Lethame Capital Management

Technology : Research : Investing

Quantitative Tightening, Misdiagnosed Crises, and the Real Drivers of UK Gilt Yields

Summary

- The press narrative around UK bond markets remains fixated on fiscal headroom, inflation, and IMF-style crisis rhetoric, but this framing is misleading.
- A significant contributor to gilt dynamics is the Bank of England's **aggressive quantitative tightening (QT)** programme, which is proportionally larger and faster than the Fed's or the ECB's, and interacts with the UK's unusually long-duration debt stock.
- The BoE itself concedes QT has measurable effects on yields, revising its estimate of the 10-year gilt impact up to 0.15–0.25bps.
- Crucially, QT sales to non-banks **destroy deposits (broad money)** as well as reserves, making the programme **disinflationary at the margin as well as potentially yield-supportive**.

Introduction

Further to our recent notes on how money and deficits work, a 3rd September 2025 *FT* article was titled *"Reeves' leeway shrinks as pound falls and borrowing costs hit 27-year high"*[1]. Despite acknowledging similar falls in German and US bonds, the article went on to quote: *"Lord Ken Clarke, a former Conservative chancellor, claimed that Britain was 'much nearer to the risk of a financial crisis than the government is remotely acknowledging' and claimed it was not impossible it would have to seek a bail-out from the IMF."*

As we have repeatedly argued, a country that issues debt in its own currency cannot default. When the UK went to the IMF in the 1970s, it was still operating under the post–Bretton Woods fixed exchange rate regime, where "default" in the form of an external financing crisis was possible. With a floating exchange rate and sterling-denominated debt, such an outcome is categorically different. The government cannot run out of its own currency. So why does a former Chancellor of the Exchequer still frame the debate in these terms?

The Press Narrative

In recent months, commentary in the UK press has focused on three themes:

- The sell-off in long-dated UK gilts.
- The persistence of inflationary pressures.

- The limited fiscal room for manoeuvre available to the current Chancellor.

All of these are relevant, but they obscure the drivers of recent gilt dynamics.

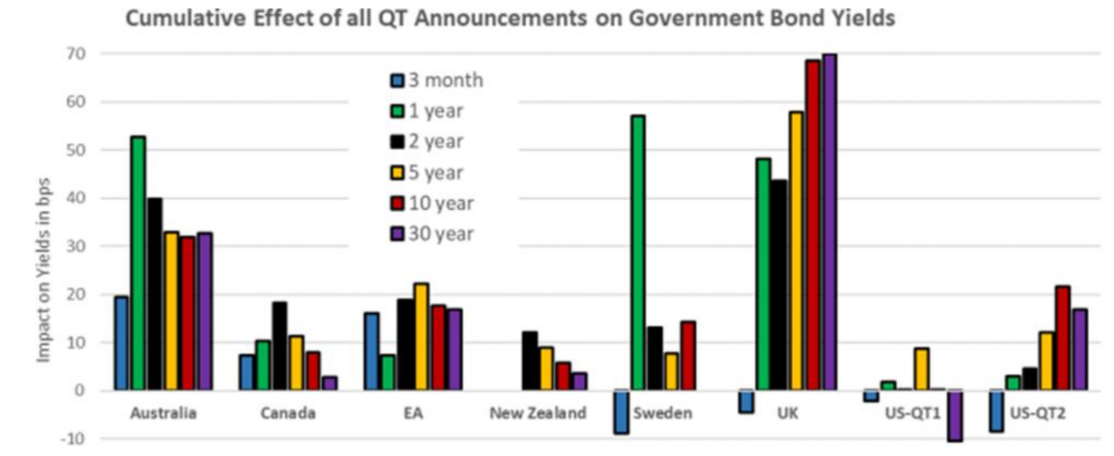
Quantitative Tightening

The UK is currently pursuing the most aggressive quantitative tightening (QT) programme of any major central bank, and it is doing so against the backdrop of one of the longest duration sovereign debt portfolios in the world. To quote the *FT*: *"The BoE went from having the world's most aggressive QE programme to the world's most aggressive QT programme"*[2]

The scale is striking: *"Adjusting for the size of the market, in the UK the net effect is equivalent to sales of about 7.4% of all outstanding government debt. This is around 70% faster than the US Fed and well over twice the pace of the European Central Bank. That's a huge amount of what is effectively new bond issuance that the gilt market has had to digest."*[3]

In terms of duration, UK gilts have an average maturity of fourteen years, compared with roughly six years for US Treasuries and shorter profiles across most other sovereign markets. This amplifies the market impact of any sales.

The academic evidence supports this. The National Bureau of Economic Research has shown that: *"QT announcements increase government bond yields, steepening the yield curve...Active QT has a larger impact than passive QT, particularly on longer maturities."*[4] From the NBER white paper *"Quantitative Tightening Around the Globe: What Have We Learned?"* (Du, Forbes and Luzzetti, 2024, p. 32) comes the following chart…



Notes: Calculated as the sum of the estimated effects of each individual QT announcement by country, based on estimates in Appendix Table A3.3. These aggregate effects only includes QT events that are new or additional QT (i.e., not *WindDown* events) and only include post-pandemic QT annoucements, except for the US annoucements from 2014-2017, which are included as US-QT-1.

Official Acknowledgement

Even the Bank of England itself is beginning to concede the point. The UK Chancellor of the Exchequer, Andrew Bailey, appeared before a House of Commons select committee on 4th September to address QT. According to

Reuters, *"Bailey repeated previous remarks that the BoE viewed the impact of QT on yields as low but would look 'very seriously' at the 'interaction' between higher long-dated gilt yields and its sales programme."*[5]

In a report published after its August MPC meeting, the Bank revised upward its estimate of the effect of QT on 10-year gilt yields. It now places the impact in the range of **0.15–0.25 percentage points**, compared with **0.10–0.20 percentage points** a year earlier[6]. This revision reflects the cumulative gilt sales conducted over the past year.

QT and the destruction of broad money

One further consequence, often overlooked, is the monetary impact of QT when gilts are sold to the non-bank sector. The Bank of England's QT programme involves transactions with both banks (money-neutral) and non-banks (money-destructive). Despite persistent fears about UK inflation, double-entry accounting shows that gilt sales to non-banks—pension funds, insurers, asset managers—actually **destroy deposits and reduce broad money**. At the margin, this is disinflationary.

The mechanics are straightforward:

1. **Transaction initiation** – The Bank of England sells a Gilt (asset) to a pension fund.
2. **Pension fund balance sheet** –
    - Debit (−): Deposits (asset)
    - Credit (+): Gilts (asset)
    - Wealth composition shifts from cash to bonds.
3. **Commercial bank balance sheet** – The Pension fund's bank reduces its deposit liability (credit, (+)) and simultaneously reduces its reserve asset (debit, (−)).
4. **Bank of England balance sheet** – The BoE reduces its reserve liability (credit, (+)) to commercial banks, offset by the sale of its gilt asset (debit, (−)).

Government Sector

	Debit (-)	Credit (+)
Bank of England	-Gilts (asset)	-Reserves (liability)

Private Sector

	Debit (-)	Credit (+)
Commercial Bank	-Reserves (Asset)	-Deposit (Liability)
Pension Fund	-Deposit (Asset)	+Gilt (Asset)

End Result

- Reserves shrink (commercial bank asset / BoE liability).
- Non-bank deposits shrink (broad money destroyed).
- Wealth shifts from deposits to gilts.

This is not a neutral asset swap. It directly contracts the money balances of the private sector, tightening liquidity conditions and exerting disinflationary pressure.

Conclusion

In this light, the market's obsession with "fiscal headroom," "money printing," and apocalyptic warnings about an IMF bail-out is profoundly misplaced. While the Bank of England itself still downplays the yield effect, the combination of:

- the most aggressive QT programme in the world,
- an unusually long-duration debt profile, and
- the active destruction of deposits when selling to non-banks,

means QT is not simply a technical background operation. It is a contractionary monetary policy in its own right, reinforcing monetary policy through the balance-sheet channel.

The reality is far more technical—and far more important—than the headlines suggest. And this is precisely why, when the debate is reduced to soundbites about "out-of-control money printing" or "buy digital gold before it's too late", we despair.

Bibliography

[1] **Financial Times (2025)** "*Reeves' leeway shrinks as pound falls and borrowing costs hit 27-year high*", 3 September.
[2] **FT Alphaville (2025**) "*Britain's quantitative tightening will hurt us for a long time*", 16 May.
[3] **The Standard (2023)** *"Is the Bank of England's gilts offload a 'selling gold at the bottom' moment?"* 19 September.
[4] **Du, W., Forbes, K. and Luzzetti, M.N. (2024)** "*Quantitative tightening around the globe: What have we learned?"* NBER Working Paper No. 32321. Cambridge, MA: National Bureau of Economic Research. Available at: http://www.nber.org/papers/w32321.
[5] **Reuters (2025)** "Bank of England's Bailey says September QT decision is 'open'" 4 September.
[6] **Bank of England (2025)** *"Monetary Policy Report – August 2025"*. London: Bank of England. Available at: https://www.bankofengland.co.uk/monetary-policy-report/2025/august-2025