Views from the LDI Desk

BlackRock

Shifting Gilt market regime

Executive Summary

The UK gilt market has moved away from one dominated by yield insensitive pension and insurance demand to one that is more sensitive to changes in yield and price.

The marginal buyer is now more balance-sheet-sensitive. Meaning that demand depends not only on yield or valuations, but also the capacity to finance, warehouse and hedge positions. Banks and dealers must allocate capital and leverage capacity; hedge funds depend on repo funding, haircuts and margin availability; overseas investors assess FX-hedged returns and cross-market relative value. Their willingness to hold gilts can therefore change quickly as funding costs, capital usage or market volatility move.

The DMO's evolving funding strategy reflects this change in market behaviour. Long-dated and Index-Linked issuance has been reduced, the weighted-average maturity of new borrowing is shortening, and greater emphasis is being placed on front-end flexibility and active liability management. T-bill reform is one component of that adjustment. A larger and more liquid bill market could attract Money Market Funds (MMFs), bank treasury desks, corporate cash investors and reserve managers, reducing the marginal amount of duration that must clear through conventional gilts.

In this piece we explore these factors and the impact they're having or may have on the Gilt market moving forward. Specifically, we discuss:

Expectation for elevated supply: The net supply picture remains elevated with continued fiscal pressure and Quantitative Tightening ('QT')

Increased participation by Bank Treasuries : Banks have reacted to Gilt cheapness on asset swaps by allocating more to Gilts but this demand driver is heavily linked to relative spread levels.

A less automatic long-end pension bid: Higher Defined Benefit funding ratios and de-risking reduce the need for pension schemes to add duration in the future.

More repo-funded and relative-value intermediation: Hedge funds and RV accounts support liquidity but increase sensitivity to funding conditions and leverage constraints.

An increase in dynamism from the DMO: The DMO has actively adjusted the profile of supply and is enabling market evolution through T-bill reform and other market tools

Highlights for investors

c.20%
Insurance and Pension share of gilt holdings. Falling by 10% over the last decade

c.33%
Overseas Investors are now the largest holder of Gilts

13.9yrs
Average maturity of UK Gilt Stock (significantly longer than peers)

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Dual supply problem

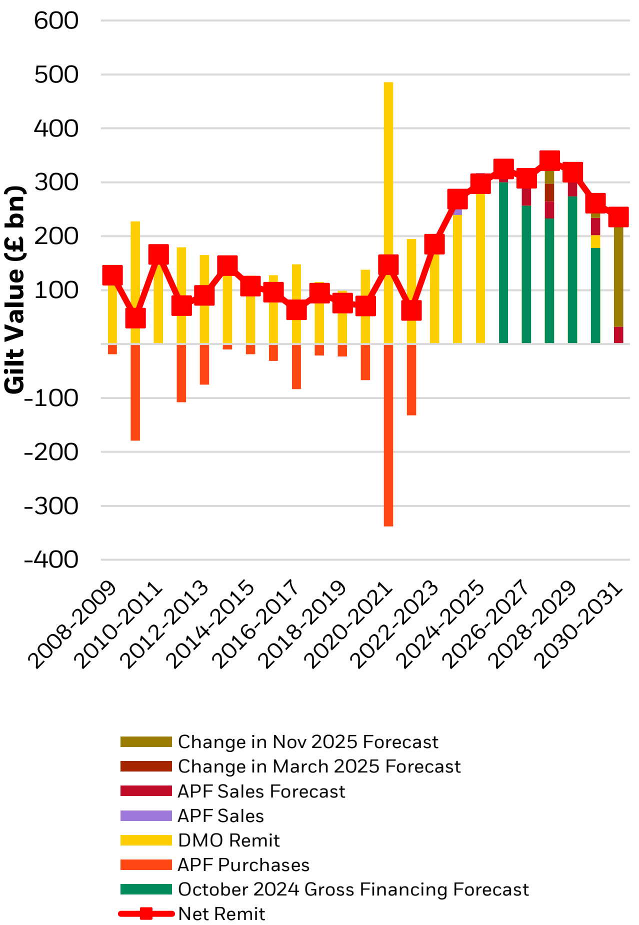
The gilt market is now clearing two sources of supply simultaneously: new issuance from the DMO and the reduction of the Bank of England's Asset Purchase Facility ('APF') gilt holdings through maturities and sales. This marks a structural break from the QE period, when central bank purchases absorbed part of the public-sector financing requirement and reduced the effective amount of duration left for private investors.

In the QT regime, that support has reversed. Private investors must absorb both the government's ongoing borrowing needs and the duration released from the Bank's balance sheet. The result is a higher effective supply burden, greater sensitivity to auction concessions and a larger role for overseas investors, dealers, hedge funds and bank balance sheets in clearing the market.

With continued pressure on medium-term public finances, along with emerging challenges such as increased defence spending, and broader commitments such as nationalisation of certain parts of the private sector it's likely that net issuance will remain elevated for some time. Over the next 3 years we estimate this in the region of £250-300bn per annum.

Supply has remained elevated

Increase in net supply has added further pressure to markets as outright issuance post covid has remained at all time highs



Forecasts may not come to pass. Source: BlackRock, DMO, OBR, BoE. Assumes updated pace of quantitative tightening allowing for passive and active sales.

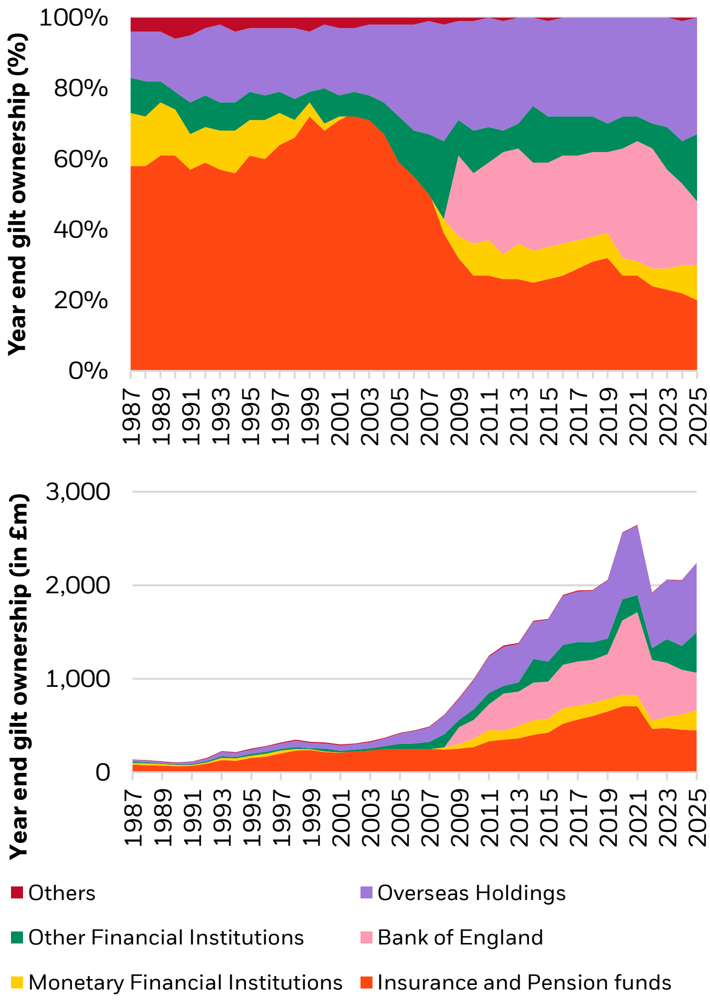
Ownership shift in Gilt Holdings

The ownership of Gilts has shifted considerably over the last few decades, in late 2007/ 08 we saw a significant increase in the expansion of the Bank of England ('BoE') balance sheet through Quantitative Easing. More recently we've seen a steady reduction in share of ownership of yield and price insensitive investors such as the BoE and Insurance and Pension funds.

We've also seen increased ownership from overseas investors, Monetary Financial Institutions (such as domestic UK banks), and Other Financial Institutions (such as hedge funds) which are typically more price and yield sensitive. This is resulting in a rethink in how existing institutions raise capital (such as the DMO) as well as having knock-on implications for a broader investor base.

Year end market share of Gilt Holdings

Chart shows the % split of ownership by institution for the stock of Gilts



Forecasts may not come to pass. Source: BoE.

In a world of elevated net-supply, who will be the incremental buyer of Gilts in coming years?

Existing market demand

The gilt investor base is broader than in the earlier pension-led regime, but current ownership remains concentrated in a few sectors. At the end of 2025, overseas investors were the largest holder group, followed by insurance companies and pension funds, other financial institutions, the BoE and monetary financial institutions.

Participant	Q4 2025	Trend	Why they buy gilts / T-bills	Principal constraint	Market implication
Overseas investors	33%	Increasing	Benchmark allocation, reserve management, relative value, FX-hedged yield and global duration exposure	Sterling risk, hedging costs, fiscal credibility, global rates and cross-market relative value	The largest source of current demand, but also a mobile and price-sensitive one. Gilt clearing is increasingly linked to global rates and the attractiveness of sterling assets relative to other sovereign markets.
Insurance companies and pension funds	20%	Decreasing	Liability matching, inflation hedging, long-duration exposure	Improved DB funding, lower leverage, scheme maturity and movement toward buy-out or run-off. Potential future demand from Defined Contributions ('DC') Schemes and Local Government Pension Schemes ('LGPS')	Still a major holder of long gilts and linkers, but less likely to provide an automatically expanding bid for new duration supply.
Other financial institutions	19%	Increasing	Investment-fund allocation, securities dealing, relative value, liquidity management and other financial-intermediation activities	Funding, liquidity, investor redemptions and heterogeneous balance-sheet constraints	A large but poorly disaggregated source of demand. The category includes investment funds, securities dealers, hedge funds and other financial intermediaries, so it cannot be interpreted as a clean measure of any single investor type.
Bank of England	18%	Decreasing	Holdings originated through monetary-policy asset purchases	QT reduces the stock through maturities and sales	The APF remains a large holder, but its declining share adds to the duration that must be absorbed by private investors rather than providing new demand.
Monetary financial institutions, excluding the BoE	10%	Increasing	Liquidity buffers, HQLA, collateral, ALM, market-making inventories and short-term cash management	Leverage ratio, capital usage, balance-sheet cost and relative value versus reserves	Potentially increasing demand, particularly at the front end, but the scale of participation depends on whether returns compensate for balance-sheet usage.
Other domestic sectors	<1%	Stabilised	Savings, treasury management and low-risk investment	Access, tax treatment, product availability and limited operational scale	Supplementary rather than market-clearing demand under the current structure.

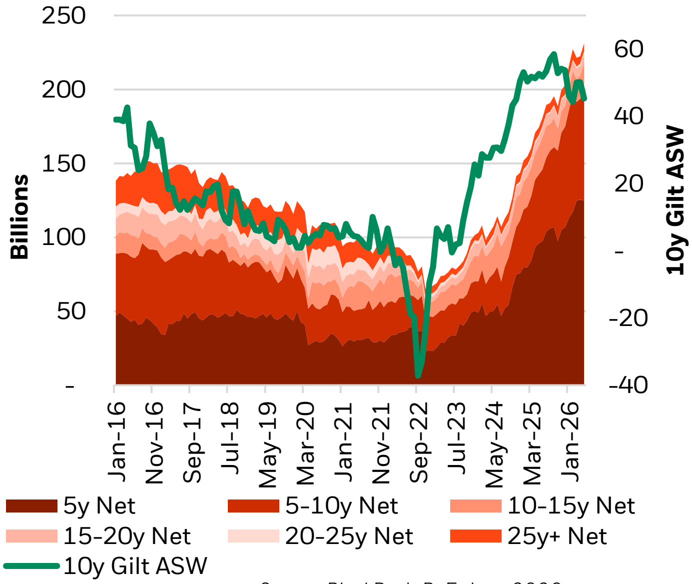
Demand from Bank Treasuries

One of the significant areas of demand in recent years has been driven by bank treasuries purchasing gilts on asset swap ('ASW'). (i.e. purchasing a 5y Gilt that provides a pick-up relative to cash and swapping back the rates risk).

The net change in allocation has been significant; however, this demand tends to be more opportunistic and level-dependent.

Gilt ownership by bank treasuries

Monetary financial institutions (excl BoE) gilt ownership relative to 10y Gilt asset swap



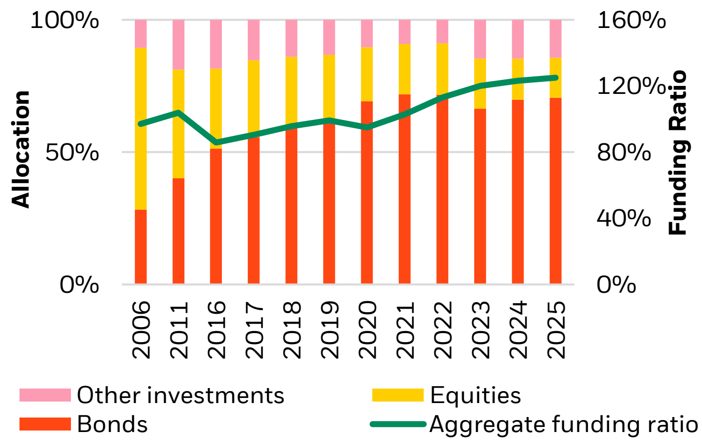
Forecasts may not come to pass. Source: BlackRock, BoE, June 2026

This demand is also sensitive to changes in bank leverage ratio requirements and balance sheet usage, meaning that Banks need to be sufficiently compensated for allocating to Gilts

Demand from Insurance and Pensions

Defined benefit pensions were historically the structural buyer in the gilt market. This has waned in recent years as net purchases from Schemes has reduced driven by stabilised allocations to bonds and rapid increases in funding levels post gilt-crisis. Potential demand may come from the broader Defined Contribution and Local Government Pensions markets as they mature, the size of which could be significant over the medium term.

Funding ratios over time and allocations to Bonds.

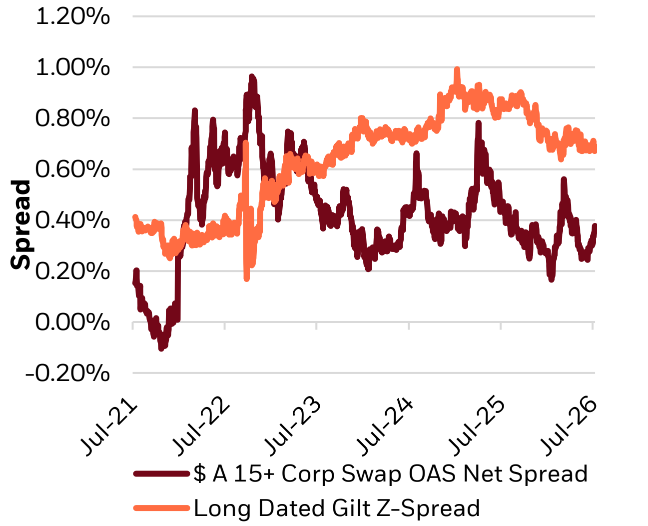


Source: BlackRock, PPF Purple Book, December 2025

Furthermore, as Pension Schemes have sought a risk-transfer to life insurance (via Buy-in or Buy-out), Gilts have often been sold for high quality credit that fits and insurers matching adjustment portfolio. In recent years, the trend of insurers selling Gilts for Corporate Bonds has flipped on its head with incremental increases in Gilt holdings as they appear attractive to insurers on a capital-adjusted spread basis.

Cost-of-capital adjusted relative value

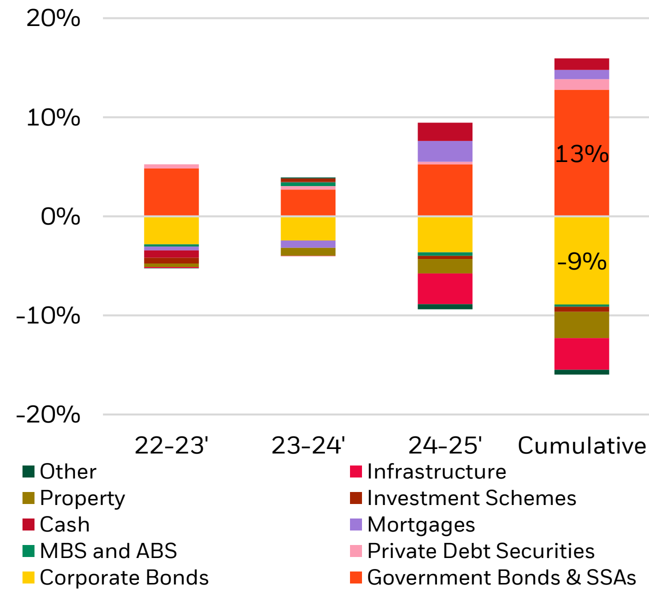
US Credit adjusted for fundamental spread and cost of capital looks less attractive than holding long-dated gilts



Source: BlackRock, Bloomberg, July 2026

Life insurer allocations have adjusted accordingly

Over the last 2-3 years we've seen a step change in insurance allocations to Gilts relative to Corporate Bonds



Source: SFCR Submissions, Insurer report and accounts

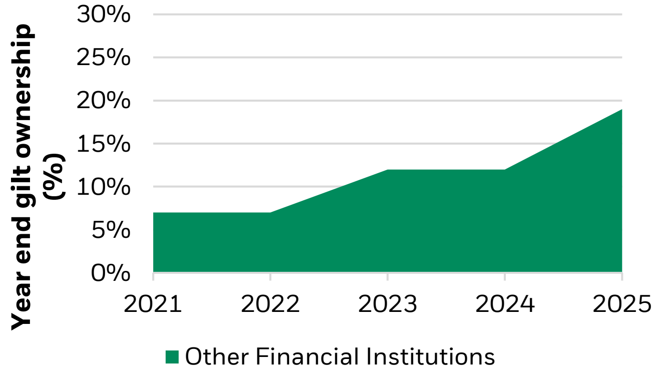
Once again, this demand is sensitive to the spread of Government bonds relative to credit and is something we continue to monitor closely, particularly for longer-dated Gilt demand.

Both bank treasuries and life insurers are spread-sensitive meaning that changes in Gilt asset swap levels can drive large incremental flows from participants

Demand from Other Financial Institutions

An area of significant growth over the last 3-4 years has been the participation of other financial institution post Gilt crisis as highlighted in the chart below

Increased Gilt ownership from other financial institutions



Source: BoE.

One of the major drivers here is the increased participation of hedge funds via Gilt basis trades

Gilt basis trades essentially involve simultaneously entering two trades to earn the basis between the physical Gilt and futures position;

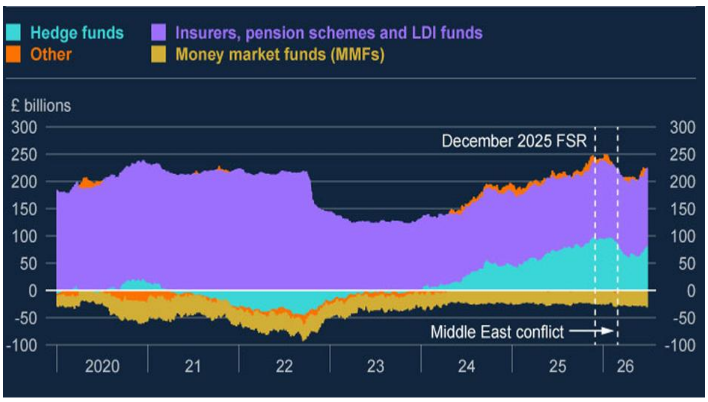
1) Purchase of Gilt via repo

2) Entering a short Gilt Future

This expansion of activity from hedge funds has also had a knock-on impact in other areas of the market. For example, hedge funds are now increasingly competing against traditional repo players (such as LDI) for limited balance sheet increasing potential costs and potentially increasingly volatility in financing spreads.

The evolving discussion on mandatory haircuts for repo may have a knock-on impact on the feasibility of these types of trades and this is an area to watch as the regulatory environment evolves.

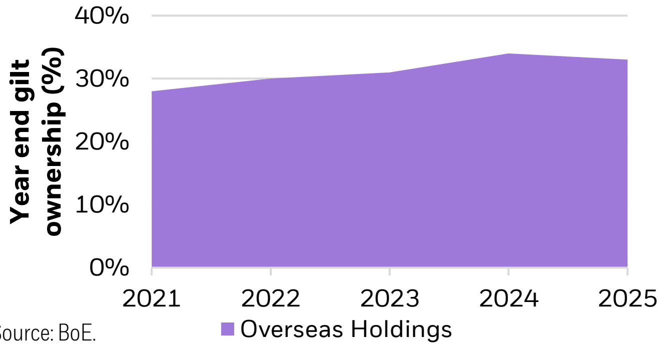
Net repo positioning across non-bank sectors



Source: Bank of England, Financial Stability Report, July 2026, Chart 4.3.
Latest data: 25 July 2026.

Demand from Overseas investors

Foreign ownership of UK government debt has increased over the past 5 years and now accounts for more than 30% of the outstanding gilt stock, making overseas investors the largest investor group.



Source: BoE.

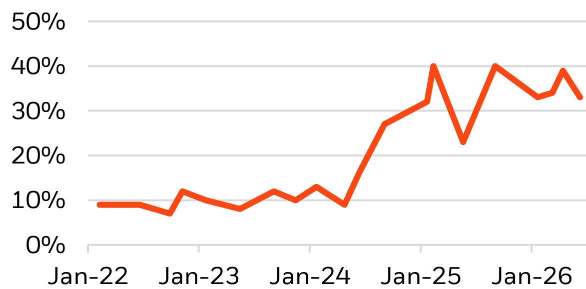
The Treasury and the DMO have limited visibility into the ultimate beneficial owners within the overseas investor category. In addition, some UK-based pension funds may also be captured within overseas investors category when investing through Irish QIAIF pooled funds. That said, sell-side feedback indicates that a significant share of this investor base consists of **official institutions**, particularly **central banks and sovereign wealth funds**.

A 2024 House of Commons Committee of Public Accounts report noted that the Office for Budget Responsibility views overseas holders of UK gilts as potentially more sensitive to market conditions than domestic investors, given their greater focus on relative returns. The DMO, by contrast, regards international investors as an important component of a broad and diversified investor base.

These investors tend to focus on yield opportunities, particularly in the shorter 5- to 10-year sector of the curve with latest weighted average maturity of net purchases being closer to 6 years. Their participation in short-dated gilt auctions has become more persistent, while their allocations in gilt syndications have also increased over time, as shown below.

Overseas investors nominal syndication allocation

Participation of overseas investor in Gilt Syndications over the last 4 years



Source: DMO Syndication results

We believe this investor base remains sensitive to valuation and yield levels. Against a backdrop of elevated gilt yields and broader diversification away from US dollar assets, demand from overseas official institutions is likely to remain well supported. Consistent with this, the DMO continues to view foreign investors as an important component of its diversified investor base.

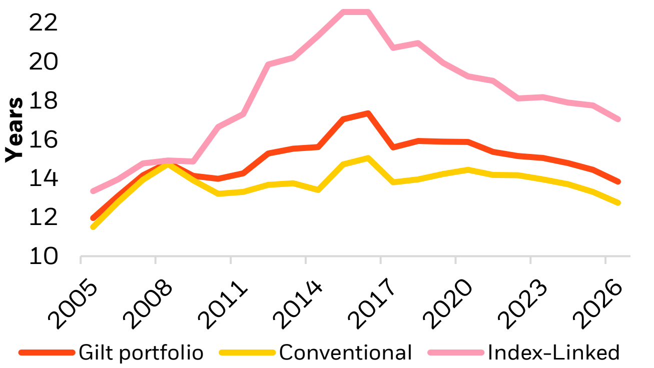
Reaction function from the DMO

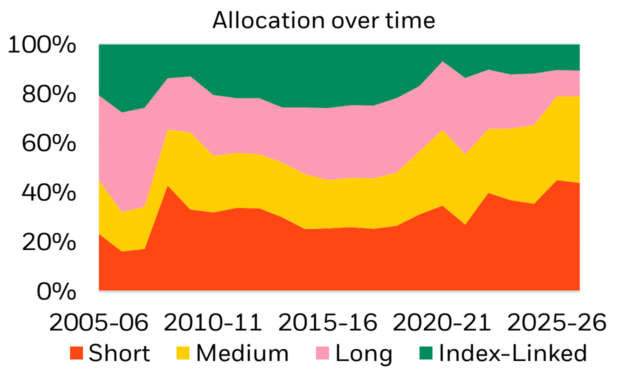
The DMO has been proactive in the shifting the supply of Gilts to reflect the changing buyer base. We've seen a significant shortening of issuance away from ultra-long dated gilts to the belly of the curve along with a reduction in the outright issuance of Index-Linked Gilts.

They have also deployed a more dynamic strategy by increasing the "unallocated" proportion of the remit and reacting to market needs.

Maturity profile of UK Gilt Stock and issuance

Weighted Average Maturity ("WAM") of the UK gilt stock has reduced c.4 years over the last decade, this is accelerating with DMO issuance behaviour.



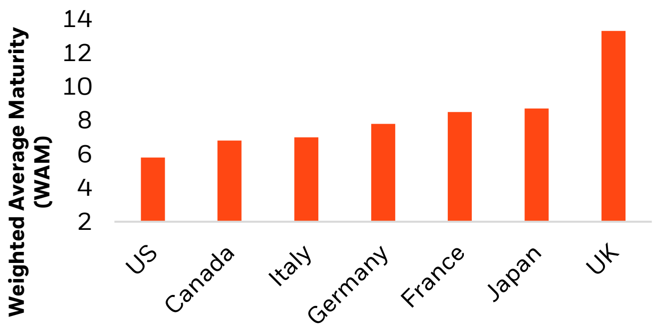


Source: DMO (nominal weighted basis, ex official holdings & inflation uplift)

Even with the reduction in supply, the UK remains an outlier relative to other G7 economies reflecting the historical dominance of the DB pensions system. We expect the trend of shortening WAM to continue as the DMO reacts to demand factors. Note that this isn't a UK-only phenomenon, other countries are also taking steps to reduce their profile.

UK relative to G7

WAM of the UK gilt stock remains a relative outlier



Source: Debt Management Report, Bloomberg, BOE and Treasury

Shortening Demand Profile for Gilts

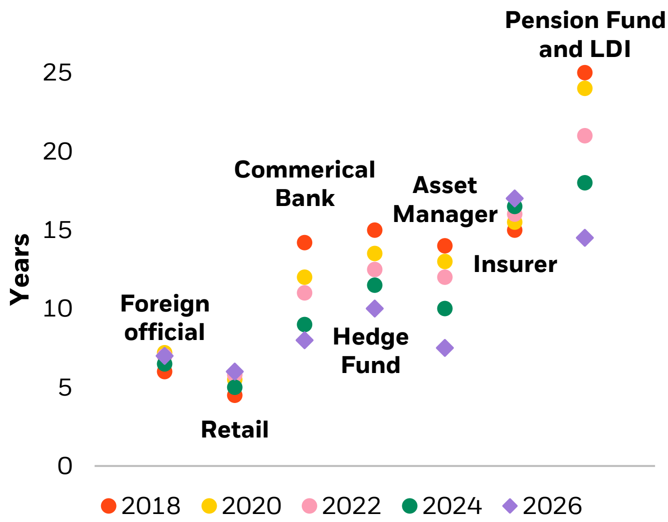
Alongside the broader structural shift in global government bond markets where higher issuance has increasingly been concentrated in shorter maturities, the preferred maturity profile of the gilt investor base has also shortened materially in recent years, as highlighted in the latest Financial Stability Report.

The overall direction is unsurprising: the weighted-average maturity of gilt demand has declined across most investor groups. However, the scale of the change within individual sectors is notable:

- **Pension Funds and LDI Investors:** the weighted average maturity of net gilt purchases has fallen from c.25 years in 2018 to c.14 years in 2026, a substantial adjustment over a relatively short period of time.
- **Asset managers:** average maturity has declined from 13 years to 7 years, representing a similarly significant shortening in demand.
- **Commercial banks:** average maturity has moved from 14 years to 8 years
- **Insurance companies** are the only client sector to see an increase in average maturity from 15 years to 17 years driven by a rotation of their back-book
- **Hedge funds:** demand remains most concentrated around the 10-year sector, broadly consistent with their relative-value and trading-oriented activity

Overall, this suggests that long-dated gilt demand has become increasingly concentrated within the insurance sector with increased buy-outs on the pensions sector, while the broader investor base has shifted towards short and intermediate maturities. This supports the case for a structurally shorter issuance profile and suggests that the adjustment in the long-end supply-demand balance may have further to run.

Evolution of weighted-average maturity of gilt purchases by investor sector



Source: BOE Financial Stability Report; reconstructed from published figure

The reaction function from the DMO to shorten the WAM of supply is likely set to continue

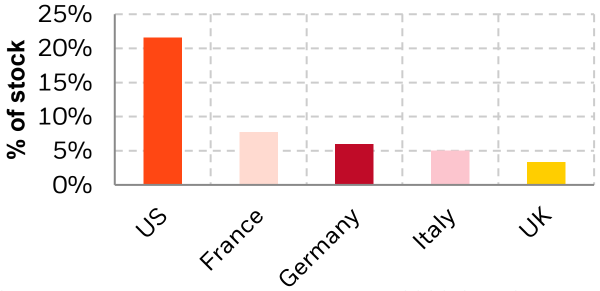
Regulatory shifts: T-bill reform

One shift that is taking place is reform of the T-bill market. Currently the DMO issues a small amount of short-dated T-bills (typically <6 months). The UK's issuance in this space is considerably below a number of its comparators with it sitting at approximately 3% of current stock.

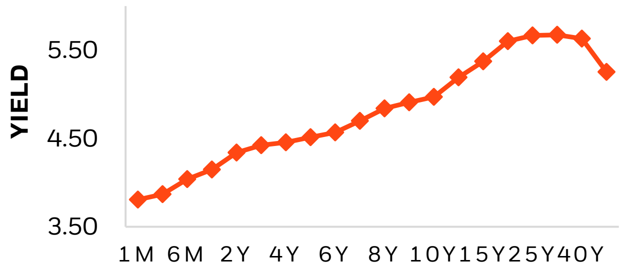
This could potentially become a much larger component of issuance under revised DMO plans and potentially attractive for the tax-payer given the existing term premium embedded in the Gilt Curve.

UK T-Bill stock relative to peers

T-Bills form a very small amount of issuance and could potentially an attractive tool for the DMO to use



Source: HM Treasury Debt Management Report 2026-27; U.S. Treasury Monthly Statement of the Public Debt; Agence France Tresor; Deutsche Finanzagentur; and MEF Italy



Source: Bloomberg

As part of reforming the T-bill market there are several changes that aim to bring about increased participation in the bills market;

1) Building out a more distinct T-bill curve

Existing bill market has limited number of maturities, DMO wants to build out a T-bill curve up to 1yr. This could potentially create a broader investor base....

2) Establishing a Standing Repo Facility for T-Bills

Creating a functioning repo market with the DMO may potentially allow dealers to become more comfortable quoting pricing, with the ability for dealers to borrow from the DMO facility on a temporary basis, helping resolve sourcing challenges intermarket.

Linked to the above, the DMO are intending on building their own pool of T-bills to support lending. This pool is expected to be established post Autumn budget 2026.

Whilst these points assist in resolving some of the challenges, there are reservations as to how effective some of these tools are and do not address topics such as access to retail investors, treatment of bills consistent with broader capital gains treatment of low-coupon Gilts,

Reform for leverage ratio

The FPC and PRA plan to consult on a package of leverage ratio reforms aimed at making the framework more proportionate, effective, and better targeted, although no firm timeline has been provided. Key proposals include aligning the Additional Leverage Ratio Buffer (ALRB) for firms with systemic buffers to international standards by setting it at 50% of risk-weighted systemic buffers. Similar to the risk-weighted framework, the ALRB for domestic systemically important firms would become releasable during periods of stress.

The package would also increase the proportion of leverage requirements that can be released in a downturn. The minimum Tier 1 leverage ratio requirement would be reduced from 3.25% to 3.0%, while a new general leverage ratio buffer of 25bps of leverage exposure would be introduced. This buffer, which would be fully releasable if required, is intended to enhance banks' ability to absorb losses and continue supporting the real economy and functioning of financial markets during periods of stress.

Current Leverage Capital Stack	Proposed Leverage Capital Stack
Countercyclical Leverage buffer (CCLB) (x35%)	Additional Leverage Ratio Buffer increase to x50%
Additional Leverage Ratio Buffer (ALRB) (x35%)	General Leverage Ratio Buffer (GLRB) 0.25%
3.25% Leverage Minimum	3.00% Leverage Minimum

According to the BoE, **these changes could reduce aggregate leverage requirements for large UK banks by around 20bps**, although the benefit is likely to vary significantly across institutions. Importantly, **gilts would remain included within the leverage exposure measure.** Andrew Bailey has stated that excluding government bonds is not under consideration and would be inconsistent with the Basel framework. Santander bank estimates the proposed changes **could support up to £13bn of additional gilt purchases under current balance-sheet allocation assumptions**. However, the extent of any increase in gilt demand will ultimately depend on banks' willingness to deploy the additional balance-sheet capacity and the relative attractiveness of gilts compared with other assets.

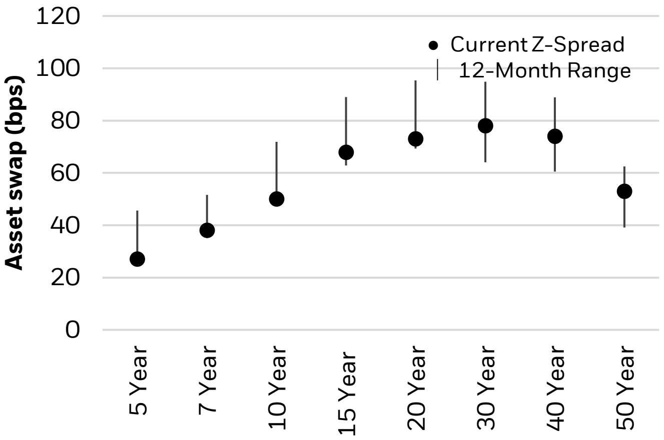
Separately, the FPC is reviewing **gilt repo market resilience**, including potential reforms such as mandatory clearing and minimum haircut requirements. The FPC and PRA are considering how these measures interact with the broader regulatory framework to avoid unintended consequences. Consequently, any increase in repo capacity resulting from lower leverage constraints may be partly offset by the introduction of new prudential requirements

Market view

We believe the structural reduction in weighted average maturity of supply, combined with an increasingly price-sensitive buyer base, could place pressure on front-end Gilts relative to swaps. We also expect volatility to remain elevated, driven by both domestic political developments and broader geopolitical risks, which are likely to continue influencing the Gilt market. This environment should create attractive opportunities for LDI investors to capture market dislocations through a more discretionary approach to portfolio management.

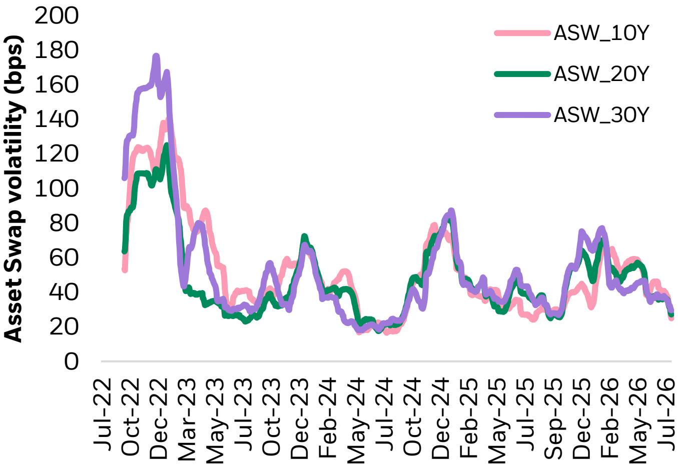
Nominal Gilts asset swaps

Supply and demand driving structural shifts in Z-spreads across the curve we expect shorter-dated gilt ASW to widen in the medium term



Asset Swap Volatility at lows but may pick up

Gilt–swap spreads have been experiencing periods of episodic volatility, we expect this continued with domestic and geopolitical risks likely to remain elevated



Key takeaways

- The gilt market is no longer only supported by a large base of “buy-and-hold” investors**.** Demand has shifted away from pensions, insurers, and the BoE **towards investors whose participation depends on valuations, funding conditions and balance-sheet capacity**.
- **Gilt supply remains structurally elevated.** Investors now need to absorb both ongoing government borrowing and the continued unwind of the BoE’s gilt holdings under QT, creating a more challenging environment.
- **The identity of the marginal buyer has changed.** Overseas investors, bank treasuries, hedge funds and other financial intermediaries are playing a larger role, making gilt demand more sensitive to relative value, funding costs and market volatility
- **Pension schemes are unlikely to provide the same structural long-end support as in the past.** Improved funding levels, mature schemes and ongoing de-risking and shift to Defined Contribution reduce the need for automatic duration purchases.
- **Spread-driven investors are becoming increasingly important.** Both insurers and bank treasuries have increased allocations to gilts when relative value is attractive, but this demand is opportunistic rather than permanent.
- **Policy makers are adapting to the new regime.** The DMO is shortening issuance, reducing long-dated and index-linked supply and pursuing reforms such as T-bill expansion to broaden the investor base and improve market resilience.
- **Future gilt performance may be driven as much by market plumbing as macroeconomics.** Funding availability, leverage constraints, repo conditions and FX-hedged returns are increasingly important determinants of demand and market clearing.

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