

We are not and never will be dependent on bond markets

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There [was an article on the UK gilts market](#) in the FT yesterday by Elaine Moore. Published under its 'long read' banner this one really does deserve to be called out for precisely what it was, the technical description for which is pure drivel.

Clearly intended as a pulp piece to justify the rewards paid to those who advise on investment in this area (which as a career choice must make undertaking look like fun) the entire premise of the article was false. The claims made can be summarised in a couple of quotations, such as this:

The market is already showing signs of concern about just how long the rally in gilts can last. In recent days, a sell-off has raised yields. Dwindling appetite from international investors, improving economic data and a fiscal policy that increases the supply of gilts all pose potential threats. Previous market meltdowns suggest that with yields so low, the sell-off could be sharp. In a matter of days, rates could jump by whole percentage points - making future government borrowing more expensive.

And

Overseas ownership of gilts jumped from a quarter of the total market to a third as the UK began issuing shorter-dated bonds preferred by foreign banks and treasuries. There is no breakdown of foreign ownership of UK debt but China is thought to be among the biggest buyers. Crucial to the gilt market and by extension the country's financial stability, this group is notoriously less "sticky" than domestic investors.

The comments support two claims. The first, by implication, is that we are entirely dependent upon the fickleness of these people. The second is that every month the UK must sell £11 billion or so of bonds, part to cover the deficit, the rest to replace debt rolling over and if we don't then crisis awaits us.

This, however, is blatantly untrue. In effect (I stress, in effect, but the effect is what matters) almost half this total will be covered by quantitative easing in the next year, as a result of which £60 billion of gilts will be bought by the UK government. On

average this has been the case for the last seven years. And if in that case the rates on UK government bonds were to rise by 1% then QE could reverse the situation almost at whim. The claimed uncertainty in this market simply does not exist now QE is in use.

And because it ignores QE entirely (it never even gets a mention) the article also fails to mention the reality that one quarter of the whole UK gilt market is owned by the UK government at present - or has effectively been cancelled, because there is not a hope that these gilts will ever be sold back into the markets at any time in any foreseeable future. As misrepresentations go in an FT piece that is pretty staggering.

What is also ignored is the fact that no government need issue gilts at all. It has only been EU law that has required the UK to do so in recent years. It is that law which has prevented the government simply issuing new money instead at any time. And it is the article's ignorance of this fact, or willingness to turn a blind eye to it, that hides the fact that far from investors doing the government a favour by investing in gilts the government does savers an enormous favour by letting them place funds on effective deposit at guaranteed fixed rates with the only deposit taker who will never default because they can always print more money to make sure that they will not do so. The government could, in effect, entirely avoid paying this interest but for the essential role that the government wants its bonds to play in certain key financial markets, such as the repo and pension sectors.

The FT would clearly like to preserve the myth that Bill Clinton once promoted that bond traders hold all the power in an economy. In practice the truth is that those traders [should be very grateful that their continued existence is still tolerated](#) because the reality is any government and we as a society could do without them. There are good reasons why we choose not to do so, but both Bill Clinton and the FT really need to give up their myths: all the power in the market for the bonds of a mature government rest with that government and not the market makers. It's a pity we don't have politicians or a financial press willing to say so.