

Over the week two-year yields rose by 0.55%, five-year yields about 0.45% and ten-year yields by about 0.4%. Fixed term mortgage rates followed suit.

As the graph shows, at all but the shortest terms, the yield curve is now eerily close to that of the 9 October last year, which marked the Trussomics high for long dated yields. That is bad news for the Treasury, which still has almost £195bn of gilts to sell in 2023/24, according to the latest [Debt Management Office data](#).

Comment

The weekend's kite-flying of price controls on basic food products suggest that the Government is becoming increasingly concerned that Rish Sunak's halving inflation pledge – the only one of his quintet with a number and a deadline – will prove an albatross ahead of 2024's general election.

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