Debt Market Update

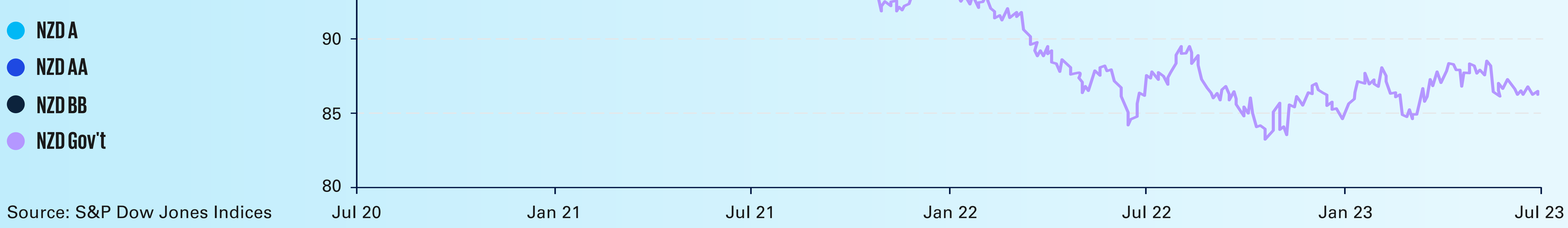
August 2023

The RBNZ increased the Official Cash Rate (OCR) by 25bps to a 14 year high of 5.50% in its May meeting. The increase marked the twelfth consecutive OCR rise since October 2021, with the RBNZ signaling that its tightening monetary policy cycle has achieved the target of reigning in widespread inflation. In its July meeting RBNZ maintained a 5.50% OCR. The OCR is expected to remain stable at this elevated level well into next year.

- At its May meeting, the RBNZ Monetary Policy Committee (MPC) increased the OCR by 25bps to take the OCR to 5.50%, the highest since October 2008.
- The RBNZ's statement noted that, "while inflation decreased more than expected, it is still too high and most measures of core inflation have remained near their recent peaks." Annual CPI figures declined from 7.2% in the December 2022 quarter to 6.0% in the June 2023 quarter.
- In its July meeting, the RBNZ MPC agreed to leave the OCR at 5.50%.
- The RBNZ is confident that keeping the OCR at its current level will bring inflation back to within the 1-3% target range whilst also supporting maximum sustainable employment.
- The RBNZ remains more hawkish than some global central banks, with the Reserve Bank of Australia setting its cash rate at 4.10% following its June meeting. Furthermore, the US Federal Fund Rate sits at 5.25% following the Federal Reserve's June meeting.
- The 90 day Bank Bill Benchmark Rate (BKBM) climbed to 587bps before falling to 569bps following the RBNZ's May announcement, and remains around this level.
- The BKBM now sits above the 3 year and 5 year swap rates, indicating the market is anticipating rates will soften in the medium to long term.
- The S&P/NZX Fixed Interest Series is a broad benchmark index family designed to measure the performance of the NZ bond market. The chart below presents the performance of NZX AA, A and BBB Rated Corporate bonds against Government Bonds over the last three years. All four indices have declined over the period, largely due to the effect of sustained and increasing OCR hikes by the RBNZ.

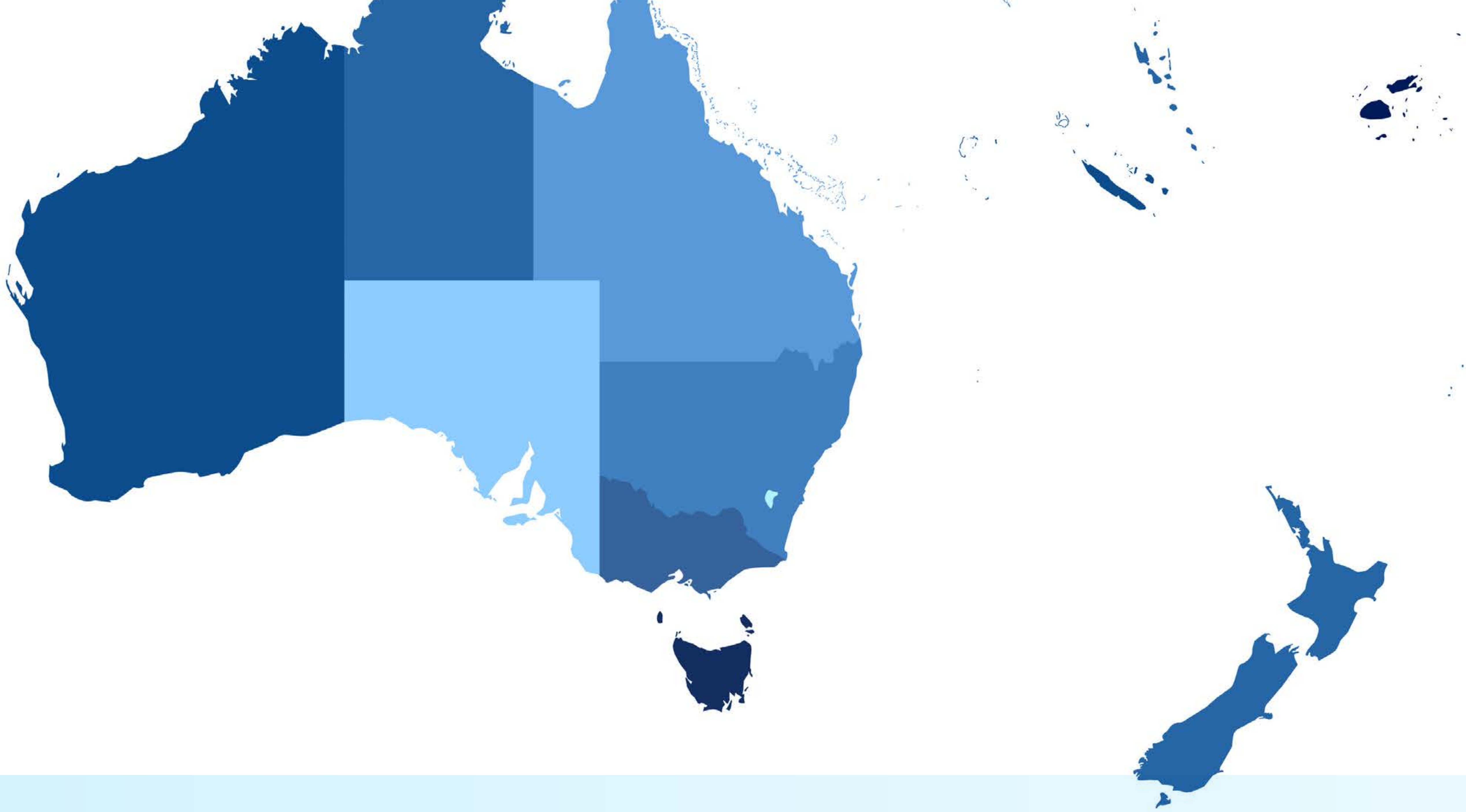
Figure 1

NZ 3-YEAR INVESTMENT GRADE BOND INDICES VS GOVERNMENT BOND INDEX



Source: S&P Dow Jones Indices

Looking across the ditch

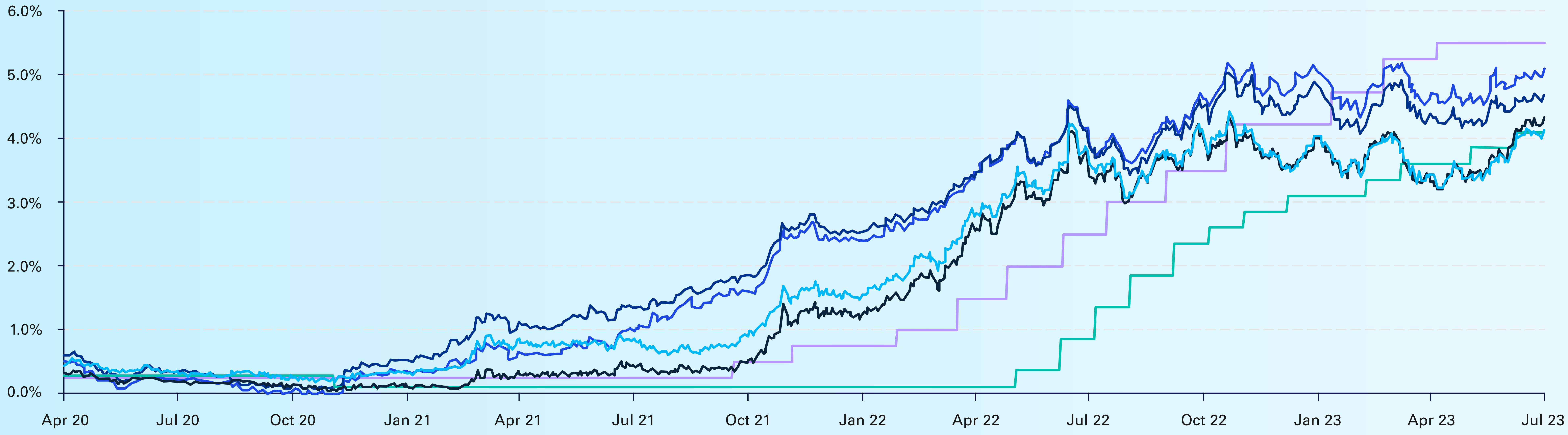


- Australian and New Zealand 3 year and 5 year swap rates were increasingly divergent to begin 2023 as the Reserve Bank of Australia (RBA)'s expectations remained more dovish than its Kiwi counterpart. That being said, the tightening of Australian monetary policy at the May and June RBA Board meetings, and analogous levels of inflation, have contributed to a convergence in swap rates.
- Much like the cash rate set by RBA when compared to RBNZ, Australian swap rates remain below NZ rates, as well as tighter over medium-term horizons. Movements of swap rates in both countries appear to have settled with more confidence surrounding prevailing interest rates.

Figure 2

NEW ZEALAND VS AUSTRALIAN CASH RATES & SWAP RATES

- NZD OCR
- NZD 3Yr Swap
- NZD 5Yr Swap
- AUD Cash Rate
- AUD 3Yr Swap
- AUD 5Yr Swap



Sources: Refinitiv, RBNZ, RBA (July 2023)

Debt Issuance

- Despite persistent uncertainty in market conditions, the New Zealand bond and loan markets reflected optimistic investor appetite evidenced by a number of substantial Green, Social, Sustainability and Sustainability-Linked (GSSS) transactions. 18% of the listed bonds issued in the first half of 2023 had a GSSS label.
- The World Bank's International Bank for Reconstruction and Development (AAA, S&P) priced a NZD$950m three-year fixed rate Sustainable Development Bond – the largest three-year transaction in the Kauri market to date.
- Renewable energy generator Meridian Energy (BBB+, S&P) made its first issuance in the primary market since 2018 with a NZD$200m green bond deal.
- Auckland International Airport issued a further NZD$150m in 5.5-year fixed-rate bonds to retail and institutional investors to bolster its ongoing investment programme and meet its working capital requirements.

Notable bond and syndicated loan issuances					
Borrower	**Type**	**Date**	**Amount (NZD m)**	**Tenor (yrs)**	**Yield (bps)**
IBRD	B	22-Jun-23	950	3	500
Meridian Energy	B	20-Mar-23	200	5.5	524
Kiwi Property Group	B	27-Mar23	125	6.5	624
Auckland Int'l Airport	B	17-May-23	100	3	544
CCHL Ltd	B	6-Apr-23	150	5	504
NZ LGFA	B	17-Apr-23	1100	5&1/12	476
Borrower	**Type**	**Date**	**Amount (NZD m)**	**Tenor (yrs)**	**Margin (bps)**
KMD Group Ltd	L	16-May-23	310	3.5	-
WIAL Ltd	L	3-Apr-23	100	-	-

- April saw Christchurch City Holdings Limited (CCHL) issue NZD$150m of bonds in efforts to reduce its current commercial paper and LGFA funding positions.
- Wellington International Airport strengthened its commitments to sustainable initiatives as it converted NZD$100m of bank facilities into sustainability-linked loans.
- In May, KMD Brands completed a NZD$310m sustainability-linked debt refinance of its existing syndicated facilities, with revised targets that incorporate a pricing mechanism that incentivises ongoing improvement in achieving key ESG objectives.
- The organisation responsible for providing diversified financing sources to local government, the Local Government Funding Agency (LGFA), issued NZD$1.1b of sustainable financing bonds. Funds are used by the LGFA to issue loans to member councils and CCOs under the Green, Social and Sustainability (GSS) Lending Programme and the Climate Action Loans (CALs) Programme.

Figure 3

NZX BOND ISSUANCE JANUARY - JUNE 2023

- Volume (NZ$m)
- No. of deals per month (RHS)

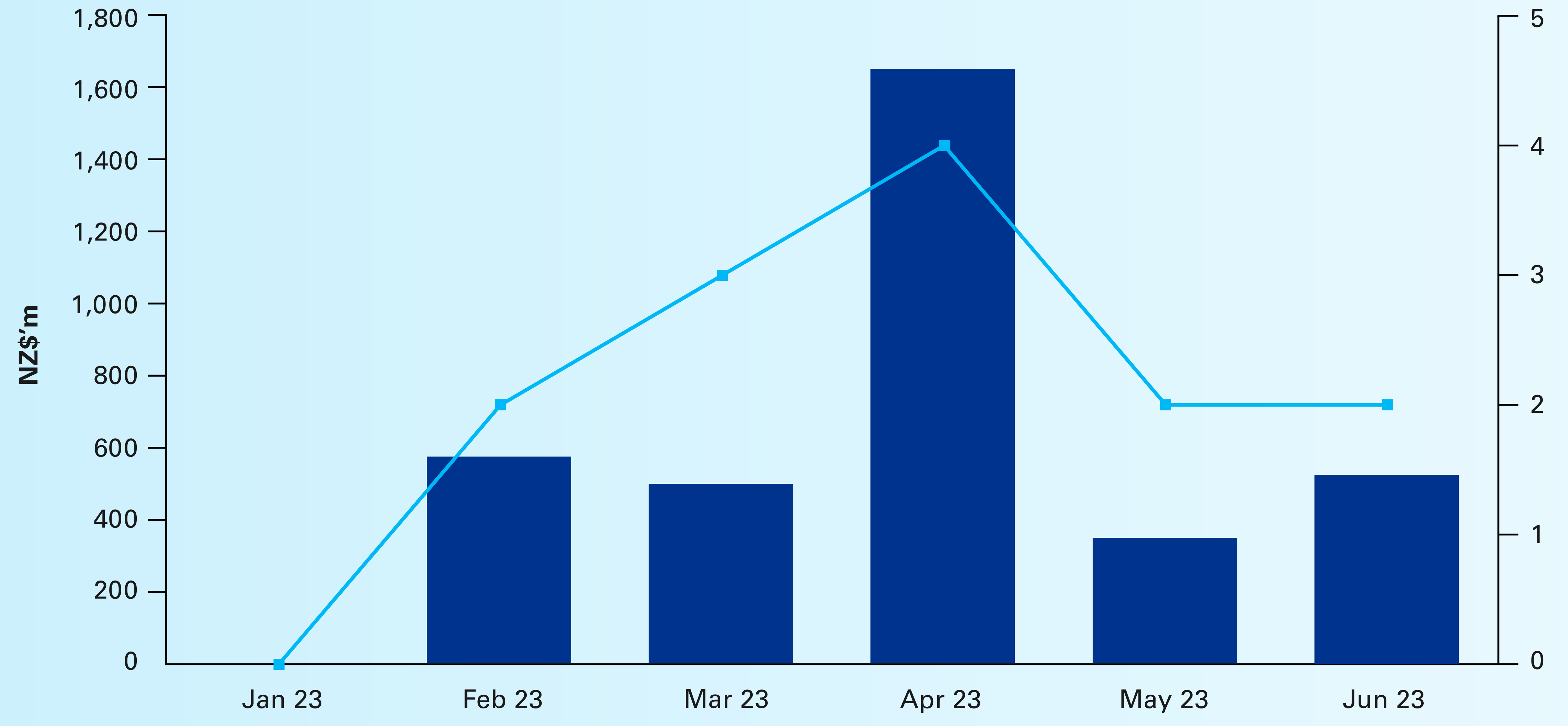
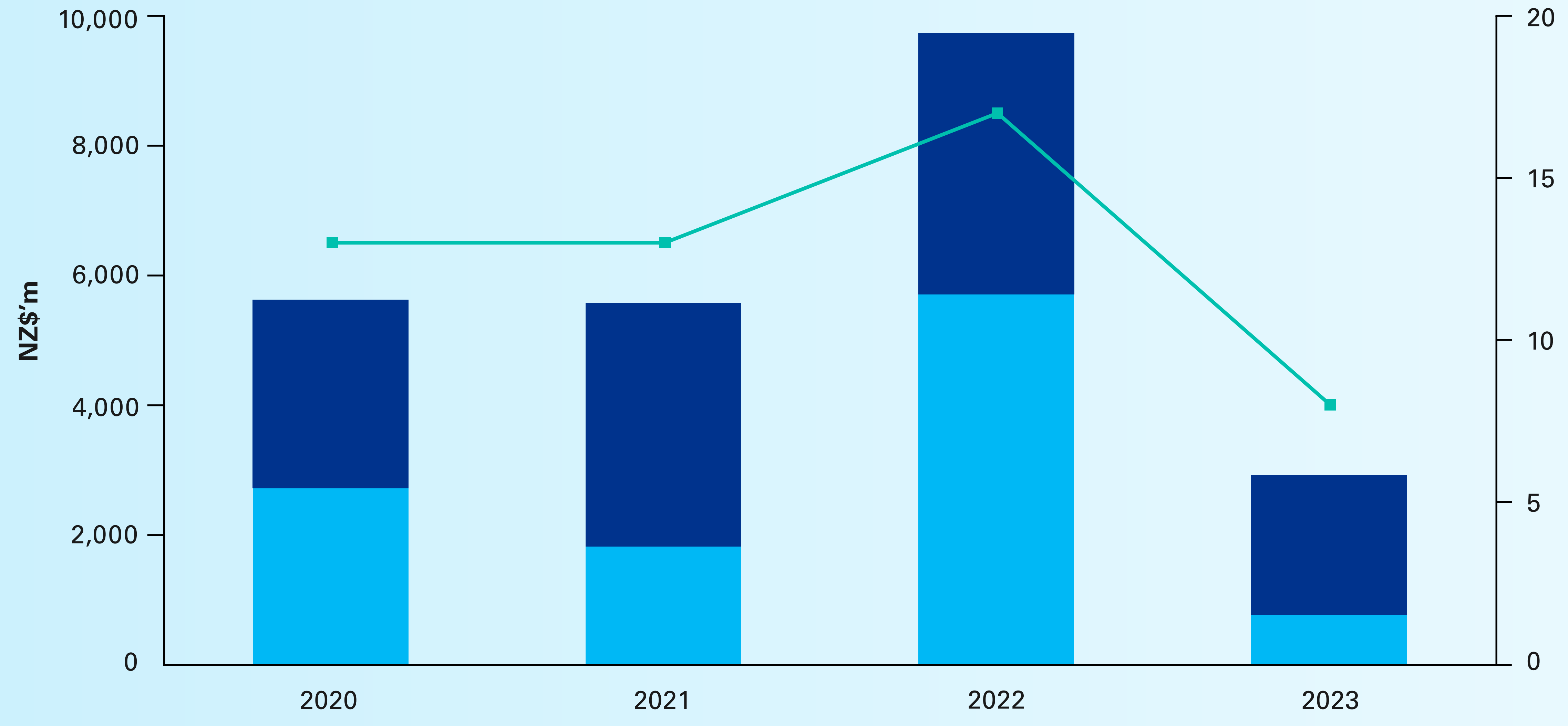


Figure 4

NEW ZEALAND SUSTAINABLE BOND DEAL VOLUME

- Domestic Deals
- Kauri Deals
- Number of Deals (RHS)



Forecast for Q3 2023 and beyond:

- Treasury has increased its forecast for the 2023/24 New Zealand Government Bond (NZGB) programme to NZD$34b. Before Covid-19, the bond tender forecast was only NZD$6b. The NZ Debt Management Office has advised they intend to take a more flexible approach to short-term borrowing.
- With a reduction in RBNZ bond buying, the NZ debt market will ultimately need to rely on foreign investors – who already account for approximately 60% of the market.

FIPS observations:

- KPMG NZ recently released its March quarterly review on the banking sector. The sector's net profits decreased by 13% to NZD$1.54b in the quarter ended March 2023. The major banks saw a substantial increase of 192% to impaired asset expenses when compared to the previous quarter. The banks have begun to increase their loan provisions, with impairment charges being the single largest contributor to the decrease in banking sector profits.
- A negative outlook is visible at both a consumer and institutional level, as credit arrears continue to climb for Kiwi households, and credit spreads widen in the wake of tougher economic conditions.

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