

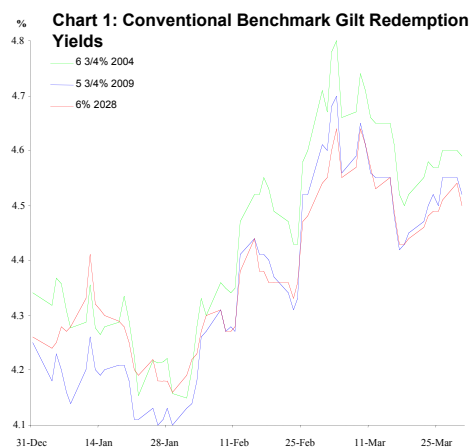
Gilts

REVIEW

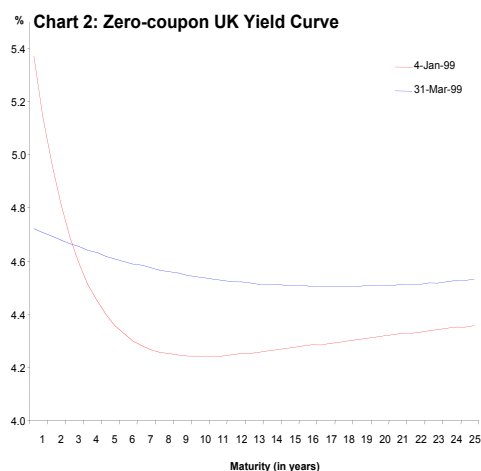
1st Quarter 1999 January - March

Overview

Benchmark gilt yields fell by between 140 and 170 basis points in the financial year to end December. The first quarter of 1999 saw a slight reversal of this trend with yields increasing by 20 to 25 basis points. Gilt yields followed the international trend. They bottomed out at the end of January, rose into March and closed the quarter at slightly below peak levels, after a slight recovery through the middle of March. The 10-year benchmark yield rose by 38 basis points from the end of January to the end of March, see chart 1. Chart 2 shows that the zero-coupon yield curve disinverted and rose over the quarter. This occurred against a backdrop of low gilt issuance. The DMO issued no conventional gilts for the second successive quarter. The end of January saw the second auction of index-linked stock.



Source: DMO

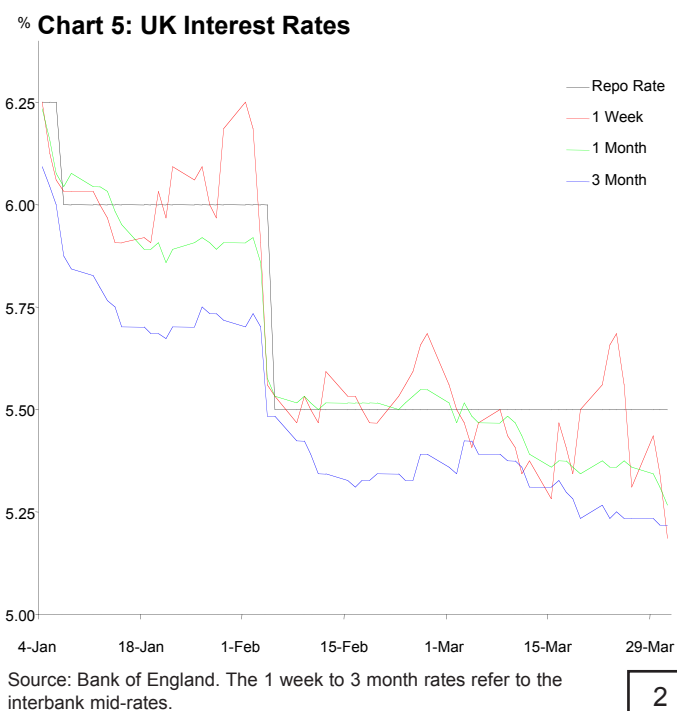
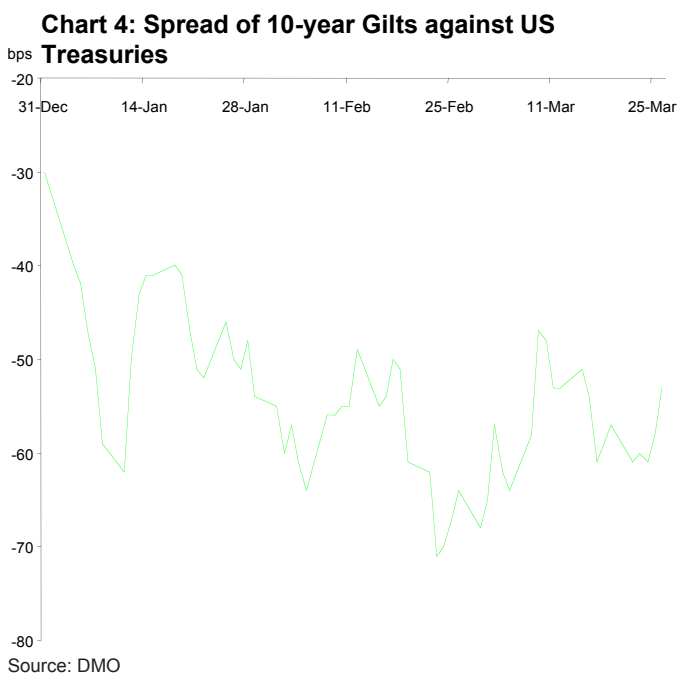
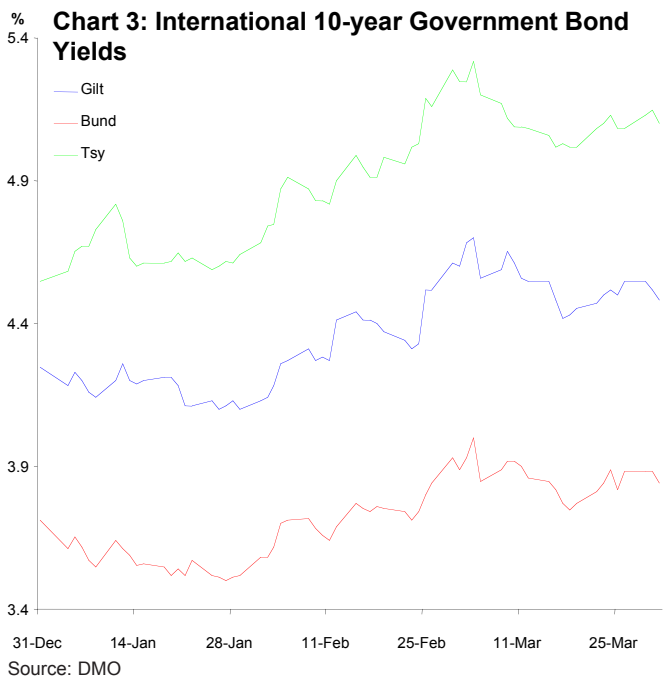


Source: Bank of England

Review

Early in the quarter yields continued their downward trend. Global growth expectations continued to fall and central banks continued to cut rates, including the Bank of England, whose Monetary Policy Committee cut rates by 25 basis points on 7 January. Gilts and other major government bonds were supported by safe-haven flows following the de facto devaluation of the Brazilian real on 13 January (chart 3). US Treasuries slightly lagged this fall in yields because of a weakening dollar against the yen, and growing wariness of the strength of the US economy. Gilts were also supported by the data released mid-month: retail sales data on 20 January were much weaker than expected, increasing hopes of a fifth consecutive rate cut by the MPC. The UK 10-year benchmark reached a low of 4.10% on 29 January, the lowest level of conventional yields since the mid-1950s.





From the end of January, international government bond yields began to increase, peaking in early March. The continually surprising strength of the US economy led to fears of an increase in interest rates in the US. Non-farm payroll data on 5 February were surprisingly strong. Mr Greenspan's Humphrey Hawkins testimony increased concern that the FOMC had a tightening bias. Indeed, US Treasuries fared worse than gilts over the period, with the spread over the UK 10-year benchmark increasing to 70 basis points by the end of February (chart 4). In Japan, fears of increasing JGB supply led to increasing yields.

UK data over this period were mixed, but survey data showed an improvement in business confidence and data on February retail sales showed a greater than expected increase. UK gilt yields rose, following other major government bond yields, and barely broke rank despite a 50 basis point repo rate cut by the MPC on 4 February which surprised the markets (chart 5).

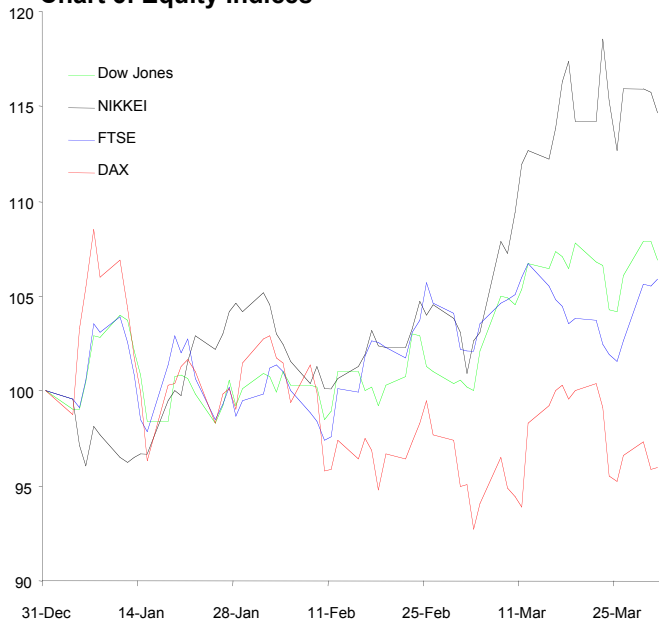
Gilts recovered some ground in mid-March compared to early March. This move again reflected movement in overseas bond markets. Increasing expectations that the MPC would reduce the repo rate in the next few months further supported this. However, rising equity markets (see chart 6), particularly the Dow Jones closing above 10,000 on 29 March, fuelled expectations that the FOMC would increase the Fed funds rate on 30 March. Although this did not occur, the market ended the quarter believing the next move by the Federal Reserve would be upward.

The DMO held the second auction of index-linked stock on 27 January. £450mn (nominal) of 2 1/2% IL 2024 were auctioned at a clearing price implying a real yield of 2.01%. This is the lowest real yield achieved at issue by the UK Government. Index-linked gilt yields fell over the quarter (see chart 7). The 2016 index-linked gilt fell 18 basis points, while the 2% IL 2006 fell by 23 basis points to a yield of 1.73%. This is the lowest level of index-linked real yields since their launch in 1981.

The two factors believed to be driving these low yields are: a lack of supply and an increase in institutional demand created by the Minimum Funding Requirement and the maturing of pension funds. Chart 7 also illustrates how the prospect of additional supply held up the falling market trend at the end of January, with a sharp fall in yields after the auction.

The DMO converted 12 1/2% Treasury 2003-05 into

Chart 6: Equity Indices

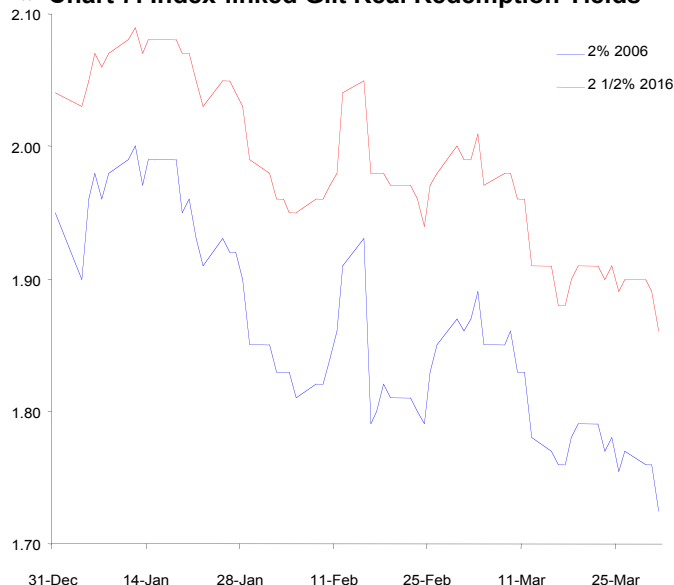


Source: Reuters. 1 January 1999 = 100.

6 1/2% Treasury 2003 during the quarter, with the conversion offer occurring on 1 February. At the start of January the DMO opened a switch offer in which it would accept holdings of 8% Treasury 2009 for 5 3/4% Treasury 2009. This offer was made after market participants had voiced concern over the low levels of liquidity in 8% Treasury 2009, following the conversion held in the previous quarter. To date £64.5mn (nominal) of 5 3/4% Treasury 2009 has been switched into.

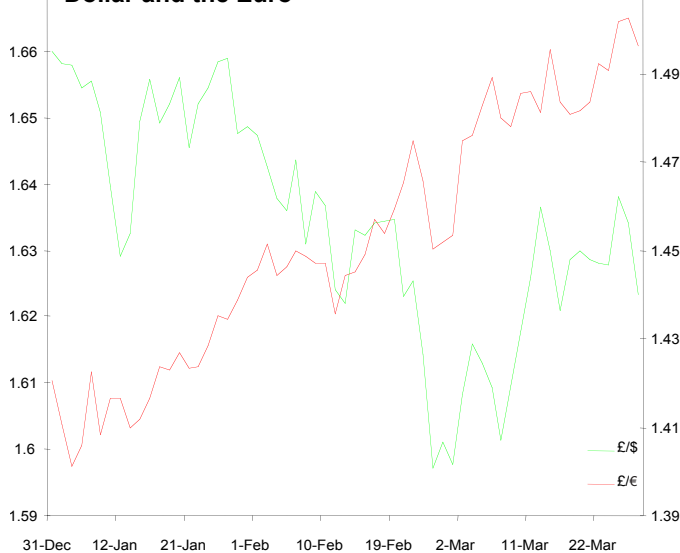
HM Treasury published the DMO's remit for 1999-2000, alongside the Budget on 9 March. Details of this can be found on page 5. Yields were not significantly affected by this publication, despite the fact that total expected gilt sales were somewhat greater than market expectations.

Chart 7: Index-linked Gilt Real Redemption Yields



Source: DMO. Using a 3% inflation assumption.

Chart 8: Sterling Exchange Rates against the Dollar and the Euro



Source: Reuters.

1998-99 Financing Requirement

	EFSR (1) June 1998	PBR (2) November 1998	Budget March 1999	Sales to end of March
CGNCR Forecast	3.5	-2.1	-2.7	-
Gilt Redemptions	16.8	16.8	16.9*	-
Gilt Sales Residual from 1997-98	-8.2	-8.2	-8.2	-
Financing Requirement	12.1	6.5	6.1	-
<i>Less net financing from:</i>				
National Savings	0.5	0.1	0.2	-
Gross Gilt Sales Required	11.6	6.4	5.9	-
<i>of which</i>				
Ultra-short conventionals (1-3 years)	0.0	0.0	0.0	0.0
Short conventionals (3-7 years)	2.5	0.0	0.0	0.0
Medium conventionals (7-15 years)	2.5	2.5	2.5	2.5
Long conventionals (>15 years)	3.1	3.1	3.1	3.1
Index-linked gilts	3.5	2.5 - 3.0	2.6	2.6
Total	11.6	8.1 - 8.6	8.2	8.1

Note: figures may not sum due to rounding
 (1) Economic and Financial Strategy Report
 (2) Pre-Budget Report

* Budget forecast of redemptions includes ESA95 reclassification of Bank of England holdings

Auction Results 1998-99

Auction Date	Issue Amount	Stock	Cover	Tail	Lowest Accepted Price ¹	Yield at Lowest Accepted Price
20 May 1998	£3bn	6% 2028	2.26	0	£102-30	5.79%
29 July 1998	£2.5bn	5 3/4% 2009	2.93	0	£100-05	5.73%
25 November 1998	£0.45bn	2 1/2% IL 2013	2.29	-*	£183.20	2.42%
27 January 1999	£0.45bn	2 1/2% IL 2024	1.83	-*	£181.60	2.01%

Taps of Index-linked Gilts 1998-99

Date of Tap	Issue amount £mm	Stock	Price at Issue	Price when exhausted	Yield when exhausted
3 April 1998	150	2 1/2% IL 2024	£151-12	£151-12	2.84%
21 May 1998	150	2 1/2% IL 2016	£185-08	£185-08	2.88%
12 June 1998	150	4 1/8% IL 2030	£160-24	£160-24	2.53%
7 August 1998	150	4 3/8% IL 2004	£128-10	£128-10	2.92%

Conversions 1998-99

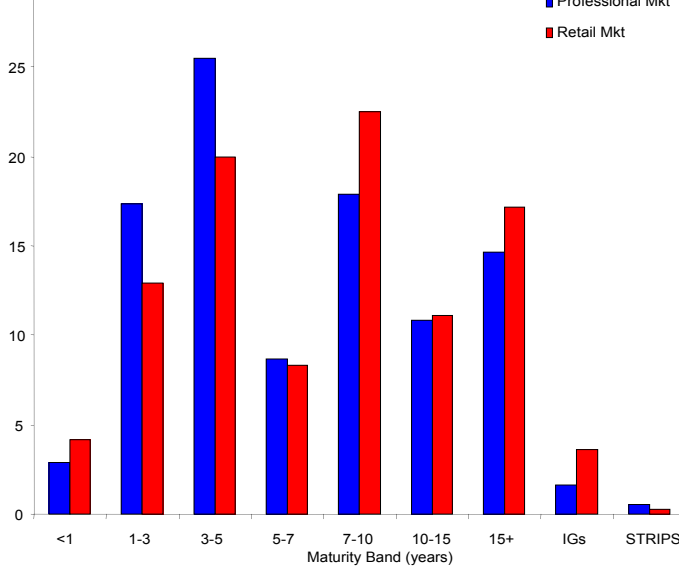
Date	Source Stock	Nominal Converted	Destination Stock	Nominal Converted into
22 July 1998	11 3/4% 2003-07	£2.9bn	6 1/2% 2003	£3.4bn
16 November 1998	8% 2009	£2.9bn	5 3/4% 2009	£3.4bn
1 February 1999	12 1/2% 2003-05	£2.0bn	6 1/2% 2003	£2.5bn

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

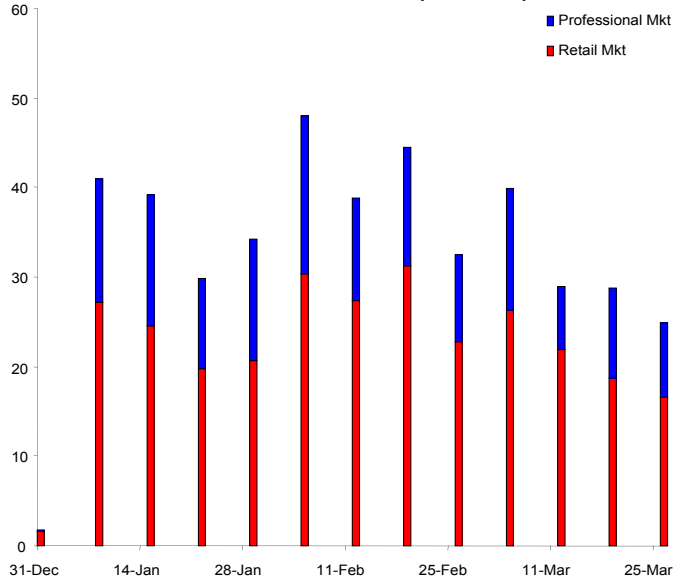
¹ Prices quoted before 1 November 1998 are in 1/32s reflecting the gilt market convention before decimalisation.

Details of GEMM Market Turnover 1st Quarter 1999

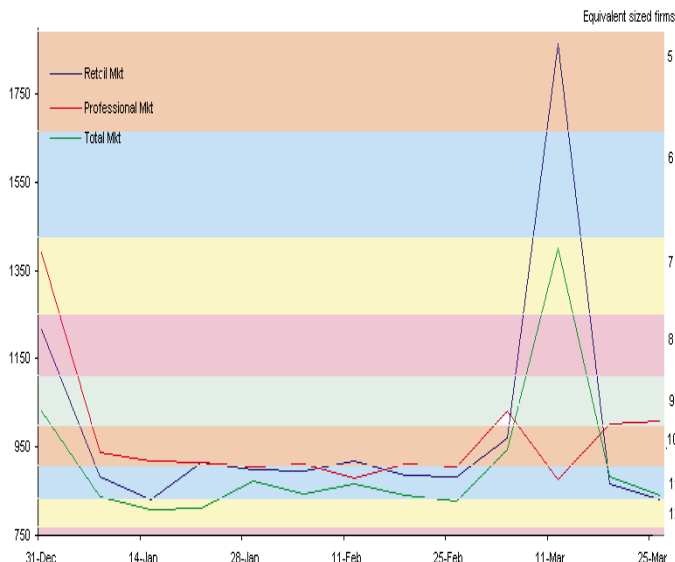
Percentage GEMM Market Turnover by Maturity Band Q1 1999



Total GEMM Market Turnover (nominal)



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, DMO and Bank of England.

Charts are based on data reported to DMO by GEMMs for the period starting 27 December 1998 and ending 26 March 1999.

The DMO's Remit for 1999-2000

On 9 March the DMO's annual remit was released alongside the Budget. The remit is contained in HM Treasury's Debt Management Report, which is available directly from HM Treasury and the DMO and appears on both websites. This article summarises the DMO's remit for 1999-2000.

The DMO, on behalf of the Government, will aim for gilt sales of approximately £17.3bn during 1999-2000. The table below presents the financing arithmetic. This is subject to the confirmation of the size of the overshoot of the gilt sales target in 1998-99. The arithmetic below is calculated on the basis that the DMO takes responsibility of the Exchequer's cash management during this financial year. Cash management requires an adjustment to the stock of short-term debt instruments. In the event that the transfer of cash management does not take place in this financial year, the gross gilt sales required will be adjusted upwards by assuming no net financing from Treasury bills and other short-term debt instruments.

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

There are nine planned auctions scheduled for the following dates. The stocks for the first three auctions were announced on 31 March 1999, as was a change to the June auction date.

Wednesday 28 April 1999	4 1/8% IL 2030
Wednesday 26 May 1999	6% Treasury 2028
Tuesday 22 June 1999	New June 2004 stock
Wednesday 28 July 1999	Index-linked
Tuesday 28 September 1999	Conventional
Wednesday 27 October 1999*	Index-linked
Wednesday 24 November 1999*	Conventional
Wednesday 26 January 2000	Index-linked
Wednesday 29 March 2000*	Conventional

* Denotes that the dates are subject to the Chancellor's decision on the Budgetary timetable. If required a sixth conventional auction would be scheduled for 23 February 2000.

Assuming the transfer of cash management responsibilities to the DMO takes place in 1999-2000, any increase or decrease in the 1999-2000 financing requirement will be accommodated first by an adjustment to the level of planned Treasury bill issuance by up to £3bn. If the financing requirement increases or decreases by a sufficient amount to justify a change to the auction programme, and it is not too late to make a change, the DMO would add a long, or cancel a short, auction accordingly. If the financing requirement were to change sufficiently to justify a further revision of the remit, the DMO would expect to have consulted the market about the maturity of the gilt auction to be added or cut.

During 1999-2000 the DMO will aim to issue about 20% of gilt sales in index-linked gilts, within the range of £2.5-4bn cash. The four scheduled index-linked auctions will be directed at medium and longer dated maturities i.e. 2009 and longer.

The DMO would also be prepared to issue a further £0.5bn (cash) of index-linked stock through taps, between auctions. This would only be issued if necessary for the purposes of market management or to relieve overall market shortages. Conventional stocks have not been tapped since 1996 and the DMO would only contemplate taps of conventional stocks in exceptional circumstances.

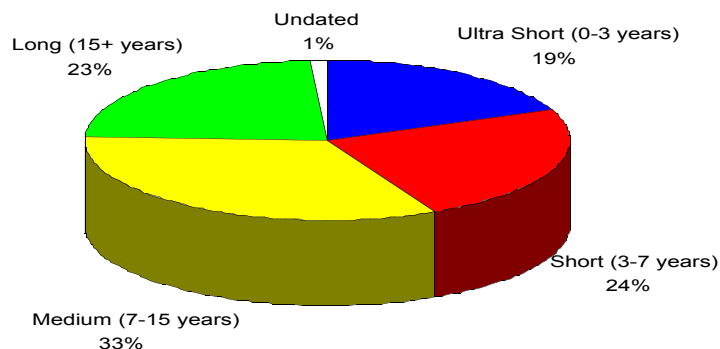
The conversion programme of non-strippable stock into benchmarks of similar maturity is envisaged to continue. Details will be announced in due course. This programme may be supplemented by switch auctions into benchmark stocks during 1999-2000. The DMO will publish, in advance, the proposals outlining the structure of any such switch auctions.

The remit may be varied during the year in the light of substantial revisions to: the Government's forecast of the gilt sales requirement; the level and slope of the yield curve; the market's expectations of future interest and inflation rates and market volatility. Any revisions to the remit will, of course, be announced in the usual manner.

Details of the Gilts Portfolio as of 31 March 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

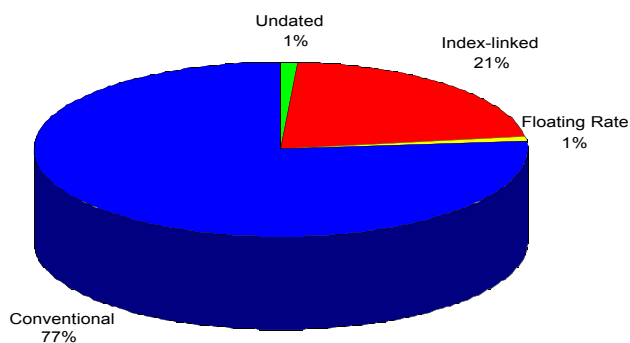
Portfolio Average Maturity: 9.9 years

Portfolio Average Modified Duration: 7.4 years

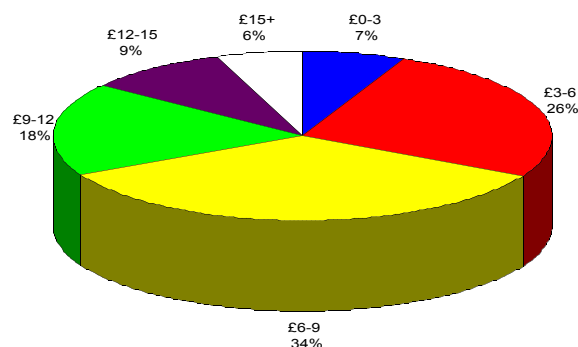
Portfolio Average Convexity: 102.3

Average Amount Issued of Largest 20 Gilts: £9.2bn

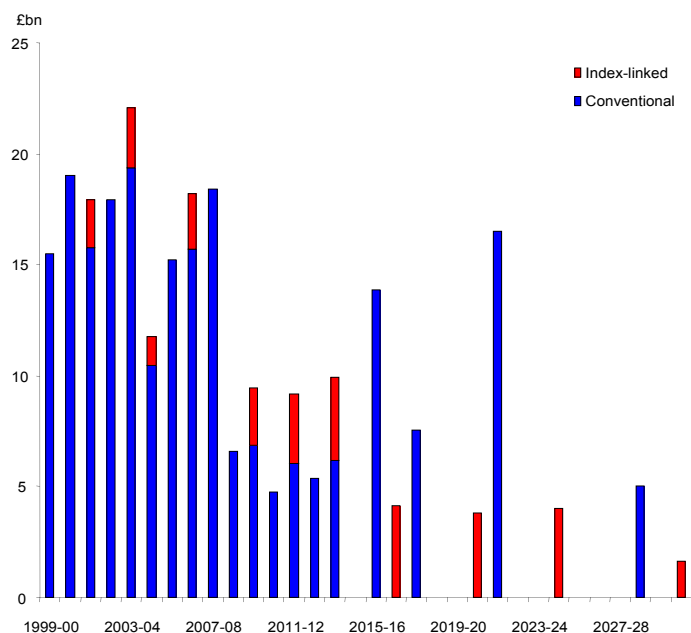
Gilt Portfolio's Maturity Split



Size of Issues in £ bn as Percentage of the Portfolio

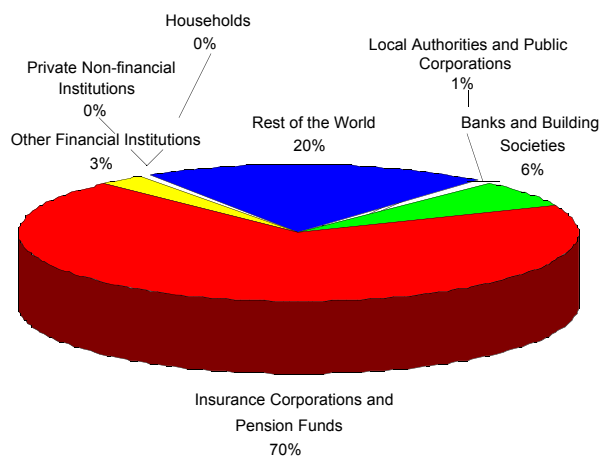


Gilt Redemptions (by Financial Year)



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.

Distributions of Holdings of Gilts in Market Hands Q4 1998



Source: ONS. Holdings of Gilts in Market Values.

Stock in Issue at 31 March 1999* (£mn)

Conventional Gilts

Stock	Redemption Date	Amount in Issue	Amount held in Stripped form	Central Government Holdings (end-December 1998)+
10 1/2% Treasury 1999	19-May-99	1,252	-	15
6% Treasury 1999	10-Aug-99	6,950	-	476
10 1/4% Conversion 1999	22-Nov-99	1,798	-	17
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	125	219
10% Treasury 2001	26-Feb-01	4,406	-	15
11 1/2% Treasury 2001-04	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	242	76
9 3/4% Treasury 2002	27-Aug-02	6,527	-	14
8% Treasury 2002-06	05-Oct-02	2,050	-	65
8% Treasury 2003	10-Jun-03	8,600	-	418
10% Treasury 2003	08-Sep-03	2,506	-	-
6 1/2% Treasury 2003	07-Dec-03	7,987	115	32
3 1/2% Funding 1999-2004	14-Jul-04	543	-	32
9 1/2% Conversion 2004	25-Oct-04	3,412	-	-
6 3/4% Treasury 2004	26-Nov-04	6,500	-	364
9 1/2% Conversion 2005	18-Apr-05	4,842	-	-
8 1/2% Treasury 2005	07-Dec-05	10,373	489	188
7 3/4% Treasury 2006	08-Sep-06	4,000	-	261
7 1/2% Treasury 2006	07-Dec-06	11,700	166	132
8 1/2% Treasury 2007	16-Jul-07	7,397	-	216
7 1/4% Treasury 2007	07-Dec-07	11,000	249	91
5 1/2% Treasury 2008-12	10-Sep-08	1,000	-	49
9% Treasury 2008	13-Oct-08	5,621	-	-
8% Treasury 2009	25-Sep-09	560	-	10
5 3/4% Treasury 2009	07-Dec-09	6,277	81	203
6 1/4% Treasury 2010	25-Nov-10	4,750	-	256
9% Conversion 2011	12-Jul-11	5,273	-	110
7 3/4% Treasury 2012-15	26-Jan-12	800	-	148
9% Treasury 2012	06-Aug-12	5,361	-	-
8% Treasury 2013	27-Sep-13	6,100	-	330
8% Treasury 2015	07-Dec-15	13,787	210	86
8 3/4% Treasury 2017	25-Aug-17	7,550	-	179
8% Treasury 2021	07-Jun-21	16,500	487	127
6% Treasury 2028	07-Dec-28	5,000	154	43
2 1/2% Treasury	Undated	474	-	-
3 1/2% War	Undated	1,909	-	-
2 1/2% Consolidated	Undated	275	-	-
4% Consolidated	Undated	358	-	-

Index-linked Gilts

		Nominal	Nominal Including Inflation Uplift	
2 1/2% I-L Treasury 2001	24-Sep-01	2,150	4,477	17
2 1/2% I-L Treasury 2003	20-May-03	2,700	5,588	12
4 3/8% I-L Treasury 2004	21-Oct-04	1,300	1,563	-
2% I-L Treasury 2006	19-Jul-06	2,500	5,865	-
2 1/2% I-L Treasury 2009	20-May-09	2,625	5,433	26
2 1/2% I-L Treasury 2011	23-Aug-11	3,100	6,778	3
2 1/2% I-L Treasury 2013	16-Aug-13	4,200	7,675	20
2 1/2% I-L Treasury 2016	26-Jul-16	4,125	8,238	25
2 1/2% I-L Treasury 2020	16-Apr-20	3,800	7,466	4
2 1/2% I-L Treasury 2024	17-Jul-24	4,450	7,427	-
4 1/8% I-L Treasury 2030	22-Jul-30	1,650	1,991	-

* Stock of liquid issues. "Rump" stocks are excluded; a full list is obtainable from the DMO. 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. Figures no longer contain Bank of England holdings because of ESA 95 reclassifications.

Announcements, Events and Contacts

Date	Notice	Title
7 January	Press Notice	Gilt-Edged Conversion Offer: From 12 1/2% Treasury Stock 2003-05 into 6 1/2% Treasury Stock 2003.
7 January	Press Notice	Facility to Switch Holdings of 8% Treasury Stock 2009 into 5 3/4% Treasury Stock 2009.
19 January	Press Notice	Index-linked Gilt Auction.
27 January	Press Notice	Sale by Auction of £450mn of 2 1/2% Index-linked Treasury Stock 2024.
29 January	Press Notice	Provisional Result: Gilt-Edged Conversion Offer: From 12 1/2% Treasury Stock 2003-05 into 6 1/2% Treasury Stock 2003.
1 February	Press Notice	Final Result: Gilt-Edged Conversion Offer: From 12 1/2% Treasury Stock 2003-05 into 6 1/2% Treasury Stock 2003.
18 February	Press Notice	Capitalisation of Inter Dealer Brokers (IDBs).
4 March	Consultation Paper	Euro Settlement for Gilts and Bulldog Issues.
9 March	Press Notice	Financing Remit and Issuance Calendar for 1999-2000.
9 March	Press Notice	Gilt Financing Arithmetic for 1999-2000.
17 March	Publication	Debt Management Report 1999-2000.
17 March	Operational Note	Revised Page Layout for GEMMA Gilt Reference Prices.
22 March	Proposals Document	IDB Services: Proposal Following Joint Consultation by the London Stock Exchange and the UK Debt Management Office.
23 March	Press Notice	Euro Settlement for Gilts and Bulldog Issues.
31 March	Press Notice	Gilt-Edged Auctions: April to June 1999.
31 March	Minutes	Minutes of consultation meetings

Date	Event
28 April	Auction of 4 1/8% IL 2030
26 May	Auction of 6% Treasury 2028
21 June	GEMMs Quarterly Consultation
22 June	Auction of new June 2004 Stock
22 June	End Investors Quarterly Consultation
30 June	Auction Schedule Announcement: July to September 1999

Name	Position	Telephone No.
Mike Williams	Chief Executive	0171 862 6533
Paul Mills	Head of Policy	0171 862 6521
Hamish Watson	Chief Dealer	0171 862 6530
Jo Whelan	Head of Markets	0171 862 6531
Jim Juffs	Press Officer	0171 862 6520
Robert Scott	Assistant Press Officer	0171 862 6527
David Page	Economic Analyst	0171 862 6524
Steve Whiting	Financing Remit	0171 862 6532
Martin Duffell	Market Liaison Officer	0171 862 6517
Mark Deacon	Quantitative Analyst	0171 862 6516
Gurminder Bhachu	Quantitative Analyst	0171 862 6512
Switchboard no.		0171 862 6500
Fax no.		0171 862 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
GEMMA ref prices (Index-linked)	GEMMA08	47223		44805
GEMMA ref prices (STRIPS)	GEMMA13 to 19	21291 to 21297		44850 to 44856
DMO website: http://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 0171 862 6524 or e-mail at david.page@dmo.gov.uk

