Te Tai Ōhanga
The Treasury

New Zealand Government Securities Funding Strategy

2021/22: Edition 1

New Zealand Government

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2021/22 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.

Nominal bonds remain the primary funding vehicle. Forecast inflation indexed bond tender issuance of around NZ$1 billion.

Treasury Bills on issue forecast to decline to NZ$5 billion by fiscal year end.

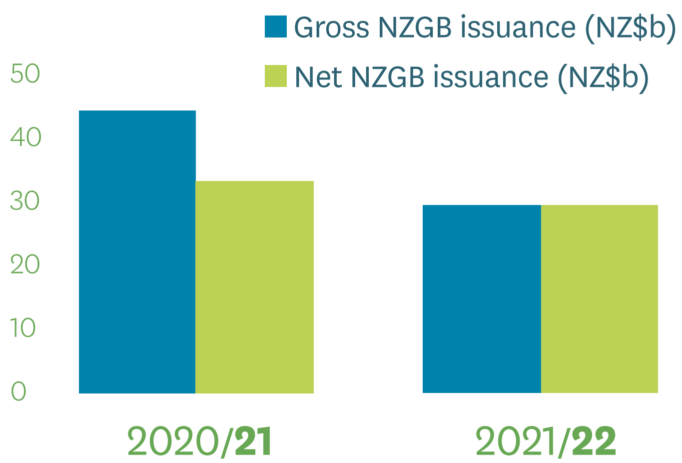
Monthly tender schedules announced in advanced, with multiple bonds offered per weekly tender.

Forecast financial asset balances remain high relative to history, to help manage funding and liquidity risk.

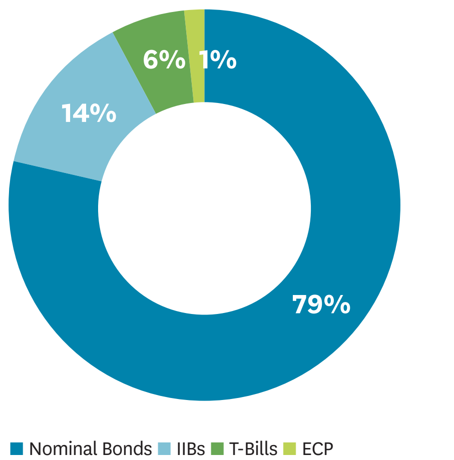
Two new NZGBs expected to be launched by syndication, including a 2051 nominal bond, representing a curve extension.

New Zealand Government Securities Market

Forecast issuance



Portfolio composition as at 31 May 2021

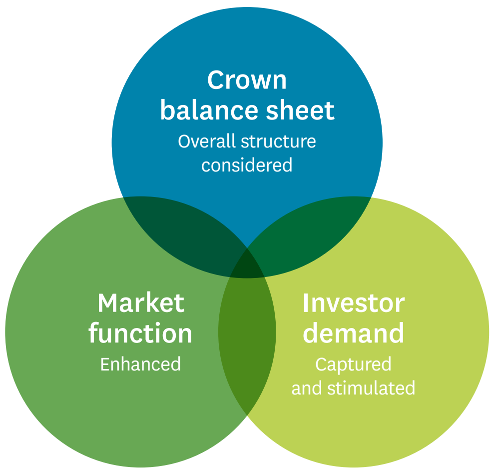


Core principles and achieving a balance between the following three goals:

Even-handed

Consistent

Transparent



New Zealand Debt Management (NZDM) is a function within the Treasury[1] and is responsible for managing the Crown's[2] net cash flows and liquidity position. This document covers recent developments in the New Zealand Government Securities (NZGS) Market and updates NZDM's Funding Strategy for the 2021/22 year.

Recent developments

Since the last Funding Strategy publication in February 2021, the following developments have occurred:

- The forecast New Zealand Government Bond (NZGB) borrowing programme was updated alongside the *Budget Economic and Fiscal Update* (BEFU) in May 2021. The forecast NZGB programme for 2021/22 is set at NZ$30 billion.
- From 2020/21 to 2024/25, forecast NZGB issuance is NZ$10 billion lower, in total, than published on 16 December 2020 at the *Half Year Economic and Fiscal Update* (HYEFU).
- Tender issuance into inflation-indexed bonds (IIBs) is expected to be around NZ$1 billion in 2021/22.
- It was announced that, subject to market conditions, NZDM plan to syndicate two new NZGBs in 2021/22. One of the bonds is expected to be a 30-year nominal bond, representing an extension of the curve.
- Forecast Treasury Bills (T-Bills) on issue at end-June have been reduced by between NZ$1 billion and NZ$2 billion across the forecast period.
- On 9 June, NZ$2.25 billion of a new 15 May 2032 nominal bond was issued at 13bps over the 15 May 2031 nominal bond.

NZGS forecasts as published at BEFU 2021

Year ending 30 June (face value)	2020 (actual)	2021	2022	2023	2024	2025	Total (forecast period)
Gross NZGB issuance (NZ$ billion)	29.0	45	30	25	25	25	150
Net NZGB issuance (NZ$ billion)	23.6	33.9	30.0	9.1	12.4	9.8	95.2
T-Bills on issue (NZ$ billion)	11.9	8	5	4	4	4	n/a
Change in T-Bills on issue (relative to HYEFU)	n/a	0	-1	-2	-2	-2	n/a

Source: The Treasury

1 The Treasury is the Government's lead economic and financial adviser. The Treasury provides advice to the Government on its overarching economic framework, on its fiscal strategy and on achieving value for money from its investments.

2 The 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".

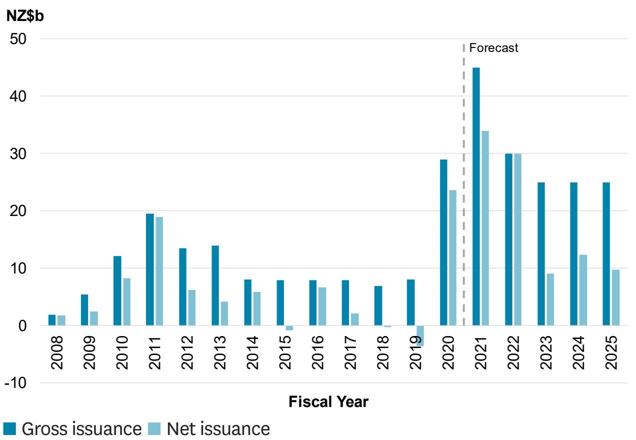
Funding the Crown

New Zealand has been successful in eliminating COVID-19 in the community throughout nearly all of the 2021 fiscal year, allowing most of the economy to operate relatively normally. However, borders to most other countries have remained closed, weighing on specific industries, such as tourism. The Treasury's forecasts at BEFU 2021 show an improvement in the Crown's fiscal position, relative to that forecast at HYEFU 2020. Between fiscal years 2020/21 and 2024/25, a cash shortfall of NZ$92.9 billion is expected. This is an improvement of $8.9 billion relative to HYEFU 2020. The core Crown cash shortfall ('residual cash deficit') is funded largely through borrowing via the New Zealand Government Securities (NZGS) market. Changes to the forecast core Crown cash positions are therefore a key driver of changes to the core Crown borrowing programme. NZDM also consider liquidity requirements and the size of forecast financial asset balances, when compiling borrowing programme forecasts.

While economic risks relating to COVID-19 have reduced, heightened uncertainty remains on the timing, and to a lesser extent the size, of cash requirements. To mitigate this uncertainty, NZDM have maintained forecast financial asset balances at a level which is high relative to history. This allows the Government to be better placed to manage funding and liquidity risks. Further guidance on the expected level of enduring balances will be provided at future *Economic and Fiscal Updates*.

The core Crown borrowing programme includes the issuance of both NZGBs which include nominal bonds and IIBs, and short-term borrowings such as T-Bills and European Commercial Paper (ECP). Together, these make up NZGS. Consistent with the profile of the core Crown cash shortfall, net NZGB issuance is highest in the first year of the forecast period, as shown in the chart below.

Forecast NZGB issuance



Source: The Treasury

Funding Strategy principles and objectives

NZDM's Funding Strategy is based on the principles of transparency, consistency and even-handedness. The core 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.

The Funding Strategy is aimed at balancing three key goals: consideration of the overall structure of the Crown's balance sheet, the ability to capture and stimulate investor demand, as well as promoting well-functioning and liquid NZGS markets.

For the NZGB market, this objective is achieved by taking a long-term structured approach, rather than a short-term tactical approach to funding activities. This supports the overall aim of reducing uncertainty or illiquidity premiums associated with NZGBs, complemented by clearly communicating future actions in advance.

Rather than mechanically setting borrowing programmes equal to the Crown's forecast funding requirement and maturing borrowings, the aim is to ensure some smoothing of the profile of NZGB issuance over the forecast period. This reduces year-to-year fluctuations in issuance that could occur if funding programmes were set to exactly match cash requirements. NZDM also places value on providing market participants with as much consistency as possible, and avoid unnecessarily revising borrowing programme forecasts. This approach aims to ensure there are not periods of excessive NZGB issuance followed by periods of insufficient NZGB issuance, relative to demand. Ultimately this will help reduce unnecessary volatility in prices, minimise risk premia over the long-term, and ensure investors and intermediaries remain engaged in the NZGB market through time.

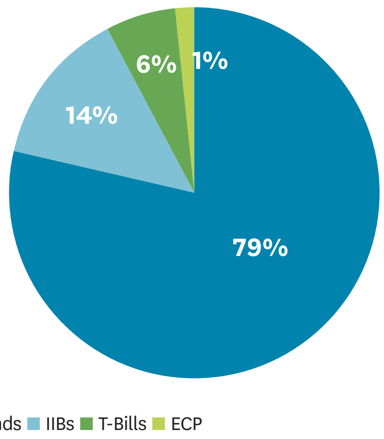
When cash proceeds from NZGB issuance are higher than strictly required, financial asset positions will increase over and above minimum liquidity requirements. This provides additional financial resilience for the Crown, as these assets can be liquidated to provide additional funds in the presence of unforeseen shocks (such as the impact from COVID-19). These financial assets help to minimise the need to immediately adjust the borrowing programme, further supporting predictability and consistency in NZGB issuance.

Wholesale Funding Strategy 2021/22[3]

Funding instruments

The following chart indicates the proportions of the funding instruments within the overall portfolio.

Current NZGS portfolio as at 31 May 2021



Source: The Treasury

Nominal bonds remain the primary funding instrument and are forecast to constitute the majority of the 2021/22 NZGB programme.

Nominal bond lines are capped at NZ$18 billion. This level allows for the need to promote liquidity in each bond line, while managing the size of maturity cash flows and mitigating refinancing risk. However, the full capacity of any bond line may not always be utilised.

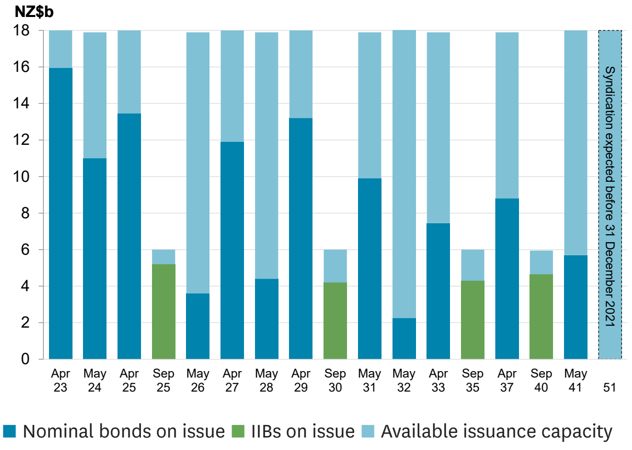
The NZGB portfolio is constructed to accommodate demand at different points on the curve, to maintain key benchmark lines and to ensure relatively regular spacing between bonds across the curve. The current structure of the NZGB portfolio allows for in-fill bond maturities to be introduced within the current NZGB curve or for extension of the curve.

A 2051 nominal NZGB is expected to be launched prior to 31 December 2021, a natural curve extension given 30-years is considered a standard international benchmark. Given the step-change in the size of forecast annual borrowing programmes since the onset of the COVID-19 pandemic, programmes are now of sufficient size to support an extension of the nominal bond curve. Previously, an extension of the curve beyond 20-years was less viable whilst also achieving other portfolio construction objectives.

Several issues have been considered in scheduling the launch of a 30-year bond:

- The relative cost of issuing a 30-year compared to a 20-year nominal NZGB.
- The reduction of annual refinancing risk through the extension of the curve.
- Increased investor diversification through attracting demand from investors with mandates that inherently favour long-dated assets.
- The potential for further development of New Zealand capital markets, by providing a long-dated reference point for other issuers, long-term project costing and the swaps market.

NZGB portfolio and expected syndication issuance as at 31 May 2021



Source: The Treasury

Inflation-indexed bonds (IIBs) remain an important instrument in the core Crown borrowing programme. IIBs support diversification of the investor base and enable a portion of interest expenses to be correlated with the economic cycle and thereby fiscal revenues.

IIBs constitute a solid proportion of the total NZGS portfolio, at 14 per cent. This proportion has reduced from a peak of 23 per cent in mid-2019, as recent increased NZGB issuance has been focused in the nominal product. This strategy has taken into account market feedback and the relative cost of issuance. The appropriate proportion of IIBs within the portfolio, and the appropriate rate of issuance, is assessed on an ongoing basis. However, commitment to the IIB product as part of the portfolio remains constant.

Individual IIB lines remain capped at NZ$6 billion face value. It is expected that there will be approximately NZ$1 billion of IIB tender issuance in 2021/22, subject to market conditions.

Treasury Bills (T-Bills) provide flexibility to address short-term cash needs which may arise as a result of upcoming bond maturities, or seasonal or unexpected changes in cash flows. T- Bills are made available through weekly tenders.

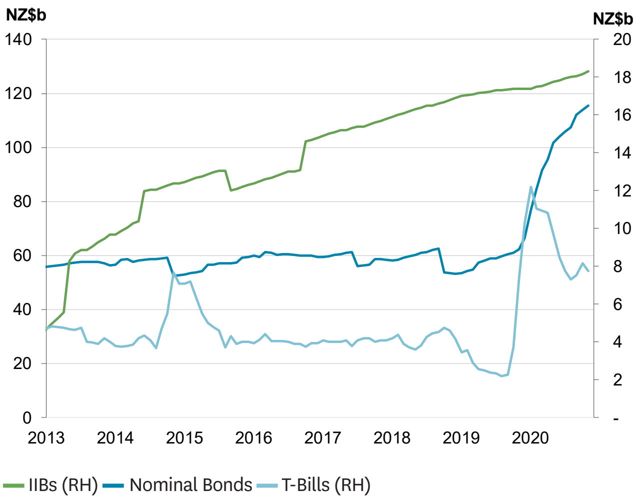
T-Bills on issue are forecast to be NZ$5 billion at 30 June 2022. This is NZ$1 billion lower than previously forecast at HYEFU, reducing short-term refinancing risk and reflecting a lower overall funding task. The actual volume of T-Bills on issue may vary from forecast, based on factors such as the relative cost of T-Bill issuance versus alternative short-term funding mechanisms and actual short-term cash needs.

3 Wholesale debt accounts for over 99 percent of New Zealand Government Securities on issue, with retail debt (Kiwi Bonds) making up the remainder.

European Commercial Paper (ECP)[4] issuance was recommenced in April 2020 and there is currently around NZ$1.6 billion on issue (as at 31 May 2021). NZDM intend to maintain a small volume of ECP on issue so the market can be easily accessed, should it be required.

Alternative funding mechanisms are available, which further help to meet any short-term cash needs of the Crown, if, and when, they arise. These include a NZ$5 billion overdraft facility with the Central Bank, The Reserve Bank of New Zealand (RBNZ). NZDM also maintain up-to-date legal documentation for an EMTN[5] programme, should this be required. However, at present there is no intention to undertake long-dated foreign currency issuance within the forecast period.

NZGS issuance history



Source: The Treasury

Primary Issuance

Tender issuance. Issuance into existing NZGBs will occur via regular tenders. Complete details of the upcoming month's tender schedule are published in advance to provide market participants with as much certainty as possible regarding issuance plans, while maintaining some flexibility to adjust the issuance profile throughout the year. At each weekly tender, multiple NZGBs are offered. Tender schedules are announced at the set time of 8am (NZT), on the day prior to the last tender of the previous month.

During the month of July 2021, a total of seven different NZGB lines will be offered through weekly tenders. Weekly tender volumes will be approximately NZ$500 million. Each week, short, medium and long-dated bonds are scheduled to be issued. This profile is designed to provide liquidity and price transparency at different maturities across the curve, to appeal to a wide range of investors. NZDM constantly review the optimal number of bonds offered per tender, given the overall weekly issuance volume.

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

Only Registered Tender Counterparties (RTC) may participate in tenders. To qualify as an RTC, an intermediary must play a significant role in intermediation of NZGS products to investors, as well as commit to supporting secondary market liquidity and price transparency. An RTC must also support the primary market through regular participation in NZGS tenders.

RTCs are listed on the NZDM website to create visibility for investors. Only RTCs are eligible for syndication issuance panels.

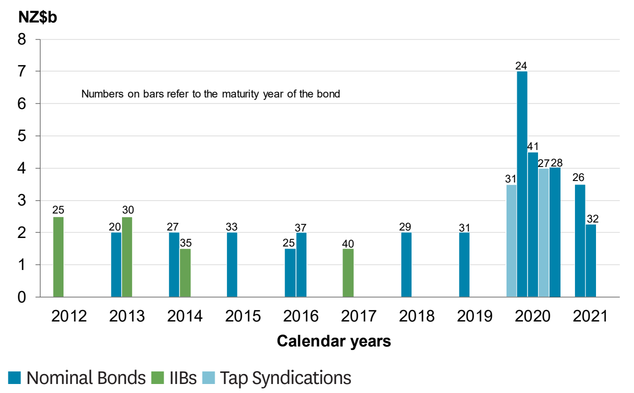
Syndicated issuance. Syndications remain the preferred method for the issuance of new bond lines, as it enables the placement of a large initial volume into the market, promoting immediate liquidity in the new bond. The frequency of syndications has increased over the past year in response to the increased funding requirement. With the increased volume of issuance in 2020/21, tap syndications have also been used to add sizable volume to existing bond lines. However, there is currently no intention to utilise tap syndications in 2021/22.

Syndication intentions are generally announced alongside an *Economic and Fiscal Update*, with further details, such as the timing and maturity, typically provided alongside monthly tender schedule announcements. Further operational announcements are made subsequently, which specify the appointment of any syndication panel and launch of the transaction.

The decision on whether to launch a new bond line depends on multiple factors, including the NZGB portfolio structure, investor demand, individual line sizes and remaining capacity, the size of the annual core Crown borrowing programme, and market conditions.

As announced at BEFU, two additional NZGBs are expected to be introduced, via syndication, in the 2021/22 year. The first is expected to be a 2051 nominal NZGB, and will be launched by 31 December 2021. Further details of the second will be announced in subsequent updates.

Syndication history



Source: The Treasury

4 ECP is an unsecured, *short-term* debt instrument that is typically denominated in a currency differing from the domestic currency of the market where it is issued.
5 Euro Medium Term Note is a *medium-term* debt instrument that is denominated in a currency differing from the domestic currency of the market where it is issued.

ECP issuance. Consistent with nearly all other ECP programmes, the Crown's programme operates through a closed dealer group. This means any ECP issued to investors can only be distributed by those banks named on the programme. ECP is issued by reverse enquiry whereby NZDM post price levels to ECP programme dealers on a daily basis.

Private placements. The Funding Strategy does not include the use of private placements. This activity is considered to be inconsistent with the core principles of transparency, consistency and even-handedness. Priority is also given to maintaining liquidity in core market-traded instruments.

Secondary market support

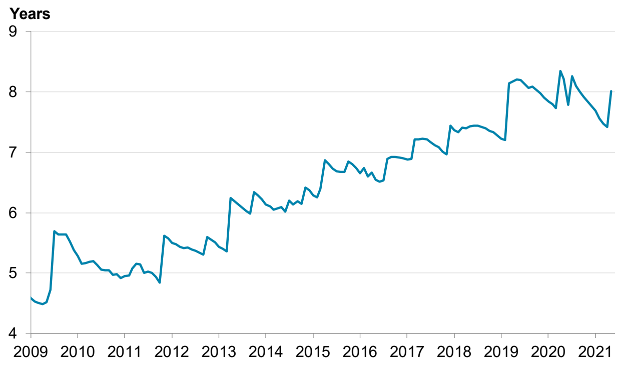
Maximising liquidity in the secondary market for NZGS remains a priority. Strong relationships with intermediaries that support the NZGS markets are crucial to achieving this outcome. In addition, the Funding Strategy also incorporates elements to help maximise liquidity:

- **Focusing on core instruments issued in NZD**. The focus is on New Zealand Dollar (NZD) denominated issuance in the domestic market. This helps to maximise liquidity in existing NZGS, and a well-developed NZD denominated NZGS market supports domestic capital markets.
- **Issuing new bond lines via syndication**. Syndicated issuance ensures a sizable volume of a bond line is on issue from initiation. After a blackout period of typically at least two months, tender issuance into the bond commences which helps promote liquidity in the new bond line.
- **Undertaking bond buybacks**. The Funding Strategy generally incorporates a policy of buying back bonds prior to maturity. This helps to smooth cash flows around bond maturities and enables the recycling of maturity proceeds to investment further out the NZGS curve.
- It has been recent practice to buyback outstanding bonds within an 18 month window before a bond matures. The RBNZ typically assumes responsibility for buyback activities during the final six month period before a bond matures, in an effort to ensure overall financial system liquidity.
- At this stage, NZDM do not have plans to begin repurchasing the 2023 nominal bond, given it is part of the Reserve Bank of New Zealand's Large Scale Asset Purchases programme. This approach is consistent with that taken to the 2021 nominal bond. Nevertheless, the long-term strategy remains for NZDM to buyback bonds prior to maturity.
- **Broadly matching ACGB maturities**. NZDM aim to issue NZGBs with maturities that closely align with Australian Commonwealth Government Bond (ACGB) equivalents to enable investors to easily assess relative value between these assets.

Average maturity

Over a number of years, the Funding Strategy has extended the average weighted maturity of the NZGB portfolio. The average weighted maturity of the NZGB portfolio has increased from approximately 4.5 years in mid-2009 to recently stabilise around 8 years.

Average weighted maturity of NZGB portfolio



Source: The Treasury

Several factors have been considered when extending the average weighted maturity of the portfolio. These include the impact on asset and liability composition of the Crown's overall balance sheet; investor diversification, including capturing demand from investors seeking duration or aiming to offset long-dated liabilities; reducing refinancing risk and frequency, and the contribution that can be made to the development of New Zealand's capital markets more broadly.

Over the long-term, there is no specific target for the average weighted maturity of the portfolio. Broadly, NZDM continue to see some benefits in increasing the average weighted maturity of the bond portfolio. However, issuance decisions will also be influenced by an assessment of investor demand and market conditions.

Environmental, Social and Governance (ESG) considerations

On various independent sustainability and ESG metrics, New Zealand is one of the most highly rated sovereigns in the world. This includes a 2021 Sustainable Development Goals (SDG) global rank of 23 out of 165 countries.

The New Zealand Government also has clearly stated wellbeing objectives. The first 'Wellbeing Budget' was delivered in 2019 and included a package of initiatives to measure progress focused around five Budget Priorities.[6] In June 2020, an amendment to the Public Finance Act introduced new requirements for the Government to report annually on its wellbeing objectives in the Budget, and for the Treasury to periodically report independently on the state of wellbeing in New Zealand. While the five priorities also underpin investment decisions in Budget 2021, the latest Budget also built on work from the previous two Budgets by continuing the application of the Living Standards Framework and introducing a te ao Māori view of wellbeing.[7]

6 Mental health, child wellbeing, supporting Māori and Pasifika aspirations, building a productive nation, transforming the economy.
7 To take into account the view of the indigenous people of New Zealand.

In June 2021, the New Zealand Climate Commission[8] laid out advice to the Government on the steps New Zealand can take to reduce greenhouse gas emissions and address climate change. The Government is required to respond with an Emissions Reduction Plan before the end of the year, which will set out how the first three emissions budgets will be achieved. The Commission's advice includes:

- The proposed first three emissions budgets for New Zealand.
- Recommendations on the direction of the country's first emissions reduction plan, which provides policy guidance to Government on how the emissions budgets could be met.

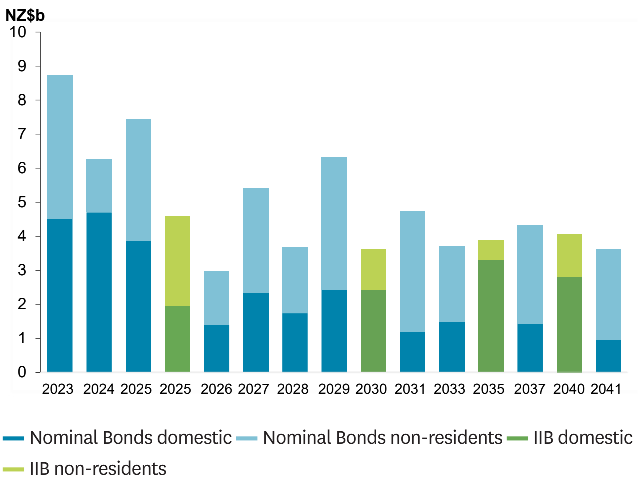
NZDM are aware of the contribution an efficient, holistic and well managed debt funding strategy can make in supporting the Government to achieve its broad ESG objectives.

Diversifying investor base

Maintaining an investor base which is diverse by geography, investor type and mandate is achieved through an active investor engagement strategy.

The proportion of NZGBs held by non-residents has recently stabilised at around 50 per cent, after declining over recent years. Recent years has seen an increase in the value of domestic investor holdings. During calendar year 2020, there was a notable increase in the value of holdings by domestic registered banks, from around NZ$12 billion to NZ$18 billion. The proportion of nominal bonds held by non-residents is 54.6 per cent, compared to 35.1 per cent for IIBs (as at 31 May 2021). These figures exclude the bonds purchased by the RBNZ as part of the Large Scale Asset Purchases programme. As shown in the figure below, as a proportion, non-resident holdings of NZGBs tend be higher in bonds with longer-dated maturities.

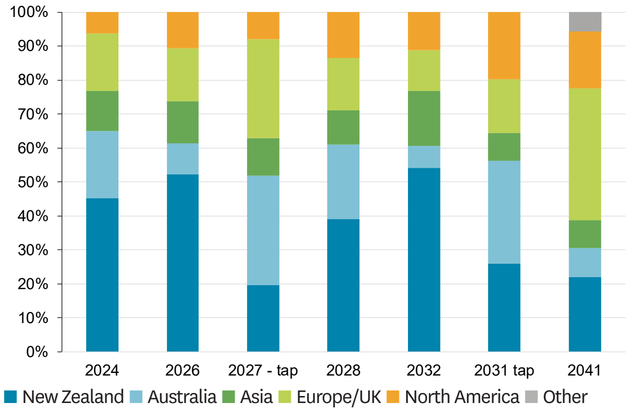
Non-resident holdings of NZGBs (as at 31 May 2021)



Source: RBNZ

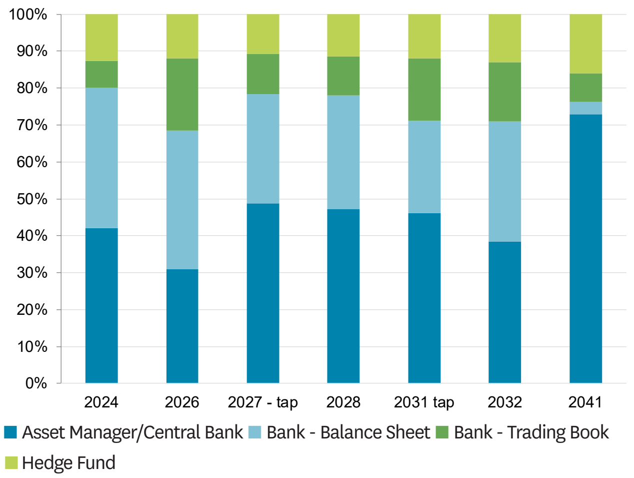
The diverse investor base is also reflected in the syndication statistics which are published on the NZDM website. The allocation statistics are grouped by Location and Investor Type, and cover transactions that have occurred since the start of the 2020 calendar year. The charts below illustrate how investor participation in syndications varies dependent on the maturity of the bond issued. Demand for shorter-dated bonds tends to be higher from domestic investors. This partly reflects investment mandates of domestic bank-balance sheet investors. Offshore investors are better represented in longer-dated syndications.

Recent nominal bond syndication allocations snapshot – investor proportions by Location



Source: The Treasury

Recent nominal bond syndication allocations snapshot – investor proportions by Investor Type



Source: The Treasury

As part of the investor engagement strategy, NZDM undertake frequent interactions with the existing and prospective investor base. This includes publication of a monthly Investor Update and a regular meeting and presentation schedule. In the current environment, the strategy has been adapted to incorporate virtual platforms. More detail on all media and external publications can be found at debtmanagement.treasury.govt.nz/investor-resources.

8 The New Zealand Climate Change Commission is an independent Crown entity that advises the New Zealand Government on climate change action within the framework of the Climate Change Response Amendment Act.

Conclusion

While the impact of COVID-19 continues to impact the Crown's fiscal outlook, the fiscal and economic position of New Zealand has improved substantially over the past year, and the forecast core Crown borrowing programme has consequently been revised down.

Key elements of the 2021/22 Funding Strategy remain unchanged from 2020/21. Nominal bonds will continue to be the primary funding instrument although IIBs remain an important instrument in the funding portfolio. NZDM will maintain flexibility in T-Bill issuance to ensure short-term liquidity requirements can be met in an efficient manner. This approach is augmented by an ECP issuance programme, with the primary purpose to maintain a market presence.

Issuance into existing NZGB lines will primarily occur via regular tenders, with multiple bonds offered across the curve at each weekly auction. Syndications remain the preferred method for the issuance of new bond lines, as it enables the placement of a large initial volume into the market, promoting immediate liquidity in the new bond.

Notably, a 30-year bond is expected to be launched, via syndication, by 31 December 2021. An additional new bond line is also expected to be launched in the fiscal year.

Maximising liquidity in the secondary market for NZGS remains a priority. To assist in this aim NZDM prioritise issuing into core instruments in NZD, issuing new bonds via syndication, ensuring avenues for buybacks of upcoming bond maturities, and broadly matching NZGB issuance maturities to ACGBs.

NZDM's proactive investor engagement strategy helps maintain a diverse global investor base. The results can be seen in data showing holdings of NZGBs and recent syndication allocations.