

NEW ZEALAND ECONOMICS

RBNZ FINANCIAL STABILITY REPORT

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STILL CONCERNED

BOTTOM LINE

While the RBNZ believes the financial system is “sound”, its level of concern over the risks faced remains elevated (more elevated than we thought it would be, to be fair). It is keeping a particularly close eye on housing (and high debt-to-income lending), dairy sector indebtedness and bank funding pressures. Additionally, the RBNZ has made it clear it wants the ability to limit high debt-to-income lending, with the ball now in the Government’s court.

KEY POINTS

- **First and foremost, the RBNZ believes that the financial system is “sound and continues to operate effectively”.** It would have been a massive surprise if the RBNZ had said anything different. However, that is not really the point of this document. Rather, what is far more interesting is the RBNZ’s perception of the financial system’s risk profile (and therefore the risk profile of the economy more broadly).
- **It is fair to say that the RBNZ still have some considerable (and valid) concerns.** These concerns centre on three broad themes: the housing market, bank funding pressures and dairy sector indebtedness. Two of those are unchanged from May, while concern over bank funding is new, and replaces worries over the global economy more broadly (although we doubt that that signals the Bank is no longer worried about the global backdrop).
- **We had thought that the RBNZ would consider that the risk profile had eased, at least relative to May.** That doesn’t appear to be the case. In fact, the RBNZ believes “vulnerabilities in the housing market have grown” and “indebtedness in the [dairy] sector has increased.” It is downplaying recent dairy price gains and believes problem loans in the sector will continue to increase.
- **On housing risks specifically, the RBNZ certainly isn’t claiming victory** despite signs that the Auckland market is cooling and LVR restrictions have improved bank resilience to price falls. In particular, it is worried about a growing share of high debt-to-income lending. As earlier signalled, it wants the ability to restrict this type of lending (although it has stated it wouldn’t necessarily restrict it right now) and has asked the Minister of Finance to include it in the Memorandum of Understanding. There was no indication on the timing or likelihood of this, and the ball looks to be in the Government’s court.
- **The notable inclusion of bank funding pressures (replacing broader global risks) touches on points we have raised in the past.** The large gap between credit and deposit growth is not sustainable. While banks are rationing credit and competing more aggressively for deposits, they are also relying more on offshore funding. And despite regulatory liquidity requirements, the RBNZ is still concerned about the growing exposure banks have to rollover risk and international funding conditions.
- **We are always reluctant to draw strong conclusions for monetary policy from this document.** But if anything, the risks discussed reinforce that the OCR is likely on hold for the foreseeable future.

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