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Rise in UK gilt yields - a canary in the Bank of England mine

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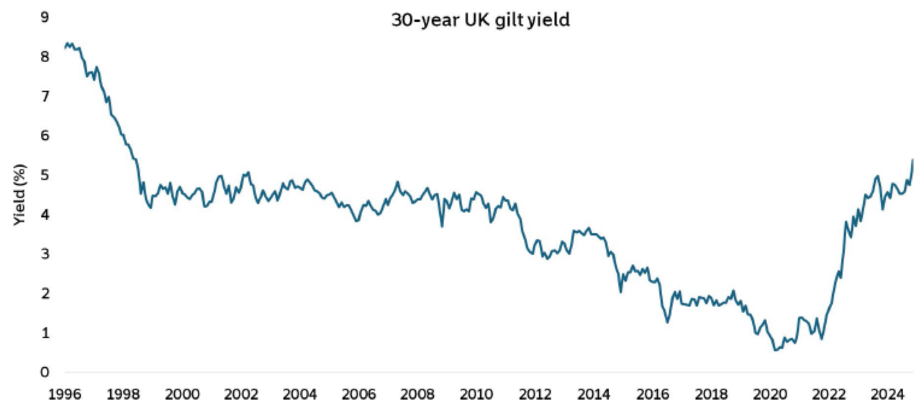
Chart of the Week



Sources: Bloomberg Finance L.P. as at 10 January 2025

What this chart shows

This chart shows UK 30-year government bonds hitting yields not seen since the last century. The start of the New Year has not been a particularly favourable one for the fixed income market. The upward pressure on yields observed in the final weeks of 2024 has continued into 2025. While this trend is common across government bond markets in developed economies, the UK Gilt market has been especially hard hit. A combination of relatively high inflation, sluggish economic growth, and diminishing support for the new government has rekindled memories of the 'Liz Truss' crisis. As a result, investor appetite for UK long-term debt has been weak.

Why this is important

The longer end of the government bond curve is driven by a variety of factors, including inflation expectations, fiscal policy, and the relative value of UK bonds compared to other developed markets. So far, inflation expectations in the market have remained stable. Many point to uncertainty in the US as the main catalyst for bringing fiscal issues to the forefront. However, the fiscal concerns are not new. In 2024, investors saw French government bond yields widen against German bonds to multi-year highs.

So why is the UK making headlines, with long-term bond yields rising to multi-decade highs? The answer lies in the starting point. Yields have been climbing in recent weeks, particularly after markets largely ignored central bank decisions in December to cut interest rate. However, in the Eurozone or even the US, the starting point for yield increases was lower than in the UK, where investors—still mindful of the 2022 'Liz Truss' crisis—have been more cautious.

If rates keep rising, it likely signals instability across many asset classes, potentially leading to increased price volatility. Government bond yields serve as a risk-free element in multi-asset models, and their rise could have widespread consequences. The Bank of England could opt for the 'nuclear option' and introduce yield control measures, but this may come at the cost of currency depreciation, which, in the case of the UK, could exacerbate inflationary pressures.

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