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New Zealand Financial Institution Ratings Unchanged Despite Property Price Concerns

Primary Credit Analyst:
Nico N DeLange, Sydney (61) 2-9255-9887; nico.delange@spglobal.com

Secondary Contacts:
Sharad Jain, Melbourne (61) 3-9631-2077; sharad.jain@spglobal.com
Andrew Mayes, Melbourne (61) 3-9631-2078; andrew.mayes@spglobal.com
Michael D Puli, Sydney (61) 2-9255-9823; michael.puli@spglobal.com

OVERVIEW

- In our opinion, economic risks facing financial institutions operating in New Zealand have heightened as a result of continued strong growth in residential property prices nationally.
- Reflecting the increased risks, we now apply higher risk weights in our capital analysis of the financial institutions we rate in New Zealand, and consequently, we expect forecast risk-adjusted capital (RAC) ratios for all of them to be lower than would have been the case otherwise.
- Nevertheless, our ratings on all the financial institutions operating in New Zealand remain unchanged. This reflects our expectation that despite some weakening in the capital levels of all these financial institutions, their stand-alone credit profiles (SACPs) would remain unchanged; except in the case of ASB Bank Ltd. and Rabobank New Zealand Ltd., whose SACPs have weakened by one notch each. Our ratings on them remain unchanged reflecting our assessment of timely financial support from their respective parents, if needed.
- The revision of the SACPs of ASB Bank and Rabobank NZ stem from our view of increased systemic risks in New Zealand rather than emergence of any new risks specific to these institutions.

SYDNEY (S&P Global Ratings) Aug. 23, 2016--S&P Global Ratings today said that the economic risks facing financial institutions operating in New Zealand have

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heightened (see list below). Continued strong growth in residential property prices nationally (estimated to have increased in excess of 10% annually) coupled with an increase in private sector credit growth (from about 152% of GDP in 2015 to about 157% of GDP in 2016) have driven the increased risks in our view. Consequently, we believe the risk of a sharp correction in property prices has further increased and, if it were to occur--with about 56% of registered banks' lending assets secured by residential home loans--the impact on financial institutions would be amplified by the New Zealand economy's external weaknesses (in particular its persistent current account deficits and high level of external debt).

The increase in the economic risks facing financial institutions in New Zealand is contrary to our previous base-case expectation that the rise in New Zealand house prices would slow in 2016 (see "New Zealand Property Market Should Remain Steady Despite Lower Official Cash Rate," published March 20, 2016).

In our assessment of New Zealand's banking system risk we have also factored in the macroprudential tools initiated by the central bank, including the recent proposal to further expand the scope of these tools. The macroprudential toolkit includes temporary restrictions on high loan-to-value ratio (LVR) lending and higher capital requirements for investor mortgages to address a buildup of risk in the banking system. We consider that these tools have been only partly successful in limiting the pace of buildup of risks facing financial institutions in New Zealand. In our opinion, structural constraints such as supply and demand imbalances and continued high migration levels will pose significant challenges to the effectiveness of macroprudential tools.

Reflecting the increased economic risks facing the financial institutions in New Zealand, we now apply higher risk weights for their loans in our capital analysis. Consequently, we estimate that for all the financial institutions we rate in the country, the forecast risk adjusted capital (RAC) ratios would be lower by an average of about 11% than would otherwise have been the case.

In our assessment, the impact on RAC ratios (and consequently on the credit profiles) for each of the financial institutions is potentially different, reflecting the differences in their current and expected asset mixes, our understanding of their capital strategies, and buffers above the threshold for a lower stand-alone credit profile (SACP). In our base case, we expect that for all the financial institutions we rate in New Zealand, capital levels--with the exception of ASB Bank Ltd. and Rabobank New Zealand Ltd.--would remain above the levels needed to maintain their current SACPs, albeit with some weakening. We have lowered our assessment of ASB Bank's SACP to 'bbb+' from 'a-' (which is now on par with the SACP of the three other major banks in New Zealand) and Rabobank NZ's SACP to 'bbb-' from 'bbb' reflecting our view that their forecast capital levels will moderate. Our revised forecast RAC ratio over the next two years for ASB Bank is within the 7%-10% range (in line with that for the three other major banks in New Zealand); and 10%-15% for Rabobank. Nevertheless, our ratings on these two banks also remain unchanged reflecting our assessment of likely timely financial support from their respective parents, if needed.

The revisions of the SACPs of ASB Bank and Rabobank NZ stem from our view of increased risks across the banking system in New Zealand. We consider that no new significant bank-specific risks--such as any asset quality concerns--have emerged that drive these revisions.

SUMMARY OF BICRA SNAPSHOT

	SCORE	
	To	From
BICRA	4*	4*
Economic Risk	5*	4*
Economic Risk Trend	Stable	Stable
Economic Resilience	Low risk	Very low risk
Economic Imbalances	Very high risk	High risk
Credit Risk In The Economy	Intermediate risk	Intermediate risk
Industry Risk	4*	4*
Industry Risk Trend	Stable	Stable
Institutional Framework	Low risk	Low risk
Competitive Dynamics	Low risk	Low risk
Systemwide Funding	High risk	High risk

*On a scale of 1 (lowest risk) to 10 (highest risk)

Only a rating committee may determine a rating action and this report does not constitute a rating action.