STATEMENT 7: ASSET AND LIABILITY MANAGEMENT

The global economy is experiencing the deepest global recession since the Great Depression.

This dramatic deterioration in the economic outlook has resulted in significant downward revisions to estimated tax receipts. These revisions, coupled with timely and decisive fiscal stimulus to support jobs and activity, will require a necessary and responsible increase in borrowing over the forward estimates.

Australia's levels of net debt will remain small by world standards. The Government's balance sheet position remains strong and it has sufficient capacity to absorb temporary budget deficits.

The small size of Australia's borrowing program relative to many other advanced economies leaves the Government well-placed to pay down debt quickly as the economy improves and the Budget returns to surplus.

The Australian Government's major assets and liabilities **7-3**
Measurement of the Government's financial position 7-3
Assets 7-4
Liabilities 7-6

Managing changes in the Government's borrowing needs **7-7**
Treasury Bonds 7-7
Treasury Notes 7-8
Aussie Infrastructure Bonds 7-8
Legislative framework 7-8

STATEMENT 7: ASSET AND LIABILITY MANAGEMENT

Despite the sharp contraction in global economic growth, the Government's balance sheet position remains strong and it has sufficient capacity to absorb temporary budget deficits. Australia's projected net debt levels remain below the major advanced economies across the forward estimates.

The temporary deficits forecast in the Budget year and over the forward estimates are an inevitable consequence of the worst global recession since the Great Depression. Downward revisions to taxation receipts since the 2008-09 Budget total around an estimated $210 billion across the forward estimates to 2012-13, and early and decisive fiscal stimulus has also been essential to support economic activity and jobs, along with investment in the economy's future productivity.

Given the relative strength of the Government's balance sheet, the forecast temporary deficits are an appropriate response in the current circumstances.

THE AUSTRALIAN GOVERNMENT'S MAJOR ASSETS AND LIABILITIES

The Government's balance sheet shows the stocks of all government assets and liabilities. The underlying cash balance measures the flows of receipts and payments over the financial year. Generally speaking, where government outlays exceed government receipts, this will result in an underlying cash deficit. A deficit will either reduce the stock of assets or increase the stock of liabilities on the Government's balance sheet.

Net debt, net worth and net financial worth are aggregates drawn from the balance sheet which provide an indication of the Government's financial strength.

Measurement of the Government's financial position

Net debt is the most commonly quoted and well-known measure of a government's financial strength. One of the reasons is that it is part of everyday life for business and households. Another reason is that, historically, it was the only available stock measure for governments that were recording financial information in a cash-based accounting system. Net debt provides a useful measure for international comparisons, given most OECD countries report on it.

Net worth provides a more comprehensive picture of the Government's overall financial position than net debt. However, the valuation of physical assets can be problematic as they are typically valued without consideration of their potential use. Also, the Government may not be in a position to sell certain non-financial assets, and therefore these assets would not be available to meet the Government's financing requirements.

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.

The projected deterioration in net financial worth is largely driven by the sharp downward revisions to tax receipts over the forward estimates resulting from the deterioration in the global economic outlook.

The small size of Australia's borrowing program relative to the major advanced economies leaves the Government well-placed to pay down debt quickly as the economy improves and the budget returns to surplus. Based on current projections, net debt will reach a peak of 13.8 per cent of GDP in 2013-14 before declining to around 3.7 per cent in 2019-20.

The outlook for the Government's balance sheet, including the aggregates of net debt, net worth and net financial worth, are based on a range of assumptions. If the basis for these assumptions changes, it is likely to impact on the projected value of assets and liabilities, and hence change the projected path of net financial worth.

Statement 3: Fiscal Strategy and Outlook examines the impact of altering key economic assumptions on expenses and revenue. Since the budget outcome 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 net financial worth.

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 financial worth position.

Assets

The Government's financial assets are expected to increase by around $37 billion over the Budget year and forward estimates to $238 billion.

Nation-building Funds

The *Nation-building Funds Act 2008* established three Nation-building Funds to finance investment in critical areas of infrastructure such as transport and broadband infrastructure, higher education and research, vocational education and training facilities, and hospitals and medical research facilities and projects.

The Government has committed to transfer the realised 2007-08 surplus and the balance of the Telstra Sale Special Account to the Funds by 30 June 2009.

The funds will be drawn on to finance the Government's nation-building investments announced in the Budget: $10.7 billion will be drawn from the Building Australia Fund (BAF); $3.0 billion from the Education Investment Fund (EIF); and $3.2 billion from the Health and Hospitals Fund (HHF). This includes funding from the BAF for part of the Government's equity contribution in the company established to build and operate a new super fast National Broadband Network. It also includes the public debt interest for the part of the Government's equity injection financed through Aussie Infrastructure Bonds.

Prior to closing the Telstra Sale Special Account, the Government will redirect $1.5 billion for a range of significant infrastructure projects, including for clean energy and key transport projects. The Government will also invest $2.5 billion set aside for the EIF in its Clean Energy Initiative. The Clean Energy Special Account will have a balance of $3.1 billion.

The Government's nation-building investments will help support economic activity in the short term and expand growth potential in the medium to long term.

Future Fund

The Future Fund was established to finance the Government's unfunded public sector superannuation liability. The fund was valued at $58.1 billion as at 31 March 2009, consisting of:

- $30.2 billion of (non-Telstra) assets including equities, fixed-interest instruments and global property;
- $21.0 billion in cash and cash-like assets; and
- $6.8 billion in Telstra shares.

The fund declined in value by 9.6 per cent over the first nine months of 2008-09, reflecting the extremely difficult investment climate associated with the global financial crisis. By way of a comparison, the Australian All Ordinaries index fell by 34 per cent over the same period.

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. The value of HELP is estimated to be over $11 billion as at 30 June 2009 and is estimated to grow to over $13 billion by 2012-13. The steady rise in outstanding loans reflects decisions to relax and then uncap the number of public university places and to increase the rate of indexation applied to maximum student contributions.

National Broadband Network

On 7 April 2009, the Government announced it would establish a new company that will invest up to $43 billion to build and operate an enhanced National Broadband Network to deliver telephony and high speed broadband to Australian homes and businesses. The preliminary estimate is that the enhanced National Broadband Network will cost up to $43 billion, with detailed engineering, commercial and structural issues to be the subject of an implementation study to be completed by early 2010. The Government will make an initial investment of $4.7 billion.

The company has been established under corporations law and will operate as a government business enterprise. Private investment will be encouraged but ownership caps will be established to protect the Government's objective of establishing a wholesale-only open access network that is independent of retail providers.

Further information can be found in the measures: *National Broadband Network — initial investment; National Broadband Network — implementation and establishment;* and *National Broadband Network — regional backbone blackspots program*, detailed under the Broadband, Communications and the Digital Economy portfolio in Budget Paper No. 2.

Residential Mortgage-Backed Securities

On 26 September 2008, the Government announced its intention to purchase Residential Mortgage-Backed Securities (RMBS) to support competition in mortgage markets following the dislocation of the Australian RMBS market. Up to $8 billion is available for investment, with at least $4 billion to be allocated to issuer/originators that are non-authorised deposit-taking institutions.

To date, the Australian Office of Financial Management (AOFM) has purchased around $5 billion of RMBS. The RMBS are assets on the Government's balance sheet.

Liabilities

Total liabilities are expected to rise by $224 billion over the Budget year and forward estimates to $507 billion.

Public sector employee superannuation liabilities

Public sector employee superannuation entitlements relating to past and present civilian employees and military personnel constitute the largest financial liability on the Government's balance sheet. The Government's superannuation liability is estimated to be around $118 billion as at 30 June 2009.

The Australian Government has never fully funded its superannuation liabilities. The Commonwealth Sector Superannuation Scheme and the Public Sector Superannuation Scheme were closed to new members in 1990 and 2005 respectively. From 1 July 2005, the Public Sector Superannuation Accumulation Plan was introduced 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 $135 billion by the end of the forward estimates and around $162 billion by 2020. This is the result of growth in the membership of the Military Superannuation and Benefits Scheme, 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 value the nominal amounts of the future superannuation liability to today's dollars. 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 total stock of Commonwealth Government Securities (CGS) on issue at 30 June 2010 is expected to be $169.9 billion, an increase of $58.0 billion on 30 June 2009. The total stock of CGS on issue is expected to rise to $300.8 billion by the end of the forward estimates.

The increase in CGS on issue reflects an increased borrowing requirement driven largely by the substantial downward revisions to taxation receipts since the 2008-09 Budget. In total, these revisions have stripped around an estimated $210 billion across the forward estimates to 2012-13 from the Budget bottom line.

MANAGING CHANGES IN THE GOVERNMENT'S BORROWING NEEDS

The Government's increased borrowing requirement in 2009-10 and over the forward estimates will be largely met by issuance of Treasury Bonds and Treasury Notes. The AOFM will continue to explore the use of other financing instruments, such as Treasury Indexed Bonds, in consultation with market participants.

Treasury Bonds

The increase in Treasury Bond issuance in the second half of 2008-09 has been absorbed relatively smoothly by the market. The face value of Treasury Bonds on issue at end-June 2009 is projected to be around $79 billion, an increase of approximately $30 billion on end-June 2008.

Treasury Bond issuance in 2009-10 is expected to be around $60 billion. The stock of Treasury Bonds on issue at end-June 2010 is projected to be around $133 billion.

The bulk of the issuance in 2009-10 will be into existing bond lines and will take account of the relative demand for lines of different maturities. This will enhance the liquidity and efficiency of the Treasury Bond market. At least one new Treasury Bond line is planned to be issued in 2009-10. This is expected to be a Treasury Bond maturing in 2022. Issuance of this bond line will support the operation of the 10-year Treasury Bond futures contract.

Treasury Notes

Since the February 2009 *Updated Economic and Fiscal Outlook*, the Government has recommenced issuance of Treasury Notes. These are short-term debt securities used primarily to meet within-year financing requirements resulting from differences in the timing of budget receipts and expenditures.

At end-June 2009, the volume of Treasury Notes on issue is expected to be around $17 billion. Issuance of Treasury Notes in 2009-10 will depend on the size and profile of the within-year funding flows. The volume of Treasury Notes will therefore vary over the course of the year. At least $10 billion of Treasury Notes will be kept on issue at all times to maintain a liquid market in the notes.

Aussie Infrastructure Bonds

The Government's investment in the National Broadband Network company will, in part, be funded through the issuance of Aussie Infrastructure Bonds (AIBs). AIBs will provide an opportunity for households and institutions to invest in the National Broadband Network.

The structure and form of AIBs will be finalised in conjunction with the implementation study for the National Broadband Network.

Legislative framework

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