

11/2023

# Financial Stability Report

## SNAPSHOTS

### New Zealand financial system remains sound in the higher interest rate environment.

Central banks have maintained tight monetary policy settings in the face of elevated global inflationary pressures. This has led to the ongoing increase in interest rates that has raised debt servicing costs for households and businesses. Despite headwinds, most New Zealand households and businesses are adapting to the higher interest rate environment. The financial system continues to demonstrate resilience and is well placed to manage the possible emergence of more severe stress and weaker economic conditions.

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 an international perspective on the financial stability implications of higher interest rates, the financial strain on households and businesses in the higher interest rate environment, and developments in the agricultural sector.

			
<p>The global economy is continuing to adjust to the higher interest rate environment, however, risks remain.</p>	<p>New Zealand households and businesses continue to face higher debt servicing costs, with pockets of stress likely to grow.</p>	<p>The New Zealand housing market has stabilised following a decline in prices, supported by strong net migration.</p>	<p>New Zealand's financial system continues to display resilience despite the recent headwinds.</p>

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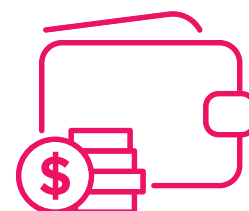
## The global economy is continuing to adjust to the higher interest rate environment, however, risks remain.



- Inflation remains elevated globally and central banks are expected to keep monetary policy tight for some time. The full impact of previous monetary policy tightening is yet to be seen and there is a risk further tightening will be needed to bring inflation back within central banks' targets. Pockets of stress are likely to emerge globally as debt servicing costs continue to increase.
- Financial systems have stabilised since the US banking turmoil earlier this year, with limited ongoing impact. The current slowdown in the Chinese property market has potential to escalate and weigh on economic growth globally, even though direct impacts on New Zealand's financial system are likely to be limited. The economic impact of the Israel-Hamas conflict is still uncertain, and we are closely monitoring the situation.

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## New Zealand households and businesses continue to face higher debt servicing costs, with pockets of stress likely to grow.



- Ongoing increases in debt servicing costs for households and businesses have contributed to the share of mortgages in arrears rising from a low level. While measures of severe stress continue to be relatively low, pockets of stress are likely to grow in the medium term. A significant increase in unemployment remains a key risk to financial stability, as this could see arrears increase materially.
- The agricultural sector is facing a period of more challenging economic conditions, facing a lower milk payout and inflation in on-farm expenses in addition to higher debt servicing costs. A single season of low milk payouts is unlikely to lead to widespread financial distress across the industry, due to an improvement in dairy farmers' resilience over recent seasons. However, if prices remain low over a prolonged period, more significant impacts would be expected.

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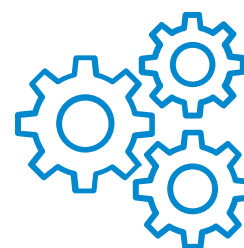
## The New Zealand housing market has stabilised following a decline in prices, supported by strong net migration.



- House prices have stabilised in the past six months, following declining prices since late 2021. The growth in house prices has been broad-based across regions, supported by strong net migration to New Zealand. Recent gains have been modest, and prices remain within the range of sustainable levels suggested by the indicators we monitor.
- Construction activity has remained at historically high levels to this point; however, the number of new projects being started is set to decline going forward. Banks' requirement for developers to pre-sell enough units to cover the full value of any borrowing continues to limit the number of new large developments which are financially viable, with buyers' interest in pre-sales remaining very low compared to recent years.

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## New Zealand's financial system continues to display resilience despite the recent headwinds.



- Banks remain profitable and have strong capital and liquidity positions. This provides buffers to absorb losses if more severe financial stress and weaker economic conditions eventuate. Banks have made good progress towards meeting future capital requirements, which are strengthening the ability of the sector to manage severe economic shocks. This is demonstrated by the results of our bank stress tests.
- Insurer solvency positions are robust, despite profits being under pressure. Increasing reinsurance costs are putting upward pressure on insurance premium rates for general insurers. Our recent life insurance stress test demonstrated the resilience of the sector to a severe stress scenario.