LDI Monthly Update

Strategy Update
Liability-Driven Investing

September 2023

- MPC leaves UK base rate unchanged
- Unexpected declines in latest UK inflation prints
- GBP 100 billion quantitative tightening (QT) supply for the next 12 months confirmed

Market Commentary

In September, following a series of 14 consecutive rate hikes, the Bank of England's Monetary Policy Committee (MPC) decided to pause and leave rates unchanged at 5.25%, with a narrow 5–4 vote split (four members opted for a 25 bp hike). Accompanying its decision, the MPC reiterated comments from its previous meeting, stating that it sees the current monetary policy stance as being "restrictive," and that while "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures [...] there are increasing signs of some impact of tighter monetary policy on the labour market and on momentum in the real economy more generally."

Markets closed the month with a terminal rate priced below 5.4%, over 30 bp lower than the peak rate forecasted at the end of August. Furthermore, gilt yields at the front of the curve declined MoM, with 5-year nominal rates falling by 15 bp.

The latest UK headline Consumer Price Index (CPI) print for August surprised to the downside, falling from 6.8% YoY in July to 6.7% YoY, well below MPC's forecast of 7.1%. Importantly, for the central bank, both core inflation (which excludes more volatile components such as food and energy) and services inflation experienced larger declines than anticipated by both the market and the MPC.

Alongside the hold in rates, the MPC confirmed its QT supply for the next 12 months, which is set at GBP 100 billion, broadly in line with market expectations. The impact on supply, however, may be two-fold. At current prices, this QT supply will be locking in losses to be absorbed by the Treasury well above the Office for Budget Responsibility's (OBR) forecasts. Consequently, the Debt Management Office (DMO) may need to issue more bonds to cover. Throughout the month, longer-tenor gilt yields rose across the curve, with 30-year nominal yields rising by nearly 30 bp MoM.

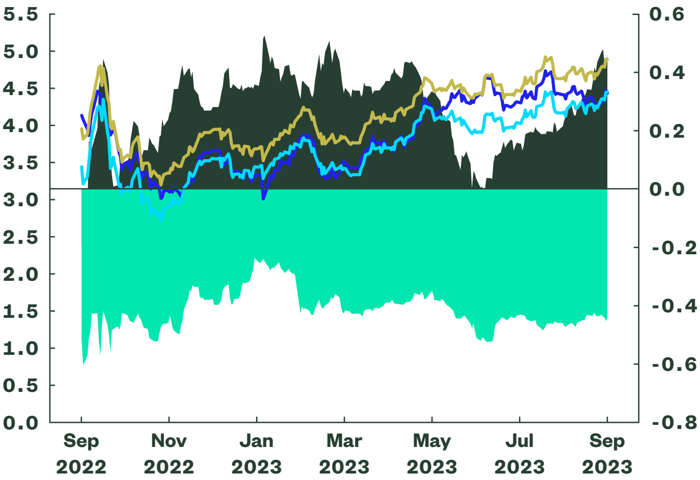
Figure 1 **Market Moves**

29 September 2023	Gilt Yields		OIS Swaps		Swap Spreads		Gilt Real Yields		Gilt Breakeven		RPI Swaps		Iota Spread	
	%	CoM (bp)	%	CoM (bp)	bp	CoM (bp)	%	CoM (bp)	%	CoM (bp)	%	CoM (bp)	bp	CoM (bp)
5yr	4.50	-15.5	4.60	-17.3	60.4	-11.2	0.48	-32.8	4.02	17.3	4.26	19.2	23.8	1.9
10yr	4.44	7.9	4.35	4.8	-17.7	-6.0	0.59	-0.5	3.85	8.3	3.93	6.7	8.5	-1.6
30yr	4.90	29.2	4.22	24.9	-62.8	-7.1	1.47	30.3	3.42	-0.8	3.41	2.0	-1.4	2.8
50yr	4.45	32.5	3.99	29.1	-43.5	-7.9	1.06	37.0	3.39	-4.5	3.30	-4.1	-9.3	0.4
10s30s	0.46	21.3	-0.13	20.0	-45.1	-1.1	0.88	30.8	-0.43	-9.1	-0.53	-4.7	-9.9	4.4
30s50s	-0.44	3.3	-0.23	4.3	19.3	-0.8	-0.41	6.7	-0.03	-3.7	-0.11	-6.1	-7.9	-2.4

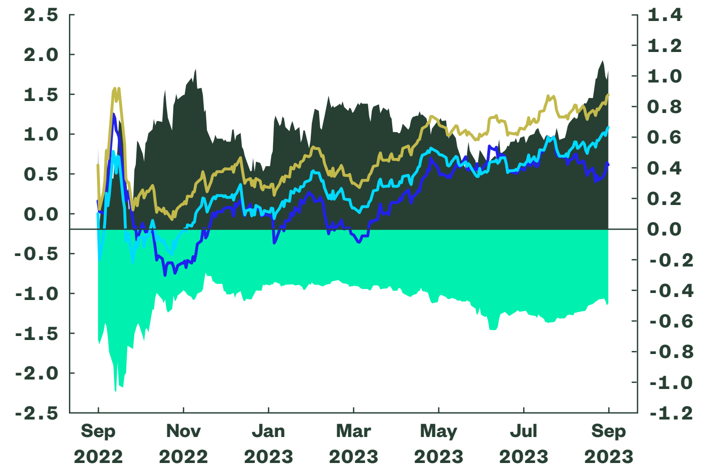
Source: Bloomberg, State Street Global Advisors, as at 29 September 2023
Past performance is not a reliable indicator of future performance.

Figure 2 **Market Curves**

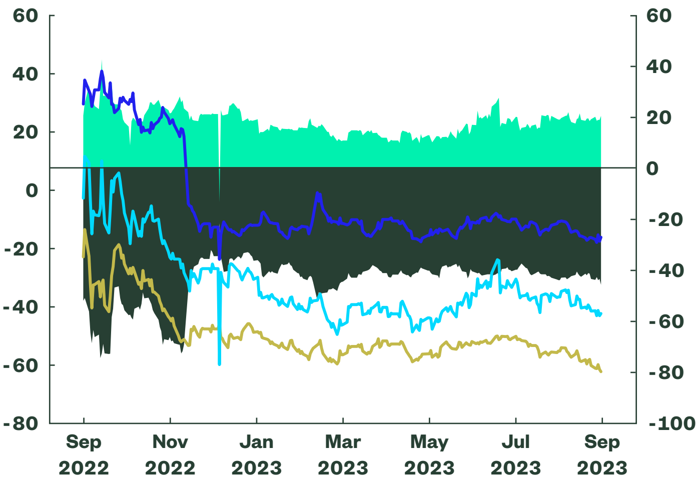
Nominal Gilt Yields (%)



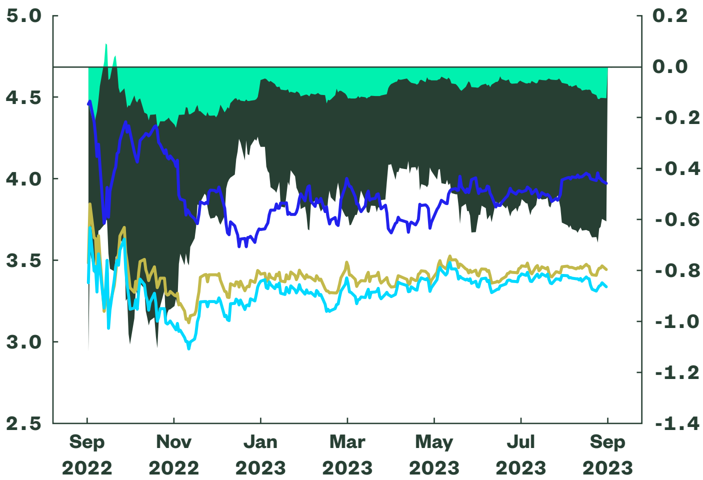
Real Gilt Yields (%)



OIS Swap Spreads (bp)



RPI Swaps (%)



10s30s (RHS) 30s50s (RHS) 10yr 30yr 50yr

Source: Bloomberg, State Street Global Advisors, as at 29 September 2023.
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