DEBT MANAGEMENT REPORT

2000-01

Her Majesty's Treasury

March 2000

Foreword by the Economic Secretary to the Treasury

Since coming to office the Government has made sure that the public finances are on a sound footing, in order to lock in economic stability and provide a platform for steady growth. The Code for Fiscal Stability has put the new fiscal policy framework on a statutory basis. In line with this new framework, and the two tough fiscal rules, the Government has cut annual borrowing by £30 billion in its first three years, and halted the rise in government debt.

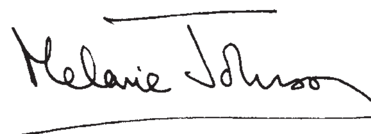
The Government is determined to continue to be prudent. The fiscal projections published in the Budget demonstrate that the Government is set to continue to meet both its tough fiscal rules. Thanks to the introduction of the new monetary and fiscal framework, the debt interest bill is projected to be £4 billion a year lower. Because of this prudence and modest net borrowing needs, the Government is in a position to restructure some of its liabilities in order to secure best value for money for taxpayers.

This restructuring will help ensure new gilts issuance is at a level which will contribute to maintaining liquidity in the market at a time of exceptionally strong demand, especially for long gilts. This additional liquidity will help ensure that the Government's costs of borrowing are minimised over the long term.

1999-2000 has been another year of improvements in the gilts market. The main innovations were the publication of how the Government would alter its auction schedule in the light of changes to the financing requirement, and the introduction of switch auctions to enhance the liquidity of benchmark stocks. During the year, the Debt Management Office has also consulted on how the DMO should interact with the gilt market in the light of developments in electronic trading and how it intends to conduct any special repo operations. It has announced a standing repo facility for Gilt-edged Market Makers, to become operational in June 2000.

The financing plans for 2000-01 reflect the transfer of the Government's cash management from the Bank of England to the Debt Management Office. This is a very significant and complicated undertaking. The Debt Management Office has consulted widely on the implementation of the new system, which will take effect at the beginning of the financial year.

1999-2000 was also the first full year of National Savings partnership with Siemens Business Service for provision of operational services. This partnership will bring better service to National Savings' customers and savings to the taxpayer. On a more strategic level, on 11 January I announced the launch of a review of National Savings, as part of the Government's five-yearly rolling programme of agency reviews. This review will look at the options for National Savings' future, including the future status of National Savings, possible improvements within the current agency framework and what further scope there is for partnership working.



21st March 2000

MELANIE JOHNSON
Economic Secretary to the Treasury

INTRODUCTION

This is the sixth 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 1999-2000;
- developments in the gilt market and National Savings in 1999-2000; and
- the Government's financing programme for 2000-01 and remits to National Savings and to the Debt Management Office.

SIZE AND STRUCTURE OF UK GOVERNMENT'S DEBT IN 1999-2000

Debt Stock

The total outstanding UK Central Government marketable sterling debt (including official holdings by government) is estimated to be £298 billion at the end of March 2000. This comprises £225 billion of conventional gilt-edged stock, £66 billion of index-linked gilts (including accrued inflation uplift) and £7 billion of Treasury bills (Table 1). In addition, an estimated £63 billion (including accrued interest) will be invested in National Savings instruments at the end of March 2000.

Table 1
Composition of UK Government marketable sterling debt

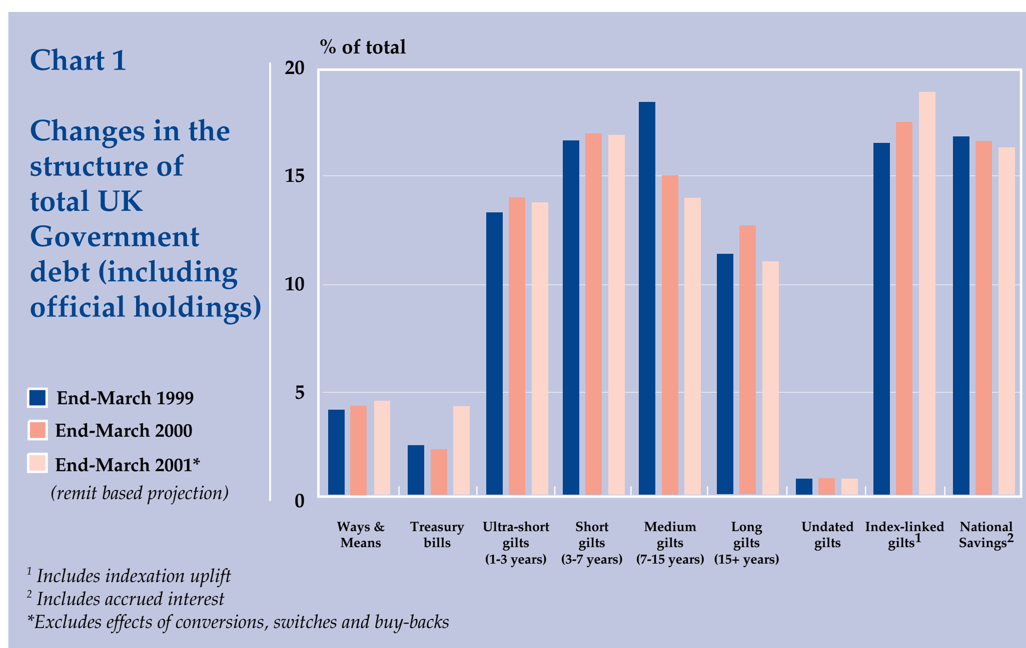
(£ billion, nominal value, including official holdings)

	End-March 1999	End-March 2000 *
Conventional gilts[1]	229.3	224.5
Index-linked gilts [2]	62.5	66.1
Treasury bills [3]	9.2	7.2
	301.0	**297.8**
National Savings	63.6	62.6

**estimates*
[1]includes floating rate gilt and undated stocks
[2]includes accrued indexation uplift
[3]net of temporary increase in assets for cash management

Chart 1 compares the composition of the Government's debt portfolio at the beginning of the 1999-2000 financial year with the composition estimated for end-March 2000, and the projected composition for end-March 2001. 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, but does not make assumptions about conversion offers, switch auctions or buy-backs. The path for the level of the "Ways & Means" advances[1] is similar to that of 1999-2000 Report, when the expectation was that the DMO would take on responsibility for managing the Government's cash balances during 1999-2000. The transfer of cash management from the Bank of England will now be completed at the beginning of April 2000. The assumption underlying the figures for short term debt is that the balance on the Ways and Means facility at 31 March 2000 will be close to £15 billion. In 2000-01 the stock of Treasury bills is projected to rise, to a level more appropriate for the DMO's cash management operations.

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



The average maturity of the stock of all dated gilts will have remained broadly constant at 9.9 years from end-March 1999 to end-March 2000, while the average maturity of conventional gilts will have risen slightly from 8.7 to 8.8 years. The modified duration of the whole gilt portfolio should rise from 7.4 years to 7.5 years over the same period, while that for conventional gilts alone should rise from 6.4 years to 6.5 years. The maturity of the UK Government's marketable domestic debt remains among the longest of OECD countries. Table 2 shows the sectoral composition of gilt holdings at the end of March 1999. Figures for March 1998 are also provided, using the same definitions.

Interest Payments

Gross central government debt interest payments are forecast to be £25.5 billion in 1999-2000, approximately 8 per cent of total central government current expenditure. This figure is expected to rise in 2000-01, to £27.8 billion (8.4 per cent), reflecting projections of higher short term interest rates and increasing RPI inflation as RPIX returns to its 2½ per cent target level, before falling to £27.1 billion (7.8 per cent) in 2001-02 and to £26.7 billion (7.3 per cent) in 2002-03.

Table 2
Distribution of holdings of gilts at end-March 1998 and 1999 (market values)

	End-March 1998		End-March 1999	
	£ bn	%	£ bn	%
Non-bank private sector	235.5	73.5	250.0	74.6
Overseas sector	60.4	18.8	64.8	19.3
Monetary sector	22.2	6.9	16.7	5.0
Public sector holdings*	2.5	0.8	3.6	1.1
	320.6	**100.0**	**335.1**	**100.0**

**Local authorities and public corporations*

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 and other market operations including switch auctions, conversion offers and, now, buy-backs;
- developing a liquid and efficient gilts market; and
- offering cost-effective savings instruments through National Savings.

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 other short term instruments required in 2000-01 for cash management.

The Government keeps its optimal issuance framework under review. In the past year, the forecast financing requirement was higher than the previous year. This allowed some bias towards long issuance to respond to a structural change in demand, in addition to maintaining liquidity in benchmark gilt issues.

This coming year, the Government is again faced with a relatively low financing requirement. The strength of demand for long gilts reflects ongoing demand from UK pension funds and life companies, on the back of increasing private sector provision, an increasing proportion of these funds needing to match assets more closely with liabilities as pension funds mature, and an ageing population (see box on page 5 for more detail).

Given exceptional demand for long gilts combined with the low issuance environment, the Government believes it is prudent to bias a greater proportion of its issuance towards longs than in previous years. The high proportion of long gilts issuance should help alleviate low levels of liquidity in the long end of the gilts market. This will benefit both investors and the Government as issuer.

The 1999-2000 Report showed the long run characteristics of the debt portfolio implied by the planned split of auctions in the initial remit for that year. Because of the low level of issuance this year, its maturity structure will not have a significant impact on the portfolio as a whole. Given that this year's issuance pattern is atypical compared to recent

years, the box on page 7 shows the implications for the portfolio if issuance from 2001-02 onwards reverted back to the 1997-98 proportions of 35:30:35.

Transfer of Cash Management Function

The DMO is scheduled to take over the day-to-day responsibility for Exchequer cash management on 3 April 2000. The box on page 6 outlines the rationale behind the transfer and the developments since the decision was announced in May 1997. The DMO's cash management remit on pages 26 and 27 describe how the DMO will carry out its new responsibilities.

The DMO's primary objective in carrying out its Exchequer cash management operations will be to offset, through its market operations, the expected cash flow into or out of the National Loans Fund on every business day; and to do so in a cost-effective manner. In doing so the DMO will strike a balance between cost and risk in its choice of strategies and attempt to manage the Exchequer's cash flows without: influencing the level of short term interest rates; undermining Bank of England operations for the implementation of its monetary policy objectives; or adversely affecting the efficiency of the sterling money market.

While the primary objective of the establishment of the new cash management system has been to avoid any perceived conflict of interest between the implementation of monetary policy by the Bank and the management of the Exchequer's cash flows, there should be other advantages to the new system. In particular: the Government's longer term sterling debt management decisions can be integrated more fully

DEMAND FOR LONG GILTS

The improvement in the Government's finances over the past two years has led to relatively low levels of long gilt supply. This reduction in supply has been accompanied by a sharp increase in demand from UK institutional investors: pension funds and life assurance firms.

Demand from insurance firms has increased because of the change in pension fund maturity. Life assurance firms provide the annuities that pensioners must buy on, or shortly after, retirement. Typically a life assurance firm will back this liability with a gilt asset. Historically this has been the case, with life assurance firms having increased their holdings of long gilts by over £1 billion per quarter during the 1990s. Life assurers' demand for long-dated gilts has increased in line with the number of people in retirement and with life expectancy.

Pension fund demand has increased because of three factors. First there has been rapid growth in private and company pension provision over the last decade. Second, life expectancy has risen. Third, the client base of these pension providers is maturing as the number of pensions in payment increases.

A maturing pension fund will tend to increase their holdings of bonds, so that their future payments for pensioners will be matched by a corresponding fixed income. Gilts have in the past been most widely held by maturing pension funds for this purpose. Pension funds have also made use of index-linked gilts to match their index-linked liabilities.

The Minimum Funding Requirement (MFR) put into law the need for consistently adequate funding, reinforcing the need to match investments with liabilities, and bringing into focus the effect of demographic changes on investment behaviour. The MFR is currently undergoing review by the Faculty and Institute of Actuaries on behalf of the DSS. This review was largely a response to a tax change in 1997 which complicated the calculation of "true" equity yields and changed an important part of the process of discounting liabilities under the MFR. The actuaries are due to make their report to DSS in spring 2000.

into the cash management strategy; and the DMO will be able to transact at longer repo maturities (up to six months) than the Bank's daily monetary policy operations.

Throughout, the DMO and the Bank of England have worked together to ensure that the new system avoids clashes in the delivery of their respective objectives in the money markets. The DMO will not take speculative positions on interest rate decisions by the Bank nor hold operations which by their nature or timing in the day could be perceived to clash with the Bank's open market operations.

The system is also designed to contain the credit risk exposure of the Exchequer by concentrating on secured transactions and to minimise the size of the overall Exchequer balance. Hence, although the DMO's end year net asset position may vary somewhat with unanticipated changes in the Exchequer daily flows, for forecasting purposes the assumption will be that the DMO's end year position equates to its cash deposit at the Bank of England (currently set at £0.2 billion).

TRANSFER OF EXCHEQUER CASH MANAGEMENT TO THE DMO

The assumption of full responsibility for Exchequer cash management by the DMO, scheduled for 3 April 2000, represents a significant development in the structure of the sterling money markets.

The move completes the restructuring of Government debt and cash management foreshadowed in the Chancellor of the Exchequer's statement of 6 May 1997, announcing the transfer of responsibility for the setting of official interest rates from the Treasury to the Bank of England. The Chancellor also announced that the Bank's role as the Government's agent for debt and cash management was to be transferred to the Treasury.

The transfer of debt management took place on 1 April 1998 when the DMO began operation. The transfer of Exchequer cash management to the DMO is due to be completed on 3 April 2000. The Bank of England will continue with its responsibility for operations in the sterling money markets relating to its monetary policy objectives.

The DMO has consulted the market closely during the development of the new cash management framework. A detailed description of the new framework was published on 4 December 1998 and the first version of the operational market notice on 29 July 1999. An updated version of the operational market notice was published on 6 January 2000.

Responsibility for cash management has been transferred two years after debt management to cater for the implementation of new support systems. Latterly the transfer was delayed until after January 2000 to take into account the market's preference to avoid making the transfer close to the year 2000 weekend.

Features of the new regime have been phased in. The Debt Management Account, through which all the DMO's gilt and cash transactions will pass, came into operation on 15 November 1999 (dealing only with gilt transactions initially). On 14 January 2000 the DMO took on responsibility from the Bank for the conduct of weekly ("structured") Treasury bill tenders. The Bank retains responsibility for determining the size and maturity of the tenders until transfer of cash management is complete. On 14 February 2000 the DMO began bilateral dealing with counterparties in the money markets, in small size, with the aim of helping to balance the flows of cash into and out of the Exchequer.

DEBT PORTFOLIO STOCK-FLOW DYNAMICS

The Treasury continues to pay close attention to the effects of the maturity mix of issuance on the resulting debt portfolio in the long run.

Issuance decisions for 2000-01 do not signal a change in the Government's long term optimal issuance strategy. Although the Government may change its issuance strategy in future years, it would do so consistent with maintaining its commitment to predictability and transparency.

Low issuance combined with liquidity needs at the long end of the maturity spectrum have led to a much stronger bias in issuance towards longs than in previous years. The following table shows the long run characteristics of the debt portfolio under some illustrative options for issuance in future years. The first assumes that issuance from 2001-02 onwards contains a strong bias towards the long end (30% shorts: 25% mediums: 45% longs). The second assumes that future issuance reverts back to the proportions of the 1997-98 Debt Management Report (35:30:35). These are, of course, only two of the options for future issuance.

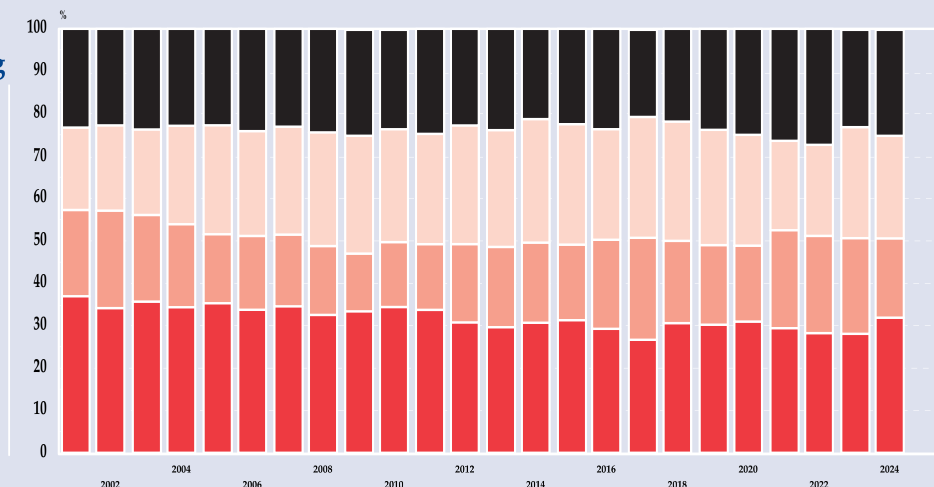
Illustrative options for the mix of debt issuance in future years, and the resulting debt portfolio

Example remit	Resulting equilibrium debt portfolios				
	per cent of conventional gilts				
	Short	Medium	Long	Average maturity (years)	Duration (years)
Issuance with strong bias towards longs (30:25:45)	42	27	31	10.6	8.1
From 2000-01 issuance reverts to 35:30:35	45	26	29	10.2	7.9

As in last year's report, for illustrative purposes the calculations assume: £5 billion net cash requirement annually; 20% issuance index-linked, distributed evenly across yield curve. Figures include indexation uplift on index-linked gilts.

The following chart illustrates approximately how the debt portfolio would develop over time if future issuance reverted back to the proportions of the 1997-98 Debt Management Report (35:30:35).

Effect on debt portfolio assuming future issuance reverts to 1997-98 remit proportings



IGs
Long CG
Medium CG
Short CG

IG = Index-linked gilts
CG = Conventional gilts

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

THE GOVERNMENT'S BORROWING PROGRAMME 1999-2000

Gilt Market Review 1999-2000

Yields on conventional gilts rose in 1999-2000, with the increase greater for short- and medium-dated stocks. In the financial year to end-February the yields on the 5-year and 10-year benchmarks had risen by 155 and 96 basis points respectively to 6.10 per cent and 5.44 per cent, whereas the yield on the 30-year benchmark had risen by only 6 basis points to 4.53 per cent.

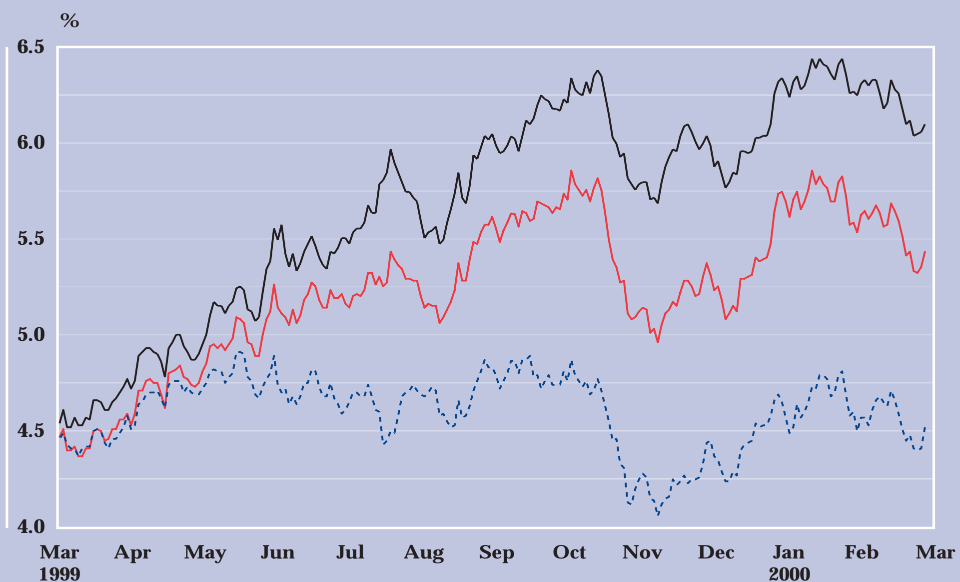
In the first two quarters of the financial year short- and medium-dated gilt yields continued the upward trend in the final quarter of 1998-99. This increase in short and medium yields reflected stronger than expected economic growth in the UK, the US and the euro area leading to rises in official interest rates. This resulted in a growing inversion of the gilt yield curve as strong demand and limited supply constrained yields at the long end. Long yields fell from around 10 basis points below short yields to around 160 basis points below.

In late October and early November gilt yields fell across the curve by around ¾ of a percentage point, with the yield on the 6% 2028 stock touching a record intra-day low of 4.01 per cent on 5 November. Prices rose on supply concerns from the continuing strength of public finance outturns. But long gilts were also affected by the decline in global inflation expectations as the Bank of England, US Federal Reserve and the ECB all tightened monetary policy. From mid-November yields rose back to mid-October levels as increasingly robust economic data, particularly in the US and Europe, signalled a likely rise in interest rates early in 2000. There was also evidence of buying pressure from traders as they sought to unwind positions in advance of 1 January 2000. Gilt yields continued to rise in January as economic data remained strong. Yields began to fall back again in February, helped in part by a growing belief that a further round of interest rate increases at the start of the month represented a pre-emptive strike against inflationary pressures.

Index-linked yields were less affected by international developments. The main movements were in August, when lack of demand consequent on rumoured corporate supply drove yields higher, and November,

Chart 2

Par gilt yields 1999-2000

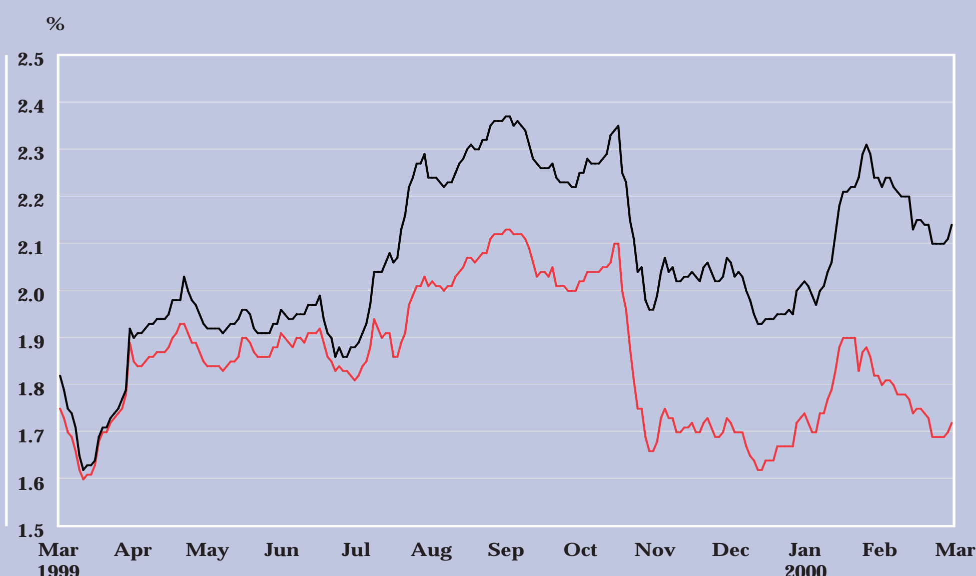


Short 5 year

Medium 10 year

Long 30 year

Chart 3 Index-linked gilt yields 1999-2000



when yields fell sharply with conventional gilts on concerns over supply. At end-February the yield on the 4⅛% IL 2030 was 1.72 per cent, much the same as the yield at the beginning of the year, while the yield on the 2½% IL 2009 had risen 32 basis points to 2.14 per cent. The demand and supply factors affecting long conventional gilts have also affected index-linked yields although there have been far fewer substitute corporate index-linked bond issues.

While gilt yields have risen during the year, yields in most other major government bond markets rose further. The 10-year gilt yield spread narrowed from 64 basis points above the 10-year German bund yield

Table 3
1999-2000 financing requirement (£ billion)

	Original remit	Revised remit[1] April 1999	Pre-Budget November 1999	Budget March 2000
Central government net cash requirement forecast	6.2	6.2	1.1	-5.8
Expected net financing of Official Reserves	2.4	2.3	2.3	2.2
Expected gilt redemptions	14.8	14.9	14.9	14.9
Gilt sales residual from 1998-99	-2.3	-4.1	-4.1	-4.1
Financing requirement	**21.0**	**19.3**	**14.2**	**7.2**
Financed by:				
Assumed net National Savings contributions	0.1	0.1	-0.9	-1.0
Expected net sales of Treasury bills and other short-term debt	3.6	1.9	0.8	-5.7
Gilt sales required	**17.3**	**17.3**	**14.2**	**13.8**
Assumed gilt sales in 1999-2000			13.8-14.6	13.8

Note: Figures may not sum due to rounding
[1]Remit revised following outturn of the 1998-99 central government net cash requirement.

to 1 above at the end of February (having traded below the bund yield for 2 days in late February). At the same time 10-year gilts were trading 11 basis points below French OATs. Compared with the US market, the gilt yield has fallen from 62 basis points below the 10-year Treasury to 101 basis points below.

Gilt Sales

During the year projected gilt sales have fallen from £17.3 billion when the 1999-2000 Debt Management Report was published to £13.8 billion (net of DMO secondary market purchases). The Government provided the market with its plans for such a contingency in the DMO's remit for 1999-2000. As the requirement for gilt sales fell during the year, the Government kept to its published plans.

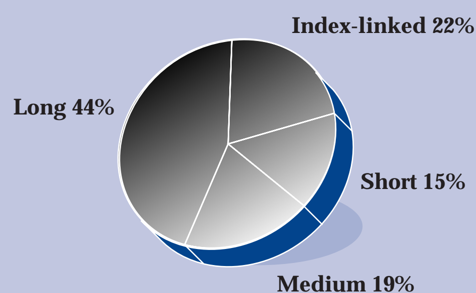
Projected gilt sales of £17.3 billion, based on a forecast central government net cash requirement of £6.2 billion, were published on 9 March 1999 in the remit for 1999-2000. Following publication of the outturn central government net cash requirement for 1998-99 the financing requirement was reduced by £1.7 billion. The volume of planned gilt sales remained unchanged at £17.3 billion, with the change being absorbed through a reduction in planned Treasury bill sales as anticipated in the remit.

On 9 November 1999, the Pre-Budget Report revised the forecast for the central government net cash requirement down by £5.1 billion to £1.1 billion for 1999-2000, and the contribution from National Savings to -£0.9 billion (from +£0.1 billion). Taken together this implied a reduction in gilt sales and short term debt of £4.1 billion. With gilts sales of between £13.8 billion and £14.6 billion already committed, the gilt sales requirement was reduced by £3.1 billion, and projected Treasury bill sales were reduced further.

The March 2000 Budget includes a forecast for the 1999-2000 central government net cash requirement of -£5.8 billion. This reduces the 1999-2000 financing requirement by a further £7.0 billion to £7.2 billion. Gilt sales of £13.8 billion are projected. The effect of the changed forecast is entirely absorbed within a reduction in the planned level of Treasury bills and other short term debt.

Chart 4

Gilt sales in 1999-2000



The 1999-2000 remit included a calendar for five conventional and four index-linked auctions. With the reduction of the financing requirement in the Pre-Budget Report, the conventional auction scheduled for 29 March 2000 was cancelled. Two conventional auctions were held of the long-dated benchmark 6% 2028 (accounting for £5.6 billion of long gilt sales in cash terms). The remaining £0.5 billion long issuance was sold in the tap issue on 6 August 1999. The other two conventional auctions were of the new 5-year benchmark 5% 2004, subsequently built up by a conversion offer and switch auction (see below) and the 10-year benchmark 5¾% 2009.

Although the Government's finances improved during the year, the Government sold £3.1 billion of index-linked gilts (22 per cent of total gilt issuance) and kept its commitment to issue at least £2.5 billion (cash). In this first full year of index-linked gilt auctions, four auctions were held as planned. Although the full amount on offer was not sold at the April 1999 auction, the remaining stock was quickly bought up in the market after the required 21-day period at higher prices

Table 4
Results of gilts auctions held in 1999-2000

Stock Title	Amount (nominal) of issue (£ billion)	Date of auction	Lowest yield	Average yield	Highest yield	Times covered	Tail (basis points)
6% Treasury 2028[1]	2.5	26 May 1999	4.68	4.70	4.72	2.24	2
5% Treasury 2004[1]	2.5	22 June 1999	5.26	5.28	5.30	2.01	2
5¾% Treasury 2009[1]	2.75	28 September 1999	5.68	5.70	5.71	2.54	1
6% Treasury 2028[1,3]	2.0	24 November 1999	4.24	4.25	4.27	1.79	2
4⅛% Index-linked Treasury 2030[2]	0.5	28 April 1999		1.97		0.94	n/a
2½% Index-linked Treasury 2011[2]	0.375	28 July 1999		2.19		1.93	n/a
2½% Index-linked Treasury 2016[2]	0.35[4]	27 October 1999		2.34		2.65	n/a
2½% Index-linked Treasury 2024[2]	0.35[4]	26 January 2000		1.93		2.54	n/a

[1]*Conventional auctions: multiple price format*
[2]*Index-linked auctions: uniform price format*
[3]*A further £0.4 billion of 6% 2028 was tapped on 6 August 1999 at a yield of 4.45 per cent*
[4]*Excludes £0.02 billion of marketable debt issued to CRND*

than accepted at the auction. Cover was much improved in subsequent auctions, with bids being more than 2½ times the amount on offer in the final two auctions.

Conversion Offer and Switch Auctions

One conversion offer was held during the financial year. The new 5-year benchmark (5% 2004) was built up to £6.3 billion, first by auction of £2.5 billion then by a conversion from the 9½% 2004 stock which added a further £3.8 billion.

The 5% 2004 stock was increased further on 21 October 1999 by the DMO's first ever switch auction (which followed consultation with the market over the summer). The auction for up to £1 billion (nominal) of 8% 2003 was covered 5.13 times, with an average "dirty" (i.e. including accrued interest) price ratio of 1.1201 for accepted bids. £1.12 billion of 5% 2004 was issued, increasing the stock to £7.41 billion.

A second switch auction was held on 8 February 2000 to provide some additional liquidity in the 6% 2028. Through the process, it was increased by £1.6 billion (nominal) by a switch from 8% 2015. The offer was covered 1.44 times, with an average dirty price ratio of 1.0745 for accepted bids. Through the switch auction the Government extended the maturity of this borrowing at an average forward rate between 2015 and 2028 of just under 4 per cent.

National Savings

The outstanding balance of National Savings' instruments at the start of the financial year was £63.6 billion. During the year to the end of March 2000 National Savings are expected to make a negative net financing contribution of about £1.0 billion. Gross sales of National Savings' products for 1999-2000 are expected to be around £10 billion (including accrued interest). The change in the composition of outstanding products is shown in Table 5.

Table 5
Change in National Savings products outstanding (1999-2000)

(including accrued interest)

	End-March 1999		End-March 2000 *	
	£bn	%	£bn	%
Variable rate	33.6	52.8	33.7	53.8
Fixed rate	19.8	31.2	19.1	30.6
Index-linked	10.2	16.0	9.8	15.6
	63.6	**100.0**	**62.6**	**100.0**

* *estimates*

National Savings' overall cost of financing remained cheaper than comparable gilts throughout the year, after taking into account management costs and imputed tax foregone. National Savings announced twelve 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. New issues of fixed rate products were introduced during the year to reflect movements in medium term market rates. With shorter term interest rates remaining higher than 5-year rates, demand for National Savings' traditional 5-year fixed rate products remained relatively low. However, this was partly offset by the introduction of shorter terms (in addition to the existing 5-year versions) for Pensioners Bonds and Savings Certificates. National Savings also launched their new Fixed Rate Savings. Bond offering terms from six months to three years, further increasing customer choice.

DEVELOPMENTS IN NATIONAL SAVINGS

1999-2000 represents the first full year of National Savings' partnership agreement with Siemens Business Service for provision of operational services delivery. This partnership will bring better service to National Savings' customers, savings to the taxpayer, and wider opportunities for former National Savings' employees. The introduction of private sector expertise through this new partnership has allowed National Savings to continue its development into a more business focussed operation, strengthening its expertise in the personal financial sector.

National Savings continued to develop its product range to provide a balanced portfolio and to allow it to continue to deliver its primary objective of marketing retail debt so as to contribute to cost-effective government financing. At the same time National Savings continues to offer a balanced choice of products and investment terms to savers and investors so that they can decide what best suits their needs

Work on extending the product range during 1999-2000 saw the introduction of a National Savings CAT standard cash mini ISA; a new 2-year Pensioners Bond; new 2 year Savings Certificates (both index-linked and fixed rate) and a new Fixed Rate Saving Bond. All these developments are aimed at providing customers with a choice of investment terms from shorter term up to a five year term, and build on National Savings' track record for offering competitive, safe, and easy to understand savings products to meet a wide range of customers' needs. By doing so, they will help National Savings deliver its financing remit for government in the coming years.

Looking further to the future, on 11 January 2000, the Economic Secretary launched a review of National Savings. The review, which is part of the Government's rolling five-yearly programme of agency reviews, will look at the options for National Savings' future, including the future status of National Savings, possible improvements within the current agency framework and what further scope there is for partnership working. These, and all the other options identified, will be considered on their merits with a view to reaching the best outcome in the interests of the economy and the taxpayer, and taking full account of the interests of the individuals and organisations that might be affected.

The review is being conducted by HM Treasury working in collaboration with National Savings.

DEVELOPMENTS IN THE STRUCTURE OF THE GILT MARKET

Developments in 1999-2000

Further developments in the gilt market in 1999-2000 continued the process of reform designed to increase the efficiency of the market and the openness and transparency of gilt supply. 1999-2000 was the first year in which all index-linked gilts were issued by auction as opposed to tap. Other major innovations were the publication of how the Government would alter its auction schedule in the light of changes to the financing requirement, and the introduction of switch auctions to enhance the liquidity of benchmark stocks. During the year the DMO consulted on how it intended to conduct any special repo operations, and on how it should interact with the gilt market in the developing electronic environment. In addition, the first steps in transferring gilt settlement to CREST took place; the gilt futures contract started trading on LIFFE's Connect trading platform; a further strippable stock was created; and the DMO published an investor's guide to gilts and enhanced their website.

Remit Contingencies

For the first time the remit set out the Government's intentions for altering gilt issuance in response to changes to the financing requirement. These were:

- a change to the financing requirement of up to £3 billion would be accommodated by an adjustment to the level of planned Treasury bill issuance; and
- a change of more than £3 billion would be accommodated through a combination of adjustment to the size and number of gilt auctions and, as necessary, changes to Treasury bill issuance;
- for a change sufficient to alter the auction programme (and not too late in the financial year to make the change) the DMO would first either add a long gilt auction or cancel a short auction.

The Government kept to these contingency plans as the forecasts for the central government net cash requirement fell during the year.

Switch Auctions

The prospect of switch auctions was foreshadowed in the remit for 1999-2000. On 7 August 1999 the DMO consulted the market on the conduct of such auctions and published its operational procedures on 13 September. Switch auctions add to conversion offers as a tool to build up benchmark gilts. The DMO's operating procedures specify that:

- new stocks will not be launched through a switch auction;
- auctions will be for between £1/2-2 billion (nominal) of the source stock;
- only stocks within the same maturity bracket (0-7 years, 5-15 years, or 14 years or longer) will be eligible for switching;
- auctions will be held on a competitive bid basis, with the DMO first publishing an indicative clean price for the source stock, and Gilt-edged Market Makers (GEMMs) then bidding a quantity of the source stock and a clean price for the destination stock.

The DMO will seek market views each quarter on switch auction candidates and announce decisions at the same time as the regular quarterly auction timetable.

Strippable Stocks

One stock was added to the list of strippable stocks in 1999-2000: the new 5-year benchmark 5% 2004. The number of strippable gilts in issue is now eleven. Total nominal strippable stock in issue is £116 billion (of which £2.5 billion was held in stripped form at end-February 2000).

Table 6
Strippable stocks outstanding (£ million)

Stock title	Nominal amount in issue at end-February 2000	Nominal amount held in stripped form at end-February 2000	Nominal amount held in unstripped form at end-February 2000
8% Treasury 2000	9,800	122	9,678
7% Treasury 2002	9,000	270	8,730
6½% Treasury 2003	7,987	94	7,893
5% Treasury 2004	7,408	1	7,407
8½% Treasury 2005	10,373	537	9,836
7½% Treasury 2006	11,700	225	11,475
7¼% Treasury 2007	11,000	294	10,706
5¾% Treasury 2009	8,827	113	8,714
8% Treasury 2015	12,287	179	12,108
8% Treasury 2021	16,500	452	16,048
6% Treasury 2028	11,512	251	11,261
Total	**116,394**	**2,538**	**113,856**

Gilt Settlement Systems

The first step in transferring gilts settlement to CREST took place on 24 May 1999. On that date, CRESTCo took over ownership and responsibility for the existing Central Gilts Office (CGO) service from the Bank of England. The Bank continues to operate and support the CGO on CRESTCo's behalf until all gilts activity merges fully with CREST's settlement system, due at the beginning of July 2000. The merger is proceeding on course.

As part of the preparations involved in the merger, CRESTCo issued a consultation paper in May 1999, "Gilts Settlement in CREST", which consulted on the changes needed for the transfer of gilts settlement activity to CREST. The results were published in September 1999. Since then CRESTCo has issued technical and business documentation to inform users about the necessary changes to their internal systems and has also issued guidance on the timetable for, and the process of, transferring gilts settlement into CREST.

LIFFE

The two gilt futures contracts, the long gilt and five-year contracts, were activated on LIFFE's Connect electronic trading platform on 12 April 1999. The short-sterling interest rate futures contracts were added to the system on 6 September 1999. The impact of the change in environment from the pits to the screens on trading volume is difficult to assess as other factors, such as the approach of the year 2000, affected behaviour independently of the change in venue. However, market participants say they value highly the ability to observe the depth of the market.

Over the calendar year of 1999, an average of 33,674 contracts traded in the long gilt contract. This fell slightly to an average of 30,694 contracts between April and December. In the financial year 1999-2000 to

end-February, the average daily turnover fell further to 29,110 contracts. Volumes in December were particularly low (an average of only 12,706 contracts traded) reflecting the year 2000 effect.

Responding to market wishes, LIFFE introduced a block trading facility for financial futures enabling participants to negotiate large trades bilaterally off-screen. This block trading facility is one of a wider suite of wholesale trading products.

Special Repo Operations

The DMO issued a paper to the market in September 1999 clarifying the conditions under which the DMO would undertake a special repo operation and seeking market participants' views on whether they would find an automatic facility useful. Following consideration of the responses, on 22 February 2000 the DMO announced that it proposes to introduce an automatic facility in the forthcoming financial year. The facility will be available, at a rate of 10 per cent of the Bank of England's repo rate, to all DMO counterparties who have signed the relevant repurchase agreements. Any such operation will involve a simultaneous reverse repurchase with the same counterparty against general gilt collateral at the Bank of England's repo rate and will, therefore, have no effect on Exchequer cash management operations.

Future of Gilt Trading in an Electronic Environment

The DMO issued a consultation paper on 24 January 2000 on how the DMO's relationship with the GEMMs might change as a consequence of new trading methods becoming a feature of the gilt market. The paper explored whether the current arrangements would still be appropriate and how they might be modified to achieve the same end - investor access and ease of execution at tight prices across the full range of gilts - in a trading environment characterised by electronic trading systems. The paper did not put forward any firm conclusions, but sought market views on possible approaches and the implications arising. The consultation period ran until 3 March. The DMO expects to publish its response early in 2000-01.

Turnover in the Secondary Market

A total market value of £1,433 billion was traded in gilts on the London Stock Exchange in the financial year to end-February. This suggests that an average value of £6.3 billion of gilts turned over each day on the Exchange. This is lower than the level of turnover of £7.4 billion reported for 1998-99.

Just under a third of this turnover was concentrated in the long end of the market (i.e. gilts with more than 15 years of remaining maturity); another third was in short stocks (with between 18 months and 7 years of remaining maturity) while just under a quarter was in medium term stocks (with between 7 and 15 years of remaining maturity).

Publications

Since October 1998 the DMO has been supplementing its annual Gilt Review, with quarterly reviews early in the month following the quarter end. These describe developments in the gilts market in both the national and international context and update information on the gilts portfolio. From April 2000, they will also provide information on Treasury bill issuance.

On 30 September 1999 the DMO published an Investor's Guide to Gilts, aimed primarily at the institutional investor. The guide complements a retail investors' guide published jointly by the DMO and the Bank of England in 1998. These and other publications are available on the DMO website.

DMO Website

The DMO's website can be found at http://www.dmo.gov.uk. Gilts market data have been added to the site in the past year, but the whole site is currently being updated and expanded.

At present the site comprises:

- information regarding the structure and organisation of the DMO;
- the Debt Management Report, including the DMO's financing remit;
- the gilt auction calendar;
- copies of the DMO's major publications;
- all major announcements and press releases;
- static data relating to the gilts market including the current gilt stock list and gilt ISIN and SEDOL codes.

Plans are in place to incorporate an on-line database providing easy access to information about developments in the gilts market, including historic gilt prices, yields and auction results.

THE GOVERNMENT'S FINANCING PROGRAMME FOR 2000-01

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. In addition, the Government will enhance liquidity through conversion offers, switch auctions and reverse auctions of non-benchmark stocks.

The financing requirement for 2000-01 also takes account of the DMO's new responsibility for government cash management. This will require some increase in the level of Treasury bills and other short term debt in 2000-01, with the possibility of smaller increases in following years.

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 2000-01, on the basis of the 2000 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 2000-01 is forecast to be in £4.9 billion surplus. Some £18.6 billion of gilts are expected to mature outside central government portfolios and will need to be refinanced (table 8). In line with the assumption for 1999-2000, the underlying level of foreign exchange reserves is assumed to be unchanged between end-March 2000 and end-March 2001.

In this low issuance environment, the Government believes it is prudent to restructure some of its liabilities in order to secure best value for money for taxpayers. This refinancing will add to gross gilts issuance and will help maintain liquidity in the market at a time of strong demand.

Table 7
2000-01 financing requirement (£ billion)

Central government net cash requirement forecast	-4.9
Expected net financing of Official Reserves[1]	3.5
Gilt redemptions	18.6
Debt buy-backs	3.5
Gilt sales residual from 1999-2000[2]	-9.5
Financing requirement	**11.2**
Less net financing from:	
National Savings	-0.8
Treasury bills and other short term debt[3]	-0.2
Gross gilt sales required	**12.2**
of which:	
Ultra-short conventionals (1-3 years)	
Short conventionals (3-7 years)	0.0
Medium conventionals (7-15 years)	2.2
Long conventionals (>15 years)	6.5
Index-linked gilts	3.5

Note: Figures may not sum due to rounding.

[1] *The Reserves require financing in 2000-01 to replace the €2 billion Euronote, the €2.5 billion Eurobond and expiring forward contracts.*

[2] *See Table 9 for derivation of 1999-2000 gilt sales residual.*

[3] *Financing of cash deposit at Bank of England (for DMO's*

Table 8
Stocks maturing in 2000-01 (£ million)

Redemption date	Stock	Nominal amount outstanding	Official holdings (end December)	Nominal value of market holdings (end December)
	Conventionals			
14 July 2000	Treasury 13% 2000	3,171	96	3,075
25 July 2000	Treasury 13¾% 2000/03[1]	53	4	49
7 December 2000	Treasury 8% 2000	9,800	219	9,581
26 February 2001	Treasury 10% 2001	4,406	15	4,391
19 March 2001	Treasury 11½% 2001/04[1]	1,620	142	1,478
	Index-linked			
	none			
	Total outstanding	**19,049**	**476**	**18,574**

[1] *Assumes redemption at earliest possible date*

As in 1999-2000, the Government has decided to refinance foreign currency borrowings maturing in the coming year by additional gilts issuance. During 2000-01 €4.5 billion of euro debt matures (a €2 billion euro note in January 2001 and a €2.5 billion Ecu bond in February 2001). These debts need to be refinanced to maintain the foreign currency reserves at their present level. Similar to practice in 1999-2000, foreign currency swaps out of additional sterling financing of £2.8 billion at the current exchange rate will replace that part of the reserves previously financed by these foreign currency borrowing instruments (see box on page 22). These transactions should provide better value for money for the taxpayer than new foreign currency borrowing given the premium currently paid for gilts. As a result of these transactions, the Government will not be facing additional foreign exchange rate risk and the level of the spot reserves will remain broadly unchanged.

In addition, the Government has decided to replace $1.2 billion of forward contracts to purchase foreign currency with spot foreign currency reserves. At current exchange rates this will require an additional £0.8 billion sterling financing. The total level of reserves (spot plus forward) will remain unchanged.

Gross gilt sales will be increased further by plans to buy back £3.5 billion of less liquid debt in market hands. At least £2.5 billion will be through reverse auctions of non-strippable conventional gilts with over £1 billion nominal in issue and maturities in calendar years 2003 to 2008. The DMO will consult the market on the methodology to be adopted in such reverse auctions.

These buy-backs and foreign exchange transactions will enable further issuance of gilts into benchmark stocks, especially at the long end. They will complement conversion offers and switch auctions as instruments for maintaining liquidity in the market across the yield curve. They will help maintain liquidity and gilts market infrastructure, which in turn should help minimise the Government's cost of borrowing in future years when the financing requirement is expected to be higher.

Increase in Short Term Debt for Cash Management

The financing requirement in Table 7 is reduced by a "gilt sales residual". This residual is the difference in the stock of short term debt between the level targeted at the beginning of the financial year and the forecast outturn. It represents that part of the change in the central government net cash requirement that has not been accommodated by changes in gilt sales or other financing items. Table 9 shows that the improvement during the year in the Government's finances (and the central government net cash requirement) has mostly been accommodated through short term debt and therefore the residual.

The plans for 2000-01 assume a stock of Treasury bills issued outside central government of about £10 billion at the end of the financial year. The level of Ways and Means planned for 31 March 2001 is £17 billion The difficulty in predicting the Government's cash flows at the end of the financial year 1999-2000 means that it is unlikely the balance will be £17 billion exactly. Currently the forecast implies a balance on the Ways and Means close to £15 billion on 31 March 2000. After 31 March 2000 the balance will be brought to £17 billion, following a limited series of transactions whose timing has been agreed in advance with the Bank, and will then be held at that level. This will ensure that the separation of Exchequer cash management from the Bank's money market operations is not compromised.

National Savings

National Savings are assumed to make a negative net contribution to financing (including accrued interest) of around £0.8 billion. This subsumes gross sales (i.e. sales and deposits including accrued interest) of around £12½ billion. The net contribution is not a target, but an estimate based on experience in previous years, trends in 1999-2000, and National Savings' forecast and objectives for 2000-01. It also reflects the large amount of maturities which are due on National Savings' products during 2000-01.

Table 9
Gilt sales residual from 1999-2000 (£ billion)

	Original remit 1999-2000	Budget March 2000	Change
Central government net cash requirement forecast	6.2	-5.8	-12.0
Expected net financing of Official Reserves	2.4	2.2	-0.1
Expected gilt redemptions	14.8	14.9	0.0
Gilt sales residual from 1998-99	-2.3	-4.1	-1.7
Financing requirement	**21.0**	**7.2**	**-13.8**
Financed by:			
Assumed net National Savings contribution	0.1	-1.0	-1.1
Other short term debt	-0.2	0.0	0.2
Gilt sales	17.3	13.8	-3.3
Gilt sales residual			**-9.5**

Note: Figures may not sum due to rounding

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 2000 Budget central government net cash requirement forecast, this means gross gilt sales to the market of approximately £12¼ billion.

Nature of Stocks

The Government will continue to have available the full range of financing instruments, including conversion offers and switch auctions, to maintain large liquid issues across the maturity spectrum. 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 will be focussed on medium- and longer-term maturities, although the option to issue shorter maturity stocks remains open.

Maturity Structure of Issuance

In order to allow more outright issuance of benchmark stocks, the Government intends to hold a series of reverse auctions in 2000-01 to buy back stock. These will be of non-benchmark short and medium maturities, allowing for additional issuance of benchmark stocks in different maturity brackets.

With limited gilt supply, issuance will be concentrated in long conventional gilts and index-linked. As in the 1999-2000 Report, the issuance split of conventional gilts has been determined in terms of the number of auctions rather than issuance proportions. The remit assumes four auctions of conventional gilts. Three auctions are for long (over 15 years maturity) gilts, and one of mediums (7-15 years maturity).

This year's programme is intended to achieve a level of index-linked gilts issuance of over a quarter of total gilt sales. This reflects the Government's continuing commitment to the index-linked market, against a background of sustained low inflation. Continuing to concentrate issuance in the medium to long maturity areas provides additional index-linked supply where demand is currently strongest.

Changes to the 2000-01 Financing Programme

Given the low level of issuance and the demand for long gilts the Treasury will try to avoid cancelling an auction if the central government net cash requirement is revised down (a larger surplus). The Treasury would consider accommodating such a revision by: pre-financing foreign currency debt due to mature in 2001-02 (up to £3.8 billion) and 2002-03 (up to £1.9 billion); some repayment of its Ways and Means facility at the Bank of England (up to £2 billion); and reducing the assumed Treasury bill stock at end-March 2001 (by up to £2 billion).

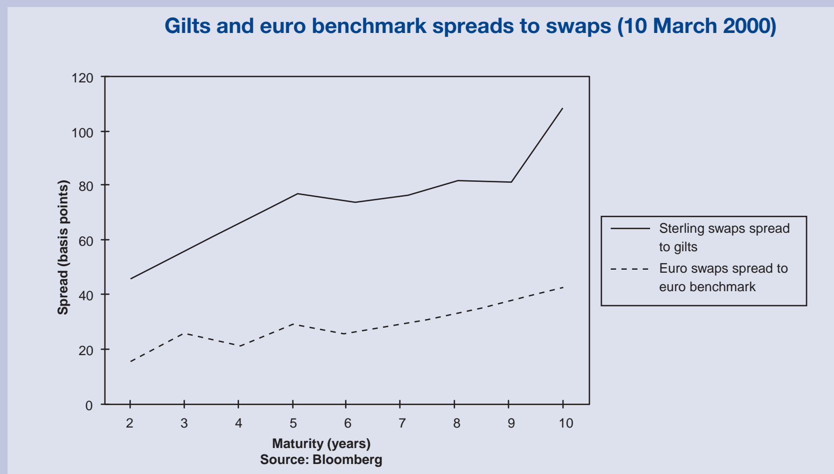
If the financing requirement were to be revised upwards, the DMO would first scale back its buy-back programme. It would then allow the Treasury bill stock to rise by up to £5 billion before holding additional gilt auctions.

GILTS AND THE RESERVES

£3.5 billion of gilts issuance in 2000-01 will be used to finance the foreign currency reserves instead of new foreign currency borrowing. This follows the successful refinancing of the Treasury's euro bill programme which will have added £2.2 billion to the financing requirement in 1999-2000.

€4.5 billion of the Treasury's foreign currency debt matures during 2000-01 (a €2 billion "euro note" issued during 1998 and maturing in January 2001 and a €2.5 billion "Ecu Bond" issued in 1991 and maturing in February 2001). Redeeming this debt will be a drain on the foreign currency reserves. To offset this drain and so maintain the spot reserves broadly at their current level this debt will be refinanced during 2000-01 by issuing an extra £2.7 billion of gilts and swapping the proceeds into foreign currency assets. Auctions of the 2003 Euro note will continue as announced. The Bank of England have announced that they will take over the programme at the end of the calendar year 2000.

The current spread between the gilts yield curve and the sterling swaps curve means swapping out of gilts continues to be a more cost-effective method of financing the foreign currency reserves for the Treasury than borrowing directly in foreign currency.



The remaining £0.8 billion of financing for the reserves will be used to replace expiring forward contracts to buy foreign currency with a greater level of spot reserves. Neither this nor swapping out of gilts to refinance foreign currency borrowing will change the Treasury's foreign currency exposures.

As a contingency measure, if the forecast central government net cash requirement for 2000-01 is revised down during the year then before reducing gilts issuance the Treasury will consider pre-financing foreign currency debt maturing during 2001-02 by swapping the surplus sterling receipts into foreign currency assets. Again there would be no change in the Treasury's foreign currency exposures. While there would be a temporary rise in the Treasury's spot reserves this would be offset by a fall in the forward book. Foreign currency debt maturing in 2001-02 totals the equivalent of £3.8 billion (a $2 billion bond maturing in July 2001, a $2 billion floating rate note maturing in October 2001 and a €2 billion note maturing in January 2002). There is a further £1.9 billion of foreign currency debt that matures during 2002-03 that could also be pre-financed (a $3 billion bond maturing in December 2002).

THE DEBT MANAGEMENT OFFICE REMIT FOR 2000-01

A) Gilt Remit

Objectives

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

- to meet the annual remit set by Treasury Ministers for the sale of gilts, with high regard to long term cost minimisation taking account of risk;
- to advise Ministers on setting the remit to meet the Government's debt management objectives, and to report to Ministers on the DMO's performance against its remit, objectives and targets;
- to develop policy on and promote advances in new instruments, issuance techniques and structural changes to the debt markets that will help to lower the cost of debt management, liaising as appropriate with the Bank of England, Financial Services Authority, London Stock Exchange, and other bodies; and to provide policy advice to Treasury Ministers and senior officials accordingly;
- to conduct its market operations, liaising as necessary with regulatory and other bodies, with a view to maintaining orderly and efficient markets and promoting a liquid market for gilts;
- to provide, including in liaison with the Bank of England and CRESTCo, a high quality efficient service to investors in government debt, and to deal fairly and professionally with market participants in the gilt and money markets, consistent with achieving low cost issuance;
- to contribute to HM Treasury's work on the development of the strategy for the debt portfolio; and
- to make information publicly available on the debt markets and DMO policies where that contributes through openness and predictability to efficient markets and lower costs of debt issuance.

Quantity of Gilt Sales

2. The DMO, on behalf of the Government, will aim for gilt sales of approximately £12¼ billion in 2000-01.

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 governed by the Exchequer cash management remit, mainly changes to the weekly Treasury bill tender.

Amount and Maturity Mix of Index-linked Gilt Issuance

4. Over 2000-01, the DMO plans to sell £3.5 billion (cash), about 30 per cent of its gilts sales, in index-linked stocks.

5. Four auctions of index-linked stocks are planned in 2000-01. Issuance will be directed at medium- and longer-dated maturities (i.e. stocks dated 2009 and longer).

6. 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 for the foreseeable future.

Amount and Maturity Mix of Conventional Gilt Issuance

7. Four auctions of conventional stocks are planned in 2000-01; three in the long (15 years and over) maturity area and one in the medium (7-15 years) area.

8. HM Treasury will consider accommodating reductions in the forecast 2000-01 financing requirement by: pre-financing foreign currency debt due to mature in 2001-02 (up to £3.8 billion) and 2002-03 (up to £1.9 billion); some repayment of its Ways and Means facility at the Bank of England (up to £2 billion); and reducing the assumed Treasury bill stock at end-March 2001 (by up to £2 billion).

9. Increases in the financing requirement will be accommodated first by scaling back the buy-back programme and second by increasing the stock of Treasury bills by up to £5 billion.

10. For 2000-01, 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.

Buy-Backs of Debt

11. The DMO may offer to buy back from the market a total of £3.5 billion (cash) of debt in 2000-01. At least £2.5 billion will be through reverse auctions of non-strippable conventional gilts with over £1 billion (nominal) in issue and maturities in calendar years 2003 to 2008. The DMO will consult the market about the methodology to be adopted in any such auctions and publish its conclusions before launching any buy-backs.

Method of Issuance of Gilts

12. Auctions will constitute the primary means of issuance of all gilts (conventional and index-linked). The DMO plans to hold four 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.

Gilt Auction Calendar 2000-01

Date	Type
Wednesday 3 May 2000	Index-linked
Wednesday 24 May 2000	Conventional
Wednesday 26 July 2000	Index-linked
Wednesday 27 September 2000	Conventional
Wednesday 25 October 2000*	Index-linked
Late November/early December 2000*	Conventional
Wednesday 24 January 2001	Index-linked
Wednesday 28 March 2001*	Conventional

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

13. Each auction of conventional gilts is planned to be for between £1½ 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) 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. The DMO would only contemplate taps of 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 DMO may create and repo out stock in accordance with its response to the consultation exercise on special repo operations dated 22 February 2000.

In-Year Consultation and Announcements on Auctions

17. 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, the auction date, 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.

18. The auction plan for the first quarter of 2000-01 will be announced at 3.30p.m. on Friday 31 March 2000.

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

Coupons

20. As far as possible, coupons on new issues of gilts will be set to price the stock close to par at the time of issue.

Buy-Ins of Short Maturity Debt

21. The DMO will have responsibility for buying in stocks close to maturity to manage Exchequer cash flows.

Conversions and Switch Auctions

22. In order to build up the pool of benchmark stocks further, the DMO envisages making offers for the conversion of unstrippable stocks into benchmarks of similar maturity during 2000-01. The programme of conversion offers may be supplemented by switch auctions into benchmark stocks during 2000-01. In particular the DMO will look closely at the merits of further switches out of the 8% Treasury 2015 into longer maturity stocks. Details of any future switch auction stocks will be announced at the same time as the end-quarter announcements of forthcoming outright auctions.

Reviews to the Remit

23. This remit, and in particular the number 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.

24. Any revisions to this remit will be announced.

B) Exchequer Cash Management Remit:

Objective

The DMO's primary objective in carrying out its Exchequer cash management operations will be to offset, through its market operations, the expected cash flow into or out of the National Loans Fund on every business day; and to do so in a cost-effective manner. In doing so the DMO should:

- balance cost and risk in its choice of strategies;
- manage cash flows without influencing the level of short term interest rates.

2. The DMO should also take account of:

- the operational requirements for the Bank of England for implementation of its monetary policy objectives;
- its impact on the efficiency of the sterling money market.

3. The DMO will carry out its objective primarily by a combination of:

- structured weekly Treasury bill tenders;
- bilateral market operations with DMO counterparties;
- ad hoc tenders of Treasury bills (and repo or reverse repo transactions).

4. The DMO and the Bank of England will work together to avoid clashes in the delivery of their respective objectives in the money markets. The DMO will not take speculative positions on interest rate decisions by the Bank nor hold operations which by their nature or timing in the day could be perceived to clash with the Bank's open market operations.

I) Structured Treasury Bill Tenders

Timing and Schedule of Announcements

5. The DMO will hold structured Treasury bill tenders on the last business day of each week. When announcing the result, the DMO will also announce the quantity and maturity of Treasury bills on offer in the structured tender in the following week and may give the maturity and indicative size of any ad hoc tenders in the following week.

6. Following the final structured tender at the end of each quarter, the DMO will issue a notice outlining the maturities of Treasury bills likely to be available via structured tenders over the following quarter.

Maturities

7. The DMO's structured Treasury bill tenders in 2000-01 may be of the following maturities:

- one month (approximately 28 days);
- three months (approximately 91 days);
- six months (approximately 182 days); and
- twelve months (approximately 364 days).

8. The DMO expects to give priority to establishing fully the shorter maturities before introducing the longer maturity instruments.

Level of Stocks

9. The DMO will manage Treasury bill transactions with a view to running down the stock of bills in months of positive cash flows and increasing it in months of higher net expenditure. Once the Treasury bill stock rises above £5 billion outstanding, a minimum stock of £5 billion outstanding is expected to be maintained thereafter.

Interaction with Bank of England's Money Market Operations

10. The DMO may also issue Treasury bills to the market to assist the Bank of England in its management of the sterling money markets. In response to a request from the Bank, the DMO will add a specified amount to the size(s) of the next structured bill tender(s) and deposit the proceeds with the Bank, remunerated at the weighted average yield(s) of the respective tenders. The amount being offered to accommodate the Bank's request will be identified in the DMO's weekly structured bill tender announcement. Treasury bills issued at the request of the Bank will be identical in all respects with the rest of the stock of Treasury bills outstanding.

II) Bilateral Operations with the Market

11. In pursuit of its cash management objectives, the DMO expects to trade on a daily basis with its counterparties across a range of instruments.

12. The DMO's bilateral operations may comprise:

- purchase from the market for future resale (reverse repo);
- sale to the market for future repurchase (repo);
- outright sale and purchase of gilts, Treasury bills and eligible bills ;
- unsecured cash borrowing and lending with its counterparties.

13. The DMO would give prior notice to the market if it planned to introduce additional instruments for use in its bilateral operations.

14. Other than gilts and Treasury bills, collateral used in the repo and reverse repo transactions may include selected euro denominated Government securities, eligible bank bills, supranational sterling and euro denominated securities. In carrying out these transactions, the DMO may make use of those of its own holdings of marketable gilts, or funds managed by NILO, which are maintained for collateral purposes. If required, in exceptional circumstances, HM Treasury may issue gilts or Treasury bills to the DMO for collateral purposes.

III) Ad Hoc Tenders

15. The DMO may also issue short maturity Treasury bills (up to 28 days) at ad hoc tenders. The objective of such tenders will be to provide additional flexibility for the DMO in smoothing Exchequer cash flows. Treasury bills issued in ad hoc tenders will be identical in every respect with those issued by structured tenders.

16. In addition to issuing Treasury bills, the DMO may also execute repo or reverse repo transactions at ad hoc tenders. For such transactions, collateral used would either be gilts or Treasury bills.

17. The DMO may also hold ad hoc tenders for buying in gilts (or gilt strips) with a residual maturity of less than six months.

Timing of Ad Hoc Tenders

18. The DMO will usually announce its intention to hold ad hoc tenders in the weekly announcement of the structured tender result. Such announcements will indicate the day(s) of the following week on which ad hoc tender(s) are expected to be held, together with a guide to the expected maturity and size.

19. The precise details of the maturity and nominal on offer will be announced at the opening of the offer on the morning of the tender (usually at either 8.30a.m. or 10.00a.m.). The DMO may hold ad hoc tenders for the same maturity date on successive business days. Ad hoc tenders will be open for 15 minutes.

20. The DMO may hold up to two ad hoc tenders per day. The DMO will not hold a second ad hoc tender on gilt auction days or Monetary Policy Committee decision days.

NATIONAL SAVINGS' FINANCING REMIT 2000-01

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 financing needs; and
- 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 2000-01

3. Sales and deposits (including accrued interest) of NS' products are assumed to be around £12½ billion in 2000-01. After meeting maturities and withdrawals there will be a negative net contribution to government financing of around £0.8 billion.

Product Terms

4. HM Treasury is ultimately responsible, under the National Loans Act 1968, for setting the terms of NS' 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 HM 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' financing remit, and the need for NS to retain the capability and market presence to contribute to Government financing over the medium term.

Review of Remit

8. HM Treasury or NS may initiate a review of the remit in the course of 2000-01 in the light of any relevant factors. The remit will be reviewed before the start of each financial year.

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