

RBNZ Financial Stability Report

29 May 2019



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Resilient, but...

Bottom line

In its May 2019 Financial Stability Report, the RBNZ kept loan-to-value ratio restrictions unchanged as we anticipated, following a slight easing in January. The RBNZ's overall assessment is that New Zealand's financial system is "resilient" but "ongoing effort" is needed to bolster soundness and efficiency. Tail risks remain for highly indebted households and dairy farms, and vulnerabilities to global risks remain elevated, but these vulnerabilities **haven't intensified** since the November Report. A portion of the document focused on the banking system, and in particular, justification for the proposed changes to bank capital requirements. A final announcement on this policy is planned by the end of November.

Key points

The May 2019 Financial Stability Report provided few surprises, with loan-to-value ratio (LVR) restrictions left unchanged as the Bank assesses the effects of previous easing and mortgage rate falls. The RBNZ noted that financial system risks remain elevated, but are largely unchanged from the November FSR. Ongoing effort is seen as needed to bolster system soundness and efficiency, a nod to their assessment that higher bank capital requirements are necessary.

While LVR settings were left unchanged today, the RBNZ noted that restrictions will be reviewed every six months. We expect that the LVR policy will be eased again in November as housing market risks continue to **decline and banks' lending standards** for new mortgages remain prudent. The focus from here will be on developments in house prices, credit growth, and credit lending standards.

For the dairy sector, the emphasis in the FSR was on highly indebted farmers, as around a third of dairy debt is held in farms with high debt-to-income ratios. Dairy sector debt remains a financial stability concern (and will do for some time yet), but the sector is currently being supported by higher farm-gate prices.

Vulnerabilities to global risks were perceived to be still elevated, but these **vulnerabilities haven't intensified since the November Report** despite further slowing in global growth. Global risks relate to stretched asset prices and debt levels, and limited monetary and fiscal capacity should the outlook weaken.

The FSR again dedicated a box to financial stability risks from climate change, outlining a survey of banks and insurers regarding potential industry impacts. Banking system risks were seen as coming through potential defaults and risks to business opportunities. The RBNZ noted a commitment to develop an appropriate climate risk disclosure framework for New Zealand.

In the insurance sector, there have been substantial changes associated with a greater movement towards risk-based pricing. This has resulted in increased selectivity, differential pricing, and changes in levels of coverage for insurance contracts. Risk-based pricing will result in higher insurance costs for some, and the impact is likely to be amplified by the high concentration in the insurance sector.

A portion of the document focused on the banking system, with endorsement of the proposed bank capital changes. However, there was little discussion of why current capital requirements are considered insufficient. The RBNZ is currently reviewing submissions on the proposed increases in bank capital requirements, and reports by an independent panel of experts are due by the end of August. A final announcement on any changes in bank capital requirements is planned by the end of November, around the time of the next FSR.



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