



HM Treasury

Debt management report 2019-20

March 2019



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Chapter 1

Introduction

- 1.1 The 'Debt management report' is published in accordance with the 'Charter for Budget Responsibility'.¹ The Charter requires the Treasury to "report through a debt management report – published annually – 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 target for net financing through NS&I
- 1.2 Public sector net borrowing (PSNB) has fallen from the post-war high of 9.9% of Gross Domestic Product (GDP) in 2009-10 to an expected 1.1% of GDP in 2018-19, the lowest level since 2001-02. Public sector net debt (PSND) as a share of GDP has begun its first sustained fall in a generation after peaking at 85.1% in 2016-17. The government's balanced approach has enabled this while supporting public services, investing in the economy and infrastructure and keeping taxes low.
- 1.3 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'.²
- 1.4 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 2019-20 is contained in Annex D.

¹ 'Charter for Budget Responsibility: autumn 2016 update', HM Treasury, January 2017.

² www.dmo.gov.uk/publications/annual-reviews

Chapter 2

Debt management policy

2.1 This chapter provides an overview of the government’s debt management framework and sets out medium-term considerations for debt management policy. The debt management framework is part of the overall macroeconomic framework, which includes the fiscal, macro prudential and monetary policy frameworks. These were outlined in the Budget 2018 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 HM Treasury and the Debt Management Office (DMO)
- the full funding rule

Debt management objective

2.3 The debt management objective, originally established in 1995 following the ‘Debt Management Review’ and set out in the ‘Charter for Budget Responsibility’,² 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 advance 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 the 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

¹ ‘Budget 2018’, HM Treasury, October 2018.

² ‘Report of the Debt Management Review’, HM Treasury and the Bank of England, July 1995 – available at: www.dmo.gov.uk/media/2083/report95.pdf – and ‘Charter for Budget Responsibility: autumn 2016 update’, HM Treasury, January 2017.

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
 - 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 2019-20 is set out in Annex B.

Debt management policy principles

- 2.8 The debt management objective is achieved by:
- meeting the principles of openness, predictability and transparency
 - encouraging the development of 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 retail financing through NS&I while balancing the interests of taxpayers, savers and the wider financial sector
- 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.³

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'.⁴

³ More information about the DMO can be found here: www.dmo.gov.uk/about/who-we-are

⁴ 'Executive Agency Framework Document', United Kingdom Debt Management Office, April 2005. Available at www.dmo.gov.uk/media/14536/fwork040405.pdf

- 2.11 In support of the government's approach to debt management policy:
- the DMO will 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 advise on and encourage the development of liquid and efficient gilt and Treasury bill markets
- 2.12 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

- 2.13 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'.⁵ The government therefore issues sufficient wholesale and retail debt instruments, through gilts, Treasury bills (for debt financing purposes) and NS&I products, to enable it to meet its projected financing requirement.
- 2.14 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 policy
- 2.15 The total amount of financing raised in a financial year will in practice differ marginally 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 and its outturn
 - the difference between the projected net contribution to financing by NS&I and its outturn
 - auction proceeds in the period following the Spring Statement that are different from those required to meet relevant financing targets
 - the implementation of the syndication programme at year-end

⁵ The full funding rule is set out in 'Report of the Debt Management Review', HM Treasury and the Bank of England, July 1995. Available at: www.dmo.gov.uk/media/2083/report95.pdf

2.16 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 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 (see Annex D). The DMO's flexibility to vary the stock of Treasury bills for cash management purposes is implemented with full adherence to the full funding rule.

Debt management considerations

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, 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
- encouraging 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 long average maturity debt portfolio to limit exposure to refinancing risk
- issue an appropriate balance of conventional and index-linked gilts over a range of maturities, taking account of structural demand, the diversity of the investor base and the government's preferences for inflation exposure
- maintain the Treasury bill stock at a level that will support market liquidity and the cash management objective

Index-linked gilts

2.20 The UK's stock of index-linked debt stood at around £426 billion at the end of 2018, making up 26% of the government's debt portfolio (Chart A.10).⁶ In the 4 years prior to 2018-19, index-linked gilts accounted for around 25% of the government's annual debt issuance (see Chart A.12), for which both the principal and interest payments are linked to the Retail Prices Index (RPI).

⁶ In nominal uplifted terms.

- 2.21 Issuing index-linked gilts has historically brought cost advantages due to strong demand, and has built the UK's financial resilience through supporting the UK's long average debt maturity and diversifying the investor base. Tying debt interest payments to inflation also underscored the government's commitment to price stability in the period prior to central bank independence.
- 2.22 The UK's relatively large stock of index-linked debt, however, increases the sensitivity of the public finances to inflation shocks, as highlighted in the OBR's 2017 'Fiscal risks report'.⁷ As discussed in its July 2018 response to the OBR's report and at Budget 2018,⁸ the government has been considering the appropriate balance between index-linked and conventional gilts, taking account of the level of structural demand, the diversity of the investor base, and the government's desired inflation exposure.
- 2.23 As part of the government's responsible approach to fiscal risk management – and as set out at Budget 2018 – the government will look to reduce the proportion of index-linked gilt issuance in a measured fashion as a share of total issuance over the medium term, in line with the 1 to 2 percentage point reduction planned for 2018-19.⁹ Decisions on precise levels of index-linked and conventional gilt issuance will continue to be taken as part of the annual financing remit and in consultation with market participants. Consistent with this, the 2019-20 financing remit includes a 2 percentage point reduction in index-linked gilt issuance compared to that planned at the start of the previous year.
- 2.24 On 17 January 2019, the House of Lords Economic Affairs Committee published a report on 'Measuring Inflation' at the conclusion of its inquiry into the use of RPI.¹⁰ The government is considering the report, and the complex issues it raises. The Economic Affairs Committee made several recommendations both to the government and the UK Statistics Authority (UKSA). The government is discussing the relevant issues with the UKSA and will respond to the Committee's report in April.

Sovereign Sukuk

- 2.25 In 2014, the government became the first country outside the Islamic world to issue £200 million of sovereign Sukuk (the Islamic equivalent of government bonds), which matures on 22 July 2019.¹¹ The redemption of

⁷ 'Fiscal risks report', Office for Budget Responsibility, July 2017.

⁸ 'Managing fiscal risks: government response to the 2017 Fiscal risks report', HM Treasury, July 2018; and 'Budget 2018', HM Treasury, October 2018. This has included work by HM Treasury and the DMO to explore the long-term inflation exposure in the debt portfolio.

⁹ The 2018-19 financing remit planned to issue 21.1% of total issuance via index-linked gilts. On the basis of the updated financing arithmetic set out in this document, index-linked gilts are expected to account for 21.7% of total issuance at the end of 2018-19. This compares to 23.1%, which was the index-linked share of total gilts planned for issuance in the 2017-18 financing remit.

¹⁰ 'Measuring Inflation', House of Lords Economic Affairs Committee, HL Paper 246, January 2019.

¹¹ 'Government issues first Islamic bond', HM Treasury, June 2014. Available at: <https://www.gov.uk/government/news/government-issues-first-islamic-bond>

the sovereign Sukuk is accounted for in the financing arithmetic for 2019-20 (see Table 3.A).

- 2.26 The government is currently assessing the case for issuing a new sovereign Sukuk after the current one matures. This assessment will take into consideration market conditions, value for money for taxpayers and the government's wider objectives. The government will provide further information in due course.

Borrowing by devolved administrations

- 2.27 The Scottish government, Welsh government and Northern Ireland Executive have the power to borrow for capital investment, as set out in the Scotland Act 1998, Wales Act 2006, and Northern Ireland (Loans) Act 1975, respectively. The Scottish and Welsh governments' capital borrowing powers were updated in the ensuing Scotland Act 2016 and Wales Act 2017, with further detail set out in their respective fiscal frameworks.¹² The Northern Ireland Executive's borrowing powers were updated in the Northern Ireland (Miscellaneous Provisions) Act 2006.
- 2.28 Both the Scottish and Welsh governments also have the power to issue bonds to finance capital investment. 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. If there is an increase in the Scottish or Welsh government's borrowing limits, the UK government will also review devolved administrations' powers to issue bonds. In addition, the Scottish and Welsh governments would need further approval from HM Treasury to issue in any currency other than sterling.
- 2.29 The Scottish and Welsh governments also have resource borrowing powers to manage their budgets, as set out in the Acts above. Further detail on the Scottish and Welsh governments resource borrowing powers are included in their respective fiscal frameworks. The Northern Ireland Executive have short-term resource borrowing powers to assist cashflow management in the Northern Ireland Consolidated Fund.

Borrowing by local authorities

- 2.30 Under the prudential code, each local authority is responsible for meeting its own liabilities, including those taken on through extending guarantees. The UK government provides no guarantee on local authority borrowing.
- 2.31 Local authority capital financing decisions are subject to prudential guidance published by the Ministry of Housing, Communities & Local Government and the Chartered Institute of Public Finance and Accountancy (CIPFA). Taken together, these documents form the prudential framework. Following

¹² The Scottish government's fiscal framework was agreed in March 2016 and the Welsh government's fiscal framework was agreed in December 2016. They can be found here: www.gov.uk/government/publications/the-agreement-between-the-scottish-government-and-the-united-kingdom-government-on-the-scottish-governments-fiscal-framework and www.gov.uk/government/publications/the-agreement-between-the-welsh-government-and-the-united-kingdom-government-on-the-welsh-governments-fiscal-framework

consultation in 2017, the government and CIPFA have updated their respective elements of the framework.¹³ Local authorities are required by statute to have regard to this guidance. These changes which came into force in April 2018:

- extended the requirement to consider security, liquidity and yield in that order of importance to all investments, not just financial investments
- enhanced transparency requirements
- required authorities to demonstrate how they have ensured that those signing off commercial decisions understand the risks and opportunities
- made it clear that borrowing more than or in advance of need solely to generate a profit is not prudential
- required local authorities to demonstrate that the level of debt taken on and aggregate risk from investments is proportionate to the size of the authority
- updated the guidance on calculating minimum revenue provision to make it clear that local authorities should not make imprudent assumptions to minimise their debt servicing costs

2.32 Local authorities undertake the bulk of their borrowing via the Public Works Loan Board (PWLB). Following a consultation, the government has confirmed its plans to abolish the PWLB Commissioners and transfer the relevant powers from the PWLB to the Treasury.¹⁴ The government plans to implement these changes, pursuant to its powers in the Public Bodies Act 2011, following a draft Order to be laid before Parliament. This change is about governance only: local authorities will continue to be able to access borrowing from central government.

¹³ 'Consultation on the proposed changes to the prudential framework of capital finance: Summary of consultation responses and Government response', Ministry of Housing, Communities & Local Government, February 2018; and 'Consultation on Proposed Changes to the Prudential Code', The Chartered Institute of Public Finance and Accountancy, August 2017.

¹⁴ 'Transfer of Functions from the Public Works Loan Board: response to the consultation', HM Treasury, November 2016.

Chapter 3

The Debt Management Office's financing remit for 2019-20

Introduction

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

Financing arithmetic

- 3.2 The Office for Budget Responsibility's (OBR) forecast for the central government net cash requirement (excluding NRAM, Bradford and Bingley and Network Rail) (CGNCR (ex NRAM, B&B and NR)) in 2019-20 is £23.7 billion. This is the fiscal aggregate that determines gross debt sales and is derived from the public sector net borrowing (PSNB) forecast. The relationship between PSNB and the CGNCR (ex NRAM, B&B and NR) is set out in the OBR's March 2019 'Economic and fiscal outlook'.¹
- 3.3 The forecast NFR in 2019-20 of £118.1 billion also reflects: projected gilt redemptions of £98.9 billion; redemption of the sovereign Sukuk of £0.2 billion; a planned short-term financing adjustment of £0.3 billion resulting from unanticipated underfunding in 2018-19; and additional sterling financing for the Official Reserves of £6.0 billion.
- 3.4 Proceeds from NS&I are expected to make a £11.0 billion net contribution to financing in 2019-20, following a forecast net contribution of £11.0 billion in 2018-19. The projection for 2019-20 assumes gross inflows of £37.7 billion. Details of NS&I's Net Financing target are set out in Annex C.
- 3.5 Gilt issuance is the government's primary means by which it meets the NFR. Treasury bill issuance (for debt financing purposes) may also make a net contribution to meeting the NFR.
- 3.6 In 2019-20, the NFR will be met by gross gilt issuance of £114.1 billion, while net issuance of Treasury bills for debt financing purposes will be £4.0 billion (i.e. the stock of Treasury bills in issue for debt financing purposes is planned to increase to £60.0 billion).
- 3.7 Table 3.A sets out details of the financing arithmetic for 2018-19 and 2019-20.

¹ 'Economic and fiscal outlook', Office for Budget Responsibility, March 2019.

Table 3.A: Financing arithmetic in 2018-19 and 2019-20 (£ billion)¹

	2018-19	2019-20
CGNCR (ex NRAM, B&B and NR)²	34.0	23.7
Gilt redemptions	66.7	98.9
Redemption of the sovereign Sukuk	0.0	0.2
Planned financing for the Official Reserves	6.0	6.0
Financing adjustment carried forward from previous financial years	-1.4	0.3
Gross financing requirement	105.4	129.1
<i>less:</i>		
NS&I net financing	11.0	11.0
Other financing ³	-0.2	0.0
Net financing requirement (NFR) for the Debt Management Office (DMO)	94.6	118.1
DMO's NFR will be financed through:		
Gilt sales, through sales of:		
Short conventional gilts	26.2	29.4
Medium conventional gilts	21.2	24.8
Long conventional gilts	29.7	30.8
Index-linked gilts	21.3	21.8
Unallocated amount of gilts	0.0	7.3
Total gilt sales for debt financing	98.3	114.1
Total net contribution of Treasury bills for debt financing	-4.0	4.0
Total financing	94.3	118.1
DMO net cash position	0.2	0.5

¹ Figures may not sum due to rounding.

² Central government net cash requirement (excluding NRAM, Bradford and Bingley and Network Rail).

³ Prior to publication of the end-year outturn in April each year, this financing item will usually mainly comprise estimated revenue from coinage. For 2018-19, the estimate also reflects near-maturity purchases of gilts redeeming in 2019-20 by the DMO in January 2019, which has resulted in an offsetting reduction of £0.2 billion in gilt redemptions in 2019-20.

Source: DMO, HM Treasury, NS&I and OBR.

Other short-term debt

- 3.8 The projected level of the Ways and Means Advance at the Bank of England at 31 March 2019 is £0.4 billion.² No changes to the level of the Ways and Means Advance are planned in 2019-20.
- 3.9 The projected level of the DMO's net cash balance at 31 March 2019 is £0.2 billion, £0.2 billion below the level projected at Budget 2018.³ The level will be increased to £0.5 billion during 2019-20, as shown by the planned short-term financing adjustment, and this will in turn reduce the NFR in 2019-20.

Gilt issuance by method, type and maturity

- 3.10 Auctions will remain the government's primary method of gilt issuance. In addition, the government will continue issuance via syndications and gilt tenders. Any type and maturity of gilts can be issued via syndication or gilt tender. Further details are set out in the DMO's 2019-20 financing remit announcement.⁴
- 3.11 The government plans gilt sales via auction of £85.8 billion (or 75.2% of total issuance) which will be split by maturity and type as follows: ⁵
- £29.4 billion of short conventional gilts (25.8% of total issuance)
 - £24.8 billion of medium conventional gilts (21.7% of total issuance)
 - £17.8 billion of long conventional gilts (15.6% of total issuance)
 - £13.8 billion of index-linked gilts (12.1% of total issuance)
- 3.12 The government is also currently planning to sell £21.0 billion of gilts (18.4% of total issuance) via syndication. The DMO's remit announcement sets out further detail about the planned syndication programme.
- 3.13 In addition, the DMO's financing remit includes an initially unallocated portion of £7.3 billion (6.4% of total issuance), through which gilts of any type or maturity may be sold, via any issuance method.
- 3.14 The deployment of the unallocated amount of gilt sales is designed to facilitate the effective delivery of the gilt financing programme while remaining consistent with the debt management principles of openness, predictability and transparency.
- 3.15 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.
- 3.16 Through its gilt issuance programme, the government aims at regular issuance across the maturity spectrum throughout the financial year and at

² This is in line with the decision set out in 'Debt and reserves management report 2008-09', HM Treasury, March 2008.

³ Figures may not sum due to rounding.

⁴ www.dmo.gov.uk

⁵ Maturities are defined as follows: short (1-7 years), medium (7-15 years) and long (over 15 years).

building up benchmarks at key maturities in both conventional and index-linked gilts.

3.17 The planning assumption for gilt issuance in 2019-20 by type, maturity and issuance method is shown in Table 3.B.

Table 3.B: Breakdown of planned gilt issuance in 2019-20 by type, maturity and issuance method (£ billion and % of total)¹

	Auction	Syndication	Gilt tender	Unallocated	Total
Short	29.4	-	-	-	29.4 (25.8%)
Medium	24.8	-	-	-	24.8 (21.7%)
Long	17.8	13.0	-	-	30.8 (27.0%)
Index-linked	13.8	8.0	-	-	21.8 (19.1%)
Unallocated	-	-	-	7.3	7.3 (6.4%)
Total	85.8 (75.2%)	21.0 (18.4%)	-	7.3 (6.4%)	114.1

¹ Figures may not sum due to rounding.

Source: DMO.

Gilt auction calendar

3.18 On the same day as the publication of the 'Debt management report', the DMO will publish a planning assumption for the gilt auction calendar consistent with the remit. The planned auction calendar may be adjusted during the year. The DMO will explain the parameters for any adjustments alongside the publication of the auction calendar.

Post-Auction Option Facility

3.19 In 2019-20, the DMO will continue to offer successful bidders at auction (both primary dealers and investors) the option to purchase additional stock. The details of how this facility works are set out in the DMO's gilt market Operational Notice.⁶

The Standing Repo Facility

3.20 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 2 August 2018.⁷ Any such gilts

⁶ 'Official Operations in the Gilt Market: An Operational Notice', Debt Management Office, November 2018.

⁷ 'Standing Repo Facility – Revised Terms', Debt Management Office, December 2017.

created will not be sold outright to the market and will be cancelled on return.

Other operations

3.21 The DMO has no current plans for a programme of reverse or switch auctions or conversion offers in 2019-20.

Coupons

3.22 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

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

Treasury bill issuance

3.24 It is currently planned that Treasury bill issuance for debt financing purposes will make a £4.0 billion net contribution to debt financing in 2019-20. The amount which Treasury bills have contributed to debt financing up to, and including, 2018-19 will be reported by the DMO shortly after the end of 2018-19.

New gilt instruments

3.25 There are no current plans to introduce new types of gilt instruments in 2019-20.

Revisions to the remit

3.26 In addition to planned updates to the remit, any aspect of this remit may be revised during the year in light of relevant new information. For example, this might include revisions in response to 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

3.27 Any such in-year revisions will be announced transparently to the market.

Medium-term projections for annual financing requirements

3.28 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 cash requirement (excluding NRAM, Bradford and Bingley and Network Rail) (CGNCR (ex NRAM, B&B and NR)), the redemption profile for gilts and the sovereign Sukuk, and Official

Financing for the Reserves. Table 3.C sets out the financing requirement projections from 2018-19 to 2023-24.

Table 3.C: Financing requirement projections, 2018-19 to 2023-24 (£ billion)¹

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
CGNCR (ex NRAM, B&B and NR) ²	34.0	23.7	47.2	41.2	40.7	36.6
Redemptions ³	66.7	99.1	97.6	79.3	73.3	71.8
Official Financing for the Reserves	6.0	6.0	0.0	0.0	0.0	0.0
Illustrative gross financing requirement	106.8	128.9	144.8	120.5	114.0	108.3

¹ Figures may not sum due to rounding.

² Central government net cash requirement (excluding NRAM, Bradford and Bingley and Network Rail).

³ Includes £0.2 billion for the redemption of the sovereign Sukuk in 2019-20.

Source: DMO, HM Treasury and OBR.

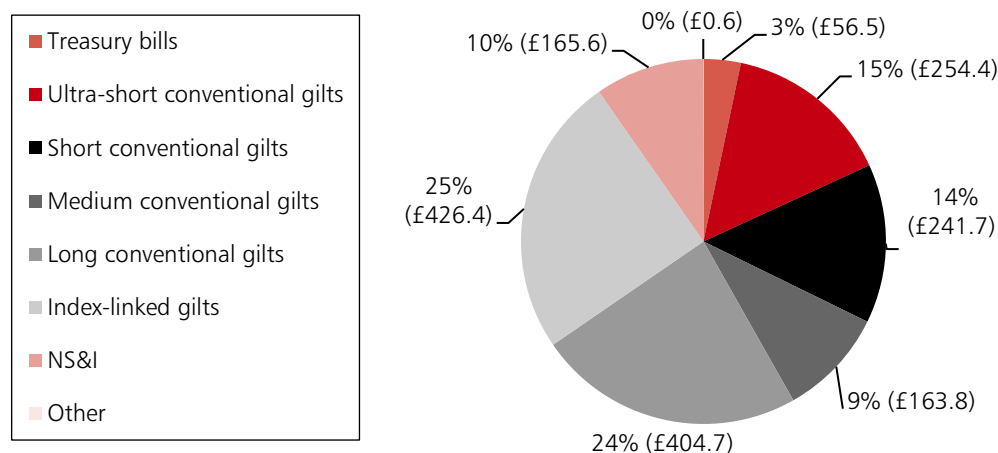
Annex A

Debt portfolio

Debt stock

- A.1 The total nominal outstanding stock of central government sterling wholesale debt excluding official holdings by central government was £1,547.5 billion at end-December 2018.¹ The components of this stock are set out in Table A.1.
- A.2 Chart A.1 shows the composition of the government's debt portfolio at end-December 2018.² Conventional and index-linked gilts made up the largest proportion of government debt at 87%.

Chart A.1 Composition of central government sterling debt in % and £ billion (end-December 2018)¹



¹ Figures may not sum due to rounding.

Source: DMO and NS&I.

¹ Official holdings of gilts comprise holdings by the Debt Management Office (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). This also includes any DMO purchases of near-maturity gilts. It does not include gilts held by the Bank of England's Asset Purchase Facility.

² Maturities here are defined as follows: Treasury bills (0-12 months), ultra-short (1-3 years), short (3-7 years), medium (7-15 years) and long (over 15 years).

Table A.1: Composition of central government wholesale and retail debt¹

£ billion nominal value	End-December 2017	End-December 2018
Wholesale		
Conventional gilts	1,153.4	1,174.4
<i>Less government holdings</i>	<i>104.6</i>	<i>109.7</i>
	1,048.8	1,064.6
Index-linked gilts	309.8	325.8
<i>less government holdings</i>	<i>3.7</i>	<i>3.7</i>
<i>plus accrued inflation uplift</i>	<i>90.3</i>	<i>104.2</i>
	396.4	426.4
Treasury bills	80.5	71.8
<i>less bills for cash management</i>	<i>19.5</i>	<i>15.3</i>
	61.0	56.5
Total wholesale debt	1,506.2	1,547.5
Retail		
NS&I	153.7	165.6
Other		
Balance on Ways and Means Advance	0.4	0.4
Sovereign Sukuk	0.2	0.2
Total central government sterling debt	1,660.5	1,713.7
Other government debt less liquid assets	99.8	95.0
Public sector net debt	1,760.3	1,808.7
Public sector net debt to GDP (%) ²	84.5%	84.0%
Statistics: Wholesale debt		
Wholesale debt to GDP (%) ²	72.3%	71.9%
Average time to maturity (years) ³	15.2 years	15.2 years
Debt maturing in one year (%)	9.5%	11.4%

¹ Figures may not sum due to rounding.

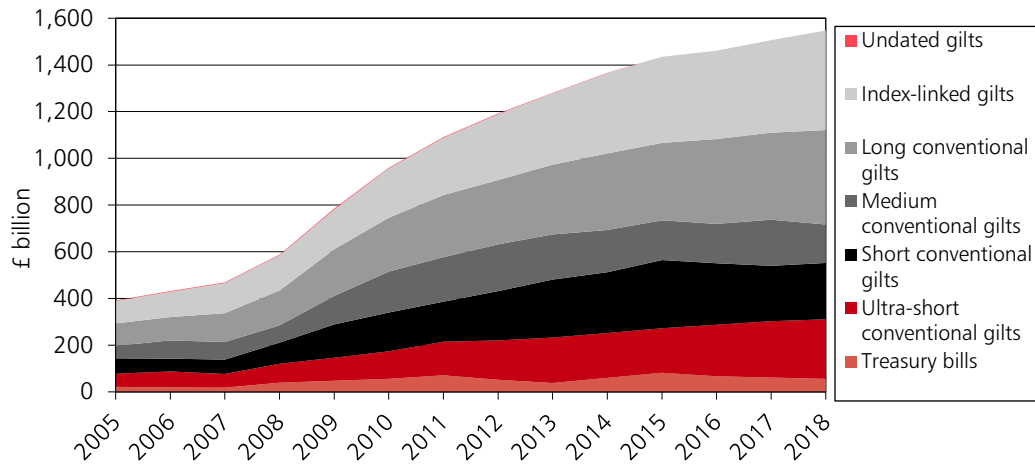
² GDP centred on end-December.

³ Calculated on a nominal weighted basis, excluding government holdings, including accrued inflation uplift.

Source: DMO, OBR, ONS and NS&I.

A.3 Chart A.2 shows the evolution of the gilt stock over time. Conventional gilts continue to make up the largest share of the gilt stock. The proportionate breakdown between different maturities of conventional and index-linked gilts has remained relatively stable over the past decade.

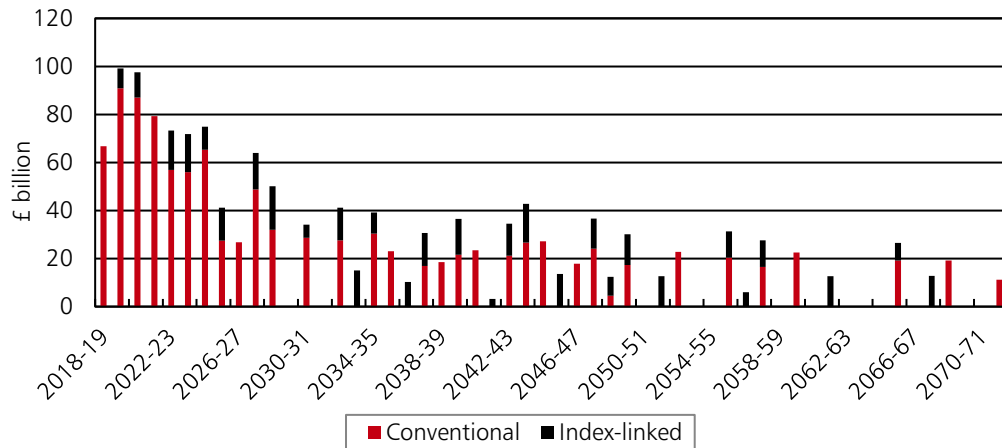
Chart A.2 Composition of central government wholesale debt stock (end-December values)



Source: DMO.

A.4 Chart A.3 shows the government’s gilt redemption profile as of end-December 2018. Following the extension of the maturity of the conventional gilt curve from 2068 to 2071,³ the longest maturity gilt in issue is due to redeem in 2071-72. While the majority of gilts in issue are conventional, particularly at shorter maturities, the split between conventional and index-linked gilts becomes more balanced at longer maturities.

Chart A.3 Gilt redemption profile (end-December 2018)



Source: DMO.

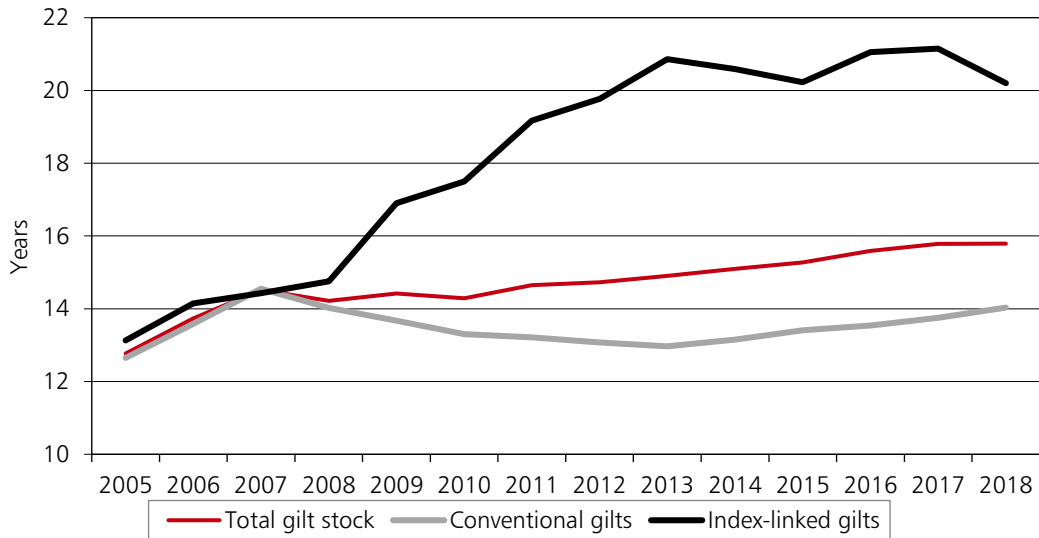
Maturity and duration of the debt stock

A.5 By end-December 2018, the average maturity of the total stock of gilts had remained at 15.8 years, as shown in Chart A.4. The average maturity of the stock of conventional gilts had also risen to 14.0 years, with the average maturity of index-linked gilts falling from 21.2 to 20.2 years. The average maturity of the government’s wholesale debt remains consistently longer

³ ‘Press Notice: Syndicated launch of £6.0 billion nominal of 1.625% Treasury Gilt 2071: Result’, Debt Management Office, May 2018.

than the average across the G7 group of advanced economies, as shown in Chart A.5.

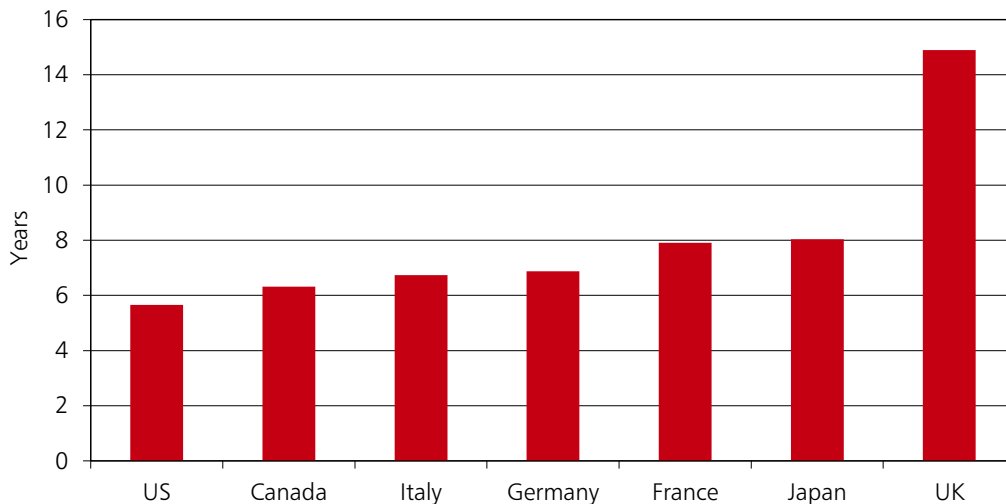
Chart A.4 Average maturity of UK gilt stock (end-December values)¹



¹ Calculated on a nominal weighted basis, excluding official holdings, including accrued inflation uplifts.

Source: DMO.

Chart A.5 Average maturity of the debt stock by country (end-December 2018)¹



¹ Calculated on a nominal weighted basis, excluding inflation uplift.

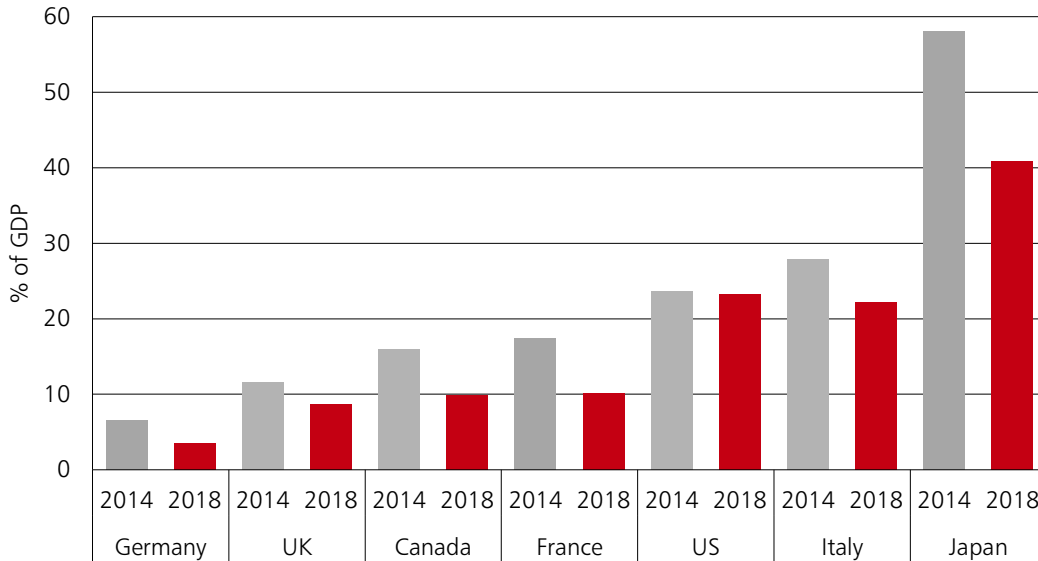
Source: Bloomberg L.P.

A.6 A long average maturity of debt significantly reduces the UK government’s exposure to refinancing risks. Chart A.6 shows the expected gross financing requirement as a share of GDP for all G7 countries in 2014 and 2018. Further, according to the IMF, on average since 2010, the UK government has refinanced debt equivalent to 6.9% of GDP each year.⁴ This is the lowest across the G7, with the comparable figure at 7.0% in Germany, 17.6% in the US, 20.8% in Italy, and 46.1% in Japan. This illustrates the supportive impact

⁴ ‘IMF Fiscal Monitor’, International Monetary Fund, 2010-2018.

that the long average maturity of the UK's debt stock has on the UK's gross financing requirement, thereby lowering refinancing risk.

Chart A.6 Annual gross financing requirement as % of GDP

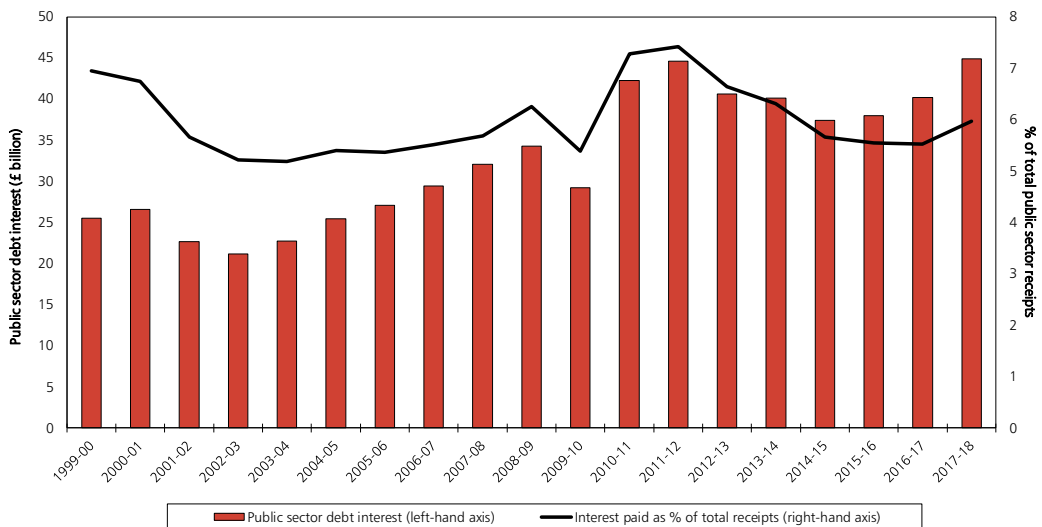


Source: IMF Fiscal Monitor October 2014/2018 and Bloomberg L.P.

Debt interest

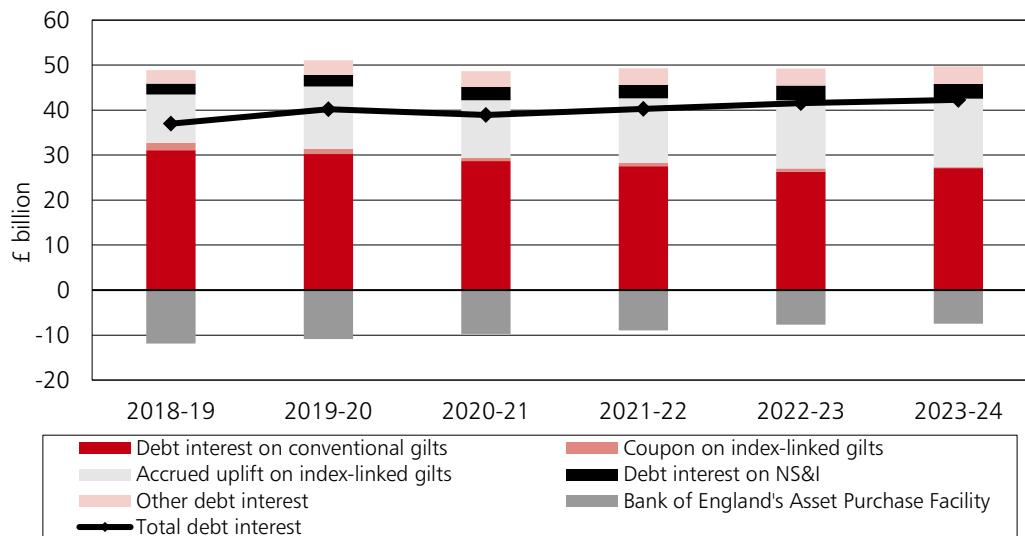
A.7 Despite the gross financing requirement almost doubling since the start of the financial crisis, debt interest has remained broadly stable in recent years, as shown in Chart A.7. This is due to declining interest rates for new issuance. Moving forwards, while debt interest on conventional gilts is forecast to fall in nominal terms over the 5-year period, this will be offset by an increase in forecast inflation and declining income from the Asset Purchase Facility (APF), leaving nominal debt interest broadly stable over the period (Chart A.8).

Chart A.7 Debt interest in £ billion and as % of public sector receipts



Source: ONS.

Chart A.8 Breakdown of debt interest forecast

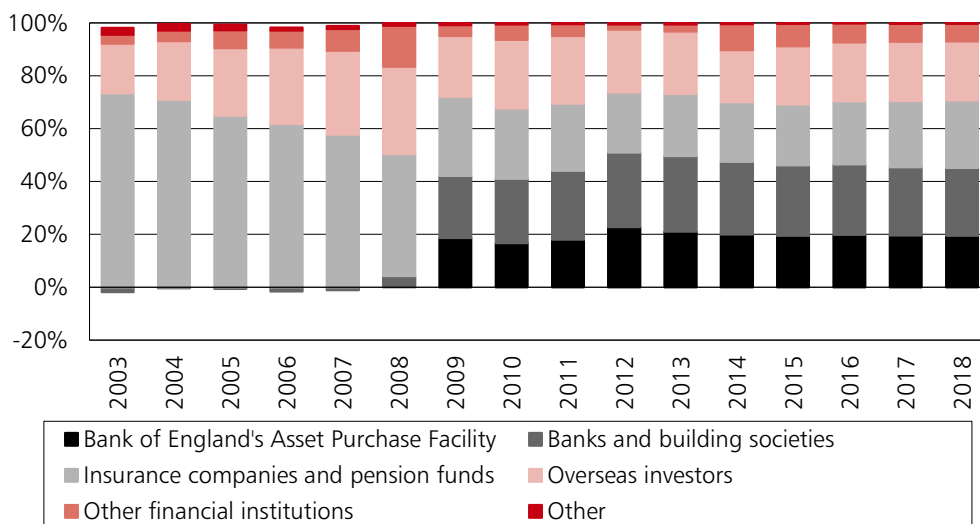


Source: OBR.

Gilt holdings by sector

A.8 At end-September 2018, the 3 largest investor groups of gilt holdings continued to be insurance companies and pension funds (32%), overseas investors (28%), and the Bank of England's Asset Purchase Facility (24%), as shown in Chart A.9.

Chart A.9 Gilt holdings by sector (% of total market value gilt holdings)¹



¹ All end-December, except 2018 for which data is only available until end-September. 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.

A.9 The introduction of quantitative easing through the Bank of England's Asset Purchase Facility has caused the largest change to gilt holdings by sector over time, as shown in Chart A.9. Since its introduction in 2008, the value of holdings in the Asset Purchase Facility has increased; as of end-December 2018 it stood at £459 billion. Domestic insurance companies and pension funds have frequently been the largest holders of gilts, though the share of

gilts held by overseas investors has increased over time to make up a similar share of the investor base.

Gilt issuance

A.10 The central government net cash requirement (excluding NRAM, Bradford and Bingley and Network Rail) (CGNCR (ex NRAM, B&B and NR)), gilt redemptions, and the volume of gilt sales for each year since 2007-08 is shown in Table A.2. In 2019-20, CGNCR (ex NRAM, B&B and NR) will be lower than redemptions for the third consecutive year.

Table A.2: Central government net cash requirement, redemptions and gilt sales (£ billion)

	CGNCR (ex NRAM, B&B and NR) ¹	Redemptions	Gross gilt sales ²
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	166.4
2011-12	126.5	49.0	179.4
2012-13	98.6	52.9	165.1
2013-14	79.3	51.5	153.4
2014-15	92.3	64.5	126.4
2015-16	78.5	70.2	127.7
2016-17	70.9	69.9	147.6
2017-18	40.3	80.0	115.1
2018-19 ³	34.0	66.7	98.3
2019-20 ³	23.7	99.1 ⁴	114.1

¹ Central government net cash requirement (excluding NRAM, Bradford and Bingley and Network Rail).

² Figures are in cash terms.

³ Spring Statement 2019 projections.

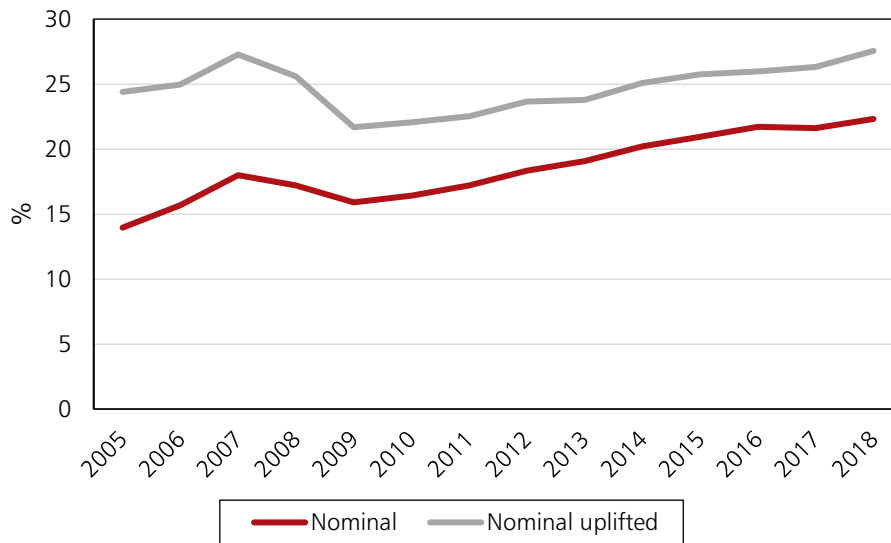
⁴ Includes £0.2 billion for the redemption of the sovereign Sukuk in 2019-20.

Source: DMO, HM Treasury, ONS and OBR.

Index-linked gilts

A.11 The stock of index-linked gilts has increased over time and stood at around £426 billion in nominal uplifted terms at the end of 2018. Index-linked gilts make up 26% of the government's debt portfolio in nominal uplifted terms (Chart A.10).

Chart A.10 Index-linked proportion of the debt stock¹

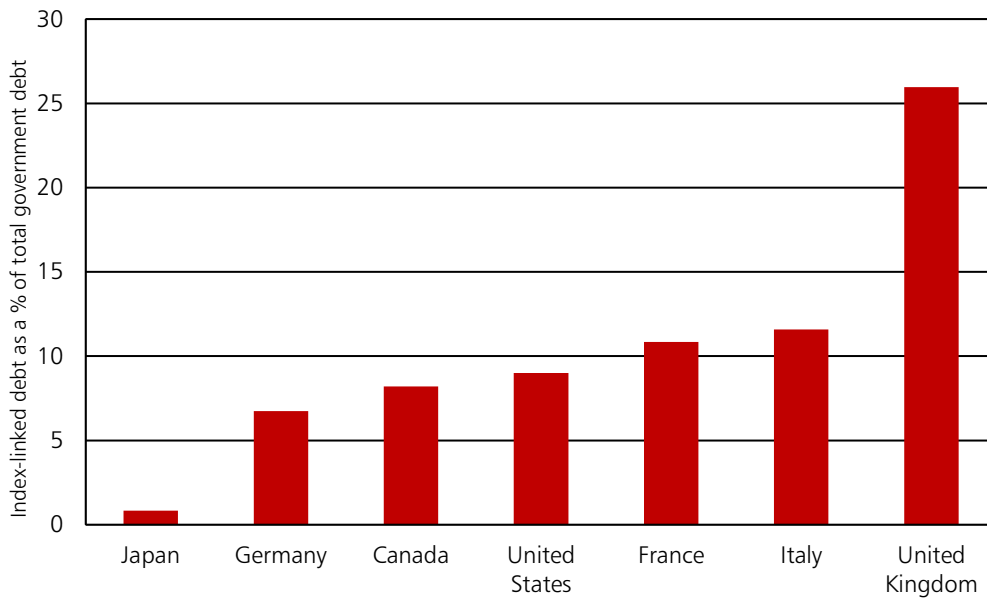


¹ The term 'nominal value' refers to the nominal amount of gilts in issue; the term 'nominal uplifted' refers to the nominal amount in issue multiplied by the known inflation uplift on the gilts to date.

Source: DMO.

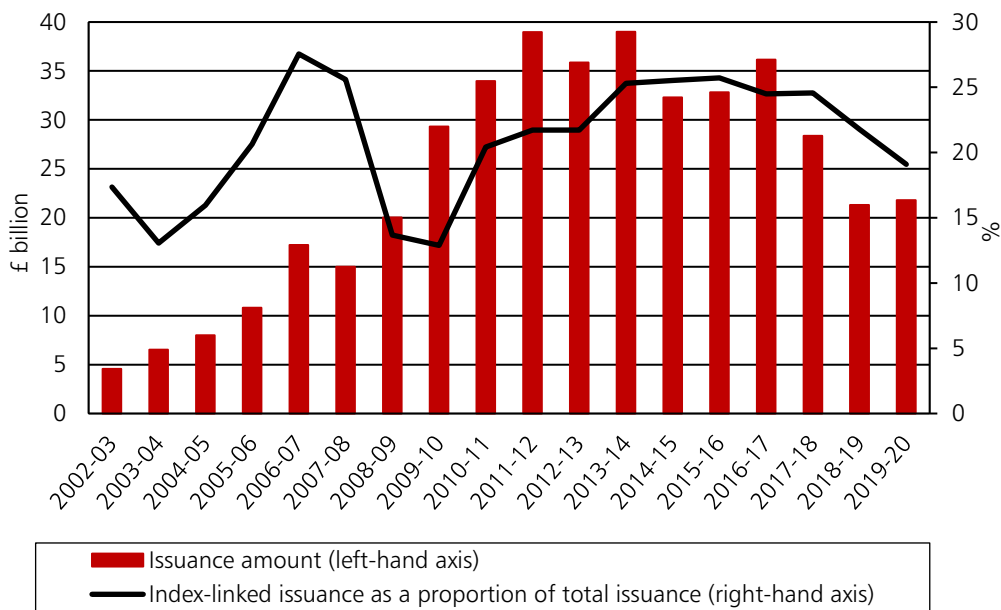
- A.12** The index-linked proportion of the UK's debt stock is considerably higher than in other G7 countries (Chart A.11), and is more than double that of Italy, the next closest G7 member. To some extent, this reflects the particular strength of demand for index-linked gilts in the UK, especially from institutional investors, such as domestic pension funds and insurance companies. This has built the UK's financial resilience through supporting the UK's long average debt maturity and diversifying the investor base.
- A.13** In the 4 years prior to 2018-19, around 25% of the government's annual debt issuance has been through index-linked gilts (Chart A.12), for which both the principal and interest payments are linked to the Retail Prices Index (RPI). As set out in Chapter 2, as part of the government's responsible approach to fiscal risk management, the government will look to reduce the proportion of index-linked gilt issuance in a measured fashion as a share of total issuance over the medium term. Consistent with this, the 2018-19 and 2019-20 financing remits include a 1 to 2 percentage point reduction in index-linked gilt issuance as a share of total issuance.

Chart A.11 International comparisons of index-linked government debt (2018)



Source: OECD Sovereign Borrowing Outlook 2018.

Chart A.12 Annual index-linked gilt issuance¹



¹ 2018-19 is the projection for the year. 2019-20 is the planned issuance, which is subject to change as the unallocated amount of gilts is distributed over the year. Data for both years comes from Chapter 3 in this Debt management report 2019-20.

Source: DMO.

Annex B

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

Introduction

- B.1 This annex provides the context for the government's decisions for the Debt Management Office's (DMO) gilt and Treasury bill issuance in 2019-20, setting out the qualitative and quantitative considerations that have influenced them.
- 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 (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. 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

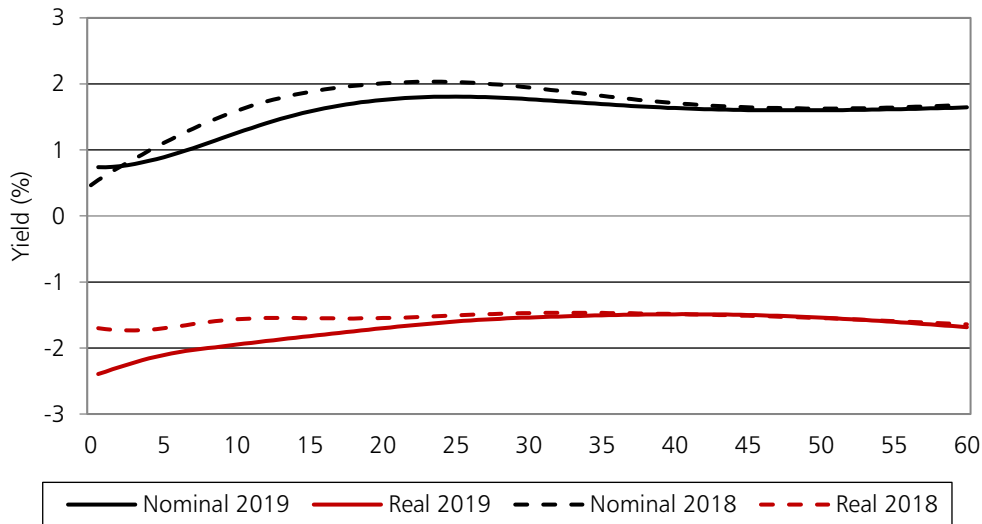
- B.5 Both Gilt-Edged Market Makers (GEMMs) and gilt investors have reported ongoing demand for conventional and index-linked gilts that is well diversified across the maturity spectrum and by investor type.
- B.6 At the annual consultation meetings in January 2019, attendees noted that the relative strength of demand has moved from the ultra-long area of the curve for all gilts to medium and long maturities for conventional gilts and long maturities for index-linked gilts.¹

¹ Minutes of the meetings are available at: www.dmo.gov.uk/media/15769/sa220119.pdf and www.dmo.gov.uk/media/15777/sa280119.pdf

Cost

- B.7** 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 31 January 2019 and 31 January 2018. Yield curves are little changed compared to last year. The wedge between real and nominal yields illustrates the continued cost-effectiveness of issuing gilts right across the yield curve.

Chart B.1 Nominal and real spot yield curves (31 January 2018 and 2019)



Source: DMO.

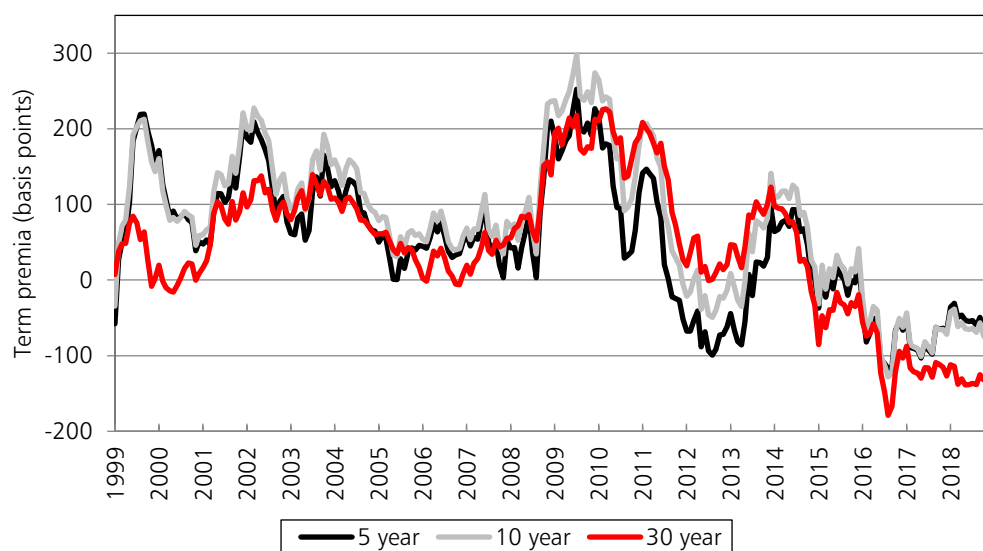
- B.8** Asset pricing theory suggests the observed yield on a bond can be decomposed into 2 components: a 'risk neutral' yield representing the implied forward path of short-term rates; and a risk premium to compensate holders for the longer-term maturity. The risk neutral yield is the interest rate under 'pure expectations'.² In practice, forward yields may follow a different path, as markets typically demand higher yields in order to protect investments against a variety of longer-term risks, which gives rise to a risk (or term) premium.³ The variability and trends in risk premia reflect investors' risk preferences over time. It is cost-effective for a government to issue at maturities where the risk (or term) premium demanded by investors is lowest relative to other maturities.
- B.9** Analysis of the risk (or term) premia in the nominal yield curve between January 1999 and January 2019 indicates the existence of time-varying

² The investor typically charges the issuer through yields for risks associated with investment in bonds. For example, the investor may charge a premium for illiquidity and/or inflation risk. The 'pure expectations' referred to here excludes these premia.

³ The risk premium 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 discount or premium owing to the different levels of liquidity in some bonds or maturities, which enhances or restricts investors' ability to hedge; and (iv) an inflation risk premium to compensate investors in nominal bonds for uncertainty owing 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.

premia in the conventional gilt market that are usually positive (Chart B.2).⁴ Further, as a general rule, the premia increases with maturity, although the premia at different maturities have recently been in a compressed range. In 2018-19, term premia remained close to historically low levels at all key benchmark maturities. This suggests that, on this measure, conventional gilts across the maturity spectrum are more cost-effective than has historically been the case.

Chart B.2 Term premia in the conventional gilt market



Source: DMO.

- B.10** Alongside this analysis of the relative cost-effectiveness of conventional gilts across different maturity sectors, the government undertakes an evaluation of the cost-effectiveness of index-linked gilts. It compares long-run historic inflation with market-implied breakeven inflation rates to assess the cost-effectiveness of inflation-linked gilt issuance relative to conventional gilts.⁵
- B.11** Similar to nominal yields, real gilt yields can be decomposed into 3 components: the nominal gilt yield; an expected inflation rate; and a premium (or discount) for affording investors inflation protection. These last 2 components constitute the 'breakeven inflation rate' which represents the market-implied average rate of inflation over the life of the bond. For illustrative purposes, if the long-run historical average inflation rate is assumed to remain at 3%, then a breakeven inflation rate of 3.25% suggests investors are paying a premium of 25 basis points to hold an index-linked bond over conventional gilts. The government benefits from the premium but takes the risk that future inflation – in terms of the Retail Prices Index (RPI) – might be higher than 3.25%, on average. Therefore, for investors this risk premium is a combination of 'protection' against a sustained rise in RPI

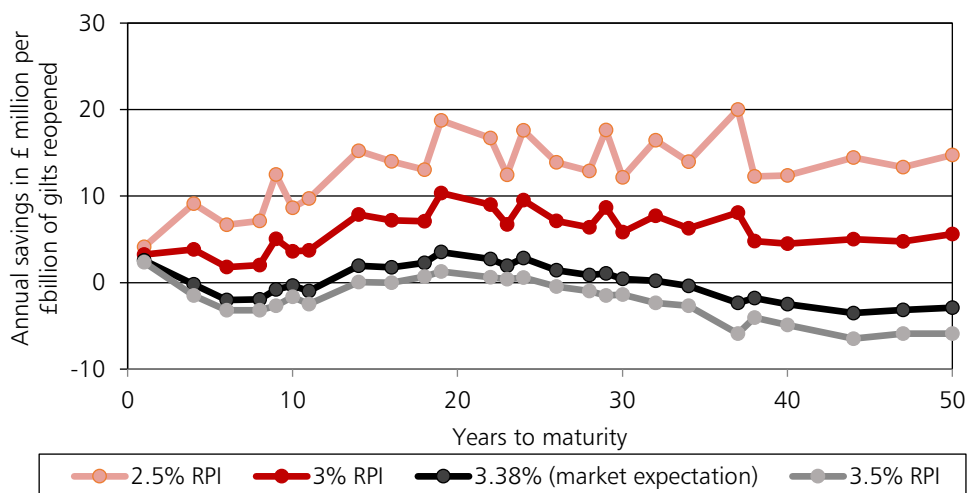
⁴ This analysis is based on academic research: 'The Affine Arbitrage-Free Class of Nelson-Siegel Term Structure Models', Christensen, Diebold and Rudebusch, *Journal of Econometrics*, 2011.

⁵ A more detailed explanation of the methodology used in this analysis can be found at: www.oecd-ilibrary.org/finance-and-investment/assessing-the-cost-effectiveness-of-index-linked-bond-issuance_5k481881kjwh-en and www.bankofengland.co.uk/working-paper/2015/the-informational-content-of-market-based-measures-of-inflation-expectations-derived-from

inflation above 3.25%, factors such as liquidity and the product of an imbalance of demand and supply.

- B.12 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 2 strategies are cost-equivalent if future realised inflation turns out to be equal to the level implied in the breakeven inflation rate at issue.
- B.13 When considering the split of issuance between index-linked and conventional gilts, the government takes into account cost-effectiveness. At end-January 2019, the DMO's model shows that for an assumption that RPI remains constant at 3% over the life of the bond, index-linked gilts offer better value to the government than equivalent maturity conventional gilts across the maturity structure (as shown in Chart B.3).

Chart B.3 The cost-effectiveness of index-linked gilts under different RPI assumptions (end-January 2019)¹



¹ Current in the RPI 3.3.8% line is based on the breakeven inflation rate as of January 2019, which is the difference between the yield of a nominal bond and an inflation-linked bond of the same maturity.

Source: DMO.

Risk

- B.14 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.15 The government places a high weight on minimising near-term exposure to refinancing risk. This exposure is managed partly by maintaining a sizeable proportion of long-dated debt in the portfolio, which reduces the need to refinance debt frequently. The government places importance on avoiding, when practicable, 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.16** As part of the government's responsible approach to fiscal risk management – and as set out at Budget 2018 – the government will look to reduce the proportion of index-linked gilt issuance in a measured fashion as a share of total issuance over the medium term, in line with the 1 to 2 percentage point reduction planned in 2018-19.⁶ Decisions on precise levels of index-linked and conventional gilt issuance will continue to be taken as part of the annual financing remit and in consultation with market participants. Consistent with this, the 2019-20 financing remit includes a 2 percentage point reduction in index-linked gilt issuance compared to that planned at the start of the previous year.
- B.17** Prudent debt management is also served by promoting sustainable market access, which the remit is designed to support. The government places significant importance on encouraging 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** 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. 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, accrued over the life of each bond, measured in terms of the relevant yield. 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.
- B.21** As in previous years the exercise has been carried out over a 15-year horizon, close to the average maturity of the gilt portfolio, and therefore captures a rollover of approximately half of it. The metrics resulting from this analysis combine the impact from alternative issuance strategies for financing new government debt (to meet the central government net cash requirement and the refinancing of redemptions) with the existing characteristics of the debt portfolio inherited from previous financial years.

⁶ The 2018-19 financing remit planned to issue 21.1% of total issuance via index-linked gilts. On the basis of the updated financing arithmetic set out in this document, index-linked gilts are expected to account for 21.7% of total issuance at the end of 2018-19. This compares to 23.1%, which was the index-linked share of total gilts planned for issuance in the 2017-18 financing remit.

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 two alternative distribution assumptions for simulating the yield curve, to depict risk in cost terms. In this way, the PST maps the projected yield curve distributions to a debt interest cost distribution so that simulated cost and risk metrics can be analysed.

B.23 In undertaking this analysis for consideration of the 2019-20 financing remit, the 2018-19 issuance skew planned at the start of 2018-19 was used, which was well diversified across maturity ranges (see Table B.1).

Table B.1: Gilt issuance strategy composition for 2018-19 (%)¹

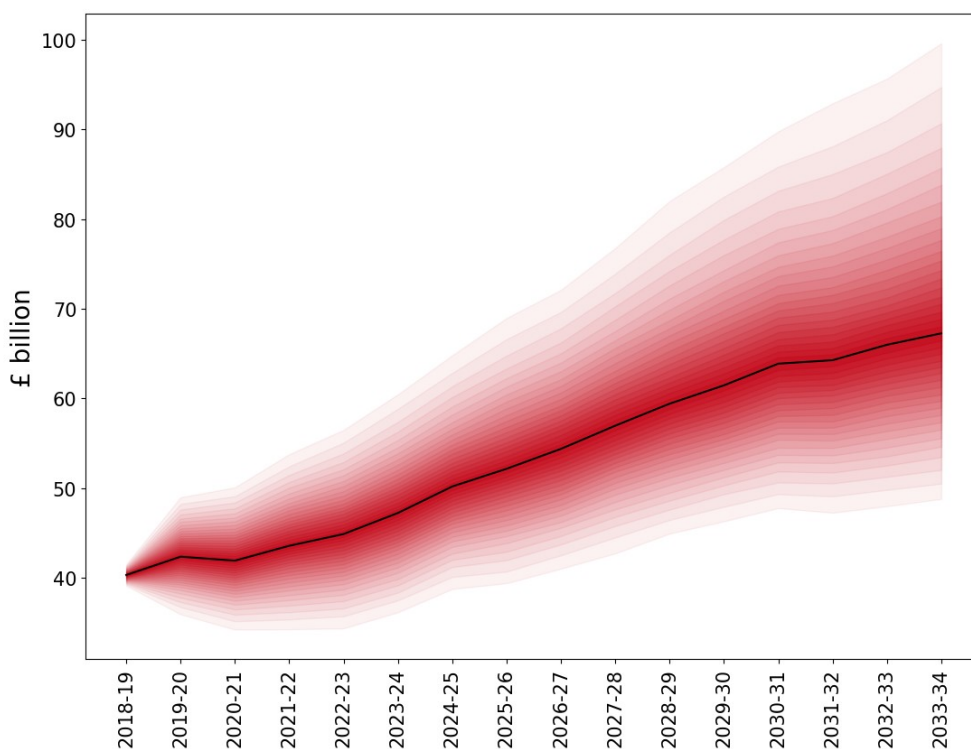
	Short conventional	Medium conventional	Long conventional	Index-linked	Unallocated
Issuance skew for 2018-19	24.2	19.7	28.5	21.1	6.4

¹ Figures may not sum due to rounding. Maturities are defined as follows: short (1-7 years), medium (7-15 years), and long (over 15 years).

Source: *Debt management report 2018-19*.

B.24 The resulting probability distributions of debt interest costs (if issuance continued to follow the current issuance maturity skew for the next 15 years) is shown in Chart B.4. It is worth noting that the projected yields are not in line with current market expectations. This supports the view that there are currently negative risk premia priced in to the gilt yield curve.

Chart B.4 Probability distribution of debt service costs (normal distribution)¹



¹ This is net of the Bank of England’s Asset Purchase Facility.

Source: *DMO*.

- 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 has 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. 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 each. 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 10% top and bottom 'tails' of the distribution) that debt interest costs will be between £52 billion and £88 billion, with a median value of around £66 billion.
- B.26** It is important to note that the debt interest simulations in Chart B.4 reflect the combination of simulated future yields and projected debt issuance together with the unfolding of existing portfolio dynamics. As a consequence, debt interest appears to pick up in the latter part of the horizon. This reflects the redemption profile of the debt portfolio, with a higher volume of redemptions that will mature and be refinanced at new interest rates, among other factors. Given the long average maturity of the UK's debt, which creates 'stickiness' in the evolution of the portfolio,⁷ any impact from debt issuance is slow to take effect. In the 2018-19 issuance skew example, only about half of the entire debt interest cost bill would have been refinanced at new yield levels after 15 years.

Gilt distribution

- B.27** Auctions will remain the primary method of issuance.
- B.28** Any type and maturity of gilt can be sold through syndication and the DMO will announce on a quarterly basis its planned syndication programme, which may include short and medium conventional gilt issuance if judged appropriate by the DMO. However, the DMO's current planning assumption is that the syndication programme in 2019-20 will be used to launch new long conventional and index-linked gilts and/or for re-openings of high duration gilts.
- B.29** Reflecting the larger financing requirement in 2019-20 relative to 2018-19, the government's initial planning assumption is that it will hold 5 syndicated offerings in 2019-20.
- B.30** Gilt tenders may be used in 2019-20 to issue any type and maturity of gilts. Further details are set out in the DMO's 2019-20 financing remit announcement.
- B.31** The government remains committed to the GEMM model to distribute gilts through auctions, syndications and tenders and the government recognises

⁷ Owing to the maturity structure and outstanding size of the debt portfolio, any change in issuance takes a long time to affect its composition.

that GEMMs play an important role in helping to facilitate liquidity in the secondary market.

Gilt issuance by maturity and type in 2019-20

- B.32** 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.33** Continuing demand for short conventional gilts is anticipated, in particular, due to redemption reinvestment flows. The government places a relatively high weight on managing its near-term exposure to refinancing risk which has also influenced its decision on the amount of short-dated conventional gilts to be issued.
- B.34** 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. Market feedback suggests that demand for medium conventional gilts may be relatively stronger in 2019-20 compared to other maturities.
- B.35** Market feedback suggests ongoing demand exists for long 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.36** For conventional gilts, the term premia analysis suggests that issuance across the maturity spectrum is more cost-effective than has historically been the case. Under market-implied inflation expectations, index-linked gilts are expected to be more cost-effective to issue than equivalent maturity conventional gilts at all maturities. As set out in Chapter 2 and above, as part of the government's responsible approach to fiscal risk management, the 2019-20 financing remit includes a 2 percentage point reduction in index-linked gilt issuance compared to that planned at the start of the previous year.
- B.37** A similar portion of issuance will be held in an initially unallocated form in 2019-20 compared with 2018-19. The main purpose of the unallocated portion of issuance is to give increased flexibility to the DMO to issue any type or maturity of gilt by any issuance method, while remaining consistent with the principles of openness, predictability and transparency.

Treasury bill issuance in 2019-20

- B.38** Treasury bills are used for both debt and cash management purposes. With regard 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.39 The government does not target a planned end-year Treasury bill stock. Information on the outstanding stock of Treasury bills will continue to be published monthly in arrears on the DMO's website.⁸
- B.40 It is expected that the net contribution from Treasury bills to debt financing in 2019-20 will be £4.0 billion.

⁸ www.dmo.gov.uk/data/treasury-bills

Annex C

NS&I's financing remit for 2019-20

Introduction

- C.1 This annex sets out information on the activities of NS&I in 2018-19 and 2019-20. 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 2019-20.
- 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 2018-19

- C.3 NS&I's contribution to financing in 2018-19 is projected to be £11.0 billion with gross inflows (including reinvestments and gross accrued interest) of approximately £38.6 billion. This is within NS&I's revised 2018-19 target range of £6.0 billion to £12.0 billion, set at Budget 2018.¹ Table C.1 shows changes in NS&I's product stock during 2018-19.

Table C.1: Changes in NS&I's product stock in 2018-19 (£ billion)

	End-March 2018	End-March 2019 ¹
Variable rate	112.6	123.0
Fixed rate	24.2	25.0
Index-linked	19.9	19.7
Total	156.7	167.7

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).² These comparator rates have continued to be at or close to historic lows over the course of the year. On this basis, NS&I projects a Value

¹ 'Budget 2018', HM Treasury, October 2018.

² Further detail on the Value Indicator is available in NS&I's Annual Report and Accounts, which can be found here: www.nsandi-corporate.com/performance/historic-annual-reports

Indicator return of £6.0 million in 2018-19. This is lower than the target £125.0 million set by HM Treasury at Spring Statement 2018, but above the 'floor' Value Indicator of £0.³

Table C.2: Calculator of Value Indicator

	Value Indicator
<i>Equals</i>	Comparator cost to the government ¹
<i>Less</i>	Interest and prizes earned by investors in NS&I's products ²
<i>Less</i>	Management costs of NS&I products (net of the equivalent of the Debt Management Office's costs and leveraging revenue)
<i>Less</i>	Tax foregone on NS&I's total stock of 'tax-free' products

¹ This 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. Some adjustments and assumptions are made to the calculation, including in identifying and applying an equivalent gilt, in response to specific NS&I product issues.

² This does not include costs arising from policy products, which are reported separately by HM Treasury. Policy products are issued from time to time by NS&I at the request of HM Treasury in order to support particular policy objectives.

Source: NS&I.

Volume of financing in 2019-20

- C.5** Gross inflows (including reinvestments and gross accrued interest) of NS&I's products are projected to be around £37.7 billion in 2019-20. After allowing for expected maturities and withdrawals, NS&I will have a 2019-20 Net Financing target of £11.0 billion, within a range of £8.0 billion to £14.0 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 target Value Indicator for 2019-20 is £20.0 million, with a floor of £0.
- C.7** Further details of NS&I's activities in 2018-19 and 2019-20 will be included in its 2018-19 Annual Report and Accounts, which is scheduled to be laid in Parliament in 2019 and will be available in print form and at www.nsandi.com.

³ 'NS&I Annual Report and Accounts and Product Accounts 2017-18', NS&I, June 2018.

Annex D

The Exchequer cash management remit for 2019-20

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 Debt Management Office (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; 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 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 4 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.

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 within 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

¹ The 4 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 Annual Review 2004-05', which is available at: www.dmo.gov.uk/media/14483/gar0405.pdf

- conflict with the operational requirements of the Bank of England for monetary policy implementation

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, are set out in the DMO's Exchequer cash management Operational Notice.²
- D.7 Treasury bills may be used for both cash and debt management purposes. In relation to the latter, any positive or negative net contribution to the government's debt financing plans that is attributable to changes in the stock of Treasury bills is set out in the financing arithmetic table (Table 3.A).
- D.8 For cash management, the DMO uses Treasury bills to help manage fluctuations in the government's cash flow profile throughout the year and does so by varying the amount raised through Treasury bills by reference to the forecast net cash position. In order to provide flexibility for the DMO to use Treasury bills across the financial year-end for cash management, no end-year target stock of Treasury bills is set. Information on the total stock of Treasury bills is published monthly on the DMO's website.³
- 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 Treasury bill tender(s) and deposit the proceeds with the Bank of England, remunerated at the weighted average yield(s) of the respective tenders. The amount being offered to accommodate the Bank of England'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 of England 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 Gilts and/or Treasury bills may be issued to the DMO to help in the efficient execution of its cash management operations. The amounts will be chosen to have a negligible effect on any relevant indices. This will normally be on the third Tuesday of April, July and October 2019 and January 2020. 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 2 full working days in advance of the creation date. If no

² 'Exchequer cash management in the United Kingdom: Cash Management Operational Notice & UK Treasury Bills Information Memorandum', Debt Management Office, November 2018.

³ www.dmo.gov.uk/data/treasury-bills

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 gilt and Treasury bill collateral at other times. 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. 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.⁴

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 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.⁵

⁴ More information about the Discount Window Facility can be found on the relevant section of the Bank of England's website at: www.bankofengland.co.uk/markets/the-sterling-monetary-framework

⁵ For the latest report see Annex B of the 'DMO Annual Review 2017-18', Debt Management Office, August 2018. This is available at: www.dmo.gov.uk/media/15622/gar1718.pdf

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This document can be downloaded from
www.gov.uk

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