



Important Notice: The circumstances in which this publication has been produced are such that it is not appropriate to characterise it as independent investment research as referred to in MIFID and that it should be treated as a marketing communication even if it contains a research recommendation. This publication is also not subject to any prohibition on dealing ahead of the dissemination of investment research. However, SG is required to have policies to manage the conflicts which may arise in the production of its research, including preventing dealing ahead of investment research.

The 100Y gilt: The Chancellor agrees

julian.wiseman@sgcib.com

Key points:

The Chancellor of the Exchequer, whilst on a plane to the USA, seems to have briefed journalists on the possibility of a 100Y gilt.

Hurray: in December 2011 SocGen advised that the UK issue a 100Y ([Please, only one more long](#)).

"if in the next decade there is to be another long conventional gilt, we hope that the authorities choose a maturity of Monday 7th December 2111."

But the press has reports on the possibility of a perpetual: please don't.

We also hope that in the general enthusiasm for a new properly-long, the authorities do not forget semi-strippability.

for political gain, and perhaps just for the enjoyment of the continuation of history.

So this press briefing should be seen as mostly pre-Budget self-promotion. Expect to hear in the Budget speech on 22 March much about how the Conservative's (or maybe the Coalition's) austerity has allowed low long yields, whereas the Opposition's plans, of course described as foolish, would have been worse. Politics, continued.

So these releases were not aimed at the technical folks in the gilt market. Nonetheless we have to work with what we have.

Perpetuals: please no

■ The press mentions the possibility of a new perpetual. Perhaps this idea comes from people in Her Majesty's Treasury who are more familiar with history than with modern fixed-income markets.

① The FT gilt indices include War Loan, and so would probably include a new perpetual. But the JPM indices do not; nor do most others. So the DMO should not issue a new perpetual.

② Further, not all investors' systems can cope with non-standard payment structures. So the DMO should not issue a new perpetual.

③ Callable or non-callable? A callable gilt entails investors selling an option to HMT. With modern risk-management, and credit-crisis risk-aversion, the sale price would be much lower. So the DMO should not issue a new perpetual.

④ But a non-callable perpetual is also a problem. Eventually, after a century or a few centuries, the DMO would still be making lots of small payments for a gilt that has become irrelevantly small. So, as this author has [previously written](#), "perpetuals would be better with a 'sunset clause', the easiest example of which is for them to mature – but only eventually, not soon." Of course, this wouldn't really be a perpetual.

Indeed, the Dutch example is a warning. There are outstanding DSL perpetuals, and the DSTA has an ongoing repurchase programme to tidy this corner of the market. (There was also a campaign, from 1996 to 1 April 2006, to convert outstanding bearer bonds to registered form, with non-registered bonds then being cancelled.)

So if HMT wants a 'perpetual', it should issue a 200Y. But not an actual gilts-are-forever all-carbon perpetual.

Consultation as experiment

■ It may well be that the DMO believes that UK investors would not buy (much of) a gilt longer than 100Y.

The Press

■ The UK authorities have heard SocGen's request for a very long gilt. But a bad idea has been added to the mix; and a good one not mentioned.

The UK press has been covering the possibility of a new 100Y gilt.

[The Financial Times](#): *The UK chancellor aims to launch an "Osborne bond" – a 100-year debt issue or even a perpetual gilt that never matures – to take advantage of the country's historically low interest rates.*

[BBC](#): *The new plan is looking at issuing bonds with a 100-year repayment date, or even longer. In his Budget next week, Chancellor George Osborne will announce that he will consult on creating a new "super-long" gilt that could even be issued with no set redemption date.*

[The Telegraph](#): *Britain is to offer 100-year gilts, meaning current Government borrowing will not be repaid until the next century, under a radical plan to be unveiled by George Osborne in next week's budget. ... A Treasury source said tonight: "This is about locking in for the future the tangible benefits of the safe haven status we have today. The prize is lower debt interest repayments for decades to come. ..."*

The annual UK Budget is both an economic event and a political event. It is rich with traditions—it is the only time that alcohol may be drunk in the chamber of the House—and each Chancellor of the Exchequer uses these traditions

Fixed Income & Forex Research

Nonetheless, the DMO's consultation should ask about longer gilts, in particular 150Y and 200Y maturities.

If the investors reply as we believe the DMO believes, then fine, the DMO can be pleased that the DMO so-well understands investor preferences. But if the investors are keener on post-century gilts, then fine, the DMO can be pleased that something important was learnt. So we very much hope that the consultation will invite comment on maturities far beyond the DMO's current comfort zone.

Rephrased, a well-designed experiment allows the possibility of learning something new. Please do not excessively restrict the range of possible maturities: the DMO's questions should stretch to 200Y, even if the DMO expects the longer maturities to be too long.

Indeed, the list of candidate maturities should include precise maturity dates, in case there is unexpected reasoning about the minutiae. This list might include Fri 07 Jun 2086; Mon 07 Dec 2111; Wed 07 Dec 2112; Mon 07 Dec 2161; and Fri 07 Jun 2211. (The last of these admits the nickname "last orders"; not a reason not to consider it.)

Semi-strippability

■ The author has been advocating semi-strippability to the DMO for ages: for example see [Please, only one more long](#) of December 2011, or [Issuance of ultra-long gilts](#) of Jan 2005. So some readers might wish to skip this section.

A June 2111 coupon strip would have a price of about £4.74. So £100 cash would buy £2110 nominal, which would require stripping about £0.13m nominal of a 3Q2111. There is no realistic bid-ask spread on £100 cash that can pay for that balance sheet usage.

And it isn't even what a client wants in a long strip. Really, the purpose of a long strip is to be a non-derivative low-cash high-duration higher-convexity instrument.

So instead, or in addition, the DMO should make the new very-long gilt semi-strippable. That is, it should be strippable into two pieces, an 'annuity' comprising the coupons up to end-2037, and a '2038+ talon', comprising all the payments beyond.

Such a talon would have about 40% of the PV; about 79% of the DV01, so a Macaulay-Weil duration of almost 56 years; and about 94% of the convexity, so a Macaulay-Weil convexity-per-cash of 3695 years² (compared to the 4%60's 774 years²).

Why 2037?

Why is the annuity to the end of 2037, and the talon 2038+?

The objective is that an investor putting £1m into one part, does not leave a GEMM with very much of the other. If the PV split were ninety-ten, then a purchase of the 'ten' part would leave the dealer with nine times as much of the other. Not so good.

So a PV split something like fifty-fifty would be ideal.

But there is drift. As coupons are paid the PV of the annuity drops; but the PV of the talon does not lose payments until after the annuity has ceased to exist (and the talon merged into the gilt).

So making the annuity slightly larger means that over the next decade it will approximately average a price similar to that of the talon. Hence the chosen split of about sixty-forty, which does not have to be precise. (And there is ease of nomenclature in not splitting a calendar year.)

Later, the DMO might make the 2038+ talon sub-strippable into a forward-starting annuity, perhaps of about 15Y, and a longer talon (e.g., perhaps 2053+). But this decision would be for later.

That fulfils the purpose of stripping, without destroying dealers' balance sheets. And would cost the DMO approximately zero to do.

But what trade?

■ The above is a recommendation to the UK DMO. What of the investor?

The yield spread 3¾ July 2052 → 4% Jan 2060 is now about -5bp, only 0.5bp less inverted since yesterday's close. But the longest-gilt premium of the 4%60 will surely lessen, later if not sooner. Investors should switch shorter from the 4%60, DV01-neutral.

The cash-constrained must switch shorter and longer. We recommend switching, cash- and DV01-neutral, from the 4¼ Dec 2046 and 4%60 into the 3T52.

There will be further comment on this trade in the *Fixed Income Weekly*, to be published on Thursday.

CROSS ASSET RESEARCH – FIXED INCOME & FOREX GROUPS

Global Head of Research



Patrick Legland
(33) 1 42 13 97 79
patrick.legland@sgcib.com

Head of Fixed Income Strategy



Vincent Chaigneau
(33) 1 42 13 30 53
vincent.chaigneau@sgcib.com



Alberto Brondolo
(44) 20 7676 7510
alberto.brondolo@sgcib.com



Patrick Gouraud
(1) 212 278 7671
patrick.gouraud@sgcib.com



Fidello Tata
(1) 212 278 6213
fidello.tata@sgcib.com



Christian Carrillo
(81) 3 5549 5626
christian.carrillo@sgcib.com



Ciaran O'Hagan
(33) 1 42 13 58 60
ciaran.ohagan@sgcib.com



Julian Wiseman
(44) 20 7676 7342
julian.wiseman@sgcib.com



Jean-David Crotteau
(33) 1 42 13 72 52
jean-david.crotteau@sgcib.com



Adam Kurpiel
(33) 1 42 13 63 42
adam.kurpiel@sgcib.com



Takuma Sugawara
81-3-5549-5432
takuma.sugawara@sgcib.com



Wee-Khoon Chong
(852) 2166 5462
wee-khoon.chong@sgcib.com



Jose Sarafana
(33) 1 42 13 56 59
jose.sarafana@sgcib.com

Head of Foreign Exchange



Kit Jukes
(44) 20 7676 7972
kit.jukes@sgcib.com



David Deddouche
(33) 1 42 13 56 22
david.deddouche@sgcib.com



Sébastien Galy
(1) 212 278 7644
sebastien.galy@sgcib.com



Olivier Korber (Derivatives)
(33) 1 42 13 32 88
olivier.korber@sgcib.com



Lauren Rosborough
(44) 20 7676 7878
Lauren.rosborough@sgcib.com

Head of Emerging Markets Strategy



Benoît Anne
(44) 20 7676 7622
benoit.anne@sgcib.com



Gaëlle Blanchard
(44) 20 7676 7439
gaelle.blanchard@sgcib.com



Esther Law
(44) 20 7676 7396
esther.law@sgcib.com



Guillaume Salomon
(44) 20 7676 7514
guillaume.salomon@sgcib.com

Technical analysis



Hugues Naka
(33) 1 42 13 51 10
hugues.naka@sgcib.com



Fabien Manac'h
(33) 1 42 13 88 35
fabien.manach@sgcib.com

ANALYST CERTIFICATION

Each author of this research report listed on the cover hereby certifies that the views expressed in the research report accurately reflect his or her personal views, including views about subject securities or issuers mentioned in the report, if any. No part of his or her compensation was, is or will be related, directly or indirectly to the specific recommendations or views expressed in this report.

The information herein is not intended to be an offer to buy or sell, or a solicitation of an offer to buy or sell, any securities or other financial instrument and including any expression of opinion, has been obtained from or is based upon sources believed to be reliable but is not guaranteed as to accuracy or completeness although Société Générale ("SG") believe it to be fair and not misleading or deceptive. SG, and their affiliated companies in the SG Group, may from time to time deal in, profit from the trading of, hold or act as market-makers or act as advisers, brokers or bankers, in relation to the securities, or derivatives of persons, firms or entities mentioned in this publication, or be represented on the board of such persons, firms or entities. Employees of SG, and their affiliated companies in the SG Group, or individuals connected to them may from time to time have a position in or be holding any of the investments or related investments mentioned in this publication. SG and their affiliated companies in the SG Group are under no obligation to disclose or take account of this publication when advising or dealing with or for their customers. The views of SG reflected in this publication may change without notice. To the maximum extent possible at law, SG does not accept any liability whatsoever arising from the use of the material or information contained herein. Dealing in warrants and/or derivative products such as futures, options, and contracts for differences has specific risks and other significant aspects. You should not deal in these products unless you understand their nature and the extent of your exposure to risk. This publication is not intended for use by or targeted at retail customers. Should a retail customer obtain a copy of this report they should not base their investment decisions solely on the basis of this document but must seek independent financial advice.

The financial instrument discussed in this report may not be suitable for all investors and investors must make their own informed decisions and seek their own advice regarding the appropriateness of investing in financial instruments or implementing strategies discussed herein. The value of securities and financial instruments is subject to currency exchange rate fluctuation that may have a positive or negative effect on the price of such securities or financial instruments, and investors in securities such as ADRs effectively assume this risk. SG does not provide any tax advice. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. Investments in general and derivatives in particular, involve numerous risks, including, among others, market, counterparty default and liquidity risk. Trading in options involves additional risks and is not suitable for all investors. An option may become worthless by its expiration date, as it is a depreciating asset. Option ownership could result in significant loss or gain, especially for options of unhedged positions. Prior to buying or selling an option, investors must review the "Characteristics and Risks of Standardized Options" at <http://www.optionsclearing.com/publications/risks/riskchap.1.jsp>.

CONFLICTS OF INTEREST

This research contains the views, opinions and recommendations of Société Générale (SG) analysts and/or strategists. Analysts and/or strategists routinely consult with SG sales and trading desk personnel regarding market information including, but not limited to, pricing, spread levels and trading activity of a specific fixed income security or financial instrument, sector or other asset class. Trading desks may trade, or have traded, as principal on the basis of the analyst(s) views and reports. In addition, analysts receive compensation based, in part, on the quality and accuracy of their analysis, client feedback, trading desk and firm revenues and competitive factors. As a general matter, SG and/or its affiliates normally make a market and trade as principal in fixed income securities discussed in research reports.

Notice to French Investors: This publication is issued in France by or through Société Générale ("SG") which is authorised and supervised by the Autorité de Contrôle Prudentiel and regulated by the Autorité des Marchés Financiers.

Notice to U.K. Investors: This publication is issued in the United Kingdom by or through Société Générale ("SG"), London Branch. Société Générale is a French credit institution (bank) authorised and supervised by the Autorité de Contrôle Prudentiel (the French Prudential Control Authority). Société Générale is subject to limited regulation by the Financial Services Authority ("FSA") in the U.K. Details of the extent of SG's regulation by the FSA are available from SG on request. The information and any advice contained herein is directed only at, and made available only to, professional clients and eligible counterparties (as defined in the FSA rules) and should not be relied upon by any other person or party.

Notice to Polish Investors: this publication has been issued in Poland by Societe Generale S.A. Oddzial w Polsce ("the Branch") with its registered office in Warsaw (Poland) at 111 Marszałkowska St. The Branch is supervised by the Polish Financial Supervision Authority and the French "Autorité de Contrôle Prudentiel". This report is addressed to financial institutions only, as defined in the Act on trading in financial instruments. The Branch certifies that this publication has been elaborated with due diligence and care.

Notice to US Investors: SG research reports issued by non-US SG analysts or affiliates on securities are issued solely to major US institutional investors pursuant to SEC Rule 15a-6. Any US person wishing to discuss this report or effect transactions in any security discussed herein should do so with or through SG Americas Securities, LLC to conform with the requirements of US securities law. SG Americas Securities LLC has its registered office at 1221 Avenue of the Americas, New York, NY, 10020. (212) 278-6000.

Notice to Canadian Investors: This publication is for information purposes only and is intended for use by Permitted Clients, as defined under National Instrument 31-103, Accredited Investors, as defined under National Instrument 45-106, Accredited Counterparties as defined under the Derivatives Act (Québec) and "Qualified Parties" as defined under the ASC, BCSC, SFSC and NBSC Orders.

Notice to Singapore Investors: This publication is provided in Singapore by or through Société Générale ("SG"), Singapore Branch and is provided only to accredited investors, expert investors and institutional investors, as defined in Section 4A of the Securities and Futures Act, Cap. 289. Recipients of this publication are to contact Société Générale, Singapore Branch in respect of any matters arising from, or in connection with, the publication. If you are an accredited investor or expert investor, please be informed that in SG's dealings with you, SG is relying on the following exemptions to the Financial Advisers Act, Cap. 110 ("FAA"): (1) the exemption in Regulation 33 of the Financial Advisers Regulations ("FAR"), which exempts SG from complying with Section 25 of the FAA on disclosure of product information to clients; (2) the exemption set out in Regulation 34 of the FAR, which exempts SG from complying with Section 27 of the FAA on recommendations; and (3) the exemption set out in Regulation 35 of the FAR, which exempts SG from complying with Section 36 of the FAA on disclosure of certain interests in securities.

Notice to Hong Kong Investors: This report is distributed in Hong Kong by Société Générale, Hong Kong Branch which is licensed by the Securities and Futures Commission of Hong Kong under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO"). This publication does not constitute a solicitation or an offer of securities or an invitation to the public within the meaning of the SFO. This report is to be circulated only to "professional investors" as defined in the SFO.

Notice to Japanese Investors: This publication is distributed in Japan by Societe Generale Securities (North Pacific) Ltd., Tokyo Branch, which is regulated by the Financial Services Agency of Japan. This publication is intended only for the Specified Investors, as defined by the Financial Instruments and Exchange Law in Japan and only for those people to whom it is sent directly by Societe Generale Securities (North Pacific) Ltd., Tokyo Branch, and under no circumstances should it be forwarded to any third party. The products mentioned in this report may not be eligible for sale in Japan and they may not be suitable for all types of investors.

Notice to Australian Investors: This publication is issued in Australia by Société Générale (ABN 71 092 516 286) ("SG"). SG is regulated by APRA and ASIC and holds an AFSL no. 236651 issued under the Corporations Act 2001 (Cth) ("Act"). The information contained in this publication is only directed to recipients who are wholesale clients as defined under the Act.

<http://www.sgcib.com>. Copyright: The Société Générale Group 2012. All rights reserved.

This publication may not be reproduced or redistributed in whole in part without the prior consent of SG or its affiliates.