European Rates Watch

January UK public sector finances: nothing to nudge the Budget

Big picture unchanged: finances consistent with Gilt Remit

Today's UK public sector finance data for Jan suggests that November's projected CGNCR for 2023-24 (on which the Gilt Remit update was based) still looks fair. The Jan CGNCR came in at -£19.5bn, a slightly larger drop than the OBR's projection of -£17.4bn (Exhibit 1). Cumulatively, the CGNCR stood at £121.9bn for fiscal year-to-Jan, £3.2bn above the OBR's projection of £118.7bn (it was £5.3bn above in Dec, Exhibit 1). Meanwhile, the NS&I monthly flow was -£0.8bn in Jan, after Dec's £0.4bn inflow (Exhibit 2). Cumulatively, NS&I has raised a net £11.9bn fiscal year-to-Jan, £4.4bn above DMO's target of £7.5bn. With a reduced CGNCR overshoot but a slight reduction in the NS&I overfund, the big picture is more or less on track (see also our preview in the Rates–UK section of Duration Divergence, 16 Feb, for background information).

Quarterly APF interest bill on the higher side in Jan

The APF quarterly interest bill that the Bank now charges the Treasury (combining coupons, reserve financing costs, and losses crystallised on Gilt sales) came in at £11.2bn, after £9.1bn in Oct 2023. This was the second largest transfer to the APF since they began (Exhibit 3), and due to Bank rate at 5.25% for the whole quarter and a large crystalised loss (the yield rally of late Dec came too late to have a meaningful impact).

Good news on deficit front, but all eyes on the headroom

More broadly, the data showed tax revenues exceeding public spending by £16.7bn in Jan; better than the £7.5bn surplus in Jan 2023 but slightly smaller than either the OBR's forecast of £18.2bn or the Bloomberg consensus of £18.4bn. The PSNB in 2023/24 is on course to come in below the OBR's projection of £123.9bn, with a fiscal year-to-Jan balance of £96.6bn below the OBR's projection of £105.8bn. With Jan's UK public finances data being the last before the Budget on 6 March, all eyes will be on the likely headroom against Chancellor's fiscal rules. Recent media reports suggest the Chancellor has no more room to manoeuvre than was assumed in November. The OBR will continue providing forecast rounds to the Chancellor heading into the Budget, with Round 3 provided yesterday and Round 4 due in a week's time, on 28 Feb.

Expect changes in 24/25 Remit to be met via bills & NS&I

With the current fiscal year going broadly to plan, changes in total Gilt issuance in 2024/25 will be mostly down to Budget measures, and a balancing of lower than anticipated interest rates, a smaller indexation cost, stronger population projections and moderating fiscal drag from tax bracket freeze, among other things. Our working assumption is that the DMO will aim to meet any upside in the financing need via net T-bill issuance and NS&I, minimising the need for material Gilt Remit changes. This would not be unprecedented; the net contribution of T-bills has been quite variable in recent years, with the DMO pencilling as much as £40bn in September 2022 (Exhibit 4).

21 February 2024

Rates Research
Europe

European Rates Research
MLI (UK)

Agne Stengeryte, CFA
Rates Strategist
MLI (UK)
agne.stengeryte@bofa.com

Mark Capleton
Rates Strategist
MLI (UK)
mark.capleton@bofa.com

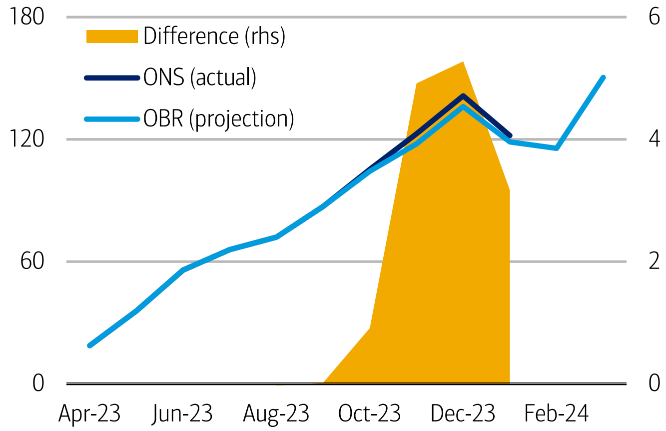
Kamal Sharma
FX Strategist
MLI (UK)
ksharma32@bofa.com

Abbreviations:

APF: Asset Purchase Facility
BoE: Bank of England
CGNCR: Central Government Net Cash Requirement
PSNB: Public Sector Net Borrowing
DMO: Debt Management Office
FY: Fiscal Year
LDI: Liability Driven Investment
B&B: Bradford & Bingley
NRAM: NRAM Ltd
NIC: National Insurance contribution
CCFF: Covid Corporate Financing Facility
VAT: Value added tax
NS&I: National Savings and Investment
OBR: Office for Budget Responsibility
ONS: Office for National Statistics
QE: Quantitative Easing
QT: Quantitative Tightening
GEMM: Gilt Edged Market Maker

Refer to important disclosures on page 4 to 5.

Exhibit 1: CGNCR ex. B&B, NRAM, Network Rail and CCFF, £bn cum.
CGNCR stood £3.2bn above OBR's projection as of Jan 2024



Source: BofA Global Research, Office for Budget Responsibility, Office for National Statistics
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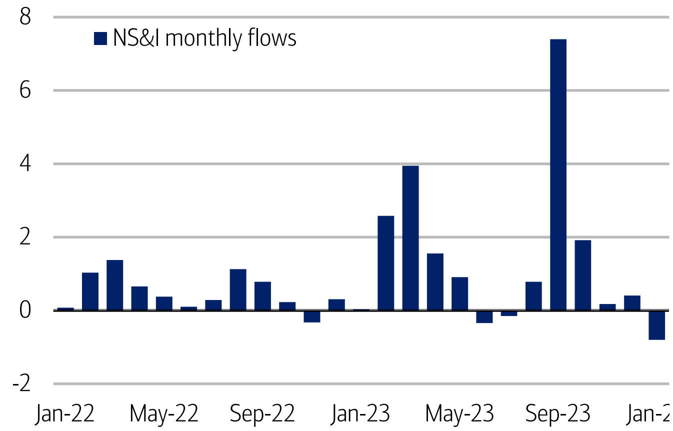
Exhibit 2: NS&I monthly flows, £bn
NS&I monthly flow was -£0.8bn in Jan, after Dec's £0.4bn inflow



Source: BofA Global Research, Office for National Statistics
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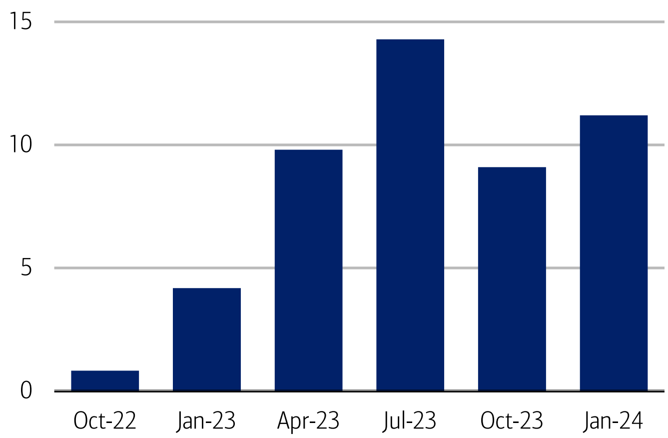
Exhibit 3: Capital transfers to APF, £bn
Jan 2024 transfer on the higher side historically



Source: BofA Global Research, Office for National Statistics
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Exhibit 4: Total net contribution of T-bills for debt financing, £bn
Big variation in net contribution of T-bills for debt financing in recent years

	2020/21	2021/22	2022/23	2023/24
March Remit	0	1.8	23.2	5
April revision	6	1.8	30.2	5
Sep 2022 update			40.2	
Autumn Statement	-2	-23.2	33.2	-5
Outturn	-2	-23.2	33.2	

Source: BofA Global Research, Debt Management Office
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Market to take its meds

We expect the Gilt issuance maturity split to mean fewer longs and linkers, more shorts and (quite a lot more) mediums.

Assuming the remaining unallocated portion of this year's Gilt Remit is used for the last linker syndication, this year's split will be 36% shorts, 29% meds, 22% longs and 12% linkers (Exhibit 5 on next page).

For 2024/25, we pencil in 5% unallocated, the same share as at the start of the current fiscal year. In line with late January feedback from GEMMs and Gilt investors, we expect the shares of longs and linkers to be reduced to 17% and 10%, from 21.1% and 10.9% in Mar 2023, respectively. This allows shorts and medium weightings to be lifted to 37% and 31%, respectively.

A skew shorter within the long and linker buckets is also likely, meaning that the effective skew shorter is greater than the simple bucket weights show.

Exhibit 5: 2023/24 and 2024/25 Gilt Remit splits per "bucket", %

We expect 5% unalloc, 37% shorts, 31% mediums, 17% longs and 10% ILBs

	23/24	23/24	23/24	23/24	24/25 (f)
	Mar'23	Apr'23	Nov'23	Outturn (f)	Mar'24
Short	36.0%	35.6%	36.5%	36.5%	37.0%
Medium	27.1%	27.5%	28.8%	28.8%	31.0%
Long	21.1%	20.9%	21.6%	22.3%	17.0%
ILB	10.9%	11.0%	12.1%	12.4%	10.0%
Unallocated	5.0%	5.0%	1.1%	0.0%	5.0%

Source: BofA Global Research, Bloomberg

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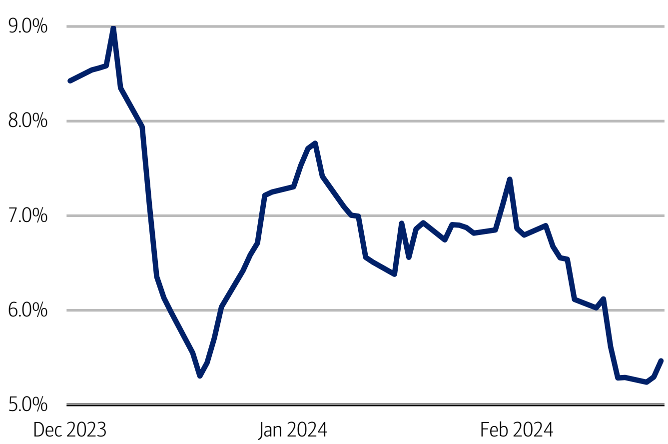
GBP: Wiggle Room

At the start of this year, markets were awaiting the Spring Budget with some trepidation. With a General Election looming and Government popularity waning according to the polls, the narrative was that the Chancellor would forgo his fiscal rules in order for the Government to regain some momentum. The public finance data has therefore been a more significant driver for GBP than it traditionally has and the recent figures appear to have assuaged concerns that March 6th could be a re-run of September 2022. The better-than-expected borrowing figures may allow the Chancellor more room for manoeuvre to cut taxes and add some stimulus to the economy. This appears to be the path of least resistance according to recent press reports and the only question remains quantum. For GBP, with the tail risk now removed, the Budget should not be an event risk for markets to worry about. We note that front-end GBP/USD implied vol which covers the Budget remains well behaved (Exhibit 6)

More importantly will be the BoE response to any stimulus and how this factors into its reaction function. We are taking a constructive approach to GBP heading into the final month of the quarter and into April as we believe that a combination of fiscal stimulus and positive seasonality should be supportive for the pound. Nonetheless, our medium-term concerns remain about the sustainability of large current account and fiscal deficits (the so called "dual deficit") as shown in Exhibit 7. Lower trend growth is likely to a be key input that will prevent a more meaningful improvement in the fiscal deficit whilst the current account balance should see some respite following significant Brexit dislocation on the financial account and a return to UK asset markets.

Exhibit 6: GBP/USD 2wk implied volatility

Front-end of GBP vol curve remains well behaved ahead of budget.



Source: BofA Global Research, Bloomberg

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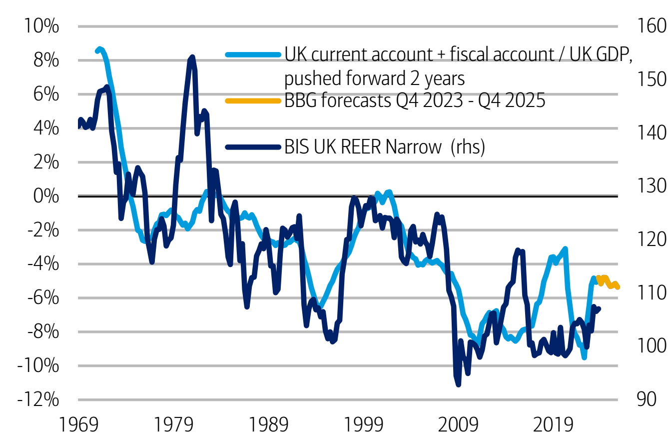
Exhibit 7: UK dual deficit: current account + fiscal balance

Dual deficit remains a medium-term structural concern for GBP.



Source: BofA Global Research, Bloomberg

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