BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Bramwell Brown Limited – Newsletter – August 2016

Germany

Our three weeks in Germany and Italy to attend our son's wedding was a welcome break from the New Zealand winter. Coming home to eight degrees after a week of thirty-five degree heat in Rome and Milan was a shock to the system, and the subsequent flu-like cough and cold is an inevitable consequence of spending twenty three hours in a plane.

It seems investors in Europe are grappling with very similar problems to those here – low interest rates, volatility, and high asset prices (including housing). These issues were complicated while we were there by the Brexit vote, which brought immigration to the forefront of the problems facing Europe. From what I saw on TV and read in the papers Brexit was more about immigration than it was about economics. The majority of people I spoke to in Germany, while initially in favour of opening their borders to refugees, are now regretting that policy. As much as I enjoyed the Europe experience I found the sight of police armed with sub-machine guns at airports, railway stations, banks and embassies a bit disconcerting. It was good to get back to provincial New Zealand!

Interest Rates

If you think our interest rates are low spare a thought for those living in Europe. The German Government issued a ten year bond in July at an interest rate of negative 0.05%. The issue raised €4 billion! Could this happen here in New Zealand? My heart says no but my head says absolutely yes it could happen here. The Reserve Bank is charged with keeping inflation around the 2% level and unfortunately altering the Official Cash Rate is one of the few tools it has to achieve this. If inflation remains below the target level the Reserve Bank will continue to lower interest rates. It is already expected to lower the OCR this month from 2.25% to 2.00%, with predictions of further cuts throughout the year.

These somewhat gloomy predictions cast a new light on the current bank deposit and bond rates on offer. The "new normal" bond rates now have a four in front of them rather than a five, and the bank deposit rates now start with a three. Don't expect this to change any time soon.

Wellington Airport

Wellington International Airport has announced an issue of $60 million of unsecured, unsubordinated, fixed rate bonds.

- Interest rate – 4%
- Maturity date – August 5th 2024
- Interest paid semi-annually in August and February

Westpac Subordinated Notes

Westpac Banking Corporation has announced that it is making an offer of up to NZ$250 million of unsecured, subordinated, fixed rate notes with the ability to accept unlimited oversubscriptions. The offer will open on 5 August 2016 and is expected to close on 26 August 2016. The Offer is only open to investors resident in New Zealand. Investors will only be able to obtain an allocation of Notes through the Joint Lead Managers, the Co-Managers or their financial adviser.

The Notes have a term of 10 years and are scheduled to be repaid on 1 September 2026. However, at Westpac's option and subject to certain conditions, including the prior written approval of the Australian Prudential Regulation Authority (APRA), the Notes may be repaid from 1 September 2021. If Westpac encounters severe financial difficulty, a non-viability trigger event could occur and some or all of the Notes may be converted into Westpac ordinary shares (or written off completely). The Notes will qualify as Tier 2 Capital for Westpac under APRA's Basel III capital adequacy framework.

The Notes will pay a fixed rate of interest, which will be reset on 1 September 2021. The interest rate will be the sum of the New Zealand 5 year swap rate on the rate set date (being 4 August 2016) and the margin. Interest is scheduled to be paid quarterly in arrears subject to Westpac satisfying the solvency condition. The indicative margin range for the Notes is 2.60% to 2.80% per annum. The margin will be determined by Westpac following the bookbuild and will not change over the term of the Notes. The margin and interest rate will be announced via NZX on or before the opening date for the Offer. The Notes are expected to be quoted on the NZX Debt Market and have been assigned a BBB+ rating by S&P Global Ratings.

These notes are designed to absorb losses if a bank experiences severe financial difficulties and may not be suitable for many investors. It is essential potential investors read the investment statement carefully, and understand the nature of these securities. For a fuller explanation of Tier 1 and Tier 2 securities refer to the May 2015 and December 2015 newsletters.