Bonds and mortgages

The Bank of England yesterday after a bruising few days for them in the bond market decided that they needed to stop selling bonds, driving prices down, and do something to try to rally them. That is good news at last. The Bank's selling came on top of the bond rout brought on by the US Central Banks interest rate rising policy, and their own sales policy of government bonds. If the Central Banks themselves think bonds are too dear and should be brought down in price, others will agree with them.

Bonds are parts of the debt the UK government has borrowed from pension funds, insurance companies and others. They are the government promises to repay the money they borrowed. They can be sold on by the people and institutions that first lent the money to the government, so they do not have to wait for the repayment date of the loan. If the prices of the bond fall then the rate of interest you get on it goes up, and if the price rises interest rates go down. If you bought a bond where the government promised to pay just 1% interest but interest rates meanwhile had gone up to 2% then you would sell the money you lent to the government for less so the next person receiving the interest on the bond would get a 2% return on his investment. How much the bond falls by depends on when the government is going to repay the full amount anyway.

The biggest buyer of these bonds in recent years has been the Bank itself since Labour introduced the policy of the Bank buying up state debt, continued by the Coalition and the Conservatives. At its peak the Bank owned £875bn of government debt. It rightly stopped buying up more of it last year, as the policy was proving inflationary. More recently it said it would start selling some of the bonds it owns. It said it wanted to shrink its balance sheet, swollen by the large amount of bonds it owns as an asset. They started selling very recently just as global bond markets led by the USA took another nose dive on interest rate rises announced by many Central Banks and in anticipation of more rises to come. The addition of Bank of England selling implied that they wanted to see the bonds go down in value and added to the general selling pressures on UK bonds.

Yesterday the Bank acknowledged that selling now with bonds so much lower in price would not be good idea. They did not, however, say they would end the sales programme unless and until bonds had picked up substantially. That was a pity, as the value of these bonds matters to families with mortgages and businesses with longer term borrowings. All the time the Bank says it will sell as the largest potential seller it can spook the market. The Bank's wish to shrink its balance sheet has ironically been achieved in the last few weeks by the fall in the value of the bonds it holds. Crystalizing the loss makes no sense.

These interest rates matter. There are 2,5, 10, 20,30 year rates and others in between. If the 10 year or 20 year bond rate goes up so bank lending for people to buy homes will also go up, as will the cost to business of a longer term loan to invest in their company. Mortgage holders and businesses do not want their Central Bank actively intervening in the markets to drive these interest rates higher. The Bank should believe its own forecasts which show inflation tumbling next year. High energy prices and dearer mortgages are already taking too much demand out of the economy. Thank you Bank for at least a temporary pause to your driving the mortgage rates up.