Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates, 2 June – 4 June 2009

Question: bet 92

Topic: Interest Payable on Australia's National Debt

Hansard Page: E123-125

Senator Bushby asked:

Senator BUSHBY—As we have already mentioned this evening and as Mr Hyden mentioned last night, the trend in the yield curve is up. That the trend in the yield curve is up would suggest that future issuances would have the potential to be issued at a higher rate than four per cent. I understand all the reasons that you have outlined and that Mr Hyden outlined last night for why you would pick an appropriate rate now and forecast on that basis. Nonetheless, the reality is that you could probably say with a very high degree of certainty that the securities we issue in the coming years will not be issued at a rate of four per cent on average.

Mr Ray—I do not know that I can say that. The yield curve through the course of this year has moved up and down, I think. The Australian Office of Financial Management can make different decisions about where to issue into the yield curve depending on both demand and supply factors, which may be reflected in the pricing. I think the short answer to your question is: in the hypothetical situation in which the yield curve steepens or shifts upwards, obviously that will affect the pricing of the debt, but these things would be updated at estimates updates. I am not going to predict what is going to happen.

Senator BUSHBY—No, I would not expect you to predict what will happen, but the reality is that different things could happen and that will lead to a need for you to consider what impact that might have on the figures.

Senator Conroy—I think the officer is indicating he does not want to speculate in this area.

Senator BUSHBY—That is fine. I am not going to ask him to speculate but what I would ask him is—

Mr Ray—The point we made this morning is that the yield curve at the time that we do the estimates update is the market's view of the future course of interest rates.

Senator BUSHBY—Which obviously may change next week or in 12 months time. I am not criticising your methodology and the way you have done this. I am just interested in working out what might happen if things do change.

Mr Ray—The other thing that I should say is that, were there to be significant movement in the yield curve, there would be all sorts of other things going on in the global economy which would affect all sorts of estimates, particularly for the revenue.

Senator BUSHBY—That may well be the case and no doubt we can look at that if that happens, but what I am interested in is what the impact on net interest payments would be if the average interest payable turned out to be 5.5 per cent, say, instead of four per cent. That is a calculation that I imagine you could do and I am happy for you to take that on notice.

Senator Conroy—I am sure they could do it but I am also sure you could do it.

Senator BUSHBY—I do not have access to the—

Senator Conroy—You are—

Senator BUSHBY—We have heard how complicated the aggregate of net debt—

Senator Conroy—You are asking the officers to speculate.

Senator BUSHBY—No, I am asking them to do a simple calculation on notice.

Senator Conroy—It is a hypothetical.

Senator BUSHBY—It is not a hypothetical.

Senator Conroy—You have asked them to do a calculation based on a hypothetical.

Senator BUSHBY—I am asking them to go through an exercise.

Senator Conroy—A hypothetical exercise.

Senator BUSHBY—I am asking them to take on notice what the net interest payment would be if instead of using a figure of four per cent they used the figure of 5.5 per cent.

Senator Conroy—I am happy to take that on notice.

Mr Ray—The minister is happy to take it on notice, so we will take it on notice, although I should say that I do not think it is that useful. I think what you are asking is, with a given profile of debt, what would—

Senator BUSHBY—Given the trajectory of debt issuance.

Mr Ray—And then you change the interest rate. I do not think that is a particularly useful thing for us to do because if the average yield went from four per cent to 5.5 per cent, there would be all sorts of other things going on and the trajectory of debt would be different.

Senator BUSHBY—What would the likely impact on trajectory of debt be in that circumstance?

Mr Ray—It would depend on the cause, I suspect.

Senator BUSHBY—The minister has agreed to take it on notice.

Mr Ray—Yes. We will take it on notice.

Senator Conroy—I will see if the Treasurer has any further information he wants to give the committee.

Answer:

In estimating the interest cost of Commonwealth Government Securities (CGS) across the forward estimates, an assumption is made about the shape of the yield curve. It is assumed that the current secondary market yields on CGS debt of different tenors (eg, 1 year, 3 year, 10 year, etc) will hold in the forward estimates period. The use of this methodology is a long-standing practice and has been used in successive budgets.

Providing an estimate of what net interest payments would be if the yield curve assumption resulted in an average interest rate of 5.5 per cent being paid, and holding all other things equal, is unlikely to be meaningful. This is because macroeconomic variables are interrelated and do not move independently of each other. If interest rates were to increase, on average, 1.5 per cent across the entire yield curve, there would be many other factors influencing the economy. This would impact on the economic parameters that underpin the budget estimates and projections and flow through the forecast budget position, including gross debt on issue. In other words, amongst other things, the amount of CGS on issue would change as would the value of interest receipts.