Bank of England faces growing pressure for emergency rate rises as bond yields jump

G
overnment bond yields surged as the City bet on emergency hikes in interest rates and financial markets gave a firm beating to the pound and other UKassets today.

Sterling fell to lows not seen in a generation and lifted the returns investors were demanding to lend to the UK past 4%.

That was taken as a clear sign of waning confidence in the UK's economic prospects following a controversial "mini" budget on Friday.

The pound bounced up slightly off lows under $1.035 it touched during Asian trade. It reached $1.077, which still left it down 0.7% on the session. The yield on 10-year government debt hit 4.16%, with shorter-dated, two-year bonds yielding almost 4.5% as traders sold out of gilts. Before Friday's budget both those yields were at around 3.5%.

There is mounting pressure on the Bank of England for an emergency interest rate rise to try and relieve the pressure on sterling, with a plunge to parity with the dollar seen as increasingly likely. The next meeting of the Monetary Policy Committee is not due until November.

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Victoria Scholar at Interactive Investor said: “The slump in sterling could exacerbate the UK’s inflation problem with price levels currently flirting with double digits. More expensive imports may add to the UK’s upward price pressures, which is likely to prompt more aggressive action from central bank policy makers.”

While that prospect helped shares in companies earning revenue in the US currency and booking profit in dollars, it also stoked fears about deepening inflation into the winter, with international energy markets denominated in foreign currency, making the cost of the UK’s energy subsidy programme more expensive just as the tax cuts announced by Chancellor, Kwasi Kwarteng, will slash government revenue.

Susannah Streeter at Hargreaves Lansdown, said: ”The fresh bout of panic appears to have been brought on by rumours that the Bank of England may step in with an emergency rate hike. But comments by Kwarteng that he will go even further with historic tax cuts, which are already being criticised as reckless, have added to the anxiety. The worry is that not only will borrowing balloon to eye watering levels, but that the fires of inflation will be fanned further by this tax giveaway.”

The FTSE 100 was steadier, down 14 points to 7004.20, with its multinational constituents boosted by the weaker pound and offsetting sharp declines for housebuilders and other domestically-focused stocks. But it was unable to hold a modest overall rally seen in early trade. The FTSE 250, more rooted in the UK economy, was down 55 points at 17918.40.

Russ Mould, investment director at stockbroker AJ Bell said: “The market’s continuing verdict on the mini-Budget which turned out to be anything but mini couldn’t really have been any more savage. With government borrowing costs also going through the roof, a key question facing investors in the face of all this is can and will Truss, Kwarteng and co. hold their nerve?”