HM TREASURY

Debt and reserves management report 2013-14

March 2013

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1 Introduction

1.1 The *Debt and reserves management report* (DRMR) is published in accordance with the Charter for Budget Responsibility. The Charter requires the Treasury to "report through its Debt Management Report – published as part of the Budget Report – on its plans for borrowing in each financial year" and to set remits for its agents. In particular, 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 conventional and index-linked gilt issuance; and
- a forecast of net financing through National Savings and Investments (NS&I).

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

1.3 Chapters 2 and 3 and 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. Detail on the management of the UK's Official Reserves can be found on HM Treasury's website.[1]

1.4 The DMO's cash management remit is contained in Annex D.

[1] http://www.hm-treasury.gov.uk/ukecon_eea_index.htm

2 Debt management policy

2.1 This chapter contains an overview of the Government's debt management framework. It also sets out medium-term considerations for debt management policy during the current period of fiscal consolidation. The debt management framework is part of the overall macroeconomic framework which includes the fiscal and monetary policy frameworks. These are outlined in the Budget 2013 document.[1]

Debt management framework

2.2 The debt management framework includes:

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

Debt management objective

2.3 The debt management objective was established in 1995 following the *Debt Management Review.* The objective, which is explicitly long term, is:

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

2.4 While decisions on debt management policy must be taken with a long-term perspective, specific decisions on funding the Government's gross financing requirement are taken annually. Those decisions are announced in the Budget for the forthcoming year and are updated during the year consistent with published revisions to the fiscal aggregates, typically in April following the publication of the central government net cash requirement (CGNCR) outturn for the prior year and in the Autumn alongside the publication of the Office for Budget Responsibility's (OBR) updated forecasts. The components of the objective are examined in Box 2.A.

[1] Available at www.hm-treasury.gov.uk

Box 2.A: Components of the debt management objective

The cost of meeting the Government's financing needs in the long term arises directly from interest payable on debt (coupons 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 borrow in the future over the long term, that is, beyond the forecast period for fiscal policy. This expectation is reflected in the Government's choice of debt management strategies. For example, the Government promotes secondary market liquidity because it is a 'repeat borrower'. In addition, the Government may dismiss strategies offering short-term 'opportunistic' benefits if those strategies would adversely affect investors' attitudes over the long term.

There is no single definition of risk in debt management. Rather, a number of risks are taken into account when selecting possible debt management strategies. Five particularly important risks are:

- interest rate risk – the risk associated with new issuance each year as interest rate exposure arises at the time that new debt is issued;
- refinancing risk – the risk associated with the roll-over of maturing debt. An interest rate exposure arises at the time that debt is rolled over and the debt may need to be rolled over at a time when the future CGNCR may also be high, and against a market background that cannot be forecast. In addition, refinancing risk is greater if redemptions are concentrated in particular years;
- inflation risk – the exposure to inflation arising 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 point in time because that part of the market is insufficiently liquid for it to do so; and
- execution risk – the risk that the Government may not be able to sell the offered amount of debt at a particular point in time, either in full, or at a particularly deep discount to the market price, that would not yield value for money for the Exchequer.

This list of risks is not exhaustive. However, these are the major risks that have been taken into account in recent years in the determination of the debt management remit and are expected to be taken 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 2013-14 is set out in Annex B.

Debt management policy principles

2.5 The debt management objective is achieved by:

- meeting the principles of openness, transparency and predictability;
- developing a liquid and efficient gilt market;
- issuing gilts that achieve a benchmark premium;
- adjusting the maturity and nature of the Government's debt portfolio, primarily by means of the maturity and composition of debt issuance and potentially by other market operations including switch auctions, conversion offers and buy-backs; and
- offering cost-effective savings instruments to the retail sector through NS&I.

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

Roles of HM Treasury and the DMO

2.7 The respective roles of HM Treasury and the DMO are set out in the DMO's *Executive Agency Framework Document*.[2]

2.8 The Government's approach to debt management is based on the principles of openness, predictability and transparency, which is recognised internationally as the most effective way to minimise the long-term costs of debt management. In support of this:

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

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

The full funding rule

2.10 An overarching requirement of debt management policy is that the Government fully finances its projected financing requirement each year through the sale of debt. This is known as the 'full funding rule'. The Government therefore issues sufficient wholesale and retail debt instruments to enable it to meet its projected financing requirement.[3]

2.11 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; and
- 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.[4]

2.12 However, the total amount of financing raised in a financial year will at the margin differ in practice 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 CGNCR and its outturn; auction proceeds (including via the Post Auction Option Facility (PAOF)) in the period following the Autumn Statement that are

[2] Available at http://www.dmo.gov.uk/documentview.aspx?docname=publications/corpgovernance/fwork040405.pdf&page=.

[3] Wholesale refers to gilts and Treasury bills; retail to NS&I products.

[4] With the exception of a small and stable balance on the Debt Management Account held at the Bank of England and the Ways and Means Advance (a Government account at the Bank of England), the short-term net cash position of the Exchequer will be held with market counterparts. This means that, in practice, financial transactions of the public sector would not affect monetary conditions.

different from those required to meet relevant financing targets;[5] the sale of Treasury bills, including the DMO's operational flexibility to vary the end-year stock, as well as the bilateral sale of Treasury bills that mature in the next financial year; and the implementation of the syndication programme at year-end.[6]

2.13 The difference will be reflected in an increase/decrease in the DMO's cash balance at the end of the financial year. To meet the full funding rule year by year, the Government aims to return the DMO's net cash balance to its original level by adjusting the projected net financing requirement in the following financial year.

Medium-term projections for annual financing requirements

2.14 The Government publishes projections for the financing requirement in each year of the fiscal policy forecast period, consistent with the path for fiscal consolidation. The financing requirement includes the projected path for borrowing, the gilt redemption profile and financing for the Official Reserves. Table 2.A sets out the financing requirement projections from 2014-15 to 2017-18. The projected financing requirements are a broad indication of future gilt sales on the neutral assumption that the Treasury bill stock is unchanged and NS&I makes a zero net contribution to financing.

Table 2.A: Financing requirement projections, 2014-15 to 2017-18

	2014-15	2015-16	2016-17	2017-18
£ billion				
CGNCR	113	99	83	61
Adjustment for Northern Rock (Asset Management) (NRAM) and Bradford & Bingley plc (B&B)[1]	-3	-2	-1	-3
Redemptions	62	68	69	79
Financing for the Official Reserves	6	0	0	0
Financing requirement	178	165	150	138

[1] See explanation in paragraph 3.3.

Source: OBR, HM Treasury and DMO

2.15 Debt management considerations during the period of fiscal consolidation are set out in Box 2.B.

[5] To meet the financing requirement, which is determined in cash terms, the DMO sizes auctions in nominal terms and takes into account prevailing market prices. Movements in market prices between the announcement of auction sizes and gilt auctions taking place mean that it is not possible to meet these targets precisely. In addition, in sizing auctions in the period following the Autumn Statement (AS), the Government makes an assumption about proceeds that will be raised via the PAOF in the period following the AS – proceeds raised may deviate from this assumption. See the DMO operational note, *Applying Proceeds from the Post Auction Option Facility to Auction Sizing.* http://www.dmo.gov.uk/documentview.aspx?docname=publications/operationalrules/opnot311011.pdf&page=operational_rules/Document

[6] Outlined further in Annex B.

Box 2.B: Debt management considerations during the period of fiscal consolidation

Decisions on debt management policy are taken annually, in advance, to achieve the debt management objective:

"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."

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 evidence and information about market conditions and demand for debt instruments.

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

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

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

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

3 The Debt Management Office's financing remit for 2013-14

Introduction

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

Financing arithmetic

3.2 The OBR's forecast for the CGNCR in 2013-14 is £113.9 billion. The CGNCR, which is the fiscal aggregate that ultimately determines gross debt sales, is derived from public sector net borrowing (PSNB). The relationship between PSNB and the CGNCR is set out in the OBR's March 2013 *Economic and fiscal outlook*.

3.3 There is a -£2.9 billion adjustment for Northern Rock (Asset Management) (NRAM) and Bradford and Bingley plc (B&B) in 2013-14. As set out at Autumn Statement 2012, NRAM and B&B have been reclassified as part of central government and so their activities influence the CGNCR. However, there are additional cash flows, mostly from the repayment of loans into the Exchequer, which reduce the Exchequer's need to raise cash.

3.4 The forecast net financing requirement in 2013-14 of £162.9 billion reflects projected gilt redemptions of £51.5 billion and additional sterling financing for the Official Reserves of £6.0 billion.

3.5 NS&I is expected to make a zero net contribution to financing in 2013-14, following a net contribution of -£750 million in 2012-13. This projection assumes gross inflows of £13.4 billion in 2013-14.

3.6 Gilt issuance is the Government's primary means of meeting the net financing requirement. Treasury bills and other cash management instruments may be used at the margin.

3.7 The net financing requirement will be met by:

- gross gilt issuance of £151.0 billion; and
- £11.9 billion net issuance of Treasury bills, implying an end-March 2014 stock of £68.0 billion.

Table 3.A: Financing arithmetic in 2012-13 and 2013-14

	2012-13	2013-14
£ billion		
Central government net cash requirement	**105.1**	**113.9**
Adjustment for Northern Rock (Asset Management) (NRAM) and Bradford & Bingley plc (B&B)[1]	-2.7	-2.9
Gilt redemptions	52.9	51.5
Financing for the Official Reserves	6.0	6.0
Buy-backs[2]	0.0	0.0
Planned short-term financing adjustment[3]	-17.2	-5.6
Gross financing requirement	**144.1**	**162.9**
Less		
National Savings and Investments	-0.8	0.0
Net financing requirement	**144.9**	**162.9**
Financed by:		
1. Debt issuance by the Debt Management Office (DMO)		
a. Treasury bills[4]	**-14.4**	**11.9**
b. Gilts	**164.8**	**151.0**
of which:		
Conventional:		
Short	50.8	42.6
Medium	34.7	30.0
Long	37.5	32.6
Index-linked	35.9	35.8
Mini-tenders	6.0	10.0
2. Other planned changes in net short-term debt[5]		
Change in the Ways and Means Advance	0.0	0.0
3. Changes in net short-term cash position[6]	**5.6**	**0.0**
Total financing	**150.5**	**162.9**
Short-term debt levels at end of financial year		
Treasury bill stock[7]	56.1	68.0
Ways and Means Advance	0.4	0.4
DMO net cash position	6.1	0.5

Figures may not sum due to rounding.

[1] See explanation in paragraph 3.3.

[2] Purchases of 'rump' gilts, with a small nominal outstanding, in which Gilt-edged Market Makers (GEMMs) are not required to make two-way markets. The Government will not sell further amounts of such gilts to the market but the DMO is prepared, when asked by a GEMM, to make a price to purchase such gilts.

[3] To accommodate changes to the current year's financing requirement resulting from: (i) publication of the previous year's CGNCR outturn; (ii) an increase in the DMO's cash position; and/or (iii) carryover of unanticipated changes to the cash position from the previous year.

[4] The stock change shown for 2012-13 is a planning assumption and measures the change in the level of the Treasury bill stock in issue between end-March 2012 and that currently forecast for end-March 2013. The stock of bills for this purpose comprises both those issued at weekly tenders and those issued separately to individual cash management counterparties. The stock change shown for 2013-14 is that currently required to take the stock of Treasury bills to £68.0 billion by end-March 2014.

[5] Total planned changes to short-term debt are the sum of: (i) the planned short-term financing adjustment; (ii) net Treasury bill sales; and (iii) changes to the level of the Ways and Means Advance.

[6] The change in the short-term cash position for 2012-13 (and the level of the net short term cash position at the end of the financial year) reflects changes to the public finance forecasts, any changes to financing from NS&I and Treasury bills (including those sold directly to counterparties separately from weekly tenders). It will also reflect any differences between the gilt sales outturn and plans. In addition, the change will include any impact on financing arising from other activities carried out within Government (e.g. issuance of tax instruments, transfers between central government and other sectors, and foreign exchange transactions). The zero change for the short-term cash position in 2013-14 assumes that the DMO's planning assumption for the end-year Treasury bill stock is met. A negative (positive) number here indicates an increase in (reduction in) the financing requirement for the following financial year.

[7] The DMO has operational flexibility to vary the end-financial year stock subject to its operational requirements.

Source: DMO, HM Treasury and OBR

Financing for the Official Reserves[1]

3.8 The financing arithmetic provides for £6.0 billion of sterling finance for the Official Reserves in 2013-14. The Government continues to envisage sterling financing being held at a similar level in 2014-15. This additional financing, announced at Budget 2011, is intended to meet potential calls on the Official Reserves that may arise and ensure that the level of foreign currency reserves held is sufficient.

3.9 For the purposes of the financing arithmetic in Table 3.A, it is assumed that sterling will remain the main form of financing for the Official Reserves (as has been the case in recent years) and no new foreign currency debt will be issued in 2013-14. However, if the Government judges that there is a case for doing so, taking into account cost, risk, market conditions and consistency with debt management objectives, consideration would be given to issuing foreign currency securities to finance part of the increase in the Official Reserves in 2013-14. If the Government were to decide to issue a foreign currency bond later in the year, this would be taken into account in subsequent updates to the DMO's financing remit. The Bank of England will act as HM Treasury's agent in issuing and managing any foreign currency liabilities associated with the Official Reserves.

Other short-term debt

3.10 The projected level of the Ways and Means Advance at the Bank of England at March 2013 is £0.4 billion. No changes to the level of the Ways and Means Advance are planned in 2013-14.

3.11 The projected level of the DMO's net cash balance at 31 March 2013 is £6.1 billion, £5.6 billion above the level projected at Autumn Statement 2012. The level will be reduced to £0.5 billion during 2013-14, as shown by the planned short-term financing adjustment, and this will in turn reduce the net financing requirement in 2013-14.

Quantity of gilt sales

3.12 The DMO, on behalf of the Government, will deliver gilt sales of £151.0 billion (cash) in 2013-14.

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

Gilt issuance methods

3.13 Auctions will remain the Government's primary method of gilt issuance. In addition, the Government has decided to continue the use of supplementary methods of gilt issuance, which will comprise syndications and mini-tenders.

3.14 The use of supplementary methods adds flexibility to the gilt issuance programme. This additional flexibility is designed to facilitate the effective delivery of the gilt issuance programme while remaining consistent with the debt management principles of openness, predictability and transparency.

3.15 It is anticipated that:

- £121.0 billion (80.1 per cent of total issuance) will be issued by auction;
- £20.0 billion (13.2 per cent of total issuance) will be issued by syndication; and
- £10.0 billion (6.6 per cent of total issuance) will be issued by mini-tender.

The maturity structure of debt issuance

3.16 The amount of issuance via auctions and syndicated offerings in 2013-14 is planned to total £141.0 billion (or 93.4 per cent of total issuance) and will be split by maturity and type as follows:[2]

- £42.6 billion of short conventional gilts (28.2 per cent of total issuance);
- £30.0 billion of medium conventional gilts (19.9 per cent of total issuance);
- £32.6 billion of long conventional gilts (21.6 per cent of total issuance); and
- £35.8 billion of index-linked gilts (23.7 per cent of total issuance).

3.17 In addition, the DMO plans to deliver sales via mini-tender of £10.0 billion (6.6 per cent of total issuance), which can be used for issuance of conventional and index-linked gilts across the curve, following consultation with the market. The mini-tender programme will continue to be used to support the syndication programme by providing flexibility to accommodate any variations in proceeds from syndicated offerings.

3.18 To maintain the operational viability of syndicated offerings at the end of each programme, the overall size of the syndication programmes (conventional and index-linked) may be increased by up to 10 per cent at the time of time of the final syndicated offering of each type.

3.19 The Government announced at Autumn Statement 2012 that it judged that the issuance of gilts with maturities in excess of 50 years could represent cost-effective financing for the Exchequer, while contributing to effective risk management of the Government's debt portfolio. However, it recognised that the strength of demand for these instruments is uncertain and that a cautious approach to issuance and, therefore, to extension of the yield curve is appropriate. The Government therefore removed the maturity cap on gilt issuance which was set at approximately 50 years and anticipates that in 2013-14 the DMO will look to launch new issuance in the 50-60 year area, subject to demand and market conditions. Decisions on specific maturities for issuance during the year will be taken by the DMO after consultation with the market through the normal channels.

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

[2] Short = 1-7 years maturity; medium =7-15 years maturity; long = >15 years maturity.

3.21 The planning assumption for gilt issuance in 2013-14 by method of issue, type and maturity is shown in Table 3.B.

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

£ billion (per cent)	Auction	Syndication	Mini-tender	Total
Short	42.6			42.6 (28.2 per cent)
Medium	30.0			30.0 (19.9 per cent)
Long	24.6	8.0		32.6 (21.6 per cent)
Index-linked	23.8	12.0		35.8 (23.7 per cent)
Total	121.0 (80.1 per cent)	20.0 (13.2 per cent)	10.0 (6.6 per cent)	151.0

Figures may not sum due to rounding.

3.22 There are no current plans to introduce new gilt issuance methods in 2013-14. Before introducing any such methods, the DMO would consult market participants and seek HM Treasury's approval.

Gilt auction calendar

3.23 The DMO will publish, alongside the DRMR, a gilt auction calendar consistent with the remit which sets out the expected timing of gilt auctions.

Post-auction option facility

3.24 In 2013-14, the DMO will continue to offer to successful bidders (both primary dealers and investors) an option to purchase additional stock of up to 10 per cent of the amount allocated to them at auction, at the average accepted price at conventional auctions and the clearing (or strike) price at index-linked auctions. Further details of this facility are available in the DMO's gilt market operational notice.[3]

3.25 Any additional amounts sold via this facility will count towards the remit sales targets and may be used to reduce the required average sizes for the remaining auctions of the maturity/type of gilt in question. If exercised consistently, the option may allow the cancellation of future auctions, but any such cancellation would be announced well in advance as part of the regular issuance calendar announcements and/or at Autumn Statement 2013.

Taps and reserve taps

3.26 The programme of gilt sales by auction, syndicated offering and mini-tender set out above may be supplemented by sales or purchases of gilts "on tap".[4] Taps of gilts will be used only as a market management mechanism in exceptional circumstances.

The Standing Repo Facility

3.27 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

[3] http://www.dmo.gov.uk/documentview.aspx?docname=publications/operationalrules/Opnot20130125.pdf&page=operational_rules/Document

[4] Taps (reverse taps) are sales (purchases) of gilts undertaken directly with the GEMMs by the DMO as a market management mechanism in circumstances, temporary or otherwise, such that the secondary market has become, or is likely to become, dislocated.

recently revised on 6 August 2009.[5] Any gilts so created will not be sold outright to the market and will be cancelled on return.

Other operations

3.28 The DMO has no current plans for a programme of reverse or switch auctions or conversion offers in 2013-14.

Coupons

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

Buy-ins of short maturity debt

3.30 The DMO will have responsibility for buying-in gilts close to maturity to help manage Exchequer cash flows.

Treasury bill sales

3.31 The outstanding stock of Treasury bills at end-March 2014 is expected to be £68.0 billion. In addition to the scheduled weekly tenders, the DMO may continue to re-open, on request, existing issues of Treasury bills for sale on a bilateral basis, to raise funds for cash management. Consequently, the DMO will continue to have operational flexibility to vary the end-financial year stock subject to its operational requirements. The 2012-13 outturn for the Treasury bill stock will be reported alongside the CGNCR outturn in April 2013.

New instruments

3.32 The Government has no plans to introduce new types of gilt instrument in 2013-14. Before introducing any new instruments, the DMO would consult market participants and seek HM Treasury's approval.

Revisions to the remit

3.33 In addition to the planned revisions to the remit in April 2013 and at Autumn Statement 2013, any aspect of this remit may be revised during the year in light of exceptional circumstances and/or substantial changes in any of the following:

- the Government's forecast for the net financing requirement;
- the level and/or shape of the gilt yield curve;
- market expectations of future interest and inflation rates; and
- market volatility.

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

[5] http://www.dmo.gov.uk/documentview.aspx?docname=publications/operationalrules/RepoTC060809B.pdf&page=operational_rules/Document

A Debt portfolio

Debt stock

A.1 The total nominal outstanding stock of central government sterling debt (excluding official holdings by central government) was £1294.6 billion at end-December 2012. The components of this stock are set out in Table A.1.

Table A.1: Composition of central government sterling debt

	End-December 2011	End-December 2012
£ billion, nominal value, excluding official holdings		
Conventional gilts[1]	775.0	858.1
Index-linked gilts[2]	245.8	282.1
Treasury bills	70.3	52.0
Total gilts and Treasury bills	**1091.0**	**1192.2**
NS&I	103.8	102.0
Balance on Ways & Means Advance	0.4	0.4
Total central government sterling debt	**1195.2**	**1294.6**

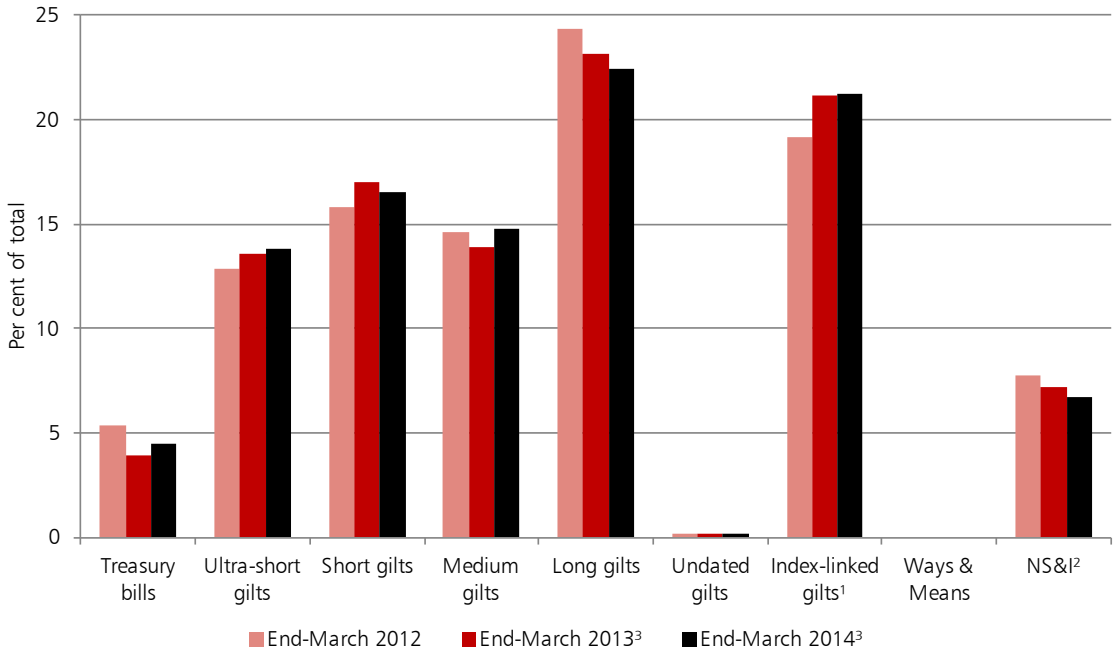
[1] Includes undated and double-dated gilts.

[2] Includes accrued inflation uplift.

Source: DMO and NS&I

A.2 Chart A.1 shows a comparison of the Government's debt portfolio at end-March 2012 through to the projected composition at end-March 2014. It assumes that new debt is issued in accordance with the DMO's and NS&I's financing remits and also takes account of the ageing of existing debt.

Chart A.1: The composition of central government debt



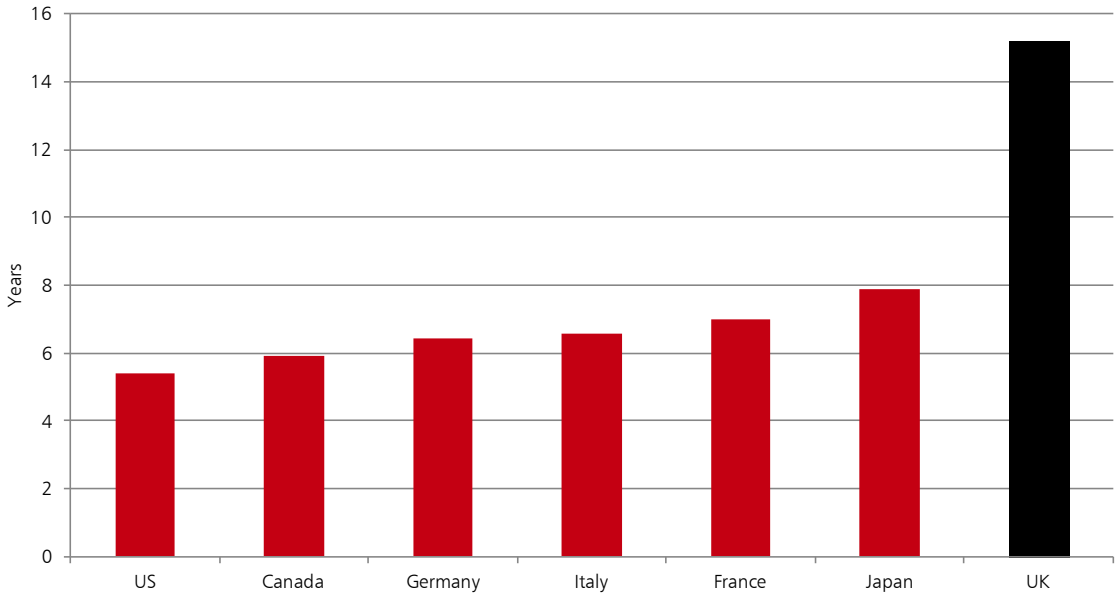
[1] Includes inflation uplift.
[2] Includes accrued interest.
[3] Projections.

Source: DMO and NS&I

Maturity and duration of the debt stock

A.3 The average maturity of the stock of all marketable debt is projected to increase from 14.5 years at end-March 2012 to 14.7 years at end-March 2013. Over the same period, the average modified duration of the stock of conventional gilts is projected to fall from 9.1 years to 8.9 years. The average maturity of the Government's wholesale debt is considerably larger than the G7 average, as shown in Chart A.2.

Chart A.2: Maturity of the debt stock by country (2012)[1]

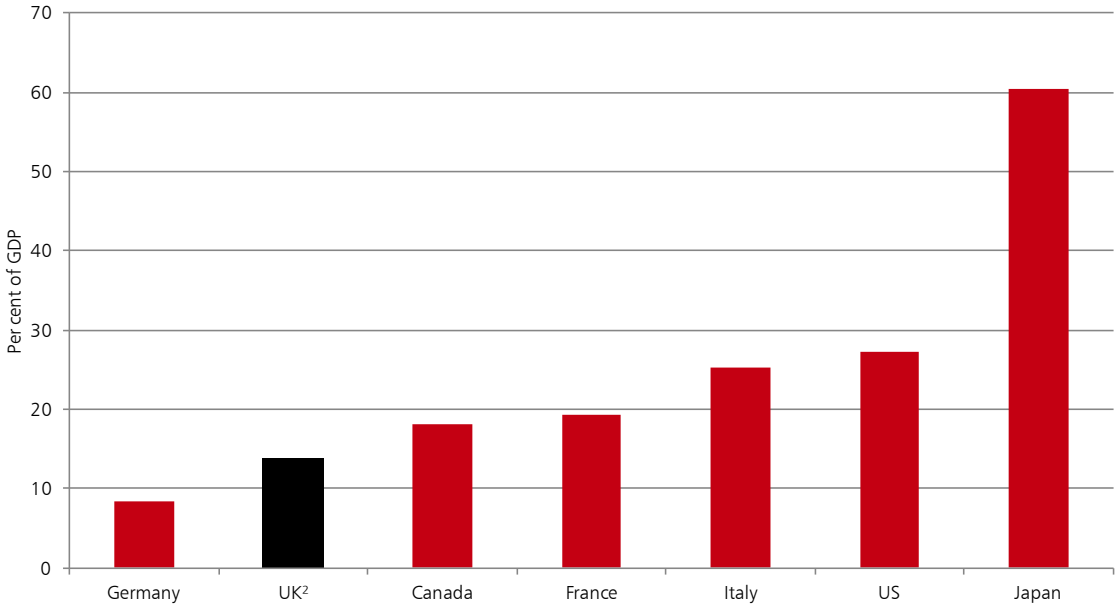


[1] Excludes Treasury bills. Data for Canada is as at end-December 2011.

Source: DMO and OECD

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

Chart A.3: Gross financing needs as a per cent of GDP (2013)[1]



[1] Includes roll-over of short-term debt (i.e. the stock of Treasury bills).

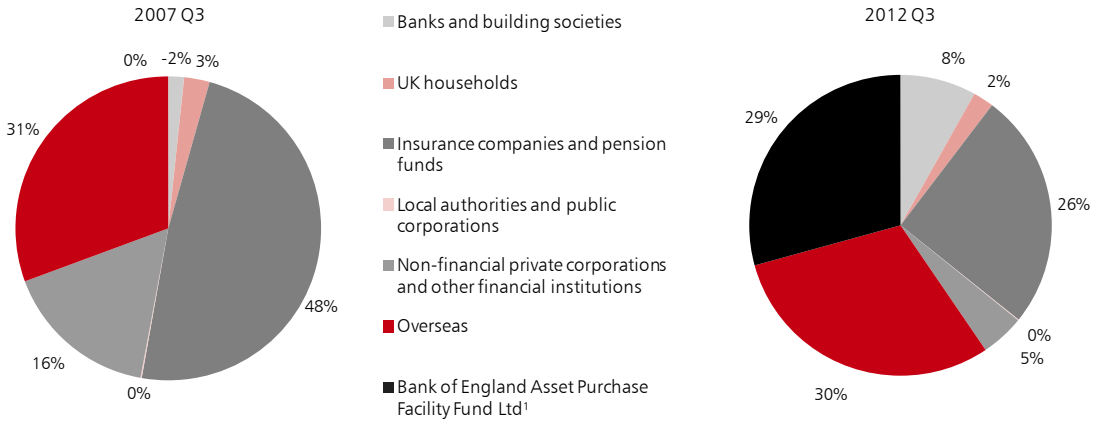
[2] For financial year 2013-14.

Source: HMT, OBR and IMF Fiscal Monitor October 2012

Gilt holdings by sector

A.5 Chart A.4 shows gilt holdings by sector. Data published by the Office for National Statistics (ONS) show that in Q3 2007 the three largest gilt investor groups were: insurance companies and pension funds (48 per cent), overseas investors (31 per cent) and non-financial private corporations and other financial institutions (16 per cent). Since then, there have been significant shifts in the proportionate holdings of gilts, in part driven by the substantial increase in the total size of the debt stock, as well as by the introduction of the quantitative easing programme by the Bank of England in 2009. In Q3 2012, the three largest gilt investor groups were: overseas investors (30 per cent), the Bank of England Asset Purchase Facility (APF) (29 per cent) and insurance companies and pension funds (26 per cent).

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



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

Source: ONS and Bank of England

Gilt issuance

A.6 The CGNCR measures the cash amount that the central government needs to borrow for the financial year and is the key fiscal measure from which the volume of gilt issuance is derived. The CGNCR for each of the years in which the DMO has been responsible for gilt issuance, and the volume of gilt sales in each of those years, is shown in Table A.2.

Table A.2: CGNCR and gross gilt sales, 1998-99 to 2013-14

	CGNCR[1]	Gross gilt sales[2]
£ billion		
1998-99	-4.5	8.2
1999-00	-9.1	14.4
2000-01	-35.6[3]	10.0
2001-02	2.8	13.7
2002-03	21.8	26.3
2003-04	39.4	49.9
2004-05	38.5	50.1
2005-06	40.8	52.3
2006-07	37.1	62.5
2007-08	32.6	58.5
2008-09	162.4	146.5
2009-10	198.8	227.6
2010-11	139.7	166.4
2011-12	126.5	179.4
2012-13[4]	102.4	164.8
2013-14[4]	111.0	151.0

[1] These figures are for the CGNCR *excluding* the adjustment for NRAM and B&B
[2] Figures are in cash terms.
[3] Reflecting proceeds from the 3G Spectrum auction.
[4] Budget 2013 projections.

Source: DMO, HM Treasury and OBR

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 2013-14, setting out the qualitative and quantitative considerations that have influenced the Government's decisions.

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

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

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

Demand

B.5 The Gilt-edged Market Makers (GEMMs) and end-investors continue to report well diversified demand for conventional and index-linked gilts across the yield curve. These views were most recently expressed at the Government's annual consultation meetings with gilt market participants in January 2013.[1]

B.6 In 2012-13, overseas investors were an important source of demand for gilts, given 'safe haven' flows as a result of developments in other sovereign debt markets (particularly within the euro area) and purchases of gilts by central banks and reserve managers looking to diversify growing reserves. In the coming financial year, market expectations are for continued demand from international investors. While some cross-border flows may be affected by any reassessment of global financial market conditions, expectations are for continued demand from official sources, in part reflecting the on-going growth in international reserves and these investors' reported appreciation of the depth and liquidity of the gilt market.

B.7 In recent years there has been significant demand for shorter-dated conventional gilts from domestic banks and building societies to hold in their liquidity buffers. During 2012-13, demand for gilts from domestic financial institutions is reported to have eased reflecting changing regulatory requirements and this is a trend that the market anticipates could continue in the coming financial year.

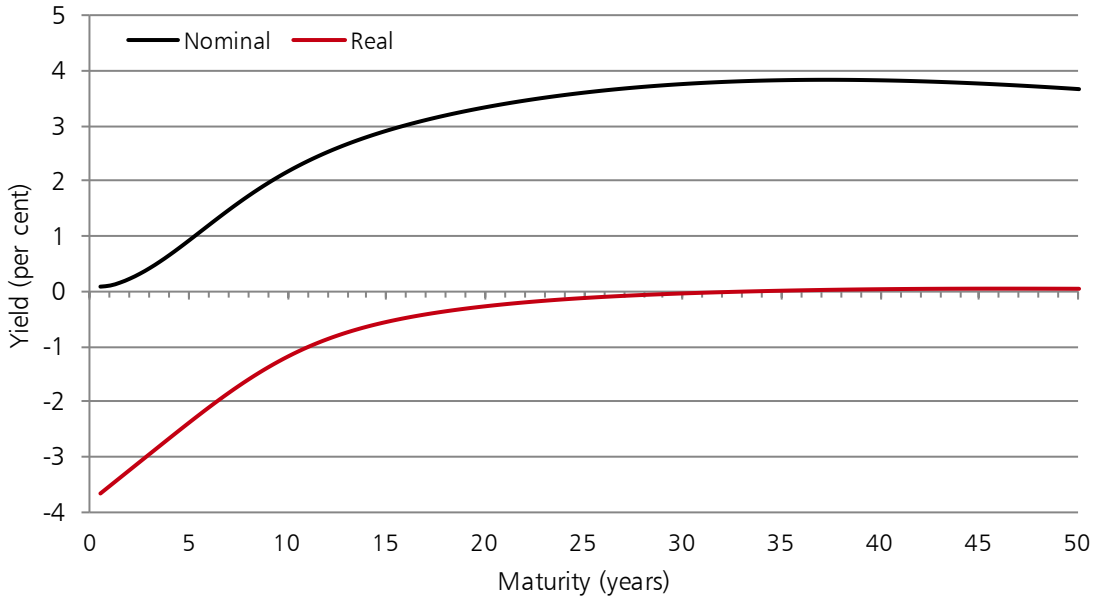
[1] Minutes available at http://www.dmo.gov.uk/documentview.aspx?docName=/gilts/press/sa250113.pdf and http://www.dmo.gov.uk/documentview.aspx?docName=/gilts/press/sa280113.pdf.

B.8 Pension funds and insurance companies remain an important source of domestic demand for gilts, as they continue to seek to match liabilities with appropriate assets. In this context, significant demand from pension funds is anticipated in 2013-14, particularly for index-linked gilts.

Cost

B.9 In assessing the cost of different types of debt issuance by maturity and type the Government undertakes an analysis of the nominal and real yield curves. Chart B.1 shows the shape of the nominal and real spot curves as at 11 March 2013.

Chart B.1: Nominal and real spot yield curves (11 March 2013)



Source: DMO

B.10 As part of this analysis, the Government seeks to estimate bond risk premia in the yield curve in order to identify maturity segments where premia are lower. Issuing into these maturity segments might deliver cost savings over a long time horizon.

B.11 Modern asset pricing theory suggests that the observed yield on a bond can be decomposed into two components, a 'risk neutral' yield and a risk premium. The risk neutral yield is the interest rate under 'pure expectations'. The risk premium represents the charge that the investor imposes on the issuer in order to protect investments against a variety of risks.[2] Theory suggests that the risk premium should be positive and increase with maturity, reflecting the fact that investors require compensation for holding riskier (i.e. longer maturity) assets. The variability and trends in the risk premium over time give an indication of which gilt maturities should be most cost-effective for the Government to issue.

B.12 Results from the DMO's risk premia analysis indicate the existence of a time-varying risk premium in the conventional gilt market which is usually positive and, as a general rule, increases with maturity.[3] Premia increased at all maturities during the second half of 2008, but the magnitude of this rise varied with maturity and it was followed by a significant fall after

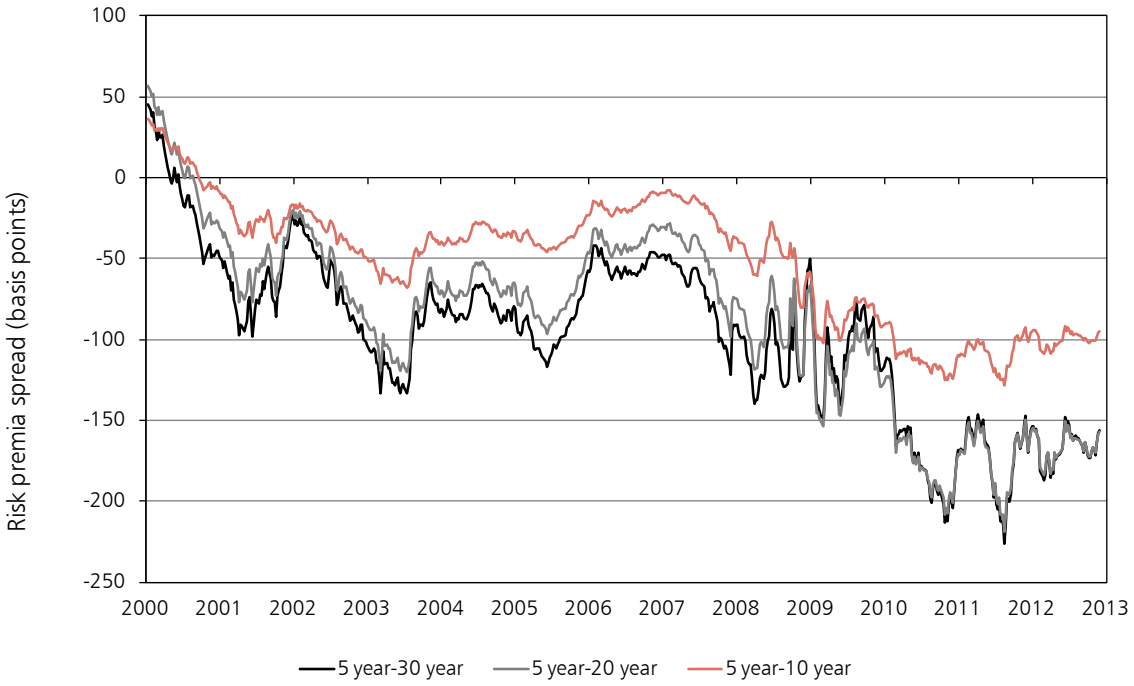
[2] The risk premium can be considered to have several components, including, but not limited to: (i) a term premium, which compensates investors for the fact that uncertainty increases for longer maturity investments; (ii) a credit and default risk premium; (iii) a liquidity premium due to the lower level of liquidity in some bonds or maturities, which restricts investors ability to hedge; and (iv) an inflation risk premium to compensate investors in nominal bonds for uncertainty due to inflation.

[3] This analysis is based on recent academic research by Christensen, Diebold and Rudebusch. Refer to the DMO's Annual Review 2011-12 for further details, http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar1112.pdf.

April 2011. The premium at December 2012 was close to its lowest level since the start of the financial crisis.

B.13 Over the period examined, the risk premium at short maturities (proxied by the 5-year maturity point) has been consistently lower than at other maturities, indicating that short gilts have been the most cost-effective maturity of conventional gilts to issue.[4] Chart B.2 plots the spread between the risk premium at the short-end of the yield curve and at all other maturities. It shows that spreads are negative due to the premium at the short end being lower than at other (longer) maturities. These spreads widened significantly at the onset of the financial crisis and peaked in 2011 before narrowing slightly during 2012. This suggests that the relative cost-effectiveness of short maturities in December 2012 remained close to the highest point in the period. These results have been tested against an analysis of the forward curve.[5]

Chart B.2: Risk premia spreads



Source: DMO

B.14 Alongside this analysis of the relative cost-effectiveness of conventional gilts across different maturity sectors, the Government undertakes an evaluation of index-linked gilt cost-effectiveness, using conventional gilts as a benchmark for comparison, by examining the evolution of break-even inflation rates.[6]

B.15 The break-even inflation rate is the rate of inflation that equalises the return on an index-linked gilt with that of a conventional gilt of the same maturity. It can be seen as the average rate of inflation, over the life of an index-linked gilt issue, that will make the Government indifferent on cost grounds between issuing either a conventional or an index-linked gilt.

B.16 To the extent that future inflation turns out to be higher or lower than the break-even inflation rate prevailing at the time an index-linked gilt is issued, it will have been more cost-effective for the Government to have issued a conventional or an index-linked gilt respectively.

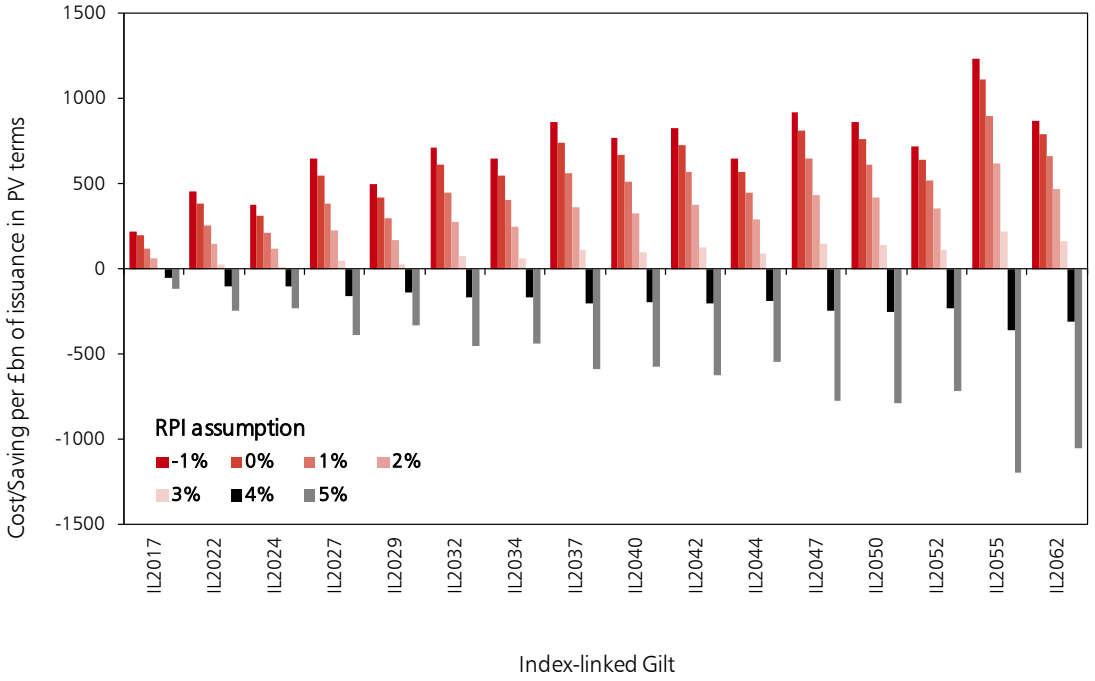
[4] Data sample: January 2000 to December 2012.

[5] Analysis of the forward curve provides a useful indication of the existence of historical risk premia.

[6] A more detailed explanation of the methodology used in this analysis can be found in the DMO's Annual Review 2011-12, http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar1112.pdf.

B.17 As such, the Government can compare prevailing break-even inflation rates on index-linked gilts against a range of paths for future inflation (see Chart B.3) to evaluate (at a point in time) the relative cost-effectiveness of conventional and index-linked gilt issuance of similar maturities.

Chart B.3: Cost-effectiveness of index-linked gilts relative to equivalent maturity conventional gilts under a range of RPI inflation assumptions



Source: DMO

B.18 On the assumption that inflation returns to the Bank of England's target rate in the medium term, and based on the neutral assumption than inflation remains at target thereafter, an assessment of the path of long-term inflation relative to that priced in by the market indicates that there is currently a cost advantage to the Exchequer from issuing long-dated index-linked gilts relative to equivalent maturity conventional gilts.[7]

Risk

B.19 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.

B.20 Different maturities and types of issuance give rise to different risk exposures. The Government assesses the relative importance of each risk in accordance with its risk appetite. These risks are also considered in the context of supporting fiscal resilience in the medium term while remaining consistent with the long-term focus of the debt management objective.

B.21 The Government currently places a relatively high weight on minimising near-term exposure to refinancing risk as far as possible. One of the ways in which the Government can manage this exposure is by maintaining a high proportion of long-dated debt in its portfolio, which can reduce the need to roll over debt frequently. The Government also places significant importance

[7] Assuming that the long run wedge between the Consumer Prices Index (CPI) and Retail Prices Index (RPI) is within the range of external estimates.

on avoiding large concentrations of redemptions in any one year. To achieve this, it will issue debt across a range of maturities, smoothing the profile of gilt redemptions.

Cost and risk simulations

B.22 An additional input to the analysis underpinning the Government's decisions on its issuance strategy is an exercise in which cost and risk simulations are generated to illustrate the cost-risk trade-off associated with different issuance strategies.[8] This allows the Government to investigate the near-term implications of different annual issuance strategies.

B.23 This exercise provides estimates of the evolution, over a 5-year horizon, of cost and risk metrics of the gilt portfolio. Debt service cost is defined as the cost of the coupon payments and redemptions associated with government debt, measured in terms of the relevant yield. Risk is defined as the standard deviation of debt service cost or debt service cost volatility.

B.24 The metrics resulting from this analysis combine the impact from alternative issuance strategies for financing new government debt with the existing characteristics of the debt portfolio inherited from previous financial years. The DMO's Portfolio Simulation Tool (PST), which calculates debt interest cost, is used in conjunction with a macroeconomic-based unrestricted Vector Autoregressive (VAR) model, which provides a distribution of projections of the yield curve, to depict risk in cost terms.[9] [10] In this way, the PST 'maps' the projected yield curve distribution to a debt service cost distribution so that simulated cost and risk metrics can be derived.

B.25 Table B.1 illustrates three issuance strategies. Strategies 1 and 3 represent two extreme issuance programmes with 100 per cent allocation to short and long gilt issuance respectively. Strategy 2 represents a split of issuance based on the actual 2012-13 issuance split followed by the DMO, which is well diversified across maturity buckets. All strategies have the same issuance split between conventional and index-linked gilts, 78 and 22 per cent respectively.

[8] The Government does not use this simulation tool to determine a single optimal debt issuance strategy.

[9] There are differences in the methods used to calculate debt interest cost by the DMO and the OBR (the latter publishes the official debt interest forecast).

[10] The variables in the VAR model are: GDP, CPI and the Bank Rate as macroeconomic variables and three 'latent factors' taken from the work of Diebold and Li (2006) that describe the yield curve, using 10 benchmark maturity points. The VAR is estimated using data from October 1991 to September 2012 without restrictions and is then used for forecasting. For each year of the 5-year horizon, a yield curve forecast is produced. In order to generate a distribution of yield curve forecasts, simulations around the central forecast are made by drawing from a normally distributed series of errors, one thousand times. This implies that the volatility of the yield curve forecasts varies every year, i.e. there is more uncertainty and volatility the longer is the forecast horizon. The VAR currently only forecasts nominal yields; the break-even inflation rate from the Variable Roughness Penalty yield curve model (used by the Bank of England) is used to derive the real yield curve.

Table B.1: Gilt issuance strategy composition (per cent)[11]

	Short conventional (0 – 7 years)	**Medium conventional** (7 – 15 years)	**Long conventional** (over 15 years)	**Index-linked**
Strategy 1	78	0	0	22
Strategy 2 2012-13 skew	34	22	23	22
Strategy 3	0	0	78	22

B.26 Debt service cost is shown in Chart B.4, with the standard deviation of debt service cost also plotted around Strategy 2. The debt servicing costs of following Strategy 2 are expected to increase towards 3.4 per cent of GDP by 2017-18 despite the fact that overall gross financing is predicted to fall. The increase is mainly driven by the projected increase in yields over this horizon.

B.27 Of the three strategies considered, Strategy 1 results in the lowest cost, whereas Strategy 3 results in the highest cost. These results mainly reflect the upward sloping shape of the yield curve, i.e. short-term issuance is comparatively more cost-effective than long-term issuance in the near term.

B.28 The standard deviation of debt service cost, or debt service cost volatility, is also shown in Chart B.4. This illustrates the cost volatility that might occur around Strategy 2, amounting to around +/-0.1 per cent of GDP by the end of 2017-18. This means costs could vary in a range between 3.3 and 3.5 per cent of GDP by the end of the horizon, reflecting the impact of potential yield movements on financing and refinancing of existing debt over the forecast horizon.[12]

B.29 Although not depicted in Chart B.4, the results also show that the debt service cost volatility of Strategy 1 is the highest of all strategies, as short maturity gilts need to be refinanced more often and short-term yields are typically more volatile than long-term yields.[13] The opposite is found for Strategy 3, with the lowest cost volatility of the three strategies considered. Strategy 2, with a more 'even' skew of issuance, lies between the two. These results illustrate the trade-off that is required between cost and risk when making choices on the skew of issuance.

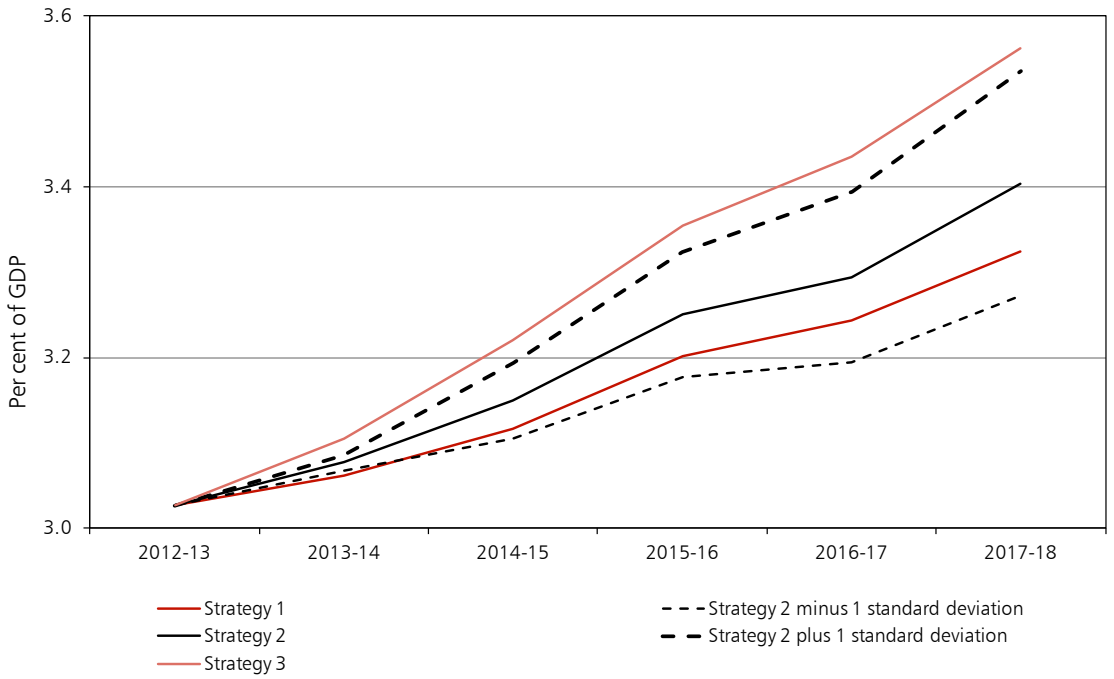
B.30 It is worth noting that Chart B.4 also illustrates that cost volatility (reflecting yield curve movements over the forecast horizon) can potentially dominate the projected cost savings that could be achieved by following a particular issuance strategy. For example, this can be seen by observing that cost volatility of one standard deviation more relative to Strategy 2 would lead to cost associated with that strategy only slightly below the cost associated with the 'central case' for Strategy 3. Likewise, cost volatility of one standard deviation less could lead to Strategy 2 turning out to be cheaper than the central case associated with Strategy 1.

[11] Numbers may not sum to 100 due to rounding.

[12] For a normal distribution, the probability of values occurring within one standard deviation at either side of the mean of the distribution is 34.1 per cent at each side. On this basis, the range of costs presented has a probability of occurring of just over 68 per cent.

[13] Quantitative easing has compressed short-term yield volatility given current historically low short-term yields.

Chart B.4: Debt service cost and standard deviation of debt service cost



Source: DMO

B.31 It is worth noting that in the simulation it takes several years before the different issuance strategies start to diverge significantly in terms of their cost and risk characteristics.[14] This is due to the large existing debt stock relative to the flow of new issuance, which in essence induces 'inertia' in the debt portfolio, with any changes to its structure as a result of issuance being slow to take effect.

B.32 Given the long-term nature of the Government's debt management objective, further analysis is carried out to illustrate the impact on the profile of gilt redemptions and coupon payment obligations from projecting forward the current issuance strategy over a longer horizon.[15]

B.33 Overall, the results of the cost and risk simulations support the Government's approach to the issuance across maturities, which balances the estimated lower cost of shorter maturity issuance (with its higher exposure to near-term refinancing risk) against the higher cost (and reduced near-term exposure to refinancing risk) associated with longer maturity issuance. The results also provide a useful indication of the implications for the debt stock over a longer term horizon of rolling forward a particular issuance strategy over successive years.

Liquidity, market management and portfolio diversification

B.34 The Government places significant importance on maintaining a deep and liquid gilt market and a diverse investor base in order to maintain continuous access to cost-effective financing in all market conditions. To do so, the Government will continue to issue both conventional and index-linked gilts at key maturities in sufficient size, seeking to achieve a benchmark premium for issuance.

[14] In order to depict completely the cost and risk characteristics of each issuance strategy, a longer horizon that covers all cash flows up to the maturity of the longest bond should be considered. This is, however, beyond the scope of this analysis.
[15] In practice, however, issuance strategies are determined on an annual basis.

Gilt distribution

B.35 The gilt issuance programme in 2013-14 will be broadly similar to the previous financial year. To raise this amount of financing in 2013-14, the Government will issue conventional and index-linked gilts across a range of maturities, with auctions remaining the primary method of issuance.

B.36 The Government has evaluated the on-going use of syndications and mini-tenders and judges that they should continue to be used in the coming financial year, although the operation of the syndication programme will be modified at the margin in 2013-14.

B.37 The Government has reviewed the functioning of the syndication programme and its effectiveness as a financing mechanism. It has determined that syndications have been most effective (i.e. encouraged greater investor participation) when used for issuing new bonds. Hence, in 2013-14, the Government intends that the syndication programme will be used primarily for issuance of new long conventional and index-linked gilts, or for the re-opening of existing high duration gilts.

B.38 As a consequence, it anticipates that there will be fewer syndications overall in the coming financial year relative to 2012-13, with at least four transactions during the year (one per quarter). Additional transactions may be held after consultation with the market, on the basis of emerging end-investor demand for the types of gilts mentioned above. The Government is also relaxing the even-flow constraint introduced in 2012-13 on the size of individual syndicated offerings to provide the flexibility necessary to ensure a better match between transaction size and underlying end-investor demand, taking into account the level of risk on offer.

B.39 To maintain the operational viability of the final syndicated offerings (by type) at the end of the financial year, the overall size of the long conventional and index-linked programmes may be increased by up to 10 per cent (in cash terms) at the time of the relevant transactions.

B.40 The mini-tender programme will be used as the primary means to accommodate variations in proceeds from syndicated offerings. Mini-tenders will continue to be used for the issuance of conventional and index-linked gilts across maturities. The DMO will determine the maturity and type of gilts sold at mini-tenders in consultation with the market during the year.

Gilt issuance by maturity and type in 2013-14

B.41 The relatively high weight that the Government places on managing its near-term exposure to refinancing risk has continued to influence its decision on the amount of short conventional gilt issuance in 2013-14. Risk management considerations were weighed against an assessment that short conventional issuance in the coming financial year is likely to be relatively cost-effective in comparison with medium and long conventional gilt issuance. On this basis, short conventional gilts will constitute a broadly similar proportion of gilt sales as in 2012-13.

B.42 The Government recognises the important role that medium conventional gilts (particularly in the 10-year maturity area) play in facilitating the hedging of a wide range of gilt market exposures through the futures market, which in turn underpins the overall cost-effectiveness of the Government's financing programme. In addition, given a large financing programme, the liquidity of the sector means that issuance of medium conventional gilts enables the Government to raise financing in an efficient manner. Taking into account these factors, in the context of wider cost and risk considerations, as well as the shape of the redemption profile, the Government intends to issue a broadly similar proportion of medium conventional gilts in 2013-14 as in 2012-13.

B.43 The analysis set out above suggests that long conventional gilts are less cost-effective to issue than shorter-dated instruments. However, the Government has also weighed the

contribution that long conventional issuance can make to mitigating its near-term exposure to refinancing risk. Overall, the Government has chosen to reduce marginally the allocation of issuance to long conventional gilts in 2013-14 relative to 2012-13.

B.44 The Government judges that index-linked gilts remain a cost-effective means of financing, especially at longer maturities. The Government has also noted the anticipated strong demand for index-linked gilts in 2013-14 from domestic pension funds, as well as the additional demand that may be generated by the redemption of 2½ per cent Index-linked Treasury Stock 2013 in year. As a result, the Government has chosen to increase slightly the proportion of issuance of index-linked gilts in the coming financial year.

Treasury bill issuance in 2013-14

B.45 The Government has also assessed the contribution to financing made by Treasury bill issuance. The Government has concluded that Treasury bills continue to offer value in terms of cost-effectiveness as well as contributing to effective risk management. For example, changes to the Treasury bill stock offer an efficient way to accommodate in-year changes to the financing requirement (particularly towards the end of the financial year) and maintaining a larger stock is a means to increase investor diversification.[16]

B.46 Accordingly, the Government has determined that the planned end-March 2014 Treasury bill stock should be increased, relative to end-March 2013, by £11.9 billion to £68.0 billion.

[16] In 2012-13, the planned stock build in Treasury bills announced at Budget 2012 facilitated a smooth handling of a significant reduction in the financing requirement announced at Autumn Statement 2012, protecting the gilt sales programme from a significant in-year reduction.

C National Savings and Investments' financing remit for 2013-14

C.1 This annex sets out information on the activities of National Savings and Investments (NS&I) in 2012-13 and 2013-14. 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 2013-14.

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 2012-13

C.3 NS&I's contribution to financing in 2012-13 is projected to be -£750 million with gross inflows (including reinvestments and gross accrued interest) of approximately £13 billion. This is in line with NS&I's target range of -£3 billion to +£1 billion. Table C.1 shows changes in NS&I's product stock during 2012-13.

Table C.1: Changes in NS&I's product stock in 2012-13

£ billion	End-March 2012	End-March 2013[1]
Variable rate	63.7	64.5
Fixed rate	13.8	12.2
Index-linked	25.5	25.5
Total	**102.9**	**102.2**

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

C.4 NS&I calculates the value it creates for the Government using the Value Indicator, which compares the cost of funds raised to comparable gilt yields (see Table C.2). These comparator rates have been close to historic lows over the course of the year. On this basis, NS&I projects a Value Indicator return of -£239 million in 2012-13. This in line with the target set by HM Treasury at Autumn Statement 2012; for NS&I to deliver positive value, with a lower limit of -£320 million. For NS&I to deliver positive value for taxpayers in 2012-13, as measured by the Value Indicator, would have required reducing its rates to levels that could have affected its ability to raise cost-effective finance in the future.

Table C.2: Calculation of Value Indicator

	Comparator cost[1]
Less	Capitalised and accrued interest paid on total NS&I stock
Less	Management costs of NS&I products (net equivalent of DMO costs & leveraging revenue)
Less	Tax foregone on total stock of 'tax free' products
Equals	Value Indicator

[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.
Source: NS&I

Volume of financing in 2013-14

C.5 Gross inflows (including reinvestments and gross accrued interest) of NS&I's products are projected to be around £13.4 billion in 2013-14. After allowing for expected maturities and withdrawals, NS&I is expected to make a zero net contribution to financing (within a range of -£2 billion to +£2 billion) for 2013-14.

C.6 Based on current market expectations for comparator gilt yields, the cost to government of NS&I's stock is expected to be higher than wholesale funding costs for the year. A lower limit of -£320 million has been set.

C.7 Over the last four years NS&I has saved the taxpayer £2.4 billion in net debt interest payments, as measured by the Value Indicator. Based on market expectations of future gilt yields NS&I is expected to return to producing positive value over time.

C.8 Further details of NS&I's activities in 2013-14 will be included in its *Annual Report and Accounts*, which is scheduled to be laid in Parliament in 2013 and will be available in print form and at www.nsandi.com.

D The Debt Management Office's Exchequer cash management remit for 2013-14

Exchequer cash management objective

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

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

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

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

The DMO's cash management objective

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

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

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

Instruments and operations used in Exchequer cash management

D.6 The range of instruments and operations that the DMO may use for cash management purposes is set out in its Operational Notice[2]. The arrangements for the issuance of Treasury bills, and the management of the Treasury bill stock in market hands, is set out in, and operated according to, the DMO's Operational Notice.

D.7 One component of the debt sales planned to meet the Government's annual financing requirement is the year-on-year change in the outstanding stock of Treasury bills, excluding bills issued solely for collateral purposes (see paragraph D.11).

D.8 During the financial year, the DMO will manage the level of the Treasury bill stock and may increase or reduce the stock in relation to the end of year target level, in order to support the implementation of Government cash management. The DMO will announce the dates of Treasury bill tenders on a quarterly basis. The precise details of the maturity and the amount of the Treasury bills on offer at specific tenders will be announced one week in advance. In addition to the bills issued at weekly and ad hoc tenders, the DMO is able to reopen, on request from its counterparties, existing issues of Treasury bills on a bilateral basis to raise funds for cash management.

D.9 As a contingency measure, the DMO may issue Treasury bills to the market at the request of the Bank of England and, in agreement with HM Treasury, to assist the Bank of England's operations in the sterling money market for the purpose of implementing monetary policy while meeting the liquidity needs of the banking sector as a whole. In response to such a request, the DMO may add a specified amount to the size(s) of the next bill tender(s) and deposit the proceeds with the Bank 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 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 To assist the DMO in the efficient execution of its cash management operations an amount of gilts, which shall be chosen to have a negligible effect on relevant indices, may be issued to the DMO on the third Tuesday of April, July and October 2013 and January 2014. Any such issues to the DMO will only be used as collateral in the DMO's cash management operations 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 to take place in a particular quarter, the DMO will announce that this is the case in advance.

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

D.12 The DMO's collateral pool may also be used to support HM Treasury's agreement to provide gilt collateral for the purpose of the Bank of England's Discount Window Facility (DWF).[3] 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.

[2] The current edition of Exchequer Cash Management Operational Notice and Treasury Bill Information Memorandum is available on the DMO's website at: http://www.dmo.gov.uk/documentview.aspx?docname=publications/moneymarkets/cmopnot180210.pdf&page=money_markets/publication

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

Active cash management

D.13 The combination of HM Treasury's cash flow forecasts and the DMO's market operations characterises the active approach to Exchequer cash management. In 2007-08, a new 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 – was introduced. These include quantifying excess returns to active management, after deducting an interest charge equivalent to the Government's marginal cost of funds. Performance against key indicators, including quantitative and qualitative measures, is reported in the DMO's Annual Review.[4]

[4] For the latest report see Annex B of the DMO Annual Review 2011-12, which can be found on the DMO's website at: http://www.dmo.gov.uk/documentview.aspx?docname=publications/annualreviews/gar1112.pdf&page=Annual_Review

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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