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**Submission on Serviceability Restrictions as a Potential Macroprudential Tool in New Zealand**

Thank you for the opportunity to comment on the above document.

The New Zealand Manufacturers and Exporters Association (NZMEA) represents the interests of manufacturers and exporters throughout New Zealand.

The NZMEA is New Zealand's only focused and independent voice for manufacturers and exporters, representing over $6 billion in sales per year, with an export value of around $3 billion. The Association can trace its beginnings back to the early history of New Zealand.

The Association also includes in its membership affiliate organisations such as the Wood Processors and Manufacturers Association, E tū (the merged Engineering, Printing & Manufacturing and Service and Food Workers' Unions), the Heavy Engineering Research Association (HERA), and Plastics New Zealand.

**Comment**

We generally support the introduction of macroprudential tools to protect the financial stability of our banking system, particularly in the face of rising asset prices, as New Zealand has been experiencing.

We believe macroprudential tools should be used to support and supplement the Official Cash Rate (OCR) to jointly target inflation and financial stability. We see the separate pursuit of those targets as artificial and not that helpful. This view is supported by international comment that sees the policy rate and financial stability as interconnected, not separate[1]. Since the Global Financial Crisis (GFC), benchmark interest rates appear to be a tool of limited effectiveness in the face of systematically low inflation around the world - we see any tools in addition to the OCR as being helpful for balancing outcomes, particularly when rising asset prices are putting pressure on decisions between financial stability and growth in the rest of the economy, particularly the productive tradable sector.

We understand that the use of macroprudential interventions present challenges to the central bank, however others have been successful, as is pointed out in examples within the discussion document, and there should be no reason for such success not to be repeated in New Zealand.

We have previously supported the RBNZ's introduction of Loan-to-Value Restrictions and agree with the Bank's evidence that these have been helpful both in increasing the quality of loans and somewhat dampening house price inflation since their introduction, therefore contributing to improved financial stability.

We agree, however, that their effectiveness may fall over time and that they only target one part of the equation; hence the need for DTI limits in addition.

Should the DTI tool be developed, it should be well-used and not simply built and left on the shelf, just in case. Despite the current apparent easing of house price inflation, this may only be temporary and we see such restrictions as potentially acting as a more long-term limit on excessive and potentially risky lending into existing assets.

Excessive asset price inflation and higher lending that requires more tight monetary policy directly effects the tradable sector, through an overvalued exchange rate. We also believe the introduction of additional tools, such as the previous LVR and the potenial DTIs, can vitally give the RBNZ more room to act on other critical elements effecting our economy's growth, most notably, the exchange rate.
The exchange rate remains at levels higher than Reserve Bank forecasts and acts as a factor weakening tradable growth and inflation - we believe this needs more consideration in future decisions.

Over the last four years, we have heard numerous times from the RBNZ about the dampening effect our relativelyhigh exchange rate has been having on tradable inflation and the ability for this part of our economy to grow.

In the August OCR announcment, Governor Wheeler said, *"The trade-weighted exchange rate has increased since the May Statement, partly in response to a weaker US dollar. A lower New Zealand dollar is needed to increase tradable inflation and help deliver more balanced growth."*

In addition to the financial stability risk that recent house price inflation is posing, the price increases are increasingly putting pressure on wages and the ability to get staff. It is becoming harder and harder for staff to afford to live in areas close to where they work, particularly in the Auckland area. This threatens to exasperate existing skill shortages and add additional wage pressure.

*Q1: Do you have any comments on the evidence that high DTI borrowers are more susceptible to mortgage default and consumption stress? Are there other relevant studies, or other relevant channels through which a DTI policy would influence financial stability?*

We agree in large part with the evidence provided in the discussion document, particularlythat DTI limits can be effective in slowing credit growth during housing booms and that investors and those with high DTI loans have a higher chance of coming under stress during periods of financial stability.

*Q2: Do you agree that the current levels of debt (relative to income) that some borrowers are able to borrow risk putting them under pressure, especially if interest rates rise? Why are the DTIs achievable in New Zealand apparently higher than in other markets like the UK?*

We believe one factor influencing the willingness, particularly of investors, to take on high DTIs is expected capital gain. Current tax advantages for housing and assets mean much of this gain will be untaxed, increasing their relative expected gain. The evidence presented in the discussion document showing New Zealand has a high house-price-to-rent ratio while having very high house prices and high house-price-to-income ratios suggests investors are in large part investing in pursuit of capital gain, rather than expected rental income. This area of tax is obviously out of the Reserve Bank's responsibility, but we believe the Bank should continue to point this out to any future Government and encourage it to be addressed.

We would like to point out a critical link missing in the section "Interest rates", on page 20. One of the biggest issues with relying on interest rates alone to lean against building asset prices and financial risks is the impact on the exchange rate. The outcome of having a higher interest rate than we would otherwise require directly influences a higher exchange rate, especially when our interest rates lie higher than those in most of the developed world, as has been the case in recent years.

*Q3: Do you agree with our assessment of other possible policies that are under the Reserve Bank's control, or do you think one or more of them could be preferable to DTI limits? Are there other policy options under the Reserve Bank's control that we haven't listed that could be relevant?*

We believe that DTIs are the most logical and effective solution put forward in the document, given their effectiveness of targeting serviceability of mortgages, and that they have particular potential to be introduced in conjunction with LVRs, especially since it appears that LVRs have a more muted effect over time, in contrast to DTIs.

We support their introduction and believe the Reserve Bank should be willing to use these immediately, in conjunction with existing LVR limits. We point to the RBNZ's comments above regarding the exchange rate needing to fall to boost tradable growth – we believe these additional tools give the Bank more freedom to address this issue.

*Q4: If a DTI policy was used, what would be the challenges and issues that could arise in the detailed rules and (for lenders and the Reserve Bank) monitoring compliance with the policy?*

The main question we have is around the use of mortgages to fund businesses investment. With current banking practises and preferences for asset-backed loans, lending to small businesses for capital investment is hard to secure. So it is unfortunately reasonably common for small businesses to use their home to secure funds. We would like to see the Bank look into this issue further to try and assess the extent of this, and adjust the DTI tool to ensure this source of funding will not be damaged bythe policy.

*Q5: Do you agree that a DTI policy (if implemented) should be broadly as described above (a speed limit, with similar exemptions to the LVR policy)? Are there other design options or additional exemptions (besides the suggestion described above for relatively inexpensive owner occupied homes) that would be worth considering?*

The only comment we have on implementation regards to the answer to question 4 above, regarding how mortgages that are funding business investment area treated.

s9(2)(ba)(i) protect supply of confidential info [redacted]

Yours sincerely

s9(2)(a) privacy [redacted]

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1. Olivier Blanchard, In the Wake of the Crisis, page 9 & 10.