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Australian Office of Financial Management

Australian Business Economists

AOFM – Activities for 2004-05

**Presentation by Neil Hyden
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12 July 2004**



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Outline

- Bond Issuance and Market Liquidity
- Cash Management
- Portfolio Management
- Interest Rate Swaps
- Collateral Arrangements



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Bond Issuance – Objectives

- We aim to maintain sufficient CGS on issue to support the Treasury bond futures market:
 - in order to maintain the role that Treasury bonds and bond futures play in supporting interest rate risk management in the economy.
 - as recognised in last year’s CGS review.



Bond Issuance – Objectives

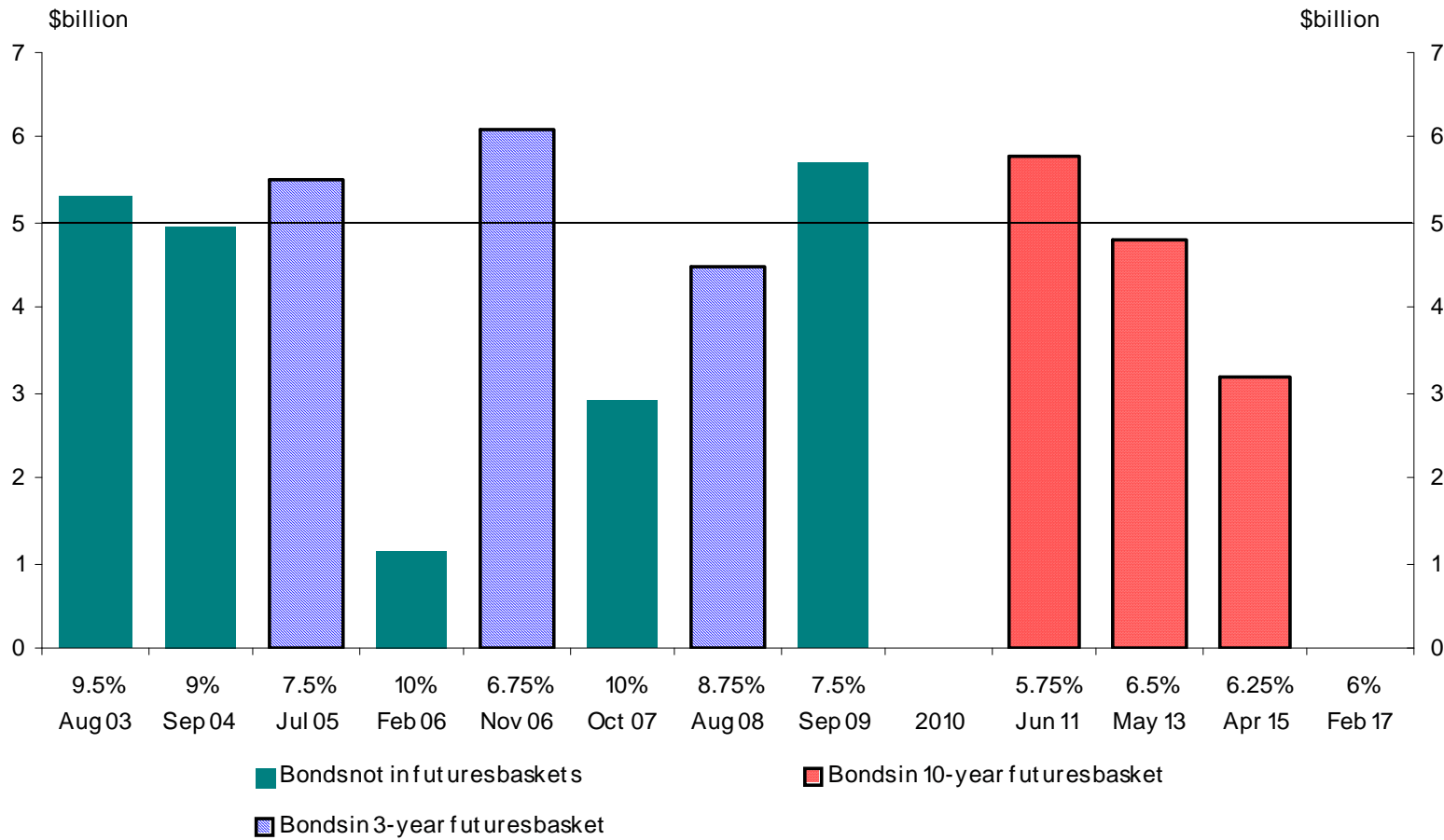
- Issuance is now targeted to maintain liquid and efficient CGS and Treasury bond futures markets.
 - Long-dated bonds to support the 10 year futures contract.
 - Mid-curve bonds to support the 3 year contract.
 - Each bond line to be built up to around \$5 billion.
- Around \$5 billion of issuance each year.



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Bonds on Issue End June 2003





Bond Issuance in 2003-04

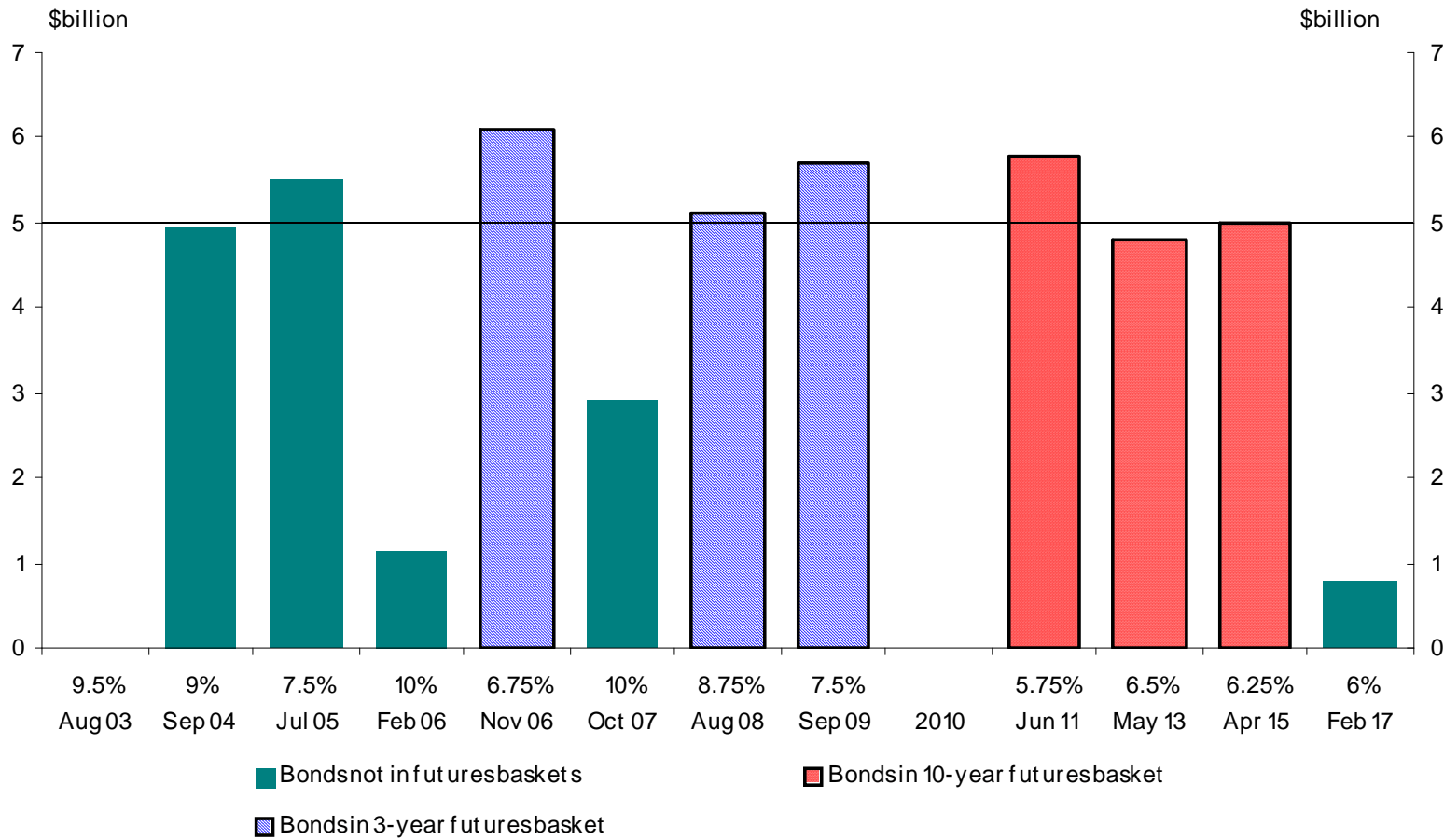
- \$3.2 billion issued across three different lines.
 - \$1.8bn of April 2015;
 - \$600m of August 2008;
 - \$800m of February 2017;
- April 2015
 - \$5 billion now on issue.
- August 2008
 - \$5.1 billion now on issue.
- February 2017
 - \$800m on issue.



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Bonds on Issue End June 2004





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Bond Issuance in 2004-05

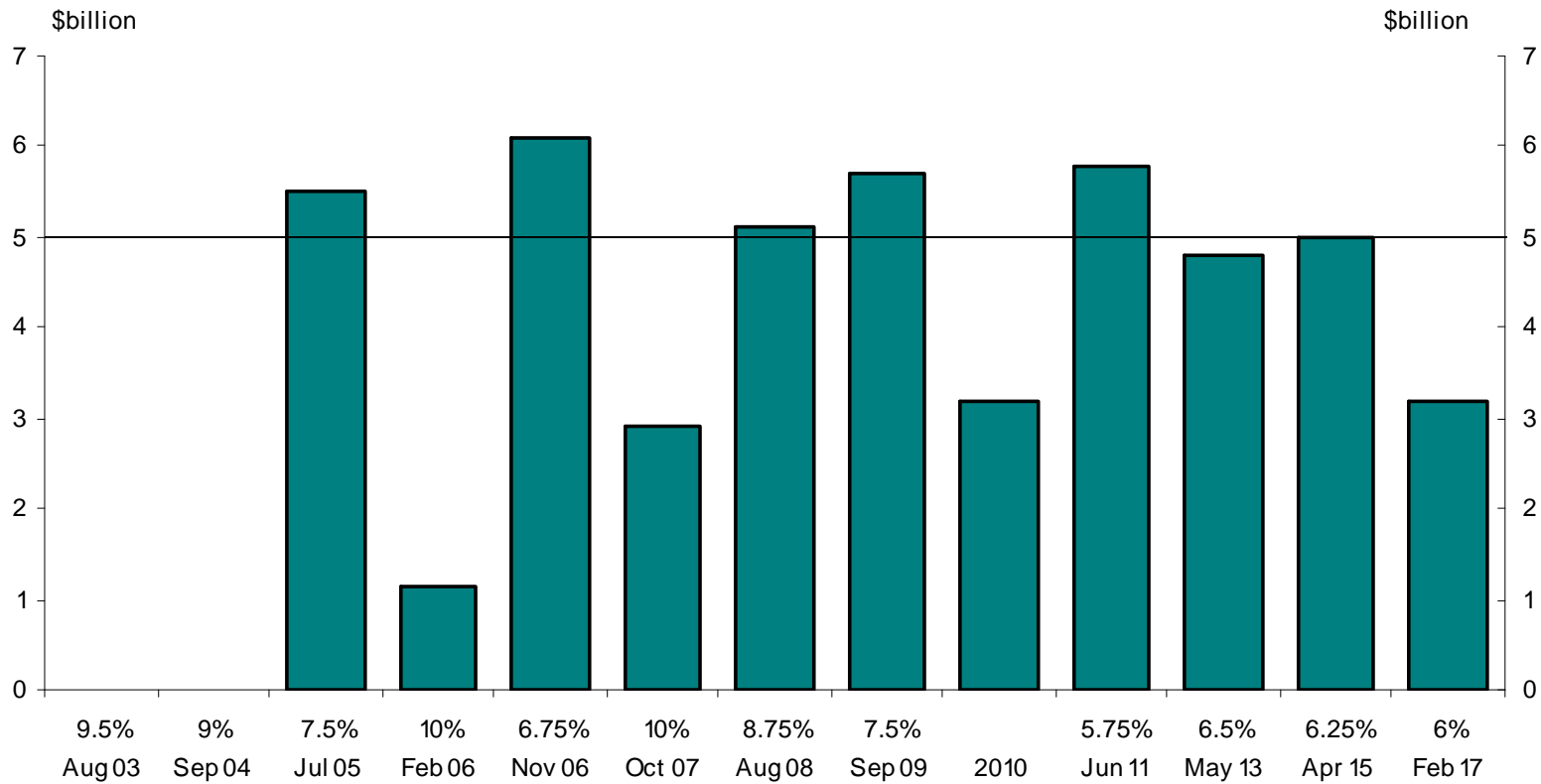
- Total issuance between \$5 and \$6 billion.
- Supporting two new bond lines.
 - February 2017. Around \$2.5bn to be issued in first 6 months of 2004-05.
 - New 5-year bond. Around \$3bn to be issued in second half of 2004-05.
- Indicative calendar of tender dates published on AOFM website.



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Bonds on Issue End June 2005





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Monitoring of the Bond Market

- Strengthened market contact over the past 12 months.
 - Strong liaison with market participants, RBA, AFMA and SFE.
- AOFM looking to be responsive to developments in the market.
 - AOFM ready to receive on-going feedback from market participants.



Liquidity

- Some pressures in the repo market in 2003-04.
 - Focused on bonds in the 3 and 10-year bond futures baskets.
- AFMA paper on CGS liquidity.
 - Consistent pressures could impinge on liquidity and the price discovery mechanism underpinning bond futures contracts.
- Suggested possible solutions.
 - Yield curve consolidation, vary issuance pattern, stock lending facility.
- AOFM and Treasury examining these options.



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Indexed Bonds

- TIB issuance suspended post CGS review.
 - Bond issuance is now concentrated on Treasury bonds.
 - To avoid adding unnecessarily to the level of financial assets.
- No TIB issuance for 2004-05.



Cash Management

- Term deposits are now our primary cash management tool.
- T-Notes secondary tool and issued as required.
- T-Note issuance for 2003-04 was \$1.1bn.
- T-Note issuance for 2004-05 could be a little higher, reflecting within year cash flows.
 - But day by day cash flow timing is very variable.
 - Indicative tender schedules will continue to be provided throughout 2004-05.



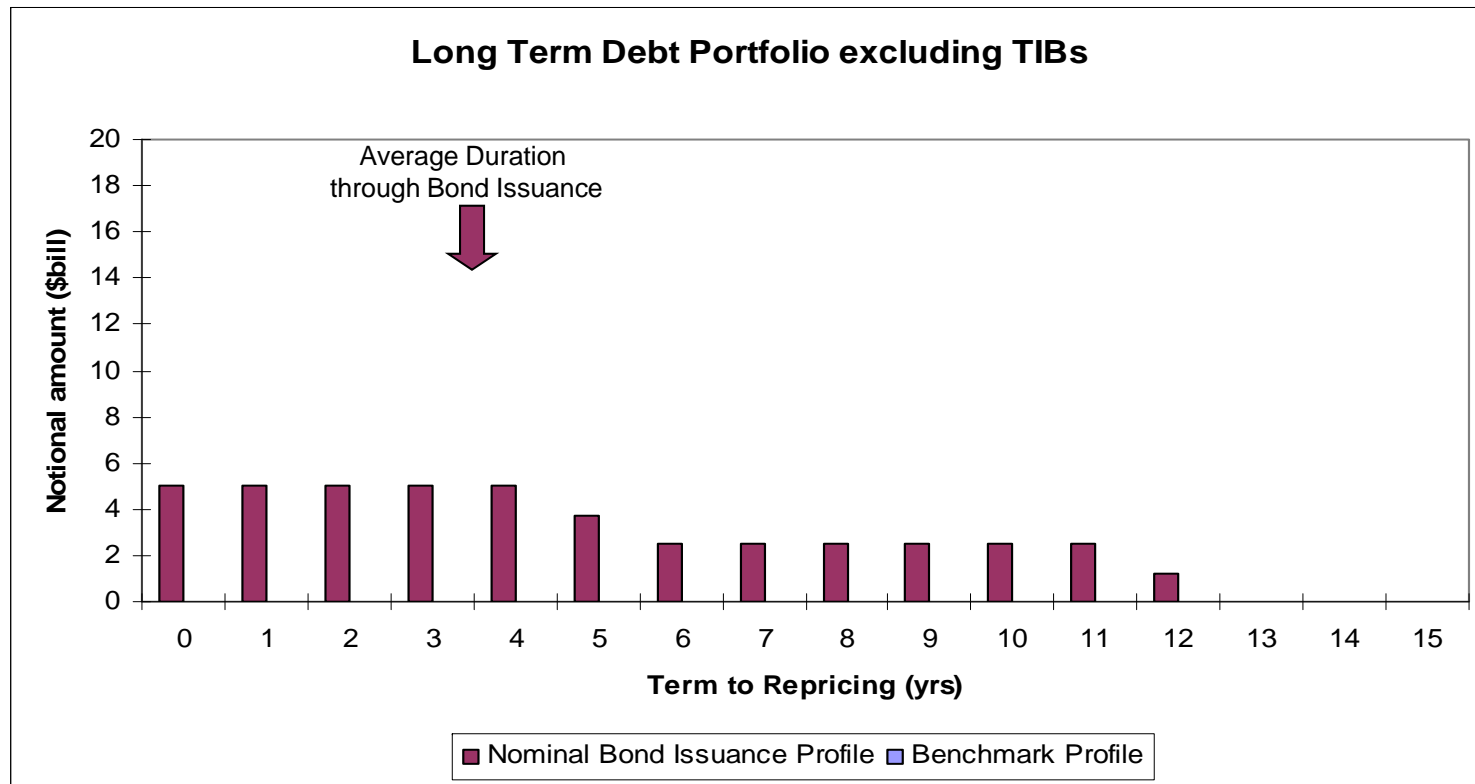
Portfolio Management

- We do not take positions in the portfolio, but manage it to a benchmark using swaps.
- A new benchmark was approved by the Treasurer in September 2003:
 - Modified Duration of 2; and
 - Short Dated Exposure of 35%.
- This is designed to have a lower interest cost over time.



Portfolio Management

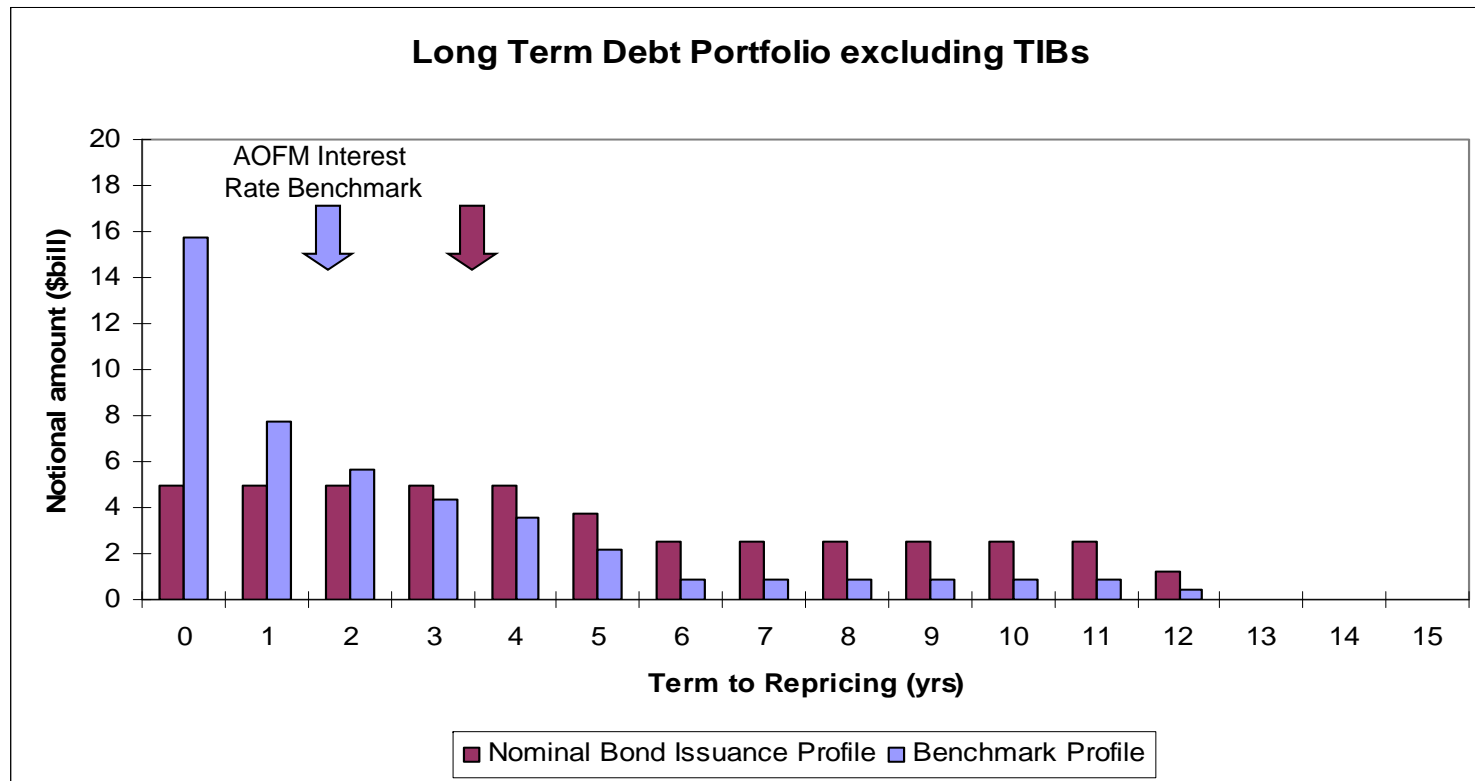
- Bond issuance to meet futures market objectives produces a relatively long duration portfolio.





Portfolio Management

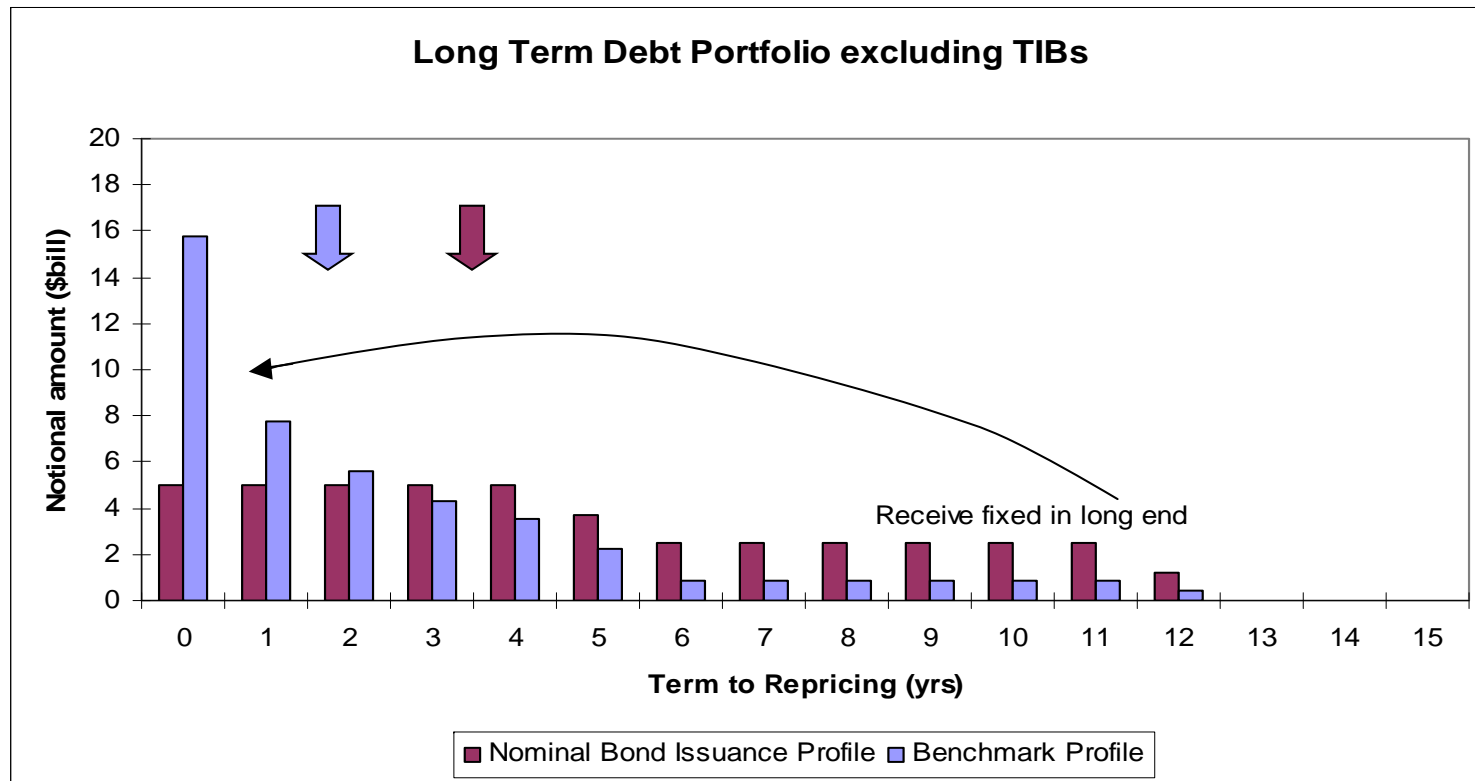
- The benchmark has lower duration and lower expected cost.





Portfolio Management

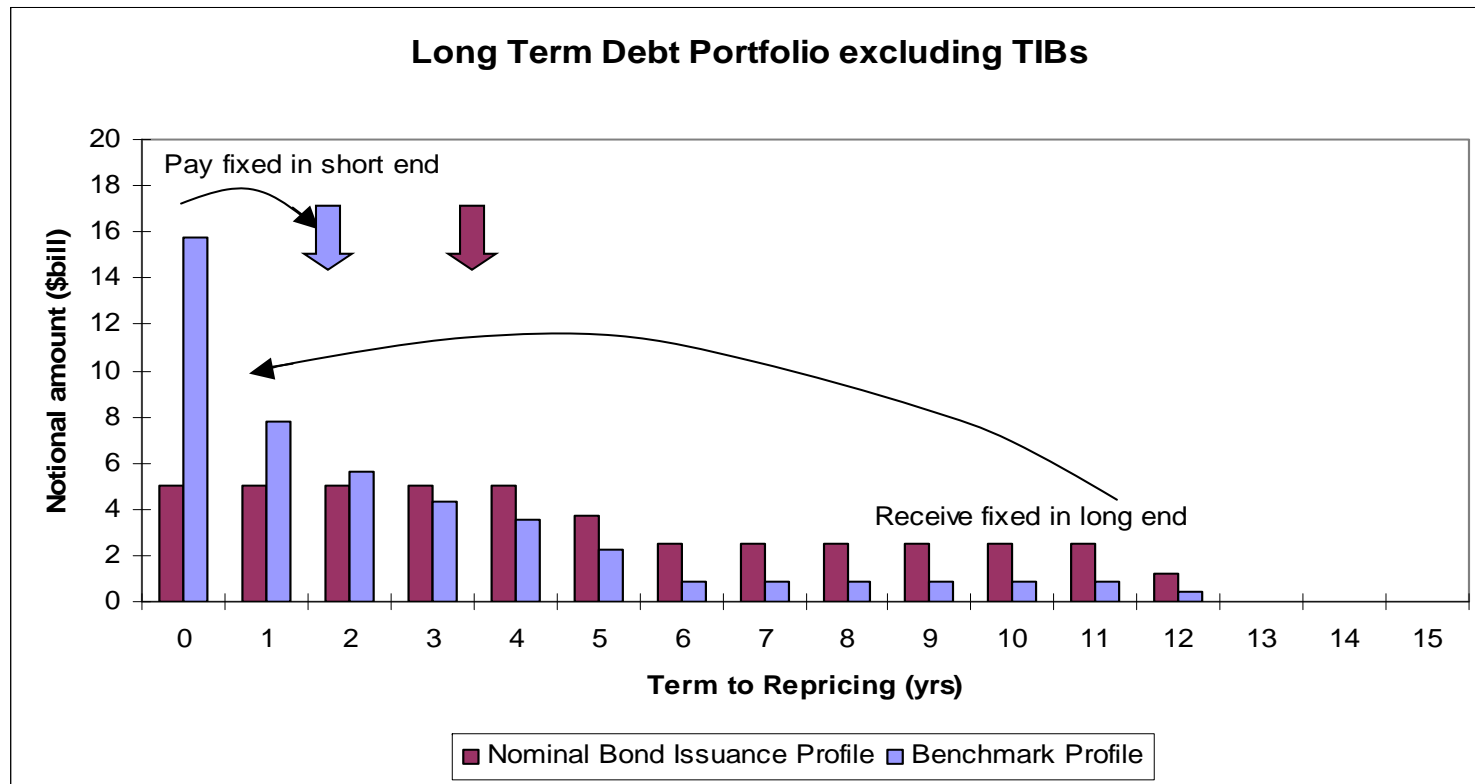
- Receiving fixed in the long end reduces duration.





Portfolio Management

- Paying fixed in the short end spreads reset risk.





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Swap Activity 2003-04

- Resumed executing interest rate swaps in October 2003.
- Total program of \$7.6 billion comprised:
 - \$3.3 billion of short dated pay swaps.
 - \$4.3 billion of long dated receive swaps.



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Swap Activity 2004-05

- Indicative Program.
- Around \$3 ½ billion of short dated pay swaps (terms 2 - 4 years).
- Around \$6 billion of long dated receive swaps (terms of at least 5 years).
 - Continue to test market appetite beyond 10 years.
- Commencing later this week.



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Swap Activity 2004-05

- This program represents about the same monthly level of swap activity as in 2003-04.
 - When the program operated for only 9 months.
 - Whereas this year it will operate for 12.
- It should allow us to complete the transition to the new benchmark portfolio by end June 2005, subject to market conditions and budget developments.



Collateral Arrangements

- We are discussing with counterparties the introduction of collateral arrangements on our interest rate swaps.
- Main features:
 - Club deal (collateral thresholds tied to credit ratings).
 - one-way collateral.
 - AUD cash only form of eligible collateral.
 - AOFM will pay interest at the RBA cash rate.
 - In the form of a Credit Support Annex to the ISDA Master Agreement.
- Will provide draft CSA to counterparties shortly.



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