MOODY'S

HD **Moody's: Outlook for New Zealand banking system remains stable**

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Moody's Investors Service says that its outlook on New Zealand's banking system is stable, reflecting its expectation of sustained economic growth and stable asset quality over the next 12-18 months.

"While the banks face pressure on their loan margins as borrowers continue to shift to lower-margin fixed-rate mortgages, low provision expenses will help preserve profits and allow the banks to maintain their strong capital buffers," says Daniel Yu, a Moody's Assistant Vice President and Analyst.

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"Our stable outlook for the New Zealand banking system is also consistent with our stable outlook for the country's rated banks, which are rated Aa3 on a weighted - average basis" says Yu.

Yu was speaking on the release of Moody's "Banking System Outlook New Zealand".

The report - whose outlook expresses Moody's expectations of how bank creditworthiness will evolve in this system over the next 12-18 months - looks at New Zealand's banking system in terms of five factors: Operating environment (which is classified as "stable"); asset quality and capital ("stable"); funding and liquidity ("stable"); profitability and efficiency ("stable"); and systemic support ("stable").

Moody's central scenario assumes slightly above-trend GDP growth of 3.3% in 2014 and 2.9% in 2015. While the Reserve Bank of New Zealand (RBNZ) has started a tightening cycle, Moody's expects only a gradual and modest rise in interest rates over the course of this outlook.

This modest rise, together with the RBNZ's latest measures to restrict risky mortgage lending, will help limit the banks' exposures to high house prices and high household indebtedness.

Agricultural exports play an important role in the New Zealand economy, creating a sensitivity to changes in demand for, and prices of, commodities. Demand for commodities will be supported by continuing growth in New Zealand's largest trading partners, **China** and Australia. Hence, despite recent declines, **dairy** prices are expected to remain above the historical norm.

Under these circumstances, Moody's expects asset quality to remain strong, supported by ongoing positive momentum in the economy and slower growth in household debt. Both factors will offset a rise in mortgage servicing costs from monetary tightening.

Funding conditions are also expected to remain favorable, as deposit growth continues to exceed loan growth. Consequently, the banks will not have to increase the proportion of their funding from wholesale sources. However, at 29% of total funding, with a sizeable foreign component, the banks' reliance on wholesale funding remains a key credit sensitivity.

Banks will see increasing pressure on their loan margins from rising competition for low loan-to-value ratio mortgage products, as well as a preference by borrowers to shift to fixed-rate mortgages, as the RBNZ tightens its official cash rate.

Moody's also expects bank profitability remain strong, supported by strong operating efficiency and low loan-loss provision expenses.

Moody's rates five of New Zealand's 13 locally incorporated banks. The five accounted for 88% of total system loans at March 2014. The average (asset-weighted) standalone bank financial strength of New Zealand banks is C, which is equivalent to a baseline credit assessment of a3. All rated banks carry stable outlooks.

Subscribers can access the report at https://www.moodys.com/research/PBC_173339

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