Daily Dose of Macro & Markets 3rd September 2025: "UK Gilts – Risks Rising"

The 'Daily Dose of Macro & Markets' is our new publication designed to speak to the key global macro debates that matter for markets (with 1 - 3 charts and two paragraphs). This product will be published every Tuesday, Wednesday and Thursday morning (early London time).

Key Quote:

"The UK government sector is too large, it's unproductive and crowds out the private sector (slowing economy-wide productivity growth), while the current Labour government shows no real intent of reforming it/reducing its size."

"In the absence of a genuine, marked change of direction by this Labour government, the path towards a crisis (and possible IMF bailout) during the next recession, in perhaps 2 – 5 years' time, will continue"

Source: Longview Letter No. 148, 30th April 2025: "UK: Boom First -> IMF Bailout Later? a.k.a. How to Fix the Economy, Part III", available HERE

UK Gilts – Risks Rising

A sense of panic has returned to the Gilt market. Yesterday, for example, 30 year yields rose to new highs (closing at 5.67%, FIG 5), while the spread of both 10 & 30 year Gilt yields over the US is now approaching 'Liz Truss levels' (FIG 2). As such, and with sterling down 1.1% on the session, markets are re-focussing on the potential for a **further erosion of UK fiscal credibility** at this autumn's budget.

That concern was highlighted by the NIESR report last month (available HERE), which suggested that Reeves is on track to breach (i) her 'stability rule' (i.e. fail to balance the current budget by 2029-30, FIG 1); (ii) her 'investment rule' (debt won't be falling as a % of GDP by year 3 of the OBR's forecast horizon); and (iii) her claim to have a meaningful "buffer" against shocks. That is, the £9.9bn of headroom she 'pencilled in' is all but gone, and £40–50bn of **spending cuts and/or tax hikes** is now needed to comply with those two rules (according to NIESR estimates).

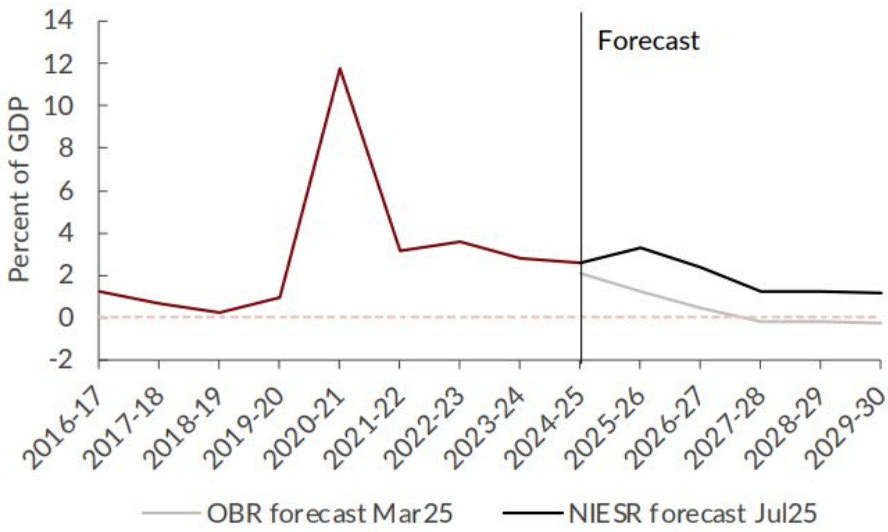
So far, though, this government appears to be unable to meaningfully cut spending. Various attempts to cut welfare spending, in particular, have failed (including on Winter Fuel and Personal Independence Payments, amongst other concessions). Equally, revenue raising efforts have been disappointing (e.g. with higher CGT rates resulting in lower CGT revenue). There's also good evidence that a 'wealth taxes' approach (expected this autumn) will be ineffective/is unlikely to work (hence why many OECD countries have repealed them, see HERE).

The risk, therefore, is that the government's **fiscal discipline keeps slipping** this autumn (and beyond) – with more borrowing, higher interest costs (which are already high relative to revenues), and growing **questions about UK debt sustainability**.

Naturally, much depends on Reeves' policy choices this autumn. Poor choices, though, would come against a backdrop of (a) ongoing QT by the BoE (a drain on bond market liquidity); (b) softening economic growth, see FIG 3 (and therefore government revenue growth); (c) bloated government spending, which currently stands at 45% of GDP (a level that's only been reached during crises, see FIG 4); and (d) sticky inflation, which has risen in the past 12 months (and will increase borrowing costs at the margin, given that 'index-linked' bonds are 25% of total borrowing, see HERE for detail).

Overall, therefore, higher long end yields are consistent with our view that the UK remains **on the path towards a crisis and an IMF bailout**, probably in its next recession (see quote above for detail).

FIG 1: Current Budget Deficit (% of GDP)



Source: OBR, NiGEM database and NIESR forecast.

Available HERE: https://niesr.ac.uk/wp-content/uploads/2025/08/JC883-NIESR-Outlook-Summer-2025-UK-v6-1.pdf

FIG 2: Spread of UK 10 & 30 years over US Treasury yields (bps)

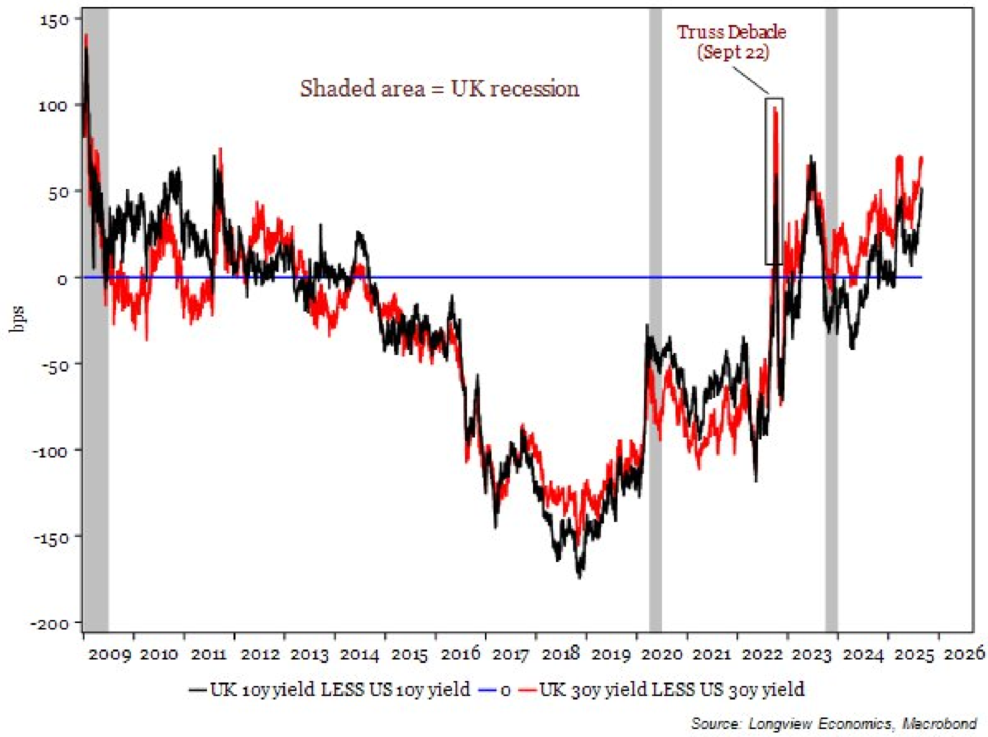


FIG 3: UK GDP growth (q-o-q % vs. NIESR estimate "3 months on previous 3 months", %)

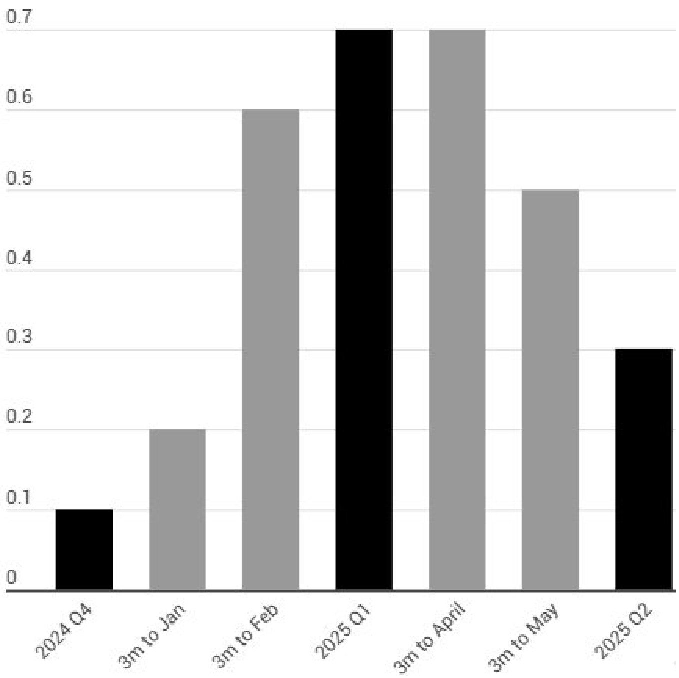
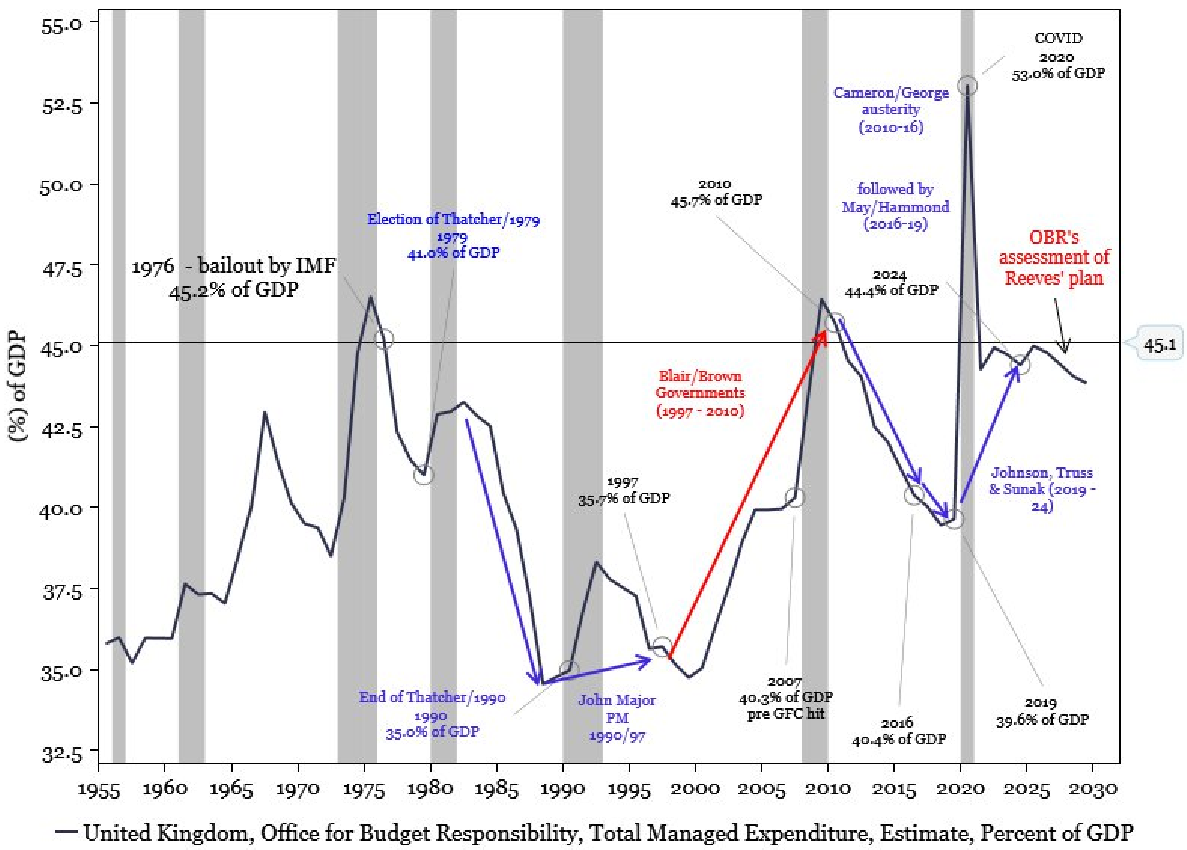
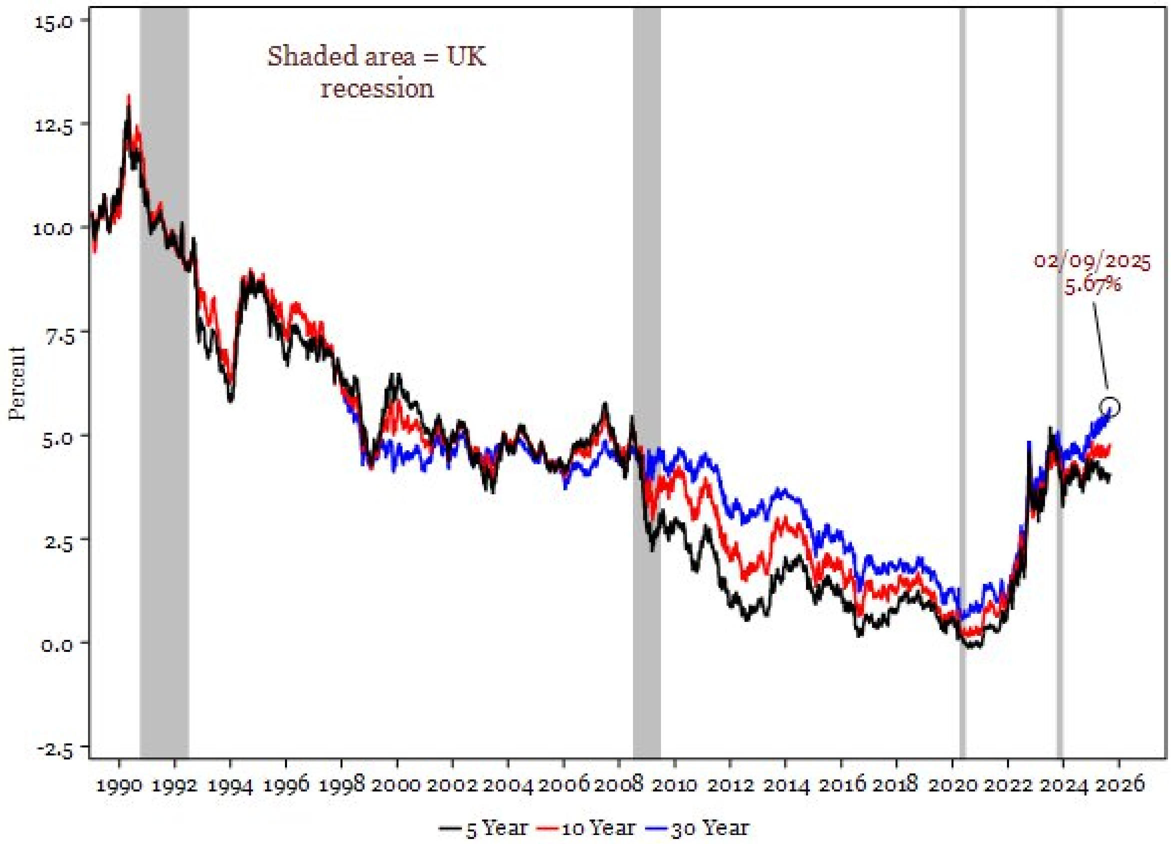


FIG 4: UK total managed expenditure (government spending) as % of GDP



Source: Longview Economics, Macrobond

FIG 5: UK Gilt yields (5, 10, & 30 year maturities, %)



Source: Longview Economics, Macrobond