

UK Rates Strategy

Surprisingly large fall in gilt issuance

- Following today's UK Budget, the DMO have announced plans to issue £128.4bn of gilts in FY2014-15. This is much lower than both our forecast of £146bn and the consensus expectation of £150.5bn.
- The maturity split showed an increase in the allocation to longs, with a small reduction in linkers and a greater reduction in shorts.
- The initial market reaction has seen the 10s30s gilt curve steepen sharply and a widening in long-dated break-even inflation spreads. While the latter may have legs, we expect the former to be temporary.

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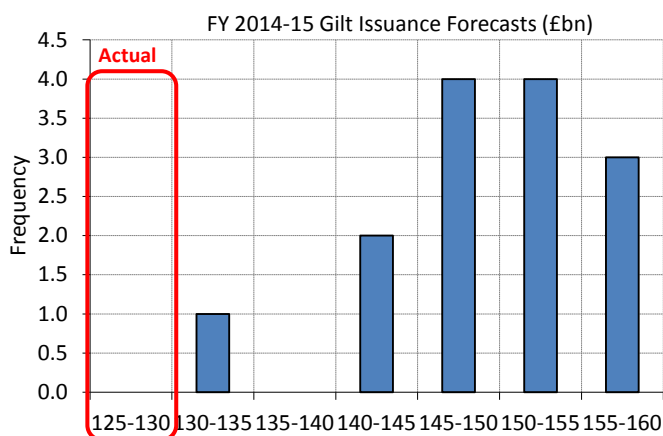
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Surprisingly large fall in gilt issuance

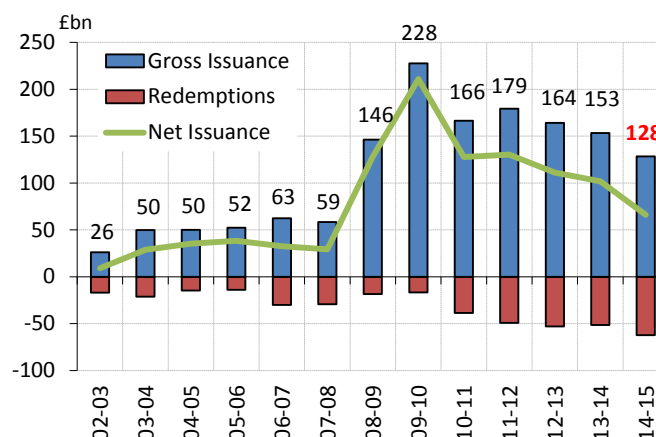
The new gilt remit for FY2014-15 – published alongside the Budget today – shows gilt issuance of £128.4bn. This was significantly below both consensus expectations of £150.5bn and our own forecast of £146bn. Ahead of the Budget, expectations for gilt issuance were relatively tightly bunched in the £145-155bn range with few outliers (Figure 1). As such, the outcome is a significant surprise, prompting gilts to rally. The maturity split – see below – also showed a greater allocation to longs and less allocation to linkers and, in particular, shorts. This has prompted the 10s30s curve to steepen sharply and a rally in long-dated break-even inflation spreads. While the latter may have legs, we expect the former to be temporary.

Figure 1. Distribution of gilt issuance forecasts



Source: Citi Research, Reuters.

Figure 2. Both gross and net issuance falling



Source: Citi Research, DMO.

Improving trend in issuance

Gross issuance in FY2014-15 is set to fall by £25bn compared with FY2013-14, putting it at the lowest level since FY2007-08. This is the largest annual fall in gross issuance since FY2010-11, but falls on this scale are unlikely in the next couple of years, given the high level of redemptions – see below. Net issuance will be just £66bn in FY2014-15, a drop of 35% compared with FY2013-14. However, it is still around double the pre-crisis norms (Figure 2).

What explains the sharp fall in gilt issuance?

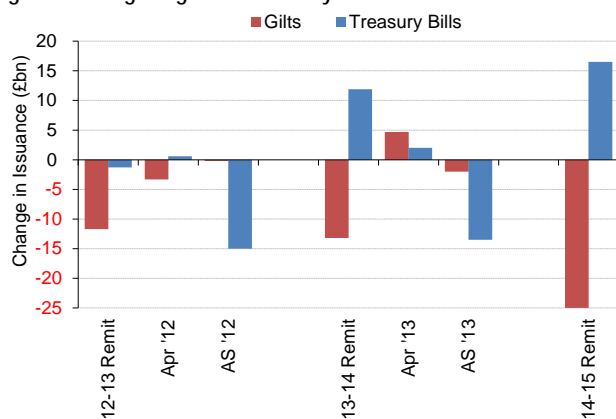
The sharp fall in gross issuance compared with FY2013-14, despite a rise in redemptions of £11bn, can be put down to several factors. First, the OBR's projection for the CGNCR (excluding Bradford & Bingley and Northern Rock) in FY2013-14 was revised lower by £11.5bn, creating an overfund which translates into lower issuance in FY2014-15. Second, the DMO have opted to increase planned Treasury bill sales by £16.5bn, thereby reducing the need to issue gilts. This has become a pattern in recent years, with the DMO preferring to make changes to the level of gilt issuance at the beginning of the fiscal year and then keep it stable during the fiscal year by meeting any changes in the financing need by modifying Treasury bill sales (Figure 3). Increasing planned Treasury bill sales at the beginning of the fiscal year is, therefore, a way of building flexibility into the remit. Third, changes to tax efficient savings products announced in the Budget have resulted in an assumed contribution to financing from National Savings & Investments of £13bn. This is much larger than usual and again means lower gilt issuance.

Maturity split and syndications

The maturity split shows a greater allocation to longs and less to linkers and, in particular, shorts (Figure 4). This has put pressure on the long end of the curve in the initial market reaction, but it is worth noting that absolute issuance in longs is actually a touch lower. Strong demand for long gilts from the LDI investor base is likely to mean that any steepening pressure is brief, in our view. The absolute level of linker issuance will be £7.4bn lower. We expect this to be supportive for long-end break-evens both over the near and medium term.

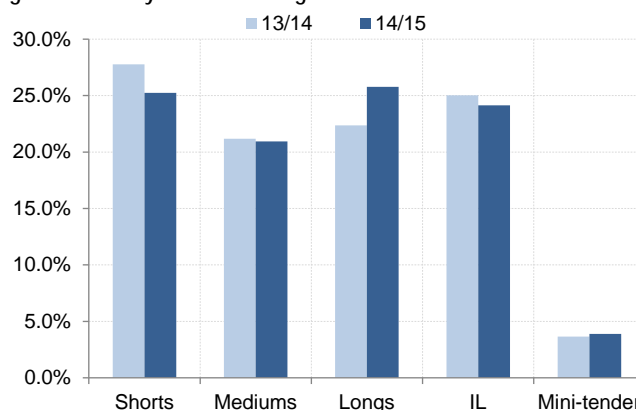
Syndications will remain an important feature of the remit in FY2014-15. The DMO plan to raise £17bn from syndications, split £8.5bn in longs and £8.5bn in linkers. There are likely to be 4 syndications, two longs and two linkers. The auction calendar for April-June 2014 will be published on 31 March and will likely include details of the syndication(s) to take place in the quarter. We expect the first syndication to be a conventional long, quite possibly a re-opening of the super-long 2068 maturity (last re-opened via syndication in October 2013).

Figure 3. Swings in gilt and Treasury bill issuance



Source: Citi Research, DMO.

Figure 4. Maturity breakdown of gilt issuance

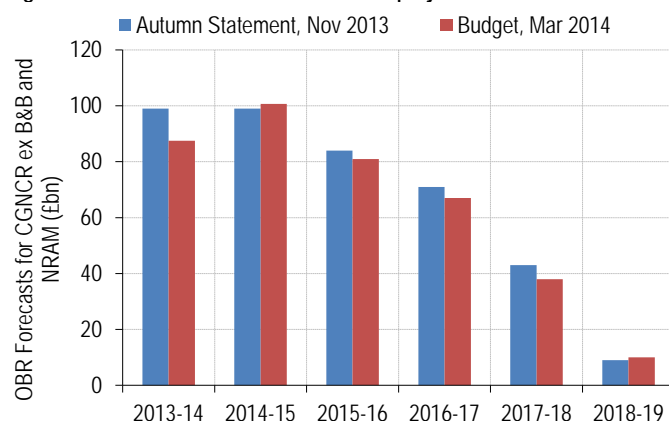


Source: Citi Research, DMO.

Future gross issuance trends – slow decline

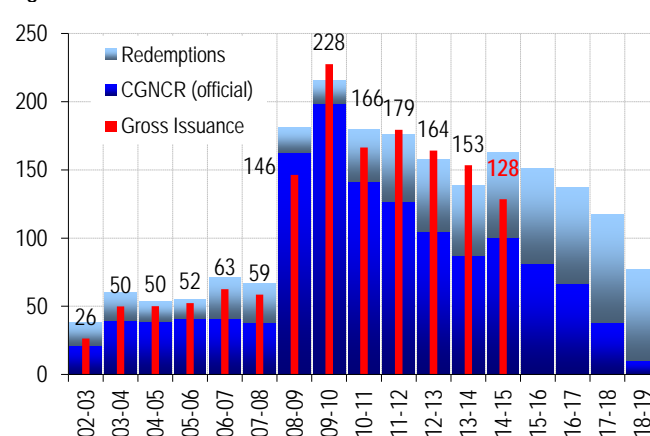
Figure 5 shows the revisions made to the OBR's forecasts for the CGNCR (excluding Bradford & Bingley and Northern Rock) since the Autumn Statement. The changes are quite minimal, with FY2014-15 actually being revised higher. Consequently, with redemptions moving higher in the coming years, gross issuance is likely to remain around current levels in the coming years - Figure 6.

Figure 5. Revisions to the official CGNCR projections



Source: Citi Research, OBR.

Figure 6. Gross issuance set to remain elevated



Source: Citi Research, DMO, OBR.

Appendix A-1

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