# Bank of England urged to act on gilt market volatility amid US Treasury turbulence



The Financial Times is reporting that recent actions and statements by US President Donald Trump have caused significant volatility in US Treasury markets, raising concerns about the potential for spillover effects on the UK gilt market and broader economic conditions. The uncertainty heightened recently when President Trump criticised Federal Reserve Chair Jay Powell, triggering fears about the possibility of Powell's dismissal. Although those fears have since subsided, the episode, coupled with the announcement of unexpectedly high tariff rates, has introduced instability that may affect UK financial markets.

Historically, UK gilt yields tend to rise in tandem with increases in US interest rates. This relationship means that turbulence in US markets could prompt upward pressure on gilt yields. Higher gilt yields have the potential to slow down corporate investment, depress the housing market, and increase fiscal pressures by forcing the government either to reduce spending or raise taxes. In an environment where economic growth is already under strain, further headwinds could add to the challenges facing the UK economy.

The Bank of England (BoE) is recognised as having a pivotal role in responding to these risks. The institution played a stabilising role after the significant gilt market turmoil triggered by the Truss-Kwarteng mini-budget in September 2022. Despite the BoE’s intervention preventing a deeper crisis, the rapid 1 percentage point rise in 20-year gilt yields over three trading days prior to action caused notable damage to confidence among businesses and consumers.

In light of this, there is a call for the BoE to adopt more proactive measures to mitigate the contagion risk from US market developments. BoE Governor Andrew Bailey recently signalled an awareness of such risks at a conference in Washington, stating that the Bank “needs to take seriously” the threats to growth posed by US tariff policies. This has been interpreted as a dovish indication regarding future interest rate decisions.

It has been suggested that the BoE should go further by explicitly reminding markets that unjustified upward moves in gilt yields effectively tighten financial conditions. By signalling that such movements could lead the BoE to lower short-term interest rates, markets may be less inclined to react sharply when gilt yields rise in sympathy with US Treasuries. This approach would require the BoE’s Monetary Policy Committee (MPC) to make judgments about the “fair value” of gilt yields—a subjective assessment central bankers might usually be reluctant to make. However, given that some US developments, such as threats to Fed independence, have limited direct relevance to UK gilt fundamentals, a bolder stance might be warranted.

Communication strategies have also been highlighted as an area for improvement. For instance, on 9 April, 30-year gilt yields experienced their largest single-day fall since the Truss crisis due to spillovers from US Treasury market problems. The BoE’s subsequent decision on 10 April to postpone an auction of long-dated gilts was well received. Yet the Bank missed the chance to promote a more durable decoupling of gilt yields from US Treasuries by refraining from indicating that it might offset unwarranted gilt yield rises through future monetary policy adjustments. If markets were convinced that the BoE might reduce short-term interest rates to counter unwarranted tightening, gilt yields might be less prone to tracking rises in US Treasuries.

A further recommendation includes the possibility of modifying the BoE’s quantitative tightening (QT) programme. Since some of Trump’s actions appear to have exerted greater influence on longer-term UK bond yields than on short-term yields, signalling that the QT programme—essentially the run-off of gilt holdings acquired during previous bond-buying efforts—is flexible could give another tool to manage long-end gilt yields. In contrast to operating on an automatic pilot, adjustments to QT could convey the Bank’s policy stance more directly, helping to dampen damaging gilt yield increases.

Given ongoing concerns that the Federal Reserve’s independence may be undermined at some point in the future despite President Trump’s recent assurances that he will not fire Powell, it is suggested that the UK could strengthen the perceived independence of the BoE. One proposal is to allow the Bank to set its own inflation target. This could lower the “inflation risk premium” embedded in UK gilt yields and further aid the decoupling of gilt yields from US Treasury market turbulence.

Overall, these analyses stress the importance of proactive and flexible monetary policy responses by the BoE to address the risks posed by external shocks emanating from US economic and political developments, particularly those linked to President Trump’s actions. The financial and economic implications of higher gilt yields accentuate the need for vigilant management of the UK’s bond market dynamics.

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