



NEW ZEALAND
DEBT MANAGEMENT

New Zealand Government Securities Funding Strategy

2021/22: Edition 2

Te Kāwanatanga o Aotearoa
New Zealand Government



TE TAI ŌHANGA
THE TREASURY

Contacts:

Matthew Collin
Head of Funding
Investment and Markets

✉ debtmanagement@treasury.govt.nz

☎ +64 4 917 6015

New Zealand Debt Management
The Treasury
1 The Terrace, PO Box 3724
Wellington 6011, New Zealand

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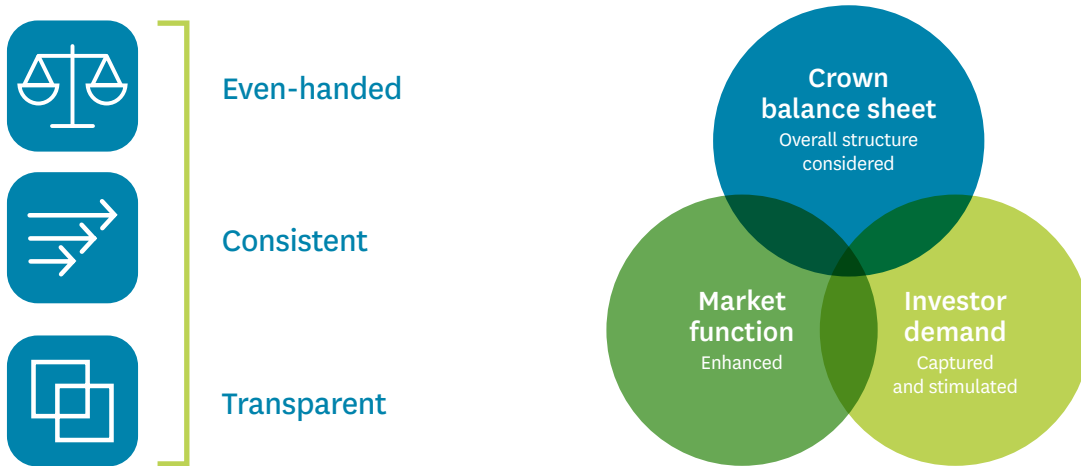
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The URL for this publication on the New Zealand Debt Management website at June 2021 is <https://debtmanagement.treasury.govt.nz/investor-resources/nz-govt-securities-funding-strategy>

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.

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



New Zealand Government Securities Market

Nominal Bonds:

The primary funding instrument with issuance to be concentrated into existing benchmark lines for the remainder of fiscal year 2021/22.

Inflation-Indexed Bonds (IIBs):

A move towards more flexible issuance and tender mechanism is aimed at improving market vibrancy for IIBs as a core funding product.

Green Bonds:

New Zealand expects to issue its first Sovereign Green Bond in late 2022, with details of the framework available mid-year.

Treasury Bills (T-Bills):

Issuance to provide flexibility in addressing short-term liquidity requirements. Tenders are now fortnightly supporting a reduction in outstanding by around NZ\$3 billion in 2021/22.

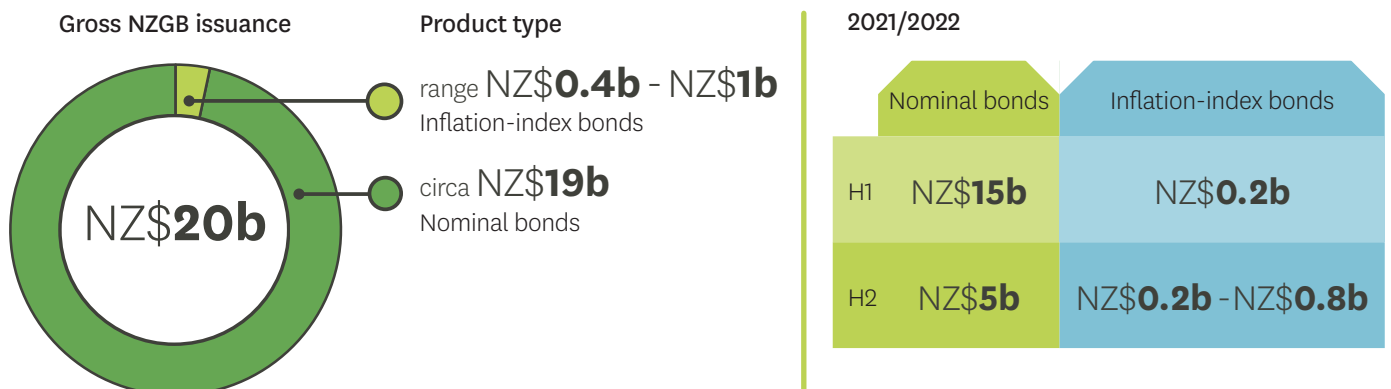
European Commercial Paper (ECP):

Issuance steady to maintain market presence and provide optionality to increase in certain scenarios.

Foreign Currency (EMTN):

Programme documentation remains current but unutilised for more than 10 years. Market pricing is unfavourable and preference is to support activity in NZD products.

2021/22 New Zealand Government Bond (NZGB) programme forecasts



New Zealand Debt Management (NZDM) is a function within the Treasury¹ and is responsible for managing the Crown's² 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 July 2021, recent developments include:

- COVID-19 Response:** New Zealand has transitioned away from an elimination strategy to the more permissive COVID-19 Protection Framework. Developments will continue to be a major influence on economic and fiscal outcomes and represent a significant source of uncertainty and risk.
- Macroeconomic Backdrop:** The New Zealand economy has displayed resilience to the pandemic, with a broad-based recovery across most industry groups and sectors. Strong aggregate demand has seen the unemployment rate fall to a record low and contributed to strong inflationary pressures.
- Monetary Policy:** The Reserve Bank of New Zealand (RBNZ) is at the early stages of raising the monetary policy rate. The Large-Scale Asset Purchases (LSAP) programme was paused in July 2021, with the focus now shifting to how the LSAP portfolio will be managed. The RBNZ expects to gradually manage LSAP bond holdings down in a way that maintains the smooth functioning of financial markets. More details will be provided at the Monetary Policy Statement in February.
- Fiscal Outlook:** The rapid recovery in the economy has led to a significant improvement in tax revenue outturns and forecasts. The operating balance before gains and losses (OBEGAL) is now expected to return to surplus in the 2023/24 year. Net core Crown debt is now forecast to peak nominally at NZ\$165.5 billion in 2023/24 (40% of GDP), before declining to 30% by 2025/26.
- Borrowing programme:** At the Half Year Economic and Fiscal Update (HYEFU), the forecast New Zealand Government Bond (NZGB) programme for 2021/22 was adjusted to NZ\$20 billion, a large reduction of NZ\$10 billion relative to the Budget Economic and Fiscal Update (BEFU) forecasts. NZGB programmes over the full forecast period were reduced by a total NZ\$31 billion. Better than expected fiscal outcomes are the primary driver for reduced issuance alongside a reduction in cash holdings, which were accumulated during the peak of pandemic uncertainty.
- Liquidity Management:** NZDM reviewed the size of the liquidity buffer held for scenarios that may result in a temporary loss of market access or unfavourable financing costs. A gradual transition to the new buffer size of NZ\$15 billion will result in less issuance, all else being equal, given current elevated liquidity levels.
- Green Bond Programme:** In November 2021 it was announced that New Zealand would issue its first Sovereign Green Bonds in late 2022. These new nominal fixed income bonds will help ensure high quality Government projects with robust environmental outcomes are financed, delivered, monitored and reported on
- Curve Extension:** In September, NZDM issued a 15 May 2051 nominal bond, extending the NZGB curve to 30 years. The syndication was well-subscribed with notable sponsorship from offshore accounts. It was issued at a 25bps spread over the 15 May 2041 nominal bond.
- IIB Issuance Approach:** After a period of consultation with market participants several changes have been implemented to support activity in the IIB market. These include taking a more flexible approach to tender issuance and updating the tender mechanism.

NZGS forecasts as published at HYEFU 2021

Year ending 30 June (face value)	2022	2023	2024	2025	2026	Total
Gross NZGB issuance (NZ\$ billion)	20	18	18	18	10	84
NZGB maturities and repurchases (NZ\$ billion)	2.4	15.5	13.8	14.9	11.9	58.5
Net NZGB issuance (NZ\$ billion)	17.6	2.5	4.2	3.2	-1.9	25.5
NZGBs outstanding (NZ\$ billion)	144.8	147.3	151.5	154.7	152.8	n/a
NZGBs outstanding (% of GDP)	40%	37%	37%	35%	33%	n/a
Forecast T-Bills on issue (NZ\$ billion)	4	3	3	3	3	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 Strategy Principles

NZDM's primary objective is to minimise the Crown's borrowing costs over the long-term with due consideration to risk, while ensuring a well-functioning market for New Zealand Government securities (NZGS).

For the NZGB market, meeting this objective is currently best achieved by taking a strategic, rather than short-term tactical approach to funding activities. NZDM aims to smooth the Crown's borrowing through time to reduce the variability in annual programmes which could impact market function.

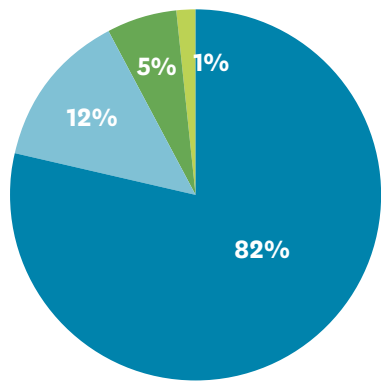
Delivery of funding activity is underpinned by the core principles of transparency, consistency and even-handedness, and future actions are communicated in a timely manner.

The funding strategy aims to balance three key goals:

- Considering the overall structure of the Crown's balance sheet.
- Capturing and stimulating investor demand.
- Promoting well-functioning and liquid NZGS markets.

Wholesale Funding Strategy 2021/22

NZGS portfolio as at 31 December 2021



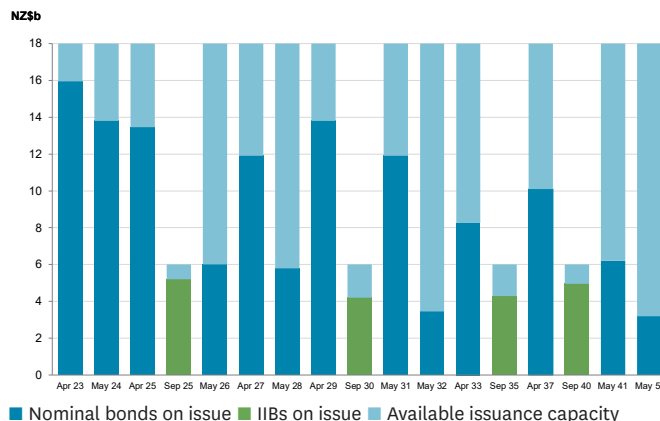
■ Nominal Bonds ■ IIBs ■ T-Bills ■ ECP

Source: The Treasury

Term Funding

Gross issuance for 2021/22 has been revised to NZ\$20 billion, with around NZ\$5 billion remaining for the second half of the fiscal year. Issuance will be evenly distributed and target average sales of around NZ\$200 million per weekly tender spread across multiple lines. Given the reduction in borrowing at HYEFU, there will be no further bond lines added this fiscal year.

NZGB portfolio as at 31 December 2021



Source: The Treasury

Nominal Bonds

Nominal bonds continue to be the primary funding instrument. Line capacity remains capped at NZ\$18 billion which balances the need to promote liquidity in each security, while managing the size of maturity cash flows and refinancing risk.

The NZGB nominal portfolio is constructed to:

- Accommodate demand at different points on the curve which contributes to a diversified investor base.
- Target tender issuance in benchmark securities which now extend out to 30 years.
- Aim to build new lines quickly to at least NZ\$4 billion.
- Ensure regular spacing between bond lines across the yield curve. One-year gaps are currently typical out to 10 years. The spacing between maturities increases to 3-4 years for longer tenors, conditional on future funding requirements.

Details of the upcoming month's tender schedule are published in advance to provide market participants with as much certainty as possible, while maintaining some flexibility to adjust the issuance profile throughout the year. At each weekly tender, multiple NZGBs are offered to cater to a range of investor demand.

Inflation-Indexed Bonds (IIBs)

IIB issuance is expected to be between NZ\$400 million and NZ\$1 billion in 2021/22 with NZ\$200 million having been issued by end-December 2021. Individual lines remain capped at NZ\$6 billion face value.

Although the proportion of IIBs in the bond portfolio has decreased from a peak of 24% in 2019 to around 13% currently, IIBs continue to be a core product. This is not impacted by the development of the Green Bond programme. IIBs contribute to investor diversification and inflation adjusted coupon and principal amounts align repayments with the variability in Crown revenues thus reducing the risk of the Crown's balance sheet.

In recognition of the liquidity challenges for IIBs, NZDM paused issuance in September while consulting with market participants on actions to boost activity and aid in price transparency. Several changes to the IIB issuance process were announced at HYEFU:

- NZDM will take a more flexible approach to issuance in the future. Forecasts at EFUs will now include a range of expected IIB issuance for the current fiscal year, rather than a specific expected volume.
- Primary IIB issuance will be more flexible and responsive to changes in demand. Specific details of upcoming IIB tenders will not be published in the monthly bond tender schedules. Instead, NZDM will regularly survey market participants to gauge demand for IIBs. Following this, NZDM will announce when IIB tender issuance is to be offered, at the usual tender confirmation date for nominal bonds.
- The tender mechanism is changing from a 'multi-price' to 'single-price' from March 2022. Our analysis suggests single-price auctions may offer benefits for less-liquid markets like IIBs. As all successful bidders are allocated at the same yield, it avoids the 'winners curse' which refers to the winning bid exceeding an asset's 'intrinsic value' due to information asymmetry or price uncertainty.

NZDM will assess the impact of the changes alongside potential further actions to support the market as required.

Euro Medium Term Note (EMTN)

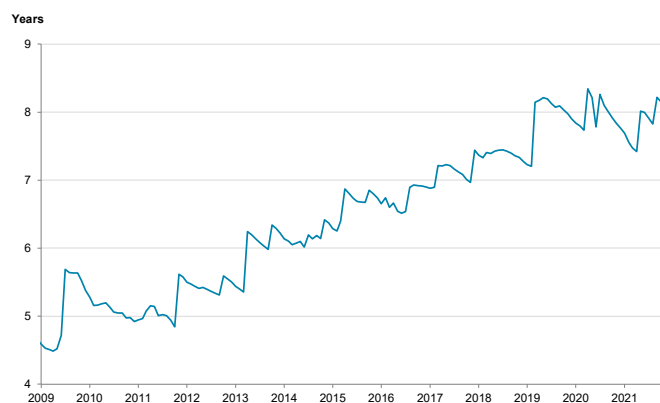
NZDM maintains up-to-date legal documentation for an EMTN programme, should this be required. However, this facility has not been used since 2004 and there is no current intention to undertake long-dated foreign currency issuance, given market pricing and objectives to support NZ Dollar securities markets.

Average Maturity

The average weighted time to maturity (ATM) of the bond portfolio has increased consistently over recent years. Several factors have been considered in this decision:

- The impact on the 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.
- Contributing to the development of New Zealand's capital markets by the risk-free curve.

Average weighted maturity of NZGB portfolio including IIBs



Source: The Treasury

There are currently no plans to extend the NZGB curve beyond the 30 year point. With regular issuance into tenors across the curve, the ATM is expected to stabilise around current levels.

Bond Buybacks

NZDM generally repurchases bonds prior to maturity to smooth cash flows and this enables investors to recycle proceeds further out the yield curve. There are plans to commence a repurchase programme of the 15 April 2023 nominal bond before 30 June 2022. Repurchase activities will be dependent on portfolio requirements and market conditions. The previous four repurchase programmes have resulted in between NZ\$2 billion to NZ\$6 billion of each line being sold back to NZDM.

Green Bond Programme

New Zealand plans to issue Sovereign Green Bonds in late 2022. NZDM is developing the bond framework, with details expected to be confirmed mid-year and the first issuance expected via syndication late in the year.

Green Bonds are a new source of funding but do not represent additional 'funds' for the Crown and will be issued as part of the overall forecast core Crown borrowing programme. Alongside Nominal Bonds and Inflation-Indexed Bonds, Green Bonds are expected to be an important and enduring part of the New Zealand Government Bond portfolio.

Our climate context

Climate change is a priority for the New Zealand Government. Measures introduced to ensure our financial system addresses the emergency include:

- Requirement for all investments by Crown Financial Institutions to be carbon neutral by 2050.
- The first country in the world to pass legislation to require all listed companies and large financial institutions to report on their climate related risks.
- Requiring KiwiSaver Default Funds to divest from fossil fuels.
- Creating NZ Green Investment Finance and quadrupled the capital available to invest in low carbon technologies of the future.
- Considerable broader work is underway domestically including an Emissions Reduction Plan and National Adaption Plan, both due for completion this year.

Our global commitment includes an enhanced Nationally Determined Contribution to reduce our net greenhouse gas emission by 50 percent by 2030 and increased investment to support our Pacific neighbours.

What is a New Zealand Green Bond?

New Zealand's Green Bonds will be nominal fixed income bonds which provide finance for Government projects with positive environmental outcomes.

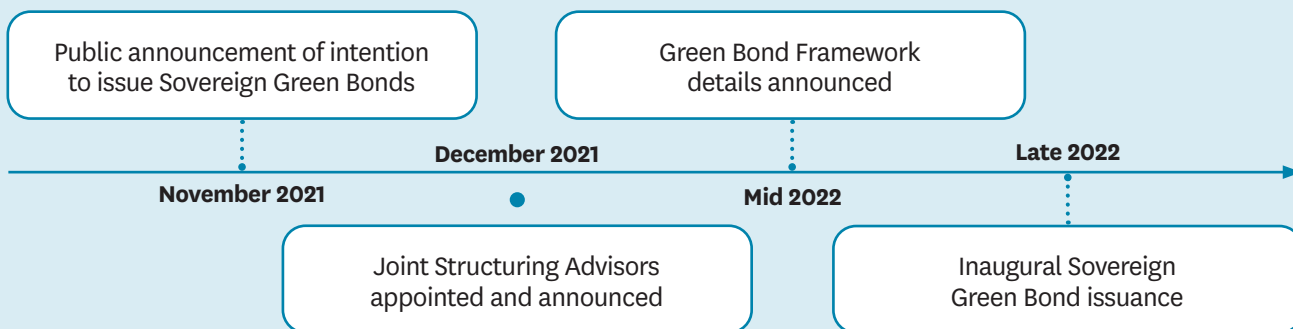
Why issue Green Bonds?

New Zealand Sovereign Green Bonds will help ensure high quality Government projects with robust environmental outcomes are financed, delivered, monitored and reported on.

Issuance of Sovereign Green Bonds is expected to provide further diversification of NZDM's investor base and support development in the broader New Zealand sustainable finance market. In some cases, Sovereign Green Bond issues have resulted in lower cost of funding or 'greenium' where they price inside their own nominal yield curve. These features align to NZDM's core objective of minimising risk-adjusted funding costs over the long-term, alongside promoting a diversified investor base.

Next steps

Design of the Green Bond programme will be informed by international best practice and consideration of New Zealand specific elements. Joint structuring advisors have been appointed to support development of the framework. The first Green Bond issuance is expected in late 2022.



Short Term Funding

Treasury Bills (T-Bills)

T-Bills provide flexibility to address short-term cash needs which may arise from upcoming bond maturities, or seasonal or unexpected changes in cash flows. The short-term funding portfolio incorporates a core issuance assumption of NZ\$3 billion to retain market presence and function. This is around NZ\$1 billion higher than pre-pandemic levels, reflecting an increase in outstanding debt, as well as larger and more frequent bond maturities, which require greater depth in short-term funding markets.

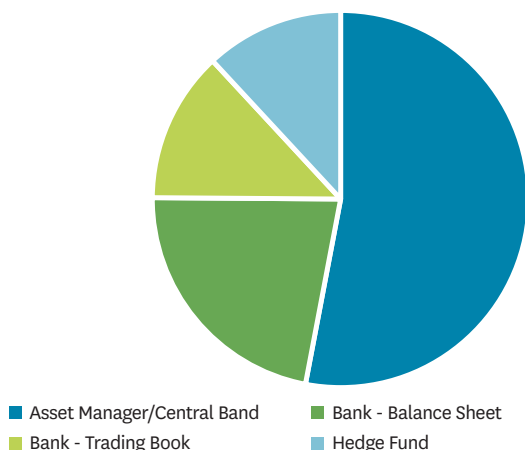
T-Bills are made available through fortnightly tenders and volumes on issue may vary, based on factors such as the relative cost of issuance versus alternative short-term funding mechanisms and short-term cash needs. It is expected that T-Bills on issue may vary from NZ\$3 billion up to NZ\$10 billion depending on liquidity considerations.

European Commercial Paper (ECP)

ECP issuance was restarted in April 2020 and there is currently around NZ\$1.7 billion on issue. NZDM intends to maintain a small volume of ECP on issue so the market can be easily accessed, should it be required.

The Crown's programme operates through a closed dealer group. This means any issuance to end investors can only be distributed by those banks named on the programme. ECP is issued by reverse enquiry with NZDM setting pricing levels to the ECP programme dealers daily.

Investor type - syndications FY 21 onwards



Source: The Treasury

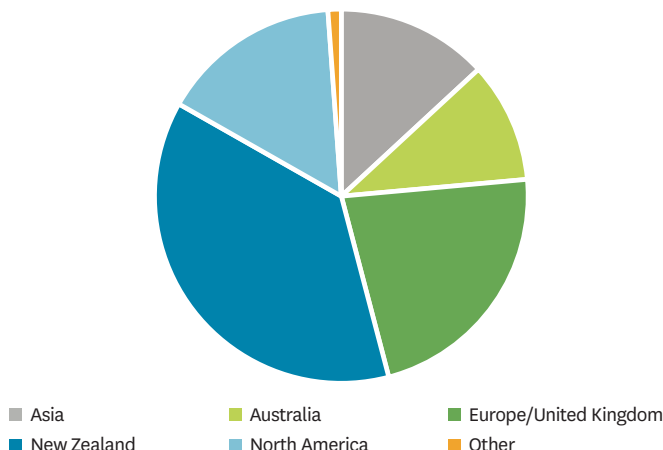
Investor Engagement

The funding strategy aims to balance demand from different investor types, whether by geography, style or mandate. NZDM has a structured investor engagement programme which includes *Investor Update* and *Investor Insights* publications and a regular meeting and presentation schedule.

Non-residents held NZ\$52 billion of NZGBs as at end December 2021 representing 58% of the market free float³ and an increase of NZ\$13 billion from 12 months earlier. For many investors, NZGBs are an 'off-benchmark' position highlighting the importance of stimulating foreign investor interest and demand alongside that of domestic financial institutions.

Regional NZGB turnover data from registered tender counterparties is available on the website. Syndication statistics also provide insights into the investor base and reveal demand to be well-diversified across investor type and geographies. The data available on the NZDM website aggregates syndication statistics since the start of fiscal year 2020/21. In the recent 2051 syndication, there were several new investors participating. Stimulating a broad range of investor groups is a core objective of the engagement programme.

Country breakdown - syndications FY 21 onwards



Source: The Treasury

³ Outstanding bonds less RBNZ large scale asset purchases.