

UK neutral rates to settle lower, despite a volatile path

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A declining UK neutral rate does not translate into a simple long-duration call. Explore where investors may find value across the gilt curve.

The gilt market is sending two different signals. Restrictive policy and a potentially lower long-term neutral rate point to eventual easing, but inflation risk, heavy issuance and fragile fiscal confidence continue to raise the compensation investors demand for holding long-dated gilts. For now, the pressure at the long end looks more consistent with elevated risk premia than with a material rise in the UK's longer-term interest-rate anchor, or what is called the “neutral rate.”

This distinction—between risk premia and neutral rate—matters because policy is already restrictive. With the Bank Rate at 3.75%, monetary policy is weighing on growth and labor demand. The Bank of England may stay cautious while inflation risks linger, but caution is not the same as confirmation of a higher neutral rate.

The neutral rate, therefore, provides a useful anchor: it separates volatility in the path of rates from the likely policy destination, even if inflation scares, quantitative tightening (QT), fiscal risk and term premia remain persistent.

The neutral rate is lower than today's policy setting

In our estimate, the long-term UK nominal neutral rate is between 2.5% and 3.00%. The post-pandemic rise in neutral was driven less by a lasting improvement in the real economy than by the inflation shock itself—energy prices, supply disruption, wage pressure, tax changes and Brexit-related frictions. Those forces lifted the policy hurdle, but they did not rewrite the UK's structural growth outlook.

As inflation expectations normalize, that structural outlook should dominate again: weak productivity, aging demographics and subdued investment demand all point to a lower policy anchor. The path may be uneven, but the direction still looks down.

Structural factors should ultimately pull rates lower

The structural forces are pulling in different directions. Higher net gilt issuance and QT can lift real yields by requiring private investors to absorb more duration. Over time, however, weak productivity, aging demographics and subdued investment demand would weigh more persistently on the real neutral rate by lowering expected returns, reducing capital demand and encouraging precautionary saving.

Fiscal pressure is the main near-term upside risk to yields. Heavy issuance, high public debt and BoE balance-sheet reduction place more duration with private investors, keeping real yields and term premia elevated without necessarily changing the neutral rate itself.

Demographics is the more durable counterweight. Aging and longer life expectancy support saving, while lower birth rates and slower migration reduce labor-force growth, capital demand and the real neutral rate.

Productivity points the same way. Weak productivity growth lowers potential output, expected returns, wages and borrowing capacity—all consistent with a lower neutral rate. AI offers upside, but evidence of a lasting economy-wide productivity boost remains too thin to make it part of the central case.

The opportunity lies in the curve—not outright duration

For fixed income investors, the destination matters, but the path matters more. While the long-term outlook points to lower policy rates, the market must first navigate inflation shocks, fiscal supply and a less reliable buyer base for long gilts.

This creates a clear investment tension. If neutral drifts lower as we expect, today's Bank Rate remains meaningfully restrictive, supporting the front end of the gilt curve as the cutting cycle unfolds. The long end, however, faces a different challenge. Fiscal pressures, QT and higher term premia, along with a shrinking natural buyer base, continue to weigh on long-dated gilts.

Pension schemes are no longer adding materially to long-end exposure, existing holdings are rolling off, and limited new demand has emerged to replace them.

The gilt market's recent whiplash should be read as more than noise. Markets have already tightened financial conditions on the BoE's behalf: rate expectations have repriced, 10-year yields have surpassed 5%, and oil and geopolitical risks have revived inflation concerns. Yet domestic demand remains weak and the inflation impulse is more supply-led than demand-led, giving the BoE room to wait while leaving the curve vulnerable to volatility and, over time, renewed steepening pressure.

Inflation cools durably, services inflation eases, energy prices stabilizes and the MPC resumes a measured cutting cycle toward a lower neutral rate.

Front-end and belly gilts rally; curve bull-steepens; breakevens edge lower; nominals outperform linkers; sterling IG credit tightens.

Add duration selectively in the 5–10-year area; favor nominals over linkers; maintain constructive sterling IG credit exposure, especially higher-quality spread.

Inflation remains sticky, energy and wage pressures persist, and the BoE stays on hold or is forced into a reactive tightening bias despite weaker growth.

10-year gilt yields remain elevated; the curve stays broadly flat and uneven, with the long end vulnerable to term-premium pressure; duration offers limited protection; linkers exposure provides better resilience.

Keep duration short to neutral, focused on 3–5 years; overweight medium-dated linkers; favor credit issuers with pricing power, low refinancing risk and global revenues.

Growth disappoints, fiscal headroom erodes, gilt supply remains heavy and investors demand a higher term premium for holding long-dated UK risk.

Curve bear-steepens; ultra-long gilt yields rise sharply; sterling weakens; long-end volatility increases; sterling credit risk premium widens.

Underweight ultra-long gilts; reduce sterling credit concentration in favor of diversified multi-currency or USD IG exposure.

Source: State Street Investment Management, Bloomberg, as of September 4, 2026

Scenario 1: Orderly normalization: The soft-landing route (~15% probability)

This upside case would validate the neutral-rate thesis most cleanly, allowing the belly of the curve to rally without a sharp deterioration in growth. It remains credible, but requires several favourable conditions to align.

Scenario 2: Stagflationary plateau: Higher for longer (~55% probability)

Our modal case is an uncomfortable holding pattern: the route toward a lower medium-term neutral rate is delayed and volatile, favouring selective rather than broad duration exposure.

Scenario 3: Fiscal credibility test: The long-end risk (~30% probability)

The principal tail risk is a gradual loss of confidence rather than a repeat of the abrupt 2022 shock. That makes long-end protection valuable insurance rather than a central position.

Favor the belly, protect against the tail

Across all three scenarios, the message is consistent: investors should not confuse a lower medium- to long-term neutral rate with a simple long-duration signal. The opportunity is selective, curve-aware and risk-managed.

In our view, the most attractive part of the curve has shifted toward the 5–7-year area. It is long enough to benefit from eventual policy normalization, but short enough to limit exposure to term-premium damage if stagflation or fiscal stress dominates. The ultra-long end, once the natural anchor for pension and LDI investors, now offers a much a less attractive risk-reward profile.

UK real yields are at their most attractive levels since the mid-2000s, creating a compelling entry point for long-term investors.

Medium-dated linkers also deserve a structural overweight in liability-matching portfolios. Real yields above 1.5% provide a rare entry point, while inflation carry offers protection if the disinflation path remains uneven.

The bottom line is clear. Policy rates may have more room to fall than markets currently price, but the road to that outcome is likely to be volatile. In that environment, tactical optionality—moderate duration, attractive real yields, curve selectivity and disciplined credit risk—is not a contradiction of the long-term neutral-rate view. It is the practical way to invest around it.

Investing involves risk including the risk of loss of principal.

Source: <https://www.ssga.com/hk/en/institutional/insights/uk-neutral-rates-to-settle-lower-despite-a-volatile-path>