

# B

## Financing

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### Debt management objective

**B.1** The Government's debt management objective is:

*"to minimise, over the long term, the costs of meeting the Government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the aims of monetary policy".*

**B.2** The debt management policy objective is achieved by:

- pursuing an issuance policy that is open, transparent and predictable;
- issuing gilts that achieve a benchmark premium;
- adjusting the maturity and nature of the Government's debt portfolio, primarily by means of the maturity and composition of debt issuance and potentially by other market operations including switch auctions, conversion offers and buy-backs;
- developing a liquid and efficient gilt market; and
- offering cost-effective savings instruments to the retail sector through National Savings and Investments (NS&I).

**B.3** HM Treasury has overall responsibility for meeting the debt management policy objective but has delegated operational responsibility for debt management to its agents:

- the Debt Management Office (DMO) undertakes borrowing in sterling through issuance of government bonds and short-term debt instruments in the wholesale market;
- NS&I undertakes retail borrowing through sales of retail savings products; and
- the Bank of England undertakes borrowing in foreign currencies through the issuance of foreign currency denominated government bonds.

### Financing framework

**B.4** The Government intends to continue to finance the central government net cash requirement (CGNCR) using the framework that was established in the 1995 Debt Management Review. The Government aims to finance its net cash requirement plus maturing debt and any financing required for additional net foreign currency reserves through the issuance of debt. All such debt issuance will take place within a set maturity structure. Auctions remain the primary means of gilt issuance but will be supported by a supplementary issuance programme comprising syndication and mini-tenders.

## Maturity and composition of debt issuance

**B.5** In order to determine the maturity and composition of debt issuance, the Government needs to take account of a number of factors including:

- investors' demand for gilts;
- the Government's own appetite for risk, both nominal and real;
- the shape of both the nominal and real yield curves and the expected effect of issuance policy; and
- changes to the stock of Treasury bills and other short-term instruments.

## Net cash requirement

**B.6** The CGNCR measures the cash required by central government to finance its operations and is the key fiscal aggregate for debt management purposes. It forms the basis of the net financing requirement (NFR) as set out in Table B3.

**B.7** The Public Sector Net Borrowing (PSNB) forecast has been produced by the interim Office for Budget Responsibility (OBR) and is set out in Annex C. Table B1 shows HM Treasury's reconciliation between PSNB and CGNCR which is achieved by: changing the scope from the whole of the public sector to central government only; moving from the accruals based net borrowing measure to the cash-based CGNCR; and accounting for lending within the public sector.

Table B1: Reconciliation of PSNB and CGNCR

	£ billion						
	Estimate	Forecasts					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
<b>Public sector net borrowing</b>	<b>154.7</b>	<b>149</b>	<b>116</b>	<b>89</b>	<b>60</b>	<b>37</b>	<b>20</b>
<i>minus</i> Local authorities net borrowing	2.6	6	4	3	3	3	2
<i>minus</i> Public corporations net borrowing <sup>1</sup>	-3.3	0	-1	-1	-2	-2	-3
<b>Central government net borrowing</b>	<b>155.4</b>	<b>144</b>	<b>113</b>	<b>87</b>	<b>59</b>	<b>37</b>	<b>21</b>
Financial transactions	28.5	5	5	2	2	2	5
Accruals adjustments	13.8	-5	1	-2	3	-5	-6
<b>Central government net cash requirement ("own account")</b>	<b>197.7</b>	<b>144</b>	<b>119</b>	<b>88</b>	<b>63</b>	<b>34</b>	<b>20</b>
Net lending within the public sector	1.1	2	2	2	2	2	2
<b>Central government net cash requirement</b>	<b>198.9</b>	<b>146</b>	<b>121</b>	<b>90</b>	<b>65</b>	<b>35</b>	<b>21</b>

Note: Totals may not sum due to rounding.

<sup>1</sup> This includes removing the temporary effects of financial interventions.

**B.8** The movement from PSNB to central government net borrowing (CGNB) requires the removal of the contributions of local authorities and public corporations. The negative numbers for public corporations reflect the fact that this sub-sector is generally a net saver.

**B.9** The difference between CGNB and the CGNCR arises from either timing differences or from the impact of financial transactions involving cash. Timing

differences arise because net borrowing is an accruals measure whereas the CGNCR is cash based. The measures are reconciled via accruals adjustments. Exchanges of financial assets involving cash are not net borrowing because they do not change the net liabilities position of the public sector, but the cash impact is captured in the CGNCR.

**B.10** The methods used to forecast financial transactions and accruals adjustments are:

- the relatively small accruals adjustments on receipts and expenditure are produced by the modelling of the public finances more generally;
- for regular financial transactions for which the size and timing of the transaction are reasonably certain – for example, the repayment of loans to the financial sector and student loans repayments – an estimate based on the latest available information is included in the forecast; and
- potential financial transactions for which firm plans are not in place are not included in the forecast.

**B.11** The transactions described above produce an estimate of the cash that central government needs to fund its own operations (the CGNCR (“own account”)). In addition, central government lends money to local authorities and public corporations. The adjustment for the net effect of this impact produces the CGNCR.

**B.12** In most years, the CGNCR and PSNB are similar. The measures have differed by more than usual in 2008-09 and 2009-10 reflecting the cash implications of the financial sector interventions. As shown in Table B2, these items were significant in 2008-09 and 2009-10 but are forecast to be much smaller in future years in which the only impact results from the repayment of loans.

**Table B2: Financial interventions and Bank of England schemes - impact on CGNCR**

	£ billion			
	Outturn	Estimate	Forecasts	
	2008-09	2009-10	2010-11	2011-12
<b>Total<sup>1</sup></b>	<b>74.5</b>	<b>34.1</b>	<b>-1.6</b>	<b>-3.2</b>
Loans	20.6	11.0	-1.2	-3.3
Equity injections (net acquisition)	30.8	23.0	0.0	0.0
Depositor compensation	23.1	0.2	-0.4	0.0

*Note: Totals may not sum due to rounding.*

<sup>1</sup> *Total effect of financial interventions and Bank of England schemes on the difference between PSNB and CGNCR.*

**B.13** Box B1 sets out an update of the costs of financial sector interventions.

#### **Box B1: Estimates of the costs of financial sector interventions**

The eventual direct fiscal cost from the support provided by the previous Government to the financial sector will be dependent on a number of factors including the eventual sale price achieved for the shares in Royal Bank of Scotland (RBS) and Lloyds Banking Group (LBG). It is possible to estimate the final cost on the basis of current market prices and, where these are not available, on an assessment of the fees and risks associated with each scheme. Using the latest market prices, the cost of the financial sector interventions, net of fees and other income, is estimated at £2 billion. This estimate is based on:

- the current market value of the Government's shareholdings in RBS and LBG which implies a cost of £7 billion on these investments net of the value of the Dividend Access Share in RBS and fees received during the recapitalisation and for the provision of contingent capital;
- the Asset Protection Agency's central expectation that there will be a net benefit to the taxpayer of at least £5 billion from the Asset Protection Scheme; and
- the expectation that the aggregate costs of all other interventions will not be material after fees, other income and recoveries are taken into account.

The estimate reflects the potential direct costs of the Government's support provided to the financial sector and does not include the much more significant wider costs of the financial crisis to the economy as a whole.

## **Revisions to the Net Financing Requirement in 2010-11**

**B.14** In line with the new fiscal forecasts set out in this Budget, the financing arithmetic for 2010-11 has been revised. There has been a reduction in the NFR of £20.2 billion – from £182.7 billion, in the revision to financing announced on 22 April 2010, to £162.5 billion. The reduction in the NFR is the net effect of:

- a decrease in the CGNCR of £20.3 billion from the March Budget 2010 forecast which includes a fall in PSNB of £14 billion; and
- £0.1 billion of buybacks.

**B.15** NS&I is not forecast to make a contribution to net financing; this forecast is unchanged from the projection in the revision announced on 22 April 2010.

**B.16** In order to meet the reduction in the NFR, the DMO's remit has been revised. The revisions to financing are shown in Table B3.

**Table B3: Financing requirement forecast**

	£ billion			
	2009-10	2010-11		
	Outturn	March Budget	April Revision <sup>1</sup>	June Budget
<b>Central government net cash requirement</b>	<b>198.9</b>	<b>166.4</b>	<b>166.4</b>	<b>146.1</b>
Gilt redemptions	16.6	39.0	38.6	38.6
Financing for the official reserves	4.0	4.0	4.0	4.0
Financing for the Asset Purchase Facility	-0.9	0.0	0.0	0.0
Buy-backs <sup>2</sup>	0.4	0.0	0.0	0.1
Planned short-term financing adjustment <sup>3</sup>	-0.6	-24.0	-26.3	-26.3
<b>Gross financing requirement</b>	<b>218.4</b>	<b>185.4</b>	<b>182.7</b>	<b>162.5</b>
Less Assumed net contribution from National Savings and Investments	1.6	0.0	0.0	0.0
<b>Net financing requirement</b>	<b>216.8</b>	<b>185.4</b>	<b>182.7</b>	<b>162.5</b>
<i>Financed by:</i>				
<b>Debt issuance by the Debt Management Office</b>				
Treasury bills	19.4	-1.9	-2.5	-2.5
Gilts	227.6	187.3	185.2	165.0
<i>Of which:</i>				
Conventional				
Short	75.4	59.0	59.0	52.6
Medium	71.3	45.0	42.9	38.2
Long	51.6	45.3	45.3	40.4
Index-linked	29.3	38.0	38.0	33.8
<b>Other planned changes in short-term cash position<sup>4</sup></b>				
Changes in Ways & Means <sup>5</sup>	-3.8	0.0	0.0	0.0
<b>Unanticipated changes in short-term cash posi</b>	<b>26.3</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Total financing</b>	<b>243.1</b>	<b>185.4</b>	<b>182.7</b>	<b>162.5</b>
<b>Short-term debt levels at end of financial year</b>				
Treasury bill stock in market hands <sup>7</sup>	63.3	60.8	60.8	60.8
Ways & Means	0.4	0.4	0.4	0.4
DMO net cash position	26.8	0.5	0.5	0.5

Note: Totals may not sum due to rounding.

<sup>1</sup> The financing arithmetic for 2010-11 was revised on 22 April 2010. This revision followed the publication of the outturn CGNCR for 2009-10. The outturn CGNCR was £2.1 billion lower than projected in the March 2010 Budget. The reduction in the CGNCR, among other factors, resulted in an increase in the DMO's net cash position at the Bank of England as at 31 March 2010 of £2.4 billion above that projected in the March 2010 Budget. This increase results in a larger than planned short-term financing adjustment in 2010-11 (by £2.3 billion) in 2010-11 from the projection in the March 2010 Budget.

<sup>2</sup> Purchases of "rump" gilts which are older, small gilts, declared as such by the DMO and in which Gilt-edged Market Makers (GEMMs) are not required to make two-way markets. The Government will not sell further amounts of such gilts to the market but the DMO is prepared, when asked by a GEMM, to make a price to purchase such gilts.

<sup>3</sup> To accommodate changes to the current year's financing requirement resulting from: (i) publication of the previous year's outturn CGNCR; (ii) an increase in the DMO's cash position at the Bank of England; and / or (iii) carry over of unanticipated changes to the cash

<sup>4</sup> Total planned changes to short-term debt are the sum of: (i) the planned short-term financing adjustment; (ii) net Treasury bill sales; and (iii) changes to the level of the Ways and Means Advance.

<sup>5</sup> Reflects the Government's decision to repay £3.8 billion of the remaining balance of the Ways and Means Advance in 2009-10.

<sup>6</sup> A negative (positive) number indicates an addition to (reduction in) the financing requirement for the following financial year.

<sup>7</sup> The DMO has operational flexibility to vary the end-financial year stock subject to its operational requirements in 2010-11.

### B.17 The NFR will be financed by:

- £165 billion in gross gilt issuance (a decline of £20.2 billion from the projection in the April 2010 revision); and
- a reduction of £2.5 billion in the planned Treasury bill stock as at 31 March 2011 (unchanged from the projection in the April 2010 revision).

### B.18 Reflecting these changes, gross gilt issuance of £165 billion is expected to be split as follows:

- £52.6 billion of short maturity gilt issuance (31.9 per cent of total issuance);

- £38.2 billion of medium maturity gilt issuance (23.2 per cent of total issuance);
- £40.4 billion of long maturity gilt issuance (24.5 per cent of total issuance); and
- £33.8 billion of index-linked gilt issuance (20.5 per cent of total issuance).

**B.19** The proportionate split of gross gilt issuance between gilts of different maturities and types takes into account the factors in paragraph B.5 and is unchanged from that in the April 2010 revision. As at 31 March 2010, the average maturity of the outstanding debt stock was 13.2 years. The maturity of the outstanding debt stock in the UK is the longest in the G7.

**B.20** Auctions will remain the Government's primary method by which to issue gilts. The Government will continue to use supplementary methods – syndication, mini-tenders and the post auction 'top up' facility – to issue gilts in the remainder of 2010-11. It is anticipated that, for the year as a whole:

- £132 billion (80 per cent of total issuance) will be issued through pre-announced auctions;
- £26 billion (16 per cent of total issuance) will be issued by syndication; and
- £7 billion (4 per cent of total issuance) will be issued through mini-tenders.

**B.21** The proportionate split of gilt issuance by method of issuance is broadly unchanged from the revision to financing announced 22 April 2010. These revisions will be implemented in the third and fourth quarters of 2010-11. Further details can be found in the DMO's Press Notice issued on 22 June 2010 which is available on the DMO's website: [www.dmo.gov.uk](http://www.dmo.gov.uk).