



Yield market update

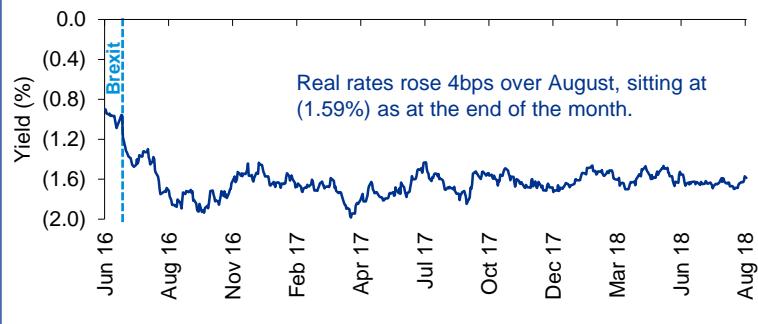
October 2018



Historic yield movements - 31 August 2018

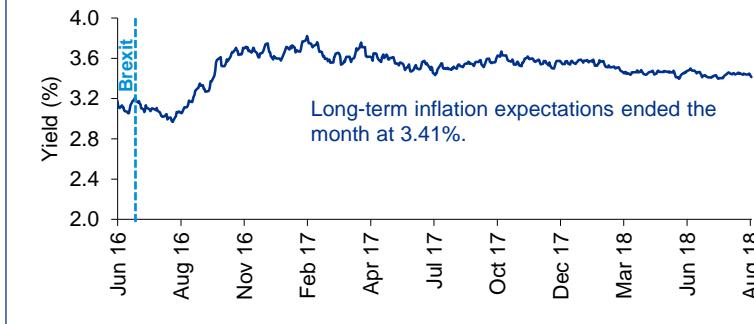
Real yields

20 Year Real Gilt Yields – June 2016 to date



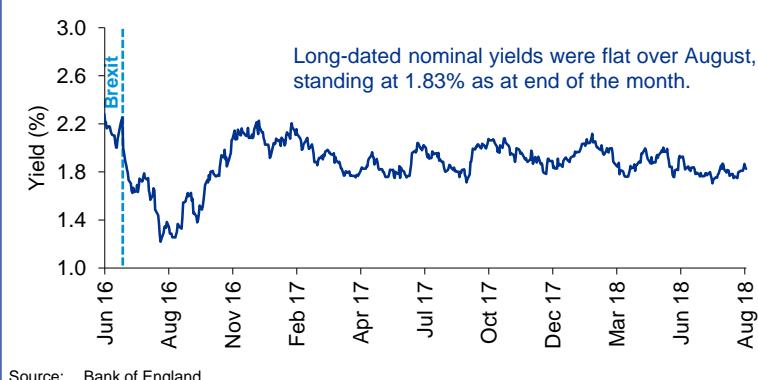
Inflation

20 year implied inflation – June 2016 to date



Interest rates

20 year nominal gilt yields – June 2016 to date



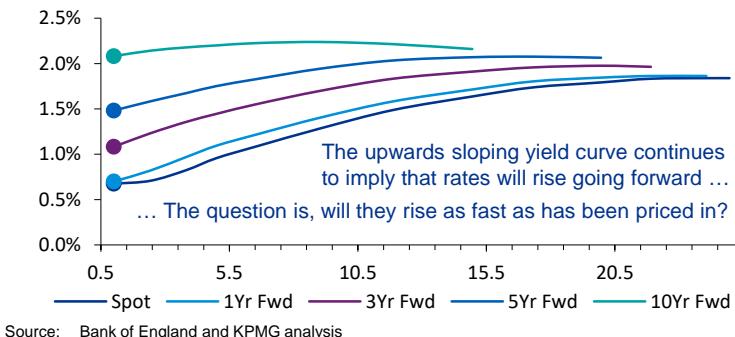
Summary

- Nominal yields were flat over August, though this masked some intra-month volatility. The rapid depreciation of the Turkish lira and emerging market currency volatility set a risk-off tone for the first half of the month, while rates rose back in the final week as equity markets stabilized.
- Focus has now shifted to global trade, in particular the renegotiation of NAFTA and prospects of protectionism around US-China trade.
- Inflation expectations fell c.4bps, which were reflected in higher real yields, owing to a strong month for sterling, as news that Michel Barnier (the EU's chief negotiator) indicated a unique deal for the UK on Brexit was possible. Demand for index-linked gilts also remained weak into month end.
- Long-dated (20 year) real yields are currently standing at -1.59% as at the end of the month. Contributing to this:
 - Long dated nominal yields stood at 1.83% at end of August;
 - Long dated inflation expectations fell 4bps to end the month at 3.41%.

Looking forward

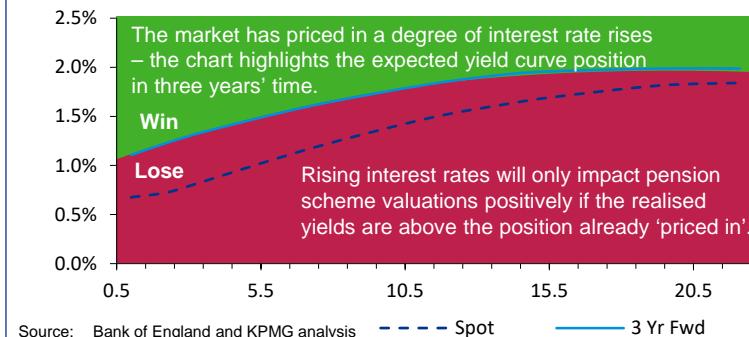
UK interest rates – Forward curves

31 August 2018



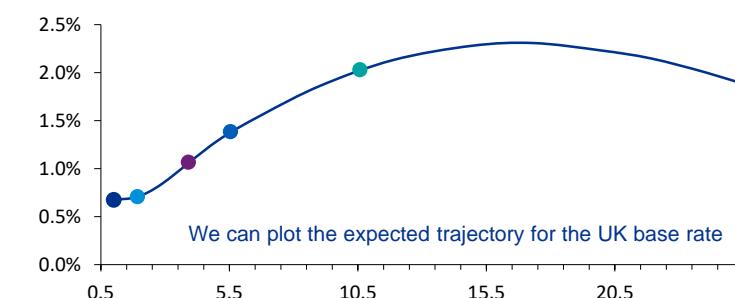
Interest rates – Today versus implied position in three years time

Implied yield curve in three years – win lose or draw?



Base rate

Implied base rate trajectory – 31 August 2018



Summary

- The UK forward curve continues to slope upwards – implying that interest rates will rise going forward. We can identify the pace of these increases by looking at the forward curves.
- A subtle, but important, point is that rates have to rise above the market expectation to impact valuations positively.
- In terms of the impact of pension scheme valuations:
 - **Win:** yields in three years time higher than already priced in (by three year forward curve);
 - **Draw:** yields move up in line with markets expectation (i.e. follows forward curve);
 - **Lose:** Yields don't increase to meet the market's expected position.

Analysis of change

Monthly yield movements

Yield movements over past 12 months

12 months	Nominal	Real	Inflation
September 2017	0.24	0.23	0.01
October 2017	(0.01)	(0.01)	0.01
November 2017	(0.06)	(0.05)	(0.01)
December 2017	(0.13)	(0.11)	(0.01)
January 2018	0.16	0.13	0.03
February 2018	(0.01)	0.04	(0.05)
March 2018	(0.22)	(0.16)	(0.06)
April 2018	0.12	0.13	(0.01)
May 2018	(0.12)	(0.10)	(0.02)
June 2018	0.04	0.04	0.00
July 2018	0.03	0.00	0.03
August 2018	0.00	0.04	(0.04)

Note: All movements quoted in percentage points change over the period

Source: Bank of England and KPMG analysis

Quarterly yield movements

Yield movements over 2018

Period	Nominal	Real	Inflation
Q1	(0.07)	0.01	(0.08)
Q2	0.03	0.07	(0.04)
Q3 (to date)	0.03	0.04	(0.01)
Q4	-	-	-
YTD	0.00	0.13	(0.13)

Summary analysis

Yield movements over past 12 months

12 months	Nominal	Real	Inflation
Max	2.12	(1.46)	3.67
Min	1.70	(1.85)	3.40

Longer term analysis

Period	Nominal	Real	Inflation
3 months	0.07	0.08	(0.01)
6 months	(0.15)	(0.05)	(0.11)
1 year	0.04	0.17	(0.14)
3 years	(0.77)	(0.76)	(0.01)
5 years	(1.81)	(1.65)	(0.16)



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