



Dairy portfolio stress testing

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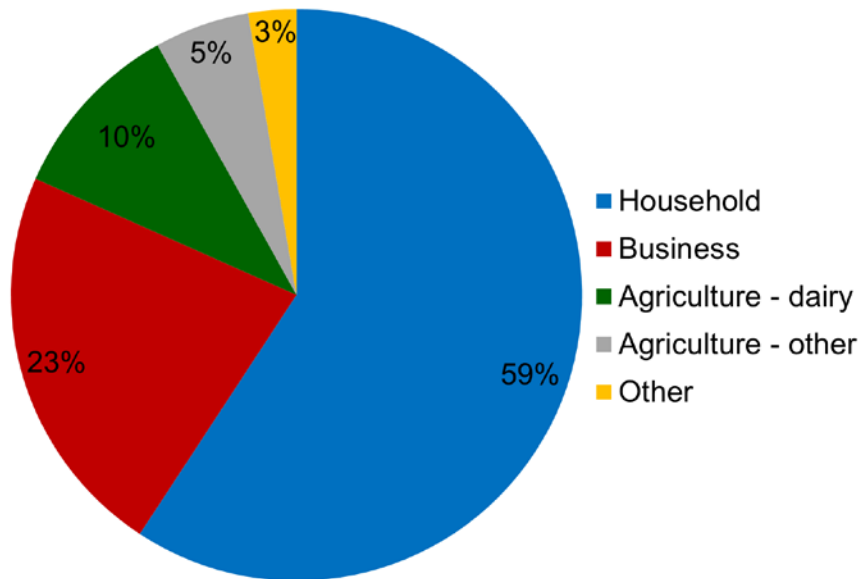
Dairy stress tests - objectives

- How would the banks' dairy sector asset quality evolve under stress scenarios?
- How would banks respond to a rise in defaults?
- Stress tests an input into bank risk management.

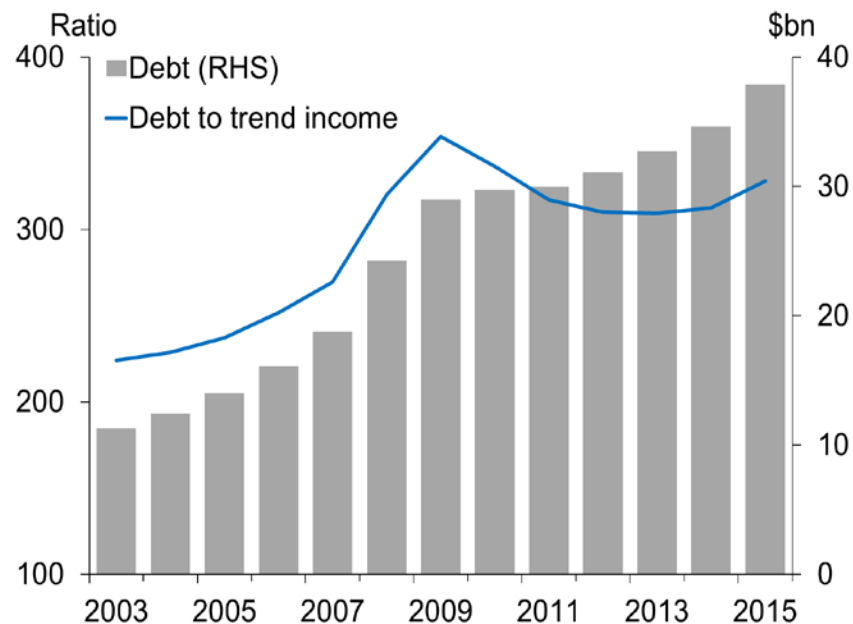


Dairy sector debt

Dairy sector is around 10% of bank lending



Debt levels remain elevated relative to incomes



[Total banking system loans = \$348 billion]



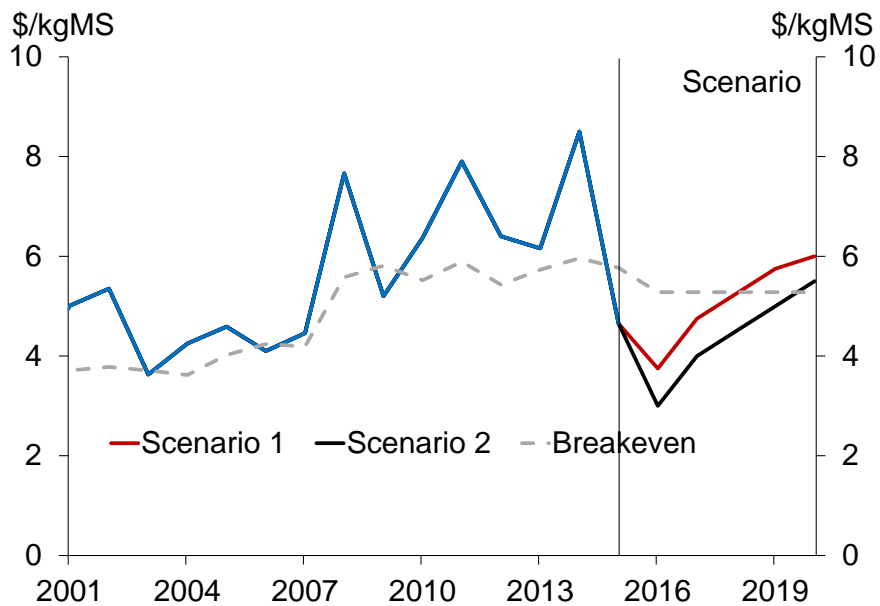
Two stress scenarios

	Fonterra payout (\$ per kgMS)		Dairy land price (% change)	
	Scenario 1	Scenario 2	Scenario 1	Scenario 2
2014-15	4.65	4.65	10	10
2015-16	3.75	3.00	-15	-20
2016-17	4.75	4.00	-10	-15
2017-18	5.25	4.50	0	-10
2018-19	5.75	5.00	0	0
2019-20	6.00	5.50	0	0

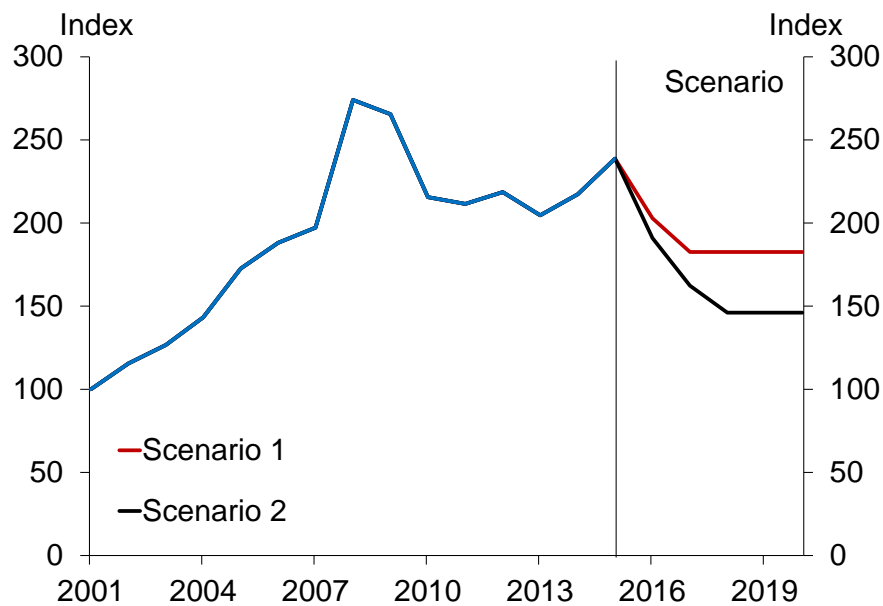


Stress scenarios

Fonterra payout



Farm land price





Three stages in the evolution of problem loans

Rating downgrade

- Assessed risk increases.
- Profits decline due to general provision.
- Required capital increases.



Default

- Breach of loan agreement
- e.g. 90 days past due.
- Profits decline due to specific provision.



Write-off

- Loan collateral is sold.
- Could be voluntary.
- Written off balance sheet.
- Profits adjusted if actual loss differs from provision.

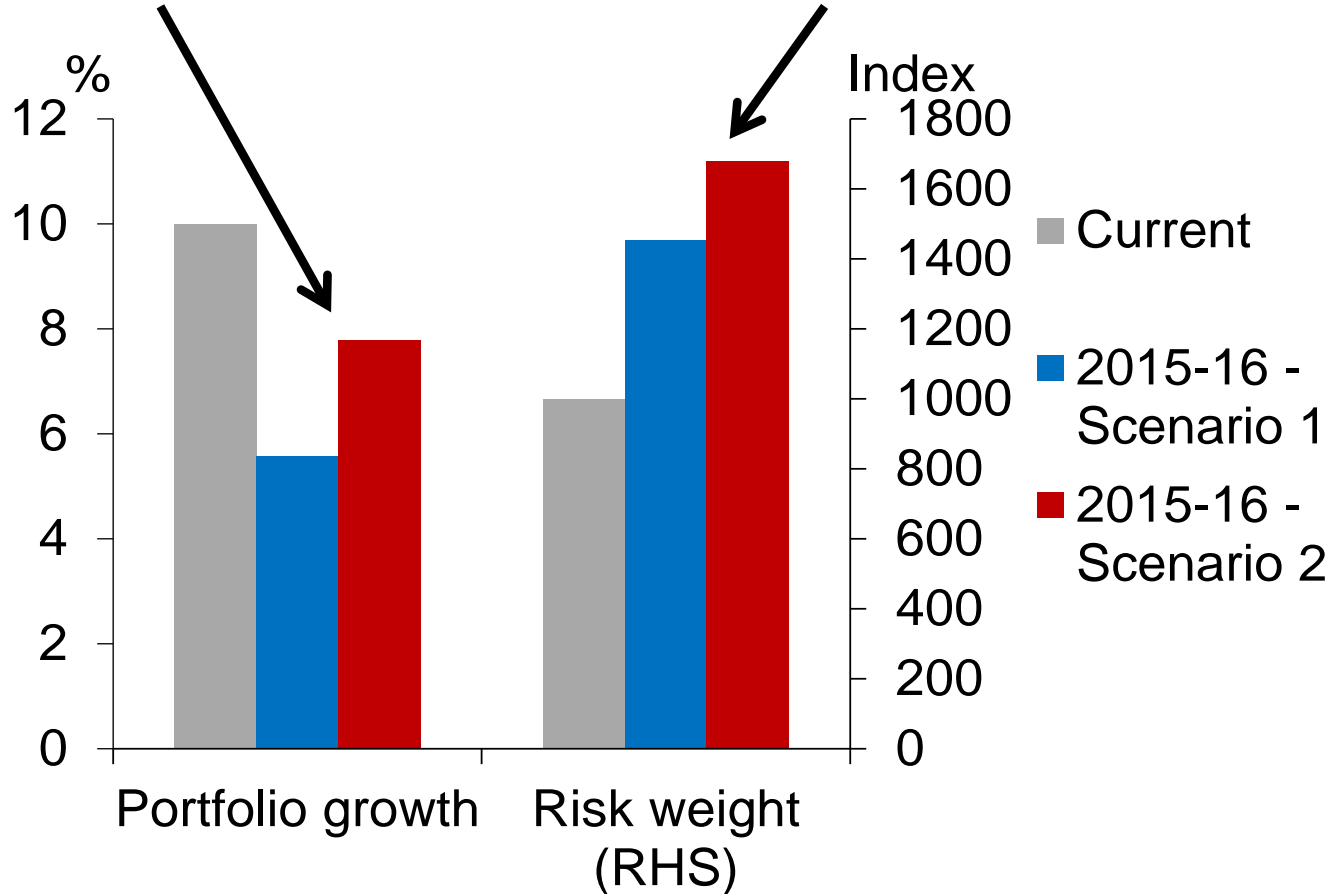
Increasing bank oversight and ongoing negotiations between bank and farmer

Capital held against dairy loans would increase in the near-term

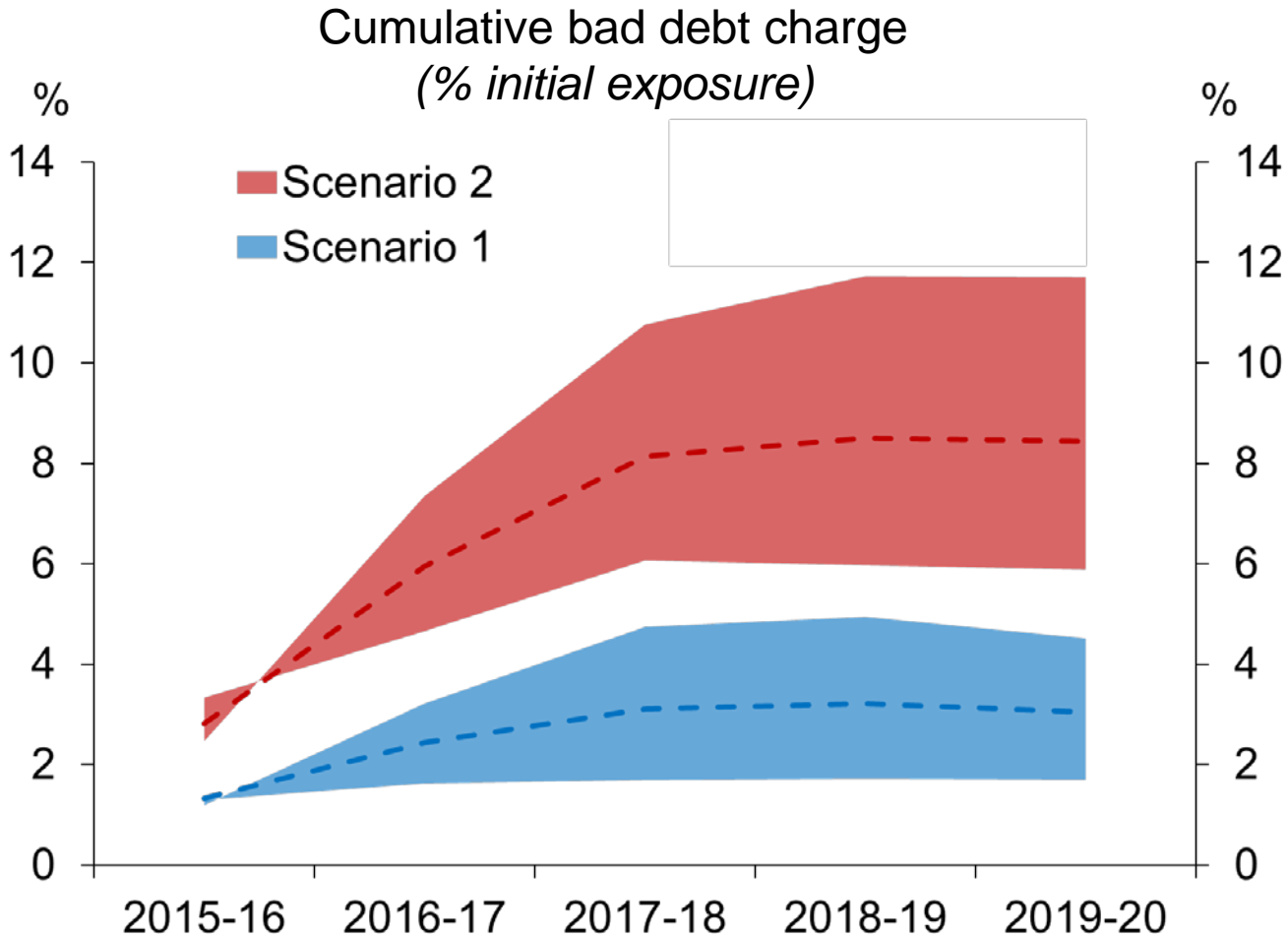


Banks continue to provide working capital

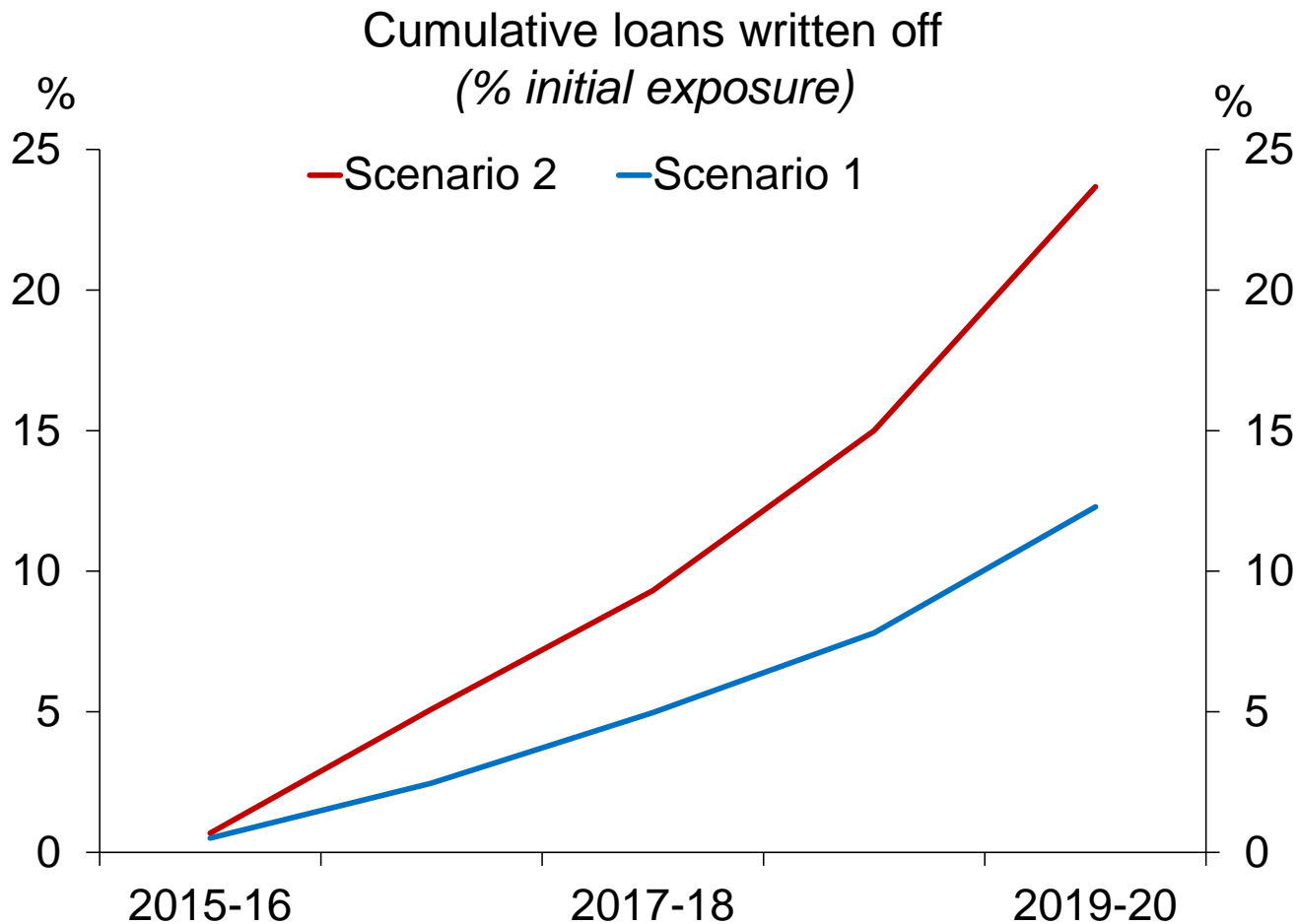
Assessed portfolio risk increases



Banks provision for losses during first three years of the scenarios



Some stressed loans are written off in later years





Some observations

- Modelled scenarios are intentionally severe.
- Reported loss rates manageable for banking system.
- Losses largely absorbed through profits.
- Resolving stressed assets could take longer.
- Stress tests useful input to bank risk management.