

Quarterly Review

2nd Quarter 2000 April - June

Economic Background

International bond yields rose during the first part of the quarter (see chart 1), particularly in the US, where continuing robust economic data took the yield on the 10-year Treasury from below 6% to 6.6% by mid-May. Continental bonds were also adversely affected by the weak euro. The second half of the period, after the US Fed's decision to raise rates by 50 basis points on 16 May, saw some recovery in bond markets, helped by some signs in early June that the growth rate of the US economy might be beginning to slow. The ECB's decision to raise euro-zone rates by an unexpected 50 basis points on 8 June was seen as helpful in addressing inflationary pressures.

Chart 1: International 10-year Government Bond Yields



Source: DMO

Chart 2: Conventional Benchmark Gilt Redemption Yields



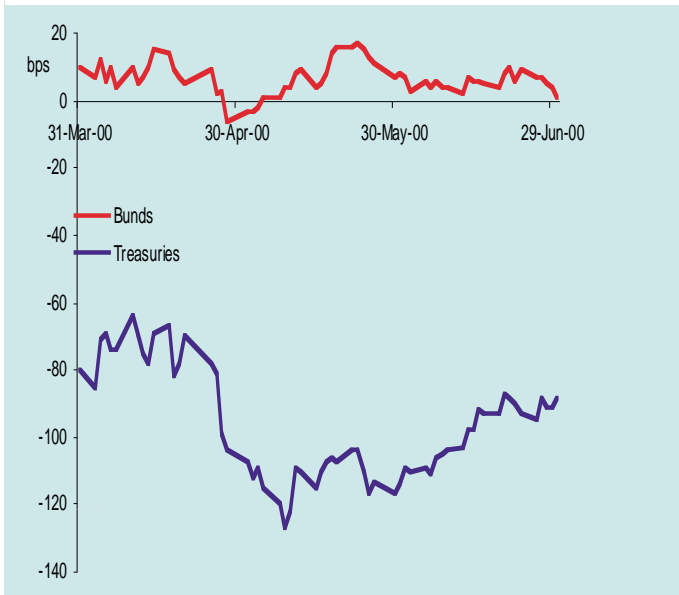
Source: DMO

The direction in the UK market largely reflected international movements, although the Bank of England kept UK rates on hold at 6% throughout the quarter, as economic indicators continued to give mixed signals and showed continuing divergence between the manufacturing and service sectors of the economy. Increasingly the market began to expect that UK rates may peak at a lower level than had been previously anticipated.

10-year spreads under US Treasuries widened by 10 basis points to 90 basis points over the quarter, although this represented a recovery by Treasuries relative to gilts in the second half of the period - in mid-May the comparable spread had been around 120 basis points. Gilts were more

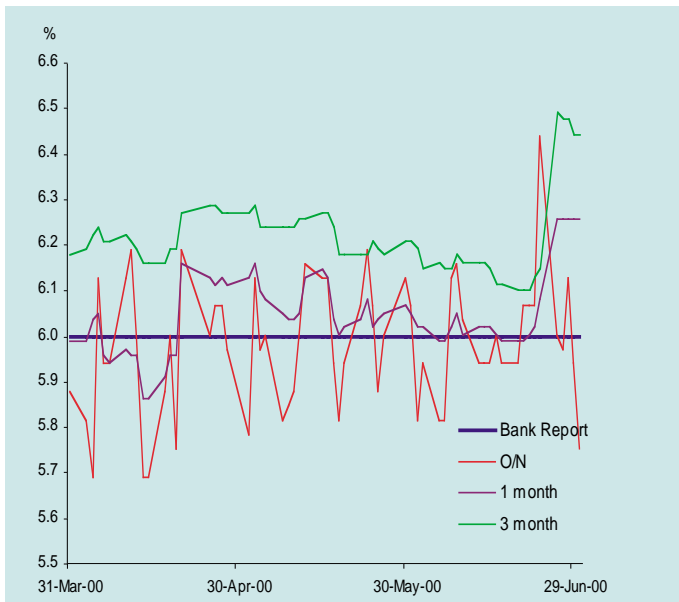


Chart 3: Spread of 10-year Gilt Yields against German Bunds and US Treasuries



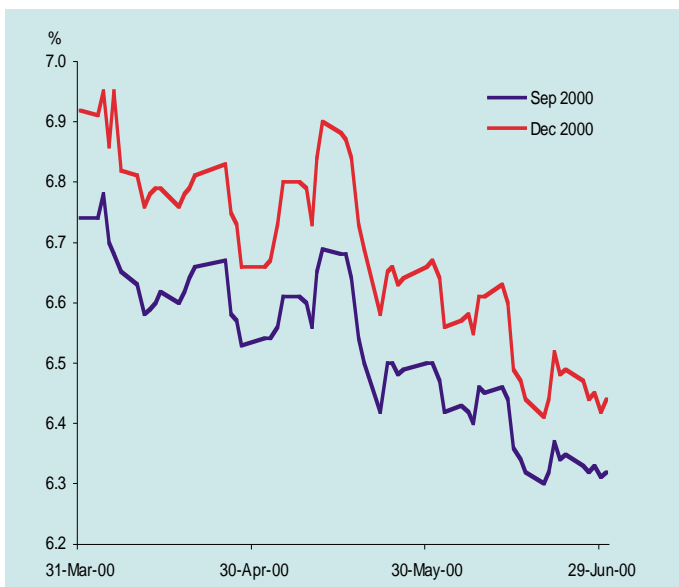
Source: DMO

Chart 4: UK Interest Rates



Source: Bank of England

Chart 5: Implied Interest Rates from Short Sterling Contracts



Source: Bloomberg

stable against continental bonds, with the 10-year gilt trading in single basis points above bunds throughout most of the quarter.

A major structural development within the gilt market was the start of a process of yield curve disinversion as shorter-dated maturities began to benefit from lower interest rate expectations. Longs were also affected by supply considerations after the DMO reaffirmed its intention to maintain long conventional and index-linked gilt issuance on 12 June despite the spectrum auction “windfall” and MFR speculation. Over the quarter the spread between the 5- and 30-year benchmarks narrowed by 22 basis points to 126 basis points.

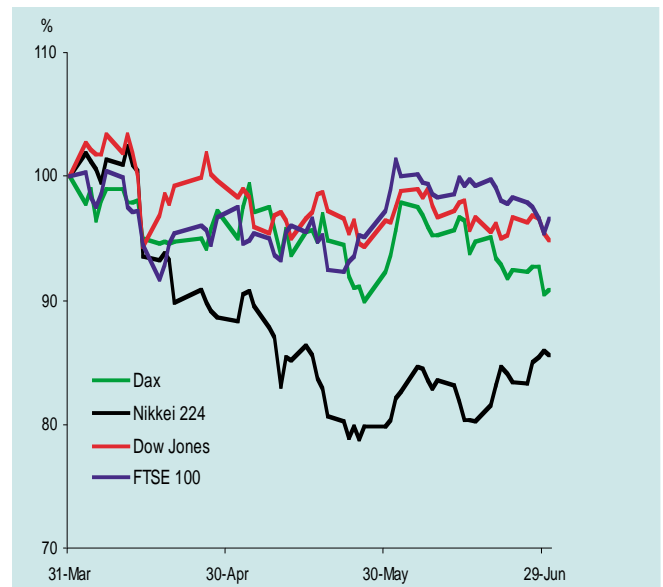
Gilt Market Operations

The DMO held two outright auctions (of the 2½% IL 2020 on 3 May and of the new ultra-long 4¼% 2032 on 24 May) in the quarter. The new 2032 stock was then built up from £2.5 billion to £4.55 billion in issue as a result of a subsequent switch auction into it from 8% 2015 on 22 June. On 12 June the DMO announced the cancellation of a (medium maturity) conventional gilt auction scheduled for September, and the consequent reduction in planned gilt sales in 2000-01 from £12.2 billion to £10 billion.

Money Market Operations

The DMO took over full responsibility for Exchequer cash management on 3 April. The major initial challenge was the handling of the cash receipts from the auction of the first three radio spectrum licenses. £8.3 billion was received on 9 May (amongst the largest ever cash payments to the Government on a single day) and £3.9 billion on 16 May. A regular series of weekly structured Treasury bill tenders and two ad hoc Treasury bill tenders were carried out in the quarter.

Chart 6: Equity Indices



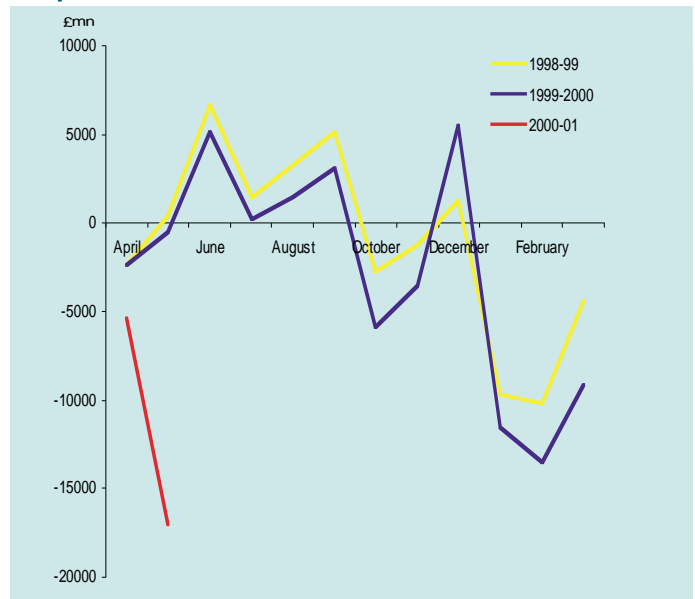
Source: Reuters. 31 March 2000 = 100.

Chart 7: Exchange Rates



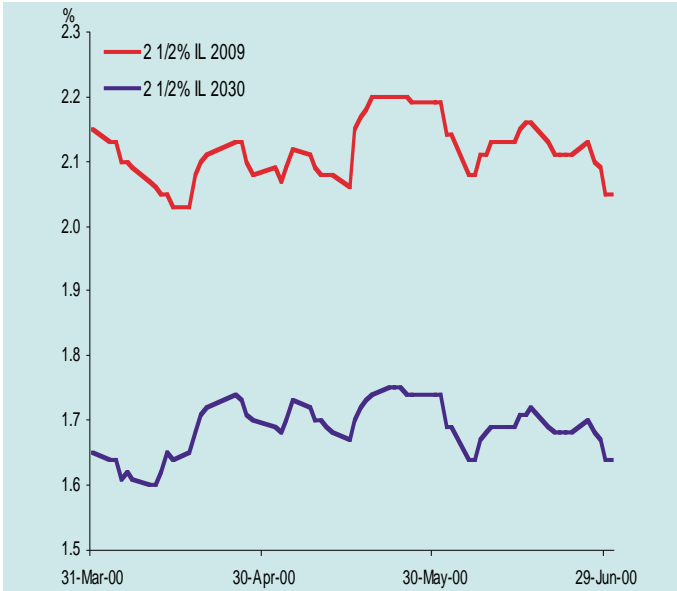
Source: DMO.

Chart 8: Cumulative Central Government Net Cash Requirement



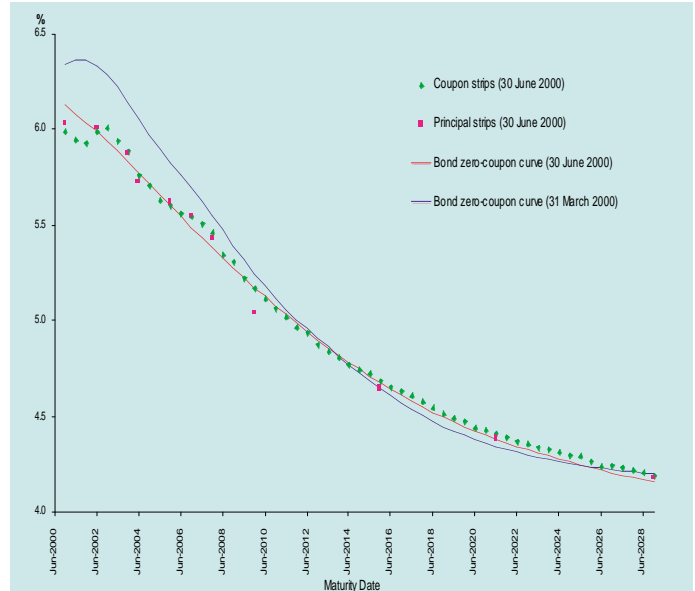
Source: ONS

Chart 9: Index-linked Gilt Real Redemption Yields



Source: DMO. 3% inflation assumption.

Chart 10: Zero-Coupon UK Yield Curves



Source: DMO.

2000-01 Financing Requirement (£bn)

	Budget 12 March	20 April	12 June	Gross sales at auctions- (to end June)	Net Central Government Gilt purchases (to end June)
CGNCR Forecast	-4.9	-4.9	-4.9		
Impact of Spectrum windfall	-	-	-19.5		
Replacing foreign currency debt	3.5	3.5	9.5		
Gilt Redemptions	18.6	18.6	18.6		
Debt buy-backs	3.5	3.5	3.5		
Gilt Sales Residual from 1999-2000	-9.5	-12.8	-12.8		0.2
Financing Requirement	11.2	7.9	-5.6		
<i>Less net financing from:</i>					
National Savings	-0.8	-0.8	-0.8		
DMO cash deposit at Bank of England	-0.2	-0.2	-0.2		
Repayment of Ways & Means	-	-2.0	-2.0		
Reduction in planned T-Bill stock	-	-1.3	-2.0		
Further reductions in net short-term debt	-	-	-10.7		
Gilt Sales Planned	12.2	12.2	10.0		
Short conventionals (1-7 years)	0.0	0.0	0.0		0.2
Medium Conventionals (7-15 years)	2.2	2.2	0.0		0.1
Long conventionals (>15 years)	6.5	6.5	6.5	2.4	0.0
Index-linked gilts	3.5	3.5	3.5	0.8	-0.1

Auction Results 2000-01

Auction Date	Issue Amount (nominal)	Stock	Cover	Tail (bp)	Average Accepted Price	Yield at Average Accepted Price (%)
3 May 2000	£375mn	2½% IL 2020	2.30	-*	£219.00	1.92
24 May 2000	£2,500mn	4¼% 2032	1.63	2	£96.21	4.47

* Index-linked gilts are issued through a uniform price format

Switch Auction Results

Date	Source Stock	Nominal Switched	Destination Stock	Nominal Created	Avg DP ratio*
22 June 2000	8% 2015	£1.5bn	4¼% 2032	£2.05bn	1.3641

* Dirty Price Ratio, based on average price of the destination stock.

Treasury Bill Tender Results Q2 2000

Date	Issue Amount (£mn)	Average Yield (%)	Average Price	Cover	Yield Tail (bp)
3M T-bills					
7 April	100	5.980	£98.531	6.15	0
14 April	100	5.950	£98.538	7.95	0
20 April	100	6.047	£98.531	5.05	0
28 April	100	6.046	£98.531	5.45	0
5 May	100	6.010	£98.524	5.30	1
12 May	100	6.080	£98.507	5.05	0
19 May	100	5.940	£98.541	4.45	0
26 May	100	5.950	£98.538	4.90	0
2 June	100	5.960	£98.536	5.80	0
9 June	100	5.960	£98.536	4.90	0
16 June	100	5.899	£98.551	5.55	0
23 June	100	5.950	£98.538	5.75	0
30 June	100	5.933	£98.542	3.50	0
1M T-bills					
7 April	150	5.810	£99.556	6.10	0
14 April	150	5.700	£99.565	6.97	0
20 April	150	5.900	£99.565	4.70	0
28 April	150	5.947	£99.546	4.30	0
5 May	150	5.900	£99.549	5.53	0
12 May	150	5.892	£99.500	5.54	1
19 May	150	5.820	£99.555	3.37	1
26 May	150	5.849	£99.569	3.47	1
2 June	150	5.847	£99.533	4.53	0
9 June	500	5.800	£99.557	6.09	0
16 June	750	5.770	£99.599	5.39	0
23 June	750	5.830	£99.555	5.05	0
30 June	750	5.770	£99.559	3.33	0
Ad hoc					
12 April: 14 day	500	5.800	£99.778	8.07	0
27 April: 26 day	350	5.900	£99.581	4.00	0

Chart 11: Structured T-bill Stock by Maturity at Issue in Q2 2000

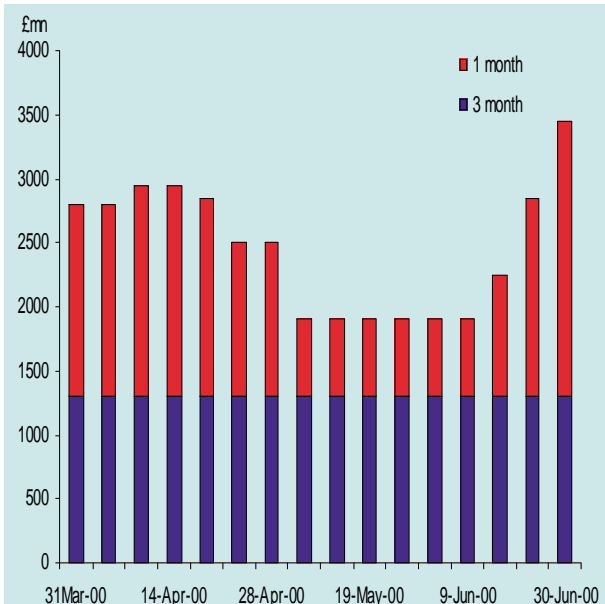
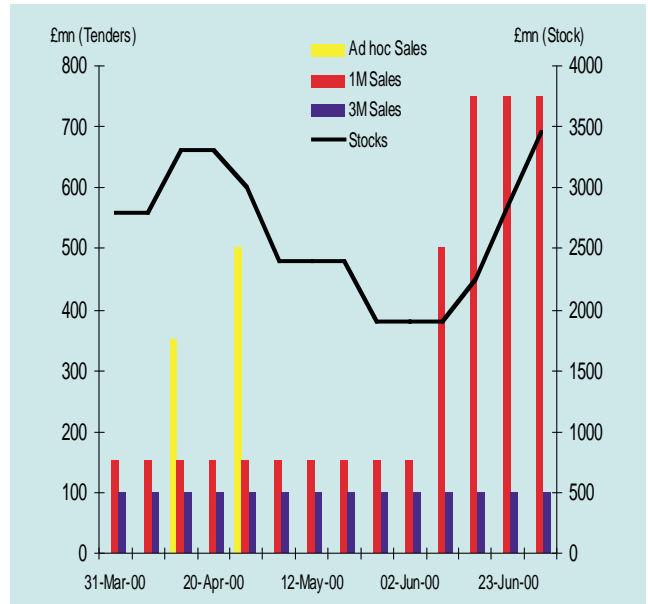


Chart 12: T-bill Stocks and Tenders in Q2 2000



Details of Gilt Market Turnover (2nd Quarter 2000)

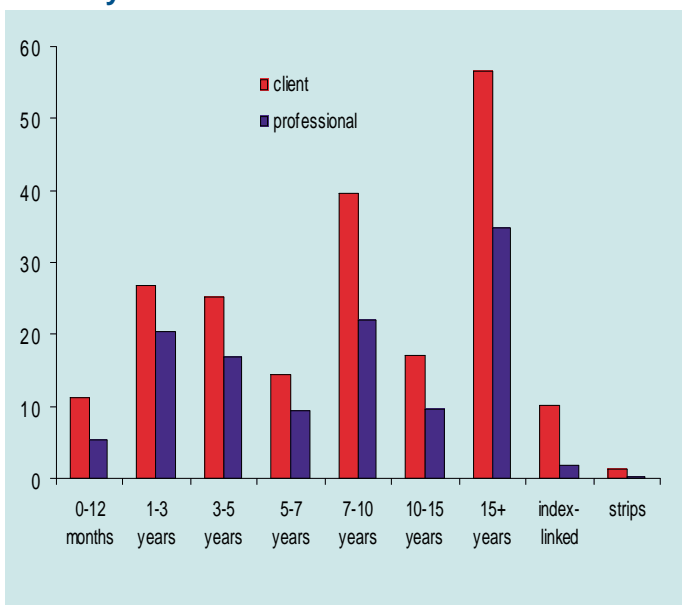
Top Ten Stocks Traded (by Market Value) in the 13 Weeks to 30 June 2000*

Stock	Market Value of Trades (£mn)	% of Value of all Gilt Trades	Number of Bargains ('000's)	Average Bargain Size (£mn)
5¾% Treasury 2009	47,914	13%	10.0	4.8
6% Treasury 2028	35,202	9%	7.2	4.9
8% Treasury 2021	28,914	8%	6.0	4.8
7% Treasury 2002	28,696	7%	4.5	6.4
8% Treasury 2015	20,983	5%	4.1	5.1
9% Conversion 2011	20,684	5%	2.2	9.5
8% Treasury 2000	17,994	5%	2.2	8.1
6½% Treasury 2003	17,361	5%	6.1	2.9
4¼% Treasury 2032	17,245	5%	2.7	6.3
7% Treasury 2001	16,797	4%	5.0	3.4
Total Market	382,666	66%	122	3.0

The top ten stocks account for % of total market turnover.

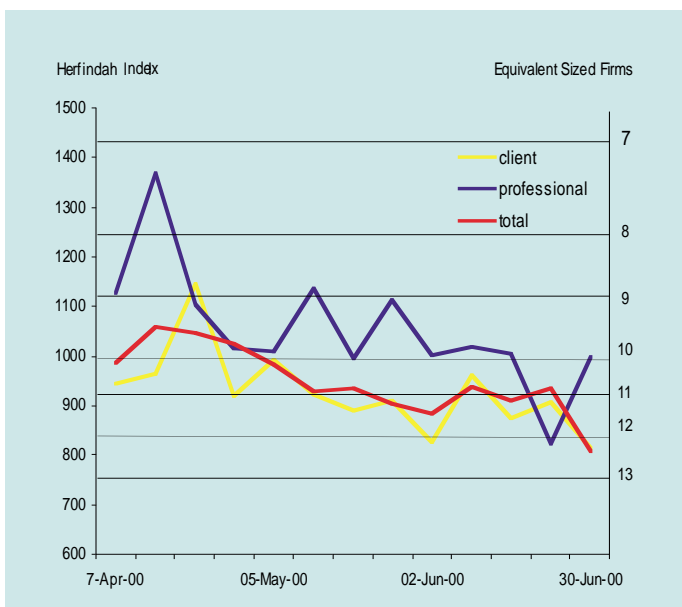
*Disclaimer: This information is based on provisional information provided by the London Stock Exchange and should only be treated as indicative.

GEMM Market Turnover (£bn nominal) by Maturity Band



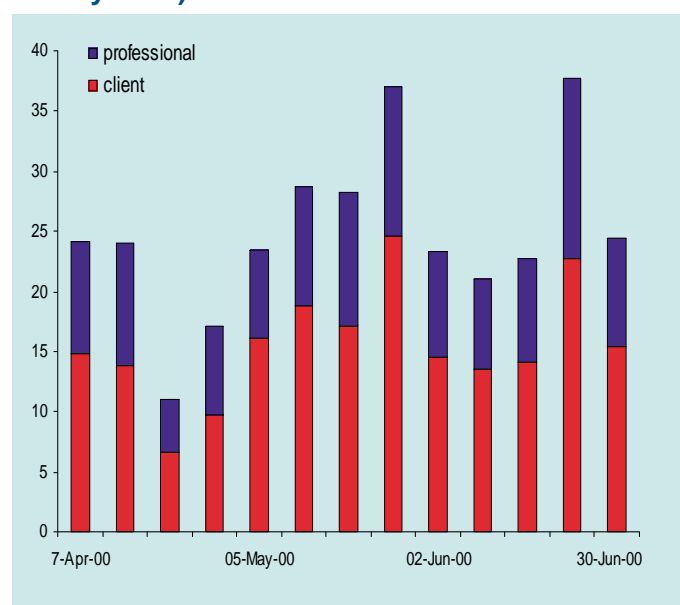
Source: DMO

Herfindahl Index of Total GEMM Market Turnover



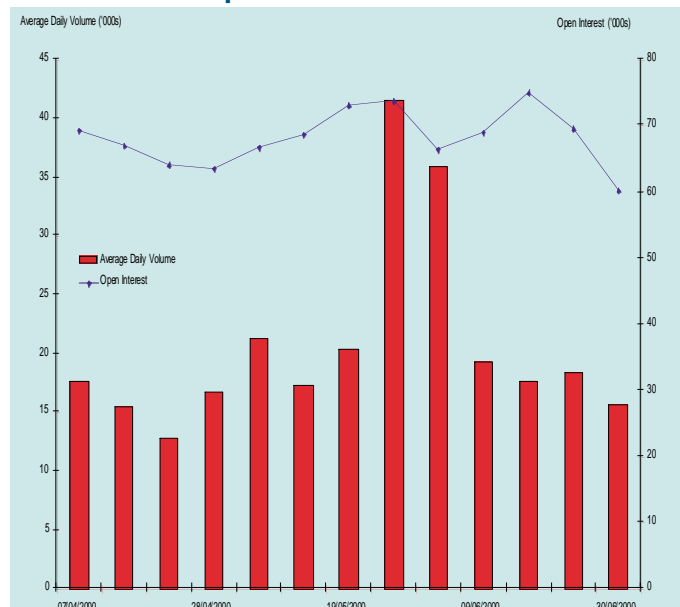
Source: DMO

Total GEMM Market Turnover (£bn nominal, weekly total)



Source: DMO

Average Daily Turnover of the Long Gilt Futures Contract and Open Interest



Source: London International Financial Futures Exchange

