Public sector debt: end March 1999

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This article continues the annual series in the Quarterly Bulletin *analysing the debt position of the UK public sector. It looks at market and statistical developments in the financial year to end March 1999, and examines some of the domestic and European issues that have influenced these measures. It also analyses the composition and distribution of the national debt.*

- *Public sector net debt fell by £3.7 billion to £349 billion, at nominal value, during the financial year to end March 1999. This was the first annual reduction since 1989/90. At end March 1999 public sector net debt stood at 40.6% of GDP, the lowest end-March figure since 1994, and 2 percentage points lower than at end March 1998.*

- *General government gross debt—the 'Maastricht' measure—also fell during the year, to £399 billion at end March. At 47.4% of GDP, this is comfortably below the 60% reference value in the Maastricht Treaty. The general government had a financial surplus of 0.9% of GDP in 1998/99, well within the Maastricht reference value, which allows a deficit of up to 3% of GDP.*

- *All data presented in this article reflect the transition to the latest international statistical standards, the European System of Accounts (ESA95). This is consistent with the UK National Accounts, published by the Office for National Statistics. However, as before, government debt figures are still presented on a nominal, rather than a market, valuation. The box on pages 356–57 gives details of the changes and shows the impact on the measurement of the public sector debt position.*

Introduction

This article first looks at how the UK public sector debt (the stock of debt) relates to the public sector net cash requirement, ie the balance between the public sector's cash income and expenditure. Central government debt—by far the largest component of public sector debt—is then analysed in more detail, including changes in market holdings of each instrument during the year. The British Government Securities (gilts) market is considered in some detail, as gilts outstanding constitute the bulk of government debt. The structure of the outstanding gilt portfolio and developments in the gilt market during 1998/99 are discussed. This is followed by an analysis of the sterling national debt by economic sector of holders of the debt instruments. Separate boxes consider issues affecting the measurement of public sector debt during the year, and a detailed list of notes and definitions is given at the end of the article.

Public sector debt

Public sector debt (net of short-term financial assets) fell by 1% in the financial year 1998/99, from £353 billion to £349 billion (see Table A). In relation to GDP, it fell by 1.6 percentage points, from 42.2% to 40.6%. This is near the middle of the range of debt ratios during the past 25 years, with the highest (54%) recorded in 1976 and the lowest (26%) in 1991 (see Chart 1). By historical standards the recent ratio is low, as Chart 2 shows. The chart illustrates how the ratio can decrease (eg during the 1970s), even when the nominal level of debt is rising, if nominal GDP increases more quickly because of high inflation (as in the 1970s) or real output growth. Inflation erodes the real value of debt stocks (with the exception of index-linked debt, which rises in value in line with inflation).

The ratio of public sector net debt (PSND) to GDP is used to measure the Government's objective of holding debt at a 'stable and prudent level over the economic cycle' (the 'sustainable investment' rule). In its 1999 Budget, the Government stated that it 'believes that a modest reduction is desirable, other things being equal, to below 40% of GDP over the economic cycle'. HM Treasury forecasts that the PSND will fall to below 40% of GDP by March 2000, and that the downward trend will continue until at least 2004.

The main component of public sector debt is the liability of central government. Central government gross debt fell by £1.7 billion to £392.1 billion by end March 1999. Local government and public corporations' gross debt both rose by less than £1 billion in 1998/99. The fall in central

Table A
Public sector net debt

£ millions, nominal values (a); *percentages in italics*

31 March (b)	1997	1998	1999	Changes 1998–99
Central government				
Market holdings of national debt (Table D)	379,736	381,878	380,187	-1,691
as a percentage of GDP	*48.0*	*45.7*	*44.2*	*-1.5*
National Savings Ordinary Account	1,419	1,398	1,371	-27
Accrued interest and indexing on National Savings	3,422	2,932	2,746	-186
Coin in circulation	2,363	2,472	2,637	165
Funds lodged in courts	1,980	2,180	2,550	370
Other	2,996	3,019	2,656	-363
Total central government gross debt	**391,916**	**393,879**	**392,147**	**-1,732**
as a percentage of GDP	*49.6*	*47.1*	*45.6*	*-1.5*
Local government				
Total gross debt	51,598	51,932	52,793	861
less holdings of other public sector debt:				
Central government holdings of local government debt	42,555	43,397	45,277	1,880
Local government holdings of central government debt	155	170	274	104
General government consolidated gross debt	**400,804**	**402,245**	**399,389**	**-2,855**
as a percentage of GDP	*50.7*	*48.1*	*46.5*	*-1.6*
Public corporations				
Total gross debt	26,158	26,044	26,775	731
less holdings of other public sector debt:				
Central government holdings of public corporation debt	25,664	25,668	26,440	772
Local government holdings of public corporation debt	1	0	4	4
Public corporation holdings of central government debt	7,107	7,467	6,336	-1,131
Public corporation holdings of local government debt	805	810	780	-30
Public sector consolidated gross debt	**393,385**	**394,344**	**392,604**	**-1,739**
as a percentage of GDP	*49.8*	*47.2*	*45.7*	*-1.5*
Total public sector liquid assets (Table B)	**44,888**	**41,468**	**43,439**	**1,971**
as a percentage of GDP	*5.7*	*5.0*	*5.1*	*0.1*
Net public sector debt	**348,497**	**352,876**	**349,165**	**-3,710**
as a percentage of GDP	*44.1*	*42.2*	*40.6*	*-1.6*

(a) Figures shown may not sum to totals because of rounding.
(b) Data from 1975–99 are published in the *Bank of England Statistical Abstract 1999*, Part 1, Table 14.1.

Table B
Public sector liquid assets

£ millions, nominal values

31 March (a)	1997	1998	1999	Changes 1998–99
Central government				
Official reserves	25,547	21,293	22,147	854
Bank and building society deposits	2,067	2,286	1,635	-651
Total central government liquid assets	**27,614**	**23,579**	**23,782**	**203**
Local government				
Bank deposits	7,134	7,994	8,040	46
Building society deposits	4,142	3,796	4,235	439
Other short-term assets	3,256	3,693	4,295	602
Total local government liquid assets	**14,532**	**15,483**	**16,570**	**1,087**
Public corporations				
Bank and building society deposits	1,778	1,469	1,860	391
Other short-term assets	964	937	1,227	290
Total public corporation liquid assets	**2,742**	**2,406**	**3,087**	**681**
Total public sector liquid assets	**44,888**	**41,468**	**43,439**	**1,971**

(a) Data from 1975–99 are published in the *Bank of England Statistical Abstract 1999*, Part 1, Table 14.1.

government gross debt and an increase of nearly £2 billion in public sector liquid assets (which are deducted from gross debt in calculating net debt) were the main components of the fall of more than £3 billion in public sector net debt in 1998/99.

Chart 1
Measures of public sector debt as a percentage of GDP, 1975–99

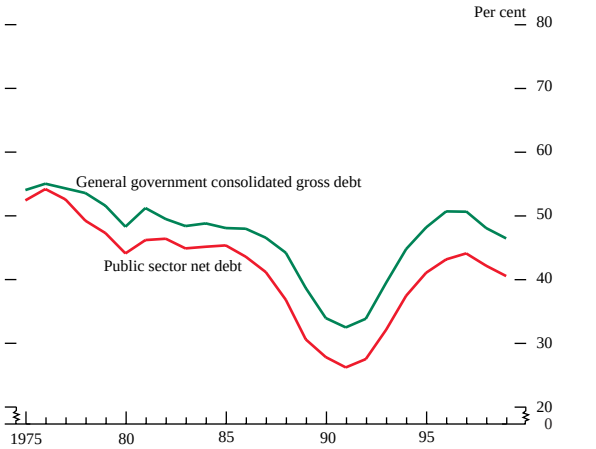
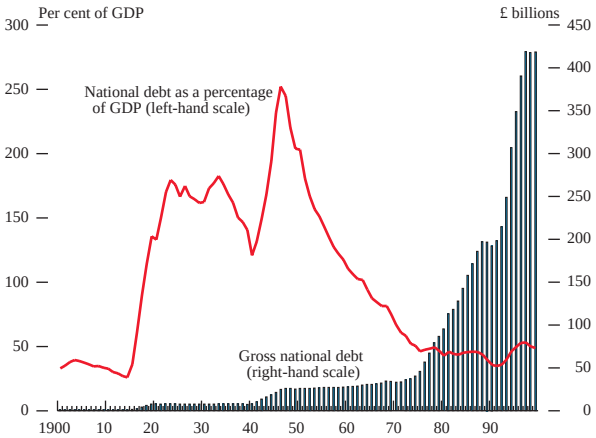


Chart 2
Gross national debt: 1900–99



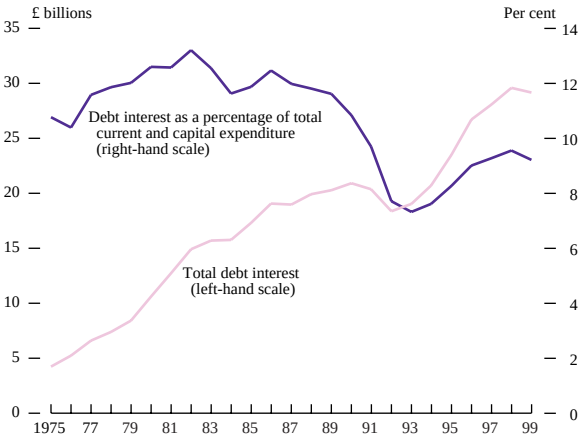
Source: HM Treasury.

Debt financing

The government's ability to finance its expenditure plans has a direct link with the amount of outstanding debt. A fiscal stance is considered sustainable if the government can expect to maintain its current spending and taxation policies indefinitely, while continuing to meet its debt-servicing obligations.

Interest payments on public sector debt in 1998/99, at £29.2 billion, were £0.4 billion lower than in the previous twelve months (see Chart 3). This was the first annual fall since 1990/91, and partly reflects the lower absolute level of the public sector debt. Falling short-term interest rates also reduce the amount of debt interest payable; interest rates payable on short-term instruments such as Treasury bills and certain National Savings accounts react quickly to changes in short-term interest rates, and coupons on new gilt issues are closely related to the prevailing rates at the time of issue. HM Treasury forecasts that gross interest will fall sharply again in 1999/2000. Interest payments accounted for 9.2% of total government current and capital spending in 1998/99, slightly lower than in the previous year (9.6%).

Chart 3
Public sector debt interest(a)



Source: ONS.

(a) At end March each year.

The public sector net cash requirement (PSNCR) moved into a surplus (ie a net repayment) of £7.0 billion in 1998/99 (see Table C). This continues the trend since 1993/94, when the PSNCR was £46.2 billion, and is the first annual repayment since 1990/91. The main reason for this change was the central government's net repayment of £4.5 billion in 1998/99. Local government and public corporations also made net repayments in 1998/99, as in the previous financial year.

Table C
Composition of the PSNCR

£ millions

	1996/97	1997/98	1998/99
Central government net cash requirement (CGNCR)	**25,156**	**3,542**	**-4,537**
Memo item: CGNCR on own account	24,995	2,650	-6,163
Local authority net cash requirement (LANCR)	**-843**	**-820**	**-481**
less borrowing from central government	*1,517*	*955*	*1,869*
General government net cash requirement (GGNCR)	**22,796**	**1,767**	**-6,887**
Public corporations' net cash requirement (PCNCR)	**-1,424**	**-719**	**-387**
less borrowing from central government	*-1,356*	*-63*	*-234*
Public sector net cash requirement (PSNCR)	**22,728**	**1,111**	**-7,040**
as a percentage of GDP	*2.9*	*0.1*	*-0.8*

The PSND is the approximate stock counterpart of the PSNCR. The two measures differ, however, because of a number of factors unrelated to expenditure, such as the revaluation of debt held in foreign currencies. The box opposite explains the differences.

Debt and deficit under the Stability and Growth Pact

EU countries are required to report debt and deficit ratios to the European Commission, and the Stability and Growth Pact ('the Pact') requires that Member States keep their public finances under tight control.

The measure of debt specified for the purposes of the Pact (as in the Maastricht Treaty) is general government consolidated gross debt (GGCGD) as a percentage of GDP.

The PSNCR and changes in the public sector net debt: reconciliation

Public sector net debt (PSND) is a stock measure, and its change is calculated on a nominal, accrued basis. In contrast, the PSNCR, financed by transactions in assets and liabilities, is measured on a cash-flow basis. This leads to differences between the change in PSND and the PSNCR for any given period, mainly because of the following:

- The value of foreign currency liabilities and assets is affected by fluctuations in exchange rates, and so the debt changes independently of any transactions that affect the PSNCR.
- When gilts are issued (or bought in ahead of their redemption date) at a discount or premium, the PSNCR is financed by the actual cash amount received (or paid out). The level of debt, however, is deemed to have changed by the nominal value of gilts issued (or redeemed).
- The capital uplift on index-linked gilts is recorded in the PSNCR only when it is paid out, ie when the stock is redeemed. In the measure of debt outstanding, it is accrued over the life of the stock.

£ billions	Year ending March 1999
PSNCR	**-7.0**
Plus	
Revaluation of foreign currency assets/liabilities	0.5
Capital uplift on index-linked gilts	2.0
Discount/premium on gilt issues	1.2
Other	-0.4
Equals	
Change in public sector net debt	**-3.7**

Note: Figures may not sum to total because of roundings.

Now that the United Kingdom's public debt measure is consistent with the latest international definitions (see the box on pages 356–57), the absolute level of GGCGD is consistent with the requirements of the Pact. However, the debt to GDP ratio still differs slightly, because until March 2000, submissions under the Pact will continue to be based on GDP as measured under the old system of National Accounts (ESA79). On current ESA79 measurements, the United Kingdom's debt was 47.4% of GDP at end March 1999, comfortably below the reference level of 60%. The box on pages 358–59 compares the UK figures with those of other EU countries.

The deficit measured under the Pact is the ratio to GDP of general government net borrowing, previously known as the general government financial deficit. As with the debt ratio, GDP is currently measured according to ESA79 for this purpose. In the year to March 1999, the United Kingdom's general government net borrowing was

European System of Accounts 1995

The UK National Accounts are produced by the Office for National Statistics (ONS) according to the latest international definitions, the European System of National and Regional Accounts, 1995 edition (ESA95). This replaced the European System of Integrated Economic Accounts (ESA79). Public sector net debt figures are now also published regularly on the new basis, but this is the first time that ESA95-consistent figures have been used in this annual series of *Quarterly Bulletin* articles.

One of the effects of moving to the new definitions is the introduction of the central bank sector. This new sector, separate from central government, means that the sector classification of the Bank of England has changed. The UK central bank sector is constituted as follows:

- *the Bank of England Issue Department* has the primary function of issuing banknotes, and holds assets to back the note issue; and
- *the Bank of England Banking Department* reflects the rest of the Bank's business, eg banker to the government, other UK banks and overseas central banks.

Before the implementation of ESA95, the Issue Department was classified in the National Accounts within the central government sector; notes issued by the Issue Department were recorded in central government debt as a liability of central government. The Banking Department was classified in the banking sector and so as part of the market. However, Banking Department's holdings of national debt instruments were classified as official holdings, and reflected in central government debt through net indebtedness to the Bank of England Banking Department.

Both the Issue and Banking Departments of the Bank of England are now classified in the central bank sector, a sub-sector of the monetary financial institutions sector. As the Issue Department is now part of the market, liabilities of the Issue Department—notes in circulation—are no longer components of central government gross debt. Similarly, Issue Department's holdings of central government debt instruments have become market holdings of debt. The Banking Department remains a part of the market. For simplicity, both the Banking and Issue Departments' holdings of national debt instruments are now classified as market holdings of national debt. The concept of net indebtedness to the Bank of England therefore disappears.

The introduction of the central bank sector also affects the components of public sector liquid assets, which are deducted from gross debt to derive the public sector net debt. Assets of the Bank of England Issue and Banking Departments—mainly gilts, Treasury bills and commercial paper held under sale and repurchase agreements—are now excluded. Offsetting this is the inclusion of debt instruments issued by the Issue and Banking Departments held by the public sector. In practice, this means banknotes held by public corporations. These were previously consolidated out of the public sector liquid assets calculation.

The new definitions also include certain components, not previously seen as liabilities of the government, within the definition of central government debt. These are:

- deposits with the National Debt Commissioners of funds lodged in courts;
- third-party deposits from the Insolvency Service; and
- funds held on behalf of the European Commission.

Following the reclassification of its transactions to central government, the net liabilities, guaranteed by government, of the Guaranteed Export Finance Company (GEFCO) are also now included in central government gross debt. Interest-free notes held by the International Monetary Fund are now excluded from the central government gross debt, since they represent the United Kingdom's subscription to the IMF, and any drawing down creates an equivalent UK asset (an increase in the reserve position with the IMF) or a decrease in other UK debt to the IMF. This treatment is consistent with the calculation of the public sector net cash requirement.

Overall, these changes have led to a slight downward movement in gross debt measures, because the Issue Department's assets include non-government debt instruments. The effect on net debt measures is broadly neutral, since decreases in gross debt have been offset by the reduction in central government's liquid assets. The table opposite illustrates these changes in more detail.

The Bank of England is planning to begin publishing monthly figures for components of the PSND from November 1999. The information, to be included in its monthly publication, *Monetary and Financial Statistics*, will supplement the existing quarterly information on the breakdown of central government gross debt.

Public sector net debt at end March 1999

£ millions

	Before implementation of ESA95			After implementation of ESA95	
	Market holdings of national debt (excludes holdings of the Bank of England Issue and Banking Departments, and includes IMF interest-free notes)	363,410		Market holdings of national debt (includes holdings of the Bank of England Issue and Banking Departments, and excludes IMF interest-free notes)	380,187
+	Net indebtedness to the Bank of England Banking Department	0		Banking Department's holdings are included in market holdings of national debt	
+	Notes and coin in circulation	26,845	+	Coin in circulation	2,637
			+	Funds lodged in courts, Insolvency Service Investment account, EC funds and GEFCO net liabilities	4,926
+	Other central government liabilities	4,397	+	Other central government liabilities	4,397
=	Central government gross debt	394,652	=	Central government gross debt	392,147
+	Local government and public corporations' consolidated debt	457	+	Local government and public corporations' consolidated debt	457
=	Public sector consolidated gross debt	395,109	=	Public sector consolidated gross debt	392,604
			–	Short-term assets of Bank of England Issue and Banking Departments	1,058
–	Net claim on Bank of England Banking Department	893			
–	Debt instruments issued by the Issue or Banking Departments held by the public sector	6,365			
–	Other public sector liquid assets	42,381	–	Other public sector liquid assets	42,381
=	**Net public sector debt**	**345,470**	**=**	**Net public sector debt**	**349,165**

-0.9% of GDP (a net repayment). This is well within the reference ratio, which allows for deficits of up to +3% of GDP. The box on pages 358–59 shows how changes in the United Kingdom's debt and deficit positions under the Maastricht Treaty compare with those of other EU Member States.

Analysis of central government debt by instrument

Central government gross debt (CGGD) accounts almost entirely for the public sector gross debt (see Table A). Although gross debt levels of local government and public corporations are significant (£53 billion and £27 billion respectively at end March 1999), most is held by central government and so is not included in the consolidated public sector debt.

Table A shows that CGGD consists of market holdings of national debt and a few other components, including coin in circulation and deposits with the National Debt Commissioners of funds lodged in courts. The national debt represents the liabilities of the National Loans Fund, and consists mainly of British Government Securities (gilts) and National Savings instruments (as Table D shows).

Total national debt remained largely unchanged at £414 billion during 1998/99. The slight fall in market holdings was offset by a similar increase in official

Table D
Market and official holdings of national debt

£ millions, nominal values; *percentage of market holdings in italics*

End March (a)	1998		1999	
Market holdings				
British government stocks	291,021	*76.2*	285,394	*75.1*
of which: index-linked	58,729	*15.4*	62,289	*16.4*
other	232,292	*60.8*	223,105	*58.7*
Treasury bills	2,106	*0.6*	4,721	*1.2*
National Savings	58,955	*15.4*	59,531	*15.7*
of which: index-linked	8,912	*2.3*	9,133	*2.4*
other	50,043	*13.1*	50,398	*13.3*
Certificates of tax deposit	706	*0.2*	574	*0.2*
Other	17,624	*4.6*	18,147	*4.8*
Market holdings of sterling debt	**370,412**	***97.0***	**368,367**	***96.9***
North American government loans	534	*0.1*	453	*0.1*
US$ floating-rate notes	1,194	*0.3*	1,239	*0.3*
US$ bonds	2,986	*0.8*	3,098	*0.8*
Euro Treasury bills	2,249	*0.6*	2,341	*0.6*
Euro 9 1/8% 2001 bond	1,606	*0.4*	1,672	*0.4*
Euro Treasury notes	2,891	*0.8*	3,010	*0.8*
Debt assigned to the government	7	*0.0*	6	*0.0*
Market holdings of foreign currency debt (b)	**11,466**	***3.0***	**11,820**	***3.1***
Total market holdings of national debt	**381,878**	***100.0***	**380,187**	***100.0***
Official holdings	32,205		33,367	
Total national debt (c)	**414,083**		**413,554**	

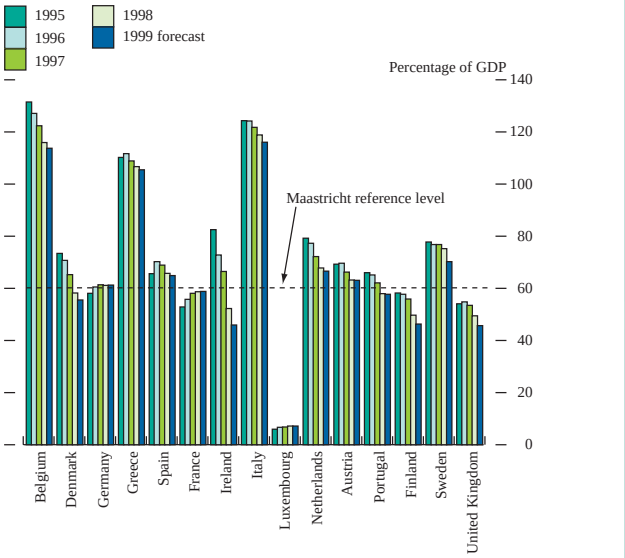
(a) Data from 1975 to 1999 are published in the *Bank of England Statistical Abstract 1999*, Part 1, Table 14.2.
(b) Sterling valuation rates:
31 March 1998: £1 = US$1.6745, Can$2.3821, ECU1.5565, DM3.0963
31 March 1999: £1 = US$1.6138, Can$2.4415, €1.4951, DM2.9242
(c) Excludes IMF interest-free notes. Although officially part of the national debt, these are not components of central government gross debt.

Public finances in the European Union

The public finances of each EU Member State are subject to close scrutiny, and Member States participating in the single currency may be subject to financial penalties if they maintain persistently excessive budget deficits. The Stability and Growth Pact requires EU members to maintain deficits (measured as general government net borrowing) below 3% of GDP, and, for those countries with debt ratios still above 60% of GDP, to achieve a declining general government consolidated gross debt in the short term. The Pact stipulates that government deficits should be close to balance, or in surplus, in the medium term.

Charts A and B show how the reported debt and deficit positions for each Member State have changed since 1995, and are forecast to change this year. The United Kingdom's debt comfortably met the criterion in March 1999; its debt is forecast to fall again during 1999, for the third consecutive year, and is expected to remain well below the 60% reference level. Except for Germany, France and Luxembourg, all Member States have reported a fall in their debt positions relative to GDP since 1995. In Germany and France the debt position has remained fairly stable at around 60%, and in Luxembourg, where there is very low public debt, the increase was minimal. In Belgium, Greece and Italy, which have exceptionally high government debt ratios, consistent falls were reported (with the exception of a slight rise in Greece's debt in 1996). However, the debt in each of these countries was forecast to remain well above 100% of GDP at end 1999. Five other member states, including Germany, Spain and the Netherlands, forecast that debt will remain in excess of the reference level in 1999. Ireland's strong economic growth and consistent budget surplus in recent years have helped it to achieve the steepest decline, from 82% in 1995 to a forecast 46% in 1999.

Chart A
General government consolidated gross debt (end year)



Source: Eurostat.

Falling debt ratios, combined with generally lower interest rates, have reduced interest burdens in most countries (see Chart B). This is reflected in improved annual deficits since 1995 in all EU Member States. UK annual net borrowing has fallen from 5.5% of GDP in 1995 to a net repayment of 0.6% in

holdings[1]—holdings by central government bodies such as the National Investment and Loans Office and central government departments. The structure of market holdings of national debt remained broadly unchanged from 1998, as did marketable debt, the proportion of debt that can be traded in a secondary market (gilts, Treasury bills and some foreign currency instruments).

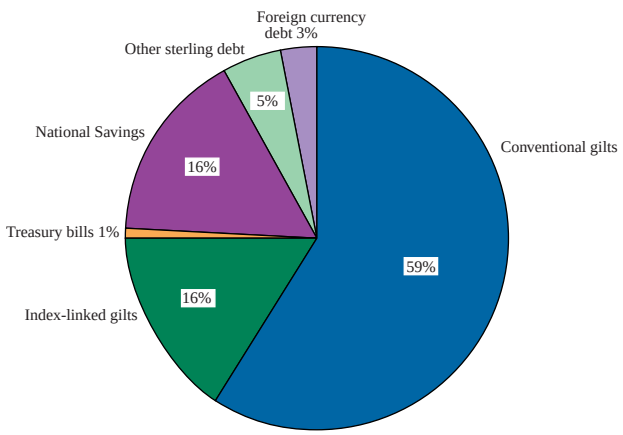
National debt instruments

The composition of market holdings of national debt is shown in Chart 4. This section gives a more detailed analysis of the major national debt instruments, explaining significant year-on-year changes.

British Government Securities (gilts)

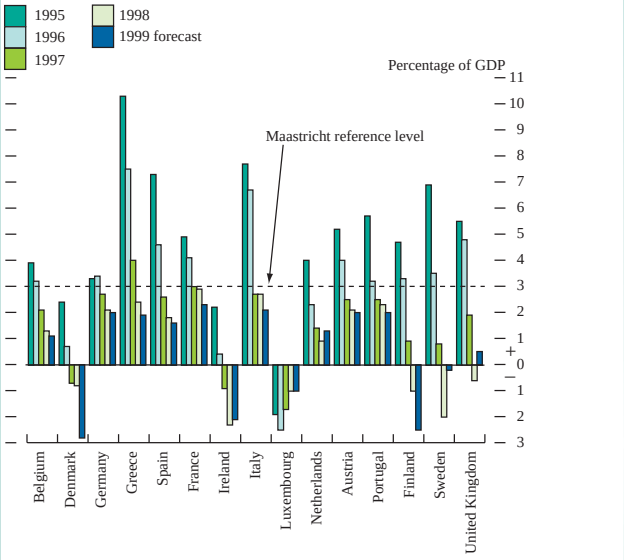
Gilts are by far the largest component of national debt. At end March 1999, market holdings of gilts[2] were £285.4 billion at nominal value, accounting for 75% of total market holdings of national debt (see Chart 4). This is £5.6 billion (and 1 percentage point) lower than the previous year, with a £9.2 billion decrease in holdings of conventional gilts only partly offset by a £3.6 billion increase in market holdings of index-linked gilts.

Chart 4
Composition of market holdings of national debt by instrument, end March 1999



(1) Note that, although a consistent picture is presented in this article, the coverage of market and official holdings was affected by the switch to ESA95 definitions since the article in the November 1998 *Quarterly Bulletin*. This is explained in the box on pages 356–57.
(2) Unless otherwise stated, all figures are in nominal terms and include capital uplift accrued on index-linked stock.

Chart B
General government net borrowing (calendar year)



Source: Eurostat.

1998, with net borrowing of 0.5% forecast for 1999. Steep falls in net borrowing were also reported by countries which had relatively high debt ratios during the early 1990s. In Greece, Spain and Italy, in particular, net borrowing fell from levels as high as 10% of GDP in 1995 to levels below the 3% requirement by 1998. Denmark, Ireland, Finland, Sweden and the United Kingdom have now joined Luxembourg in recording annual net repayments.

Many countries reported significant falls in their deficit figures for 1997, the year over which eligibility for membership of the first wave of Economic and Monetary Union (EMU) was judged. In their 1999 Public Finance Report, the European Central Bank (ECB) acknowledged that temporary measures—such as the Italian euro tax—played a significant role in reducing deficits in 1997 (by an average of 0.4% of GDP). These measures had less influence in 1998 (around 0.1%), when decisions had been taken on EMU entry. Although deficits continued to fall in 1998, assisted by historically low interest rates in the euro area, the falls were much smaller than in 1997. The ECB's report expressed disappointment that the 'opportunity to use the windfalls of buoyant growth and low interest rates to make more substantial progress in improving underlying budgetary positions was largely forgone in many Member States'. They noted that 'developments in 1998 represented a noticeable slowdown if not a standstill in fiscal consolidation'.

The ECB report also contrasted the generally more positive debt and deficit positions in 1998 for Member States not adopting the single currency (Denmark, Greece, Sweden and the United Kingdom) than for those already committed. On average, the deficit ratio for participating countries fell from 2.5% in 1997 to 2.1% in 1998, and for non-participating Member States the average fell from a deficit of 1.7% in 1997 to a surplus of 0.6% in 1998.

The ECB expects only small improvements in countries' budgetary positions in 1999 and the medium-term future. It points out that any increase in interest rates could lead to some countries having difficulty meeting the requirements of the Stability and Growth Pact, which expects net borrowing to be in balance or surplus in the medium term. Despite the generally negative outlook, the individual assessment for the United Kingdom is relatively positive. The ECB predicts that both deficit and debt for the United Kingdom will soon be comfortably within the Maastricht limits.

The nominal value of index-linked gilts held by the market at end March 1999 was £62.3 billion, a 6% annual rise. Index-linked issuance totalled £1.5 billion (excluding capital uplift) during 1998/99. This included the first auction of index-linked gilts in November 1998—all previous issues of index-linked stock had been conducted via the tap mechanism. The Debt Management Office (DMO) expects issuance of index-linked gilts via auctions to become general practice in the longer term, as it currently is for conventional gilts.

Despite the growth of index-linked stock in recent years, conventional gilts still accounted for 59% of the national debt held by the market at end March 1999 (see Table D). In total, £5.9 billion of conventional gilts were issued during 1998/99. This comprised further issues of 5¾% Treasury Stock 2009 and 6% Treasury Stock 2028, which are now regarded by the market as the 10-year and 30-year benchmarks respectively.

Several conventional gilts were redeemed during 1998/99. Major redemptions included £5.7 billion of Floating Rate Treasury Stock 1999, £3.9 billion of 12% Exchequer Stock 1998 and £3.0 billion of 12¼% Exchequer Stock 1999.

In March 1998, the DMO projected gross gilt sales of £14.2 billion in 1998/99, to contribute towards a forecast financing requirement of £15.2 billion. This target was revised downwards during the year for a number of reasons. The overfunding carried forward from 1997/98 was £3.1 billion higher than had been anticipated, and the 1998/99 central government net cash requirement (CGNCR) was revised up by £8.2 billion, from an initial forecast deficit of £3.7 billion to a £4.5 billion outturn surplus. These effects were partly offset by a £600 million reduction in the forecast net contribution from National Savings, resulting in a final gilt financing requirement of £4.0 billion. Actual sales during the year were £8.1 billion (£7.4 billion at nominal value).

The average remaining life of market holdings of gilts at end March 1999 was ten years. As Table E shows, this figure has changed little in recent years. However, through consultation with the market, the DMO has identified an increased demand for long-dated gilts. This is partly due to factors such as the minimum funding requirements applied to pension funds, and the relative competitiveness of bonds compared with equities brought about by the abolition of advance corporation tax and dividend tax credits. As a

result, the Government's issuance strategy is now biased towards long-dated stocks, which, other things being equal, will lengthen the average gilt maturity. Chart 5 shows the maturities of existing dated stocks by value in market hands.

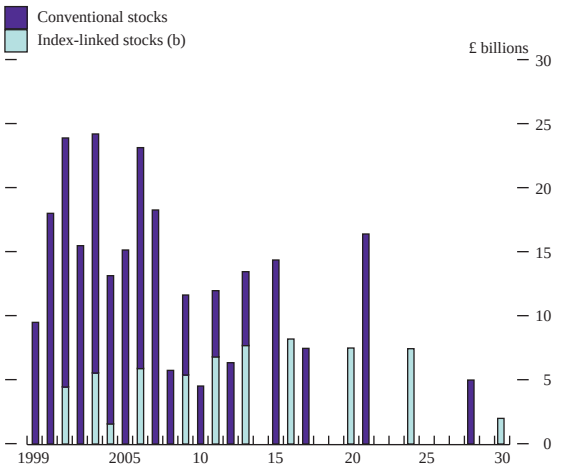
Table E
Average remaining life of dated stocks in market hands(a)

Years to maturity at 31 March

	1992	1993	1994	1995	1996	1997	1998	1999
Latest possible redemption:								
All dated stocks (b)	10.0	10.8	10.6	10.4	10.1	10.1	10.2	10.0
Excluding index-linked stocks	8.4	9.4	9.1	9.1	8.8	8.8	9.0	8.9
Earliest possible redemption date:								
All dated stocks	9.8	10.5	10.4	10.2	9.9	9.9	10.0	9.9
Excluding index-linked stocks	8.1	9.0	8.9	9.1	8.8	8.7	8.9	8.8

(a) These data are based on the nominal value of dated stocks held by the market at 31 March each year.
(b) Index-linked stocks are given a weight reflecting capital uplift accrued to 31 March.

Chart 5
Redemption dates of dated stocks in market hands(a)



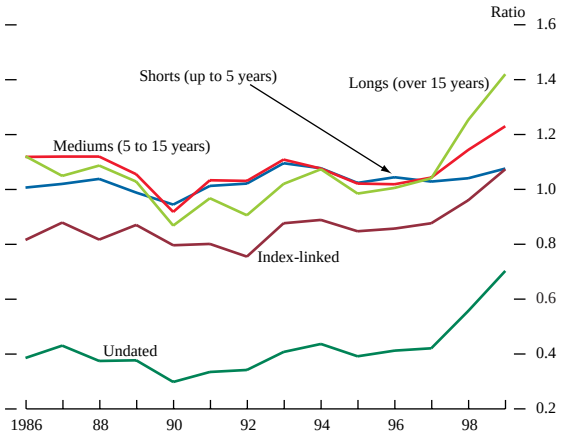
(a) As at end March 1999, using latest possible redemption dates.
(b) Figures include accrued capital uplift to 31 March 1999.

The gilt market in 1998/99

Gilt yields continued to fall in 1998/99. A decline in global stock markets precipitated by economic uncertainty in Russia and East Asia led to rising gilt prices—and falling yields—in the second quarter of the financial year. The transfer of capital from equities into government bonds in this period was seen as a 'flight to quality'. During October the fall in yields was sharply reversed because of the liquidation of holdings in response to the global economic difficulties, but this was short-lived: reductions in global interest rates caused further falls in yields. By the end of the financial year yields had begun to rise, but over the whole of 1998/99 yields fell by more than 100 basis points across all maturity bands. The fall was most marked in the five-year benchmark, which was 144 basis points lower at the end of the year.

The strength of gilt prices resulted in a sharp rise in their market to nominal ratio (see Chart 6). The market value of all gilts in market hands at end March 1999 was £335 billion, 17% higher than the nominal value (up from 9% a year earlier). The increased demand for long-dated gilts since 1997 has resulted in longs being at an average 42% premium to their nominal value at end March 1999. This reflects greater demand from pension funds, partly because of the minimum funding requirements introduced in 1997, as shown by the increased holdings of gilts by pension funds (described below).

Chart 6
Ratios of market to nominal values of stocks in market hands



Despite the increased issuance of index-linked gilts, demand, particularly from institutional investors, remained very strong, and yields fell. For the first time since their introduction, index-linked gilts were being traded at a premium to their nominal value at the end of the 1998/99 financial year. The market to nominal premium at the end of the year was 7%, compared with a discount of 4% a year earlier. Market prices of undated stocks rose in response to falling interest rates and yields. At the beginning of 1998/99, undated stocks were trading at a 44% discount; this fell to 30% by the end of the year.

The financing Remit for 1999/2000

The Government's Remit to the DMO was published in March 1999,(1) with a target for gross gilt sales in 1999/2000 of £17.3 billion. This was based on a forecast CGNCR of £6.2 billion, and takes into account gilt over-funding during 1998/99 of £2.3 billion and expected gilt redemptions in 1999/2000 of £14.9 billion. The target for index-linked issuance is £3.5 billion (20% of gross sales). Reflecting the increased demand for long-dated stock mentioned earlier in this article, the Government has set a target issuance of £5.8 billion of long conventional gilts (34%), up from £3.1 billion in 1998/99. 1999/2000 targets for short and medium conventional gilts are £5.0 billion (29%) and £3.0 billion (17%) respectively.

National Savings

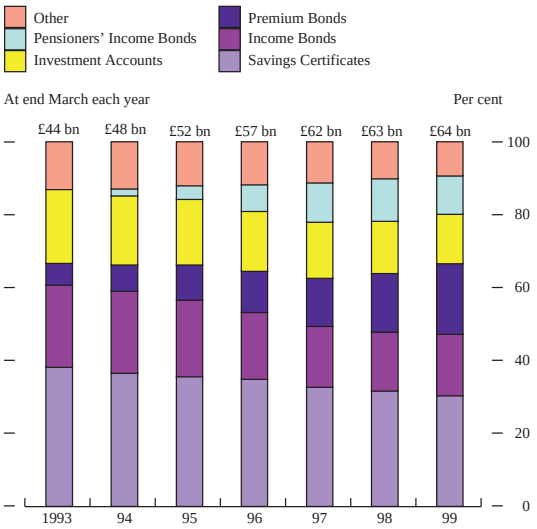
National Savings instruments accounted for 16% of market holdings of national debt at end March 1999 (see Chart 4).

(1) *Debt Management Report 1999–2000*, HM Treasury, March 1999.

Including Ordinary Account deposits and accrued interest and index-linked increments on other National Savings products, which are not part of national debt, outstanding National Savings instruments totalled £63.7 billion. The increase of £0.4 billion during the financial year constitutes the net funding contribution to the Government's financing requirement. The gross sales (ie sales and deposits including accrued interest) of National Savings products for 1998/99 was approximately £12 billion.

The proportion of National Savings held in Premium Bonds continued to grow in 1998/99, to 19% at the end of the period. This compares with 6% at end March 1993. The share of Pensioners' Income Bonds,(1) which had increased every year since their introduction in 1994, fell back slightly in 1998/99 to 11%. The growth in the proportion of National Savings held in Premium Bonds and Pensioners' Income Bonds has been at the expense of holdings of conventional Income Bonds and Investment Account deposits (see Chart 7).

Chart 7
Composition of National Savings by product



Source: Department of National Savings.

The net contribution of National Savings to the Government's financing programme for 1999/2000 is expected to be around £100 million, with gross sales of around £11 billion. This is lower than 1998/99, reflecting the high level of redemptions due on National Savings products during 1999/2000.

Sterling Treasury bills

Market holdings of sterling Treasury bills at end March 1999 stood at £4.7 billion, or 1.2% of national debt. This is markedly higher than a year earlier, when the stock was £2.1 billion (0.6%). The rise was the result of an increased three-month tender from £100 million to £200 million, and the introduction of a one-month tender of £500 million a week, during March 1999. These were necessary to offset a prospective easing in money-market conditions arising from two large gilt redemptions on 11 and 26 March, and the seasonal rise in government expenditure at the end of the financial year. This was the first offer of one-month sterling Treasury bills since end 1997. They allow more flexibility than longer-dated bills in influencing the outstanding stock of money-market refinancing.

Following the decrease in the estimated CGNCR, the DMO confirmed in the *1998/99 Gilt Review*(2) that its estimated net Treasury bill issuance during 1999/2000 had been revised downwards from an earlier estimate of £3.6 billion to £1.9 billion. The DMO also announced on 29 July its intention to assume full responsibility for Exchequer cash management by the end of the 1999/2000 financial year. Once these arrangements are in place, Treasury bills will become the primary short-term financing instrument used to meet the seasonal fluctuation of the Government's within-year cash requirements. The DMO's holdings of short-term instruments will then reflect daily changes in the net cash position, a function currently performed by the Ways and Means overdraft with the Bank of England. After this transfer of cash management responsibilities, the Ways and Means advances will no longer be used to balance the Government's overnight needs, and will be frozen.

Foreign currency debt

The sterling value of foreign currency debt outstanding increased during 1998/99, from £11.5 billion to £11.8 billion, as shown in Table D. Foreign currency debt as a proportion of total market holdings of national debt also rose slightly, from 3.0% to 3.1%, mainly because of the revaluation of existing liabilities; the sterling effective exchange rate (as measured by the Bank's exchange rate index) rose from 102.8 at the start to 106.8 at the end of 1998/99.

Sterling national debt: analysis by holder

Tables F and G show an estimated distribution by economic sector of the sterling national debt at end March 1999.(3)

Table F shows that this distribution has remained broadly unchanged from last year. Individuals' and private trusts' holdings of national debt instruments increased during 1998/99 by more than £10 billion, to £85.0 billion. Most of this sector's holdings were again in National Savings products, but growth in their holdings of gilts (to £25.3 billion at end March 1999) accounted for all of the increase.

Total sterling national debt held by non-UK residents increased during the year by £6 billion, also reflecting increased investment in gilts. As in the previous year, their net investment was concentrated on the short to

(1) Holders must be 60 years of age or over; interest rates are fixed for five years.
(2) *1998/99 Gilt Review*, Debt Management Office, July 1999.
(3) These tables are compiled from a variety of sources, including banks' aggregated balance sheets, the 1998 gilt ownership survey (Bank of England), and the ONS' quarterly and annual surveys of various financial and non-financial companies.

medium-term end of the market. This increase means that non-residents' holdings of national debt instruments accounted for just over 16.6% of total market holdings, an increase of 1½ percentage points from 1997/98. This may have been because overseas investors perceived the United Kingdom as a 'safe haven' from both EMU uncertainty and turbulence in Russia and the Far East.

Table F
Distribution of the sterling national debt: summary(a)

£ billions; *percentage of market holdings in italics*

Amounts outstanding at 31 March	1998		1999		Change in 1998/99
Market holdings					
Public sector	7.1	*1.9*	5.9	*1.6*	-1.2
Banks	28.4	*7.6*	26.9	*7.2*	-1.8
Building societies	1.0	*0.4*	0.7	*0.2*	-0.3
Institutional investors	192.4	*51.3*	183.1	*48.9*	-9.3
Individuals and private trusts	74.4	*19.8*	85.0	*22.7*	10.6
Other UK residents	15.2	*4.0*	10.5	*2.8*	-4.7
Non-residents	56.4	*15.1*	62.2	*16.6*	5.8
Total market holdings	**374.8**	***100.0***	**374.3**	***100.0***	**-0.5**
Official holdings	31.2		32.0		0.8
Total sterling debt	**406.0**		**406.4**		**0.3**

Note: Figures shown may not sum to totals because of rounding.

(a) See Table G for a more detailed analysis. Data for 1975–99 are published in the *Bank of England Statistical Abstract 1999*, Part 1, Table 14.3.

Although institutional investors remain by far the largest holders of sterling national debt, accounting for 49% of total market holdings in 1999, their holdings fell by £9 billion during the year. As Table G shows, these holdings are concentrated largely in medium and long-dated stocks, reflecting the institutions' need to match their assets with their typically longer-term liabilities. The fall during the year was almost entirely in insurance companies' holdings of gilts. Holdings by pension funds continued to grow (in particular holdings of long-term gilts), reflecting increasing demand for pensions, and following the introduction of the minimum funding requirement solvency test, which came into force in April 1997 (implementing the Pensions Act 1995).

Banks' and building societies' holdings of sterling national debt instruments fell again in 1998/99, and were £27.6 billion at end March 1999. Within this, holdings of gilts fell, but holdings of other debt instruments, such as Treasury bills, rose.

The Bank of England conducted a survey of Central Gilts Office members to ascertain the beneficial ownership of the sterling British Government Securities (gilts) held on behalf of their clients as at the end of 1998. The results, which have been used in the compilation of Table G, are contained in an article published in the Bank of England's *Monetary and Financial Statistics* (July 1999, and supplement in September 1999).

Table G
Estimated distribution of the sterling national debt: 31 March 1999

£ billions, nominal values (a)

	Total holdings of sterling debt	British government stock (b) *Total*	Up to 5 years to residual maturity	Over 5 years and up to 15 years	Over 15 years and undated	Treasury bills	Non-marketable debt
Market holdings							
Local government	0.2	*0.2*	0.0	0.1	0.1	0.0	0.0
Public corporations	5.8	*3.0*	1.2	1.4	0.4	0.0	2.8
Total public sector	**5.9**	***3.2***	**1.2**	**1.5**	**0.4**	**0.0**	**2.8**
Banks (c)	26.9	*9.4*	4.5	3.5	1.4	1.8	15.8
Building societies	0.7	*0.7*	0.6	0.1	0.0	0.0	0.0
Institutional investors:							
Insurance companies	102.7	*102.1*	25.6	43.8	32.7	0.6	0.0
Pension funds	76.0	*75.4*	19.6	37.3	18.6	0.6	0.0
Investment and unit trusts	4.3	*4.3*	1.5	1.7	1.1	0.0	0.0
Total institutional investors	**183.1**	***181.9***	**46.7**	**82.7**	**52.4**	**1.2**	**0.0**
Individuals and private trusts	85.0	*25.3*	8.4	12.7	4.2	0.0	59.7
Other UK residents	10.5	*9.9*	6.4	2.1	1.4	0.3	0.3
of which: Industrial and commercial companies	1.2	*0.6*	0.1	0.3	0.2	0.3	0.3
Non-residents:							
International organisations	6.1	*0.5*	0.3	0.2	0.0	0.0	5.7
Central monetary institutions	16.3	*15.5*	9.3	5.1	1.2	0.8	0.0
Other	39.8	*39.2*	15.3	13.7	10.2	0.6	0.0
Total non-residents	**62.2**	***55.2***	**24.8**	**19.0**	**11.4**	**1.4**	**5.7**
Total market holdings	**374.3**	***285.4***	**92.5**	**121.6**	**71.3**	**4.7**	**84.2**
Official holdings	32.0	*6.4*	2.6	3.0	0.8	4.5	21.1
Total sterling national debt	**406.4**	***291.8***	**95.1**	**124.6**	**72.1**	**9.2**	**105.4**

Note: Figures shown may not sum to totals because of rounding.

(a) Some of these estimates are based on reported market values; certain others rely on broad nominal/market value ratios.
(b) A sectoral analysis of gilt holdings from 1975–99 is published in the *Bank of England Statistical Abstract 1999*, Part 1, Table 14.4.
(c) Includes the Issue and Banking Departments of the Bank of England.

Annex
Notes and definitions

The national debt

The *national debt* represents the total liabilities of the National Loans Fund (NLF). *Market holdings* include holdings by local government and public corporations, and, since the transition to ESA95 definitions, the Issue and Banking Departments of the Bank of England. Market holdings exclude holdings by other central government bodies (principally the funds of the National Investment and Loans Office, the Exchange Equalisation Account and government departments).

The national debt comprises:

British Government Stocks (BGS): Sterling, marketable, interest-bearing securities issued by the UK Government. The nominal value of index-linked gilt-edged stocks is increased by the amount of accrued capital uplift. The whole nominal value of all issued stocks is recorded, even where outstanding instalments are due from market holders (where this is the case, the outstanding instalments are recorded as holdings of liquid assets). This article uses the same definition of short and medium-dated gilts as the NLF accounts (under five years and five to ten years respectively). In the financing requirement, however, and in general market usage, short-dated gilts are defined as three to seven years and medium-dated as seven to fifteen years.

Treasury bills: Short-term instruments generally issued with a maturity of 91 days. The bills, which can be traded on the secondary market, are sold at a discount and redeemed at par. The amount of discount depends on the price accepted by the Bank at the tender.

National Savings securities: Non-marketable debt comprising a variety of products available to the public. The national debt excludes deposits in ordinary accounts of the National Savings Bank, as well as accrued interest and indexing on National Savings products.

IMF interest-free notes: Non-marketable non interest bearing Treasury notes, issued by the Bank of England on the authority of warrants from HM Treasury. The warrants authorise various sums to be placed at the disposal of the International Monetary Fund (IMF) as a reciprocal facility for loans received by the United Kingdom. All transactions are initiated by the IMF. Interest-free notes held by the IMF are excluded from the central government gross debt, since they represent the United Kingdom's subscription to the IMF, and any drawing down creates an equivalent UK asset (an increase in the reserve position with the IMF) or a decrease in other UK debt to the IMF.

Certificates of tax deposit: Non-marketable debt available to taxpayers generally, which may be used in payment of most taxes.

Other sterling debt: Includes *Ways and Means advances* (the method by which government departments etc lend overnight to the NLF), *NILO stocks* (non-marketable stocks, issued directly to the National Debt Commissioners, whose terms reflect those on existing BGS), and the *temporary deposit facility* (deposits by central government bodies and public corporations with the NLF).

Foreign currency debt: Converted to sterling at end-period middle-market closing rates of exchange and comprises *foreign currency bonds* (denominated in US$, DM and euro), *euro Treasury notes and bills, long-term post-war loans* from the governments of the United States and Canada and *assigned debt* (debt originally drawn under the Exchange Cover Scheme and transferred to the government following privatisations of public corporations).

Central government gross debt

Includes *market holdings of national debt* (except IMF interest-free notes) and also any market holdings of other central government gross debt, which comprises:

National Savings ordinary account, accrued interest and indexing on National Savings: Excluded from market holdings of national debt.

Coin in circulation

Deposits with the National Debt Commissioners of *funds lodged in courts*.

Other central government gross debt: Comprises market holdings of *Northern Ireland government debt* (principally Ulster Savings Certificates), *bank and building society lending, balances of certain public corporations with the Paymaster General, funds held on behalf of the European Commission, other third-party deposits* (from the Insolvency Service), and the *net liabilities, guaranteed by government, of the Guaranteed Export Finance Company (GEFCO)*, following the reclassification of its transactions to central government in 1987.

Public sector consolidated gross debt

This includes *central government gross debt*, as well as all *local government and public corporation debt*. All holdings of each other's debt by these three parts of the public sector are netted off to produce a consolidated total.

The local government sector comprises all bodies required to make returns under the various local authorities acts. Public corporations are trading bodies (including nationalised industries), which have a substantial degree of independence from the public authority that created them, including the power to borrow and maintain reserves.[1]

Public sector net debt

The *public sector net debt* is derived from the consolidated debt of the public sector by deducting the public sectors' holdings of liquid assets.

General government consolidated gross debt

This is *central government* and *local government gross debt* with holdings of each other's debt netted off to produce a consolidated total. The Maastricht measure of GGCGD—the government debt figures produced under the terms of the Stability and Growth Pact—is calculated on the ESA79 basis. In absolute terms this is the same for the United Kingdom as the ESA95 definition, but is slightly higher as a percentage of GDP (47.4% at end March 1999). Beginning with the March 2000 submission to the Commissions, all data will be on the latest, ESA95, basis.

(1) For further details, see Chapter 4 of the *Financial Statistics Explanatory Handbook*, published by the Office for National Statistics.