New Issuance in Inflation Linked Bonds – additional information September 2009

Following on from our email to you on 17th August, the Australian Office of Financial Management (AOFM) has provided new detail on their issuance of inflation linked bonds (ILBs).

The AOFM announcement, made on 4th September, confirms the issuance of a new capital indexed bond with a maturity date of 20 September 2025. The initial issue size is expected to be at least $A1 billion. This bond is a new line and provides the market with a government real yield curve beyond 10 years. The issue date is still expected to be late September or early October 2009 with the first coupon payment on 21 December 2009. This is significant as coupons are payable in months other than August, November, February and May which will assist with the market's liquidity.

The statement by AOFM also suggested that issuance into existing lines "may also be held" which is contrary to the markets initial understanding. A firmer commitment to extending the curve beyond 2025 "subject to investor demand" has also been provided. We believe that it is likely that a 2030 bond could be issued early next year.

For holders of 2010 bonds, a switching facility has been confirmed for current owners to move into the new line. This will bring forward the duration impact on the market from the maturity of these bonds with benchmark duration extending via monthly recalculations as bond owners take up the buyback offer. Another important fact to note is that the current market value of the 2010 bonds is $A2.4 billion. Less than half of existing holders will need to use the switching facility in order for the minimum issue size to be reached.

Another key benefit of the issuance size is that the Australian weighting in the Barclays World Government Inflation Linked Bond Index will be retained. In addition, to attract offshore investors to the sector, changes to non-resident interest withholding tax have also been announced, which should underpin a new floor in demand for Australian sovereign issuance. This dovetails with the attractiveness of Australian ILBs compared to other OECD countries.

Ardea Investment Management Pty Ltd

ACN 132 902 722 AFSL 329 828