DMO Remit 2006-07: Consultation meetings with GEMMs and Investors on 1 February 2006

The Economic Secretary to the Treasury chaired the regular annual meetings with representatives of the Gilt-Edged Market Makers (GEMMs) and gilt investors on 1 February. Officials from HM Treasury and the DMO were also present. These consultation meetings are held annually and are designed to provide gilt market participants with the opportunity to help inform HM Treasury's decisions regarding the financing remit for the DMO in the forthcoming financial year (2006-07 in this case).

The 2005 Pre-Budget Report forecast the Central Government Cash Requirement (CGNCR) for the financial year 2006-07 to be £40 billion. Gilt redemptions in 2006-07 will be £30 billion. On this basis it was noted that the gross financing requirement for 2006-07 would be around £70 billion. It is expected that most of the financing requirement will be met by the sale of gilts. It is expected that the DMO financing remit for 2006-07 will be published alongside Budget 2006. The main points discussed at the meetings are summarised below.

<u>GEMMs</u>

There was a general consensus for gilt issuance to be skewed toward long-maturities in 2006-07 for both conventional and index-linked issuance. Attendees agreed that the planned level of index-linked gilt sales should rise next year with a wide range of targets suggested for next year. Many recommended the opening of new 40-year gilts (both conventional and index-linked) and for gaps in the curve between 30-year and 50-year maturities to be filled. There were mixed views on the question of whether to increase the number or size of auctions, with most favouring smaller and more frequent regular auctions to boost liquidity, whilst others thought the size of auctions could be increased. Despite calls for skewing issuance towards the long-end, some attendees cautioned against neglecting issuance at shorter-maturities.

There was support for looking at ways of introducing greater flexibility into the DMO's remit whilst recognising the implications for the transparency and predictability currently in the debt management framework. A number of different ways of achieving this were put forward. Some attendees suggested that firm targets for issuance in each maturity basket / type of gilt should be replaced either by ranges or minimum issuance targets with additional flexibility to be allocated in-year (typically on a quarterly basis). There were some calls for the use of switch auctions primarily to help manage index-lengthening events in the next financial year.

Investors

There was widespread acknowledgement of the structural nature of the current pension industry related demand for gilts and the consequent impact on market liquidity. There were strong calls for gilt issuance to be heavily skewed towards long-maturities in 2006-07 especially for index-linked issuance. Attendees advised that the planned amount of index-linked gilt sales should be increased significantly in the next financial year. The majority of attendees indicated a preference for smaller and more regular index-linked auctions. Here too, some attendees cautioned against neglecting issuance at shorter-maturities.

There was some support for greater remit flexibility, particularly in the form of quarterly reviews of the remit. Many attendees indicated a preference for increased regularity in the pattern of supply each quarter. There were some calls for the use of taps to match the timing of client demand during financial year 2006-07. However, others advised that the use of taps as a financing tool would add to market volatility and could have adverse implications for index tracking. There were some calls for Government to consider the use of derivatives (swaps) to help address structural demand in the market.