DEBT MANAGEMENT REPORT

1999-2000

Her Majesty's Treasury

March 1999

FOREWORD BY THE ECONOMIC SECRETARY TO THE TREASURY

As a result of the Government's sound economic management, including prudent custodianship of the public finances, the forecast debt interest bill has been reduced by £2½ billion in 1999-2000, compared to the previous forecast, and by £4 billion in total over the next three years.

The past year has also seen major changes in the way government debt has been managed. On 1 April 1998 the UK Debt Management Office was established as an Executive Agency of the Treasury and took over responsibility from the Bank of England for the sale of gilts and the management of the gilts market. However, the Government's issuance policy has remained the same, based on openness, predictability and transparency. November saw a successful first auction of index-linked gilts thereby extending the policy of precommitment into that sector of the market.

The year also saw a commitment to major institutional changes in the retail sector. National Savings has signed a contract with Siemens Business Services for the supply of their operational services to deliver benefits to both the taxpayer and the retail saver.

The Government is forecasting another year with a much smaller net cash requirement than has been seen in earlier years, with a consequential containment to the amount of financing required. Nevertheless, the emphasis on reducing the debt interest bill through policies designed to make gilts and National Savings products attractive remains a key part of the Government's strategy. Under the Code for Fiscal Stability the Government is required to report annually on the structure of borrowing and the cost of the National Debt. This Debt Management Report is the main vehicle through which these obligations are met. It sets out the required forecast of net financing through National Savings, the overall size of the gilts issuance programme, the planned maturity structure and proportions of types of gilts and the gilt auction calendar.

The financing plans anticipate the transfer of day to day government cash management from the Bank of England to the Debt Management Office thereby completing the separation between monetary policy and cash and debt management policy. This is a very significant undertaking and much more complex than the transfer of debt management. However, the plans are well advanced and it is a development that we look forward to in the course of the coming year.

17th March 1999

PATRICIA HEWITT, MP.
Economic Secretary to the Treasury

INTRODUCTION

This is the fifth annual Debt Management Report published by the Treasury. It is designed to review developments in debt management 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 Debt Management Office (DMO) each year. This report 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 1998-99;
- developments in the gilt market and in National Savings in 1998-99; and
- the Government's financing programme for 1999-2000 and remits to National Savings and to the Debt Management Office.

SIZE AND STRUCTURE OF UK GOVERNMENT DEBT IN 1998-99

Debt Stock

The total outstanding UK central government marketable sterling debt (including official holdings by government) is estimated to be £300 billion at the end of March 1999. This comprises £229 billion of conventional gilt-edged stock, £63 billion of index-linked gilts (including accrued inflation uplift) and £9 billion of Treasury bills (see Table 1). In addition, £64 billion (including accrued interest) will be invested in National Savings instruments at the end of March 1999.

Table 1
Composition of UK Government marketable sterling debt

(£ billion, nominal value, including official holdings)

	End-March 1998	End-March 1999*
Conventional Gilts[1]	238.4	228.8
Index-linked Gilts[2]	58.9	62.5
Treasury Bills	5.7	8.7
	303.1	**300.0**
National Savings	63.3	63.5

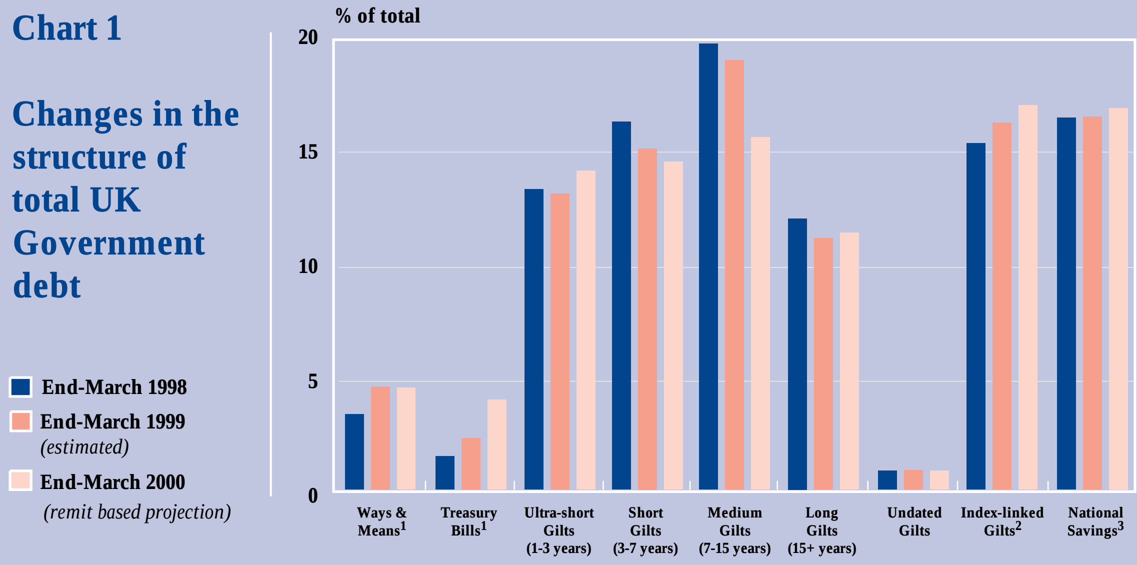
** estimates*
[1] includes Floating Rate Gilts and undated stocks
[2] includes accrued indexation uplift

Chart 1 compares the composition of the Government's debt portfolio at the beginning of the 1998-99 financial year with the composition estimated for end-March 1999, and the projected composition for end-March 2000. 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 and Means advances[1] and the level of Treasury bills. Until 1999-2000 the relationship between the stock of these short term financing instruments followed from the Bank of England's operations in the sterling money markets. Chart 1 shows a similar balance in the Ways and Means account at March 2000 to that at March 1999. It also shows a significant increase in the stock of Treasury bills. The Government intends to rationalise its methods for short term borrowing by closing and running down its Ways and Means facility with the Bank of England (although the precise method and timing is uncertain). As a consequence the stock of Treasury bills will be increased. This will facilitate the intended transfer of the government's cash management activity from the Bank of England to the Debt Management Office during 1999-2000.

[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 debt



[1] *Assumes transfer of cash management to DMO during 1999-2000*
[2] *Includes indexation uplift*
[3] *Includes accrued interest*

The average maturity of the stock of all dated gilts will have fallen marginally from 10.0 years in March 1998 to 9.8 years in March 1999, while the average maturity of conventional gilts will have fallen from 8.8 to 8.6 years. The modified duration of the whole gilt portfolio will have risen from 7.1 years to 7.3 years over the same period, whilst that for conventional gilts alone will have risen from 6.3 years to 6.4 years. Duration will have increased because the fall in interest rates means that future cashflows are discounted by a lower rate, bringing the duration of a gilt closer to its maturity. This effect will have outweighed the effect of shortening maturity. The maturity of the UK Government's marketable domestic debt remains among the longest of OECD countries. Table 2 shows the sectoral composition of gilts holdings at the end of March 1998.

Table 2
Distribution of holdings of gilts at end-March 1998

	£bn	per cent
Non-bank private sector	230.8	72.7
Overseas sector	65.1	20.5
Monetary sector	19.0	6.0
Public sector and official holdings	2.5	0.8
	317.4	**100.0**

Interest Payments

Gross central government debt interest payments are forecast to be £29.5 billion in 1998-99, approximately 9.8 per cent of total central government current expenditure. This figure is expected to fall in 1999-2000, to £26.0 billion (8.3 per cent).

UK GOVERNMENT DEBT MANAGEMENT POLICY

Objectives of Debt Management

The debt management policy objective remains:

"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 debt management policy objective is achieved by:

- pursuing an issuance policy that is open, predictable and transparent;
- issuing conventional gilts that achieve a benchmark premium;
- issuing index-linked gilts;
- adjusting the maturity and nature of the government debt portfolio, by means of the maturity and composition of debt issuance;
- 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 and composition of debt issuance, the Government 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;
- the shape and composition of the conventional and index-linked yield curves, and the expected effects of Government issuance; and
- changes to the stock of Treasury bills and Ways and Means required in 1999-2000 for cash management, assuming that the DMO takes on this function during this coming year.

The Government keeps its optimal issuance framework under review. In the past year, when the financing requirement was very low, the Government's issuance was driven almost entirely by the need to maintain liquidity in benchmark gilt issues. This coming year, higher expected gilts issuance means that the Government can direct the issuance of gilts more towards its optimal issuance view, while still maintaining liquidity in benchmarks. However, because the number of auctions of conventional gilts remains relatively low, the issuance split of conventional gilts has been set in terms of the number of auctions rather than issuance proportions.

This coming year's programme is intended to achieve a level of index-linked gilts issuance of about 20 per cent of total gilt sales. This reflects the Government's continued commitment to the index-linked market, against a background of sustained low inflation.

Given that the remit assumes five auctions of conventional gilts, the Government has split this issuance into two auctions each of short (3-7 years maturity) and long (over 15 years maturity) gilts, and one of mediums (7-15 years maturity), with the volume of issuance biased towards longs. This maintains the previous broadly even pattern of issuance, whilst taking into account institutional investor preferences that are expected to deliver slightly lower yields at the long and short end, relative to the underlying yield curve, reflecting preferred habitats and term premia. It also takes into account the need for issuance into benchmarks, the availability of conversion candidates, and the results of consultation with the market which revealed a strong and increased demand for longs. At least part of this increased demand appears to be structural in nature, reflecting the increased credibility of the Government's macroeconomic framework, and institutional and regulatory factors such as pension funds' minimum funding requirements, and the abolition of Advance Corporation Tax and dividend tax credits, all of which should continue to increase demand for long-dated gilts in future.

The Government's issuance strategy has therefore been modified to bias it more towards longs, reflecting the additional institutional demand. This will benefit both investors and the Government as issuer. This bias is most marked in the plans for changes to auctions, if the gilt sales requirement changes sufficiently in year to necessitate adding or cancelling an auction. If the financing requirement were to increase sufficiently, the DMO would first hold an additional auction of long gilts. If the financing requirement were to be revised down sufficiently, subject to the timing of changes to the financing requirement, the DMO would first cancel a short gilt auction. Further details of these contingency plans are given in paragraphs 9 and 10 of the DMO remit contained in this report. These contingency plans are a new feature which are intended to further increase the transparency and predictability of the Government's debt issuance plans.

The long run characteristics of the debt portfolio implied by the planned split of auctions in the initial remit are shown in the box on page 8.

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

In addition to issuing debt into benchmarks, liquidity can also be built up by offering conversions from stocks of similar maturity or duration into benchmark stocks. Where the source stock is less liquid than the benchmark stock both parties can benefit as the increase in liquidity has a value that can be realised at little cost. The Government will continue to make conversion offers where there is economic justification in doing so. When gilt sales and the availability of suitable candidates for conversion are insufficient to provide adequate liquidity, the Government will be willing to consider additional measures, such as switch auctions.

THE FINANCING REQUIREMENT OVER THE MEDIUM TERM

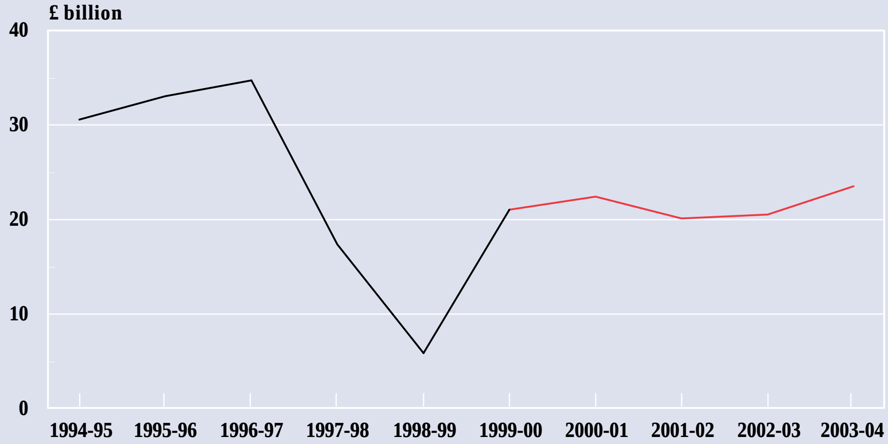
The chart shows the impact of the projected low levels of public borrowing on the financing requirement over the medium term. From 1999-2000 onwards the financing requirement remains fairly stable around £20 billion to £25 billion. This mainly reflects the fairly stable path for redemptions over this period, which rises from £15 billion in 1999-2000 to a little over £21 billion in 2003-04.

The Central Government Net Cash Requirement is the second key determinant of the overall financing requirement. Its path is influenced strongly by the Government's determination to meet two strict fiscal rules to promote economic stability: the golden rule and the sustainable investment rule. Taken together, the rules require that the Government only borrow for investment (and not consumption) and any borrowing must be consistent with maintaining public sector net debt as a proportion of GDP at a stable and prudent level. The rules apply to the whole public sector - including local government and public corporations - and must be met over the economic cycle.

To ensure that the rules are met, the projections of the public finances for the next two financial years - including the financing requirement - are based on deliberately cautious forecasts of economic growth. They do not take credit in advance for any benefits that may stem from the Government's economic reforms and are based on a range of other cautious assumptions, which have been approved by the National Audit Office. For the final three years, the chart uses a stylised assumption of a cash requirement of £5 billion a year.

The estimated outturn for 1998-99 is £6.4 billion lower than forecast at the time of the last Debt Management Report, mainly because of lower cash outlays. For 1999-2000 the forecast is some £3 billion higher. The projections in last year's Debt Management Report were based on illustrative spending growth, but there are now firm spending plans for the three years 1999-2000 to 2001-02. There have also been measures in the 1999 Budget which affect the cash deficit. A reclassification of the refinancing by the Guaranteed Export Finance Company of fixed rate export finance loans guaranteed by the Export Credit Guarantee Department adds some £0.5 billion to recorded cash borrowing in 1999-2000.

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 1999). No allowance is made for conversion offers. High-coupon double-dated stocks are assumed to be redeemed on their earliest possible date

Previous financing of the Central Government Net Cash Requirement

The table to the right shows figures for the Central Government Net Cash Requirement and gross gilt sales, to show how low the current gilts issuance is compared with recent years. Throughout the mid 1990s, annual gross gilt issuance was above £25 billion. The 1998-99 gross issuance total of £8.2 billion reflects the Government's sound economic management and prudent custodianship of the public finances.

Central Government Net Cash Requirements and Gross Gilt Issuance (£ billion)

Year	Central Government Net Cash Requirement	Gross Gilt Issuance
1993-94	49.7	54.8
1994-95	39.1	29.8
1995-96	35.3	30.1
1996-97	25.2	38.8
1997-98	3.5	25.8
1998-99	-2.7	8.2
1999-2000	6.2	17.3

Source for years before 1998-99: Financial Statistics

The following table brings together figures for the financing of the Central Government Net Cash Requirement since 1996-97 in the format of the Government's financing arithmetic, following the framework of the 1995 Debt Management Review.

Financing Requirement

	Central Government Net Cash Requirement	Net finance for foreign exchange reserves	Gilt redemp-tions	Residual adjust-ment in respect of previous year	Financing Require-ment	**Financed by**			
						Net National Savings inflow	Net CTD inflow	Change in T-bill and other short term debt	Gross gilt issuance
Year									
1996-97	25.2	-0.3	12.3	2.2	39.4	4.8	-0.4	-3.9	38.8
1997-98	3.5	0.0	19.5	-3.9	19.1	1.6	-0.1	-8.1	25.8
1998-99*	-2.7	0.0	16.9	-8.2	6.1	0.2	0.0	-2.3	8.2
1999-2000 (remit)	6.2	2.4	14.8	-2.3	21.0	0.1	0.0	3.6	17.3

Source: Financial Statistics   * *(forecast outturn)*

DEBT PORTFOLIO STOCK-FLOW DYNAMICS

The effect of the maturity mix of issuance on the debt portfolio in the long run remains an area of major interest for the Treasury. The Government keeps its optimal issuance strategy under review, taking into account the considerations explained in this report. This means that the Government may change its issuance strategy in future years, though it would do so in such a way as to maintain its commitment to predictability and transparency. Any consideration of the possible debt portfolio in the future therefore must be based on illustrative options for the maturity mix of issuance.

The issuance strategy in this Debt Management Report builds upon the previous strategy in the 1997-98 Debt Management Report - which biased issuance towards shorts and longs - and then further increases the bias towards longs, to relieve some of the current excess demand for longs, which is driven in part by institutional and regulatory structures.

The following table shows the long run characteristics of the debt portfolio under two illustrative options for issuance in future years, based on current and previous issuance strategies. The first option assumes that the maturity mix of issuance continues in the proportions suggested by this coming year's auctions; the second option assumes that, from 2000-01 onwards, issuance reverts back to the proportions of the 1997-98 Debt Management Report (35:30:35). These are, of course, only two of the possible options for future issuance.

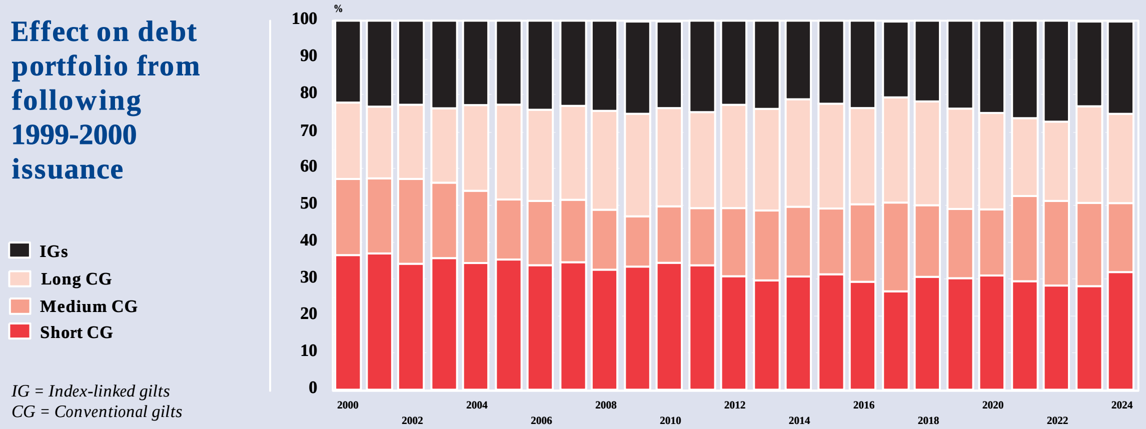
Illustrative options for the mix of debt issuance in future years, and the resulting debt portfolio

Example remit	Resulting Equilibrium Debt Portfolios				
	% of conventional gilts				
	Short	Medium	Long	Average Maturity (years)	Duration (years)
Issuance in proportions approximating 1999-2000 remit	42	25	33	10.9	7.9
From 2000-01 issuance reverts to 35:30:35	44	24	32	10.5	7.7

Calculations assume £5 billion net cash requirement annually; 20 per cent issuance index-linked, distributed evenly across yield curve. Figures include indexation uplift on index-linked gilts. 1999-2000 issuance assumed as 35:25:40.

The following chart illustrates approximately how the debt portfolio would develop over time if the coming year's auction pattern were repeated in future years.

Effect on debt portfolio from following 1999-2000 issuance



IG = Index-linked gilts
CG = Conventional gilts

Assumptions as in table above. Portfolio as at end-March

The Transfer of Debt Management and Cash Management Functions

In May 1997, the Chancellor announced that responsibility for the setting of interest rates to meet the Government's inflation target was being given 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. These functions were transferred to avoid any perception that debt management decisions could be influenced by inside information on interest rate decisions, and to increase transparency in debt management and cash management operations.

The DMO was established as an Executive Agency of the Treasury[2] on 1 April 1998, and took over responsibility for all debt management operations from that date.

The DMO is now expected to take over cash management during the course of 1999-2000, although this timetable is dependent on successful systems implementation. This will complete the separation of debt and cash management from monetary policy operations. DMO decisions will be taken without any inside knowledge of future decisions on interest rates, and without speculating on those decisions. This will achieve maximum transparency and openness. Debt and cash management operations will be conducted with the sole aim of meeting the Government's debt management objective set out above.

After the transfer of cash management, the issue of Treasury bills will take on the new role of being the primary short term financing instrument used to meet the seasonal fluctuation in government's in-year cash requirements. Daily changes in the Government's net cash position will be reflected in the DMO's holdings of short term cash instruments. Previously, this role was met by the Ways and Means overdraft with the Bank of England. When the DMO take over cash management, the level of Ways and Means will cease to be used as the means of balancing the Government's day-to-day cash needs, and the level of Ways and Means will be frozen.

The DMO will need to increase the volume of Treasury bills so that they can be used as the main seasonal cash management instrument. The 1999-2000 debt management plans therefore include an initial increase in net issuance of short term debt. There may also be a further increase in the following year, since it will take time for Treasury bills to be used fully in their new role.

Further details of the proposed cash management operations are explained in the box overleaf.

[2] The relationship of the DMO to the Treasury was set out in the DMO's Executive Agency Framework Document, which was published in March 1998. This set out the DMO's objectives, targets and the structural framework for its operations. Copies are available from the DMO.

THE PROPOSED CASH MANAGEMENT FRAMEWORK

The objective of the DMO's cash management operations will be to smooth the net daily cash flows that occur between the private sector and central government in an efficient and cost effective manner. The DMO's daily operations will neutralise the change in the Exchequer's cash position across government accounts at the Bank of England. The DMO will not take speculative positions on the outcome of the Monetary Policy Committee's (MPC) interest rate decisions. The DMO will have no contact with the MPC or the non-voting HM Treasury representative with regard to interest rate decisions or thinking. Further, the DMO will receive no advance warning of market sensitive policy statements from HM Treasury, the Office for National Statistics or any other government department. The only exception to this shall be announcements, data and forecasts relating to the Government's financing needs. The ultimate goal is to separate the delivery of interest rate decisions by the MPC from meeting the cashflow needs of central government.

The DMO intends to use changes in the level of Treasury bills (T-bills) outstanding to smooth the seasonal fluctuations that regularly occur in the Central Government Net Cash Requirement. The T-bill stock will be run down in periods of net cash inflow and increased in periods of higher net expenditure. Changing the amount on offer at the weekly structured T-bill auctions, relative to bills maturing, will change the stock. A structured T-bill programme is envisaged with the following characteristics:

- Issuance of 1, 3, 6 and 12 month maturities, with the majority in 1 and 3 month maturities. (12 month maturity T-bills will be issued on a trial basis due to their limited role for in-year cash flow management.)
- A minimum T-bill stock of £5 billion in issue at any one time.
- A minimum total weekly T-bill tender of £250 million.
- A quarterly calendar announcing maturities of T-bills to be auctioned. Quantities will be announced one week in advance.
- The DMO will consider establishing benchmarks in T-bills, by re-opening 12 month T-bills at 6 month, 3 month and 1 month maturities, if there is market interest in larger issues.

The DMO will also make use of cash management bills of 1-27 days maturity. These will be issued on a less structured basis to accommodate short term cash needs as they arise.

The DMO will use a combination of money market tenders and bilateral dealings with cash management counterparties to neutralise the remaining net daily cash flows. The DMO will aim to do the bulk of its dealing when the cash markets are the most liquid. Changes late in the day to the Exchequer cash forecasts, however, will still need to be catered for.

The DMO will focus its dealing in outright and repo transactions in UK government paper: gilts, gilt strips, T-bills and foreign currency debt instruments (for repo only). A clear separation between cash and debt management operational functions will be maintained. In addition, the DMO plans to take a wide range of other high credit quality instruments subject to prudential limits, liquidity criteria and settlement arrangements. This will include selected eligible bank bills, major highest-rated European government euro debt instruments and sterling debt instruments issued by highest-rated supranational bodies. This list will be reviewed periodically.

The DMO will seek to deal with a wide range of counterparties to facilitate overall market operations. Counterparties will be regular participants in markets in instruments in which they propose to deal with the DMO. They are therefore likely to be regulated financial intermediaries. The DMO does not envisage a formal market-maker system for T-bills. The DMO will not publish a list of its money market counterparties. Counterparties will be expected to bid regularly and competitively at T-bill auctions and money market tenders.

Counterparties will have:

- The facility to bid by phone at structured T-bill auctions.
- Access to the DMO's ad hoc cash management bill auctions.
- Access to competitive repo and outright tenders.
- Ability to deal with the DMO on a bilateral basis.
- Consultations with the DMO on the state of the money markets and direction of DMO policies.

The DMO published a fuller description of the proposed new cash management framework on 4 December 1998. Copies of the document are available from the DMO.

THE GOVERNMENT'S BORROWING PROGRAMME 1998-99

Gilt Market Review 1998-99

Gilts were the strongest performing government bond market in 1998, as they were in 1997.

Gilt yields fell across the curve over 1998-99, reaching their lowest levels since the mid-1950s. The yield curve remained inverted during the year, but became flatter. The change in yields over the year is shown in Chart 2. Over the year to February, yields on the long benchmark (6% 2028) fell by 121 basis points to 4.5 per cent; the ten year benchmark yield fell 138 basis points to 4.5 per cent, while the five year benchmark dropped by 142 basis points to 4.6 per cent.

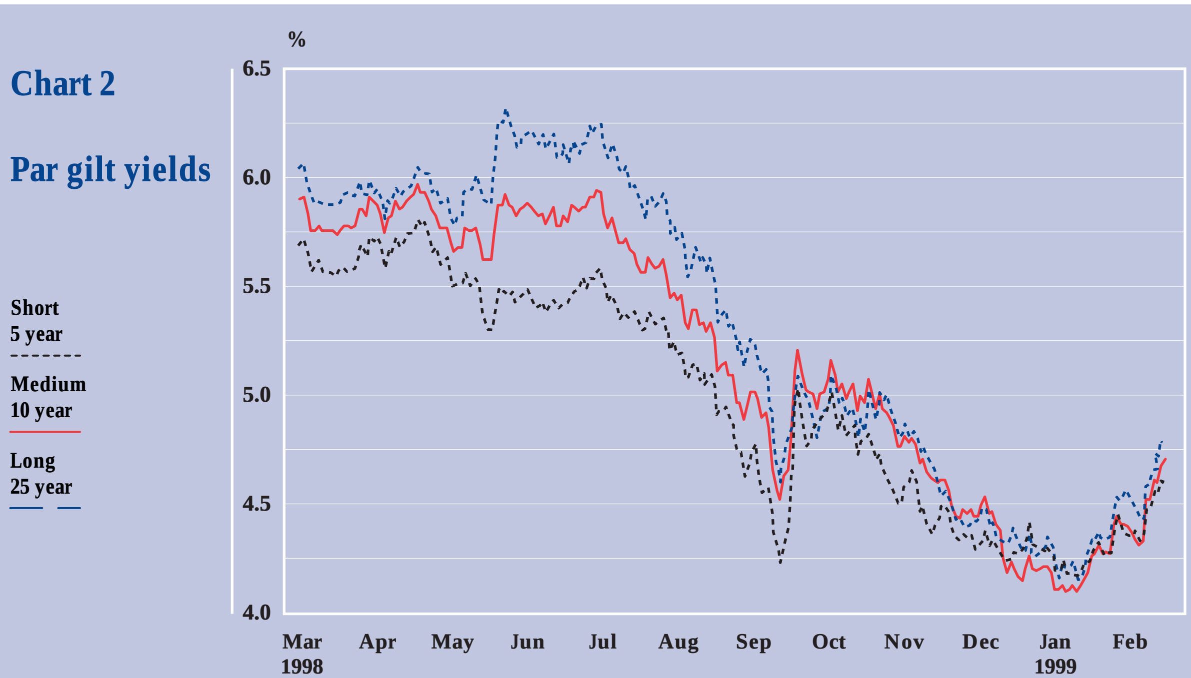
The fall in gilt yields over 1998-99 began in July. Prior to July yields had risen slightly, particularly at the short end (causing the yield curve to invert more steeply), as fears of further interest rate increases grew. However, the turning point came in July when gilt yields began to fall steeply, driven primarily by international developments, and buttressed by falls in interest rates and the reduced supply of gilts. The devaluation and rescheduling of Russian debt repayments and concern of other emerging markets' debts led to growing market fears of default. Yields fell sharply as investors sought the credit quality and liquidity of government debt. Stock markets fell from mid-July. Sterling swap spreads widened to twice their usual level in August.

Central banks around the world began to reduce interest rates in September. The Monetary Policy Committee cut the Bank of England's repo rate by a total of two per cent in five successive meetings. Despite a sharp reversal early in the fourth quarter in common with other major bond markets (as leveraged funds adjusted their portfolios and sold gilts at least in part to unwind yen carry trades) gilt yields continued to fall in the falling global interest rate and bond yield environment. This continued until the end of January. By then uncertainty about the immediate future for interest rates had increased, especially in the US where an increase in rates was factored in as a possible reaction to stronger than expected economic growth.

Index-linked gilts also performed strongly over 1998-99, influenced by many of the same factors as conventional gilts. Towards the end of the year, real

Chart 2

Par gilt yields



yields fell more sharply than those for conventional gilts driven by limited supply and renewed institutional demand influenced by pension funds' minimum funding requirement and an increased desire to hold fixed income securities. In the fourth quarter the ten year index-linked gilt yield dipped below 2 per cent for the first time since index-linked gilts were launched in 1981.

Against the backdrop of growing demand for safe, fixed income products, the supply of gilts fell, reflecting successive reductions in the Government's financing requirement in 1998-99. (The background is given in the Gilt Sales section below.) The low levels of supply contributed to low gilt yields. This weighed particularly heavily at the long end of the yield curve.

The lack of gilts supplied to the market and the positive interest rate differential over other markets helped to reduce the spread of gilt yields over German and US government bonds. The ten-year (annualised) spread between gilts and German bunds narrowed significantly over the year, from around 106 basis points to 68 basis points. The thirty-year spread fell from 21 basis points above the bund yield to 47 basis points below bunds. Against US Treasuries the ten-year yield spread fell from 23 basis points above to 64 basis points below.

Gilt Sales

The remit for 1998-99 published in March 1998 projected total gilt sales of £14.2 billion to meet a forecast financing requirement of £15.2 billion. This was based on a forecast Central Government Net Cash Requirement of £3.7 billion in the 1998 Budget and assumed net financing of £1 billion from National Savings. The gilt sales target fell sharply during the year, first to reflect an increase from £5.1 billion to £8.2 billion in the overshoot from 1997-98 (carried over into the 1998-99 arithmetic) and later, and more significantly, to incorporate a change in the forecast for the 1998-99 Central Government Net Cash Requirement in the November 1998 Pre-Budget Report

Table 3
The 1998-99 financing requirement (£ billion)

	Original Remit	EFSR June 1998	Pre-Budget November 1998	Budget March 1999
Central Government Net Cash Requirement Forecast	3.7	3.5	-2.1	-2.7
Expected net change in Official Reserves	0.0	0.0	0.0	0.0
Expected gilt redemptions	16.7	16.8	16.8	16.9[1]
Under/Over-fund from 1997-98	-5.1	-8.2	-8.2	-8.2
Financing Requirement	**15.2**	**12.1**	**6.5**	**6.1**
Financed by:				
Assumed net National Savings contribution	1.0	0.5	0.1	0.2
Expected net sales of other public debt	0.0	0.0	0.0	0.0
Gilt sales required	**14.2**	**11.6**	**6.4**	**5.9**
Assumed gilt sales in 1998-99	-	-	8.1 - 8.6	8.2
Implied overshoot in 1998-99	-	-	1.7 - 2.2	2.3

Note: Figures may not sum due to rounding
[1] *Budget forecast of redemptions includes ESA95 reclassification of Bank of England holdings*

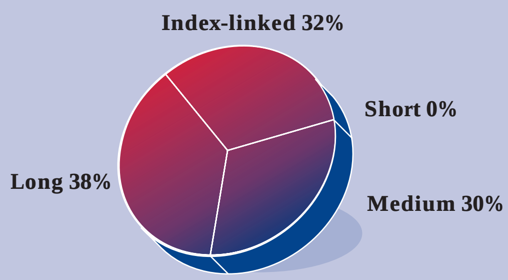
to a surplus of £2.1 billion. This was partly offset by revisions to the forecast net contribution from National Savings, which was reduced during the year from £1 billion to £0.2 billion. The overall effect of these changes was a level of gilt sales required for financing of £5.9 billion (see Table 3). On the basis of the 1999 Budget forecast, and with gilt sales in the financial year to end-February 1999 of £8.2 billion and no further auctions planned, gilt sales are forecast to exceed the level required by £2.3 billion in 1998-99.

The 1998-99 remit included a calendar for four conventional auctions of gilts and two auctions of index-linked gilts. The May and July auctions of conventional gilts were held as planned. The November/December and March auctions of conventional stock were cancelled. The first index-linked auction, due in October, was postponed until November, to avoid a potential clash with the Pre-Budget Report. The second went ahead as planned in January. Auction sizes were in accordance with the remit.

The remit stated that the DMO would aim to make 25 per cent of gilt sales index-linked stock, subject to the minimum of £2.5 billion. With only four auctions, conventional gilt sales would be apportioned approximately 25 per cent in each of the short and medium maturity areas (one auction each) and 50 per cent in longs (two auctions). Conventional taps were to be used only as a market management instrument. In practice, no conventional tap took place during the year. With the required minimum index-linked issuance and only two conventional auctions, debt issued during the year will be split fairly evenly between index-linked, medium, and long maturity conventionals (see Chart 3).

Chart 3

Gilt sales in 1998-99



Three conversion offers were held during the year: two into the five-year benchmark and one into the ten-year benchmark. The $6^{1}/_{2}$% 2003 was built up from £2 billion to £7.99 billion entirely by conversion offers. The new ten-year benchmark ($5^{3}/_{4}$% 2009) was built up to £5.9 billion, first by an auction of £2.5 billion, then by conversion.

The May auction of the 6% Treasury 2028 was the re-opening of a stock first launched in January 1998. The DMO chose an auction size of £3 billion to increase total issuance of this stock to the £5 billion minimum required to allow the bond to become strippable. A new $5^{3}/_{4}$% 2009 stock was opened in July and the market increasingly regards it as the new ten-year benchmark. A total of eight stocks will have been redeemed in 1998-99. The largest of these was the redemption of £5.7 billion nominal of the 1999 Floating Rate Gilt on 11 March 1999. Results of auctions held are shown in Table 4.

Table 4
Results of gilt auctions held in 1998-99

Stock Title	Amount of issue (£ bn nominal)	Date of auction	Lowest yield	Average yield	Highest yield	Times covered	Tail (basis points)
6% Treasury 2028[1]	3.0	20 May 1998	5.77	5.79	5.79	2.26	0
5¾% Treasury 2009[1]	2.5	29 July 1998	5.70	5.72	5.73	2.93	0
2½% Index-linked[2] Treasury 2013	0.45	25 November 1998		2.42		2.29	n/a
2½% Index-linked[2] Treasury 2024	0.45	27 January 1999		2.01		1.83	n/a

[1] *Convention auctions multiple price format*
[2] *Index-linked auctions uniform price format*

National Savings

The outstanding balance of National Savings instruments at the start of the financial year was £63.3 billion. During the year to the end of March 1999 National Savings are expected to make a net financing contribution of about £0.2 billion. Gross sales of National Savings products for 1998-99 are expected to be around £12 billion (including accrued interest). The change in the composition of outstanding products is shown in Table 5.

National Savings' overall cost of financing remained slightly cheaper than gilts throughout the year, after taking into account management costs and imputed tax foregone. National Savings announced eight packages of rate changes during the year. For variable rate products, the changes reflected movements by competitors and in short term interest rates following changes in the repo rate announced by the Bank of England's Monetary Policy Committee. Medium and longer term market rates have also fallen steadily from the third quarter of 1998, leading to reductions in rates for new sales of fixed rate products from both National Savings and other financial institutions. With short term interest rates higher than five-year rates there was some reduction in demand for National Savings' fixed rate products.

Table 5
Change in National Savings products outstanding (1998-99)

(including accrued interest)

	End-March 1998		**End-March 1999***	
	£ bn	per cent	£ bn	per cent
Variable Rate	31.9	50.4	33.5	52.7
Fixed Rate	21.4	33.8	19.8	31.2
Index-linked	10.0	15.8	10.2	16.1
	63.3	**100.0**	**63.5**	**100.0**

**estimates*

DEVELOPMENTS IN NATIONAL SAVINGS: BUILDING CAPABILITY

Building on earlier work to reorganise the Agency into a more business focused operation and to further improve efficiency and flexibility, National Savings signed a partnership agreement with Siemens Business Services for operational services delivery. The arrangement, which comes into effect in April 1999, involves outsourcing the administrative processes required to sell, repay and provide customer service for all National Savings products, and will bring better service to National Savings' customers, savings to the taxpayer, and wider opportunities for staff.

The new partnership introduces private sector capital and expertise which will help National Savings modernise its systems and processes, and will allow National Savings' core to concentrate on its primary objective of marketing retail debt and raising cost-effective financing for the Government as set out in their financing remit.

A priority for 1999-2000 will be action to develop the National Savings brand.

Work on developing the product range has already started, in particular work has been done to develop a National Savings CAT standard mini cash Individual Savings Account (ISA) for launch in April 1999. Also under development is a new pensioner bond offering guaranteed interest rates, but for fixed terms of less than the five-year term of existing National Savings Pensioners Bonds.

More generally, National Savings is working to develop its marketing strategy. This will include examining how each product contributes to the financing task and the changes needed to maintain a balanced portfolio that will help safeguard National Savings' future financing capability. National Savings will also consider how they might best exploit the opportunities offered by new technology, including the potential to develop multi-channel sales methods and tailor them for specific products and customer segments.

DEVELOPMENTS IN THE STRUCTURE OF THE GILT MARKET

Developments in 1998-99

Further developments in the gilt market in 1998-99 continued the process of reform designed to increase the efficiency of the market and the openness and transparency of gilt supply.

Sales of Index-linked Gilts through Auctions

Issuance of index-linked gilts by auction commenced in 1998-99. Prior to the first auction the DMO announced the eight firms selected to be specialist index-linked Gilt-Edged Market-Makers. Despite the sharp drop in the gilt financing requirement the Government stood by its plans to hold two auctions in the second half of the financial year, and its commitment to issue at least £2.5 billion (cash) of index-linked gilts to support the transition to issuance by auction. Although the first index-linked auction had to be postponed to avoid a possible clash with the Pre-Budget Report, both it and the second auction were highly successful, being roughly twice covered with clearing prices close to prevailing market prices. At 2.01 per cent, the real yield on the second auction was the lowest of any index-linked gilt at issue. The Government is again committed to issue a minimum of £2.5 billion (cash) by index-linked auction, and four (quarterly) auctions are scheduled for 1999-2000.

Conventional Gilt Conversion Offers

To build up the liquidity in benchmarks more quickly, particularly in times of relatively low issuance, the 1998-99 Debt Management Report envisaged conversion offers being made, whereby holders of older higher coupon unstrippable stocks could convert their holdings into a current coupon strippable benchmark.

On 5 August 1998 the DMO published a document[3] setting out the rationale for conversions and the methodology it intended to follow and undertook:

- to consider conversions only out of stocks with around five years or more to maturity;
- to consider conversions only out of source stocks with £5 billion (nominal) or less in issue;
- to aim to avoid running two conversion offers concurrently or to run a conversion offer coincident with a gilt auction in the same maturity area;
- to avoid making a conversion offer for a stock which was (or was likely to be) cheapest to deliver into any of the listed gilt futures contracts (or making an offer for a gilt whose terms were open between the dates on which LIFFE or MATIF published their lists of deliverable gilts and the relevant delivery day or month); and
- to consider the application of switch auctions (as an alternative to conversion offers) from 1999-2000.

The document also set out the DMO's pricing methodology and sought market views about the timetable for conversion offers. Following consultation the two week period between announcing the offer and setting the terms was abolished; offers may be settled on days other than dividend dates of the source stock; and the DMO amended its pricing methodology to take some account of the prevailing market prices of both source and destination stocks.

Strippable Stocks

Two more stocks were added to the list of strippable stocks in 1998-99, the new ten-year benchmark stock, 5¾% 2009, and the new thirty-year benchmark, 6% 2028, when its total issuance reached £5 billion. The table below shows the amount of stock held in strippable form at the end of February 1999.

[3] *Gilt-Edged Stock Conversion Offers: Rationale and Methodology*

Table 6
Strippable stocks outstanding (£ million)

Stock Title	Nominal amount in issue at end-February 1999	Nominal amount held in stripped form at end-February 1999	Nominal amount held in unstripped form at end-February 1999
8% Treasury 2000	9,800	135	9,665
7% Treasury 2002	9,000	252	8,748
6½% Treasury 2003	7,987	115	7,872
8½% Treasury 2005	10,373	489	9,884
7½% Treasury 2006	11,700	166	11,534
7¼% Treasury 2007	11,000	219	10,781
5¾% Treasury 2009	6,277	80	6,197
8% Treasury 2015	13,787	210	13,577
8% Treasury 2021	16,500	487	16,013
6% Treasury 2028	5,000	191	4,809
Total	**101,425**	**2,344**	**99,081**

Gilt Market Trading Conventions

Major changes to gilt market trading conventions to help bring the market more into line with major European bond markets were introduced for all trades settling after 1 November 1998. These changes had the following effects:

- Gilt prices quoted in decimals (ie £ and pence) replaced quotes in £ 1/32. Auction bids are now to two decimal places and Gilt-Edged Market-Makers' reference prices are reported to two decimal places or more;
- The daycount convention for the calculation of accrued interest was changed from "actual/365" to "actual/actual" which uses actual coupon payment dates in place of notional half-yearly ones;
- The DMO promulgated[4] an improved methodology for calculating the accrued interest embodied in gilt prices. This has been adopted by the market.

In addition, 31 July 1998 saw the end of the arrangements for the special ex-dividend period gilt trading whereby during 21 calendar days prior to the ex-dividend date, the parties to a gilt transaction could agree to trade on an ex-dividend basis (with the purchaser taking delivery of the gilt without the right to the next dividend). Consequently, fewer trades should now give rise to credit exposure on dividend payments.

LIFFE

From 12 April 1999 the ten year gilt and five year gilt futures contracts will be traded on LIFFE's Connect electronic trading platform, in addition to current options contracts at present. The short sterling contract is expected to transfer to the system in July 1999.

With effect from the September 1999 contract, LIFFE will calculate price factors for the long gilt and five year gilt futures contracts in accordance with the new DMO methodology[4] for calculating accrued interest and yields.

[4] *UK Debt Management Office, "Formulae for Calculating Gilt Prices from Yields", published 8 June 1998. Effective 1 November 1998*

National Savings Stock Register / Bank of England's Registrar's Department

The Government's two separate gilt registers were brought together on 21 July 1998 when the Bank of England Brokerage Service assumed responsibility for the postal purchase and sales service in gilts to small investors previously offered through the National Savings Stock Register. This should reduce the cost of gilt registration and facilitate proposed improvements to the gilt market.

The Future of Gilt and Money Market Settlement Systems

Responsibility for settlement of transactions in gilts and money market instruments is due to be transferred to CRESTCo from the Bank of England in the second quarter of 1999, subject to the necessary statutory and regulatory changes. The gilts settlement service will remain in the Bank under CRESTCo's management until gilts settlement is absorbed into the CREST system, in the second quarter of 2000 on current plans.

The Structure of Gilt Inter-Dealer Brokers

Following the joint consultation paper on inter-dealer brokers issued by the London Stock Exchange (LSE) and the DMO in June 1998, the LSE and DMO announced in February 1999 that they would no longer require gilt inter-dealer brokers to be separately capitalised. The new rules are expected to become effective on 22 March 1999 once the LSE's current consultation is completed.

THE GOVERNMENT'S FINANCING PROGRAMME FOR 1999-2000

Financing Framework

The Government intends to continue to finance the Central Government Net Cash Requirement using the framework which was established in the 1995 Debt Management Review. The Government aims to finance its net cash requirement plus maturing debt and any net finance required for 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 the Debt Management Report.

Table 7
1999-2000 financing requirement (£ billion)

Central Government Net Cash Requirement	6.2
Net financing for Official Reserves[1]	2.4
Gilt redemptions	14.8
Gilt sales residual from 1998-99[2]	-2.3
Financing requirement	**21.0**
Less net financing from:	
National Savings	0.1
Treasury bill & other short-term debt[3]	3.6
Gross gilt sales required	**17.3**
of which:	
Short conventional (3-7 yrs)	5.0
Medium conventionals (7-15 yrs)	3.0
Long conventionals (>15 yrs)	5.8
Index-linked gilts	3.5

Note: Figures may not sum due to rounding
[1] The reserves require financing in 1999-2000 to replace € 3.5 billion of Euro Treasury Bills Estimated at current exchange rate
[2] See Table 3 for derivation of 1998-99 gilt sales residual
[3] The stock of T-bills and other short-term debt will need to increase during 1999-2000 to accommodate the DMO's cash management operations

For 1999-2000, the financing requirement will also take account of the scheduled transfer to the DMO of government cash management. This will require an increase in the level of Treasury bills and other short term debt.

Financing Arithmetic

Table 7 gives full details of the debt instruments that the Government intends to use to finance the Central Government Net Cash Requirement in 1999-2000, on the basis of the 1999 Budget forecast of the Central Government Net Cash Requirement, the expected level of gilts maturing outside central government, and the expected net finance required for the foreign exchange reserves.

The Central Government Net Cash Requirement for 1999-2000 is forecast to be £6.2 billion. Some £14.8 billion of gilts are expected to mature outside central government and will need to be refinanced (see Table 8). The foreign exchange reserves are assumed to remain unchanged. However, these reserves will require additional sterling financing to replace €3.5 billion of Euro Treasury Bills (worth around £2.4 billion at the current exchange rate). Foreign currency swaps out of new sterling borrowing will replace that part of the reserves previously financed by these Euro Treasury Bills (see box on page 23). Hence the financing requirement for 1999-2000 will be increased by the sterling equivalent of €3.5 billion.

Although the expected increased issuance of Treasury bills for cash management reduces gilt sales in 1999-2000, this effect is expected to be largely offset by the need for additional financing for the foreign exchange reserves.

The financing requirement for 1999-2000 is forecast to be around £21.0 billion, subject to confirmation of the outturn in 1998-99. Table 7 shows the net amount

Table 8
Stocks maturing in 1999-2000 (£ million)

Redemption date	Stock	Nominal amount outstanding	Official holdings (end-December)	Nominal value of market holdings (end-December)
Conventionals				
19 May 1999	Treasury 10 1/2% 1999	1,252	15	1,237
10 Aug 1999	Treasury 6% 1999	6,950	476	6,474
22 Nov 1999	Conversion 10 1/4% 1999	1,798	17	1,781
28 Jan 2000	Treasury 8 1/2% 2000	109	91	18
3 Mar 2000	Conversion 9% 2000	5,358	42	5,317
Index-linked				
22 Nov 1999	Conversion IL 2 1/2% 1999	2	0	2
Total Outstanding		**15,470**	**641**	**14,829**
	of which:			
	conventional	15,468	641	14,827
	index-linked	2	0	2

of each type of debt that the Government intends to issue to meet this financing requirement in 1999-2000.

Increase in Short Term Debt for Cash Management

The financing requirement in Table 7 is reduced by a "gilt sales residual" which unwinds the excess sales of gilts in 1998-99, based on the forecast for the 1998-99 Central Government Net Cash Requirement in the Budget. This "gilt sales residual" in the financing arithmetic increases the issuance of short term debt in 1999-2000 (thereby reducing the financing requirement), and unwinds the expected reduction in short term debt in 1998-99 necessary to accommodate the excess gilts sales.

In recent years, the decision to unwind the previous year's undershoot or overshoot in gilt sales has been a portfolio decision. For 1999-2000, the inclusion of the residual which unwinds the previous year's excess gilt sales is only a presentational device. For 1999-2000, as part of its portfolio decisions, the Government has decided to issue more Treasury bills in order to build up the stock to a level that will enable the DMO to start to use them as the main instrument for smoothing the Government's cash flow, as a key part of the cash management operations. This requires an increase in short term debt above that necessary for unwinding the effects of excess gilt sales in 1998-99. The total increase in short term debt is assumed to be £5.9 billion. In the financing arithmetic the increase in short term debt is presented in two parts to make clear how much of the increase is necessary to return the stock of short term debt to its previous level - the unwinding residual - and the amount of short term debt that the Government plans to issue to reach the higher level of stock needed initially for cash management. This is illustrated in Table 9.

For the purposes of these plans, the net increase in Treasury bills and Ways and Means during 1999-2000 is assumed to achieve a stock of Treasury bills issued outside central government of about £10 billion and a level of Ways and Means of about £17 billion, at 31 March 2000. This is the assumed level at which Ways and Means will be frozen, following completion

Table 9
Change in short term debt in 1999-2000 for cash management

	£ billion
Increase in Treasury bills	6.2
Financing of cash deposit in Bank of England	0.2
Expected repayment of Ways and Means	-0.5
Total net increase in short term debt	**5.9**
Presentation in financing arithmetic:	
Residual unwinding the decrease in short term debt in 1998-99[1]	2.3
Expected net increase in issuance to meet initial requirements of DMO's cash management operations in 1999-2000	3.6
Total net increase in short term debt	**5.9**

[1] The stock of short term debt was reduced in 1998-99 to offset excess gilt sales

of cash management transfer. These 31 March 2000 stock level figures are only planning assumptions. In the event that the Government revises its financing programme for 1999-2000, any changes in the financing requirement could be accommodated by changes to planned issuance of short term debt, which would affect the stock of Treasury bills and other short term debt at 31 March 2000, as well as by changes to planned gilt issuance. Further details of how any changes to the financing requirement might be accommodated are contained in paragraphs 9 and 10 of the DMO remit.

National Savings

The net contribution of National Savings to financing (including accrued interest) is assumed to be around £0.1 billion. This assumes gross sales (i.e. sales and deposits including accrued interest) of around £11 billion. The net contribution is not a target, but an estimate based on experience in previous years, trends in 1998-99, and National Savings' forecast and objectives for 1999-2000. It reflects the large amount of redemptions which are due on National Savings products during 1999-2000.

Quantity of Gilt Sales

The Debt Management Office, on behalf of the Government, will aim to meet the remainder of the financing requirement by selling gilts to the private sector. On the basis of the 1999 Budget Central Government Net Cash Requirement forecast, this means gilt sales to the market of approximately £17.3 billion.

Nature of Stocks

The Government will continue to have available the full range of financing instruments. Within conventional stocks, the Government will aim for liquid benchmark issues in the five-year, ten-year and long-dated maturity areas. There are no current plans for floating rate issuance or issuance of gilts of less than 3 years maturity, although the DMO reserves the right to tap sub-3 year gilts for market management purposes. Index-linked issuance is likely to be focused on medium and longer term maturities, although the option to issue shorter maturity stocks remains open.

Changes to the 1999-2000 Financing Programme

The total net increase in short term debt included in Table 7 above is contingent on the final outturn for the Central Government Net Cash Requirement in 1998-99. Table 7 assumes an overshoot of the gilt sales target in 1998-99 of £2.3 billion, based on the Budget forecast for the Central Government Net Cash Requirement in 1998-99 of a repayment of £2.7 billion (see table 3). If the 1998-99 Central Government Net Cash Requirement outturn differs from this forecast, that will change: the size of the gilts overshoot; the offsetting reduction in short term debt in 1998-99; and the net increase in short term debt in 1999-2000 to unwind these effects. The consequent change to the size of the residual carried over into 1999-2000 to unwind the gilt sales overshoot will affect the financing requirement in 1999-2000. If necessary, the Treasury will publish a revised 1999-2000 financing requirement when the outturn for the Central Government Net Cash Requirement in 1998-99 becomes available. Paragraphs 9 and 10 of the DMO remit specify how the DMO expect to alter the debt issuance plans in 1999-2000 to deal with any change in the financing requirement. This explanation and advance specification is intended to make any subsequent changes to the Government's financing programme for 1999-2000 predictable and transparent.

If the transfer of cash management is delayed beyond 1999-2000, the Government will not increase the net issuance of short term debt beyond the increase necessary to offset the size of the gilts overshoot in 1998-99.

Assuming that the transfer of cash management does go ahead in 1999-2000, the Government may need to increase the issuance of Treasury bills further in 2000-01.

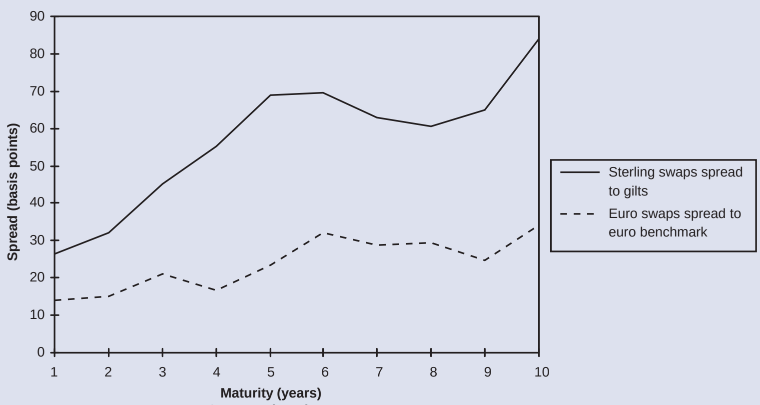
GILTS AND THE RESERVES

A little under £2$^{1}/_{2}$ billion of 1999-2000 gilts issuance will be used to finance the foreign currency reserves. The sterling receipts will be invested in high grade foreign currency assets using cross-currency swaps to hedge the currency risk.

These swaps will replace the €3$^{1}/_{2}$ billion Euro Treasury Bill programme. Every month the Treasury has been issuing €200 million of one month bills, €500 million of 3 month bills and €300 million of 6 month bills with €3$^{1}/_{2}$ billion of bills outstanding at any time. The proceeds from this programme, as with other foreign currency borrowing, have been used to finance the foreign currency reserves.

During the first half of 1999-2000 the Bank of England will be taking over the Euro Bill programme and issuing Euro Bills in its own name to finance the Bank's provision of intra-day liquidity through TARGET. For the moment the Treasury has decided to replace its Euro Bill programme by combining gilts issuance with currency swaps rather than borrowing directly in foreign currency. The current spread between the gilts yield curve and the sterling swaps curve means swapping out of gilts is a more cost-effective method of financing the foreign currency reserves for the Treasury than borrowing directly in euros for example.

Gilts and euro benchmark spreads to swaps (8 March 1999)



Source: Bloomberg

THE DEBT MANAGEMENT OFFICE REMIT FOR 1999-2000

Objectives

1. The Debt Management Office (DMO), an Executive Agency of HM Treasury, has been given the following objectives:

- To meet the annual remit set by Treasury Ministers for the sale of gilts, with high regard to long-term cost minimisation and risk.
- To provide a high-quality efficient service to primary dealers and investors in gilts, consistent with achieving low cost issuance.
- Once the office takes over responsibility for cash management, to provide for the daily aggregate cash needs of the Exchequer in an efficient and cost-effective manner.
- 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.
- To act as sponsor of the gilts market, liaising with the Bank of England, Financial Services Authority, LIFFE and London Stock Exchange, so that the market is healthy, orderly and well-regulated, to meet the issuer's needs.
- To advise Ministers on setting the remit to meet the Government's debt management objectives.
- To provide policy advice to Treasury Ministers and senior officials on new instruments and structural changes to the gilt market that will help to lower the cost of debt management.

Quantity of Gilt Sales

2. The Debt Management Office, on behalf of the Government, will aim for gilt sales of approximately £17.3 billion in 1999-2000, subject to confirmation of the size of any overshoot of the gilt sales target in 1998-99. This figure assumes the transfer of government cash management responsibilities to the DMO during 1999-2000 and takes account of the resulting adjustment to the stock of short term debt instruments.

3. In the event that cash management responsibilities are not transferred to the DMO in 1999-2000 the gilt financing requirement will be adjusted downward by carrying forward the over-financing from 1998-99 but no further change to the level of short term financing instruments would be assumed in 1999-2000.

Pace of Gilt Sales

4. 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, until such time as the DMO takes over responsibility for cash management, the Ways & Means advances.

Amount and Maturity Mix of Index-linked Gilt Issuance

5. Over 1999-2000, the Debt Management Office will aim to make about 20 per cent of its gilts sales in index-linked stocks, subject to lower and upper limits of £2.5 billion and £4.0 billion (cash). On the initial financing requirement this would result in sales of £3.5 billion index-linked (cash).

6. Four auctions of index-linked stocks are planned in 1999-2000. Given that auctions will only cover a

single stock, it will not be possible to reopen each stock in this year and issuance will be directed at medium- and longer-dated maturities, i.e. stocks dated 2009 and beyond. However, the DMO will be prepared to issue up to a further £0.5 billion (cash) of index-linked stocks through taps between auctions, if necessary, whether for market management purposes or to relieve any overall market shortages.

7. To ensure the medium term viability of the index-linked auction programme, the authorities remain committed to a minimum supply of £2.5 billion (cash) of index-linked stocks in 1999-2000 and for the foreseeable future.

Amount and Maturity Mix of Conventional Gilt Issuance

8. Five auctions of conventional stocks are planned in 1999-2000; two each in the short (3-7 years) and long (15 years and over) maturity areas and one in the medium (7-15 years) area.

9. On the assumption of the transfer to the DMO of cash management responsibilities during 1999-2000, any increases or reductions in the 1999-2000 financing requirement in this remit will be accommodated first by an adjustment to the level of planned Treasury bill issuance of up to £3 billion. Any increases or reductions to the financing requirement of more than £3 billion will be accommodated through a combination of an adjustment to the number and size of gilt auctions and, as necessary, changes in planned Treasury bill issuance (in such a way that a minimum Treasury bill stock of £5 billion is maintained).

10. If the 1999-2000 financing requirement increases by a sufficient amount to justify a change to the auction programme, and it is not too late in the financial year to make the change, the current expectation is that the DMO would first add a long gilt auction to the financing programme. If the 1999-2000 financing requirement decreases by a sufficient amount, again subject to timing constraints, the current expectation is that the DMO would first cancel a short gilt auction. If the financing requirement were to change sufficiently to justify the addition or cutting of a second gilt auction, again subject to timing constraints, the DMO would expect to have consulted the market about the maturity of the gilt auction to be added or cut.

11. For 1999-2000, there are no plans to meet the financing requirement through sales of gilts with a maturity of less than 3 years, but the DMO reserves the right to tap sub-3 year gilts for market management purposes.

Method of Issuance of Gilts

12. Auctions will constitute the primary means of issuance of all gilts (conventional and index-linked). The authorities plan to hold five auctions of conventional gilts and four auctions of index-linked gilts on the calendar set out below. All auctions will be single auctions held on the day indicated.

13. Each auction of conventional gilts is planned to be for between £2 billion and £3 billion (cash) of stock on a competitive bid price basis. Each auction of index-linked gilts will be for between £0.5 billion and £1.25 billion (cash) of one stock on a uniform price basis.

14. The programme of conventional and index-linked gilt auctions may be supplemented between auctions by official sales of stock by the DMO "on tap". Taps of stocks will be used only as a market management instrument in conditions of temporary excess demand in a particular stock or sector. Paragraph 6 above describes the circumstances applying to index-linked taps. Conventional stocks have not been tapped since late 1996 and the DMO would only contemplate taps of conventional stocks in exceptional circumstances.

15. 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.

16. For the purposes of market management, the Debt Management Office may create and repo out stock.

The Auction Calendar

17. The calendar for auctions in 1999-2000, covering auctions of conventional and index-linked stocks, is shown below.

Gilt auction calendar 1999-2000

Date	Type
Wednesday 28 April 1999	Index-linked
Wednesday 26 May 1999	Conventional
Wednesday 23 June 1999	Conventional
Wednesday 28 July 1999	Index-linked
Tuesday 28 September 1999	Conventional
Wednesday 27 October 1999*	Index-linked
Wednesday 24 November 1999*	Conventional
Wednesday 26 January 2000	Index-linked
Wednesday 29 March 2000*	Conventional

**Subject to confirmation following the Chancellor's decisions on the Budgetary timetable.*
If required, a sixth conventional gilt auction would be held on Wednesday 23 February 2000. If not required, cancellations of conventional auctions would be announced at the same time as the publication of a lower financing requirement. DMO will bear in mind the need to provide sufficient notice to the market of the cancelling of an auction.

In-year Consultation and Announcements on Auctions

18. Towards the end of each calendar quarter, the DMO will publish, with the agenda for the consultation meetings with gilt market participants, details of progress to date with the gilt issuance programme, including any changes to the Government's financing requirement and any changes to the gilts auction programme. The DMO will then consult Gilt-Edged Market-Makers and end-investors on the auction programme for the following quarter, and any other issues that may arise. Following that consultation, at the end of the quarter, the DMO will announce plans for the auctions scheduled for the coming quarter. For each auction, this will indicate the stock to be auctioned or, where relevant, the approximate maturity of a new stock.

19. The auction plan for the first quarter of 1999-2000 will be announced at 3.30pm on Wednesday 31 March 1999.

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

Coupons

21. As far as possible, coupons on new issues of gilts will be close to par yields at the relevant maturity, at the time of issue.

Buy-ins of Short Maturity Debt

22. Following the transfer of cash management, the DMO will also take over from the Bank of England responsibility for buying in stocks close to maturity to manage Exchequer cash flows.

Conversions and Switch Auctions

23. In order to build up the pool of benchmark stocks further, the Debt Management Office envisages making offers for the conversion of unstrippable stocks into benchmarks of similar maturity during 1999-2000. Details of any such offers will be announced in due course, in the light of market conditions.

24. The programme of conversion offers may be supplemented by switch offers into benchmark stocks during 1999-2000. Before the start of any such programme the DMO will publish proposals outlining the structure of such switch offers.

Reviews to the Remit

25. 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 (including possible change arising from slippage in the timetable for cash management) ;
- the level and shape of the gilt yield curve;
- market expectations of future interest and inflation rates; and
- market volatility.

26. Any revisions to this remit will be announced.

NATIONAL SAVINGS' FINANCING REMIT 1999-2000

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

- To market government debt to retail investors so as to help to minimise the combined cost and risk of the total national debt and to contribute to the Government funding needs.
- To promote Government savings policies amongst personal investors.

2. In meeting these objectives, the agency will operate cost-effectively and in a competitive and commercial manner that does not distort the savings market. Its main aim is to provide cost-effective financing, and it should contribute to government financing in a manner that benefits both Government and the retail saver - now and in the future.

Volume of Government Financing in 1999-2000

3. Sales and deposits (including accrued interest) of National Savings' products are assumed to be around £11 billion in 1999-2000. After meeting maturities and withdrawals there will be a net contribution to government financing of around £0.1 billion.

Product Terms

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

5. NS will normally take the lead in bringing forward proposals to Treasury Ministers on product terms, including interest rates. If the proposals are consistent with NS' objectives and this remit, as set by Treasury Ministers, then Treasury Ministers would expect to support them.

Cost/volume Limits

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

7. 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 cost of NS products, the achievement of NS' funding remit, and the need for NS to retain the capability and market presence to contribute to government funding over the medium term.

Review of Remit

8. The Treasury or NS may initiate a review of the remit in the course of 1999-2000 in the light of any relevant factors. The remit will be reviewed before the start of each financial year.

Any enquiries about this document should be addressed to:

HM Treasury

Philippa Todd, Tel (44) 171 270 5471
Roy Westwater, Tel (44) 171 270 4613

Address : Debt & Reserves Management Team, 2nd Floor, HM Treasury, Parliament Street, London SW1P 3AG
E-mail : firstname.lastname@hm-treasury.gov.uk

UK Debt Management Office

Paul Mills, Tel (44) 171 862 6521

Address: UK Debt Management Office, 1st Floor, Cheapside House, 138 Cheapside, London EC2V 6BB

Further copies of this document are available from:

The Public Enquiry Unit, HM Treasury, Parliament Street, London SW1P 3AG
Tel: (44) 171 270 4558