THE UK DEBT MANAGEMENT OFFICE'S REMIT 2012-13: MINUTE OF CONSULTATION MEETINGS WITH GEMMs AND INVESTORS, HELD AT HM TREASURY ON 12 JANUARY 2012

The Commercial Secretary to the Treasury, Lord Sassoon, chaired the annual meetings with representatives of the Gilt-edged Market Makers (GEMMs) and of UK-based gilt investors on 12 January 2012. Officials from HM Treasury and the UK Debt Management Office (DMO) were also present. These meetings provide gilt market participants with the opportunity to inform HM Treasury's decisions regarding the debt financing remit for 2012-13.

The forecast in the Economic and Fiscal Outlook (November 2011), published by the Office for Budget Responsibility (OBR), for the Central Government Net Cash Requirement (CGNCR) for 2012-13 is £130 billion. Gilt redemptions in 2012-13 are forecast to be £53 billion and financing for the Official Reserves is forecast to be £6 billion. On this basis, the gross financing requirement for 2012-13 would be around £189 billion (compared with £181.4 billion forecast for 2011-12). The DMO's financing remit for 2012-13 will be published alongside Budget 2012 on 21 March 2012.

The Commercial Secretary opened both meetings by thanking attendees for their commitment to the gilt market in 2011-12.

The main points discussed at the meetings are summarised below.

Investors:

A general endorsement of the structure of the current remit was expressed which most attendees suggested could broadly be replicated in 2012-13. There were a number of calls for an increase in supply of long-dated conventional and long-dated index-linked gilts, particularly for the pension sector, where demand remained strong. Others echoed the strength of demand for index-linked gilts but suggested that additional supply was needed at short and medium maturities. The point was also made that with breakeven inflation rates at current levels, there might be a case for constraining supply of index-linked gilts on cost grounds and that with no index-linked redemption in 2012-13, net supply would increase relative to 2011-12 even with no increase in absolute supply.

At the shorter end of the curve, there were some calls for higher issuance of short- and medium-dated maturities and also a number of recommendations for increased issuance of Treasury bills (as well as a few suggestions for a Floating Rate Note).

Mini-tenders were generally seen as providing a welcome degree of flexibility within the supplementary programme and there were some suggestions that the period of notice around tenders could be shortened.

Other business

Views were mixed on the Government's decision not to issue CPI linked gilts in 2012-13. Some regarded it as a missed opportunity and suggested that the decision be looked at again in the short term. Others, however, understood the rationale for the decision not to proceed next financial year, noting both the importance of avoiding fragmentation of the RPI index-linked gilt market and achieving clarity around the composition of the CPI.

There were also a number of calls for clarification of the prospects for the redemption of 3½% War Loan.

GEMMs:

There was general support for an increase in the supply of index-linked gilts, although views were mixed about the extent of any increase. Ongoing demand for index-linked gilts was cited, albeit increasingly on breakeven and asset swap bases rather than outright. It was noted however that the exclusion of index-linked gilts from the Bank of England's asset purchase programme was leading to a rising free float (as a proportion of the overall gilt stock) which might point to the need for caution in any increase. There was also a general view that the size of index-linked gilt auctions could be increased.

Views were mixed on recommended changes to the maturity splits of conventional issuance. Some attendees recommended increasing the issuance of short-dated maturities, given the high gilt redemptions in 2012-13 while others recommended beginning a gradual reduction in short issuance. A number of recommendations were made for increasing medium issuance, citing the increasing lack of free float, the need for a well functioning liquid futures contract and the fact that international investors were moving along the curve in search of yield pick-up. GEMMs generally favoured a modest increase in long conventional issuance. There was also some support for larger auction sizes (and fewer auctions).

The continuation of the syndication programme was widely supported, with a number of suggestions that an additional (long conventional) syndication be added to the 2012-13 supplementary issuance programme relative to 2011-12.

Views were mixed on the merits of the mini-tender programme. Some GEMMs valued the degree of flexibility the programme provided and its use in addressing market squeezes. Others suggested they were relevant mainly in the exceptional market conditions of 2008 and were therefore now redundant. Some suggested that mini-tenders were least useful for index-linked gilts and that their future use might better be extended to shorter dated conventional gilts.

Other business

Strong concern was expressed at the potential impact of proposed regulatory measures, in particular regarding the short selling regulation and the Volcker Rule. It was pointed out that other major national issuing authorities had made public representations to the US authorities on the adverse effect of the rule on sovereign issuance.

There were also a number of calls for clarification around the prospects for the redemption of 3½% War Loan, although mixed views were expressed on whether there was a case for calling it. It was noted that any such decision would be taken in the context of the Government's debt management objective and that if any decision was made to redeem 3½% War Loan, that decision would be announced via the usual channels to all market participants at the same time.