

Why Labour cannot ignore the gilt market

Leadership hopefuls should not get into a trial of strength with investors.

For the fifth time since 2016, the UK is facing a potential midterm change of prime minister. Health secretary Wes Streeting has resigned, calling for a “broad” contest to replace Sir Keir Starmer as premier and Labour leader. Streeting has not yet launched a leadership bid himself, and a contest is not guaranteed. But other mooted candidates are limbering up for a struggle that could once again thrust the country into months of uncertainty. Given the restive state of bond markets, there could hardly be a worse moment — something leadership hopefuls and the rest of the party should keep in mind.

Britain’s long-term government borrowing costs have edged higher since the Covid-19 pandemic, propelled by wasteful spending, weak growth, fiscal own goals — including prime minister Liz Truss’s disastrous “mini” Budget — and the Iran war. Investors are fretting that the UK’s dependence on fossil fuel imports makes it particularly vulnerable to higher interest rates and inflation. Reduced bond-buying by domestic pension funds and the Bank of England’s quantitative tightening programme have played a part, too.

Britain does not have the highest debt-to-GDP ratio among major economies. But its 10-year yield has been the highest in the G7 since around the time of Labour’s first, growth-sapping Budget in October 2024. The party’s leadership turbulence has made things worse by raising uncertainty around future debt issuance.

Though Starmer’s authority has waned with many MPs and voters, investors trust him and his chancellor Rachel Reeves with the public finances more than their potential successors. Among the leading possible candidates, FT research suggests gilt investors are most worried about Andy Burnham, the Greater Manchester mayor — who yesterday was offered a potential route back into parliament — and former deputy prime minister Angela Rayner. Both are popular on the Labour left. Burnham has said the country should not be “in hock” to the bond market, and Rayner is seen as a fan of bigger state.

Either way there is concern that a new leader, or Starmer if he remains in post, will have to win over colleagues with new spending. After all, it was Labour’s backbench MPs who voted down Reeves’ attempt to curb rising benefit payments last year, jolting yields higher. This, in part, reflects fiscal complacency on the party’s left. Paula Barker, an MP who has shown support for Burnham, has said the bond market would “have to fall in line” with his agenda.

It may be appealing for politicians to blame the tight public purse strings on shadowy financiers. But such arguments reveal a naive grasp of finance. If a nation consistently spends more than it collects in tax it needs to issue bonds, which investors fund. If it shows little sign of reducing expenditure or increasing revenues debt holders logically demand a higher rate for taking on greater credit risk.

Britain has been constrained by investors for precisely those reasons. A selloff in gilts is a signal to policymakers that the public finances are on an unsustainable trajectory. This should not be taken lightly. Britain already spends almost twice as much on debt interest payments as on defence, and higher government yields are pushing up mortgage rates. It cannot afford even dearer borrowing costs.

At a time when politicians are failing to cut spending and deliver credible growth strategies — while stoking instability with political infighting and a blasé attitude towards fiscal discipline — the bond market is acting as a rare adult in the room. Potential leadership challengers seeking to defy it would do so at Britain's peril.