

Funding the Future

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Liz Truss and Rachel Reeves have a lot in common. I never thought I would say that, but I really think they have. Both are the undoubted victims of UK government gilt crises created by the Bank of England.

I know it is popular to say that Liz Truss crashed the economy in September 2022, and let me make it clear that I think that she was actually incompetent. She did, after all, let Kwasi Kwarteng present a ridiculous and uncosted budget during that month. But the crash that happened thereafter was not her fault.

That crash happened because the day before that Budget was presented to Parliament, the Bank of England had announced the first stage of its quantitative tightening program. As a result, it was stated that the Bank would sell £80 billion of government bonds into financial markets in the following year, and none of the proceeds of sale would be used to fund the government spending. Instead, the aim was to drain the private sector of funds, supposedly to reduce the risk of inflation.

The consequence was, however, the so-called LDI crisis. That happened because this dramatic change in policy from the Bank of England caught out all those pension funds, in particular, who had invested in government bonds assuming a stable market, which no longer existed. The consequence was that those funds had an immediate liquidity crisis. Far from undertaking quantitative tightening, the Bank of England did, instead, have to put in place an emergency quantitative easing programme to keep major financial institutions from insolvency.

You can argue that the pension funds should not have pursued the policies they did, and I would have some sympathy.

But a much more effective argument would be one that suggested the Bank of England should have:

- understood what it was doing,
- given prior warning of its intentions, and
- should have proceeded with vastly more caution so that markets were not disrupted by its reckless actions.

Bailey survived that debacle, even though he should not have done so. However

incompetent Truss and Kwarteng were, Bailey was very much worse, and he was the person who should have really paid the price for what happened.

Now Bailey has created another financial crisis, this time for Rachel Reeves, on the back of which others are now riding. This one is also easier to understand. Rachel Reeves has the simultaneous goals of delivering growth and balanced budgets. To achieve that, she needs low interest rates and a ready market for the government bonds that she wishes to sell, having changed the fiscal rule to ensure that gilt sales to fund investment will not upset her plans.

So, what has Bailey done? He and his reckless colleagues at the Bank agreed to continue with quantitative tightening, planning to sell pointlessly £100 billion worth of bonds in financial markets this year, realising considerable losers whilst doing so. Their sole aim in doing so is to remove funds from markets that might otherwise be used for productive purposes by funding investment. In addition, this plan was intended to push interest rates up to supposedly control inflation. There has been no perceived impact on inflation, and nor will there be, but the interest rate rises have happened and are exactly what has created Rachel Reeves' crisis.

Rachel Reeves is not a good chancellor. It will take quite extraordinary on her part for anyone to change their mind about that. There are very good reasons to question her competence. However, the current crisis is not even remotely of her making, whatever some right-wing commentators want to suggest.

Worldwide, interest rates are rising. That is down to Trump.

Musk has attacked the UK, and his friends in the City of London are willingly joining in the attack on Labour.

But, neither might have had much impact if Andrew Bailey and the Bank of England had managed monetary policy in a way that was even remotely responsible. They have not done that. In fact, what is very clear is that Bailey has, himself, gone out of his way to do everything he can to undermine the government by undermining growth and inflating its interest costs.

It is questionable as to whether either Liz Truss or Rachel Reeves should have reached the high offices to which they were appointed. But the one thing that seems certain is that Andrew Bailey set up both of them to fail and, so far, has got away with it.