

## Section One

# Is Quantitative Tightening helping depress productivity and lower economic growth?



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**In March 2009, in the depths of the Global Financial Crisis, the Bank of England (“BoE”) was concerned about the possibility of deflation, due to collapsing aggregate demand.**

They believed that encouraging demand in the UK economy by increasing liquidity would help them maintain their inflation target. They also wanted to reduce the potential for further market disruption because there was a real fear that institutions would begin to hoard money and the financial system would seize up.

Their main, and preferred, monetary policy tool to stimulate economic demand – reducing Bank Rate – had been exhausted following a series of rapid rate cuts from the 5.75% which Bank Rate stood at in November 2007, to just 0.5% by April 2009.<sup>1</sup> The BoE then rejected reducing it below zero. The solution was Quantitative Easing (“QE”) – buying UK Government and corporate bonds in large quantities with newly created money to reduce gilt yields. This would inject liquidity into the economy by reducing borrowing costs for companies and the Government.

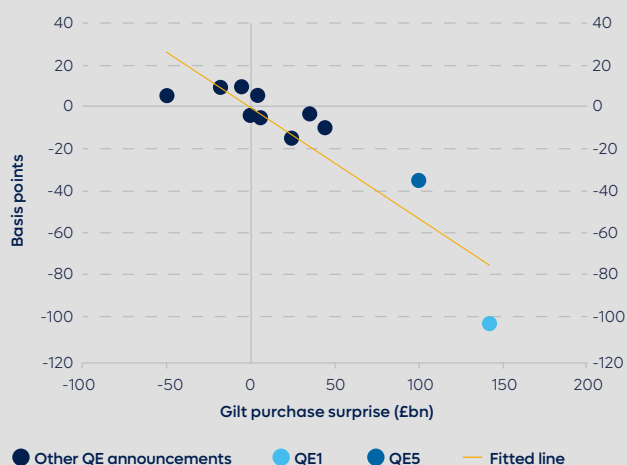
In May 2022, the BoE published an analysis of the functioning and effectiveness of its QE programme. This showed that QE’s effectiveness at lowering gilt yields was highest in the first round of QE, with an overall reduction of 100 basis points (“bps”). This reduced in subsequent announcements, as shown below in figure one. The BoE’s analysis also found that insurance companies played a key role in QE’s transmission mechanism by selling gilts to the BoE and shifting to corporate bonds.<sup>3</sup>

The BoE hold the gilts and bonds purchased under QE in the Asset Purchase Facility (APF) a Bank-owned subsidiary, indemnified by the Treasury, separate to the Bank’s core balance sheet.

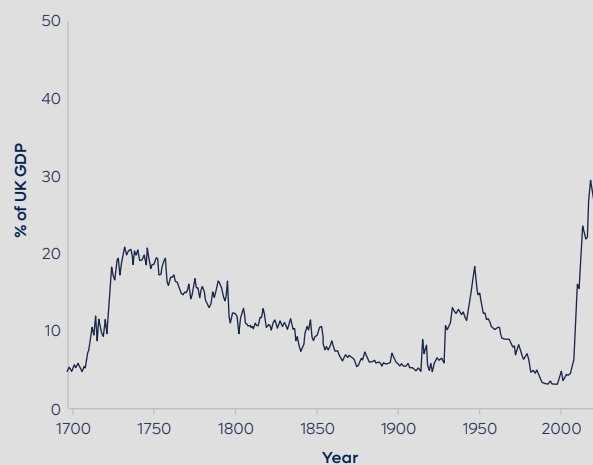
Under QE, the BoE’s balance sheet expanded rapidly (see Figure Two). It peaked at £895 billion in January 2022.<sup>4</sup>

Technically there is no limit to the size of the BoE’s balance sheet, but there are clearly questions about the sustainability of the quantum of Government debt. We are at a historically unique moment in the history of monetary policy in the UK.

**Figure One: Change in 10-year gilt yields after QE announcement and gilt purchase surprise<sup>2</sup>:**



**Figure Two: Bank of England Balance Sheet as a percentage of nominal UK GDP, 1697-2023:<sup>5</sup>**



<sup>1</sup> Bank of England Database, [Official Bank Rate history](#)

<sup>2</sup> Bank of England, [QE at the Bank of England: a perspective on its functioning and effectiveness](#), Quarterly Bulletin 2022 Q1

<sup>3</sup> Bank of England, [Quarterly Bulletin 2022 Q1, QE at the Bank of England: a perspective on its functioning and effectiveness](#), May 2022

<sup>4</sup> HM Treasury, [Correspondence, Letter from the Chancellor of the Exchequer to the Governor of the Bank of England](#), 13 May 2025

<sup>5</sup> Bank of England, [Optimal quantitative easing and tightening](#), Staff Working Paper No. 1,063, March 2024

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### How is the Bank of England undertaking QT?

In February 2022, the BoE started its QT programme by reducing the size of the APF through passive QT, that is ceasing the reinvestment of maturing gilts and corporate bonds. However, in November 2022, the Bank began the active sale of corporate and government bonds.

The BoE make clear that “the aim of QT is not to affect interest rates or inflation. Instead, the aim is to ensure that it is possible to undertake QE again in future, should that be needed to achieve the inflation target.”<sup>6</sup> With the disruption we have seen in markets in recent years, including Covid, the LDI crisis, and the Trump tariff disruptions, the BoE’s desire to have the capacity to act decisively again sounds wise.

However, there are consequences in the short term. The size of the BoE’s balance sheet can distort the markets by influencing the availability of reserves, which impacts market liquidity and can affect short-term interest rates. The larger it is, the more it distorts markets.

While the BoE recognise that QT is part of the macro environment that informs yields, they believe the impact is limited, and in any case significantly smaller than the reduction in gilt yields under the first round QE. In their view this is because QT has been signalled in advance. However, they do acknowledge there is, “uncertainty about the impact of reducing the stock of purchased assets on monetary conditions.”<sup>7</sup>

Writing for the Institute of Economic Affairs on the cost of QT, the right of centre Rt Hon Sir John Redwood states that an outcome of QE was to drive bond prices higher and yields lower, so we should expect QT to lower bond prices and drive yields higher.<sup>8</sup>

Yet QE and QT may not have precisely matching inverse impacts, because QT is being undertaken well signalled in advance according to a timetable, rather than in high pressure circumstances with dramatic interventions. QT also follows QE, so the economic situation is different, as the UK now has a substantial stock of debt it did not have in 2009 and so the risks of maintaining high debt levels should also be considered.

While the BoE state they are not altering the overall size or pace of their QT programme<sup>9</sup>, they have in practice adjusted QT by delaying the sale of long-term bonds in response to the turmoil in long-term bonds in England, and the Trump tariffs of 2025.

### How is the BoE acting differently to other central banks?

Many central banks are conducting passive QT, but unlike the BoE most have taken action to reduce their losses on QT by not doing active QT or not charging current losses back to the taxpayer.

The European Central Bank is holding its bonds to maturity and since September 2023 is not paying interest on minimum reserves.<sup>10</sup> The US Federal Reserve has created a matching asset on its balance sheet to cover these losses out of future profits.

The indemnity provided by HM Treasury to the BoE for losses in the APF has empowered it to act differently. Initially, it made a profit on QE but current losses on these assets look set to far exceed those initial profits. Overall the taxpayer will begin to make a net loss on the programme (profits minus losses) beginning early 2026. The Office for Budget Responsibility is now forecasting a cumulative net lifetime loss of £133.7 billion on the APF assets, although this figure is heavily sensitive to future interest rates.<sup>11</sup> The taxpayer is losing money on QT in two direct ways: As interest rates have risen, the income on the gilts the BoE holds no longer cover the interest it pays to private banks on their deposits; and through active QT the BoE is selling bonds before maturity at a loss to reduce its balance sheet quicker.

The taxpayer is also impacted indirectly because the higher yield on government debt means higher interest payments, which come out of tax receipts.



<sup>6</sup> Bank of England, [Quantitative Easing](#)

<sup>7</sup> Bank of England, Monetary Policy Committee, [Monetary Policy Report August 2021](#)

<sup>8</sup> Institute of Economic Affairs, [The Cost of Quantitative Tightening](#), Recommendations for Government and the Bank of England, Rt Hon Sir John Redwood, March 2025

<sup>9</sup> Financial Times, [Bank of England drops sale of long-dated bonds amid market turmoil](#), April 2025

<sup>10</sup> European Central Bank, [ECB adjusts remuneration of minimum reserves](#), July 2023

<sup>11</sup> Office for Budget Responsibility, [Economic and fiscal outlook – March 2025](#)

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### What are the alternatives to the BoE's approach?

The scale of the losses is controversial because it is linked with the BoE's decision to engage in active QT. This is compounded by the BoE's decision to pay Bank Rate interest on all reserves held with it, when it could pay no interest on bank reserves, or only pay interest on reserves held above the minimum level – operating a tiered reserve policy – as other central banks do.

The BoE could decide to allow the APF assets to run off without active sales, a process called passive QT and not reinvest the proceeds. This would negate the need for a timetable.

Monetary policy could also be more balanced without the swings between long distinct periods of QE and QT.

The BoE could also adopt a tiered reserve policy. Tiered reserves, where banks would be expected to hold a portion of their reserves unremunerated, are in practice not much different to the negative interest rate previously considered as part of the BoE toolkit. Commercial banks' profits might take a hit and/or they could reduce their lending, but they may prefer this to an explicit windfall tax which could otherwise occur.

For example, the Trades Union Congress (TUC) has said one policy option would be to introduce a windfall tax surcharge of 35% on bank profits bringing the corporate tax plus surcharge rate to 60%<sup>12</sup>. The TUC reference analysis by Positive Money, a campaign group, which estimated that a surcharge of 35% would have raised £20 billion in 2023 alone<sup>13</sup>.

Were the BoE to end active QT, there would be a substantial saving for the taxpayer. The left-wing think tank The New Economics Foundation (NEF) estimates that HM Treasury could save £13.5 billion per annum in this scenario.<sup>14</sup>

NEF also estimate that up to £11.5 billion in addition could be saved per annum by adopting a tiered reserve policy.<sup>15</sup> This is a lot of money for a fiscally constrained government to leave on the table.

### How QT helps lower productivity

Whatever the actual level, by helping to push gilt yields higher than they otherwise might be, QT is causing those borrowing in the listed and private capital markets – including housing associations ("HAs") – to reduce their borrowing, the cost of which is referenced to those yields. This depresses productivity and slows economic development.

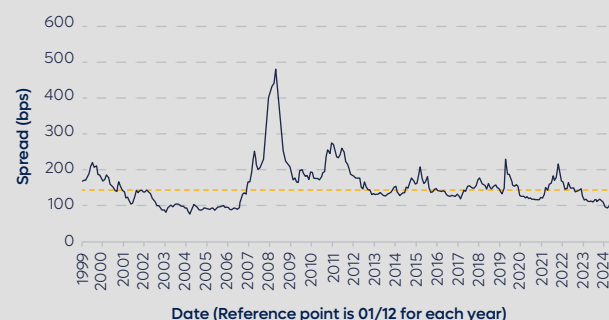
PIC has lent more than £3 billion to HAs to date. However, over the past year, the supply of HAs looking to borrow has dried up, because of the overall rise in the cost of borrowing including the impact of QT.

HAs set long-term strategy to match expected borrowing costs over periods of up to 30 years, and do not want to lock into high borrowing costs for long periods. So, even where they are currently borrowing, they are doing so for shorter terms, hoping to refinance when rates drop (see Section Three: Focus on Social Housing).

Institutional investors like pension funds and insurance companies, seek to lend over the very long-term in order to secure the cashflows to match pension liabilities which stretch out decades into the future. As prudent investors who expect to hold these investments over multiple economic cycles, institutional investors are wary of investing when markets are overvalued – which in practice means when credit spreads are low. The credit spread represents the additional compensation investors demand for taking on the credit risk of a non-government borrower, compared to the "risk-free" government bond. They are used by investors as a reference point to price risk in credit markets and, as figure three shows, credit spreads are historically low today due to the sheer weight of money chasing investment opportunities.

**Figure Three: Long Dated UK Credit Spreads:**

Long-dated UK credit spreads are now trading in the 17th percentile



So, we have a situation where, in the current environment, the HA thinks it is expensive to borrow – a situation compounded by QT – but institutional investors think it's expensive to lend. So overall investment in social and affordable housing goes down.

In turn, this impacts the outcomes of the UK Government's stated missions to grow the economy and deliver 1.5 million houses.<sup>16</sup>

Money spent covering BoE losses on bond sales also represents an economic opportunity cost. It could be spent on extra hospital places; government guarantees to boost private investment in infrastructure; or a range of other projects that could boost economic growth.

The problem with indemnifying the BoE on bond losses is that there is no government body pushing for a cost benefit analysis of the benefits of QT compared to other forms of fiscal stimulus. This is an important piece of work that should ideally be completed. If the BoE is incorrect and is underestimating the real impact of QT on yields, it could cause an economic downturn by tightening too much.

<sup>12</sup> Trades Union Congress, [Bank taxation](#), November 2023

<sup>13</sup> Positive Money, [Campaigners Trick or Treat the Banks](#), October 2023

<sup>14</sup> New Economics Foundation, [Treasury to hand Bank of England £130bn in next five years in stealth subsidy to bankers](#), February 2025

<sup>15</sup> New Economics Foundation, [Government could save £55bn over next five years by limiting Bank of England's interest payments to commercial banks](#), November 2023

<sup>16</sup> HM Government, [Plan for Change, Milestones for mission-led government](#), December 2024



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### How can we estimate QT's impact on gilt yields and the bank rate?

Currently, the BoE assess QT's impact on gilt yields by estimating its impact on term premia, the additional compensation investors demand to hold a longer-term bond relative to a series of shorter-term bonds. They believe QT's impact on 10-year gilt yields is low, at between 10-20 bps of the 40 bps term premia impact since QT began. At the other end of the spectrum, the National Bureau of Economic Research (NBER) suggests that the cumulative impact of all QT announcements on government bond yields is between 44-70 bps.<sup>17</sup>

Handelsbanken estimate that QT's impact on the bank rate specifically could be equivalent to the BoE raising interest rates by around 50 bps by mid-2025.<sup>18</sup> Taking up to 50bps off the cost of borrowing would clearly affect lots of marginal investment decisions, but the impact of QT may be greater in future.

Most assessments of QT's impact focus on market movements in the days following future sale announcements. However, the assessments should be made in an analysis of the overall increase in gilt yields, which includes the tightening because of interest rate decisions. QT has reinforced the impact of base rate increases. Since QT was announced, bond yields have surged (see figure four below) and it is in this context that QT is adding to the cost of borrowing.

**Figure Four: 30 Year HM Treasury Gilt Yields<sup>19</sup>**



We should consider whether it is wise to use the same metric to assess the impact of QE, which was first announced as a surprise, for QT, which has been heavily signalled in advance. For QE, the claim that the market moves represented the impact for QE are justifiable because the announcements were a response to crisis. QT was not a surprise, so the moves in gilt yields on market days following the announcements reflect the extra speed of QT, rather than the quantum of QT. It is therefore likely that they underestimate its impact.



### Will QT's impact on UK borrowing costs increase?

The BoE is cancelling the bank reserves it created to purchase the stock of gilts they hold in the APF as they mature or are sold. This reduces liquidity and tightens the money supply.

The market is also being asked to absorb £100 billion of secondary gilts in the year to September 2025, with more sales likely to follow in future years. This is in direct competition with the UK Government's plan to borrow over £300 billion in 2025/26.<sup>20</sup> This means that government primary borrowing could in practice be higher. The OBR has confirmed that for 2024/25 the government has overshot expectations by £15 billion.<sup>21</sup> This can create dangers.

<sup>17</sup> NBER WORKING PAPER SERIES, **Quantitative Tightening Around the Globe: What have we learned?** April 2024

<sup>18</sup> House of Commons, Treasury Select Committee, **Written evidence submitted by Handelsbanken plc**

<sup>19</sup> Trading Economics, **United Kingdom 30-Year Treasury Gilt Auction**

<sup>20</sup> HM Treasury, **Policy paper, Debt Management Report 2025-26 (Accessible)**, April 2025

<sup>21</sup> Office for National Statistics, **Public sector finances**, UK: March 2025

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### Who'll buy all these gilts?

The question then is who will buy all these gilts? Under QE, private sector defined benefit pension schemes were the primary domestic buyers of gilts – purchasing hundreds of billions of pounds of supply. It is generally accepted that they have no more capacity. Foreign official sector buyers bought £132 billion of gilts at the same time as the Bank sold £131 billion between Q4 2021 and Q4 2023, which means the impact of QT on the UK private market has been limited so far.<sup>22</sup>

However, as QT progresses, observers are starting to become concerned. As the International Monetary Fund ("IMF") has noted, "Vulnerabilities have...risen [in the gilts market], given increased supply and the reduction in demand by more patient investors, with hedge funds and non-residents playing a greater role, and the BoE reducing its holdings as part of QT."<sup>23</sup>

### Could the BoE change its policy?

The BoE has been flexible in implementing QT but remains committed to an overall plan to deleverage. Governor Bailey has suggested that bank reserves could fall to the preferred minimum level of reserves by the end of 2025.<sup>24</sup> Policymakers often defer to the BoE because they are reluctant to question the BoE's independence. They are also wary about signalling any change on QT that could spook markets. Given this relative balance, it is possible that the Chancellor says we will just accept these losses.

However, the BoE has an objective to support the UK Government's economic policy objectives and responsible fiscal policy<sup>25</sup>. Bodies across the spectrum are campaigning for a change, with the left of centre NEF highlighting the costs, and the right of centre Conservative Way Forward think tank and the cross-party Treasury Select Committee urging the bank and HM Treasury to consider value for money criteria in deciding on the ongoing pace and timing of QT.<sup>26</sup>

Current economic conditions are weak. This was acknowledged by the BoE when they cut Bank Rate by 25 bps in May 2025. Governor Bailey has stated that while he would not make predictions on interest rates his view was "that the path, gradually and carefully, is downwards".<sup>27</sup> These cuts are designed to support demand and meet the 2% inflation target over the medium term. Usually, the BoE wants both monetary policy tools to support each other e.g. lower interest rates and QE both aim to reduce the real interest rate. If they continue with active QT but reduce the base rate, then their two tools of monetary policy will be working against each other – tightening (QT) and loosening (Bank Rate cuts) at the same time.

One possible catalyst for HM Treasury to drop the indemnity it provides to the BoE would be if the economic situation deteriorates further. The Government could face a scenario where it will break its fiscal rules which they are very wary about changing. There is a lot of political risk for the Government if they are seen to be playing fast and loose with these rules.



### Thoughts on the way forward:

As we have seen while QE had some benefits as a response to the initial financial crisis, it was arguably used too much and has caused significant problems including the distortions caused by the large BoE balance sheet. Now QT is being undertaken to enable more QE, and it is causing problems in the form of higher borrowing costs. A more moderate approach without huge swings from QE to QT to QE is needed.

By adopting a more cautious approach to future use of QE we would not need the same pace of QT. It could be slowed through ending active QT, and the losses on keeping the gilts in the APF for longer reduced by ending the payment of bank rate on minimum reserves held with the BoE. QE should return to being viewed as an extraordinary tool for use in a genuine crisis and not to manage routine economic corrections.

In times of genuine crisis recent experience shows that higher balance sheets are tolerated by markets, so the current pace of QT looks too aggressive. How to manage the APF in runoff is a subject which we may explore in more detail in a future edition of Compound Interest.

<sup>22</sup> Financial Times, [Did the Bank of England misunderestimate QT? It's all about the gilt tilt](#), August 2024

<sup>23</sup> International Monetary Fund, [United Kingdom: Staff Concluding Statement of the 2025 Article IV Mission](#), May 2025

<sup>24</sup> Bank of England, [The importance of central bank reserves – lecture by Andrew Bailey](#) Lecture in honour of Charles Goodhart, London School of Economics, May 2024

<sup>25</sup> Fiscal policy, [The Bank of England's statutory monetary policy objectives: a historical and legal account](#)

<sup>26</sup> House of Commons, Treasury Select Committee, [Quantitative Tightening](#), January 2024

<sup>27</sup> BBC News, [Bank lowers interest rates to 4.25% and hints at more to come](#) – BBC News, May 2025