

STATEMENT 7: ASSET AND LIABILITY MANAGEMENT

This statement previously focused on debt management. With the elimination of government net debt and a new focus on net worth, this statement now covers the management of the major assets and liabilities on the Government's balance sheet and provides detailed information on Australian Government net debt and net worth.

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The Australian Government balance sheet provides information on the Government's assets and liabilities and provides an indication of the sustainability of government finances. Maintaining a strong balance sheet ensures the Government has the capacity and flexibility to deal with longer term fiscal pressures.

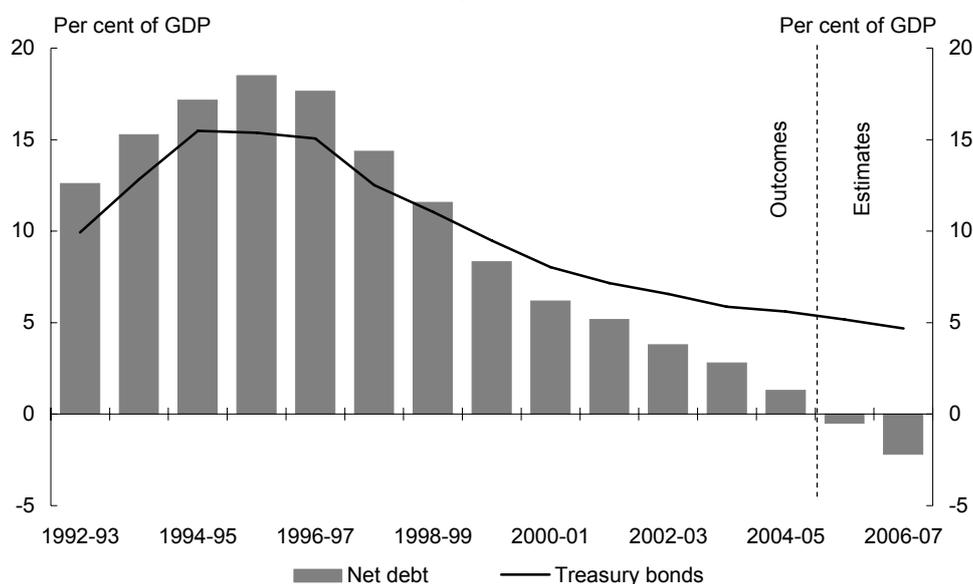
The balance sheet presents the Government's assets and liabilities, which contribute to the calculation of net debt and net worth. A detailed balance sheet for the Australian Government general government sector is provided in Appendix B of Statement 2 (Table B2).

NET DEBT AND NET WORTH

As a result of ten years of strong economic management, net debt was eliminated in April 2006 after falling from a peak of \$95.8 billion (18.5 per cent of GDP) in 1995-96.

Net debt is expected to fall further below zero in 2006-07 and over the forward years. This means a build up in selected financial assets, reflecting continued budget surpluses and the assumption that the full sale of Telstra is achieved in 2006-07 (Chart 1).

Chart 1: Australian Government general government sector net debt and Treasury bonds on issue



Source: Data are from ABS cat. no. 5501.0, Australian Government Final Budget Outcomes and Treasury estimates.

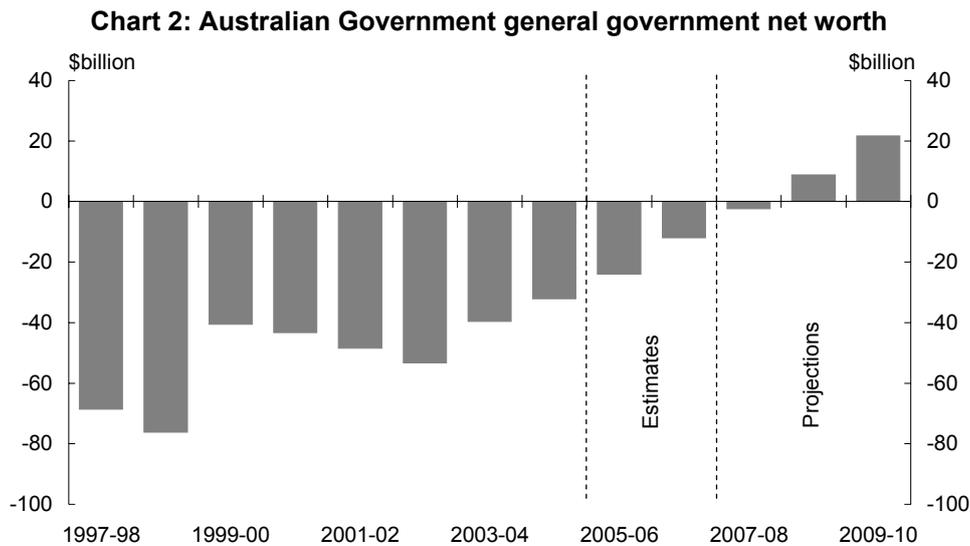
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Australia's net debt position compares favourably to other industrialised countries. The ratio of Australia's total general government sector net debt to GDP is among the lowest in the OECD and is considerably less than in the United Kingdom, Japan and the United States (see Statement 1).

Net debt is a sub-set of the Government's broader financial portfolio. It includes financial liabilities such as government securities and other loans and borrowing and financial assets such as cash, deposits and other investments. Net debt is a common measure of the strength of a government's fiscal position and performance.

Net worth is a broader measure of the Government's overall financial position which incorporates the Government's non-financial assets, such as land and other fixed assets, as well as certain financial assets and liabilities not included in net debt, most notably accrued employee superannuation liabilities.

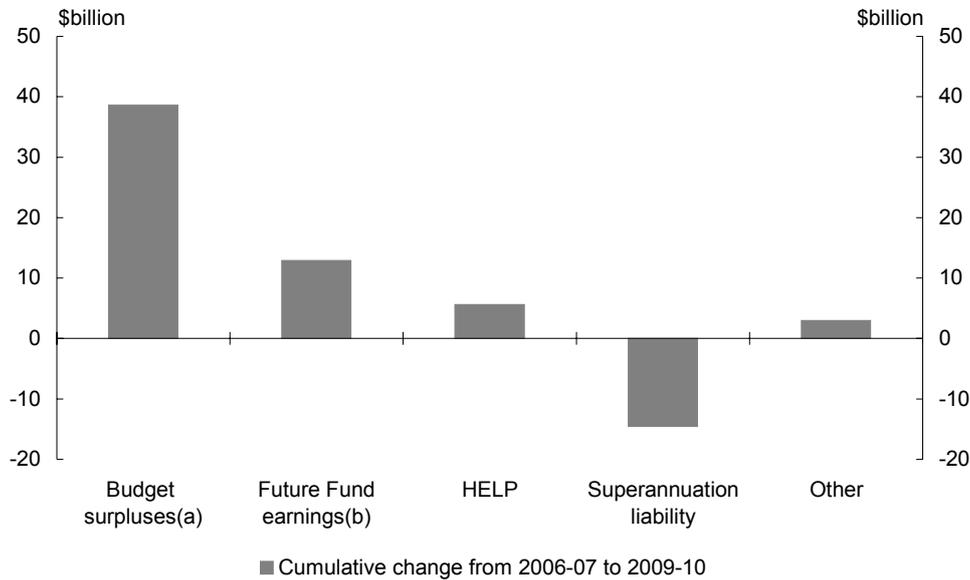
Australian Government general government sector net worth is expected to strengthen over the forward estimates with the establishment of the Future Fund. It is projected that by 2008-09 the Australian Government will have positive net worth (Chart 2).



Source: Data are from ABS cat. no. 5501.0, Australian Government Final Budget Outcomes and Treasury estimates.

The improvement in net worth is primarily driven by growth in budget surpluses, higher returns on investments in the Future Fund and increases in loans provided by the Higher Education Loans Program (HELP). These factors significantly outweigh growth in the Government's unfunded superannuation liability (Chart 3).

Chart 3: Contributions to net worth over the forward estimates



(a) Budget surpluses are assumed to reflect term deposits at the Reserve Bank of Australia.
 (b) The transfer of seed capital and Telstra sale proceeds are excluded as they are financing transactions that do not impact on net worth.
 Source: Treasury estimates.

The positive outlook for net worth and net debt means the Government is well placed to deal with future emerging fiscal pressures.

ASSET MANAGEMENT

The Australian Government holds a wide range of assets including investments in the Future Fund, term deposits at the Reserve Bank of Australia, higher education loans and non-financial assets such as land and buildings. Strong fiscal outcomes over recent years have contributed to both an increase in financial assets and Australian Government net worth.

The establishment of the Future Fund and possible sale of the Government’s remaining share in Telstra in 2006-07 will have an impact on the size and composition of Australian Government assets.

Future Fund

The Australian Government established the Future Fund in 2005-06 with seed capital of \$18 billion. The aim of the Future Fund is to fully offset the Government’s unfunded public sector superannuation liabilities by around 2020, thereby allowing the budget to cater for the increased fiscal pressures arising from the ageing of the population.

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The Future Fund will be invested in a broad range of financial assets and be managed by an independent statutory agency governed by an appropriately qualified board – the Future Fund Board of Guardians (the Board). Further contributions to the Future Fund will be made from future realised budget surpluses and asset sales.

The investment strategy adopted by the Board will have an impact on the Government's balance sheet. The recently appointed Board has not yet developed an investment strategy for the Future Fund, so standardised assumptions have been made about asset returns for the purposes of this budget, with assets invested in term deposits in the short term and progressively being invested in equities over the forward estimates. The actual impact on the forward estimates will depend on the investment strategy adopted by the Board.

Assuming the Board has a diversified holding of financial assets, net debt will be affected during the transition from the short to long term. This is because some of the Government's holdings of cash and fixed-interest securities will be converted into equities, which are not included in the calculation of net debt. Beyond the forward estimates period, the Future Fund is expected to contribute to improved net debt, largely due to compound growth from fixed interest and cash holdings within the overall asset portfolio.

Net worth over the forward estimates is likely to improve due to the establishment of the Future Fund. While transfers of funds between asset classes have no impact on net worth, the Future Fund is expected to improve net worth beyond the forward estimates due to an expectation of higher average returns through the Future Fund than under current arrangements.

Telstra

The budget estimates have been constructed assuming the full sale of the Government's remaining shares in Telstra in 2006-07. The estimates also assume that the sale proceeds will be transferred to the Future Fund. However, the Government has not made final decisions in relation to the sale, including the structure of the sale, the nature of securities to be sold, or the quantity of shares to be sold. The structure that is ultimately adopted may vary depending on market circumstances and expert advice provided at the time.

LIABILITY MANAGEMENT

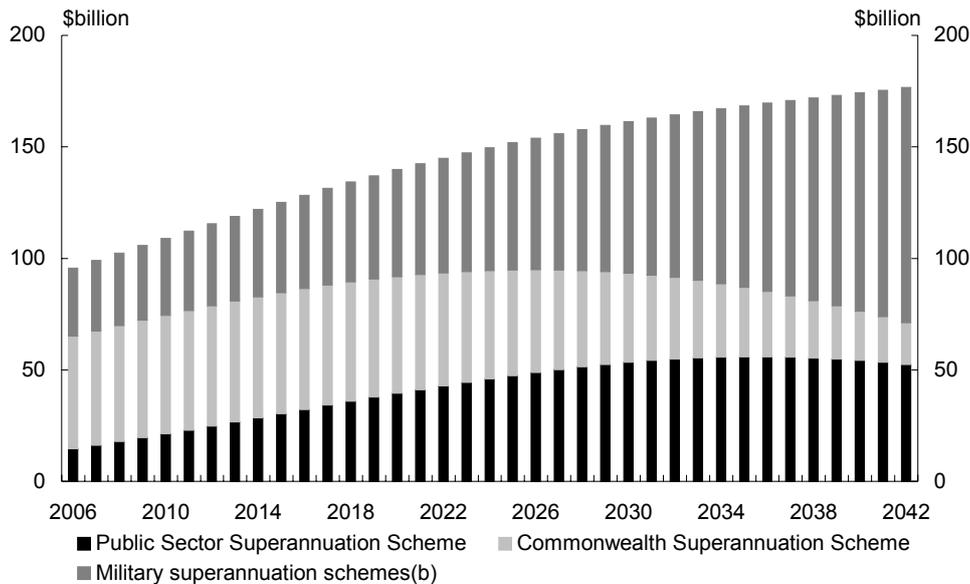
The major liabilities on the Australian Government's balance sheet are the Government's superannuation liability for public sector employees and government debt securities. In 2006-07, these liabilities are estimated to comprise more than three quarters of total Australian Government liabilities.

Public sector employee superannuation liabilities

Public sector employee superannuation entitlements are the largest financial liability on the Government's balance sheet. This liability relates to past and current public sector employees. It is currently valued at around \$96 billion and is estimated to grow to around \$140 billion by 2020.

The Australian Government has never fully funded its superannuation liability. However, in 1990 and 2005 the Australian Government closed the main civilian superannuation schemes to new members. From 2005 the Government began paying the superannuation liability for new civilians employed as they accrue, rather than growing the superannuation liability further. Funding employee superannuation entitlements as they accrue contributes to improved net worth over the medium term. Despite this, the existing superannuation liability is expected to continue to grow, largely due to growth in the military superannuation schemes and continued growth of entitlements accruing to existing members of the closed civilian schemes (Chart 4).

Chart 4: Public sector superannuation liability^(a)



(a) The Public Sector Superannuation Scheme and the Commonwealth Superannuation Scheme (the main civilian schemes) and Military superannuation schemes form the dominant part of the Government's total unfunded superannuation liability.

(b) Includes the Military Superannuation and Benefits Scheme and the Defence Force Retirement and Death Benefits Scheme.

Source: Australian Government Actuary.

Further, the Government successfully negotiated the extinguishment of its liability with respect to Telstra and Australia Post superannuation in 2004. More recently, the Government has made an offer to the South Australian and Tasmanian Governments to extinguish the Australian Government's liability in respect of superannuation entitlements of former State Rail employees. Combined with the establishment of the

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Future Fund, these initiatives are expected to reduce calls on the budget at a time when significant intergenerational pressures are likely to emerge.

Government securities — issuance in 2005-06 and 2006-07

In line with the public review of the Commonwealth Government Securities market in 2002-03, the Government will continue to issue debt, despite a strong fiscal position, in order to maintain liquid and efficient Treasury bond and Treasury bond futures markets.

Accordingly, the volume and timing of Treasury bond issuance takes account of the need to have an appropriate range of Treasury bonds available for inclusion in Treasury bond futures baskets. The programme maintains a pattern where new 5-year and 13-year Treasury bonds are launched in alternate years, with total issuance over two years of around \$5 billion in each line.

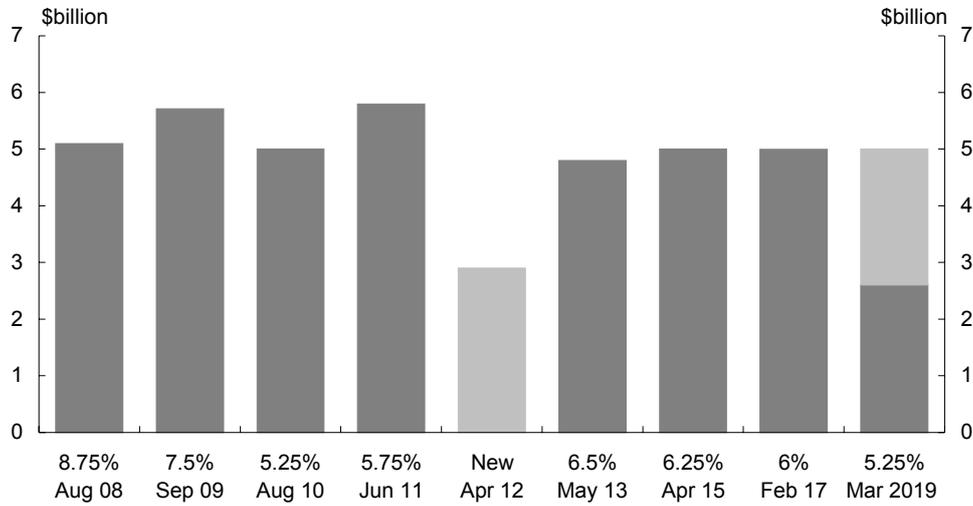
In 2005-06 one new stock was launched — the March 2019 Treasury bond. Issuance into this bond line commenced in January 2006 and is expected to reach \$2.6 billion in the period remaining to 30 June 2006. Issuance in 2005-06 was also directed at building up the August 2010 and the February 2017 bond lines. The volumes on issue for both of these bond lines are now at their \$5 billion target.

In the first half of 2006-07, issuance will be directed to building up the March 2019 Treasury bond. An additional \$2.4 billion will be issued to bring the total volume on issue for this bond line to \$5 billion by November 2006.

In December 2006, a new 5-year Treasury bond, an April 2012 bond line, will be issued to support the operation of the 3-year Treasury bond futures contract. It is planned that \$2.9 billion of this bond will be issued during 2006-07. The remaining issuance necessary to bring this bond line up to \$5 billion will be undertaken in the first half of 2007-08.

Total Treasury bond issuance during 2006-07 will be \$5.3 billion, while scheduled maturities during this period, net of Australian Government holdings, are \$6.1 billion. As a result, the total stock of Treasury bonds on issue, net of Australian Government holdings, will be around \$47.3 billion as at 30 June 2007 (Chart 5).

Chart 5: Benchmark Treasury bonds outstanding expected at 30 June 2007^(a)



(a) Treasury bonds on issue are net of Australian Government holdings. The October 2007 Treasury bond is excluded from the chart as it is not considered a benchmark bond line.

Note: The dark grey columns represent bonds outstanding at the beginning of the 2006-07 financial year. The light grey columns indicate new issuance in 2006-07.

Source: Australian Office of Financial Management and Treasury estimates.

