

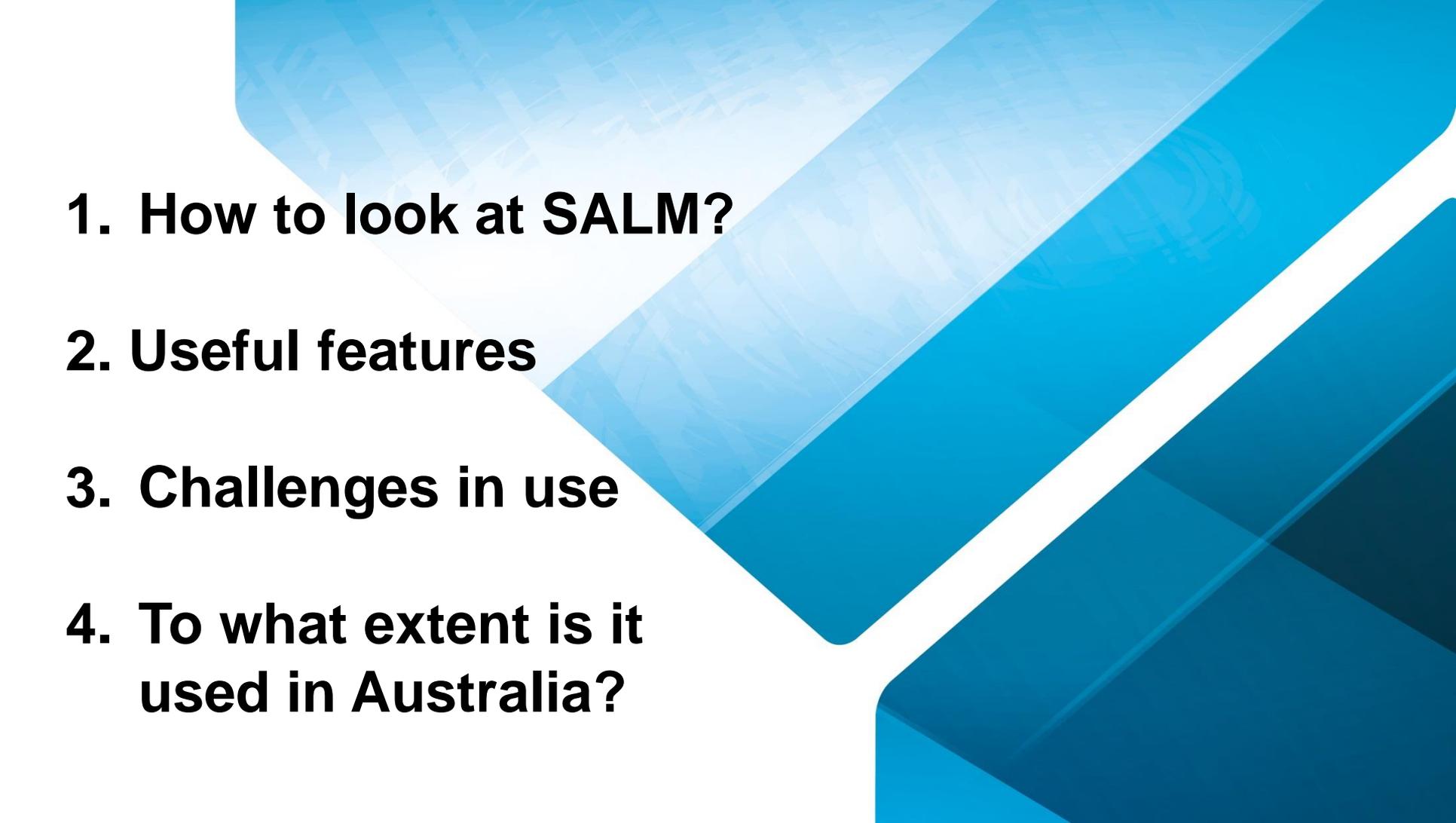


Australian Government

**Australian Office of
Financial Management**

Balance Sheet Management

**An Australian Perspective
Rob Nicholl**



1. How to look at SALM?

2. Useful features

3. Challenges in use

**4. To what extent is it
used in Australia?**

What is ALM for government?

- For the private sector (business) it is an 'optimizing tool'
 - A key focus of financial risk management to dampen volatility of returns and value
- For government it is a framework/guidelines
 - Government has a wider range of assets, liabilities & risks to consider. Different governance & decision making processes to match multi-dimension objective function. Challenges in managing longer-term social, fiscal and economic policy aims with very many variables (inflation, currency shifts, business confidence etc)

What are useful features for government?

- Can use to gain efficiencies in cash management; and Budget structure
- Better identify and understand risks to balance sheet (*although measurement, appetite and mitigation are another matter*)
- Can be used to impose discipline on fiscal policy decisions
- Helps to clarify fiscal aggregates (cash balances, net worth, gross debt, net debt etc)

Challenges in using an ALM approach?

- Who decides the 'shape' of the balance sheet – usually relates to *policy decisions* – not delegated to a committee or 'balance sheet manager' (although there is scope for an advisory role)
- How to resolve conflicts between competing policy objectives (for eg fiscal exposure to indexed welfare benefits and issuing inflation indexed debt) OR value assets (such as multiple-use non-financial assets)?
- Policy directions can and do change appreciably with a change of government – this could shorten horizon of useful balance sheet planning

Challenges cont..

- How is risk appetite determined and expressed?
- Who becomes the 'gatekeeper' for introducing new risks to the balance sheet (contingent liabilities; new borrowing; hypothecated funds, etc)?

Australian Government Public Sector

Government 'owns' all of these entities but balance sheet is not managed as a whole – nor are cash flows associated with corporations included in Budget aggregates

Public Financial Corporations

Created as separately managed entities by legislation:

Includes:

Reserve Bank of Australia

Sovereign Wealth Fund

Export Finance Corp

Largely *self-funded* but *pay* dividends

General Govt Sector

Includes:

- Agencies and departments funded by Budget,
- Cash portfolio
- Sovereign debt portfolio
- Dedicated funds (for policy purposes)

Public Non-financial corporations

Provide a range of services (eg defence housing; postal service; defence procurement)

Receive - equity injections & loans from
Pay- dividends

To what extent is ALM used in Australia?

- Sits in a broader context - primary tool is a fiscal strategy that incorporates commitments to managing a number of fiscal aggregates (Underlying Cash Balance; Net Debt; Net Financial Worth)
- There is no central 'single' manager of the government balance sheet – the largest asset pool (Future Fund) and Debt Portfolio are managed separately – is this a problem?
- There is a legislated 'Charter of Budget Honesty' and policy commitment to triple-A sovereign credit rating – these are to an extent 'anchor points' to fiscal and balance sheet discipline

To what extent is ALM used in Australia? cont...

- There is highly centralised cash management (all expenditures for GG sector 'released from' a central government fund)
- Generally a good awareness of balance sheet risks (but can conflict with policy aspirations); main risks are guarantees; loan 'performance'; inflation; interest rate; fx; returns on financial assets
- FX risk is not actively managed
- The use of dedicated 'funds' continues to some extent but awareness is improving