

STATEMENT 6 — BUDGET FUNDING

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This Statement provides information on Commonwealth budget funding.

OUTLOOK FOR 1998-99 AND THE OUT-YEARS

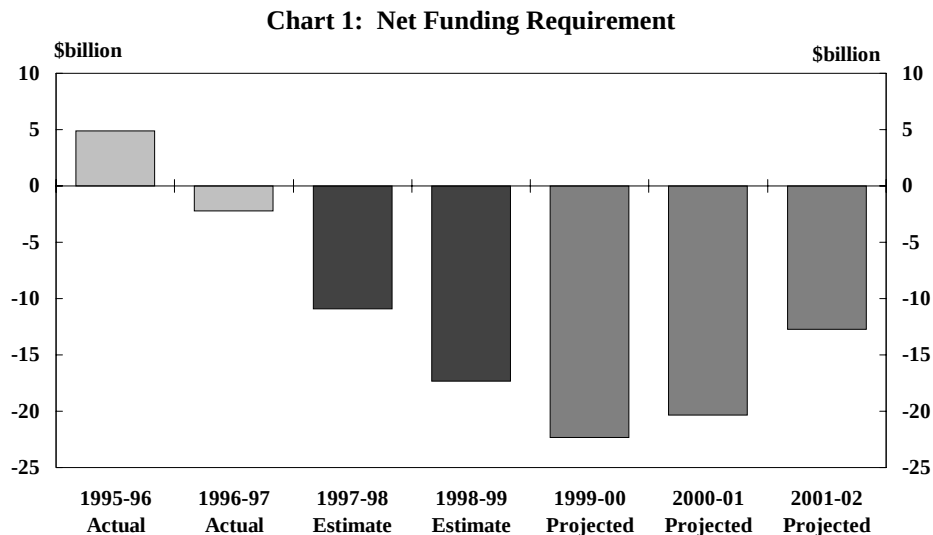
Net Funding Requirement

In 1998-99, the Commonwealth is planning to reduce general government net debt by \$18.3 billion. This is the best outcome ever achieved in Commonwealth financing.

The capacity to reduce net debt arises primarily from the following budget funding transactions: an estimated headline budget surplus of \$18.7 billion, less an estimated \$1.0 billion in payments associated with Commonwealth public trading enterprise superannuation and an estimated \$400 million in net payments associated with other financing transactions.

This negative net funding requirement — an estimated \$17.3 billion in 1998-99 — is the net funds the Commonwealth requires to meet its budget obligations. In the past the net funding requirement has principally arisen from the need to borrow to cover the budget deficit. In this situation the net funding requirement would be positive. Where the budget is in surplus and the government fully funds all its requirements from recurrent revenues it does not have a net funding requirement. In fact the surplus can be applied to reduce debt. In this case the net funding requirement is shown as 'negative'. The net funding requirement determines the Commonwealth's call on capital markets.

Chart 1 depicts the net funding requirement in recent years and that projected for each year out to 2001-02. The net funding requirement is projected to remain negative for each of the out-years: that is Commonwealth budget funding transactions are projected to reduce debt in 1999-00, 2000-01 and 2001-02 by \$22.4 billion, \$20.4 billion and \$12.7 billion respectively.



The cumulative impact of these funding requirements will be a substantial reduction in Commonwealth general government net debt. Commonwealth general government net debt is projected to fall to 1.4 per cent of GDP by end-June 2002. Statements 1 and 2 provide further details of the expected reduction in Commonwealth general government net debt.

At this stage it is not envisaged that Commonwealth Government Securities (CGS) on issue will be reduced by the full extent of the reduction in the level of general government net debt. The Government intends to manage the reduction in CGS on issue in line with the objective of maintaining the liquidity and efficiency of the Commonwealth yield curve. This, in turn, will assist the continued growth and development of the range of important domestic derivative and related markets and is consistent with the Government's commitment to the further development of Australia as a regional financial centre. A range of financial management techniques will be utilised to maintain the desired volume of CGS on issue, while at the same time reducing Commonwealth general government net debt.

Debt Issue Programme for 1998-99

A key objective of the debt issue programme in 1998-99 is to maintain the length of the yield curve and to build and maintain liquidity in key benchmark stocks. The Commonwealth's aggregate debt issue programme for 1998-99 is expected to be around \$4 billion to \$4½ billion.

Within the aggregate programme, Treasury Fixed Coupon Bond issuance is expected to be of the order of \$4½ billion to \$5 billion. As in 1997-98, Treasury Bond issuance will be weighted towards the long end of the curve. To maintain the length of the yield curve and to ensure, in the longer term, a smooth progression of stocks available to move into the ten year bond futures contract, it is planned to issue a new benchmark stock at the long end of the curve sometime in the early part of the new financial year. At this stage, the expectation is that the new benchmark will have a 2011 maturity.

The Commonwealth remains committed to the indexed bond market. A Treasury Indexed Bond issue programme of around \$500 million to \$1 billion is envisaged for 1998-99. As in 1997-98, indexed bond tenders are expected to be conducted on a regular six to eight week cycle in 1998-99.

Treasury Notes will continue to be issued primarily to fund within-year mismatches in expenditure and receipts. It is expected that there will be a run-down in the stock of Treasury Notes on issue of about \$1 billion over the course of 1998-99.

At this stage, no issuance of Treasury Adjustable Rate Bonds (TABs) is planned for 1998-99. Changes to the Prime Asset Ratio requirement have reduced demand for this instrument and domestic interest rate swaps are presently more cost effective than TABs in generating floating interest rate liability exposure for the Commonwealth.

Debt Repurchase Programme for 1998-99

As reductions occur in the stock of CGS on issue, liquidity in CGS will be promoted by concentrating stock on issue in a smaller number of benchmark lines. Consistent with this, there is expected to be a modest programme of early debt repurchases in 1998-99. Details of the programme are yet to be finalised.

EXPECTED OUTCOME FOR 1997-98

Table 1 provides details of the net funding requirement and its financing in each of 1995-96, 1996-97 and the outcome currently expected for 1997-98.

Table 1: Net Funding Requirement Reconciliation

	1995-96 Actual \$b	1996-97 Actual \$b	1997-98 Estimate \$b
Net Funding Requirement			
Headline Budget Deficit(a)	5.0	-2.6	-12.8
PTE Superannuation Financing	1.0	1.0	1.2
Other Financing(b)	-1.2	-0.6	0.6
Total	4.9	-2.2	-10.9
<i>Met as follows:</i>			
Debt Issuance^(c)			
Treasury Fixed Coupon Bond Issuance	7.8	7.0	4.5
Treasury Indexed Bond Issuance	0.6	0.8	0.7
Treasury Adjustable Rate Bond Issuance	3.4	0.9	-
Treasury Notes (Net Issuance)	1.1	-2.0	1.6
<i>Sub-total</i>	12.9	6.7	6.8
Debt Redemption^(c)			
Maturing Debt(d)	-6.3	-5.4	-11.0
Early Debt Repurchases	-2.5	-0.7	-6.8
<i>Sub-total</i>	-8.8	-6.1	-17.8
Other			
Use of Cash Balances(e)	0.8	-3.0	0.6
Face Value Adjustment(f)	-0.1	0.2	-0.5
<i>Sub-total</i>	0.8	-2.8	0.1
Total	4.9	-2.2	-10.9

(a) Deficits increase the funding requirement; surpluses reduce the requirement.

(b) Includes net subscriptions to the International Monetary Fund, proceeds and payments relating to swap transactions classified as financing transactions and other financing transactions not elsewhere identified.

(c) Based on the face value of securities.

(d) Excludes the refinancing of Treasury Notes.

(e) Cash balances held by the Commonwealth at the Reserve Bank. A negative sign denotes an increase in cash balances.

(f) Adjustment for differences between the face value and cash value of securities.

Net Funding Requirement

The Commonwealth is expected to have a negative net funding requirement of \$10.9 billion for 1997-98, \$5.7 billion greater than estimated at budget time, reflecting:

- an estimated headline budget surplus of \$12.8 billion (at budget time the surplus was estimated to be \$6.4 billion); partly offset by
- \$1.2 billion in payments associated with Commonwealth public trading enterprise superannuation (the same as at budget time); and
- \$0.6 billion in other financing transactions (assumed to be to zero at budget time), principally reflecting the payment of monies to the International Monetary Fund (IMF) in respect of a maintenance of value adjustment to Australia's IMF quota and payments in respect of swap cash flows classified as financing transactions.

Debt Issue Programme

The aggregate debt issue programme for 1997-98 is expected to be \$6.8 billion, in line with the programme of around \$6½ billion to \$7½ billion announced at budget time. Within the aggregate debt issue programme:

- Treasury Fixed Coupon Bond issuance is expected to be \$4½ billion (expected to be of the order of \$5 billion to \$6 billion at budget time);
- Treasury Indexed Bond issuance is expected to be of the order of \$700 million (expected to be of the order of \$500 million to \$1 billion at budget time); and
- on an end-year basis a run-up in the stock of Treasury Notes on issue of around \$1.6 billion is expected (no net change was expected at budget time).

In the year to date, eight tenders of Treasury Fixed Coupon Bonds have been held, raising \$4 billion. Issuance has been weighted towards the long end of the curve, consistent with a strategy of maintaining liquidity in established longer-dated benchmark bonds, as well as maintaining the length of the yield curve at around the present 12-13 years. One further tender of Treasury Fixed Coupon Bonds is expected to be held before the end of the current financial year.

Six tenders of Treasury Indexed Bonds have been conducted in 1997-98, raising an aggregate \$600 million. Reflecting the view that greater certainty as to the timing of indexed bond tenders would be beneficial to the further development of the indexed bond market, indexed bond tenders have been conducted on a regular six to eight week cycle in 1997-98. In 1997-98 new issuance has been limited to the 2020 line in order to build up liquidity in this line. Consistent with the six to eight week tender cycle, one further tender of Treasury Indexed Bonds is expected to be held before the end of the current financial year.

Treasury Note issuance in 1997-98, as in prior years, has been directed primarily towards meeting the within-year funding task that arises from day-to-day mismatches in the

timing of outlays and revenue. On a end-year basis, a \$1.6 billion run up in the stock of Treasury Notes on issue is expected.

At this stage, no issuance of Treasury Adjustable Rate Bonds (TABs) is planned for 1997-98. At budget time TABs issuance of around \$1 billion was expected in 1997-98. As noted above, there is reduced demand for this instrument as a result of changes to the Prime Asset Ratio requirement. Moreover, domestic interest rate swaps are presently more cost effective than TABs in generating floating interest rate liability exposure for the Commonwealth.

Debt Repurchase Programme

The Commonwealth's general repurchase strategy in 1997-98 has been to repurchase near to maturity bonds for cash management reasons and to reduce stock on issue in selected benchmark lines with a view to concentrating liquidity in key stocks along the curve. In the year to date, there have been aggregate early repurchases and retirement of debt scheduled for maturity in years beyond 1997-98 of around \$7 billion. At this stage, no further repurchase activity is planned for the remainder of 1997-98.

In 1997-98, early repurchase activity has been concentrated in five established benchmark lines. In face value terms, repurchases of these lines have been as follows:

- August 1998 — \$2505 million;
- March 1999 — \$740 million;
- October 2002 — \$885 million;
- September 2004 — \$760 million; and
- February 2006 — \$1160 million

In addition approximately \$780 million of illiquid lines from the Reserve Bank's portfolio of CGS have been repurchased.

All early repurchases in 1997-98 have been either directly from the Reserve Bank's portfolio of CGS or have been purchased in the market by the Reserve Bank, acting on the Commonwealth's behalf. Stock purchased by the Commonwealth from the Reserve Bank or purchased by the Reserve Bank on the Commonwealth's behalf was sold or onsold to the Commonwealth at market prices.

Full details of the Commonwealth's debt and portfolio management operations in 1997-98, as well as historical data on debt issuance and portfolio composition in previous years, will be presented in the *Commonwealth Debt Management Report* for 1997-98, which is expected to be published in September 1998.