

New Zealand Fixed Income Monthly

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New Zealand outlook muddied by Delta infections but government is well prepared

The detection of New Zealand's first COVID-19 Delta variant infections and the subsequent decision by the Reserve Bank of New Zealand (RBNZ) to postpone a widely expected rate hike muddied the country's outlook in August. The economy was previously running at a strong pace with unusually high inflation of 3.5% and very low unemployment, but the difficulty of predicting progress in containing the Delta outbreak or the length of lockdown measures has created a new source of uncertainty. Given that many other countries have already moved through lockdowns and have vaccinated a significant portion of those willing to be inoculated, it is also difficult to extrapolate what has happened in the rest of the world to New Zealand, where those factors have largely been absent. Even so, the government has already committed about half a billion New Zealand dollars (NZD) in COVID-19 support and still has approximately NZD 15 billion available to use if necessary. The New Zealand Debt Management Office (NZDMO) also has around NZD 38 billion in liquid securities. The government is therefore unlikely to see the need to increase its debt issuance program at this stage. Furthermore, the Delta outbreak has sped up New Zealand's vaccination process by prompting a rush for inoculations.

Potential rate hikes baked into yield curve for most part

Despite its decision to stand pat on 18 August, the RBNZ clearly appears determined to raise the Official Cash Rate (OCR) from the current level of 0.25% when it feels the time is right. Although the RBNZ's stance has surprised investors both in New Zealand and overseas, it seems reasonable for the central bank to take its foot off the accelerator now that the economy has seen a substantial rebound and extraordinarily low rates are no longer needed. Given that the long end of the yield curve shot up at the start of the year, the rise in long-term yields is likely to have already happened for the most part. Longer-term bond yields have been confined in a relatively narrow range of 25-40 basis points for the past six months. At the same time, New Zealand has recently seen considerable upward movement in short-term interest rates, and it is clear that potential rate hikes have already been baked into the short end of the curve for the most part. Depending on the RBNZ's rhetoric and the direction of the economy, we may see an overshoot in short-term interest rates. The yield curve is likely to become very flat at some point in the next six to 12 months, primarily through short-term rates moving higher.

Market likely to remain active for rest of year, New Zealand eyes first ultra-long bond issuance

New Zealand's bond market is currently seeing a great deal of activity and we are likely to see another 10 or 12 issuers by the end of 2021. In addition, syndication of a 30-year government bond was recently announced. The issuance could prove attractive for investors given that New Zealand has never had an ultra-long maturity bond before.

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