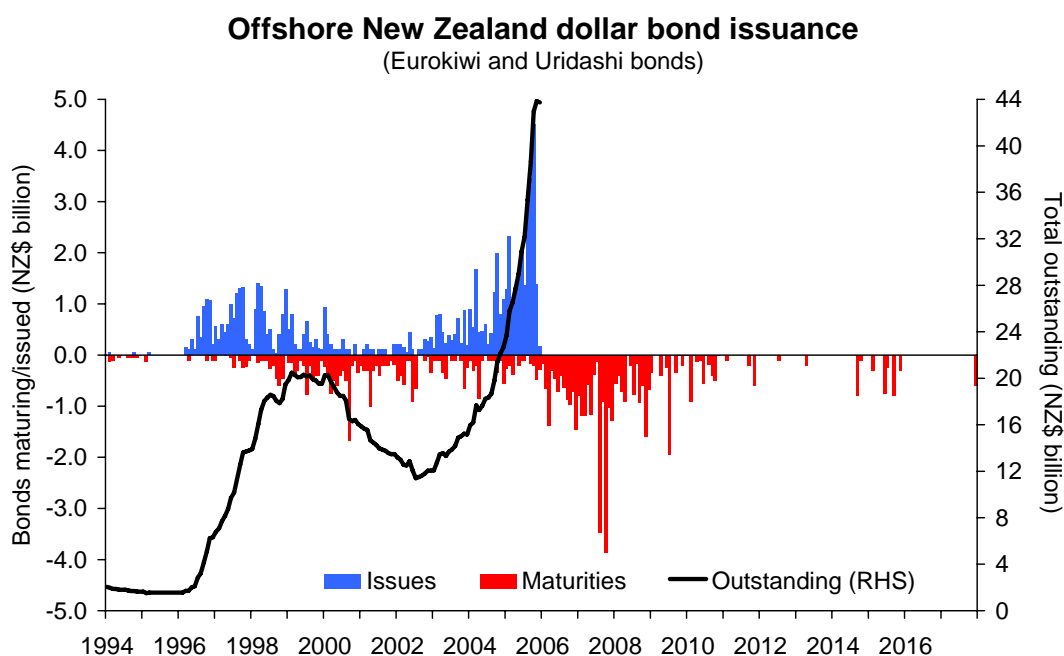


DATE

2/12/2005

*1. Background*

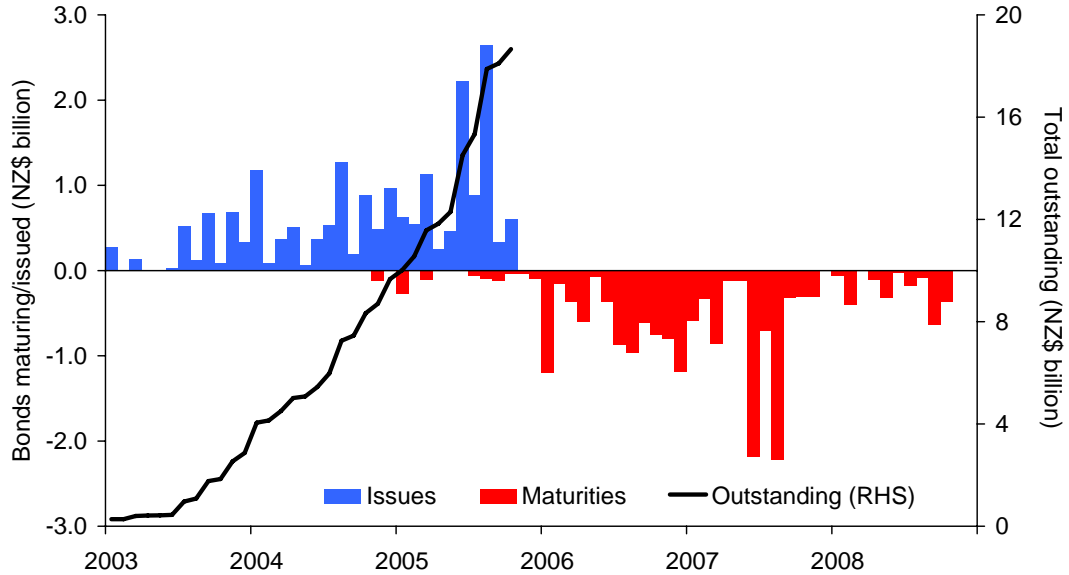
Recently, global investors have been attracted to New Zealand dollar financial assets for their relatively high yields. Offshore New Zealand dollar (NZD) denominated bond issuance – mainly Eurokiwi and Uridashi bonds – has been especially strong over the past year. The chart below shows Eurokiwi and Uridashi bond issuance, maturities, and the net amount outstanding since the early 1990s.



Uridashi bonds for the Japanese retail investor market have been a notable feature of this issuance, accounting for almost half of the total NZD 45 billion in offshore issuance that is outstanding. This total is more than double the previous peak in 1999. The amount of Uridashi bonds outstanding is equivalent to around 16 percent of New Zealand's annual GDP, and around 72 percent of New Zealand government bonds on issue. Total offshore issuance outstanding is equivalent to around 38 percent of GDP and 175 percent of government bonds on issue. Uridashi issuance in October 2005 at over NZD 2.5 billion is the highest monthly amount on record. The total monthly issuance (including Eurokiwi and Uridashi bonds) for October was over NZD 4 billion. Given the small size of the New Zealand government securities markets relative to those of the major economies, flows of these magnitudes stand out. The chart below isolates recent Uridashi bond issuance, maturities and the net amount outstanding. The second chart below compares monthly Uridashi bond issuance by currency of issue – NZD Uridashi bond issues tend to comprise a relatively large portion of total Uridashi issues, particularly after mid-2005 (note that this chart uses a different data source from the first two charts so the issuance figures differ slightly).

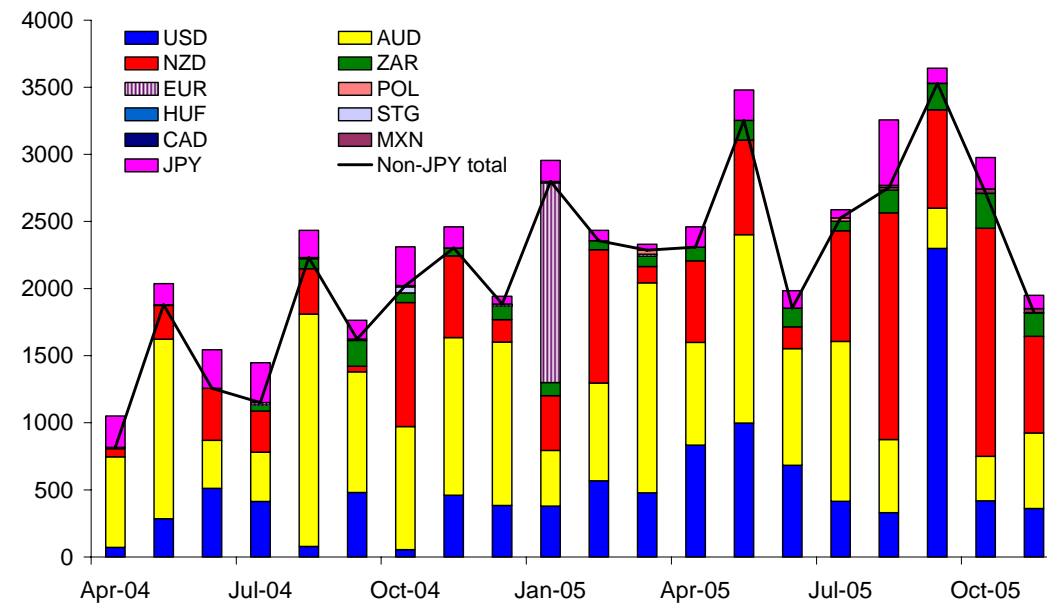
In August, October and November, there was more Uridashi bond issuance denominated in NZD than any other currency.

### Recent NZD Uridashi bond issuance



100 Million Yen

### Uridashi bond issuance by currency



The bulk of Uridashi bonds have had two- to three-year maturities, and are issued by supranational organisations (including the World Bank) and Japanese security houses. Individual issues have increased in size over the past year, especially amongst several of the larger security houses. The recent high levels of issuance have given rise to a sizeable maturity profile for NZD Uridashi bonds over late 2006 to 2008.

At present, financial market participants suggest that Japanese retail investors will continue to demand NZD denominated bonds in the absence of a substantial fall in the currency and while New Zealand interest rates remain relatively high.

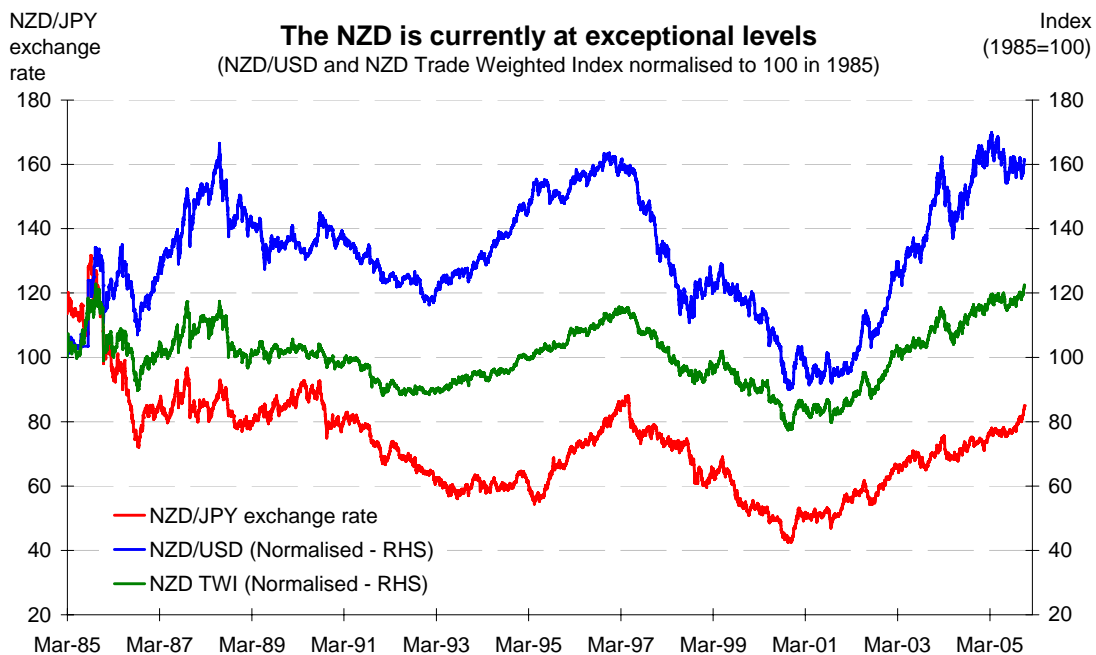
## ***2. Implications for NZ monetary policy and the financial system***

The offshore issuance of NZD denominated bonds has a number of impacts and potential impacts on the New Zealand economy and financial system.

Importantly, Uridashi and Eurokiwi bond issuance provides one source of capital inflows to the New Zealand financial system. These issues facilitate the financing of New Zealand's current account deficit by providing New Zealand banks with a cost-effective mechanism for converting – or swapping, and thus hedging – their overseas borrowings into NZD.

The hedging of Uridashi and Eurokiwi bond issues through the New Zealand interest rate swap market has tended to depress swap rates in the two to three year part of the yield curve. This in turn has enabled domestic banks to offer relatively low fixed interest rate mortgages for real-estate purchases. At a time when New Zealand's monetary policy is above neutral in order to work against inflationary pressures emanating particularly from the domestic (non-tradeables) sectors of the economy, this has reduced the effectiveness of, and increased the lags involved in, the transmission of increases in the Official Cash Rate.

Uridashi and Eurokiwi bond issues have also added to (unhedged) demand for the NZD, which has seen the currency at high levels against the major currencies, particularly the US dollar, the euro and the Japanese yen. The Japanese retail investor is exposed to movements in the NZD. The NZD is around its highest level against the yen since early 1997. On a trade weighted basis, the NZD is at a post-float (1985 to 2005) high.



Given our relatively high yields, these investment flows, and to some extent their impacts, are to be expected, and are all part of having open and well developed capital markets – something we certainly encourage.

**[Further information deleted on the grounds specified in section 6(b) of the Official Information Act 1982: disclosure would be likely to prejudice the entrusting of information to the Government of New Zealand on a basis of confidence by the agency of the Government of another country.]**