

European Rates Watch

Gilt buying in September: domestics at the forefront

Domestic banks could go net long for first time since 2016

The data in today's BoE Bankstats report reveals that September's Gilt supply was acquired by domestic investors (banks: +£3.8bn in Sep after +£3.1bn in Aug; domestic non-banks: +£4.6bn in Sep, more than reversing -£3.2bn in Aug; non-residents: £-0.6bn in Sep, after +£14.0bn in Aug - Exhibit 1). Year-to-Sep, domestic non-banks remain the main buyers of Gilts (+£87.7bn). However, +£22.4bn of Gilts from domestic banks in the first three quarters of 2023 is significant: if sustained, 2023 will be the first year since 2016 in which domestic banks will be net long Gilts (Exhibit 2).

Foreigners staying on the sidelines does not worry us

Despite marginal £0.6bn selling of Gilts in Sep, foreigners still accumulated £18.1bn through Q3. The marginal selling in Sep does not worry us too much because:

1. Overseas investors deposited a substantial £15.0bn with UK MFIs in Sep. These sterling deposits could be deployed into Gilts in the months ahead.
2. Foreign demand for Gilts continues to fluctuate in line with the quarterly seasonal pattern (Exhibit 3). Q4 tends to be a strong quarter for Gilt buying, at least partially due to a slowdown in GBP SSA primary supply into year-end, we think.
3. Oil price strength could aid foreign demand (Exhibit 4); weaker GBP should in theory result in rebalancing into Gilts – we wonder if September's 2.5% drop in trade-weighted GBP has fed through into Gilt buying data yet.

“Who will buy Gilts?”: still a worry, but less so than before

In Year Ahead 2023: Prepare for landing (20 Nov 2022) we emphasized the increasing dependency on the kindness of strangers (the need for overseas investors to buy even more Gilts than they had been doing) as one of several macroeconomic fragilities that we felt would lead to Gilt underperformance vs. forwards and peers. As of Q3, it appears that overseas demand for Gilts has indeed weakened relative to prior years (strong Q4 could still reverse this), but strong demand from domestics has been a positive offsetting development. The issue of “who will buy Gilts?” has not gone away completely but is developing somewhat more positively than expected at the start of the year.

FX Not for Now

The foreign Gilt purchases data have been closely watched since last year's market tumult. However, it would be wrong to over exaggerate the significance of these numbers to the current market set up. Ahead of the BoE and approaching month-end, a small net drawdown by foreigners will not be sufficient to shift the dial on price action, particularly with the recent trend having been so strong. This not to say that concerns about the UK's dual deficits has been forgotten. **(Paragraph continued on next page)**

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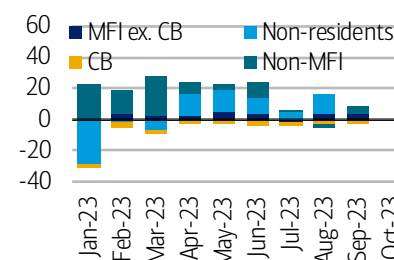
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Exhibit 1: Monthly net Gilt buying, £bn

Domestics – main Gilt buyers in September



Source: Bank of England, BoFA Global Research
BoFA GLOBAL RESEARCH

Abbreviations:
BoE: Bank of England
MFI: Monetary Financial Institution

True the headline current account deficit still remains a concern to us and the latest basic balance readings reveal and overall deficit of over 11% GDP. But the key to this becoming a more sensitive driver for GBP is based on market conditions. Despite the upheaval in geopolitical risks, we would observe that this has not extended into broader funding pressures or concerns on cross border capital flows. An orderly market therefore provides some cover, but we are still concerned: the key question remains how durable the market can be to any fiscal stimulus ahead of the election. For now – rate differentials are back on the radar for GBP investors

Exhibit 2: Net buying of Gilts per investor type, £bn

Domestic non-banks the main buyer of Gilts so far in 2023

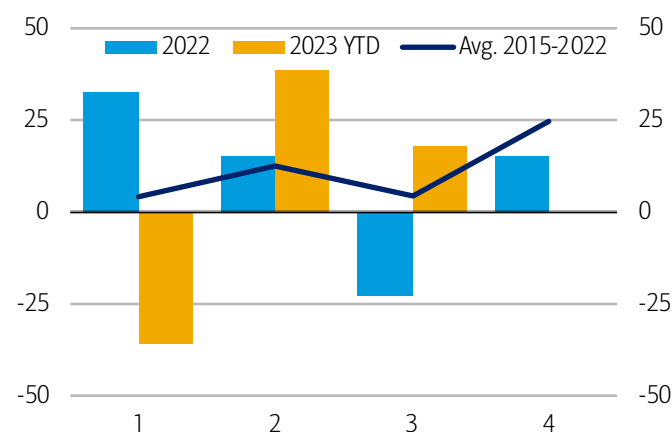
	MFI ex. CB	Non-residents	BoE	Non-MFI
2015	2.6	60.5	27.5	-2.7
2016	5.3	44.4	68.5	-34.0
2017	-15.4	22.7	32.6	31.9
2018	-10.8	22.0	21.2	24.8
2019	-10	46.4	40	-22
2020	-18.1	51.2	317.9	38.8
2021	-5.7	81.9	190.0	-58.7
2022	-1.7	40.1	-3.8	24.5
2023 YTD	22.4	21.0	-33.7	87.7

Source: Bank of England, BofA Global Research

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Exhibit 3: Quarterly overseas investor net buying of Gilts, £bn

Seasonality implies strong quarter for Gilt buying by foreigners

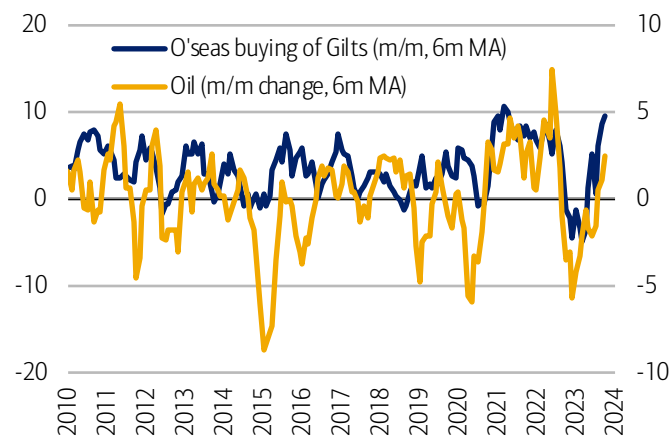


Source: Bank of England, BofA Global Research

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Exhibit 4: O'seas buying of Gilts vs. oil price changes,

Seemingly aligned in the last few years



Source: Bloomberg, Bank of England, BofA Global Research

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