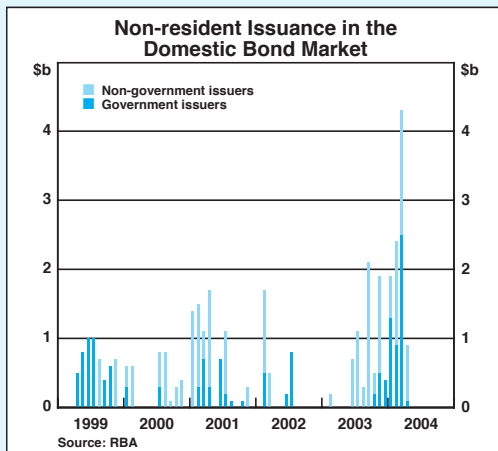


Box B: Non-resident Issuance in the Australian Bond Market

After a two-year hiatus, a broad range of non-resident issuers returned to the Australian bond market in mid 2003 and were particularly active in the first quarter of 2004 (Graph B1). While these entities' total Australian dollar raisings typically represent a small share of their overall raisings – around 5 per cent in the case of supnationals – they are an important source of credit diversification (without currency risk) for local investors.

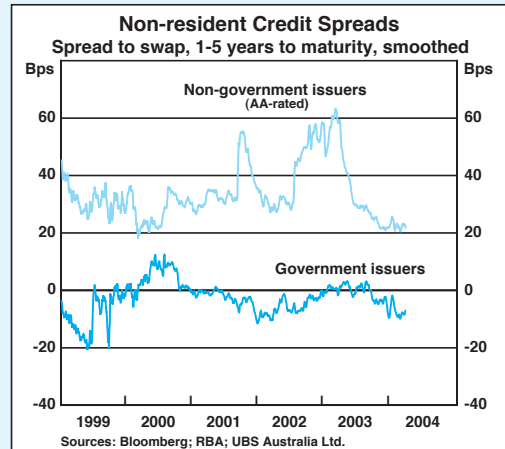
Graph B1



The increase in issuance has been due to a fall in the relative cost of issuing debt in Australia. The two main components of this are corporate bond spreads and the cost of hedging the proceeds back to the home currency of the issuer. (The available evidence suggests non-residents swap the bulk of their Australian dollar issuance back into their home currencies.)

Credit spreads (relative to swap rates) in the Australian bond market have been quite low recently for both non-government and government non-resident borrowers, and are likely to have encouraged the surge in Australian dollar issuance (Graph B2). One

Graph B2

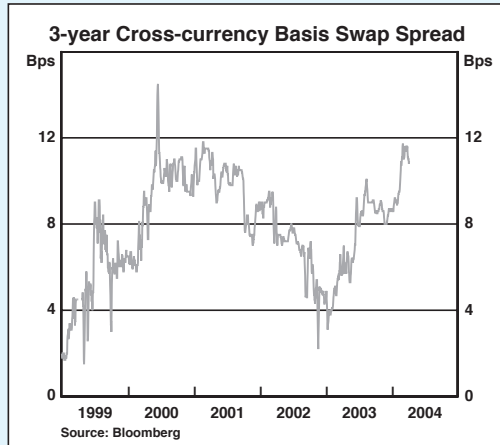


factor contributing to the low spreads may be the strength of demand for such debt by investors who regard it as an alternative to CGS, which are in short supply. Demand is also coming from foreign investors, including central banks, seeking an Australian dollar exposure. The broadening of the RBA's eligibility criteria for market operations, to include a wider range of bonds issued by foreign governments, at the margin has also increased demand for these bonds.

Foreign borrowers issuing in Australia and seeking to swap back to their home currency usually receive favourable prices in the currency swap market because of greater demand by Australian borrowers to do the reverse – i.e. borrow in foreign currency and swap into Australian dollars. Record foreign currency bond issuance by Australian entities in 2004 has pushed up the cost of converting foreign currency to Australian dollars and made it cheap for foreigners to do the opposite (Graph B3).

While corporate spreads in major foreign markets have also declined in recent months, this has not been sufficient to offset the combined effect of the fall in Australian

Graph B3



credit spreads and the rise in currency swap premia. As a result, the relative cost of issuing in Australia has decreased.