

Bank of England Faces Tough Choices on Bond Sales Strategy

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The Bank of England (BoE) is poised to recalibrate its approach to shrinking its £558 billion government bond portfolio, with economists anticipating clarity on its long-term strategy following the August 7, 2025, policy statement. This comes alongside expectations of a quarter-point interest rate cut to 4%, a move that reflects the delicate balancing act the BoE faces amid turbulent bond markets and political scrutiny over losses incurred from bond sales.

The BoE's quantitative tightening (QT) programme, which involves both auctioning bonds and allowing existing holdings to mature, has been under intense scrutiny. Over the past year, the Bank sold £13 billion in gilts and let £87 billion mature, maintaining a £100 billion reduction pace. Continuing this trajectory would necessitate a record £51 billion in active sales over the next 12 months due to fewer maturities, a prospect that could unsettle markets. "The market would likely react poorly to such a large sale," warned Peter Schaffrik, global macro strategist at RBC, in a recent interview. He noted that market conditions have shifted since the BoE last sold nearly £50 billion in gilts in the year to September 2024.

Unlike its global counterparts, the BoE's QT strategy relies heavily on active bond auctions, a method that has drawn criticism for its impact on market stability. This forced the BoE to postpone a bond sale, highlighting the challenges of executing QT in a falling interest rate environment. "Active QT has never been tested in a context where Bank Rate is declining, so there's a risk of unforeseen interactions," said Dani Stoilova, Europe economist at BNP Paribas, who predicts the BoE may halt gilt sales from October to mitigate market disruption.

Political pressure is mounting, with the Labour government's fiscal policies adding to the BoE's challenges. The significant losses from bond sales have sparked debate, particularly as the Bank maintains that QT operates "in the background." Governor Andrew Bailey recently dismissed claims that QT is driving up borrowing costs, stating, "We need to examine the interplay between yield curve movements, QT, and monetary policy." However, former Monetary Policy Committee member Michael Saunders suggested the BoE might pivot to selling shorter-dated gilts or pause sales of those with maturities of 20 years or longer to ease market strain.

The BoE's survey in May 2025 revealed investor expectations of a slower QT pace, projecting a £75 billion reduction from September and £50 billion in 2026-27, with active sales potentially

ceasing by 2028. Yet, the steepening yield curve, where the gap between five- and 30-year gilt yields has doubled to 1.4 percentage points, complicates matters. Adam Dent, chief UK rates strategist at Santander CIB, argued, "QT has only a marginal impact on this steepness, so using it to control the yield curve would likely be ineffective."

A key driver of QT is to reduce banks' reserve holdings, currently at £680 billion, well above the £385-540 billion range banks deem sufficient. As reserves approach this threshold, the

BoE may continue sales for financial stability reasons, potentially increasing reliance on its repo operations. Schaffrik noted, “The BoE seems intent on pushing reserves well below current levels, but they’re navigating uncharted territory without clear guidance on their target.”

With markets on edge and political headwinds intensifying, the BoE’s next moves will be closely watched. The August 7 statement offers a critical opportunity to signal a more cautious approach, balancing economic stability with the realities of a volatile global landscape.