The government must restore economic confidence as the markets spin out of control

(Alamy)

Baroness Altmann
@rosaltmann

4 min read | 29 September

Yesterday's extraordinary intervention by the Bank of England in the United Kingdom government bond market is a clear U-turn.

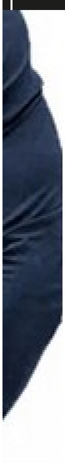
Just a few days ago, the Bank was actually planning to start selling £80bn worth of gilts, as the first step in trying to unwind the hundreds of billions of pounds of bond purchases from QE (Quantitative Easing). The announcement yesterday, although saying that the gilt-buying would only be temporary, was catalysed by the problems … UK pension funds, who hold hundreds of billions of pounds …ts and who have suffered severe losses on their holdings.

…ds have been rising for several months already. For example, 30-year gilts yielded under 1 per cent at the end of 2021, but by July the yield had risen to 2.5 per cent and in August to 3 per cent, which entailed significant capital losses for gilt-holders, especially pension investors. However, other global interest rates were also rising, so the UK did not stand out as so exceptional. With inflation and interest rates increasing across the world, the rise in gilt yields did not create undue concerns.

> **Markets need to have confidence that the UK has a plan for reducing the debt, boosting growth and managing inflation over time**

st Friday, however, there has been a sudden collapse of nce in the Sterling following Friday's fiscal event. This caused a exit from UK assets, accelerating the rise in UK gilt yields, piked to 4 per cent in the past few days and yesterday crashed through 5 per cent. International investors have been selling, but the specific issue that arose in recent days was around domestic pension fund investors, who were being caught with collateral calls, making them forced sellers too.

den crash in gilt prices, meant pension funds needed to meet calls on their gilt derivative contracts. Although they have quired to meet such collateral demands in recent months, as



[redacted]s have risen sharply, they were mostly able to manage to those, because in the previous years they actually received cash on these contracts, as gilt yields kept falling after successive rounds of QE.

Related

Foreign Secretary Says Next Week's Spending Plans Could Be Delayed

By Caitlin Doherty

4 hr

However, the latest spike was too much for many of the funds to manage or had exceeded the buffers which they were holding and the financial firms who had issued the derivative contracts were demanding cash within one or two days, whereas in the past it was [redacted]wo weeks to allow time for a more orderly process. It is [redacted]d that a typical £1bn pension fund may have faced a sudden [redacted]l of over £100mn – so they became forced sellers of gilts or [redacted]sets, adding domestic selling to the pressure from

international sellers.

With the situation in the markets spinning out of control, the Bank of England, given its remit to protect financial stability, stepped in to buy. It succeeded in bringing 30 year gilt yields down to around 4 per cent.

Although, in theory, pension funds can benefit if gilt yields rise, because the present value of their liabilities is lowered and they can expect to earn higher returns over time to meet their pension payments, the speed of the rises left them forced into selling gilts or unwinding the contracts that created the vicious negative spiral of ongoing price falls.

After many years of QE making policy decisions much easier, government now needs to make hard choices. Public and private debt are at very high levels, as they are in many other countries, especially after the Covid and energy price interventions and the balance of [illegible]ts deterioration since leaving the EU. Markets need to have [illegible]nce that the UK has a plan for reducing the debt, boosting [illegible] and managing inflation over time. Government must [illegible]se the importance of restoring confidence in UK economic management urgently if we are to avoid an ongoing series of crises.

Ros Altmann, Conservative peer.