Bank of England intervenes for second day running to ease market turmoil

T
he Bank of England has stepped in with further emergency action for the second day running to head off a "fire sale" of UK government bonds amid ongoing turmoil in markets triggered by the Chancellor's mini-budget.

The central bank warned that the sell-off in the UK government bond market poses a "material risk to UK financial stability" after yields on long-dated gilts soared once more on Monday, despite action by the Bank and Government to try to allay investor concerns.

Threadneedle Street said it will now widen the scope of its bond-buying programme to include purchases of index-linked gilts – a type of UK government bond that tracks inflation.

On Monday, it doubled its daily bond-buying limit to £10 billion, while Chancellor Kwasi Kwarteng brought forward his new fiscal plan and independent economic forecasts to October 31 in an attempt to calm turbulent markets.

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The Bank's latest action helped sharply lower yields on long-dated gilts on Tuesday morning in welcome relief after 30-year government bonds yields hit 4.7% on Monday – the highest level since the Bank was forced to step in last month to avoid a mini financial market crisis.

But the pound remained under pressure, standing at 1.10 US dollars, despite the Bank's extra measures.

The Bank said: "The beginning of this week has seen a further significant repricing of UK government debt, particularly index-linked gilts.

"Dysfunction in this market, and the prospect of self-reinforcing 'fire sale' dynamics pose a material risk to UK financial stability."

It added that its latest efforts will "act as a further backstop to restore orderly market conditions".

The move came as the Institute for Fiscal Studies (IFS) think tank warned that the Chancellor will have to find spending cuts of more than £60 billion if he is to meet his target to get the public finances back under control.

Neil Wilson, chief market analyst at Markets.com, said the Bank's third tranche of bond-buying action "seems rather messy and panicky".

He said: "As expected the market was always going to retest the Bank's resolve and put the Budget to the sword.

"To expand your emergency intervention in the market once is unfortunate, to do so twice looks like carelessness."

Shadow chief secretary to the Treasury Pat McFadden said:

“That the Bank of England has been forced to step in for a second day running to reassure markets shows the Government’s approach is not working, and creates renewed pressure for the Chancellor to reverse his Budget.”

Threadneedle Street intervened with emergency action on September 28 when the mini-budget market chaos caused the pound to tumble and yields on gilts to soar, which left some pension funds across the industry close to collapse.

The market turmoil had forced pension funds to sell gilts to head off worries over their solvency.

Investment banks made calls on so-called liability driven investment (LDI) funds, which in turn called on pension funds, forcing them into a fire sale of gilts, driving prices still lower and yields higher and creating a downward spiral.

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The Bank laid bare the scale of the woes last week when it said its emergency scheme helped the UK narrowly avoid a market meltdown caused by concerns over the Chancellor’s tax cut plans.

But gilt yields started to surge once more due to ongoing fears over the Government’s economic policies and worries that the October 14 deadline set by the Bank for its bond-buying scheme could see a return to pension fund woes.

In particular, index-linked gilts have picked up sharply, sparking the latest action to stabilise the market, while the Bank also signalled other bonds have come under pressure, announcing it would pause its corporate bond sales this week.

“The Bank continues to monitor developments in financial markets very closely in light of the significant asset repricing of recent weeks,” the Bank said.