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ECONOMIC ALERT

RBNZ BANK CAPITAL DECISION — DECEMBER 2019

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Decisions

"The key decisions, which start to take effect from 1 July 2020, include banks' total capital increasing from a minimum of 10.5% now, to 18% for the four large banks and 16% for the remaining smaller banks."

And ...

"All these changes would be phased in over a seven-year period (rather than over five years as originally proposed)."

However ...

"The large four banks will have to report to the Reserve Bank, and the public, what their capital levels are using in both their own models and the Reserve Bank's models."

In conclusion ...

"Compared to the 2018 proposal, the 2019 reforms are an improvement. They will have a smaller (upward) estimated effect on average lending rates than reforms in the 2018 proposal."

Looking ahead ...

"More capital also reduces the likelihood of a bank failure."

And ...

"The Reserve Bank's estimate of the impact on lending rates of the 2019 reforms is 20.5 basis points."

And ...

"The annual net benefit [of the Capital Review decisions] is estimated to be 0.43% of GDP."

Comment

Overall, the Reserve Bank's final Capital Review decisions were softer than it indicated earlier this year and, more significantly, much softer than what local banks had feared. A lot of that 'softness' was in the detail, e.g. redeemable preference shares are now accepted as Tier 1 capital, long term subordinated debt is now accepted as Tier 2 capital and up to 2.5% of capital can be on leveraged products.

The immediate market response was very positive. The obvious response was by the New Zealand dollar, which rose dramatically. The NZD/USD climbed above 0.6550 for the first time in four months and the main cross-rates hit equally time-related highs. Swap rates lifted slightly, continuing the upward trend since the October lows

Market implications

Such was the initial relief from the big four banks that one of them changed its call for two OCR cuts in the next year to one. Taken in conjunction with the Government's renewed fiscal spending push, the domestic outlook is looking more promising.

Not surprisingly, the banks are estimating a higher impact to the cost of credit than the Reserve Bank's 20.5 basis points estimate but the banks' revised estimates are a long way below their official (and unofficial) previous scaremongering estimates.

Looking further ahead, much of the recent doomsaying by the big four banks has proven unfounded. There will be a flow on effect from the big four banks having higher requirements than the rest. Overall, the Reserve Bank's Capital Review decisions should not curb bank lending and dramatically push up borrowing costs to the extent that the banks feared.

Those who have recently refinanced however, will be aware that banks are certainly being more selective in their lending, something we expect to continue.

From an external perspective, the Reserve Bank's Capital review would seem to be another positive for New Zealand because it reduces a key domestic risk without reducing the reward.