



THE TREASURY
Kaitohutohu Kaupapa Rawa

New Zealand Government Securities Overview

January 2018

The Treasury's New Zealand Debt Management Office (NZDMO)

The NZDMO manages the issuance of debt securities 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 fifteen 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.

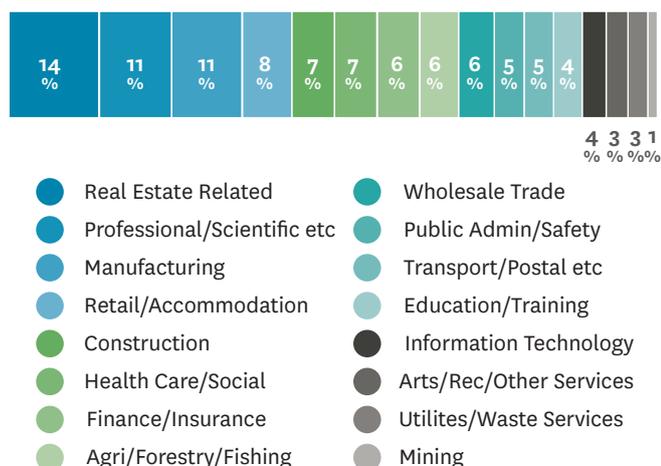
Economic Backdrop

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

Its land size is similar to Japan or the UK, with a resident population of 4.8 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 exports and commodities are significant sources of the country's export receipts. Exports of services and manufactured products also make a notable contribution. Tourism is a key services export, as New Zealand is a popular destination for overseas visitors. Other 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 2017



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

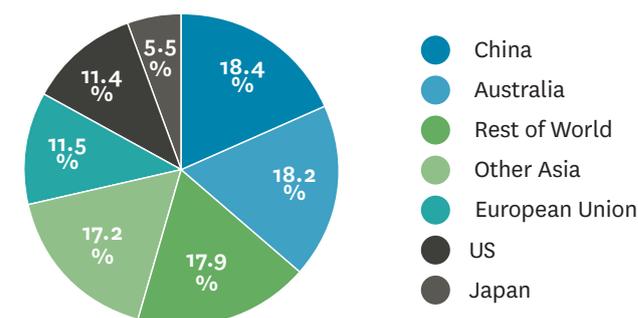
The New Zealand economy made a solid recovery from the 2008/09 recession, which was shallow compared to those in many other advanced economies. More recently, over the year to September 2017, the economy grew at an annual average rate of 3.0% in real terms. This was underpinned by low interest rates, population growth, (supported by strong migration inflows) investment and private consumption. Gross Domestic Product (GDP) per capita grew 0.8% on an annual average basis.

New Zealand generally runs a current account deficit. This has narrowed from around 8.0% of GDP during the mid-to-late 2000s to below 3.0% in recent quarters. Over the same period, New Zealand's net external liability position has improved from over 80% of GDP to under 60%.

New Zealand's unemployment rate in the September quarter 2017 was 4.6%. Some spare capacity remains in the labour market, as indicated by contained wage growth. However, New Zealand has one of the highest labour participation rates in the OECD, measured at 71% by Statistics New Zealand in the September quarter 2017.

Annual headline CPI inflation was above 2.0% in the March quarter 2017 for the first time since 2011, driven by food and oil price movements. Subsequent quarterly releases have dipped back slightly below 2.0%. However, inflation excluding food and fuel prices remains subdued, indicating limited underlying inflationary pressures. Monetary policy continues to remain accommodative.

Chart 2: Total Exports – Destination – Year Ended June 2017



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.

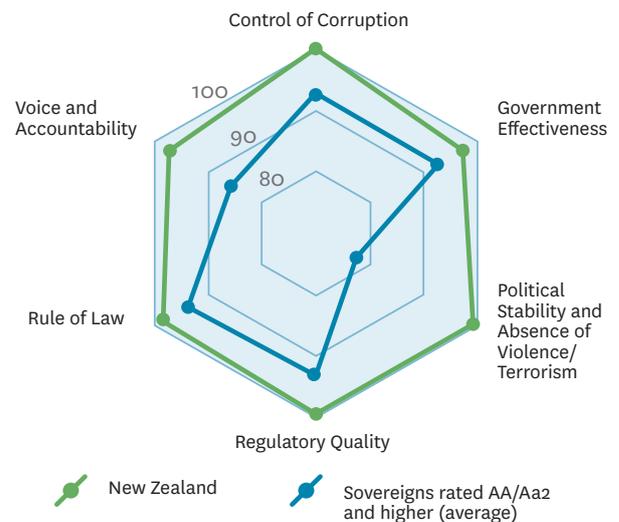
Legislative power is vested in Parliament, a single chambered body designated the House of Representatives. Members are elected for three-year terms through general elections. It currently has 120 members. Eligible residents over 18 years of age may vote in general elections.

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 his/her 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: Stable Institutional Backdrop



Source: World Bank Worldwide Governance Indicators-2016

Monetary Policy Framework

The Reserve Bank of New Zealand (RBNZ) was established as Central Bank in 1934. The Reserve Bank of New Zealand Act 1989³ cemented its independence. It is responsible for monetary policy and financial stability.

The focus of monetary policy is to maintain price stability. The Governor of the RBNZ and the Minister of Finance sign a Policy Targets Agreement (PTA) which sets out the specific targets for maintaining price stability, while seeking to avoid unnecessary instability in output, interest rates and the exchange rate.

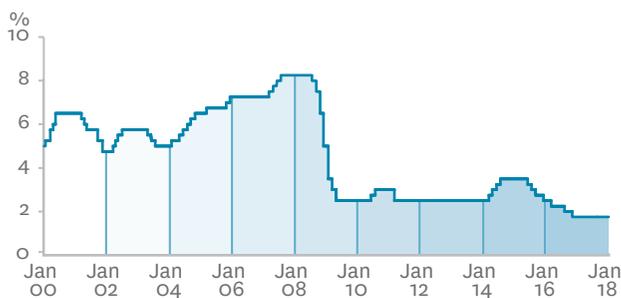
3 In November 2017 the Government announced it will undertake a review of the Reserve Bank of New Zealand Act 1989.

The PTA signed in November 2017 requires the RBNZ to maintain inflation in the range of 1 percent to 3 percent on average over the medium term. More specifically there is a “focus on keeping future average inflation near the 2 percent target midpoint”.

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 the PTA.

The RBNZ is also responsible for promoting the maintenance of a sound and efficient financial system. In May 2013, a Memorandum of Understanding was signed that defined macro-prudential policy and its operating guidelines. Its objective is to increase the resilience of the domestic financial system and counter instability arising from credit, asset price or liquidity shocks.

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 and current Governments have 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 nationwide elections, which occur at least every three years. 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 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 2017 and highlights 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 NZGB (New Zealand Government Bond) market. The Budget Policy Statement includes a commitment to maintain levels of NZGBs on issue at not less than 20 percent of GDP over time even if net core Crown debt were to fall below 20 percent 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 2016/17 the operating balance before gains and losses was a surplus of NZD 4.1 billion (1.5 percent of GDP). Surpluses are forecast to be sustained across the forecast period, reaching 2.5 percent of GDP in 2021/22.

Core Crown expenditure, as a percentage of GDP, was 28.0 percent in 2016/17 and is expected to remain close to this level over the forecast period.

A core Crown residual cash surplus was achieved in 2016/17. Over the next three years, forecast capital spending is expected to lead to residual cash deficits, before surpluses are restored later in the forecast period.

Net core Crown debt was 21.8 percent of GDP in 2016/17. This ratio is forecast to rise slightly to 22.2 percent in 2018/19 before falling to 19.3 percent in 2021/22.

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 (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.

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

Year Ending 30 June	Actual	Estimate	Forecast			
	2017	2018	2019	2020	2021	2022
Economic						
Real production GDP (annual average % change)	2.7	2.9	3.6	3.0	2.6	2.1
Real GDP per capita (annual average % change)	0.6	0.9	1.7	1.4	1.4	1.1
Unemployment rate (June quarter)	4.8	4.6	4.4	4.2	4.0	4.1
CPI inflation (annual % change, June quarter)	1.7	2.0	1.9	2.1	2.2	2.2
Current account balance (% of GDP)	(2.9)	(2.1)	(2.3)	(2.7)	(3.3)	(3.9)
Fiscal (% of GDP)						
Core Crown tax revenue	27.7	27.3	27.5	27.7	28.0	28.3
Core Crown expenses	28.0	28.5	28.6	28.2	28.0	27.6
Total Crown Operating balance before gains and losses	1.5	0.9	0.9	1.6	2.0	2.5
Core Crown residual cash	0.9	(0.9)	(1.5)	(0.8)	0.1	0.7
Net core Crown debt	21.8	21.7	22.2	21.9	20.8	19.3
Net worth attributable to the Crown	40.5	40.7	40.6	41.4	42.7	44.7

Source: Stats NZ, the Treasury

Finalisation dates for forecasts:

Economic – 23 November 2017, Fiscal – 27 November 2017



New Zealand Government Securities Market

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.

During 1988, as part of the reform of the Government's financial management, the New Zealand Debt Management Office (NZDMO) was formed as an operational unit of the Treasury. It is responsible for the efficient management of the Crown's debt and associated financial assets within an appropriate risk management framework. Its broader responsibilities include providing capital market advice and financial transaction services to other agencies of the Crown.

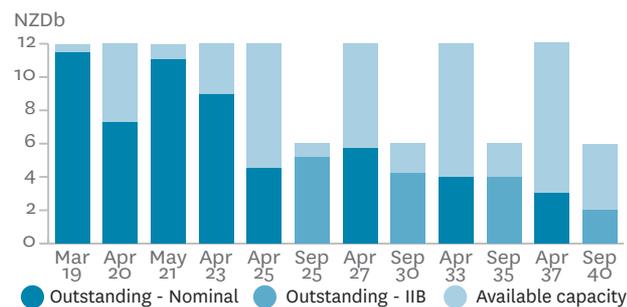
New Zealand Government Securities

The Treasury's NZDMO manages the issuance of nominal bonds, inflation-indexed bonds (IIBs) and Treasury bills in the wholesale market. At 31 December 2017 there were NZD74.4b of bonds on issue. Of these, NZD71.4b were market bonds that may be freely traded in the secondary market. In addition, there were NZD4.1b of Treasury bills on issue.

Over the forecast period, total outstanding bonds are projected to remain above NZD65b. 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.

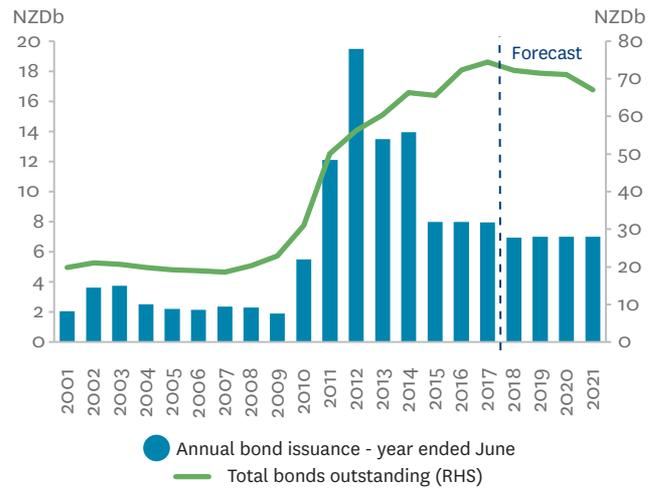
At 31 December 2017 there were eight nominal bond and four IIB maturities as shown in Chart 5. Individual nominal bond maturities are capped at NZD12b outstanding, while IIB maturities are capped at NZD6b. Coupons on nominal bonds are paid on a semi-annual basis, in arrears. For IIBs, coupons are paid quarterly.

Chart 5: Outstanding NZGBs and Capacity for Issuance



Source: The Treasury

Chart 6: Total NZGBs and Projections



Source: The Treasury

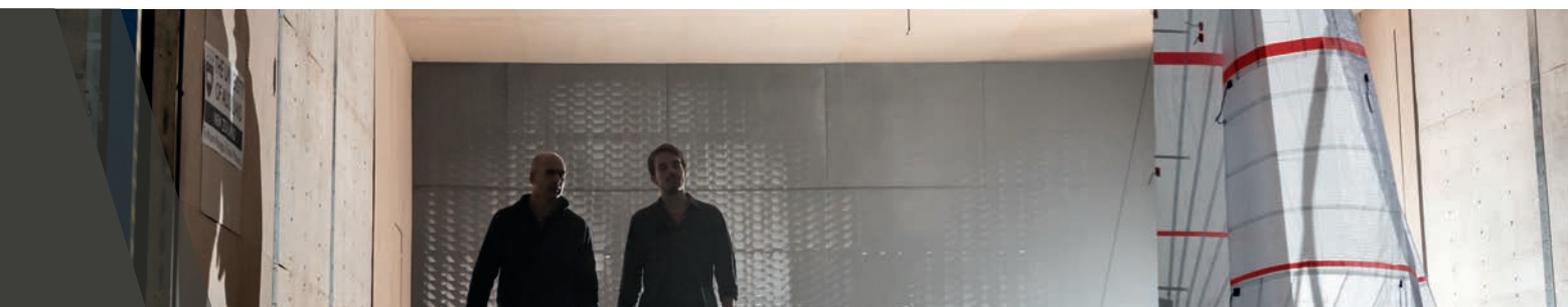
Credit Ratings

New Zealand's credit rating is within the top fifteen 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 Review Date
Moody's Investor Service	Aaa (stable outlook)	Aaa (stable outlook)	Oct-17
Standard & Poor's	AA+ (stable outlook)	AA (stable outlook)	Jan-18
Fitch Ratings	AA+ (stable outlook)	AA (stable outlook)	Feb-17

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



Primary Issuance

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

The BEFU and HYEPU announcements contain a breakdown of the Crown's funding needs and annual bond issuance forecasts. The most recent update, published alongside HYEPU in December 2017, is shown in Table 3.

Ahead of each quarter, the Treasury's NZDMO pre-announces a regular bond issuance schedule. Approximately two weeks prior to the end of the quarter (around the time of the last tender of that quarter) the NZD value, and maturity of bonds to be issued on specified dates in the subsequent quarter, are announced.

NZGB tenders are typically held on Thursdays. 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 NZD1m (principal) and in multiples of NZD1m thereafter.

Treasury 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 precise volume and maturities on offer 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 NZD1.5-2.0b.

Table 3: Forecast NZGB Issuance

Year Ending 30 June (face value) (NZDb)	2018	2019	2020	2021	2022	Total
Gross NZGB issuance	7.0	7.0	7.0	7.0	7.0	35.0
NZGB maturities and repurchases	9.1	7.9	7.3	11.1	0.0	35.3
Net NZGB issuance	-2.1	-0.9	-0.3	-4.1	7.0	-0.3
NZGBs on issue	72.3	71.4	71.2	67.1	74.1	n/a
NZGBs on issue (percent of GDP)	25.2%	23.7%	22.5%	20.2%	21.4%	n/a

⁴ This data captures turnover on the RBNZ's NZClear clearing and settlement system.

Trading History

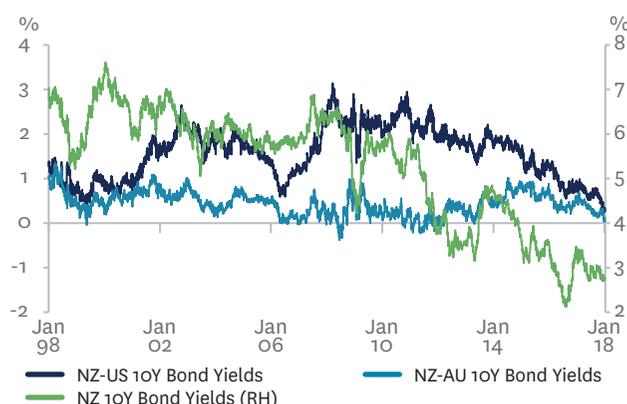
NZGB yields generally trade some way above their global developed market peers. Over the past two decades generic 10-year NZGBs have traded between 20bps and 300bps above their US equivalents. Over the same period they have traded between -40bps and 140bps over Australian equivalents.

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.

Secondary Market

The secondary market is supported by major local banks and global intermediaries. There is a repurchase market for NZGBs. The RBNZ publishes data showing weekly and monthly turnover of New Zealand Government Securities⁴.

Chart 7: NZGB Yields Relative to Peers*



Source: Bloomberg, * Generic bond spreads

Source: The Treasury, in conjunction with HYEPU, 14 December 2017



Considerations for Non-Residents

NZGBs are effectively free from withholding tax for non-resident investors. 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 2017, over 60 percent of NZGBs were held by non-resident investors. Over the past fifteen years this percentage has ranged between 50 percent and 80 percent. 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

The Treasury's NZDMO maintains regular contact with its investors via a variety of channels and welcomes enquiries.

To receive communications via email please contact: info@nzdmo.govt.nz

For further information on New Zealand Government Securities see: <https://www.nzdmo.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>

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ISBN

978-1-98-853442-8 (online)

978-1-98-853443-5 (print)

The URL for this publication on the NZDMO website at January 2018 is

<https://www.nzdmo.govt.nz/analyst-centre/economic-overview>

