

New Zealand Fixed Income Monthly November 2021

20 December 2021

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New Zealand in the vanguard of recovery

New Zealand faces the same kind of uncertainties other countries are confronting due to the global pandemic. But New Zealand, in some ways, has been in the vanguard of recovery from the COVID-19 outbreak. The country is gripped by rising inflation, interest rates are climbing and the decline of asset prices within the bond market has started to spill over into equities. New Zealand bonds have been in a bear market for the last 12 months, with interest rates rising sharply, particularly in October.

The New Zealand economy appears strong, however. Although inflation will likely remain a concern for some time to come, we believe that the bond market has pulled through for the time being. Economic uncertainties have become less of a factor, and should risks emerge that could upset the pace of the economy's recovery, the Reserve Bank of New Zealand (RBNZ) stands poised to respond appropriately.

RBNZ hikes rates by 25 bps, also raises neutral rate forecast

Regarding the RBNZ and monetary policy, the markets have priced in a significant number of rate hikes. At its policy meeting on 24 November, the RBNZ raised the overnight cash rate (OCR), by 25 basis points (bps) to 0.75%, but not by the 50 bps that some in the market had anticipated. However, the central bank caused a slight surprise as it now expects the neutral rate to peak at 2.6% at the end of 2023, revising its previous forecast for the rate to reach 2.1% at the end of 2022. It also surprised with its comment on its bond holdings. As a result of its quantitative easing, the RBNZ now owns NZD 53 billion of New Zealand government bonds, just over a third of the NZD 140-billion market. The central bank indicated that its preference was not to reinvest the proceeds from the holdings (i.e. coupons, maturing bonds) and allow the bonds to mature; the RBNZ also showed a preference to sell the bonds directly back to the New Zealand Treasury should it need to, rather than in the open market.

Positive view towards credit

We are generally positive in our view of credit. The last several credit issues to the debt market have been very well sought after by investors, and there has been a shortage of supply relative to demand—buyers have been getting only half of what they bid for and credit margins have been moving towards the bottom of their range. We have seen buyers become a little more demanding in the last few weeks. However, as the end of the year approaches, we will get a break from both government and credit issuance through January or February and this will result in a build up of money that needs to be reinvested. We are therefore positive in our outlook for government bonds and credit as we approach 2022.

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