Senate Finance and Public Administration Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Finance and Administration Portfolio

Department of Finance and Administration

November Estimates Hearings 2003-04 – 4 November 2003

Question: 31 D (ii)

Outcome 1, Output 1.1.1

Topic: Forex Risk Management

Hansard page: N/A

Written Question on Notice: Tuesday, 4 November 2003

Senator Forshaw asked:

How does this performance relate to the Finance circular on Forex management? Ie. does this reflect exemptions to external hedging or, is it comparable to past years when this policy did not apply?

Answer:

Only two agencies have been given general exemptions to the hedging prohibition set out in Finance Circular 2002/01 "Foreign Exchange (Forex) Risk Management". These are the Australian Broadcasting Corporation (ABC) and Indigenous Business Australia (IBA). The combined value of the exposures that these agencies were managing by hedging arrangements as at 31 October 2003 was $12.7 million.

The ABC and IBA did not contribute to the net foreign exchange loss of $151 million from 1 July 2003 to 31 August 2003. This loss was primarily attributable to a loss of $192 million on foreign exchange transactions undertaken by the Australian Office of Financial Management (AOFM). The AOFM is not included in the Government's policy on foreign exchange risk management. The policy explicitly excludes AOFM because it is not intended to cover the types of financial activity that the AOFM transacts. The AOFM undertakes transactions in a range of financial instruments in order to mange the Government's debt portfolio.

The losses recorded for the AOFM relate to the revaluation of cross currency swaps, forward exchange agreements and physical foreign currency debt due to a weakening of the Australian dollar compared to the U.S. dollar over that period. The value of the U.S. dollar to the Australian dollar was $0.6674 at 30 June 2003, fell to $0.6529 at end July 2003 and then fell again to $0.6400 at end August 2003.

The loss of $151 million is not attributable to general exemptions to the prohibition on external hedging.

Foreign exchange movements can be very volatile over short time periods. Therefore, useful comparisons cannot generally be made over time periods of a few months. For example, the AOFM loss of $192 million recorded in July 2003 and August 2003 has been reversed. Updating the above AOFM number, reveals a net gain of $117 million due to exchange rate changes as the exchange rate had moved to $0.7046 at the end of October 2003.

Comparison between years is also difficult because the Australian dollar, for instance, moves against a variety of currencies and it is this mix of exposures to these currencies which results in gains or losses and the mix may vary from one year to the next.

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