



HM Treasury

Debt management report 2016-17

March 2016



HM Treasury

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1 Introduction

1.1 The 'Debt management report' (DMR) is published in accordance with the Charter for Budget Responsibility.¹ The Charter requires the Treasury to "report through its Debt Management Report – published as part of the Budget Report – on its plans for borrowing for each financial year" and to set remits for its agents. The Charter requires the report to include:

- the overall size of the debt financing programme for each financial year
- the planned maturity structure of gilt issuance and the proportion of index-linked and conventional gilt issuance
- a forecast of net financing through National Savings and Investments (NS&I)

1.2 The UK Debt Management Office (DMO) publishes detailed information on developments in debt management and the gilt market over the previous year in its 'Annual Review'.

1.3 Chapters 2 and 3 along with annexes A and B contain information on the government's wholesale debt management activities. Information about financing from NS&I is set out in annex C. The Exchequer cash management remit for 2016-17 is contained in annex D.

¹ Available at <https://www.gov.uk/government/publications>

2 Debt management policy

2.1 This chapter provides an overview of the government's debt management framework. It also sets out medium-term considerations for debt management policy during the current period of fiscal consolidation. The debt management framework is part of the overall macroeconomic framework, which includes the fiscal, macroprudential and monetary policy frameworks. These are outlined in the Budget 2016 document.¹

Debt management framework

2.2 The debt management framework includes:

- the debt management objective
- the principles that underpin the debt management policy framework
- the roles of the DMO and HM Treasury
- the full funding rule

Debt management objective

2.3 The debt management objective, established in 1995 following the 'Debt Management Review', is:

"to minimise, over the long term, the costs of meeting the government's financing needs, taking into account risk, while ensuring that debt management policy is consistent with the aims of monetary policy."

2.4 While decisions on debt management policy must be taken with a long-term perspective, specific decisions on funding the government's gross financing requirement are taken annually. Those decisions are announced in the Budget for the forthcoming year and can be updated during the year.

Components of the debt management objective

2.5 The costs of meeting the government's financing needs arise directly from interest payable on debt (coupon payments and the difference between issuance proceeds and redemption payments) and the costs associated with issuance. 'Over the long term' means that the government expects to issue debt beyond the forecast period. This expectation is reflected in the government's choice of debt management strategies.

2.6 A number of risks are taken into account when selecting possible debt management strategies. Five particularly important risks are:

- interest rate risk – interest rate exposure arising when new debt is issued
- refinancing risk – interest rate exposure arising when debt is rolled over, with an increase in refinancing risk if redemptions are concentrated in particular years
- inflation risk – exposure to inflation from the indexation of coupons and principal of index-linked gilts

¹ Available at <https://www.gov.uk/government/publications>

- liquidity risk – the risk that the government may not be able to borrow from a particular part of the market in the required size at a particular time, because that part of the market is insufficiently liquid
- execution risk – the risk that the government is not able to sell the offered amount of debt at a particular time, or must sell it at a large discount to the market price

2.7 These are the major risks that the government has taken into account in recent years and expects to take into account in future years. The weight placed on each risk can change over time. An explanation of how risk is taken into account in determining the DMO's financing remit for 2016-17 is set out in annex B.

Debt management policy principles

2.8 The debt management objective is achieved by:

- meeting the principles of openness, transparency and predictability
- developing a liquid and efficient gilt market
- issuing gilts that achieve a benchmark premium
- adjusting the maturity and nature of the government's debt portfolio
- offering cost-effective savings instruments to the retail sector through NS&I

2.9 The framework is underpinned by the institutional arrangements for debt management policy established in 1998, in particular the creation of the DMO with responsibility for the implementation and operation of debt management policy.

Roles of HM Treasury and the DMO

2.10 The respective roles of HM Treasury and the DMO are set out in the DMO's 'Executive Agency Framework Document'.² In particular:

- the DMO will continue to conduct its operations in accordance with the principles of openness, predictability and transparency
- HM Treasury and the DMO will explain the basis for their decisions on debt issuance as fully as possible to allow market participants to understand the rationale behind the decisions
- the DMO will continue to have a responsibility to advise on, and promote the liquidity and efficiency of, the gilt and Treasury bill markets

2.11 HM Treasury sets the annual financing remit using the projected financing requirement prepared on the basis of the Office for Budget Responsibility's (OBR) forecasts for the fiscal policy aggregates. The DMO has responsibility for pre-announcing the details of its issuance plans to the market, including a planned auction calendar setting out the dates and type of gilt, and details of planned average auction sizes.

The full funding rule

2.12 An overarching requirement of debt management policy is that the government fully finances its projected financing requirement each year through the sale of debt. This is known as the 'full funding rule'. The government therefore issues sufficient wholesale and retail debt

² Available at <http://www.dmo.gov.uk/documentview.aspx?docname=publications/corpgovernance/fwork040405.pdf>

instruments, through Treasury bills and gilts and NS&I products respectively, to enable it to meet its projected financing requirement.

2.13 The rationale for the full funding rule is:

- that the government believes that the principles of transparency and predictability are best met by full funding of its financing requirement
- to avoid the perception that financial transactions of the public sector could affect monetary conditions, consistent with the institutional separation between monetary policy and debt management policy³

2.14 The total amount of financing raised in a financial year will in practice at the margin differ from the projected financing requirement. This divergence normally occurs towards the end of the financial year and can be explained by a number of different factors. These include:

- the difference between the projected central government net cash requirement (CGNCR) and its outturn
- the difference between the projected net contribution to financing by National Savings and Investments (NS&I) and its outturn
- auction proceeds in the period following the Autumn Statement that are different from those required to meet relevant financing targets⁴
- the implementation of the syndication programme at year-end

2.15 The difference will be reflected in a change in the DMO's cash balance at the end of the financial year. To meet the full funding rule, the government adjusts the projected net financing requirement (NFR) in the following financial year to offset any difference. However, this does not affect the DMO's cash management operations intended to smooth the government's cash flows across the financial year-end. The changes outlined in paragraph D.8, to increase flexibility for the DMO to vary the stock of Treasury bills for cash management purposes, will be implemented with full adherence to the full funding rule.

Medium-term projections for annual financing requirements

2.16 The government has published projections for financing requirements in the fiscal policy forecast period. The financing requirements include the forecast path for the central government net financing requirement (excluding NRAM plc, Bradford and Bingley and Network Rail) (CGNCR (ex NRAM, B&B and NR)), the gilt redemption profile and planned financing for the Official Reserves.⁵ Table 2.A sets out the financing requirement projections from 2017-18 to 2020-21.

³ The short-term net cash position of the Exchequer will be held with market counterparts, with the exception of any agreed balance on the Debt Management Account held at the Bank of England and the Ways and Means Advance (a government account at the Bank of England). This means that, in practice, financial transactions of the public sector should not affect monetary conditions.

⁴ To meet the financing requirement, which is determined in cash terms, the DMO sizes auctions in nominal terms, taking into account prevailing market prices. Movements in market prices between the announcement of auction sizes and gilt auctions taking place mean that it is not possible to meet these targets precisely.

⁵ This excludes Network Rail's cash requirement but includes HM Treasury's requirement for financing lending to Network Rail.

Table 2.A: Financing requirement projections, 2017-18 to 2020-21

£ billion	2017-18	2018-19	2019-20	2020-21
CGNCR (ex NRAM, B&B and NR)	41.0	32.3	3.0	17.0
Gilt redemptions	79.5	67.3	93.2	85.2
Planned financing for the reserves	6.0	6.0	6.0	0.0
Illustrative gross financing requirement	126.5	105.5	102.2	102.3
Figures may not sum due to rounding				
Source: OBR, HM Treasury and DMO				

Debt management considerations during the period of fiscal consolidation

2.17 Decisions on debt management policy are taken in advance to achieve the debt management objective. Each year, the government assesses the costs and risks associated with different possible patterns of debt issuance taking into account the most up-to-date information on market conditions and demand for debt instruments.

2.18 At present, annual debt management decisions are also made in the context of an elevated level of debt relative to gross domestic product (GDP), high but falling government borrowing and fiscal consolidation. Consistent with the long-term focus of the debt management objective, the government takes annual decisions that enhance fiscal resilience by:

- mitigating refinancing risk, that is, the need to roll over high levels of debt continuously and to avoid concentrating redemptions in particular years, by taking decisions which spread gilt issuance along the maturity spectrum
- promoting the liquidity and efficiency of the gilt market
- maintaining a diversity of exposure, both real and nominal, across the maturity spectrum, reflecting its preference for a balanced portfolio

2.19 As a result, subject to cost-effective financing, the government will:

- maintain a relatively high proportion of fixed-rate exposure at a relatively long average maturity in the debt portfolio to limit exposure to interest rate volatility
- maintain a significant proportion of real exposure by issuing index-linked gilts
- continue to issue conventional and index-linked gilts over a range of maturities, taking account of structural demand and the diversity of the investor base
- maintain the Treasury bill stock at a level that will support market liquidity and the cash management objective

Bond issuance by devolved administrations

2.20 The Scottish government has the power to borrow up to £2.2 billion for capital investment, through the Scotland Act 2012. Annual capital borrowing is limited to 10% of the Scottish government's capital departmental expenditure limit from the UK government. Since 1 April 2015, the Scottish government has had the power to issue bonds to finance capital investment, in addition to borrowing from the National Loans Fund or commercial lenders.

2.21 The fiscal framework agreed by the UK and Scottish governments in February 2016 increased the limits for capital borrowing by the Scottish government. From 1 April 2017, the Scottish government will be able to borrow up to £3 billion for capital expenditure, with up to

15% of the total limit available for borrowing in any one financial year. The fiscal framework agreement reaffirmed that Scottish government capital borrowing can only be in sterling.

2.22 On 27 February 2015, the government announced that the Welsh government's means of borrowing for capital investment from April 2018 would also be extended to include bond issuance. The level of borrowing for capital investment will remain up to £125 million per year within an overall cap of £500 million. The devolution of bond issuance powers will broaden the sources of financing available to the devolved administrations for capital investment such as major transport projects, hospitals, schools and flood defences when their borrowing powers are implemented.

2.23 The Scottish and Welsh governments will be solely responsible for meeting their liabilities and the UK government will provide no guarantee on any bonds issued by the Scottish and Welsh governments. The UK government will review the extent to which bond issuance powers apply in the event of any subsequent increase in borrowing limits. In addition, the Scottish and Welsh governments would need further approval from HM Treasury to issue in any currency other than sterling.

Borrowing by local authorities

2.24 Under the prudential code, local authorities are fully responsible for meeting their own liabilities, including those they incur by entering into any guarantee commitments. The UK government provides no guarantee on local authority debt.

2.25 Local authorities undertake the bulk of their borrowing via the Public Works Loan Board (PWLB). Last year the government announced plans to abolish the PWLB and transfer the function to another entity via the Public Bodies Act 2011. The government will be consulting on the proposed change and the new arrangements. This change is about governance only: local authorities will continue to be able to access borrowing from central government.

The Debt Management Office's financing remit for 2016-17

3

Introduction

3.1 The financing arithmetic sets out the components of the government's NFR and the contributions from various sources of financing. The DMO's financing remit sets out how the DMO, acting as the government's agent, will fund the projected NFR.

Financing arithmetic

3.2 The OBR's forecast for the CGNCR (ex NRAM, B&B and NR) in 2016-17 is £62.1 billion. This is the fiscal aggregate that determines gross debt sales and is derived from public sector net borrowing (PSNB). The relationship between PSNB and the CGNCR (ex NRAM, B&B and NR) is set out in the OBR's March 2016 'Economic and fiscal outlook' (EFO).

3.3 The forecast NFR in 2016-17 of £129.4 billion also reflects: projected gilt redemptions of £69.9 billion; a planned short-term financing adjustment of -£2.5 billion resulting from unanticipated overfunding in 2015-16; and additional sterling financing for the Official Reserves of £6.0 billion.

3.4 Proceeds from NS&I are expected to make a £6.0 billion net contribution to financing in 2016-17, following a net contribution of £11.5 billion in 2015-16. This projection assumes gross inflows of £26.0 billion in 2016-17.

3.5 Gilt issuance is the government's primary means of meeting the NFR. Treasury bills may also make a net contribution to meet the NFR.

3.6 In 2016-17, the NFR will be met by gross gilt issuance of £129.4 billion with no planned net contribution from Treasury bills.

3.7 Table 3.A sets out details of the financing arithmetic for 2015-16 and 2016-17.

Table 3.A: Financing arithmetic in 2015-16 and 2016-17

£ billion	2015-16	2016-17
CGNCR (ex NRAM, B&B and NR)	75.5	62.1
Gilt redemptions	70.2	69.9
Planned financing for the reserves	5.3	6.0
Financing adjustment carried forward from previous financial years	-13.1	-2.5
Gross financing requirement	138.0	135.6
<i>less:</i>		
Contribution from National Savings and Investments	11.5	6.0
Other financing ¹	0.2	0.2
Net financing requirement (NFR) for the Debt Management Office (DMO)	126.2	129.4
Financed by debt issuance:		
Gilt sales	127.7	129.4
<i>of which</i>		
Short conventional	32.6	30.4
Medium conventional	25.0	24.8
Long conventional	37.2	36.2
Index-linked	32.2	30.0
Unallocated supplementary sales	0.6	8.0
Planned net contribution to financing from Treasury bills²	1.0	0.0
Total financing	128.7	129.4
DMO net cash position	3.0	0.5
<i>Figures may not sum due to rounding.</i>		
¹ Prior to publication of the end-year outturn in April each year, this financing item will only comprise estimated revenue from coinage.		
² From Budget 2016 onwards, financial year-end stock levels will not be published as part of the financing arithmetic.		
<i>Source: DMO, NS&I, HM Treasury and OBR</i>		

Financing for the Official Reserves¹

3.8 The financing arithmetic provides for £6.0 billion of sterling financing for the Official Reserves in 2016-17. This additional financing, announced at Autumn Statement 2014, is intended to meet potential calls on the Official Reserves that may arise and ensure the level of foreign currency reserves held is sufficient so that the UK remains resilient to possible future shocks.

3.9 For the purposes of the financing arithmetic in table 3.A, it is assumed that sterling will remain the main form of financing for the Official Reserves and no new foreign currency debt will be issued in 2016-17. However, if the government judges that there is a case for doing so, taking into account cost, risk, market conditions and consistency with debt management objectives, consideration would be given to issuing foreign currency securities to finance part of the increase in the reserves in 2016-17.

3.10 If the government were to decide to issue a foreign currency bond later in the year, this would be taken into account in subsequent updates to the DMO's financing remit. The Bank of

¹ The government's official holdings of international reserves, with the exception of some Special Drawing Right (SDR) assets, are held in the Exchange Equalisation Account (EEA).

England will act as HM Treasury's agent in issuing and managing any foreign currency liabilities associated with the reserves.

Other short-term debt

3.11 The projected level of the Ways and Means Advance at the Bank of England at 31 March 2016 is £0.4 billion. No changes to the level of the Ways and Means Advance are planned in 2016-17.

3.12 As shown in table 3.A, the projected level of the DMO's net cash balance at 31 March 2016 is £3.0 billion, £2.5 billion above the level projected at Autumn Statement 2015. The level will be reduced to £0.5 billion during 2016-17, as shown by the planned short-term downward financing adjustment, and this will in turn reduce the NFR in 2016-17.

Gilt issuance by method, type and maturity

3.13 Auctions will remain the government's primary method of gilt issuance. In addition, the government has decided to continue the use of issuance via syndications. Any type and maturity of gilts can be issued via syndication. However, the current planning assumption is that they will be used for sales of long-dated conventional and index-linked gilts.

3.14 The government is introducing a further issuance method, gilt tenders. These will be a form of auctioning gilts outside of the usual auction calendar in response to market feedback. They will replace mini-tenders and sales via taps, and will be used to supplement gilt issuance through auctions and syndications. Gilt tenders may take place for any type and maturity of gilt, and can be sized flexibly in advance of each operation, but will in general be smaller than auctions of comparable gilts. To support the DMO's operational flexibility, gilt tenders may be added to the operations calendar at short notice, usually subject to a seven day notification period.

3.15 The government plans gilt sales via auction of £95.9 billion (or 74.1% of total issuance) which will be split by maturity and type as follows:²

- £30.4 billion of short conventional gilts (23.5% of total issuance)
- £24.8 billion of medium conventional gilts (19.2% of total issuance)
- £26.7 billion of long conventional gilts (20.6% of total issuance)
- £14.0 billion of index-linked gilts (10.8% of total issuance)

3.16 The government is also currently planning to sell a minimum of £25.5 billion of gilts (19.7% of total issuance) via syndication, split as follows:

- a minimum of £9.5 billion of long conventional gilts in 2 transactions
- a minimum of £16.0 billion of index-linked gilts in 4 transactions

3.17 In addition, the financing remit of the DMO includes an initially unallocated portion of £8.0 billion through which gilts of any type or maturity may be issued, subject to prior notification. It is anticipated that such issuance will principally take place via gilt tenders and/or increases in sales through syndications.

3.18 The deployment of the unallocated amount of gilt sales is designed to facilitate the effective delivery of the gilt issuance programme while remaining consistent with the debt

² Short = 1-7 years maturity; medium = 7-15 years maturity; long = greater than 15 years maturity.

management principles of openness, predictability and transparency. These sales will be conducted in such a way as to respond best to evolving market conditions.

3.19 To maintain the operational viability of syndicated offerings at the end of each financial year, the overall size of the syndication programmes (conventional and/or index-linked) may be increased by up to 10% at the time of the final syndicated offering of each type. The programmes would only be upsized if, at the time of the final operations, the entire unallocated issuance amount had been exhausted.

3.20 Through its gilt issuance programme, the government aims at regular issuance across the maturity spectrum throughout the financial year and building up benchmarks at key maturities in both conventional and index-linked gilts.

3.21 The planning assumption for gilt issuance in 2016-17 by method of issue, type and maturity is shown in table 3.B.

Table 3.B: Breakdown of planned gilt issuance by type, maturity and issuance method

£ billion	Auction	Syndication	Gilt tender	Unallocated	Total
Short	30.4	-	-	-	30.4 (23.5%)
Medium	24.8	-	-	-	24.8 (19.2%)
Long	26.7	9.5	-	-	36.2 (28.0%)
Index-linked	14.0	16.0	-	-	30.0 (23.2%)
Unallocated	-	-	-	8.0	8.0 (6.2%)
Total	95.9 (74.1%)	25.5 (19.7%)	-	8.0 (6.2%)	129.4

Figures may not sum due to rounding

Source: DMO

Gilt auction calendar

3.22 The DMO is publishing a planned gilt auction calendar consistent with the remit alongside the DMR. This calendar may be adjusted, at the margin, to accommodate any in-year changes to the planned split of issuance methods. The DMO will set out the parameters for this alongside the publication of the auction calendar.

Post-Auction Option Facility

3.23 In 2016-17, the DMO will continue to offer successful bidders (both primary dealers and investors) the option to purchase additional stock. The details of how this facility works are set out in the DMO operational notices. In 2016-17 the size of the option is planned to be increased from 10% to 15%. Any further changes to this percentage over the course of the year will be communicated by the DMO in its operational notices.³ Any amounts sold via this facility in 2016-17 will count towards the remit sales targets on an auction by auction basis and will, all else equal, be used progressively to reduce the average sizes for the remaining auctions of the maturity/type of gilt in question.

³ Available at http://www.dmo.gov.uk/index.aspx?page=Gilts/Operational_Rules

The Standing Repo Facility

3.24 For the purposes of market management, the DMO may create and repo out gilts in accordance with the provisions of its Standing Repo Facility launched on 1 June 2000 and most recently revised on 6 August 2009.⁴ Any such gilts created will not be sold outright to the market and will be cancelled on return.

Other operations

3.25 The DMO has no current plans for a programme of reverse or switch auction or conversion offers in 2016-17.

Coupons

3.26 As far as possible, the DMO will set coupons on new issues to price the gilt close to par at the time of issue.

Purchases of short maturity debt

3.27 The DMO may buy-in gilts close to maturity to help manage Exchequer cash flows.

Treasury bill issuance

3.28 Treasury bill issuance is not expected to make a net contribution to debt financing in 2016-17. The amount Treasury bills have contributed to debt financing up to and including 2015-16 will be reported by the DMO shortly after the end of 2015-16.

New gilt instruments

3.29 There are no current plans to introduce new types of gilt instruments in 2016-17.

Revisions to the remit

3.30 In addition to planned updates to the remit, any aspect of this remit may be revised during the year in light of exceptional circumstances and/or substantial changes in the following:

- the government's forecast for the NFR
- the level and/or shape of the gilt yield curves
- market expectations of future interest and inflation rates
- market volatility

3.31 Any such unplanned revisions will be announced transparently to the market.

⁴ Available at http://www.dmo.gov.uk/index.aspx?page=Gilts/Operational_Rules

A Debt portfolio

Debt stock

A.1 The total nominal outstanding stock of central government sterling debt excluding official holdings by central government was £1,553.3 billion at end-December 2015.¹ The components of this stock are set out in table A.1.

Table A.1: Composition of central government wholesale and retail debt

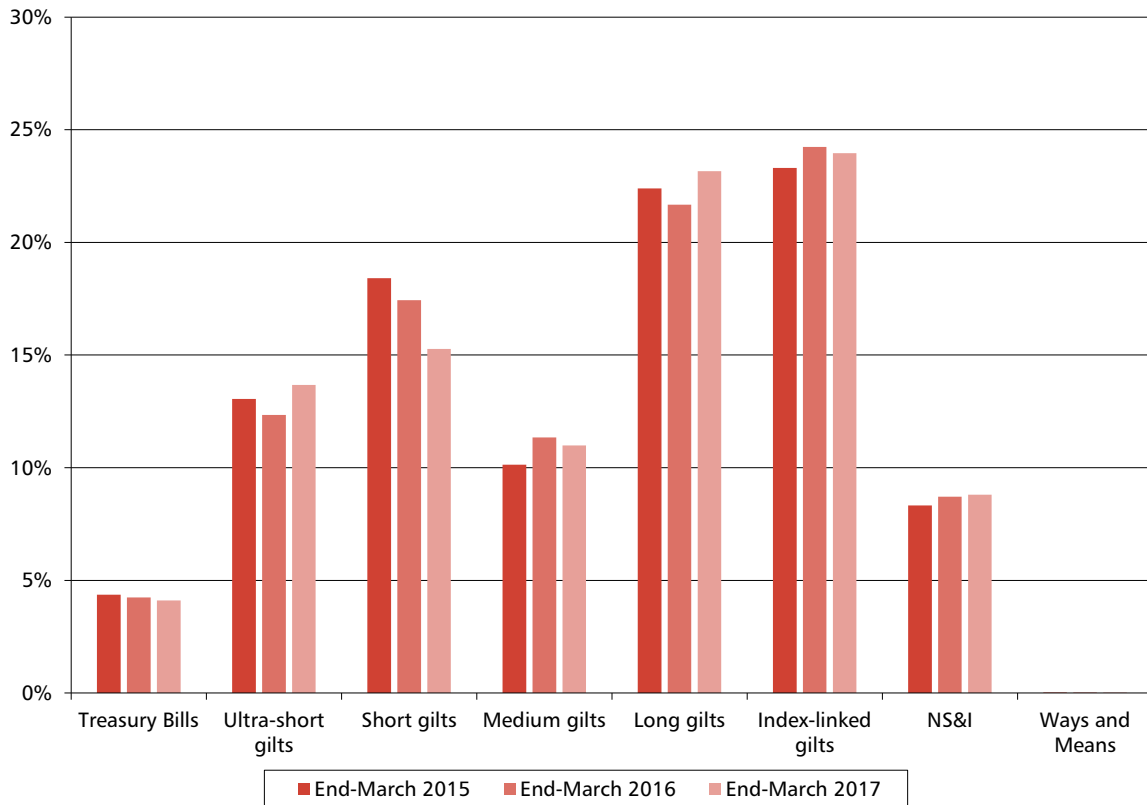
£ billion nominal value, excluding official holdings	End-December 2014	End-December 2015
Conventional gilts ¹	964.6	983.5
Index-linked gilts ²	342.7	369.7
Treasury bills	63.0	82.8
Total gilts and Treasury bills	1,370.4	1,436.0
NS&I	111.6	134.0
Balance on Ways and Means Advance	0.4	0.4
Total	1,482.4	1,570.4

¹Includes undated gilts
²Includes accrued inflation uplift
Source: DMO & NS&I

A.2 Chart A.1 shows a comparison of the government's debt portfolio at end-March 2015 through to the projected composition at end-March 2017. It assumes that new debt is issued in accordance with the DMO's and NS&I's financing remits and also takes account of the ageing of existing debt.

¹ Official holdings of gilts comprise holdings by the DMO of gilts created for use as collateral in the conduct of its Exchequer Cash Management operations (such gilts are not available for outright sale to the market).

Chart A.1: Composition of central government sterling debt



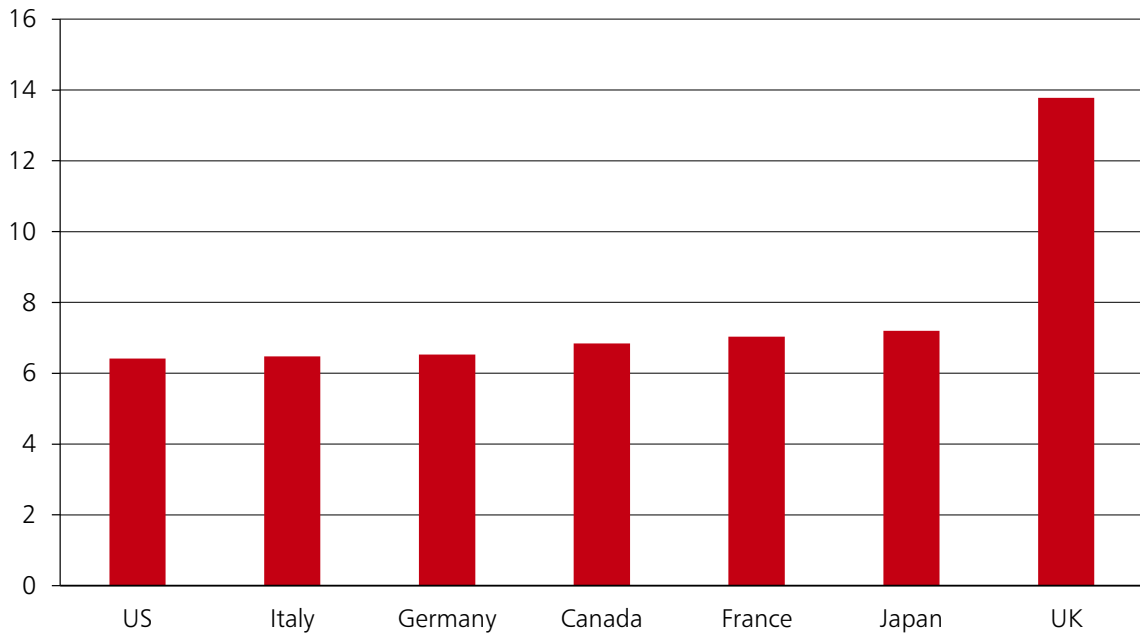
Source: DMO and NS&I

Maturity and duration of the debt stock

A.3 By end-March 2016, the average maturity of the stock of all marketable debt is projected to rise to above 16 years. The average maturity of the stock of conventional gilts is projected to rise to 15 years, with index-linked gilts continuing to be above 22 years.² The average maturity of the government’s wholesale debt is consistently longer than the average across the G7 group of advanced economies, as shown in chart A.2.

² Net figures (excluding government holdings). Average maturities calculated using market value weightings.

Chart A.2: Average maturity in years of the debt stock by country (end-December 2015)¹

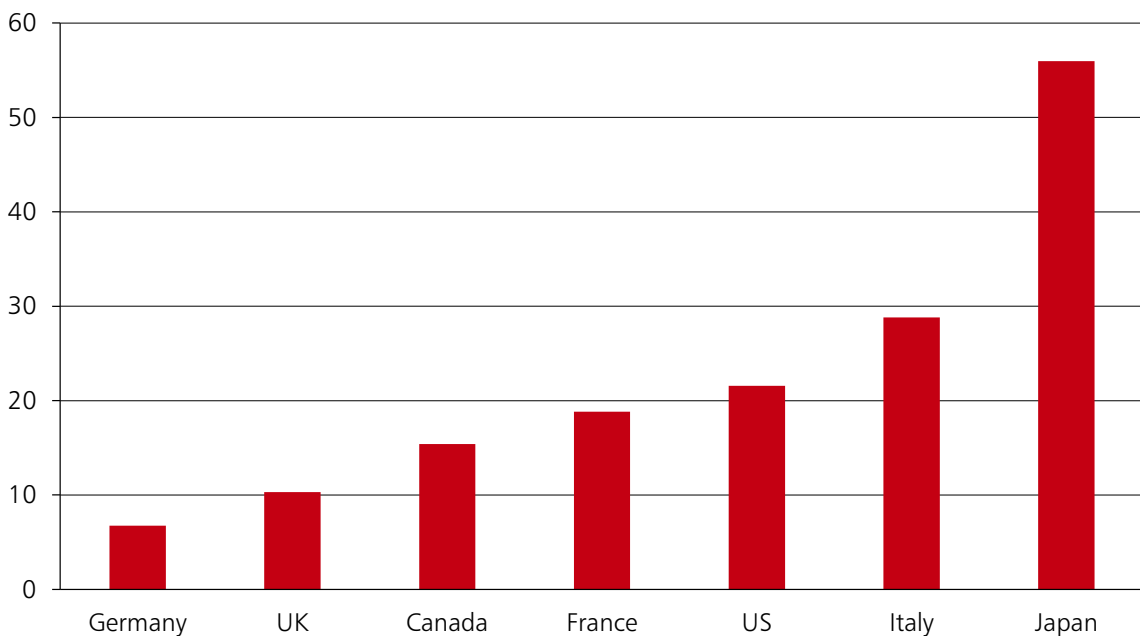


¹Average maturities calculated on a nominal weighted basis, excluding inflation uplift.

Source: Bloomberg

A.4 Chart A.3 shows the supportive impact of the long average maturity of the stock of UK wholesale debt on the UK's gross financing requirement, which compares favourably with that of other G7 countries.

Chart A.3: Annual gross financing requirement as % of GDP (2015)

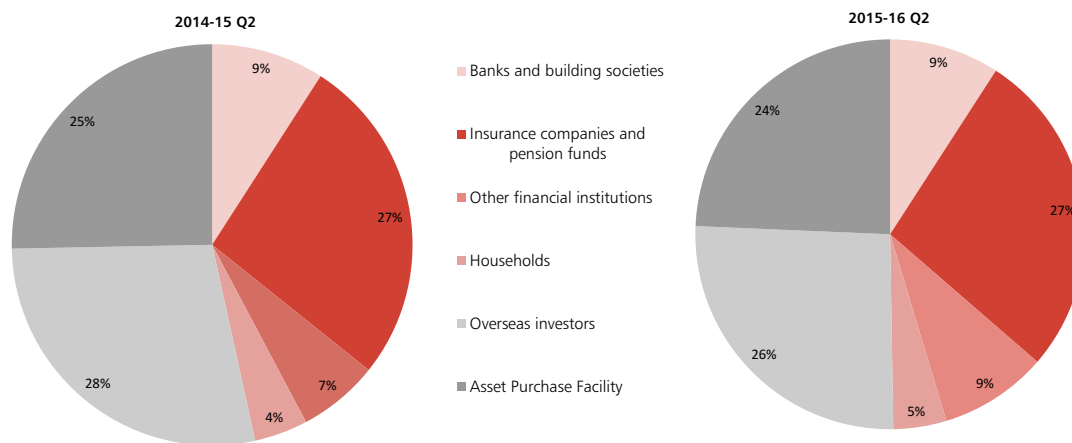


Source: IMF Fiscal Monitor October 2014 (forecast) and Bloomberg

Gilt holdings by sector

A.5 Chart A.4 shows gilt holdings by sector. This data is published by the Office for National Statistics (ONS). In Q2 2015-16, the 3 largest investor groups were insurance companies and pension funds (27%), overseas investors (26%) and the Bank of England Asset Purchase Facility Fund Ltd (24%). This is largely consistent with gilt holdings by sector in 2014-15.

Chart A.4: Gilt holdings by sector (£ billion, market value)¹



¹ Figures may not sum due to rounding.

² The Bank of England's holdings of gilts not related to the Asset Purchase Facility are included in the 'Banks and building societies' category.

Source: ONS and Bank of England

Gilt issuance

A.6 The CGNCR (ex NRAM, B&B and NR), gilt redemptions, and the volume of gilt sales for each of the last 10 years is shown in table A.2.

Table A.2: CGNCR ex and gross gilt sales

£ billion	CGNCR (ex NRAM, B&B and NR)	Redemptions	Gross gilt sales ¹
2007-08	32.6	29.2	58.5
2008-09	162.4	18.3	146.5
2009-10	198.8	16.6	227.6
2010-11	139.6	38.6	166.3
2011-12	126.5	49.0	179.4
2012-13	98.6	52.9	165.0
2013-14	79.3	51.5	155.4
2014-15	92.3	64.5	126.4
2015-16 ²	75.5	70.2	127.7
2016-17 ²	62.1	69.9	129.4

¹ Figures are in cash terms

² Budget 2016 projections

Source: DMO, HM Treasury and OBR

Context for decisions on the Debt Management Office's financing remit

B

Introduction

B.1 This annex provides the context for the government's decisions on gilt and Treasury bill issuance in 2016-17, setting out the qualitative and quantitative considerations that have influenced the government's decisions.

B.2 The government's decisions on the structure of the financing remit, which are taken annually, are made in accordance with the debt management objective, the debt management framework and wider policy considerations during the period of fiscal consolidation (see chapter 2).

B.3 In determining the overall structure of the financing remit, the government assesses the costs and risks of debt issuance by maturity and type of instrument. The government's decisions on the composition of debt issuance are also informed by an assessment of investor demand for debt instruments by maturity and type as reported by stakeholders, and as manifested in the shape of the nominal and real yield curves, as well as the government's appetite for risk.

B.4 Alongside these considerations, the government takes into account the practical implications of issuance (for example the scheduling of operations during the course of the year and the appropriate use of different issuance methods).

Demand

B.5 Both Gilt-Edged Market Makers (GEMMs) and end-investors have reported ongoing demand for conventional and index-linked gilts that is well diversified across the maturity spectrum and by investor type. However, a combination of factors, including a changing operating environment and strains in the money markets, mean that accessing such demand may be more challenging in 2016-17.

B.6 At the annual consultation meetings in January 2016 attendees anticipated continued demand for UK government debt from domestic pension funds in 2016-17, with a particular focus on index-linked gilts.¹

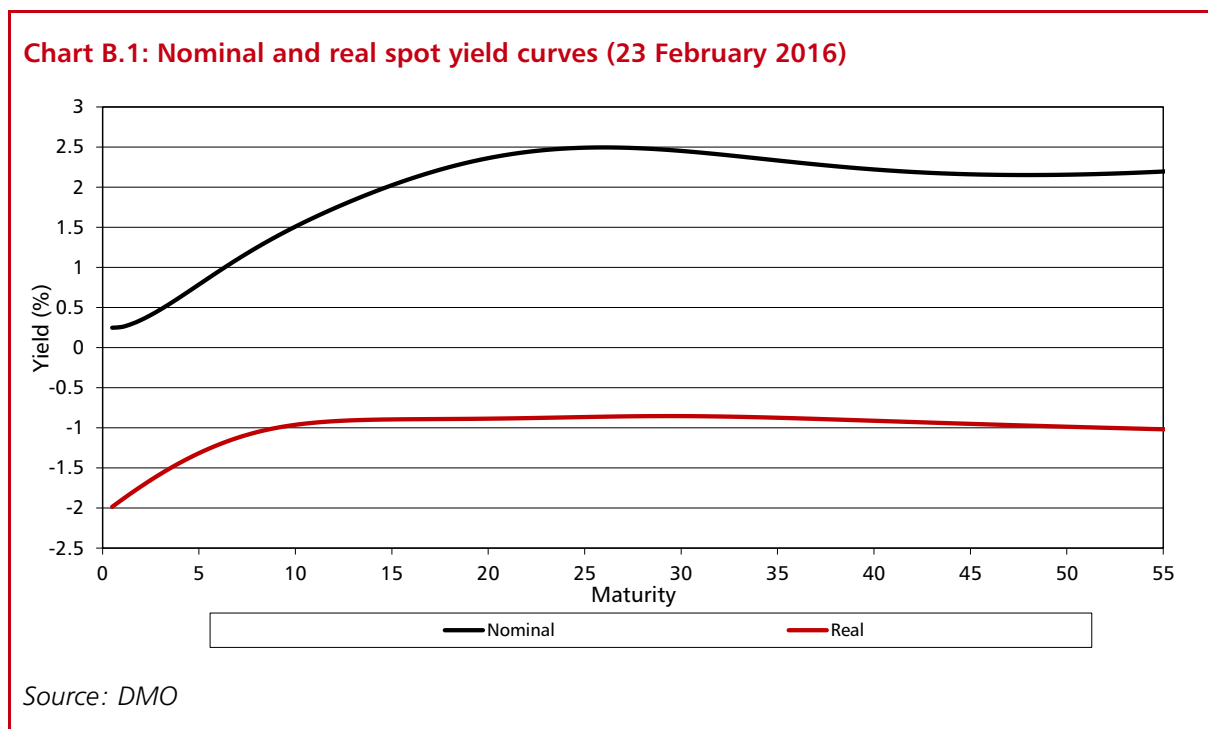
B.7 Market participants also anticipate ongoing demand for gilts from a range of international investors, including central banks and reserve managers, as well as overseas pension funds.

B.8 Domestic banks and building societies have become significant holders of gilts in recent years for regulatory purposes. No major changes in gilt investment by domestic financial institutions are expected in the coming year.

¹ Minutes of the meetings are available at: <http://www.dmo.gov.uk/documentview.aspx?docName=/gilts/press/sa270116.pdf>

Cost

B.9 In assessing the cost of different types of debt issuance by maturity and type, the government undertakes an analysis of the nominal and real yield curves. Chart B.1 shows the shape of the nominal and real spot curves at 23 February 2016.



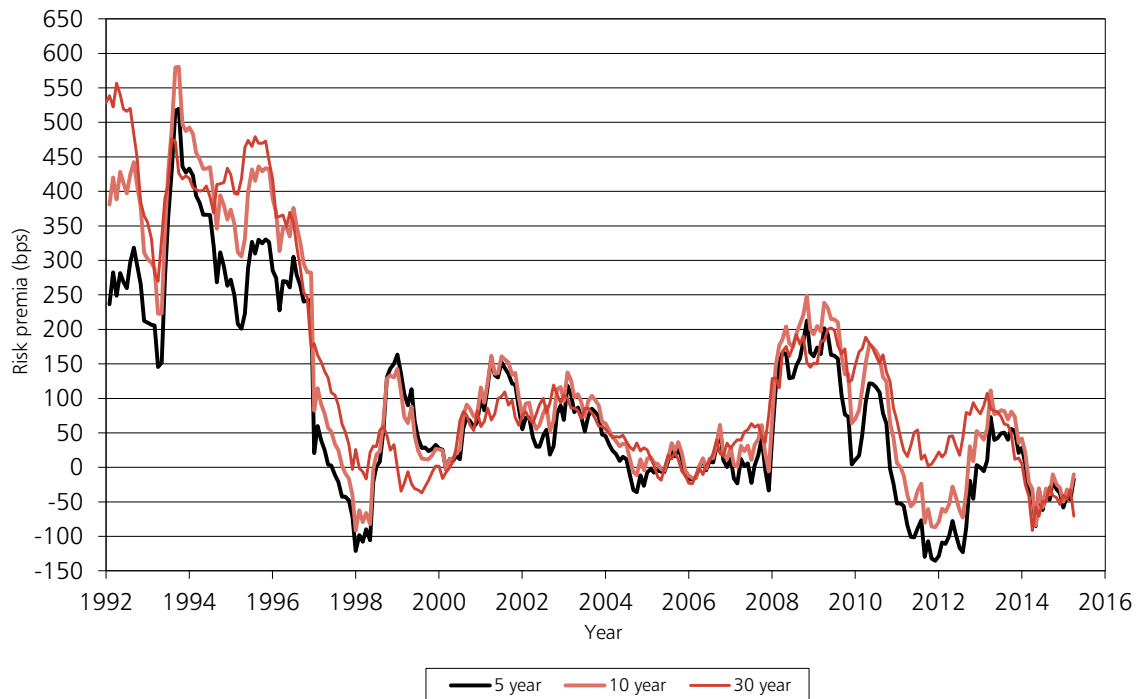
B.10 Conventional asset pricing theory suggests the observed yield on a bond can be decomposed into two components: a 'risk neutral' yield and a risk premium. The risk neutral yield is the interest rate under 'pure expectations'. In practice, forward yields follow a different path, as markets demand higher yields in order to protect investments against a variety of risks.² This gives rise to the risk premium. The variability and trends in risk premia reflect investors' risk preferences over time. By definition, it is cost effective for a government to issue at maturities where the risk premium demanded by the investor is lowest relative to other maturities.

B.11 Chart B.2 shows risk premia in the nominal yield curve between 1992 and end-January 2016. Results indicate the existence of a time-varying risk premium in the conventional gilt market which is usually positive and, as a general rule, increases with maturity.³ Risk premia are now estimated to be at historically low levels at all key benchmark maturities. Premia for different maturities are within a very narrow range. This suggests that conventional gilts across the maturity spectrum are broadly equal in terms of cost effectiveness.

² The risk premium to has several components, including, but not limited to: (i) a premium which compensates investors for duration risk that increases for longer maturity investments; (ii) a credit and default risk premium; (iii) a liquidity premium due to the lower level of liquidity in some bonds or maturities, which restricts investors ability to hedge; and (iv) an inflation risk premium to compensate investors in nominal bonds for uncertainty due to inflation. In general, the premium is the extra return investors expect to obtain from holding long-term bonds as opposed to holding and rolling over a sequence of short-term securities over the same period. The risk premium estimated by the DMO's model also includes a 'convexity premium' component – this increases with maturity and yield volatility and it offsets to some degree the other risk premium components as it represents a charge that the investor pays the issuer.

³ This analysis is based on academic research by Christensen, Diebold and Rudebusch. The model has not been adjusted to account for 'zero bound effects'.

Chart B.2: Risk premia



Source: DMO

B.12 Alongside this analysis of the relative cost-effectiveness of conventional gilts across different maturity sectors, the government undertakes an evaluation of index-linked gilt cost effectiveness, using conventional gilts as a benchmark for comparison, by examining breakeven inflation rates, the difference between nominal and real yields.⁴

B.13 Similar to nominal yields, breakeven rates can also be decomposed into two components: a 'risk neutral' inflation rate, which is the pure market implied expectation of future inflation embedded in nominal yields, and a risk premium, which includes the premium for inflation risk in conventional gilt yields.⁵ The government can choose either to pay the inflation risk premium and the level of inflation priced in the conventional gilt yield, which is 'fixed' at issue for the life of the bond, or it can issue an inflation-linked gilt, pay future realised inflation at a later time and bear the inflation risk. The two strategies are cost equivalent if future realised inflation turns out to be equal to the level implied in the breakeven rate at issue. Chart B.3 shows the cost effectiveness of issuance of index-linked gilts, relative to conventional gilts, under a range of paths for future inflation, which also includes market implied pure expectations.

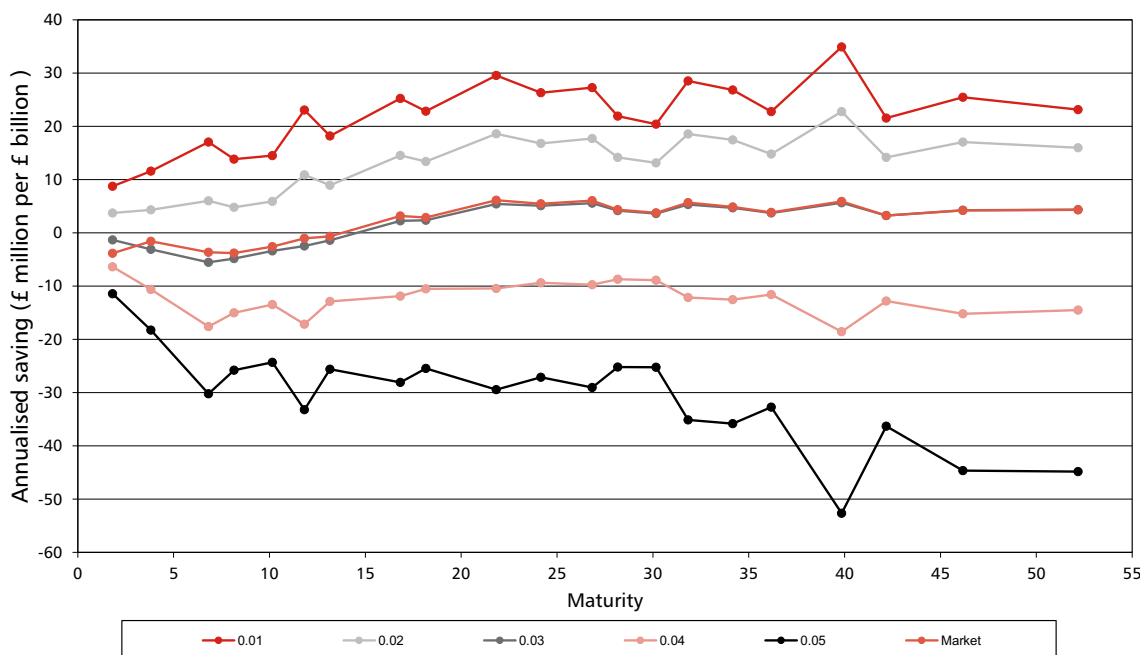
B.14 As at end-January 2016 the model shows that for an assumption that RPI remains constant at 3% over the life of the bond, index-linked gilts are generally more cost effective than equivalent maturity conventional gilts, with the exception of issuance at the short-end of the index-linked market. Results using the market implied inflation forecast are very similar, although there is some divergence at shorter maturities reflecting the market's expectations around the

⁴ A more detailed explanation of the methodology used in this analysis can be found in the following documents: http://www.oecd-ilibrary.org/finance-and-investment/assessing-the-cost-effectiveness-of-index-linked-bond-issuance_5k481881kjwh-en and <http://www.bankofengland.co.uk/research/Pages/workingpapers/2015/swp551.aspx>

⁵ There is an additional risk due to liquidity conditions in the two markets. This is in relation with the cost to finance the purchase of the bond in the money market and to transact in the secondary market. A more detailed explanation of the methodology to estimate breakeven inflation risk premia can be found in the following document: <http://www.bankofengland.co.uk/research/Pages/workingpapers/2015/swp551.aspx>

path of near-term inflation. Compared to a year ago, the majority of index-linked gilts are marginally more cost effective across the curve.

Chart B.3: Index-linked cost effectiveness under different RPI assumptions (end-January 2016)



Source: DMO

Risk

B.15 In the context of the long-term focus of the debt management objective, the other key determinant in the government's decisions on debt issuance by maturity and type of instrument is its assessment of risk. In reaching a decision on the overall structure of the remit, the government considers the risks to which the Exchequer is exposed through its debt issuance decisions and assesses the relative importance of each risk in accordance with its risk appetite.

B.16 The government places a high weight on minimising near-term exposure to refinancing risk. The government can partly manage this exposure by maintaining a high proportion of long-dated debt in its portfolio, which reduces the need to refinance debt frequently. The government places importance on avoiding large concentrations of redemptions in any one year. To achieve this, the government will issue debt across a range of maturities, smoothing the profile of gilt redemptions.

B.17 Prudent debt management is also served by promoting sustainable market access. The government places significant importance on maintaining a deep, liquid and efficient gilt market and a diverse investor base in order to maintain continuous access to cost-effective financing in all market conditions.

B.18 The remit structure is designed to support sustainable market access by maintaining a deep and liquid gilt market that can readily be understood and engaged with by investors globally, a healthy intermediation model and a well-diversified investor base. Promoting these features of the gilt market will also serve to minimise debt costs to the government because investors reward an issuer for providing a continuous and ready market and a globally recognised benchmark product.

Modelling of cost, interest rate and refinancing risk

B.19 The analysis underpinning the government’s decisions on its issuance strategy includes an exercise in which debt interest cost and risk simulations are generated to illustrate the cost-risk trade-off associated with different issuance strategies.⁶ This allows the government to investigate the medium-term implications of different possible future issuance skews relative to the current annual issuance strategy.

B.20 Debt interest cost is defined as the cost of the coupon payments and redemptions associated with government debt, measured in terms of the relevant yield.⁷ Risk is defined as the standard deviation of debt interest cost or debt interest cost volatility, reflecting potential variation in the relevant yield. This can be seen as a measure combining both interest rate risk and refinancing risk.⁸

B.21 Similarly to last year the exercise has been carried out over a 15-year horizon to approximately match the average maturity of the gilt portfolio and thus reflect the rolling over of about half of the debt portfolio. The metrics resulting from this analysis combine the impact from alternative issuance strategies for financing new government debt (to meet the CGNCR and the refinancing of redemptions) with the existing characteristics of the debt portfolio inherited from previous financial years.⁹

B.22 The DMO’s Portfolio Simulation Tool (PST), which calculates debt interest cost, is used in conjunction with a macroeconomic-based Vector Autoregressive (VAR) model, which provides a distribution of projections of the yield curve, to depict risk in cost terms.¹⁰ In this way, the PST maps the projected yield curve distribution to a debt interest cost distribution so that simulated cost and risk metrics can be analysed.

B.23 As an example, table B.1 illustrates the issuance skew followed by the DMO in 2015-16, which is well diversified across maturity buckets.

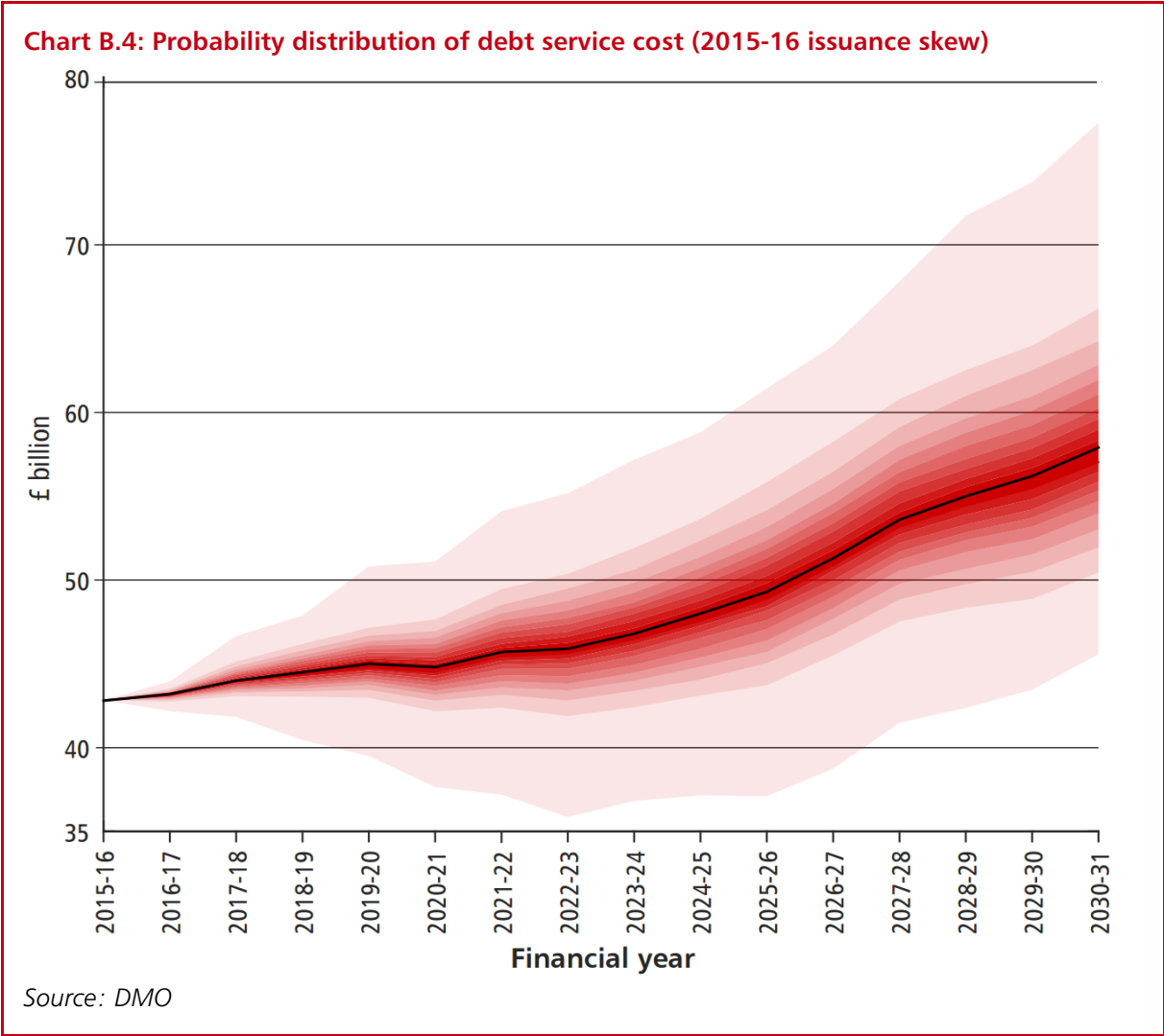
Table B.1: Gilt issuance strategy composition (per cent)

	Short conventional (0-7 years)	Medium conventional (7-15 years)	Long conventional (over 15 years)	Index-linked	Unallocated
Issuance skew 2015-16	25.4	20.0	28.0	23.5	3.0
<i>Figures may not sum due to rounding</i>					
<i>Source: Budget 2015</i>					

B.24 The resulting probability distribution of debt interest cost if issuance continued to follow the current issuance maturity skew for the next 15 years is shown in chart B.4.¹¹ In this example,

⁶ The government does not use this simulation tool to determine a single optimal debt issuance strategy.
⁷ There are small differences in the methods used to calculate debt interest cost here from those used by the Office of Budget Responsibility (OBR), which publishes the official debt interest forecast. These include differences in coverage, on the RPI inflation assumption used and some simplifying assumptions to the debt management operational details.
⁸ Interest rate risk is the risk associated with new issuance while refinancing risk is the risk associated with the roll-over of maturing debt.
⁹ The financing assumptions used in this exercise are in line with Autumn Statement 2015 numbers.
¹⁰ The VAR is estimated using data from October 1992 to October 2015, making use of the OBR EFO November 2015 forecasts for the macroeconomic variables. For each year of the 15-year horizon, a yield curve forecast is produced. In order to generate a distribution of yield curve forecasts for each year, simulations around the central forecast are made by drawing from a distribution of errors, one thousand times. Two alternative yield curve distributions are analysed, normal and bootstrapped distributions. Nominal yields’ forecasts are not restricted to positive values. The VAR currently only forecasts nominal yields; the break-even inflation rate from the Variable Roughness Penalty (VRP) yield curve model is used to derive the real yield curve.
¹¹ Debt interest from APF holdings is not netted out here while it is in the OBR’s official debt interest forecast, in line with changes brought about by the European System of Accounts (ESA) 2010 statistical guidelines.

similarly to last year, a bootstrapping technique has been used for the simulation of yields.¹² It is worth noting that the underlying yield projections used here are broadly in line with current market expectations and thus do not currently predict a return to historical long-run yield levels but remain relatively lower.



B.25 The central line of the fan chart represents the median debt interest cost after 1,000 simulations using the PST model (each simulation using an alternative yield curve) for each financial year. The shaded red areas (from darker to lighter red respectively) around the median debt interest cost projection represent the percentiles of the probability distribution, with each colour area representing an additional 5% probability.¹³ The debt interest values in the lightest shades of red at the top and at the bottom of the fan chart represent the ‘tails’ of the distribution, with only 5% probability associated with them. For example, debt interest values on the upper tail of the distribution would not be expected to be reached with a 95% probability. Forecast uncertainty increases further into the future and, therefore, the ‘fan’ widens over the horizon. Overall, at the 15-year horizon, it can be said with 90% certainty (i.e. excluding the top

¹² Yields data currently deviate substantially from the normal distribution assumption. Bootstrapping is an econometric technique that does not make an assumption about the parametric form of the distribution of errors from estimation, such as the normal distribution. Instead, resampling techniques are applied to actual estimation errors in order to deduce the underlying distribution of the data sample.

¹³ A percentile is a statistical measure indicating the value below which a given percentage of observations in a group of observations fall. For example, the 20th percentile is the value below which 20 percent of the observations may be found.

and bottom ‘tails’ of the distribution) that debt interest cost will be between £50 billion and £66 billion, with a median value of £58 billion.¹⁴

B.26 It is important to note when looking at chart B.4 that debt interest simulations reflect the combination of simulated future yields and projected debt issuance together with the unfolding of existing portfolio dynamics. In this way, it can be seen that debt interest seems to pick up in the later part of the horizon. Amongst other factors, this reflects the redemption profile of the debt portfolio, with a higher volume of redemptions that will mature and be refinanced at new rates of financing. Given the long average maturity of the UK’s debt portfolio, which creates ‘stickiness’ in the debt portfolio, any impact on its structure as a result of debt issuance is slow to take effect. Following the current issuance skew example, after 15 years only about half of the entire debt interest cost bill would have been refinanced at new yield levels.

Gilt distribution

B.27 Market conditions have been reported to have deteriorated relative to a year ago and concerns regarding liquidity and volatility in the gilt market have been expressed. The government’s decisions regarding gilt issuance have been taken with these factors in mind.

B.28 The gilt issuance programme in 2016-17 will be of a similar size to the previous financial year, and remains large by historical standards. To raise this amount of financing in 2016-17, the government will issue conventional and index-linked gilts across a range of maturities, with auctions remaining the primary method of issuance.

B.29 The government will continue the syndication programme in 2016-17. Gilts of any type and maturity can be sold via syndication. However, the current planning assumption is that:

- syndications will be used to launch new gilts or to re-open high duration conventional and index-linked gilts
- the size of transactions will be determined in response to market demand for the gilt being sold

B.30 The government expects to hold six syndicated offerings in 2016-17.

B.31 As a whole, weaker liquidity conditions persist and the market environment has become more fragile. At the government’s annual consultation meeting with the GEMMs in January, many GEMMs expressed a general view that market conditions in both gilt and repo markets were particularly strained.¹⁵

B.32 Given the potentially challenging market backdrop, the government is introducing a package of measures to support gilt distribution and the smooth delivery of the DMO’s financing Remit, including holding smaller auctions, introducing another gilt issuance method (gilt tenders), increasing the initially unallocated portion of gilt issuance and the eligibility to buy gilts post auction. Gilt tenders have been introduced to allow the government to respond more dynamically to changing market conditions.

B.33 The government remains committed to the GEMM model to distribute gilts through auctions, syndications and tenders. In addition, GEMMs play an important role in helping to facilitate liquidity in the secondary market.

¹⁴ Note that the bootstrapped distribution in this example is asymmetric, so that for the same underlying probability, the area of debt interest values above the median of the distribution is larger than the area of values found below the median.

¹⁵ Minutes of the meetings are available at: <http://www.dmo.gov.uk/documentview.aspx?docName=/gilts/press/sa270116.pdf>

Gilt issuance by maturity and type in 2016-17

B.34 In determining the split of gilt issuance, the government has considered its analysis of the relative cost-effectiveness of the different gilt types and maturities, its risk preferences including for the portfolio as well as the issuance programme, and the market feedback it has received.

B.35 Continuing demand for short conventional gilts is anticipated, including from overseas investors. However, the relatively high weight that the government places on managing its near-term exposure to refinancing risk has also continued to influence its decision on the amount of short-dated conventional gilt issuance.

B.36 In deciding the proportion of medium conventional gilts to issue, the government recognises the important role that medium conventional gilts (particularly in the 10-year maturity) play in facilitating the hedging of a wide range of gilt market exposures through the futures market, which helps underpin liquidity in the sector.

B.37 Market feedback suggests ongoing demand for long-dated conventional gilts from domestic investors in particular. Additionally, in determining the amount of long-dated conventional gilts to issue, the government has taken into account the role of long conventional issuance in mitigating its near-term exposure to refinancing risk.

B.38 For conventional gilts, the risk premia analysis suggests that issuance across the maturity spectrum is broadly equivalent in terms of cost effectiveness. In addition, conventional and index-linked gilts are broadly cost equivalent under market implied inflation expectations. The exception is for long-dated index-linked gilts, where the analysis suggests they are more cost-effective to issue than long-dated conventional gilts. In relation to risk, the government is aware the significant volume of index-linked issuance in recent years has consequences for the overall amount of index-linked debt outstanding. Therefore, the cost effectiveness of index-linked gilts has been weighed against the need to retain a balance in the debt portfolio as well as in the annual issuance programmes.

B.39 Taking these considerations into account, the government's intention is to deliver in 2016-17 a well-diversified gilt issuance programme that utilises different types and maturities of gilts.

B.40 A somewhat larger portion of issuance will also be held in initially unallocated form in 2016-17 compared to last year. The main purpose of the unallocated portion of issuance is to grant increased flexibility to the DMO to issue any type or maturity of gilt in response to in-year evolution in demand and market conditions, while remaining consistent with the principles of predictability and transparency.

Treasury bill issuance in 2016-17

B.41 Treasury bills can be used for both debt and cash management purposes. With regards to the former, changes to the Treasury bill stock have historically offered an efficient way to accommodate in-year changes to the financing requirement.

B.42 In 2016-17, the government has introduced greater flexibility in the way that Treasury bills are used for the purposes of debt and cash management. As such, from this financial year, the government will no longer target a planned end-year Treasury bill stock. Information on the outstanding stock of Treasury bills will, however, continue to be published monthly in arrears on the DMO's website.

B.43 Treasury bills are not anticipated to make a net contribution to financing in 2016-17.

National Savings and Investments' financing remit for 2016-17

C

C.1 This annex sets out information on the activities of National Savings and Investments (NS&I) in 2015-16 and 2016-17. NS&I is both a government department and an executive agency of the Chancellor of the Exchequer. Its activities are conducted in accordance with its remit, which is to provide cost-effective finance now and in the future for the government. It does this by raising deposits and investments from retail customers. This will remain the case in 2016-17.

C.2 NS&I's contribution to financing is agreed with HM Treasury each year, and is based on the government's gross financing requirement, conditions in the retail financial services market and NS&I's ability to raise the funding without distorting the market.

Volume of financing in 2015-16

C.3 NS&I's contribution to financing in 2015-16 is projected to be £11.5 billion with gross inflows (including reinvestments and gross accrued interest) of approximately £32.5 billion. This is within the net financing range of £8.0 billion to £12.0 billion set for NS&I at Budget 2015. Table C.1 shows changes in NS&I's product stock during 2014-15.

Table C.1: Changes in NS&I's product stock in 2015-16

£ billion	End-March 2015	End-March 2016 ¹
Variable rate	78.6	90.8
Fixed rate	20.8	21.3
Index-linked	24.5	23.3
Total	123.9	135.4

Figures may not sum due to rounding.
¹ Projections
Source: NS&I

C.4 NS&I calculates the value it creates for the government using the Value Indicator, which compares the cost of funds raised to comparable gilt yields (see table C.2). These comparator rates have been at or close to historic lows over the course of the year. On this basis, NS&I projects a Value Indicator return of £141.8 million in 2015-16. This is in line with the target set by HM Treasury at Budget 2015; for NS&I to deliver positive value.

Table C.2: Calculator of Value Indicator

Comparator cost¹	
<i>Less</i>	Interest and prizes earned by investors
<i>Less</i>	Management costs of NS&I products (net equivalent of DMO costs & leveraging revenue)
<i>Less</i>	Tax foregone on total stock of 'tax-free' products
Equals	Value Indicator

¹This is the cost of raising funds in the wholesale market of an equivalent term. For fixed-rate products it is the term of the product while, for variable rate products, it is the average length of time the product is held by the customer.

Source: NS&I

Volume of financing in 2016-17

C.5 Gross inflows (including reinvestments and gross accrued interest) of NS&I’s products are projected to be around £26.0 billion in 2016-17. After allowing for expected maturities and withdrawals, NS&I will have a net financing target of £6.0 billion in 2016-17, within a range of £4.0 and £8.0 billion.

C.6 Based on current market expectations for comparator gilt yields, the cost to government of NS&I’s stock is expected to be lower than wholesale funding costs for the year. NS&I’s expected Value Indicator outturn for 2016-17 is £115 million.

C.7 Further details of NS&I’s activities in 2016-17 will be included in its Annual Report and Accounts, which is scheduled to be laid in Parliament in 2016 and will be available in print form and at www.nsandi.com.

The Exchequer cash management remit for 2016-17

D

Exchequer cash management objective

D.1 The government's cash management objective is to ensure that sufficient funds are always available to meet any net daily central government cash shortfall and, on any day when there is a net cash surplus, to ensure this is used to best advantage. HM Treasury and the DMO work together to achieve this.

D.2 HM Treasury's role in this regard is to make arrangements for a forecast of the daily net flows into or out of the National Loans Fund (NLF); and its objective in so doing is to provide the DMO with timely and accurate forecasts of the expected net cash position over time.

D.3 The DMO's role is to make arrangements for funding and for placing the net cash positions, primarily by carrying out market transactions in the light of the forecast; and its objective in so doing is to minimise the costs of cash management while operating within the risk appetite approved by ministers.

D.4 The government's preferences in relation to the different types of risk taking inherent in cash management are defined by a set of explicit limits covering four types of risk which, taken together, represent the government's overall risk appetite.¹ The risk appetite defines objectively the bounds of appropriate government cash management in accordance with the government's ethos for cash management as a cost minimising, rather than profit maximising, activity and playing no role in the determination of interest rates. The DMO may not exceed this boundary, but, within it, the DMO will have discretion to take the actions it judges will best achieve the cost minimisation objective.

The DMO's cash management objective

D.5 The DMO's cash management objective is to minimise the cost of offsetting the government's net cash flows over time, while operating to the government's risk appetite. In so doing, the DMO will seek to avoid actions or arrangements that would:

- undermine the efficient functioning of the sterling money markets
- conflict with the operational requirements of the Bank of England for monetary policy implementation

¹ The four types of risk for cash management are liquidity risk, interest rate risk, foreign exchange risk and credit risk. An explanation of these risks and the government's cash management operations more generally is set out in chapter 5 of the DMO's Annual Review 2004-05, which is available on the DMO's website: http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar0405.pdf&page=Annual_Review

Instruments and operations used in Exchequer cash management

D.6 The range of instruments and operations that the DMO may use for cash management purposes, including the arrangements for the issuance of Treasury bills, is set out in its Operational Notice.²

D.7 Treasury bills can be used for both cash and debt management purposes. As noted in paragraph 3.28 there will be no net contribution from Treasury bills to debt financing in 2016-17.

D.8 For cash management, Treasury bills help the DMO manage fluctuations in the government's cash flow profile throughout the year by varying the amount raised through Treasury bills in response to the forecast cash position. For 2015-16, the DMO has been given the flexibility to vary the planned Treasury bill stock around end-year by \pm £10 billion. From 2016-17 onwards, in order to provide greater flexibility to the DMO to use Treasury bills across financial year-end for cash management, an end-year target stock of Treasury bills will no longer be set. Information on the total stock of Treasury bills will continue to be published monthly on the DMO's website.

D.9 As a contingency measure, the DMO may issue Treasury bills to the market at the request of the Bank of England and, in agreement with HM Treasury, to assist the Bank of England's operations in the sterling money market for the purpose of implementing monetary policy while meeting the liquidity needs of the banking sector as a whole. In response to such a request, the DMO may add a specified amount to the size(s) of the next bill tender(s) and deposit the proceeds with the Bank, remunerated at the weighted average yield(s) of the respective tenders. The amount being offered to accommodate the Bank's request will be identified in the DMO's weekly Treasury bill tender announcement. Treasury bills may also be issued bilaterally to the Bank of England to support intervention schemes. Treasury bill issues made at the request of the Bank will be identical in all respects to Treasury bills issued in the normal course of DMO business. The DMO may also raise funds to finance advances to the Bank of England and would, in conjunction with HM Treasury, determine the appropriate instruments through which to raise those funds.

DMO collateral pool

D.10 To assist the DMO in the efficient execution of its cash management operations an amount of gilts, which shall be chosen to have a negligible effect on relevant indices, may be issued to the DMO and this will normally be on the third Tuesday of April, July and October 2016 and January 2017. Any such issues to the DMO will be used as collateral and will not be available for outright sale. The precise details of any such issues to the DMO will be announced at least two full working days in advance of the creation date. If no issue is planned to take place in a particular quarter, the DMO will announce that this is the case in advance.

D.11 In the event that the DMO requires collateral to manage short-term requirements, the DMO may create additional Treasury bill collateral. Any such issues to the DMO will only be used as collateral and will not be available for outright sale by the DMO.

D.12 The DMO's collateral pool may also be used to support HM Treasury's agreement to provide gilt collateral for the purpose of the Bank of England's Discount Window Facility (DWF).

² The current edition of Exchequer Cash Management Operational Notice and Treasury Bill Information Memorandum is available on the DMO's website at: http://www.dmo.gov.uk/index.aspx?page=publications/money_markets

The gilt collateral will be held by the DMO and lent to the Bank of England on an 'as needed' basis; gilts created for this purpose will not be sold or issued outright into the market.³

Active cash management

D.13 The combination of HM Treasury's cash flow forecasts and the DMO's market operations characterises an active approach to Exchequer cash management. Since 2007-08, a performance measurement framework for active cash management – in which discretionary decisions that are informed by forecast cash flows are evaluated against a range of indicators – has been in place. These include qualitative measures as well as measures quantifying excess returns to active management, after deducting an interest charge representing the government's cost of funds. Performance against these key indicators is reported in the DMO's Annual Review.⁴

³ More information about the Discount Window Facility can be found on the Bank of England's website at: <http://www.bankofengland.co.uk/markets/money/dwff/index.htm>

⁴ For the latest report See annex B of the DMO Annual Review which can be found on the DMO's website at: http://www.dmo.gov.uk/index.aspx?page=publications/Annual_Reviews

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