

National Treasury Management Agency

44. National Debt

Role of the Agency

The National Treasury Management Agency has the statutory function of borrowing moneys on behalf of the Exchequer and managing the National Debt on behalf of and subject to the control and general superintendence of the Minister for Finance.

The Agency in managing the National Debt is obliged to comply with two key performance objectives -

- that annual debt service costs “correspond as nearly as may be” to an Exchequer funding budget approved by the Minister for Finance.²
- to manage the debt relative to a benchmark which is recommended by an independent external advisor and approved by the Minister for Finance on the basis of a medium term trade-off between cost and risk.

Basis for Audit

Expenses incurred by the Agency in the performance of its functions are met from the Central Fund. The Agency incurred expenditure of £6.2m on administration in 1997 (£5.9m in 1996).

Under the provisions of section 12 of the National Treasury Management Agency Act, 1990, I am required to audit the accounts of the Agency and when making my statutory annual report on the Appropriation Accounts, to make also a report to Dáil Éireann regarding the correctness of the sums brought to account by the Agency in the year. The Agency’s accounts for 1997 have been audited and the accounts, including an administration account and accounts relating to the National Debt, have been presented to the Minister who has laid copies thereof before both Houses of the Oireachtas.

I am satisfied that the accounts properly present the transactions of the Agency in 1997 and its balances at year end.

Debt Service Cost

Debt service costs, at £2.8 billion, increased in 1997 by £279m over the 1996 cost. The increase was made up of the following elements

² Section 5(2)(a)(iv) of the National Treasury Management Agency Act, 1990.

Cost Heading	Increase / (decrease) £m
Provisions	110
Interest costs	
-underlying	(138)
-debt management	<u>218</u>
Debt Management:	
-capital payments	65
Sinking fund payments	<u>24</u>
Total increase	279

Increase in provisions-£110m

£110m of the increase in servicing costs was accounted for by an increased provision in respect of the Small Savings Reserve Fund. As a cash basis of accounting is used interest on small savings is only recognised in the National Debt accounts when paid on encashment. Because of this deficiency inherent in the basis of accounting the Small Savings Reserve Fund was established in 1994 to take account of interest due but not provided for. The Small Savings Reserve Fund provides a fund of money to meet encashments of interest on Savings Bonds, Savings Certificates and National Instalment Savings in specified instances. As of 31 December 1997 an estimated £1.6 billion in interest had accrued under these schemes. After allowing for the Small Savings Reserve Fund which stood at £623m by 31 December 1997 the net interest liabilities not provided for in the National Debt accounts amounted to £950m.

Underlying interest costs -(£138m)

- The interest paid on Irish Government Bonds in 1997 decreased by £28m due primarily to lower interest rates in the Irish bond market. This decrease occurred despite the level of bonds outstanding increasing from £16.4 billion at the end of 1996 to £17 billion at the end of 1997.
- Interest paid on foreign currency borrowing in 1997 decreased by £121m reflecting reduced interest rates in international markets and a reduction in foreign currency borrowing outstanding.
- An increase in interest paid on small savings schemes of £25m arose as a result of increased encashments on such schemes which became less attractive to investors following a reduction in interest rates introduced during 1997.
- Interest due on other debt decreased by £14m.

Interest costs-debt management- £218m

In 1997 there was a variance of £218m in interest paid in respect of debt management activities (net payments of £108m in 1997 compared with net receipts of £110m in 1996).

The Agency took the view during 1997 that long term rates were relatively low and short term rates were expected to rise over the course of the next two to three years. It was therefore decided to increase the weighting of fixed rate liabilities in the foreign currency portfolio - a change that was in line with the benchmark. The additional outlay associated with fixing the cost of longer dated liabilities included an amount of £88m in respect of foreign currency interest rate swap terminations. The benefits from the action taken are projected to come in the form of cash savings in 1998 and future years.

Debt management activity- Capital payments-£65m

An increased charge of £65m arose in respect of capital payments in 1997 relating to maturing and terminated cross currency swaps and foreign exchange contracts. The Agency informed me that these transactions, which were designed to keep the portfolio in line with the benchmark, had the effect of reducing the foreign currency debt while at the same time maintaining debt service costs within budget. These payments, while relating to the capital element of the swaps and foreign exchange contracts, are nevertheless accounted for as a debt service item in accordance with the accounting policy of the Agency.

Sinking Fund Payments-£24m

An increase of £24m arose in respect of certain capital payments on the National Debt which are charged to debt service costs annually to provide for the amortisation of Government borrowing for voted capital services. These capital payments are provided for in each year's Finance Act.

Outstanding Debt

The National Debt outstanding at 31 December 1997 was £30.7 billion which represented an increase of £777m over the debt at the end of the previous year. The composition of the debt was as follows:

	£m	£m	£m
Domestic Debt:			
National Loans		17,010	
Medium/Long term Indebtedness		240	
Short term Indebtedness	6,123		
Less: Domestic Liquid Assets	<u>(972)</u>		
Net Short term Indebtedness		<u>5,151</u>	
Net Domestic Debt			22,401
Foreign Debt:			
Foreign Loans			<u>8,288</u>
National Debt			30,689

Note:

An estimated £4.1 billion of National Loans were held by non-residents at 31 December 1997.

The increase in the nominal value of the national debt arose as follows:

	£m
Net new borrowings	415
Exchange fluctuations	612
Net movement in nominal value of debt due to issues and cancellations ³	<u>(70)</u>
Gross increase	957
Less increase in cash balances	<u>180</u>
Net increase	<u>777</u>

Risk Management and Performance

In managing the National Debt the Agency has to take account of a number of risk factors including interest rate and exchange rate risk, counter-party credit risk, operational risk and the obligation to maintain liquidity.

The Agency has developed policies to measure and control such risks including liquidity targets, currency and interest rate limits and techniques to assess value at risk.⁴

The strategic management of the national debt is effected relative to a benchmark (a shadow portfolio) which is devised and measured by an international investment bank and approved by the Department of Finance.⁵ The general approach in devising this benchmark is to maintain a low risk portfolio over the medium term. While funding and debt management transactions aim to add value by reducing overall debt costs, such transactions are effected within value at risk limits. The investment bank determined that, measured on a net present value basis against the benchmark portfolio, savings attributable to the Agency's management in 1997 amounted to £30.9m.

The Agency controls a major part of its debt management risk and in order to comply with benchmark requirements adjusts the currency composition of the national debt through engaging in swaps and foreign exchange contracts. The Agency informed me that, on a net present value basis, there was a liability of £154m at 31 December 1997 arising from this activity. This liability is attributable to sterling swaps and foreign exchange contracts which formed part of a strategy, agreed with the Department of Finance, to reposition the portfolio over a number of years to take account of the Exchequer's exposure to the sterling exchange rate.

³ *Tranches of national loans are issued or cancelled from time to time. The movement reflects the fact that the nominal debt created or cancelled differs from the cash proceeds or outlay since such transactions are effected at market values.*

⁴ *Value at risk allows for an assessment of the worst-case loss expected over a given holding period. It summarises in one number the combined risk arising from all instruments in the portfolio, taking account of the degree to which certain exposures may be offset by others.*

⁵ *The benchmark takes account of funding targets and portfolio composition adjustments agreed with the Department of Finance.*

45. Savings Bank Fund

The audit of the Post Office Savings Bank is carried out on my behalf by the auditors of An Post subject to my right to carry out any further audit tests which I consider necessary.

In 1998 they reported to me on their audit of the 1997 accounts. I accept their opinion that the accounts of the Post Office Savings Bank give a true and fair view of its transactions for that year end and of its year end balance.

In addition to managing the National Debt, the National Treasury Management Agency is responsible for the investment and management of funds remitted to the Exchequer by the Post Office Savings Bank and the TSB Bank. The Exchequer is responsible for the repayment to the Banks of all such funds and for meeting interest charges thereon.

The state of affairs of these funds at year end was as follows:

	1997 £m	1996 £m
Liability in respect of funds due to depositors and creditors	481 ^a	609
Value of related investments held by Post Office Savings Bank Fund (at cost prices) ^b	<u>508</u>	<u>632</u>
Surplus at 31 December	27	23

^a The decrease is mainly due to a reduction in funds received from the TSB Bank (£15m at 31 December 1997 as compared to £137m at 31 December 1996) in line with arrangements made in 1992 whereby the funds to be deposited by the TSB Bank with the Agency are being reduced each year.

^b The market value of the investments held by the Fund was £0.6m more than their cost price.