

Reserve Bank to ease loan-to-value ratio restrictions

The Reserve Bank says it will ease LVR restrictions. Here's what it said with the release of today's Financial Stability Report.

- Wednesday, November 28th 2018

LVR restrictions will be eased from 1 January 2019



Risks to New Zealand's financial system have eased over the past six months, but vulnerabilities persist. In particular, households remain exposed to financial shocks due to their large mortgage debt burden.

However, both mortgage credit growth and house price inflation have eased to more sustainable rates, reducing the riskiness of banks' new housing lending. In response, we are easing our loan-to-value ratio (LVR) restrictions on banks' new mortgage loans. If banks' lending standards are maintained we expect to further ease LVR restrictions over the next few years.

- The RBNZ relaxed both owner-occupier and investor loan-to-value ratio restrictions (LVRs), in effect from 1 January 2019.
- Owner-occupier restriction shifts to 20% (from 15%) of such loans can be for 80+% LVR.
- Investor restriction sees LVR limit up from 65% to 70%, with the same 5% 'speed limit' on higher LVR loans.
- The magnitude of both these easings is the same as for when the restrictions were eased a year earlier.

Debt levels also remain high in the agriculture sector, particularly for dairy farms, implying ongoing financial vulnerability. Balance sheets need to be further strengthened. In the medium-term, an industry response to a variety of climate change-related challenges appears likely, requiring investment.

While domestic risks have eased, global financial vulnerability has risen. Significant build-ups in debt and asset prices, and ongoing geopolitical tensions, overhang financial markets. This vulnerability is highlighted by the current elevated price volatility in equity and debt markets. New Zealand's exposure to these global risks has reduced somewhat, as New Zealand banks have become less reliant on short-term, and foreign, funding.

The domestic banking system remains sound at present. We are using this period of relative calm to reassess whether the banking system has sufficient capital to weather future extreme shocks. Our preliminary view is that higher capital requirements are necessary, so that the banking system can be sufficiently resilient whilst remaining efficient. We will release a final consultation paper on bank capital requirements in December.

The banking system remains profitable, reflecting banks' low operating costs and strong asset performance. While positive overall, banks' low costs have been partly achieved through underinvestment in core IT infrastructure and risk management systems in New Zealand. This was highlighted in our review of bank's conduct and culture with the Financial Markets Authority. We will be jointly reviewing banks' responses to our review in March 2019, and following up as required.

CBL Insurance Ltd was placed into full liquidation by the High Court on 12 November. Aside from CBL, the insurance sector as a whole is meeting its minimum capital requirements. However, capital strength has declined and a number of insurers are operating with small buffers. The insurance industry must ensure it has sufficient capital to maintain solvency in all business conditions. Our ongoing review of conduct and culture in the insurance sector with the Financial Markets Authority will illuminate the industry's risk management capability. The review will be released in January 2019.