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Financial Stability Report

SNAPSHOTS

Financial system well positioned to support the economy.

New Zealand's financial system is well placed to handle the increasing interest rate environment and international financial market disruptions. Monetary policy tightening in response to high inflation continues to pass through to higher debt servicing costs for households and businesses. Internationally, the higher interest rate environment has exposed some fragilities in the global financial system, which has contributed to the failure of a number of banks in the United States and Europe.

In this *Financial Stability Report* we present in-depth analysis of several issues important for assessing the stability of the New Zealand financial system. These include the implications of recent North Island weather events, financial strain on households and businesses under higher interest rates, and trends in bank profitability.



Households and businesses are facing increased pressure from rising debt servicing costs.



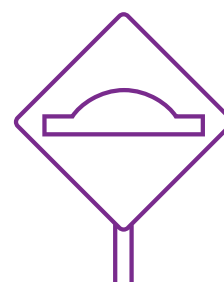
- New Zealand households and businesses are facing increased debt servicing costs as their borrowing reprices onto higher interest rates. However, only a small share of borrowers have fallen behind on their debt repayments so far. For households this reflects the tight labour market, and that borrowers have been able to adjust their spending and draw on previous repayments and savings buffers. Businesses have had to adjust quicker to higher debt servicing costs, aided by robust economic activity. However, pockets of vulnerabilities are emerging, particularly in the agricultural and commercial property sectors.
- Nationally, house prices have fallen around 16% since their peak, taking them back to levels last seen around the start of 2021. To date, negative equity is still a relatively small proportion of lending and is largely concentrated in Auckland and Wellington. We intend to ease LVR settings reflecting that current lending activity presents low risks to the financial system and that banks' current debt servicing requirements are likely to limit the extent of any pick up in riskier lending in the near term.

Recent weather events have caused significant damage in affected areas, impacting insurer profitability.



- The extreme weather events experienced in much of the North Island caused significant disruption to payments systems and cash availability, triggered insurance claims for damages and created debt servicing difficulties for borrowers in affected areas. While the effects were severe in some places, the impact on financial stability is not expected to be material.
- Given the increased likelihood of extreme weather events in the future as a result of climate change, addressing concerns about the resilience of the cash sector, the impact of managed insurance retreat and the potential difficulties for borrowers meeting debt repayments will all remain priorities into the future.

The higher interest rate environment is exposing fragilities in the global financial system, prompting regulators to intervene.



- The higher interest rate environment has identified some fragilities in the international financial system. While banking systems as a whole have become more resilient since the Global Financial Crisis, some institutions that have taken on excessive risks during the period of low interest rates have faced difficulties. Where these difficulties have resulted in a loss of confidence by depositors and investors, as was the case with three medium-sized banks in the US and Credit Suisse in Europe, bank failures occurred.
- While each of these bank had idiosyncratic issues that contributed to their failure, it has highlighted the speed at which investors can lose confidence in institutions and need for interventions by regulators to prevent wider contagion risks. New Zealand banks generally take on little interest rate risk and are required to hold capital buffers for this risk, incentivising prudent risk management.

The banking system is well positioned to handle domestic and international pressures.



- Banks' funding and liquidity positions remain healthy and capital levels continue to gradually increase, ahead of increasing regulatory requirements. Bank profitability has increased, with most metrics returning to around pre-pandemic levels. In the current environment the benefit of profitable banks is particularly evident with New Zealand banks in strong positions to manage increasing stress in their lending books and a deterioration in global economic conditions.