

# New Zealand Fixed Income Monthly July 2021

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## Long term sector outperforms, short term sector lags as rate hike expectations mount

New Zealand's bond market performed well overall in July, although the long term sector outperformed its short term peers significantly. The short term sector's underperformance was primarily due to expectations that the Reserve Bank of New Zealand (RBNZ) will raise the Official Cash Rate (OCR), currently at 0.25%, as early as 18 August, when the central bank is scheduled to hold its next monetary policy meeting.

New Zealand's economy has been surprisingly strong. Its GDP increased 1.6% in the April-June quarter for year-on-year growth of 3.3%, above the RBNZ's 1–3% target band. A significant number of private sector economists therefore appear quite confident about bringing forward their monetary tightening expectations and are almost demanding a rate hike from the RBNZ. However, we continue to believe that growth and inflation will be transitory unless there is a recovery in the number of international tourists, students and migrants coming to New Zealand. New catalysts are needed for high growth and at this stage it is difficult to see what the next big mover will be.

Therefore, even if the RBNZ hikes the OCR, the central bank is unlikely to tighten as much as in previous cycles, and we believe that 1.5–2% could be the OCR's high point. The spread of the Delta variant has of course muddied the waters when trying to predict when the RBNZ might hike rates. The outbreak in neighbouring Australia and the subsequent lockdowns there highlight the risks from the pandemic and may prompt the RBNZ to sit on its hands for a little while longer.

## RBNZ focuses on climate change

The RBNZ recently said it is looking to incorporate climate change into its stress testing for banks and insurers. RBNZ Assistant Governor Simone Robbers commented that climate change is a direct challenge to financial stability and therefore relates directly to the mandates of central banks. We have said previously that central banks are setting multiple goals and this is the latest one they will have to meet. According to the RBNZ, their plan for 2021 includes drought conditions in a bank stress test scenario and severe events in an insurance scenario.

Risks facing financial institutions' balance sheets are definitely widening. Furthermore, if the RBNZ determines that risks are elevated—and keep in mind that risks are starting to be defined far more generally—a bank will have to hold more capital against such risks. It also means that a bank's balance sheet will have to be funded with more equity than debt.

## Kiwi Property issues 7-year green bonds, ANZ preparing subordinated bond issue

Kiwi Property issued seven-year green bonds at a time when debt in general is very well sought after. In addition, the ANZ is bringing a subordinated bond issue which will be a five plus five years (first five years will be equity credits); this issuance will have a minus credit rating compared to the ANZ's senior unsecured rating of AA-, and we believe the new issuance should see broad support from retail and wholesale markets. Also of note, the Asian Development Bank issued a 2026 gender bond, which is an ESG bond supporting women in business.

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