

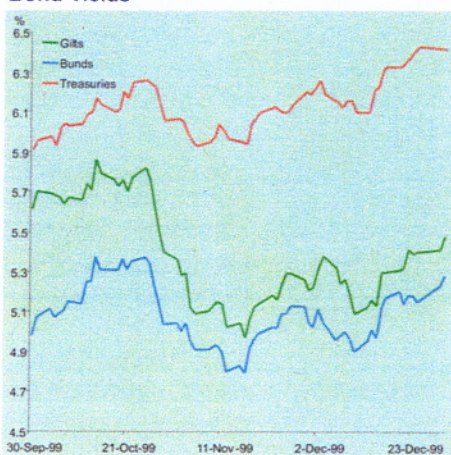
Gilts

REVIEW

4th Quarter 1999 October - December

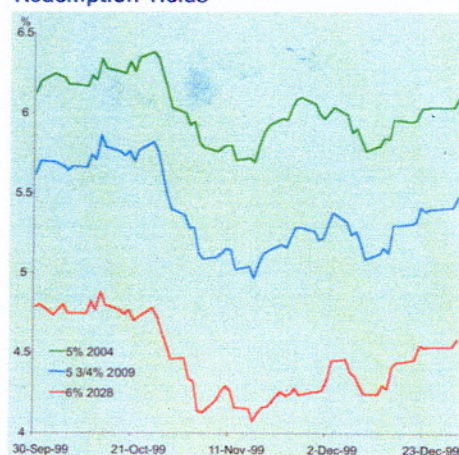
Gilt yields fell slightly over the quarter, unlike yields on bunds, other eurozone bonds and US Treasuries. However, Treasury yield movements diverged from European bonds over the quarter. This was the result of an ECB rate increase, in response to increasing signs of a eurozone recovery, and reducing fears of European inflation. The US also increased rates, but ten-year Treasury yields then increased because the rate change was accompanied by expectations of further rises being likely in the immediate future. The quarter also witnessed low volumes of trading and relatively low levels of primary issuance. This was a reaction to the approaching year-end and fears of the Y2K problem.

Chart 1: International 10-year Government Bond Yields



Source: DMO

Chart 2: Conventional Benchmark Gilt Redemption Yields



Source: DMO

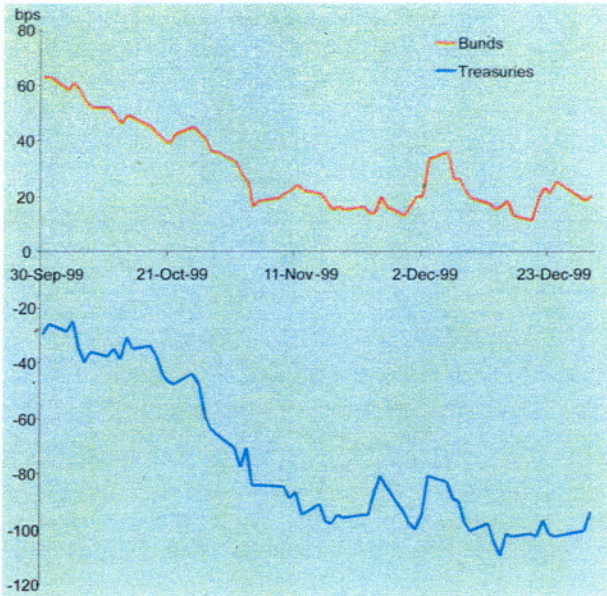
Chart 1 shows how gilts closely followed international bond movements. However, gilts outperformed both bunds and Treasuries. Chart 3 shows that the spread of the 10-year benchmark gilt over 10-year bunds reduced significantly over the first half of the quarter. The spread fell from 63bps at the start of the quarter to around 20bps from mid-November. Similarly the spread of Treasuries over gilts increased from 30bps at the start of the quarter to 94bps at the close. The majority of this change took place in the first half of the quarter, reflecting the increasing concerns over eurozone and US inflation.

Gilt yields were relatively stable throughout October. They rose slightly over the month, first on signs of US economic strength, particularly in retail sales on 14 October, then on domestic strength, highlighted in the Q3 BCC survey, and finally on concerns of eurozone strength. Gilts rallied at the end of October, following the lead of eurozone bonds. The latter rallied as stronger than expected Euro-11 M3 data, released on 25 October, led the market to conclude that the ECB would increase rates at the next meeting on 4 November. This in turn eased concerns over eurozone inflation and the market perceived that fewer rate rises would be necessary after this initial increase.

The MPC and the ECB both increased rates on 4 November. The MPC increased its repo rate by 25bps to 5.5%. Chart 4 shows how the timing of this move was not wholly anticipated, but that there was a clear expectation of rate increases. The ECB

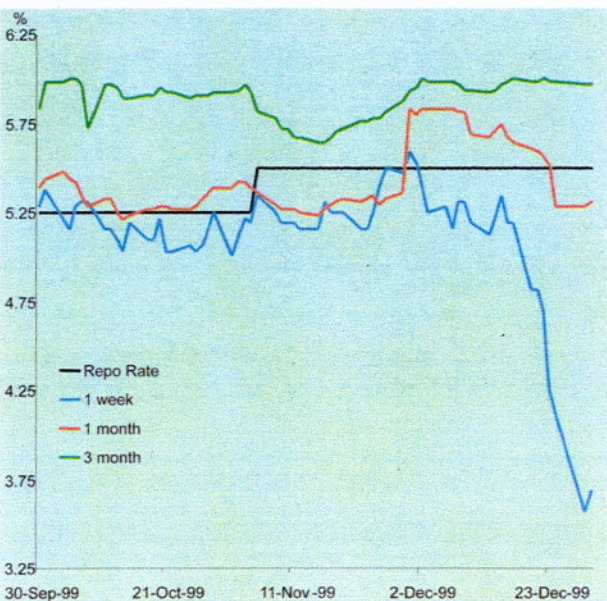


Chart 3: Spread of 10-year Gilts against German Bunds and US Treasuries



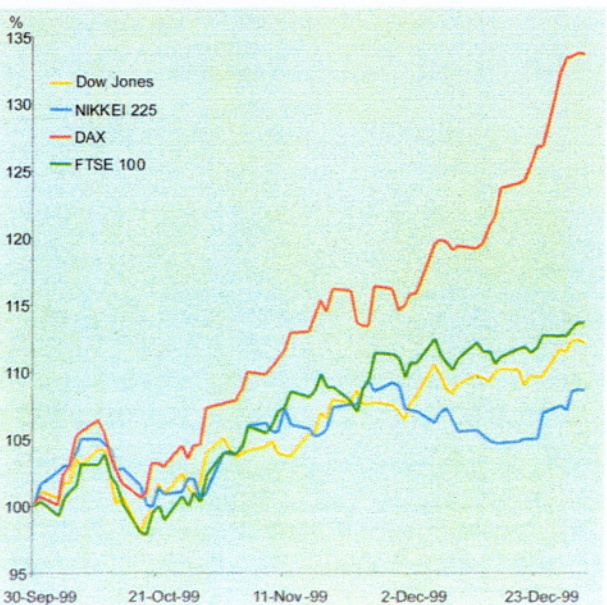
Source: DMO

Chart 4: UK Interest Rates



Source: Bank of England. The 1-week to 3-month rates refer to inter-bank mid-rates.

Chart 5: Equity Indices



Source: Reuters. 30 September 1999 = 100.

increased rates by 50bps to 3%. European bond markets outperformed on the back of this rate rise. The markets' fears of growing inflationary pressures in the eurozone were eased. The markets began to discount further rate rises from the MPC and the ECB ahead of the year-end.

Gilts then tracked eurozone bond market movements. Gilt yields were seemingly unaffected by the Pre-Budget Report of 9 November. The report announced a change to the forecast central government net cash requirement and a consequent change to the gilt financing requirement. This required the cancellation of the proposed auction for short gilts, to have been held in March 2000. This action was widely anticipated by the market. Gilt yields reached the lows of the quarter on 16 November, following RPI data releases, which were in line with expectations.

The Federal Reserve's FOMC increased the US's Fed funds rate by 25bps to 5.5% on 16 November, after gilts closed in London. This led to an immediate increase in global bond yields. Further, following the Fed funds rate increase, global bond yields gradually increased amidst thin trading ahead of the year-end and fears of Y2K problems. This gradual rise reflected increasing expectations of further interest rate rises in Q1 2000.

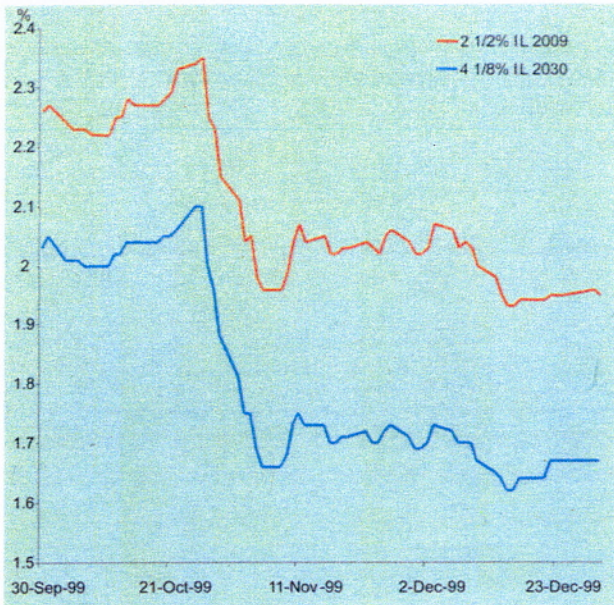
Longer gilts moved out of step with international bonds and shorter gilts in the first week of December. This particular movement was in reaction to a market rumour regarding the review of the minimum funding requirement (MFR), being carried out by the Faculty and Institute of Actuaries on behalf of the DSS. This rumour encouraged selling of long gilts, and yields rose. Long gilts had seen continued demand pressure over the quarter, with yields reaching an intraday low of 4.01% on 5 November. This was the lowest recorded yield of a 30-year gilt since the 1950s. However, turnover in over 15-year gilts remained at the higher levels seen in Q3 1999 (see page 4).

Long gilt yields decreased more than other sectors of the gilt market over the quarter, falling by 20bps from 4.79% to 4.59%. The ten-year benchmark yield fell from 5.61% to 5.48%, a fall of 13bps, while short gilts fell by only 3bps over the quarter from 6.13% to 6.10%.

Chart 5 shows that equity markets performed strongly over the quarter. The Nikkei 225 was the weakest of the highlighted indices. This increased by 8.6% over the quarter. The FTSE 100 and Dow Jones both increased by similar levels of around 13½% and 12% respectively. The best performer of the highlighted indices was the Dax, which increased by over 30%. This rise reflected a strong rebound in expectations of German economic activity.

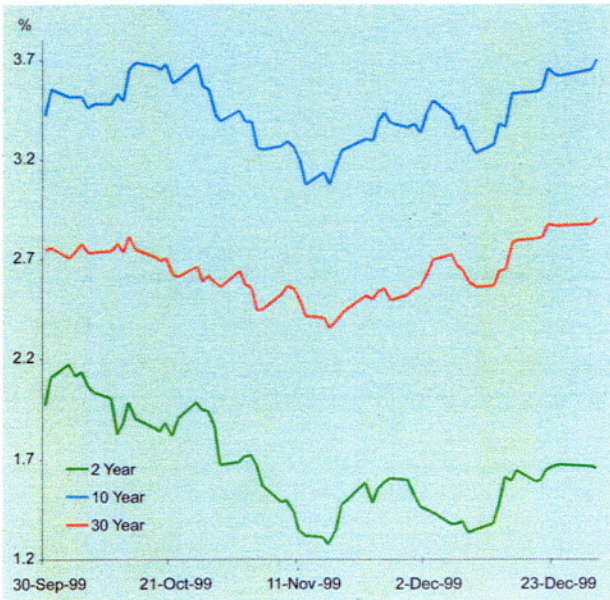
Index-linked gilt yields followed conventional gilts in their downward step change at the end of October. This move followed the auction of 2½% Index-linked Treasury 2016, and was a result of the strength of demand revealed at this auction being greater than expected. Index-linked yields moved to accommodate this. This can be seen in chart 6. Breakeven inflation is shown in chart 7. This shows a fall in breakeven inflation in the first half of the

Chart 6: Index-linked Gilt Real Redemption Yields



Source: DMO. 3% inflation assumption.

Chart 7: UK Break-even Inflation

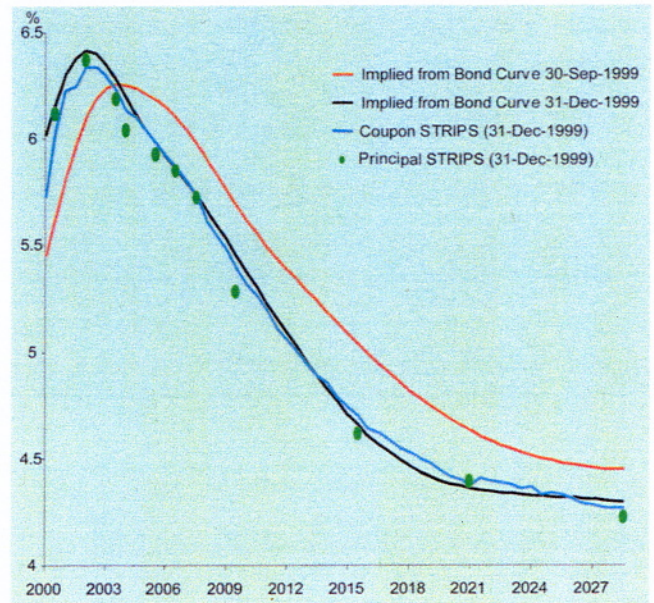


Source: DMO.

quarter. However, as the rate rises were digested and the US increased the Fed funds rate, breakeven inflation rose to finish the quarter higher than it started in the over ten-year sector.

The DMO held three auctions in this quarter, two outright auctions and a switch auction. The first was a switch auction involving £1bn nominal of 8% Treasury 2003 being switched into 5% Treasury 2004. This was the first auction of its kind undertaken by the DMO. The auction was 5.13 times covered, achieving an average dirty price ratio of 1.20. The auction created £1.12bn of 5% Treasury 2004, increasing the stock outstanding to £6.29bn. The second auction was the sale of £350mn nominal of 2½% Index-linked Treasury 2016 on 27 October. The auction was well covered and cleared at a 2.34% real yield. The third auction was of £2bn nominal of 6% Treasury 2028 on 24 November. This auction was 1.79 times covered, with an average yield of 4.25% and a yield tail of 2bps.

Chart 8: Zero Coupon UK Yield Curves



Source: DMO.

	Update 20 April 1999	Pre-Budget Report 9 November 1999	Sales to end-December	Remaining
CGNCR Forecast	6.2	1.1	-	-
Net Financing for Official Reserves	2.3	2.3	-	-
Gilt Redemptions	14.9	14.9	-	-
Gilt Sales Residual from 1998-99	-4.1	-4.1	-	-
Financing Requirement	19.3	19.3	-	-
<i>Less net financing from:</i>				
National Savings	0.1	-0.9	-	-
Treasury Bill and other short-term debt	1.9	0.8	-	-
Gross Gilt Sales Required	17.3	14.2	-	-
<i>of which</i>				
Ultra-short conventionals (1-3 years)	0	0	0.00	-
Short conventionals (3-7 years)	5.0	2.4	2.26	-
Medium conventionals (7-15 years)	3.0	2.7	2.68	-
Long conventionals (>15 years)	5.8	5.8-6.2	6.02	-
Index-linked gilts	3.5	2.9-3.3	2.43	0.5 - 0.9
Total			13.38	0.5 - 0.9

Note: figures may not sum due to rounding

Auction Results 1999-2000

Auction Date	Issue Amount (nominal)	Stock	Cover	Tail (bp)	Lowest Accepted Price	Yield at Lowest Accepted Price (%)
28 April 1999	£0.5bn	4 1/8% IL 2030	0.94	-*	£179.34	1.97
26 May 1999	£2.5bn	6% 2028	2.24	2	£120.20	4.72
22 June 1999	£2.5bn	5% 2004	2.01	2	£98.70	5.30
28 July 1999	£0.375bn	2 1/2% IL 2011	1.93	-*	£225.50	2.19
28 September 1999	£2.75bn	5 3/4% 2009	2.54	1	£100.30	5.71
27 October 1999	£0.350bn	2 1/2% IL 2016	2.65	-*	£204.61	2.34
24 November 1999	£2.0bn	6% 2028	1.79	2	£128.60	4.27

Taps of Gilts

Date of Tap	Issue Amount (nominal)	Stock	Price at Issue	Price when exhausted	Yield when exhausted (%)
6 August 1999	£0.4bn	6% 2028	£125.30	£125.30	4.45

Switch Auction Results

Date	Source Stock	Nominal Converted	Destination Stock	Nominal Created	AvgDP ratio ¹
21 October 1999	8% 2003	£1.0bn	5% 2004	£1.1bn	1.1201

Conversions 1999-2000

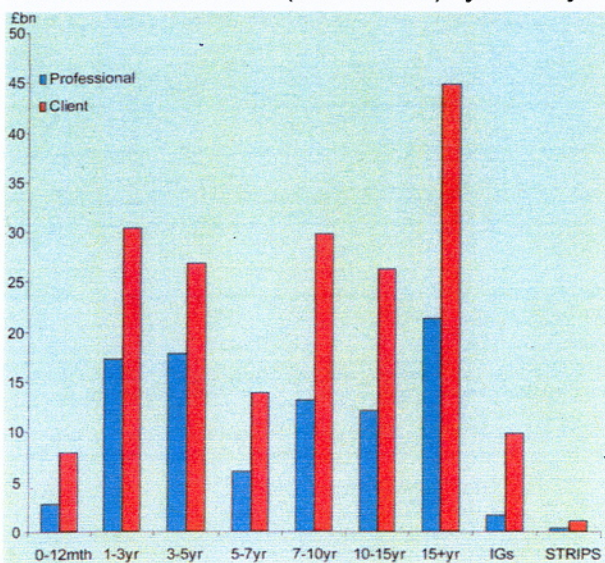
Date	Source Stock	Nominal Converted	Destination Stock	Nominal Created
26 July 1999	9 1/2% 2004	£3.1bn	5% 2004	£3.8bn

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

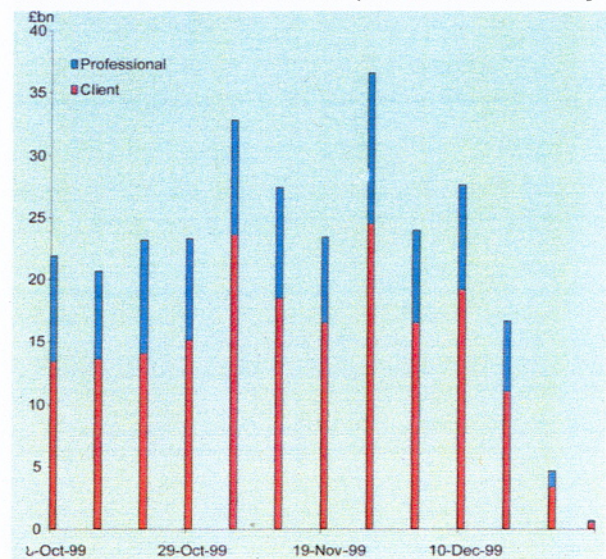
¹ Average dirty price ratio

Details of GEMM Market Turnover (4th Quarter 1999)

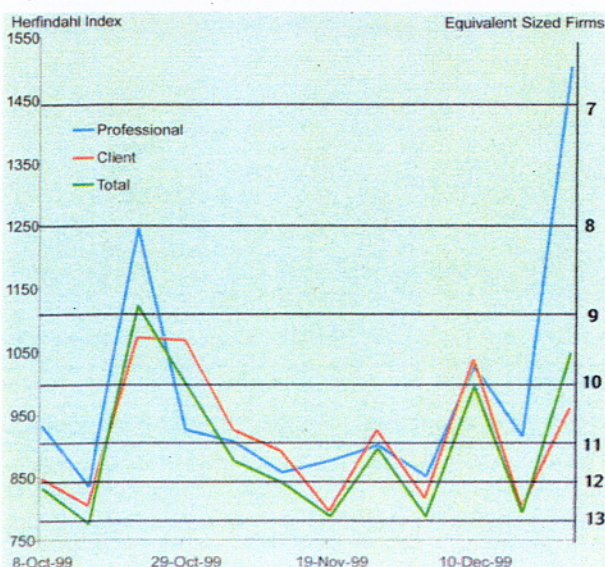
GEMM Market Turnover (£bn nominal) by Maturity Band



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



Herfindahl Index of Total GEMM Market Turnover



Explanatory Notes:

A Herfindahl Index (HI) is a statistical measure of concentration. The HI is calculated as the sum of firms' squared market share. It is compared against numbers of equal sized firms' market shares e.g. five equal sized firms have a Herfindahl number of 2,000, sixteen have 625.

Professional trades are defined as GEMM trades with IDBs, other GEMMs, the DMO and the Bank of England.

Charts are based on data reported to the DMO by GEMMs for the period starting 4 October 1999 and ending 31 December 1999. The Herfindahl chart excludes measurement of the final week of the quarter. This is due to extremely low volumes traded in this week.

The Pre-Budget Report and the Revised DMO Remit

The Pre-Budget Report (PBR) was published on 9 November 1999. The report gave a revised estimate of the Central Government Net Cash Requirement (CGNCR) of £1.1bn, £5.1bn lower than the Budget estimate. This led to a revision of the DMO's gilt sales requirement and remit. Details can be found in the 1999-2000 Financing Requirement box on page 3.

The PBR also includes forecasts of the CGNCR as a percentage of GDP up to, and including, the financial year 2004-05, as well as nominal GDP up to 2002-03. These are set out in the table below¹.

Table 1: Forecast CGNCR and estimated Financing Requirements

£bn	2000-01	2001-02	2002-03	2003-04	2004-05
CGNCR (as % GDP)	0.0	-0.1	0.1	0.6	0.7
Money GDP at Market Prices	934 - 939	978 - 988	1024 - 1039	1075 - 1091 ²	1129 - 1145 ²
Calculated CGNCR ³	0.0	-1.0	1.0	6.5 ⁴	8.0 ⁴
Forecast Gilt Redemptions ⁵	18.6	17.1	17.6	20.6	15.6
Implied £ Financing Requirement	18.6	16.1	18.6	27.1⁶	23.6⁶

The financing requirement will be met in the usual manner by the net contribution of National Savings and primary issuance by the DMO. The DMO will be taking over the role of managing the Exchequer's daily cash position in 2000-01, see the box below. Treasury bills (T-bills) will be used as the primary instrument to smooth the seasonal pattern of the Government's borrowing. To sustain their liquidity, the DMO intends to increase somewhat the stock of T-bills over the next few years. In effect the DMO will finance the Government's cash requirement by increasing the stock of T-bills as well as by issuing gilts.

Details of the DMO's projected debt sales in 2000-01 will be contained in the Debt Management Report 2000-01, which will be published by HM Treasury at the time of the Budget.

(1) Forecasts qualified in the PBR as follows (para 2.48, page 19):

"It is important to note, however, that the public finance projections in the PBR present an interim forecast update and do not necessarily represent the outcome the Government is seeking. The projections have a quite different status from those contained in the EFSR and FSBR at Budget time since those include the effects of all Budget policy decisions".

(2) Illustrative calculation based on a 5% nominal growth assumption.

(3) Assumes the mid-range of money GDP at market prices forecasts.

(4) Derived from the illustrative money GDP figure.

(5) Assumes that Stocks and Central Government Holdings are unchanged from those reported on page 7 of this review.

(6) Derived from the illustrative money GDP and calculated CGNCR figures.

The DMO's Cash Management Operations

The Chancellor of the Exchequer's letter of 6 May 1997 to the Governor of the Bank of England set out, amongst other issues, the transfer of Exchequer cash management from the Bank to the Treasury. Since April 1998 the Debt Management Office (DMO) has had responsibility for gilt issuance and for other debt management functions and operations. It has also been establishing its cash management capability. On 29 July 1999 the DMO announced a phased transition for cash management. The following article provides an update of this timetable, which remains as set out in the 29 July press release.

On 12 November 1999 the DMO announced the launch of the Debt Management Account ("DMA"), which came into effect from 15 November 1999. From that date, the DMO's transactions in gilts have been accounted for on the DMA, taking over the function previously met by the Gilt-edged Official Operations Account (GOOA). From 14th January 2000, issues of Treasury bills (T-bills) and the DMO's other transactions in other money market instruments will be accounted for on the DMA.

The DMO is planning to start dealing in the money markets in February, initially in small size and with the aim of complementing the Bank of England's operations to manage the market impact of the Exchequer's daily cash flow. Dealing will be primarily in the repo markets and be conducted bilaterally with the DMO's counterparties. The DMO may make use of the holdings of marketable gilts, currently held on its own behalf or by funds managed by NILO, as collateral for its repo transactions (see page 7 for list of holdings as of 30 September 1999). It is expected that the DMO will assume full responsibility from the Bank for managing the Exchequer's cash position early in Q2 2000. From this time the DMO will make use of the full range of operations set out in the Exchequer cash management Operational Notice.

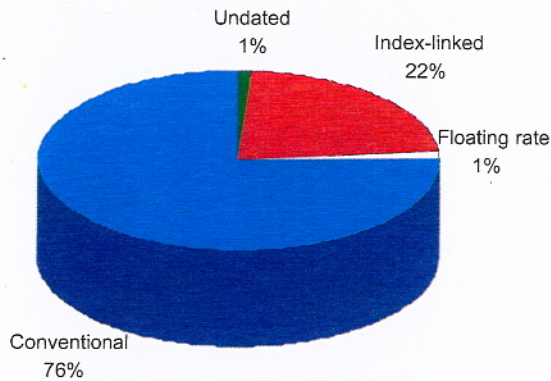
On 14 January 2000, the DMO will start to conduct T-bill tenders in accordance with the conventions set out in the Exchequer cash management Operational Notice. Initially these tenders will be held on behalf of the Bank of England, who will advise the DMO on the quantity and maturity of T-bills to be tendered. Once the DMO takes full responsibility for Exchequer cash management, the DMO will be offering for tender T-bills on its own behalf to smooth the seasonal patterns of the Exchequer's net cash flows.

The Exchequer cash management Operational Notice was published on 29 July 1999. A revised version was published on 7 January 2000. Copies are available directly from the DMO or can be found on the DMO website.

Details of the Gilts Portfolio as of 31 December 1999

The following charts are based on nominal values. Index-linked gilts are uplifted to account for accrued inflation.

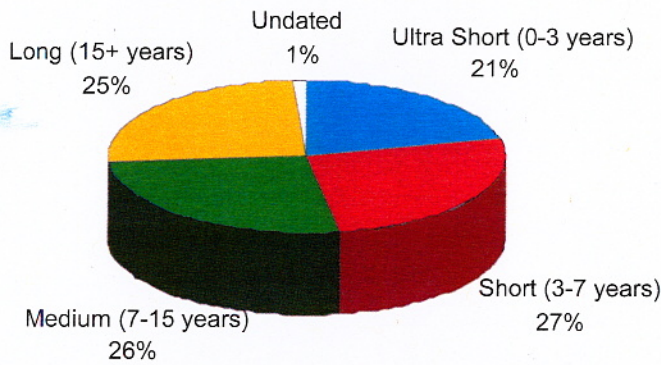
Composition of Gilts Stock



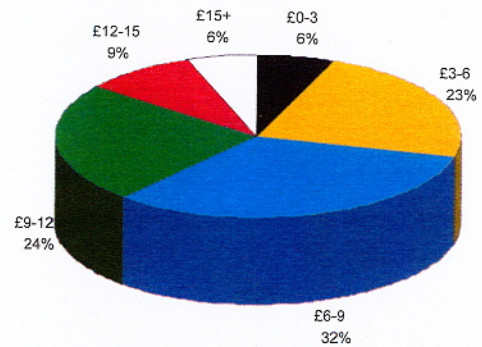
Portfolio Summary Statistics

Nominal Value of the Gilt Portfolio:	£294.29bn
Market Value of the Gilt Portfolio:	£333.45bn
Weighted Average Market Yield of the Portfolio:	5.44%
Portfolio Average Maturity:	9.77 years
Portfolio Average Modified Duration:	7.40 years
Portfolio Average Convexity:	103.9
Average Amount Outstanding of Largest 20 Gilts:	£9.52bn

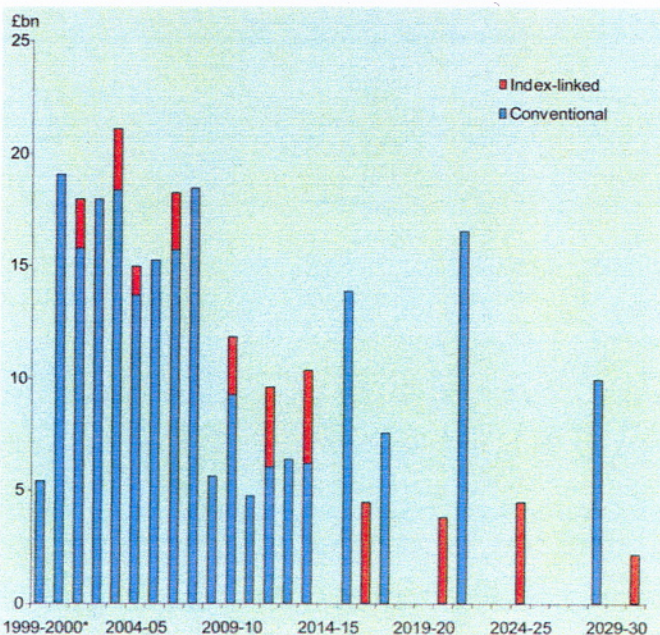
Gilt Portfolio's Maturity Split



Size of Issues in £ bn as Percentage of the Portfolio



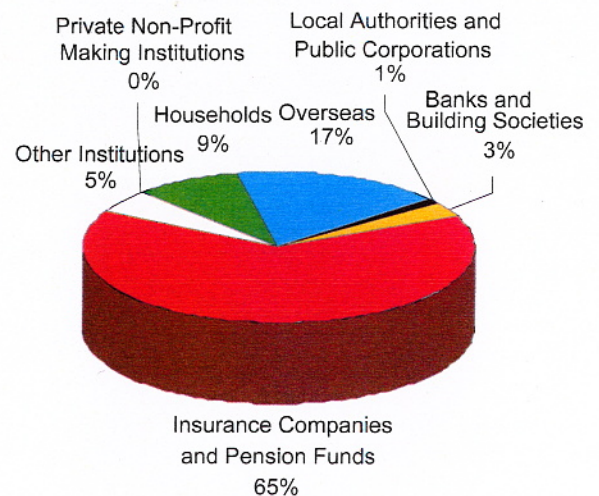
Gilt Redemptions (by Financial Year)



Double-dated issues currently above par are assumed to be called at first maturity. Index-linked gilts are not uplifted for inflation. Inflation uplift is scored in the CGNCR on maturity.

* Remaining this financial year.

Distributions of Holdings of Gilts in Market Hands Q3 1999



Source: ONS. Holdings of gilts are in market value terms.

Stock in Issue at 31 December 1999 (£mn nominal)

Conventional Gilts	Redemption Date	Amount in Issue (£mn)	Amount held in Stripped form (£mn)	Central Government Holdings* (DMO and NILO) at 30 Sep 99
9% Conversion 2000	03-Mar-00	5,358	-	42
13% Treasury 2000	14-Jul-00	3,171	-	96
8% Treasury 2000	07-Dec-00	9,800	119	219
10% Treasury 2001	26-Feb-01	4,406	-	15
11% 1/2 Treasury 2001-2004	19-Mar-01	1,620	-	142
Floating Rate 2001	10-Jul-01	3,000	-	16
7% Treasury 2001	06-Nov-01	12,750	-	692
7% Treasury 2002	07-Jun-02	9,000	280	76
9 3/4% Treasury 2002	27-Aug-02	6,527	-	12
8% Treasury 2002-2006	05-Oct-02	2,050	-	65
8% Treasury 2003	10-Jun-03	7,600	-	418
10% Treasury 2003	08-Sep-03	2,506	-	0
6 1/2% Treasury 2003	07-Dec-03	7,987	145	32
5% Treasury 2004	07-Jun-04	6,289	2	49
3 1/2% Funding 1999-2004	14-Jul-04	543	-	32
6 3/4% Treasury 2004	26-Nov-04	6,500	-	363
9 1/2% Conversion 2005	18-Apr-05	4,842	-	0
8 1/2% Treasury 2005	07-Dec-05	10,373	584	188
7 3/4% Treasury 2006	08-Sep-06	4,000	-	261
7 1/2% Treasury 2006	07-Dec-06	11,700	259	132
8 1/2% Treasury 2007	16-Jul-07	7,397	-	216
7 1/4% Treasury 2007	07-Dec-07	11,000	303	91
9% Treasury 2008	13-Oct-08	5,621	-	0
5 3/4% Treasury 2009	07-Dec-09	8,827	106	235
6 1/4% Treasury 2010	25-Nov-10	4,750	-	254
9% Conversion 2011	12-Jul-11	5,273	-	110
7 3/4% Treasury 2012-2015	26-Jan-12	800	-	177
9% Treasury 2012	06-Aug-12	5,361	-	0
5 1/2% Treasury 2008-2012	10-Sep-12	1,000	-	56
8% Treasury 2013	27-Sep-13	6,100	-	307
8% Treasury 2015	07-Dec-15	13,787	167	86
8 3/4% Treasury 2017	25-Aug-17	7,550	-	179
8% Treasury 2021	07-Jun-21	16,500	517	114
6% Treasury 2028	07-Dec-28	9,900	333	64
2 1/2% Treasury	Undated	474	-	0
3 1/2% War	Undated	1,909	-	0
Index-linked Gilts	Redemption Date	Amount in Issue (£mn)	Nominal Including Inflation Uplift (£mn)	Central Government Holdings* (DMO and NILO) at 30 Sep 99
2 1/2% I-L Treasury 2001	24-Sep-01	2,150	4,538	36
2 1/2% I-L Treasury 2003	20-May-03	2,700	5,663	14
4 3/8% I-L Treasury 2004	21-Oct-04	1,300	1,584	0
2% I-L Treasury 2006	19-Jul-06	2,500	5,944	0
2 1/2% I-L Treasury 2009	20-May-09	2,625	5,506	26
2 1/2% I-L Treasury 2011	23-Aug-11	3,475	7,700	8
2 1/2% I-L Treasury 2013	16-Aug-13	4,200	7,778	7
2 1/2% I-L Treasury 2016	26-Jul-16	4,495	9,098	25
2 1/2% I-L Treasury 2020	16-Apr-20	3,800	7,566	10
2 1/2% I-L Treasury 2024	17-Jul-24	4,450	7,527	10
4 1/8% I-L Treasury 2030	22-Jul-30	2,150	2,629	0
"Rump" Gilts	Redemption Date	Amount in Issue (£mn)		Central Government Holdings* (DMO and NILO) at 30 Sep 99
8 1/2% Treasury 2000	28-Jan-00	109		92
13 3/4% Treasury 2000-2003	25-Jul-00	53		4
9 1/2% Conversion 2001	12-Jul-01	3		3
9 3/4% Conversion 2001	10-Aug-01	35		28
10% Conversion 2002	11-Apr-02	21		11
9 1/2% Conversion 2002	14-Jun-02	2		2
9% Exchequer 2002	19-Nov-02	83		65
11 3/4% Treasury 2003-2007	22-Jan-03	234		47
9 3/4% Conversion 2003	07-May-03	11		9
12 1/2% Treasury 2003-2005	21-Nov-03	152		41
13 1/2% Treasury 2004-2008	26-Mar-04	95		9
10% Treasury 2004	18-May-04	20		5
9 1/2% Conversion 2004	25-Oct-04	307		15
10 1/2% Exchequer 2005	20-Sep-05	23		13
9 3/4% Conversion 2006	15-Nov-06	6		2
8% Treasury 2009	25-Sep-09	393		172
12% Exchequer 2013-2017	12-Dec-13	57		1
2 1/2% Annuities	Undated	3		0
3% Treasury	Undated	55		0
3 1/2% Conversion	Undated	99		75
2 1/2% Consolidated	Undated	275		18
2 3/4% Annuities	Undated	1		0
4% Consolidated	Undated	358		3

Double-dated issues currently above par are assumed to be called at first maturity.

*Includes holdings by National Investments and Loans Office (NILO) and DMO. Excludes local authority, public corporation and Bank of England holdings.

Announcements, Events and Contacts

Date	Notice	Title
12 October	Press Notice	Gilt Switch Auction: 8% Treasury 2003 into 5% Treasury 2004: Initial Announcement
19 October	Press Notice	Index-linked Gilt Auction: 2 1/2% Index-linked Treasury 2016: Initial Announcement
21 October	Press Notice	Gilt Switch Auction: 8% Treasury 2003 into 5% Treasury 2004: Result
27 October	Press Notice	Sale by Auction of £350mn of 2 1/2% Index-linked Treasury 2016: Result
9 November	Press Notice	Pre-Budget Report: Gilt Financing Arithmetic and Revised DMO Remit
12 November	Press Notice	Launch of the Debt Management Account
16 November	Press Notice	Gilt Auction: 6% Treasury 2028: Initial Announcement
24 November	Press Notice	Sale by Auction of £2,000mn of 6% Treasury 2028: Result
17 December	Press Notice	Gilt-edged Auction and Switch Auction: January to March 2000
17 December	Press Notice	Cancellation of British Government Stock

Date	Event
14 January	First DMO weekly T-bill tender
18 January	Announcement of Size of Auction of 2 1/2% IL Treasury 2024
26 January	Auction of 2 1/2% IL Treasury 2024
1 February	Announcement of maximum amount of 8% Treasury 2015 to be switched into 6% Treasury 2028
7 February	GEMMs consultation with the Economic Secretary
8 February	End Investors consultation with the Economic Secretary
9 February	Switch Auction of 8% Treasury 2015 into 6% Treasury 2028
14 February	DMO plan to start limited bilateral cash transactions
20 March*	GEMMs Quarterly Consultation
21 March*	End-Investors Quarterly Consultation
31 March	Auction Schedule Announcement: April to June 2000
To be announced	Budget
To be announced	Publication of the Debt Management Report 2000-2001

* subject to the timing of the Budget

Name	Position	Telephone No.
Mike Williams	Chief Executive	020 7862 6533
Paul Mills	Head of Policy	020 7862 6521
Jo Whelan	Head of Markets	020 7862 6531
Hamish Watson	Chief Gilts Dealer	020 7862 6530
Mike Ness	Chief Cash Dealer	020 7862 6522
Jim Juffs	Head of Operational Control	020 7862 6520
Steve Whiting	Press Officer	020 7862 6532
Jason Phillips	Assistant Press Officer	020 7862 6527
David Page	Economic Analyst	020 7862 6524
Martin Duffell	Market Liaison Officer	020 7862 6517
Mark Deacon	Quantitative Analyst	020 7862 6516
Gurminder Bhachu	Quantitative Analyst	020 7862 6512
David Cuthbert	Operations Manager	020 7862 6542
Switchboard no.		020 7862 6500
Fax no.		020 7862 6509

Information	Reuters/Bridge/ADP	Telerate	Bloomberg	Topic3/ASCII Broadcast
Index	DMO/INDEX		DMO<GO>	
Announcements	DMO/GILTS1 to 7	22550 to 2256		44715
Shop window general info	DMOGILTS8	6615		44715
Shop window 1	DMO/GILTS9	6516		44716
Shop window 2	DMO/GILTS10	6517		44717
Shop window 3	DMO/GILTS11	6518		44718
				Stock ID
				ISIN code
GEMMA ref prices (Conventionals)	GEMMA01 to 06	47216 to 47221		44800 to 44894 44806 to 44809
GEMMA ref prices (Index-linked)	GEMMA08	47223		44805 44811
GEMMA ref prices (STRIPS)	GEMMA13 to 19	21291 to 21297		44850 to 44856 44850 to 44854
DMO website: www.dmo.gov.uk		Address: DMO, Cheapside House, 138 Cheapside, London EC2V 6BB.		

If readers have any comments on this review, please contact David Page on 020 7862 6524 or e-mail at david.page@dmo.gov.uk

