INFLATION ADJUSTED SAVINGS BONDS

INTRODUCTION

The purpose of this article is to introduce a new Bulletin table designed to present information on the inflation adjustment payable on the redemption of an inflation adjusted savings bond. By way of background to the table, this article provides some explanatory information on the bonds, including an outline of the terms and conditions attached to them. The table will appear occasionally in subsequent issues of the *Bulletin*.

BACKGROUND

Inflation adjusted savings bonds were introduced by the Government in the 1977 Budget in recognition of the difficulties small savers had been facing in protecting their savings against inflation. The instrument was specifically aimed at small savers and was designed to help preserve the purchasing power of their savings. The bonds have been available continuously since 10 October 1977.

As with other public debt instruments the Reserve Bank is empowered to act as the Government's agent in the management and registration of these bonds, which have been issued in terms of the prospectuses dated 10th October 1977 and 5th November 1979, and of Part V of the Public Finance Act 1977.

Although it has taken some time for small savers to recognise the relative merits of these bonds as compared with alternative small savings investment, the $198.6 million held by bondholders as at 31st March 1981, as well as the recent strong demand for bonds, is indicative of the present widespread acceptance of this new form of investment.

TERMS AND CONDITIONS

These are summarised under the following subheadings.

Subscriptions

Applications can only be in the name of sole persons, on their own behalf. Bonds may only be issued to persons who are 7 years of age or older. Bonds are non-transferable and may not be issued in joint names, or to trusts, companies, clubs, etc.

Each application must be for a minimum of $100 and in multiples of $50 thereafter.

Whereas in the earlier prospectus, the maximum that could be applied for was $1,000 in any one calendar year and overall no more than $5,000, these amounts were changed in the second prospectus to $5,000 and $10,000 respectively.

Repayments

All repayments are subject to one month's notice being given and bonds must be held at least five years except in the following circumstances:

Premium on Redemption

An inflation adjustment (premium) is payable when a bond is redeemed. The premium is calculated by applying to the nominal value of a bond the percentage by which the Consumers Price Index (All Groups), as published by the Government Statistician, has changed over an equivalent number of completed three-monthly periods between the date of issue of the bond and the date of receipt of notice by the Registrar that repayment is required. For the purposes of this calculation the final index number to be taken into account is that for the quarter immediately preceding the quarter in which the Registrar receives the redemption notice.

If the adjustment, as calculated above, is less than the sum of 5 percent per annum compounded quarterly over the same number of quarters, then a minimum premium of 5 percent per annum compounded quarterly will be paid.

The premium is exempt from income tax.

A DESCRIPTION OF THE TABLE

The appended table presents the income tax free premium payable in each and every redemption case to date. The premiums are expressed in percentage form and represent only the inflation adjustment payable on the redemption of a bond. The information contained in the table excludes the 2 percent interest rate payable on the bonds, and thus the table does not show the total rate of return.

The premiums shown in the table should be regarded as a close approximation of the actual inflation adjustment which would have been paid. The premiums showns are in the form of percentage increases in the Consumers Price Index calculated to one decimal, and hence contain rounding error. On redemption, repayments are actually calculated on the basis of the Index values themselves, which may produce a premium slightly different from (but more accurate than) those shown in the table.

An example

A $1,000 bond was purchased on 15 October 1978 and the one month's notice of repayment is received by the Reserve Bank on 5 May 1981. At that point, the bond has been held two years, six months and 20 days i.e. 10 complete three-monthly periods.

Referring to the table, starting from the quarter immediately prior to the date of repayment request of 5 May 1981, i.e., 31 March 1981, and going along the row to the point which intersects with the column representing the number of three-month periods the bond has been held, i.e. 10, gives the approximate premium of 43.2 percent.

Thus, approximately $432 free of tax would be paid as the inflation adjustment on $1,000 when the one month's notice has expired on 5 June 1981, together with the interest at 2 percent accrued to 5 June 1981.

(a) A holder is 60 years of age or over when repayment is required;

(b) Proceeds are to be used to acquire a dwelling, farm, or a commercial fishing vessel for the bondholder's own use, providing he or she does not hold or had not held a beneficial interest in one before;

(c) Bonds are deemed to mature on death and no interest is paid thereafter. However, when calculating the inflation premium, the date repayment is requested is used in assessing the number of complete three-monthly periods involved.

(d) Bonds are repaid at any time at the request of the administrator of the estate of a holder who has been adjudged bankrupt.

Furthermore, the Minister of Finance reserves the right to repay bonds which have been on issue for five years or more on giving at least one month's notice in the New Zealand Gazette.

Interest

Interest at the rate of 2 percent per annum is paid on bonds and commences from the date of receipt of the application. It is paid annually on 1st July each year, and ceases on repayment of the bond (or on date of death — see (c) above).

Interest is liable for income tax within the general $200 exemption.

The actual (accurate) premium is calculated as follows.

(a)	Amount of bond:	$1,000
(b)	Date issued	15 October 1978
(c)	Date notice of repayment received	5 May 1981
(d)	Number of completed three-month periods between (b) and (c)	10
(e)	Consumers Price Index value for quarter immediately preceding date notice of repayment received (c), i.e. March 1981 quarter (31.12.1980 = 1000)	1031
(f)	Consumers Price Index value 10 quarters earlier	720
(g)	Value of bond on redemption (excluding 2 percent interest) $\frac{1031}{720} \times \frac{\$1{,}000}{1} =$	$1,431.94
(h)	Value of premium $1,431.94 — $1,000	$431.94

TABLE 1
INFLATION ADJUSTED SAVINGS BONDS
(Premiums Percent)[1]

Quarter Preceding Date Redemption Notice is Received by Reserve Bank	*Number of Three-Month Periods Bonds Held* 1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	*13*	*14*	*Consumers Price Index (31/12/80 = 1000)*
30/ 9/77															648
31/12/77	3.5														671
31/ 3/78	2.1	5.7													685
30/ 6/78	2.6	4.8	8.5												703
30/ 9/78	2.4	5.1	7.3	11.1											720
31/12/78	2.6	5.1	7.9	10.1	14.0										739
31/ 3/79	2.3	5.0	7.5	10.4	12.7	16.7									756
30/ 6/79	4.5	6.9	9.7	12.4	15.3	17.7	21.9								790
30/ 9/79	5.1	9.8	12.3	15.3	18.1	21.2	23.7	28.1							830
31/12/79	3.7	9.0	13.9	16.5	19.6	22.5	25.7	28.3	32.9						861
31/ 3/80	3.9	7.8	13.3	18.4	21.1	24.3	27.3	30.7	33.4	38.1					895
30/ 6/80	4.1	8.2	12.3	18.0	23.3	26.1	29.4	32.6	36.1	38.9	43.8				932
30/ 9/80	3.5	7.8	12.1	16.3	22.2	27.6	30.6	34.0	37.3	40.9	43.8	48.9			965
31/12/80	3.6	7.3	11.7	16.1	20.5	26.6	32.3	35.3	38.9	42.2	46.0	49.0	54.3		1000
31/ 3/81	3.1	6.8	10.6	15.2	19.7	24.2	30.5	36.4	39.5	43.2	46.7	50.5	53.7	59.1	1031

1. This premium is the non-taxable inflation adjustment. Bonds also earn 2 percent interest per annum (taxable).

Example: $1,000 bond purchased 15/10/1978
Notice of repayment received by Reserve Bank 5/5/1981
Number of three-month periods = 10
Quarter preceding date redemption notice is received: 31/3/1981
Premium is 43.2 percent (10th column in line headed 31/3/1981)

Note: The premiums shown in this table are close approximations only. Actual calculations are based on the Consumers Price Index values shown above, in the manner set out in the accompanying article.