

This was released a short time ago

11 November

9am

November 2009 Financial Stability Report released

The outlook for the New Zealand economy and financial system has improved in the past six months as international conditions have stabilised, but some risks and challenges remain, Reserve Bank Governor Alan Bollard said today when releasing the Bank's November 2009 Financial Stability Report.

"Financial market strains have eased, equity markets have mounted a recovery and confidence has improved. Economic forecasts are now tending to be revised upwards rather than downwards. However, global recovery has been fuelled by stimulatory fiscal and monetary policy settings which cannot be kept in place forever. Also, the global banking system remains vulnerable to further shocks."

Dr Bollard noted that while the improved global outlook was generally positive for New Zealand, the rise in the New Zealand dollar over recent months could hinder continued improvement in the external balance. "The New Zealand economy needs to live more within its means to reduce its vulnerability to adverse developments in offshore markets.

"While we see some progress to recover savings and reduce our current account deficit, there is still a considerable adjustment needed to reduce our vulnerability to external shocks. To assist this we need to ensure there is no return to a debt-fuelled housing cycle, which would likely bring with it further exchange rate pressure and erosion of competitiveness."

Commenting on the financial system, Deputy Governor Grant Spencer said that banks in New Zealand and Australia had withstood the crisis better than those in many other countries. However, the banks were overly dependent on offshore wholesale capital markets which broke down during the crisis. Also, the banks' asset quality has deteriorated during the recession, as reflected in recent provisioning and profit results. Further loan losses are likely as unemployment continues to rise through into 2010.

Mr Spencer noted that the improvement in global financial markets is now making it easier for the banks to raise funds in the international markets. "For this reason we are now starting to remove some of our special liquidity facilities that were brought in to support the banks during the crisis.

"The banks nevertheless remain very cautious in their credit and funding decisions. While generally supporting this approach, we have continued to emphasise that the banks should not overly restrict lending to the business sector.

"In support of the banks' more careful approach to liquidity, we have recently introduced a new prudential liquidity policy that is intended to reduce the banks' vulnerability to short-term wholesale funding markets. This policy comes into force in April 2010.

"We also expect that international policy reforms through the Basel Committee will see a tightening of bank capital adequacy standards over the next year or two. We will be watching these developments closely to assess which reforms are suitable for introduction in New Zealand."

Mr Spencer said many non-banks remain under pressure as they seek to repair the damage to balance sheets from the recession. "The non-bank sector is now also faced with the challenge, over the coming year, of meeting the requirements of the Reserve Bank's new non-bank prudential regime. In meeting these challenges, we fully expect to see further rationalisation and closures. The government has extended the deposit guarantee for a year to help the sector through this difficult period."