



DISCUSSION PAPER

NEW ZEALAND'S BANKING SYSTEM

New Zealand Bankers' Association

26 February 2009

Ahead of the Employment Summit, New Zealand banks wish to reinforce their commitment to the role they play in the New Zealand economy, and stress to the fundamental importance to the New Zealand economy of maintaining a functioning, profitable banking sector.

The New Zealand Bankers' Association and its member banks (ANZ National Bank Ltd, ASB Bank Ltd, BNZ, Citibank, N.A., The Hongkong and Shanghai Banking Corporation Ltd, Kiwibank Ltd, TSB Bank Ltd and Westpac New Zealand Ltd) will be active participants in the Summit and have prepared this background document to help participants develop a greater understanding of the dynamics within which banks operate in New Zealand.

Kind regards

New Zealand Bankers' Association

INTRODUCTION

A wide range of views have been reported recently about the banks and the banking system in New Zealand. The purpose of this paper is to provide the banking sector's assessment of the current environment in New Zealand and the challenges posed by the global economic and financial developments. The banks are highly committed to assisting New Zealand, and New Zealanders, through these challenges and are conscious they have a key responsibility during these difficult times to maintain liquidity and fulfil their roles as intermediaries for credit, deposits and access to foreign funding.

This paper details some of the initiatives that have been implemented by banks to date to in response to the economic environment. The banks welcome the opportunity to discuss these initiatives, as well as any further ideas.

The paper is in three parts:

1. **Role of banks:** A summary of key themes as they relate to New Zealand's banking sector and economy as a whole.
 2. **Frequently asked questions:** Response to some questions frequently directed towards banks.
 3. **What more can be done:** Recommendations as to what more could be done, both by banks and others, to help New Zealand's response to the economic conditions.
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ROLE OF BANKS IN NEW ZEALAND

A strong, well performing financial system is critical for a successful modern economy. Banks are intermediaries between savers and borrowers. They help allocate capital to those who need it, assisting in the production, distribution and exchange of goods and services, leading to the creation of jobs and wealth.

Banks also underpin the payments system, support international trade, provide wealth management services and risk management capability (eg foreign exchange and interest rate hedging and derivatives).

At a basic level, banks channel money from depositors (savers) to borrowers. In its most simple form, this intermediation function occurs domestically within a country's own economy. However, in modern economies, countries can mobilize foreign savings to sustain a faster rate of economic growth than could be achieved by utilizing their pool of domestic savings. New Zealand is one of these countries and it's our banking system that largely secures these savings by tapping funding from offshore investors. For banks and the economy to thrive, banks need to have the absolute trust and confidence of households, businesses and global investors. This means a strict adherence to good banking practices and processes.

Banks are also like any other business. They too need to make a profit and a suitable return on capital invested. Without this they do not gain, or maintain, the confidence of investors or depositors, as pressure on local finance companies and some international financial institutions attests. They have multi-tier responsibilities to customers, their staff, shareholders and investors and to the communities in which they operate. **Banks in New Zealand are closely regulated (more so than most other businesses) are well capitalised, have predictable and diversified sources of funding and have strong liquidity.** Close regulation and conservative management reflects the fact that banks, as businesses, operate on finer margins and higher gearing compared to most other business sectors in the economy.

Northern hemisphere countries are facing a deep systemic downturn initiated in the wholesale destabilization of their finance sectors and spreading rapidly to all other sectors of their economies. It has been widely reported that recessions which originate in the finance sector are generally more severe and prolonged than normal business cycles. Importantly, the co-called 'credit crunch' has not only significantly weakened the financial sectors in these countries, it has re-based the risk appetite of investors globally, resulting in higher costs of risk (credit) and a scarcity (and increased cost) of available capital

(equity). These changes, while extreme at the moment due to market volatility and low investor confidence, are likely to have a lasting impact as the world economy unwinds from a ten year boom period.

The soundness and effective functioning of the New Zealand banking system is a key distinction between what is currently happening in the New Zealand (and Australian) economy compared with the US and Europe.

This is owing to a range of factors:

- **Banks in New Zealand have stuck to core banking principles** in terms of customer lending, risk management and deposit activity.
 - Virtually 100% of lending activity has been to New Zealand borrowers, eliminating risks of lending outside 'core markets'.
 - Very little lending has been securitized; with loans remaining on bank balance sheets, underwriting standards have been maintained even during the very competitive market of recent years.
 - Banks did not engage in so-called 'sub-prime' lending, although it could be argued some New Zealand non-banks were engaged in similar high risk lending activity.
 - Products remained relatively 'vanilla' with many of the complex financial instruments not offered to the market. Banks also do not invest, on their own account, into high risk financial instruments as a means of attempting to boost their earnings.
- The Banks have retained very strong credit ratings (AA to AA- for the larger domestic banks) with the major NZ banks now amongst the most highly rated in the world (only 13 banks rated AA left in the world). The Australian parent banks have been very supportive of the NZ Banking system (and therefore the New Zealand economy) and the ability to draw on this support remains a key source of strength for New Zealand. The rating agencies have to some extent based their ratings on the ability of banks to self-generate capital through strong earnings. Again, the continued viability of the banks is therefore important.
- Banks have very diversified lending portfolios and historically lower loss rates; with mortgage lending making up a large proportion of the asset books, the overall risk profile compares favourably to offshore banks.

New Zealand has been in mild 'recession' for more than a year, but the origins of our slowdown to date largely reflect the impact of a conventional policy induced business cycle to combat excesses and structural weaknesses in the economy (current account deficit, low productivity, asset price inflation, etc).

What is clear is that a deteriorating global scene will further impact the business cycle for New Zealand. Key transmission mechanisms include trade links and our dependence on international finance. **What remains unclear is the extent to which New Zealand will be impacted.** The magnitude of the impact will be determined by both the real economic picture internationally (the trade link) but also the perceived underlying health of New Zealand (the dependence on foreign capital). A huge degree of uncertainty surrounds both effects but it is clear that the **perceived health of the New Zealand financial system is a key component to ensuring that the local downturn does not turn systemic.**

The old world of wide availability of liquidity with minimal pricing for risk is not coming back and should not be seen as the benchmark against which we judge the current environment.

In today's environment, continued strong adherence to the principles of sound banking practice and financial management is required. Fundamentally, the most important role New Zealand banks can play in ensuring that the New Zealand economy navigates its way through the next few years is to ensure that banks continue to remain sound and fulfil their roles as intermediaries for credit, deposits and access to foreign funding. This will ensure a smoother adjustment within New Zealand than would otherwise be the case.

The banking system is supporting the New Zealand economy on a number of fronts.

- The banking and insurance industry accounts for 7 percent of GDP and directly impacts on the remaining 93 percent via the channelling of capital and provision of core financial services. Banks collectively contributed \$1.6 billion in corporate tax in 2007, employed 26,500 New Zealanders, are key innovators and provide substantial direct investment into the economy, and their dividend streams directly support the incomes of New Zealanders.
- Unlike many overseas markets, New Zealand banks have not required any taxpayer capital, leaving the government to focus its spending power and priorities elsewhere in the economy. Total US and European Government (taxpayers) direct equity injections into the banking sector so far totals some US\$380 billion. However the estimated total Government commitment to solving the financial crisis has been put as high as US\$9.7 trillion (9 Feb, Bloomberg).
- It continues to access global funding which is essential for a smooth adjustment in the economy.
- It remains strong, profitable and well managed, thereby supporting the economy by continuing to channel capital to those who need it.
- It is working actively and diligently with customers affected by the recession; banks have in place programmes to help customers in distress and will work with customers to try to find solutions to financial pressures.
- As businesses themselves, banks will contribute to keeping employment and investment going in the economy.
- It is maintaining confidence within the financial system by acting responsibly and prudently in light of economic developments. This includes making prudent decisions on behalf of investors and depositors as well as borrowers. Banks consistently work with customers to find solutions to temporary liquidity challenges. It is rarely in anyone's interests to take precipitous action where work-outs are viable.

Likewise, there are some things the banks cannot do in the current environment:

- The banks cannot support all customers who get into financial difficulties. Businesses fail and consumers get into financial stress even in the best of times. There are many reasons for this and they are handled case by case. Customers can assist themselves (and banks) by contacting banks early should they get into financial difficulties.
- Banks cannot pick industry sector 'winners' that are especially deserving of support; assessments must be case by case which means supporting sound operators irrespective of which industry sector they operate in.
- Banks make 'large' dollar profits because they are very large businesses in the New Zealand context. They cannot, as some commentators suggest, just 'accept' smaller profits to support the wider economy. To do so would potentially impact banks' financial ratios and ratings and therefore work against their ability to function effectively as financial intermediaries. It is already clear that the banks are sharing the pain of the current downturn with lower industry net interest margins, increasing provisions and lowered returns on capital.

But the customer banking outcomes will also be influenced by the dynamics of a competitive banking market:

- In a very uncertain economic environment, banks are likely to have different views of risk and experiences at the individual customer level will reflect this;
- Moreover at the portfolio level, banks are likely to be reshaping their sector risk profiles and this will influence their competitive strategies, including pricing;
- It can be expected that robust competition will continue in the banking markets and that customers will have alternative choices if their current banking relationships are not satisfying their needs.

The best way for banks to support jobs is by remaining strong and viable themselves.

- This ensures the mobilisation of both domestic and foreign capital is available for consumption and investment, thereby supporting jobs.
- The United States situation provides a clear example of what happens when banks become unprofitable and struggle to remain solvent. Since the start of the recession in the United States, over 3.5 million jobs have been lost, and the unemployment rate has increased from 4.9 percent at the start of 2008 to 7.6 percent now. The United Kingdom provides another harsh example in regard to how a dysfunctional banking system can impact on the wider economy.

FREQUENTLY ASKED QUESTIONS

Are banks still lending?

Managing the provision of credit to customers is a core principle of good banking and it is in the mutual best interests of both banks and the economy to ensure that there is an adequate supply of credit to those customers of good quality and viability. A large driver to credit growth is demand, which is in turn driven (amongst other things) by price and confidence. It is evident that both the higher cost of debt and lower business and consumer confidence have impacted demand.

However, it is not in the best interests of banks to curtail the supply of credit to the economy as this would reduce growth and impact negatively on most economic indicators, as well as asset prices. It would also exacerbate lending losses.

Reserve Bank statistics show that banks have continued to increase their provision of credit, though not as rapidly as in previous years (the slowdown in credit growth has been a deliberate objective of the Reserve Bank's application of monetary policy). Banks continue to provide personal customers with mortgages and credit cards, and provide New Zealand businesses and corporates with debt and overdraft facilities.

	Agriculture ¹		Business ²		Total household claims		
	(\$m)	(Y/Y%) ³	(\$m)	(Y/Y%) ³	(\$m)	(Y/Y%) ³	(M/M%sa) ⁴
Previous years:							
Dec 2006	31,016	14.2	63,091	15.8	148,978	12.9	1.1
Dec 2007	35,556	14.6	71,396	12.7	167,400	12.2	0.7
Monthly:							
Jan 2008	35,719	13.9	71,296	12.2	168,472	11.8	0.8
Feb 2008	36,023	14.5	72,039	12.5	169,776	11.5	0.8
Mar 2008	36,743	16.3	73,121	12.6	170,935	10.8	0.4
Apr 2008	37,231	17.1	73,461	12.2	171,551	9.9	0.3
May 2008	38,898	20.0	74,283	10.3	172,214	9.2	0.5
Jun 2008	40,216	20.7	75,264	10.1	172,699	8.4	0.2
Jul 2008	40,714	20.6	75,886	10.3	172,918	7.7	0.3
Aug 2008	41,459	21.8	76,904	9.7	173,476	7.2	0.4
Sep 2008	42,097	22.1	77,850	10.0	173,801	6.6	0.2
Oct 2008	42,687	22.4	79,333	11.0	173,995	5.8	0.1
Nov 2008	43,090	22.4	80,253	12.3	174,178	4.7	-0.1
Dec 2008	43,485	22.3	80,185	12.2	174,477	4.2	0.2

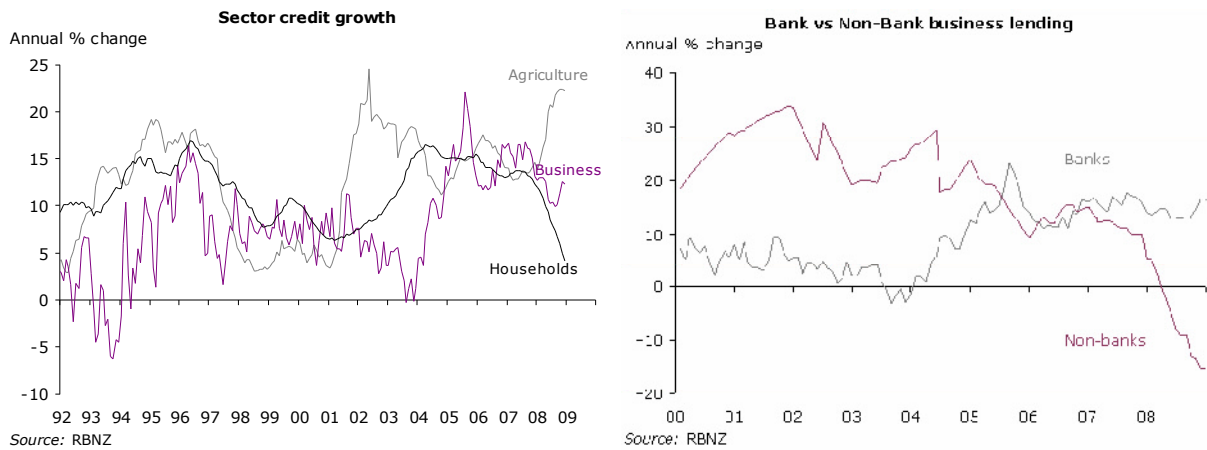
¹Series break: Dec 05: \$156m; Jun 06: \$7m; Dec 06: \$2m; Dec 07: \$5m;

²Series break: Dec 04: \$169m; Jun 05: \$68m; Dec 05: \$64m; Mar 06: \$150m; Jun 06: \$41m; Dec 06: \$38m; Mar 07: \$98m; Jun 07: \$107m; Sep 07: -\$12m; Dec 07: \$96m; Mar 08: -\$20m; Apr 08: \$8m; Sep 08: \$21m; Dec 08: -\$64m;

³Nominal percentage rate calculations have been break-adjusted, reflecting the underlying market change.

⁴Seasonally-adjusted percentage rate calculations have been break-adjusted, reflecting the underlying market change.

The survey released by Business New Zealand this week also confirms that businesses have not experienced a significant drop in access to credit. Only 8% of respondents indicated they had had credit lines withdrawn or debt financing rejected. Indeed, it is to be expected that there will always be a small proportion of customers who are unsuccessful in their financing requests.



Total private sector credit growth was 7.8 percent compared to a year ago, down from the 14 percent growth rate in 2007, but still positive – i.e. the amount of credit available in the economy is still expanding. While banks have adjusted their risk settings (e.g. credit criteria such as Loan-to-value ratios) this is not due to credit-rationing, but rather a prudent and responsible response to current and expected economic developments. The economy is no longer in the low-risk benign credit and economic environment of the past. In a tougher economic climate it is prudent to pay extra attention to the quality of lending.

In tougher times households take a more conservative stance and curtail activities. Businesses defer investment. Investors tend to stay defensive in their asset allocations. This leads to reduced demand for credit and that is what we are seeing in the credit aggregates. In some instances, economic downturns lead to greater demand for credit and working capital, and financial intermediaries work proactively to support clients in such instances. Such dynamics are normal and the real issue, of striking a balance in response to pressures associated with a rapidly changing economic climate, is at the heart of the principles of good banking.

An issue, not unique to New Zealand, is that other sources of household and business financing have withdrawn from the market, leaving the banking sector to take up the slack. The clearest illustration of this development is lending by non bank institutions. A number of players have folded, and some surviving ones are pulling out of segments of the market (e.g. GE, GMAC). For example, non-bank lending to businesses contracted by 15% over 2008 while bank lending to businesses grew by 16%. The full vacuum created by the retreat of the non-bank sector is unlikely to be entirely filled by banks, who (sensibly) strike a more prudent balance than a number of failed lenders did.

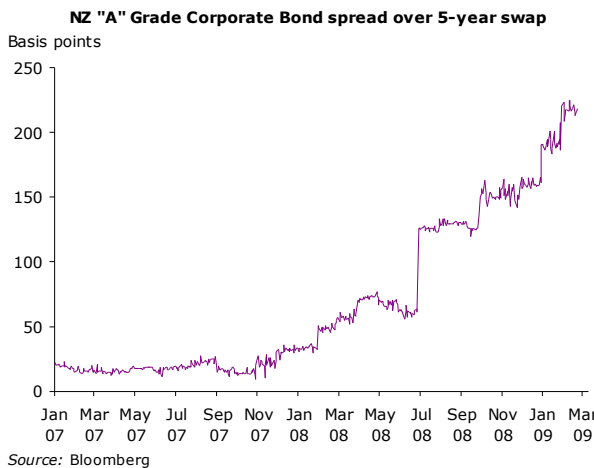
How do cuts in the Official Cash Rate influence the cost of funding passed on to borrowers?

Borrowing rates are influenced by an array of forces but particularly the cost that banks pay for funds (including capital) and the assessed credit risk margin. Commentators typically focus on New Zealand wholesale interest rate settings, and the role the Reserve Bank plays in moving the Official Cash Rate (OCR), to judge where interest rates 'should' be. While broadly correct, this overlooks other dynamics that are also very influential:

- Banks do not raise all their funding at the Official Cash Rate. More than a third is borrowed overseas, at a range of maturities and in a range of markets, to manage funding risks prudently. The cost of that funding reflects the applicable rates in these markets, which do not necessarily move in step with the OCR in New Zealand.
- The premiums demanded by offshore funding providers have increased, reflecting an increase in credit risk margins as part of the credit crunch. In addition, the cost of the Government guarantee (90bps for more than 1 year) has further inflated offshore borrowing costs. The cost of offshore borrowing has risen for the major banks by over 200 bps across the board.

- As the offshore cost of borrowing has risen, attention has progressively turned to securing local deposits to maintain funding. However, in many instances, New Zealand deposit rates are now higher than wholesale interest rates. While depositors are benefiting from these higher rates, borrowers are impacted by the banks' higher overall cost of funding – whether that is sourced internationally or domestically.
- The cost of funding also incorporates a margin to cover the risk of borrowers defaulting. The risks associated with new lending, and therefore the margins applied, have increased both in New Zealand and overseas in light of the credit crunch.
- Fixed lending rates are influenced not only by what the Reserve Bank does today, but also by expectations over the coming year. As a result, the OCR is only one factor considered when setting the rates, and so the rates do not always respond immediately to movements in the OCR. Banks will generally match the term of their borrowing costs to the term of the lending to customers. In New Zealand, a large proportion of this is fixed for terms from one to five years;
- With the increased level of financial risk, the cost of capital to banks has also increased.

These trends are not just in bank lending. Retail bond investors are demanding higher nominal returns (relative to where the wholesale interest rate curve resides) to invest in high quality New Zealand corporate paper. The A grade corporate bonds traded on the NZX has seen the spreads widen markedly. Recent issuances have been priced at between 340 to 500bps over swap, including for well known New Zealand names. Hence we see a dichotomy in the market in terms of what returns investor's expect when it comes to their own money, but benefits they expect to manifest in a falling interest rate environment when it comes to borrowing.



Change in OCR and retail mortgage rates (bps)			
	Dec 03 to Jul 07	Aug 07 to Jun 08	Jun 08 to Jan 09
OCR	325	0	-475
Floating	314	47	-379
6 months	267	49	-375
1 year	237	20	-355
2 years	180	0	-327
3 years	138	15	-299
4 years	129	15	-260
5 years	117	22	-256

Source: RBNZ

Are New Zealand banks focussing on New Zealand?

Some commentators have suggested that the New Zealand subsidiaries of Australian banks are either not being supported by their parents or that the parents are withdrawing funding to support Australian operations. This is not correct. New Zealand remains our core focus.

New Zealand subsidiaries of Australian banks are required to run their businesses independently of their Australian parents. Reserve Bank conditions of registration require Australian subsidiaries to be locally incorporated, where possible, and at all times operated under full supervision of the Reserve Bank, with separate boards and governance structures from their parent. Funding is the responsibility of the New Zealand banks and they lend to New Zealand based customers.

There has been no withdrawal of support by parent banks. To the contrary, the New Zealand banks (and therefore customers of the banks and the economy more generally) have benefited from continued funding support via parent banks as part of overall funding plans. Reserve Bank data shows that bank funding from associates rose by \$4.65bn (or 9.1%) between September and December 2008, encompassing the worst period of global market turmoil. The strength (credit ratings,

profitability and access to international markets) and diversity of the Australian parent banks has directly supported New Zealand's finance sector in what is the worst financial crisis in more than 60 years.

Why is there a cost to breaking fixed lending agreements?

New Zealand borrowers benefited greatly through being able to fix their interest rates (and have certainty as to their interest payments) when the Official Cash Rate was rising, between the start of 2004 and late 2007. They were able to protect themselves from interest rate increases during that time, giving them considerable cash-flow benefit they would not otherwise have received. The flip side to this, however, is that these same customers are yet to benefit from the recent fall in interest rates.

Banks source funding to match the longer durations of these fixed rate loan contracts, and so enter into commitments of similar terms (whether through offering term deposits or otherwise). Where a customer wishes to terminate its fixed-rate loan contract, banks are not necessarily able to terminate (in turn) their own funding commitments. They could not, for example, terminate term deposits because it is no longer economic for the bank to pay the applicable interest rate.

This is why fixed rate loan contracts include a clause relating to the breaking of the contract and the implications of that. These contracts make it clear that customers must meet any costs incurred by banks as a result of fixed rate loans being terminated. This is also made clear to customers before they make a decision to break their fixed interest loans.

In short, banks are willing to work with customers who seek to take advantage of the falling interest rate environment, particularly if cash-flow is a constraint. However, typically this involves a break cost being capitalised in lieu of near-term cash relief. It is important to understand that this is not a penalty, but the recovery of a cost.

Ideally break cost calculations would be more standard across the industry, and they must be fair and reasonable to both parties involved.

Have banks benefited unduly as a result of the Government guarantee?

We have regularly seen comments such as "Banks have been very happy to accept a government guarantee, but it seems they are not prepared to give a helping hand to business". (Sunday Star Times 22 Feb)

There was a necessity to introduce the government guarantee schemes, given that corresponding measures were introduced around the globe. However, the retail guarantee is in place for the benefit of deposit customers, rather than the banks. It is these customers that are guaranteed by the Crown. The guarantee has helped maintain domestic confidence in the wider financial system. However, it tends to support relatively weaker players in the market, but is paid for by the stronger, larger players who have behaved prudently and responsibly.

The wholesale guarantee is primarily about assisting New Zealand, via the financial system, to access offshore capital as opposed to directly supporting the banks per se. Reducing the cost of this guarantee would reduce banks' cost of funding and therefore, the cost passed on to borrowers.

There is no free lunch, with the Government receiving a "guarantee fee" for its obligation. While the provision of guarantees creates a contingent liability for the government and taxpayers, the strength of the domestic banking system means that the likelihood of this liability being crystallised is low.

Are business borrowers benefiting from interest rate cuts?

Many business customers have been getting lower interest rates. This is particularly so for businesses using residential mortgages or other collateral to support their loans. Not all businesses have had the full rate cuts passed through largely due to changes in the funding and risk environment. All lending is evaluated on a case-by-case basis. The overall pricing will reflect trends in funding costs, the banks' assessment of risk and the nature of the security being offered.

What are banks doing to ensure they are acting responsibly in the current environment?

The actions of New Zealand banks are aligned with the values of corporate responsibility and are visible on a number of fronts:

- Through the New Zealand Bankers' Association, banks have funded financial literacy programmes in schools. Some banks have also established their own specific programmes. These provide education to help participants to achieve their financial goals by making better judgments and more informed decisions.
- Financial wellbeing programmes are offered to assist customers facing financial difficulty. These programmes provide frontline bank staff with the confidence and skills required to help customers who are under financial pressure and need support, advice, or alternative banking solutions.
- Taking a more prudent approach to lending balances the needs of 'sound banking' with the needs of our customers. This extends to practices designed at helping customers to manage their debt; for example, extending or restructuring loans, debt consolidation, budgeting advice and ensuring customers have the capacity to take-on additional debt in a difficult environment.
- Banks have active health and safety strategies, which include confidential programmes to help employees manage workplace and personal difficulties that may impact on their overall wellbeing.
- Community programmes and use of staff volunteer leave benefit both employees and their community.
- New Zealand banks provide considerable financial support for community groups, charities, non-profit organisations and victims of natural disasters.
- Banks are undertaking environmentally sustainable practices and buildings that assist them to reduce their carbon footprints.

Are credit card rates likely to reduce further?

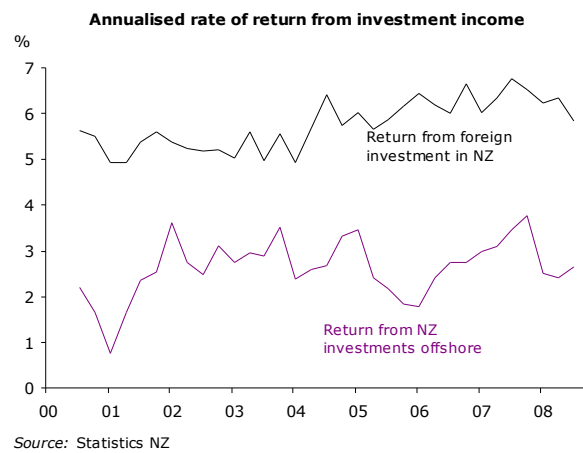
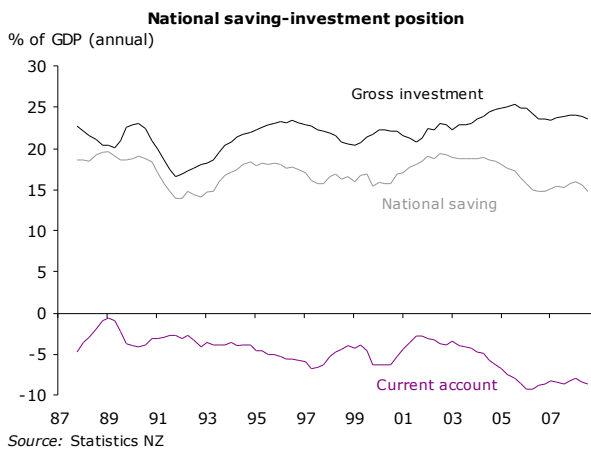
Credit cards offer customers the convenience of immediate credit, which comes with a higher interest rate than other lending. Credit cards provide unsecured lending without the vetting of each and every transaction. In a downturn there will be greater risk of non-repayment, hence risk premiums should be higher. Banks have lowered credit card interest rates and have specific low interest rate cards on offer. For those looking to access the benefits of the higher rate credit cards, it is also worth noting that customers can avoid the higher interest cost if they pay off their outstanding balances every month.

For more risk-averse customers, banks have debit cards available to prevent customers spending beyond their means.

Is a reliance on offshore funding contributing to New Zealand's economic problems?

New Zealand has run large current account deficits for decades. The nation consistently needs to borrow offshore to fund a savings shortfall. Since the early 1990s financial intermediaries have been the vehicles through which the deficits have been funded, or how the demand for credit has been funnelled. In prior decades the Government did the borrowing and spending on our collective behalf. In modern economies, many countries mobilize foreign saving to sustain a faster rate of economic growth than could be achieved by utilizing their pool of domestic savings. New Zealand is one of these countries and it's our banking system that largely secures these savings by tapping funding from offshore investors. Indeed, were it not for the ability to

borrow from offshore, there would have been far less investment taking place in New Zealand, and less jobs and wealth. However, cumulative deficits over decades have left New Zealand vulnerable to adverse turns in global sentiment or events, such as what we have seen of late.



Stepping beyond global malaise - which has merely exposed New Zealand's Achilles heel - the heart of the issue resides in:

- Consistently poor domestic savings as a nation, primarily across households.
- A fixation with housing, which dominates the household balance sheet, and relative insensitivity to high real interest rates.
- Poor offshore investment returns relative to those foreigners receive in New Zealand. New Zealand has a poor investment record on top of a low savings rate. This has accentuated the net investment income deficit, or debt servicing burden across the economy.

Addressing all three areas will be critical if New Zealand is going to reduce its reliance on offshore capital and generate sufficient domestic savings to fund required investment and raise living standards.

Are mortgage sales increasing?

The volume of mortgage sales has increased as a consequence of the changing economic environment. However, they remain a last resort option for banks. The strong preference is to find a solution to keep customers in their homes or minimise the losses when it is clear that the customer can no longer afford the repayments. Alternatives such as extending loan terms, repayment holidays and debt consolidation are worked through first. It is only when these avenues have been exhausted, that a mortgage sale is considered. The number of mortgage sales is still incredibly small in the context of the number of home owners in New Zealand.

WHAT MORE CAN BE DONE?

Banks play an important role within the economy, and it is certainly in the banks' interests to ensure that consumers, businesses, employees and the government are able to navigate through the current challenging times. What more can be done?

- Businesses and households need to manage their own cash-flows prudently in the context of the current slowdown in the economy.
- Businesses or individuals should approach their bank quickly if issues are arising, and be prepared to provide more information. The earlier and better informed banks are, the better placed they are to help.
- Policy responses need to be targeted at medium-term issues including improving domestic savings, driving productivity growth, and improving financial literacy.
- Banks need to have concrete plans that lock in forward funding requirements well into the back half of 2009 and into 2010. This will reduce the risk that further de-stabilisation in the major international markets could impact sharply on New Zealand. The Reserve Bank has assisted in this planning through amendments to its liquidity management arrangements and by conducting presentations in the international markets. Effective on-going collaboration between all parties will benefit New Zealand.

Banks' roles supporting the economy could further be enhanced by:

There are several things the Government could do to assist banks in the current environment that would flow through to the borrowing costs facing New Zealand businesses and individuals:

- Further reduce the costs of the wholesale guarantee scheme. The experience in Australia has been that banks are able to issue in larger amounts and for longer maturities (which reduces liquidity risk) than before the guarantee was introduced. The use of the guarantee should be strongly encouraged, and the cost should be set solely with regard to the benefit that it provides to the New Zealand economy through increased access to, and reduced cost of, needed foreign funding;
- Introduce a 'widely offered test' similar to that in force in Australia which would make it cheaper for banks to access offshore capital from New Zealand by integrating New Zealand's debt capital market with the offshore market in New Zealand dollar securities;
- Consider zero-rating the approved issuer levy to remove impediments to the direct raising of deposits offshore;
- Ensure that any changes to capital adequacy and liquidity policies do not impose large short term costs on the major banks as they adjust to regulatory changes – necessary changes should be phased in sensibly;
- Continue to lobby for 'repo eligibility' for New Zealand securities with the European Central Bank. The absence of this is currently an impediment to funding from European markets;
- Align Trans-Tasman regulatory frameworks, where it makes sense to do so;
- Finally, but probably most importantly, maintaining New Zealand's sovereign rating, which underpins access to, and the cost of, offshore funding for the economy as a whole. A downgrade to the foreign currency rating, as S&P has warned, could lead to rating downgrades (or at least speculation about this) for New Zealand banks and other corporates. This would put pressure on both sides of banks' balance sheets – not only would it put further pressure on their ability to raise funds offshore, but it could see more firms turn to banks for funding if they are shut out of capital markets.

Ends