2022 New Zealand Fixed Income Outlook: Boxing on into 2022

December 2021

By Fergus McDonald, Head of Bonds & Currency

Boxing on into 2022: A financial markets perspective

For a nation that prides itself on punching above its weight in all we do, 2021 has seen us bobbing and weaving against the ropes somewhat, as we've fought the economic impact of an enduring COVID-19 pandemic. We may have been down in some places, but we're certainly not out.

The blows we've taken have been felt keenly by the bond and equity markets, which after years of delivering strong returns to New Zealand investors have this year underperformed their global counterparts. However, while the NZX has waned, private equity has waxed with many companies, particularly in the tech sector, attracting global interest.

Our export sector continues to underpin our recovery—not least through our dairy industry which, despite its many criticisms, has this year poured billions of dollars into New Zealand's economy to help make up for the lost output from international tourism, education and hospitality. Add in our still buoyant commercial and residential property markets, and from a macro level we can see that total economic activity has held up well. The question on all of our lips though, is will this continue?

Red flags near and far

To look forward, we still need to look back. In the past New Zealand has been able to rely on a growing population to add momentum to its economic growth rates. But with immigration having been stalled by the pandemic, and the increasing likelihood of more Kiwis looking offshore for opportunities or feeling less inclined to return home, at least in the short term, we look set to remain handicapped by a countrywide skills shortage. Without this growth potential, I believe we'll see the official cash rate (OCR) peaking earlier than the Reserve Bank of New Zealand (RBNZ) and financial markets are currently pricing.

There are also global threats to New Zealand's economic wellbeing that have been signalled this year. The US is starting to tighten its monetary policy—a move that will likely slow the world's largest economy and the largest buyer of consumer goods. China's growth rate is also likely to slow, which has implications for our export sector and therefore our overall prosperity. Given that it's our top export destination, China's aging population and falling birth rate remains a longer-term concern.

Life gets in the way

So called "black swan" events that impact global economies, like the COVID-19 pandemic, are unpredictable but also increasingly less unexpected. Natural disasters that are still termed "one-in-a-hundred-year" phenomena seem to now occur with far greater frequency than their nomenclature suggests; while developments as varied as Brexit, armed conflict, the GFC and nuclear meltdowns continue to offer regular reminders that we don't need to rely on

Mother Nature to put ourselves on the back foot. We also can't ignore the impact of the possible emergence of further COVID variants.

With the first economic policy response from central banks to such events being to cut interest rates, my point here is that life has this uncanny knack of simply getting in the way. So, while the RBNZ is forecasting raising the cash rate by 2.6% by the end of 2023, it may not get the chance to push it this high if, indeed, life gets in the way again.

Housing

We all know of the negative impact rising mortgage rates have on the housing market. But this is by no means the only headwind the sector now faces—particularly in our biggest centre, Auckland. In the year to June 2021, Auckland's population actually fell for the first time on record, as immigration was strangled by the pandemic and an increasing number of Aucklanders reacted to it by heading for the provinces. Another example of life getting in the way.

The corollary of this is that 2022 will likely see more developers put their plans on hold as demand for new builds decline. I expect the pace of house price growth to reduce and then plateau, which will take some of the heat out of both the sales and construction sectors.

More than just a numbers game

Supporting the country's wellbeing through economic growth isn't all just about numbers. Nurturing the feeling of inclusiveness; providing a good education for our children; letting families grow up in healthy homes in safe neighbourhoods; having a well-resourced health sector; providing the elderly and needy with dignity and support; and even supporting the business community in times of crisis are all things we can and should strive to achieve.

These things take money. Some of them, a lot of money. That's why having economic settings that support healthy business and export sectors and encourage an environment that provides jobs and income for all New Zealanders matters.

Creating the right economic settings for our emerging tech and innovation sectors to thrive is central to our future well-being. The economic and employment impact of the New Zealand tech sector over the last decade has been huge. Rocket Lab, Xero, Weta Digital, Zuru … these are all home grown businesses attracting huge global investor attention while providing Kiwis with highly paid work and the opportunity to further develop and enhance their talents.

Alongside our tech sector, let's not forget that there is also the upside potential of the down-trodden hospitality, tourism and education sectors coming back to life as 2022 progresses. If this bounce back is to occur, it will add significantly to the strong performance of the export sector that has helped sustain New Zealand income levels over the dark days of the pandemic lockdowns.

But let's end with some numbers nonetheless

With the caveat that if the last two years have shown us anything, it's surely the folly of making predictions, I'll stick out my neck sufficiently to say that inflation, the OCR and long-term bond yields will all peak in 2022. Long-term bond yields are likely to peak before the OCR tightening cycle is complete, and I'm picking that the CPI will likely reach its highest point by mid-2022. Pending no further extended lockdowns from other COVID variants, I'd expect the Delta variant rebound to have lost its momentum by September, at a time when house prices are stalling and migrant numbers remain low. Collectively these influences will reduce the pressure for interest rates to rise further.

Reference to individual stocks is for illustration purpose only and does not guarantee their continued inclusion in the strategy's portfolio, nor constitute a recommendation to buy or sell.

Important information: This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (Nikko AM) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute personal investment advice or a personal recommendation and it does not consider in any way the objectives, financial situation or needs of any recipients. All recipients are recommended to consult with their independent tax, financial and legal advisers prior to any investment.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this document will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual securities, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association.

United Kingdom and rest of Europe: This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the Financial Conduct Authority (the FCA) (FRN 122084). This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the FCA in the United Kingdom, and is directed at professional clients as defined in the FCA Handbook of Rules and Guidance.

United States: This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information to institutional investors as defined in the Securities and Futures Act (Chapter 289), and intermediaries only. Nikko Asset Management Asia Limited (Co. Reg. No. 198202562H) is regulated by the Monetary Authority of Singapore.

Hong Kong: This document is for information to professional investors as defined in the Securities and Futures Ordinance, and intermediaries only. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

New Zealand: This document is issued in New Zealand by Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562). It is for the use of wholesale clients, researchers, licensed financial advisers and their authorised representatives only.

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Holdings group and not available to

Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.

Republic of Korea: This document is being provided for general information purposes only, and shall not, and under no circumstances is, to be construed as, an offering of financial investment products or services. Nikko AM is not making any representation with respect to the eligibility of any person to acquire any financial investment product or service. The offering and sale of any financial investment product is subject to the applicable regulations of the Republic of Korea. Any interests in a fund or collective investment scheme shall be sold after such fund is registered under the private placement registration regime in accordance with the applicable regulations of the Republic of Korea, and the offering of such registered fund shall be conducted only through a locally licensed distributor.