



THE TREASURY

Kaitohutohu Kaupapa Rawa

New Zealand Government Securities Overview

2018/19: Edition 1

New Zealand Government Securities

New Zealand Government Securities are issued by the Treasury on behalf of the New Zealand Crown¹. These securities provide investors with exposure to a diverse and robust economy, a strong fiscal and institutional framework, a sovereign credit rating in the top twenty globally, and a yield above many peers.

This overview provides investors with insights into New Zealand's:

- Economic Backdrop
- Institutional Framework
- Government Securities Market

It includes practical information on participating in the New Zealand Government Securities Market.

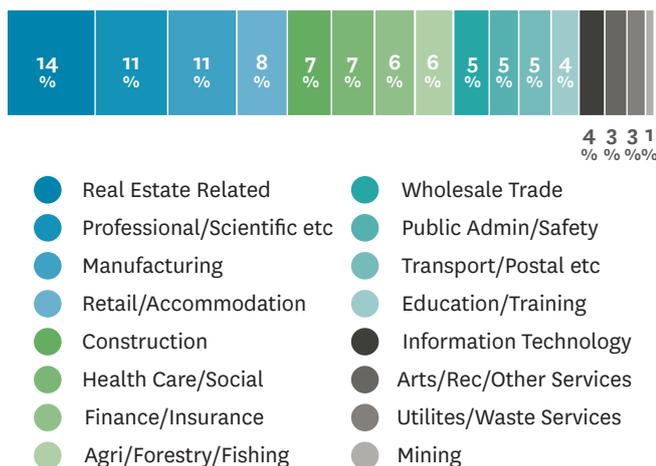
Economic Backdrop

New Zealand is a parliamentary democracy which operates on free market principles. It has a large services sector and a sizable manufacturing sector complementing an efficient export-oriented primary sector.

Its land size is similar to Japan or the UK, with a resident population of 4.9 million. The climate is temperate, supporting agriculture, forestry and horticulture. It has abundant natural resources and makes wide use of hydroelectric power generation.

External trade is of fundamental importance to New Zealand. Primary sector products, commodities, manufactured products and services are all important sources of export income. Tourism is a key services export as New Zealand is a popular destination for overseas visitors. Additional services exports include information technology, transport, education, and financial and business services. Raw materials, consumer goods and capital equipment for industry are important components of New Zealand's imports.

Chart 1: NZ GDP by Industry – Year Ended March 2018



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. The NZD is one of the top ten currencies traded on a global basis².

Economic Performance

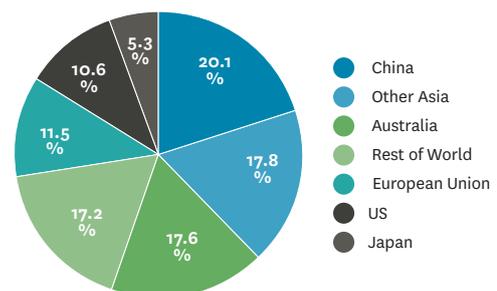
The New Zealand economy has been on a solid footing in recent years. Real Gross Domestic Product (GDP) growth has averaged 3.3% over the past five years. More recently, in the year ended 30 June 2018 (2017/18), the economy grew at an annual average rate of 2.7%. This was underpinned by low interest rates, population growth, (supported by strong migration inflows) investment and government consumption. GDP per capita grew 0.7% on an annual average basis. The economy is forecast to grow at an annual average rate of 2.7% over the forecast period (2018/19 to 2022/23) in real terms.

New Zealand generally runs a current account deficit. This has narrowed from around 8.0% of GDP during the mid-to-late 2000s to 3.3% in the year to 30 June 2018. Over the same period, New Zealand's net external liability position has improved from over 80% of GDP to under 55%.

New Zealand's unemployment rate in the September quarter 2018 was 3.9%, down from 4.7% at the same time in the previous year. Annual wage growth increased to 2.9% in September 2018, from a low of 1.3% in the year to December 2016. New Zealand has one of the highest labour participation rates in the OECD, measured at just over 71% by Statistics New Zealand in the September quarter 2018. The unemployment rate is forecast to remain close to 4% throughout the forecast period.

Annual headline CPI inflation was 1.9% in the year to September 2018, boosted by higher petrol prices. Excluding petrol, annual inflation was 1.2%. Monetary policy continues to remain accommodative. Annual headline CPI inflation is forecast to remain around 2.0% over the forecast period.

Chart 2: NZ Total Exports - Destination - Year Ended June 2018



Source: Stats NZ

¹ Securities are issued in the name of "Her Majesty the Queen in right of New Zealand"

² Bank for International Settlements, Triennial Survey, April 2016, percentage shares of average daily turnover.

Institutional Framework

New Zealand is globally recognised for its robust institutional framework. It ranks highly in all of the World Bank's Governance indicators, illustrating its institutional strength, as shown in Chart 3.

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 British Crown and the indigenous Māori people.

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, and there is no single document that can be termed the New Zealand constitution. The Constitution Act 1986, however, updated, clarified and brought together 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.

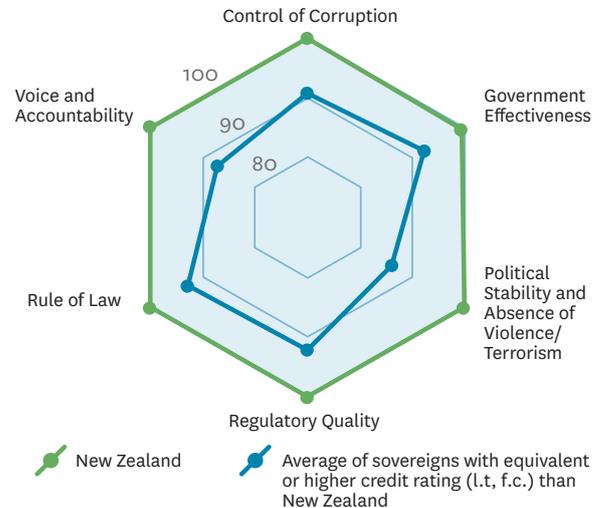
Legislative power is vested in Parliament, a single chambered body designated the House of Representatives. Members are elected for three-year terms through general elections. It currently has 120 members. Eligible residents over 18 years of age may vote in general elections.

The executive government of New Zealand is carried out by the Executive Council. This is 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.

As a result of a referendum held in conjunction with the 1993 election, New Zealand changed from a "First Past the Post" (FPP) system of electing Members of Parliament to a "Mixed Member Proportional" (MMP) system of proportional representation. Under MMP, the total number of seats each party has in Parliament is proportional to that party's share of the total list vote. This change was put in place for the 1996 election.

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.

Chart 3: Percentile Ranking on Key Governance Indicators



Source: World Bank Worldwide Governance Indicators-2017

Monetary Policy Framework

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

Under the Act, monetary policy is directed towards maintaining stability in the general level of prices. The Governor of the RBNZ and the Minister of Finance sign a Policy Targets Agreement (PTA). It sets out the operational objectives for monetary policy which must be consistent with maintaining stability in the general level of prices.

Under the current PTA, signed in March 2018, the policy target is to keep future annual CPI inflation between 1 and 3% over the medium-term, with a focus on keeping future inflation near the 2% mid-point. However, the RBNZ will implement a flexible inflation targeting regime. In particular, the Bank is required to seek to avoid unnecessary instability in output, employment, interest rates and the exchange rate in the pursuit of the price stability target. It must also have regard to the soundness and efficiency of the financial system.

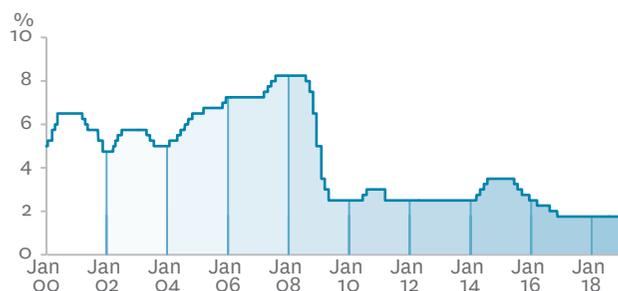
The Government has recently amended the monetary policy framework to include ‘supporting maximum sustainable employment’ as an economic objective alongside price stability; and moving to international best practice by introducing a committee decision-making model for monetary policy, the Monetary Policy Committee.

The legislation that implements these changes will come into force on 1 April 2019. At that point the current PTA will be replaced by a remit for the Monetary Policy Committee, issued by the Minister of Finance.

The RBNZ maintains the ability to intervene in the foreign-exchange market to influence the level of the exchange rate for monetary policy purposes. Such intervention may occur when the exchange rate is deemed exceptional and unjustified by economic fundamentals and when doing so is consistent with its operational objectives.

The Government is currently undertaking a Review that considers the RBNZ’s responsibilities in promoting the maintenance of a sound and efficient financial system. This includes the implementation of prudential policies, such as capital and liquidity standards, macro-prudential policy and undertaking supervision of banks. Renewed legislation is expected to be introduced in mid-2020.

Chart 4: NZ Official Cash Rate



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. 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. The forecasts extend for four years beyond the current fiscal year i.e. “the forecast period”.

Without parliamentary authority, the Government has no authorisation to incur expenses and capital expenditure and spend public money. 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.

Fiscal Strategy

The Government formally communicates its fiscal strategy twice a year, typically alongside the Budget 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 Budget. The Budget Policy Statement is generally released alongside HYEFU.

The Government’s most recent Budget Policy Statement was published in December 2018 and reaffirms the Government’s commitment to operating with five Budget Responsibility Rules underpinning its fiscal strategy.

These are to:

- Deliver a sustainable operating surplus across an economic cycle.
- Reduce the level of net Core Crown debt to 20% of GDP within five years of taking office (the current Government took office in October 2017).
- Prioritise investments to address the long-term financial and sustainability challenges facing New Zealand.
- Take a prudent approach to ensure expenditure is phased, controlled and directed to maximise its benefits. The Government will maintain its expenditure to within the recent historical range of spending to GDP ratio.



- Ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy.

In addition, the Government recognises the importance of maintaining a sustainable New Zealand Government Bond (NZGB) market. The Fiscal Strategy Report, May 2018, restated the Government’s commitment to maintain levels of NZGBs on issue at not less than 20% of GDP over time, even if net Core Crown debt were to fall below 20% of GDP.

Fiscal Performance

In the year ended 30 June 2015 (2014/15) the Government achieved an operating surplus for the first time since the global financial crisis. In 2017/18 the operating balance before gains and losses was a surplus of NZD 5.5 billion (1.9% of GDP). Operating surpluses are forecast to be sustained across the forecast period, reaching 2.3% of GDP in 2022/23.

Core Crown expenditure, as a proportion of GDP, was 28.0% in 2017/18 and is forecast to peak in 2018/19, at 29.5%, before gradually declining to 28.3% in 2022/23.

A Core Crown residual cash surplus sustained in 2017/18. In the current and subsequent two fiscal years, forecast capital spending is expected to lead to Core Crown residual cash deficits. In 2021/22 a surplus is forecast to be restored.

Net Core Crown debt was 20% of GDP in 2017/18. This ratio is forecast to remain fairly steady, before declining to 17.4% in 2022/23.

Securities Law

The Financial Markets Authority Act 2011 establishes 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 2013 (FMC) Act.

The FMC Act 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.

Table 1: Summary of the Treasury’s Economic and Fiscal Forecasts

Year Ending 30 June	Actual	Forecast				
	2018	2019	2020	2021	2022	2023
Economic						
Real GDP (production basis, annual average % change)	2.7	2.9	3.1	2.7	2.5	2.3
Real GDP per capita (production basis, annual average % change)	0.7	1.1	1.5	1.4	1.2	1.2
Unemployment rate (June quarter %)	4.4	4.1	3.9	4.0	4.1	4.1
CPI inflation (annual % change, June quarter)	1.5	2.0	1.8	2.0	2.0	2.0
Current account balance (% of GDP)	-3.4	-3.5	-3.6	-3.6	-3.6	-3.7
Fiscal (% of GDP)						
Core Crown tax revenue	27.9	28.1	28.2	28.5	28.8	28.9
Core Crown expenses	28.0	29.5	28.7	28.8	28.4	28.3
Total Crown operating balance before gains and losses	1.9	0.6	1.3	1.5	2.2	2.3
Core Crown residual cash	0.5	-1.7	-0.8	-0.3	0.3	0.8
Net Core Crown debt	20.0	20.9	20.7	20.1	19.0	17.4
Net worth attributable to the Crown	45.1	44.5	44.5	45.0	46.3	48.0

Source: The Treasury, Half Year Economic and Fiscal Update 2018

New Zealand Government Securities Market

New Zealand Debt Management is one of the functions of the New Zealand Treasury. The 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 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.

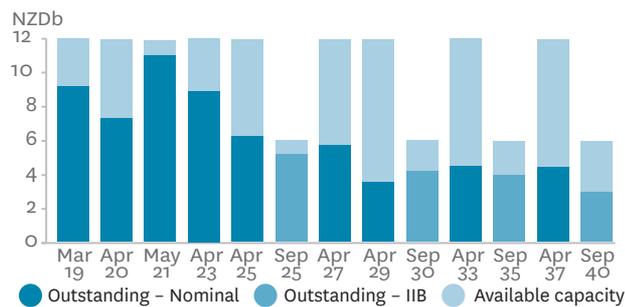
New Zealand Government Securities

New Zealand Debt Management manages the issuance of nominal bonds, inflation-indexed bonds (IIBs) and Treasury Bills (T-Bills) in the wholesale market. At 30 November 2018 there were NZD 80.5 billion of bonds on issue. Of these, NZD 77.2 billion were market bonds that may be freely traded in the secondary market. In addition, there were NZD 3.8 billion of T-Bills on issue.

Over the forecast period, total outstanding market bonds are projected to remain above NZD 70 billion. The Government's recent commitment to maintain NZGBs on issue at not less than 20% of GDP over time ensures long-term durability of the NZGB market, even if net Core Crown debt were to fall below 20% of GDP.

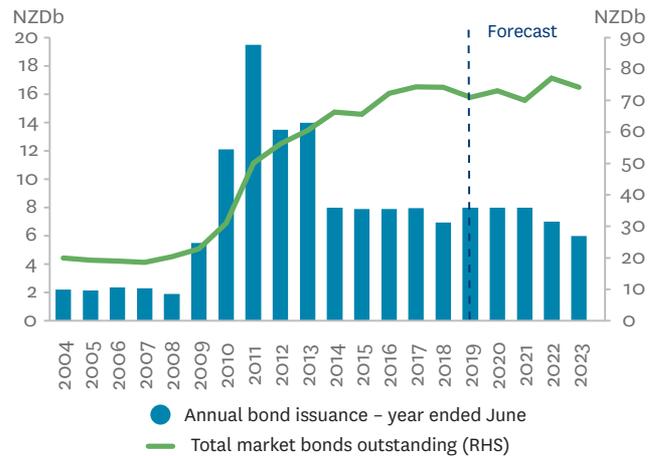
At 30 November 2018 there were nine nominal bond and four IIB maturities on issue, as shown in Chart 5. Individual nominal bond maturities are capped at NZD 12 billion outstanding, while IIB maturities are capped at NZD 6 billion. Coupons on nominal bonds are paid on a semi-annual basis, in arrears. For IIBs, coupons are paid quarterly.

Chart 5: Outstanding NZGBs and Capacity for Issuance – At 30 November 2018



Source: The Treasury

Chart 6: NZGB Issuance and Outstanding



Source: The Treasury

Credit Ratings

New Zealand's credit rating is within the top twenty sovereign ratings globally. Rating agencies Standard & Poor's and Fitch currently maintain an AA long-term foreign currency rating for NZGBs. Moody's has maintained an Aaa long-term foreign currency rating on the bonds since October 2002.

Table 2: NZGB Long-term Credit Ratings

Rating Agency	Local Currency	Foreign Currency	Latest Update
Moody's Investor Service	Aaa (stable outlook)	Aaa (stable outlook)	Sep-18
Standard & Poor's	AA+ (stable outlook)	AA (stable outlook)	Jan-18
Fitch Ratings	AA+ (stable outlook)	AA (stable outlook)	Feb-18

Source: Moody's Investor Service, Standard and Poor's, Fitch Ratings



Primary Issuance

Primary issuance of New Zealand Government Securities is undertaken through competitive tenders and/or syndications.

BEFU and HYEFU documentation contains a breakdown of the Core Crown funding need and annual bond issuance forecasts. The most recent update, published alongside HYEFU on 13 December 2018, is shown in Table 3.

Ahead of each quarter, a regular bond issuance schedule is announced, including the full details of tender dates, maturities, and volumes. This will generally occur at the time of the confirmation announcement for the last tender of the preceding quarter.

NZGB tenders are typically held on Thursdays. Only registered tender counterparties may take part in tenders. Interested parties may offer their bids through a registered tender counterparty. Bids must be submitted by 2pm on the day of tender. The minimum denomination is NZD 1 million (principal) and in multiples of NZD 1 million thereafter.

T-Bills are also issued via tender. These occur fortnightly, 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.

Syndication has historically been confined to launching a new bond. This method enables the placement of a large volume into the market, promoting liquidity in the new bond from initiation. Recent syndication volumes have been between NZD 1.5-2.0 billion.

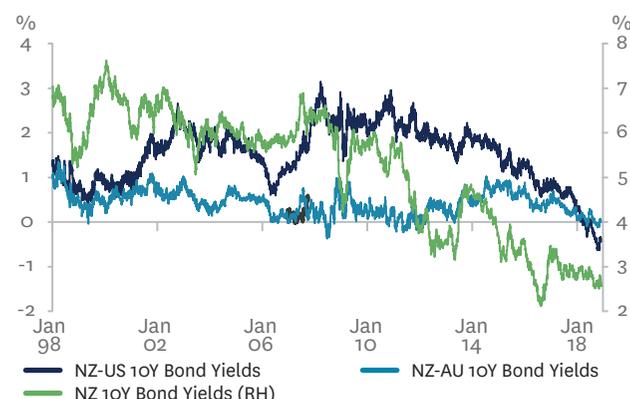
Secondary Market

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

NZGB yields have generally traded some way above global developed market peers. Over the past two decades generic 10-year NZGBs have traded between -70bps and 300bps relative to US equivalents. Over the same period they have traded between -40bps and 140bps relative to Australian equivalents.

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.

Chart 7: NZGB Yields Relative to Peers*



Source: Bloomberg, * Generic bond spreads

Table 3: Forecasts - New Zealand Government Bonds and Treasury Bills

Year Ending 30 June (face value)	2019	2020	2021	2022	2023	Total
Gross NZGB issuance (NZD billion)	8.0	8.0	8.0	7.0	6.0	37.0
NZGB maturities and repurchases (NZD billion)	11.2	5.8	11.1	0.0	8.9	37.0
Net NZGB issuance (NZD billion)	-3.2	2.2	-3.1	7.0	-2.9	0.0
NZGBs on issue (NZD billion)	71.0	73.2	70.1	77.1	74.2	n/a
NZGBs on issue (% of GDP)	23.5%	23.0%	20.9%	22.0%	20.2%	n/a
Forecast T-Bills on issue (NZD billion)	2	2	4	2	2	n/a

Source: The Treasury, in conjunction with HYEFU, 13 December 2018



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 November 2018, 56.2% of NZGBs were held by non-resident investors. Over the past fifteen years this percentage has ranged between 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.

New Zealand Government Securities are currently issued only in New Zealand dollars. However, documentation is maintained to enable issuance in alternative currencies.

Investor Communications

Regular communication with investors is maintained via a variety of channels. Enquiries are welcomed.

To receive communications via email please contact: debtmanagement@treasury.govt.nz

For further information on New Zealand Government Securities see: <https://debtmanagement.treasury.govt.nz/>

For detailed current economic information see: <http://www.treasury.govt.nz>

For further information on the RBNZ see: <http://www.rbnz.govt.nz>

Contacts:

Kim Martin
Head of Funding Strategy and Engagement

✉ debtmanagement@treasury.govt.nz
☎ +64 4 890 7274

Andrew Hagan
Acting Director, Capital Markets

✉ debtmanagement@treasury.govt.nz
☎ +64 4 917 6937

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

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ISBN

978-1-98-855695-6 (online)

978-1-98-855696-3 (print)

The URL for this publication on the New Zealand Debt Management website at December 2018 is

<https://debtmanagement.treasury.govt.nz/investor-resources/economic-overview>

