

New Zealand Fixed Income Monthly

April 2022

Bonds remain under pressure, New Zealand's tightening cycle ahead of its peers

18 May 2022

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Bond market remains under pressure

The New Zealand bond market remained under pressure, with the 10-year yield rising to 3.65% end-April from 3.27% a month prior. It has still been a tough year so far for New Zealand bonds amid pressure from inflation. That said, the market in New Zealand has been an outperformer among global peers since the beginning of 2022. Central banks globally have a strong desire to rein in inflation expectations because they lead to wage and price setting behaviour, which will be harder to control down the road if left unchecked.

New Zealand's tightening cycle well ahead of its peers

New Zealand's tightening cycle is well ahead of other countries, with the Reserve Bank of New Zealand (RBNZ) raising the Official Cash Rate (OCR) in October 2021. The OCR is currently at 1.5%, having started the latest tightening cycle at 0.25%. Mortgage rates have been rising above the cash rate as the market has been trying to price in further RBNZ moves into long-term rates. House prices peaked around October to November of 2021 and have declined since then, mainly in population centres such as Auckland and Wellington. We believe that this negative wealth effect on the economy should not be underestimated.

Re-opened borders helpful for the economy, but tourist sector recovery could be slow

The general level of prices in New Zealand is rising far more quickly than incomes, and this has taken a toll on consumer confidence. The re-opening of the country's borders after a series of tough COVID-19 restrictions will be helpful for the economy, but the tourist sector's recovery is likely to be slow. Neighbouring Australia re-opened its borders slightly ahead of New Zealand, but it hasn't seen a big surge in inbound tourism. Both Australia and New Zealand are heavily reliant on Chinese tourists, who may not be able to leave their country in a significant way until 2023 or later. Furthermore, tourists originating elsewhere in the northern hemisphere may refrain from immediately taking long-haul journeys.

Labour market strong, for now

One bright spot in the economy is the consistently strong labour market, which we are keeping a close eye on. However, if the labour market is unable to hold up, the RBNZ may have to backtrack on its rate hike projections. For now, the central bank is expected to hike the OCR by 50 basis points at its next policy meeting on 25 May. The RBNZ's perceived high point for the cash rate remains 3.25% to 3.50%, to be reached late in 2023 or early 2024. Tools such as loan-to-value ratio and debt-to-income ratio restrictions could become a permanent part of the RBNZ's toolkit to control the housing market and therefore the economy. These tools may impact the interest rate market as the RBNZ will become less reliant on interest rate adjustments.

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