Impact on New Zealand Debt Markets

In recent days we've heard fears expressed that credit markets have ground to a halt as result of COVID-19: so far this is not the case. While banks and non-bank deposit takers are certainly cautious, markets are still very much open and functioning.

So far, we haven't seen the rapid withdrawing of credit that was at the heart of the GFC. This means that there is a real chance for businesses to remember those lessons and not be caught sitting on their hands when liquidity is available to set-up for a post-crisis environment. But what are the factors that need to be considered first?

Cost of credit is rising but will be mitigated

The profile of borrowers that lenders will provide funding to – and the price at which they will advance that funding – has changed swiftly as a result of the pandemic and the length of the crisis will dictate what further movements there will be in the coming months.

The coronavirus-triggered increases in the cost of credit could be anywhere between 50 and 150 basis points or higher, depending on where you fit in terms of exposure to date and therefore on the credit spectrum

Offsetting this, however, is the fact that interest rates have reduced as the Reserve Bank has reacted swiftly to cut rates. This means that any increase in margins in the short term is likely to be partially offset by the reduction in the base rate. It has also deferred planned capital rules by 12 months delaying what would otherwise have resulted in an increase in pricing.

Banks have liquidity ready

The strong message we are getting currently from the banks is that they are open for business with liquidity to deploy to help shore up businesses. Banks are certainly signalling that they are keen to step up and support their customers.

New Zealand's major banks are relatively well capitalised and have buffers in place to ride the wave of events like the current pandemic. With these factors considered, along with the scope of the RBNZ to provide additional support, we believe the banking system is well placed to continue supporting long-term growth, however under scenario 2 – a longer term recovery - it remains unclear what appetite banks will have to lend.

If you want funding, you need a solid plan

Let's be clear: It won't be straightforward for most businesses to secure credit in this environment. That's especially the case if you operate in a vulnerable sector severely impacted by COVID-19. The hurdles to get approvals will be higher than they have been historically. In Australia we're hearing some new-to-bank sign offs will now automatically go to the national head of credit, (and maybe even offshore for foreign banks), for approval and we'd expect the same to apply here.

Several businesses are saying they need short-term financing and working capital support to deal with the cash flow implications of coronavirus. Developing a solid plan and identifying the levers available to the business to manage short-term funding requirements will be an important element in discussions with lenders. The long-term outlook and impact of COVID-19 is still uncertain. Planning for a period of volatility will be a critical feature of any plan.

Accessing the debt market or equity markets for liquidity will require a clearly articulated plan and strategy.

There are alternate funding options that weren't available during the GFC

New Zealand has only just started to see the influx of new players into the private credit market that has been a feature of the Australian debt markets over the past decade. What has been a feature is the emergence of new international players in the New Zealand banking market, particularly from Asia and Europe. There is available liquidity outside of the traditional sources in the New Zealand market if you know where to look, particularly for higher quality credits.

The culmination of these factors makes the current situation significantly better for borrowers than it was in 2009/2010. Back then, given the position of the banks and the significant cost of accessing the equity markets for listed companies, a number of companies had limited options which meant that many just rode the crisis out. Today that may not be necessary.