

Old exposures, new actors: Implications for monetary policy of the UK's External Imbalances – speech by Catherine L. Mann

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Speech

Introduction

I began this speech on the UK's external imbalances thinking back on my professional roots. My early academic work focused on the US economy in the global context, and I started my career in the International Finance Division at the Federal Reserve Board of Governors. My job focused on how international economic exposures through trade and financial markets might affect the exchange rate, inflation, and economic activity – and therefore matter for monetary policy. Twenty-four years ago, I published an article to evaluate the sustainability of the US current account deficit looking through both trade and financial lenses.¹ These two sides come together in the fundamental framework of international economics, the balance of payments identities, the discipline they impose, and exposures they reveal.

I return to these roots today, but focus on the UK. Of course, the UK has never been an international trade or monetary island, and a number of my previous speeches have focused on UK monetary policy in light of global spillovers, for instance focusing on how changes in US interest rates transmit to UK financial conditions and economic performance.² If anything, recent geopolitical events have only reinforced how exposed the UK economy is to international shocks that might require a domestic policy response.

But spillovers from interest rates are not the whole story. There are structural sources of international exposures which can be evaluated by looking at the balance of payments (BoP) accounting identities. The UK has run a current account deficit for the last few decades – these are old exposures – which are financed by a surplus on the financial account – populated with new actors. While the accounting fact is 'simple', the implications of old exposures interacting with new actors are not.

I will first explore drivers of the UK's current account deficit in recent history. Given the energy price shocks – two of them during my time on the MPC – I will consider how the old exposures of the UK's economy to energy imports and prices affect the trade balance, inflation, and the real economy.

The bulk of my remarks, however, will focus on the financial account, which tells us how much financing the UK receives from abroad, but more importantly in what form, at what maturity, and from whom – the new actors. I will zero in on the international dimension of portfolio debt flows and specifically on the gilt market. To give a prelude, the changes in

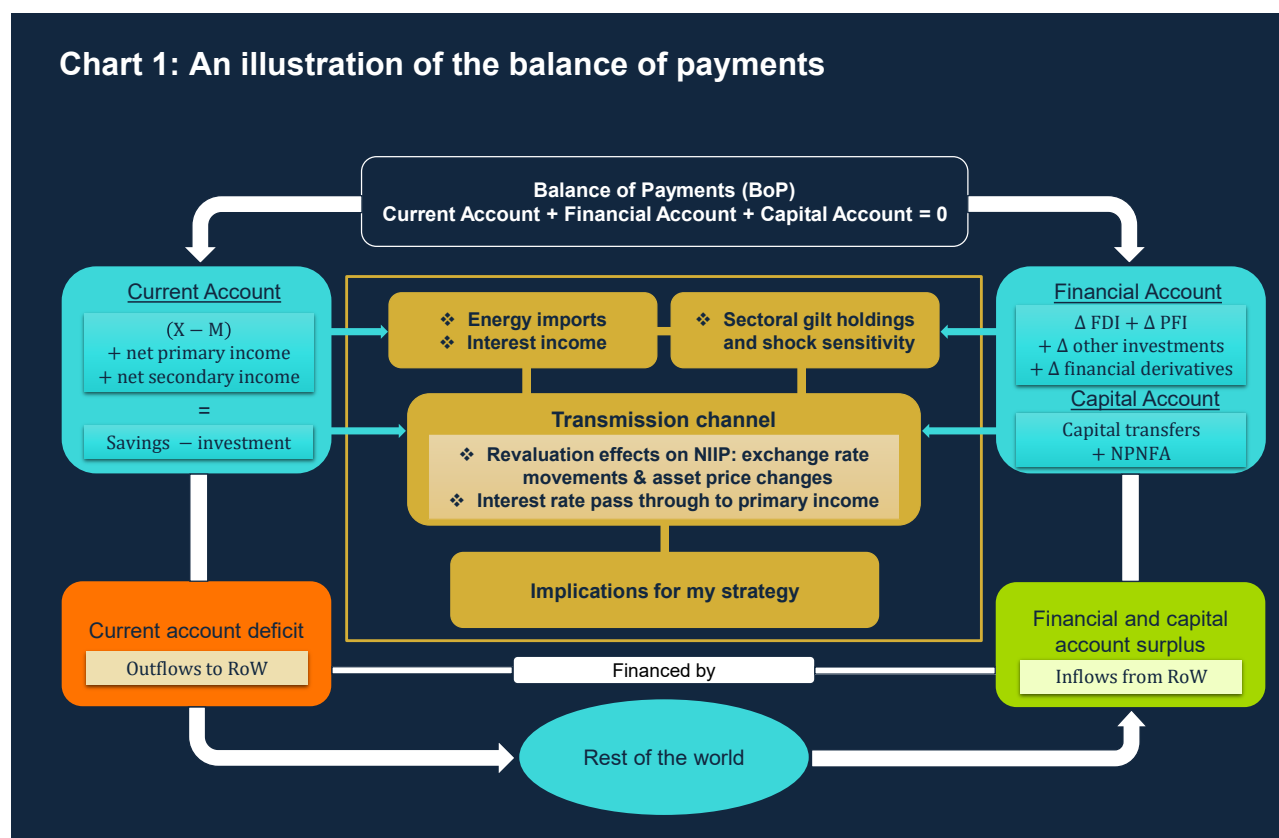
¹ See [Mann \(2002\)](#).

² See [Mann \(2022\)](#), [Mann \(2024a\)](#) and [Mann \(2024b\)](#).

the investor base for gilts likely will affect the cost of borrowing on international markets, the volatility of UK financial conditions to global shocks, the sterling exchange rate, and therefore the transmission of monetary policy. Considering the monetary policy implications of the UK's international exposures from a balance of payments perspective is especially relevant in the current global environment characterized by more frequent shocks and higher volatility, which are transmitted across borders and through balance sheets.

The balance of payments

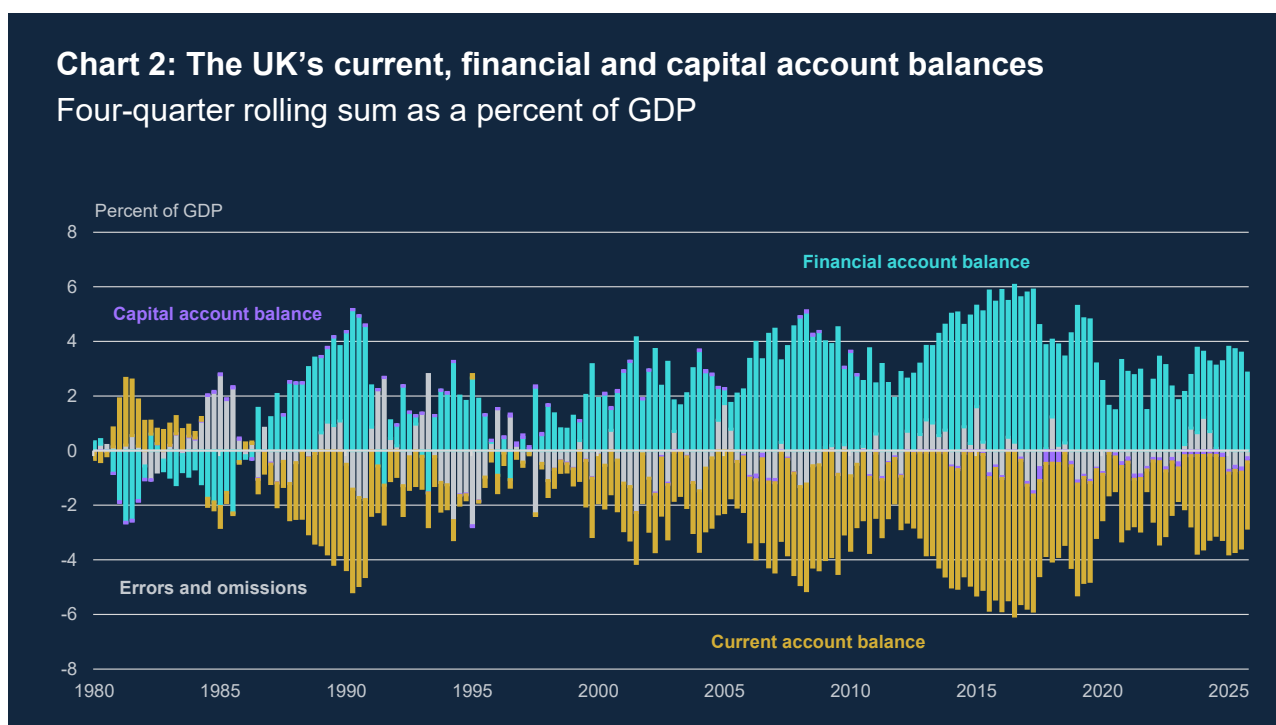
Let me first go back to the framework of international accounts. The balance of payments records the UK's economic transactions with the rest of the world and how these transactions are financed. At its core is an accounting identity that links the current account, the financial account, and the (much smaller) capital account (**Chart 1**). Within these identities, I will focus on the highlighted elements indicated in **Chart 1**. On the current account side, these include energy imports through the trade balance and interest income through net primary income. On the financial account side, I will focus on sectoral gilt ownership – how it has evolved over time and how responsive different holders are to UK-specific and global risk shocks. I will also examine how the UK's net international investment position has evolved, particularly the role of valuation effects, and what this implies for the UK's external financial vulnerability.



Notes: Δ FDI and Δ FPI denote the change in foreign direct and foreign portfolio investments. X denotes exports and M denotes imports. NPNFA denotes acquisitions and disposals of non-produced non-financial assets, as defined under BPM6.

By definition of an accounting identity, the balance of payments must always be in balance. In practice, this means that a current account deficit must be financed by net financial inflows (a surplus) through the financial and capital accounts, as depicted in **Chart 2**. As the gold bars in **Chart 2** indicate, the UK's current account has been in a persistent deficit for over three decades. It includes several components – the trade balance (exports minus imports), primary income (such as income on financial investments) and secondary income (which includes transfers). This external balance can also be expressed as an internal balance, that is as the difference between national saving and investment. I will return to that point in the next section.

The balancing surplus on the financial account records the UK's financial flows: changes in UK residents' claims on the rest of the world and their liabilities. These flows take many forms: direct investment, portfolio equity, portfolio debt, and other investment (such as activities of the banking sector).³ The capital account,⁴ while part of the identity, is comparatively small and plays only a limited role in the UK's external financing, as the purple bars in **Chart 2** show.



Source: ONS and Bank calculations.

³ Other investment covers all financial transactions not classified as direct investment, portfolio investment, or reserve assets. These are, for example, loans, deposits, and trade credit – activities of the banking sector.

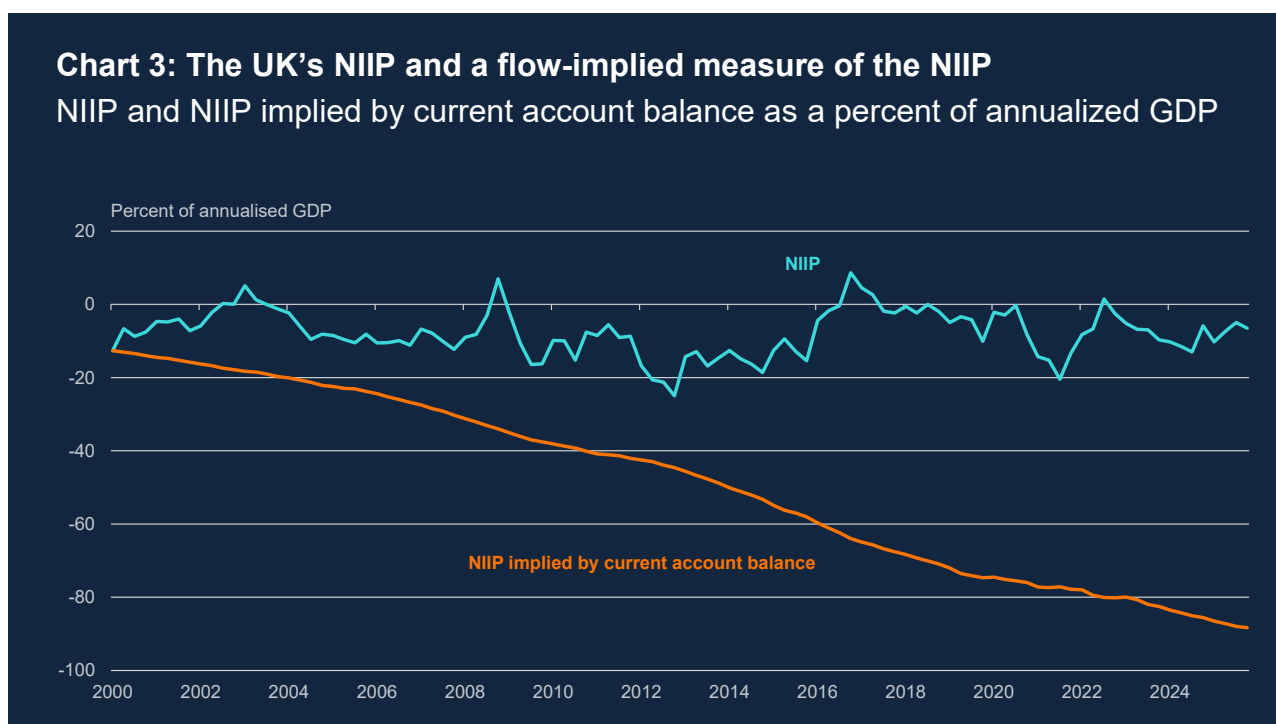
⁴ Capital account comprises two components: capital transfers and the acquisition or disposal of non-produced, non-financial assets.

Notes: Flows are non-seasonally adjusted. Latest data: Q4 2025.

A final perspective on the international balances is the net international investment position (NIIP), which represents the net financial exposure in stock (instead of flow) terms. Despite the long-running trade deficits and net borrowing from abroad, the UK's NIIP as a percent of GDP has remained broadly stable over time.

How does that work? **Chart 3** shows what the accumulation of net foreign borrowing would look like without valuation effects on those assets and liabilities. By cumulating the current account balance and applying these flows to the UK's starting net stock position in 2000 we can derive a flow-implied NIIP. This measure, shown by the orange line, suggests a much weaker external position than is observed in the actual NIIP data.⁵

As will be discussed in more detail, it is different valuation effects on both the asset and liability side of the financial account which make the NIIP materially smaller than would be the case based on accumulated net borrowing alone. The apparently stable NIIP-to-GDP ratio in the data masks underlying dynamics. Valuation changes, data revisions, and shifts in the composition of investors and instruments used to finance the deficit can alter the transmission of external shocks to the UK economy and can make the economy sensitive to shifts in investor sentiments, which creates vulnerabilities.



Source: ONS and Bank calculations.

⁵ This is consistent with research evidence from [Burgess and Shanbhogue \(2017\)](#) and [Forbes et al. \(2016\)](#).

Notes: The flow-implied NIIP series applies cumulative current account balances to the observed NIIP in Q1 2000, showing how the UK's net external position would have evolved in the absence of valuation effects. Latest data: Q4 2025.

The UK's current account balance

The balance of payments records the UK's transactions with the rest of the world over a certain time period. It consists of two components: the current account balance and the financial account balance. The current account balance, which I will focus on in the first part of my speech, is made up of net trade in goods and services (or "trade balance"), primary income (which are net UK earnings on foreign investments), and secondary income ("net current transfers").⁶

$$CA + FA + KA = 0^7$$

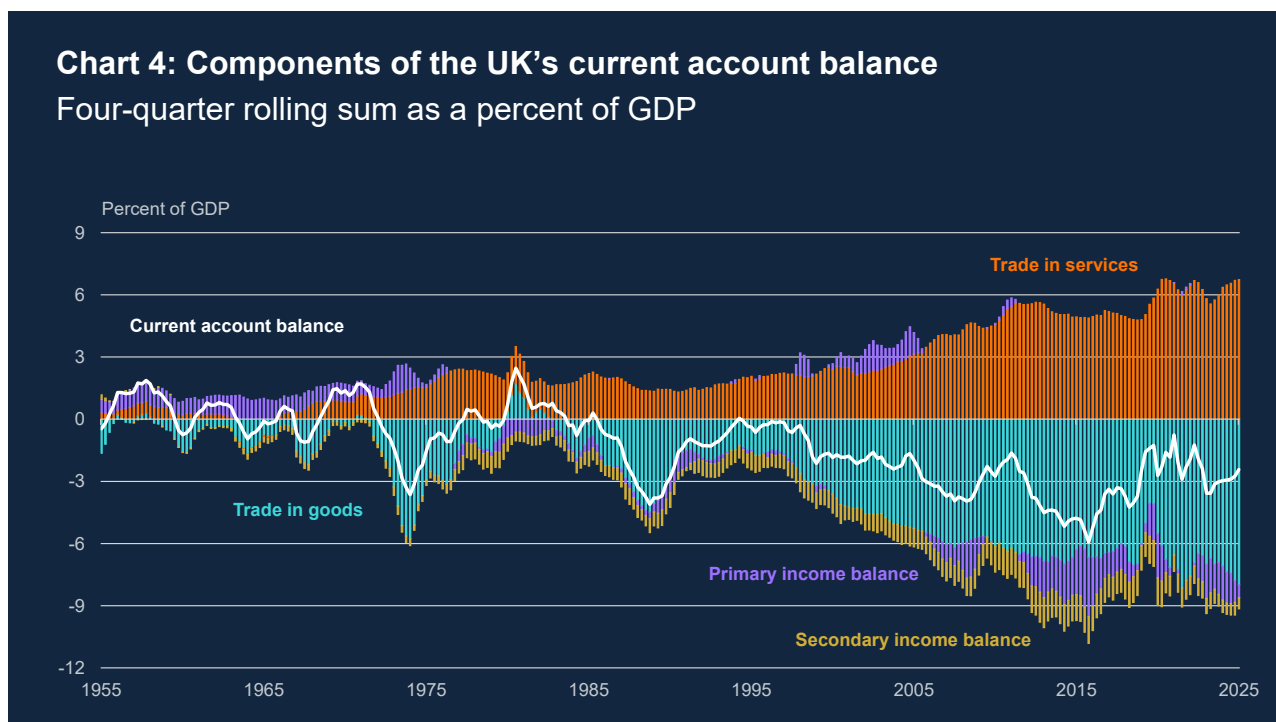
$$\text{Current account} = (X - M) + NY + NCT = S - I$$

Historically, as shown in **Chart 4**, prior to the turn of the century, periods with a current account deficit were predominantly driven by negative trade balances, with exchange rate movements influencing the valuation and adjustment of trade flows. This occurred during periods of major institutional changes, including the breakdown of the Bretton Woods system in the early 1970s and the subsequent shift to a floating exchange rate regime.

Alongside this were financial liberalization policies, including the 1986 'Big Bang' reforms, which expanded the openness of the UK economy and the scale of cross-border financial flows. Although net secondary income has been in persistent deficit as well, it is the pattern of net primary income that is of greatest interest, since this is where investment returns and investor sentiment are expressed. This has flipped from positive before 2006 to persistently negative since, and episodically large, to worsen the current account deficit. A topic to which I will return.

⁶ The secondary income account shows current transfers between residents and non-residents. These are transactions in which economic value is provided without a direct quid pro quo – that is, without a corresponding exchange of goods, services, or financial assets. Examples include foreign aid, military grants, and remittances.

⁷ CA, FA and KA denote the current, financial, and capital account balances, respectively.



Source: ONS and Bank calculations.

Notes: Flows are seasonally adjusted. Latest data: Q4 2025.

The negative trade balance has some relevance for monetary policy given the current economic conjuncture. Specifically, the negative trade balance is mostly driven by trade in goods, while the UK has maintained a trade surplus in services since the 1960s, largely reflecting its comparative advantage in financial, professional, and business services.

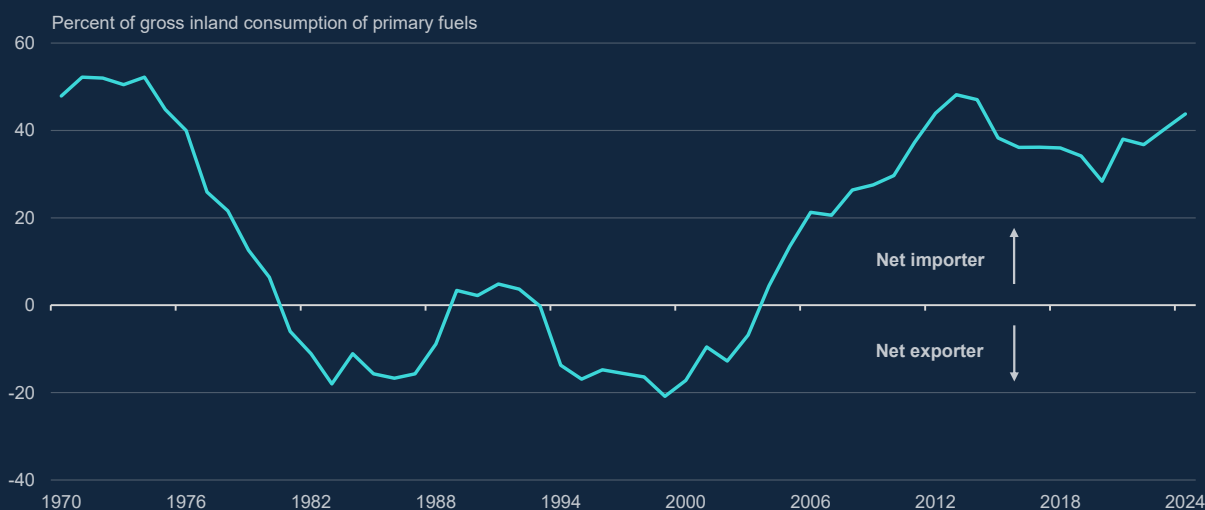
The role of energy in the current account deficit

Within the negative goods balance, the UK has been a net energy importer since 2004 (**Chart 5**), leaving the current account exposed to movements in global energy prices. That exposure has become more salient in the current conjuncture with the energy price shock resulting from the conflict in the Middle East.

The oil price shock caused by the war raises import prices and is a negative cost-push shock. The conflict in the Middle East is also expected to materially raise UK non-energy import prices over the coming quarters ([Bank of England, 2026](#)). These pressures tend to push up inflation, reduce real incomes, and weigh on growth, as episodes of elevated energy prices in the recent past have demonstrated.

Chart 5: UK energy import dependency

Energy imports/exports as a share of gross domestic consumption of primary fuels

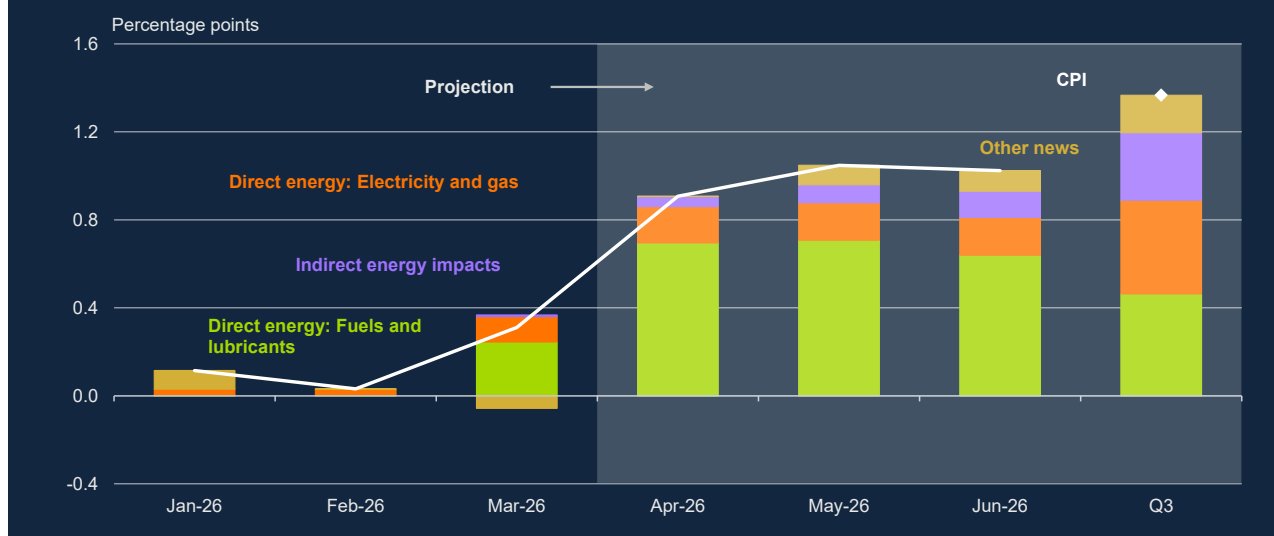


Source: Department for Energy Security and Net Zero.

Notes: Latest data: 2024.

I highlighted this tension between persistent inflation and weak economic growth that the UK economy is facing in my [speech](#) in August last year. Since then, inflation has remained above target, economic growth has been modest, and unemployment has gone up. In light of the recent energy price shock, the inflation-output trade-off and the associated monetary policy response has become even more difficult, especially as monetary policy cannot offset such cost-push shocks. Compared to the Monetary Policy Report in February 2026, the contribution of energy components to CPI inflation picked up in March 2026 and is projected to increase further, as illustrated by the direct and indirect energy impacts in [Chart 6 \(Bank of England, 2026\)](#).

Chart 6: The contribution from higher energy prices to near-term CPI inflation
News to CPI inflation compared to the February 2026 projection



Source: [April 2026 Monetary Policy Report](#).

Notes: Bank staff's short-term inflation forecast only extends for six months. For that reason, the Q3 'Other news' bar represents the difference between the April Report short-term forecast shown in Chart 1.1 and the February Report 2026 Q3 projection. The 'fuels and lubricants' and 'electricity and gas' bars capture direct CPI news from energy prices since the previous Report, while the 'Indirect energy impacts' are based on a range of model estimates, Agency intelligence and survey evidence. Electricity and gas also includes liquid fuels.

Notwithstanding, it is important to highlight that a negative trade balance in goods is not necessarily something problematic – what matters is its composition and the nature of the exposures it creates. For instance, imports of capital and intermediate goods can support future productive capacity and strengthen the economy's ability to service foreign financing over time. In practice, the UK's goods deficit reflects relatively more consumer-goods imports alongside an increasing share of capital and intermediate goods.

A first look at the implications of financing the current account deficit

The trade balance is only one part of the current account. Income flows also play an important role. As shown earlier in **Chart 4**, the primary income component has contributed materially to the current account deficit in recent years. Within that, the net primary income deficit has been driven largely by outflows of interest income on portfolio debt including gilt instruments, and other investment, as interest rates have risen both domestically and globally across private instruments as well as sovereign ones.

The larger stock of portfolio liabilities relative to portfolio assets implies a worsening of the net primary income balance, as it leads to higher interest payments on liabilities relative to

interest income received. Changes in interest rates associated with monetary policy decisions also affect these income flows by non-residents.⁸

Internal imbalances are reflected in external imbalances

As I noted earlier, a current account deficit implies that the domestic economy is, in aggregate, spending more than it earns, and must therefore attract net financial inflows from abroad. These can be split by economic sector, as shown in **Chart 7**. Following the recession in the early 1990s, which was characterized by weak demand, high unemployment and inflation, falling tax receipts, and a rise in government spending, households were persistent net savers. This was largely offset by net borrowing from government and other financial institutions (OFIs).⁹

From the turn of the century until just before the global financial crisis (GFC), household net saving declined sharply, alongside a sustained rise in borrowing by both government and OFIs. This period coincided with strong consumer confidence and consumption, easier credit conditions, and rising house prices. In that environment, private-sector dissaving and public borrowing jointly contributed to larger trade and current account deficits.

In the aftermath of the GFC, this pattern shifted again. Household net saving rose materially as repairing their balance sheets became a priority, while government borrowing increased sharply in response to automatic stabilizers and discretionary fiscal support. Although less dramatic in magnitude, the behavior of OFIs warrants attention. From around 2019 onwards, OFIs deleveraged and shifted from net inflows (borrowing) to sustained net saving (net outflows), amid Brexit-related institutional uncertainties, a trend that intensified around the onset of the pandemic and remains today.

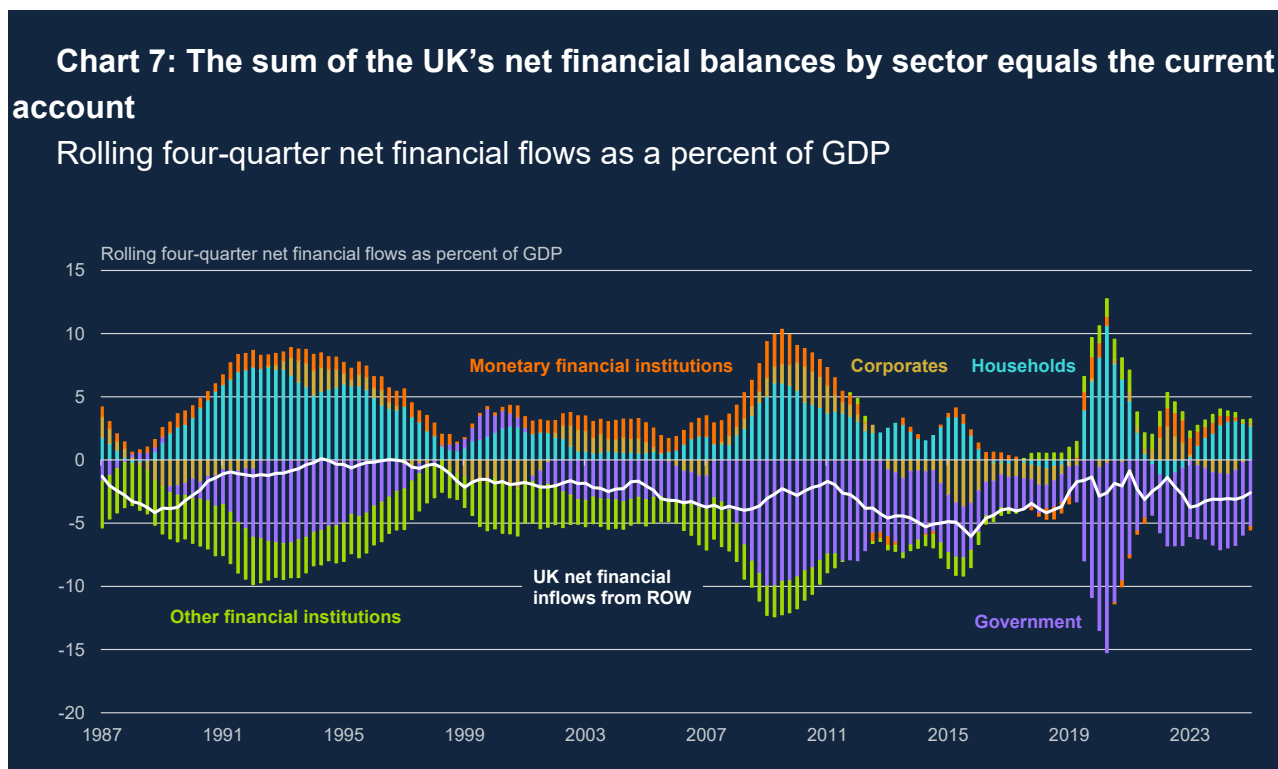
So-called 'forced' household saving sharply increased during the pandemic, alongside an unprecedented increase in government borrowing. Although household saving has moderated somewhat since, it remains high, as consumption continues to be weak with robust precautionary balances, as outlined in my [speech](#) in October last year.

Government borrowing has eased from pandemic highs, but remains higher than at any time since the GFC. As we started raising Bank Rate from December 2021 onwards, this decomposition has become more salient: the interaction between elevated government financing needs and higher yields has amplified net primary income outflows, particularly given the high share of non-resident holdings of UK government debt. Official data

⁸ For the purpose of this speech, while income on foreign direct investment (FDI) supports the primary income balance, I will abstract from this category as it is less sensitive to changes in interest rates.

⁹ Other financial institutions (OFIs) comprise non-money market funds, other financial intermediaries excluding insurance corporations and pension funds, financial auxiliaries and captive financial institutions and money lenders. This category includes, among others, hedge funds, investment trusts, and fund managers. Improvements are continually being made by the ONS to improve the data quality.

indicates that foreign investors own well over 50% of UK equity¹⁰ and around 30% of UK government bonds.¹¹



Source: ONS and Bank calculations based on [Manning \(2025\)](#).

Notes: Flows are non-seasonally adjusted. Latest data: Q4 2025.

As I have highlighted earlier, a current account deficit is only one side of the balance of payments – and, abstracting from the discussion of trade exposures, is not in itself, a vulnerability. What matters is how it is financed and who holds the resulting liabilities.

When I first started working on these issues in the 1980s, the focus was almost entirely on the current account, with far less attention paid to the financial account. That made sense in a world of fixed or tightly managed exchange rates, limited cross-border capital mobility, and strong home bias in asset holdings. That focus is no longer appropriate. So, the natural next question is: how has the UK's financial account evolved since, and what does that tell us about how the UK finances its external deficits today?

¹⁰ UK equity positions are based on ONS balance of payments data for total equity liabilities and portfolio investment liabilities in equity and investment fund shares.

¹¹ UK government debt is based on ONS data on general government debt liabilities.

The UK's financial account balance

I now turn to the financial account. Recall the balance of payments identity I showed earlier:

$$CA + \mathbf{FA} + KA = 0$$

$$\mathbf{Financial\ account} = \Delta\text{Foreign direct investment} + \Delta\text{Portfolio debt} + \Delta\text{Portfolio equity} \\ + \Delta\text{Other investment} + \Delta\text{Financial derivatives}$$

The financial account describes how the current account balance is matched by changes in financial assets and liabilities, across foreign direct investment, portfolio investment in equities and debt, other investment (which are primarily banking activities), and financial derivatives.

As discussed earlier, the UK's current account deficit is offset by a financial account surplus, financed either through borrowing from the rest of the world (i.e. higher external liabilities and foreign holdings of UK assets) or through UK residents selling assets overseas. The persistent current account deficit implies sustained capital inflows by overseas investors such that the UK's external liability position is around five times annual GDP. That said, liabilities are only one side of the balance sheet. The UK also holds a very large stock of external assets, reflecting extensive outward investment by UK residents across similar asset classes, with the asset position only slightly smaller in scale as a share of GDP.

Taken together, the UK's large gross external liabilities are matched by similarly large external assets to form the UK's net international investment position (NIIP). The NIIP measures the difference between the UK's stock of external assets (UK-owned claims on non-residents) and liabilities (foreign-owned claims on UK residents). As noted earlier, based on an accumulated accounting of current account deficits, the UK 'should' be in a position of much larger indebtedness, but **Chart 8**, shows that the UK's NIIP and associated primary income flows have fluctuated over time.

Before turning to what lies behind the fluctuations in the primary income balance, it is worth noting how changes in the UK's external position have evolved. These changes are primarily and persistently associated with rising net indebtedness in portfolio debt, which is reflected in increasing net outflows of interest payments on those liabilities.

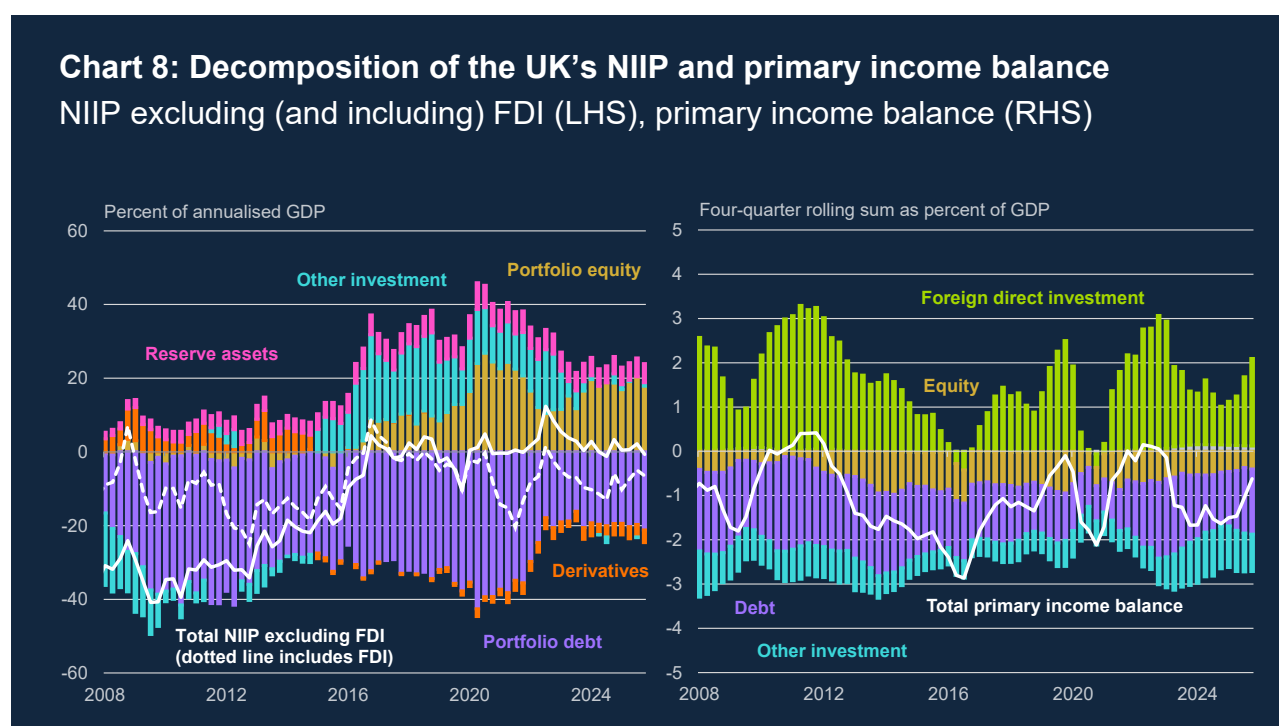
At the same time, the UK has seen increases in holdings of portfolio equity and in net asset positions in other investment. However, despite the expansion in these asset positions, the associated income flows remain net negative. This points to lower effective rates of return on UK-owned external assets relative to those paid on UK liabilities.

On the evolution of the NIIP and primary income balance

Short run fluctuations in the primary income balance itself are driven largely by movements in returns rather than quantities. In particular, returns on foreign direct investment -built up over decades or more- tend to be higher on UK investment abroad than on foreign investment in the UK, providing support to the primary income balance. At the same time, these returns can be volatile, as subcomponents of FDI income reflect the performance and payout decisions of individual firms. For example, earnings may be retained rather than paid out as dividends in any given year.

Meanwhile, given the UK's role as a major financial center, other investment comprises a large share of cross-border banking positions. Income on these positions reflects interest rate differentials between the UK and abroad. For instance, given the UK has a higher base rate than the ECB, it will make higher interest payments on deposits and interbank liabilities than income earned on comparable foreign assets.

Taken together, both the scale and the composition of the UK's external assets and liabilities matter for net primary income and the evolution of the NIIP. Rates of return, valuation effects, and the characteristics of instruments and investors differ systematically across asset classes and between the asset and liability sides of the balance sheet.

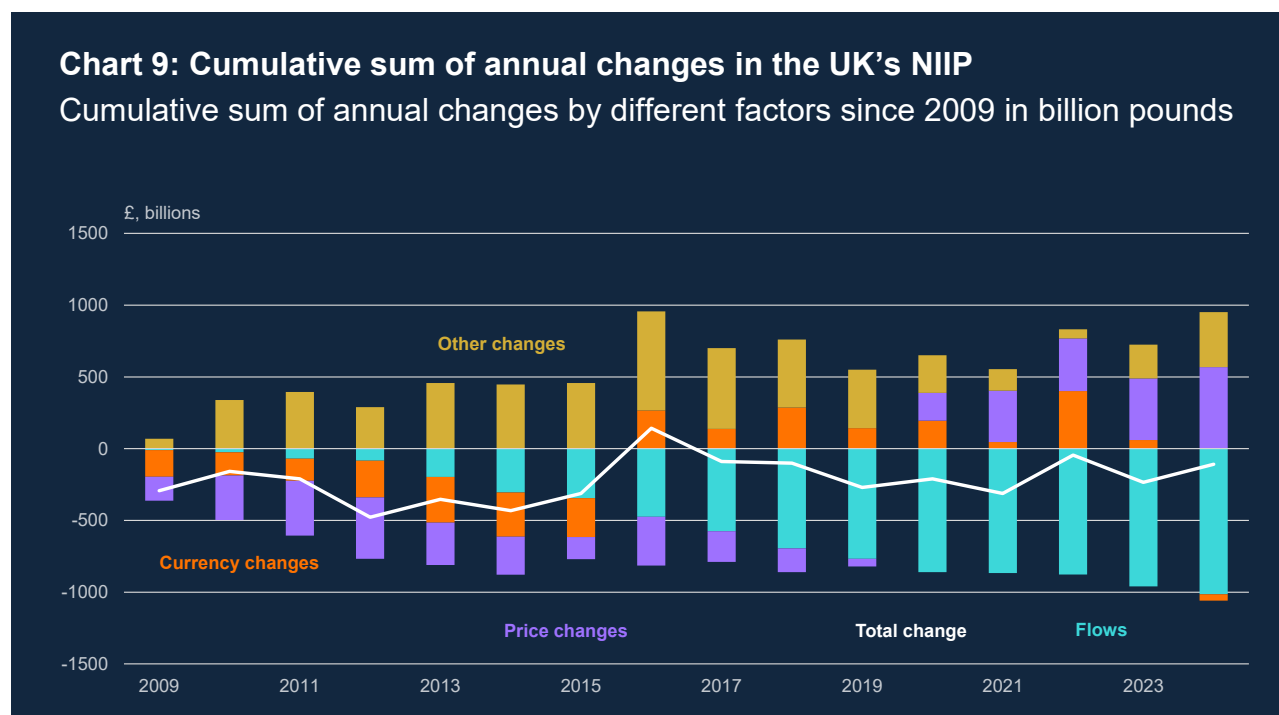


Source: ONS and Bank calculations based on [Manning \(2025\)](#).

Notes: Primary income balance is shown as a four-quarter moving sum as a percent of GDP. Latest data: Q4 2025.

Chart 9 illustrates this interplay, showing how the financing of the current account deficit through the financial account fluctuates once valuation, currency, and other revaluation effects on outstanding positions are taken into account. This raises the question of how movements in global asset prices, together with balance sheet adjustments not attributed to price or exchange rate effects,¹² have helped support the NIIP. Estimates suggest that price changes contributed around £300 billion to the increase in UK external assets, compared to only £160 billion to liabilities, reflecting relatively stronger equity-market performance on UK holdings of foreign equities ([ONS, 2025](#)).

By contrast, currency changes have oscillated over time. Periods of sterling appreciation (shown by negative orange bars) reduce the sterling value of foreign-currency assets, while periods of depreciation (positive orange bars) have the opposite effect, mechanically boosting the NIIP. These exchange-rate effects therefore tend to move the external position around from year to year, but do not provide a persistent source of support. For instance, the depreciation of sterling during the 2022 mini-budget temporarily boosted the value of UK residents' external assets, as shown by the relatively higher orange bar at that time in **Chart 9**.



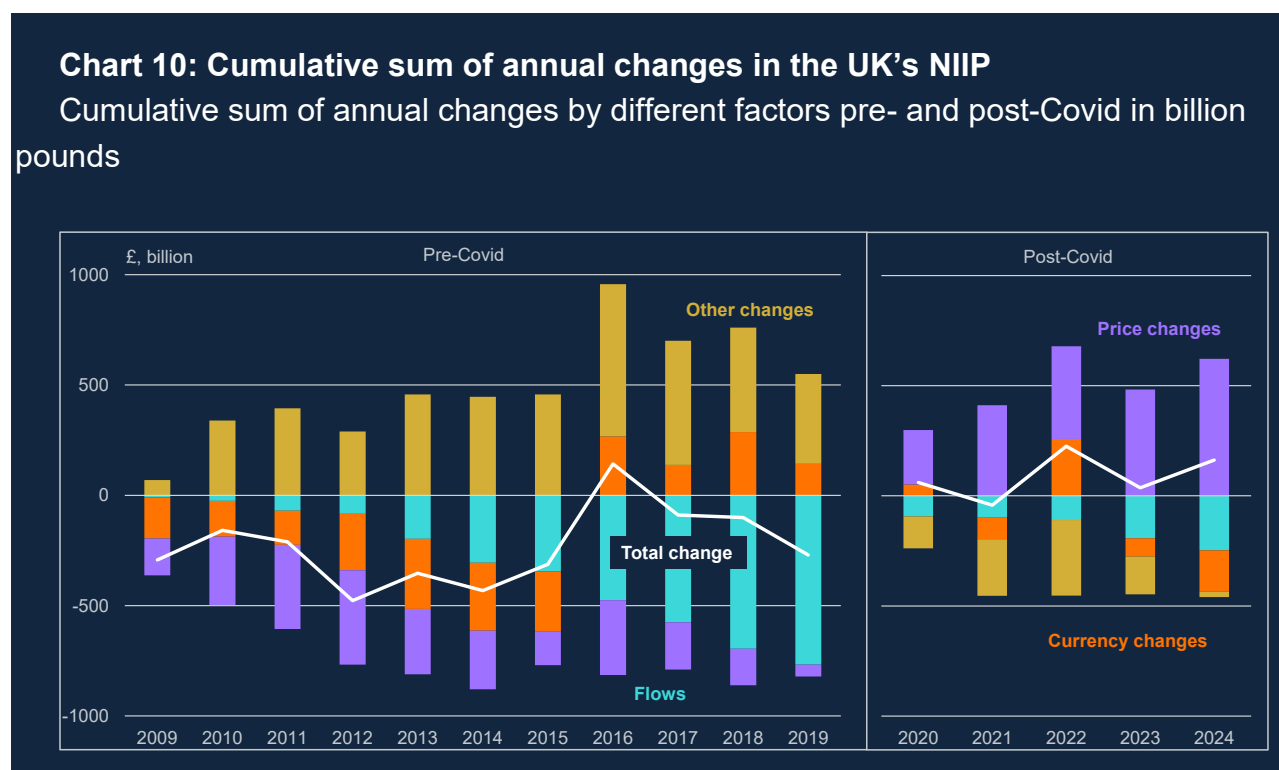
Source: ONS and Bank calculations.

¹² Other changes reflect balance sheet adjustments due neither to transactions nor to revaluation. These include debt write-offs or cancellations (e.g. following bankruptcy), reclassifications across investment categories (e.g. conversion of convertible bonds, or portfolio equity being reclassified as foreign direct investment following mergers), changes arising from reclassification due to changes in institutional residence, and other revisions linked to data updates or methodological improvements.

Notes: Other changes includes items such as debt cancellation and write-offs and reclassifications. The estimate does not include financial derivatives or special drawing rights.

The role of valuation effects on the changes in the NIIP are even clearer when we split into the pre- and post-Covid periods (**Chart 10**). Since the Covid pandemic, the role played by flows – which have typically financed the current account deficit – has fallen noticeably. At the same time, price changes have gone from weighing on the NIIP before the pandemic to supporting it more recently. That tells us something important about how the external position is being held up.

Increasingly, movements in the NIIP are being driven and supported by valuation effects. And because price and other revaluation effects are influenced by the investor and investment characteristics and their response to domestic and global financial conditions, this leaves the UK's external position more exposed than headline levels alone might suggest.



Source: ONS and Bank calculations.

Notes: Other changes includes items such as debt cancellation and write-offs and reclassifications. The estimate does not include financial derivatives or special drawing rights.

Who owns the UK's gilts, and what are the implications?

What does this mean for the UK's exposure to the global economy? Given the particularly large role played by non-resident investors in portfolio debt, I want to focus on this

channel, and in particular on gilt holdings, given their central role in financial conditions in the UK and in the transmission of monetary policy.

$$\text{Financial account} = \Delta\text{Foreign direct investment} + \Delta\text{Portfolio debt} + \Delta\text{Portfolio equity} \\ + \Delta\text{Other Investment} + \Delta\text{Financial Derivatives}$$

From a monetary policy perspective, the composition of gilt holdings matter as much as the amount. Shifts in demand and supply for gilts affect interest rates, term premia, and the pricing of risk across the economy. In my [speech](#) about quantitative tightening (QT) last year, I discussed how quantitative easing reduced longer-term yields through the Bank of England's purchases of longer-dated gilts, and how that was being reversed through QT.

As the period of quantitative tightening has evolved, the composition of both supply and demand in the gilt market also has changed, reflecting a combination of factors. On the supply side, issuance has become increasingly skewed towards shorter maturities, broadly in line with global trends and higher financing needs. There have also been structural shifts in investor demand, including a decline in demand from defined-benefit pension schemes- which had historically acted as stable long-term holders of gilts- alongside differing demand dynamics between pension funds and insurers, reflecting their distinct objectives and constraints. Therefore, the share of gilt holdings has evolved, and the ONS data allows us to split this by sector.¹³

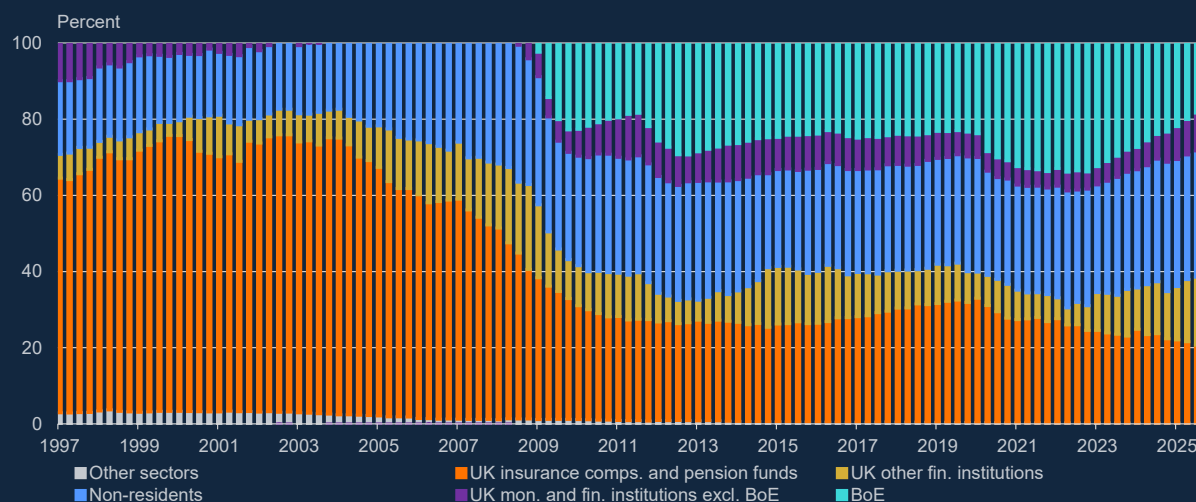
Although the Bank of England remains a significant holder of gilts, a larger fraction of the gilt stock now sits with non-residents, followed by UK insurance companies and pension funds (ICPFs) and OFIs, as the ownership shares in **Chart 11** show.

Non-residents (in blue), comprise a heterogeneous and non-exhaustive group of investors, including foreign central banks, sovereign wealth funds, non-resident market participants such as banks, asset managers (including hedge funds and money market funds), and pension funds. Given this heterogeneity, their behavioral patterns also differ markedly. For instance, there are important distinctions between non-residents with sterling-denominated liabilities, foreign reserve managers, non-residents investing in gilts on an FX-swap basis, and non-resident hedge funds. That said, it is primarily the latter group – reliant on leverage – for whom shifts in market conditions are most likely to generate the monetary policy effects discussed later in the speech.

¹³ The IMF Financial Sector Assessment Programme (FSAP) for the UK has highlighted data limitations regarding holdings of government debt, noting that data gaps in the non-bank financial intermediary (NBF) sector hinder a comprehensive assessment of systemic risks and granular holdings across investor types. Therefore, our analysis relies on ONS sectoral data, which remain the best available source, and are subject to these data limitations.

Chart 11: Sectoral shares of UK gilt holdings

Share of total stock of gilts outstanding held by different sectors

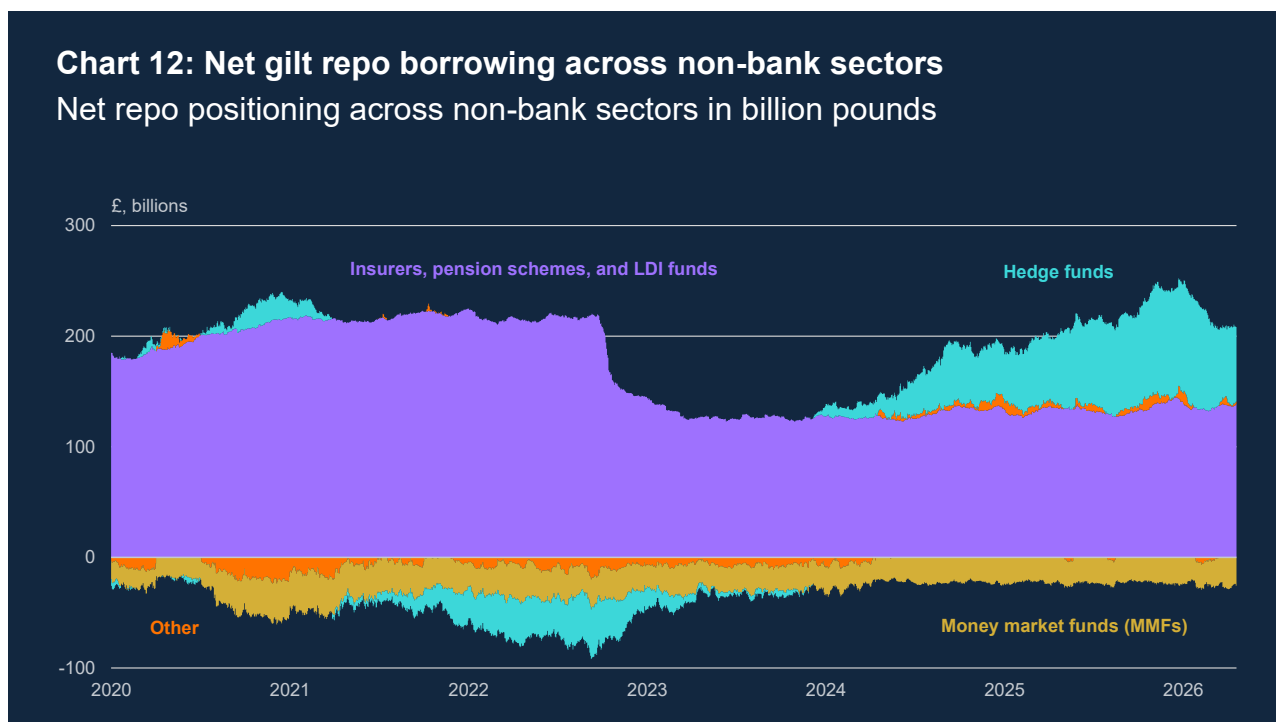


Source: ONS and Bank calculations.

Notes: ONS data on sectoral holdings in the UK financial accounts are subject to limitations related to data granularity, coverage gaps, and the constraints of traditional survey-based methodologies and should be interpreted with caution. Latest data: Q4 2025.

Within the OFI sector, more price-sensitive and leveraged investors, such as hedge funds, have increased their net gilt repo borrowing, shown in aqua in **Chart 12**.¹⁴ More recently, these investors have also expanded their holdings of gilts for trading, with net gilt repo positioning reaching its highest level since data collection began in 2017 ([Breedon, 2026](#)). In normal market conditions, these investors can support liquidity by intermediating risk across market participants. However, their use of leverage introduces risk. As some of these investors seek to profit from cyclical macroeconomic opportunities in interest rates and volatility ([Saporta, 2025](#)), they tend to be highly price-sensitive. As a result, their positions can adjust quickly in response to shocks, with effects that can sometimes amplify volatility in prices and quantities, or in some other episodes, support market functioning.

¹⁴ These developments are monitored by the Financial Policy Committee (FPC).



Source: Sterling Money Market Data and Bank calculations.

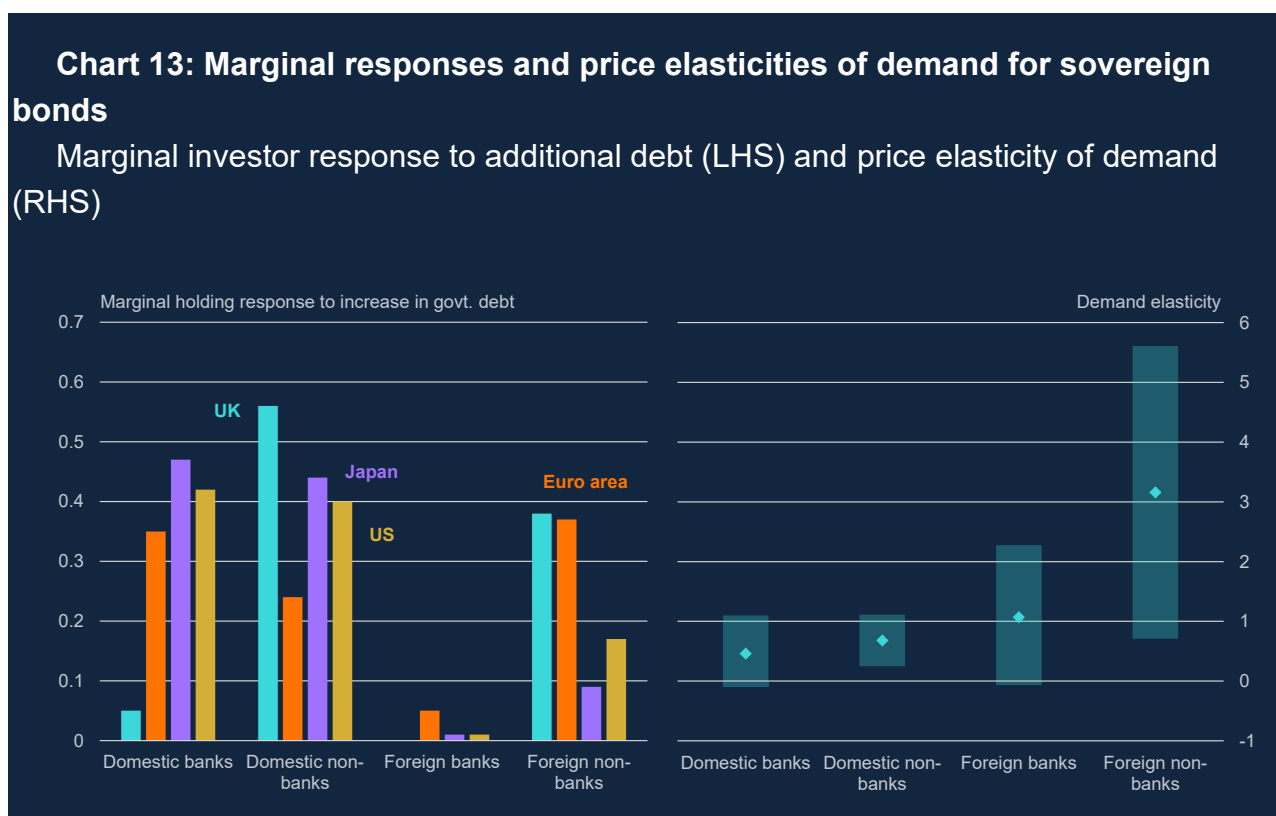
Notes: Latest data: 1st May 2026.

The previous discussion focused on the changing characteristics of the investor base for the existing stock of gilts. For the UK, research shows that newly issued government debt is absorbed most strongly by domestic non-bank investors, followed by foreign non-banks¹⁵ (left-hand panel of **Chart 13**). Specifically, domestic non-banks in the UK absorb more than half of every unit of government debt supplied (**Norges Bank Investment Management, 2024**).¹⁶ This reflects the historically outsized role of the UK's domestic ICPF and LDI sector over their study sample, which runs up to 2022. However, important in today's context, demand from these investors has weakened since then, with a growing share of absorption now coming from non-residents, and OFIs excluding the ICPF sector, such as hedge funds (**Chart 12**).

The study also finds that foreign non-banks exhibit a relatively high price elasticity of demand, implying that only a modest change in yields are required for them to buy or sell their gilts (right panel of **Chart 13**). In practice, as noted earlier, this is a heterogeneous group, so non-residents such as hedge funds relying on leverage are likely to be more price-elastic.

¹⁵ In this research, non-banks are defined as non-financial corporations, pension and insurance companies, households, and other financial institutions (mainly investment funds) (**Norges Bank Investment Management, 2024**).

¹⁶ Similarly, **Fang et al. (2024)** find that private non-banks absorb relatively more additional debt issuance than other types of investors.



Source: [Norges Bank Investment Management \(2024\)](#) and Bank calculations.

Notes: Marginal responses to increases in government debt (left chart) capture country-specific absorption of new debt by different investor types. Price elasticities of demand (right chart) capture investor-specific price sensitivity and are assumed to be common across countries. Aqua diamonds in the right chart denote demand elasticities by investor type, which are reported in absolute value terms for ease of interpretation. Shaded bars denote 95% confidence intervals.

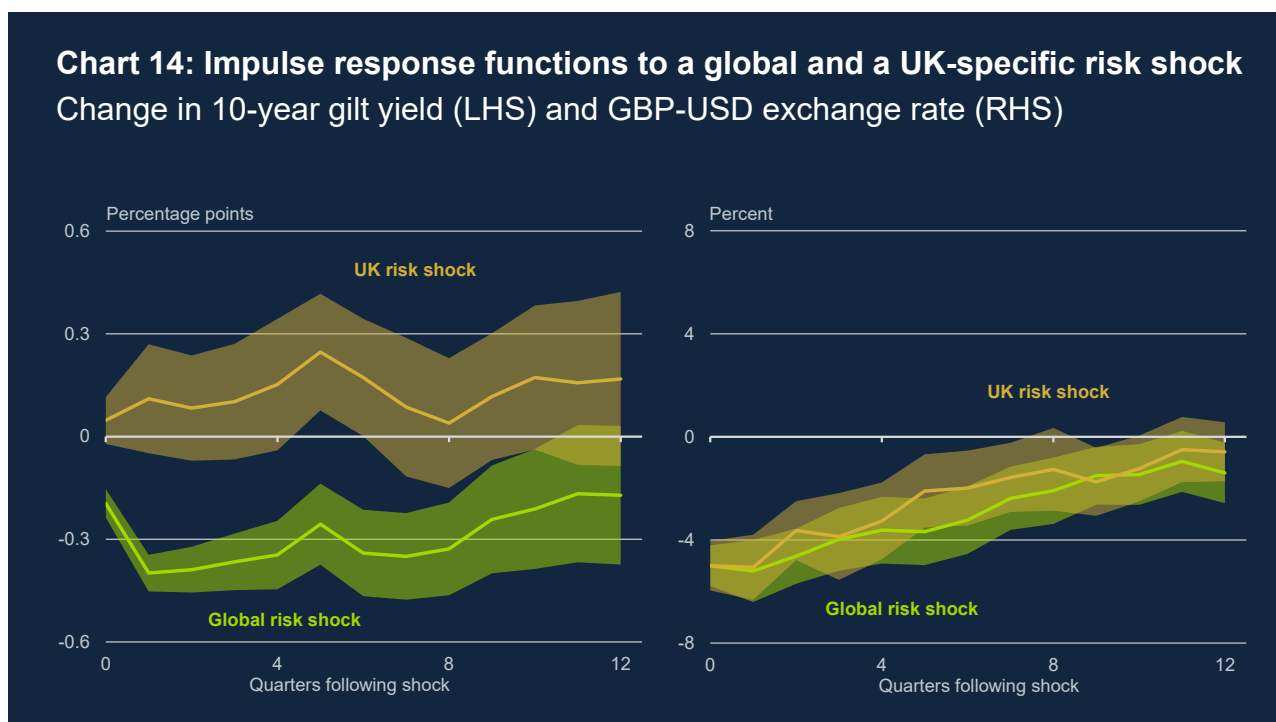
Why does gilt ownership matter?

Because domestic and foreign non-banks play such a central role in absorbing new gilt issuance, and apparently have different price elasticities for gilt holdings, different types of shocks can affect the demand for and the price of gilts. I use local projections to evaluate how different types of investors might respond to global and UK-specific risk shocks that reflects changes in investors' risk preferences and perceptions ([Mann, 2023](#)).

As shown in **Chart 14** the global risk shock makes lower-risk assets (including government bonds) more attractive compared to risky assets – it raises bond prices and makes dollar-denominated assets (which are typically regarded as safer-haven assets) more attractive. It therefore lowers UK and US yields, but UK yields by less and thus leads to a depreciation of sterling against the US dollar.

The UK-specific risk shock also leads to a depreciation in sterling, but raises UK yields because UK government bonds become relatively less attractive. **Chart 14** shows the

impulse response functions of 10-year gilt yields (left panel) and the exchange rate (right panel) in response to these shocks, normalized to result in a 5% depreciation in sterling relative to the US dollar on impact. This magnitude is comparable to the depreciation of the pound in the days following the mini-budget in September 2022. Following a global risk shock, 10-year gilt yields decrease, while they rise after a UK-specific risk shock.



Source: Bloomberg Finance L.P. and Bank calculations.

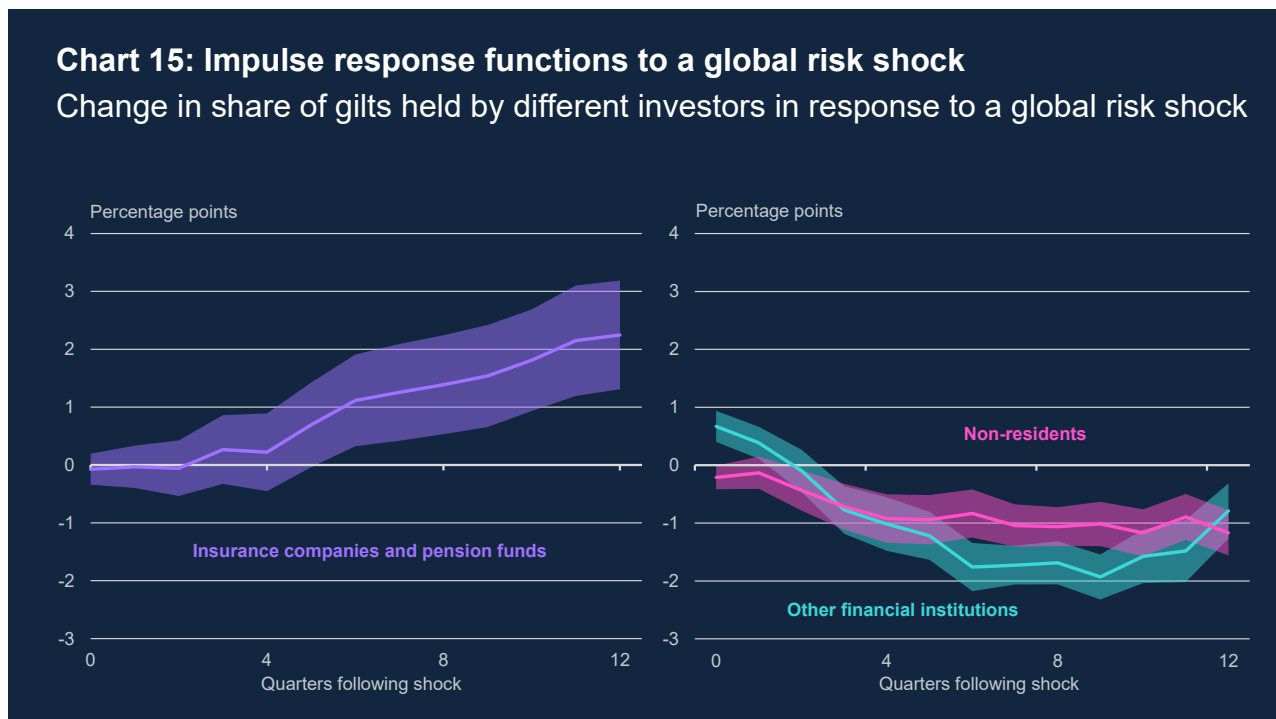
Notes: Impulse response functions are derived from a local projection model estimated over the period 1997-2025. Shaded areas denote 68% confidence intervals using Newey-West standard errors. The impulse response functions are scaled to reflect a 5% depreciation in pound sterling relative to the US dollar on impact. The global and UK risk shocks are identified using a structural decomposition as in [Mann \(2023\)](#).

Given this backdrop of yields and sterling exchange rate, let me now evaluate how different types of investors respond to the global and UK-specific risk shocks. **Charts 15** and **16** show the impulse response functions of the share of total gilts held by different investor types to a global and a UK-specific risk shock.

I consider three types of gilt owners as defined by ONS data, which currently hold around 70% of the total stock of gilts (**Chart 11**) – UK insurance companies and pension funds, other financial institutions (OFIs) in the UK (including domestic hedge funds), and non-residents (which also include different classes of investors, including foreign hedge funds).

Consider a global risk shock first. In response to a global risk shock, investors that exhibit a relatively high price elasticity of demand (such as OFIs and non-residents) reduce their

share of gilts held by around one to two percentage points, reflecting a flight to safety and shift away from lower-return UK assets (right panel of **Chart 15**). By contrast, the impulse responses suggest that, following a global risk shock, the share of UK gilts held by insurance companies and pension funds rises, as shown in the left panel of **Chart 15**.

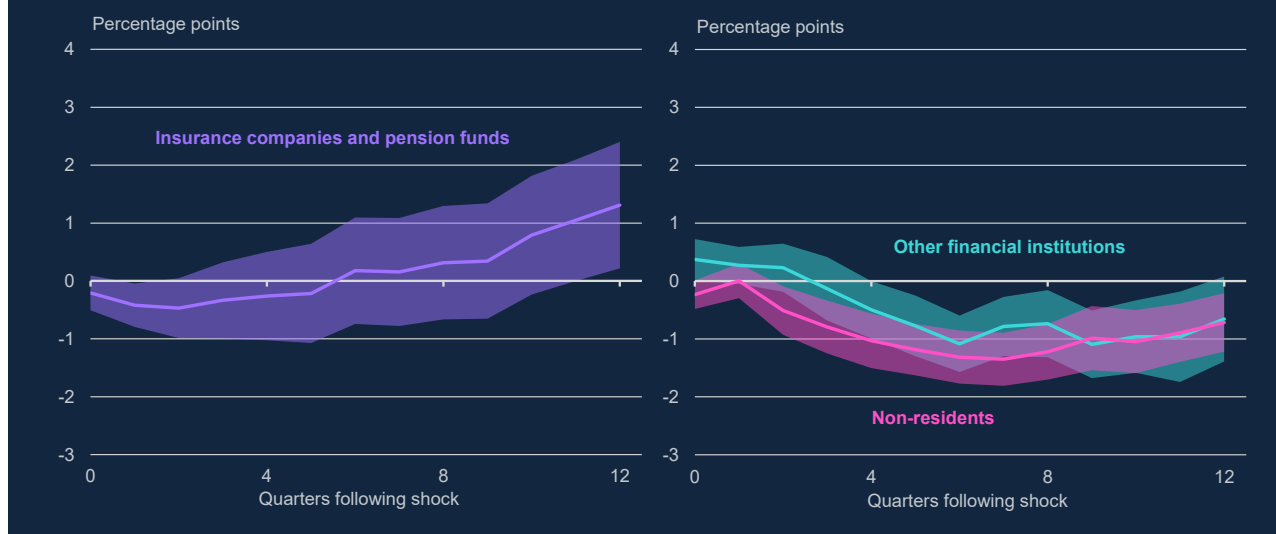


Source: ONS and Bank calculations.

Notes: Impulse response functions are derived from a local projection model estimated over the period 1997-2025. Shaded areas denote 68% confidence intervals using Newey-West standard errors. The impulse response functions are scaled to reflect a 5% depreciation in pound sterling relative to the US dollar on impact. The global and UK risk shocks are identified using a structural decomposition as in [Mann \(2023\)](#). ONS data on sectoral holdings in the UK financial accounts are subject to limitations related to data granularity, coverage gaps, and the constraints of traditional survey-based methodologies and should be interpreted with caution.

Chart 16 shows how investors respond to a UK-specific risk shock. Similar to a global risk shock, OFIs and non-residents reduce their share of total gilts held (and this is despite higher returns). However, contrary to a global risk shock, UK insurance companies and pension funds do not significantly alter the share of gilts they own over the time horizon and at the quarterly frequency that we consider here (left panel of **Chart 16**). This likely reflects the importance of holding sterling-denominated assets for pension funds to match their assets with their liabilities.

Chart 16: Impulse response functions to a UK-specific risk shock
Change in share of gilts held by different investors in response to a UK risk shock



Source: ONS and Bank calculations.

Notes: Impulse response functions are derived from a local projection model estimated over the period 1997-2025. Shaded areas denote 68% confidence intervals using Newey-West standard errors. The impulse response functions are scaled to reflect a 5% depreciation in pound sterling relative to the US dollar on impact. The global and UK risk shocks are identified using a structural decomposition as in [Mann \(2023\)](#). ONS data on sectoral holdings in the UK financial accounts are subject to limitations related to data granularity, coverage gaps, and the constraints of traditional survey-based methodologies and should be interpreted with caution.

Recalling **Chart 11**, the Bank of England's balance sheet has also played an important role in the gilt market, but that role has differed across episodes. In the face of global shocks such as the GFC and the Covid pandemic, the MPC expanded asset purchases through the Asset Purchase Facility as part of the monetary policy response, alongside Bank Rate cuts, to ease financial conditions. During the UK-specific shock of the September 2022 mini-budget, the Bank undertook temporary and targeted purchases of long-dated gilts to restore orderly market conditions.

That was then, this is now in the gilt market

These local projection estimates draw on data from 1997 to 2025. But the structure of the gilt market has changed markedly in recent years. As shown in **Charts 11 and 12** earlier, the investor base in UK gilts has shifted towards OFIs and non-residents in recent years, while the share of gilts held by the UK insurance companies and pension funds category¹⁷

¹⁷ Although the ONS-grouped category of UK insurance companies and pension funds has declined, this largely reflects lower holdings by pension funds, while insurance company holdings have increased in recent years.

and the Bank of England (since the start of quantitative tightening) has declined. What might be the implication of that?

Based on the price elasticity of demand estimates in **Chart 13** and research on preferred-habitat behavior ([Giese et al., 2024](#)), the shift in the investor base of UK gilts has been from less elastic investors, such as insurance companies and pension funds, to more elastic ones.

This shift in the investor base towards investors whose demand is more elastic to changes in prices has important implications going forward. On the one hand, with respect to the level of interest rates, research suggests that smaller marginal increases in yields would be required for the more elastic investors such as OFIs and non-residents to absorb additional issuance of government debt ([Fang et al., 2024](#)).

This behavior also appears to be relevant for QT. For instance, [Kaminska et al. \(2025\)](#) find that during QT, price-elastic hedge funds have become increasingly important participants in gilt markets, in contrast to earlier phases of QE, when less elastic investors such as ICPFs played a larger role. In particular, the study shows that as the outstanding supply of bonds increases, preferred habitat elasticities- such as those associated with pension funds- decline, while arbitrageurs, including hedge funds, end up holding a larger share of the additional issuance.¹⁸

To the extent that a larger share of gilts is held by price-elastic investors (i.e. non-residents and OFIs), this shift will feed into the net primary income balance, as a greater proportion of interest payments on government debt accrue abroad rather than to domestic gilt holders.

Moreover, in periods of volatile financial conditions, this same price elasticity can translate into larger and faster adjustments in portfolio holdings. These can amplify movements in yields, particularly when positions are leveraged or funded at short maturities, with rapid deleveraging as funding conditions tighten or risk appetite deteriorates. Within this group, portfolio adjustments by non-resident investors, especially for hedge funds, can also be reflected in heightened exchange rate volatility ([International Monetary Fund, 2025](#)).

Monetary policy strategy

Let me collect key points in the international landscape: the UK has the old exposure of a persistent current account deficit and corresponding financial account surplus, but with

¹⁸ Similar dynamics are evident in Canada, where Bank of Canada analysis shows that hedge funds' participation in government bond auctions has risen sharply alongside increased issuance, reflecting their greater willingness to absorb supply at the margin ([Epp and Gao, 2025](#)).

new actors on the financial side, particularly in the gilt market. We also know that we are in an increasingly shock-prone world.¹⁹ There are several reasons why these are pertinent now for my monetary policy strategy.

On the trade side of the balance of payments, global energy price developments are worsening the external deficit and domestic economic activity along with raising inflation and inflation expectations. For monetary policy decision-making, the trade-off between inflation and activity is increasingly stark.

On the financial side of the balance of payments, the marked shift in the composition of gilt holders over time, away from domestic, long-term, relatively stable investors and towards new actors that are more foreign, price-elastic, leveraged, and with shorter-duration portfolios may affect the monetary policy landscape.

In general, given additional fiscal issuance and (or) QT, the prevalence of more price-elastic actors would tend to lower sovereign borrowing rates, relative to the previous composition of investors.

But the local projection estimates show that the more price-elastic investors display a negative response to both UK-specific and global risk shocks. Considering the international dimension, with the share of gilts held abroad increasing, and gilt yields tending to be higher than other foreign sovereign obligations, this could result in a deterioration in the net primary income balance within the sovereign debt investment portfolio. That would worsen the current account deficit and require even more foreign financing.

In addition, valuation effects have played a particularly important role in keeping the NIIP fluctuating around zero. With a growing share of gilts held by more price-elastic and often leveraged investors, monetary policy in the UK and abroad might have an increasingly important effect on valuation adjustments and the overall size of the NIIP.

Finally, although price-elastic investors can be an advantage in terms of the level of interest rates, they are also more responsive to changes in interest rates on account of domestic or global shocks, which could yield more volatility in cross-border capital flows and in financial conditions. Hypothetically, if a new shock were to occur and weigh on investor confidence, these more price-elastic international investors could respond by reducing their gilt holdings. The resulting volatility in yields could be reflected in a persistent risk premium on gilts.

It also matters who replaces these investors as marginal holders – domestic or foreign. Pressures may instead manifest through the exchange rate, as sterling-denominated gilts are sold by non-resident investors, particularly highly leveraged ones.

From the standpoint of balance of payments accounting, although declining gilt prices reduce the market value of UK liabilities, a more price-elastic investor base can still worsen the current account balance and NIIP if their behavior amplifies the risk-off

¹⁹ See [Mann \(2024b\)](#).

dynamics. Indeed, [Cesa-Bianchi et al. \(2026\)](#) highlight how vulnerabilities in large external balance sheets can interact with periods of financial stress.

The international dimension adds to the already complex environment. If a tighter policy stance were pursued – particularly in the current environment where the old exposure of energy prices adds to inflationary pressure – the higher yields could support demand for UK assets abroad, but also imply a worsening of the primary income balance. Given fragilities and economic uncertainties in the domestic and global financial markets, investor sentiment can shift abruptly. A tighter monetary policy stance could trigger volatility as the new actors unwind positions, potentially leading to tighter domestic financial conditions than intended.

Monetary policy needs to remain alert to the impact of the old exposures and the new actors in the UK's international accounts.

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