



**Australian Government**

**Australian Office of Financial Management**

## **Australian Business Economists**

# **AOFM – Activities for 2006-07**

**Presentation by Neil Hyden  
Chief Executive Officer, AOFM  
5 July 2006**



Australian Government

Australian Office of Financial Management

# Outline

- Bond Issuance and Market Efficiency.
  - CGS Tender Arrangements.
- Interest Rate Swaps.
  - Swap Activity 2005-06.
  - Benchmark review.
  - Swap Activity 2006-07.
  - Use of discretion.
  - Swap arrangements.
- Communications Fund.



Australian Government

Australian Office of Financial Management

## Bond Issuance – Objectives

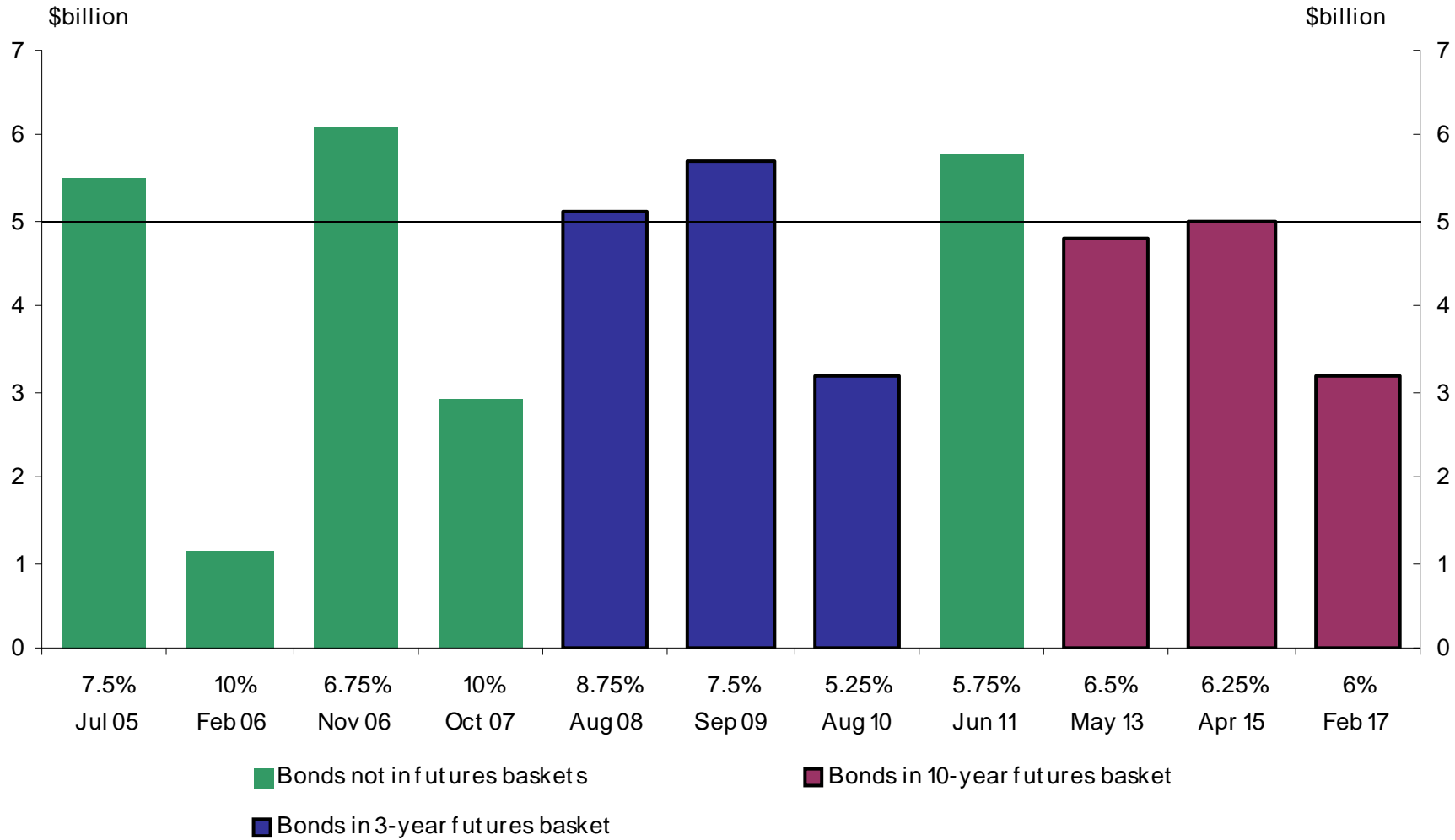
- Bond issuance is targeted to maintain the Treasury Bond and bond futures markets.
- We issue:
  - Mid-curve bonds to support the 3-year futures contract.
  - Long-dated bonds to support the 10-year contract.
- Each bond line is built up to around \$5 billion.



Australian Government

Australian Office of Financial Management

# Bonds on Issue End June 2005

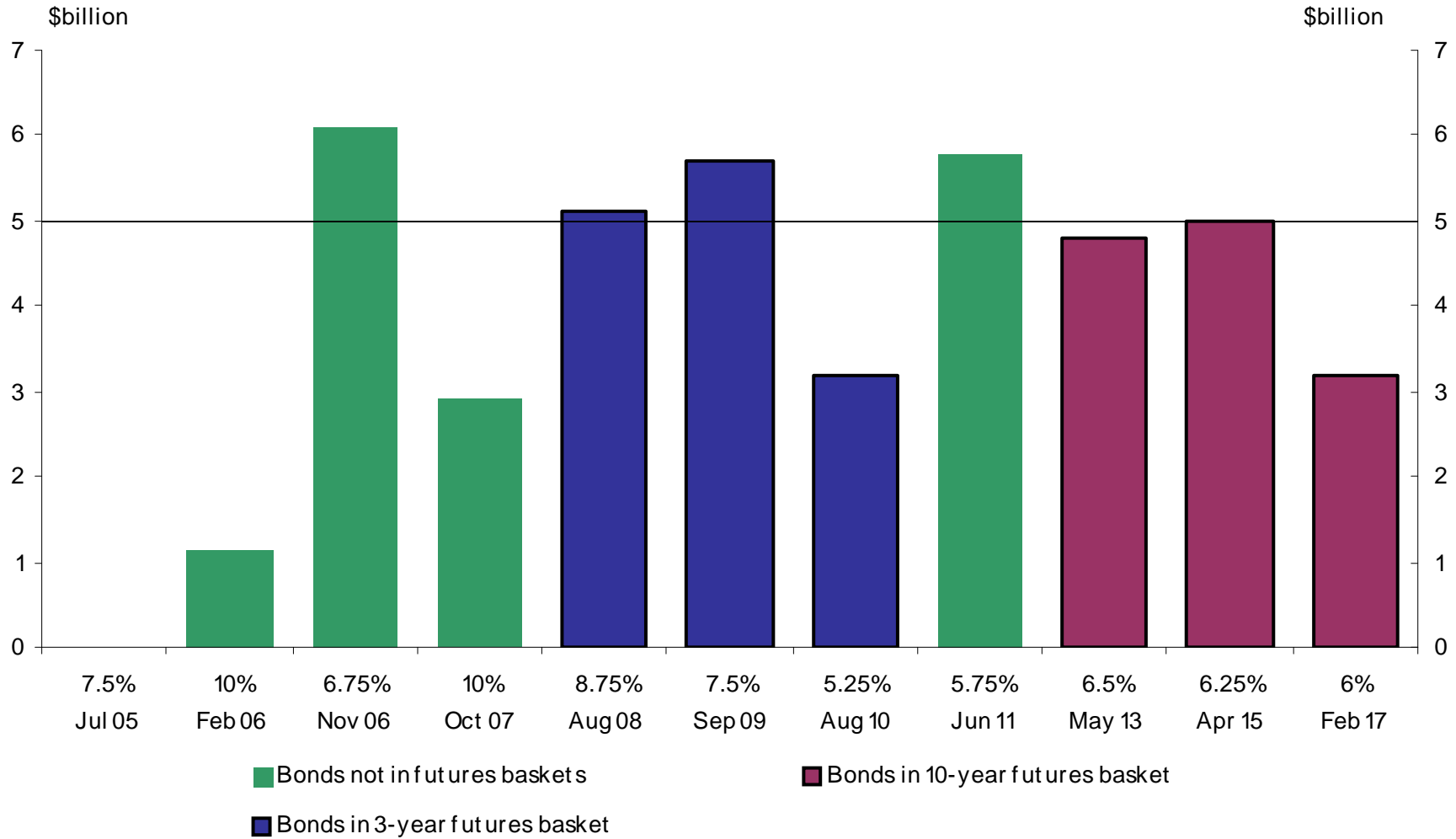




Australian Government

Australian Office of Financial Management

# Bonds on Issue July 2005 maturity



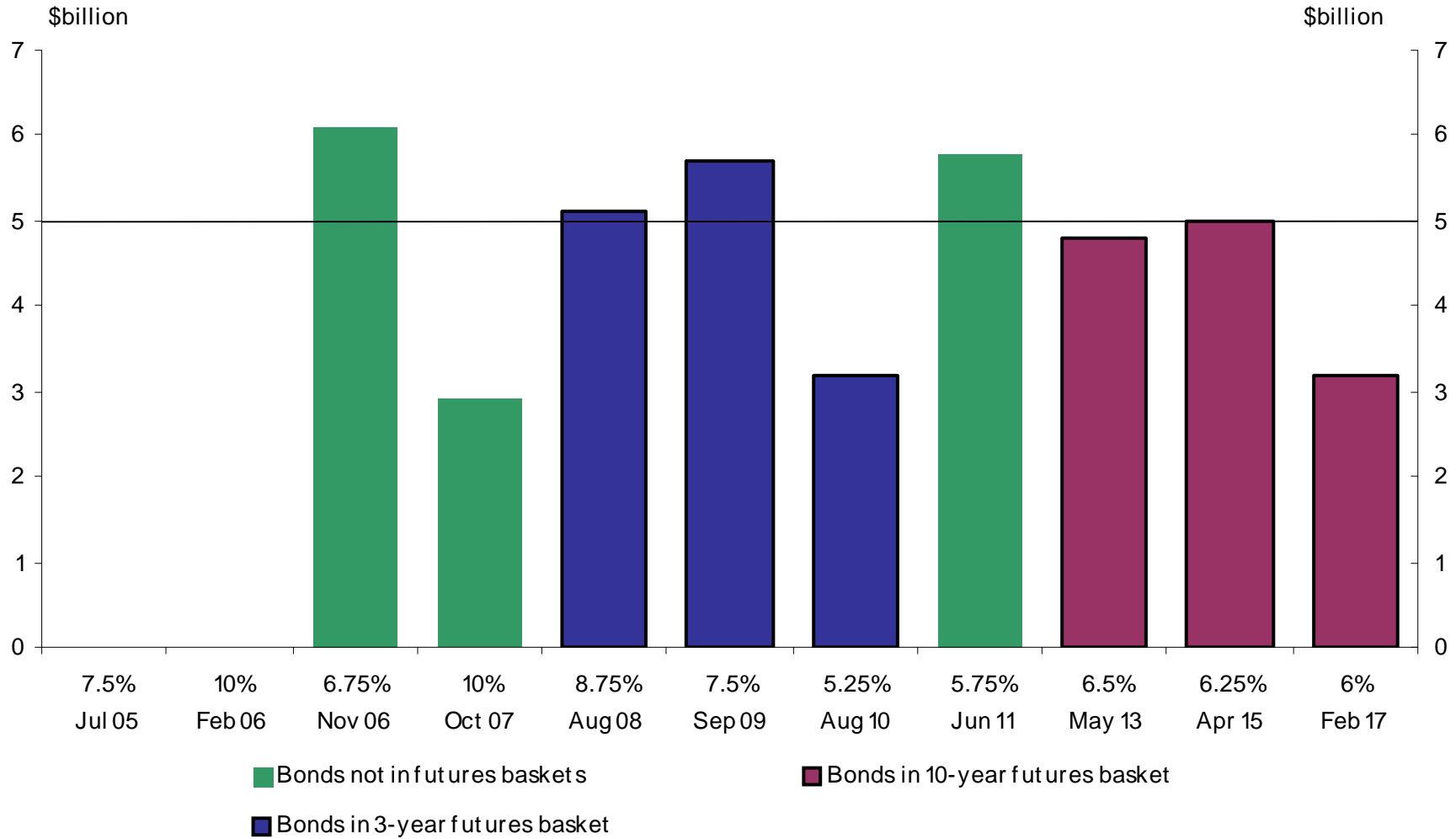


Australian Government

Australian Office of Financial Management

# Bonds on Issue

## February 2006 maturity

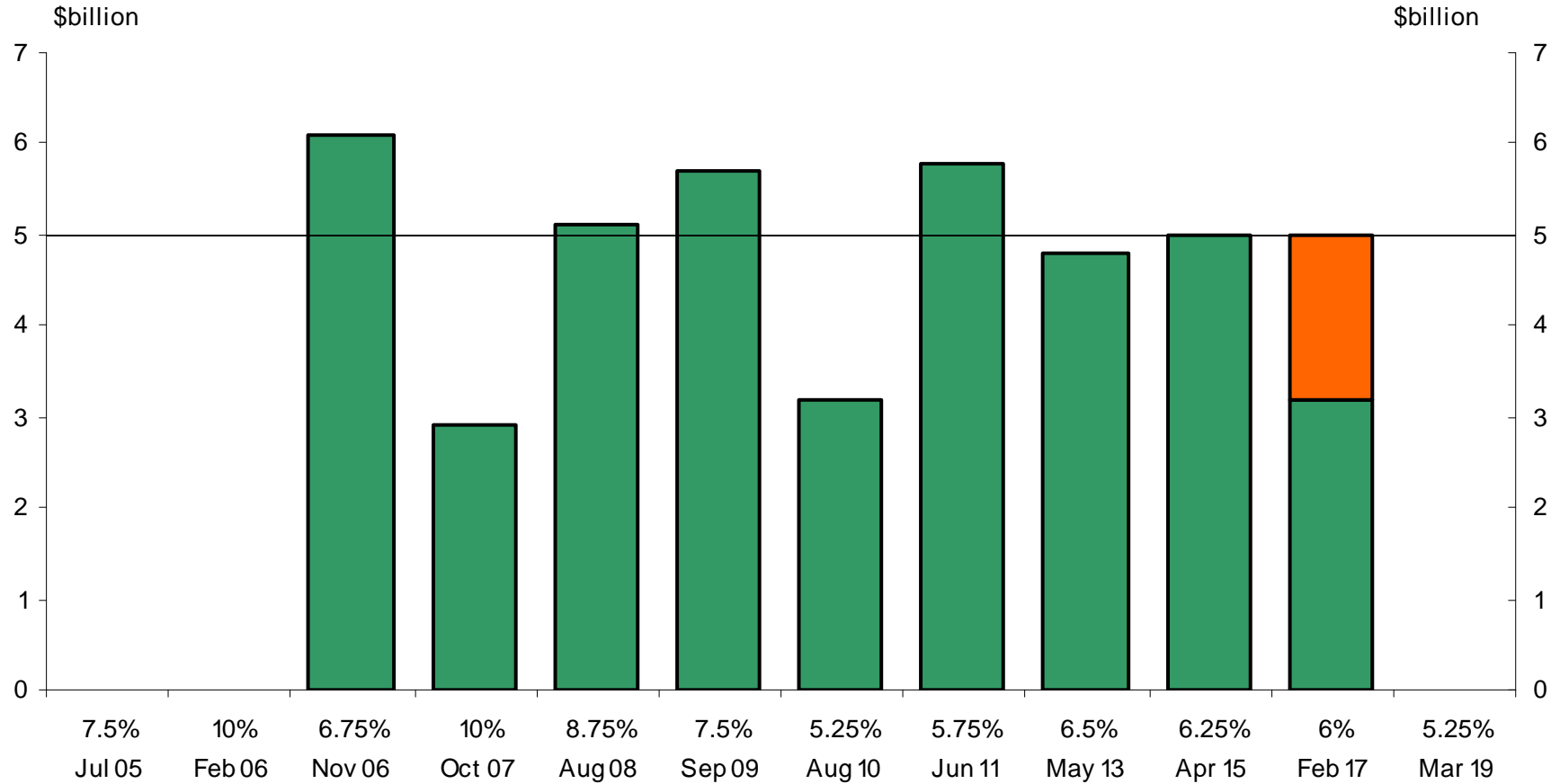




Australian Government

Australian Office of Financial Management

# Bonds on Issue 2017 issuance

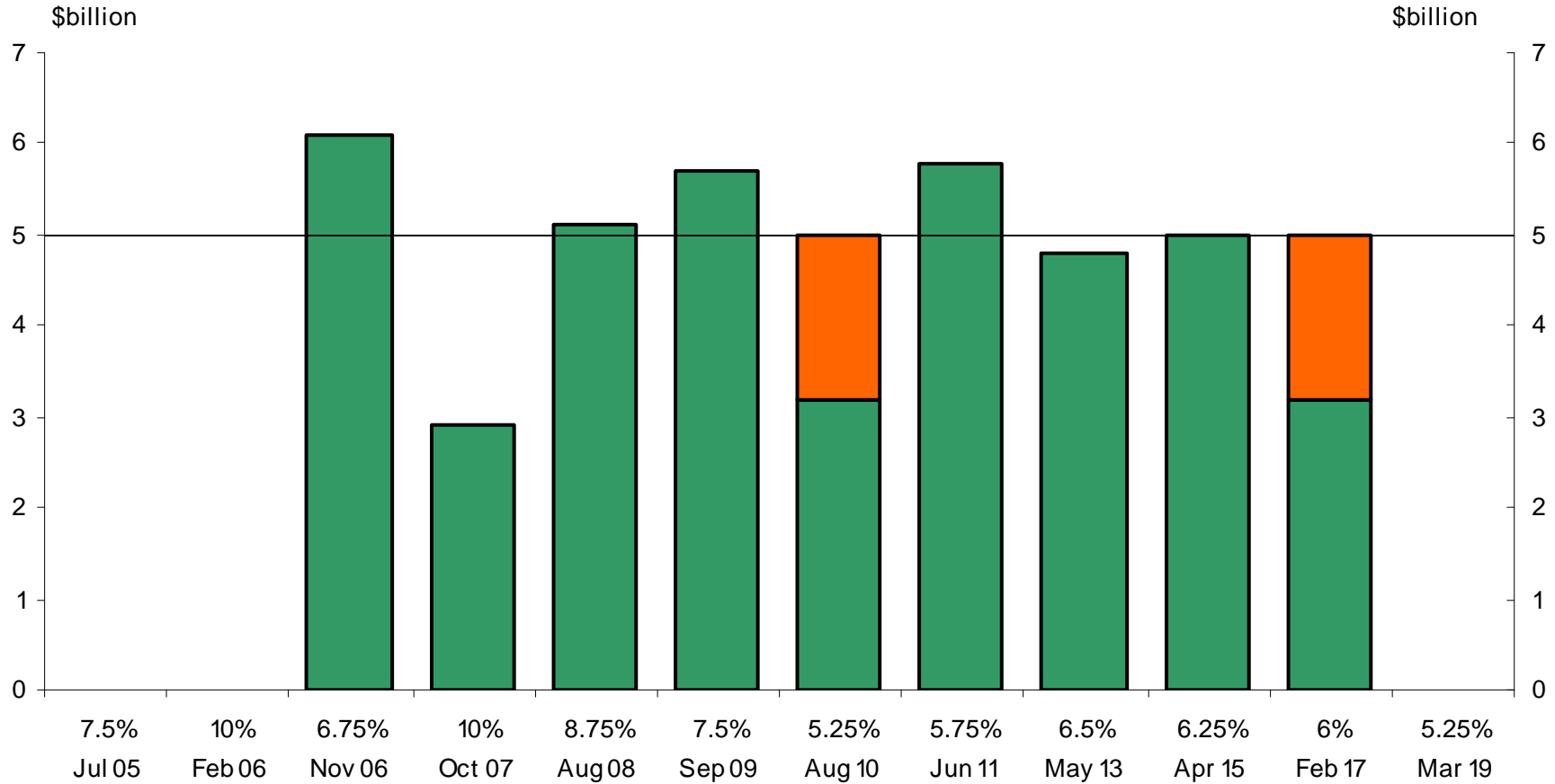




Australian Government

Australian Office of Financial Management

# Bonds on Issue 2010 issuance



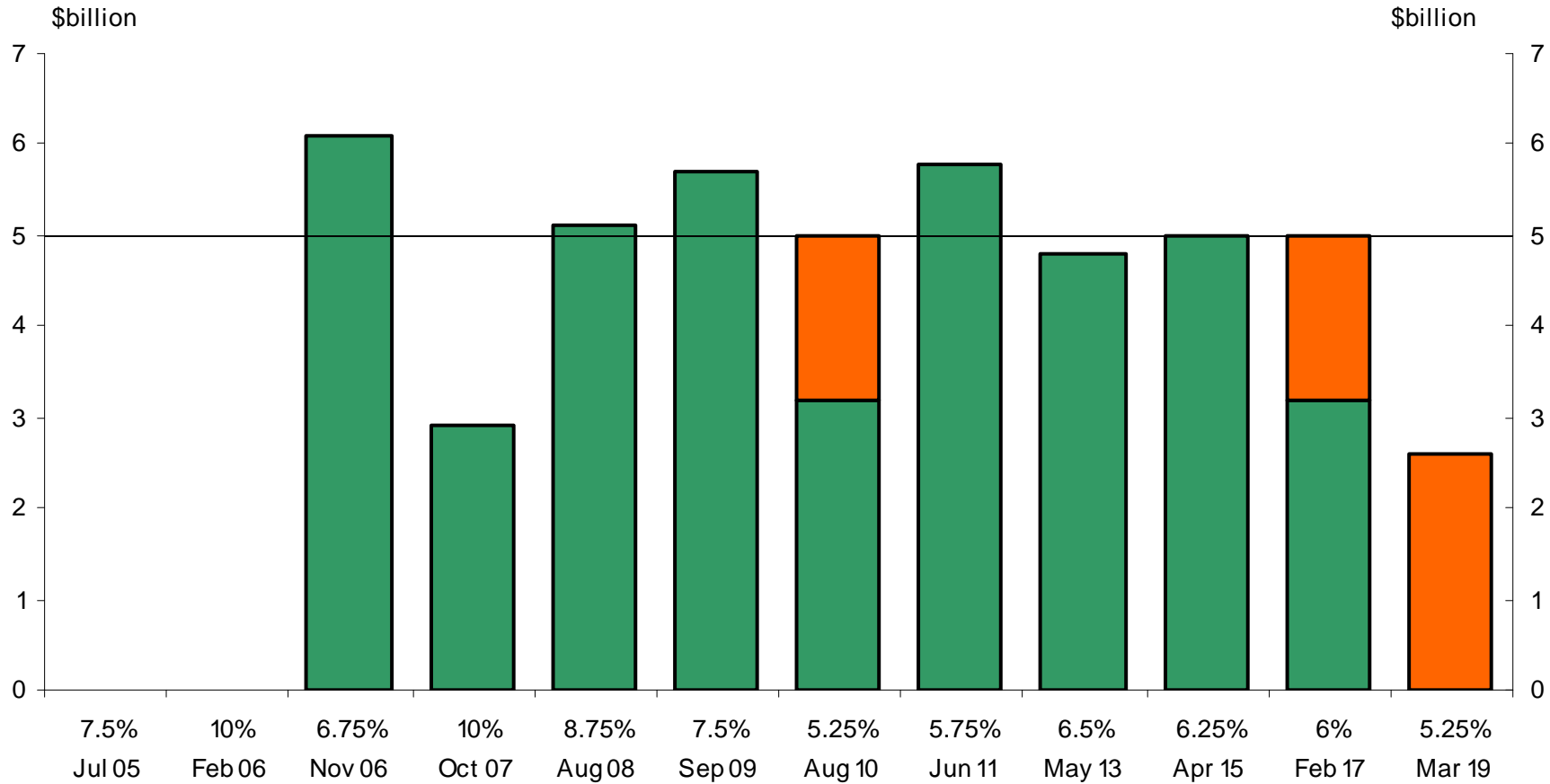




Australian Government

Australian Office of Financial Management

# Bonds on Issue 2019 issuance

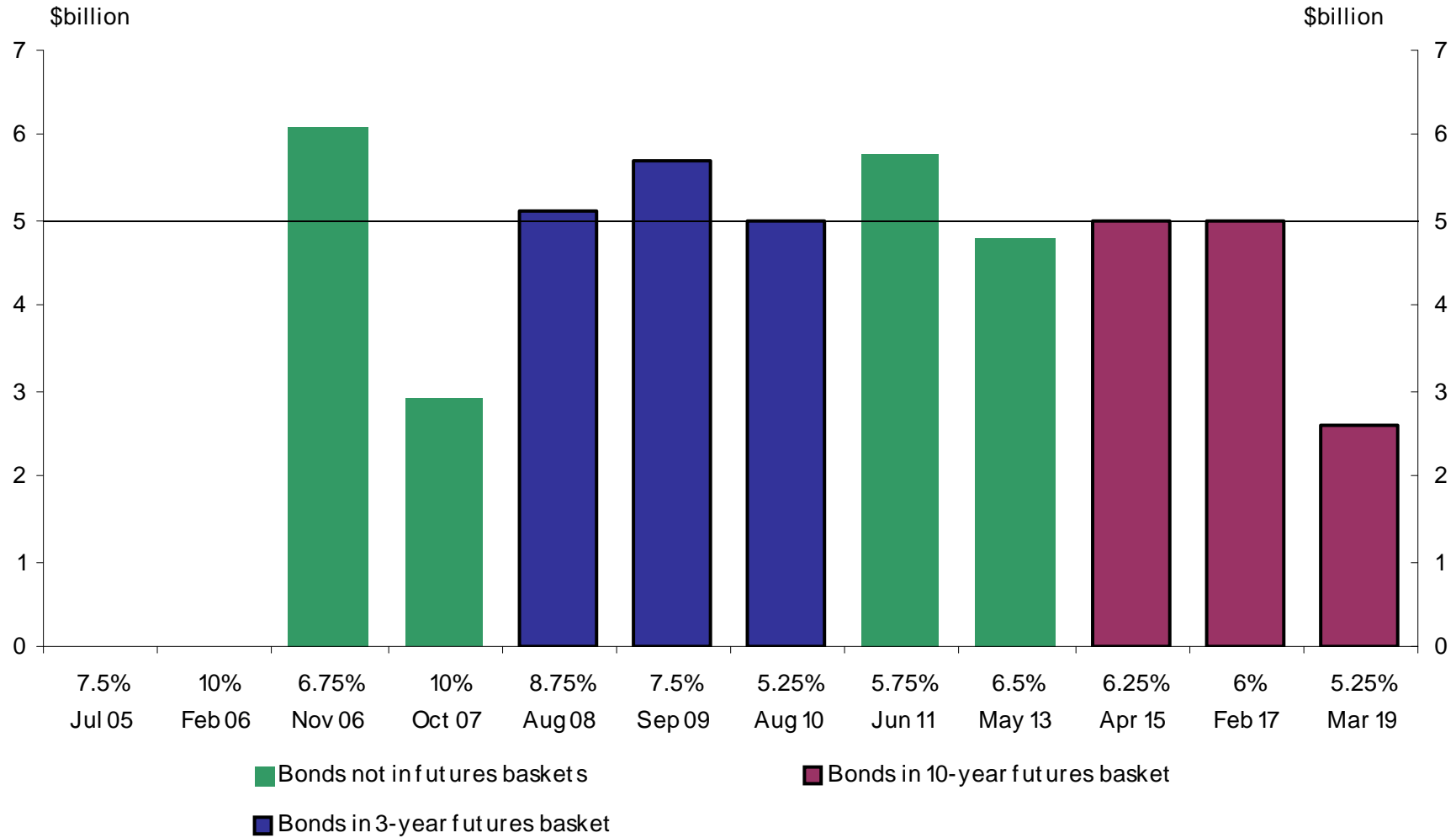




Australian Government

Australian Office of Financial Management

# Bonds on Issue End June 2006

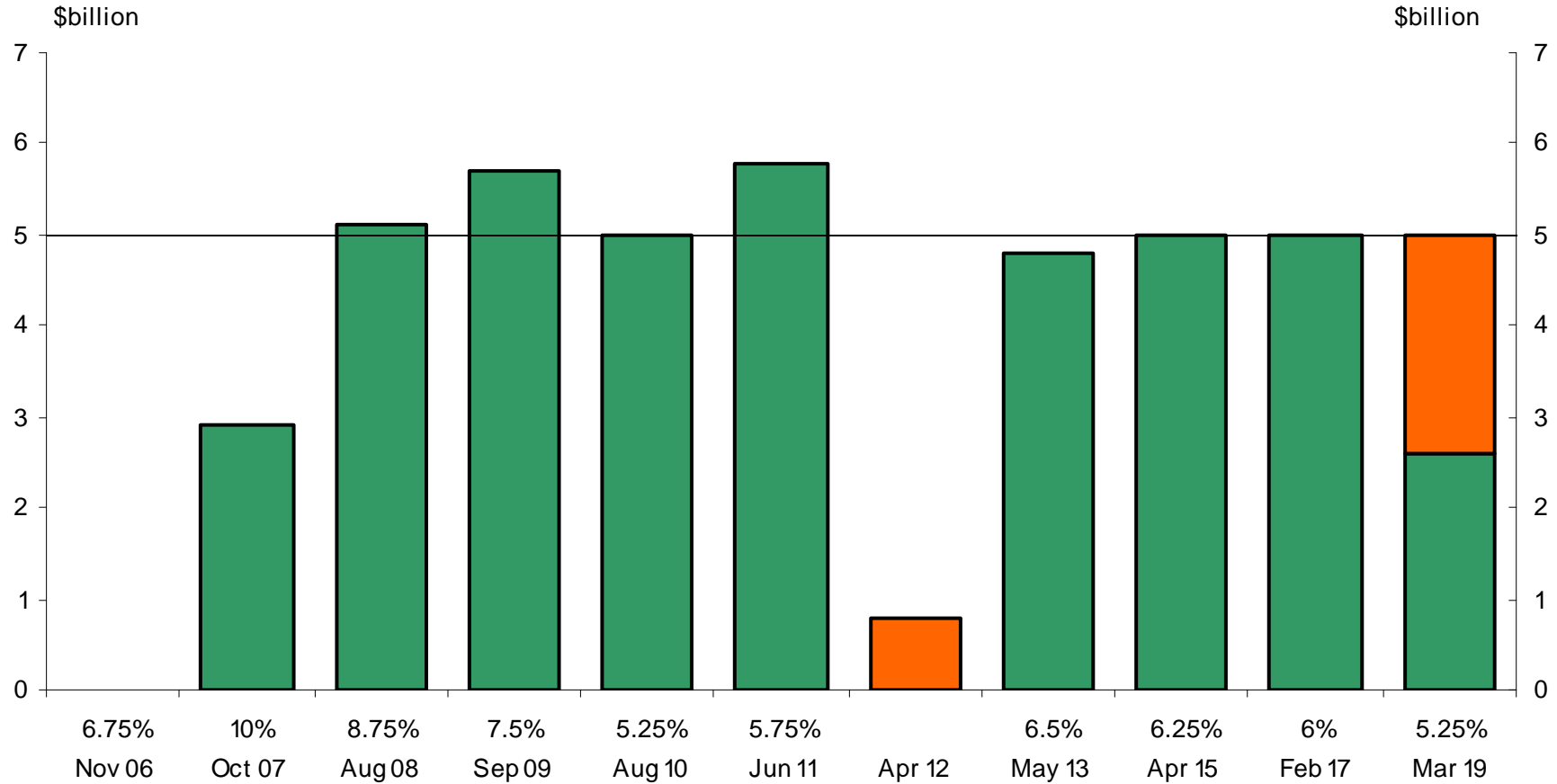




Australian Government

Australian Office of Financial Management

# Bonds on Issue End December 2006

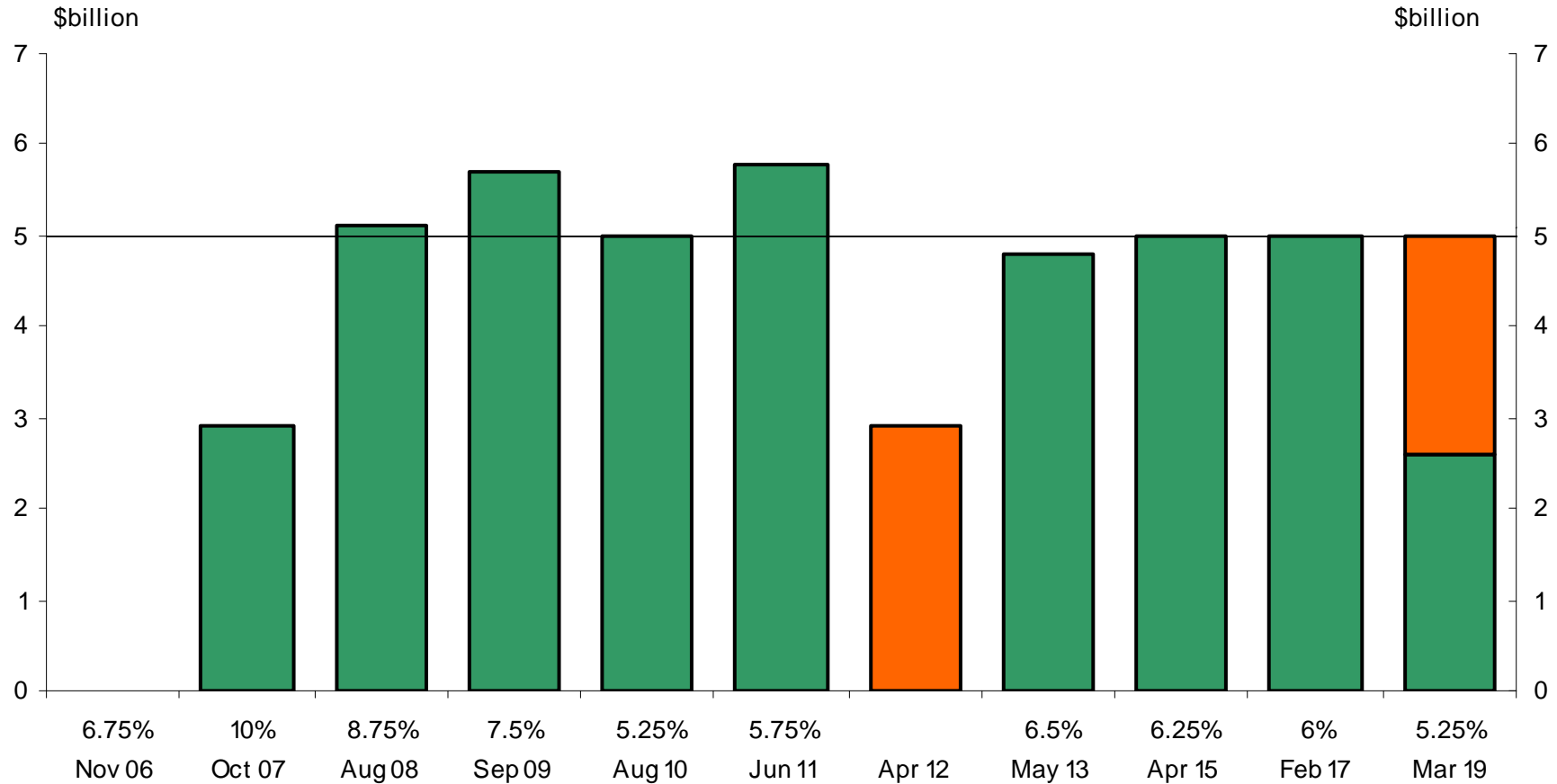




Australian Government

Australian Office of Financial Management

# Bonds on Issue End June 2007





Australian Government

Australian Office of Financial Management

# Bond Market Efficiency

- We are concerned to maintain the efficiency of the Treasury bond and bond futures markets.
  - Welcome feedback from market participants.
  - Monitor market conditions and developments.
  - Maintain close contact with RBA, AFMA and SFE.



# Bond Market Efficiency

- During 2005-06:
  - Fine two-way pricing was maintained.
  - Some instances of tightness in the repo market.
    - But not protracted or unusual.
  - Usage of Securities Lending Facility (37 times) was less than in 2004-05.
    - Mostly May 2013 or April 2015 bonds.
    - Mostly for one day.
- Most participants report that liquidity is generally available.



Australian Government

Australian Office of Financial Management

# Bond Market Efficiency

- Turnover of Treasury Bonds has declined.
  - Although turnover of Treasury bond futures has increased.
- Overall, the markets appear to be operating efficiently.



# Tender Arrangements

- We are introducing a new tender system for the issue of CGS.
  - Bloomberg Auction System.
- Benefits include:
  - Bidders can view their bids and amend them up till close of tender
  - Plausibility limits.
    - 5 basis points from mid market.
  - Potential to further reduce the announcement window.





# Tender Arrangements

- First Treasury Bond tender using the new system is scheduled for 10 October 2006.
  - Documentation will be sent to all price makers and other current RITS members shortly.
  - Users will need to sign a new registered bidders agreement and conditions of operation.
  - Test tenders will be conducted using the new system.
  - Training will be available from Bloomberg.



# Outline

- Bond Issuance and Market Efficiency.
  - CGS Tender Arrangements.
  
- Interest Rate Swaps.
  - Swap Activity 2005-06.
  - Benchmark review.
  - Swap Activity 2006-07.
  - Use of discretion.
  - Swap arrangements.
  
- Communications Fund.



# Interest Rate Swaps

- We use interest rate swaps to manage the expected cost and risk of the portfolio.
- Use a benchmark as a guide to indicate a desirable balance between cost and variability of cost (risk).
  - The benchmark has a medium term focus and is reviewed annually.



Australian Government

Australian Office of Financial Management

## Swap Activity 2005-06

- Last year we announced a programme of interest rate swaps for 2005-06 of:
  - around \$2 billion in short-dated swaps to pay fixed; and
  - up to \$1 billion in longer-dated swaps to receive fixed.
- Subject to market conditions.



## Swap Activity 2005-06

- This indicative programme took account of the planned transfer of assets to the Future Fund.
- This transfer:
  - acted to reduce the duration of our net debt portfolio;  
and
  - reduced the need for swaps to receive fixed.
- This was a one-off effect that won't occur again.



## Swap Activity 2005-06

- Our execution of the swap programme was affected by market conditions.
  - Executed short-dated swaps to pay fixed in the period up to end February 2006 and longer-dated swaps to receive fixed in May and June 2006.
  - Did not undertake swaps where conditions were significantly out of line with the assumptions underlying the benchmark.
- Will talk more about market conditions and swap execution in a moment.



Australian Government

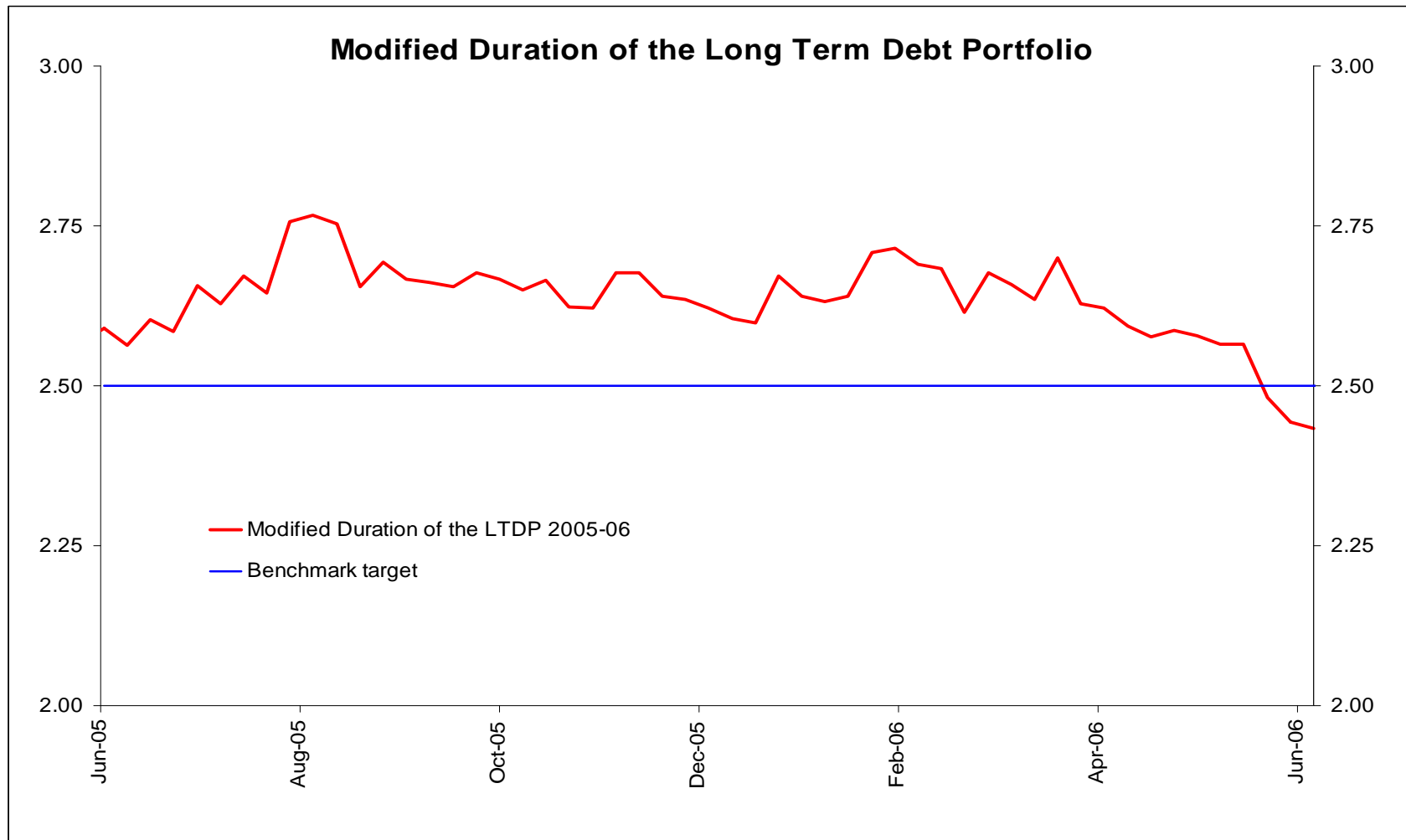
Australian Office of Financial Management

## Swap Activity 2005-06

- As a result:
  - Total swap activity in 2005-06 was less than planned:
    - \$1.3 billion in short-dated swaps to pay fixed.
    - \$0.3 billion in longer-dated swaps to receive fixed.
  - Portfolio duration remained above benchmark for most of 2005-06, although it ended the year slightly below benchmark.



# Duration Profile 2005-06







Australian Government

Australian Office of Financial Management

# Benchmark Portfolio

- Recent annual benchmark review concluded no change to benchmark.
  - Modified Duration 2.5.
  - Short Dated Exposure 35%.



Australian Government

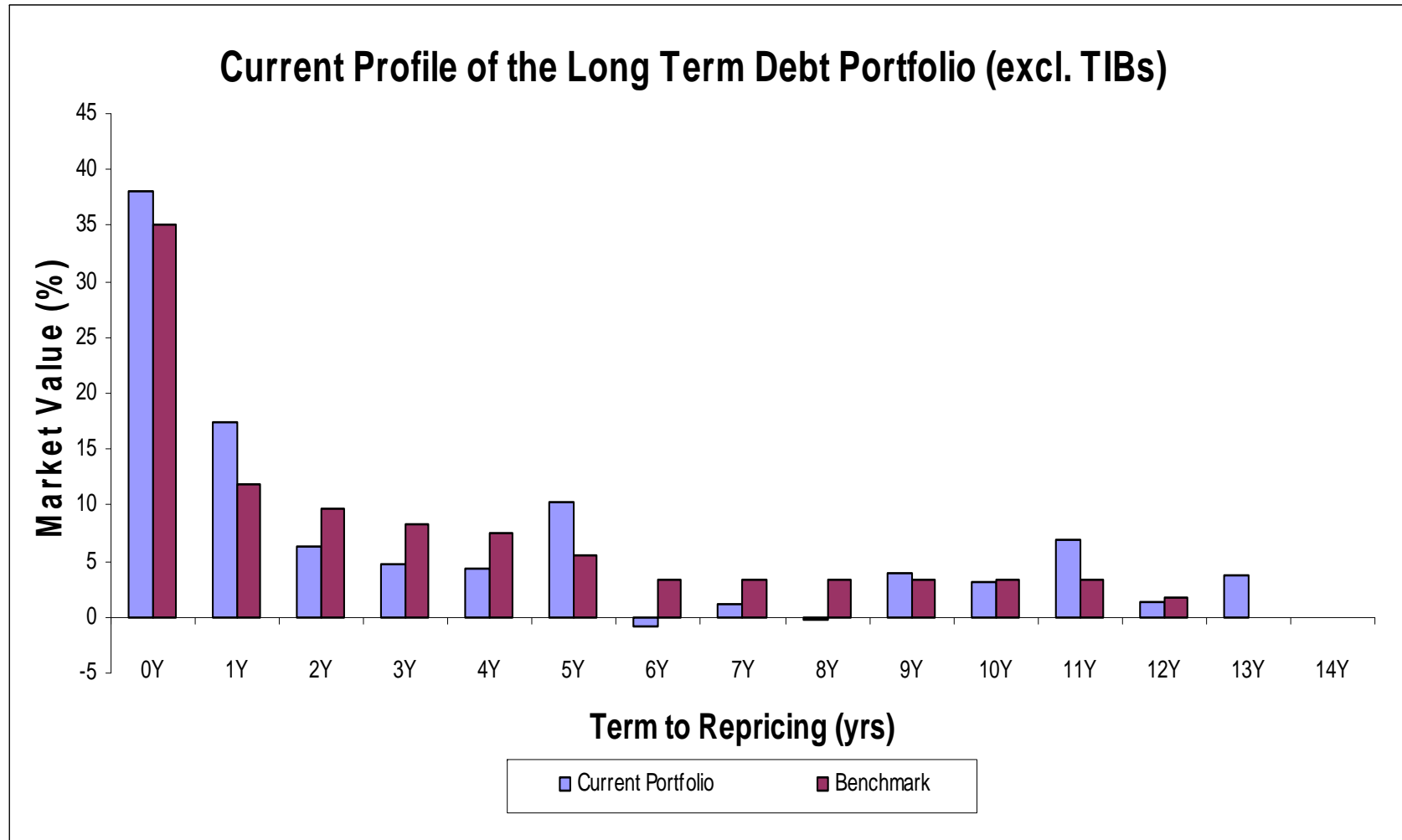
Australian Office of Financial Management

## Swap Activity 2006-07

- 2006-07 indicative programme:
  - Up to \$2 billion in short-dated swaps to pay fixed (up to 3 years).
  - Between \$1 billion and \$3 billion in longer-dated swaps to receive fixed (at least 4 years).
  - Subject to market conditions.



# Repricing Profile





## Use of Discretion

- ‘Subject to market conditions’ means we will continue to exercise discretion in undertaking swaps.
- Execution of the programme at the upper end of the ranges would allow us to follow the benchmark closely.
- But we will not follow the benchmark blindly at times when there is a high chance that the benchmark term premium assumption won’t be realised.



## Use of Discretion

- Our approach is tilted towards reducing absolute risk when conditions are unfavourable.
  - And against increasing risk to take advantage of favourable conditions.
- In particular, we will be cautious about:
  - executing swaps that would increase the absolute risk of the portfolio when the expected benefits are significantly less favourable than the benchmark assumptions; and
  - executing short-dated swaps to pay fixed rates when the expected cost is significantly higher than the benchmark assumption.



## Use of Discretion

- In assessing market conditions we compare current conditions with the assumptions in the benchmark, rather than seeking to forecast movements in rates.
- There is an important difference between identifying that something is expensive and taking a view that it will get cheaper at a later date.



## Use of Discretion

- At the beginning of the year we announce the overall scale of the swap programme and the areas of the curve where we will pay and receive fixed.
- This prevents round-tripping:
  - We cannot pay and receive fixed at the same tenor in the same financial year.
  - Helps ensure that our activities are consistent with promoting market efficiency and are not perceived as ‘trading’.



Australian Government

Australian Office of Financial Management

## Swap Arrangements

- We will continue in 2006-07 to ask for prices from four counterparties when undertaking swaps.
- Swap counterparties are rotated each tender.
  - But the successful counterparty from the previous swap tender will be included, provided it has a collateral agreement with us.





Australian Government

Australian Office of Financial Management

## Swap Arrangements - Collateral

- The introduction of collateral arrangements has proceeded smoothly.
- CSAs have been signed with 17 counterparties and others are well advanced.
- From the beginning of the 2007 calendar year a signed CSA will be an eligibility requirement to execute new swaps with the AOFM.



Australian Government

Australian Office of Financial Management

# Outline

- Bond Issuance and Market Efficiency.
  - CGS Tender Arrangements.
  
- Interest Rate Swaps.
  - Swap Activity 2005-06.
  - Benchmark review.
  - Swap Activity 2006-07.
  - Use of discretion.
  - Swap arrangements.
  
- Communications Fund.



## Communications Fund

- The Communications Fund has been established and will be used to deliver an income stream to fund Government responses to the recommendations of future reviews into regional telecommunications.
- The AOFM was asked to manage the \$2 billion fund on an interim basis, as agent for the Department of Communications, Information Technology and the Arts, using term deposits with the Reserve Bank until longer-term arrangements were decided.



Australian Government

Australian Office of Financial Management

## Communications Fund

- The AOFM has now been invited to manage the Fund for DCITA on a continuing basis.
- It is proposed to invest in a portfolio of short term low risk assets, including:
  - Bank bills/NCDs.
  - Commercial paper.
- Performance benchmark to be the UBS bank bill index.



## Communications Fund

- An investment dealing panel will be established with membership criteria:
  - Banking licence, AFMA membership and short term S&P rating of at least A1.
  - Austraclear member.
  - Significant market player.
- Documentation available for potential members shortly.
- The new arrangements should be fully implemented within 6 months.



Australian Government

Australian Office of Financial Management

## **Australian Business Economists**

# **AOFM – Activities for 2006-07**

**Presentation by Neil Hyden  
Chief Executive Officer, AOFM  
5 July 2006**