

Funding the Future

The government's claims about the additional interest c...

Published: January 13, 2026, 3:36 am

Robert Peston claimed yesterday that:



Robert Peston 
@Peston

...

Interest payments on the national debt rose 70% in May to £7.6bn (compared with a year earlier) - largely because of the impact of rising inflation on income paid to holders of index-linked gilts (inflation-protected government bonds). More worryingly, this was 49%...

8:52 AM · Jun 23, 2022 · Twitter for iPhone

54 Retweets 8 Quote Tweets 59 Likes

Like many journalists, Peston has a habit of misreading data. He has taken this data, [published by the Office for National Statistics](#), with regard to the public finances in May at face value:

Table 3: Central government expenditure
Central government expenditure compared with the same month a year earlier, UK, May 2022

	May (£ billion)		Change on a year ago	
	2021	2022	£ billion	%
Interest payments ¹	4.5	7.6	3.1	70.4
National Insurance Fund Benefits	9.6	10.0	0.4	4.1
Social Assistance	10.0	9.8	-0.1	-1.3
Other Net social Benefits	-0.1	0.1	0.2	-200.0
Procurement ^{2,3}	15.9	16.3	0.4	2.8
Pay	13.9	13.7	-0.2	-1.5
Transfers to Local Government ⁴	12.1	9.9	-2.2	-18.6
Contributions to EU ⁵	0.0	0.0	0.0	-
Current transfers paid abroad - UK payments to EU ⁶	0.0	0.9	0.9	-
Current transfers paid abroad - Other	0.4	0.3	-0.1	-25.0
Subsidies - CJRS ⁷	1.9	0.0	-1.9	-100.0
Subsidies - SEISS ⁸	2.7	0.0	-2.7	-100.0
Subsidies - Other	3.2	2.9	-0.3	-9.4
Other Expenditure	2.2	2.5	0.3	13.6
Total Current Expenditure	76.2	74.0	-2.2	-2.9

He panicked about that top line - and the 70.4% increase in interest costs. He really should not do so. The ONS added this explanation to this figure:

Interest payments on debt by central government

The recent high levels of debt interest payments are largely a result of higher inflation, as the interest paid on index-linked gilts rises with increases in the Retail Prices Index (RPI).

In May 2022, central government debt interest was £7.6 billion, of which the RPI uplift on index-linked gilts contributed £5.0 billion over and above the accrued coupon payments and other components of debt interest. On an accrued basis, this month saw the third highest debt interest payment made by central government in any single month and the highest payment made in any May on record.

To estimate the RPI uplift for three-month lagged index-linked gilts in May 2022, we reference the RPI movement between February and March 2022. RPI increases in the most recent months will be reflected in our interest estimates in due course.

Put that in plain language and what they are saying is the real interest cost this month was not £7.6 billion. It was actually £5 billion less than that. It was really only £2.6 billion.

And for the record, [last month they said](#) that the cash cost was only £0.5 billion, although they recorded an expense that was £3.9 billion higher at £4.4 billion in all.

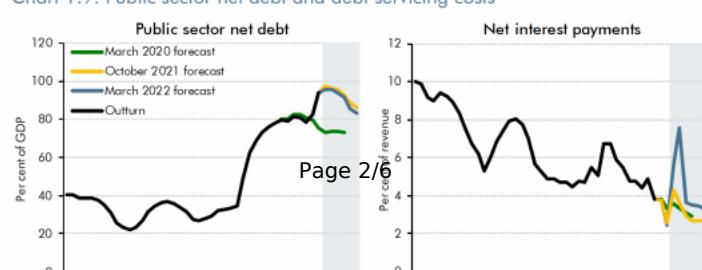
So, in that case the real interest cost to the government this year has been £3.1 billion and the Office for National Statistics say it is £8.9 billion more than that, making their total £12 billion for the year to date.

What it looks like is that the ONS is overstating the cost of government borrowing by more than £50 billion this year as a result, implying it could come to well over £70 billion in the year if we extrapolate these results when the cash cost may be less than £40 billion.

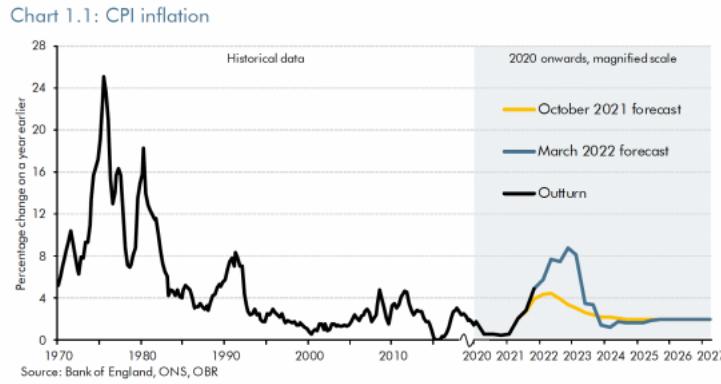
And to be clear, the Office for National Statistics is not alone in doing this. The Office for Budget Responsibility is forecasting an interest cost of £87 billion this year.

So how is this possible? What explains the freak expense? And I stress, according to the Office for Budget Responsibility they think it is a freak expense as this chart [from their March forecasts](#) shows:

Chart 1.9: Public sector net debt and debt servicing costs



That right-hand chart is pretty clear: overall, they think interest costs in coming years are headed downwards. But I should add that this was their inflation forecast:



They were expecting inflation to reach around 9% later this year. We now know it is likely to be 11%. Then they expect it to fall, and to be clear, so do I, because the historical evidence is that this is what always happens.

Why are these issues linked? That's because of the way that the UK gilt market (or government borrowing market) is structured. The UK Debt Management Office summarised this [at the end of March](#) as follows:

Debt Portfolio Overview				
Debt portfolio statistics				
	30 June 2021	30 September 2021	31 December 2021	31 March 2022
Gross values				
Uplifted nominal value of the debt portfolio	£2,088.13bn	£2,125.40bn	£2,164.14bn	£2,140.04bn
▪ Conventional gilts ⁴	£1,551.26bn	£1,579.29bn	£1,614.15bn	£1,593.13bn
▪ Index-linked gilts	£476.87bn	£486.12bn	£499.49bn	£510.90bn
▪ Treasury bills ⁵	£60.00bn	£60.00bn	£50.50bn	£36.80bn
Average maturity of the debt portfolio ⁶	14.83 years	14.80 years	14.70 years	14.86 years
Gilt portfolio	15.26 years	15.22 years	15.04 years	15.12 years
▪ Conventional gilts	14.22 years	14.24 years	14.05 years	14.20 years
▪ Index-linked gilts	18.65 years	18.42 years	18.24 years	17.98 years
Net values⁷				
Uplifted nominal value of the debt portfolio	£1,983.97bn	£2,023.34bn	£2,061.94bn	£2,040.48bn
▪ Conventional gilts ⁴	£1,453.26bn	£1,483.40bn	£1,518.27bn	£1,499.99bn
▪ Index-linked gilts	£470.71bn	£479.94bn	£493.17bn	£503.80bn
▪ Treasury bills ⁵	£60.00bn	£60.00bn	£50.50bn	£36.80bn
Average maturity of the debt portfolio ⁶	14.84 years	14.80 years	14.71 years	14.88 years
Gilt portfolio	15.29 years	15.25 years	15.07 years	15.15 years
▪ Conventional gilts	14.17 years	14.19 years	14.01 years	14.16 years
▪ Index-linked gilts	18.76 years	18.54 years	18.35 years	18.10 years

These portfolio statistics exclude the £500m UK Sovereign Sukuk issue which was launched on 25 March 2021.
1. Based on nominal values, including inflation uplift. The difference between the debt portfolio average maturity statistic included in the table above and the one presented at the top of the next page (calculated from market values) is driven by the divergence of gilt prices from their par values. In the current low interest rate environment, the effect is to increase the average maturity of the market value calculation.
2. The 'net values' category excludes gilts held by the DMO.

The market value of those bonds is a little different to their nominal value:

Debt Portfolio - Market Value Statistics				
	31 December 2021	31 March 2022	31 December 2021	31 March 2022
Gross Values				
Portfolio market value			Portfolio market value	
Debt portfolio	£2,841.87bn	£2,614.26bn	Debt portfolio	£2,696.35bn
▪ Conventional gilts	£1,916.22bn	£1,748.44bn	▪ Conventional gilts	£1,780.63bn
▪ Index-linked gilts	£875.17bn	£829.07bn	▪ Index-linked gilts	£865.24bn
▪ Treasury bills	£50.49bn	£36.76bn	▪ Treasury bills	£50.49bn
Average portfolio yield			Average portfolio yield	
▪ Conventional gilts	0.90%	1.57%	▪ Conventional gilts	0.89%
▪ Index-linked gilts	-2.67%	-2.60%	▪ Index-linked gilts	-2.86%
Debt portfolio average maturity	17.30 years	16.69 years	Debt portfolio average maturity	17.36 years
Average modified duration			Average modified duration	
▪ Conventional gilts	12.20 years	11.47 years	▪ Conventional gilts	12.20 years
▪ Index-linked gilts	21.29 years	20.30 years	▪ Index-linked gilts	21.41 years
				20.42 years

It is not hard to spot that it is index-linked bonds that are the issue when it comes to market values differing from nominal value. And let's be clear, the Office for National Statistics says that too.

To explain this requires that the working of an index-linked bond be understood. When an index-linked bond is issued the person buying it puts a lump sum into that bond. Let's say it was £1,000. Let's assume that they keep it for the life of the bond. Let's assume that life is 4 years.

Now let's assume that the interest rate on the bond was set at 2% paid annually, and is fixed at that rate for the whole period (which is normal on these bonds). And let's assume that the principal value of the bond is updated for inflation throughout its life, as is normal, again. Let's assume that rate is 4% each year (unlikely, but it makes the numbers grow more quickly). The payments due in that case are:

Principal	1,000					
Interest rate	2%					
Inflation	4%					
Term (years)	4					
		Year 1	Year 2	Year 3	Year 4	Total paid
Principal at start		1,000.0	1,040.0	1,081.6	1,124.9	
Add: inflation factor	4%	40.0	41.6	43.3	45.0	
Princial at year end		1,040.0	1,081.6	1,124.9	1,169.9	1,169.9
Interest paid	2%	20.8	21.6	22.5	23.4	88.3
Return		60.8	63.2	65.8	68.4	258.2

The owner of this bond gets two returns. One is the interest. The rate is fixed. The amount on which it is paid is increased each year to reflect inflation. They get a little over £20 each year in interest as a result, as the table shows, with inflation literally inflating this.

Then they get the inflation-adjusted capital back when the bond is redeemed. The capital has increased from £1,000 to £1,169.90 as a result of inflation. So they get this last sum back - an increase of £169.90. But they only get this when the bond is repaid.

Now let me throw in a twist. In year two assume that inflation is 10%. Now the table looks like this:

Principal	1,000					
Interest rate	2%					
Inflation	4% Except year 2 when 10%					
Term (years)	4					
		Year 1	Year 2	Year 3	Year 4	
Principal at start		1,000.0	1,040.0	1,144.0	1,189.8	
Add: inflation factor	4%	40.0	104.0	45.8	47.6	
Princial at year end		1,040.0	1,144.0	1,189.8	1,237.4	1,237.4
Interest paid	2%	20.8	22.9	23.8	24.7	92.2
Return		60.8	126.9	69.6	72.3	329.6

What you will notice is the apparently aberrational cost in the year when inflation increases. It's not that the interest cost changes much. What does happen is that the amount due on redemption increases. GGGGGGGGGGG

But let's be clear about this: it is not payable until the end of the term, which is four years in this case. There is little additional cash outflow in the current year, at all. And I stress, this is exactly what is happening now. Whatever the cost of the current inflation might be when it comes to index-linked bonds, it is not going to hit for a long time. The Debt Management Office report shows the average life of index-linked bonds: depending on how estimated they are between 18 and 20 years on average, meaning this cost is not going to hit for that long.

Now, I am not saying that just because a cost does not hit for twenty years it should be ignored. But, to explore what this means I reworked the above tables with a twenty year bond and just one year at 10% inflation and all others at the target 2%, which is much more likely than 4%:

Principal	1,000										
Interest rate	2%										
Inflation	2%	Except year 2 when	10%								
Term (years)	20										
		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 19	Year 20	Total paid	
Principal at start		1,000.0	1,020.0	1,122.0	1,144.4	1,167.3	1,190.7	1,540.3	1,571.1		
Add: inflation factor	2%	20.0	102.0	22.4	22.9	23.3	23.8	30.8	31.4		
Principal at year end		1,020.0	1,122.0	1,144.4	1,167.3	1,190.7	1,214.5	1,571.1	1,602.5		1,602.5
Interest paid	2%	20.4	22.4	22.9	23.3	23.8	24.3	31.4	32.0		532.9
Return		40.4	124.4	45.3	46.2	47.2	48.1	62.2	63.5		2,135.4

For the sake of comparison, the bottom chart removes the inflation in year 2.

Both charts exclude a print for a number of interim years to get them on the screen: they are there in the data.

There is, as is apparent, an increase in interest costs over time: but this though only amounts to £37.2 (£532.9 - £495.7). Few would argue that these cannot be recognised as they happen. But the real change is the additional cost on redemption of £116.60 arising eighteen years after the inflation that gave rise to it, and which inflates the current value of index-linked bonds on the second-hand bond market now. How should this be accounted for?

There are two options. One is that this is an event now, requiring to be accounted for at

this moment. That is the option the government is adopting. The other is to suggest that this is an event happening in maybe 18 years time which has to be accrued for between now and then in equal equivalent stages over that period.

Roughly speaking (and because I am talking about issues of principle here roughly speaking is good enough) this can either be shown as above, with a massive one-off boost in costs now and modest increases thereafter, or the interest can be paid as it accrues and the £116.60 additional cost of capital redemption can be spread over the 19 years it will take to accrue to payment, given that the payment day is that far away. My argument is that since the bond was designed to last until expiry (and they always do) then this cost accrues over 19 years at roughly £6 or so a year on top of the roughly £2 a year extra interest cost. So the increased cost is £8 (roughly) a year and there is no one-off cost of £83 now.

The government, however, is saying this is a cost now. But why? When issuing a twenty-year bond shouldn't the cost of settling it be averaged over its remaining life? My suggestion is a simple one: the government and ONS are offering accounting here that fails to tell an objective or politically appropriate story on interest costs to facilitate a crackdown on working people to deny them a pay rise now. And that is a political conspiracy using data that I think is wholly unjustified.

Peston has fallen for the ruse, and so have lots of others. But it is just that i.e. a ruse to make them think the government is heading for hell in a hand cast as a result of massive additional interest costs when on average these are not going to be paid for eighteen years.

It's time to stop falling for the accounting abuses and talk about reality. There is nothing about the current inflation that is stopping this government from affording pay rises. And that's a simple fact.