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## Hedge Funds Raise UK Gilt Market Risk, Bank Warns

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Foreign hedge funds are ramping up a controversial trading strategy in the UK government bond market, sparking warnings from the Bank of England over potential systemic risks.

According to a report by *Yahoo Finance*, the tactic known as the “basis trade” seeks to profit from small price differences between the cash value of government bonds, or gilts, and their

future prices. The approach relies heavily on borrowing to amplify gains through arbitrage, but it also magnifies losses during market stress.

Data from the research platform IndexBox shows borrowing against UK gilts reached £77 billion in June 2025, the highest level since records began in 2016. Almost 90 % of this net borrowing in the repo market is concentrated in a small number of hedge funds, raising concerns among regulators about the market's vulnerability to sudden disruptions.

The Bank of England has warned that a rapid unwinding of leveraged positions in the gilt market could intensify market shocks, particularly during volatile periods. In its latest Financial Stability Report, the central bank noted that heavy reliance on leverage makes the market more prone to sharp swings.

Andrew Bailey, Governor of the Bank of England and Chair of the Financial Stability Board, believes that while financial innovation plays an important role in modern markets, excessive concentration of risk in a few participants poses dangers. He did not rule out the possibility of public interventions to maintain market stability if conditions worsen.

Efforts to tighten oversight of hedge fund activity in the gilt market have faced pushback from the financial sector. Proposals for stricter reporting requirements and higher collateral thresholds have been diluted following industry lobbying.

However, UK regulators are still considering measures to direct more bond trading through central clearing houses. Such a move would enforce higher margin requirements, potentially reducing the leverage levels that make basis trades risky in periods of instability.

The Bank of England and the Financial Conduct Authority are closely monitoring the situation, with both institutions engaging with international regulators to share intelligence on leveraged trading strategies.

The debate underscores the challenge for policymakers: encouraging innovation and market efficiency while guarding against the type of systemic risks that have triggered crises in the past.

As hedge fund involvement in the gilt market continues to grow, the balance between freedom for market participants and protection of financial stability remains a pressing concern for the UK's economic authorities.