

Financial Stability Report November 2019



**Full details contained in
the FSR on our website –
www.rbnz.govt.nz**

**This presentation is not
financial advice.**



The Financial Stability Report...

reports on the soundness and efficiency of New Zealand's financial system.



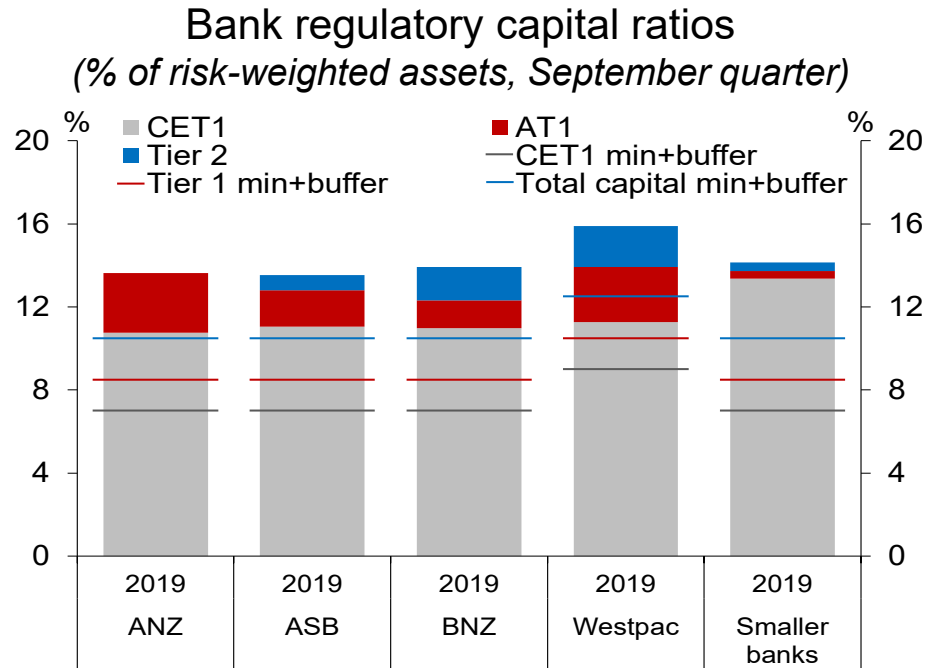
A sound financial system but with risks



1. Sound financial system, but more work needed to improve long-term resilience.
2. Risks from international developments, low interest rates, and inadequate operational risk governance.
3. Current LVR policy remains appropriate to protect against risky household lending.
4. Dairy sector remains vulnerable.
5. Prudential initiatives.



Banks meeting current capital and liquidity requirements

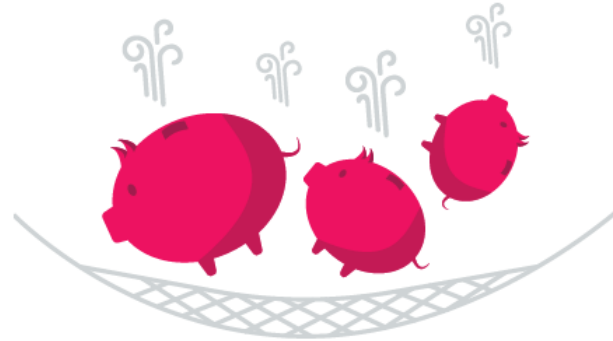


Source: Registered banks' disclosure statements, RBNZ Capital Adequacy Survey.

Note: CET1 stands for Common Equity Tier 1 capital. AT1 stands for Additional Tier 1 capital.

Bank Capital Review decision coming on 5 December

- To help the banking system weather a severe downturn, the RBNZ is reviewing:
 - The types of instruments that qualify as capital.
 - Calculation of risk-weighted assets.
 - Regulatory capital ratio requirements.



Banks' operational risk governance needs work



- Breaches of conditions of registration.
 - Calculation errors.
 - Weak processes.
 - Need for better assurance frameworks.
- Weaknesses revealed in Culture and Conduct review.
- Reserve Bank to take more intensive supervisory approach.



Cyber risk grows with technological advancement

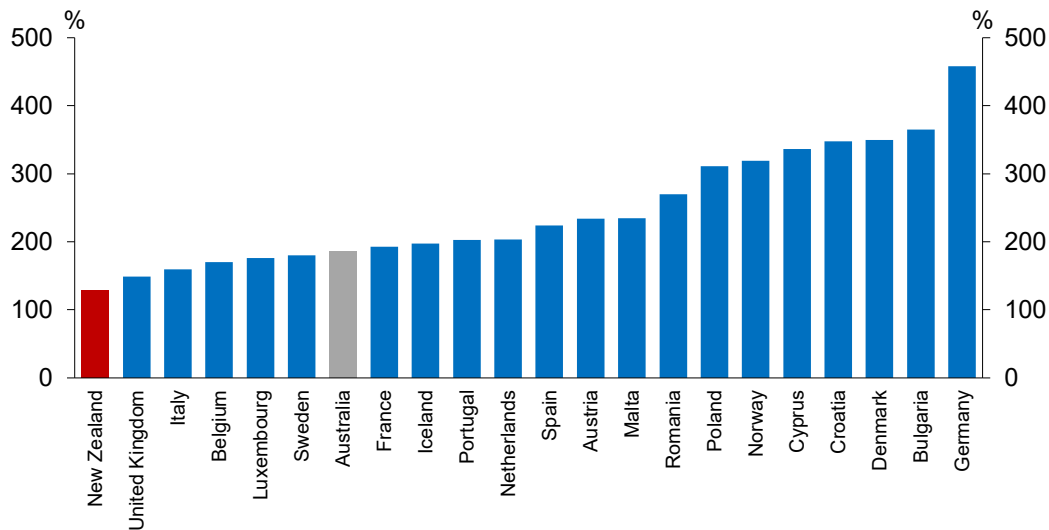
- Cyber incidents on the rise in number and severity.
- Public and private interests on cyber are aligned to an extent.
- But the Reserve Bank sees benefit in
 - information-sharing.
 - development of principle-based guidance.



Some insurers have low solvency buffers



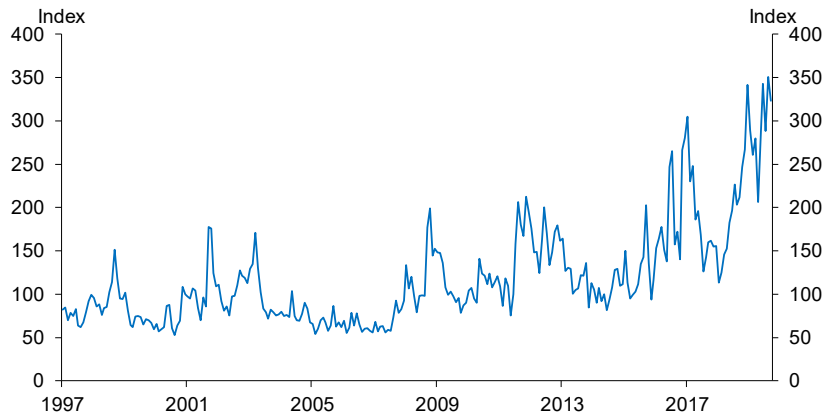
Solvency ratios of international life insurers
(2018)



Trade tensions and uncertainty are a drag on global growth...



Global economic policy uncertainty index



Trading partner real GDP growth (annual)

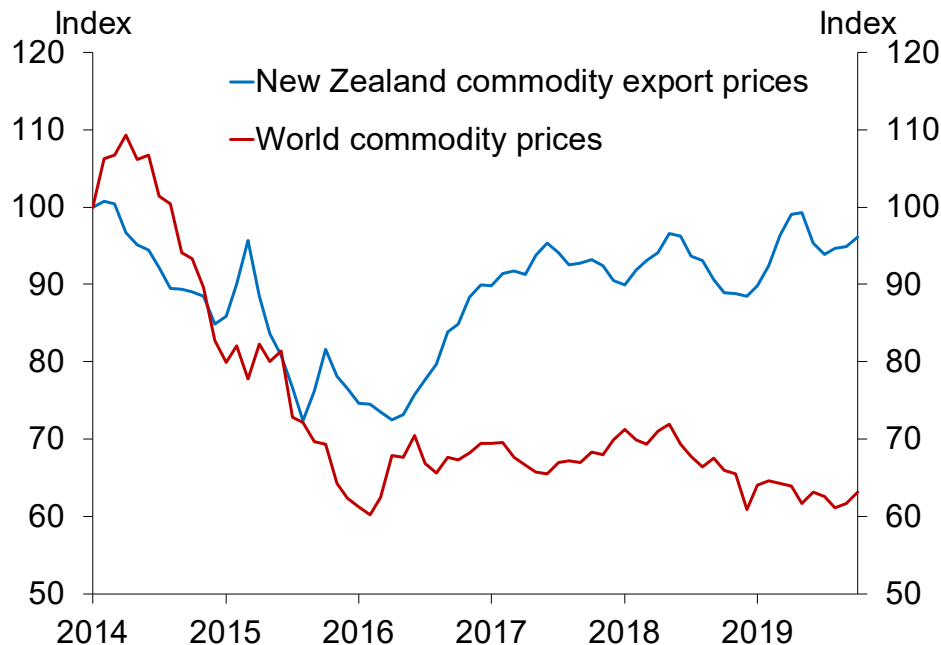




...but New Zealand has been largely sheltered from the impact so far



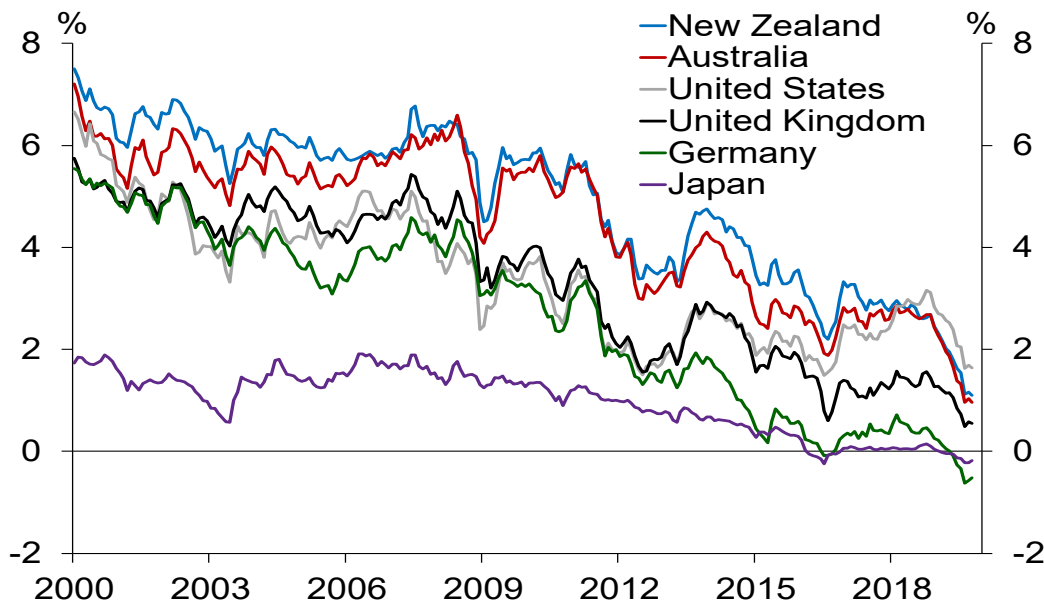
Relative performance of NZ commodity export prices
(January 2014 = 100)



Monetary stimulus has driven global interest rates to low levels



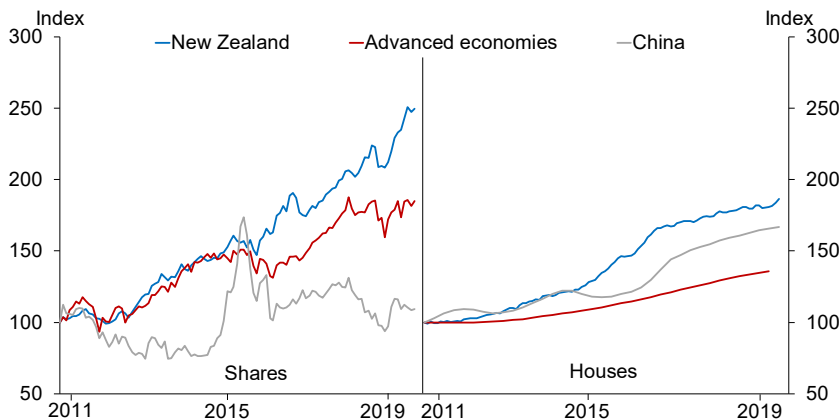
10-year government bond yields
(monthly average)



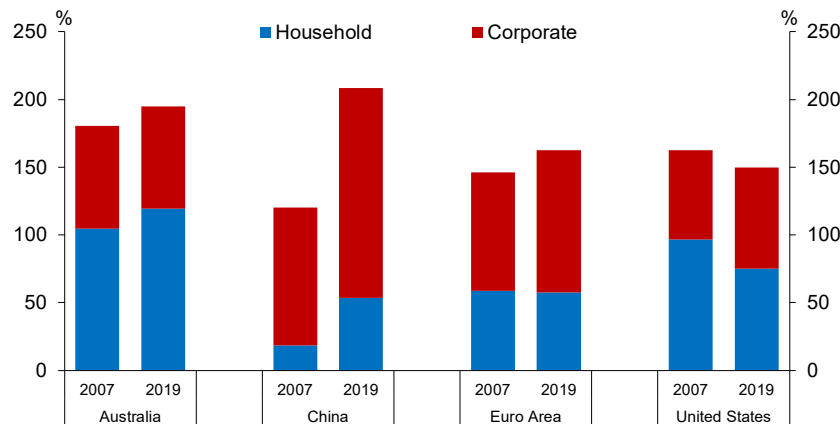
Low interest rates could lead to excessive debt and overheated asset prices...



Asset prices
(March 2009 = 100)



Non-financial corporate and household debt
(% of GDP)



...and could affect bank profitability

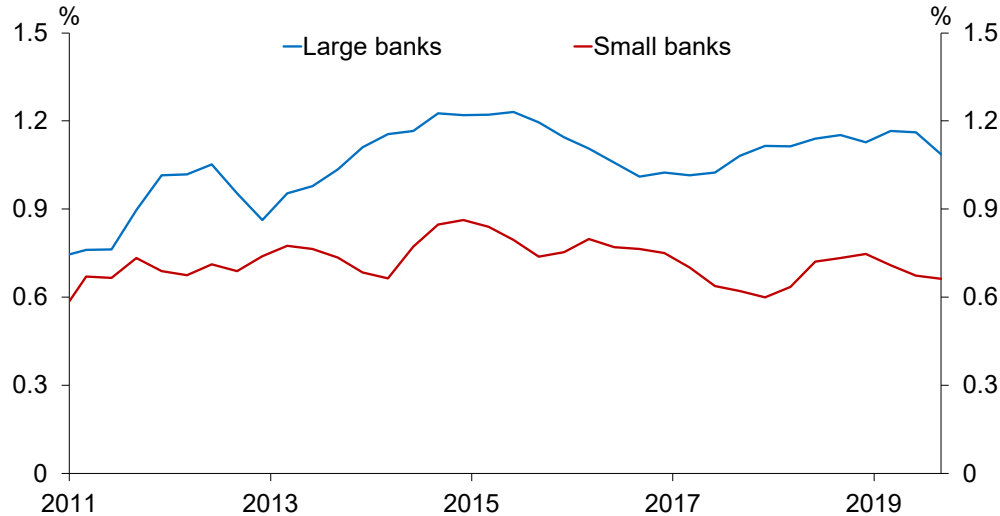
- Low interest rates can reduce profits by
 - compressing net interest margins.
 - flattening of yield curve.
- However, internationally banks have effective responses.
 - Increased fee-based incomes.
 - Greater lending volumes.
- There are other potential effects on bank resilience (e.g. risk taking).





NZ banks still profitable but with risks from low interest rates

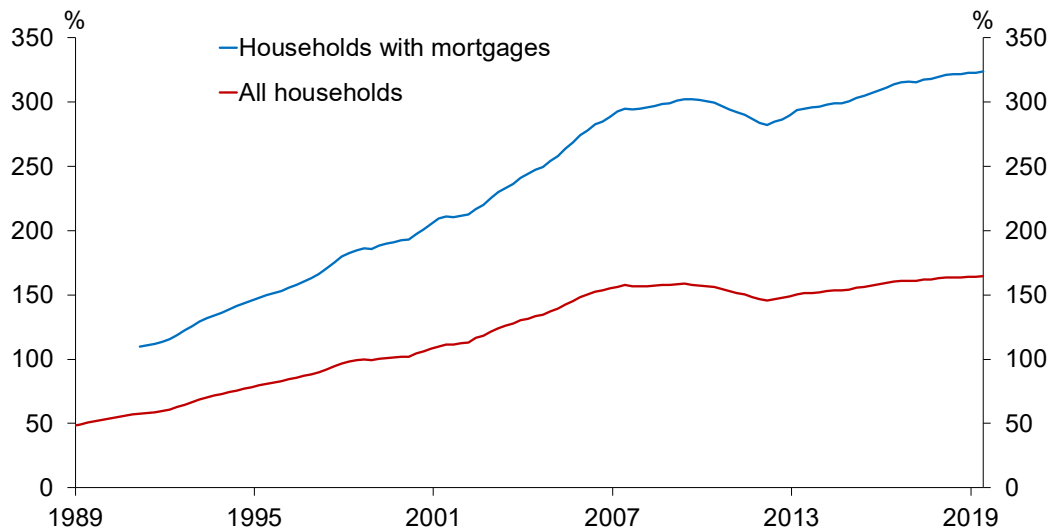
Average return on assets by banks
(% of total assets)



High household debts expose borrowers to financial shocks...



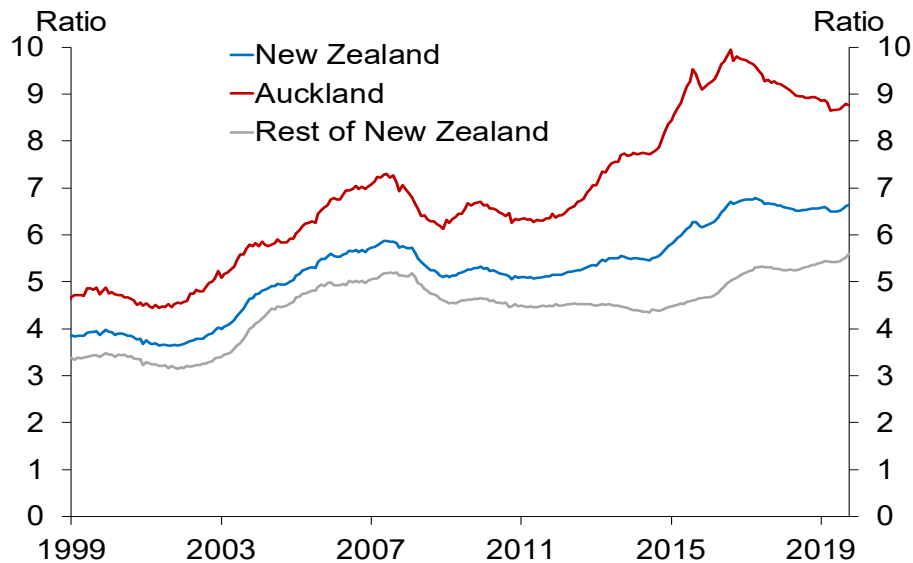
Household debt-to-income ratio



...and house prices remain high, despite recent slowing in growth



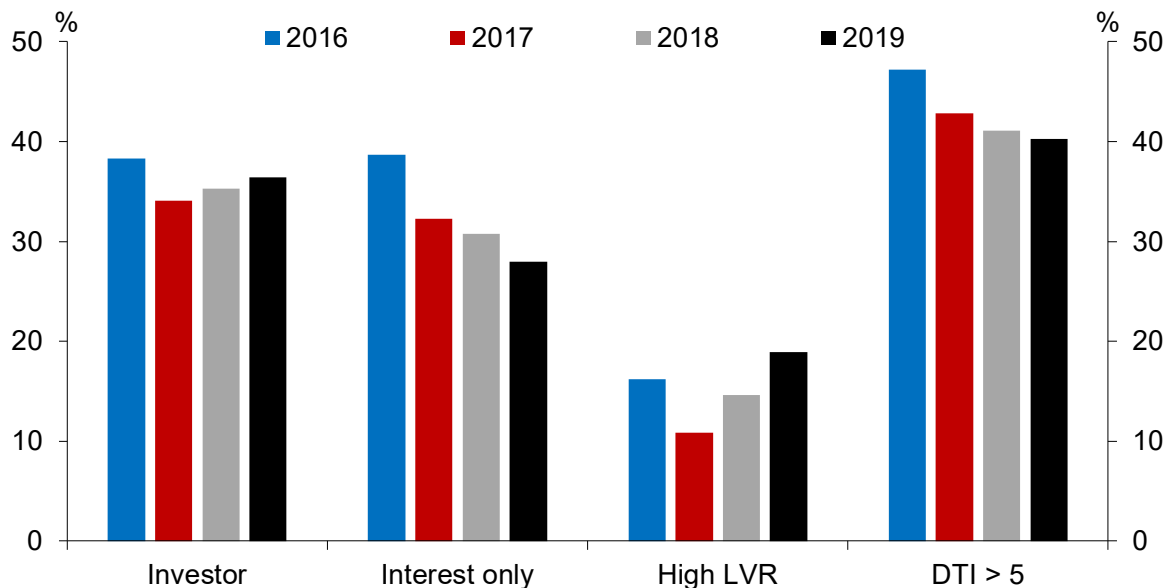
House price-to-income ratio



Early signs that banks are relaxing mortgage lending standards



Risk characteristics of new mortgage lending
(share of new lending, 3 months to August)



Loan-to-value ratio (LVR) restrictions remain to guard against risks

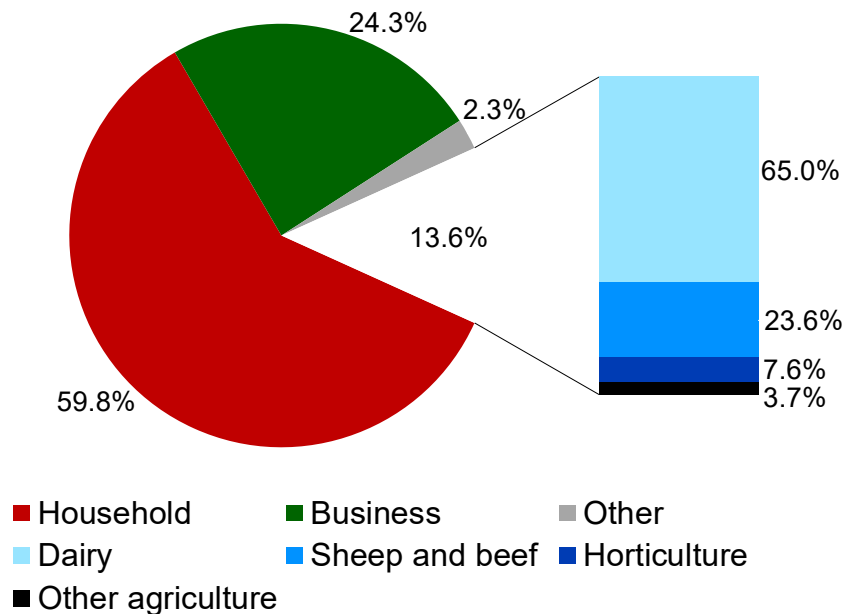
- Housing market imbalances may re-emerge.
 - Low interest rates may fuel debt build-up.
 - Lending standards may loosen.
- Restrictions on high-LVR lending make banks and households more resilient.



Financial system is vulnerable to downturns in the agriculture sector



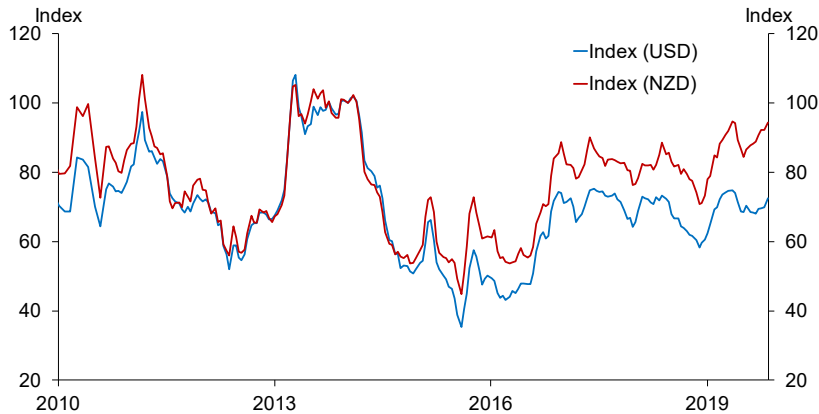
Composition of bank lending



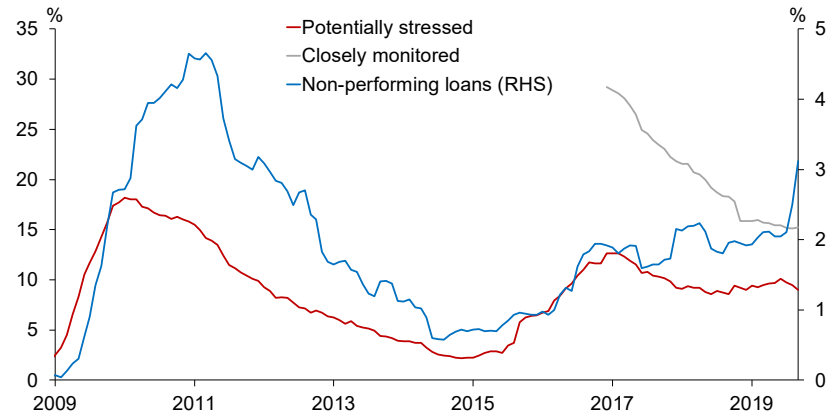
Dairy prices are okay, but dairy debt is high and concentrated



Dairy commodity prices
(January 2014 = 100)



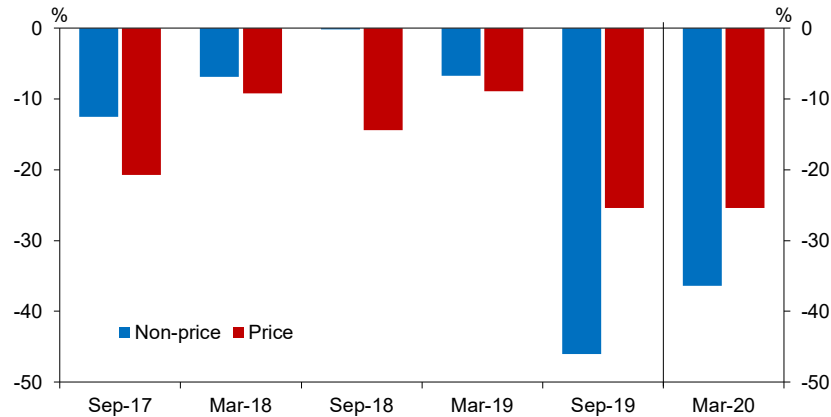
Dairy loan performance metrics



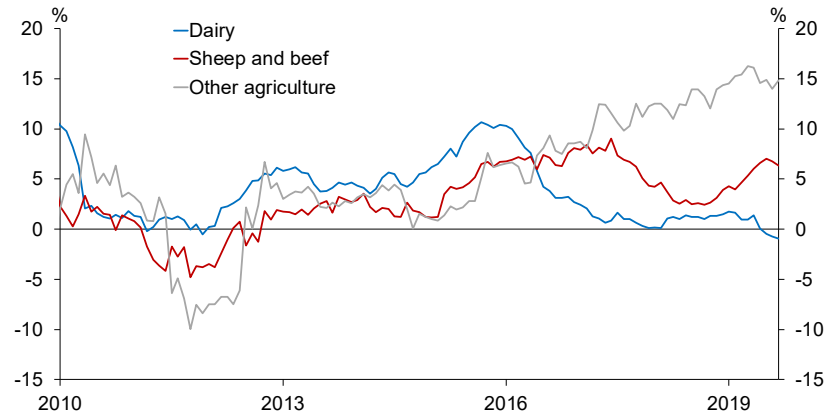
Banks have tightened their dairy lending, and are diversifying their agricultural exposure



Credit availability to the agriculture sector, relative to the previous six months



Annual agriculture sector credit growth



Current prudential initiatives

- Phase 2 review of the Reserve Bank Act.
- Review of capital requirements.
- Liquidity review.
- Framework on breach reporting.
- Review of regulatory framework for insurers.
- Financial Market Infrastructures Bill.
- Climate change strategy.



Questions?





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