STATEMENT 7: ASSET AND LIABILITY MANAGEMENT

The Australian Government's balance sheet remains amongst the strongest in the developed world. This is a key reason behind the retention of the Australian Government's AAA credit rating.

The strong balance sheet position continues to provide the Government with the capacity and flexibility to respond to changes in economic circumstances.

Net debt will peak at 7.2 per cent of GDP in 2011-12, higher than previously anticipated, owing to the immediate economic and fiscal impacts of recent natural disasters and the downward revision to expected tax receipts in 2010-11 and 2011-12.

Despite this, the strength of the balance sheet and the projected return to surplus in 2012-13 means that the Government will begin to reduce net debt as a share of GDP from 2012-13.

The Australian Government's net debt position remains extremely low by international standards. The expected peak in Australia's net debt is at a level less than one tenth of the average of the major advanced economies in 2011.

In this Budget, the Government is clarifying its objectives with regard to the future of the Commonwealth Government Securities (CGS) market. It is timely to review the CGS market following the global financial crisis, and in light of the changing nature of the CGS investor base, new global bank liquidity rules and the anticipated return to surplus.

A detailed balance sheet for the Australian Government general government sector is provided in Statement 9: Budget Financial Statements.

STATEMENT 7: ASSET AND LIABILITY MANAGEMENT

OVERVIEW OF THE AUSTRALIAN GOVERNMENT'S BALANCE SHEET

The Government's balance sheet shows the stocks of all government assets and liabilities. Measures such as net debt, net financial worth and net worth are aggregates drawn from the balance sheet that provide an indication of the Government's financial strength at a point in time (see Box 1).

The outlook for the Government's stocks of assets and liabilities — or the Government's balance sheet — over the forward estimates is based on a range of estimates and assumptions about those assets and liabilities. If the estimates or assumptions change, this is likely to impact on the projected value of assets and liabilities, and hence change the projected path of the balance sheet measures outlined above.

The outlook for the Government's stocks of assets across the forward estimates is broadly similar to the 2010-11 Budget. However, the downward revision to expected tax receipts in 2010-11 and 2011-12 and the impact of the natural disasters on the fiscal outlook have driven an increase in expected liabilities, predominantly in Commonwealth Government Securities. These changes have contributed to higher estimates for net debt, and lower estimated net financial worth and net worth than was expected at the 2010-11 Budget.

However, the outlook for net debt, net financial worth and net worth remains significantly better than during the height of the global financial crisis, and the Australian Government's finances remain amongst the strongest in the developed world.

Statement 3: Fiscal Strategy and Outlook examines the impact of altering key economic assumptions on payments and receipts. Since the Budget position is one of the main drivers of the movement in the Government's asset and liability position, changes in the economic assumptions will also impact on the Government's financial stocks.

The Government reports on a range of other fiscal risks in Statement 8: Statement of Risks. These risks comprise general developments or specific events that may affect the fiscal outlook. Fiscal risks may affect expenses or revenue and, as a result, may contribute to variability in the Government's projected net debt, net financial worth and net worth position.

Measurement of the Government's financial position

Box 1: Net debt, net financial worth and net worth

Net debt is a commonly quoted measure of a government's financial strength. Historically, this was the only available stock measure for governments that were recording financial information in a cash-based accounting system. Net debt provides the most useful measure for international comparisons, given most OECD countries report on it.

Net financial worth is used by the Government as the primary indicator of balance sheet sustainability because it provides a more effective and intuitive indicator of the sustainability of the Government's finances. It is a broader measure than net debt as it includes government borrowing, superannuation and all financial assets, but is narrower than net worth since it excludes non-financial assets. There are advantages to excluding non-financial assets since they are often illiquid and cannot easily be drawn upon to meet the Government's financing needs.

Net worth is the broadest measure of the Government's financial position. It is the net position of total assets and liabilities recorded on the balance sheet.

Net debt, net financial worth and net worth

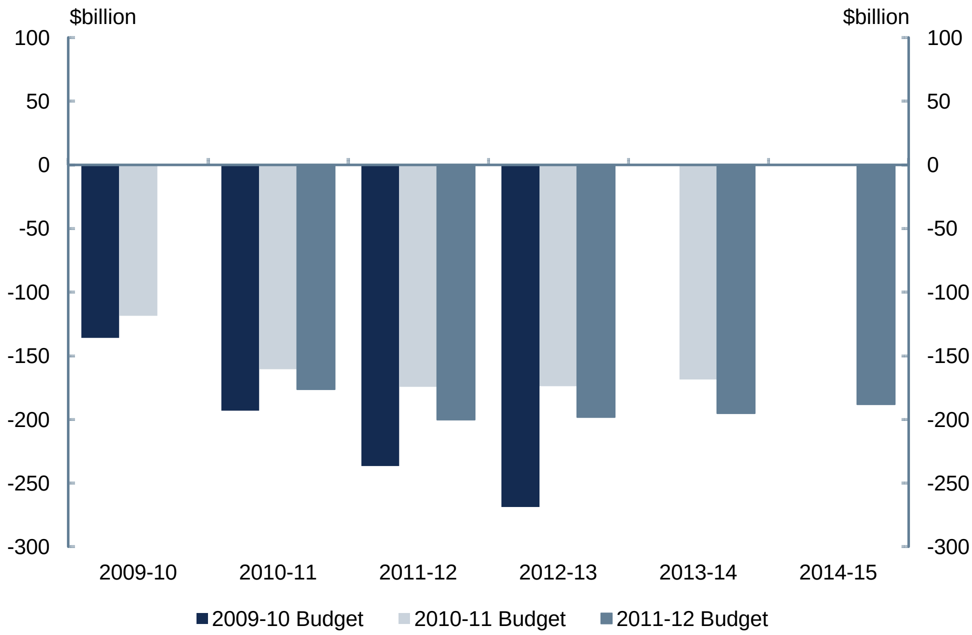
The economic and fiscal impacts of recent natural disasters at home and overseas and the weaker outlook for tax receipts have contributed to a higher expected level of net debt, and lower expected net financial worth and net worth, than was forecast in the 2010-11 Budget. However, these estimates are significantly better than those expected during the global financial crisis — net debt, for example, was expected to peak at 13.8 per cent of GDP in 2013-14 in the 2009-10 Budget.

Net debt is now expected to peak at $106.6 billion in 2011-12 (7.2 per cent of GDP), falling to 5.8 per cent of GDP by the end of the forward estimates.

In 2011-12, net financial worth is estimated to be -$200.6 billion, compared to the 2010-11 Budget estimate of -$174.3 billion. Net financial worth is estimated to be -$188.5 billion by the end of the forward estimates.

Chart 1 shows the projected movements in net financial worth since the 2009-10 Budget.

Chart 1: Net financial worth comparison



Note: Net financial worth for 2013-14 was not projected in the 2009-10 Budget; net financial worth for 2014-15 was not projected in the 2010-11 Budget.

Net worth is currently estimated at -$87.5 billion for 2011-12, compared with -$66.4 billion estimated at the time of the 2010-11 Budget.

The Australian Government's financial position remains amongst the strongest in the developed world (Box 2) and is a key reason behind the retention of the Australian Government's AAA credit rating. Other key factors underpinning Australia's credit rating are the strength and resilience of the economy, stability of the financial system and the quality of policy and institutional arrangements, including independent monetary policy, strong financial regulation and the Government's adherence to a credible medium-term fiscal framework.

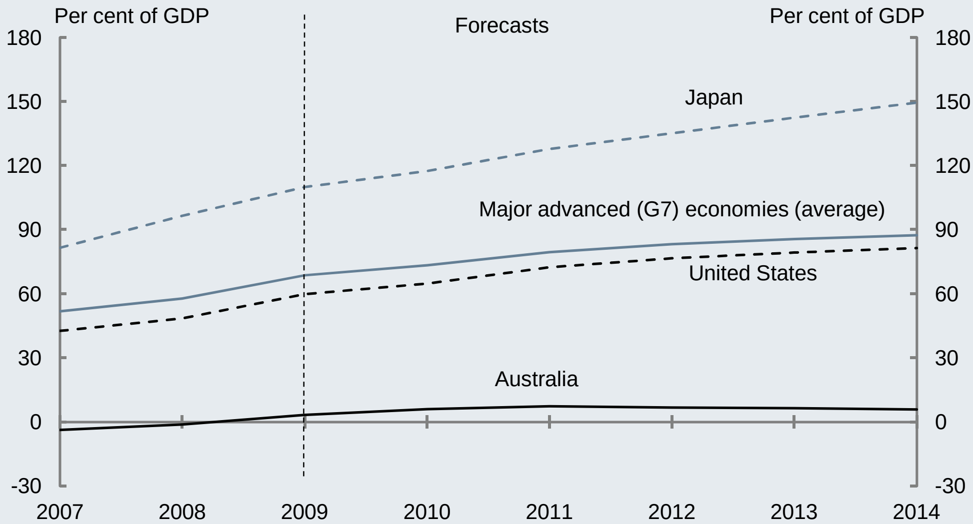
Box 2: The strength of the Australian Government's financial position

During 2010-11, many countries have faced profound financial challenges as a result of the accumulation of large budget deficits and high levels of sovereign debt. Several governments have had to implement severe austerity measures in order to support more sustainable trajectories for government debt.

This stands in sharp contrast to the strength and resilience of the Australian Government's financial position.

Australia's level of net debt remains extremely low by international standards (Chart A). Australian Government net debt is expected to peak at 7.2 per cent of GDP in 2011-12, which is less than one tenth of the average net debt position of the major advanced economies in 2011. The peak in Australia's net debt compares with the net debt position of the United States, which the IMF projects will continue to increase until at least the end of 2016.

Chart A: Government net debt for Australia and selected economies

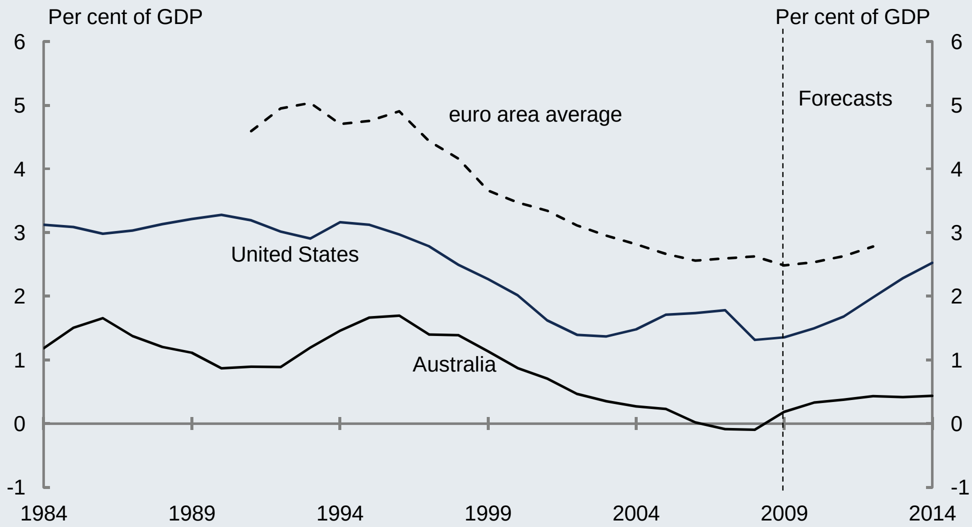


Note: Australian data are for the Australian Government general government sector and refer to financial years beginning 2007-08. Data for all other economies are total government and refer to calendar years beginning 2007.
Source: IMF *Fiscal Monitor* April 2011 and Treasury.

Box 2: The strength of the Australian Government's financial position (continued)

Similarly, Australia's net interest payments are low by international comparison (Chart B).

Chart B: Net interest payments for Australia, the US and the euro area



Note: Net interest payments are equal to the difference between interest paid and interest receipts on government assets and liabilities. Australian and US data are federal government data. Australian data refer to financial years beginning 1984-85. US data refer to US fiscal years beginning October 1984. Euro area data are total government and refer to calendar years beginning 1991.
Source: United States Congressional Budget Office *Budget and Economic Outlook* January 2011, OECD *Economic Outlook 88* November 2010, Thomson Reuters and Treasury.

Not only are the Government's debt levels extremely low by international comparison, the expected return to budget surplus in 2012-13 means that the Government is well placed to reduce net debt.

A return to budget surpluses will strengthen the balance sheet further, thereby ensuring Australia continues to have the flexibility to respond to any unanticipated future events that have a fiscal impact.

THE AUSTRALIAN GOVERNMENT'S MAJOR ASSETS AND LIABILITIES

Assets

The Government's financial assets are estimated to be $214.6 billion at 30 June 2011, increasing to $232.1 billion in 2011-12 and $263.9 billion by the end of the forward estimates.

The Government's total stock of assets is estimated to be around $323.0 billion at 30 June 2011, increasing to $345.2 billion in 2011-12 and $381.3 billion by the end of the forward estimates.

Future Fund

The Future Fund was established in 2006 to accumulate financial assets and invest them on behalf of the Australian Government to address the Government's unfunded superannuation liability.

The Treasurer and the Minister for Finance and Deregulation set the Investment Mandate for the Future Fund, which, since the Fund's establishment, has set a benchmark return of at least the CPI plus 4.5 per cent to 5.5 per cent per annum over the long term. The Investment Mandate gives guidance to the Future Fund Board of Guardians in relation to its investment strategy. The Board is independently responsible for the investment decisions of the Fund. The Investment Mandate also requires the Board to take an acceptable but not excessive level of risk for the Fund, measured in terms such as the probability of losses in a particular year.

During the initial transition period of the Future Fund, it was envisaged that returns would be lower while investments were built in line with the long-term strategic asset allocation. Since inception, returns have reflected this situation. Returns have also been affected by the difficult investment climate associated with the global financial crisis, although the Fund's performance compared favourably with institutional investors generally during this period.

Since the effective start of the investment program on 1 July 2007, the Future Fund has generated a nominal return of 5.0 per cent (excluding its Telstra holdings). Since the first contribution to the Future Fund on 5 May 2006, the return has been 5.3 per cent per annum.

At 31 March 2011 the Future Fund's return for the financial year to date was 11.7 per cent (excluding its Telstra holdings). The Future Fund's Telstra portfolio returned 8.2 per cent for the March 2011 quarter and 0.2 per cent for the year to 31 March 2011.

On 24 March 2011, consistent with its strategic asset allocation, the Board announced that it had reduced the Future Fund portfolio's holding in Telstra to 620.4 million shares or 4.99 per cent of the company. As a result of owning less than 5 per cent of the company, the Future Fund has ceased to be a substantial shareholder in Telstra. Substantial shareholders of companies listed on stock exchanges in Australia have various requirements and disclosure obligations under the *Corporations Act 2001*.

The Future Fund was valued at $74.6 billion at 31 March 2011. Table 1 shows changes in the asset allocation of the Future Fund over 2010-11.

Table 1: Asset allocation of the Future Fund

Asset class	30 June 2010	31 March 2011
	$m	$m
Australian equities	7,465	8,478
Global equities	15,764	19,905
Private equity	1,895	2,487
Property	3,125	4,451
Infrastructure	2,865	3,508
Debt securities	13,822	14,269
Alternative assets	9,871	11,868
Cash	8,266	8,025
Total (excluding Telstra holdings)	63,074	72,990
Telstra holdings	4,272	1,629
Total Future Fund assets	67,346	74,619

Nation-building Funds

The Building Australia Fund (BAF), the Education Investment Fund (EIF) and the Health and Hospitals Fund (HHF) were established on 1 January 2009. These Nation-building Funds were established to finance investment in transport, communications, broadband, energy, water, higher education, research, vocational education and training, and health infrastructure.

The Investment Mandates for the Nation-building Funds, which are set by the Treasurer and the Minister for Finance and Deregulation, give guidance to the Future Fund Board of Guardians, which has responsibility for managing the investments of the BAF, EIF and HHF. The Board is responsible for the investment decisions of the funds.

The Investment Mandates set a benchmark return on the Nation-building Funds of the Australian three-month bank bill swap rate plus 0.3 per cent per annum calculated on a rolling 12 month basis (5.2 per cent for the year to 31 March 2011). The Investment Mandates require that investments minimise the probability of capital losses over a 12 month horizon. Consistent with these requirements, the assets of the three funds are invested in combinations of short-term and medium-term debt instruments.

The March quarter 2011 return for the BAF was 1.4 per cent, while the EIF and the HHF each returned 1.5 per cent. Over the 12 months to 31 March 2011, each of the Nation-building Funds has returned 5.4 per cent, exceeding the mandated benchmark return of 5.2 per cent.

At the end of the March quarter 2011, the value of the BAF was $8.6 billion, the EIF was $5.2 billion and the HHF stood at $4.7 billion.

The estimated uncommitted balance of funds at 31 March 2011 was $1.5 billion for the BAF, $2.5 billion for the EIF and $0.5 billion for the HHF. These figures include net investment earnings up to 31 March 2011.

The Nation-building Funds are financial asset funds, consisting of cash and investments in debt instruments. When cash is drawn down from the Funds to fund projects, this reduces the size of the Funds on the balance sheet. In addition, decisions which commit to future spending from the uncommitted balances of the Funds will impact on the underlying cash balance estimates at the time those decisions are taken.

Residential mortgage-backed securities

The global financial crisis led to the profound dislocation of the Australian residential mortgage-backed securities (RMBS) market. In view of these developments, in October 2008 the Government directed the Australian Office of Financial Management (AOFM) to invest $8 billion in high-quality AAA-rated Australian securities to support competition in residential mortgage lending from smaller lenders.

In October 2009, the Treasurer announced that the Government would extend the program to invest an additional $8 billion to support competition in the mortgage market. The objectives of the program were extended to also include support for lending to small business. The AOFM estimates that close to 10 per cent of funds already invested from the Government's second $8 billion support tranche have been lent to Australian small businesses.

In December 2010, as part of its *Competitive and Sustainable Banking System* package, the Government announced a further $4 billion of investment in the RMBS market, with an additional objective of transitioning to a sustainable market. The AOFM will also continue to support innovative structures such as ‘bullet’ securities. This brings the Government’s total investment commitment to $20 billion.

As at 30 April 2011, the AOFM had invested $12.8 billion of these funds, taking an average 13 per cent interest in RMBS deals with AOFM support since 1 January 2011, down from around 80 per cent for transactions undertaken in the corresponding period in 2009.

The securitisation market has recently shown signs of improvement, with spreads in deals narrowing and some recent deals going ahead without Government support. In one case, the AOFM was completely scaled out of a transaction it was prepared to support.

The AOFM and the Treasury will continue to monitor conditions in the RMBS market closely.

National Broadband Network

NBN Co Limited (NBN Co) was created in April 2009 to build and operate the National Broadband Network (NBN). NBN Co is a Government Business Enterprise.

NBN Co's Corporate Plan for the three years from 1 July 2010 to 30 June 2013 was released in December 2010. The Corporate Plan outlines NBN Co's intended approach to delivering the NBN and details the assumptions and cost estimates underpinning that approach; it incorporates decisions made by the Government on issues such as network design and uniform national wholesale pricing. A key assumption of the Corporate Plan is the finalisation of the Definitive Agreements between NBN Co and Telstra.

The Corporate Plan confirms that the NBN is a financially viable project which will provide a return on the Government's investment over time. The Corporate Plan shows that Australian taxpayers will get their investment back, with interest, as well as a state-of-the-art high-speed broadband network.

Following the release of the Corporate Plan, the Government asked corporate advisory firm Greenhill Caliburn Pty Ltd to review the Plan and provide an independent assessment of the Plan's key assumptions and potential risks. The Greenhill Caliburn report confirms the key assumptions underlying the revenue and cost projections contained in the Corporate Plan.

As outlined in the Corporate Plan, total capital expenditure for the project is estimated to be $35.9 billion. This is lower than the $42.8 billion estimated in the NBN Implementation Study undertaken by McKinsey/KPMG.

Provisioning in the Budget for the Government's investment in the NBN has been updated to reflect a level of funding that is consistent with the estimates outlined in the Corporate Plan and the operational needs of NBN Co. The Government expects to contribute $27.5 billion in equity for the roll-out of the NBN, including $3.1 billion in 2011-12 and $18.2 billion from 2011-12 to 2014-15.

NBN Co will be funded with Government equity until NBN Co has sufficient cash flows to support private sector debt without explicit Government support. The Government expects that during the NBN roll-out period, private sector debt raised by NBN Co will complement Government equity to fund roll-out activities. The Government will retain full ownership of NBN Co during the roll-out in order to achieve its policy objectives, including its commitment to prioritise the roll-out of the NBN in regional areas.

The Government has endorsed the Corporate Plan as being compliant with the Statement of Expectations for NBN Co, which constitutes the Government's final response to the NBN Implementation Study.

Higher Education Loan Program

The Higher Education Loan Program (HELP) comprises concessional loans to students that enable them to meet their education costs prior to earning an income above a certain level. The value of HELP is estimated to be around $15.3 billion at 30 June 2011, which is $1.7 billion higher than projected in the 2010-11 Budget. The value of HELP is projected to grow to around $17.2 billion over 2011-12 and $24.5 billion by the end of the forward estimates.

This growth is largely due to the estimated increase in university commencements over the forward estimates, principally the result of the Government's Bradley reforms which lifted the over-enrolment cap from 5 per cent to 10 per cent in 2010 and 2011 and will uncap Commonwealth supported places from 2012. In addition, as announced in this Budget, from 1 January 2012 the Government will reduce the discount available to students electing to pay their student contribution up-front from 20 per cent to 10 per cent.

Liabilities

The Government's total liabilities are estimated to be $391.3 billion at 30 June 2011, increasing to $432.7 billion in 2011-12 and $452.3 billion by the end of the forward estimates.

Public sector employee superannuation liabilities

Public sector employee superannuation entitlements relating to past and present civilian employees and military personnel are a financial liability on the Government's balance sheet. The Government's superannuation liability is estimated to be around $129.5 billion at 30 June 2011.

The Australian Government has never fully funded its superannuation liabilities. The Commonwealth Sector Superannuation (CSS) Scheme and the Public Sector Superannuation (PSS) Scheme were closed to new members in 1990 and 2005 respectively. The Public Sector Superannuation Accumulation Plan was introduced from 1 July 2005 and provides fully funded accumulation benefits for new civilian employees.

Despite these reforms, the value of the Government's existing superannuation liability is projected to continue growing (in nominal terms) into the future, reaching $147.8 billion by the end of the forward estimates. This is the result of growth in the membership of the Military Superannuation and Benefits Scheme (MSBS), which remains open to new military personnel, and continued growth of entitlements accruing to existing members of the closed civilian and military schemes.

An actuarially determined discount rate is used to estimate the present value of future unfunded superannuation benefits. Consistent with the latest Long Term Cost Reports for the civilian and military schemes, the discount rate currently applied is 6.0 per cent per annum. Owing to the long term nature of the unfunded superannuation liability, the value recorded on the balance sheet is highly sensitive to the discount rate used.

As the superannuation liability is included in the Government's net worth and net financial worth aggregates, revaluations of the liability have an impact on these aggregates (see Note 1 in Budget Statement 9).

Commonwealth Government Securities

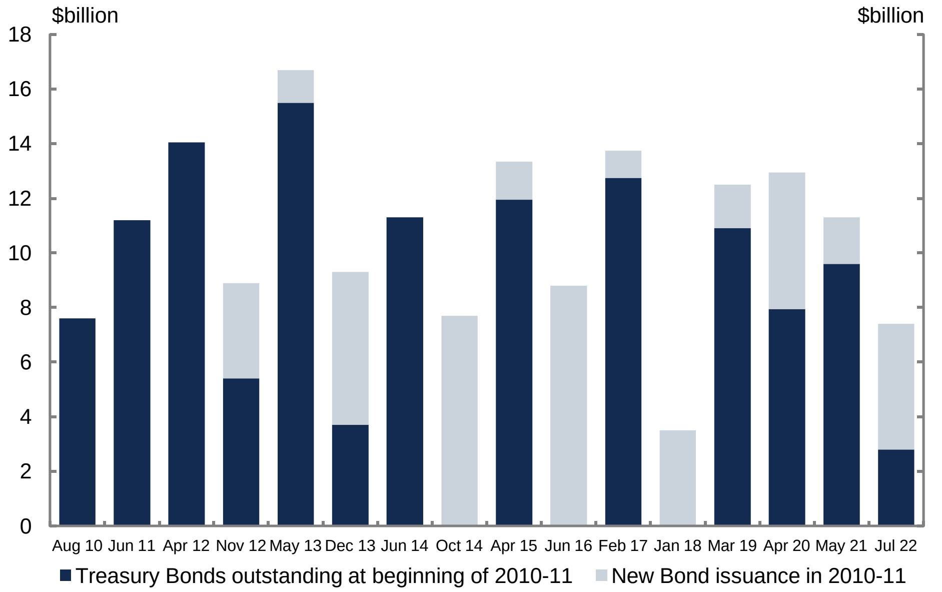
The face value of the total stock of Commonwealth Government Securities (CGS) on issue at 30 June 2011 is expected to be $192 billion. CGS is reported in the balance sheet in market value terms, consistent with relevant accounting standards.

Net issuance of CGS in 2011-12 is expected to be around $33 billion, which takes into account $53 billion in gross bond issuance, $14 billion in bond maturities and a $6 billion run down in the volume of Treasury Notes on issue.

Treasury Bonds

Chart 2 shows Treasury Bonds outstanding at 30 June 2010 and new issuance in 2010-11. Three new Treasury Bond lines were issued in 2010-11.

Chart 2: Treasury Bonds on issue



Note: New issuance in 2010-11 is to 10 May 2011.

The face value of Treasury Bonds on issue at 30 June 2011 is projected to be around $161 billion. Treasury Bond issuance in 2011-12 is expected to be around $51 billion.

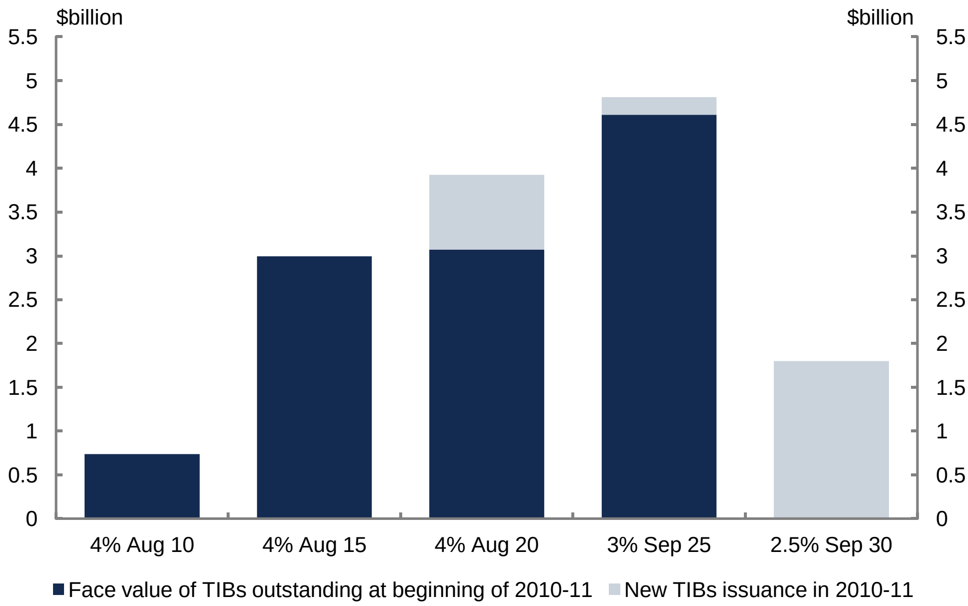
Treasury Indexed Bonds

Treasury Indexed Bonds are medium-term to long-term securities that have a capital value which is adjusted for movements in the CPI. Interest is paid quarterly, at a fixed rate, on the adjusted capital value. At maturity, investors receive the adjusted capital value of the security. The Australian Government recommenced the issuance of Treasury Indexed Bonds in 2009-10.

Treasury Indexed Bonds contribute to the management of Australian Government debt by widening the range of available debt instruments, diversifying risk and tapping additional sources of investor demand.

Chart 3 shows Treasury Indexed Bonds outstanding at 30 June 2010 and new issuance in 2010-11.

Chart 3: Treasury Indexed Bonds on issue



Note: New issuance in 2010-11 is to 10 May 2011.

The face value of Treasury Indexed Bonds on issue at 30 June 2011 is projected to be around $14 billion. Treasury Indexed Bonds issuance in 2011-12 is expected to be around $2 billion.

Treasury Notes

Treasury Notes are short-term debt securities used primarily to meet within-year financing requirements resulting from differences in the timing of receipts and payments. The volume of Treasury Notes on issue will vary over the course of the year, depending on the size and profile of the within-year funding flows. It is anticipated that at least $10 billion of Treasury Notes will be kept on issue at all times to maintain a liquid market in Treasury Notes.

The face value of Treasury Notes on issue at 30 June 2011 is projected to be around $17 billion.

Aussie Infrastructure Bonds

On 7 April 2009, the Government announced that its investment in NBN Co would be partly funded through the issuance of Aussie Infrastructure Bonds (AIBs).

AIBs will not be required until 2011-12, as the revised Government equity requirement for NBN Co in 2010-11 will be met in full with funds from the Building Australia Fund. In 2011-12, it is expected that $2.7 billion of the Government's equity investment in the National Broadband Network will be financed by AIBs, through wholesale issuance of CGS as part of the AOFM's overall debt program.

AIBs will not be separately identifiable from CGS, but will be reported as AIBs in the Budget statements. In addition, from 1 July 2011 the AOFM's weekly CGS tender notices will indicate that some of the proceeds of tenders may be used to finance the Government's investment in NBN Co.

On 12 December 2010, the Government announced that it would facilitate the trading of CGS on a retail exchange platform in Australia, as part of its *Competitive and Sustainable Banking System* reforms, to foster a deep and liquid corporate bond market. This commitment will provide the opportunity for retail investors to invest in Australian Government bonds through a mainstream and visible exchange platform, helping to finance the NBN in the same way as wholesale investors.

FUTURE OF THE COMMONWEALTH GOVERNMENT SECURITIES MARKET

During the global financial crisis, the stresses confronting financial markets around the world were unprecedented. The crisis led to significant disruption to capital flows, difficulties in pricing and hedging risk, and a general flight of investors to high-quality, safe-haven assets.

The repercussions of the crisis continue to play out in many ways, including through a heightened focus on the sustainability of other developed countries' sovereign debt positions and the introduction of new regulatory regimes for financial institutions.

In Australia, the continued functioning of a liquid, AAA-rated Commonwealth Government Securities (CGS) market through this period was critical to managing risk and retaining confidence in Australian financial markets.

In light of the crisis, the anticipated return to surplus, the new global bank liquidity requirements and the changing nature of the CGS investor base, it is timely that the Government consider the future of the CGS market.

Context

In 2002-03, the *Review of the Commonwealth Government Securities Market* was undertaken in response to concerns about the future viability of the declining CGS market. Since this review, successive governments have committed to retaining a liquid and efficient CGS market to support the three- and ten-year Treasury Bond futures market, even in the absence of a budget financing requirement.

During the global financial crisis, liquidity became severely constrained in key financial markets that had previously been considered alternatives to the CGS market for managing financial risk, such as the interest rate swaps market. In the absence of a fully functional interest rate swaps market, the continued functioning of a liquid, AAA-rated CGS market, and its associated futures market, was at times the only option available for managing interest rate risk and supporting the pricing and hedging of other financial instruments. The capacity of financial market participants to price and manage interest rate risk contributes to a lower cost of capital in Australia.

The presence of a liquid, AAA-rated fixed income market also provided a safe investment vehicle for investors and supported confidence in Australian financial markets more generally.

As investors around the world moved to safe haven assets, such as sovereign bonds, markets came under increasing pressure and liquidity became constrained. In Australia, the existence of an active, albeit small, government bond market, with an investor pool familiar with the government's debt instruments and well-established infrastructure and procedures, enabled the AOFM to increase the volume of issuance quickly as the need arose in the context of dramatically reduced government revenues.

The crisis affirmed the value in maintaining a CGS market of sufficient size to support the long-term stability of the financial markets and to ensure the Government is well placed, in a practical sense, to respond to sudden events with large fiscal impacts.

Recent developments impacting on the CGS market

The CGS investor base has changed significantly in recent years, with a number of new passive investors entering the CGS market. Passive investors form a stable and important investor base for CGS. However, they do not tend to trade their CGS holdings actively and therefore do not contribute to liquidity in secondary markets.

There has also been an increased allocation into Australian denominated securities in the foreign exchange portfolios of some investors, because of the strength of the Australian economy.

The new global capital and liquidity standards for banks, agreed by the Basel Committee for Banking Supervision in December 2010, will impact further on the investor base for CGS. The standards are expected to mean that Australian banks will generally hold larger amounts of government bonds on their balance sheets than has previously been the case.

The CGS holdings of passive investors and Australian banks in coming years will have important implications for liquidity in the CGS market.

In light of the changing CGS investor base, the fiscal outlook for a return to surplus and the peak in CGS, the Government considered it timely to review the future of the CGS market.

As part of these deliberations, and in addition to the ongoing dialogue between the AOFM and the financial markets, the Government consulted a panel of financial market participants and financial regulators on the future of the CGS market.[1]

The panel underlined the crucial role of a liquid, AAA-rated CGS market and associated futures market during the crisis and supported retaining liquidity in these markets as the primary objective for the CGS market in the future. The panel considered there was also significant value in maintaining a diversified investor base, including passive investors, to absorb any unexpected increase in issuance.

To maintain a liquid and efficient bond market that supports the three- and ten-year futures market and the requirements of the new global bank liquidity standards, the panel agreed that the CGS market should be maintained around its current size — that is, around 12 to 14 per cent of GDP over time.

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1 The panel consisted of representatives from the Treasury, the AOFM, the Reserve Bank of Australia, the Australian Prudential Regulation Authority, the NSW Treasury Corporation, the Treasury Corporation of Victoria, and a number of private sector market participants.

CGS market

Drawing on this advice, the Government is clarifying its objectives with regard to the future of the CGS market.

Maintaining liquidity in the CGS market to support the three- and ten-year bond futures market will continue to be the Government's primary objective, in particular as Australian banks prepare for the 2015 commencement of the Basel III liquidity requirements.

In addition, the Government will: support liquidity in the Treasury Indexed Bond market by maintaining around 10 to 15 per cent of the size of the total CGS market in indexed securities; and continue to lengthen the CGS yield curve incrementally, in a manner consistent with prudent sovereign debt management and market demand.

The Government will continue to monitor the CGS market, and consider the advice of the panel, to ensure the market remains of a sufficient size to support these objectives as the budget returns to surplus and headline cash surpluses are used to reduce the level of gross CGS on issue.

These objectives will mean that at some stage after the budget has returned to surplus, the Government will need to transition from reducing the level of CGS on issue to maintaining an appropriately sized CGS market, while continuing to reduce the level of net debt outstanding.

This will see the Government once again begin to accumulate financial assets. These assets will initially be held as highly liquid assets to provide the Commonwealth with flexibility in managing its financing requirements in the short term. The Government will consider the use of accumulated financial assets in conjunction with future consideration of the size of the CGS market.

To ensure flexibility in implementing the Government's objectives for maintaining a deep and liquid CGS market, and to meet the Government's financing needs over the forward estimates, the Government will seek an amendment to the *Commonwealth Inscribed Stock Act 1911* to increase the legislative limit on CGS issuance.