TE TAI ŌHANGA
THE TREASURY

New Zealand Government Securities Funding Strategy

2019/20: Edition 1

New Zealand Government

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2019/20 Funding Strategy – at a glance

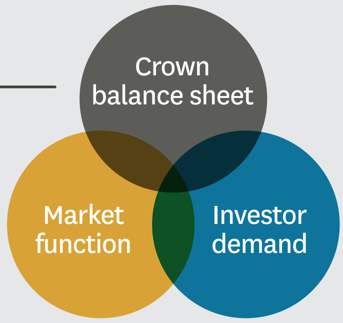
The Treasury's New Zealand Debt Management function has the objective of minimising the Crown's borrowing costs over the long-term with due consideration to risk, while ensuring ongoing access to debt funding markets.

Achieving a balance between the following three goals:

Overall structure considered

Enhanced

Captured and stimulated



Guiding principles underpinning the strategy

- Transparent
- Consistent
- Even-handed

2019/20 New Zealand Government Bond (NZGB) programme forecasts

Gross NZGB issuance

Product type

circa NZ$**0.5b**
Inflation-Index bonds

circa NZ$**9.5b**
Nominal bonds

Net NZGB issuance

NZ$**3.4b**

2019/20 Focus

- New NZGB 2031 expected via syndication by 31 December 2019
- Reduced inflation-indexed bond issuance
- Revised Primary Market Access Framework from 30 September 2019
- Buyback programme for NZGB 2020 and 2021
- Continued diversification of investor base

Government commitment to maintain NZGBs on issue at not less than 20 per cent of GDP over time.

Recent developments

Since the last edition of the *New Zealand Government Securities Funding Strategy* was published in January 2019, the following developments have occurred:

- The 2019 *Budget Economic and Fiscal Update* (BEFU) was released on 30 May.
- It highlighted that the 2019/20 New Zealand Government Bond (NZGB) programme has increased from NZ$8 billion to NZ$10 billion.
- The 2020/21 and 2021/22 forecast NZGB programmes have also increased, by NZ$2 billion and NZ$1 billion to NZ$10 billion and NZ$8 billion respectively.
- It was announced that around NZ$0.5 billion of inflation-indexed bonds issuance was expected in 2019/20, suggesting a lower rate of issuance than in 2018/19.
- It was indicated that, subject to market conditions, a new 15 May 2031 nominal NZGB is expected to be launched, via syndication, before 31 December 2019.
- The NZGB tender schedule for the September 2019 quarter was released, showing forecast issuance in the NZGB 2025, NZGB 2029 and NZGB 2037 nominal bonds and the NZGB 2040 inflation-indexed bond.
- In recent months, the Treasury undertook a consultation on its Primary Market Access Framework for New Zealand Government Securities (NZGS). A new framework will come into effect from 30 September 2019.

Funding the Crown[1]

New Zealand Debt Management is one of the functions of the Treasury, responsible for managing the Crown's net cash flows and liquidity position.

The Treasury's forecasts at BEFU 2019 show positive net operating cash flows in the year to 30 June 2020 (2019/20). However, capital spending is expected to exceed net operating cash flows, resulting in a core Crown residual cash deficit. Cash projections are taken into consideration when forecasting the total borrowing programme, along with liquidity requirements and the projected financial assets position.

New Zealand Government Bonds (NZGBs) constitute the greatest proportion of the core Crown's total borrowing programme. In 2019/20, gross issuance of NZGBs is forecast to be NZ$10 billion. When projected maturities and buybacks are taken into account, net issuance is expected to be NZ$3.4 billion. At the end of 2019/20, NZGBs on issue are forecast to be NZ$74 billion.

As is standard practice, funding requirements will be revisited ahead of the December *Half Year Economic and Fiscal Update* (HYEFU) 2019.

New Zealand Government Bonds and Treasury Bills

Year ending 30 June (face value)	2019 actual	2020 forecast
Gross NZGB issuance (NZ$ billion)	8.0	10.0
NZGB maturities and buybacks (NZ$ billion)	11.7	6.6
Net NZGB issuance (NZ$ billion)	-3.7	3.4
NZGBs on issue (NZ$ billion)	70.5	73.9
NZGBs on issue (% of GDP)	23.5%	23.3%
T-Bills on issue (NZ$ billion)	3	3

Source: The Treasury

Funding strategy principles

The objective of the funding strategy is to minimise the Crown's borrowing costs over the long-term with due consideration to risk, while ensuring ongoing access to debt funding markets.

For the NZGB market, it is believed this objective is currently best achieved by taking a long-term strategic, rather than short-term tactical approach to funding activities. The aim is to reduce uncertainty or illiquidity premiums that are associated with NZGBs, through a structured approach where future actions are well communicated in advance. This is prioritised over tactically trying to capture short-term pockets of 'value'.

The approach that best achieves the objective may change if the funding environment changes significantly. However, the core principles of transparency, consistency and even-handedness will not change.

The funding strategy is aimed at balancing three key goals; considering the overall structure of the Crown's balance sheet, capturing and stimulating investor demand, and promoting well-functioning and liquid NZGS markets.

Wholesale funding strategy 2019/20

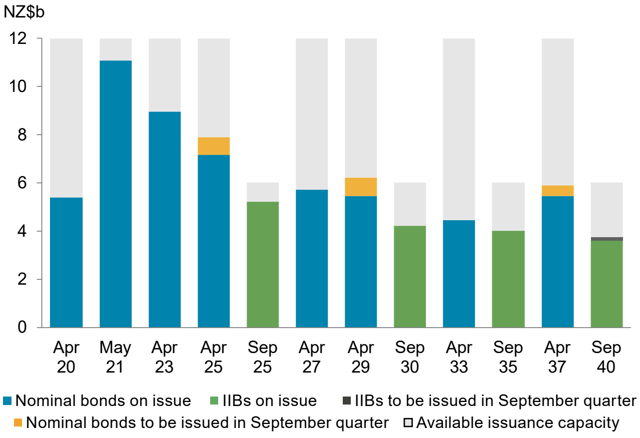
Funding instruments

Nominal Bonds remain the primary funding vehicle and are expected to constitute around NZ$9.5 billion of the 2019/20 NZGB programme.

During the September 2019 quarter, three nominal NZGB maturities will be tendered. NZ$750 million is forecast to be tendered into each of the 15 April 2025 and 20 April 2029 NZGBs. NZ$450 million is forecast to be tendered into the 15 April 2037 NZGB. This profile is designed to provide liquidity at three distinct points on the NZGB curve and help build volume in key 'benchmark' lines.

1 The British Crown is the Head of State of New Zealand. New Zealand Government Securities are issued in the name of "Her Majesty the Queen in right of New Zealand".

NZGB portfolio and announced issuance in September 2019 quarter



Source: The Treasury

For the remainder of the fiscal year, it is expected that tender volumes will continue to be in a range of NZ$50–NZ$300 million, with a single bond offered per tender.

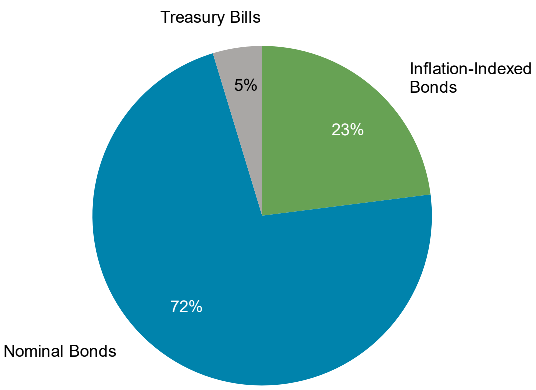
Individual nominal NZGB lines are capped at NZ$12 billion face value. This level balances the need to promote liquidity in each line, while managing the size of maturity cash flows and mitigating refinancing risk.

Inflation-Indexed Bonds (IIBs) remain an important part of the funding portfolio. IIBs enable a portion of interest expenses to be correlated with the economic cycle and thereby fiscal revenues. In addition, issuance of IIBs assists with diversifying the investor base. Individual IIB lines are capped at NZ$6 billion face value.

It is expected that there will be around NZ$0.5 billion of IIB issuance in 2019/20.During the September 2019 quarter one IIB maturity will be issued, the 20 September 2040.

IIBs constitute a sizable proportion of the total funding portfolio, at 23 per cent, relative to global peers. While a specific level is not targeted, the proportion has increased over recent years. The appropriate proportion of IIBs within the portfolio, and the appropriate rate of issuance, is assessed on an ongoing basis. In 2019/20, IIB issuance is forecast to be slightly lower than in recent years, reflecting market dynamics and the relative cost of issuance. That said, a commitment to the product remains constant.

Current New Zealand Government Securities portfolio



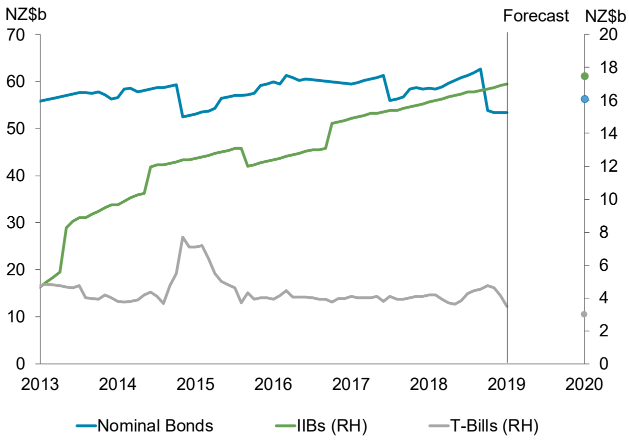
Source: The Treasury

Treasury Bills (T-Bills) provide flexibility to address short-term cash requirements. Requirements may arise as a result of upcoming bond maturities, or seasonal or unexpected changes in cash flows.

Although T-Bills on issue were at NZ$3.5 billion at 30 June 2019, BEFU forecasts show T-Bills on issue are expected to decline to NZ$3 billion by 30 June 2020. This reflects forecast cash needs at the end of 2019/20. However, the actual volume of T-Bills on issue may vary from forecast, based on an assessment of the relative cost of T-Bill issuance versus alternative short-term funding mechanisms, as well as actual short-term cash needs.

Over time, it is recognised there is value in being able to access short-term funding through the T-Bill market. Therefore, the intention is to maintain a minimum of NZ$2 billion of T-Bills on issue, with this the base forecasting assumption for annual borrowing programmes.

New Zealand Government Securities on issue



Source: The Treasury

Primary issuance methods

Primary Market Access Framework. In recent months, the Treasury has undertaken a consultation on its Primary Market Access Framework. Subsequently, changes are currently being implemented. At a high level, the changes aim to create a more structured and formalised relationship between the Treasury and intermediaries involved in the NZGB market. The ultimate objective of these changes is to assist Registered Tender Counterparties (RTC) to perform their role of intermediating primary market issuance to end investors and to support secondary market liquidity.

Key changes are, that in order to qualify as a RTC an intermediary must play a significant role in intermediation of NZGS products to investors, as well as committing to support secondary market liquidity and price transparency. They must also participate regularly in NZGS tenders, supporting the primary market.

In addition, only RTCs will be eligible for syndication issuance panels, and the Treasury will support other relevant activity conducted by the RTC.

RTCs will be listed on the New Zealand Debt Management website, to create visibility for investors regarding those entities that have primary market access, and are regular participants in the NZGB market. The list is expected to be available once the new Primary Market Access Framework comes into effect from 30 September 2019.

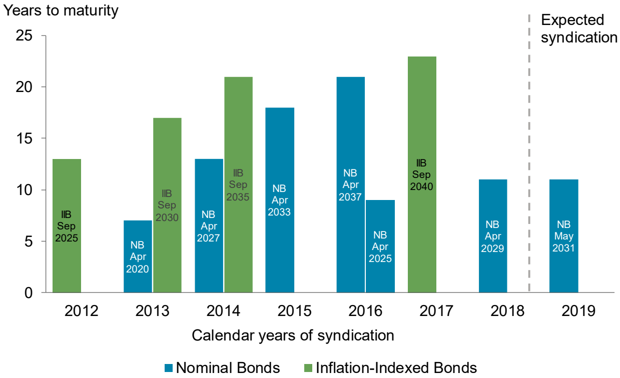
Tender issuance. Issuance into existing nominal NZGB and IIB lines will continue to occur via regular tender. Full quarterly bond tender schedules will continue to be announced ahead of each quarter, including tender dates, maturities, and volumes. This will generally occur at the time of the confirmation announcement for the last tender of the preceding quarter.

T-Bill tenders will continue to take place on a fortnightly basis. The volumes offered across the 3 month, 6 month and 12 month lines will be based on liquidity and portfolio requirements. They will be announced on the day prior to tender. The amount issued will depend on the assessment of bids received relative to other short-term funding mechanisms, subject to the relevant operating rules and guidelines.

Syndicated issuance. At BEFU 2019 it was indicated that, subject to market conditions, a new 15 May 2031 nominal NZGB is expected to be launched before 31 December, via syndication, to create a new 'ten year' benchmark bond.

Syndications remain the preferred method for the issuance of new bond lines. This method enables the placement of a large initial volume into the market, promoting immediate liquidity in the new bond. An intention to launch a new bond by syndication is generally announced alongside BEFU or HYEFU. Later, further operational announcements are released, relating to the appointment of any syndication panel and launch of the transaction.

History of syndications



Source: The Treasury

Secondary market support

Intermediaries play an important role in maintaining a well-functioning secondary market. In addition, the funding strategy aims to enhance secondary market liquidity. It prioritises:

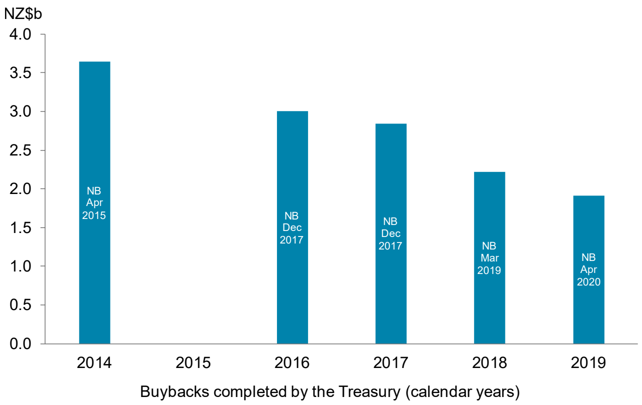
- undertaking bond buybacks ahead of upcoming maturities
- focusing on core instruments issued in NZD
- recommending a Government commitment to a minimum level of NZGBs on issue
- broadly matching NZGB issuance maturities to ACGBs
- building volume in 'benchmark' lines
- using syndications to launch new lines.

Undertaking bond buybacks. The current funding strategy incorporates a policy of buying back bonds as they approach maturity. This helps to smooth cash flows around maturities, and to enable the recycling of investments further out the curve.

It has been recent practice to buyback outstanding bonds within the 18 month window before a bond matures. The current buyback programme of the 15 April 2020 NZGB will continue through until 15 October 2019. The Reserve Bank of New Zealand typically assumes responsibility for buyback activities during the final 6 month period before a bond matures, in an effort to ensure overall financial system liquidity.

A buyback programme of the 15 May 2021 NZGB is planned to start before 30 June 2020. Buybacks will be undertaken at levels that are assessed as economic and in keeping with liquidity requirements and portfolio needs. There is no target for a specific volume of buybacks.

Recently completed buyback activity



Source: The Treasury

Focusing on core instruments issued in NZD. The current focus is on New Zealand dollar (NZD) issuance in the domestic market. This helps to maximise liquidity in NZD denominated issues. NZD issuance is also currently more cost-effective than foreign currency alternatives. An additional benefit of a well-developed NZD denominated NZGS market is that it provides support to domestic capital markets more broadly.

The 2019/20 borrowing programme forecasts do not include any foreign currency issuance.

That said, up-to-date legal documentation is maintained for both a European Commercial Paper (ECP) and a Euro Medium Term Note (EMTN) programme. ECP is seen as a potential alternative instrument to address short-term liquidity requirements.

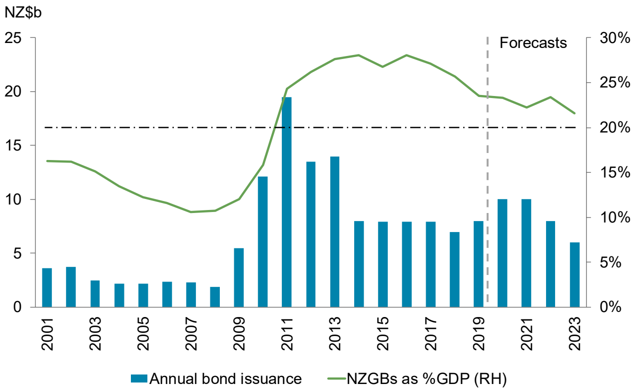
Attention is given to maximising liquidity in existing core instruments. Alternative funding instruments are assessed with respect to the impact on liquidity, relative cost and investor diversification, and with regard to wider benefits or risks.

Commitment to a minimum level of NZGBs on issue. In recent years, as the Government has been running operating surpluses and reducing net core Crown debt, it has made a commitment, on the Treasury's recommendation, to a minimum level of NZGBs on issue. Since Budget 2017 the Government has had a stated commitment to "maintain New Zealand Government Bonds on issue at not less than 20 per cent of GDP over time".

The Government sees a sustainable and readily accessible NZGB market as important in supporting fiscal resilience. A commitment to a minimum NZGB market also instils confidence in intermediaries and investors when they are choosing to participate in the market. This helps support liquidity.

NZGBs on issue were forecast to be equivalent to 23.5 per cent of GDP at 30 June 2019. It is forecast that NZGBs on issue will remain between 21.5 per cent and 23.5 per cent of GDP, over the forecast period.

NZGBs on issue to remain above 20% of GDP



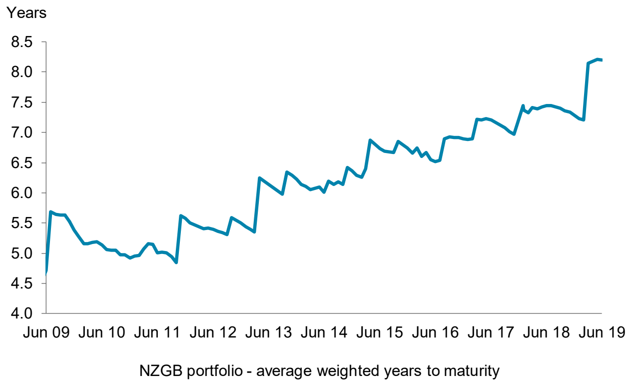
Source: The Treasury

Broadly matching ACGB maturities. The aim is to issue NZGBs with maturities that closely align with their Australian Commonwealth Government Bond (ACGB) equivalents. This promotes the ability for investors to easily assess relative value between these assets.

Average maturity

In recent years the funding strategy has included a policy of extending the average weighted maturity of the NZGB portfolio. It has increased from around 4.5 years in mid-2009 to 8.2 years at 30 June 2019.

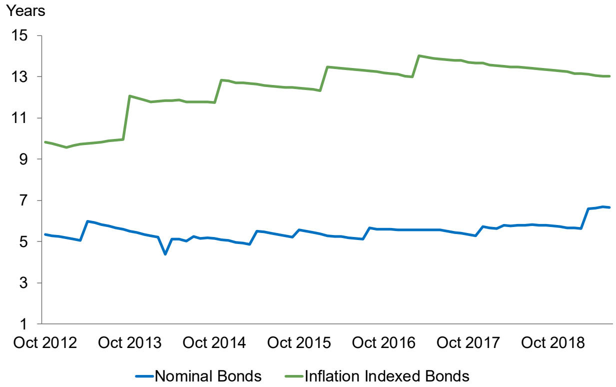
Average weighted maturity of NZGB portfolio



Source: The Treasury

This meets several objectives. It has improved the Crown's asset-liability matching, taking into account the Crown's long-dated assets. It has contributed to further diversity in the investor base, capturing demand from investors with long-dated liabilities. It has reduced refinancing risk. In addition, it has contributed to the development of New Zealand's capital markets.

Average weighted maturity by security type



Source: The Treasury

There is no specific target for the average weighted maturity of the portfolio. However, the average weighted maturity of the NZGB portfolio is expected to increase further in 2019/20, as the 15 April 2020 NZGB matures and issuance continues further out the curve.

Environmental, Social and Governance (ESG) considerations

The New Zealand Government has clearly stated Environmental, Social and Governance (ESG) objectives. Many of these are outlined in the Government's Wellbeing Budget 2019 that focuses on the wellbeing of people, the health of the environment and the strength of the community[2].

The Government is committed to progressing a climate change programme that allows for a transition to a low-emissions economy. Cabinet has agreed to a policy framework that will drive climate change policy towards low greenhouse gas emissions and climate resilience in New Zealand[3]. The framework supports New Zealand's commitments under the Paris Agreement, including the target to reduce emissions by 11 per cent below 1990 levels by 2030. The Government has also introduced a Zero Carbon Bill that will set a new emissions reduction target to be achieved by 2050. It is currently before the Environment Select Committee.

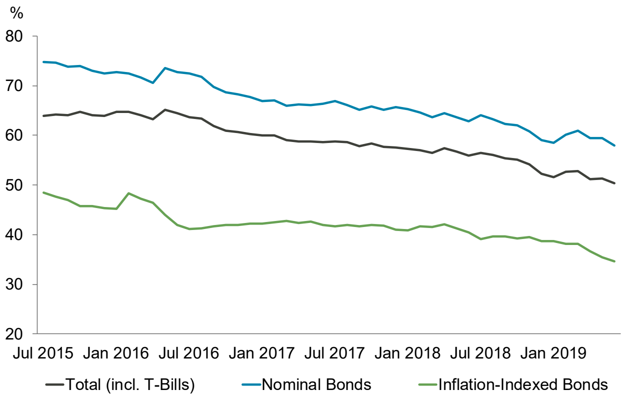
In this context, the Treasury currently has no plans to issue bonds in a specific ESG format. More broadly, it is cognisant of the contribution that efficient debt funding, conducted in a transparent, consistent and even-handed manner, can make to the Government's ESG objectives.

2 https://treasury.govt.nz/publications/wellbeing-budget/wellbeing-budget-2019
3 https://www.mfe.govt.nz/climate-change/climate-change-and-government/climate-change-programme

Diversifying investor base

Diversity in the investor base is targeted through the funding and investor engagement strategy. Diversity by geography, investor type and mandate are valued.

Non-resident holdings of NZGBs



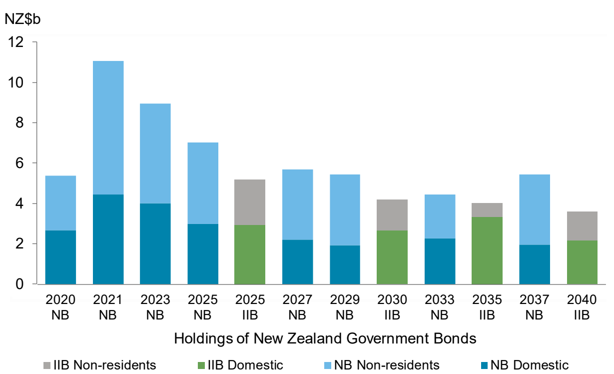
Source: RBNZ

In recent years, the proportion of NZGBs held by New Zealand residents has increased, although the majority of bonds are still held by non-residents. Non-resident holdings of NZGBs were at 52.3 per cent as at 30 June 2019. This is the lowest proportion since November 2003. The proportion of nominal bonds held by non-resident remains higher, at 58.0 per cent, compared to 34.6 per cent for IIBs.

There is notable variation in the proportion of non-resident holdings across the different NZGB maturities. The bonds with the highest proportion of non-resident holdings are the NZGB 2029 and NZGB 2037, at 65 per cent and 64 per cent respectively. Over the past year, non-resident investors have continued to increase the value of their holdings in the bonds where tendered issuance took place. They decreased the value of their holdings in non-tendered bonds, particularly the NZGB 2020, where the buyback programme has been implemented.

Holdings of T-Bills continue to be dominated by resident investors, with only 8.5 per cent held by non-residents.

Resident and non-resident holdings of NZGBs 30 June 2019



Source: RBNZ

Summary

The forecast 2019/20 borrowing programme will largely manage scheduled NZGB maturities and buyback activity, with only a small volume of 'new' funding to the Crown. In 2019/20, net issuance of NZGBs is forecast to be NZ$3.4 billion after projected maturities and buybacks are taken into account. Gross issuance is forecast to be NZ$10 billion.

The focus will remain on nominal bonds as the primary funding vehicle, although IIBs remain an important part of the funding portfolio. It is expected that IIBs will make up around NZ$0.5 billion of the 2019/20 borrowing programme. In the September 2019 quarter, three nominal and one IIB bond will be issued via regular tender: the 15 April 2025, 20 April 2029 and 15 April 2037 and the 20 September 2040.

Subject to market conditions, a new 15 May 2031 nominal NZGB is expected to be launched, before 31 December 2019, via syndication. The Treasury will continue the buyback programme of the 15 April 2020 NZGB until 15 October 2019. A buyback programme for the 15 May 2021 NZGB is planned to start before 30 June 2020.

A revised Primary Markets Access Framework will come into effect from 30 September 2019. RTCs will then be listed on the New Zealand Debt Management website.

Overall, the funding activities will be undertaken in a structured manner where actions are well communicated in advance. However, some flexibility is maintained in T-Bill issuance in order to respond to short-term cash requirements in an efficient manner. The central principles of transparency, consistency and even-handedness remain important foundations for the funding strategy.