TE TAI ŌHANGA
THE TREASURY

New Zealand Government Securities Overview

2021/2022

New Zealand Government

New Zealand Government Securities

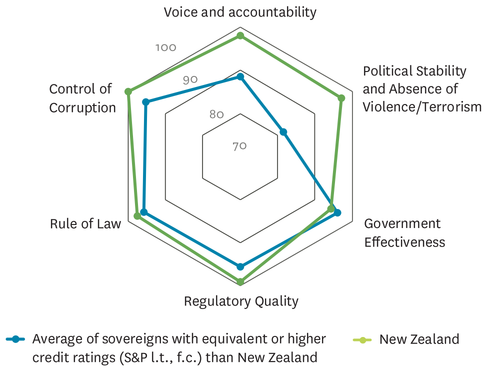
New Zealand Government Securities are issued by the Treasury[1] (Te Tai Ōhanga) on behalf of the New Zealand Crown[2]. These securities provide investors with exposure to a strong fiscal and institutional framework, a diverse and robust economy, a sovereign credit rating in the top twenty globally, and a yield above many peers. This overview is designed for new or potential investors in New Zealand Government Securities and provides insights into New Zealand's[3]:

- **Institutional Framework and Economic Structure**
- **Economic and Fiscal Performance**
- **Government Securities Market**

Institutional Framework and Economic Structure

New Zealand is globally recognised for its robust institutional framework. This institutional strength is demonstrated through high rankings across each of the World Bank's Governance indicators, shown below.

Chart 1: Percentile Ranking on Key Governance Indicators



Source: World Bank Worldwide Governance Indicators – 2019

Form of Government

New Zealand is a sovereign state with a democratic parliamentary government based on the Westminster system. Its constitutional history dates back to the signing of the Treaty of Waitangi in 1840, between the indigenous Māori people and the British Crown.

The New Zealand Constitution Act 1852 provided for the establishment of a Parliament with an elected House of Representatives. Universal suffrage was introduced in 1893. New Zealand has the British monarch as titular Head of State. The Queen is represented in New Zealand by the Governor-General, appointed by her on the advice of the New Zealand Government.

As in the United Kingdom, constitutional practice in New Zealand is an accumulation of convention, precedent and tradition. As such, there is no single document that can be termed the New Zealand constitution. The Constitution Act 1986 however, updated, clarified, and combined in one piece of legislation, the most important constitutional provisions that had been enacted in various statutes. It provides for a legislative body, an executive and administrative structure and specific protection for the judiciary.

Legislative power is vested in Parliament, a single chambered body titled the House of Representatives. The members are elected for three-year terms through general elections. Eligible residents over 18 years of age may vote in general elections.

The executive Government of New Zealand is carried out by the Executive Council – a formal body made up of the Cabinet and the Governor-General, who acts on the Cabinet's advice. The Cabinet itself consists of the Prime Minister and her/his Ministers, who must be chosen from among elected Members of Parliament. Each Minister supervises and is responsible for particular areas of government administration. Collectively, the Cabinet is responsible for all decisions of the Government.

The judicial system in New Zealand is based on the British model. By convention and the Constitution Act 1986, the judiciary is independent from the executive.

Electoral System

As a result of a referendum held in conjunction with the 1993 election, New Zealand changed from a "First Past the Post" system of electing Members of Parliament to a "Mixed Member Proportional" (MMP) system of proportional representation. Under MMP each voter has two votes to cast – a party vote and an electorate vote. A party vote helps decide the share of the 120 seats[4] in Parliament that is allocated to each political party, while the electorate vote determines the local member of Parliament. This change was implemented in the 1996 election.

Economic Structure

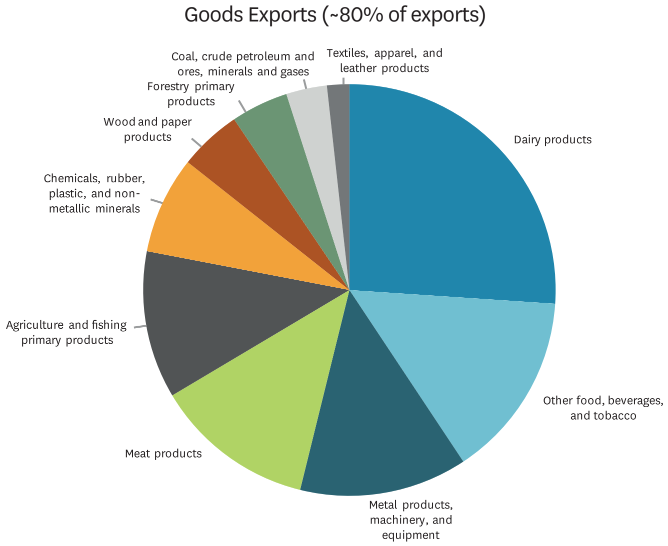
New Zealand is a small open economy and operates on free market principles. A large services sector and sizable manufacturing sector complement an efficient export-oriented primary sector.

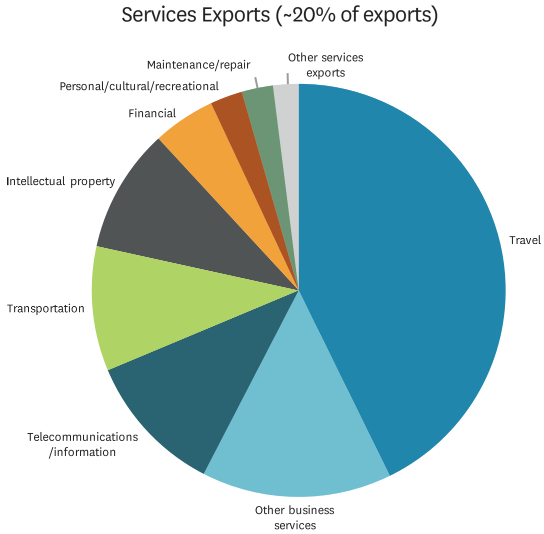
New Zealand's land size is similar to Japan and the UK but with a resident population of only 5 million. The climate is temperate, supporting agriculture, forestry and horticulture. It has abundant natural resources and over 80% of electricity generation comes from renewables, including hydroelectric and geothermal power generation.

External trade is of fundamental importance to the New Zealand economy. Primary sector products, commodities, manufactured products and services are all important sources of export income (Chart 2). While currently smaller than prior to COVID-19, tourism and education services remain the largest components of services exports, with New Zealand historically a popular destination for overseas visitors. Additional services exports include transport (also negatively affected by COVID-19), financial and business services, and information technology. Raw materials, consumer goods and capital equipment for industry are key components of New Zealand's imports.

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 New Zealand Government Securities are issued in the name of "Her Majesty the Queen in right of New Zealand".
3 The data is updated as at 31 July 2021.
4 However, there is often more than 120 seats which can occur when a party wins more electorate seats than their share of the party vote.

Chart 2: New Zealand Exports by Categories – Year Ended March 2021





Source: Stats NZ

New Zealand has had a freely floating exchange rate of its currency, the New Zealand Dollar (NZD), since March 1985. There are no exchange controls on foreign-exchange transactions undertaken in New Zealand, and the NZD is one of the top ten traded currencies globally[5].

Monetary Policy Framework

The Reserve Bank of New Zealand (RBNZ), was established as a Central Bank in 1934 and is responsible for monetary policy and financial stability policy. The Reserve Bank of New Zealand Act 1989 (the Act) cemented its independence and introduced inflation targeting.

The focus of monetary policy is to maintain price stability and support maximum sustainable employment. Monetary policy decisions are made by a committee – the Monetary Policy Committee (MPC). A remit is issued from the Minister of Finance to the MPC which sets out the specific operational objectives.

The latest remit, which came into force on 1 March 2021, stated that the objectives are "to keep future annual inflation between 1 and 3% over the medium term, with a focus on keeping future inflation near the 2% mid-point", and "to support maximum sustainable employment". In particular, the MPC is required to seek to avoid unnecessary instability in output, interest rates, and the exchange rate. The latest remit also requires the MPC to assess the effect of its monetary policy decisions on the Government's policy to support more sustainable house prices. In addition, the MPC must have regard to the efficiency and soundness of the financial system.

A review of the Act was completed in 2021. As a result, the Government has decided to replace the Act with two new pieces of legislation[6]:

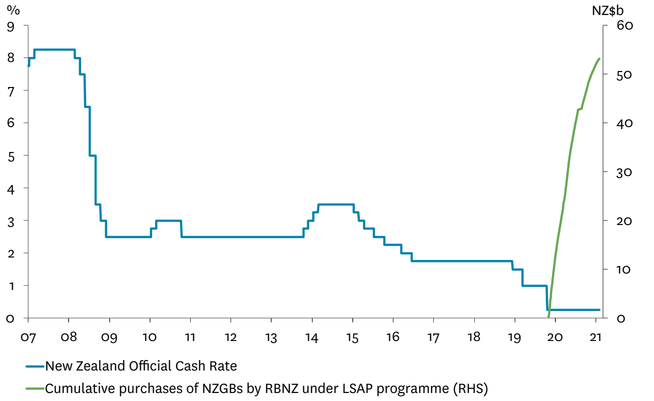
- The Reserve Bank of New Zealand Act 2021 setting out the Bank's high level objectives, functions, accountability and governance arrangements, and funding model. This Bill is expected to be enacted later this year and commence in mid-2022.
- A Deposit Takers Act, which would create a single regulatory regime for all bank and non-bank deposit takers (such as building societies and finance companies). It would also establish a deposit insurance scheme to protect New Zealanders' money held by licensed deposit takers. Drafting of this legislation is currently underway, with a target implementation date in 2023.

In March 2020, the RBNZ implemented alternative monetary policy via a Large Scale Asset Purchases (LSAP) programme. The Government has provided an indemnity to cover losses the RBNZ may incur as a result of operating the LSAP programme, set as a proportion of specific assets on issue. The assets currently covered by the indemnity are limited to nominal New Zealand Government Bonds (NZGBs), Inflation-Indexed NZGBs and Local Government Funding Agency (LGFA) bonds. In the November 2020 MPS, the RBNZ also announced the introduction of the Funding for Lending Programme, where the RBNZ offers to lend funds to eligible counterparties at the Official Cash Rate (OCR) for a term of three years.

5 Bank for International Settlements, Triennial Survey, April 2019, percentage shares of average daily turnover.
6 https://www.rbnz.govt.nz/about-us/our-legislation/reserve-bank-act-review

Port Chalmers at Otago peninsula, New Zealand. Image used under license from iStock.com

Chart 3: RBNZ Monetary Policy Implementation



Source: RBNZ

Fiscal Policy Framework

The Public Finance Act 1989 requires the New Zealand Government to be transparent in both its short- and long-term fiscal objectives and to maintain prudent debt levels. The current and recent Governments have shown a strong commitment to prudent fiscal management.

The Public Finance Act stipulates the Treasury must publish economic and fiscal forecasts twice a year. These occur at the time of the mid-year Budget (*Budget Economic and Fiscal Update* – BEFU) and at the end of the calendar year (*Half Year Economic and Fiscal Update* – HYEFU). The Treasury must also provide a *Pre-election Economic and Fiscal Update* (PREFU) prior to general elections, which occur at least every three years[7]. The forecasts extend for four years beyond the current fiscal year ie, "the forecast period".

Without parliamentary authority, the Government has no authorisation to incur expenses and capital expenditure. An Appropriation Act is the means by which Parliament approves expenses and capital expenditure for the Government for the coming year.

This is supplemented by spending that is authorised under Permanent Legislative Authority which continues in effect until revoked by Parliament. The payment of interest on debt is an example of spending authorised under Permanent Legislative Authority.

Securities Law

The Financial Markets Authority Act 2011 established the Financial Markets Authority (FMA) as New Zealand's market conduct regulator. The FMA is an independent Crown Entity whose main objective is to promote and facilitate the development of fair, efficient and transparent financial markets. The FMA enforces financial markets legislation, including the Financial Markets Conduct (FMC) Act.

The FMC Act 2013 regulates the offering and trading of investments and the provision of certain financial services. It regulates the operation of securities and derivatives exchanges and trading behaviour on those exchanges. It also provides general prohibitions on misleading and deceptive conduct in financial markets. New Zealand Government Securities are "securities" for the purposes of the FMC Act.

Economic and Fiscal Performance

Economic Performance

The impact of COVID-19 on the New Zealand economy has been less severe relative to the rest of the world and initial expectations. While the largest quarterly fall in GDP, in history, was recorded in June 2020 (-11%), the New Zealand economy has recovered rapidly to be 0.8% larger in the March 2021 quarter than in the December 2019 quarter (Chart 4). The Treasury forecasts real production GDP growth to be robust over the forecast period (2021/22 to 2024/25), averaging 4% per year.

New Zealand generally runs a current account deficit. This has narrowed from almost 8.0% of GDP during the mid-2000s, to most recently be 2.2% in the year to March 2021. Over the same period, New Zealand's net international investment liability has improved significantly, from over 80% of GDP, to under 50% of GDP currently.

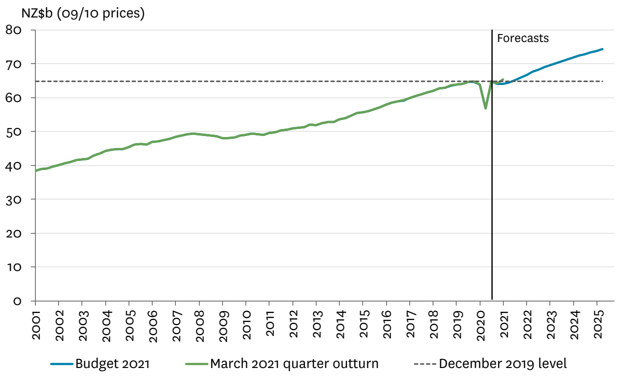
New Zealand has one of the highest labour participation rates in the OECD, at just over 70% of the working age population. New Zealand's unemployment rate in the March 2021 quarter was 4.7%, after briefly rising above 5% in the middle of 2020. The unemployment rate is expected to narrow over the forecast horizon, reaching around 4% by 2025.

Annual CPI inflation was 3.3% in the June 2021 quarter, increasing from 1.5% in the prior quarter, due to ongoing global supply chain disruptions, higher housing costs and as fuel prices rose to pre-COVID-19 levels. Annual headline CPI inflation was forecast to remain near the RBNZ's 2.0% target midpoint in the BEFU 2021 forecasts. In July 2021, the RBNZ announced they would halt their LSAP programme purchases by 23 July 2021, while the OCR has been on hold at 0.25% since March 2020.

7 Publication of the HYEFU is not required in the year if the PREFU is published between 1 October and 31 December.

Sunrise at Te Mata Peak, Napier, Hawkes Bay. Image used under license from iStock.com

Chart 4: New Zealand Quarterly Real Production GDP



Source: Stats NZ, the Treasury

Current Fiscal Strategy

The Government's fiscal strategy is formally communicated twice a year, typically alongside the BEFU and HYEFU. The Government sets out its short-term intentions and long-term objectives with respect to core parameters such as debt, operating expenses, operating revenue, the operating balance and net worth. The Fiscal Strategy Report is released alongside the BEFU, while the Budget Policy Statement is typically released alongside HYEFU.

Successive Governments have demonstrated a continued commitment to prudent fiscal strategy. Although, as a result of COVID-19, the short-term fiscal intentions have been updated to recognise the need for a period of fiscal expansion to support the economy. The Government's most recent Fiscal Strategy Report was published in May 2021.

The Government's current short-term debt intention is to allow net core Crown debt to increase in the short-term to fight COVID-19, cushion its impact and position New Zealand for recovery. The long-term fiscal objectives continue to focus on fiscal prudence, with the Government's debt objective being to stabilise net core Crown debt as a proportion of GDP by the mid-2020s and then reduce it as conditions permit.

Fiscal Performance

Prior to the onset of COVID-19, the Government had been maintaining an operating surplus and had reduced net core Crown debt to below 20% of GDP. To cushion the economy from the impact of COVID-19, there was an operating deficit of 7% in the 2019/20 fiscal year. Over the remainder of the forecast period, operating deficits are expected to average 3% per year.

Core Crown residual cash deficits are anticipated in each of the forecast years, with the exception of 2024/25, as both operating and capital spending exceeds revenues. The core Crown residual cash deficit peaks at 11% of GDP in 2021/22, in order to fund the recovery to COVID-19. Over the five year forecast period, a cumulative cash deficit of about NZ$90 billion is expected.

Consistent with the residual cash deficit forecasts, net core Crown debt to GDP is expected to increase notably. However, due to the low level immediately prior to the onset of COVID-19 (18.6% of GDP), it is still forecast to peak below 50% in 2022/23. In addition, Crown net worth as a percent of GDP is forecast to decrease from 44% in 2018/19 to 23% in 2024/25, reflecting the fiscal stimulus.

Table 1: Summary of the Treasury's Economic and Fiscal Forecasts[8]

	Actual			Forecast		
Year Ending 30 June	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Economic						
Real GDP (production basis, annual average % change)	-1.7	2.9	3.2	4.4	3.3	2.9
Unemployment rate (% of labour force, June quarter)	4.0	5.2	5.0	4.4	4.2	4.2
CPI inflation (annual % change, June quarter)	1.5	2.4	1.7	1.8	2.0	2.1
Current account balance (% of GDP)	-1.8	-2.7	-3.4	-3.5	-3.3	-3.1
Fiscal (% of GDP)						
Core Crown tax revenue	26.9	27.4	26.6	27.4	27.3	27.3
Core Crown expenses	34.4	33.1	32.8	31.1	30.0	29.2
Total Crown operating balance before gains and losses	-7.3	-4.5	-5.3	-2.6	-1.4	-0.6
Core Crown residual cash	-7.5	-7.6	-11.2	-6.9	-1.5	0.8
Net core Crown debt	26.3	34.0	43.8	48.0	46.9	43.6
Net worth attributable to the Crown	34.9	33.5	27.6	24.6	23.1	22.7

Source: The Treasury, in conjunction with BEFU, 20 May 2021

8 See: https://www.treasury.govt.nz/sites/default/files/2021-05/befu21.pdf

Summer view of Lake Wakatipu and the road from Queenstown to Glenorchy. Southern Alps mountains in the distance. Image used under license from iStock.com

Wellbeing and Sustainability

The New Zealand Government has clearly outlined wellbeing objectives to improve living standards of New Zealanders. The inaugural Wellbeing Budget was delivered in 2019 and, 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. The amendment also requires the Treasury to periodically report independently on that state of wellbeing in New Zealand. The wellbeing objectives are enduring and change little on an annual basis. The current objectives, as outlined in the 2021 Wellbeing Budget, are:

- Just Transition – supporting the transition to a climate-resilient, sustainable, low-emissions economy
- Future of Work – lift productivity and wages through innovation and support into employment those most affected by COVID-19
- Physical and Mental Wellbeing – supporting improved health outcomes
- Maori and Pacific – lifting incomes, skills and opportunities
- Child Wellbeing – reducing child poverty and improving child wellbeing

The New Zealand Climate Commission[9] recently released their final report on the steps New Zealand can take to meet the net zero carbon target and Paris Agreement commitments. The Commission's advice includes:

- The proposed first three emissions budgets for New Zealand (2022-2025, 2026-2030 and 2031-2035).
- 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.

In response to the report, the Government is required to publish an Emissions Reduction Plan before the end of the year, which will set out how the first three emissions budgets will be achieved. The Minister of Finance has also announced the Government's intention, from *Budget 2022* onwards, to hypothecate revenue generated from the Emissions Trading Scheme into emission reduction programmes.

In addition, New Zealand is amongst the highest rated sovereigns on sustainability and Environmental Social and Governance ratings. This includes a ranking of 23 out of 193 countries on the SDG (Sustainable Development Goals) Index.

Credit Ratings

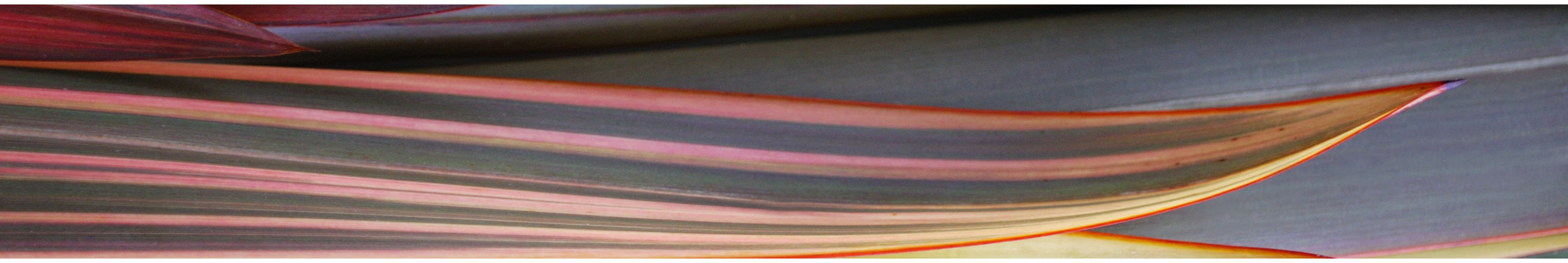
New Zealand's credit rating is within the top twenty sovereign ratings globally. S&P Global Ratings and Moody's Investors Service currently assign the highest long-term local currency rating for New Zealand, at AAA and Aaa respectively. S&P Global Ratings upgraded New Zealand's long-term credit ratings in February 2021, the first sovereign to be upgraded since the onset of COVID-19, while Moody's Investors Service have maintained the rating since October 2002. Similarly, Fitch Ratings rates New Zealand highly, with a long-term domestic currency credit rating of AA+.

Table 2: New Zealand Long-term Credit Ratings

Rating Agency	Local Currency	Foreign Currency	Latest Update
Moody's Investors Service	Aaa (stable outlook)	Aaa (stable outlook)	Apr-20
S&P Global Ratings	AAA (stable outlook)	AA+ (stable outlook)	Feb-21
Fitch Ratings	AA+ (stable outlook)	AA (positive outlook)	Jan-21

Source: Moody's Investors Service, S&P Global Ratings, Fitch Ratings

9 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.



Harakeke - New Zealand flax. Image used under license from iStock.com

New Zealand Government Securities Market

New Zealand Debt Management (NZDM) is a function within the New Zealand Treasury. Its primary responsibility is the efficient management of the Crown's debt and associated financial assets within an appropriate risk management framework. The maintenance of a well-functioning New Zealand Government Securities (NZGS) market is central to this remit.

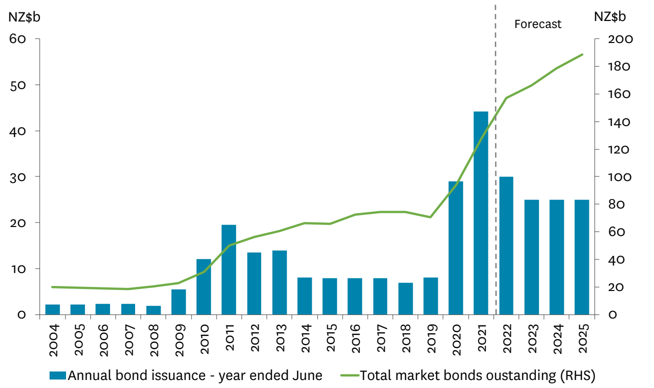
The New Zealand Crown has always paid, when due, the full amount of principal, interest and amortisation requirements upon its external and internal debt, including guaranteed debt.

New Zealand Government Securities

NZDM manages the issuance of NZGS, which include: nominal bonds, inflation-indexed bonds (IIBs), Treasury Bills (T-Bills) and European Commercial Paper (ECP) in the wholesale market. At 31 July 2021, there were NZ$130 billion New Zealand Government Bonds outstanding. In addition, there were NZ$8 billion of T-Bills and US$1 billion of ECP on issue.

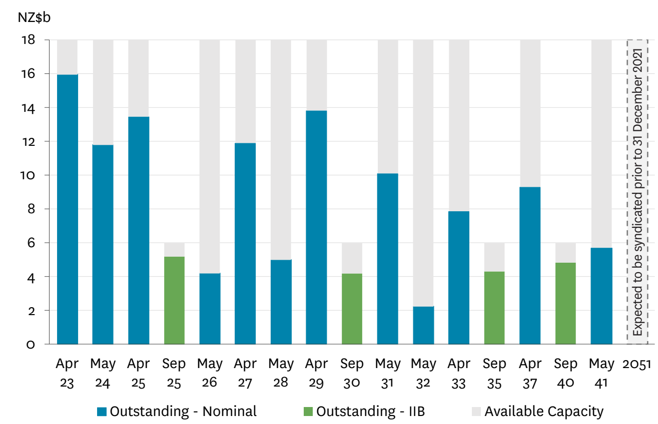
Over the five year forecast period, total market bonds outstanding are projected to increase to NZ$188 billion.

Chart 5: Total NZGBs and Projections



Source: The Treasury

Chart 6: Outstanding NZGBs and Capacity for Issuance – At 31 July 2021



Source: The Treasury

At 31 July 2021, the RBNZ had purchased NZ$54 billion of NZGBs, including IIBs, under their LSAP programme.

At 31 July 2021, there were twelve nominal bond and four IIB maturities on issue, as shown in Chart 6. Individual nominal bond lines are capped at a maximum of NZ$18 billion face value, while IIB maturities are capped at NZ$6 billion. Coupons on nominal bonds are paid on a semi-annual basis, in arrears. For IIBs, coupons are paid quarterly, in arrears.

Primary Issuance

Primary issuance of NZGBs and T-Bills is undertaken by NZDM through competitive tenders and/or syndications.

The BEFU and HYEFU announcements contain forecasts for annual bond issuance, bond maturities and repurchases, and the level of T-Bills on issue at 30 June. The most recent update, at the time of publication, was published alongside BEFU on 20 May 2021 and is shown in Table 3.

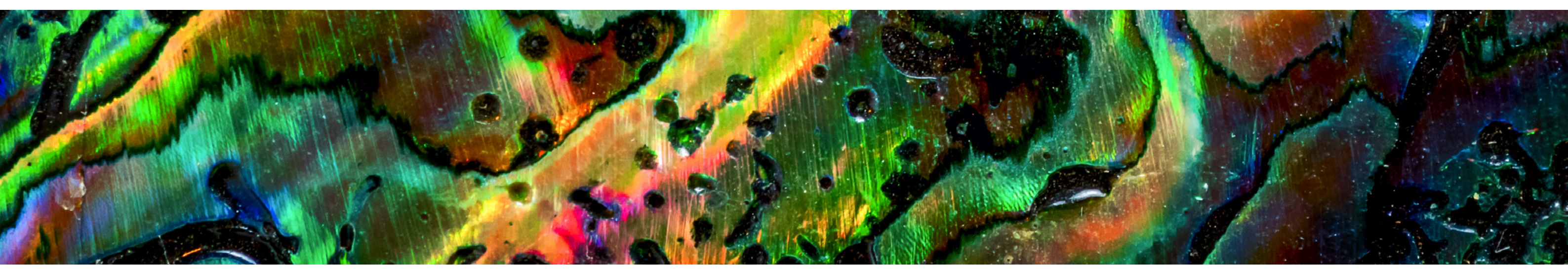
Ahead of each month, a regular NZGB issuance schedule is announced, including the full details of tender dates, bond maturities, and volumes for the entire month. The announcement occurs at 8am (NZT) on the day prior to the last tender of the preceding month.

NZGB tenders are typically held on Thursdays. Only Registered Tender Counterparties (RTC) may take part in tenders, however, interested parties may offer their bids through a RTC. Bids must be submitted by 2pm on the day of tender. The minimum denomination is NZ$1 million (principal) and in multiples of NZ$1 million thereafter.

T-Bills are also issued via tenders which occur weekly on Tuesdays, when bids need to be submitted by 2pm. Typically 3 month, 6 month and 12 month maturities are offered. The volume and maturities on offer may vary and are announced the day prior to tender.

Historically, one to two syndications were undertaken annually and were confined to launching new bonds. However, in the 2020/21 fiscal year, four syndications of new bond lines were undertaken along with one tap syndication of an existing bond line. Alongside BEFU 2021, two new bond syndications for the 2021/22 fiscal year were announced, with the first – a 2051 nominal bond – expected to be launched prior to 31 December 2021. Historically, syndication volumes were around NZ$1.5 to 2.0 billion but, in the 2020/21 fiscal year, volumes ranged from NZ$2.25 billion to NZ$4.5 billion. Volumes of future syndications will depend on annual NZGB programmes, the specific bond line being issued, and investor demand.

For more information see the New Zealand Government Securities Funding Strategy publication.



Paua, New Zealand. Image used under license from iStock.com

Table 3: Forecast – New Zealand Government Bonds and Treasury Bills

Year Ending 30 June	Actual 2021	Forecast 2022	2023	2024	2025	Total
Economic						
Gross NZGB issuance (NZ$ billion)	44	30	25	25	25	149
NZGB maturities and repurchases (NZ$ billion)	11	0	16	13	15	55
Net NZGB issuance (NZ$ billion)	33	30	9	12	10	94
Outstanding NZGBs (NZ$ billion)	127	157	166	178	188	n/a
Outstanding NZGBs (percent of GDP)	38%	45%	45%	46%	46%	n/a
T-Bills on issue* (NZ$ billion)	8	5	4	4	4	n/a

Source: The Treasury, in conjunction with BEFU, 20 May 2021, adjusted for 2021 actual

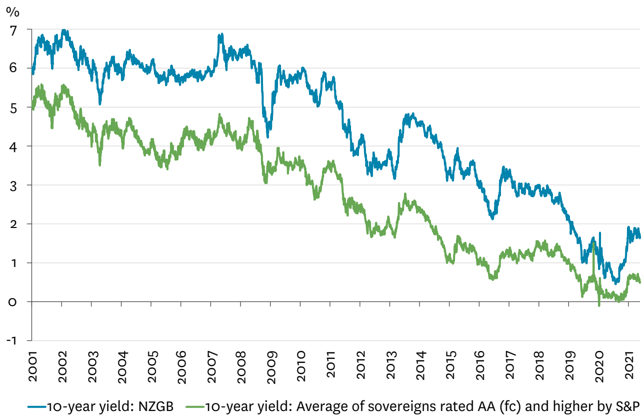
* The forecasts show current expectations of how short-term cash liquidity needs will be met at fiscal year-end. However, the actual issuance of T-Bills, may vary from forecast, based on actual short-term cash needs and an assessment of relative costs.

Secondary Market

The secondary market is supported by major local banks and global intermediaries. There is a repurchase market for NZGBs and the RBNZ also offers a bond lending facility as a lender of last resort.

NZGB yields have historically traded above global developed market peers. Chart 7 shows generic 10-year NZGBs yields relative to sovereign peers with similar credit ratings. Since 2001, generic 10-year NZGBs have traded between -70bps and 320bps over their US equivalents. Over the same period, NZGBs have traded between -40bps and 110bps over Australian equivalents.

Chart 7: NZGB Yield Relative to Peers with Similar Credit Ratings[10]



Source: Bloomberg

In terms of absolute levels, NZGB yields have been on a declining trend in recent decades, in line with the global disinflationary trend. Specifically in New Zealand, the RBNZ Act of 1989 entrenched an inflation-targeting mandate. This has contributed to structurally lower yields as inflation expectations have declined. However, more recently, market expectations of higher inflation and increases in the OCR, have contributed to a rise in NZGB yields.

Considerations for Non-Residents

For non-resident investors, NZGBs are effectively free from withholding tax. While NZGBs are subject to an Approved Issuer Levy like other New Zealand bond issues, the Crown will pay this tax on behalf of non-resident investors.

At 30 June 2021, 51% of NZGBs were held by non-resident investors. Over the past 15 years this percentage has ranged between just under 50% and 80%. Participants in the market are diverse by type and by regional location. Nominal NZGBs and IIBs are currently constituents of a number of global benchmark bond indices.

NZGS are primarily issued only in NZD. However, a small amount of foreign currency ECP is on issue and documentation for European Medium Term Note is maintained to enable longer-dated issuance in foreign currencies.

Investor Communications

NZDM maintains regular communication with investors via a variety of channels and welcomes enquiries.

To receive communications via email (including the monthly Investor Update) please contact: debtmanagement@treasury.govt.nz

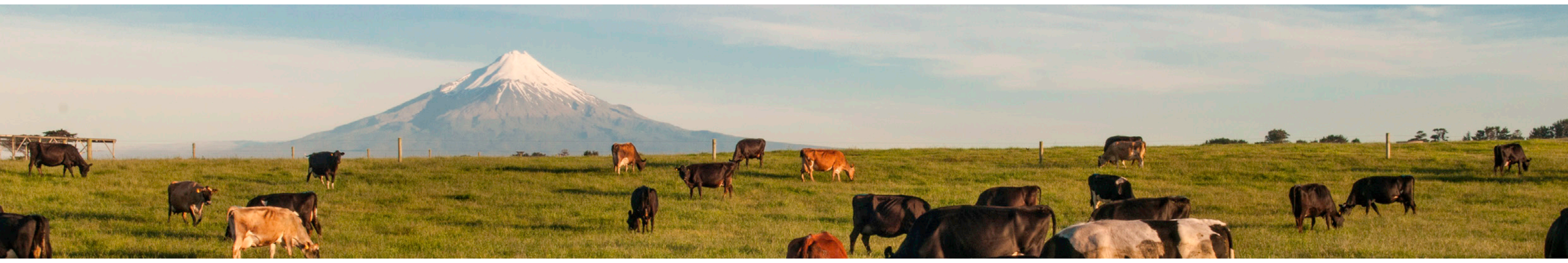
For further information on New Zealand Government Securities see: debtmanagement.treasury.govt.nz

For detailed current economic information see: treasury.govt.nz

For further information on the RBNZ see: rbnz.govt.nz

For further information on the New Zealand Government's Wellbeing Budget policies see: budget.govt.nz

10 Of those sovereigns rated AA or higher by S&P, Liechensteim, Luxembourg and United Arab Emirates are not included in the chart.



Cows grazing at the foot of Mount Taranaki. Image used under license from iStock.com

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