



HM Treasury

Managing Fiscal Risks in the UK

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HM Treasury

Debt Sustainability Workshop

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What I am going to talk to you today

Context: Development of fiscal risk management in the UK

Fiscal Risks Report (by the OBR):

- Medium and long-term fiscal risks;
- Sovereign debt risks in the overall picture of risks to the public finances;
- What the fiscal stress test revealed about our sovereign debt risks;

Managing Fiscal Risks (the government response):

- What are the risk mitigating measures the government has taken as a response to the risks identified;

What we have learnt through the FRR-MFR fiscal risk management process

Development of fiscal risk management in the UK

- The IMF publishes *Analyzing and Managing Fiscal Risk* in May 2016;
- HMT's 2015 Review of the OBR and the IMF's 2016 Fiscal Transparency Evaluation of the UK recommends publication of a fiscal risk statement;
- Charter of Budget Responsibility amended to require OBR to publish a fiscal risk report once every two years;
- OBR publishes its first *Fiscal Risks Report (FRR)* in July 2017;
- Government publishes its first *Managing Fiscal Risk (MFR)* in July 2018, responding to the findings of the FRR;
- Unprecedented internationally, this 2-year cycle provides a mechanism for Parliament and the public to assess the adequacy of the government's actions to mitigate fiscal risks and hold it to account for their implementation.

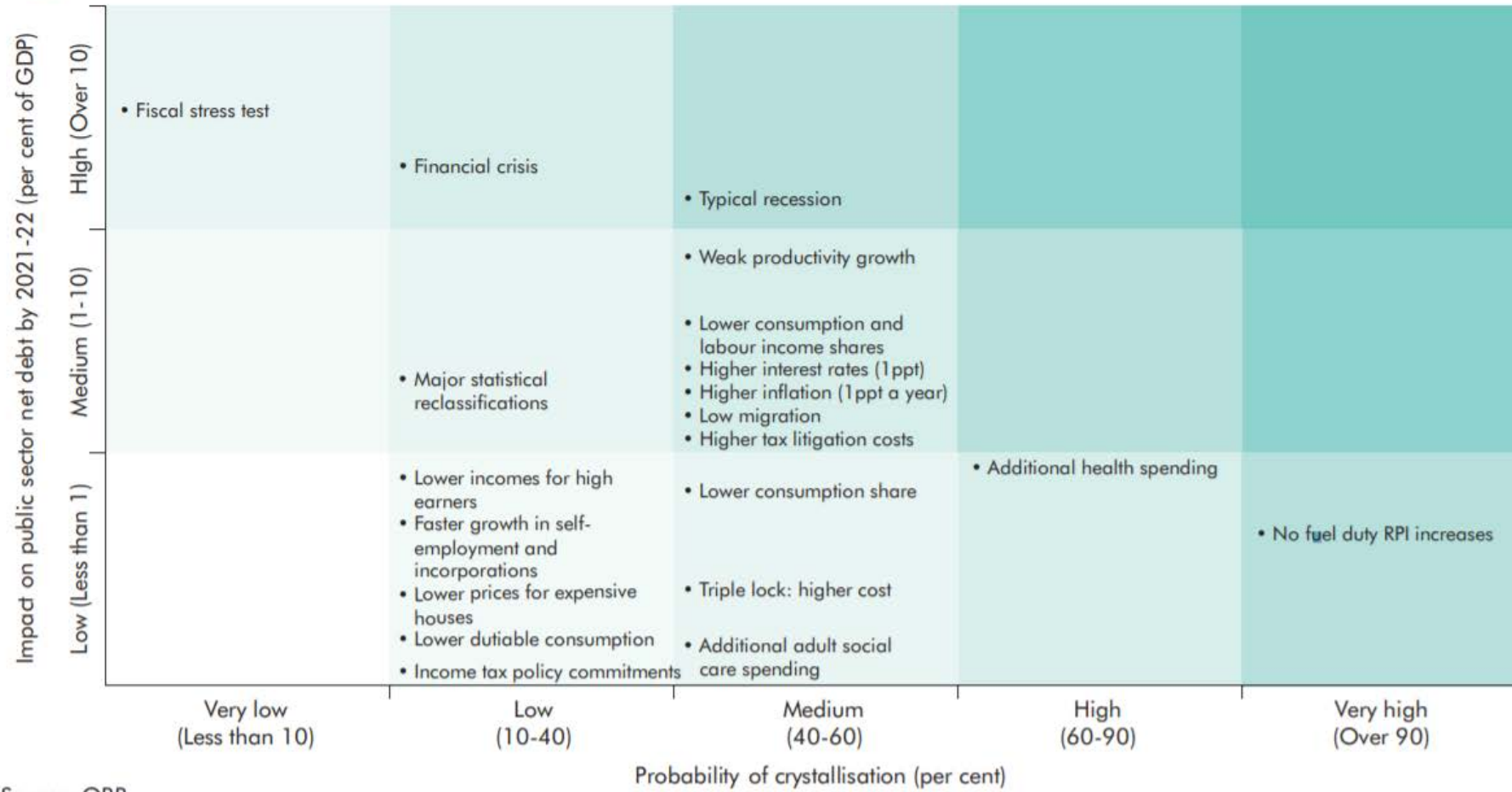
The contents of the FRR and the MFR

- The OBR's FRR covered all fiscal risks over a medium (5 year) and long-term (50 year) horizon highlighting 57 different risks to the UK's public finances from the macroeconomy to specific revenue and spending risks;
- The FRR also included a fiscal stress test which assessed the combined impact of a macroeconomic shock and specific risks, such as contingent liabilities triggered, based on the annual BoE banking stress test;
- In response, HMT's MFR covers the actions the government is taking on risks posed by external factors (such as demographic change, macroeconomic shocks, and financial sector stress) as well as actions to address risks in specific areas (including areas of tax, spending, and the government's balance sheet).



FRR: fiscal risks over the medium term

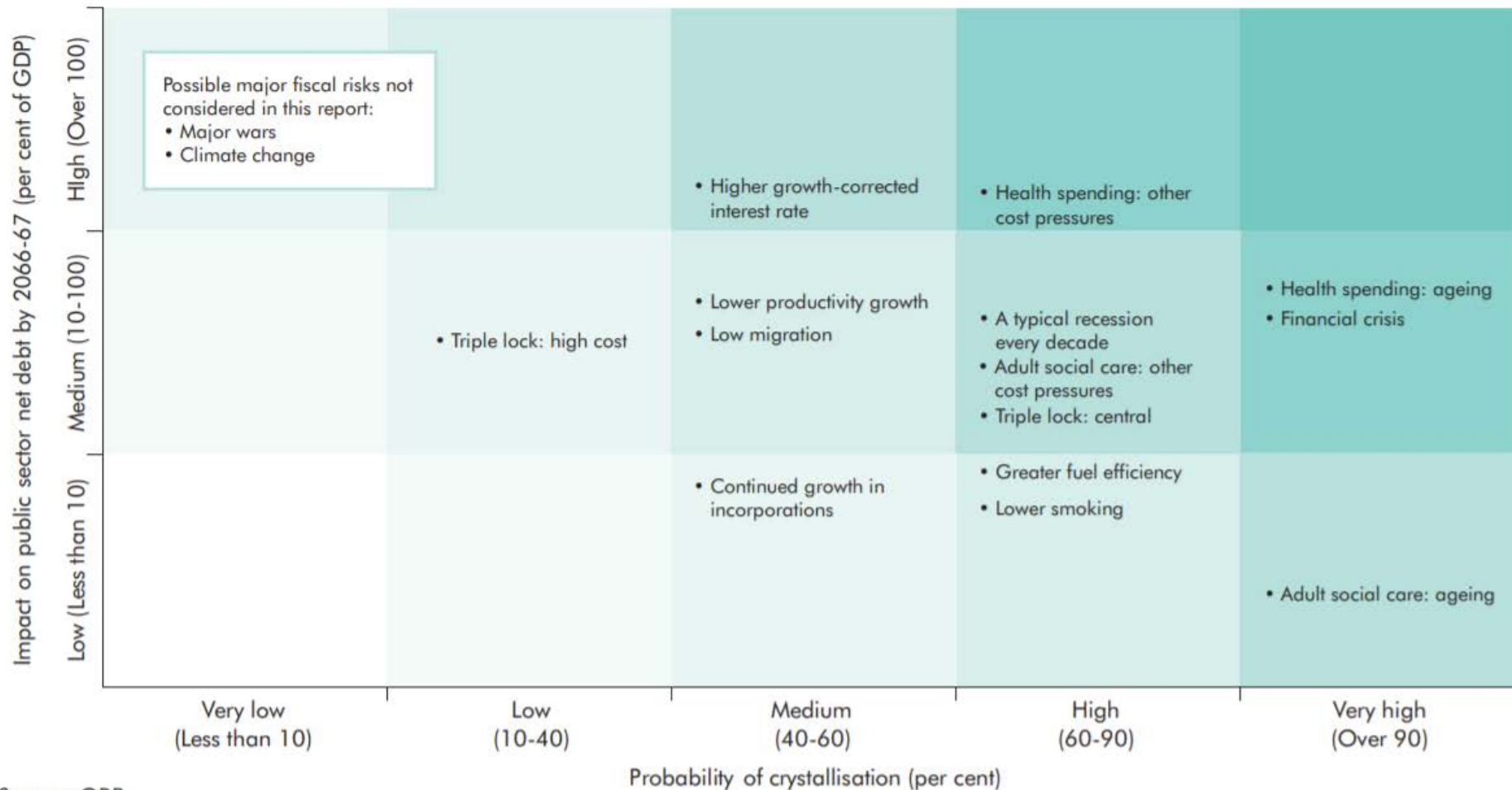
Figure 10.1: Sources of fiscal risk over the medium term



Source: OBR

FRR: fiscal risks over the long term

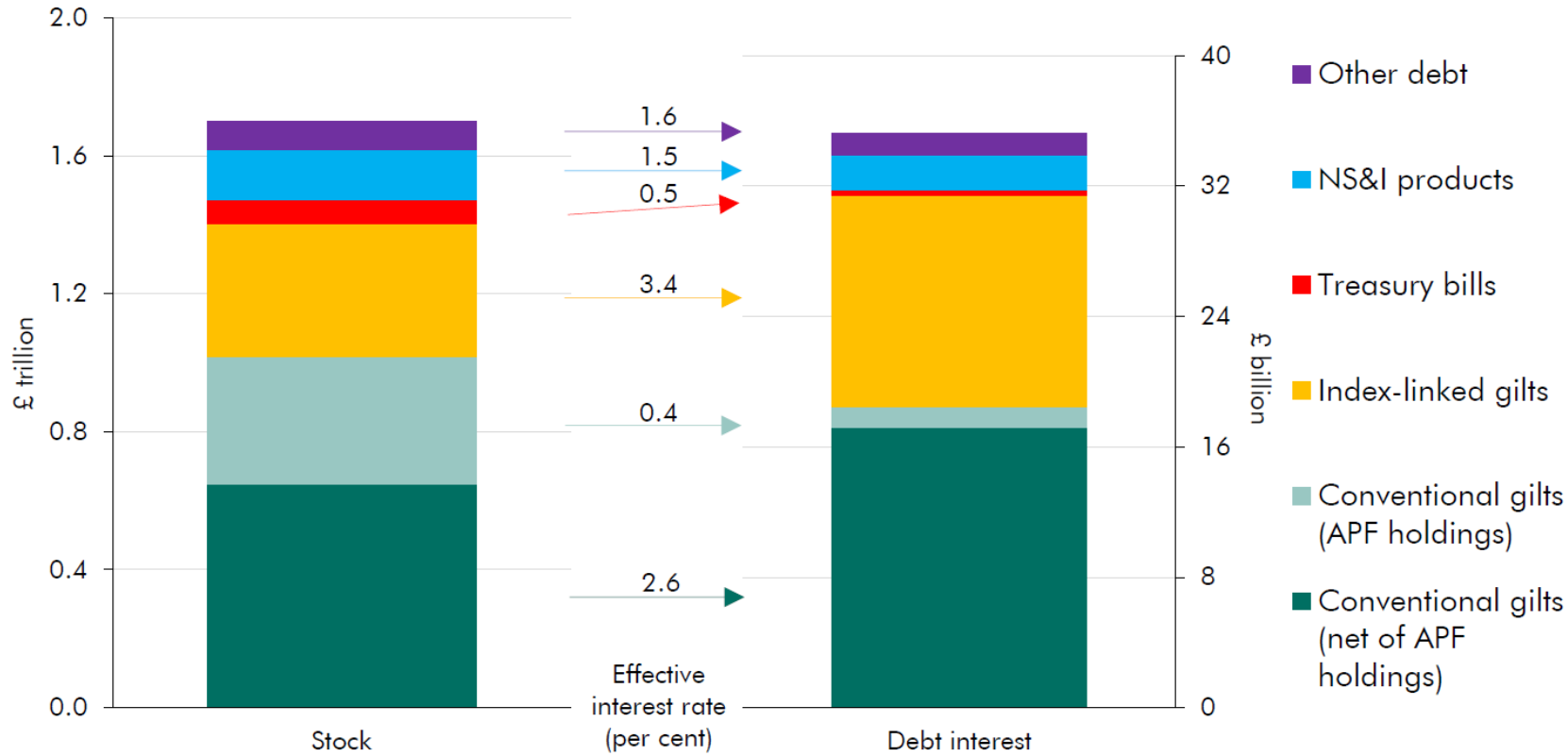
Figure 10.2: Sources of risk to fiscal sustainability



Source: OBR

FRR: The debt stock and associated interest payments

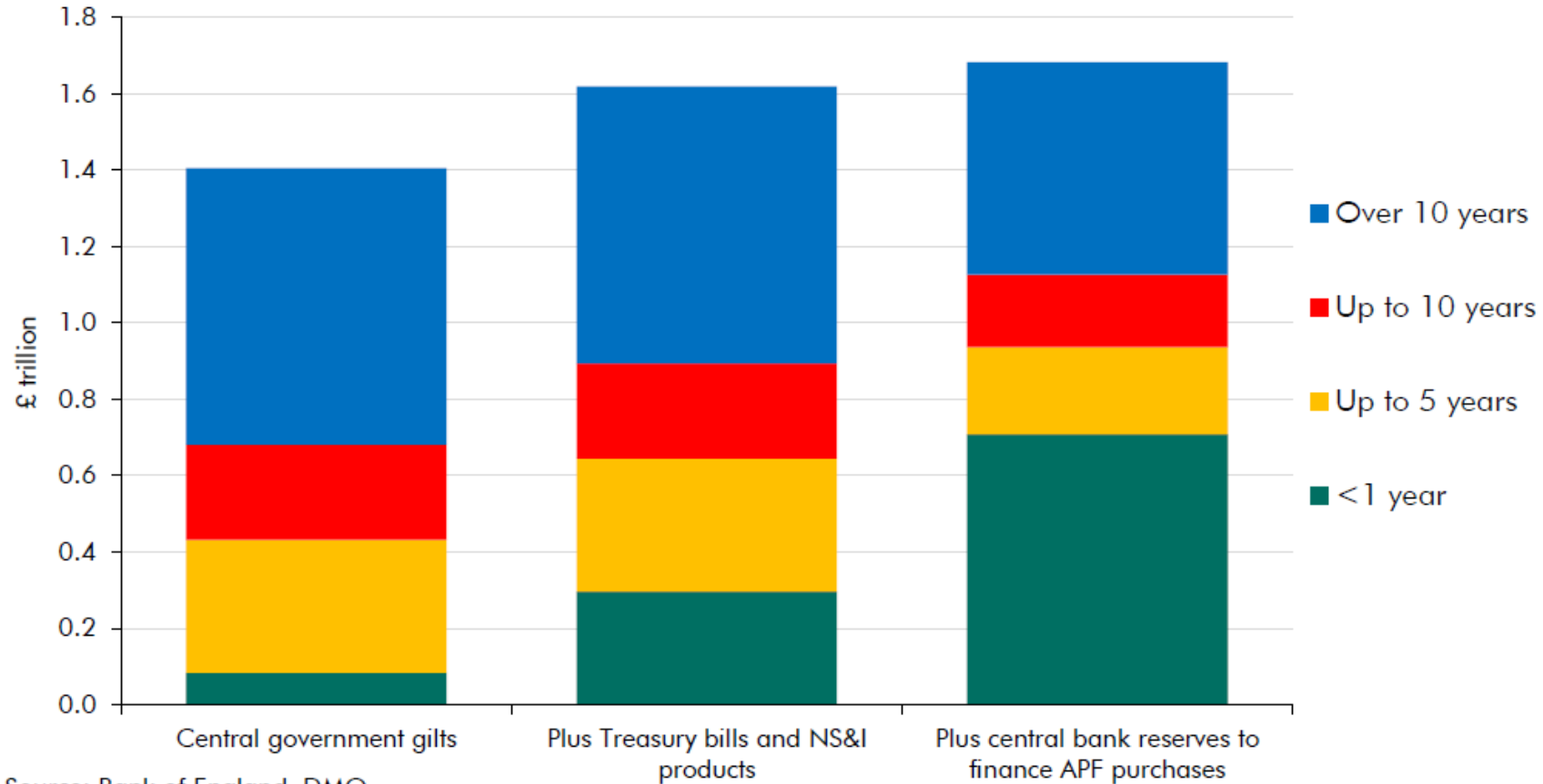
Chart 8.2: Composition of the debt stock and associated interest payments



Source: Bank of England, DMO, ONS, OBR

FRR: Maturity structure of outstanding debt

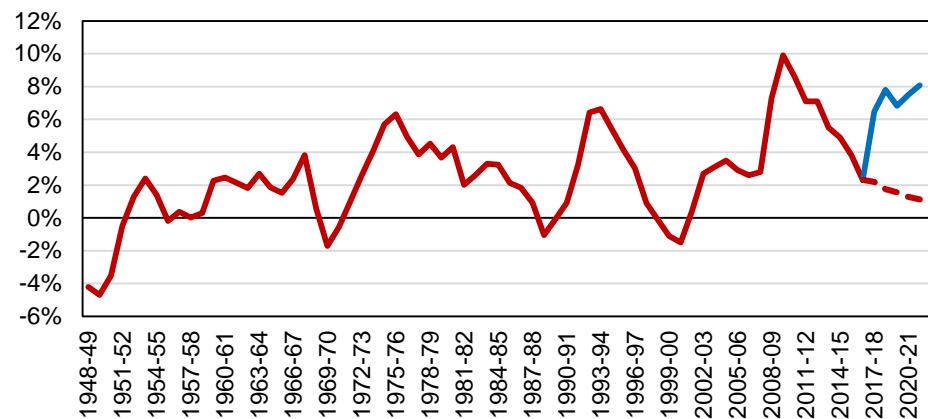
Chart 8.5: Maturity structure of outstanding debt



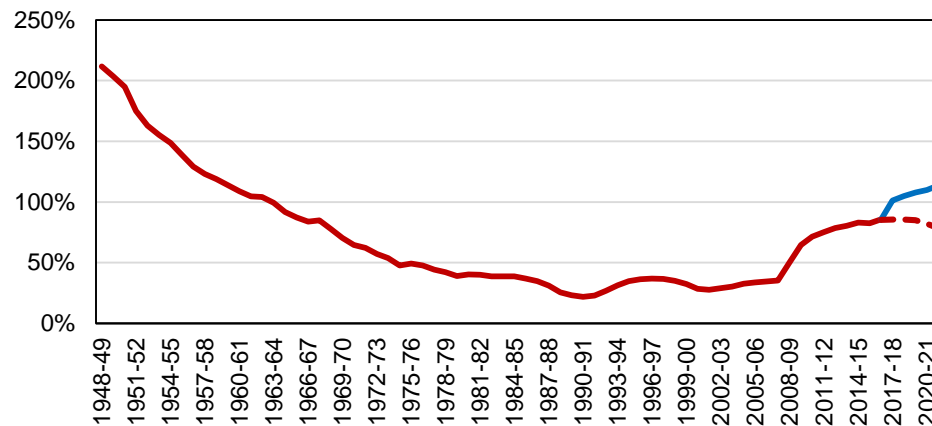
Source: Bank of England, DMO

FRR: fiscal stress test impact on debt, financing and interest

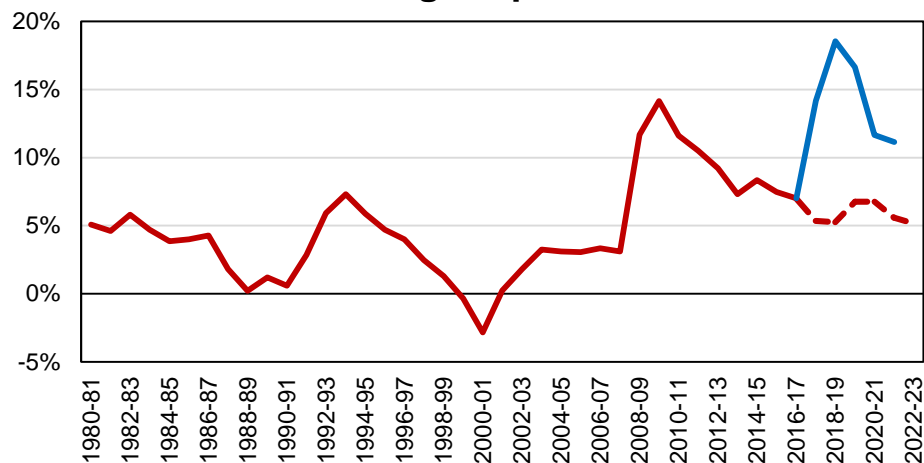
Public Sector Net Borrowing % GDP



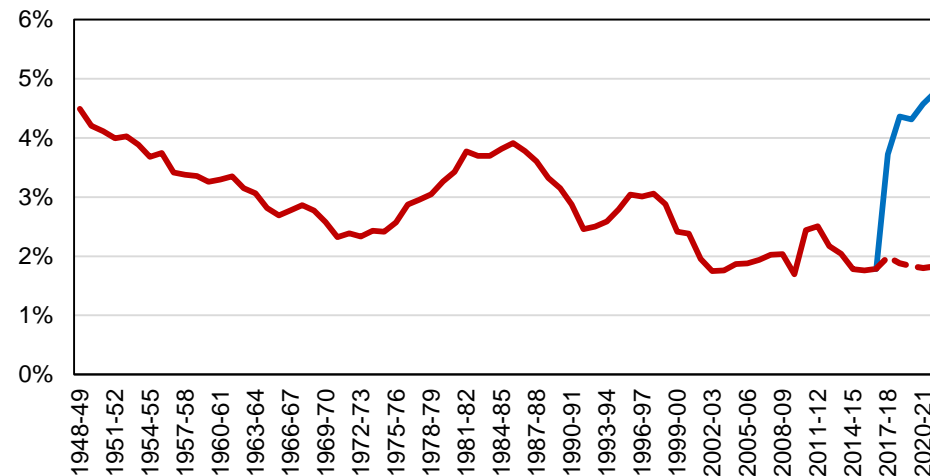
Public Sector Net Debt % GDP



Gross Financing Requirement % GDP

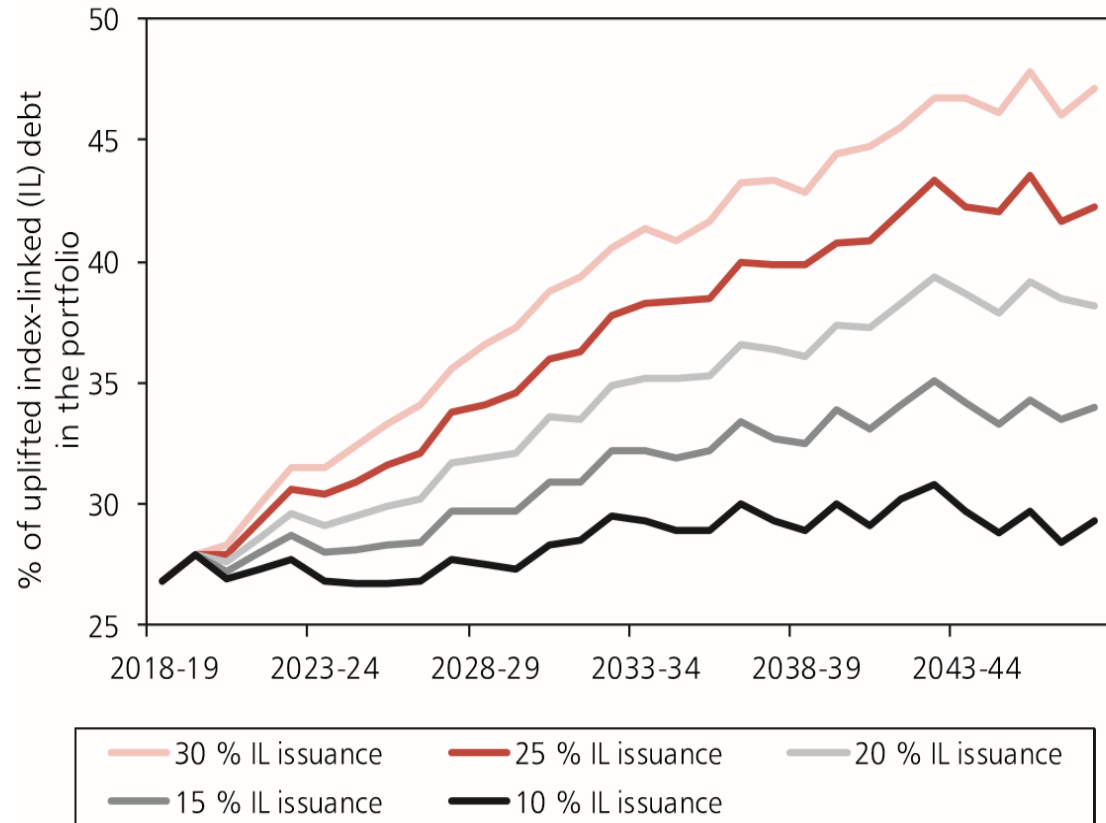


Debt Interest Costs % GDP



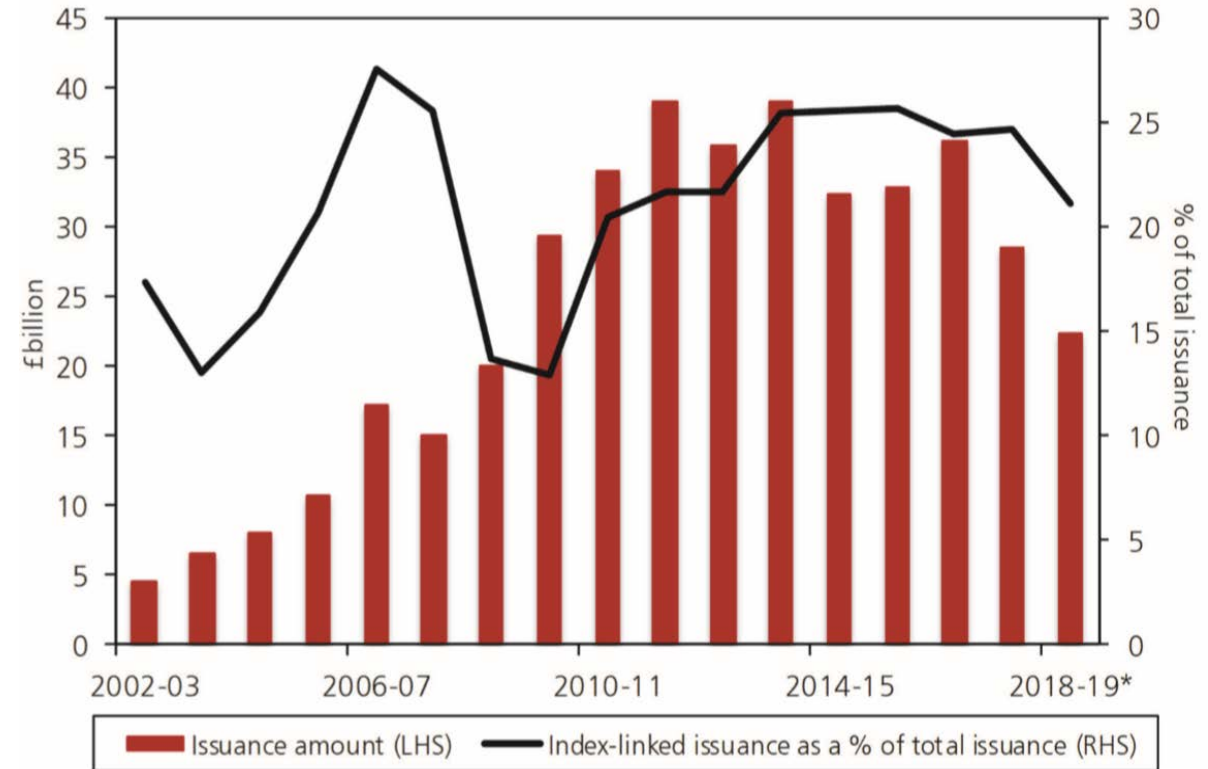
MFR: Reduction in the issuance of inflation linked debt

Chart 2.P: Future index-linked debt stock under different issuance assumptions



Source: DMO calculations

Chart 2.N: Annual index-linked gilt issuance



Source: DMO and HMT

*Planned issuance set out in April 2018 revision to the DMO's financing remit 2018-19, subject to change as the unallocated pot is distributed over the year.

MFR (July) and Autumn Budget (October) actions

- **MFR**: *the government is acting to mitigate its exposure to inflation risk by reducing the issuance the issuance of index-linked gilts in the latest financing remit and reviewing the appropriate balance between index-linked and conventional gilts going forward.*
- **Budget**: *The government is reducing its inflation exposure by looking to reduce the proportion of index-linked issuance in a measured fashion over the medium-term.*

NS&I has announced that, in line with successive government's reduction in the use of RPI, index-linked Saving Certificates entering a new term from May 2019 will receive interest based on CPI rather than RPI.

Lessons from UK Experience

- **It is possible to be open about fiscal risks without losing market or public confidence (may even improve)**
- **Fiscal stress testing can yield some novel and striking insights about the scale and sources of fiscal vulnerability**
- **Outsourcing fiscal risk disclosure and analysis to a fiscal council can enhance credibility, comprehensiveness and accountability**
- **Measuring progress in reducing overall fiscal exposure remains a challenge (for OBR's Fiscal Risks Report 2019)**

Thank You!

OBR's Fiscal Risks Report 2017:

<https://obr.uk/frr/fiscal-risk-report-july-2017/>

HM Treasury's Managing Fiscal Risks 2018:

<https://www.gov.uk/government/publications/managing-fiscal-risks-government-response-to-the-2017-fiscal-risks-report>