# Bank of England’s policy retreat and US debt surge risk tipping UK gilt market into crisis



The UK gilt market is facing a precarious situation driven by a convergence of domestic fiscal uncertainties, international monetary pressures, and the Bank of England's recent policy missteps. This confluence has created a heightened risk environment for gilt yields, inflation, and the value of sterling, signalling significant challenges ahead for investors and policymakers alike.

At the centre of the turmoil is the Bank of England’s retreat from its Corporate Bond Purchase Scheme (CBPS), which was initially introduced in 2016 to stabilise and stimulate the UK corporate bond market post-Brexit and later expanded during the COVID-19 pandemic. While the CBPS helped contain corporate borrowing costs and encouraged issuance at the time, evidence suggests that the liquidity improvements it provided were only temporary. Efforts to unwind the scheme from 2022 onwards—aimed at reducing the Bank’s roughly £10 billion bond holdings—have encountered severe obstacles. Higher interest rates have made refinancing more difficult, particularly for lower-rated "fallen angel" companies, creating liquidity gaps rather than stabilising the market. Furthermore, structural shifts such as the post-pandemic decline in dealer inventories, which traditionally absorb market volatility, have exacerbated market fragmentation. As a result, the corporate bond market is now less resilient to shocks, raising systemic risks that threaten spillover into the broader gilt market.

Compounding this domestic challenge is the international backdrop, particularly the United States’ fiscal trajectory. Tax cuts and aggressive deficit spending under the Trump administration have significantly expanded US federal debt, projected to exceed $33 trillion, far outpacing economic growth. This has forced the Federal Reserve to maintain elevated interest rates to attract global capital, prompting a global yield environment that pressures lower-yielding bonds like UK gilts. Consequently, UK gilt yields have been pushed upwards as foreign investors turn to more competitive US debt instruments. Additionally, the global inflationary impact of US fiscal policy has been profound, driving commodity prices higher and feeding UK inflation. Projections from the Bank of England warn that inflation could soar to 7% by 2025, well above the 2% target, creating a difficult environment for monetary policymakers.

UK fiscal policy uncertainty further exacerbates the gilt market’s fragility. Proposed Labour government policies emphasizing increased public spending and potential tax hikes echo the destabilising “mini-budget” crisis of 2022, which triggered a sharp gilt sell-off. Political instability, flagged by 43% of respondents in the Bank of England’s 2024 systemic risk survey as a serious concern, has investors demanding higher yields to compensate for perceived risk. With general elections looming, confidence in fiscal discipline remains tenuous, amplifying market volatility.

The combined effect of escalating gilt yields, persistent inflation, and a weakening sterling forms a dangerous feedback loop. Gilt yields have reached multi-year highs with forecasts suggesting further spikes as US rates remain elevated and UK fiscal stability is questioned. Inflation, remaining stubbornly above 5%, drives the Bank of England to maintain or even increase interest rates, risking deeper economic slowdown. Meanwhile, sterling’s depreciation—already down about 12% against the US dollar in 2024—imports additional inflation, worsening the outlook. This interaction poses severe challenges for UK economic stability and investment returns.

For investors, this environment suggests caution and strategic positioning. Shorting long-dated UK gilts or using inverse bond ETFs offers exposure to rising yield risk. Inflation-linked securities, both UK inflation-linked gilts and US Treasury Inflation-Protected Securities (TIPS), provide hedges against persistent inflation. Currency strategies that short sterling against the dollar may also benefit from continued pound weakness.

Recent statements from Bank of England Governor Andrew Bailey hint at a potential slowdown in quantitative tightening, recognising the market’s sensitivity to bond supply and liquidity conditions. This echoes global shifts where policymakers in the UK, US, and Japan are reconsidering long-term debt issuance strategies amidst record yields and market volatility. The UK Debt Management Office has already cut long-term debt issuance, and similar caution is seen in US Treasury policies.

Nevertheless, risk remains elevated. The Bank of England’s own assessments warn that refinancing risks on corporate bonds, coupled with geopolitical and fiscal uncertainties, could precipitate a hard landing for the UK economy. When combined with the US’s fiscal challenges and persistent inflationary pressures, the gilt market is positioned on a knife-edge. Investors and policymakers must respond swiftly to mitigate the threat of a full-blown market meltdown.

### 📌 Reference Map:

* Paragraph 1 – [[1]](https://www.ainvest.com/news/gilt-storm-policy-blunders-rising-debt-sink-uk-bonds-2507/), [[4]](https://www.economicsobservatory.com/bond-markets-and-the-uks-public-finances-whats-been-going-on)
* Paragraph 2 – [[1]](https://www.ainvest.com/news/gilt-storm-policy-blunders-rising-debt-sink-uk-bonds-2507/), [[2]](https://www.bankofengland.co.uk/quarterly-bulletin/2022/2022-q1/qe-at-the-bank-of-england-a-perspective-on-its-functioning-and-effectiveness/), [[3]](https://www.axa-im.co.uk/research-and-insights/investment-institute/asset-class-views/unwind-uks-corporate-bond-purchase-scheme-potential-liquidity-opportunity-db-pension-schemes)
* Paragraph 3 – [[1]](https://www.ainvest.com/news/gilt-storm-policy-blunders-rising-debt-sink-uk-bonds-2507/), [[5]](https://www.reuters.com/markets/us/us-fiscal-folly-could-create-big-beautiful-debt-spiral-2025-07-03/), [[6]](https://www.ft.com/content/0d73bb57-676e-4e73-93ec-03bdb22235de)
* Paragraph 4 – [[1]](https://www.ainvest.com/news/gilt-storm-policy-blunders-rising-debt-sink-uk-bonds-2507/), [[4]](https://www.economicsobservatory.com/bond-markets-and-the-uks-public-finances-whats-been-going-on), [[5]](https://www.reuters.com/markets/us/us-fiscal-folly-could-create-big-beautiful-debt-spiral-2025-07-03/)
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* Paragraph 7 – [[1]](https://www.ainvest.com/news/gilt-storm-policy-blunders-rising-debt-sink-uk-bonds-2507/), [[4]](https://www.economicsobservatory.com/bond-markets-and-the-uks-public-finances-whats-been-going-on), [[5]](https://www.reuters.com/markets/us/us-fiscal-folly-could-create-big-beautiful-debt-spiral-2025-07-03/), [[6]](https://www.ft.com/content/0d73bb57-676e-4e73-93ec-03bdb22235de)

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## Bibliography

1. <https://www.ainvest.com/news/gilt-storm-policy-blunders-rising-debt-sink-uk-bonds-2507/> - Please view link - unable to able to access data
2. <https://www.bankofengland.co.uk/quarterly-bulletin/2022/2022-q1/qe-at-the-bank-of-england-a-perspective-on-its-functioning-and-effectiveness/> - In August 2016, the Bank of England launched the Corporate Bond Purchase Scheme (CBPS) to support economic growth and return inflation to target following the EU referendum. The scheme aimed to purchase up to £10 billion of investment-grade sterling-denominated non-financial corporate bonds. Evidence suggests that the CBPS successfully lowered interest rates on UK corporate bonds and stimulated sterling corporate bond issuance. However, the liquidity improvements were short-lived, dissipating by the end of the programme. In March 2020, the Bank expanded its corporate bond purchase programmes in response to the COVID-19 pandemic.
3. <https://www.axa-im.co.uk/research-and-insights/investment-institute/asset-class-views/unwind-uks-corporate-bond-purchase-scheme-potential-liquidity-opportunity-db-pension-schemes> - The Bank of England's Corporate Bond Purchase Scheme (CBPS), launched in August 2016 and expanded in 2020, aimed to improve liquidity and reduce yields on corporate bonds to stimulate issuance. In February 2022, the Monetary Policy Committee voted to reduce the size of the Asset Purchase Facility by ceasing to reinvest maturing assets and initiating a programme of corporate bond sales to unwind the CBPS. This unwind could offer UK defined benefit pension schemes a liquidity opportunity to de-risk investment strategies and increase holdings of cashflow-generative assets.
4. <https://www.economicsobservatory.com/bond-markets-and-the-uks-public-finances-whats-been-going-on> - Since late 2024, the UK's cost of borrowing, measured by gilt yields, has been rising gradually. Ten-year gilt yields increased from 3.9% in September 2024 to 4.4% in December 2024, with fluctuations reaching a high of 4.9% in January 2025. This trend is part of a global pattern influenced by rising bond yields in the United States, driven by policies from the Trump administration that have led to higher inflation expectations and the belief that interest rates may remain elevated for longer periods.
5. <https://www.reuters.com/markets/us/us-fiscal-folly-could-create-big-beautiful-debt-spiral-2025-07-03/> - The recently passed U.S. tax and spending bill is projected to increase the national deficit by over $3 trillion in the next decade, prompting warnings of a long-term debt spiral. While the Congressional Budget Office (CBO) estimates the debt-to-GDP ratio will reach 145% by 2050, the U.S. Treasury projects a much bleaker 200% by then, and 535% by 2100 if current trends continue. The CBO and other economic analyses suggest that the economic growth generated by the tax cuts will be minimal and insufficient to offset the rising debt. As debt levels climb, risk premiums on U.S. Treasuries are expected to increase, leading to higher borrowing costs. U.S. Treasury Secretary Scott Bessent's reluctance to issue long-term bonds implies concerns about the affordability of elevated interest rates. Comparisons to Greece’s post-2009 crisis highlight risks of a slow-moving fiscal crisis. Possible solutions include fiscal restraint, capital controls, or Federal Reserve intervention through quantitative easing—each with significant trade-offs. Continued deficit expansion could lead to increased financial volatility, potential inflation, and diminished central bank independence. The article was authored by Joachim Klement, an investment strategist at Panmure Liberum.
6. <https://www.ft.com/content/0d73bb57-676e-4e73-93ec-03bdb22235de> - Economists surveyed by the Financial Times have expressed serious concerns about the long-term status of the US dollar as a global safe haven due to President Donald Trump's aggressive fiscal policies and repeated attacks on the Federal Reserve's independence. A poll by the University of Chicago’s Kent A Clark Center found that over 90% of respondents are worried about the stability of US dollar-denominated assets over the next 5–10 years. Trump's economic strategies, including large-scale tax cuts and increased government spending, are expected to push US federal debt to new highs, raising doubts about fiscal sustainability. His criticisms of Fed Chair Jay Powell and potential plans to replace him have further heightened fears of political interference in monetary policy. These issues have contributed to a weak dollar, rising treasury yields, and speculation that US Treasuries may no longer be seen as safe assets. Despite strong equity markets and modest economic forecasts—1.5% GDP growth and around 3% core PCE inflation in 2025—concerns remain over long-term investor confidence in US financial stability.
7. <https://www.ft.com/content/403036cd-3d49-485a-a7bc-4d2187549c5e> - Long-term UK government bonds (gilts) rallied after Bank of England (BoE) Governor Andrew Bailey suggested a possible slowdown in the central bank’s quantitative tightening (QT) program, which involves selling off its holdings of gilts. Bailey's remarks led to a drop in 30-year gilt yields by up to 0.1 percentage points to 5.19%, as investors anticipated reduced bond supply. He noted that shifts in long-term bond market liquidity have impacted yields. This response aligns with global trends where policymakers are re-evaluating debt issuance strategies amid a sell-off in long-dated bonds and rising global borrowing. The UK’s Debt Management Office has already reduced long-term debt issuance, and Japan may follow suit. In the U.S., Treasury Secretary Scott Bessent opposed increasing long-term debt issuance due to high yields, criticizing past reliance on short-term funding. His comments also spurred a rally in U.S. Treasuries, lowering 30-year yields to a two-month low of 4.73%. Policymakers are now focusing on managing debt issuance carefully to avoid further yield spikes.