



Australian Government
Australian Office of Financial Management

Australian Business Economists

AOFM - Activities for 2005-06

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13 July 2005

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Outline

- Bond Issuance and Market Efficiency
- CGS Tender Arrangements
- Interest Rate Swaps
- Collateral Arrangements
- Cash Management

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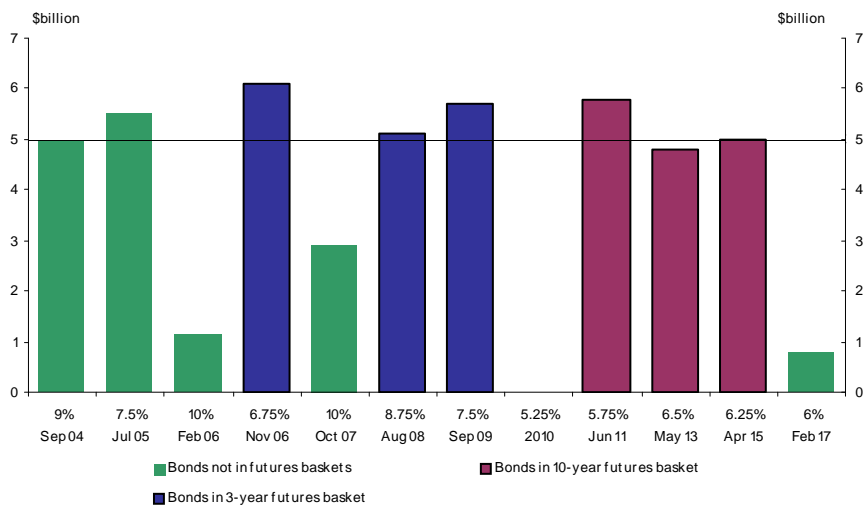


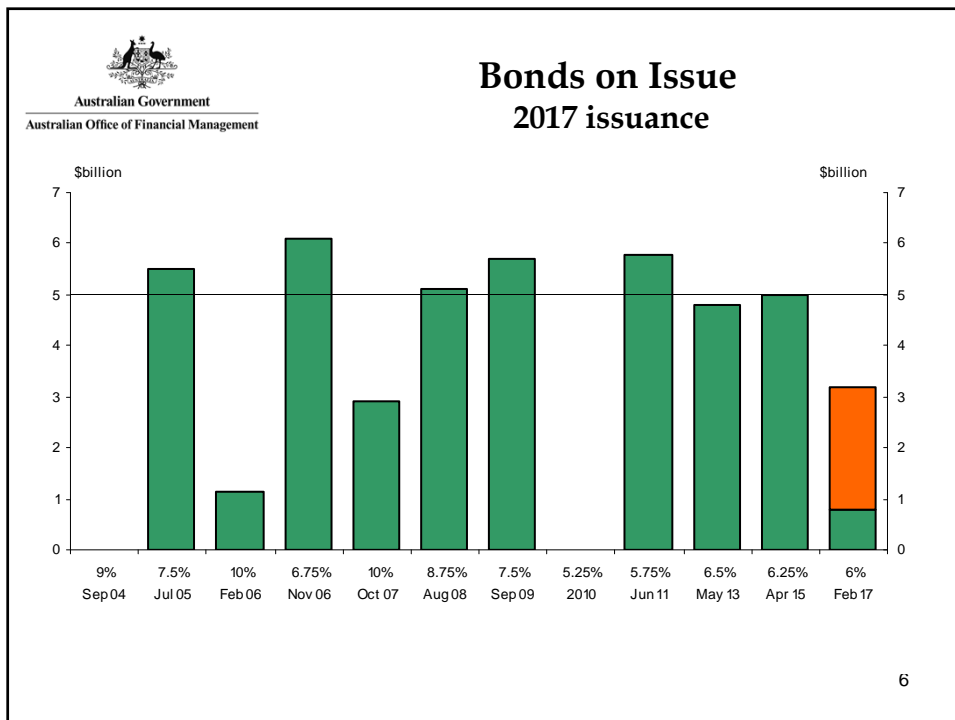
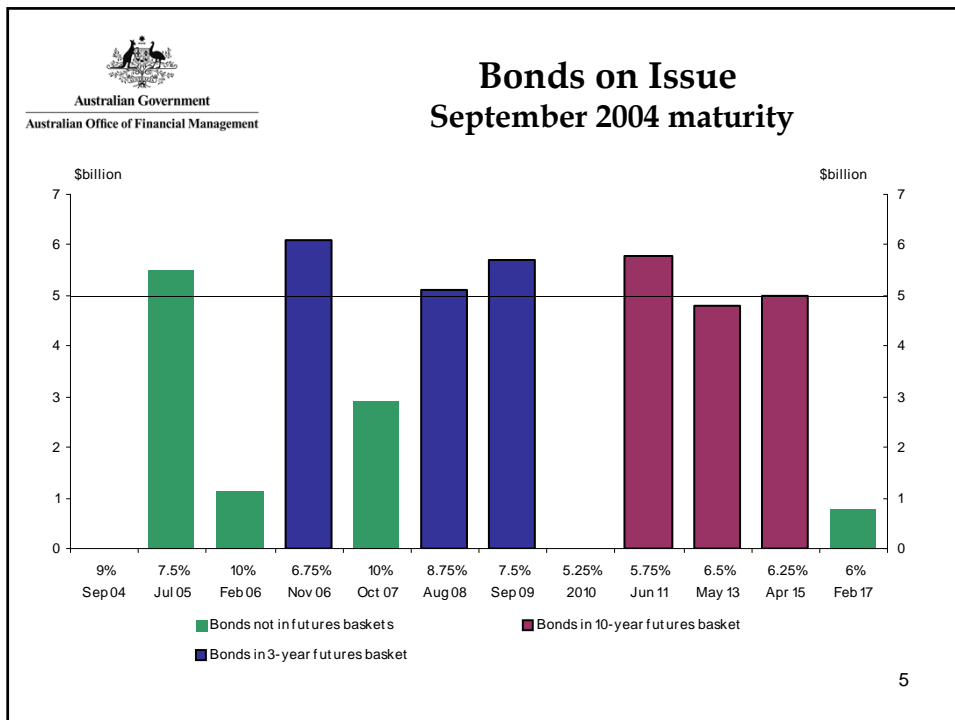
Bond Issuance - Objectives

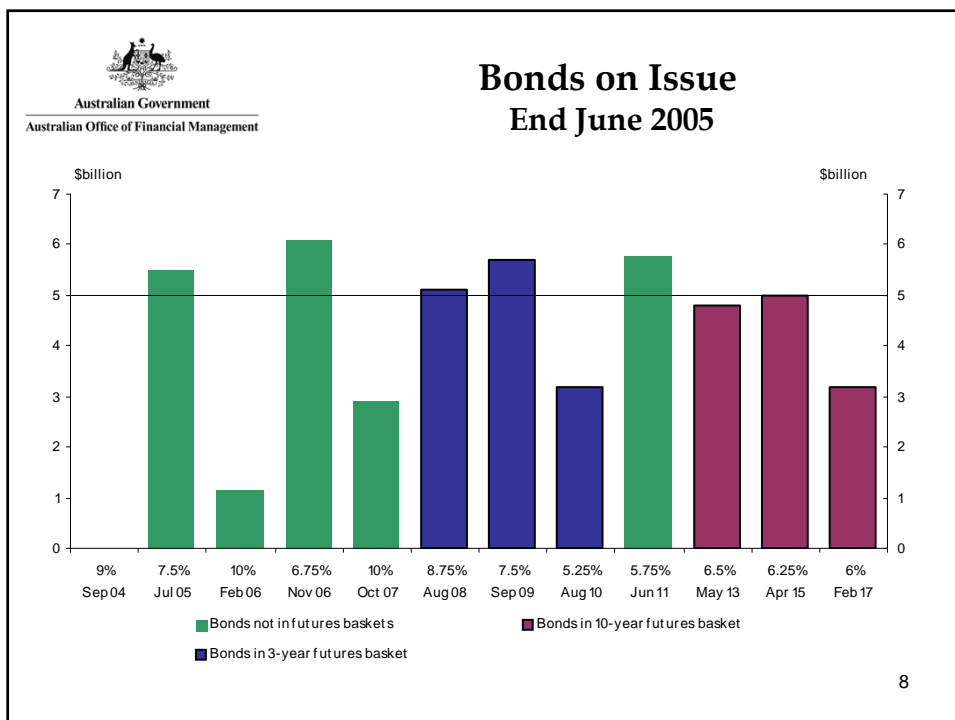
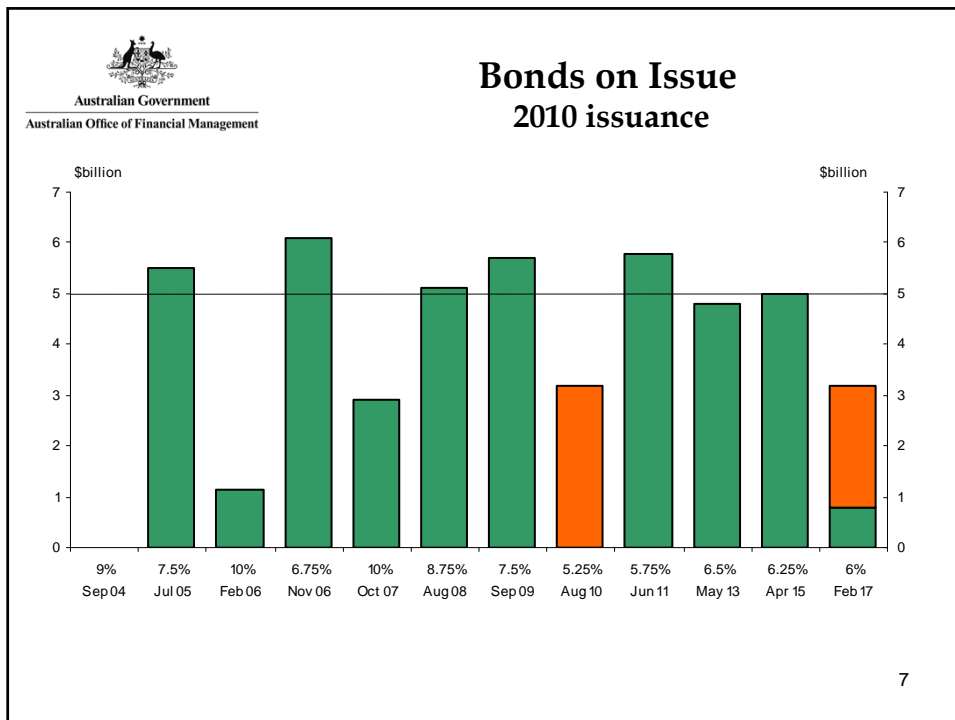
- The aim of Treasury bond issuance is to maintain the bond and bond futures markets.
- We issue:
 - Mid-curve bonds to support the 3-year futures contract.
 - Long-dated bonds to support the 10-year contract.
- Each bond line is built up to around \$5 billion.



Bonds on Issue End June 2004



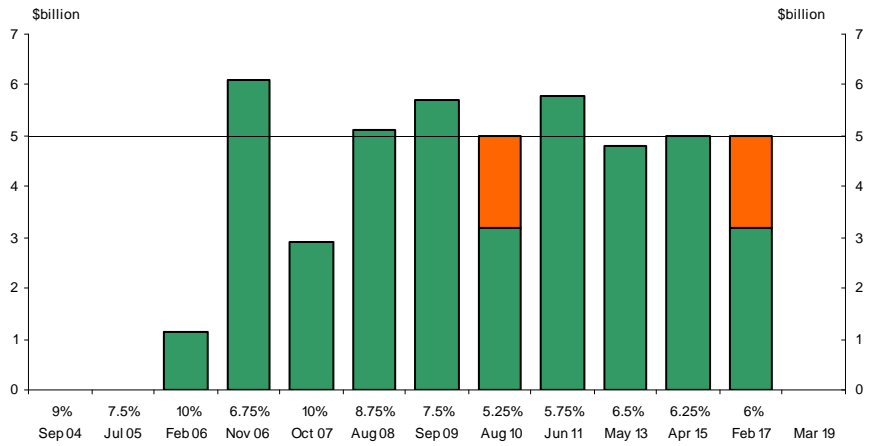






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Bonds on Issue End December 2005

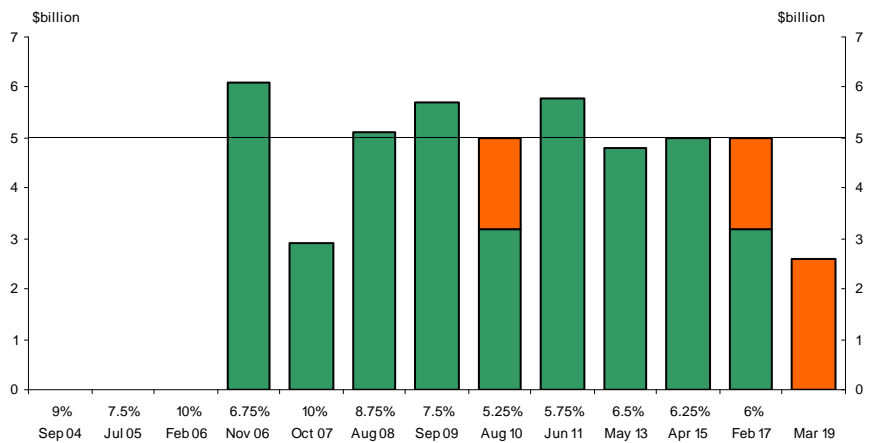


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Bonds on Issue End June 2006



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Bond Market Efficiency

- Over the past year the CGS market has been operating efficiently, with fine two-way pricing.
- Some instances of tightness in repo market affecting individual stocks for brief periods.
- AOFM will continue to monitor conditions and maintain contact with market participants, RBA, AFMA and the SFE.



Securities Lending Facility

- A securities lending facility was established in September 2004.
- Operated by the RBA on behalf of AOFM.
- Intended to enhance liquidity and price making, without undermining the normal functioning of the market.



Securities Lending Facility

- The facility has been used 40 times so far and appears to be working smoothly.
- We don't intend to adjust the margin or change other operational details at this time.



Tender Arrangements

- We have reviewed arrangements for the conduct of tenders for the issue of CGS.
 - The review included consultations with market participants and the RBA.
- Two changes:
 - Shorter time to the announcement of results.
 - New bidding system.



Tender Arrangements

- Shorter period between the closing time for submitting bids and announcement of tender:
 - Tender results will normally be announced within *15 minutes* of the close of bidding.
 - New arrangements will take effect from 26 July 2005.

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Tender Arrangements

- AOFM is also looking for a new system for the collection and processing of CGS tender bids.
 - We expect to issue a detailed request for tender later this calendar year.
 - New system operational in 2006-07.
- The new system should provide improvements in the conduct of tenders, including a further reduction in the 'announcement window'.

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Swap Activity 2004-05

- Last year we announced a program of interest rate swaps for 2004-05 of around \$9.5 billion.
- The indicative program provided for:
 - Around \$3.5 billion in short-dated swaps to pay fixed; and
 - Around \$6 billion in longer-dated swaps to receive fixed.

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Swap Activity 2004-05

- The program was suspended in May 2005 due to:
 - Unfavourable market conditions; and
 - The prospective transfer of seed capital to the Future Fund.
- Total swap activity in 2004-05:
 - \$2 billion in short-dated swaps to pay fixed.
 - \$4.6 billion in longer-dated swaps to receive fixed.

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Swap Activity 2005-06

- 2005-06 indicative program:
 - Around \$2 billion in short-dated paying.
 - Up to \$1 billion in long-dated receiving.
 - Subject to market conditions.



Swap Activity 2005-06

- The 2005-06 indicative swap program is smaller than those of recent years.
- This reflects:
 - A change to the benchmark portfolio in response to changing market conditions; and
 - The impact on the portfolio of transfers to the Future Fund.



Benchmark Portfolio

- We use interest rate swaps to manage the expected cost and risk of the portfolio, using a benchmark as a guide.
- The benchmark aims to indicate a desirable balance between cost and variability of cost (risk).

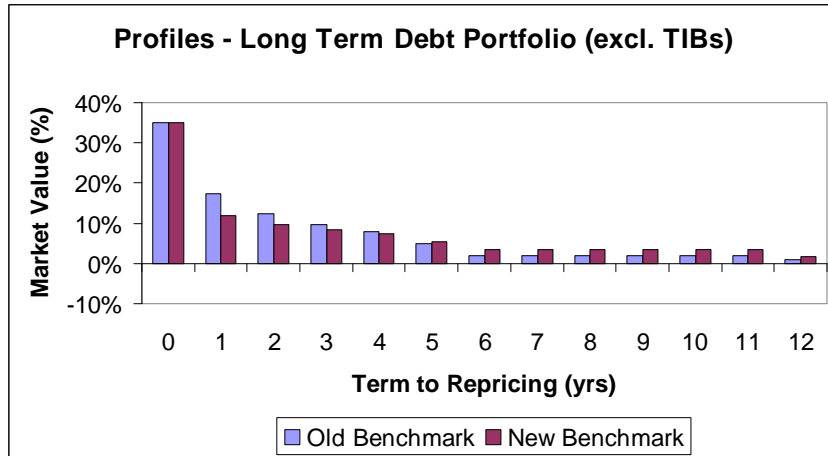


Benchmark Portfolio

- From 1 July 2005, the benchmark announced in September 2003 has been changed.
 - Modified Duration has been raised from 2 to 2.5.
 - Short Dated Exposure has been kept at 35%.
- An important factor has been that we have lowered our estimate of the term premium, reflecting changes in yield curves over recent years.
- Increased duration of the benchmark reduces the need for swaps.



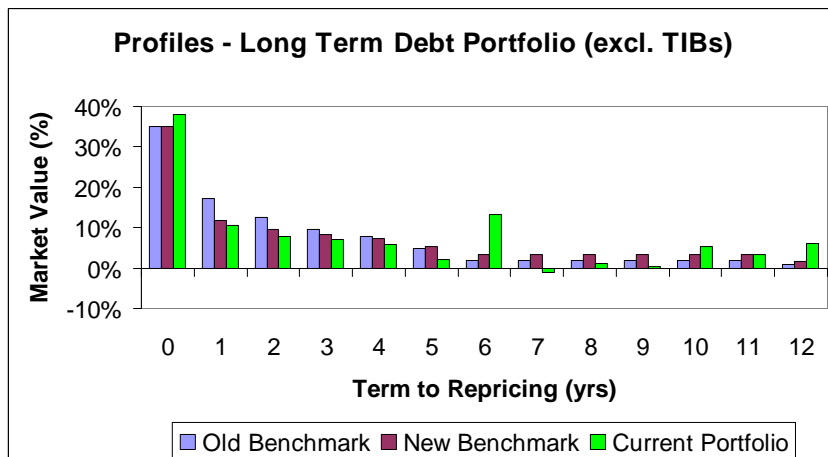
Portfolio Management



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Portfolio Management



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Benchmark Portfolio

- The AOFM will be reviewing its approach to the benchmark during the year.
- Including whether we should take account of other interest rate risks on the Australian Government's balance sheet.



Impact of the Future Fund

- The Government has announced that around \$16 billion of assets will be transferred to the Future Fund later this year as seed capital.
- The transfer of these assets will act to reduce the duration of AOFM's net debt portfolio:
 - offsetting the upward pressure caused by bond issuance; and
 - reducing the need for interest rate swaps to receive fixed rates.
- This is a one-off effect that will occur only this financial year.



Swap Arrangements - Collateral

- Last year I indicated that we were looking to introduce collateral on our interest rate swaps.
- We have now done so.
- Agreements are in place with 10 counterparties and others are well advanced.

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Swap Arrangements - Collateral

- Collateral will allow us to increase our range of eligible counterparties.
 - New counterparties (with ratings of A or better) will need to sign a collateral agreement to do swaps with us.
 - Swap business with *existing* counterparties is not at this stage contingent upon having a collateral agreement.
 - But credit limits may impact on our capacity to do swaps with existing counterparties who have not yet executed collateral agreements.

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Swap Arrangements

- We have decided to increase the number of counterparties that we contact for bids when undertaking swaps from three to four.
- We will in future normally include the successful bidder from the previous swap tender, provided it has a collateral agreement with us.



Cash Management

- Term deposits remain our primary cash management tool.
 - T-Notes secondary tool and issued as required.
- T-Note issuance for 2004-05 was zero.
- T-Note issuance for 2005-06 **may** be required to meet within year financing requirements.
 - The need for T-Note issuance will be dependent upon the size and timing of the transfer of assets to the Future Fund.



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