

UK Funding Market Update: Gilt Demand and BOE Balance Sheet Driving Repo

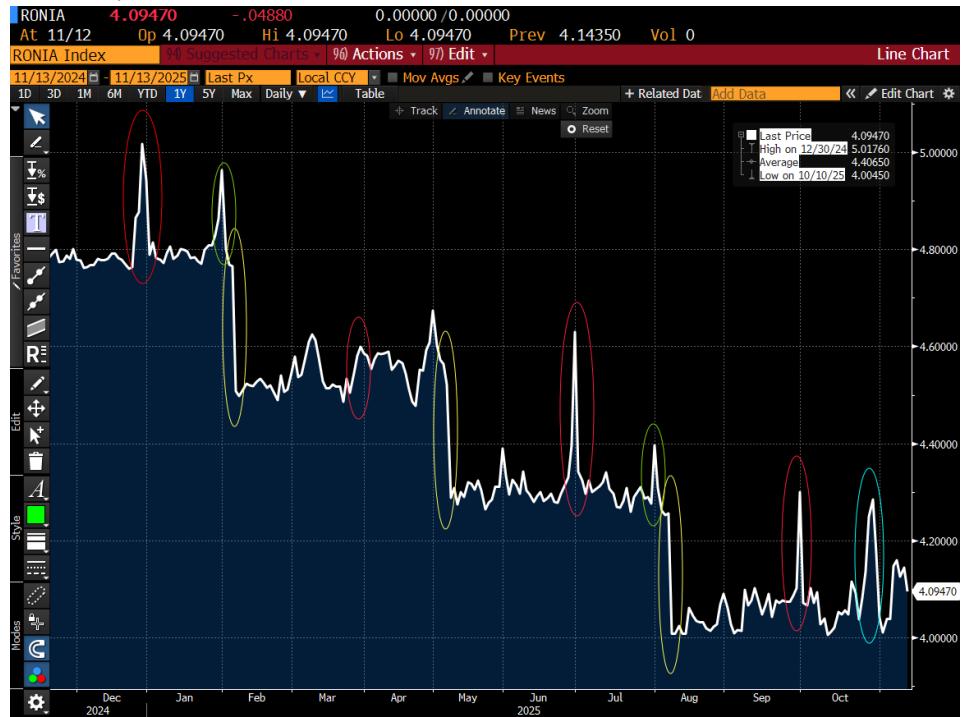
Tim Davis, 13 November 2025

We have focused a lot on the supply-side impacting UK funding markets and we draw together some of our recent coverage on that topic in this document. However, we also look at the demand side of the equation and an increase in long gilt positioning may also have been a contributing factor to the most recent increase in funding costs and RONIA.

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RONIA Spikes and Event Drivers



Ovals denote: Red: Quarter-end. Yellow: Bank Rate cut. Green: APF gilt redemption. Blue: TFSME repayment
Source: MNI, Bloomberg Finance LLP

How does gilt demand impact funding markets?

Last week's MPC meeting pushed the market further in favour of pricing a December cut. Perhaps importantly too, some of the clarity over Governor Bailey's willingness to consider the data at the December meeting only became clearer during the press conference. The STR operation is held later in the day (12:30-13:00 rather than 10:00-10:30) on days of MPC meetings to take into account any rate changes, but it is still held during the press conference. We think that some of the moves higher in repo funding costs will potentially have been due to the market buying gilts (particularly to establish new long positions). Hedge funds in particular use repo to hold long gilt positions. Therefore as long gilt positions are established if these are funded using repo, demand for repo increases. Higher demand for repo will increase the interest rates applicable.



As repo rates are higher than rates on Bank Rate, when there is an excess of demand for repo, there is an incentive for banks to borrow more via operations such as the STR from the Bank of England and then lend this on via repo and earn a spread for doing so. When there was lots of excess liquidity in the system, there were no real spikes in repo rates and RONIA seen (outside of quarter ends when banks wanted their balance sheets to look more attractive). However, as we move to a system where reserves are no longer as abundant and move towards an “ample” reserve rather than “excess” reserve system, if there are unexpected changes in demand for repo these might not be able to be immediately arbitraged away until the next weekly STR operation allows for an increase in borrowing from the Bank of England.

Last week, the extent of the demand for repo funding may not have been clear at the time market participants were bidding in the STR (given that gilt positions may have been established during or after the bidding window for the operation closed). It may also be to some extent that market participants do not attempt to anticipate repo rate increases when deciding on their STR demand, and rather only react to higher repo rates after a clear market signal. Given the significance of the MPC meeting last week, it may also be that there wasn't clear sight across the market as to the extent of additional demand to go long gilts and to fund this via repo, too.

There is no real way of really proving our hypothesis that increased demand for gilts was a contributing factor to the increase in RONIA seen last Thursday. But it does add even more focus to today's STR operation (results due at 10:40GMT).

Increased STR takeup could be a hint towards gilt positioning going forward

The other thing that might be a bit more evident when markets have fully settled down following the TFSME repayments is that STR usage may well increase when demand for long gilt positions increases (if they are funded via repo). So tracking STR usage or the overall size of the Bank of England's reserve balances may give some indication as to gilt positioning. This is likely to be very much more of an art than a science but we will be looking at big swings in STR usage that cannot be explained by other developments.

ILTR takeup also a consideration for today's STR operation

The other consideration when looking at today's STR operation will be usage of the ILTR operation. On Tuesday gross takeup in the operation was GBP6.073bln, leading to a net increase of GBP5.518bln (the third highest net increase on record – the highest being the week of the first Covid lockdown and the second highest two weeks ago aligned with peak TFSME repayments).

Note that the BOE sent out a market notice on Friday 7 November ([available here](#)) noting that from the W/C 17 November ILTR drawings using collateral level A will be priced at Bank Rate plus 3bp rather than at Bank Rate flat. So this week's operation was the last at the cheaper rate. An intended change for November (previously with unspecified date) had been first announced in June and due to the way compounding interest works it effectively equalises the costs of using the ILTR with rolling over STR operations weekly (so the ILTR will no longer be cheaper).

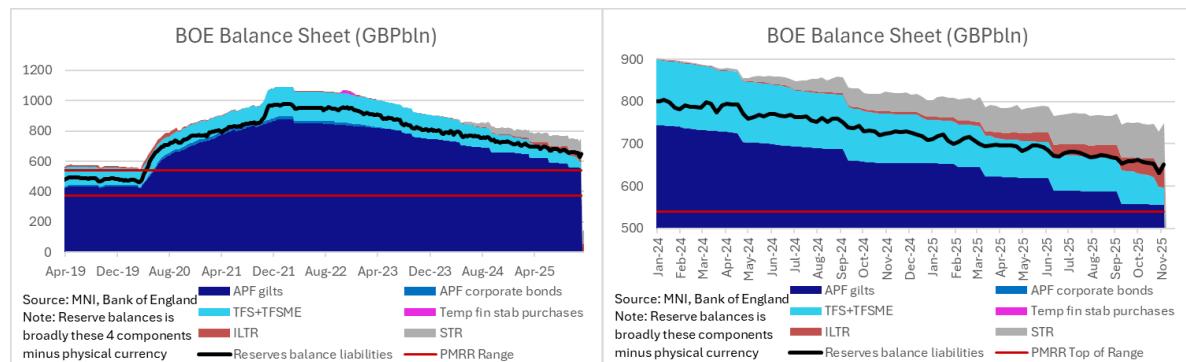
We think that some of the increase in ILTR recently may have been due to front-running this change - given that the rate will only apply to new drawings and not applied to existing balances. But it has been impossible to differentiate increase in ILTR from front-running versus an increase in demand from TFSME run-down.

Note that the spreads for collateral levels B and C will not change.

Balance Sheet Update

The TFSME repayments were the main reason that supply-led reserves balances (i.e. excluding repo operations) fell from GBP545bln in late September to just under GBP500bln by the end of October. Overall reserve balances saw a much smaller fall from GBP660bln at the end of September to around GBP650bln in last week's update (but there was a fall down to GBP630.2bln immediately after the STR repayments and this week are expected to be around GBP640bln given the repo operation takeup).

- Reserve balances rebounded to GBP651.2bln in the week to 5 November, from GBP630.2bln the prior week and only GBP2.3bln smaller than the GBP653.5bln seen on 22 October. This increase was driven by a GBP21.4bln increase in repo operations in the week (which as we noted above have since fallen back by GBP11.1bln causing the increases in RONIA again).
- There were no TFSME repayments for the week with usage remaining at GBP41.9bln.
- Supply-led balances have fallen to GBP499.1bln and are now below the top of the Bank's estimated Preferred Minimum Range of Reserves (GBP540bln). However, overall reserves are still over GBP100bln in excess at due to repo operations.



What events move RONIA?

- RONIA doesn't normally move around a whole lot, but when it picks up it is a bit of a red flag that there is tightness in UK funding markets.
- Looking at the chart on page 1 there are several times when RONIA picks up: First, quarter-end when banks prefer to show "cleaner" balance sheets so temporarily want to reduce lending within the market. Second, we can see spikes in RONIA around gilt redemptions where the BOE holds a large portion of the gilt that is being redeemed.
- This latter point all else equal is associated with reductions in reserve balances which can lead to some funding pressures in money markets. This will lead to an increase in RONIA. However, over a few days this increase in RONIA will usually be addressed. If RONIA picks up then effectively it costs more to borrow on the open market. However, many market participants can borrow from the Bank of England via the STR or ILTR facilities, so if there is a spike in RONIA we tend to see a spike in STR usage. When STR usage picks up the funding pressures subside and RONIA moves back down to more normal levels.

- Instead of there being a gilt redemption, there have been some big repayments from banks to the BOE of TFSME loans. Now, rather than having that funding those banks will look to replace that borrowing through either the BOE facilities or via RONIA.

Which facilities does the Bank of England have to deal with repo?

- The ILTR facility has a 6-month term that settles at T+2 while the STR has a weekly term and settles at T+0. Both of these operations are weekly (with operations on Tuesday and Thursday and therefore both settling on Thursday). There can therefore be a funding gap of a few days when either reserve supply reduces (due to large APF gilt redemption or TFSME repayments for example, or as discussed above an increase in repo demand) where there will be demand to replace those funds by borrowing in the market before they roll into borrowing via the STR or ILTR instead.
- T-bill auctions can also be impacted by repo demand as if you can lend on the market at a higher rate, you are less incentivised to park any spare money into T-bills.
- All in all, these are largely foreseeable temporary liquidity issues which will likely be seen again in future large reductions in BOE holdings of gilts (through large redemptions). So we wouldn't be too concerned overall.

How does the size of the Bank's balance sheet impact repo demand?

- Note we set out a primer on this in July within the appendices of [BOE September APF Decision: What you need to know](#)
- The size of the Bank's balance sheet sets the amount of available reserves so in times when the balance sheet is smaller there is greater demand for funding from other parts of the market (which can be evidenced by spikes higher in RONIA).
- As the balance sheet gets smaller and we approach the upper end of the Bank's estimate of PMRR (preferred minimum rate of reserves) this volatility will both increase and the RONIA Bank Rate spread should increase.
- For now, however, we are still around GBP100bln above the top of the Bank's estimates of PMRR - which suggests that we won't move from an "excess" to more "ample" reserves level for around a year (or possibly longer if repo operation usage keeps increasing). In a speech last week, BOE Executive Director for Markets Vicky Saporta noted that estimated of the top of PMRR remain around GBP540bln.
- Overall, we agree the top of PMRR is still some way away but we think we have entered the final straight for the balance sheet to be "demand-led" through repo operations rather than "supply-led" through the APF / TFSME. And we expect this increased volatility in RONIA-Bank Rate will remain possibly for a few weeks after each large future gilt redemption held by the APF before subduing a little in interim period (albeit with spikes around quarter ends).
- Also given that there are a lot less excess reserves around than there were in previous periods, we think year-end will likely see much larger increases in funding spreads than in previous periods. This can of course be avoided to some extent in there is increased usage of operations like the STR around big demand points - but we would still expect quarter/year-end spikes to increase as the size of the Bank's balance sheet continues to fall.

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