This special issue of Jassa is devoted to papers from the 13th Melbourne Money and Finance Conference, titled 'Recent Developments in Australian Debt Markets'. The conference was conducted by the Melbourne Centre for Financial Studies in June 2008 and was sponsored by the ANZ Bank, Commonwealth Bank of Australia (CBA), National Australia Bank (NAB), Reserve Bank of Australia (RBA) and Australian Prudential Regulation Authority (APRA).

Although there has been significant further upheaval within global financial markets since the time of the conference, the papers provide a valuable record of the events leading up to mid 2008. For finance industry professionals and academics, these papers may provide fertile ground for assessments of why the global credit crisis affected Australia as it did, and how these effects might be avoided in the future. The papers are published as being current at the time of the conference and/or including revisions made very soon after that.

With the conference being held in the wake of the sub-prime mortgage market crisis, several papers in this issue of JASSA highlight examples of financial market growth and innovation in response to changing regulatory circumstances and investor appetites, new approaches to investment and risk management, and the growing focus on market liquidity issues as the global credit crisis took hold. Other papers examine key areas of financial market failure and dislocation as well as shortcomings in the accounting, disclosure and risk management models and practices employed by financial institutions and other large corporations.

Susan Black (RBA) examines recent developments in securitisation markets, noting the dislocation in the Australian securitisation market which occurred as part of the turmoil in credit markets and investors’ reappraisal of the risks associated with structured credit products. She indicates that notwithstanding these recent difficulties, the growth in securitisation in Australia, as in other countries, had significantly enhanced competition, particularly in the mortgage market, by facilitating the entry of new lenders and thereby contributing to lower margins on housing loans.

In a similar vein, William Whitford (Treasury Corporation of Victoria) reviews the growth and development of the Australian and semi-government bond markets in the context of the long, slow and at times painful adjustment process to recent financial market turmoil. He observes that although the market upheaval has affected Australia’s government bond markets, moves to increase the issuance of CGS and abolish the interest withholding tax on all semi-government bonds should continue to support an efficient and liquid bond market and make a greater contribution to financial stability.

Continuing with the bond market theme, kangaroo bond issuance in Australia is examined by Jonathan Batten (Hong Kong University of Science & Technology and Graduate School of
Management, Macquarie University), Warren Hogan (University of Technology, Sydney) and Peter Szilagyi (Judge Business School, University of Cambridge). They indicate that the issue of kangaroo bonds (foreign A$-denominated bonds) has become a significant part of the Australian bond market and that the Australian experience offers some lessons to other countries interested in developing their domestic bond markets.

Michael Saba (Goldman Sachs JBWere) and David Finlay (Epsilon Capital) look at the evolution of the Australian hybrid market, suggesting that this is a good example of financial innovation to meet a changing issuance landscape, with the market increasing fourfold to some A$20 billion this decade. They note that the growth in the hybrid market has been driven by regulatory changes, investor demand and issuers looking for viable funding alternatives.

Turning to risk management and risk pricing issues, Adam Donaldson (CBA) observes that with the global repricing of risk in the wake of the US sub-prime mortgage crisis, the increases in Australia’s corporate credit spreads and financial sector risk premiums have almost matched those in the United States. He indicates that this appears to reflect Australia’s heavy reliance on external funding, which has left us vulnerable to disruptions in global securitisation markets.

Wilson Sy F Fin (APRA) considers the key role that credit risk models have played in the global credit crisis and discusses the main shortcomings of such models as exposed by the stressed markets and how to overcome them. He proposes a new causal framework to build deductive credit default models that have predictive capabilities.

The paper by Jane Hronsky (University of Melbourne) and David Robinson (Ernst & Young) focuses on fair value accounting, another issue that has come under significant scrutiny in the wake of the sub-prime mortgage market crisis and subsequent global liquidity crisis. They conclude that current market values for financial instruments affected by the sub-prime mortgage crisis do indeed represent fair values as defined and required by financial accounting standards. Rather than contributing to financial volatility, they argue that fair values are highly relevant to the information needs of participants in current markets.

Disclosure is another important issue that has been raised in the context of the sub-prime mortgage market crisis and global credit crunch. Alex Erskine (Australian Securities and Investments Commission) indicates that following the collapse of several issuers of unlisted unrated debentures in early 2007, ASIC established benchmarks for disclosure and advertising, and an ‘if not why not’ approach for issuers of these debentures to retail investors. He says these measures are intended to help retail investors make informed decisions about unlisted unrated debentures while maintaining the essential framework of the market. He acknowledges, however, that substantial challenges still lie ahead for investor education and investor financial literacy to take advantage of the improved disclosure.

Shifting to developments in investment markets, the papers by both Geoff Warren (Russell Investments) and Susan Buckley (QIC) examine alternative strategies for structuring fixed income investments. Geoff Warren F Fin observes that investment in fixed income is often tied to indices which suffer from various shortcomings as a basis for structuring portfolios and evaluating performance. He suggests a different approach involving tailoring benchmarks around explicit exposure targets and risk premiums, which provides a flexible way to align fixed income portfolios with investor objectives, and to ensure that risk is accounted for appropriately. Susan Buckley suggests that while traditional approaches to managing fixed interest funds rely on benchmarks that may not represent optimal risk and return outcomes, new techniques based on separate alpha and beta management should improve portfolio performance.

Andrew Worthington F Fin (Griffith Business School, Griffith University) notes that household debt in Australia has risen to record levels in recent years with highly geared households also coming under increased stress due to deteriorating conditions in asset prices, incomes and interest rates. He assesses recent developments in Australian household debt from macroeconomic and microeconomic perspectives, and proposes a research agenda to cast further light on the causes of burgeoning household debt.

And finally, Michael Lawriwsky SA Fin (Allen Consulting Group) explores the real risk-free interest rate in thin debt markets. He indicates that while it is standard practice to use the yield on inflation-indexed CGS as a direct observation of the real risk-free rate of return, it has been argued that excess demand for such securities has artificially depressed their yields, causing this estimate to be understated, and forecasts of inflation (given by the difference between nominal CGS and inflation-indexed CGS) to be overstated. His paper suggests an additional hypothesis, namely that there has also been an excess demand for nominal corporate bonds.

On behalf of Finsia, the editors thank all of the above contributors for their stimulating papers. We also record appreciation to the sponsors of the 2008 Conference, and to Marion Fahrer for her excellent work on the editing process for this volume.