

Interest payments in Public Sector Finances First Release: July 2006 (published on 18 August 2006)

Cash interest payments in July 2006 were £3.7 billion; £2.3 billion higher than in July 2005 when it was £1.4 billion. Why was this?

In July 2006 it included £2.2 billion of “uplift” on the redemption of a Government security, 2% Index-Linked Treasury Stock 2006, which matured on 19 July.

What is an index-linked gilt? What is uplift, and why is it important?

An index-linked gilt is a long-term security whose nominal value increases in line with inflation (using a standard formula); it pays interest twice a year at a fixed rate on this uplifted value. Uplift is the increase in the nominal value due to inflation. It is only payable at redemption, though is implicit in the market price. It is scored in the National Accounts as an interest payment. In the accrued-based statistics the uplift is accrued over each month of the gilt’s life, in the cash-based statistics it scores at the time of redemption. The nominal value of 2% Index-Linked Treasury Stock 2006, which was first issued in July 1981, was £2.1 billion. At redemption its value totalled £5.9 billion. Hence, there is uplift of £3.8 billion.

If the uplift is £3.8 billion why is it that only £2.2 billion is included in the July 2006 Cash interest payments?

The maturity value of £5.9 billion, including the uplift of £3.8 billion, is calculated on the basis that the whole of the £2.1 billion nominal stock was issued at the same time (on 8 July 1981). Had that been the case all the uplift would count as interest in July 2006. However, only £1.0 billion nominal stock was issued in July 1981, the remainder was issued in a series of 12 tranches between December 1987 and October 1997. In addition £0.5 billion of 2% Index-Linked Treasury Stock 2006 was cancelled in a Switch Auction held on 20 July 2001; and a further £0.1bn created for use as collateral by the DMO in cash management operations. When these tranches were issued, the price at which they were issued already included the capital uplift that had accrued to that point. This was so that all of the stock was fungible and could be traded on an equal basis. (Fungible means that the stock is seen to be the same in all respects i.e. stock from any tranche has the same value as stock from any other tranche of the same gilt.) The inclusion of the uplift in the price of each tranche at the time it is issued, known as synthetic uplift, means that it is part of the sum borrowed and thus, when repaid, cannot be part of the interest paid. So the £3.8 billion contains two components, £1.4 billion of synthetic uplift and £2.4 billion remainder.

This still leaves a small difference between the £2.4 billion due to uplift scored as cash interest at maturity and the £2.2 billion included in July 2006 cash interest payments.

The £2.2 billion included in July 2006 cash interest payments is the amount of uplift paid to **market holders** of 2% Index-Linked Treasury Stock 2006; it excludes the uplift (£0.2 billion) paid to **official holders** (the Debt Management Office and the Commissioners for the Reduction of the National Debt), who are part of central government. Intra-CG sector payments are consolidated.

When is the next Index-Linked Gilt due to mature?

The 2.5% Index-Linked Treasury Stock 2009 matures on 20 May 2009. This was first issued in October 1982. The synthetic uplift (or tranchette adjustment) on this stock stands at £2.3 billion.