

# The Treasury

## COVID-19 Information Release

April 2020

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9 April 2020

Chair  
Cabinet COVID-19 Committee

## INDEMNIFYING THE RESERVE BANK FOR LARGE SCALE ASSET PURCHASES OF LOCAL GOVERNMENT FUNDING AUTHORITY DEBT

### Recommendations

I recommend that the Cabinet Committee:

- a. **note** that the Reserve Bank (the 'Bank') has requested an indemnity for a programme of Large Scale Asset Purchases (LSAPs) of Local Government Funding Agency (LGFA) debt, to enable the MPC to meet its economic objectives.
- b. **note** that, under Section 65ZD of the Public Finance Act 1989, I have granted an indemnity to the Bank for financial losses arising from a Programme of Large Scale Asset Purchases of up to \$3 billion of Local Government Funding Authority Debt over the next 18 months.

### Background

1. With the OCR at 0.25%, the Monetary Policy Committee (MPC) considers that they have exhausted conventional monetary policy options to achieve their economic objectives of achieving and maintaining stability in the general level of prices over the medium term, and supporting maximum sustainable employment.
2. To mitigate the economic impacts of COVID-19 on New Zealanders' prosperity and wellbeing, the MPC has begun to use alternative monetary policy (AMP) tools. One such tool is LSAPs, which aim to lower interest rates and stimulate the economy.
3. On 21 March, the Crown provided the Bank with an indemnity for the purchase of up to \$30 billion of New Zealand Government bonds (NZGBs) on the secondary market over the next 18 months, financed by central bank money. The MPC then approved a programme of LSAPs of NZGBs to a total volume of \$30 billion over 12 months, beginning on 25 March.
4. To date, the NZGB LSAP programme has been successful. Liquidity in the New Zealand government debt market has improved, bond yields have declined and the yield curve has stabilised relative to conditions a few weeks ago.
5. On 6 April, the Governor of the Reserve Bank wrote to me to request that the Crown indemnity provided to the Reserve Bank on 21 March be extended to cover losses associated with the purchase of up to \$3 billion of LGFA debt, in addition to the previously agreed purchase of \$30 billion of NZGBs.
6. This request reflects the Bank's concern about the dislocation and lack of liquidity in the market for LGFA debt. Dysfunction in the LGFA debt market has flow on effects,

because LGFA debt serves as a key pricing benchmark for the rest of the credit market. If sustained, this will impact on wider economic activity by increasing interest rates and inhibiting the transmission of monetary policy.

7. Based on analysis from the Bank and the Treasury, I agree that there are signs of dislocation in the LGFA market, and that this risks the MPC not achieving its economic objectives of price stability and maximum sustainable employment.

### Financial Implications

8. Indemnifying the Bank for LSAPs of LGFA bonds presents financial risks to the Crown. These risks and their treatment differs slightly from LSAPs of NZGBs.
  - a. With LSAPs of NZGBs: The duration of the Crown's overall liabilities change, exposing the Crown to interest rate risk. However, the overall size of the Crown balance sheet is unchanged, and net debt is unchanged.
  - b. With LSAPs of LGFA bonds:
    - i. The Bank purchases an asset (the LGFA bond) that is not already part of the consolidated Crown. The consolidated Crown's assets and liabilities increase equally – the assets by the amount of the purchase, and the liabilities by the amount of the settlement cash issued.
    - ii. Net debt is unchanged at the point of purchase of LGFA bonds. Therefore, the indemnity will not need to be charged against the COVID-19 appropriation at this stage. Net debt will only be affected when losses (or gains) on the LGFA bonds are realised.
    - iii. In addition to interest rate risk the Crown will take on credit risk. However, this credit risk is very small as the probability of the LGFA defaulting is extremely low. The Bank conservatively estimates the Crown's potential exposure to losses from the combined interest rate risk and credit risk to be approximately \$289 million to \$1085 million.

### Public Interest Test

9. Section 65ZD of the Public Finance Act 1989 empowers me to give an indemnity to a person, organisation or government if it appears to be 'necessary or expedient in the public interest' to do so.
10. On balance, I decided that the requested indemnity for LSAPs of LGFA bonds is expedient in the public interest. I consider the risks to the Crown are outweighed by the benefits of enabling the MPC to support LGFA market functioning and pursue its economic objectives. Therefore, I have agreed to indemnify financial losses arising from up to \$3 billion of LGFA bond purchases over the next 18 months, to be financed by central bank money.

### Next Steps

11. I will present a statement to the House of Representatives that this indemnity has been issued, as soon as practicable.

12. <sup>33</sup>

**Hon Grant Robertson**  
Minister of Finance

Date: 8 April 2020