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New Zealand ahead in the post-recession recovery cycle

We believe that the recent rise in New Zealand's interest rates has put the bond market in a good place, as the alternative may have been a negative interest rate regime instead. Without higher interest rates the government would have found it difficult to fund itself, as the country's bonds may not have otherwise been attractive to offshore investors.

Currently, interest rates are significantly higher, predominantly in the five- to 20-year maturities. Concerns have now emerged regarding the higher rates, but we believe that most of the rate increase has likely taken place already. It is not unusual for the bond market to anticipate what will happen in the real economy and run ahead of it. Therefore, much good news around the reflation story is likely to have been already priced in by the market.

We acknowledge that New Zealand is ahead of its global peers in this cycle, with the country having rebounded from a pandemic-induced recession. Given the very contracted period between recession and recovery, the rebound has been very much V-shaped, which is quite unusual.

RBNZ's stance on interest rates a surprise, but not unwarranted

There was some surprise when the Reserve Bank of New Zealand (RBNZ) hinted at the May policy meeting that it could raise interest rates in the future. The RBNZ projected cash rates being raised from the current 0.25% to 0.50% by mid-2022 and eventually to 1.75% by 2024. The central bank's stance on rates was not unwarranted, however, as the New Zealand economy is likely running ahead of the rest of the world. As the markets ponder when the RBNZ will eventually begin raising rates, our focus is on the short end of the yield curve. Yields have already risen significantly in the long end of the curve, so our attention is on the path forward in the one- to four-year sector.

Another focal point regarding central bank policy is tapering, or the reduction of quantitative easing. To a large extent that has already occurred in New Zealand. When the government was issuing a large amount of bonds to fund its massive stimulus during the pandemic, the RBNZ was buying up to NZD 1.9 billion of bonds a week, but the amount has now been tapered back to NZD 350 million. The central bank has managed to reduce its bond purchases without a large impact on the market. The RBNZ's purchase NZD 350 million per week is roughly equivalent to the amount of debt the government issues.

Regarding supply dynamics the New Zealand bond market is still structurally short. There is not enough new issuance in the credit space to meet maturities, particularly in banking names. We believe that credit will continue adding value to investors' portfolios.