

RBNZ Financial Stability Report

27 November 2019



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No surprises there

Bottom line

In its November 2019 Financial Stability Report, the RBNZ kept loan-to-value ratio mortgage lending restrictions unchanged, highlighting the risk of a resurgence in higher-risk lending given low interest rates. **The New Zealand's financial system remains "resilient" but higher bank capital buffers are nonetheless deemed necessary to improve "longer-term" resilience.** The financial system is still vulnerable to tail risks stemming from highly indebted households and dairy farms, and global risks are considered to have increased since the May report. A portion of the document focused on the effects of very low interest rates on housing valuation and bank profitability, and concerns over the resiliency of the insurance sector. But in the end, this is just the warm-up act for the main event; the RBNZ's final bank capital decision on 5 December.

Key points

The November 2019 Financial Stability Report (FSR) provided few surprises, with loan-to-value ratio (LVR) restrictions left unchanged due to concerns that recent falls in mortgage rates could lead to a resurgence in higher-risk lending. **The New Zealand's financial system remains "resilient" but higher capital buffers are nonetheless deemed necessary to improve "longer-term" resilience.**

The RBNZ left LVR restrictions unchanged, as we had expected. The RBNZ noted that housing debt risks have stabilised, but prolonged low interest rates could lead to a resurgence in higher-risk lending. This decision seems prudent given the substantial falls in mortgage rates over the past year, and clear signs that the housing market is reigniting.

Dairy sector debt has been an ongoing financial stability concern for some time now. The FSR noted that a significant proportion of the dairy sector remains financially vulnerable, but that progress has been made by some borrowers in reducing balance sheet sustainability. Nonetheless, some farms would have little resilience to weather another period of low commodity prices. Long-term cost challenges associated with reducing environmental impacts also got a mention.

International risks also featured heavily in the report, with the New Zealand financial system's reliance on offshore funding identified as a key risk. The RBNZ assessed international risks to have increased since May, with continued world trade tensions and uncertainty slowing global growth.

Special topics throughout the report focused on the impacts of low interest rates on house valuations and on bank profitability, the increased regulatory scrutiny of **banks'** compliance processes, and cyber resilience.

The RBNZ has some concerns over the resiliency of the life insurance sector in particular. Reported solvency ratios have declined for many life and general insurers, leaving low buffers over minimum requirements.

As in May, the FSR emphasised the case for sharply higher bank capital requirements **to improve "longer-term resilience"**. The RBNZ is considering alternative options, refining its costs and benefits analysis, re-considering interest rate impacts, and assessing transitional impacts in light of feedback received.

We'll be watching the 11am press conference for any further insights. But in the end, the FSR looks like the warm-up act for the main event: the RBNZ's final bank capital decision, due next Thursday 5 December at 12 noon.



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