

26th January 2025

The ONS should add 'Bank of England' on to the national debt, not deduct it

Foreword

This paper is about the £200 billion deduction that the Office for National Statistics ('ONS') makes to the national debt, reducing its initial measure of 'Public sector net debt'. The deduction is unjustified and supplies a stepping stone and unjustified legitimization for Labour to introduce a new and even lower measure of the national debt, called 'Public sector net liabilities'. In reality an amount should be added on for 'Bank of England', not deducted.

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Bob's most recent report was entitled 'Rachel Reeves – stripping away the jargon', and correctly identified the policies that a new Labour administration would enact, and which are leading the UK into an economic and financial disaster: <https://www.lyddonconsulting.com/rachel-reeves-stripping-away-the-jargon-the-full-analysis-of-the-2024-mais-lecture/>

Executive Summary

The UK's voters are being gaslit by the authorities about the size of the national debt, and about the breathing-room for further borrowing.

The Office for National Statistics ('ONS') publishes the anchor figure for the UK's debt, which up until the October 2024 Budget was measured as 'Public sector net debt'. The ONS stated this to be 97.5% of the UK's Gross Domestic Product ('GDP') at the time of the Budget. It then backed out a substantial number for 'Bank of England', lowering the apparent debt to 90.2% of GDP.

Off the back of that Labour have announced a new measure for the UK's debt, which is 'Public sector net liabilities' and it came out at the end of October as only 83.7% of GDP¹, 6.5% lower than 'Public sector net debt with Bank of England backed out' and 13.8% lower than the ONS' 'Public sector net debt'.

There is a race on to gaslight the voters by understating the national debt, meaning the amount of money that the UK's authorities have signed us up to paying.

The reality is that an amount regarding 'Bank of England' should not be backed out but added on. Indeed, the programme to which the ONS 'largely' attributes the backed-out figure – the Bank of England's Quantitative Easing programme or 'QE' – contains a latent loss of £160 billion if the Bank of England (the 'Bank') sells the assets in the programme, and £195 billion if the Bank holds the assets until their maturity.

Either loss will be met by HM Treasury. In fact the loss has been ongoing for some time, and the government has been forced to regularly issue new debt to reimburse the Bank's losses.

When one starts to make adjustments for 'Bank of England', there is a case for going further and adding the Bank's entire funding from third-parties to the UK's debt.

If one does that, one would not be looking at a national debt of 83.7% of GDP (Public sector net liabilities), or 90.2% (Public sector net debt with Bank of England backed out) or 97.5% (Public sector net debt), but something as high as 140%, depending upon which elements in the Bank's accounts one chooses to include, and what might be eligible for netting off.

Set against that, the ONS' 90.2% of GDP for 'Public sector net debt with Bank of England backed out' is a non-starter, which means that Labour's 'Public sector net liabilities' at 83.7% is a dangerous fantasy.

¹ The figure given by the ONS is £2,394.3 billion

Background

The ONS issues a monthly report on the UK public finances. The one used behind this paper is for October 2024, issued on 21st November 2024.²

The ONS' figures for the national debt are explained as excluding the small shareholding in NatWest, as if this were a major issue. The ONS devotes many column inches to NatWest and the other banks that were taken into public ownership when they collapsed in 2007-9, during Labour's previous term-of-office. Only this small stake in NatWest remains, and it is less than 0.2% of the national debt. There is no longer any sense in its being mentioned other than in a list of assets to be considered for offsetting against the UK's debt.

The inflated significance accorded to the NatWest shareholding has the effect of obfuscating the issue of the treatment of the much larger figure for 'Bank of England'. They are similar in neither nature nor scale.

The ONS' narrative is that the £200 billion difference is 'largely' attributable to the Bank's Quantitative Easing ('QE') programme, which the Bank also calls its Asset Purchase Facility or APF.

The 'Bank of England' deduction is £197 billion if one uses the 7.3% of GDP stated by the ONS and a GDP figure of £2.7 trillion, the GDP figure we use consistently in this paper.

The £2.7 trillion figure assumes that there has been no economic growth in 2024. This tallies with the ONS' monthly estimates of the development of GDP during 2024, which now – after revisions – show no growth in Q1, a mild expansion of less than 1% in Q2, flat again in Q3 with September going downwards, and now October going downwards as well.

That is the derivation of a 'Bank of England' figure of £197 billion. By contrast the ONS gives two figures for 'Bank of England' for the same date at the end of October - £204 billion and £210 billion - while maintaining that the figure is 7.3% of GDP. It is clearly concerning that the ONS should state two figures. Furthermore these figures infer that GDP at the end of October was running at either £2.795 trillion per annum or at £2.877 trillion, expansions compared to 2023's £2.700 trillion of 3.5% and 6.6% respectively. These figures are strongly discordant with the monthly ONS figures for GDP.

In order not to make a major issue out of what the exact 'Bank of England' figure is, we have used a round amount of £200 billion in the remainder of this paper. This is the figure we will be searching for, along with a solid rationale for its being reversed out of the national debt. Absent either of both of those, it does not matter if it is £197 or £200 or £204 or £210 billion.

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<https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/october2024> accessed on 10/12/24

Section 1 – what is the NatWest deduction and what is the Asset Purchase Facility

NatWest shareholding

We can deal with the NatWest shareholding in short order. It is the last residue of the bank bailouts when several UK banks were taken into public ownership during the UK's version of the Global Financial Crisis of 2007-8, in the final years of the last term of a Labour government.³

Now that most of the shareholdings have been sold off, only an 11% holding of the voting share capital of NatWest Group remains, NatWest being the successor of the bailed-out Royal Bank of Scotland.

The shares appear to be worth about £3.5 billion – 0.13% of the UK national debt.⁴

Had the shareholding still been a majority, as it was when the shares were acquired in 2008-9, there would have been a question of the entire NatWest balance sheet being consolidated into the UK national debt, even though the debts on the NatWest balance sheet were not direct debts of the UK public sector.

There is no question of a need for consolidation now, so the shareholding in NatWest should be treated like any other public asset.

It is worth noting that the explanation by NatWest of the steps in the reduction of the shareholding contains some anomalies.⁵ The reduction from 37.97% to 11% is explained in steps that reduce it to 24.88%, not 11%. This could be due to an inadequate explanation, but there remains the chance that the shares are worth £7.89 billion. That is troubling, but the issue remains an insignificant adjustment to the national debt, of 0.29% of GDP, and not meriting the length of explanation accorded to it by the ONS.

Indeed, any amount below £15 billion or ½% of GDP is trivial in the grand scheme and within the range of normal statistical error.

Materiality of £200 billion and what the Asset Purchase Facility is

£200 billion, though, is a material difference. The ONS' narrative is that the £200 billion difference is 'largely' attributable to the Bank's Quantitative Easing ('QE') programme, which the Bank also calls its Asset Purchase Facility or APF.

The APF is run as a separate fund and contains only 'gilts' – UK government fixed-interest bonds.

The money used to buy the bonds into the APF has been borrowed by the Bank from banks and building societies (known collectively as credit institutions). The balances sit on the 'Reserve Accounts' that credit institutions are obliged to hold at the Bank. All of that amount is a liability of the Bank, and the Bank is part of the UK 'Public sector'.

³ The bailouts involved Northern Rock, Bradford and Bingley, Royal Bank of Scotland and Lloyds, the latter brought low by its ill-advised acquisition of Halifax-Bank of Scotland. Further ex-building societies in Labour areas went under but were acquired by other financial institutions (such as Alliance and Leicester by Santander), or merged (such as Britannia with Cooperative Bank)

⁴ The most recent transaction quoted by NatWest itself was the sale of a block of 263 million shares representing a stake of '3.16% of the issued ordinary share capital (excluding treasury shares) and reduced the holding of HM Treasury to 11.34% of voting rights'. The price-per-share was £3.81 meaning that the block was traded at £1.00 billion, and the residual 11% stake was worth £3.49 billion

⁵ <https://investors.natwestgroup.com/share-data/equity-ownership-statistics.aspx> accessed on 10/12/24

The Bank is not entirely clear in its documentation as to whether the amount borrowed from these credit institutions exceeds the obligatory Minimum Reserves that these credit institutions must hold on their Reserve Accounts at the Bank, and if it does, by how much. Credit institutions would normally be free to withdraw the excess, but not the base of Minimum Reserves. This base would normally only be made accessible to them in stressed market conditions, and through one of the Bank's liquidity schemes.⁶

In the Bank's 2015 Annual Report (p. 98) these deposits totalled £318 billion when the loan to the APF (Note 11, p. 117) was £375 billion. In the meantime the amount of the APF tripled before falling back to its level of double now, and the deposits were boosted to match. Did the Bank increase the obligatory Minimum Reserves so as to raise the funding – under duress – from credit institutions? Is this what the Bank means by the phrase 'creating reserves', which is part of the ONS' narrative and which is examined further in the next-following section?

The credit institutions' deposits sit on the balance sheet of the Bank's Banking department, which makes the loan to the APF for the entirety of the money the APF needs. The APF has no other source of funding.

The amount of deposits from credit institutions exceeds the APF's needs by £66 billion: this amount is used to part-fund the Term Funding scheme, under which the Bank lends to credit institutions and those credit institutions on-lend to Small and Medium-Sized Enterprises. In doing this the Bank lends credit institutions their own money back. It is questionable – but outside the scope of this paper – whether the Bank adds value by doing that.

The balance of the Term Funding scheme now is £117 billion, whilst the APF balance is £659 billion and the amount borrowed from credit institutions £725 billion.

The Bank uses £66 billion of credit institution money – or 9% of it - for the Term Funding scheme, and 91% of it to fund the APF.

What sits inside the APF?

The APF's portfolio now consists entirely of gilts and ones that have fallen sharply in value since the Bank bought them.

That creates a large latent loss if the Bank sells the gilts now and all at once, and an even larger loss if the Bank holds them until maturity and the current constellation of interest rates does not move in the Bank's favour: interest rates must come down if the loss is to be reduced.

⁶ Global central banks have coordinated many areas of bank regulation through the Bank for International Settlements in Basel, but central banks retain considerable latitude in the area of determining levels of Minimum Reserves for the banks over which they discharge prudential regulation. The BIS publishes guidance on this issue and other monetary policy issues on <https://www.bis.org/mc/elements.htm> and it is elements 4 ('Reserve requirements: ratios and size') and 5 ('Main features of reserve requirements') which relate to Minimum Reserves

The daily loss on holding the gilts is around £53 million.⁷ That equates to £19.5 billion per annum and £194.8 billion over the life of the gilts, which is 10 years on average according to the Asset Purchase Facility annual report.

The daily loss is real but not immediate; the lump-sum loss is latent but immediate - if it were to materialise, it would be now. Either way an addition some kind to 'Public sector net debt' needs to be considered on account of this.

⁷ On a £659 billion portfolio yielding 1.7946% (as per calculations shown later in this paper) the funding for which costs the Bank Rate of 4.75%: the interest loss is 2.9554%. This loss x £659 billion divided by 365 days gives a daily loss of £53.36 million, equating to £19.5 billion per annum.

Section 2 – ONS explanation of ‘Bank of England’ deduction

ONS table showing ‘Bank of England’

The ONS have issued their ‘public sector finances summary tables appendix final’ Excel spreadsheet and tab PSA9A is entitled ‘Worksheet PSA9A: The Bank of England’s contribution to public sector net debt at nominal value at end of period, UK, not seasonally adjusted [note 126]’.

This should give a clear and joined-up statement of the amount, backed by a robust justification. It does not.

The ONS worksheet row for October 2024 is 182 and there are columns A to R, with column K being ‘Bank of England contribution to public sector net debt (£ million) [note 128]’. Here are the column headings:

Time period	APF liabilities: APF loan (£ million) [note 126] [note 127] [note 131]	Banking and Issue Department liabilities not recognised in public sector net debt (£ million) [note 146]	Banking and Issue Department liabilities not recognised in public sector net debt (£ million) [note 146]	Consolidation of gilt holdings of the Asset Purchase Facility Fund at face value (£ million) [note 122]	Consolidation of gilt holdings of the Banking and Issue Department at face value (£ million) [note 123]	Consolidation of the Banking and Issue Department loans to the Asset Purchase Facility Fund (£ million) [note 143]	Consolidation of the Banking and Issue Department loans to central government (£ million) [note 144]	Banking and Issue Department liquid assets (£ million) [note 118] [note 120]	Cash held within the Asset Purchase Facility Fund (£ million) [note 124] [note 147]	Bank of England contribution to public sector net debt (£ million) [note 128]	Memo item Total asset purchases (£ million) [note 144] [note 127] [note 137]	Memo item Total asset purchases of which, purchases of gilts by the Asset Purchase Facility Fund (£ million) [note 117] [note 138] [note 139] [note 153]	Memo item Total asset purchases of which, purchases of corporate bonds at redemption value by the Asset Purchase Facility Fund (£ million)	Memo item Total asset purchases of which, purchases of corporate bonds at market value by the Asset Purchase Facility Fund (£ million)	Memo item Term Funding Scheme loans (£ million) [note 116]	Memo item Term Funding Scheme SME loans (£ million) [note 115]	Memo item APF gilt holdings: impact on net debt (£ million) [note 145]
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Here are the values in £billion in Row 182, excluding Column A as that indicated October 2024, and with negative numbers in red:

B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R
659	875	5	559	17	659	0	77	12	204	655	655	0	0	0	115	95

The cell K182 contains a figure of £204 billion, but this is not the product of the addition of cells B182 to J182. Cell K182 does not contain a @sum() function, so it is not possible to see what the figure is composed of. In fact the spreadsheet gives the impression of figures having been entered manually and individually.

The cumulative totals of the columns B-J are:

B	C	D	E	F	G	H	I	J
659	1534	1529	970	953	294	294	371	383

The narrative above columns L-R is in each case headed as ‘Memo items’, indicating that they are not to be totalled. Indeed, column R is entitled ‘Memo item APF gilt holdings: impact on net debt’, indicating that the values in this column are a contributor to the values in column K. The title could be read as meaning that this is the sole contribution of the APF to the ONS’ figure for the Bank’s overall contribution to ‘Public sector net debt’. However, the value in that cell R182 is only £95 billion, or 47% of the total contribution of the Bank to ‘Public sector net debt’ in cell K182.

There is no column for the other 53%, or £109 billion. It is not the preceding column of £117 billion, as that relates to the Term Funding scheme.

ONS' narrative about 'Bank of England'

The ONS' current narrative about the offset on account of 'Bank of England' is concerning:

Public sector net debt excluding the Bank of England (BoE) was £2,581.3 billion at the end of October 2024, or around 90.2% of GDP. This is £210.2 billion (or 7.3 percentage points of GDP) less than the wider measure (including the BoE). This difference is largely a result of the BoE's quantitative easing activities, including the gilt-purchasing activities of the Asset Purchase Facility (APF) Fund.

The APF's gilt holding is not recorded directly as a component of public sector net debt. Instead, in October 2024, we recorded the £95.1 billion difference between the £654.5 billion of reserves created to purchase its gilts (at market value at the time of purchase) and their £559.4 billion redemption value.

Firstly, 'Bank of England' was £204 billion according to the spreadsheet, but £210 billion in the narrative, on the same date.

Secondly, if these amounts were 7.3% of GDP in October, it infers that GDP was running at either £2.795 trillion per annum or at £2.877 trillion, expansions compared to 2023's £2.700 trillion of 3.5% and 6.6% respectively. These figures are strongly discordant with the ONS' own monthly estimates of the development of GDP during 2024.

Thirdly, the ONS attributes the amount 'largely' to QE, which must mean well in excess of 50%, but the ONS only gives a justification for 47% of it, or £95 billion.

Fourthly, the explanation of the 47% is not indicative of something that merits offsetting against the national debt. It is the premium 'above par' (i.e. more than the gilts' face value) that the Bank paid to buy the gilts currently in the APF. The Bank has followed the same accounting treatment for this 'asset' as Silicon Valley Bank did for the US Treasury bonds it purchased, which then fell in value causing the bank's collapse. This is to hold them on the balance sheet at the price paid for them, not their face value or market value.

An alternative treatment, which is explained later in this paper, is to split the face value of the gilts from the premium, holding the former at a constant value and depreciating the latter.

In holding a single amount on its balance sheet for the face value of the gilts and the premium combined, the Bank obscures that it has not made an investment in this premium that it will get back: it has paid out this premium and will not get it back. The premium is depreciated by the charging-off of annual amounts as an expense to its Profit and Loss Account.

The Bank's treatment and the alternative treatment have the same outcome: the premium does not have to be recognised in full as an expense in the same accounting period that the bonds were purchased, but pro rata over the bonds' remaining life. The existence of this balance sheet position does not relieve the UK of any debts, rather the opposite: the Bank had to borrow more than the bonds' face value from credit institutions in order to pay the 'above par' premium.

Finally we have the worrying formulation within the phrase ‘the £95.1 billion difference between the £654.5 billion of reserves created to purchase its gilts (at market value at the time of purchase) and their £559.4 billion redemption value’.

This formulation betokens a delusion, namely that when the Bank bought gilts at above par, and had to borrow a larger amount than the gilts’ face value from credit institutions to buy them, it ‘created reserves’. The ONS appears to have become confused by terminology: (i) the extra deposits taken on from credit institutions (possibly under duress) go onto the same account at the Bank as their Minimum Reserves and which is named a Reserve Account: (ii) this is not the same as the Bank owning ‘reserves’, meaning that the Bank booked profits on its business and has that money available to it with which to buy gilts.

Instead the Bank contracted a new liability to third-parties, and has continued to fund the entire APF with that class of liability – overnight deposits from credit institutions.

The ONS appears to have confused what ‘reserves’ are and how they arise: with the HM Treasury indemnity in place, the Bank could never have built up reserves on the back of the APF, as any profits were paid away to HM Treasury, just as any losses are now paid in by HM Treasury.

Section 3 – the Bank’s capital and reserves, and why its debts can be considered as the country’s debts

The Bank’s actual reserves and why it can operate without any

The Bank only had £5.4 billion of capital and reserves on 29th February 2024, to support a balance sheet of £944 billion.

That is a ‘leverage’ (the ratio of assets/capital and reserves) of 175-to-1, whereas the maximum permitted for a credit institution is 33-to-1.^{8 9} The credit institution’s maximum permitted leverage was agreed by global central banks through the offices of the Bank for International Settlements in Basel.¹⁰ The Bank has been a prime mover in the formulation of these Basel Accords, as they are known (and we are now into the third iteration – Basel III).

The Bank can operate like this, effectively without capital and reserves, because it is a public financial corporation, and because its creditors regard the Bank’s debts to them as being debts of the UK taxpayer.

This is an important point when it comes to defining the Bank’s contribution to the UK public debt. The UK public debt is the amount of debt which the owners of the debt have been led to believe is a liability of the UK taxpayer. The government is simply the taxpayers’ collective vehicle for contracting debts for which the taxpayers – businesses and individuals – are responsible. Within that construct the government either owes the money itself, or it backstops debts owed by other debtors in the ‘Public sector’. The understanding of creditors is that the government will bail out these other debtors within the ‘Public sector’ – such as the Bank – if the debtor is unable to service its debts itself. The backstopping process, however it is constructed in detail, is tantamount to a guarantee of those debts in the name of the UK taxpayer.

Backing for the view that the Bank’s liabilities are also the country’s liabilities

This understanding is underpinned by the regulatory treatment of the Bank’s main liability – the Reserve Account balances – by the credit institutions which own them. This treatment is also part of the Basel Accords.

In holding a balance on their Reserve Account, a credit institution has a credit risk that the Bank cannot repay the balance.

The balance ranks as an asset on the credit institution’s balance sheet. The Basel Accords set down the amount of capital that a credit institution must hold as a loss cushion against the credit risk exposure (‘CRE’ in Basel terminology) it runs on each asset it owns.¹¹

⁸ This is the Basel III Leverage Ratio agreed by global central banks through the offices of the Bank for International Settlements, documented in BCBS270 of January 2014

⁹ <https://www.bundesbank.de/en/tasks/banking-supervision/individual-aspects/leverage-ratio-622882> accessed on 14/12/24

¹⁰ <https://bis.org> accessed on 14/12/24

¹¹ The calculation is Nominal Amount of the Asset x the asset’s Risk-weighting > Risk-Weighted Asset (‘RWA’), and then RWA x Minimum Capital Requirement = the amount of capital that a credit institution must hold to account for the credit risk exposure on this particular asset

A balance held on an account at a central bank has a risk-weighting of 0%, where the credit rating of the government (or 'sovereign' in Basel terminology) sitting above the central bank is AA- or better in the Standard and Poor's system (called 'S&P Global Ratings').¹² The UK's rating is AA.

This means that a credit institution requires no capital at all as a loss cushion against its credit risk on its balance on a Reserve Account at the Bank. The asset ranks as risk-free. Para 20.7 of the salient BIS document - 'CRE - Calculation of RWA for credit risk. CRE20 Standardised approach: individual exposures' - states this 0% risk-weighting and justifies it on the basis that the credit risk on a central bank is the same as the credit risk on the sovereign that sits above it. Para 20.7 contains the phrase 'Exposures to sovereigns and their central banks'.¹³ In other words, the risk on the Bank is the same as the risk on the UK itself.

A further proof of the quality of claims on central banks is how they are treated within the Basel Accords that relate to ensuring the liquidity of the financial system in a crisis: 'central bank reserves (including required reserves)' qualify as per para 50(b) of Basel III Liquidity Coverage Ratio of January 2013 as a Level 1 'High Quality Liquid Asset' for the assurance of the liquidity of credit institutions, and with no haircut.¹⁴ 'No haircut' means that the computation made by a credit institution need include no discount between the nominal value of an asset and the asset's value in a liquidity crisis. Because this asset is of the highest quality, it will not lose value in such a crisis.

Creditors of the Bank thus have global backing for regarding their claims on the Bank as being claims on the UK government. This point argues in favour of the entirety of the Bank's liabilities to third-parties being included in the national debt.

The point applies equally to banknotes: they are treated within the Basel III regime as a claim on the government that sits behind the note issuer, which is the central bank. This argues in favour of banknotes being counted into the UK national debt.

¹² <https://www.spglobal.com/ratings/en/> accessed on 16/12/24

¹³ CR20 available from the Bank for International Settlements <https://bis.org> accessed on 14/12/24

¹⁴ BCBS238 also available from the Bank for International Settlements

Section 4 – Reserve Account balances and how they fund the APF

Qualification to treatment of reserves as an available liquid asset

Para 50(b) of BCBS238 contains a proviso about the extent to which reserves can be classed as a liquid asset available to credit institutions: it is ‘to the extent that the central bank policies allow them to be drawn down in times of stress’.

This seems a curious qualification given that the prime purpose of credit institutions holding ‘required reserves’ (a synonym for ‘Minimum Reserves’) is to ensure that they have resources set aside that they can immediately draw upon in a time of such stress. For this purpose the assets must be of the highest credit quality and not be susceptible to a decline in value in times of market stress.

How does the Bank view the level of reserves: dictated by itself or at the behest of credit institutions?

The Bank’s forward view on the amount of these reserves implies that credit institutions’ needs drive their level, and that the Bank is responding to market demand from credit institutions. The Bank states the following on p. 35 of its 2024 Annual Report: ‘Over time, reserves balances, and thus the size of our balance sheet, will fall toward a minimum level that reflects the overall level of reserves demand from the banking sector. As this happens, we expect increased borrowing of reserves across our liquidity facilities’.

This version, and the version whereby the Bank as prudential regulator determines the level of credit institutions’ minimum balances on their Reserve Accounts, cannot both be true.

The Bank’s statement betokens an expectation of the Bank having to lend back to credit institutions a greater portion of their reserves. This again raises the question of how much of credit institutions’ Reserve Account balances are Minimum Reserves and how much is excess reserves that the credit institution is free to draw out at any time. Did the Bank ‘create reserves’ by increasing credit institutions’ Minimum Reserves, and then make facilities available to lend them their own money back? Or do credit institutions voluntarily hold excess reserves because they receive the Bank Rate as credit interest?

Furthermore it raises the issue of how the Bank intends to lend credit institutions their own reserves back when 91% of those reserves are being used to fund the APF.

Is the Bank’s funding for the APF stable?

A further measure in the Basel III regime is Net Stable Funding Ratio.¹⁵ Its aim is to control the degree to which long-term assets can be funded with short-term liabilities. A problem with Net Stable Funding Ratio is that it classifies readily-marketable securities – like gilts – as short-term assets, even if their final maturity is long-term. Net Stable Funding Ratio does not concern itself with losses on market movements but with liquidity. As such it does not stop an institution buying long-term, fixed-interest securities with low yields, and funding them with short-term liabilities on which the interest is variable, as long as the securities are readily-marketable.

This is the exact constellation that Silicon Valley Bank found itself in, having short-term deposits which it had invested in long-term US Treasury bonds.

¹⁵ Basel Committee on Banking Supervision ‘Basel III – the Net Stable Funding Ratio’ of October 2014 and available from <https://bis.org> accessed on 14/12/24

It was firstly having to pay higher interest rates on the deposits as interest rates rose, thereby booking ongoing losses. Secondly, when depositors began to withdraw deposits at a faster-than-expected rate, Silicon Valley Bank had to sell its bonds for a loss to meet the withdrawals, and in doing so depleted its capital below the Basel III minimum.

The Bank is experiencing a daily loss on the difference between the APF yield and the cost of the reserves with which the APF is funded, as was Silicon Valley Bank on the difference between the yield on its US treasury bonds and the rates it was paying on deposits.

The immediate cause of Silicon Valley Bank's demise was not its losses or the depletion of its capital, but its inability to meet the depositors' requests for repayment. A portion of depositors' funds were in fixed term deposits, another portion on notice deposits, and a significant portion on demand.

The Bank's situation is that Reserve Account balances are on current accounts and are available to the depositor on demand. The limitations to this are:

1. that credit institutions are not free to withdraw their Minimum Reserves;
2. that an amount is taken from the Reserve Account at the start-of-business each day to have an opening balance on the credit institution's Settlement Account, which is the one used to settle its payment orders in CHAPS, BACS, Visa, Mastercard, Faster Payments, Cheque and Credit Clearing, CREST and so on. Without such a balance the credit institution would not be able to meet its payment obligations and a logjam would occur in these payment systems.

Against this background is the Bank obliged to meet requests from credit institutions for repayment of their Reserve Account balances:

- In full or in part;
- Under normal, unstressed market conditions and under stressed market conditions;
- With what limitation regarding Minimum Reserves;
- With what limitation regarding the Settlement Account balance given the payment turnover of the credit institution concerned;
- How much of the Reserve Account balances could be withdrawn on any one day and where does that leave the Bank with regard to funding the APF?

What is the Bank's situation? Is its funding for the APF stable or not?

This is a concern because the APF is so large and the amount of funding it needs is 91% of the Reserve Account balances, and because on the face of it the Reserve Account balances are repayable on demand, whereas the assets they funding are long-term, fixed-interest ones.

The Bank is not bound by either Liquidity Coverage Ratio or Net Stable Funding Ratio because it is a central bank, and it can run its business with next-to-no capital and reserves, because:

- It can unload onto HM Treasury and the taxpayer the kind of losses that sent Silicon Valley Bank under;
- It sets the amount of reserves that credit institutions have to deposit with it.

However, if credit institutions are permitted to withdraw their Reserve Account balances in unstressed market conditions, or if they needed to withdraw them in stressed market conditions, how does the Bank then fund the APF?

Section 5 - Accounting issues pertaining to the bonds held in the APF

Accounting for a premium paid over par on a fixed-interest bond, like a gilt

It is worth examining the ONS' explanation of its £95.1 billion figure concerning the amount above par that the Bank has paid for the gilts currently in the APF.

This will demonstrate that the premium is ineligible for offset against the national debt: it is a deferred expense, not an amount of income or a marketable asset, even though it appears on the asset side of the Bank's balance sheet, combined with the face value of the gilts.

The premium is similar to the 'Goodwill' paid when a company makes an acquisition

When a company makes an acquisition of another company, it is rare that it will pay the owners of the target company the exact 'Net Asset Value'. 'Net Asset Value' is the same as 'book value', and is the target company's Assets less its Liabilities. It is the same as its Shareholders Funds – the money attributable to the owners and not owed to anyone else.

If the acquiring company pays 150% of Net Asset Value, it creates an asset called 'Goodwill' on its balance sheet, and allocates the 50% premium into it. The Goodwill amount is depreciated via an annual charge against the Profit & Loss account, to avoid that the entire premium be charged in the year of the acquisition and result in a large loss.

The period over which the Goodwill is depreciated could be lengthy: it is the period over which the target company has value for the acquirer. In the case of Nestlé's acquisition of Rowntree Mackintosh in 1988, the target continues to add value to this day, and the Goodwill could arguably have been depreciated over 50 years, or indeed not depreciated at all.¹⁶ Bonds, though, have a maturity date, which determines the period over which the premium must be depreciated to zero.

How the Bank treats the premium it has paid for its bonds

The Bank's treatment is not uncommon and is the same as Silicon Valley Bank's. An alternative treatment is explained below, after the explanation about how the bonds have come to be traded 'above par' – for an amount greater than the bond's face value - in the first place.

A bond is priced as a percentage of its face value. The 'par' price is 100 – par means the face value. The bond has a fixed annual coupon, indicating the level of interest rates at the time the bond was issued. Interest rates fluctuate during the life of the bond but the coupon on the bond does not. Fluctuating interest rates cause the bond's price to go above or below par. Investors need to have a technique whereby variations in the bond's price above and below par are not treated as capital losses or gains and concentrated into the current financial accounting period, but as part of the yield on the bond, when the bond still has several years to run.

A price 'above par' reflects a situation where interest rates have fallen since a fixed-rate bond was issued: the bond's fixed coupon reflects interest rates at the time of issue, not the lower rates prevailing at this point.

¹⁶ <https://www.icmrindia.org/casestudies/catalogue/Marketing/nestle-s-brand-management-strategies-case.htm> accessed on 26 January 2024

An investor who – like the Bank – buys the bond at this point has to pay above par for it. This gives the Bank as an investor the same yield-to-maturity on their high-coupon bond as pertains to bonds issued now with today's lower coupons.

The same logic applies to bonds issued at whatever point in the past and with whatever coupons. All analogous bonds (same issuer, same general terms and conditions, same time to run until final maturity) on offer in the open market will carry the same yield-to-maturity, whatever the date they were issued and whatever coupon they carry.¹⁷

The price of the bond goes up so that the yield-to-maturity becomes the same lower one as that pertaining to the analogous bonds, including a newly-issued one.

The new bond would offer this same yield-to-maturity, through the combination of a coupon pitched slightly below the yield-to-maturity and a small discount compared to face value.

Simplified example, and how the 'above par' premium is accounted – but not by the Bank

A fifteen-year bond with ten years to run has a coupon of 4%. Analogous seasoned issues with 10 years to run have a yield-to-maturity of 3%. Likewise the yield-to-maturity for a new 10-year bond from the same issuer is 3%, such as with a coupon of 2.95% and a price of 99.50.

The price of the bond with fixed annual coupons of 4% adjusts upwards so that its yield-to-maturity becomes 3%.

The bond now trades at around 110 (a 10% premium over its par value): the investor buys it, paying a price of 110.

Unlike the Bank, our investor accounts for the bond and the premium separately. Our investor books the bond at its par value as an asset into 'Securities in portfolio', and then books the 10% premium as an accrual, a form of asset that is the balance sheet representation of a deferred expense. This deferred expense will definitely materialize if the investor takes no further actions. The accrual recognises an expense that will be put through the Profit and Loss account over a number of financial accounting periods and not just into the present one. If the investor did not do this, they would have to book the entire premium-over-par as a capital loss and straight away.

The accounting result is:

- 'Cash' reduces by 110;
- 'Securities in portfolio' increases by 100;
- An accrual is made of 10 – the premium.

Without the accrual, the organisation's assets would have reduced by 10, and that 10 would have had to be passed through as a loss. No new liability is created through this transaction: the investor swapped cash for two other types of asset.

The fact that this deferred expense is held as an asset does not make it eligible for offset against the national debt. This becomes clear from how the accrual is used.

¹⁷ An issuer's list of bonds already in issue are commonly referred to as its 'seasoned' bonds, to distinguish them from a new issue

How the accrual is used – it is depreciated over the bond’s remaining life

In our simplified example, on the same date each year that the investor receives the 4% annual coupon, they release one tenth of the accrual (1% out of the 10%) and book that as an interest expense.¹⁸ The investor books a 4% interest income and a 1% interest expense, so their net interest income is 3%, which is the yield-to-maturity at which they bought the bond.

Our investor holds ‘Securities in portfolio’ steady at 100, and depreciates the accrual each year by 1. On the maturity date they receive back the final coupon and the capital amount of 100, and release the final amount of the accrual.

The accounting result on that date is:

- The coupon of 4 is received;
- The accrual of 1 is released;
- ‘Securities in portfolio’ reduces by 100;
- ‘Cash’ increases by 104 (not 103, because the accrual is a non-cash accounting adjustment).

If one of the bonds is sold before maturity, the entire remaining accrual connected to that bond has to be reversed out on the sale date. The Bank will do this, as will our investor.

How the Bank’s accounting contrasts to that of our investor

The Bank is carrying out a similar process, but less transparently, because its accrual is combined with the face value of the bonds. The accrual is currently £95.1 billion, and it is being depreciated over the remaining life of its APF bonds.

The substance of this £95.1 billion accrual, how it came to exist, how it gets reduced if a bond is sold or if it is held, contain no rationale for the £95.1 billion to be deducted from the national debt.

The Bank’s holding the bonds at the full price it paid for them and establishing a ‘memo’ account for the accrual has the same economic impact as the bonds’ face value and the accrual being separated, but separation is more transparent. Not separating contributes to the ONS being able to devise this version whereby the accrual is some kind of extra asset or income stream that can be offset against real debts. In actuality the accrual is a pre-paid expense ineligible for offset.

¹⁸ In reality a financial institution investor would perform this operation at least monthly, if not daily

Section 6 – what is the UK’s national debt?

What is the UK’s national debt?

Now we switch attention briefly to what the UK’s national debt is, from which the ONS deducts the £200 billion ‘Bank of England’ offset.

After that we examine in further detail a series of explanations for the offset, and discount all of them.

The UK’s core national debt on 31st October 2024 consisted of gilts and government bills¹⁹ in issue of £2.689 trillion and National Savings and Investments’ customer liabilities of £124 billion.²⁰ That totals £2,813 billion, or 104.2% of UK GDP, if UK GDP is taken to be the same as it was at the start of 2024 - £2.7 trillion.²¹

The ONS’s difficulty in ascertaining the exact size of UK GDP is compounded by their concentrating on percentages rather than on numbers of £sterling.

We noted above that the ONS gave ‘Bank of England’ as £204 billion in their spreadsheet, but as £210 billion in their narrative, and they only offer a narrative for 47% of it, while saying that the amount is ‘largely’ tied up with the APF.

The ONS do not seem to know either what GDP is or what ‘Bank of England’ is. Given these uncertainties on their side, we prefer our own figures.

As at 31st October 2024 the ONS gave two percentages for ‘Public sector net debt’, namely 97.5%, and 90.2% with ‘Bank of England’ backed out.

If we accept that GDP was constant at £2.7 trillion, we can extrapolate the two debt amounts in £sterling from the ONS’ percentages: ‘Public sector net debt’ of £2.632 trillion, and of £2.435 trillion with ‘Bank of England’ backed out.

These figures compare to our figures for core national debt as follows:

Measure	Percentage	Amount
Core national debt	104.2%	£2,813 billion
‘Public sector net debt’ with ‘Bank of England’	97.5%	£2,632 billion
Difference	6.7%	£181 billion

...and with ‘Bank of England’ backed out:

Measure	Percentage	Amount
Core national debt	104.2%	£2,813 billion
‘Public sector net debt’ without ‘Bank of England’	90.2%	£2,435 billion
Difference	14.0%	£378 billion

¹⁹ Government bills are of an original maturity of less than one year; gilts have an original maturity above one year

²⁰ As per their 2024 balance sheet earlier in the year. It is not helpful that the ONS fails to mark out NS&I specifically in its figures, as it is the government’s largest direct borrowing channel after gilts, government bills being around £100 billion

²¹ GDP growth was zero in Q1 2024, and about 0.7% in Q2, but it was then zero in Q3, and fell 0.1% in the final month of Q3 and in October, almost all the figures having retrospectively been revised downwards by the ONS

...and with the two ONS figures compared to one another:

Measure	Percentage	Amount
'Public sector net debt' with 'Bank of England'	97.5%	£2,632 billion
'Public sector net debt' without 'Bank of England'	90.2%	£2,435 billion
Difference	7.3%	£197 billion

The main lessons here are:

- The ONS has been able to find £181 billion to eliminate from the amount of £2,813 billion that is definitely owed by the UK's central government through gilts, bills, and National Savings, in order to come to its figure for 'Public sector net debt';
- The ONS was then able to justify the elimination of a further amount of around £200 billion as 'Bank of England', so as to arrive at its adjusted, far lower figure for 'Public sector net debt';²²
- Our figure for the 'Core national debt' is not even the full amount owed by the UK public sector: it is akin to 'General government gross debt', to which the debts of other public sector entities need to be added on, in order to reach the full figure of 'Public sector gross debt';
- The major difference between 'General government gross debt' and 'Public sector gross debt' lies in the debts of Public financial corporations and Public non-financial corporations;
- This paper deals with the Public financial corporations – the Bank and NatWest (the residue of the bank bailouts during Labour's UK financial crisis);
- The debts of Public non-financial corporations need therefore to be disclosed and added on, so that we have a full figure for 'Public sector gross debt';
- This means that the deduction of £181 billion made by the ONS from our Core national debt to reach their Public sector net debt is not the whole story;
- There is a further debt tranche missing – the debt of Public non-financial corporations – and that means that the ONS' deduction exceeded £181 billion.

²² We use the rounded figure of £200 billion here as opposed to £197 billion, which is the mathematical result of the calculation in the table

Section 7 – which issues this paper will focus on out of the several that have been thrown up

Limitations to the scope of this paper

It is not within the scope of this paper to examine the validity of the £181 billion of eliminations referred to above to get from our core national debt to the ONS' 'Public sector net debt'.

Nor is it within the scope of this paper to assess whether any value has been added by the Bank's Term Funding scheme whereby the Bank lends credit institutions their own money back in order for them to then on-lend it to SMEs who were already their customers.

Nor is the paper going to delve further into the computations of credit institutions' Minimum Reserves, what proportion of credit institutions' deposits at the Bank are freely available to them to withdraw in unstressed market conditions, how the Bank would fund the APF in the case of significant withdrawals in unstressed market conditions or of requirements by credit institutions to borrow back amounts in stressed market conditions, or whether it is or should be within the Bank's gift to force credit institutions to hold Reserve Balances higher than levels before the APF existed, and higher than other central banks require of their credit institutions.

Nor is this paper going to ask why the credit institutions, if they are able to withdraw their balances in excess of Minimum Reserves, do not do so. Is the interest rate received of 4.75% so attractive that credit institutions place their money there voluntarily? Why does the Bank appear unable to stop paying interest on Reserve Account balances? Is it that the funding for the APF would disappear and the Bank might be forced to sell more of the APF out at once than it had otherwise planned to do? Or is it an IT issue, that the Bank can only apply one interest rate to Reserve Accounts at a time, and not a tiered rate, such as the Bank Rate on the Minimum Reserves and a much lower rate on the excess?²³

Focus of this paper from now on – the £200 billion

This paper will now concentrate on identifying the £200 billion elimination for 'Bank of England'.

It will become clear during this examination how trivial the amounts are under various other headings mentioned by the Bank itself, and which are referenced by the ONS. Their being mentioned at all tends to cloud the picture, as the number of items whose size is outside a range of around 0.5% of GDP is very few. Just like the NatWest shares, the space devoted to these items tends to distract rather than illuminate.

By way of example, the other items on the Bank's balance sheet that (i) have to be evaluated as possible sources of the offset; and (ii) are not tied up with the Bank's APF, fall within this lower range, and are far away from the £200 billion figure. The APF has such a dominance of the Bank's balance sheet that this figure must perforce be connected to it, even if the ONS can only account for 47% of it, and with an explanation that does not hold water.

²³ This would be akin to the situation where the Payment Systems Regulator adopted a policy of allowing non-bank financial institutions to join regulated UK payment systems, for which they required a Settlement Account at the Bank. The Bank was only able to offer two new Settlement Accounts per annum due to the limitations of its IT complex and testing facilities

What we are looking for

The amount of £200 billion backed out by the ONS should be visible in the Bank's balance sheet and ideally be categorizable as:

- i. an amount owed by the Bank to the government and which is backed by the Bank's own reserves; or
- ii. an amount owed by the government to the Bank, and funded for the time being by the Bank with its own money (its reserves).

In other words it is the Bank and the government lending one another their own money back: a circular transaction between two parts of the 'Public sector' with no third-party involvement.

Section 8 – the Bank of England’s financials

Bank of England 2024 Balance Sheet – general

The Bank’s balance sheet is in its Annual Report dated 29th February 2024. It also issues a weekly report showing the main positions in its balance sheet. The former is more detailed than the latter but the substance is little different. The only complication is that its Annual Report contains detailed balance sheets for its two different departments and a summary one for the whole organization, even though the Banking department represents 90% of the whole.²⁴ The other department is the Issue department which deals with the nation’s banknotes.

Bank of England 2024 Balance Sheet – liabilities

The Consolidated balance sheet shows liabilities as follows:

- Deposits - £834.9 billion
- Banknotes - £87.0 billion
- Other - £22.9 billion
- Total - £944.8 billion

The Banking department balance sheet shows liabilities as follows:

- Deposits from other central banks - £10.2 billion
- Deposits from financial institutions - £800.7 billion
- Other deposits - £109.5 billion
- Other - £17.5 billion
- Total - £937.9 billion

Both ‘Deposits from other central banks’ and ‘Other’ are within our stated range for triviality of around 0.5% of GDP.

‘Other deposits’ is larger, around 4% of GDP, and breaks down as per Note 12 on p. 151 as follows:

- Deposit by Issue department in respect of banknotes - £85.5 billion
- Public deposits repayable on demand - £17.5 billion
- Other deposits repayable on demand - £16.5 billion
- Total - £109.5 billion

‘Other deposits’ thus contains just one substantial amount of 3.2% of GDP: a deposit from another part of the Bank, and the counterpart to the Banknotes figure in the Consolidated balance sheet.

The other two amounts are insubstantial and within our range of 0.5% of GDP:

- The bodies to whom the Public deposits are owed are ‘HM Government accounts, including Exchequer, NLF, Debt Management Office (DMO), National Debt Commissioners and dividend accounts’. The ‘NLF’ is the National Loans Fund;
- ‘Other deposits repayable on demand’ is mainly comprised of the £15.7 bn ‘BEAPFF cash deposit’, being the portion of the Asset Purchase Facility held in cash.

²⁴ Department balance sheet footing (£937.9 bn) less the deposit from the Issue department (£85.5 bn) = £852.4 bn compared to consolidated balance sheet footing of £944.8 bn

The liabilities side of the Bank's balance sheet thus boils down to:

1. Balances on Reserve Accounts from credit institutions;
2. Banknotes.

There is no specific amount of £200 billion within the Bank's assets that is visible, connected to the APF, and offsetable against the national debt.

Bank of England 2024 Balance Sheet – assets

The Consolidated balance sheet shows assets as follows:

- Loans and advances - £911.4 billion
- Securities and financial instruments - £24.5 billion
- Other assets - £8.9 billion
- Total - £944.8 billion

'Loans and advances' are 96% of the whole.

The Banking department balance sheet shows assets as follows:

- Loan to Asset Purchase Facility (i.e. QE) - £744.3 billion
- Loans and advances to banks and other financial institutions - £166.0 billion
- Securities and Derivatives - £23.8 billion
- Other assets - £9.1 billion
- Total - £943.2 billion

The loan to the Asset Purchase Facility, of £744.3 billion at that date, represented 79% of the Banking department's balance sheet, and 76% of the Bank's consolidated assets.

£151.3 billion out of £166.0 billion, or 91%, of 'Loans and advances to banks and other financial institutions' was the Term Funding scheme for Small and Medium-Sized Enterprises, although it has reduced to £117 billion now.

The majority of the 'Securities and Derivatives' is Repurchase Agreements, a form of lending on the security of gilts or other high-quality liquid assets. That amounts to 0.8% of GDP.

'Other assets' amount to 0.3% of GDP

The largest amount by far is the loan into the APF, but there is no specific amount of £200 billion that is visible within the Bank's liabilities and connected to the APF.

Bank of England weekly report

The Weekly Report gives a filleted version of the Bank's consolidated balance sheet and, given the trivial amounts associated with other assets and liabilities, provides a good picture of the Bank's business. The Weekly Report contains no departmental balance sheets.

The Weekly Report for the date nearest to the ONS' 31st October 2024 (30th October 2024) shows only two liability positions in £sterling:²⁵

1. £724.7 billion of reserves deposited by credit institutions;
2. £89.4 billion of banknotes.

The same report shows four asset positions in £sterling:

1. Loan to APF – £659.0 billion
2. Term Funding scheme – £116.9 billion
3. Repurchase Agreements – £51.6 billion
4. Bond holdings – £14.9 billion (held as 'Securities and financial instruments' in the Consolidated balance sheet, and as 'Securities' and 'Derivatives' in the Banking department balance sheet)

Deposits from credit institutions have reduced since February by £76 billion, reflecting the reduction in the loan to the APF of £85 billion.

The Term Funding scheme has fallen. Repurchase Agreements have risen. The amounts of these lines plus the Bond holdings are funded with the smaller liability lines and with the balance of the deposits from credit institutions in excess of the APF's funding need.

There is no trace in the Bank of England's Weekly Report of an item close to the £200 billion figure that appears in the ONS' 'Public sector net debt', either on the asset or liability side:

- The asset positions other than the loan to the APF only total £183.4 billion;
- The excess of reserves deposited by credit institutions over the loan to the APF is £65.7 billion;
- This amount of funding, together with the liability on banknotes of £89.4 billion, constitutes a liability of £155.1 billion;
- The result is a shortfall of assets (which are £814.1 billion) compared to liabilities (which are £842.4 billion) of £28.3 billion;
- This Weekly Report is not a balance sheet and we are left to assume that the lines of assets that make up this shortfall are of trivial amounts, each significantly smaller than the smallest asset line that is stated (bond holdings of £14.9 billion).

Neither the balance sheet in the Bank's Annual Report nor its Weekly Reports show an individual figure of £200 billion that would qualify for offsetting from the national debt, or several figures adding up to £200 billion that would, each on their own, qualify for offsetting from the national debt.

²⁵ <https://www.bankofengland.co.uk/weekly-report/2024/30-october-2024> accessed on 16/12/24

Section 9 – why the £200 billion offset, if it exists at all, must be connected to the APF

The £200 billion, if it exists at all, must be connected to the APF

We are at this stage none the wiser as to what the £200 billion might be, and why it should be backed out of the national debt.

Nevertheless, the Bank's major business is the APF. An amount of that size can only be connected to the APF. Assets other than the APF are either transactions to do with bonds amounting to £66.5 billion (under Repurchase Agreements or Bond holdings), or they are the Term Funding scheme, where the Bank lends to commercial banks who on-lend to SMEs.

Total amount of gilts held in the Bank's 'Asset Purchase Facility'

On p. 11 of the 2024 Annual Report of the Asset Purchase Facility issued by the Bank, the Bank stated: 'As at 29 February 2024, the total amount of gilts held by the Company, valued at initial purchase price and net of redemptions and sales, was £732.8 billion (2023: £821.2 billion)'.

This holding of gilts has supposedly now been reduced to £659 billion, in line with the Bank's latest quarterly report on the Asset Purchase Facility.²⁶ That does not include £16 billion redeposited by the APF back with the Bank of England.

If there was a rationale for the Bank's holding of gilts to be netted off against the national debt, it would apply to the entire £659 billion, not just £200 billion.

Accounting issues where a gilt is sold out of the APF and when the APF holds it to maturity

If APF holdings of gilts had been netted off against the national debt whilst in the APF, this offset should reverse as and when the Bank sells off a portion of its gilts, which it has been doing. Once sold, the gilt would become a debt owed to a third-party, and not to another entity within the 'UK public sector', and its eligibility for offset would evaporate.

The gilt being held in the national debt at its face value, the Bank would have to recognise the entire premium as a loss, when it sold it.

A large premium amount would pertain to gilts with any combination of a coupon much higher than prevailing interest rates when the Bank bought them and a long remaining life. A relatively large loss would be realised by the Bank if it sold them some years before maturity.

By contrast a low premium amount would pertain to gilts with any combination of a coupon near to prevailing interest rates when the Bank bought them and a short remaining life. A relatively small loss would be realised by the Bank if it sold these gilts, and particularly if it sold them near to their maturity: by that point most of the premium pertaining to them would have been charged off.

This last point applies in some measure to any gilts in their final year to maturity: the amount of premium held regarding them is low, because it is the premium amount pertaining only to the final year. If they were sold within their final year, the remaining premium, such as it was, would be realised as a loss. If they were held, the remaining premium would be offset against the final coupon, received on the same day as the capital repayment.

²⁶ <https://www.bankofengland.co.uk/asset-purchase-facility/2024/2024-q3> accessed on 22/12/24

Section 10 – recent movements in the APF

Disparities between (i) APF balance (ii) ‘Bank of England’ offset amount (iii) reduction in the premium

One might expect these three amounts to move in a linear relationship to one another but this is not the case.

Between February and October the APF balance fell by £76 billion, whereas over the same period the ‘Bank of England’ deduction from the national debt fell by £41 billion (the difference in the ONS spreadsheet between cells K174 and K182).

The APF balance fell by 10% but the offset amount fell by 17%.

Between February and October the premium amount fell by £8.1 billion from £103.0 billion to £95.1 billion, or by 8%.

The relatively small reduction in the premium would normally derive from a combination of the following factors:

- A reduction caused by a preponderance of maturities over sales;
- Selling-off shorter dated bonds and/or bonds with coupons close to current yields-to-maturity.

Maturities

As regards maturities, the 2024 APF Annual Report states that £49 billion of bonds were to mature within one year (p. 37). If they fell due pro-rata then 66%, or £33 billion, would have matured by the end of October. Given that the APF balance fell by £76 billion between February and October, one can posit that this consisted of £33 billion of maturities and £43 billion of sales.

On that basis one can conclude that the relatively large volume of maturities – as opposed to sales - during this period made a contribution to the relatively small fall in the premium amount.

A maturity does cause a release of an amount of premium, but only that applicable to the final months of the bond’s life. Maturing gilts contain little remaining premium anyway: the impact on this year’s Profit and Loss account is almost identical whether they are held until their maturity or sold shortly before it.

Obligatory charge-off of premium for bonds held throughout a period, and when bonds are sold during it

The main base amount of premium charged off over any period, though, applies to bonds held throughout the period, and cannot be avoided. It is the pro-rata release as described earlier to equalize, for the current accounting period, the difference between the high coupons on the gilts in portfolio and the lower yields-to-maturity at which the gilts were purchased.²⁷

On top of the final charge-off for a maturing bond and the obligatory base, the third element in the release of premium derives from bonds sold off during the period. A sale necessitates the release of the entire premium held for that bond for this accounting period and all future ones up to its maturity.

²⁷ This would continue to occur right up until the gilt’s maturity. Indeed, there may well have been releases under this heading for gilts that matured between February and October

The amount of this third element can be manipulated by the Bank's selling off gilts of shorter maturity and/or with coupons closer to the yield-to-maturity at which they were bought. This reduces the lump-sum loss during the current accounting period.

The disparity between the 10% reduction of the APF and the 7.7% reduction in the accrual infers that an approach of this type has been taken.

Had gilts been sold that were of longer maturity and/or with coupons far away from the yield-to-maturity at which they were bought, the reduction in the accrual might well have been higher than the 10% reduction in the portfolio size, say from £103 billion down to £90 billion and a larger drop in percentage terms than the drop in the APF's size.

Conclusions about the disparities between (i) APF balance (ii) 'Bank of England' offset amount (iii) reduction in the premium

It has not been possible to fully justify why the offset amount fell by 17% when the APF balance fell by 10%, and the premium amount by only 8%. The premium amount is of course part of the offset amount. In February it was £103 billion out of £245 billion, or 42%, whereas in October it was £95 billion out of £204 billion, or 47%. This means that whatever the other element is in the offset changed from £142 billion in February to £109 billion in October, a reduction of £33 billion or 23%.

It appears to be a coincidence that this reduction of £33 billion is the exact amount of the maturities posited by assuming that the £49 billion of bonds of less than one year's maturity shown on p. 18 of the APF 2024 Annual Report matured pro-rata through the year. Our view that this is a coincidence is based on the accounting treatment of a bond not altering just because it is in its final year.

At any rate we can conclude from this analysis that this area does not throw up an obvious amount of £200 billion that is eligible for offset, either as one single amount or as several amounts in aggregate. All we can point to is firstly that the period between February and October 2024 saw maturities of just under 5% of the APF balance, a relatively high amount for an eight month period when the maturities in the APF portfolio stretch out well beyond 10 years, and secondly that the Bank appears to have chosen to sell off bonds which caused a relatively smaller premium release, a relatively lower loss, and a consequentially lower claim for reimbursement from HM Treasury.

Section 11 – possible explanations for the ‘Bank of England’ offset – ‘Treasury stock’

Gilts held in the Bank’s ‘Asset Purchase Facility’ cannot be construed as ‘Treasury stock’

There might be a case for offset if the Bank of England owned £200 billion of gilts in its Asset Purchase Facility, and was funding the holding with its own money, or with a specific loan from the government. In that constellation no liability to a third-party outside the scope of the ‘Public sector’ would be involved.

This would be similar to ‘Treasury stock’ owned by a company: the company’s holdings of its own shares. Companies are generally permitted to net off the Treasury stock against the Issued share capital.

The situation is not synonymous to ‘Treasury stock’, though, because the asset owner - the Bank – is not the same as the asset issuer – the government. The owner is a public financial corporation – part of the ‘UK public sector’ but not part of ‘general government’ - whilst the issuer is the ‘central government’ part of ‘general government’. These are also debt securities, not shares.

There are two further problems with the £200 billion being attributable to a ‘Treasury stock’-style treatment of bonds in the APF:

1. The bonds in the APF are much more than £200 billion;
2. The Bank obtains its funding for the APF not from itself or from the government but from third-parties – credit institutions.

Companies customarily undertake a ‘Treasury stock’ operation – usually called a ‘share buyback’ – when they have surplus cash and cannot think of a way of investing it profitably into their business. Instead the company buys its own shares in the open market. Shareholder returns increase because the company’s profit is attributable to a smaller number of shares in circulation, rather than shareholder returns increasing because the company ploughs the money into new products, geographical expansion, an acquisition or whatever.

Making a new borrowing in order to undertake a ‘Treasury stock’ operation is not normally an offence (as ‘insider trading’ would be), but at the same time it is not generally regarded as 100% above board, as it smacks of an attempt to manipulate the company’s accounts, the number of shares in circulation, and the share price, but without adding value to the business.

The APF – because it is 100% funded with borrowed money and is much bigger than £200 billion – does not lend itself to ‘Treasury stock’-style treatment and the ONS certainly does not make an argument that the APF is a ‘Treasury stock’-style operation.

Section 12 – possible explanations for the ‘Bank of England’ offset – latent loss in the APF

Latent loss in the Bank’s ‘Asset Purchase Facility’

Upon closer reading of p. 23 of the Annual Report of the Asset Purchase Facility, the Bank’s holdings of gilts at that date were not £723.8 billion, but £553.0 billion, £170.8 billion less.

This was the difference between the amount the Bank paid for the gilts, and their current market value in February. It was a latent loss at the time, but one which has since been realised in part by the Bank’s reducing the gilts in the APF, down to £659 billion (this figure being the purchase price of the ones it now holds).

Aside from the £16 billion held in cash, the main other asset item of the APF in the bank’s Annual Report was the £178.6 billion ‘Due from HM Treasury under Indemnity’.

This is the amount that the Bank would have been able to claim back from HM Treasury if it had sold all the gilts on that date at their then-current market value.

It did not sell them on that day but has sold part of them out in tranches over the course of 2024. It has realised a given loss upon each such sale and passed that loss back to HM Treasury under the indemnity.

In other words this ‘asset’ for the Asset Purchase Facility and for the Bank of England is a latent loss for the government.

How the loss is met when it is realised

Given that the funding for the gilts so sold was in the form of reserves deposited by credit institutions and had to be repaid in full, the loss realised by the Bank is unmitigated: HM Treasury has simply had to issue new gilts at current, higher interest rates, in order to make the Bank whole.

In this way the latent loss becomes an addition to the national debt when it is realised.

There was thus no potential in this area to offset the £170.8 billion shown in the Bank’s 2024 Annual Report against the UK’s national debt at the time: it was clearly a latent addition to the national debt and would have become a real addition if the Bank had sold out the entire APF portfolio on the date of the Annual Report.

Could this latent loss now be £200 billion?

Were this figure to have been valid at a time in February 2024 when the APF balance was £733 billion, the ONS’ figure at the end of October 2024 of £200 billion could not also have been valid if they both related to the same thing:

- The APF balance had fallen to £659 billion;
- The time until final maturity had fallen by 8 months;
- The latent loss will have correspondingly fallen for those two reasons;
- The rise in interest rates between February and October was not of such a magnitude as to offset these two drivers and make the latent loss higher now than it was then.

The ONS stated a figure for the ‘Bank of England’ offset at the end of February of £244.7 billion (cell K174 in its spreadsheet), a number far away from the £170.8 billion latent loss on the gilts in February, as stated in the APF’s annual report. The latent loss in February according to the Bank was only 70% of the amount of the ONS’ ‘Bank of England’ offset.

In February the amount pertaining to the above-par cost of the gilts was £103.0 billion (cell R174). The accrual of £103.0 billion and the latent loss of £170.8 billion added up to £273.8 billion, still far away from the amount of £244.7 billion in cell K174.

The latent loss could not have risen to £200 billion since February and there is again no such figure in evidence that is eligible for offsetting.

Testing the size of the latent loss - how losses on the Asset Purchase Facility arise

For completeness we need to go a level deeper into the APF losses to test what the latent loss would be in October, if the figure of £170.8 billion was correct in February. We can then demonstrate that the latent loss in October could not have been £200 billion.

The APF holds fixed-interest bonds at the price the Bank paid for them, with a ‘Memo’ amount of £95 billion representing the purchase premium above par.

While this purchase value was stated by the Bank to be £723.8 billion at 29th February 2024, the market value was £553.0 billion, the £170.8 billion being the latent loss.

When the Bank states that the APF now has £659 billion of gilts, this is also their original purchase value, not their current market value.

The Bank paid a price ‘above par’ to purchase the bonds but now the situation has turned around. The coupons on the APF gilts are lower than the current yield-to-maturity for analogous gilts in the open market. This is what gives rise to the latent loss: an investor buying these gilts from the Bank would not expect to pay either above par or par/face value. The investor would expect to pay below par. If the Bank sells the bond at below par it has to charge off as a loss the difference between the ‘above par’ purchase price and the ‘below par’ sale price.

Testing the size of the latent loss - simple model to exemplify what the losses are

We do not have precise particulars for which gilts the Bank bought and sold and at what prices, but we can create a simple model, based on the contention that the APF portfolio is owned by the Bank at a yield-to-maturity (or YTM) of 1.5%, and that it had a remaining life of 10 years in February 2024 and a remaining life of 9½ years at the end of October 2024.

The 10-year gilt yield-to-maturity on 29th February 2024, according to Trading Economics, was 4.1247%.

On 31st October the 10-year yield was 4.4253% and the 7-year yield was 4.3475%, meaning that the interpolated 9½ year yield was 4.3605% ($[(0.0778\%/6)+4.3475\%]$).

The losses-per-annum were thus:

Date	YTM on holdings	YTM in market	Loss of YTM
29 th February 2024	1.5%	4.1247%	2.6247%
31 st October 2024	1.5%	4.3605%	2.8605%

We can then apply these losses of YTM to the value of gilts held in the APF and the years until maturity:

Date	Loss of YTM	Value	Loss p.a.	Years	Loss
29 th February 2024	2.6247%	£733bn	£19.24bn	10	£192.4bn
31 st October 2024	2.8605%	£659bn	£18.85bn	9½	£179.1bn

The conclusions to be drawn from the above are:

- The APF portfolio has either a shorter duration than 9½ years and/or a better YTM than 1.5%;
- These factors would account for the loss as per the above model for February being £21.6 billion higher than the £170.8 billion stated in the Bank’s Annual Report;
- Applying that same lesson to the figures for October, the latent loss at that point would have been lower than £179.1 billion, the 10% reduction of the holding and the shorter remaining life being only partially offset by the higher ‘YTM in market’;
- The latent loss would have been even further away from the ONS’ £200 billion offset.

A latent loss of the Bank’s own figure of £170.8 billion on 29th February rather than ours of £192.4 billion would result if the YTM on the holdings were to be 1.7946% rather than 1.5%, the maturity remaining unchanged. The ‘Loss of YTM’ would have been 2.3302% instead of 2.6247%.

We can repeat the calculations using this higher ‘YTM on holdings’ firstly to recalculate the loss of YTM per annum:

Date	YTM on holdings	YTM in market	Loss of YTM
29 th February 2024	1.7946%	4.1247%	2.3301%
31 st October 2024	1.7946%	4.3605%	2.5659%

...and then the latent loss:

Date	Loss of YTM	Value	Loss p.a.	Years	Loss
29 th February 2024	2.3301%	£733bn	£17.08bn	10	£170.8bn
31 st October 2024	2.5659%	£659bn	£16.91bn	9½	£160.6bn

Under this calculation the loss for 31st October 2024 has indeed fallen and by £18.5 billion compared to the original model. The loss is now £36.4 billion away from ONS’ offset for ‘Bank of England’, a difference of such a size that the ONS’ offset cannot have this cause.

The latent loss cannot have been £200 billion at the end of October.

Section 13 – overview of unfounded explanations for the ‘Bank of England’ offset

Recap of what the £200 billion cannot be

We have tested all of the following and found none to hold water:

Explanation	Why it does not hold water
Accounting treatment of the gilts as ‘Treasury stock’	No claim for this is made and, if it were, it should apply to the entire APF balance
Annual interest loss when the Bank holds the gilts of £19.5 billion per annum or £194.8 billion over the 10 remaining life of the gilts	Closest amount to £200 billion but is a possible loss over the next 10 years, not an asset that can be offset
Amount of £95 billion that the Bank paid above par for the gilts as per cell R182 in the ONS’ spreadsheet (47% of the total contribution of the Bank to ‘Public sector net debt’ in cell K182)	Too small; no explanation for the other £109 billion; it is a deferred expense, not an asset that can be offset
Accounting treatment of maturing gilts and of gilts retained	No element or elements of a size and relevance to justify the offset
Disparities between the APF balance, the offset amount, and the premium above par amount	Nothing in here of a relevant size, or with a suitable justification
The Bank’s own reserves, invested in gilts	The Bank does not have reserves of that size: it only had £5.4 billion of capital and reserves on 29 th February 2024
Balance on Reserve Accounts deposited by credit institutions	Amounts do not match – credit institutions held £724.7 billion of reserves in October. In addition, these reserves belong to the credit institutions, not to the Bank, and still less to the government
The value of the gilts in the APF	Too large, at £659.0 billion in October, which includes the latent loss, the market value being around £500 billion
The latent loss on in the APF’s gilts	Too small at £170.8 billion in February and now of around £160.6 billion

Conclusions drawn from the analysis and further homework for the ONS

We have exhausted all possibilities and there is no single figure of £200 billion that contains even a prima facie case for being offset against the national debt, nor are there individual smaller figures adding up to £200 billion which are each backed by robust reasoning for being offset.

There is neither an identifiable figure nor robust justification for the ONS to back £200 billion out of ‘Public sector net debt’ on account of ‘Bank of England’.

Indeed there no justification for any reduction to do with ‘Bank of England’. On the contrary, there is ample justification for an addition.

Before discussing what the addition should be, the ONS has much to do regarding the figure to which any such addition is made.

The ONS should be asked to make its presentation much clearer generally, building on a baseline – which we have referred to as the core national debt – of the exact amounts of gilts and bills in issue, and the balance in National Savings and Investments.

Further debts of General government (i.e. of central and of local government) should be added line-by-line so as to deliver a figure for 'General government gross debt'.

Then the further debts of the 'Public sector' outside 'General government' should be added, line-by-line. The ONS possibly believe they already do this, but they have made it impenetrable.

Having thus reached a figure for 'Public sector gross debt', the ONS should issue a listing, line-by-line, of the offsets to that figure, which add up to the difference between 'Public sector gross debt' and 'Public sector net debt'. Each such offset should be backed up with an explanation of why the item merits being offset.

There is no need for any further mention of the banks taken into public ownership during Labour's previous term in office, other than to include the NatWest shares as a possible item eligible for offsetting.

As it is, some significant questions remain outstanding:

- What are the guiding principles for making offsets to the national debt at all, beyond cases where a debt is initially recorded twice?²⁸
- If 'Bank of England' is to be included in Public sector debt at all, then should not all of its liabilities be included?
- What is the rationale for some to be excluded, if the Bank is a 'public financial company' as the ONS terms it, and such companies are part of the public sector, and the Bank's creditors (backed up by global financial regulation) record their claims on the Bank as if they were claims on the UK government?

²⁸ This could be where a local authority has borrowed from the successor to the Public Works Loans Board, which is funded with gilts through the Debt Management Office: there are two entities with debts, but the operation is a pass-through from one 'General government' entity to another, and there is only one amount of debt to third-parties – the gilts

Section 14 – so what is the national debt actually?

Strawmen for the UK's national debt

In the absence of illumination from the ONS, we finish with our own 'strawmen' for the UK's national debt at the end of October 2024. There are four 'strawmen', and they differ by what items on the Bank's balance sheet are included and excluded.

Strawman 1 - core national debt plus credit institutions' deposits at the Bank

Categories	Amounts
Core national debt	£2,813 billion
Credit institutions' deposits at the Bank	£725 billion
Total	£3,538 billion
Percentage of GDP	131%

Strawman 2 - core national debt, plus credit institutions' deposits at the Bank, plus banknotes

Categories	Amounts
Core national debt	£2,813 billion
Credit institutions' deposits at the Bank	£725 billion
Banknotes	£89 billion
Total	£3,627 billion
Percentage of GDP	134%

Strawman 3 - core national debt, plus credit institutions' deposits at the Bank, plus banknotes, plus the latent loss on APF

Categories	Amounts
Core national debt	£2,813 billion
Credit institutions' deposits at the Bank	£725 billion
Banknotes	£89 billion
Bank's latent loss on APF	£161 billion
Total	£3,788 billion
Percentage of GDP	140%

Strawman 4 - core national debt, plus credit institutions' deposits at the Bank, plus banknotes, plus the latent loss on APF, but offsetting current market value of APF (£659bn less latent loss of £161bn)

Categories	Amounts
Core national debt	£2,813 billion
Credit institutions' deposits at the Bank	£725 billion
Banknotes	£89 billion
Bank's latent loss on APF	£161 billion
Sub-total	£3,788 billion
Current market value of APF	(£498 billion)
Total	£3,290 billion
Percentage of GDP	122%

The final ‘strawman’ is the most lenient, but is still a full 24.5% of GDP higher than the ONS’ ‘Public sector net debt’, and 31.8% of GDP higher than the ONS’ ‘Public sector net debt less Bank of England’.

Public sector gross debt

Although the ONS speak much about Public sector net debt, the Public sector gross debt is granted a low profile. It is at least our Core national debt of £2,813 billion. We have covered off in this paper what additions might be made for Public financial corporations, and that comes down to the Bank of England.

There is also the issue of Public non-financial corporations, whose numbers were significantly reduced by privatization, but where the trend is now a reinstatement, beginning with the railways.

Debts of Public non-financial corporations would need to be identified by the ONS and added on top of the Core national debt and whichever version for an addition regarding the Bank is concluded as being the most appropriate.

Thus in the table later on this page the Public sector gross debt does not include the debts of Public non-financial corporations.

General government net debt

Although we have a figure for our Core national debt which sits within a tolerable relationship to General government gross debt, we do not have a figure for General government net debt – which is the debts of General government entities less any items owned by or attributable to these entities which is eligible for offset. Transparency of General government net debt is a further important stepping stone.

Introduction of ‘Public sector net liabilities’

Now the new measure for the national debt adopted by Labour is ‘Public sector net liabilities’.²⁹ This measure permits the offset of even more assets. At the end of financial year 2023/4 it was £2,285.2 billion compared to ‘Public sector net debt’ of £2,699.6 billion. These figures would have been 84.6% and 99.98% respectively of our static GDP amount of £2.7 trillion.

The espousal of ‘Public sector net liabilities’ results in an optical shaving of a further 5.6% from the national debt as rendered by the ‘Public sector net debt less Bank of England’ measure, down from 90.2% to 84.6%.

That would further widen the chasm between the numbers which the ONS and the government show the voters and reality:

	Most lenient full figure	Most stringent full figure
Public sector gross debt ³⁰	122%	140%
Public sector net liabilities	84.6%	84.6%
Chasm in % of GDP	37.4%	55.4%
Chasm in £ billions	£1,009.8	£1,495.8

²⁹

<https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/methodologies/publicsectornetfinancialliabilitiespsnfl> accessed on 5/1/25

³⁰ Not including debts of Public non-financial corporations

Full overview of national debt measures

It will have become clear that the UK authorities need to supply the citizenry with the exact figures, both as a percentage of GDP and in number of £sterling, for all of the five measures of national debt that are in circulation, as well as for the differences between each measure.

The justification for each such difference needs also to be laid out.

The list misses out 'Public sector net debt less Bank of England', as we have proven that it is invalid.

The five measures are as follows, in the order of the percentages of GDP and amounts of £sterling that they are likely to deliver, from Highest to Lowest:

1. Public sector gross debt
2. General government gross debt
3. General government net debt³¹
4. Public sector net debt
5. Public sector net liabilities

Once we have these figures and their composition, we will be able to evaluate whether they are true, fair, and accurate, and whether further debts – for example debts of the Bank of England to credit institutions and in respect of banknotes – need to be added on.

³¹ The working assumption, which may be contradicted by the facts, is that General government entities own or have a claim on far fewer items eligible for offset than do Public sector entities outside General government

Section 15 – overall conclusions

There is no rationale for the ONS to deduct £200 billion from their 'Public sector net debt' and produce a lower figure that is more emollient, digestible, and acceptable to the UK authorities.

In fact the UK authorities have been gaslighting the voters with their figures, which already contained hundreds of billions of pounds of offsets just to reach the 'Public sector net debt' figure from which the £200 billion 'Bank of England' is deducted.

Deducting £200 billion for 'Bank of England' and issuing the result as if it had some validity is no more than a turning-up of the gas lamps.

The ONS now appears to have stopped publishing 'General government gross debt', let alone the wider 'Public sector gross debt', probably so as not to 'scare the horses' i.e. the voters, the public credit rating agencies, and the investors in gilts.

This is not good enough, firstly because it is the voters' right to know how much these authorities – acting in the voters' name – have put the voters on the hook for. Secondly this degree of gaslighting has enabled the new Labour government to switch on a whole new street of gas lamps, with their even-smaller 'Public sector net liabilities'.

The muted disapproval with which this was greeted by the other parts of the UK authority apparatus was disappointing but not surprising: when you are already emitting figures that flatter yourselves and the other parts of your nice little club, that keep the voters quiet, that ensure that credit rating agencies continue their favourable estimation of the manageability of the UK's debts, and that help to maintain the market amongst investors for the avalanche of new debt that Labour plans, you have long since lost any moral authority to challenge a club member who moves the goalposts even further off the pitch.

The adoption of 'Public sector net liabilities' requires the government, the ONS, the Office for Budget Responsibility, the Bank of England, and the rest of the UK governmental and administrative apparatus to propose and justify a minimum of £1 trillion and a maximum of £1.5 trillion of offsets in order to make their numbers credible. It could be more, as our figure for 'Public sector gross debts' only includes the debts of Public financial corporations and not those of Public non-financial corporations.

Even if the debts of Public non-financial corporations turn out to be trivial, the required offsets are £800 billion to £1.3 trillion more than the illusory 'Bank of England' offset.

The 'Bank of England' offset is the trailblazer, the living proof that even a huge latent loss attributable to spectacular financial mismanagement can be reconstituted as some kind of asset and presented to voters as a reduction – not an increase – in the amount that voters will have eventually to pay.

However, finding further offsets of between four and six times the amount of the 'Bank of England' one will require a whole new level of creativity to be applied to the nation's accounting.

BL/26.1.25