

# The Treasury

## Indemnifying Further Large Scale Asset Purchases Information Release

June 2020

This document has been prepared for release by the Treasury:

<https://uniteforrecovery.govt.nz/updates-and-resources/legislation-and-key-documents/proactive-release/>

### Context

The Minister of Finance subsequently agreed to provide an expanded indemnity for the Reserve Bank's Large Scale Asset Purchases (LSAPs). The Letter of Indemnity provided by the Minister of Finance can be found at:

<https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Monetary%20policy/ump/10-May-2020-Letter-of-Indemnity-Amendment-between-RBNZ-MOF.pdf?revision=b7522a75-43d2-47c1-82f5-d46a94306853&la=en>.

This report notes that the Treasury intended to issue a public statement to clarify the impact of LSAPs on net debt. An explanation of how the Reserve Bank's LSAPs affect the Crown balance sheet can be found at:

<https://treasury.govt.nz/publications/guide/how-reserve-banks-large-scale-asset-purchases-affect-crown-balance-sheet>.

Key to sections of the Act under which information has been withheld:

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[36] 9(2)(h) - to maintain legal professional privilege

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

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## Treasury Report: Indemnifying further Large Scale Asset Purchases

<b>Date:</b>	1 May 2020	<b>Report No:</b>	T2020/1036
		<b>File Number:</b>	MC-1-1-1-2 (RBNZ Institutional Frameworks)

### Action sought

	Action sought	Deadline
Hon Grant Robertson <b>Minister of Finance</b>	<b>Sign</b> the attached indemnity, to support potential expansions of the Reserve Bank's Large Scale Asset Purchases.	<b>Monday 4 May 2020</b> , to lodge Cabinet paper for DEV on 6 May.

### Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Elle Hughes	Analyst, Macroeconomic and Fiscal Policy	[39]	N/A (mob) ✓
Renee Philip	Manager, Macroeconomic and Fiscal Policy	[23]	

### Minister's Office actions (if required)

**Return** the signed report and letter of indemnity to the Treasury.

**Arrange** for a Statement to be presented to the House after 13 May.

Note any feedback on the quality of the report

**Enclosure:** Yes (iManage links)

# Treasury Report: Indemnifying further Large Scale Asset Purchases

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## Executive Summary

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In response to COVID-19, the Monetary Policy Committee (MPC) initiated Large Scale Asset Purchases (LSAPs) of \$30bn of New Zealand Government bonds (NZGBs) and \$3bn of Local Government Funding Agency (LGFA) bonds over the next 12 months. You provided indemnities for these purchases made prior to 30 September 2021, to manage the associated financial risks.

The Reserve Bank (the Bank) has now requested an indemnity for an expanded LSAP programme. The requested indemnity covers LSAPs of nominal NZGBs, inflation-indexed NZGBs, and LGFA bonds for up to 50%, 30% and 30% of the respective markets, until 30 September 2021. This proposal significantly expands the scale of recently agreed indemnities for LSAPs, but does not expand the type of assets the Bank may purchase. Assuming current forecasts of debt issuance, the upper limit of the LSAP programme would reach approximately \$75 billion by September 2021. Expressing the indemnity limit as a market share, rather than a dollar amount, means the MPC can expand the LSAP programme alongside debt issuance, to ensure effective stimulus and lower borrowing costs.

Contrary to our previous advice, LSAPs will increase recorded net debt in the near term, although LSAPs remain fiscally neutral over the lifetime of the bonds. This corrects a technical assumption on the accounting treatment of NZGBs purchased under the LSAP programme. However, this correction does not materially alter the fiscal risk associated with the LSAP programme and it will not affect the Government's debt issuance requirements. Consequently, the correction does not change our overall advice on the use of LSAPs.

The impact on recorded net core Crown debt is highly uncertain, but expanding the LSAP programme is likely to add in the order of a few billion dollars to net debt compared to what is captured in the Budget forecasts. We will report back to you with an estimated impact next week. However, we expect this impact to be offset by higher OBEGAL (due to lower interest expenses) over the life of the bonds, so over time the impact on net debt will be unwound. The Treasury intends to issue a public statement to correct our previous advice about the impact of LSAPs on net debt, which has been picked up in various media reports.

Section 65ZD of the Public Finance Act 1989 empowers you, as Minister of Finance, to give an indemnity on behalf of the Crown if it appears to you to be necessary or expedient in the public interest to do so.

LSAPs present fiscal risks. The Bank's best estimate of large but plausible losses arising from the expanded LSAP programme is a net loss of \$2.3bn. However, we consider these fiscal risks are outweighed by the likely economic benefits of LSAPs. If effective, LSAPs will support the economic recovery and lower Crown financing costs. In turn, this would support the fiscal position.

Officials are of the view that giving the indemnity would be expedient in the public interest. We recommend that you agree to provide the requested indemnity.

## Recommended Action

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We recommend that you:

- a **note** that the Reserve Bank has requested the indemnity be expanded to cover financial losses arising from LSAPs, until 30 September 2021, of:

- a. Up to 50% of outstanding nominal NZGBs;
  - b. Up to 30% of outstanding inflation-indexed NZGBs; and
  - c. Up to 30% of outstanding LGFA bonds.
- b **note** that the proposed indemnity would replace the existing LSAP indemnities.
- c **note** that section 65ZD of the Public Finance Act 1989 empowers the Minister of Finance to give indemnities on behalf of the Crown if it appears to the Minister to be necessary or expedient in the public interest to do so.
- d **note** that officials' view that the proposed indemnity would be expedient in the public interest.
- e **agree** that the proposed indemnity (as set out in the attached Letter of Indemnity) is necessary or expedient in the public interest.

*Agree/disagree*

- f **agree** that the attached noting paper be lodged for the 6 May DEV Cabinet committee.

*Agree/disagree*

- g **note** that section 65ZD requires you to present a statement to the House of Representatives if the contingent liability under the indemnity is greater than \$10 million.
- h **agree** to present a statement to the House of Representatives that this indemnity has been amended and restated as soon as practicable after 12 May, the effective date of the indemnity. We will provide suggested wording to your office.

*Agree /disagree*

- i **agree** that the Treasury should issue a public statement clarifying the impacts of LSAPs on the fiscal position.

*Agree /disagree*

Renee Philip  
**Manager**

Hon Grant Robertson  
**Minister of Finance**





















- **Risk control framework (RCF):** the RCF seeks to identify, measure, and manage the risks associated with implementing alternative monetary policy tools. In the Letter of Indemnity the Bank commits to work with Treasury to revise the RCF before the effective date of the indemnity (12 May 2020) to account for differences of risk associated with an expansion of the LSAP programme.
- **Reporting requirements:** the Programme will be reviewed under existing requirements set out in the Act. Additionally, the Bank commits to providing monthly reports to the Treasury on the transactions undertaken as part of the Programme, and to inform you if conditions change such that the financial risk of the Programme increases.
- **Time-limited indemnity:** the indemnity covers losses arising out of NZGB and LGFA debt purchases made prior to 30 September 2021.

The Minister of Finance will then have the opportunity to terminate the indemnity should it not continue to be in the public interest. At the termination of the indemnity period, the Bank will remain indemnified for losses on bonds purchased during the indemnity period but not for losses on any new purchases, except for new bond purchases that 'roll over' initial bonds when they reach maturity. This enables the Bank to maintain its portfolio of bonds acquired under the Programme, which protects against an unwarranted tightening of monetary policy. Having a time limit ensures that the indemnity does not bind the Crown for an indefinite period of purchases.

### **Benefits**

16. The principal benefit of providing the indemnity is that it will likely lead to the Bank undertaking further LSAPs of NZGBs and LGFA debt as the MPC deems appropriate. We expect the MPC will announce a moderate increase in the LSAP programme at the May MPS, and then announce further changes as economic circumstance warrant. This increases the ability of the Bank to use LSAPs to pursue its economic objectives (which is expected to have positive flow-on effects for the wider economy and the public interest).

### **No viable alternatives to an indemnity**

17. As noted above, the Bank has said within the context of the MOU that, without an indemnity, it would be unable to undertake LSAPs on the scale contemplated by the Programme. The Bank has operational independence and therefore the Crown cannot require the Bank to use any particular monetary policy tool. Other than the Crown, there is no other entity within New Zealand that would be able – or willing – to indemnify the Bank for the amounts required.

### **Assessment of risks and benefits against the public interest threshold**

18. In light of the above, officials consider that:
  - a there is a public interest in giving an indemnity to the Bank on the terms set out in the Letter of Indemnity; and
  - b the benefits of the proposed indemnity appear to outweigh those risks when mitigations are taken into account.
19. Accordingly, on balance, officials are of the view that the indemnity appears to be expedient in the public interest.