

# Government Borrowing

— THE BASICS —

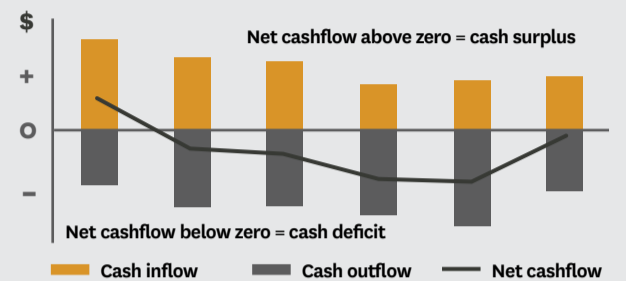
## Why does the Government borrow money?

As the Government's lead advisor on economic and fiscal policy, the Treasury provides forecast updates on how much the Government will earn and spend over the coming years. These updates usually happens twice a year, at Budget in May and again in December. The forecasts estimate how much revenue the Government will earn, compared to what it will spend. This includes the things Government pays for such as roads, hospitals and schools. It also includes the cost of current borrowing and the interest payments on outstanding debt.

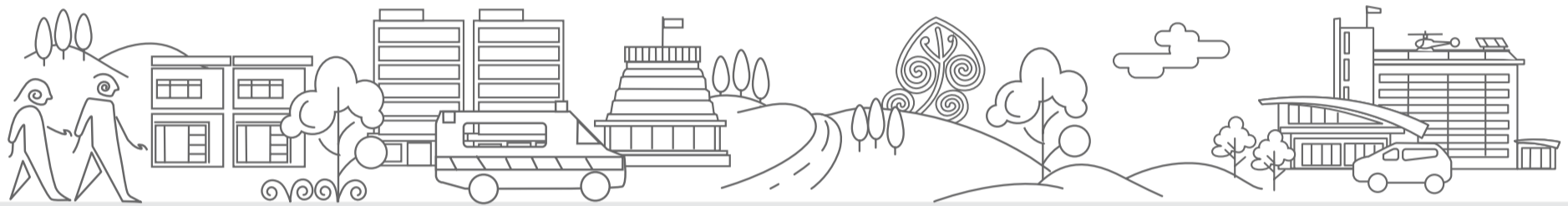
**Cash inflow** is money received from things such as tax revenue, levies, fees and investments. **Cash outflows** are the things Government has to pay for. If cash inflows are higher than cash outflows, the Government has a **cash surplus**. However, if cash inflows are lower than cash outflows, this creates a **cash deficit**.

A cash deficit generally means the Government needs to borrow money in order to continue to pay for the things they usually provide to the public.

### Government cashflow



This chart is a stylised illustration showing how cash inflows and cash outflows can change over a period of time, and how net cashflow changes in response to those fluctuations.



## How does the Government borrow?

Borrowing is done by selling **New Zealand Government Securities (NZGS)** (which includes **Bonds** and **Bills**). The majority of securities sold are in the form of **Government Bonds**. Once the Government knows how much it needs to borrow, the Treasury creates a borrowing programme which sets out how much will be borrowed over the coming year. The Treasury then make **New Zealand Government Securities (NZGS)** such as **Bonds** and **Bills**, available for investors to buy.

### How are securities sold?

Bonds and Bills are sold on a weekly basis through a **30-minute online auction** called a **tender**, where approved investors bid to buy the securities on offer. Details of the tender are communicated in advance, and interested investors participate in the auction. Investor's bids are made in multiples of \$1 million.

### What are Bonds and Bills?

These are like a written IOU. They are a legal contract between the Government and an investor. The Bond or Bill is sold at an agreed price and date for when it will be repaid. This date is called the **maturity** date. Bond holders also receive a payment twice a year called a **coupon**, which is like interest paid on a bank term deposit.



### Who buys New Zealand Government Securities?

Only approved investors, known as **Primary Market** participants can bid in the tender to buy NZGS. These investors are usually large banks. Primary Market investors will often on-sell securities to other investors, who are referred to collectively as the **Secondary Market**.

In the Secondary Market, NZGS are bought by a range of investors including, fund managers, insurance companies, Central Banks, and pension companies. They purchase NZGS because they are relatively low risk compared to other types of investment.

Approximately half of all NZGS are held by New Zealand investors with the remainder held by investors who live off-shore.



## How is Government borrowing repaid?

Because NZGS are sold with a specific maturity or due date, that date is when the borrowing must be repaid. Before a security matures, funds are built up in advance to ensure the Government can repay the investor on the due date.

If the Government has a cash surplus, it can be put towards repaying borrowings. Alternatively, additional securities can be issued which effectively extend or roll over the borrowing. Defaulting on a debt repayment is best avoided, as it can affect investor confidence and limit the ability to borrow money in the future.

### Credit Ratings

Credit ratings are given by international credit rating agencies and provide investors with an indication of a country's ability to repay debt.

New Zealand is among the world's highest-rated countries.

### Credit Rating Scale

