STATEMENT 7: ASSET AND LIABILITY MANAGEMENT

The Australian Government's financial position remains amongst the strongest in the developed world and Australia is one of only eight countries to have a AAA credit rating with a stable outlook from all three major rating agencies.

This very strong balance sheet position continues to provide the Government with the capacity and flexibility to respond to unanticipated adverse events and longer-term challenges.

The Australian Government's net debt position remains very low by international standards, notwithstanding the large further write-down to tax receipts contributing to an increase in net debt since the 2012-13 Budget. Australia's net debt levels will remain less than one-eighth of the level in major advanced economies.

In this Budget, the Government maintains its commitment to a liquid and efficient Commonwealth Government Securities market.

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 affect the projected value of assets and liabilities, and hence change the projected path of the balance sheet measures outlined above.

Since the 2012-13 Budget several factors, including the large further write-down in tax receipts and lower yields on Commonwealth Government Securities, have resulted in an increase in the expected value of liabilities over the forward estimates. This increase in liabilities has been partly offset by increases in expected value of assets, in particular increases in expected holdings of financial assets. This has led to higher estimates for net debt, and lower estimated net financial worth and net worth than was expected at the 2012-13 Budget.

However, Australia's net debt position remains very low by international standards, with Australia one of only eight countries to have a AAA credit rating with a stable outlook from all three major credit rating agencies.

The Government's ongoing commitment to fiscal discipline and the enduring savings announced in this Budget will sustain confidence in the strength of Australia's public finances.

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 affect 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

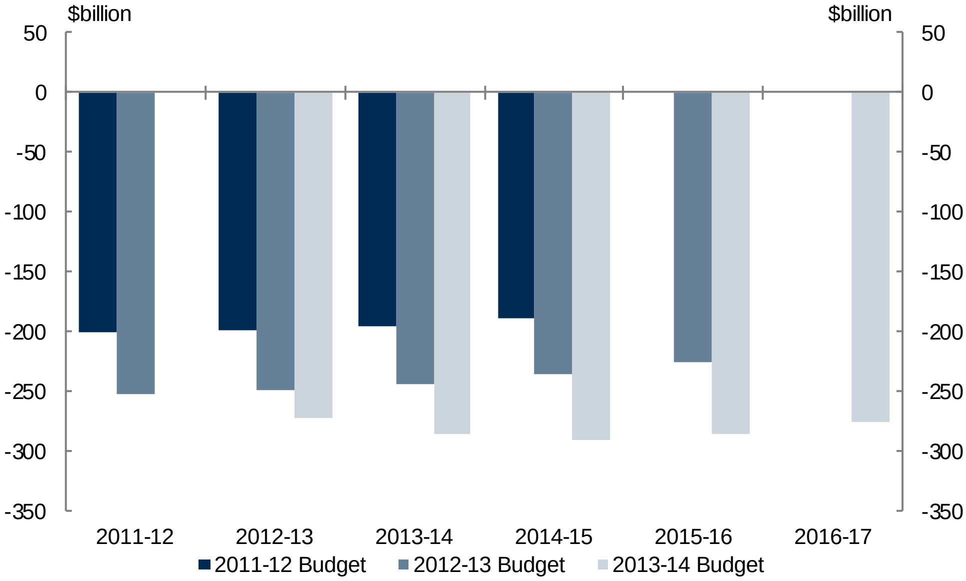
Several factors, including the large further write-down in tax receipts and lower yields on Commonwealth Government Securities, have resulted in an increase in the value of expected liabilities. This increase in liabilities has been partly offset by the assets set aside in the DisabilityCare Australia Fund as well as increases in the value of HELP assets and investments of the Future Fund. This has led to higher estimates for net debt, and lower estimated net financial worth and net worth than was expected at the 2012-13 Budget.

Net debt is now expected to peak at $191.6 billion in 2014-15 (11.4 per cent of GDP), falling to $185.7 billion (10.0 per cent of GDP) by the end of the forward estimates.

In 2013-14, net financial worth is estimated to be -$286.1 billion, compared with the 2012-13 Budget estimate of -$244.3 billion. Net financial worth is estimated to be -$275.1 billion by the end of the forward estimates.

Chart 1 shows the projected movements in net financial worth since the 2011-12 Budget.

Chart 1: Net financial worth comparison



Note: Net financial worth for 2015-16 and 2016-17 was not projected in the 2011-12 Budget; net financial worth for 2016-17 was not projected in the 2012-13 Budget. At the 2013-14 Budget, prepayments have been reclassified as financial assets to align with ABS GFS, affecting the measure of net financial worth (see Statement 9: Budget Financial Statements for further details).

Net worth is currently estimated to be -$173.5 billion in 2013-14, compared with -$132.8 billion estimated at the time of the 2012-13 Budget.

The Australian Government's financial position remains amongst the strongest in the developed world (Box 2) and is a key reason behind Australia receiving a AAA credit rating from all three major credit rating agencies. Indeed, Australia is now one of only eight countries to have a AAA rating with a stable outlook from all three agencies.

In addition to the Government's adherence to a credible medium-term fiscal framework, other key factors underpinning Australia's credit rating are the resilience of the economy, the ongoing stability of the financial system and the quality of policy and institutional arrangements, including independent monetary policy and strong financial regulation.

The Australian Government has a strong history of prudent balance sheet management, and is well placed to manage its liabilities. A recently published IMF paper on global demand for advanced economy sovereign debt noted that Australia has a particularly safe investor base, with a high share of foreign central bank and domestic investors, which are generally seen as more stable investors.

The weighted average term to maturity of Australia's Treasury Bond portfolio has been increased from 4.64 years as at 31 March 2011 to 5.22 years as at 31 March 2013. In the same period, the Australian Office of Financial Management (AOFM) has increased the rolling one year average tenor of new issuance of Treasury Bonds from 5.96 years to 8.58 years. All else being equal, increasing the term to maturity of debt reduces both refinancing risk and the variability of public debt interest costs.

Yields on Commonwealth Government Securities remain at historically low levels (see Box 3). In addition to this, all Commonwealth Government Securities are issued in Australian dollars. This means that the Australian Government faces almost no exchange rate risk on its debt and does not need to engage in foreign exchange hedging to manage its liabilities.

The Australian Government has also accumulated $85.2 billion of financial assets within the Future Fund to enhance the Government's ability to offset its unfunded superannuation liabilities.

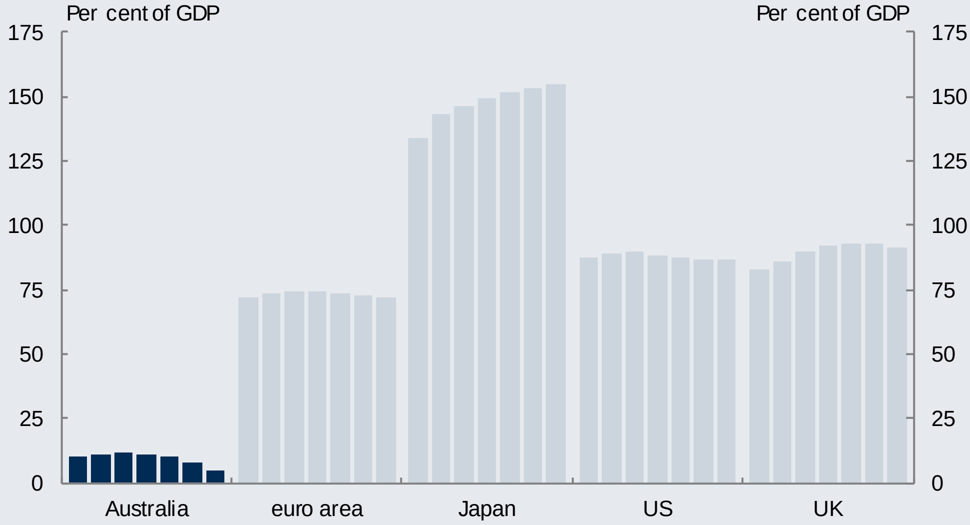
Box 2: The strength of the Australian Government's financial position

During 2012-13, many other advanced economies faced financial and fiscal challenges as a result of the accumulation of large budget deficits and high levels of sovereign debt. Several governments have continued to implement severe austerity measures to support more sustainable trajectories for government debt at a time when they also face the significant task of generating growth and reducing unacceptably high unemployment. Other governments such as those in the United States and Japan, while not currently facing market pressures, nonetheless face their own considerable medium-term fiscal consolidation challenges.

This stands in sharp contrast to the strength and resilience of the Australian Government's financial position and the resilience of the domestic economy, which is forecast to record solid growth.

Australia's level of net debt remains very low by international standards (Chart A). Australian Government net debt is expected to peak at 11.4 per cent of GDP in 2014-15, compared with the expected peak in the average net debt position of the major advanced (G7) economies of 92.6 per cent of GDP in 2014.

Chart A: Comparison of government net debt for selected economies, 2012-2018

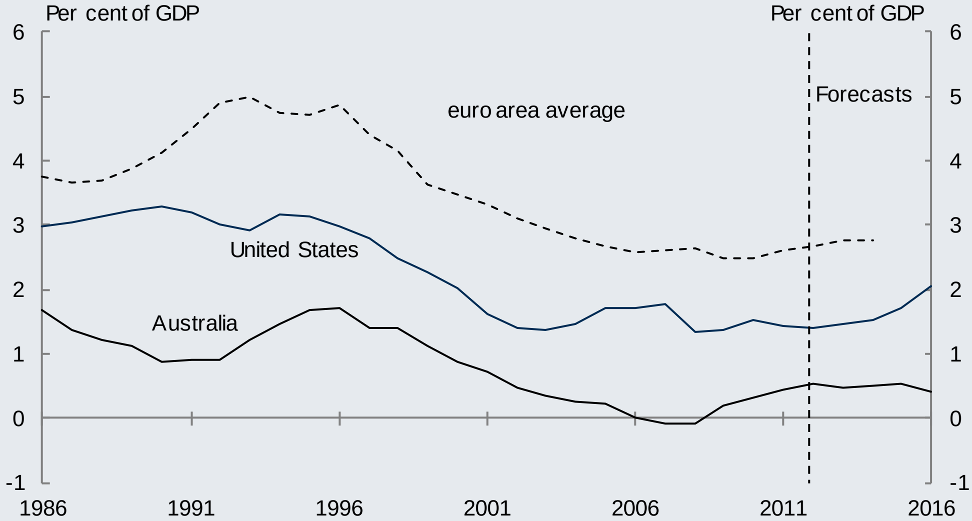


Note: Australian data are for the Australian Government general government sector and refer to financial years beginning 2012-13. Data for all other economies are total government and refer to calendar years beginning 2012.
Source: IMF *Fiscal Monitor* April 2013 and Treasury.

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

Similarly, Australia's net interest payments are very low by international standards (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 1986-87 and is for the general government sector. US data refer to US fiscal years beginning October 1986. Euro area data are total government and refer to calendar years beginning 1986.
Source: United States Congressional Budget Office *The Budget and Economic Outlook* February 2013, OECD *Economic Outlook 92* November 2012, Thomson Reuters and Treasury.

Not only are the Government's debt levels very low by international standards, the responsible fiscal consolidation and the return to surplus within the forward estimates means that the Government is well placed to reduce net debt from its already modest level.

Returning the budget to surplus will strengthen the balance sheet further and will ensure Australia continues to have the flexibility to respond to any unanticipated adverse future events and to other longer-term challenges.

THE AUSTRALIAN GOVERNMENT'S MAJOR ASSETS AND LIABILITIES

Assets

The Government's total stock of assets is estimated to be around $352.5 billion at 30 June 2013, increasing to $376.6 billion in 2013-14 and $462.2 billion by the end of the forward estimates.

The Government's financial assets are estimated to be $242.2 billion at 30 June 2013, increasing to $264.0 billion in 2013-14 and $343.0 billion by the end of the forward estimates.

The Government's non-financial assets are estimated to be $110.3 billion at 30 June 2013, increasing to $112.6 billion in 2013-14 and $119.1 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 Consumer Price Index (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 (the Board) 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.

The portfolio of assets has performed well, given the extent of uncertainty and volatility in financial markets over the past five years. Since the effective start of the investment program on 1 July 2007, the Future Fund has generated a nominal return of 5.6 per cent. Since the first contribution to the Future Fund on 5 May 2006, the return has been 5.7 per cent per annum.

At 31 March 2013, the Future Fund's return for the financial year to date was 10.6 per cent.

The Future Fund was valued at $85.2 billion at 31 March 2013.

The Future Fund's portfolio has now been substantially invested but will continue to evolve as the Board manages the portfolio in line with its mandate and strategy. Table 1 shows changes in the asset allocation of the Future Fund over 2012-13.

Table 1: Asset allocation of the Future Fund

Asset class	30 June 2012 $m	31 March 2013 $m
Australian equities	7,980	9,890
Global equities	17,343	20,262
Private equity	4,895	5,764
Property	4,948	5,473
Infrastructure	4,912	5,547
Debt securities	14,119	14,174
Alternative assets	14,653	13,060
Cash	8,163	10,996
Total Future Fund assets	77,012	85,166

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 (the Board), 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 (3.9 per cent for the year to 31 March 2013). 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.

Over the 12 months to 31 March 2013, the BAF, EIF and HHF each returned 4.6 per cent, exceeding the mandated benchmark return of 3.9 per cent.

At the end of the March quarter 2013, the value of the BAF was $5.0 billion, the EIF was $4.1 billion and the HHF stood at $3.1 billion.

The estimated uncommitted balance of funds at 31 March 2013 was $2.2 billion for the BAF, $3.1 billion for the EIF and $0.9 billion for the HHF. These figures are the amounts available for new eligible projects and include net investment earnings up to 31 March 2013.

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.

DisabilityCare Australia Fund

The Government is establishing the DisabilityCare Australia Fund (DCAF) to provide strong and stable funding for DisabilityCare Australia, the national disability insurance scheme. Revenue raised from increasing the Medicare levy by half a percentage point from 1.5 to 2 per cent will be placed into the DCAF for a fixed 10 year period from 1 July 2014 to 30 June 2024, which will only be drawn upon to fund the additional costs of delivering DisabilityCare Australia.

A fixed amount of the money flowing into the DCAF each year will be set aside for the States and Territories. In 2014-15, this fixed amount will be $825 million (which is 25 per cent of the revenue estimated to be raised in that year). Thereafter, the amount to be set aside for the States and Territories will be indexed annually by 3.5 per cent.

The balance of the DCAF will be available to the Commonwealth to meet additional expenditure during the launch and transition to full scheme of DisabilityCare Australia.

The States and Territories will be able to draw down from the DCAF when they meet key conditions, including agreement to fully implement DisabilityCare Australia and once at least 50 per cent of their eligible population is covered by the scheme. In addition, once eligible States and Territories have clients participating in DisabilityCare Australia, they will be able to access 10 per cent of their annual allocation in 2015-16 and 20 per cent of their annual allocation in 2016-17 and 2017-18 to support early establishment costs related to DisabilityCare Australia.

The DCAF will be established on 1 July 2014 and will be managed by the Future Fund Board of Guardians. The Treasurer and Minister for Finance and Deregulation will set an Investment Mandate for the DCAF which will provide guidance to the Board in relation to its investment strategy for the Fund.

Residential mortgage-backed securities

The global financial crisis led to the profound dislocation of the securitisation market globally, including the Australian residential mortgage-backed securities (RMBS) market. In view of these developments, in October 2008 the Government directed the AOFM to invest in high quality, AAA-rated Australian securities to support competition from smaller lenders in the residential mortgage and small business lending markets.

During the life of the program, the AOFM program supported 67 securitisation deals, which raised over $45 billion, assisting 20 smaller mortgage lenders to continue lending to the retail market. In total, AOFM directly invested $15.5 billion in high-quality RMBS issued by smaller lenders. It is estimated that the program assisted smaller lenders fund the equivalent of 245,000 home loans and more than $3.2 billion worth of loans to small businesses. The program also helped preserve critical market infrastructure that has allowed the market to quickly rebound after the financial crisis, which has helped smaller lenders continue to raise more economic funding to exert competitive pressure on the major banks. The AOFM program has made an important contribution to boosting competition in the banking sector.

Conditions in the Australian securitisation market have improved substantially since the introduction of the AOFM program. Since September 2012, private demand for securitisation had increased to the extent that the AOFM was not required to provide any direct investment in new RMBS deals.

Given the improvement in the market, the Deputy Prime Minister and Treasurer announced on 10 April 2013 that the program would close for new investment. The AOFM may continue to hold previously purchased RMBS until their maturity. However, where the sale of RMBS held by the AOFM can occur at a price the AOFM considers acceptable and continues to support market recovery, the AOFM is empowered to undertake such a sale.

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

National Broadband Network

NBN Co Limited (NBN Co) was established on 9 April 2009 to design, build and operate the National Broadband Network (NBN), the single largest nation building infrastructure project in Australian history. NBN Co is a Government Business Enterprise, wholly owned by the Australian Government and represented by two Shareholder Ministers — the Minister for Finance and Deregulation and the Minister for Broadband, Communications and the Digital Economy.

The finalisation of the NBN Co-Telstra Definitive Agreements in March 2012 has enabled NBN Co to commence the full scale rollout of the NBN and continue expanding construction activity across Australia. Fibre rollout to over 4.8 million Australian premises is scheduled to be underway or completed by the middle of 2016.

Recently, NBN Co has identified some delays to the rollout associated with the physical mobilisation of some of its construction partners. NBN Co is working to resolve these issues and does not expect to revise the forecast 2021 completion date or overall cost of the NBN.

As a consequence of delay, NBN Co's equity requirement from Government in 2012-13 has reduced from $4.7 billion to $2.6 billion. Over the four years from 2013-14, the Government will provide $21.4 billion in equity to NBN Co.

Higher Education Loan Program

The Higher Education Loan Program (HELP) comprises concessional loans to students that enable them to defer payment of fees for diploma level and above courses, which are paid back once earning an income above a certain level.

The value of HELP is estimated to be around $22.3 billion at 30 June 2013, which is $2.1 billion higher than projected in the 2012-13 Budget. The value of HELP is projected to grow to around $26.2 billion in 2013-14 and $42.1 billion by the end of the forward estimates.

This growth is largely a result of the estimated increase in university commencements over the forward estimates, principally the result of the uncapping of Commonwealth Support Places for Undergraduate courses from 1 January 2012 and the expansion of access to the Vocational Education and Training FEE-HELP scheme.

Clean Energy Finance Corporation

The Clean Energy Finance Corporation (CEFC) was established as a Commonwealth Authority in August 2012 through the *Clean Energy Finance Corporation Act 2012* (CEFC Act). Investment decisions are made by an independent board consistent with the CEFC Act and the high level investment mandate set by the Government. The CEFC's Special Account will be credited with $2 billion per annum for five years from 1 July 2013 to allow the CEFC to invest, directly and indirectly, in clean energy technologies.

The CEFC was established to finance Australia's clean energy sector using financial products and structures to address the barriers inhibiting investment. The CEFC is a mechanism to help mobilise investment in renewable energy, low-emissions and energy efficiency projects and technologies in Australia, as well as manufacturing businesses and services that produce the required inputs. It will invest at the demonstration, commercialisation and deployment stages of innovation using a range of financial instruments to make these investments, including loans on commercial and concessional terms, loan guarantees and equity. The CEFC will apply commercial rigour when making its investment decisions and have regard to its potential effect on other market participants when considering investment proposals.

Further information can be found in the measure: Clean Energy Finance Corporation detailed in the *Mid-Year Economic and Fiscal Outlook 2011-12*.

Liabilities

The Government's total liabilities are estimated to be $513.6 billion at 30 June 2013, increasing to $550.1 billion in 2013-14 and $618.1 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 $143.5 billion at 30 June 2013.

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 $164.8 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. The long-term nature of the unfunded superannuation liability requires the use of a discount rate that best matches the duration of the liability. The value recorded on the balance sheet is highly sensitive to the discount rate used. The use of a long-term discount rate for budget purposes avoids introducing volatility that would occur by using a discount rate based on yields on government bonds that varies periodically. 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.

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).

The Unfunded Superannuation Liability and the Future Fund Balance

The Future Fund was established by the *Future Fund Act 2006* (the Act) to enhance the ability of the Commonwealth to discharge unfunded superannuation liabilities expected after 2020. The Future Fund and the unfunded superannuation liability represent significant items on the Commonwealth's balance sheet.

Primarily as a result of changes in member behaviour, for example, members increasingly taking more of their benefit as a lifetime pension rather than as a lump sum, and members living longer after retirement, the unfunded liability has increased compared to previous projections. No government decision has materially contributed to the increase in the liability.

The open Military Superannuation and Benefits Scheme (MSBS) is the main driver of the increase in the unfunded superannuation liability into the future. Other material Government defined benefit schemes are no longer open to new members.

The size of the Future Fund depends upon its investment performance. The Future Fund has performed well, given the extent of uncertainty and volatility in financial markets over the past five years including the adverse effects of the global financial crisis. Over five years to 31 March 2013, the Fund has generated annualised returns of 6.4 per cent. This compares favourably to the 3.2 per cent returns achieved by balanced superannuation funds over the same period (Source: SuperRatings).

As at 30 June 2013, the Future Fund balance is estimated to be $87 billion and the unfunded superannuation liability is valued at $143 billion, with a difference projected to continue over the medium term. The increase in the unfunded liability compared to projections when the Future Fund was established is $19 billion.

The Government continues to support the goal of the Future Fund having sufficient resources to fund the Commonwealth's future superannuation liability and would consider further contributions to the Fund as fiscal circumstances allow.

Commonwealth Government Securities

The face value of the total stock of Commonwealth Government Securities (CGS) on issue at 30 June 2013 is expected to be $256 billion. The face value of Treasury Bonds and Notes represents the amount that the Government pays back at maturity. The face value of Treasury Indexed Bonds represents the capital value unadjusted for inflation. Face value is independent of fluctuations in market value.

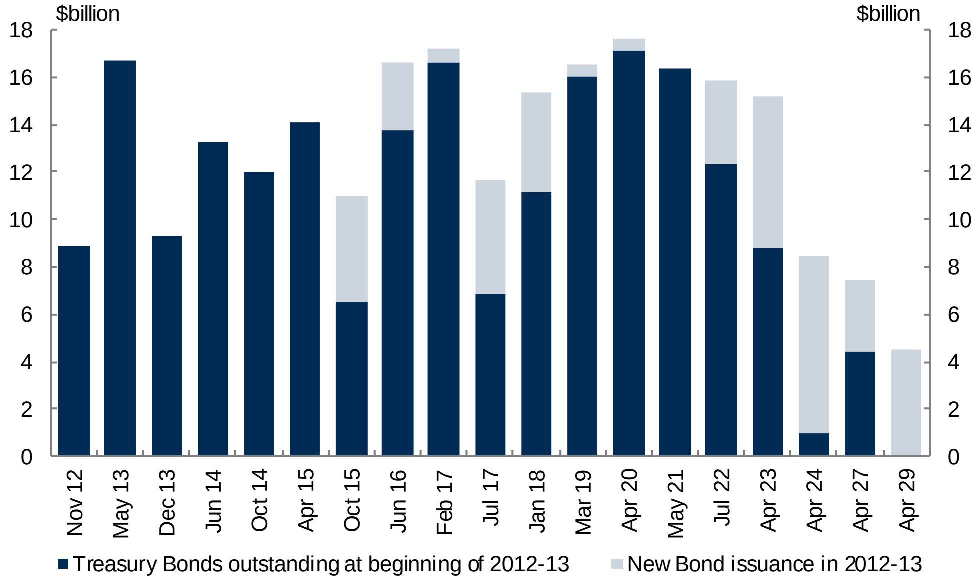
CGS are reported on the balance sheet in market value terms, consistent with relevant accounting standards. The market value of CGS reflects bond prices in the secondary market, which are constantly changing with market conditions.

The AOFM's approach in recent years has been to lengthen both the nominal and real yield curves gradually. The current yield curves extend to April 2029 for (nominal) Treasury Bonds and September 2030 for (real) Treasury Indexed Bonds. Incremental extensions to the yield curve have facilitated efficient pricing of new bond lines.

Treasury Bonds

Chart 2 shows the face value of Treasury Bonds outstanding at 30 June 2012 and new issuance in 2012-13. One new Treasury Bond line was launched in 2012-13. This was an April 2029 maturity.

Chart 2: Treasury Bonds on issue



Note: New issuance in 2012-13 is to 14 May 2013.

The face value of Treasury Bonds on issue at 30 June 2013 is projected to be around $233 billion, and around $260 billion at 30 June 2014.

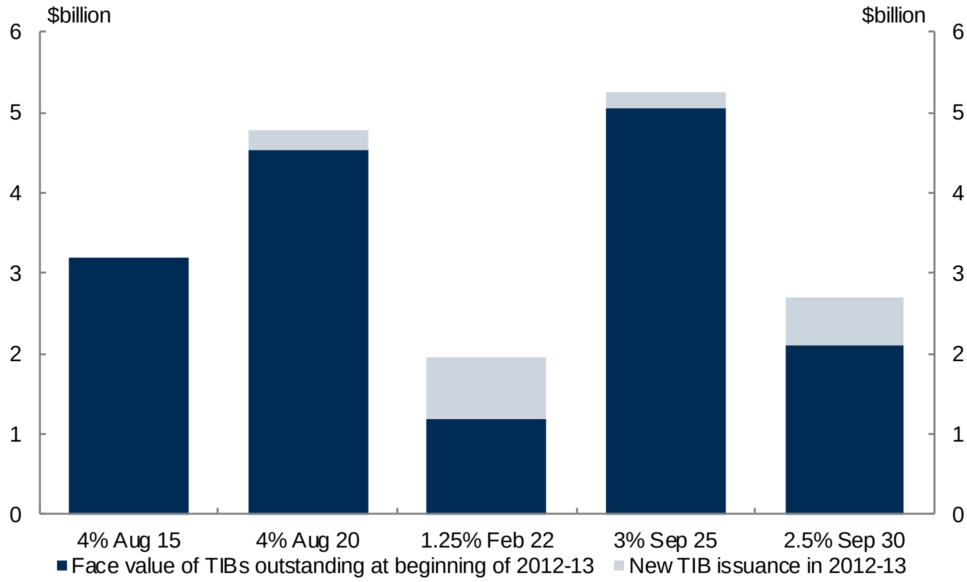
Treasury Indexed Bonds

Treasury Indexed Bonds (TIBs) 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 TIBs in 2009-10.

TIBs 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 TIBs outstanding at 30 June 2012 and new issuance in 2012-13.

Chart 3: Treasury Indexed Bonds on issue



Note: New issuance in 2012-13 is to 14 May 2013.

The face value of TIBs on issue at 30 June 2013 is projected to be around $18 billion, and around $22 billion at 30 June 2014.

Interest payments made on TIBs are reflected in the Government's cash flow statements, with the adjusted capital value paid in the year which the bond matures. In 2015-16 there is an increase in interest paid as a result of the August 2015 TIB maturing.

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. In October 2012, the AOFM announced that the 'floor' of $10 billion of Treasury Notes on issue will no longer be maintained and there are expected to be times when there will be no Treasury Notes on issue.

Aussie Infrastructure Bonds

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

AIBs were not required prior to 2011-12, as the Government's equity contributions were met in full with funds from the Building Australia Fund (BAF).

In 2011-12, all of the Government's $1.5 billion equity investment in NBN Co was financed through AIBs, through the wholesale issuance of Commonwealth Government Securities as part of the AOFM's overall debt program. In 2012-13, it is expected that $2.3 billion of the Government's $2.6 billion equity investment in NBN Co will be financed through AIBs in the same manner, with the remainder coming from the BAF. From 2013-14, all of the Government's equity contributions to NBN Co will be financed through AIBs.

Legislative framework

The *Commonwealth Inscribed Stock Act 1911* places a limit on the outstanding stock of Commonwealth Government Securities. The Government will legislate to increase the limit as it becomes necessary.

THE COMMONWEALTH GOVERNMENT SECURITIES MARKET

In the 2011-12 Budget, the Government reaffirmed that its primary objective for the future of the Commonwealth Government Securities (CGS) market is to maintain liquidity to support the three- and ten-year bond futures market. The Government is maintaining this objective in the 2013-14 Budget. The experience of the global financial crisis underscored the value of maintaining a liquid and efficient CGS market of sufficient size to support the long-term stability of the financial markets.

In considering the future of the CGS market, including the size needed to ensure liquidity, the Government's deliberations were informed by discussion with a panel of financial market participants and financial regulators. The panel considered the impact of the global financial crisis, the new global liquidity standards and the changing composition of the CGS investor base on the CGS market.

Since the 2011-12 Budget there have been significant developments in world financial markets that have had implications for the CGS market, in particular the growing demand from international investors for Australian dollar denominated securities, including CGS, against a backdrop of global economic volatility and persistently weak sovereign balance sheets in many other advanced economies.

The strength of Australia's public finances and its continued economic resilience stand in stark contrast to many other sovereigns, which are facing a significant task of placing public finances on a sustainable footing, while supporting growth and jobs.

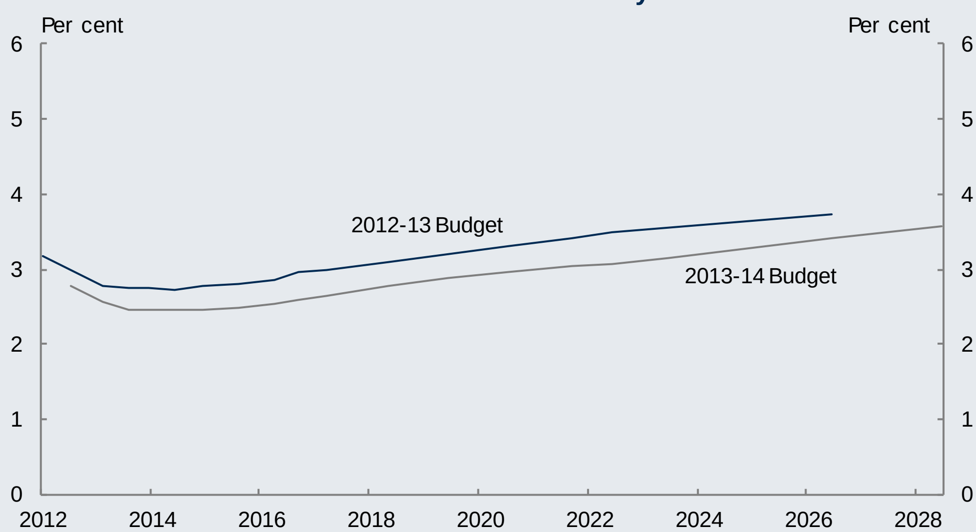
A number of factors have influenced the fall in yields on Treasury Bonds. The benchmark borrowing rate for the ten-year Treasury Bond has fallen to some of the lowest levels in Australia's history (see Box 3).

Box 3: Increased demand for Australia's sovereign debt

CGS yields have fallen across the yield curve since the 2012-13 Budget (Chart A), resulting in lower borrowing rates for the Government. Following the 2012-13 Budget, CGS yields fell to some of the lowest levels on record owing to the uncertain global economic environment. Although yields have risen since then, they remain at historically low levels (Chart B).

These historically low yields are a result of a range of factors including Australia's strong public finances and economic resilience, strong foreign demand for a dwindling pool of AAA rated securities like Australia's, the overall subdued global growth outlook which is placing downward pressure on global long-term bond yields, increasing diversity in the buyers of government debt and the attractiveness of the deep and liquid CGS market.

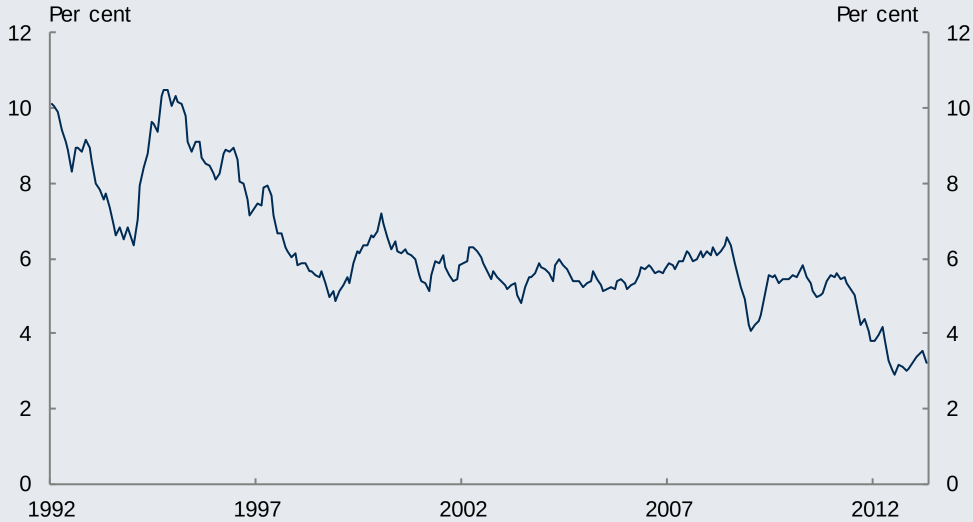
Chart A: Yield curve for Treasury Bonds



Note: Yields are indicative mid-rates of CGS. Data for the 2012-13 Budget and 2013-14 Budget refer to yields on 8 May 2012 and on 7 May 2013 respectively.
Source: RBA.

Box 3: Increased demand for Australia's sovereign debt (continued)

Chart B: Historical ten-year Treasury Bond yields



Source: RBA.