



HM Treasury

Debt management report 2020-21

March 2020



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2020-21

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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 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
- 1.3 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 2020-21 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

Introduction

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 are outlined in the Budget 2020 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.

¹ ‘Budget 2020’, HM Treasury, March 2020.

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.

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 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 2020-21 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

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

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
- 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 in full.
- 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 the 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

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

⁵ The funding rule (to fund fully the public sector borrowing requirement, maturing debt and any foreign currency reserves) was originally 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

- the difference between the projected net contribution to financing by NS&I and its outturn
 - auction proceeds in the period following the Budget that are different from those required to meet relevant financing targets
 - the implementation of the syndication programme at year-end
- 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, which are 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. Consistent with the long-term focus of the debt management objective, the government takes decisions annually 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 £443 billion at the end of 2019, making up 28% of the government's debt portfolio (Chart A.10).⁶
- 2.21 Issuing index-linked gilts has historically brought cost advantages for the government due to strong investor demand, and has built the UK's financial resilience by supporting both 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 report⁸ 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 At Budget 2018 – and as part of the government's responsible approach to fiscal risk management – the government announced that it would look to reduce the proportion of index-linked gilt issuance in a measured fashion as a means of reducing its inflation exposure in the debt portfolio.
- 2.24 In the five years prior to 2018-19, index-linked gilts accounted for around 25% of the government's annual debt issuance (see Chart A.11), for which both the principal and coupon payments are linked to the Retail Prices Index (RPI). More recently, and as a result of the government's responsible approach to fiscal risk management, this figure has been reduced. Consistent with this approach, the 2020-21 financing remit includes a 5.9 percentage point reduction in index-linked gilt issuance compared to 2019-20.
- 2.25 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.⁹ In response to this, and alongside the Budget, the government and the UK Statistics Authority (UKSA) are launching a consultation, announced on 4 September 2019,¹⁰ on UKSA's proposal to address the shortcomings of the RPI measure of inflation. The consultation will be open for responses for a period of six weeks, closing on 22 April. The government and UKSA will respond to the consultation before the Parliamentary summer recess.

Sovereign Sukuk

- 2.26 In June 2019 the government announced its intention to issue new UK sovereign Sukuk (financial certificates, similar to bonds, but which comply

⁶ In nominal uplifted terms. It does not include gilts held by the Bank of England's Asset Purchase Facility.

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

⁸ 'Managing fiscal risks', HM Treasury, July 2018.

⁹ 'Measuring Inflation', House of Lords Economic Affairs Committee, HL Paper 246, January 2019.

¹⁰ 'Letter from Sajid Javid, former Chancellor of the Exchequer', HM Treasury, January 2020.

with the principles of Islamic finance). The government subsequently announced that the new Sukuk will take an al-Ijara structure and be denominated in pounds sterling. Issuance is planned in 2020.

- 2.27 As with the first-issue in 2014, new sovereign Sukuk will not be part of the government's normal debt management policy, but are instead intended to deliver wider benefits, including reinforcing London's status as the leading centre for Islamic finance outside the Islamic world, supporting greater financial inclusion in the UK and promoting greater trade and investment into the UK.

Borrowing by devolved administrations

- 2.28 The Scottish and Welsh governments and the 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. The Northern Ireland Executive's borrowing powers were updated in the Northern Ireland (Miscellaneous Provisions) Act 2006.
- 2.29 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.
- 2.30 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 has short-term resource borrowing powers to assist cashflow management in the Northern Ireland Consolidated Fund.

Borrowing by local authorities

- 2.31 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.
- 2.32 Local authority capital financing decisions are subject to prudential guidance published by the Chartered Institute of Public Finance and Accountancy (CIPFA), the Ministry of Housing, Communities & Local Government (MHCLG), the Scottish Government, and the Welsh Government. Taken together, these documents form the prudential framework. Following consultation in 2017, MHCLG and CIPFA have updated their respective

elements of the framework.¹¹ 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

2.33 Local authorities undertake the bulk of their borrowing via the Public Works Loan Board (PWLB). On 24 February 2020 a governance change was implemented by Statutory Instrument whereby the relevant borrowing powers vested in the former PWLB Commissioners were transferred to HM Treasury.

2.34 At Budget 2020 the government cut the interest rate on new PWLB loans for social housing and offered over £1 billion of discounted lending for high-value local infrastructure projects. Alongside this, the government launched a consultation on a proposal to focus PWLB loans on service delivery, housing, and regeneration, and ensure that this money is not diverted into financial investments that serve no direct policy purpose. Once a workable system is designed and implemented, the government intends to cut the interest on all new loans from the PWLB.

¹¹ ‘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.

Chapter 3

The Debt Management Office's financing remit for 2020-21

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 Ltd, Bradford & Bingley and Network Rail) (CGNCR (ex NRAM, B&B and NR)) in 2020-21 is £65.3 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 2020 ‘Economic and fiscal outlook’. The OBR’s forecast does not incorporate either the most recent estimate of the likely fiscal impact of Covid-19 or the government’s policy response. The government’s financing plans for 2020-21 will be updated to reflect this at a later date.
- 3.3 The forecast NFR in 2020-21 of £156.1 billion also reflects: projected gilt redemptions of £97.6 billion; and a planned short-term financing adjustment of -£0.8 billion resulting from unanticipated over funding in 2019-20.
- 3.4 Proceeds from NS&I are expected to make a £6 billion net contribution to financing in 2020-21, following a forecast net contribution of £10.1 billion in 2019-20. The projection for 2020-21 assumes gross inflows of £34 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 2020-21, the NFR will be met entirely by gross gilt issuance of £156.1 billion. Net issuance of Treasury bills for debt financing purposes will be zero, (i.e. it is planned that the stock of Treasury bills in issue for debt financing purposes at end-March 2021 will remain at £62.0 billion).
- 3.7 Table 3.A sets out details of the financing arithmetic for 2019-20 and 2020-21.

Table 3.A: Financing arithmetic in 2019-20 and 2020-21 (£ billion)¹

	2019-20	2020-21
CGNCR (ex NRAM, B&B and NR) ²	43.1	65.3
Gilt redemptions	98.9	97.6
Redemption of the sovereign Sukuk	0.2	N/A
Planned financing for the Official Reserves	6.0	0.0
Financing adjustment carried forward from previous financial years	4.0	-0.8
Gross financing requirement	152.2	162.1
<i>less:</i>		
NS&I net financing	10.1	6.0
Other financing ³	0.0	0.0
Net financing requirement (NFR) for the Debt Management Office (DMO)	142.1	156.1
DMO's NFR will be financed through:		
Gilt sales, through sales of:		
Short conventional gilts	42.8	51.0
Medium conventional gilts	34.0	34.2
Long conventional gilts	36.9	42.3
Index-linked gilts	23.1	20.6
Unallocated amount of gilts	0.0	8.0
Total gilt sales for debt financing	136.9	156.1
Total net contribution of Treasury bills for debt financing	6.0	0.0
Total financing	142.9	156.1
DMO net cash position	1.3	0.5

¹ Figures may not sum due to rounding.

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

³ Prior to the publication of the end-year outturn in April each year, this financing item will mainly comprise estimated revenue from coinage.

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 2020 is 0.4 billion.¹ No changes to the level of the Ways and Means Advance are planned in 2020-21.

¹ This is in line with the decision set out in 'Debt and reserves management report 2008-09', HM Treasury, March 2008.

3.9 The projected level of the DMO's net cash balance at 31 March 2020 is £1.3 billion, £0.8 billion above the level projected at Spring Statement 2019. The level will be reduced to £0.5 billion during 2020-21, as shown by the planned short-term financing adjustment, and this will in turn reduce the NFR in 2020-21.

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 2020-21 financing remit announcement.

3.11 The government plans gilt sales via auction of £124.1 billion (or 79.5% of total issuance) which will be split by maturity² and type as follows:

- £51.0 billion of short conventional gilts (32.7% of total issuance)
- £34.2 billion of medium conventional gilts (21.9% of total issuance)
- £26.3 billion of long conventional gilts (16.8% of total issuance)
- £12.6 billion of index-linked gilts (8.1% of total issuance)

3.12 The government is also currently planning to sell up to approximately £24 billion of gilts (15.4% 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 £8.0 billion (5.1% 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 Gilt sales from either the syndication or auction programmes at any maturity sector may vary from a broadly even-flow delivery during the financial year. Proceeds raised following the final transaction of each syndication programme may also vary from the planned total for each programme. Any variations of this nature may lead to a minor adjustment to the type and maturity of gilts sold via any issuance method towards the end of the financial year.

3.17 Through its gilt issuance programme, the government aims at regular issuance across the maturity spectrum throughout the financial year and at

² 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.

- 3.18** The current planning assumption for gilt issuance in 2020-21 by type, maturity and issuance method is shown in Table 3.B.

Table 3.B: Breakdown of currently planned gilt issuance in 2020-21 by type, maturity and issuance method (£ billion and % of total)¹.

	Auction	Syndication	Gilt tender	Unallocated	Total
Short	51.0	-	-	-	51.0 (32.7%)
Medium	34.2	-	-	-	34.2 (21.9%)
Long	26.3	16.0	-	-	42.3 (27.1%)
Index-linked	12.6	8.0	-	-	20.6 (13.2%)
Unallocated	-	-	-	8.0	8.0 (5.1%)
Total	124.1 (79.5%)	24.0 (15.4%)	-	8.0 (5.1%)	156.1

¹ Figures may not sum due to rounding.

Source: DMO.

Gilt auction calendar

- 3.19** 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 this alongside the publication of the auction calendar.

Post-Auction Option Facility

- 3.20** In 2020-21, 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.³

The Standing Repo Facility

- 3.21** 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 2018.⁴ Any such gilts

³ ‘Official Operations in the Gilt Market: An Operational Notice’, DMO, August 2019

⁴ <https://www.dmo.gov.uk/media/15597/repotc020818.pdf>

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

Other operations

- 3.22 The DMO has no current plans for a programme of reverse or switch auctions or conversion offers in 2020-21.

Coupons

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

Purchases of short maturity debt

- 3.24 The DMO may buy in gilts close to their final maturity date to help manage Exchequer cash flows.

Treasury bill issuance

- 3.25 It is currently planned that Treasury bill issuance for debt financing purposes will make a zero net contribution to debt financing in 2020-21. The amount that Treasury bills have contributed to debt financing up to, and including, 2019-20 will be reported by the DMO shortly after the end of 2019-20.

New gilt instruments

- 3.26 There are no current plans to introduce new types of gilt instruments in 2020-21.

Revisions to the remit

- 3.27 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

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

Medium-term projections for annual financing requirements

- 3.29 The government has published projections for financing requirements in the fiscal forecast period. The financing requirements include the forecast path for GNCR (ex NRAM, B&B and NR) and the gilt redemption profile. Table 3.C sets out the financing requirement projections from 2019-20 to 2024-25.

Table 3.C: Financing requirement projections, 2019-20 to 2024-25 (£ billion)¹

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
CGNCR (ex NRAM, B&B and NR) ²	43.1	65.3	73.0	69.9	64.0	72.6
Redemptions ³	99.1	97.6	79.3	73.3	71.8	90.6
Official Financing for the Reserves	6.0	0.0	0.0	0.0	0.0	0.0
Financing adjustment carried forward from previous years	4.0	-0.8	0.0	0.0	0.0	0.0
Illustrative gross financing requirement	152.2	162.1	152.4	143.2	135.7	163.2

¹ Figures may not sum due to rounding.

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

³ Includes £0.2 billion for the redemption of the sovereign Sukuk in 2019-02

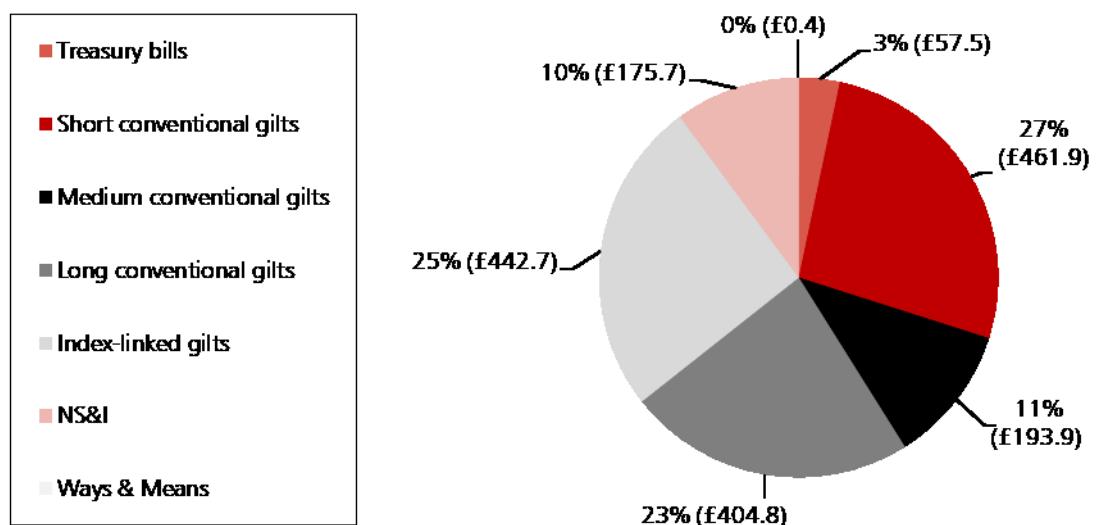
Source: DMO, HM Treasury and OBR.

Annex A

Debt portfolio

- A.1 The total nominal outstanding stock of central government sterling wholesale debt excluding official holdings by central government was £1,560.8 billion at end-December 2019.¹ 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 2019.² 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 2019)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), short (0-7 years), medium (7-15 years) and long (over 15 years). The maturity ranges defined here represent the residual maturities of the relevant instrument categories.

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

£ billion nominal value	End-December 2018	End-December 2019
Wholesale		
Conventional gilts	1,174.4	1,164.8
<i>Less government holdings</i>	109.7	104.2
	1,064.6	1,060.6
Index-linked gilts	325.8	333.3
<i>less government holdings</i>	3.7	3.7
<i>plus accrued inflation uplift</i>	104.2	113.1
	426.4	442.7
Treasury bills	71.8	108.2
<i>Less T-bills for cash management</i>	15.3	50.7
	56.5	57.5
Total wholesale debt	1,547.5	1,560.8
Retail		
NS&I	165.6	175.7
Other		
Balance on Ways and Means Advance	0.4	0.4
Sovereign Sukuk	0.2	-
Total central government sterling debt	1,713.7	1,736.9
Other government debt less liquid assets	69.7	82.0
Public sector net debt	1,783.4	1,818.9
Public sector net debt to GDP (%) ²	81.7%	80.8%
Statistics: Wholesale debt		
Wholesale debt to GDP (%) ²	70.9%	69.5%
Average time to maturity (years) ³	15.2 years	15.3 years
Debt maturing in one year (%) ⁴	10.5%	10.3%

¹ Figures may not sum due to rounding.

² GDP centred on end-December.

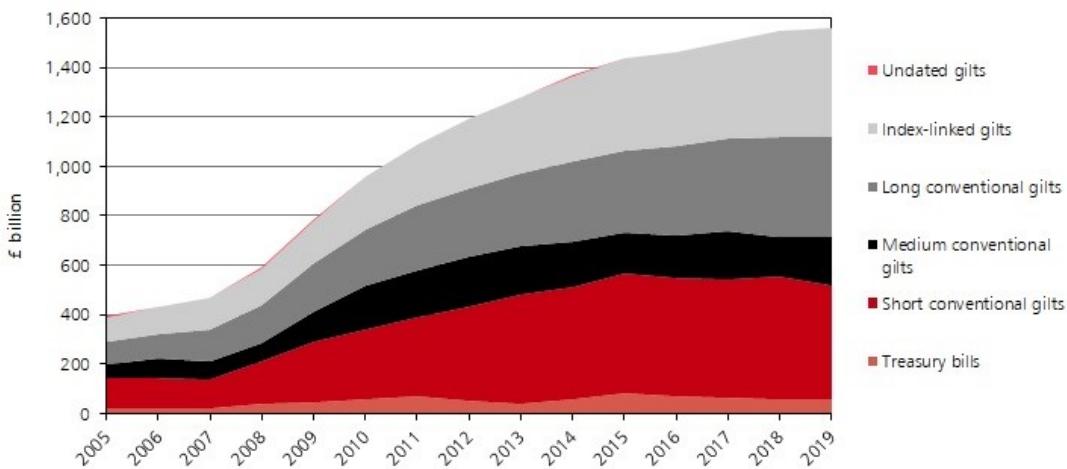
³ Calculated on a nominal weighted basis, excluding government holdings, including accrued inflation uplift.

⁴ T-bills for cash management are excluded from the calculation.

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 of the issuance of the different types of debt instrument in a given year has been relatively stable recently.

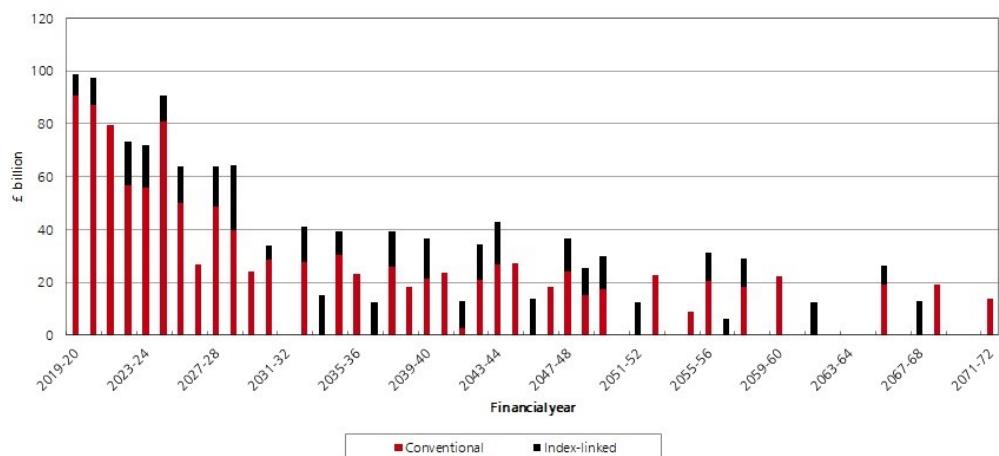
Chart A.2 Composition of central government wholesale debt stock (end-December values)



Source: DMO.

- A.4 Chart A.3 shows the government's gilt redemption profile as of 11 February 2020. 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 the 2071-72 fiscal year. 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 (February 2020)



Source: DMO.

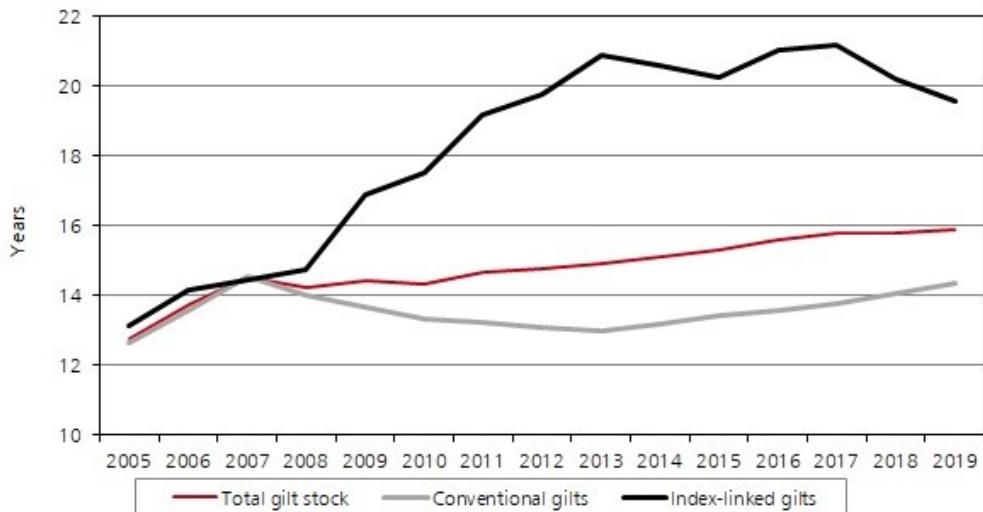
Maturity and duration of the debt stock

- A.5 By end-December 2019, the average maturity of the total stock of gilts was 15.9 years, as shown in Chart A.4. The average maturity of the stock of conventional gilts had risen from 14.0 years at end-2018 to 14.3 years at end-2019, with the average maturity of index-linked gilts falling from 20.2 years to 19.6 years. The average maturity of the government's wholesale

³ 'Press Notice: Syndicated launch of £6.0 billion nominal of 1.5% Treasury Gilt 2071: Result', Debt Management Office, May 2018.

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

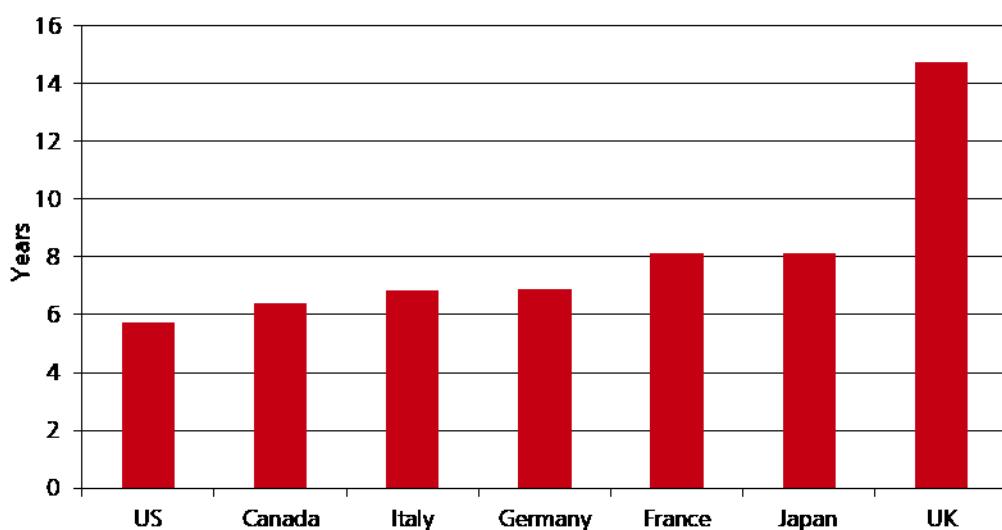
Chart A.4 Average maturity of UK gilt stock (end-December values)¹



¹ Calculated on a nominal weighted basis, including T-bills issued by tender.

Source: DMO.

Chart A.5 Average maturity of the debt stock by country (end-December 2019)¹

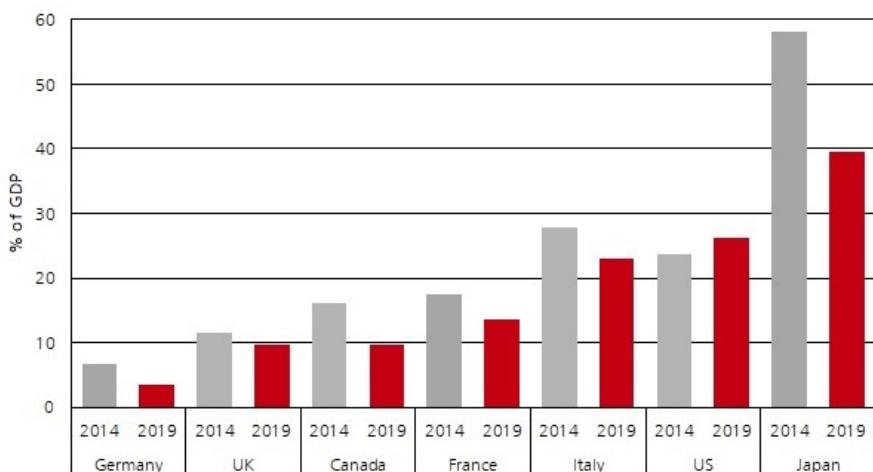


¹ Calculated on a nominal weighted basis, including T-bills issued by tender.

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 2019. This illustrates the supportive impact that the long average maturity of the UK's debt stock has on the UK's annual gross financing requirement, thereby lowering refinancing risk.

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

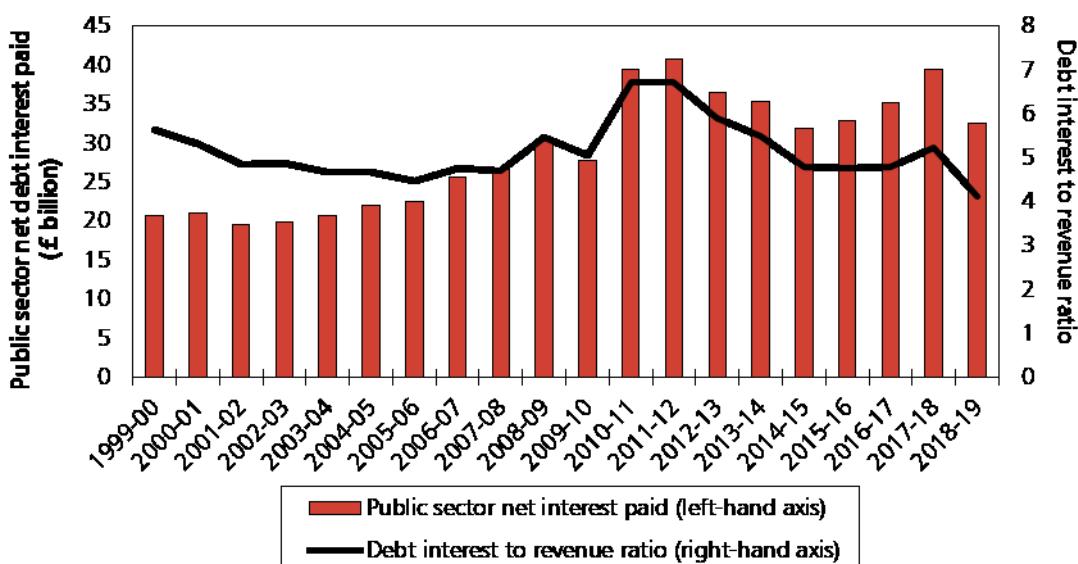


Source: IMF Fiscal Monitor October 2014 and October 2019 and Bloomberg L.P.

Debt interest

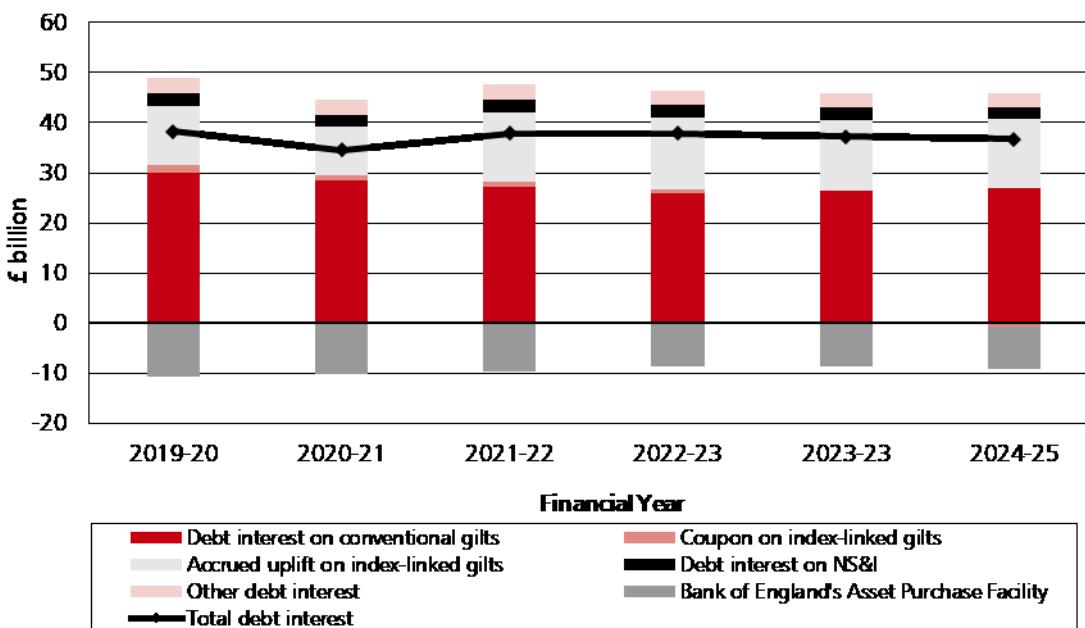
- A.7 Despite the annual gross financing requirement almost doubling since the start of the financial crisis, debt interest spending fell slightly in 2018-19, as shown in Chart A.7. This is due to both declining interest rates for new issuance and lower RPI inflation (which reduces accrued interest due on index-linked gilts). Moving forwards, while debt interest on conventional gilts is forecast to fall in nominal terms over the 5-year forecast period, this will be offset by an estimated increase in forecast inflation, leaving debt interest broadly stable over the period (Chart A.8).

Chart A.7 Net debt interest in £ billion and debt interest to revenue ratio



Source: ONS.

Chart A.8 Breakdown of debt interest forecast

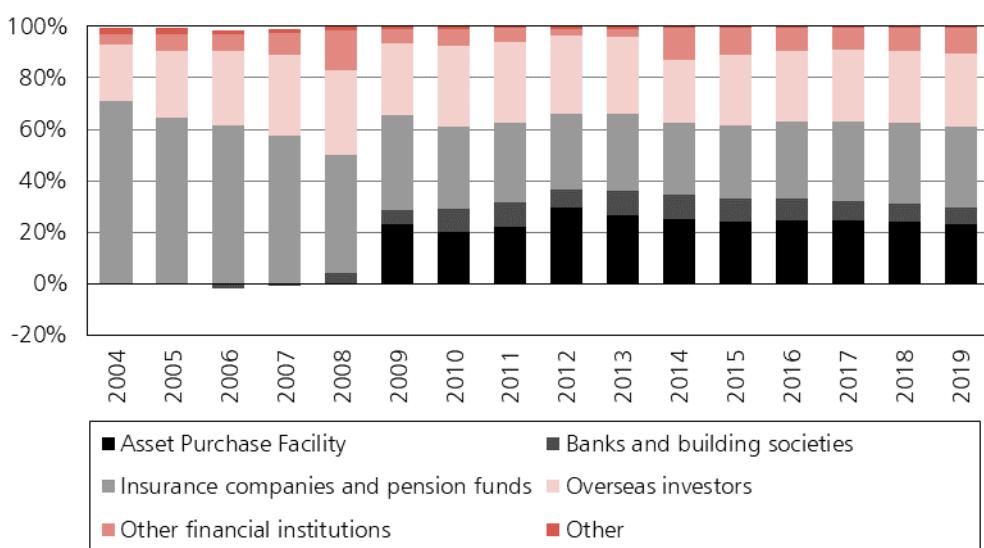


Source: OBR.

Gilt holdings by sector

- A.8 At end-September 2019, the 3 largest investor groups of gilt holdings continued to be insurance companies and pension funds (31.5%), overseas investors (28.5%), and the Bank of England's Asset Purchase Facility (23.0%), as shown in Chart A.9.

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



¹ All data are for end-December, except 2019 for which data are 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-September 2019, it stood at £497 billion. Domestic insurance companies and pension funds have frequently been the largest holders of gilts in aggregate, though the share of gilts held by overseas investors has increased over time to comprise a similar share of the investor base.

Gilt issuance

- A.10 The central government net cash requirement (excluding NRAM Ltd, Bradford & Bingley and Network Rail) (CGNCR (ex NRAM, B&B and NR)), gilt redemptions, and the volume of gilt sales for each financial year since 2008-09 are shown in Table A.2. In 2020-21, CGNCR (ex NRAM, B&B and NR) will be lower than gilt redemptions for the fourth 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
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	71.1	69.9	147.6
2017-18	40.7	79.5	115.5
2018-19	37.3	66.7	98.6
2019-20 ³	43.1	99.1 ⁴	136.9
2020-21 ³	65.3	97.6	156.1

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

² Figures are in cash terms.

³ Budget 2020 projections.

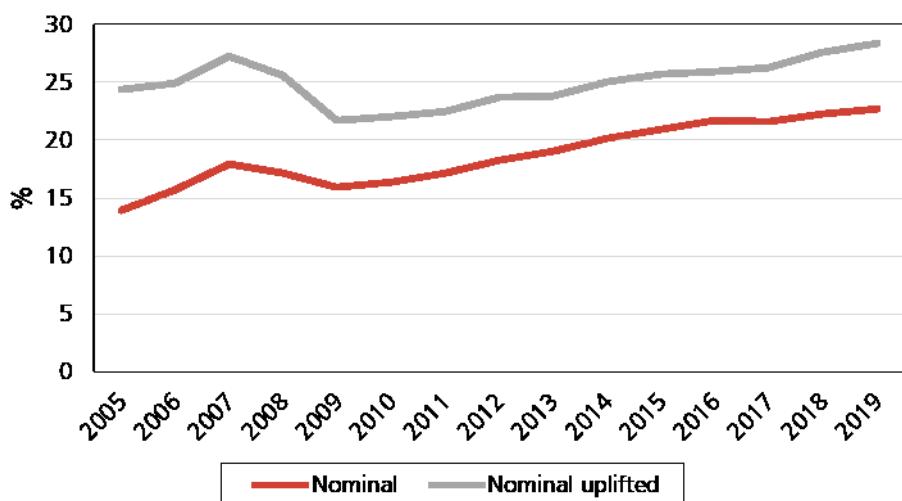
⁴ Includes £0.2 billion for the redemption of the 2014 sovereign Sukuk in 2019-20.

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 £443 billion in nominal uplifted terms at the end of 2019. Index-linked gilts make up 28% of the government's debt portfolio in nominal uplifted terms (Chart A.10).

Chart A.10 Proportion of index-linked gilts in the debt stock¹

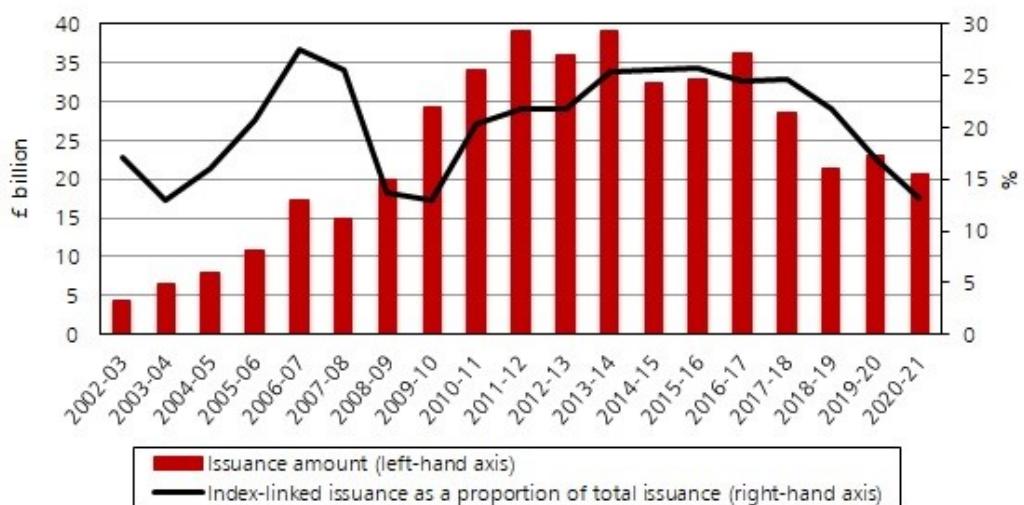


¹The term ‘nominal value’ refers to the nominal amount of gilts in issue; the term ‘nominal uplifted’ refers to the nominal amount in issue multiplied by the known inflation uplift on the gilts to date.

Source: DMO.

- A.12 In the five years prior to 2018-19, around 25% of the government’s annual debt issuance was through index-linked gilts (Chart A.11). As set out in Chapter 2, as part of the government’s responsible approach to fiscal risk management, the government announced at Budget 2018 that it would look to reduce the proportion of index-linked gilt issuance in a measured fashion as a means of reducing its inflation exposure in the debt portfolio. Consistent with this, financing remits in recent years have included a reduction in the proportion of index-linked gilt issuance.

Chart A.11 Annual index-linked gilt issuance¹



¹Data prior to 2019-20 are actual outturn data; for 2019-20 they are current estimated outturn. For 2020-21 (i) data are based on initial planned issuance, which is subject to change as the unallocated amount of gilts is distributed over the year, and (ii) no assumption is made about in-year transfers from the unallocated portion of issuance.

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 on gilt and Treasury bill issuance in 2020-21, 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 throughout the year).

Demand

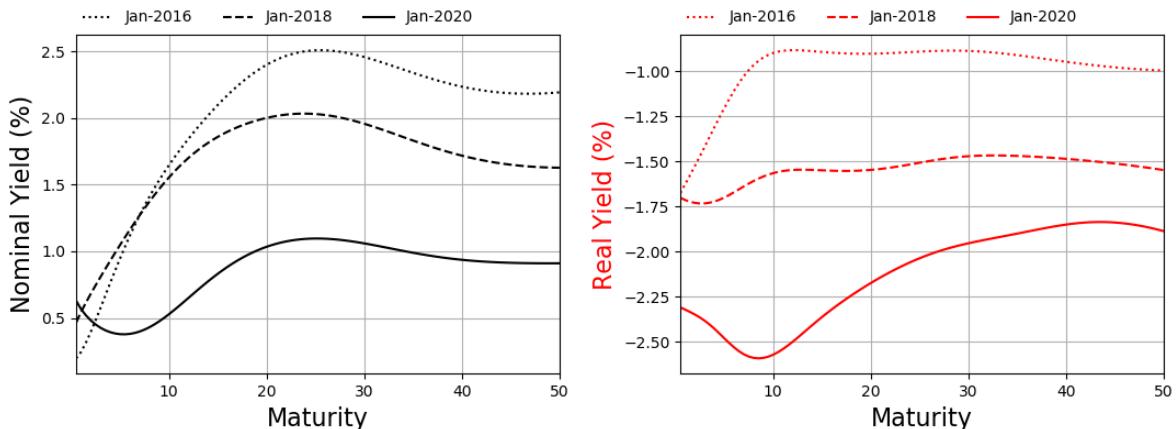
- B.5 Both Gilt-Edged Market Makers (GEMMs) and end-investors have reported ongoing demand for all instrument types. This includes demand for shorter-dated gilts, not least given the large redemptions in 2020-21; for medium gilts as a key liquidity point; and for duration in the form of long-dated conventional gilts. Ongoing demand has also been expressed for index-linked gilts, although market participants have indicated that there is likely to be continued uncertainty about the potential impact on the market arising from the government's and UK Statistics Authority's (UKSA's) consultation on RPI reform in the early part of the financial year.

Cost

- B.6 This section evaluates the relative cost effectiveness of different types of gilt issuance. Chart B.1 displays the shapes of the nominal and real spot yield curves as of end-January 2016, 2018 and 2020. Both nominal and real yield

curves have shifted downward over the years. The steepness of the curve has also been declining, especially for nominal gilts.

Chart B.1 Nominal and real spot yield curves (as of end-January 2016, 2018 and 2020)

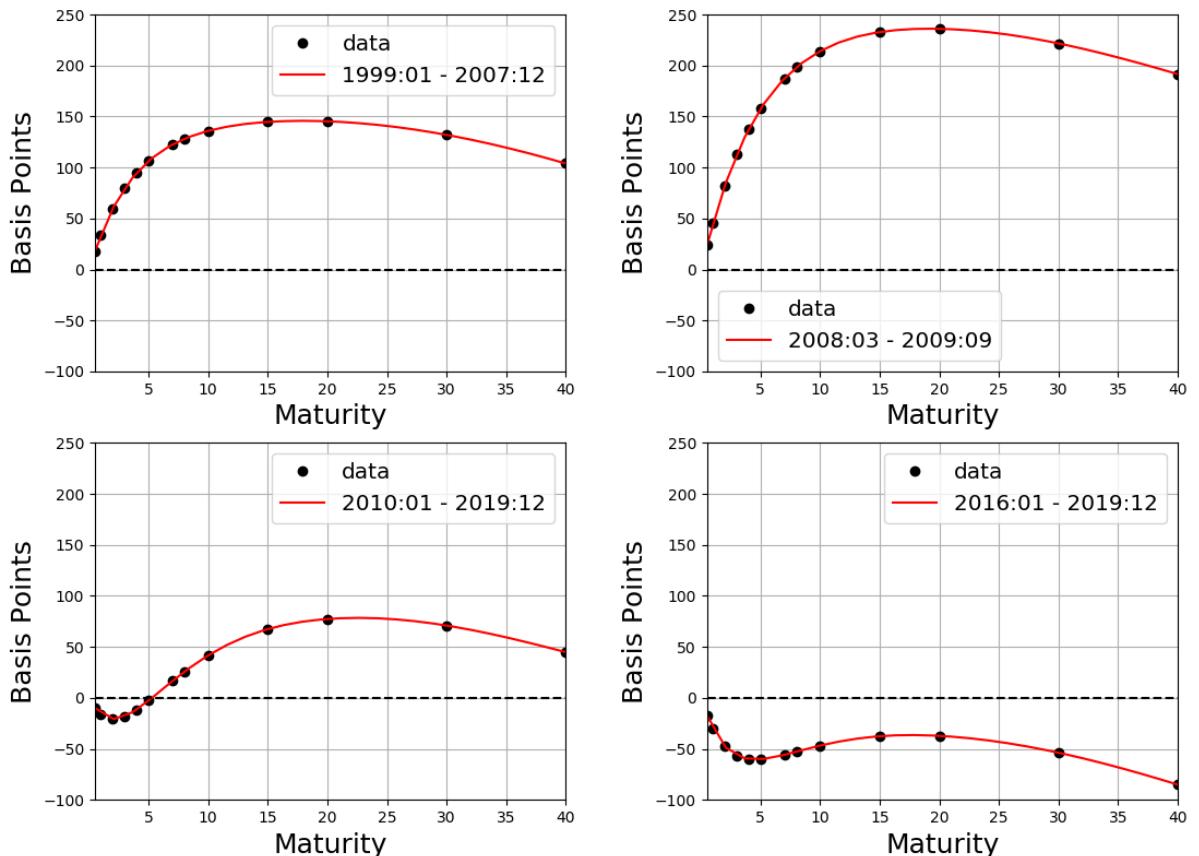


Source: DMO.

- B.7 Yields on long-term bonds can be decomposed into two components: a ‘risk neutral’ yield and a risk premium. The former corresponds to the average expected future short-term interest rates over the life of the bond. The latter is normally thought of as the additional return that risk-averse investors demand as compensation for the possibility of capital loss if a bond is sold before maturity and, in the case of conventional bonds, the risk of the bond value being eroded by inflation. The risk premium may also be determined by supply and demand imbalances for a specific instrument.¹ It is usually cost-effective for a government to issue at maturities where the risk premium demanded by investors is lowest relative to other maturities.
- B.8 Risk premia are typically maturity-specific and time-varying. Several factors contribute to the variation and trends in risk premia, among which are changes in investors’ risk preferences and expectations, and unanticipated macroeconomic shocks. Chart B.2 displays the term structure of risk premia, with each individual panel showing a selected time period. The top left panel is the period before the financial crisis when yields and risk premia were higher than today. Risk premia increased during the global financial crisis (top right panel). Since then there has been a steady decline and they are currently at historically low levels across all maturities (bottom right panel). This suggests that conventional gilts across the maturity spectrum are currently more cost-effective than has historically been the case.

¹ More generally, the risk premium can be decomposed into several components, including: (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.

Chart B.2 The term structure of risk premia in the UK conventional gilt market over selected sample periods²



Source: DMO.

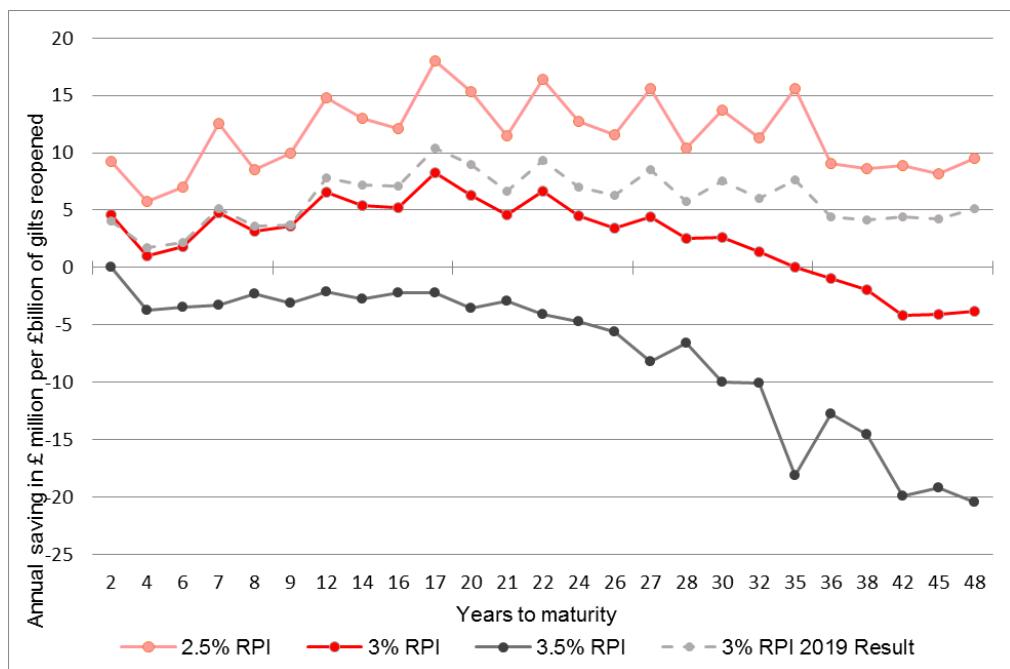
B.9 The government undertakes an evaluation of the relative cost-effectiveness of inflation-linked gilts ('ILGs'), in addition to its analysis of conventional gilts. ILGs differ from conventional gilts as both the principal and coupon payments are linked to the value of the Retail Prices Index ('RPI'). One motivation for issuing ILGs is that investors are willing to pay a premium for the protection from inflation that these securities provide.

B.10 The difference between the yield on a nominal and on an ILG of the same maturity is referred to as the breakeven inflation rate ('BEIR'). The BEIR can be seen as the rate of inflation at which investments in ILGs and conventional gilts would result in the same return. The BEIR can be decomposed into an expected inflation component and two additional factors: the additional premium investors are willing to pay for protection against inflation, and the discount they require for holding less liquid bonds. Consequently, one possible way to assess the cost-effectiveness of ILG issuance relative to conventional gilts is to compare actual inflation outturns with market-implied BEIRs. To illustrate, if we assume that the future average RPI rate is 3% (i.e. equal to the historical average) then a BEIR of 3.25% would suggest the investor is paying a premium of 25 basis points over conventional gilts. The government benefits from the premium but also

² Averages over selected time period of time-varying risk premia based on the AFNS model of Christensen, J. H., Diebold, F. X., & Rudebusch, G. D. (2011). The affine arbitrage-free class of Nelson–Siegel term structure models. *Journal of Econometrics*, 164(1), 4-20

bears the risk that future RPI inflation might be higher than 3.25% on average.

Chart B.3 The cost-effectiveness of index-linked gilts under different RPI assumptions (end-January 2020)



Source: DMO.

- B.11 Chart B.3 illustrates potential savings from ILG issuance under several RPI inflation scenarios.³ At end-January 2020, it shows that, under the assumption that the RPI remains constant at 3% over the life of the bond, ILGs offer better value to the government than equivalent maturity conventional gilts with an initial maturity of up to around 35 years. The expected cost-effectiveness of longer maturity ILGs has declined as BEIRs have fallen since 2019 (grey dotted line in Chart B.3).

Risk

- B.12 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.13 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

³ For a detailed description of the methodology used in this type of analyses, see Knight (2013). "Assessing the Cost Effectiveness of Index-linked Bond Issuance". OECD Working Papers on Sovereign Borrowing and Public Debt Management No.7.

achieve this, the government will issue debt across a range of maturities, smoothing the profile of gilt redemptions.

- B.14 The government is mindful of the long-term inflation exposure in the public finances and gives due consideration to ensuring inflation risk is prudently managed. The government will manage this exposure through its decisions on the appropriate balance between index-linked and conventional gilts in its debt issuance in the coming years.
- B.15 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 the development of 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.16 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.17 The analysis underpinning the government's decisions on its issuance strategy includes the evaluation of likely future paths of the yield curve and other macroeconomic variables. Evaluating possible future economic outcomes can be useful as a way to investigate the medium-term implications of likely issuance strategies in terms of debt interest cost.
- B.18 Debt interest cost is defined as the cost of the coupon and redemption payments associated with government debt, accrued over the life of each bond, measured in terms of the relevant yield. A plausible measure of risk associated with each issuance strategy is the standard deviation of debt interest cost, reflecting potential variation in future gilt yields.
- B.19 Simulations of expected values of debt interest cost and corresponding confidence intervals are generated by the Debt Management Office's ('DMO') Portfolio Simulation Tool ('PST'). This maps the yield curve density forecasts, obtained via a vector autoregressive ('VAR') model, to a debt interest cost distribution. The metrics resulting from this analysis combine the impact of a plausible issuance strategy for financing new government debt with the existing characteristics of the debt portfolio inherited from previous financial years.
- B.20 Forecasts of debt interest costs are carried out over a 15-year horizon. The chosen horizon is close to the average maturity of the gilt portfolio, and therefore captures a rollover of approximately half of it.
- B.21 As an example, Table B.1 shows the issuance skew planned by the DMO at the start of 2019-20, which was well diversified across maturity ranges.

Table B.1: Gilt issuance strategy composition for 2019-20 (%)¹

	Short conventional	Medium conventional	Long conventional	Index-linked	Unallocated
Issuance skew for 2019-20	25.8	21.7	27.0	19.1	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: DMO.

- B.22** The resulting forecast distribution of debt interest costs is shown in Chart B.4. It is assumed for the purposes of modelling that the 2019-20 issuance maturity skew is repeated for the next 15 years.

Chart B.4 Debt service cost forecast distribution (Gaussian)¹

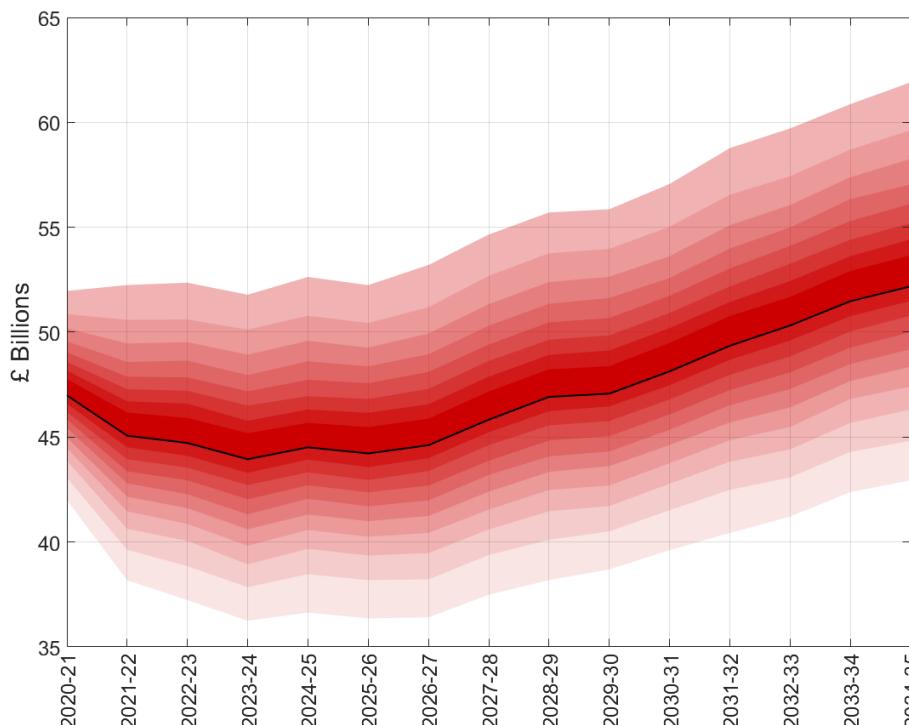


Chart B.5

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

Source: DMO.

- B.23** The central line of the fan chart represents the median debt interest cost across 10,000 simulations for each financial year. The shaded area depicts the forecast distribution around the median debt interest cost, with each colour area representing an additional 5% confidence band. The lightest shades of red at the top and at the bottom of the fan chart represent the 95th and 5th percentile band, respectively.

- B.24** It should be noted 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.

Gilt distribution

- B.25 Auctions will remain the primary method of issuance in 2020-21.
- B.26 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.
- B.27 Reflecting the larger financing requirement in 2020-21 relative to 2019-20, the government expects to hold six syndicated offerings in 2020-21 of which two are planned to be for ILGs.
- B.28 Gilt tenders may be used in 2020-21 to issue any type and maturity of gilt. Further details are set out in the DMO's 2020-21 financing remit announcement.
- B.29 The scheduling of gilt operations during the course of 2020-21 takes into account the timing of gilt redemptions early in the financial year.
- B.30 The government remains committed to the GEMM model to distribute gilts through auctions, syndications and gilt tenders and the government recognises that GEMMs play an important role in helping to facilitate liquidity in the secondary market.

Gilt issuance by maturity and type in 2020-21

- B.31 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.32 Continuing demand for short conventional gilts is anticipated, in particular owing to redemption reinvestment flows, which has been balanced against managing the government's near-term exposure to refinancing risk.
- B.33 In deciding the proportion of medium conventional gilts to issue, the government recognises the important role that medium conventional gilts (particularly at 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.34 Market feedback also 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.35 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 with maturities of up to around 35 years.

- B.36 Issuing index-linked gilts has historically brought cost advantages for the government due to strong demand, and has built the UK's financial resilience by supporting both the UK's long average debt maturity and diversifying the investor base. Tying debt interest payments to inflation has also underscored the government's commitment to price stability in the period prior to central bank independence. However, the UK's relatively large stock of index-linked debt also increases the sensitivity of the public finances to inflation shocks, as highlighted in the OBR's 2017 'Fiscal risks report'.
- B.37 At Budget 2018 – and as part of the government's responsible approach to fiscal risk management – the government announced that it would look to reduce the proportion of index-linked gilt issuance in a measured fashion over the medium term. Consistent with this, the 2020-21 financing remit includes a reduction in index-linked gilt issuance compared to 2019-20.
- B.38 A modestly smaller proportion of issuance (but a slightly higher absolute amount) will be initially unallocated in 2020-21 compared with 2019-20. 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 2020-21

- B.39 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.40 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.⁴
- B.41 It is expected that net issuance of Treasury bills will make no contribution to debt financing in 2020-21.

⁴ www.dmo.gov.uk/data/treasury-bills

Annex C

NS&I's financing remit for 2020-21

- C.1 This annex sets out information on the activities of NS&I in 2019-20 and 2020-21. 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 2020-21.
- 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 2019-20

- C.3 NS&I's contribution to financing in 2019-20 is projected to be £10.1 billion with gross inflows (including reinvestments and gross accrued interest) of approximately £36.6 billion. This is within NS&I's 2019-20 target range of £8.0 billion to £14.0 billion, set at Spring Statement 2019.¹ Table C.1 shows changes in NS&I's product stock during 2019-20.

Table C.1: Changes in NS&I's product stock in 2019-20 (£ billion)

	End-March 2019	End-March 2020 ¹
Variable rate	122.9	134.6
Fixed rate	25.0	23.8
Index-linked	19.7	19.2
Total	167.6	177.7

¹ Projections.

Source: NS&I.

Volume of financing in 2020-21

- C.4 Gross inflows (including reinvestments and gross accrued interest) of NS&I's products are projected to be around £34 billion in 2020-21. After allowing for expected maturities and withdrawals, NS&I will have a 2020-21 Net Financing target of £6 billion, within a range of £3 billion to £9 billion.
- C.5 Further details of NS&I's activities in 2019-20 and 2020-21 will be included in its 2019-20 Annual Report and Accounts, which is scheduled to be laid in

¹'Spring Statement 2019', HM Treasury, March 2020.

Parliament in 2020 and will be available in print form and at
www.nsandi.com.

Annex D

The Exchequer cash management remit for 2020-21

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 related to revenue and expenditure into or out of the central Exchequer funds; 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 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 policy for cash management as a cost minimising, rather than profit maximising, activity and one that plays 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, where possible the DMO will seek to avoid actions or arrangements that would:
- undermine the efficient functioning of the sterling money markets

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 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, is 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 and January. 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

² The DMO's Exchequer cash management Operational Notice is available at: <https://www.dmo.gov.uk/media/15751/2018-cash-man-info-mem-final.pdf>

³ www.dmo.gov.uk/data/treasury-bills

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 2018-19', Debt Management Office, October 2019. This is available at: <https://www.dmo.gov.uk/media/16118/gar1819.pdf>

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This document can be downloaded from
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