



The IFS Green Budget Fiscal Vulnerability: A Stock-take

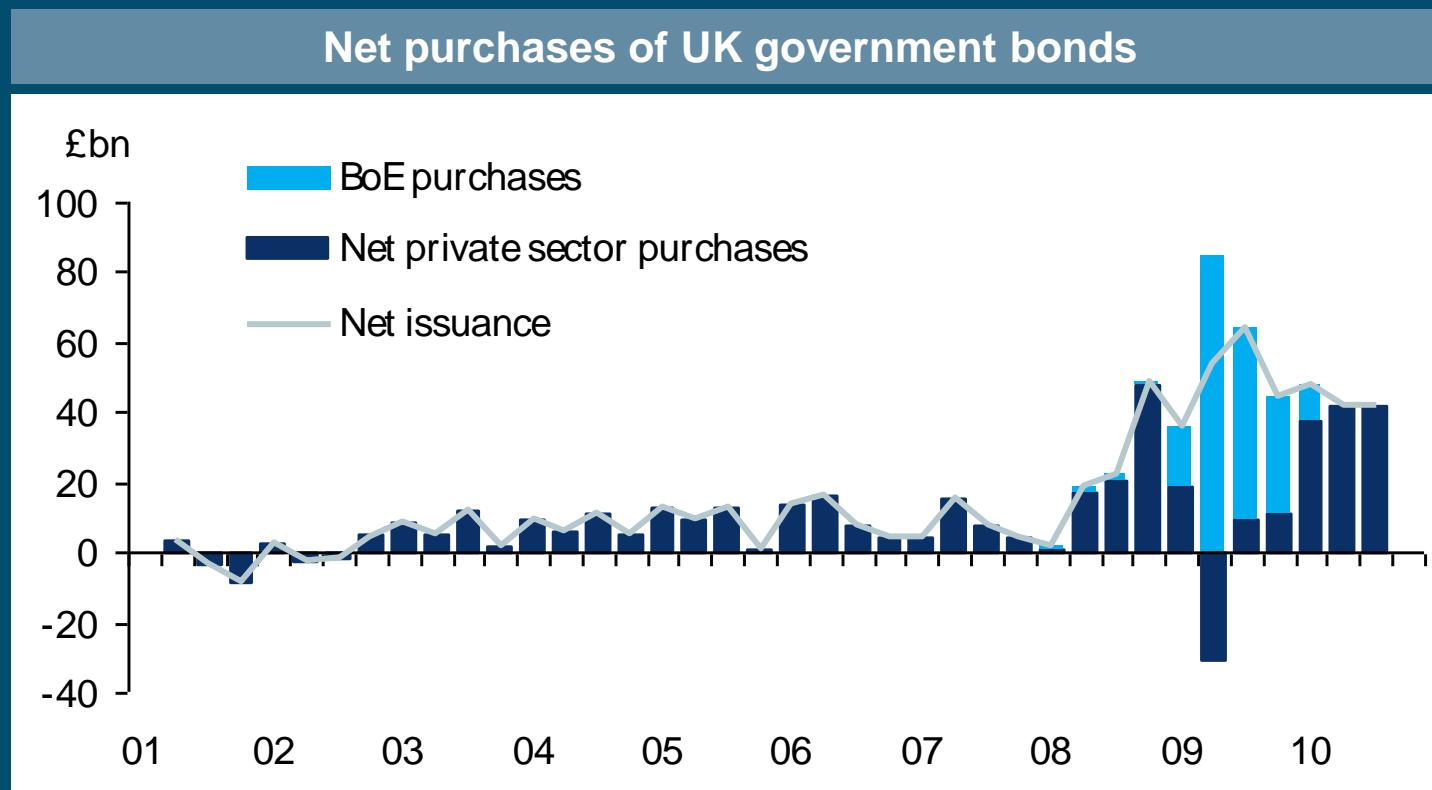
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There has been little sign of stress in the gilt market

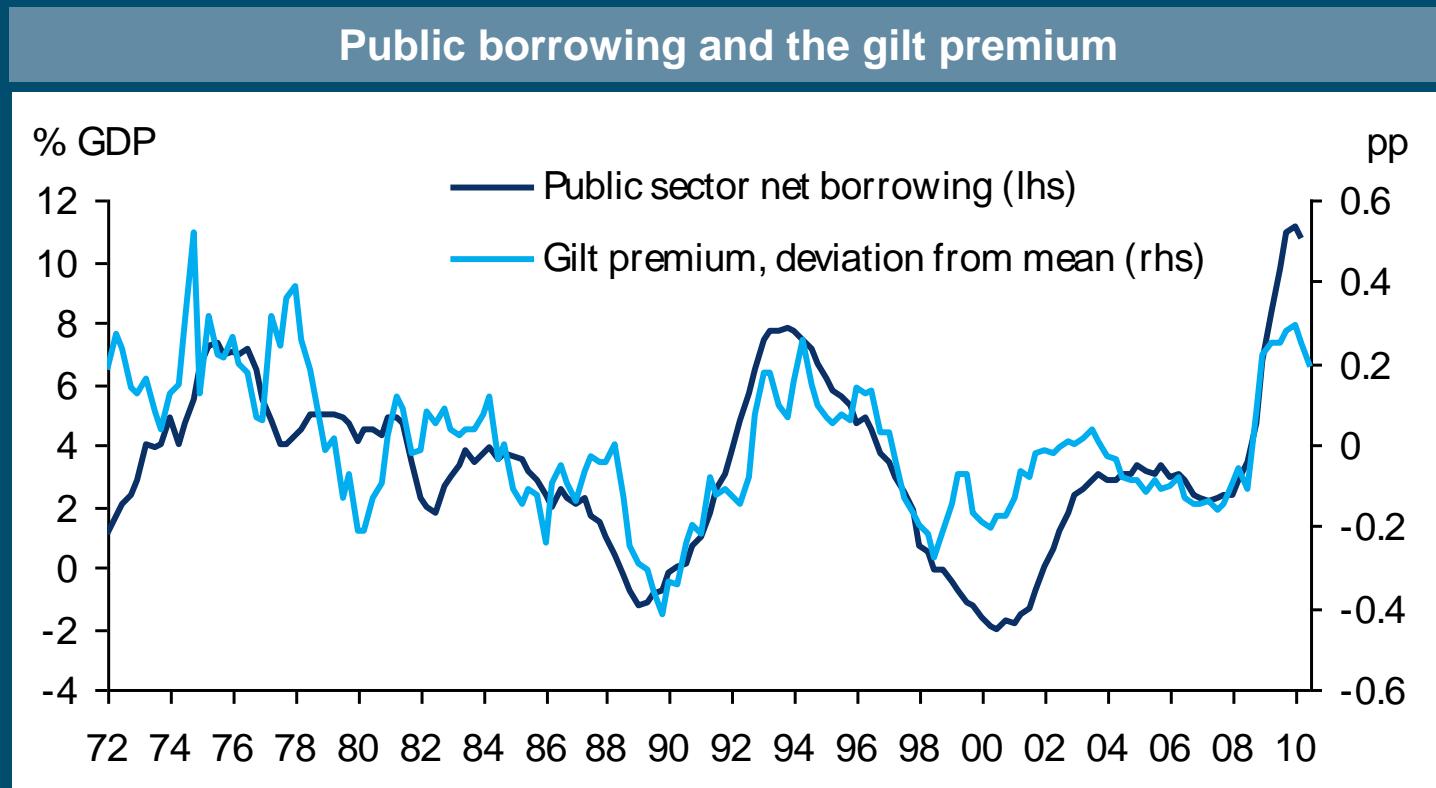
- A year ago there were concerns that private investors might not fill the void left by the cessation of the Bank of England's QE purchases
- However, private investors, including foreign investors, have increased their gilt purchases



Source: Haver Analytics, Barclays Capital

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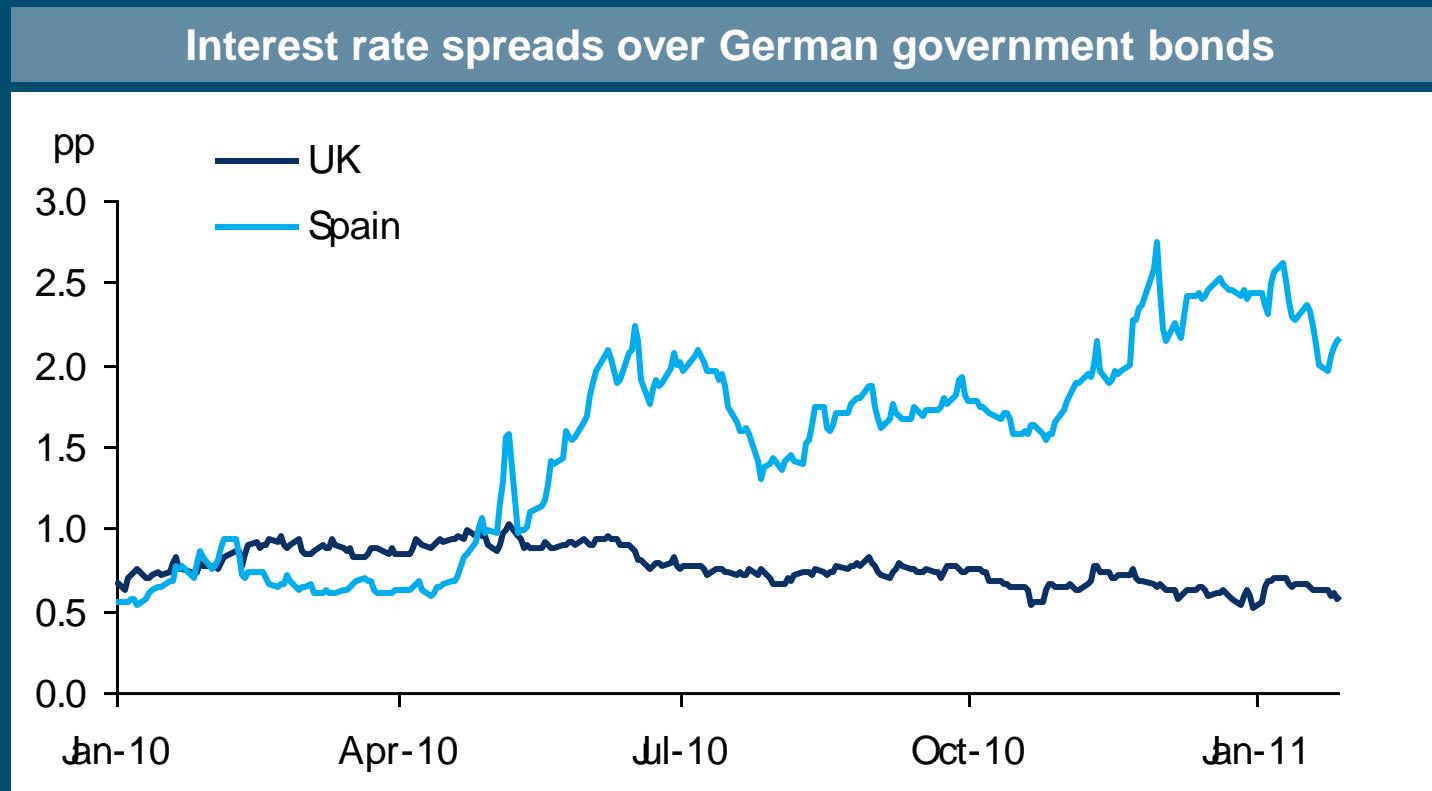
- Concerns about government solvency have added a small premium to gilt yields
- Gilt auctions have been orderly



Source: Haver Analytics, Barclays Capital

Past calm is no guarantee of future tranquility...

- Prior to May 2010, the UK and Spanish governments faced similar borrowing costs
- Spain now pays around 1.5pp more for 10-year borrowing



Source: Barclays Capital

The Barclays Capital Fiscal Vulnerability Index

- We identify 16 measures of fiscal vulnerability, covering
 - Solvency
 - Government financing needs
 - External financing dependence
 - Financial sector health
 - Institutional strength
- The UK ranks 32nd out of 57 countries in terms of fiscal soundness, close to Japan and the US and ahead of France
- The UK's middling score is the average of some strong positives and some large negative scores

The UK's fiscal strengths and vulnerabilities

- Strengths
 - The longest average debt duration of any country
 - Nearly all debt denominated in sterling
 - Institutional strength
- Vulnerabilities
 - The large deficit and implied debt dynamics
 - External debt

The balancing act

Risk of financial crisis

Social hardship



- How much social hardship is the UK willing to undergo to reduce the chance of a financial crisis?
 - Largely a matter of social choice, not economics

- Economic risks
 - Under the Barclays central scenario the fiscal mandate is not met
 - The Bank of England may not be well-placed to provide additional support

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