PART 2

2000-01 DEBT ISSUANCE

AND

DEBT REDEMPTION

2000-01 DEBT ISSUANCE AND DEBT REDEMPTION

Overview

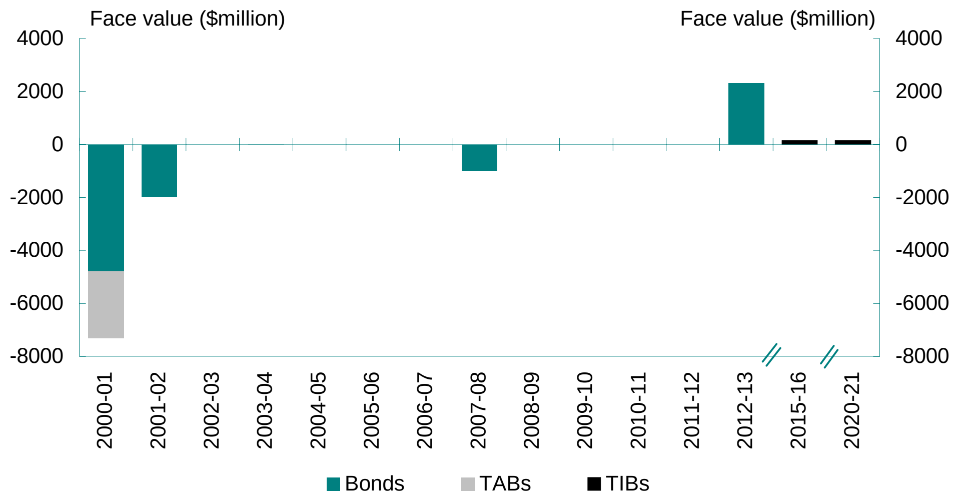
The Commonwealth had no funding need for a new debt issue program in 2000-01. The modest new issuance program undertaken in 2000-01 reflected continued pursuit of the broad debt management objectives of maintaining the liquidity and efficiency of CGS markets and the viability of supporting infrastructure.

Integral to the continuing efficient management of its funding risk, the Commonwealth's specific objective for its major debt instrument, Treasury Fixed Coupon Bonds, remains building and maintaining liquidity in key benchmark lines over a yield curve extending to around 12-13 years. The Commonwealth's ability to add liquidity in identified priority benchmark lines was aided by repurchasing stock outstanding in certain other benchmark lines.

All borrowing was undertaken in the domestic market in 2000-01. The Commonwealth's borrowing program was predominantly undertaken through the issuance of Treasury Fixed Coupon Bonds with a minor contribution through issuance of Treasury Indexed Bonds (TIBs). There was a rundown in the stock of Treasury Notes over the year to 30 June 2001. No Treasury Adjustable Rate Bonds (TABs) were issued by the Commonwealth in 2000-01. Details of the tenders in 2000-01 for all debt instruments are provided in Appendix B.

Chart 1 depicts the impact in 2000-01 of the Commonwealth's issuance and redemptions, other than in relation to Treasury Notes, on the maturity profile of the Commonwealth's debt portfolio.

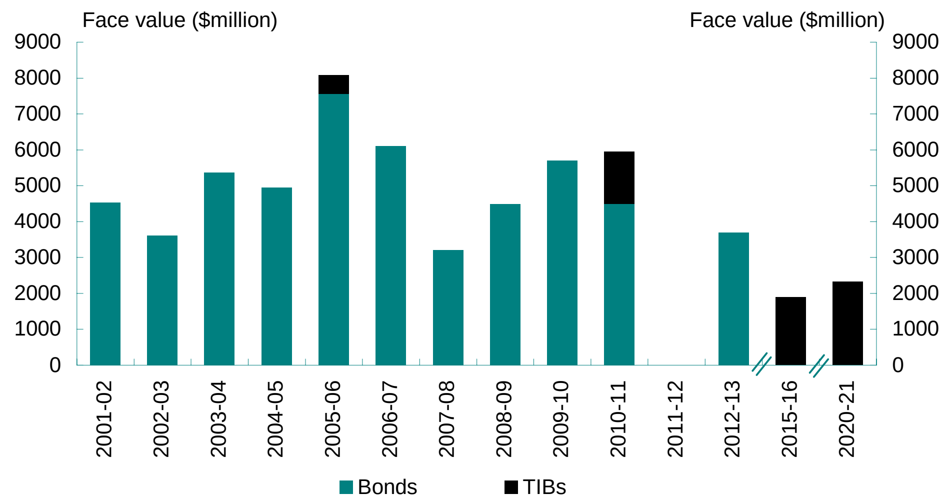
Chart 1: Commonwealth long-term domestic debt instruments — issuance and redemption in 2000-01[a][b]



(a) Excludes debt on allocation to the States and Territories.
(b) Redemptions include stock held as an investment by the Commonwealth.

The resulting maturity profile of the Commonwealth's long-term domestic debt instruments at 30 June 2001 is shown in Chart 2.

Chart 2: The maturity profile of Commonwealth long-term domestic debt instruments at 30 June 2001[a]

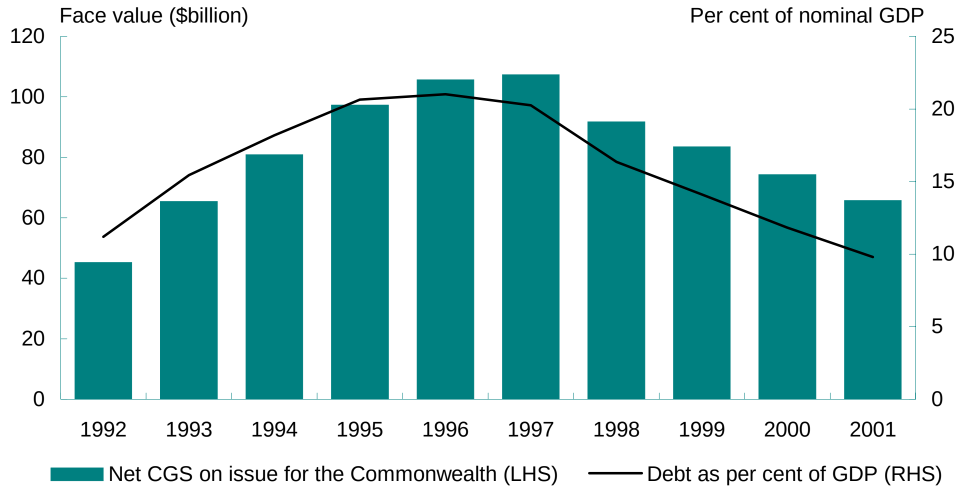


(a) Excludes debt on allocation to the States and Territories or held as an investment by the Commonwealth.

At 30 June 2001, the total face value of net CGS on issue for the Commonwealth was $65.7 billion or 9.8 per cent of nominal GDP. Compared to 30 June 2000, this represents a significant reduction in the level of debt in dollar terms (from $74.4 billion) and as a proportion of nominal GDP (from 11.8 per cent).

To put these movements into perspective, net CGS on issue for the Commonwealth as a share of nominal GDP over the last 10 years is illustrated in Chart 3.

Chart 3: Net CGS on issue for the Commonwealth as a per cent of GDP



Long-term debt issuance in 2000-01 — the year in review

This section provides details of issuance activity in 2000-01 for each of the Commonwealth's long-term debt instruments. It also provides details of repurchases of Treasury Fixed Coupon Bonds.

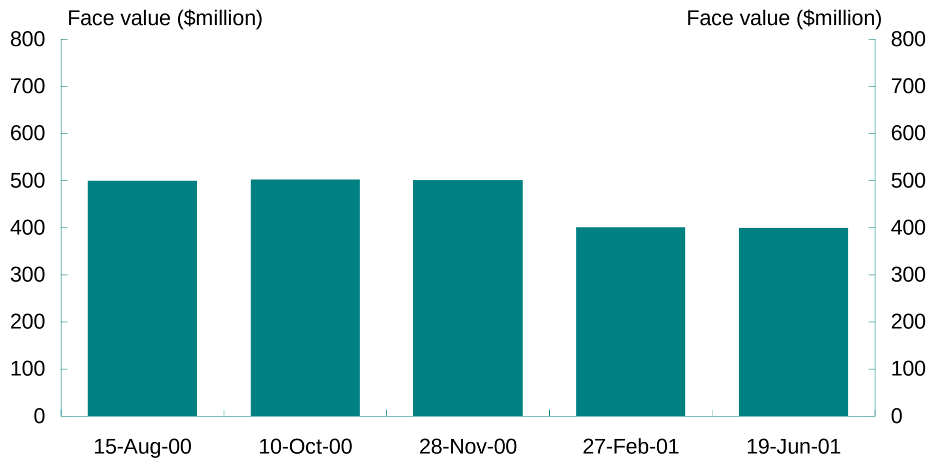
Treasury Fixed Coupon Bonds

Treasury Fixed Coupon Bonds were the main debt instrument issued by the Commonwealth in 2000-01. The $2.3 billion program in 2000-01 was a reduction on the 1999-2000 program of $3.4 billion. Despite the modest size of the program, the Commonwealth was able to maintain the length of the yield curve at around 12 to 13 years.

Five tenders were conducted in 2000-01, one less than in 1999-2000. The average tender size was $461 million, down from an average of $566 million in 1999-2000. This reduction reflects the smaller total issuance program and the relatively large tenders conducted to establish liquidity in the new May 2013 line in 1999-2000. The size and timing of the Bond tenders conducted in 2000-01 is shown in Chart 4.

As in 1999-2000, issuance was focussed solely on the long end of the Commonwealth yield curve, consistent with the objective of managing liquidity in longer-dated benchmark bonds; the only stock issued in the year was the May 2013 line.

Chart 4: Treasury Fixed Coupon Bond tenders, 2000-01



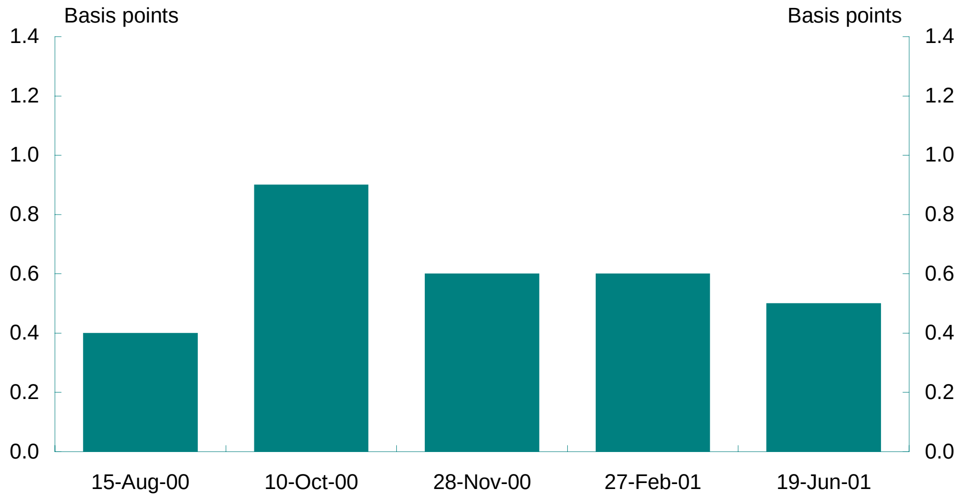
Treasury Fixed Coupon Bond tenders were well supported by the market. The average range of tender bids accepted was 1.6 basis points compared to around one basis point in 1999-2000. The average volume of bids received was around 3.8 times the stock on offer, compared to around 4.5 times coverage in 1999-2000.

The average margin between the weighted average yields achieved at tender and the prevailing secondary market mid rate (around half of one basis point) was consistent with results in 1999-2000.

The 'at tender' weighted average yields are shown in Chart 5 as margins to the market mid-rate for stock issued in 2000-01. Because, as the seller of stock, the Commonwealth comes from one side of the market in a tender, the comparison of the weighted average yield at tender with market bid (or buy) rates is also a useful performance indicator. In 2000-01, the average margin was very close to the market's bid or buy yield, consistent with results in 1999-2000.

Details of Treasury Fixed Coupon Bond tenders held in 2000-01 are provided in Table B1 of Appendix B.

Chart 5: Treasury Fixed Coupon Bonds — 'at tender' margin to secondary market yields



Aggregate Treasury Fixed Coupon Bond issuance in 2000-01 was exceeded by the sum of Bond maturities and early repurchases, which totalled $8.1 billion in 2000-01 compared to $10.2 billion in 1999-2000. This resulted in a decline of $5.9 billion in total Bonds available to the market at 30 June 2001 compared to 30 June 2000.

Stock maturing during 2000-01, including stock on issue for the States and Territories totalled around $5.2 billion face value. This consisted almost entirely of two large maturities, the remaining $737 million of the 13 per cent July 2000 and $4.4 billion of the 8.75 per cent January 2001.

In 2000-01, the Commonwealth repurchased, and cancelled, a face value of around $2 billion bonds scheduled to mature beyond that year. The major repurchase was in the 12 per cent November 2001 line ($2.0 billion). In addition, $1.0 billion of the 10 per cent October 2007 line was repurchased and is being held as a Commonwealth investment. In 2000-01, $0.9 billion of the 10 per cent October 2002 line, which had previously been held by the Commonwealth as an investment, was cancelled.

Details of repurchased stock that has been cancelled are provided in Table C1 of Appendix C. Repurchased stock held as an investment of the Commonwealth is indicated in Table A12 of Appendix A. The amount remaining on issue at 30 June 2001 in each of the affected stock lines is indicated in Table A10 of Appendix A.

Treasury Indexed Bonds

Total issuance of TIBs during the financial year was $300 million (original face value), approximately the same as in 1999-2000.

The dates for indexed bond tenders in 2000-01 were announced at the start of the financial year, with tenders timed to closely follow the dates of Treasury Indexed Bond coupon payments. Four tenders, each of $75 million were conducted, consisting of two tenders of both the 2015 and 2020 lines.

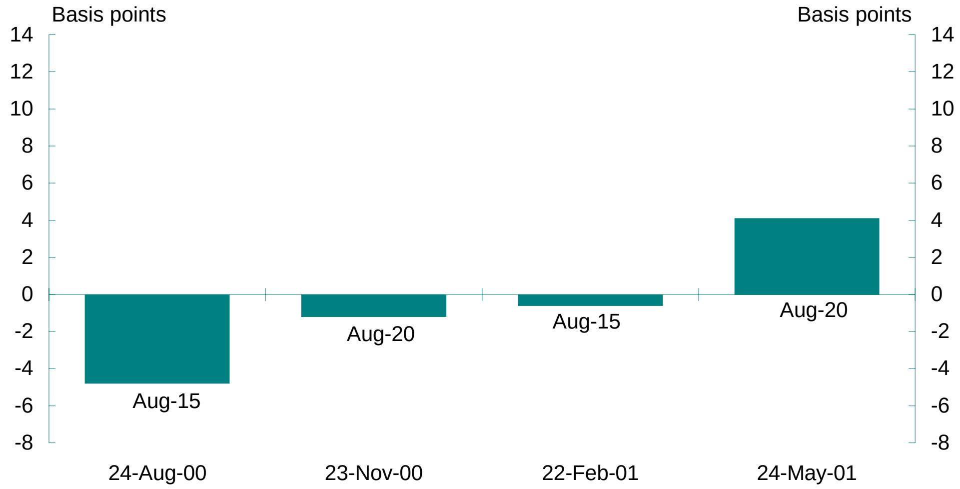
The average range of accepted bids (4.0 basis points) was narrower than that achieved in 1999-2000 (around 6.8 basis points). It is worth noting that this average is significantly influenced by the tender on 24 May 2001 where the range accepted was 8 basis points.

The average margin between yields accepted at tender and the prevailing secondary market mid-rate yields varied somewhat but, as in 1999-2000, averaged less than one basis point below the prevailing market. The margin for each of the tenders is shown in Chart 6.

The volume of bids received was around 4.1 times the stock on offer, greater than the 1999-2000 coverage ratio of 3.4.

Details of all Treasury Indexed Bond tenders held in 2000-01 are provided in Table B2 of Appendix B.

Chart 6: Treasury Indexed Bonds — 'at tender' margin to secondary market yields



Treasury Adjustable Rate Bonds

There was no issuance of TABs in 2000-01. Australian Dollar (AUD) interest rate swaps were more cost-effective than TABs in generating short duration AUD interest rate exposures for the Commonwealth during the year.

There are no outstanding TABs on issue following the maturity of the October 2000 TABs.

Commonwealth cash management and Treasury Note issuance program in 2000-01

The cash management task

The Commonwealth's cash management task arises because the day-to-day timing of the Commonwealth's receipts does not match the disbursement pattern of its outlays. The Commonwealth borrows short-term funds from the money market to cover any temporary cash shortfall, targeting maturities of such borrowings to periods of cash surplus.

To identify the Commonwealth's short-term borrowing requirements, the AOFM monitors and forecasts the daily cash balance in the Commonwealth's overdraft group of accounts at the Reserve Bank of Australia (RBA). Forecasts of the Commonwealth's daily cash position are also used as an input to decisions regarding long-term debt issuance and redemption programs.

Treasury Notes are the Commonwealth's primary cash management instrument.

During 2000-01, Treasury Notes with maturities of 5 weeks, 13 weeks and 26 weeks ceased to be issued. Instead, a new type of Treasury Note was issued with maturity dates broadly coinciding with the major quarterly tax collection periods following the introduction of *A New Taxation System*.

As discussed in Part 3 of the Report, a significant element of budget surplus proceeds over the past couple of years has been invested in a portfolio of low risk assets — in the form of term deposits with the RBA — as part of an overarching Commonwealth net debt reduction strategy. As a by-product of this facility with the RBA, entered into for long-term portfolio management reasons, term deposits can play a role in supplementing Treasury Notes in the management of the within-year financing task.

Cash management outcomes

The challenge of Commonwealth cash management is to minimise net interest outlays through minimising Treasury Note issuance to cover cash needs whilst, at the same time, avoiding use of the Commonwealth's (more costly) overdraft facility with the RBA.

The minimum issuance objective is formalised by the Commonwealth's end of year target for average cash balances. In May 1996, the Treasurer, in consultation with the Minister of Finance, determined that the year-average balance as at 30 June each year in the Commonwealth's overdraft group of accounts held with the RBA should be around a maximum of $1.5 billion. The target is intended to place a suitable degree of discipline on cash management (and debt management more generally) by encouraging the maintenance of minimum cash balances, thereby minimising borrowings and, consequently, the Commonwealth's net interest expense.

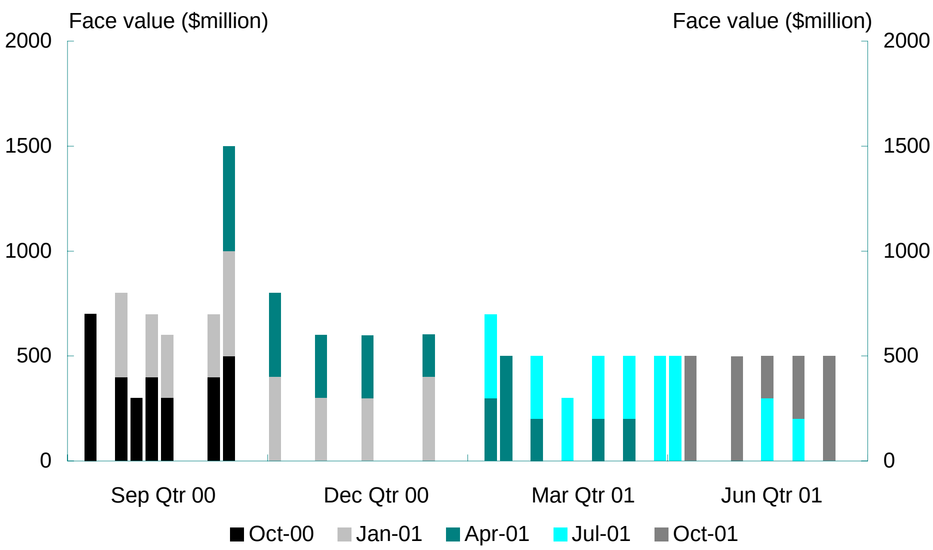
The year-average balance in the overdraft group of accounts in 2000-01 was $1.48 billion, which was below the maximum target. In 2000-01, the overdraft facility with the RBA was not utilised.

Treasury Note issuance program

In 2000-01, there were 24 Treasury Note tenders, with an average size of $600 million. These tenders raised a total of $14.1 billion to support the Commonwealth's cash management objectives. The face value of the Treasury Note issuance was $14.4 billion, around 57 per cent less issuance than in 1999-2000. Chart 7 shows the composition and total size of each Treasury Note issue in 2000-01 (in face value terms).

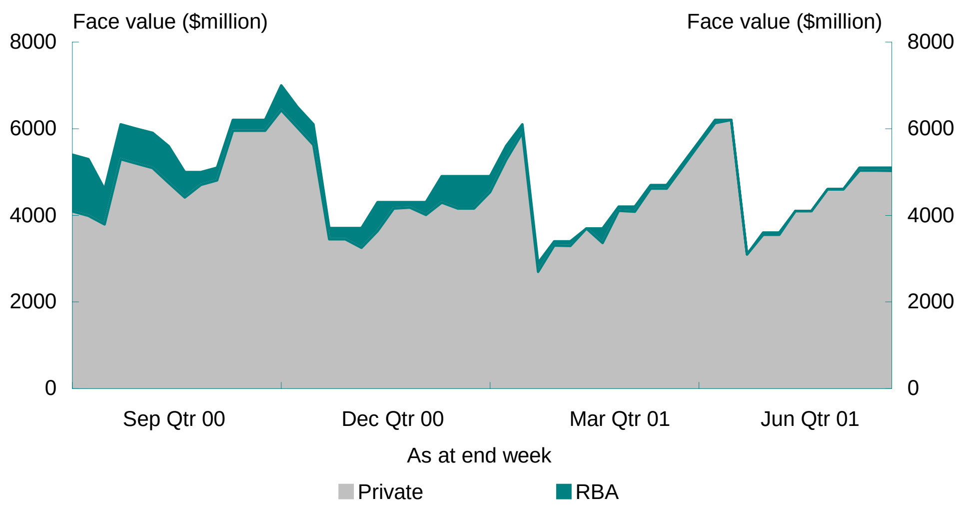
The 2000-01 total Treasury Note issuance program comprised a face value of $3.0 billion of October 2000 Notes, $3.2 billion of January 2001 Notes, $3.1 billion of April 2001 Notes, $3.1 billion of July 2001 Notes and $2.0 billion of October 2001 Notes.

Chart 7: Weekly Treasury Note issuance, 2000-01



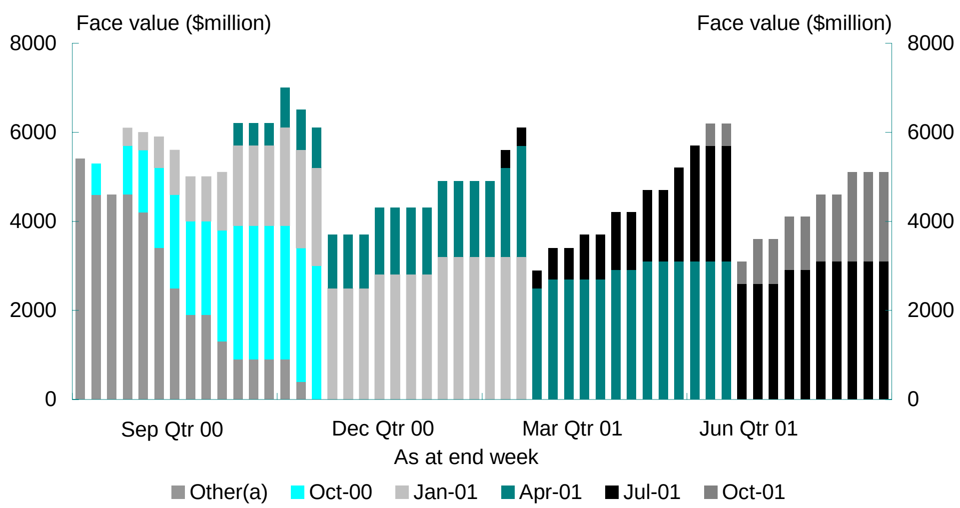
There was no RBA take up of Treasury Notes at tender in 2000-01. However, over the course of 2000-01, the RBA held an average of $306 million of Treasury Notes. The distribution of Treasury Note holdings between the private sector and the RBA is shown in Chart 8.

Chart 8: Holdings of Treasury Notes, 2000-01



At the end of 2000-01, as shown in Chart 9, Treasury Notes outstanding had declined to $5.1 billion. This was a reduction from $5.8 billion at the commencement of the financial year. The peak in Notes outstanding was $7.0 billion in October.

Chart 9: Treasury Notes outstanding, 2000-01



(a) Represents 5, 13, and 26 week Treasury notes outstanding at 30 June 2000.

Treasury Note tender results

The average volume of bids at each Treasury Note tender conducted in 2000-01 was 5.0 times the stock on offer and the average number of bidders was nine. The average range of accepted yields on the stock offered was 2.3 basis points.

In 2000-01, the average margin of Treasury Note Yields received at tender, below yields on equivalent maturity Bank Bills, narrowed to 12 basis points from 25 basis points the previous year. The largest margin between Treasury Note Yields and Bank Bills was approximately 25 basis points on the October 2000 Note in July 2000 (Tender 17), with the smallest margin of 6 basis points being recorded on the July 2001 Note and October 2001 Note in April 2001 (Tenders 8 and 9 respectively). Chart 10 shows the range in 'at tender' margins in 2000-01.

Details of all Treasury Note tenders held in 2000-01 are provided in Table B4 of Appendix B.

Chart 10: Treasury Notes — 'at tender' margin below equivalent maturity bank bill yields