Bond yields and mortgage rates

In July 2022 the UK ten year interest rate was 2%. In early September it was 3% and by the time of the Kwarteng budget on 23rd September it was approaching 4%. It peaked on 9th October at 4.38%. In July 2023 it made another new peak at 4.65% and stayed high until November. It is now just over 4%.

This pattern was similar to the pattern in the USA and the Euro area. The main cause of large rate rises in all three places was the decision of their Central banks to go in for rapid and severe monetary tightening, as they belatedly woke up to the high inflation they had allowed or caused, depending on your view.

It is true that in the period September 26th to September 28th the UK had a bad sell off in gilts . This was mainly caused by the Liability Driven Investment crisis. The Bank has written of “severe dysfunction in the UK government bond market when distressed forced selling of gilts by liability driven investment funds led to a fire sale dynamic”. The IMF also wrote how “liability driven investment funds were at the centre of the severe stress that emerged in the UK gilt (bond) market”

There are those for political reasons who claim all this was brought on by so called unfunded tax cuts in the mini budget. They overlook the fact that the increases in spending were considerably higher than the tax cuts, forget that the gilt market had fallen a long way that month before the budget because the Bank wanted a big rise in interest rates, and forget the role of LDI investors the following week in driving the market down more. The Chancellor did push the deficit up more than I suggested and could have done more to control spending. Nonetheless the pattern of rate rises and falls show that the main cause of the rate increases was Bank policy, and the main cause of the three day meltdown was LDI troubles as owners of bonds they could not afford had to sell to pay their bills. It was very difficult finding buyers when they knew the Bank was about to sell £80 bn worth and LDI investors had to sell lots of bonds as well.

Further proof of this is how the Bank turned the gilt market round. By announcing purchases of bonds and suspending the planned sales the Bank brought the ten year rate back down to 3.1% by 20th November. The fact that the following year after a series of tax rises the rate went considerably higher than in September 2022 again underlines tax cuts were not the main issue.