TE TAI ŌHANGA
THE TREASURY

New Zealand Government Securities Funding Strategy

2019/20: Edition 2

New Zealand Government

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The Funding Strategy is published twice a year; at the start of the fiscal year, and following the release of the *Half Year Economic and Fiscal Update* (HYEFU).

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ISSN
2624-1056 (online)

The URL for this publication on the New Zealand Debt Management website at 30 January 2020 is
https://debtmanagement.treasury.govt.nz/investor-resources/nz-govt-securities-funding-strategy

TSY491 01/20

2019/20 Funding Strategy – at a glance

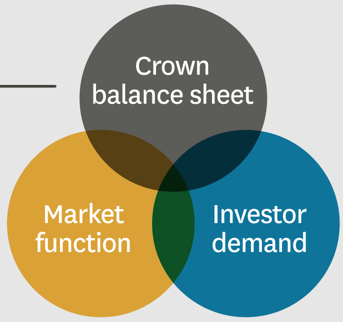
The Treasury's New Zealand Debt Management function has the objective of minimising the Crown's borrowing costs over the long-term with due consideration to risk, while ensuring ongoing access to debt funding markets.

Achieving a balance between the following three goals:

Overall structure considered

Enhanced

Captured and stimulated



Guiding principles underpinning the strategy

- Transparent
- Consistent
- Even-handed

2019/20 New Zealand Government Bond (NZGB) programme forecasts

Gross NZGB issuance

Product type

circa NZ$**0.5b**
Inflation-Index bonds

circa NZ$**9.5b**
Nominal bonds

Net NZGB issuance

NZ$**3.4b**

2019/20 Focus (updated)

- Tenders into new NZGB 2031 commenced
- Reduced Inflation-Indexed Bond issuance
- Primary Market Access Framework implemented
- Buyback programme for NZGB 2021
- Continued diversification of investor base

Government commitment to maintain NZGBs on issue at not less than 20 per cent of GDP over time.

Recent developments

Since the July 2019 edition of the *New Zealand Government Securities Funding Strategy*, the following developments have occurred:

- The December 2019 *Half Year Economic and Fiscal Update* (HYEFU) highlighted that the 2019/20 New Zealand Government Bond (NZGB) programme is unchanged at NZ$10 billion.
- The 2020/21 and 2021/22 forecast NZGB programmes are also unchanged, at NZ$10 billion and NZ$8 billion respectively, while the forecast bond programme for 2022/23 has been increased by NZ$2 billion, to NZ$8 billion.
- The 2023/24 year has been added to the forecast period, with a NZ$6 billion bond programme.
- Treasury Bills on issue at the end of 2019/20 are forecast to be NZ$3 billion. This forecast is unchanged from that published at the Budget Economic and Fiscal Update 2019.
- Inflation-indexed bond issuance is expected to be around NZ$0.5 billion of the NZ$10 billion 2019/20 bond programme.
- There are plans to commence a repurchase programme of the May 2021 nominal bond before 30 June 2020. Repurchase activities will be dependent on portfolio requirements and market conditions.
- The Treasury implemented a revised Primary Market Framework for New Zealand Government Securities.

Funding the Crown[1]

New Zealand Debt Management is a function of the Treasury responsible for managing the Crown's net cash flows and liquidity position.

The Treasury's forecasts at HYEFU 2019 show positive net operating cash flows from 2020/2021, following a minimal operating deficit in 2019/20. Over the forecast period, capital spending is expected to exceed net operating cash flows, resulting in a core Crown residual cash deficit until the final forecast year. Cash projections are taken into consideration when forecasting the total borrowing programme, along with liquidity requirements and the projected financial assets position.

New Zealand Government Bonds (NZGBs) constitute the greatest proportion of the core Crown's total borrowing programme. In 2019/20, gross issuance of NZGBs is forecast to be NZ$10 billion. When projected maturities and buybacks are taken into account, net issuance is expected to be NZ$3.4 billion. At the end of 2019/20, NZGBs on issue are forecast to be NZ$74 billion.

As is standard practice, funding requirements will be revisited ahead of the May *Budget Economic and Fiscal Update* (BEFU) 2020.

Total borrowing programme

Year ending 30 June (face value)	2019 Actual	2020 Forecast
Gross NZGB issuance (NZ$ billion)	8.0	10.0
NZGB maturities and buybacks (NZ$ billion)	11.7	6.6
Net NZGB issuance (NZ$ billion)	-3.7	3.4
NZGBs on issue (NZ$ billion)	70.6	74.0
NZGBs on issue (per cent of GDP)	23.3%	23.5%
T-Bills on issue (NZ$ billion)	3	3

Source: The Treasury

Funding strategy principles

The objective of the funding strategy is to minimize the Crown's borrowing costs over the long-term with due consideration to risk, while ensuring ongoing access to debt funding markets.

For the NZGB market, we believe this objective is achieved by taking a structured, long-term approach, rather than a short-term tactical approach, to funding activities. The aim is to reduce uncertainty or illiquidity premiums that are associated with NZGBs, through clearly communicating future actions in advance.

The strategy may change if the funding environment changes significantly, however, the core principles of transparency, consistency and even-handedness will remain unchanged.

The funding strategy is aimed at balancing three key goals; considering the overall structure of the Crown's balance sheet, capturing and stimulating investor demand, and promoting well-functioning and liquid New Zealand Government Securities (NZGS) markets.

Wholesale funding strategy 2019/20

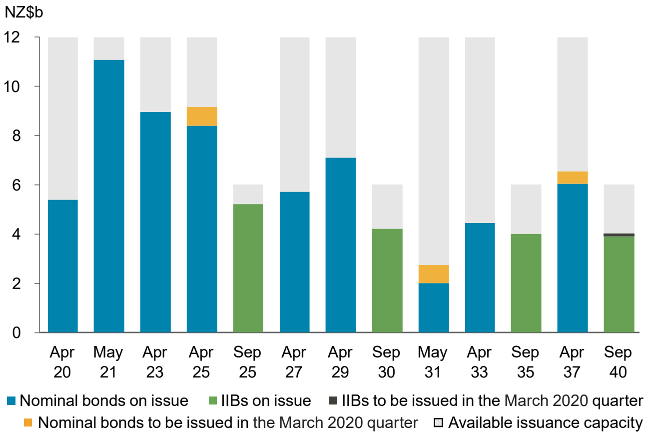
Funding instruments

Nominal Bonds remain the primary funding vehicle and will constitute around NZ$9.5 billion of the 2019/20 NZGB programme.

During the March 2020 quarter, three nominal NZGB maturities will be tendered. NZ$750 million is forecast to be tendered into each of the 15 May 2031 and 15 April 2025 NZGBs, while NZ$500 million is forecast for the 15 April 2037 NZGB. This profile is designed to provide liquidity at three distinct points on the NZGB curve and help build volume in key benchmark lines.

1 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".

NZGB portfolio and announced issuance in March 2020 quarter



Source: The Treasury

For the remainder of the fiscal year, tender volumes are expected to continue to range between NZ$100–NZ$250 million, with a single bond offered per tender.

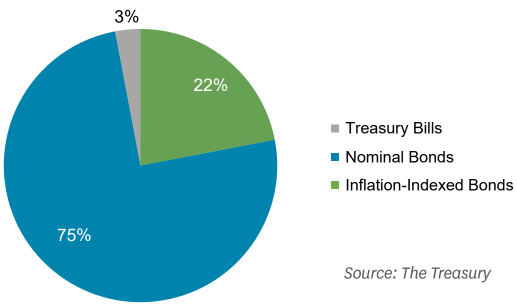
Individual nominal NZGB lines are capped at NZ$12 billion face value. This level balances the need to promote liquidity in each line, while managing the size of maturity cash flows and mitigating refinancing risk.

Inflation-Indexed Bonds (IIBs) remain an important part of the funding portfolio. IIBs enable a portion of interest expenses to be correlated with the economic cycle and thereby fiscal revenues. In addition, issuance of IIBs assists with diversifying the investor base. Individual IIB lines are capped at NZ$6 billion face value.

It is expected that there will be around NZ$0.5 billion of IIB issuance in 2019/20. During the March 2020 quarter, NZ$100 million of the 20 September 2040 IIB is forecast to be tendered.

IIBs constitute a sizable proportion of the total funding portfolio, at 22 per cent, relative to global peers. While a specific level is not targeted, the proportion has increased over recent years. The appropriate proportion of IIBs within the portfolio, and the appropriate rate of issuance, is assessed on an ongoing basis. While commitment to the IIB product remains constant, in 2019/20, issuance is forecast to be slightly lower than in recent years, reflecting market feedback and the relative cost of issuance.

Current New Zealand Government Securities portfolio



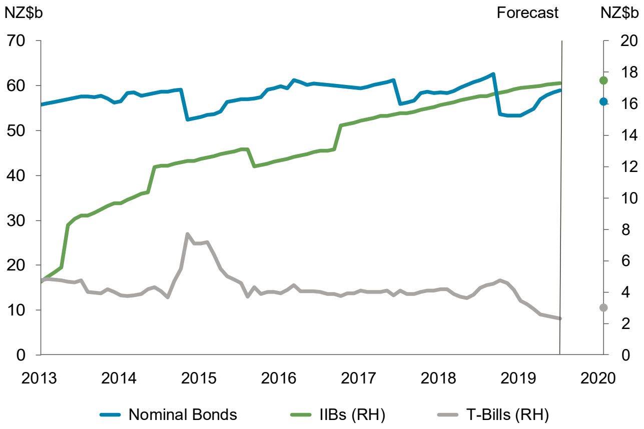
Source: The Treasury

Treasury Bills (T-Bills) provide flexibility to address short-term liquidity requirements. Requirements may arise as a result of upcoming bond maturities, or seasonal or unexpected changes in cash flows.

Although T-Bills on issue were at NZ$2.3 billion at the end of 31 December 2019, HYEFU forecasts show T-Bills on issue are expected to be at NZ$3 billion by 30 June 2020. This reflects forecast liquidity needs at the end of 2019/20. However, the actual volume of T-Bills on issue may vary from forecast, based on an assessment of the relative cost of T-Bill issuance versus alternative short-term funding mechanisms, as well as actual short-term cash needs.

There is value in being able to access short-term funding through the T-Bill market. Therefore, the intention is to maintain a minimum of NZ$2 billion of T-Bills on issue.

New Zealand Government Securities on issue



Source: The Treasury

Primary issuance methods

Primary Market Framework. In 2019 the Treasury undertook consultation on its Primary Market Framework, with changes implemented in September 2019. The changes aim to create a more structured and formalised relationship between the Treasury and intermediaries involved in the NZGB market. They are also aimed at supporting Registered Tender Counterparties (RTC) to perform their role of intermediating primary market issuance to end investors and stimulating secondary market liquidity.

Under the revised Framework, to qualify as a RTC, an intermediary must play a significant role in intermediation of NZGS products to investors, as well as committing to support secondary market liquidity and price transparency. They must also participate regularly in NZGS tenders, supporting the primary market.

Only RTCs will be eligible for syndication issuance panels, and the Treasury will support other relevant activity conducted by the RTC. RTCs are listed on the New Zealand Debt Management website[2] to create visibility for investors.

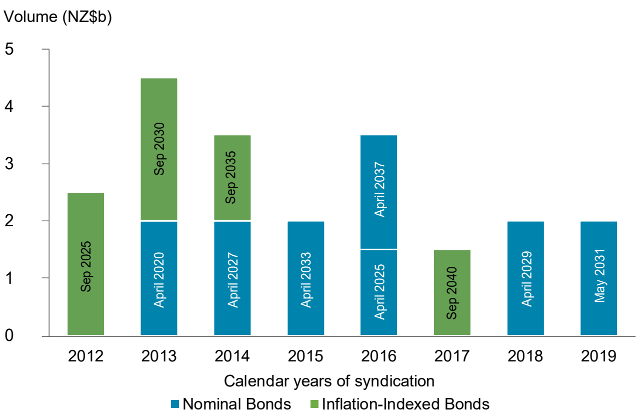
2 https://debtmanagement.treasury.govt.nz/government-securities/primary-market-access-information

Tender issuance. Issuance into existing nominal NZGB and IIB lines will continue to occur via regular tenders. Full quarterly bond tender schedules will continue to be announced ahead of each quarter, including tender dates, maturities, and volumes. This will generally occur at the time of the confirmation announcement for the last tender of the preceding quarter.

T-Bill tenders will continue to take place on a fortnightly basis. The volumes offered across the 3 month, 6 month and 12 month lines will be based on liquidity and portfolio requirements and will be announced on the day prior to tender. The amount issued will depend on the assessment of bids received relative to other short-term funding mechanisms, subject to the relevant operating rules and guidelines.

Syndicated issuance. Syndications remain the preferred method for the issuance of new bond lines. This method enables the placement of a large initial volume into the market, promoting immediate liquidity in the new bond. An intention to launch a new bond by syndication is generally announced alongside BEFU or HYEFU. Further operational announcements, related to the appointment of any syndication panel and transaction launch, are released on the New Zealand Debt Management website, as well as via Bloomberg and our investor email distribution list.

History of syndication volumes



Source: The Treasury

Secondary market support

Alongside intermediaries, the funding strategy aims to enhance secondary market liquidity by prioritising:

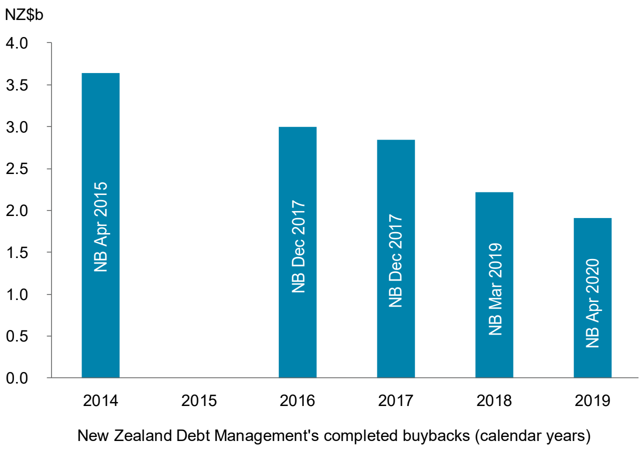
- undertaking bond buybacks ahead of upcoming maturities
- focusing on core instruments issued in New Zealand dollar (NZD)
- supporting the Government's commitment to a minimum level of NZGBs on issue
- broadly matching NZGB issuance maturities to ACGBs
- building volume in 'benchmark' lines
- using syndications to launch new lines.

Undertaking bond buybacks. The current funding strategy incorporates a policy of buying back bonds as they approach maturity. This helps to smooth cash flows around maturities, and to enable the recycling of investments further out the curve.

It has been recent practice to buyback outstanding bonds within the 18 month window before a bond matures. The Reserve Bank of New Zealand typically assumes responsibility for buyback activities during the final 6 month period before a bond matures, in an effort to ensure overall financial system liquidity.

A buyback programme of the 15 May 2021 bond is planned to start before 30 June 2020. Buybacks will be undertaken at levels that are assessed as economic and in keeping with liquidity requirements and portfolio needs. There is no target for a specific volume of buybacks.

Recently completed buyback activity



Source: The Treasury

Focusing on core instruments issued in NZD. The current focus is on NZD issuance in the domestic market. This helps to maximise liquidity in NZD denominated issues and is currently more cost-effective than foreign currency alternatives. A well-developed NZD denominated NZGS market also supports domestic capital markets.

The 2019/20 borrowing programme forecasts do not include any foreign currency issuance, however, up-to-date legal documentation is maintained for both an European Commercial Paper (ECP) and Euro Medium Term Note (EMTN) programme. ECP is seen as a potential alternative instrument to address short-term liquidity requirements.

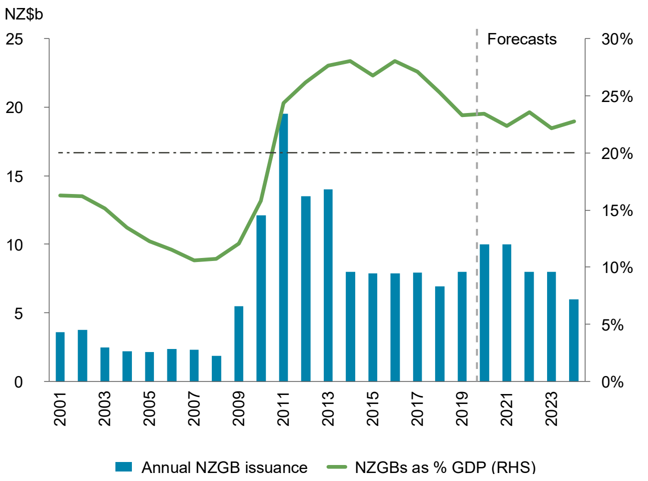
Attention is given to maximising liquidity in existing core instruments. Alternative funding instruments are assessed with respect to the impact on liquidity, relative cost and investor diversification, and with regard to wider benefits or risks.

Commitment to a minimum level of NZGBs on issue. In recent years, as the Government has been reducing net debt levels, it has made a commitment, on the Treasury's recommendation, to a minimum level of NZGBs on issue. Since Budget 2017 the Government has had a stated commitment to "maintain New Zealand Government Bonds on issue at not less than 20 per cent of GDP over time".

The Government sees a sustainable and readily accessible NZGB market as important in supporting fiscal resilience. A commitment to a minimum NZGB market also instils confidence in intermediaries and investors when they are choosing whether to participate in the market. This helps support liquidity.

NZGBs on issue are forecast to be equivalent to 23.5 per cent of GDP at 30 June 2020. It is forecast that NZGBs on issue will remain between 22.2 per cent and 23.5 per cent of GDP over the forecast period.

NZGBs on issue to remain above 20 per cent of GDP



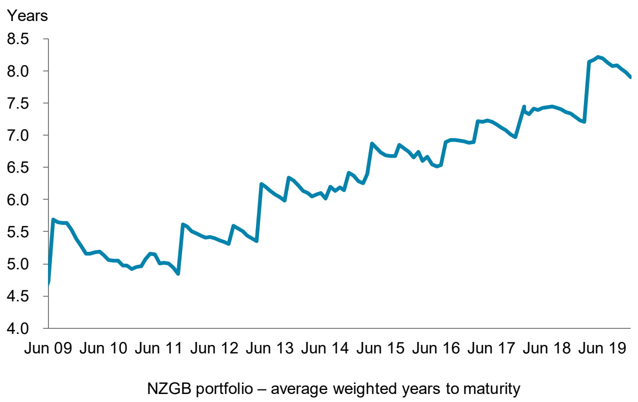
Source: The Treasury

Broadly matching ACGB maturities. The aim is to issue NZGBs with maturities that closely align with their Australian Commonwealth Government Bond (ACGB) equivalents. This promotes the ability for investors to easily assess relative value between these assets.

Average maturity

In recent years the funding strategy has included a policy of extending the average weighted maturity of the NZGB portfolio. The average weighted maturity of the NZGB portfolio has increased from around 4.5 years in mid-2009 to 7.9 years currently.

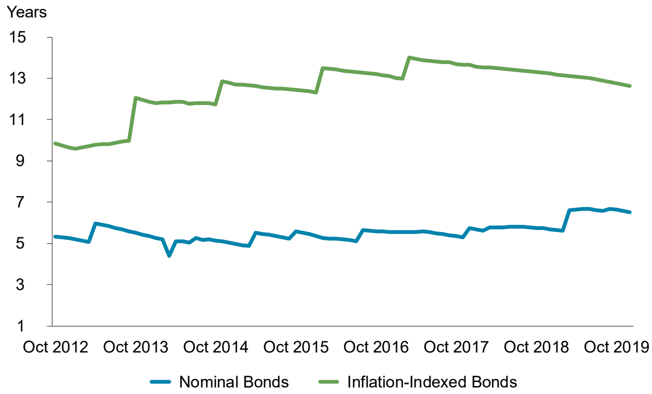
Average weighted maturity of NZGB portfolio



Source: The Treasury

This meets several objectives. It has improved the Crown's asset-liability matching, taking into account the interest rate sensitivity of the Crown's long-dated assets. It has contributed to further diversifying the investor base, capturing demand from investors with long-dated liabilities. It has reduced refinancing risk, as well as contributing to the development of New Zealand's capital markets.

Average weighted maturity by security type



Source: The Treasury

There is no specific target for the average weighted maturity of the portfolio. However, the average weighted maturity of the NZGB portfolio is expected to increase further in 2019/20, as the 15 April 2020 NZGB matures and issuance continues further out the curve.

Environmental, Social and Governance (ESG) considerations

The New Zealand Government has clearly stated Environmental, Social and Governance (ESG) objectives. Many of these are outlined in the Government's Wellbeing Budget 2019 that focuses on the wellbeing of people, the health of the environment and the strength of the community[3].

The Government has passed a policy framework that will drive climate change policy towards low greenhouse gas emissions and climate resilience in New Zealand.[4] The framework supports New Zealand's commitments under the Paris Agreement, including the target to reduce emissions by 11 per cent below 1990 levels by 2030.

In November 2019, the Government passed an Amendment to the Climate Change Response Bill that set new reduction targets by 2050 for greenhouse gases (to net zero) and biogenic methane (below 2017 levels by between 24 per cent and 47 per cent). These targets are in addition to establishing an independent Climate Change Commission to provide advice to Government on climate change mitigation and adaption, and to monitor progress towards the new 2050 target and emissions budgets.

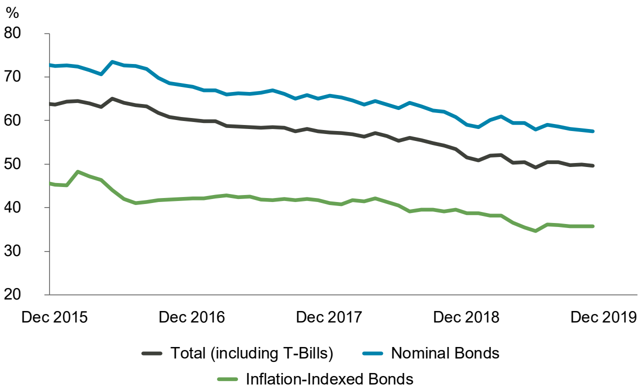
In this context, the Treasury currently has no plans to issue bonds in a specific ESG format. More broadly, it is cognisant of the contribution that efficient debt funding can make to the Government's ESG objectives.

3 https://treasury.govt.nz/publications/wellbeing-budget/wellbeing-budget-2019
4 https://www.mfe.govt.nz/climate-change/climate-change-and-government/climate-change-programme

Diversifying investor base

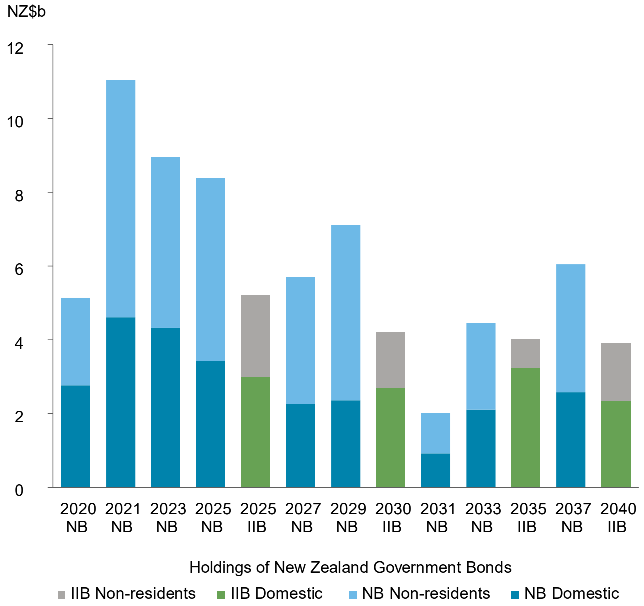
Diversity in the investor base is achieved through the funding and investor engagement strategy. Diversity by geography, investor type and mandate are valued.

Non-resident holdings of NZGBs



Source: RBNZ

Resident and non-resident holdings of NZGBs



Source: RBNZ

In recent years, the proportion of NZGBs held by New Zealand residents has increased, although the majority of bonds are still held by non-residents. During 2019 the proportion of NZGBs held by non-residents stabilised above 50 per cent with holdings at 52.0 per cent at 31 December 2019. The proportion of nominal bonds held by non-residents remains higher, at 57.0 per cent, compared to 35.1 per cent for IIBs.

There is notable variation in the proportion of non-resident holdings across the different NZGB maturities. The bonds with the highest proportion of non-resident holdings are the 15 April 2027 NZGB and the 20 April 2029 NZGB, at 60.3 per cent and 66.8 per cent respectively. In the first half of this fiscal year, non-resident investors continued to increase the value of their holdings in the bonds where tendered issuance took place.

Holdings of T-Bills continue to be dominated by resident investors, with only 7.6 per cent held by non-residents.

Summary

The forecast 2019/20 borrowing programme will largely manage scheduled NZGB maturities and buyback activity, with only a small volume of new funding to the Crown. In 2019/20, issuance of NZGBs is forecast to be NZ$3.4 billion after projected maturities and buybacks are taken into account, while gross issuance is forecast to be NZ$10 billion.

The focus will remain on nominal bonds as the primary funding vehicle, although IIBs remain an important part of the funding portfolio. It is expected that IIBs will make up around NZ$0.5 billion of the 2019/20 borrowing programme. During the March 2020 quarter, three nominal NZGBs will be issued via regular tender with maturities of 15 May 2031, 15 April 2025 and 15 April 2037. This profile is designed to provide liquidity at three distinct points on the NZGB curve and help build volume in key benchmark lines. One inflation-indexed bond will be issued to the market, the 20 September 2040. A buyback programme of the 15 May 2021 bond is planned to start before 30 June 2020.

Overall, the funding activities will be undertaken in a strategic manner where actions are communicated in advance. However, some flexibility is maintained in T-Bill issuance in order to respond to short-term liquidity requirements in an efficient manner. The central principles of transparency, consistency and even-handedness remain important foundations for the funding strategy.