MONETARY POLICY ANNOUNCEMENT

On 2 December 1983, the Minister of Finance announced the details of a new Index-Linked Government Stock which will be available for offer at the next and subsequent Government stock tenders. He also provided details of the changes to the allotment method for the conventional stock tender system, announced following the third tender.

For conventional stock, the change of the allotment system from 'yield bid' to 'uniform yield' allotment will mean that all stock of any one maturity will be issued at a uniform yield equal to the highest yield accepted in the tender. This contrasts with the arrangement in the first three tenders of issuing stock at the actual yields bid. The Minister commented that under the 'yield bid' system, there was some risk of disadvantage in the market to those bidding at low rates. Under uniform yield allotment this risk is reduced as all bids would be allotted at the highest successful yield.

Because the uniform yield allotment system removes the risk for the smaller, less active, bidders, it has been decided to withdraw the non-competitive bidding facility offered in the earlier tenders, as it no longer has any useful role. To enable easy direct access to tenders of Government stock for small bidders, the minimum bid size in the tender has been reduced from $20,000 to $5,000. The prospectus for conventional stock has been revised accordingly.

The general features of the revised conventional stock prospectus will also apply for index-linked stock. The Minister stated that the design of the new index- linked stock has been kept as close as possible to conventional stock. The major change is that the half-yearly interest payments will be determined by two components. The first is an inflation adjustment based on the percentage movement in the Consumer Price Index over the most recent six month period prior to any interest payment date, with a minimum adjustment of zero. The second component of the total interest payment would be determined by the interest rates bid for stock in the tender, over and above the inflation adjustment. All stock would be allotted at the highest acceptable interest rate bid. Stock would be issued at par, with the first interest payment taking account of the period for which the stock had been held up to that date.

The Minister noted that uncertainty over the future rate of inflation appears to have been influencing the bidding of participants in the stock tender. The index-linked stock, by effectively removing the element of inflation uncertainty from the bidding and building it automatically into the interest payment, will enable participants in the tender to bid in terms of what is effectively a real interest rate.

By way of example, if the tender-determined annual interest coupon is 2.8 per cent, and the CPI movement over the most recent six months is 2 per cent, then the total interest payable on $100 nominal stock for that half year would be $\frac{2.8}{2} + 2.0 = \$3.40$.

The Minister added that the total interest payment (inflation adjustment plus interest rate bid) would be assessable for income tax.