FOREWORD BY THE ECONOMIC SECRETARY TO THE TREASURY

In the interest of a more stable economy, the Chancellor granted the Bank of England operational independence over the setting of short-term interest rates in May 1997. At the same time, the Chancellor also announced the transfer of Government debt management responsibilites from the Bank of England to the Treasury. This led to the establishment of the UK Debt Management Office which is a candidate to become an Executive Agency of the Treasury. Although this means considerable organisational change for those involved and completes the separation between monetary policy and debt management policy, the Government's issuance policy remains one which is based on openness, predictability and transparency. Accordingly, this Debt Management Report sets remits for National Savings and the Debt Management Office for 1998-99. Government economic policy will mean a move away from the large borrowing requirements seen in the last few years and therefore the amount of financing required will be reduced. Nevertheless, there is continued emphasis in reducing the debt interest bill through policies which reduce gilt yields as well as the volume of borrowing.

In the last year we have seen a continuation of the reforms to the gilt market. The official gilt strips facility was launched on December 8th 1997. This allows the separation of coupon bearing bonds into their individual coupon and principal components which can then be traded in their own right. The Central Gilts Office was upgraded in November 1997.

Last year's Debt Management Report stated that the UK authorities saw positive merit in moving to an index-linked gilt auction programme. Accordingly, consultations were held by the Treasury regarding the form of these auctions and it has now proposed that auctions will start during the course of 1998-99.

These are examples of the continued commitment to improving the gilt market wherever possible, which I hope the new Debt Management Office will follow in the standards set for them by the Bank of England.

Helen Liddell

MRS HELEN LIDDELL, MP.
Economic Secretary to the Treasury

19th March 1998

INTRODUCTION

This is the fourth annual Debt Management Report published by the Treasury. It is designed to review developments in the gilt market over the past financial year, and sets out the details of the UK Government's borrowing programme for the forthcoming financial year.

This Report complements the detailed annual review of developments in the gilt market published by the authorities each year. It covers the following areas:

- the size and structure of the UK Government's debt;
- UK Government debt management policy;
- the Government's financing programme in 1997-98;
- developments in the gilt market in 1997-98; and
- the Government's financing programme and remits to National Savings and the Debt Management Office for 1998-99.

THE UK GOVERNMENT'S DEBT IN 1997-98

Debt Stock

The total outstanding UK Central Government marketable sterling debt was £308 billion at the end of February 1998. This comprised £245 billion of conventional gilt-edged stock, £59 billion of index-linked gilts (including accrued inflation uplift) and £5 billion of Treasury bills (see Table 1). In addition, £63 billion (including accrued interest) was invested in National Savings instruments at the end of February 1998.

Table 1
Composition of UK Government marketable sterling debt

(£ billion, nominal value, including official holdings)

	End-March 1997	End-February 1998
Conventional Gilts[1]	238.5	244.6
Index-linked Gilts[2]	51.7	58.7
Treasury Bills	7.6	4.6
	297.8	**307.9**
National Savings	61.8	63.2

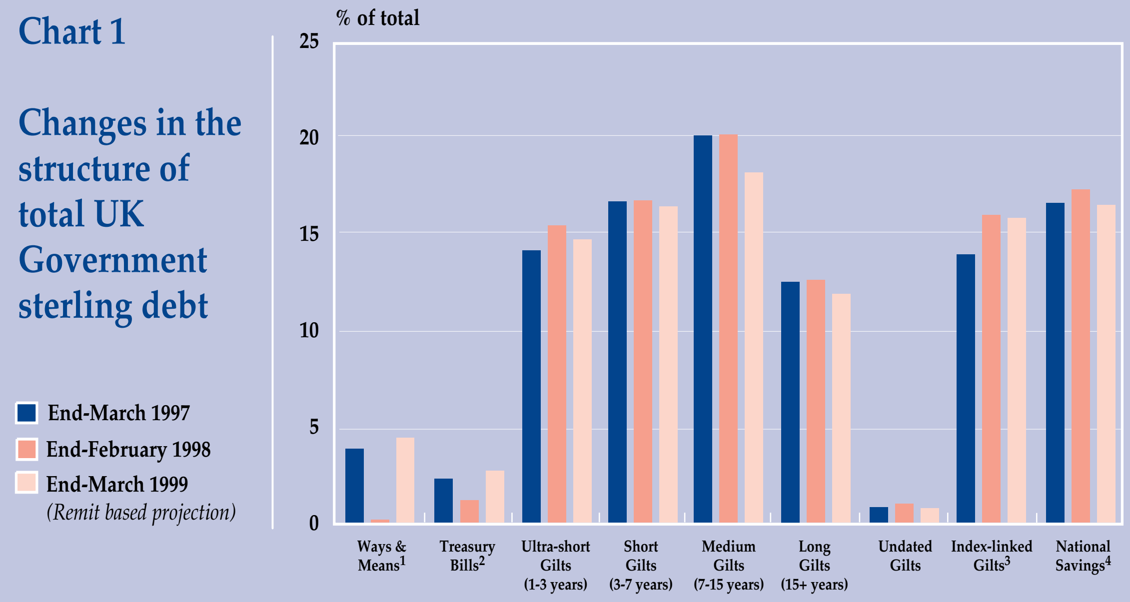
[1] *Includes Floating Rate Gilts and undated stocks*
[2] *Includes accrued uplift for RPI inflation*

Chart 1 compares the composition of the Government's debt portfolio at the beginning of the 1997-98 financial year with the composition at end-February 1998, and the projected composition for the end of 1998-99. It assumes that new debt is issued in accordance with the forecast financing requirement and issuance remit, and takes account of the ageing of existing debt. The chart includes the level of "Ways & Means" advances[1] and the level of Treasury bills. The relationship between the stock of these short-term financing instruments currently follows from the Bank of England's operations in the sterling money markets. If the Central Government Borrowing Requirement (CGBR) is fully financed year to year, and if all other things are equal, any change in the level of outstanding Treasury bills implies an equal and opposite change in the level of Ways & Means advances.

[1] *The net balance on the Government's general banking account at the Bank of England.*

Chart 1

Changes in the structure of total UK Government sterling debt



[1] Figure for end-March 1999 is based on the projected level for end-March 1998. However at the time of transfer of cash management operations to the Treasury, the Ways & Means advance will be frozen and methods will be explored to repay the balance
[2] The expected £5.1 billion overshoot in gilt sales for 1997-98 is assumed to be unwound during the course of 1998-99 through higher T-bill sales
[3] Includes indexation uplift
[4] Includes accrued interest

The average maturity of the stock of all dated gilts has risen from 9.7 years in March 1997 to 10.0 years in February 1998, while the average maturity of conventional gilts has risen from 8.9 to 9.3 years. The modified duration of the whole gilt portfolio rose from 6.2 years to 6.7 years over the same period, whilst that for conventional gilts alone rose from 5.4 years to 5.9 years. The maturity of the UK Government's marketable own-currency debt remains among the longest of OECD countries. Table 2 shows the sectoral composition of gilts holdings at the end of March 1997.

Table 2
Distribution of holdings of gilts at end-March 1997*

	£ bn	%
Non-bank private sector	199.3	68.7
Overseas sector	57.3	19.7
Monetary sector	23.5	8.1
Public sector and official holdings	10.4	3.6
	290.3	**100.0**

*****_Figures may not sum due to rounding_

Interest Payments

Gross central government debt interest payments are forecast to be £28.6 billion in 1997-98, approximately 9.7 per cent of total central government current expenditure. This figure is expected to fall slightly in 1998-99, to £28.1 billion (9.2 per cent).

UK GOVERNMENT DEBT MANAGEMENT POLICY

The Transfer of Debt Management and Cash Management Functions

On May 6th 1997, the Chancellor announced that responsibility for the setting of official interest rates was being transferred to the Bank of England, and that the Bank's role as the Government's agent for debt management, cash management and oversight of the gilts market was being transferred to the Treasury. The reasons for this transfer from the Bank were to ensure that debt management decisions could not be perceived to be influenced by inside information on interest rate decisions and to increase transparency in debt and cash management operations.

Following this announcement, the Treasury conducted a detailed consultation exercise on the future of UK Government debt and cash management operations[2], and in December 1997 Treasury Ministers announced that Government debt and cash management operations would be undertaken by an agency of the Treasury which would be called the UK Debt Management Office (DMO).

The Debt Management Office will be established from April 1st 1998 and is a candidate to become an Executive Agency of the Treasury. The Debt Management Office will take on responsibility for all official operational decision making in the gilt market from this date. The intention is that the DMO's dealing capability will also be operational by April 1st 1998. However this will depend on the successful installation of dealing and information systems. Consequently, in case of delay, there may be a short period in which the DMO uses the Bank of England's dealing facilities.

The remit for those operations in 1998-99 is set out in this Debt Management Report. The Chief Executive of the Debt Management Office will report to Treasury Ministers on the delivery of the remit. The precise relationship of the DMO to the Treasury will be set out in a published framework document.

The Debt Management Office will not take over active cash management until October 1998 at the earliest. Details of the proposed cash management operations will be announced in due course, along with any extension or adjustment to the remit contained in this Debt Management Report that is necessary to cover those operations.

Objectives of Debt Management

The primary objective of UK debt management policy has been changed slightly, to reflect the separation of responsibilities for implementing the Government's monetary and debt management objectives. The revised debt management policy objective is:

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

The separation of responsibilities for implementing the Government's monetary and debt management objectives is also reflected in a change in the sectoral boundary at which the

[2] *The Treasury published two consultation documents on the future of UK Government debt and cash management operations, in July and December 1997. The December document set out details of the Debt Management Office, and announced decisions on the gilt market aspects of the transfer. It also consulted on further details of the cash management operations, since these are being developed as a new function. Copies of these documents are available from the Debt and Reserves Management Team, 2nd Floor, HM Treasury.*

CGBR financing framework and remit applies, which changes the measurement of gilt sales. These changes follow from the implementation of the ESA95 international accounting conventions, and are explained in the box in the section on financing the CGBR.

The debt management policy objective is achieved by:

- adjusting the maturity and nature of the government debt portfolio, by means of the maturity and composition of debt issuance;
- pursuing an issuance policy that is open, predictable and transparent;
- developing a liquid and efficient gilts market; and
- offering cost-effective savings instruments through National Savings.

The Maturity and Composition of Debt Issuance

In order to determine the maturity structure of debt issuance, the Government (with advice formerly from the Bank of England and in future the DMO) constructs an "optimal issuance strategy". This work takes account of a number of considerations, including:

- investors' demand for gilts, which depends on the expected relative returns on the different types and maturity of the existing stock of gilts, on the liquidity of debt instruments, on the maturity structure of their liabilities and on relevant regulatory constraints;
- the Government's attitude to risks, both real and nominal; and
- the shape and composition of the conventional and index-linked yield curves, and the expected effects of Government issuance.

The Government keeps its optimal issuance framework under review. This coming year, however, one important objective of debt management will be to maintain liquidity in the gilts market, particularly in view of the low level of financing required. The priorities for issuance strategy in 1998-99 are therefore to build up the outstanding issue of the new long benchmark conventional gilt to enable it to become strippable and the issuance of index-linked gilts needed to sustain the move to index-linked auctions. The need to build up liquidity in the new short benchmark conventional gilt should be partly addressed by conversion offers assuming that market conditions allow. These considerations suggest a temporary increase in the proportion of long maturity conventional gilt issuance and maintaining, for the foreseeable future, a minimum annual gross supply of index-linked gilts of at least £2.5 billion cash.

The Government has therefore decided to change the remit target for conventional gilt sales in 1998-99 only to 25 per cent of conventional gilt sales in each of the short and medium maturity areas and 50 per cent in the long area. The target proportion of index-linked gilt sales is to be increased to 25 per cent of total gilt sales in 1998-99. These proportions specifically reflect the reduced gilts issuance in 1998-99, the scheduling of only four conventional auctions, the need to support liquidity in the new long benchmark and the launch of index-linked gilt auctions. The Government does not intend to follow these issuance proportions in future years, largely because of the lengthening of the portfolio that such a continued issuance strategy would imply.

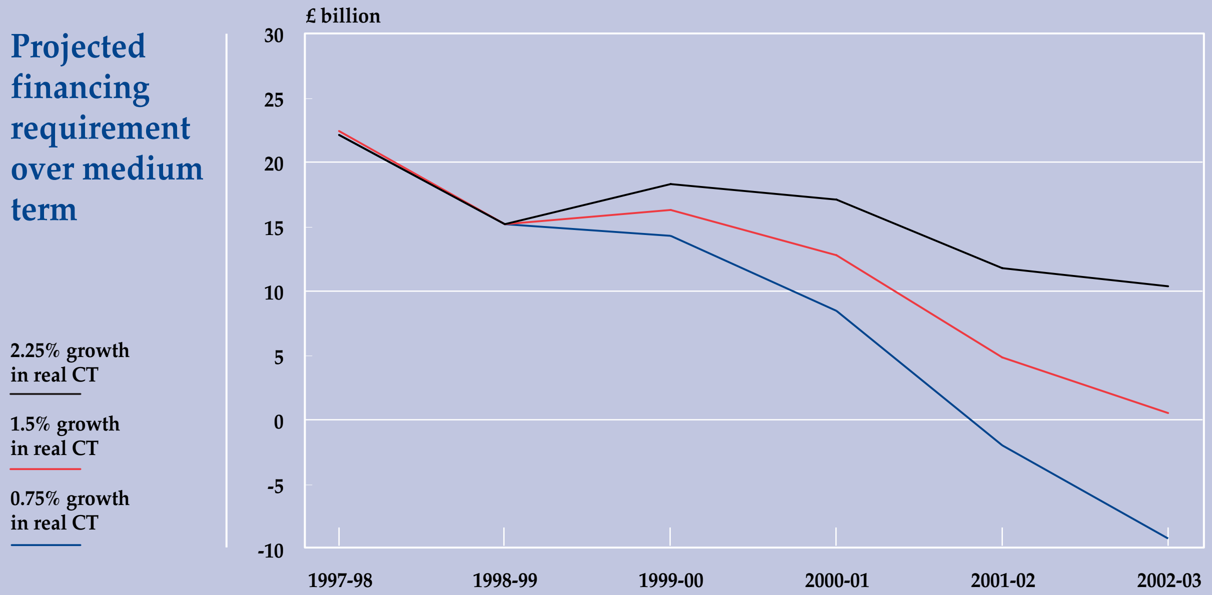
The composition of the debt portfolio in the long run as a result of following the 1998-99 remit for one year only will not change significantly from that implied by the 1997-98 issuance strategy. However, the average maturity and duration of the portfolio in equilibrium will have been lengthened by the issue of the new ultra-long conventional gilt in 1997-98. The long-run characteristics of the debt portfolio implied by following the issuance proportions of the 1997-98 remit are shown in the box on page 7, along with the effect on the long-run portfolio of the new 30-year benchmark. The 1998-99 issuance proportions will have little effect on the portfolio in the long-term given the reduced scale of issuance and because the authorities do not intend to repeat it in future years.

The projected financing requirement over the next five years on certain illustrative assumptions is shown in the box below.

THE FINANCING REQUIREMENT OVER THE MEDIUM TERM

The corollary of the projected low level of public borrowing over the medium term, as forecast in the Budget of March 1998, is a reduction in the volume of gilt sales. The chart shows the financing requirement over the medium term on each of the three illustrative assumptions used in the Budget for real growth in the Control Total after 1998-99 (¾ per cent, 1½ per cent and 2¼ per cent). The path for redemptions in future years remains relatively stable over this period, rising from £17 billion in 1998-99 to £20 billion in 2002-03.

Projected financing requirement over medium term



Note: Figures for redemptions are based on the profile for the existing stock of outstanding gilts (as at end-February 1998). No allowance is made for conversion offers and high-coupon double-dated stocks are assumed to be redeemed on their earliest possible date.

DEBT PORTFOLIO STOCK-FLOW DYNAMICS

The relationship between the remit issuance proportions and the resulting debt portfolio in equilibrium has been an active area of research at the Treasury and the Bank of England. As explained in the main text, this year the remit proportions have been driven largely by liquidity considerations and the Government does not intend to repeat this issuance pattern in future years. Hence there will be little effect on the portfolio in equilibrium from that implied by the 1997-98 Remit.

The table illustrates the effect on the debt portfolio in the long run of following the 1997-98 Remit, where the long conventional is a 25 year gilt. During the 1997-98 financial year, the authorities introduced a new 30 year benchmark. Other things being equal, this would lengthen the portfolio in equilibrium. The second example remit shows the effect on the debt portfolio in the long run of reproducing the 1997-98 issuance strategy with the long conventional gilt having 30 years to maturity.

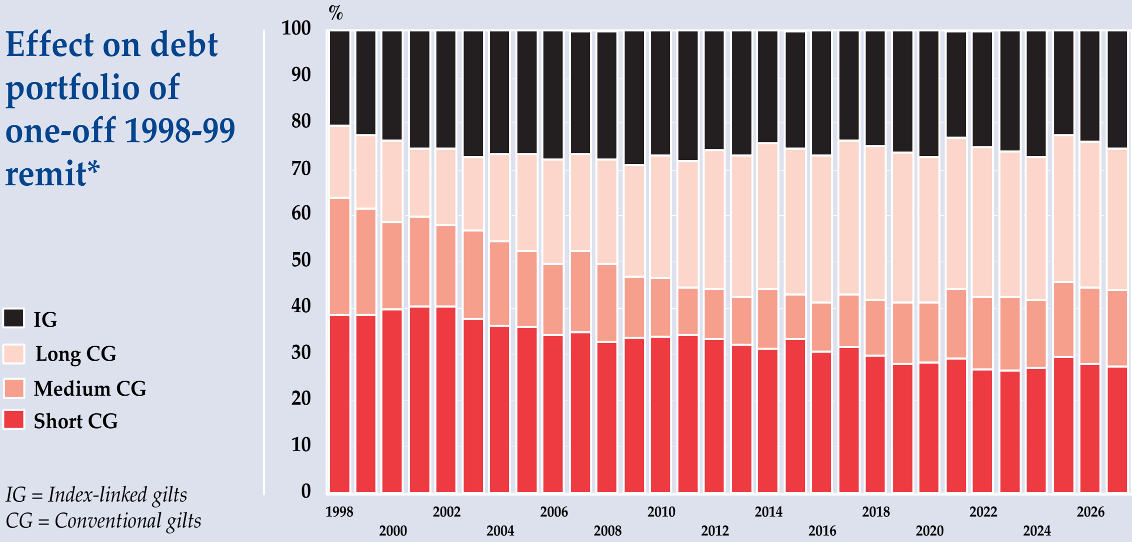
Example Remits and Resulting Debt Portfolio

Example Remit	Resulting Equilibrium Debt Portfolios						
	% of Conventional Gilts			% of Total Gilts		Average	Duration
	Short	Medium	Long	CG	IG	maturity (years)	(years)
1997-98* with 25 year long	43	26	31	75	25	11.1	7.2
1997-98* with 30 year long	37	21	42	75	25	13.1	7.8

**Conventional gilts issued in proportion 35 per cent short and long and 30 per cent medium. Index-linked are 20 per cent of gilt sales distributed evenly across the curve. Figures include indexation uplift on index-linked gilts.*

The chart illustrates how the portfolio would develop over time if the 1998-99 remit (a conventional split of 25 per cent shorts and mediums and 50 per cent longs (in the 30 year) and 25 per cent of total sales in index linked issued evenly across the curve) was to be followed in future years by reverting back to the 1997-98 remit (35:30:35, with a 30 year long, and 20 per cent index linked).

Effect on debt portfolio of one-off 1998-99 remit*



IG = Index-linked gilts
CG = Conventional gilts

***In 1998-99: conventional proportions 25:25:50 (in 30yr long), 25% index-linked; then from 1999-00 onwards: 35:30:35 (in 30yr long), 20% index-linked.**

Note: Simulations assume 1½ per cent growth in real Control Total from 1999-00 to 2002-03 and a deficit of 1½ per cent of nominal GDP from 2003-04 onwards. Nominal GDP grows at an annual rate of 4¾ per cent (2¼ per cent real GDP growth and 2½ per cent inflation).

THE GOVERNMENT'S BORROWING PROGRAMME 1997-98

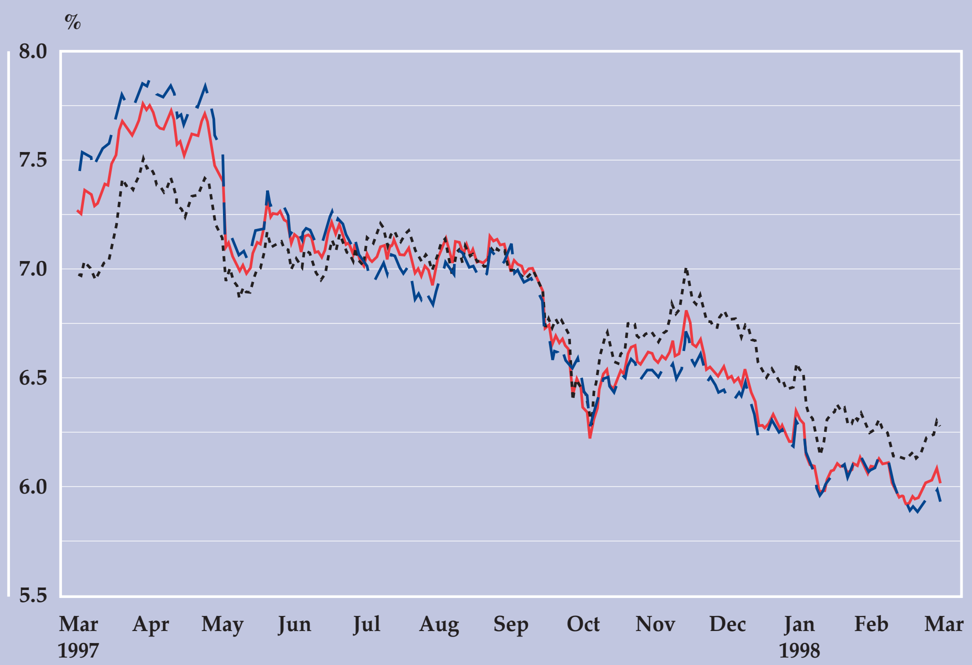
Gilt Market Review 1997-98

Gilt yields fell across the curve in 1997-98, reaching their lowest levels since 1964, although there was a marked inversion of the yield curve as the longer end outperformed shorter dated stock. The yield on the ten-year benchmark fell from around 7.8 per cent at the end of March 1997 to 6.0 per cent by the end of February 1998, a decline of around 180 basis points. At the short-end the fall in yields was somewhat less pronounced. The five-year benchmark ended February 1998 at 6.3 per cent compared to 7.5 per cent at the beginning of the financial year, a decline of 120 basis points. The yield on the long benchmark (the 8% 2021) fell by 190 basis points over the financial year, from 7.9 per cent to 6.0 per cent. The yield differential between the 25-year and 5-year gilt (a measure of the slope of the yield curve) fell from around plus 40 basis points to minus 30 basis points (Chart 2).

The movement in gilt yields over the financial year can be attributed to several factors. On the domestic front, the granting of operational independence over the setting of interest rates to the Bank of England on May 6th 1997 saw ten-year yields decline by around 50 basis points. The subsequent five increases in the Bank's repo rate, from 6 per cent at the end of April 1997 to 7¼ per cent by the end of February, saw medium and longer-dated gilts outperform shorts as the medium term outlook for inflation improved. The July 1997 Budget forecast a more rapid decline in Government borrowing which improved sentiment over gilt supply but was perceived by the market to have done little to restrain consumer spending. These factors caused the yield curve to invert.

Chart 2

Par gilt yields 1997-98



The other drivers of the gilt market were international. Intense speculation concerning the UK's earlier than expected entry into Economic and Monetary Union (EMU) in September 1997 fuelled rallies across the curve. This rally came to an end in early October after the surprise increase in the German repo rate, stronger than expected data out of the US and a Government statement clarifying the UK position on EMU. The subsequent reversal came to an end in mid-November 1997 as the Asian currency crisis caused a "flight to quality" into government securities.

The ten-year yield spread between gilts and German bunds narrowed fairly significantly over the period, from around 185 basis points to 125 basis points (on an annualised yield basis). The differential narrowed to around 80 basis points at the height of the speculation over EMU. Against US Treasuries the yield spread fell from around 75 basis points to 50 basis points (semi-annual).

Index-linked gilts also performed strongly over the year reflecting not only the flight to quality but also legislative changes. The abolition of the dividend tax credit in the July 1997 Budget and the Minimum Funding Requirement introduced in the Pensions Act, which became effective in April 1997, have both favoured pension funds switching into index-linked gilts at the expense of equities. The real yield on index-linked gilts fell from around 3.6 per cent to 3.0 per cent over the financial year to end-February 1998.

Gilt Sales

The remit published in March 1997 projected total gilt sales, including refinancing of gilt redemptions, of £36.5 billion, based on a CGBR forecast of £20 billion in the November 1996 Budget and an assumed net contribution of £3 billion from National Savings. The gilt sales target fell sharply during the year to reflect the carry-over of a £3.9 billion overshoot from 1996-97 and a much lower forecast for the 1997-98 CGBR published in the July 1997 Budget. As a result of the revision to the gilt sales requirement, the Bank of England announced on July 2nd 1997 an amended auction calendar. The two dual auctions that were due to be held in the third and fourth quarters of the 1997-98 financial year were changed to single auctions, and the auctions scheduled for August 1997 and February 1998 were cancelled. The assumed net contribution from National Savings was left unchanged. The November pre-Budget Report forecast only a slightly lower CGBR for 1997-98, but with a larger downward revision to the assumed net contribution from National Savings, the gilt sales target increased slightly. The overall effect of these changes was a final target for gilt sales of £25.4 billion (see Table 3).

On the basis of the revised financing requirement of £20.6 billion published in the March 1998 Budget, and with assumed gilt sales in the financial year as a whole of £25.8 billion, an overshoot in gilt sales of £5.1 billion is envisaged in 1997-98 to be carried forward into 1998-99.

The 1997-98 remit set out provisional dates for four dual auctions and seven single auctions to be held in the year. Following the amended auction schedule published in July 1997, there have been only two dual auctions and six single auctions with one single auction remaining, on March 25th 1998. All auctions were held as planned, subject to the July announcement, and the remit guidelines on auction size were also adhered to.

Table 3
The 1997-98 CGBR financing requirement (£ billion)

	Original Remit March 97	Budget July 97	Pre-Budget November 97	Budget March 98
CGBR Forecast	20.0	12.4	11.7	6.1
Expected net change in official reserves	0.0	0.0	0.0	0.0
Expected gilt redemptions	19.6	19.6	19.6	19.9
Under (+)/overshoot (-) from 1996-97[1]	*	-3.9	-3.9	-3.9
Financing Requirement	**39.5**	**28.1**	**27.4**	**22.1**
Financed by:				
Assumed net National Savings contribution	3.0	3.0	2.0	1.6
Expected net sales of other public debt	0.0	0.0	0.0	-0.1
Gilt sales required	**36.5**	**25.1**	**25.4**	**20.6**
Assumed gilt sales in 1997-98	-	-	-	25.8
Implied overshoot in 1997-98	-	-	-	5.1

Note: Figures may not sum due to rounding.

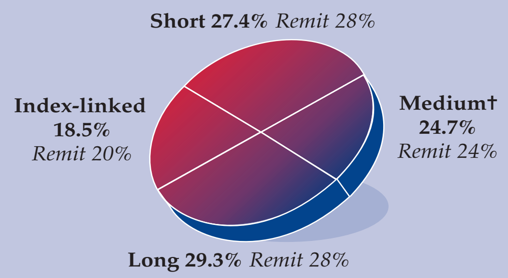
[1] *1996-97 overshoot outturn only known after the original remit was published.*

The remit stated that 20 per cent of gilt sales would be of index-linked stock. The remaining 80% of gilt sales would be for conventionals, with 35 per cent in each of the short and long maturity areas and 30 per cent in the medium area. Conventional taps were to be used only as a market management instrument; in the event, no conventional tap took place during the year. The maturity composition of gilts issued over the year is expected to be very close to that specified in the remit (see Chart 3).

Two new conventional stocks were created in 1997-98: a new 5-year benchmark ($6\frac{1}{2}$% Treasury Stock 2003) was created in December 1997 and a new long benchmark (6% Treasury Stock 2028) was created in January 1998. Neither of these new stocks were reopened during the remainder of the 1997-98 financial year. Both of these conventional stocks are strippable but, to ensure sufficient liquidity in the new long benchmark and long coupon strips, the authorities stated that stripping of this stock would not commence until the outstanding nominal issue had reached £5 billion.

A total of five stocks will have been redeemed in 1997-98. The final redemption on March 30th 1998 will be the biggest ever in the history of the UK gilts market, for £8,150 million nominal of $7\frac{1}{4}$% Treasury 1998 stock. Results of auctions held to end-February are shown in Table 4.

Chart 3
Gilt sales in 1997-98



† *Includes assumed sales from the auction on March 25th 1998.*

Table 4
Results of gilt auctions held in 1997-98*

Stock Title	Amount of issue (£ bn)	Date of auction	Lowest yield	Average yield	Highest yield	Times covered	Tail (basis points)
7% 2002	2.0	23 April 1997	7.22	7.24	7.25	3.49	1
7% 2002	1.5	20 May 1997	6.93	6.94	6.94	3.03	0
8% 2021	1.5	22 May 1997	7.22	7.24	7.28	1.29	4
7¼% 2007	2.0	25 June 1997	7.12	7.13	7.14	2.71	1
8% 2021	2.0	23 July 1997	6.84	6.86	6.87	2.32	1
7% 2002	1.5	23 September 1997	6.69	6.71	6.72	2.30	1
8% 2021	1.5	25 September 1997	6.55	6.57	6.58	2.33	1
7¼% 2007	2.0	29 October 1997	6.64	6.66	6.67	2.39	1
6½% 2003	2.0	10 December 1997	6.49	6.53	6.55	1.77	2
6% 2028	2.0	28 January 1998	5.96	5.99	6.01	1.25	2

** A single auction of £2 billion nominal of medium stock remains on March 25th 1998.*

National Savings

The outstanding balance of National Savings instruments at the start of the financial year was £61.8 billion. During the year to the end of February 1998 there was a net funding contribution of £1.4 billion. Gross sales of National Savings products for 1997-98 are expected to be around £12.6 billion. The change in the composition of outstanding products is shown in Table 5.

Table 5
Change in National Savings products outstanding (1997-98)

(including accrued interest)

	End-March 1997		End-February 1998	
	£ bn	%	£ bn	%
Variable Rate	29.4	47.6	30.7	48.6
Fixed Rate	23.2	37.5	22.5	35.6
Index-linked	9.2	14.9	10.0	15.8
	61.8	**100.0**	**63.2**	**100.0**

National Savings' overall cost of funding remained slightly cheaper than gilts throughout the year after management costs and imputed tax foregone were included. National Savings announced five packages of rate changes during the year. For variable rate products, the changes reflected movements by competitors and in short-term interest rates following increases in the repo rate announced by the Bank of England's Monetary Policy Committee. However, medium and longer-term market rates fell through the year leading to reductions in rates for new sales of fixed rate products from both National Savings and other financial institutions. The inversion of the yield curve was most noticeably reflected in National Savings' monthly income products. In the financial year to end-February 1998, the variable rates for Income Bonds rose from 6.0-6.25 per cent to 7.0-7.25 per cent, while the five year fixed rate for Pensioners' Guaranteed Income Bonds decreased from 7.0 per cent to 6.5 per cent.

DEVELOPMENTS IN THE STRUCTURE OF THE GILT MARKET

There was further development of the gilt market in 1997-98[3]. This continued the steps taken in recent years to increase its efficiency, and the openness and transparency of gilt supply.

Sales of Index-linked Gilts through Auctions

The 1996-97 Debt Management Report stated that the UK authorities saw positive merit in moving to an index-linked gilts auction programme as soon as was feasible, subject to first reviewing the impact of the initial US experience in auctioning inflation-indexed securities, and conducting a further round of consultation with the market. In January 1998, the Treasury, in conjunction with the Debt Management Office and the Bank, conducted a consultation exercise which sought views from a wide range of market participants on a series of issues concerned with index-linked auctions, including the US experience.

The responses to this consultation exercise indicated that there is now general market support for sales of index-linked gilts via auctions. The Government has therefore decided to introduce an auction programme for index-linked gilts, starting in October 1998. This programme will improve the predictability and transparency of the method of sale of these instruments, which should, over the longer-term, benefit investors, market-makers and the Government by increasing and better focusing demand, and by improving liquidity. This development is in line with the earlier reforms to the UK authorities' debt management programme, following the Debt Management Review in 1995, which adopted predictability and transparency as the guiding principles of debt management, in order to minimise the Government's debt issuance costs, over the longer-term.

In introducing index-linked auctions, the authorities are also aware of concerns expressed during the consultation exercise about the need to assist market makers in maintaining liquidity during the change from tap issuance to auctions. Only about half of the seventeen Gilt-Edged Market-Makers (GEMMs) are currently active in the index-linked gilts market. The Government proposes to introduce a separate index-linked market-maker list, prior to the start of auctions. This will improve clarity and transparency, and will enable those market-makers who are active in the secondary market to bid for stock in auctions, without concern that that stock could be allocated to speculative bidders who are not normally active in the index-linked market. The list of separate index-linked market-makers will need to be drawn up on the basis of clear privileges and obligations, which will need to be rigorously policed, but without significant barriers to entry, for market-makers who wish to make a commitment to be active in this market. The Debt Management Office will be contacting all market-makers during the first quarter of 1998-99 with detailed proposals, and inviting discussions on membership of this separate index-linked market-maker list.

In order to support the market-makers in maintaining liquidity during the change from tap issuance to auctions, the authorities are also pre-committing to a minimum annual level of £2.5 billion cash of index-linked gilts gross issuance for the foreseeable future, and proposing after auctions begin in October 1998 to reduce gradually the supply available for tap issuance between auctions. The financing

[3] For a detailed description of the gilt market in 1997-98, see "Gilt-edged and sterling money markets: developments in 1997" in the February 1998 issue of the Bank of England Quarterly Bulletin.

requirement over the medium term is shown in the box on page 6.

In 1998-99, the authorities envisage that up to a maximum of £1.5 billion cash of index-linked gilts will be available for taps during the first half of the financial year, until auctions start in October. There will then be two auctions for index-linked gilts in the second half of the year, supplemented with a further maximum of £0.5 billion cash available for taps in between auctions.

The index-linked auctions will initially use a uniform price format, although the authorities would want to keep this format under review. The uniform price format is preferable, at least initially, because it reduces the risk of the Winner's Curse faced by bidders and encourages wider participation by investors. This format is also closer to the current tap system, and follows the US experience, in which many potential bidders have participated. However auction results using a uniform price format tend to be more volatile, and there are arguments that suggest that the competitive bid price format may be more appropriate in a more liquid market.

The Government intends that index-linked auctions will be for one stock at a time. Details of the size and timing of these auctions, and the timing of further announcements concerning details of each auction, are contained in the remit to the Debt Management Office set out in this Debt Management Report.

The consultation paper on index-linked auctions also sought market participants' views on the value of redesign and of concentrating index-linked gilts issuance on benchmark issues. Whilst many in the market saw advantages in index-linked gilt redesign, the consensus was that these did not justify the transitional costs of fragmented market liquidity or holding large scale conversion offers. The Government will bear in mind the responses on these issues. It currently has no plans either to redesign or to concentrate index-linked gilts issuance on benchmark issues.

The Debt Management Office will update the "Operational Notice on Official Operations in the Gilt-Edged Market" to include all the detailed points on the operation of index-linked gilt auctions. This will be issued well in advance of the start of these auctions.

The Upgrade of the Central Gilts Office

The upgrade of the Central Gilts Office (CGO), using CREST software, was delayed from August 26th 1997 after trialing revealed the need to make certain adjustments to the system in key areas. A further dress rehearsal was held at the end of September, after which the Bank of England concluded that the conditions for a successful implementation of the upgraded system had been met. Inauguration subsequently took place on November 10th 1997. The upgrade itself has made available new features for the continued efficient and safe settlement of trades in the gilt market and introduced the gilt stripping facility. In the immediate future, the Bank is intending to speed up processes and enable the introduction of euro stocks to the register and CGO.

Gilt Strips

The official gilt strips facility was launched on December 8th 1997. Stripping is the process of separating a coupon-bearing bond into its individual coupon and principal payments, which can then be separately held and traded

Table 6
Strippable stocks outstanding (£ million)

Stock Title	Nominal amount in issue at end-February 1998	Nominal amount held in stripped form at end-February 1998	Nominal amount held in unstripped form at end-February 1998
8% 2000	9,800	129	9,671
7% 2002	9,000	208	8,792
6½% 2003	2,000	4	1,996
8½% 2005	10,373	288	10,085
7½% 2006	11,700	15	11,685
7¼% 2007	9,000	84	8,916
8% 2015	13,787	226	13,561
8% 2021	16,500	563	15,937
Total	**82,160**	**1,517**	**80,643**
6% 2028*	2,000	0	2,000

**Stock not strippable until nominal amount outstanding reaches £5 billion.*

in their own right as (zero-coupon) bonds. This strips facility is available as part of the upgraded CGO system.

In advance of the launch of the official strips facility, conventional issuance had been concentrated upon strippable benchmark issues. Consequently, the amount of strippable stock in issue at the end of February was £82 billion (see Table 6). There are currently eight strippable gilts in issue. The UK authorities remain committed to all new issues of conventional benchmark stocks being strippable for the foreseeable future.

The experience of strips markets in other countries shows that an important factor in the efficiency of strips pricing and the liquidity of strips trading is the liquidity in the underlying bond issues and the coordination of coupon payment dates across a number of bonds. In order to build up liquidity in strippable stocks, the UK authorities have concentrated issuance on a limited number of large strippable issues with a common set of coupon dates (June 7th and December 7th). Whilst the cashflow management needs of some investors may be most conveniently met by an additional set of coupon dates, the authorities will seek to build up liquidity in the current set of coupon dates before considering whether to introduce a second set. This accords with market feedback.

Activity in the strips market to date has been quiet. By the end of February, less than 2 per cent of the nominal amount of strippable stock in issue was held in stripped form. This may be due to the current slope of the yield curve. The inverted yield curve makes strips look expensive relative to conventionals and so may have deterred activity in the strips market.

New 30-year Conventional Gilt

The authorities introduced a new long conventional gilt in January 1998 with the auction of £2 billion nominal of 6% 2028 stock. The stock will become strippable only after the nominal amount outstanding reaches £5 billion. This measure was intended to safeguard liquidity in the strips market until its size had been built up.

The decision to issue a new ultra-long gilt was taken after the December 1997 quarterly consultation. It largely reflected investors' wishes to have a stock longer than the current longest, which at that time was the 25-year benchmark (8% 2021). With a nominal amount outstanding of £16½ billion, this stock had become one of the biggest single bond issues in the world. The new issue also followed trends in international capital markets towards issuing longer maturity debt.

LIFFE Contract Changes

LIFFE announced in November 1997 that they would introduce a new five-year gilt futures contract, the details of which were announced on January 29th 1998. The contract was first listed and traded from February 26th 1998 and the front month for delivery of the new contract is June 1998. The contract has a nominal value of £100,000 of a notional gilt with a 7 per cent coupon. Gilts deliverable into the contract have between four and seven years remaining to maturity on the first business day of the delivery month. The new contract was quoted in decimals from its inception.

The decision to launch a new contract was a response to market demand. LIFFE members expressed a desire to see the contract listed in decimals from the outset, ahead of the introduction of decimalisation in the cash market. Market conventions are discussed further below.

To bring the new short and existing long gilt future into line, LIFFE listed the June 1998 long gilt contract on December 1st 1997 with a reduced notional coupon of 7 per cent (down from 9 per cent). On December 17th 1997 LIFFE announced that the June 1998 long gilt contract would switch from thirty-seconds to decimals with effect from the beginning of May 1998 until the contract expires (the nominal value of the long gilt contract however remained unchanged at £50,000). The September 1998 long gilt contract has a nominal value of £100,000.

Special Repo Operations

On February 16th 1998 the Bank announced that it was prepared to repo 9% Treasury Loan 2008 between February 23rd and March 13th at zero per cent overnight interest to GEMMs who had been, or whose clients had been, subject to failed deliveries of the stock. This was prompted by concern that stock under repo agreements, and intended for delivery into the long gilt future, might deliberately fail to be delivered. The next cheapest-to-deliver stocks were considerably more expensive than 9% 2008, so resulting in a significant penalty if these gilts had to be delivered into the March 1998 futures contact. The possibility of deliberate failed deliveries was disrupting the behaviour of the futures contract and reducing its use as a hedging instrument. There was also potential damage to the liquidity of the stock in the cash and repo markets.

The Bank had previously reserved the right to repo gilt-edged stock to facilitate orderly market trading. However, this was the first occasion on which the authorities announced that they were prepared to make stock available in this way. The DMO will reserve a similar right.

In the event, the Bank was not called upon to make this facility available and the delivery process into the March 1998 contract was smooth.

Sub 3 year Gilts

The issuance of sub 3 year gilts was raised as a point in the consultation document on the future of cash management. Whilst the market expressed strong interest in a programme of ultra short-dated gilts, the authorities have no plans next year for such a programme because of the reduced borrowing requirement, but will consider such a programme in the future after the Debt Management Office takes over responsibility for Exchequer cash management. The authorities however reserve the right to tap sub 3-year gilts for market management purposes.

Tax Reform

In November 1996, the Inland Revenue proposed to further simplify and extend the arrangement for paying gilt interest gross. Measures extending the option of gross interest payment were included in the Finance (No. 2) Act 1997. From April 6th 1998, all gilt holders will be able to receive the interest gross rather than after deduction of tax if they want to. This major simplification will make the gilt market more accessible to investors and substantially reduce custodians' tax-compliance obligations. It will also make the gilt market more attractive, thus contributing to the Government's objective of reducing the cost of future public borrowing. The change affects the time when tax is paid; it does not alter the extent to which gilt interest is taxable.

A consequence of this reform is that the distinction between gilts issued on FOTRA terms – free of tax to residents abroad, guaranteeing overseas investors exemption from UK tax – and non-FOTRA gilts will be of almost no practical importance. However, some overseas investors may continue to believe that the technical distinction is still significant and so be discouraged from investing in gilts. The current Finance Bill therefore seeks to remove these residual concerns by extending FOTRA status to all existing non-FOTRA gilts. This simplification should increase international investor interest in the gilt market.

Market Conventions

On February 3rd 1997 the Bank of England launched a consultation exercise on gilt-market conventions. The consultation sought views on daycounts, decimalisation and the ex-dividend period. The results were announced on May 30th 1997.

The majority of respondents favoured switching from the "actual/365" to the "actual/actual" daycount convention for calculating accrued interest. A large majority also favoured changing the quotation of gilt prices from fractions (£1/32nds per £100) to decimals. The Bank has announced that these changes will be implemented on November 1st 1998.

The majority of respondents favoured using compound interest for all strips, including the shortest, on an "actual/actual" basis for computing market prices from gross redemption yields to allow gilt strips to trade on a yield basis. This was the pricing method adopted for strips from the start of the strips market on December 8th 1997. The Stock Exchange price/yield formulae for conventional bonds will be brought into line with this method from April 1st 1998.

The conventions proposed for the number of decimal points in strip yields and settlement prices were, respectively, three and six. These were also implemented from the start of the strips market on December 8th 1997.

A large majority of respondents favoured the proposal to abolish the ex-dividend period for gilts held in the Central Gilts Office. No decision has yet been made on whether or when to proceed with this change, which would require technical and operational changes for CGO and the Bank of England's Registrar's Department as well as market participants.

A large majority of respondents also favoured the abolition of the special ex-dividend arrangements. This will take effect from July 31st 1998. Any stock entering its special ex-dividend period before then will continue the special ex-dividend period to its normal conclusion; any stock that would have entered its special ex-dividend period on or after July 31st 1998 will not do so and will instead trade cum dividend until it enters its ex-dividend period.

NSSR/Registrar's

National Savings currently offers a postal purchase and sales service in gilts to small investors. Holdings of gilts acquired through this service are registered on the National Savings Stock Register (NSSR). This registration facility is additional to that provided by the Bank of England's Registrar's Department. In effect, the Government is funding two separate gilt-registration facilities. A Treasury review of gilt registration in 1996 concluded that the costs of gilt registration could be reduced by merging the NSSR with the Registrar's Department to create a single gilts-registration facility. The transfer should also greatly facilitate proposed improvements to the gilt market. The measures are currently being taken through Parliament as clauses of the Bank of England Bill.

The Future of Gilt and Money Market Settlement Systems

The Treasury's consultation document, "The Future of Government Debt and Cash Management" (July 29th 1997), set out the background to the upgrade of the Central Gilts Office settlement system and the links that have been maintained between the Bank and CREST over possible merger of the two systems. The document stated that:

> ***"The authorities see positive merit in the proposal to merge CREST and CGO to form a single integrated UK securities settlement system…"***

However, given the number of other pressing IT projects that the UK financial markets face, a commitment was made that the Bank would consult on the optimal sequencing of projects.

Almost every respondent to the consultation that mentioned CGO-CREST merger was strongly supportive of the idea. Respondents felt that user costs would be reduced and systems requirements simplified through only having to deal with one settlement system for bonds and equities. One representative body supported the concept of merger but stressed the IT constraints on the City and pointed out that a number of linked reforms were needed before an integrated settlement system could operate at maximum efficiency.

The Bank intend to issue shortly the promised consultation document setting out a vision of the future of securities settlement in the UK.

This vision includes the merger of settlement systems for gilts, equities, bonds and money market instruments; the introduction of full-scale Delivery-versus-Payment (DvP); enhancement of settlement services and compatibility with customer automation; possible linkages between cash and derivatives clearing and settlement; and the creation of settlement links to systems in other countries. The paper focuses on the options for CREST-CGO merger and the implications for Central Money Office and on DvP, as the components of the longer-term vision most likely to be achievable in the coming few years. The Bank hopes to publish its conclusions by June 1998.

The Structure of Gilt Inter-Dealer Brokers

Prudential supervision of gilt inter-dealer brokers (IDBs) is transferring from the Bank to the Securities and Futures Authority from April 1998. This is an appropriate time to review the future supervisory and market structure applying to gilt IDBs. Consequently, the DMO and the London Stock Exchange intend to review formally the Stock Exchange rules that apply to gilt IDBs, in particular those applying to access to screens and counterparty status. In addition, the current requirement for gilt IDBs to be separately capitalised will be reviewed in the light of market developments, particularly the recent relaxation of this requirement for Gilt-Edged Market Makers. The review will be conducted in the next few months and the outcome should be published over the summer.

FINANCING THE CENTRAL GOVERNMENT BORROWING REQUIREMENT

The Government intends to continue to finance the CGBR using the financing framework which was established in the 1995 Debt Management Review. The Government aims to finance the CGBR plus maturing gilts and any net increase in the foreign exchange reserves through the issue of debt. All such debt issuance will take place within a set maturity structure which will be determined each year and published before the start of the year in this Debt Management Report. The Government has no plans at this stage to change significantly the level of ultra short term debt (sub 3 years maturity) in 1998-99.

Table 7 gives full details of the debt instruments the Government intends to use to finance the CGBR in 1998-99, on the basis of the March 1998 Budget forecast for the CGBR and the expected level of maturing gilts. As shown in the table, the Government does not intend to issue any marketable debt instruments of less than 3 years maturity to meet the financing requirement in 1998-99. However, the authorities reserve the right to tap sub 3-year gilts for market management purposes. And the authorities will need to review the issuance of ultra short term debt after the handing over of Exchequer cash management responsibilities to the DMO. The authorities will consider issuing ultra short term stock in future years.

The Debt Management Office will not take on responsibility for Exchequer cash management until October 1998 at the earliest. Details of the proposed cash management operations will be announced in due course, along with any extension or adjustment to the remit contained in this Debt Management Report that is necessary to cover those operations.

The Government intends to repeat the treatment used this year for any under- or over-shooting of the target for gilt sales during the previous financial year. Under this treatment, the stock of short-term debt is kept constant by unwinding any under- or over-shoot of the gilt sales target through the residual carried through to the following financial year. Hence the likely overshoot of the gilt sales target for 1997-98 will be carried forward to reduce the gilt sales target for 1998-99. This is a portfolio decision whether to make any adjustment between the stock of ultra short term debt (i.e. sub 3-years maturity) and longer-term debt, which is reviewed each year.

Table 7
1998-99 Financing Requirement (£ billion)

CGBR Forecast	3.7
Expected net change in official reserves	0.0
Gilt redemptions	16.7
Gilt sales residual from 1997-98[1]	-5.1
Financing requirement	**15.2**
Less net financing from:	
National Savings	1.0
Certificates of Tax Deposit[2]	0.0
Treasury bills and other short term debt[3]	0.0
Gross gilt sales required	**14.2**
of which:	
Ultra-short conventionals (1-3 years)	0.0
Short conventionals (3-7 years)	2.7
Medium conventionals (7-15 years)	2.7
Long conventionals (>15 years)	5.3
Index-linked gilts	3.6

Note: Figures may not sum due to rounding.

[1] See Table 3 for derivation of 1997-98 gilt sales residual.

[2] Certificates of tax deposits (CTDs) are deposits made by taxpayers with the Inland Revenue in advance of potential tax liabilities. Changes in the level of CTDs act as a financing item for central government. The working assumption at the beginning of each year is that the level of CTDs remains unchanged.

[3] The level of net Treasury bill issuance may fluctuate in-year as a result of money market operations.

In previous Debt Management Reports, the extent of any under- or overshooting for the current financial year was not known until the following financial year, when the final CGBR outturn became available later in the year. Whilst this still remains the case, for this Debt Management Report the March 1998 Budget allows a more accurate estimate of the current year's CGBR with which to assess the size of any under-/overshoot. It is prudent and consistent to take account of the overshooting based on the latest current year CGBR estimate published in the Budget and carry this forward to reduce next year's financing requirement.

The authorities intend to publish a revised 1998-99 financing requirement, taking into account the actual overshoot in 1997-98, in due course.

THE IMPACT OF THE ESA95 ACCOUNTING CONVENTION

From the beginning of 1998-99, for the purposes of this financing framework, issues of debt will be measured using the definition of the central government sector which will apply in the national accounts from October 1998, under the 1995 European System of Accounts (ESA95). This introduces a separate central bank sector, outside of central government. The measurement of debt sales - principally gilts and Treasury bills - alters in that these debt sales are no longer measured net of changes in holdings of these debt instruments by the Issue Department and Banking Department of the Bank of England[1]. Rather these debt sales will now include any net issuance to the Issue Department and Banking Department, since these are both now classified outside central government. Hence, Bank of England transactions in gilts and Treasury bills will not affect the financing requirement of central government. This will bring the statistics for gilts and Treasury bills issuance closer into line with the actual volume of sales by the Debt Management Office. (The statistics will differ only in that debt issuance will be measured net of any changes in holdings by central government funds - mainly those managed by the National Investment and Loans Office.) From April 1998, Bank will publish statistics of debt issuance on the new definition, in Bank Statistics.

This change in the definition of the central government sector will have very little impact on the CGBR itself. But it does alter the boundary at which the above CGBR financing framework and remit applies. This change in the boundary is consistent with the transfer of responsibility of monetary operations to the Bank.

[1]The Issue Department of the Bank of England is the account in the Bank which holds assets to back the note issue. The remainder of the Bank's business is reflected in the accounts of the Banking Department.

THE GOVERNMENT'S FINANCING PROGRAMME FOR 1998-99

The 1998-99 Financing Requirement

The Government will aim to issue debt to finance the Central Government Borrowing Requirement (CGBR) plus maturing debt and any net increase in the foreign exchange reserves.

Any under- or overshoot of the gilt sales target for 1997-98 will be carried forward and offset in the target for sales of gilts in 1998-99.

The CGBR for 1998-99 is forecast to be £3.7 billion. Some £16.7 billion of gilts are expected to mature in market hands and will need to be refinanced. It is not possible to forecast net changes over the year in the foreign currency reserves and so these are assumed to remain unchanged. The overshoot in gilt sales carried over from 1997-98 is expected to be around £5.1 billion.

The financing requirement for 1998-99 is therefore currently forecast to be around £15.2 billion, subject to confirmation of the actual overshoot recorded in 1997-98 and to any change in the foreign exchange reserves. Table 7 gives full details of all the financing instruments the Government intends to use to achieve this in 1998-99. The Government does not intend to use marketable debt instruments of less than 3 years maturity to finance the 1998-99 gilt sales requirement, but the authorities reserve the right to tap sub 3 year gilts for market management purposes and to review the issuance of ultra short term debt after the handing over of Exchequer cash management responsibilities to the Debt Management Office. Details of the proposed cash management operations will be announced in due course, along with any extension or adjustment to the remit contained in this Debt Management Report that is necessary to cover those operations.

National Savings

The net contribution of National Savings to financing (including accrued interest) is assumed to be around £1 billion (with gross sales of around £12 billion). This is not a target, but an estimate based on experience in previous years and National Savings forecast and objectives for 1998-99.

Other debt sales

Net sales of Central Government debt instruments other than gilts and National Savings are expected to make a negligible contribution to financing. In particular, the intention is that net Treasury bill issuance and changes in the level of Ways & Means will not contribute to financing the CGBR, although the stock of Treasury bills and the pattern of issuance will fluctuate in the light of the needs of money market management. Treasury bill issuance will be reviewed when the Debt Management Office takes over responsibility for Exchequer cash management.

Gilt Sales

The Government will aim to meet the remainder of the financing requirement by selling gilts. On the basis of the March 1998 Budget CGBR forecast, this means gilt sales of approximately £14.2 billion, subject to confirmation of the 1997-98 overshoot of the gilt sales target.

The Government will continue to have available the full range of financing instruments. Within conventional stocks, the Government will aim for liquid strippable benchmark issues in the 5-year, 10-year and long-dated maturity areas. There may also be floating rate gilt issuance. The aim over the medium term will be to issue index-linked gilts across the maturity spectrum.

THE DEBT MANAGEMENT OFFICE REMIT FOR 1998-99

1. The Debt Management Office (DMO), a candidate to become an Executive Agency of the Chancellor of the Exchequer, has among its declared objectives:

- to meet the annual remit set by Treasury Ministers for the sale of gilts, with high regard to long-term cost minimisation; and
- to promote a liquid market for gilts and conduct operations in a predictable, transparent way with a view to reducing the overall cost of financing.

Quantity of gilt sales

2. The Debt Management Office, on behalf of the Government, will aim to issue approximately £14.2 billion of gilts in 1998-99, subject to confirmation of the size of the overshoot of the gilt sales target in 1997-98.

Pace of gilt sales

3. The DMO will aim to sell gilts at a broadly even pace through the year. Within-year seasonal fluctuations in the pattern of Central Government expenditure and revenue will be met by other financing means, including changes to the weekly Treasury bill tender and the Ways & Means advances.

Maturity structure of gilt issues

4. Over the year as a whole, the Debt Management Office will aim to make 25 per cent of its gilts sales in index-linked stocks with the remainder in conventional stocks, spread across the maturity ranges. On current forecasts this implies index-linked gilt sales of £3.6 billion cash and conventional gilt sales of £10.7 billion. Four auctions of conventional stocks are planned in 1998-99; two in the long maturity area and one each in the short and medium areas. This implies remit proportions in 1998-99 of 25 per cent for index-linked gilts issuance out of total sales, and, within conventional sales, approximately 25 per cent in both the short (3-7 years) and medium-dated (7-15 years) bands and 50 per cent in the long (15 years and over) band. The Government does not intend to maintain these issuance proportions in future years. For 1998-99, there are no plans to meet the financing requirement with marketable instruments with a maturity of less than 3 years, but the authorities reserve the right to tap sub 3-year gilts for market management purposes and to review the issuance of ultra short term debt after the handing over of Exchequer cash management responsibilities to the Debt Management Office.

Auctions of conventional gilts

5. Auctions will constitute the primary means of conventional gilt sales. The calendar for the four conventional auctions is set out below. All auctions will be single auctions held on the day indicated. There is no intention to hold any dual auctions of conventional gilts in 1998-99.

6. Each single auction is planned to be for between £2 billion and £3 billion nominal of stock.

Auctions of index-linked gilts

7. Following consultation on this issue the Government intends that the DMO should initiate index-linked auctions in 1998-99. But to allow for sufficient time to establish a separate list in index-linked market makers, index-linked auctions will not start until October 1998.

8. In the first half of 1998-99, in the period before auctions can start, the DMO may issue up to a maximum of £1.5 billion cash of index-linked gilts via taps.

9. With the delayed start to the index-linked auction programme, the authorities plan to hold two index-linked auctions in the second half of 1998-99, on the calendar set out below. Auctions will be for between £0.5 billion and £1.0 billion cash of one stock on a uniform price basis.

10. In the second half of the financial year, but as a transitional measure to support market-makers in maintaining liquidity whilst auctions are introduced, the DMO will be prepared to issue up to a further £0.5 billion cash of index-linked gilts through taps between auctions, for market management purposes, if necessary, to relieve any overall market shortages.

11. Over the medium term, the authorities would aim to issue index-linked gilts in such a way as to maintain liquidity in most maturity areas across the curve. However given that auctions will only cover a single stock, it may not be possible to reopen every stock in each year.

12. To ensure the medium-term viability of the index-linked auction programme, the authorities remain committed to a minimum gross supply of £2.5 billion cash of index-linked stocks in 1998-99 and for the foreseeable future.

13. In the longer term, the authorities intend that auctions will constitute the primary means of issuance of index-linked gilts.

The auction calendar

14. The calendar for auctions in 1998-99, covering auctions of conventional and index-linked stocks, is as shown.

Auction Calendar 1998-99

Wednesday 20 May 1998	(Conventional)
Wednesday 29 July 1998	(Conventional)
Wednesday 28 October 1998	(Index-linked)
Late November/December 1998*	(Conventional)
Wednesday 27 January 1999	(Index-linked)
Wednesday 24 March 1999*	(Conventional)

**Subject to Chancellor's decisions on the Budgetary timetable.*

Announcements on details of each auction

15. At the end of each calendar quarter, following consultation with the Gilt-Edged Market-Makers and end-investors, the Debt Management Office will announce plans for the auctions scheduled for the coming quarter. From September, this announcement will also cover auctions of index-linked gilts. For each auction, this will indicate either the stock (where relevant indicating a new stock) or, where further feedback on the choice of stocks would be valuable, the intended maturity range of stock. Towards the end of each quarter, the DMO will publish details of progress to date with the gilt issuance programme, any changes to the Government's financing requirement and any changes to the gilts auction programme.

16. The auction plan for the first quarter of 1998-99 will be announced at 3.30pm on Tuesday 31 March 1998.

17. Full details of these, and subsequent, auctions will be announced at 3.30pm on the Tuesday of the week preceding the auction.

Tap sales and repo operations

18. The programme of conventional gilt auctions may be supplemented by official sales of stock by the DMO "on tap". Taps of conventional stocks will be used only as a market management instrument in conditions of temporary excess demand in a particular stock or sector or when there is an exceptionally sharp general rise in the market. In 1998-99, it is envisaged that conventional tap issuance will not constitute more than about 5 per cent of expected total issuance.

19. In 1998-99, it is envisaged that taps of index-linked gilts will constitute a maximum of £2 billion cash of total index-linked gilt sales, although most of this will be expected to take place during the first half of the financial year.

20. After an auction, the DMO will generally refrain from issuing stocks of a similar type or maturity to the auction stock for a reasonable period. Such stock will only be issued if there is a clear market management case.

21. For the purposes of market management, the Debt Management Office may repo out stock. Any stock used for this purpose will only be issued via temporary repo operations and therefore will not count towards financing the CGBR.

Coupons

22. As far as possible, coupons on new issues of gilts will be around gross redemption yields at the relevant maturity, at the time of issue.

Conversions

23. In order to build up the pool of strippable benchmark stocks further, the authorities envisage the Debt Management Office making offers for the conversion of unstrippable stocks into strippable benchmarks of similar maturity during 1998-99. Details of any such offers will be announced in due course, in the light of market conditions.

Reviews to the remit

24. This remit, and in particular the timing of auctions and the allocation between maturity bands and index-linked, may be varied during the year in the light of substantial changes in the following:

- the Government's forecast of the gilt sales requirement;
- the level and shape of the gilt yield curve;
- market expectations of future interest and inflation rates; and
- market volatility.

This remit may also need to be extended or revised to take account of the cash management operations of the DMO when details are announced.

25. Any revisions to this remit will be announced.

NATIONAL SAVINGS' FUNDING REMIT 1998-99

1. National Savings (NS), an Executive Agency of the Chancellor of the Exchequer, has as its declared objectives:

- primarily, to manage the retail component of the National Debt portfolio so as to minimise the combined cost and risk of the total stock of debt and to meet funding needs cost-effectively;
- in addition, to promote Government savings policies, making explicit to Ministers any costs of so doing that are not related to the above; and
- to compete in the retail savings sector in a commercial manner without distorting the market.

Volume of funding in 1998-99

2. Gross sales of National Savings' products are assumed to be around £12 billion, with a net contribution to funding in 1998-99 of around £1 billion.

Product terms

3. The Treasury is ultimately responsible, under the National Loans Act 1968, for setting the terms of National Savings' products.

4. NS will normally take the lead in bringing forward proposals to Treasury Ministers on product terms, including interest rates. If the proposals leave the average cost of NS products at acceptable levels, Treasury Ministers would expect to support them.

Cost/volume limits

5. The average cost of NS products should lie within a reasonable range of the yield on equivalent gilts.

6. NS or the Treasury can initiate a review of product terms at any time. NS will carry out each review. The proposed changes will take account of the average cost of NS products, the need to ensure NS's contribution to the funding assumption, and the need for NS to retain the capability and market presence to contribute to the Government's funding needs over the medium term.

Review of remit

7. The Treasury or NS may initiate a review of the remit in the course of 1998-99 in the light of any relevant factors. The remit will be reviewed before the start of each financial year.