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Bank of England Expected to Ease Pace of Bond Sales

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The Bank of England is widely expected to scale back the speed of its bond sales amid rising yields and growing market sensitivity, with economists anticipating a shift in policy to maintain financial stability and protect government borrowing costs.

As the central bank prepares for its August 7 policy update, attention has turned to how it will adjust its ongoing quantitative tightening (QT) program. Quantitative tightening refers to the process of reducing the Bank of England's balance sheet by selling or allowing government bonds known as gilts to mature. The central bank currently holds £558 billion in gilts, down from a peak of £875 billion. Over the past year, it has offloaded £13 billion through active sales and allowed £87 billion to roll off through maturity.

Maintaining a 100 billion-pound annual reduction pace, as done previously, would now require unprecedented levels of gilt sales, due to a drop in bond redemptions. Many analysts expect the pace to slow to 75 billion pounds annually starting in September, with a further slowdown to 50 billion by 2026. This outlook aligns with market expectations revealed in a Bank of England survey published in May.

Peter Schaffrik, global macro strategist at Royal Bank of Canada (RBC), noted that while the BoE previously viewed QT as a background operation, recent market shifts have brought its real-world impact into sharper focus. "They are not operating in a vacuum," Schaffrik said, pointing to the sensitivity of the bond market, particularly after 30-year gilt yields surged earlier this year.

Complicating matters is the fact that this phase of QT is unfolding during a period of falling interest rates, a scenario the United Kingdom has not previously navigated. According to Dani Stoilova, European economist at BNP Paribas, this unique environment could produce unpredictable consequences. She even suggests the BoE may halt gilt sales altogether later this year to avoid distorting the yield curve further.

Despite four interest rate cuts over the past year, the gap between five-year and 30-year gilt yields has widened significantly. The BoE has maintained that its QT actions have had minimal impact on government borrowing costs. Governor Andrew Bailey recently emphasised the need to examine how yield curve movements interact with QT and broader monetary policy decisions.

There are also discussions within policy circles about focusing more on short-dated bond sales, or potentially ending the sale of gilts maturing in 20 years or more. Former Monetary Policy Committee member Michael Saunders has floated this idea as a way to limit long-term market disruptions.

The long-term direction of the BoE's balance sheet strategy remains unclear. Originally, QT aimed to reduce excess reserves in the banking system, which currently sit at approximately £680 billion, well above the estimated 385 to 540 billion-pound range considered ideal by the banking sector. Some experts believe that once reserves near this floor, the central bank may continue limited gilt sales to support liquidity and encourage use of its repurchase agreement (repo) facilities.

Still, increased participation in BoE repo operations suggests this threshold could be closer than anticipated. “They could slow things down or feel their way to that level,” Schaffrik added, noting that the central bank has yet to offer clear guidance on its ultimate QT target.

As markets brace for the BoE’s next move, it’ is clear that striking the right balance between unwinding stimulus and ensuring financial stability is proving more delicate than ever.