KPMG

FIPS

Financial Institutions Performance Survey
March 2021 Quarterly Results

Overview

Information current as at 18 June 2021

Data for quarter ended March 2021

The recently released Reserve Bank of New Zealand (RBNZ) data for the quarter ended March 2021 means that we now have 12 months of data from the banking sector covering the period that we have been living with the Covid-19 pandemic, its consequences and the related disruptions and restrictions associated with it.

When the pandemic first hit last year and the waves of lockdown started around the world, there were many financial predictions and forecasts about our economy, including a reduction in Gross Domestic Product (GDP), falling house prices and rising unemployment rates.

In April 2020, The Treasury published seven different indicative scenarios ranging from mild to severe. The RBNZ used their own scenarios to run a stress test across the banking sector[1] which concluded that Aotearoa New Zealand has a sound financial system and that the banks would stand up to the stress in all but the most extreme scenarios.

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Fortunately for us as New Zealanders, these dire economic scenarios have not eventuated. There were so many forecasts and reforecasts over the past 12 months that Sharon Zollner, ANZ's Chief Economist joked that "economic forecasters exist to make weather forecasters look good"[2].

In fact, we are currently experiencing a much more buoyant domestic economy than initially predicted.

Cameron Bagrie's article on page 24 discusses the rollercoaster ride that our economy has experienced further. It is also worth noting that while overall our economy has performed better than expected that overall result includes some extremes when examined at an industry level.

There were concerns that the housing market would crash with predictions well into the double digits but in fact the opposite has happened. Recent months have seen interventions from both the Government and the RBNZ focused on trying to take the heat out of the market and stabilise house prices while looking to engineer a soft landing as opposed to a crash. Other markets too have enjoyed a counter cyclical boom.

The banks played an important part in our financial and economic response to the initial lockdowns and assisted the Government to provide ongoing financial support through mortgage deferral schemes and business lending. They were supported through access to cheap funding and extensions to regulatory compliance deadlines.

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The phenomenal support the Government provided during the pandemic must also be acknowledged. The Government balance sheet has borne the brunt of the cost of pandemic support through tools like the wage subsidy, large asset buyback programmes and other support mechanisms.

Now most of these Government support packages have come to an end and the regulatory deadlines are once again looming, there is a lot for the sector to now focus on.

Where we are now

Closed borders

Our borders are still largely closed although recently we have seen tentatively opened travel bubbles with both Australia and the Cook Islands. Although these were long-awaited, the demand for travel has not been as high as expected, possibly due to the uncertainty that still exists and the recent hiccups with the Australian border. The quarantine-free border with Australia has been impacted a number of times since the bubble opened, the border with Victoria being the latest as Covid-19 cases appeared in Melbourne which have led to a city-wide lockdown. Prime Minister Jacinda Ardern warned us at the beginning when the bubble was introduced that any travel should be approached with a 'flyer beware' attitude[3] as borders may need to be closed quickly and without much warning in response to an outbreak in either country and this has certainly been the case.

After the initial flurry of bookings, airlines have not seen the level of demand they hoped for.

Opening the travel bubbles was seen as a lifeline for the airline and tourism industries, both significantly impacted by the pandemic and connected lockdowns. However, after the initial flurry of bookings, airlines have not seen the level of demand they hoped for and we are currently seeing sharply priced airfares and advertising campaigns aimed at encouraging New Zealanders to visit Australia and the recently opened Cook Islands.

Increase in home lending

While New Zealanders spent $1.1 billion more on domestic tourism than they did pre-Covid-19[4], this did not compare with the $9 billion spent on overseas holidays in 2019. With the borders closed, we saw increased domestic spending on consumer goods, cars and home renovations.

As people spent more time at home during the lockdowns and have continued to work from home, there has been an increasing desire to create a separate workspace, convert the garage into a fitness space or renovate the kitchen to create an environment that they may spend more time in. The low interest rates and increasing house prices have made borrowing for these improvements attractive. BNZ, for example, has seen an increase of 20% in their customers investing in home improvements[5].

BNZ has also responded to this increased desire to work from home by encouraging their employees to do so, reporting overwhelmingly positive feedback[6]. Due to this change towards a hybrid model of working some of the time at home and some of the time in the office, BNZ has been able to reduce the amount of office space it occupies and therefore operating expenses.

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New Zealanders have been borrowing at record levels with bank mortgage lending in March 2021 alone at more than $10 billion for the first time. This included $1.7 billion borrowed by First Time Buyers (FTBs) which was another record high. Increased house prices are contributing to the high amount being lent by the banks; however, the number of borrowers is also increasing, with 3,347 FTBs getting on the property ladder in March 2021 alone. This compares to 2,472 in March 2020 (which included a week of Level 4 lockdown) and 2,457 in March 2019.

The Government announced increases to the income cap to access First Home Grants and Loans which took effect from 1 April 2021[7]. However, it was too early for this to impact the April 2021 lending figures which actually saw a reduction of 19% in lending to FTBs compared to March 2021.

Most of the new lending is to those that already own a home.

Most of the new lending is to those that already own a home (60%) suggesting that many people are borrowing to improve their existing home or moving to a property more conducive to them spending more time in it.

This higher demand for building materials for home improvements and for building new homes, along with the disruption to the supply chains as a result of the pandemic, has led to stock shortages in key building materials like structural timber. In fact, those stock shortages saw Carter Holt Harvey announce in April 2021 that it would no longer supply timber to either Mitre 10, Bunnings or ITM[8].

The shortages have no doubt contributed to the cost of building a house increasing by the highest rate in two years in the quarter ended March 2021[9]. The changes to the Government's housing tax policy which encourages investors to purchase new-build houses could add further pressure on the housing sector.

Our housing market remains heated and while this is no doubt one of the factors contributing to consumer confidence, both the Government and the RBNZ feel the prices are not sustainable and have respectively introduced changes to the housing tax policy, re-introduced Loan-to-Value Ratio (LVR) restrictions and is considering a Debt-to-Income (DTI) tool in an attempt to cool the market down.

Of the record-high lending in March 2021, only 8% was over 80% LVR; however, a large proportion (74%) of this was to FTBs.

March 2021 also saw record lending levels to investors despite the LVR restrictions for them coming into effect from 1 March 2021. There is a further restriction from 1 May[10] which may have more impact.

A recent report from CoreLogic shows that the rate at which houses are rising is beginning to slow with an increase of 2.2% over May compared to 3.1% in April. This is seen as a sign that the Government and RBNZ measures are starting to take effect[11].

Employment

The recently released unemployment figure of 4.7% for the quarter ended March 2021[12] shows a slight reduction from the last quarter. Significantly, the figure is now the same for both men and women. Women were disproportionately affected by the initial job losses at the start of the Covid-19 pandemic, with 90% of the job losses after the first lockdown period impacting women. This has prompted the Government to draft an employment strategy focused specifically on women, looking at some of the more structural issues impacting women's employment such as affordable childcare, training and support[13].

Despite the unemployment figure being far lower than early predictions feared and down from a high of 5.2% in the quarter ended September 2020, the underutilisation rate has increased to 12.2% and is significantly higher than the 10.5% reported in March 2020 before the Covid-19 pandemic. This indicates that, while many people may not have lost their job entirely, they are working fewer hours than they would like to.

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However, when considered in conjunction with the *Seek NZ Employment Report* for May 2021 which saw the highest number of jobs ever being advertised on their website (almost three times as many as this time last year) and the number of applicants per role declined 11% compared to the previous month, it also points towards a skills gap or shortage[14].

The border restrictions have naturally seen a stark decline in migration with figures for the year ended February 2021 showing a 72.5% decline from the previous 12-month period[15]. This has highlighted how reliant we are on immigration to fill jobs across the board, from seasonal horticultural workers to key roles at banks. ANZ, for example, reported 300 job vacancies earlier this month, specifically across risk and compliance and technology[16]. Banks and regulators alike are suffering from a lack of experienced risk and compliance staff to respond to the increased requirements of our regulatory environment.

Easing the border restrictions to allow safe entry to skilled migrants will certainly be welcomed by business but there is a risk that it will also create an outward flow for those who haven't been able to go on their overseas experience (OE) or reunite with family due to the limitations.

The ending of the Covid-19-related Government support packages does not seem to have impacted the employment figures, however the credit bureau Centrix reported that the ending of the mortgage deferral scheme has resulted in an increase of 10% in mortgage accounts flagged as being in financial hardship[17].

The increase in house prices and recent LVR restrictions means there is a low risk for the banks' balance sheets but they need to maintain a focus on their customers and potential hardship.

Outlook for future

Easing the border restrictions

New Zealand has started the roll out of the Covid-19 vaccine albeit slower than hoped[18]. The vaccine is a crucial element to how to the borders are opened up safely, for tourists and migrants as well as citizens who want to travel and return without quarantining.

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Questions that need to be considered include: Will the vaccine roll out enable us to open the borders fully or would we need to move up an alert level in order to mitigate the risks? How will we prioritise visitors/migrants?

In recognition of – and desire to keep – its status as a global financial centre, Hong Kong is offering quarantine exemptions to senior banking executives who can prove they have been vaccinated and adhere to a strict schedule once there[19].

Whilst many people are keen for the world to start re-opening, it is critical that we do this safely and in a way that does not undermine the success that New Zealand achieved in managing the health impacts of the Covid-19 pandemic.

This is a process that will probably take longer than many people realise while systems at the border to track vaccinated people and the management of any outbreaks are all factored in and tested.

Regulation and increased reporting

In order to assist the banks successfully dealing with the impacts of the Covid-19 pandemic, the RBNZ extended the deadlines for a number of incoming regulations[20].

However, that time is largely passed and now the focus is now back firmly on regulation and compliance. The RBNZ's newly created Enforcement Team is a clear signal that it will have a low tolerance for any breaches and there has been a number of banks who have publicly corrected previous issues ranging from capital calculations[21] to customer disclosures, liquidity calculation errors and Anti-Money Laundering (AML) breaches[22].

The level of regulation impacting banks in New Zealand currently is unprecedented.

The level of regulation impacting banks in New Zealand currently is unprecedented and is not just coming from the RBNZ but also the Financial Markets Authority (FMA), The Treasury, Ministry of Business, Innovation and Employment (MBIE) and the Commerce Commission as well as international bodies like the Financial Action Task Force (FATF).

Although New Zealand scores well in comparison to many other countries when measured on ease of doing business and low corruption, the recent FAFT report[23] showed "major gaps in New Zealand's framework" when looking at anti-money laundering and counter financing of terrorism (AML/CFT). While AML/CFT regulations are well established in other jurisdictions, they are relatively immature in New Zealand. The RBNZ has demonstrated that it is not shying away from taking an "escalated regulatory response" to non-compliance[24] by the recent filing of a court claim against TSB for AML breaches.

Banks have significant programmes of work dedicated to all of the various regulatory requirements.

Banks have significant programmes of work dedicated to all of the various regulatory requirements and some are more complex than others but the message is clear – the level of historic compliance may not be good enough. Banks need to clearly demonstrate that they have the right, robust processes in place, that they are focused on good customer outcomes, that they adhere to their prudential requirements and can easily provide proof that the correct procedures have been followed.

Some of these requirements involve a significant investment in the capability of their people and the way that they interact with clients rather than an additional tick box framework. The next 'cab off the rank' is the implementation of the amendments to the Credit Contracts and Consumer Finance Act 2003 (CCCFA) which comes into effect from 1 October, requiring people who provide advice to customers to be 'fit and proper'.

Ross McEwan, CEO of National Australia Bank (NAB), parent of BNZ, announced last year that NAB would "raise the bar in banking professionalism" by providing education and accreditation for its whole workforce on both sides of the Tasman[25]. This focus on building skills and capabilities will certainly be of benefit as the expectations and responsibilities on the sector will only increase.

Complying with regulation is only part of the scrutiny that banks are experiencing from their stakeholders.

Complying with regulation is only part of the scrutiny that banks are experiencing from their stakeholders. Customer complaints to the Banking Ombudsman increased in the quarter ended December 2020 by 3.4% compared to the previous quarter and most were to do with a 'service issue'[26]. This can be complicated as it could be a result of a customer being treated differently to how they expect to be. We have seen recent media coverage of instances where banks could be considered to be doing the right thing technically but not necessarily communicating it well[27] causing confusion and emotional upset for their customers. These examples show the tightrope they walk at times between customer protection and denial of service.

It is not just bank staff who will be key to how banks operate and thrive in a more regulated and scrutinised environment. Many of the regulations have an increased focus on Directors' personal liability which means that Boards are increasingly involved in the business.

While banks are dealing with increased pressures and scrutiny, they are also operating in a competitive environment against other providers who are don't necessarily have to adhere to the same regulatory requirements. Although retail spending on electronic cards rose by 4% in April 2021 (compared with March 2021)[28], a recent Canstar survey showed that 25% of 18-29 year olds in New Zealand prefer to use Buy now, Pay Later (BNPL) services over the traditional card offerings[29].

Currently BNPL services are unregulated, something which regulators in both Australia and the UK are concerned about and are looking into. Here in New Zealand, there is also increasing concern and calls for the sector to be included in the regulatory regime[30].

Another area which could be seen as under-regulated is cyber security.

Another area which could be seen as under-regulated is cyber security. As discussed in KPMG's *FIPS Banks Review of 2020*[31], New Zealand has minimal regulation with regards to cyber security, which no doubts contributes to a relatively low level of maturity for many of New Zealand's organisations.

A number of recent high-profile cyber attacks or data breaches have highlighted the need for many organisations to increase their cyber security. This is particularly applicable to our banks which hold significant data both in nature and amount.

The RBNZ recently released a public summary of KPMG's report into the cyber attack and subsequent data breach that the RBNZ itself experienced in December 2020. The RBNZ had already issued draft guidance on what regulated entities should consider when managing cyber security risk in October 2020. Rather than waiting for regulation to be finalised or for another incident, banks should be evaluating the effectiveness of their existing controls.

As discussed on page 32, Environmental, Social and Governance (ESG) reporting is only going to increase. Some New Zealand banks already have sustainability reports which cover some of the measures that are being discussed. While the banking sector is leading the way in New Zealand for reporting, generally we have a low level of maturity compared to the UK and Australia[32].

Cost pressures

As expected, the RBNZ recently announced that the Official Cash Rate (OCR) would remain at 0.25%[33]. While we have not seen the negative interest rates that were discussed last year, there is no doubt that the banks are continuing to feel pressure from tight interest margins, which is impacting their income.

However, we are starting to see banks increase their three to five year interest rates. This steepening of the yield curve is in contrast to this time last year when the RBNZ reduced the OCR by 75 basis points (bps) as part of its measures to combat the economic impact of Covid-19.

In a recent global banking cost transformation survey[34], KPMG found that the top two issues for banks to address post-Covid-19 were the twin concerns of revenue loss and cost management.

59% of senior bank executives stated that digitisation is the most important cost lever that they can pull. One global report estimates that the lockdowns meant we progressed five years in consumer and business digital adoption in eight weeks[35]. We certainly saw that shift in New Zealand with the speed that most organisations were able to adjust to working remotely. Banks focused on assisting customers transition to non-face-to-face channels such as online and phone banking, especially over-75-year olds. BNZ recently reported that nearly 75% of its customers are "digitally active and engaged" with 80% of the transactions that used to be done in branch now done via Smart ATMs, online, or phones[36].

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We have seen a number of branch closures across the banks over the past 12 months as well as some that have reduced their opening hours. Many of these were planned pre-Covid but some were as a result of the acceleration of customers moving to digital channels. The New Zealand Bankers Association's Banking Hub pilot was delayed due to the pandemic, but started in November 2020 and runs through to the end of this year. The six banks that are participating in this trial have renewed their commitment to not close regional branches until the end of the pilot[37].

Whilst streamlining branch networks has the benefit of reducing costs, it could impact banks' ability to increase their revenue by reducing the opportunities to engage with customers.

While many customers prefer the ease of self-serve digital channels, banks need to consider how to understand additional customer needs in this environment in order to offer appropriate products and services.

Increased regulation is also contributing to higher costs.

Increased regulation is also contributing to higher costs, particularly the RBNZ's *BS11 Outsourcing Policy* which requires locally registered large banks to be able to operate independently. This requirement means that there are fewer opportunities to leverage efficiencies from an Australian parent bank for example, and was one of the reasons cited in Westpac's announcement in March 2021 that it was considering a 'de-merger' of its New Zealand business[38].

Continued uncertainty

As we work our way out of the pandemic, the only certainty is that there will be uncertainty. A recent global KPMG report[39] showed that 45% of the financial services CEOs surveyed believed that their business will return to a 'normal' course of business sometime in 2022. However, there was an increase in the level of confidence in their organisation's ability to grow through the disruption, with 86% voicing confidence in their three-year growth prospects, 9% higher than the same time last year. Interestingly, this was slightly lower among the banking sector CEOs at 75%, 5% less than last year. This was attributed globally to provisioning pressures and the low interest environment. In New Zealand, we would add the continued regulatory and competitive pressures that the banking sector is facing.

Here in New Zealand, we have been fortunate that we have not had to deal with high levels of Covid-19 infections in the community and many of our businesses have been able to return to 'normal'. That said, this has not been the case across all sectors and some businesses are still struggling with a lack of customers, a lack of skilled workers or disruption in the supply chain. There are no quick fixes to any of these issues and we need to remain agile and resilient.

Quarterly analysis of the results

As expected, we have seen a continued increase in net profit after tax (NPAT) for the banks as the provisioning requirements are re-visited in light of the performance of the banks' exposures and the seemingly better economic indicators compared to a year ago. This resulted in provisions being released and the related impaired asset expenses not reaching the levels predicted this time last year. In fact, the reduction in impaired assets expenses that we are seeing is possibly a sign that we can expect to see further reversals. Rajesh Megchiani and Dhayaparan Raman discuss this in more detail on page 26.

While the quarterly NPAT for the banking sector of $896 million reflected in the results for March 2020 was the lowest that we have seen for many years it was a continuation of a trend from the two previous quarters. It continued into the quarter ended June 2020 reflecting the continued uncertainty over the Covid-19 pandemic and its impacts. We saw a bounceback through the September and December 2020 quarters and, at $1,643 million, the NPAT for the quarter ended March 2021 is the highest since the RBNZ's Dashboard reporting commenced in March 2018.

The continued activity in the residential housing market is driving loan growth in the banking sector.

Despite this quarter showing slightly lower levels of mortgage lending compared to the quarter ended December 2020, the month of March 2021 alone accounted for over $10 billion of new mortgages. While the increases in property prices mean a proportionate increase in the lending required to purchase properties, there has also been a significant increase in the number of new loans written. There were 31,282 loans written in March 2021, a level not seen since 2016.

The growth in lending of 1.86% across the banking sector therefore seems low, but it has a number of underlying components to it. While there has been strong mortgage lending growth, this has been offset by reduced corporate, commercial, and consumer lending. In addition, some banks have seen significantly greater lending growth than others.

At the start of the pandemic, many businesses drew down on loans to provide cash, not knowing whether they might need have needed it. For a large number of organisations these loans were not required and, in fact, across the consumer sector a number of borrowers chose to repay them. We can speculate whether the source of these funds was from Government support such as the wage subsidy. As we got deeper into the pandemic, we saw global supply chains disrupted, businesses running into labour constraints and a closed border contributing to a lower demand from business borrowers. In addition, some larger businesses have chosen to raise funds in bond markets as opposed to more traditional bank borrowing.

The other significant driver of NPAT recorded this quarter is non-interest income, which is possibly a sign of the volatility of the markets over the past six months. The impact of a reduction in provisioning and the growth in non-interest income has resulted in a record quarterly profit.

However, it should be noted that the non-interest income component is highly volatile and, as shown previously, it could reduce or even reverse in the following quarters.

While the economy is generally performing better than anticipated, it is not the case across every sector and it is not a straight line. The low interest rates have kept the banks' interest income reasonably stable as the margins have been consistently low, only changing by 20 bps at the most.

Operating expenses continued to reduce across the banking sector and dropped by 1.44% (to $1,378.5 million) for the quarter ended March 2021. March 2020 saw operating expenses rise to $1,581.1 million, almost 9% higher than the previous quarter, as banks started to invest in equipping their staff to work from home. As this has now been largely completed, we have seen operating expenses reduce accordingly although we could start to see these rise again if banks need to pay more to fill their current vacancies with qualified people. We might also see an increase in operating expenses if projects that were deferred last year due to the pandemic or those that digitise part of the supply chain go ahead this year. The operating expenses/operating income ratio for the quarter was 38.53%, down from 44.25% for the quarter ended March 2020.

While capital adequacy ratios have been much discussed over the past 12 months, all of the banks covered in this survey are reporting an increase in their ratios since March 2020. This is potentially a consequence of the RBNZ's increased capital requirements ahead of the revised deadline of July 2022 (previously July 2021, but extended as part of the RBNZ's Covid-19 related relief package for the banks) and in part caused by restrictions on dividends payable over the last year.

RBNZ Covid-19 timeline[40]

March 2020 – March 2021

Events in purple text relate to Covid-19 announcements from the New Zealand Government.

Date	Event
28 Feb 2020	New Zealand records its first case of Covid-19.
9 Mar 2020	The RBNZ warns businesses to be prepared for potential disruptions from Covid-19 and consider their responses.
16 Mar 2020	Start date of increased capital requirements delayed until 1 July 2021 to increase lending supply. The Official Cash Rate reduced to 0.25% for the next 12 months to provide monetary stimulus in response to Covid-19.
18 Mar 2020	External facing work on multiple regulatory initiatives is delayed for at least six months, and the outsourcing policy transition period is extended by 12 months.
19 Mar 2020	Confirmation issued that RBNZ has adequate cash to feed into the system should Covid-19 impact regular cash operations. New Zealand's borders close to all but New Zealanders and permanent residents.
20 Mar 2020	Term Auction Facility (TAF) is introduced, giving banks access to collateralised 12-month term funding, to assist with the smooth function of markets. Other measures include funding in FX swap markets, the USD swap line being re-established, assisting to keep the New Zealand Government Bond market liquid and removing the allocated credit tiers for Exchange Settlement Account System (ESAS) accounts.
21 Mar 2020	The Government introduces a 4-tiered Alert Level system to assist New Zealand deal with the impact of Covid-19.
23 Mar 2020	The RBNZ announces intention to purchase up to $30 billion of New Zealand Government Bonds on the secondary market over a 12-month period through the Large Scale Asset Programme (LSAP). New Zealand moves to Alert Level 3.
24 Mar 2020	Financial support package announcement features a six-month principal and interest payment holiday to help homeowners and businesses affected economically by the impacts of Covid-19. At the same time capital rules are adjusted, with core funding ratios decreasing from 75% to 50%. The Government and banks also implement a $6.25 billion Business Finance Guarantee Scheme for Small and Medium Medium-sized Enterprises (SMEs) aimed at protecting jobs and supporting the economy through uncertainty.
25 Mar 2020	Financial service functions are deemed essential under Covid-19 Alert Level 4. New Zealand moves to Alert Level 4.
29 Mar 2020	New Zealand records its first Covid-19 related death.
30 Mar 2020	Weekly Open Market Operation (OMO) are deployed to provide liquidity for Corporate and Asset-Backed securities, providing another channel for banks to continue corporate funding.
2 Apr 2020	Term Lending Facility (TLF) is introduced to support the Business Finance Guarantee Scheme and promote business lending, by offering funding to banks with low interest rates for up to three years. The payment of dividends and the redemption of non-CET1 capital instruments is stopped until further notice.

Date	Event
2 April 2020	Largest increase in Covid-19 cases in one day (89).
7 Apr 2020	LSAP is expanded to include $3 billion of the Local Government Funding Agency (LGFA) debt, increasing the programme total to $33 billion over 12 months.
19 Apr 2020	Expectations for banks regarding responsibility and good conduct in a time of uncertainty are outlined.
21 Apr 2020	Intention to remove loan-to-value ratio (LVR) restrictions announced to ensure borrowers and lenders were not unduly impacted by the mortgage deferral scheme.
24 Apr 2020	Guidance issued for Financial Services providers for operating under Covid-19 Alert Level 3.
27 Apr 2020	New Zealand moves to Alert Level 3.
30 Apr 2020	LVR restrictions are removed for 12 months.
4 May 2020	Operational details of TLF are announced, offering three-year fixed rate lending with the rate equivalent to the OCR at 0.25% available until 29 October 2020. The low interest rates are expected to be passed onto borrowers.
12 May 2020	Covid-19 Alert Level 2 guidance issued.
13 May 2020	LSAP further expanded to a potential $60 billion with the introduction of New Zealand Government Inflation Indexed Bonds, which is aimed at continuing the reduction of borrowing costs. New Zealand moves to Alert Level 2.
8 Jun 2020	New Zealand moves to Alert Level 1.
24 Jun 2020	Monetary Policy Committee (MPC) agrees to continue with LSAP for the foreseeable future.
14 Jul 2020	Results of the Credit Conditions Survey for June 2020 are released, capturing changes post-lockdown from the March 2020 survey.
12 Aug 2020	LSAP is expanded to $100 billion, to further lower retail interest rates and achieve its remit. Additional monetary instruments will also remain in active preparation to be deployed if necessary. Due to new cases of Covid-19 in the community, Auckland region moves to Alert Level 3 and the rest of New Zealand moves to Alert Level 2.
17 Aug 2020	The Mortgage Deferral Scheme is extended to 31 March from 27 September, allowing banks to continue to help any customers in need without impacting their credit scores.
20 Aug 2020	The TLF offer is extended until 1 February 2021, with the term increased from three to five years. The RBNZ's balance sheet has doubled since January to approximately $60 billion, as a result of its support to the economy in response to Covid-19, and is likely to remain high for the foreseeable future.
24 Aug 2020	Banks and Non-Bank Deposit Takers (NBDTs) are granted an exception to operate under Covid-19 Alert Level 3.
30 Aug 2020	Auckland region moves to Alert Level 2 to join the rest of New Zealand but has additional restrictions on gatherings.
17 Sep 2020	Outcomes from a Covid-19 stress test of New Zealand banks in March is released and concludes that banks could successfully draw on their existing capital buffers and continue lending to support lending in the economy during a severe economic downturn.

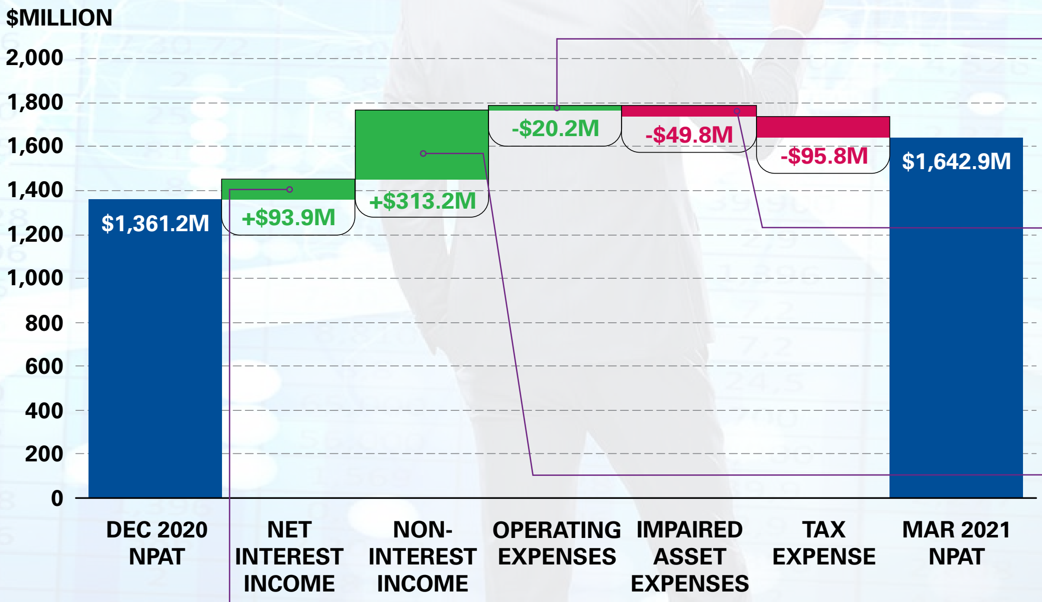
Date	Event
21 Sep 2020	All of New Zealand except the Auckland region moves to Alert Level 1.
23 Sep 2020	MPC agrees to continue with LSAP up to $100 billion. The extra restrictions on gatherings are removed for the Auckland region.
7 Oct 2020	Auckland region moves to join the rest of New Zealand in Alert Level 1.
11 Nov 2020	Announcement of a Funding for Lending Programme (FLP) to commence in December to reduce banks' funding costs and lower interest rates, with the intention of assisting in meeting remits. Announcement that required increases in bank capital have been further delayed until 2022. This is to allow banks continued capital headroom to respond to the economic impact of Covid-19 and support the financial recovery. Dividend restrictions to remain until at least 31 March 2021.
25 Nov 2020	Intention to reinstate LVR restrictions is signalled.
8 Dec 2020	Requests for views on a proposal to reinstate LVR restrictions on high-risk lending with effect from March 2021.
9 Feb 2021	The RBNZ announces LVR restrictions to be re-instated from 1 March 2021. Banks will be restricted to a maximum of 20% of new lending to owner-occupiers at LVRs of over 80% and 5% of new lending to investors at LVRs over 70%. From 1 May 2021, the restriction for new lending to investors will increase to a maximum of 5% of new lending at LVRs over 60%.
14 Feb 2021	Due to new cases of Covid-19 in the community, Auckland region moves to Alert Level 3 and the rest of New Zealand moves to Alert Level 2.
17 Feb 2021	Auckland region moves to Alert Level 2 and the rest of New Zealand moves to Alert Level 1.
22 Feb 2021	Auckland region joins the rest of New Zealand at Alert Level 1.
27 Feb 2021	Auckland region moves to Alert Level 3 and the rest of New Zealand moves to Alert Level 2.
7 Mar 2021	Auckland region moves to Alert Level 2 and the rest of New Zealand moves to Alert Level 1.
10 Mar 2021	The RBNZ announced that it will be removing temporary liquidity facilities, TAF and Corporate Open Market Operation (COMO), which were put in place during the Covid-19 pandemic.
12 Mar 2021	Auckland region joins the rest of New Zealand at Alert Level 1.
24 Mar 2021	The RBNZ expressed concerns over weaknesses in Westpac NZ's risk governance and instructed the bank to commission two independent reports to address them.
31 Mar 2021	The RBNZ eased the dividend restrictions placed on retail banks at the height of the Covid-19 pandemic.

Net profit after tax

Movement in net profit

↑ 20.69%

to $1,642.9 million



Net interest income

↑ 3.50%

to $2,779.8 million

TABLE 1: Movement in interest margin

Entity[41]	31 Mar 21 quarter ended (%)	Mvmt. during the quarter (bps)	Mvmt. for the 6 months (bps)	Mvmt. for the 12 months (bps)
ANZ	0.02	20	20	0
ASB	0.02	20	30	10
BNZ	0.02	10	10	0
Heartland	0.05	20	30	20
Kiwibank	0.02	10	20	10
SBS	0.03	20	30	20
TSB	0.02	10	10	0
Co-op	0.02	10	20	20
Westpac	0.02	0	20	10

Operating expenses

1.44%

down $20.2 million

Driven by

ANZ	$23.7M
BNZ	$14.5M
Heartland	$9.6M

Non-interest income

64.8%

up $313.2 million

Driven by

ANZ	$162.7M
BNZ	$88.2M
Westpac	$59.0M

Impaired asset expenses (writebacks)

39.4%

reduced by $49.8 million

Driven by

ANZ	$47.6M
ASB	$12.0M

Lending

Loans

1.86%

to $463,475 million

Quarterly

Kiwibank 3.16%

TSB 2.09%

Year on year

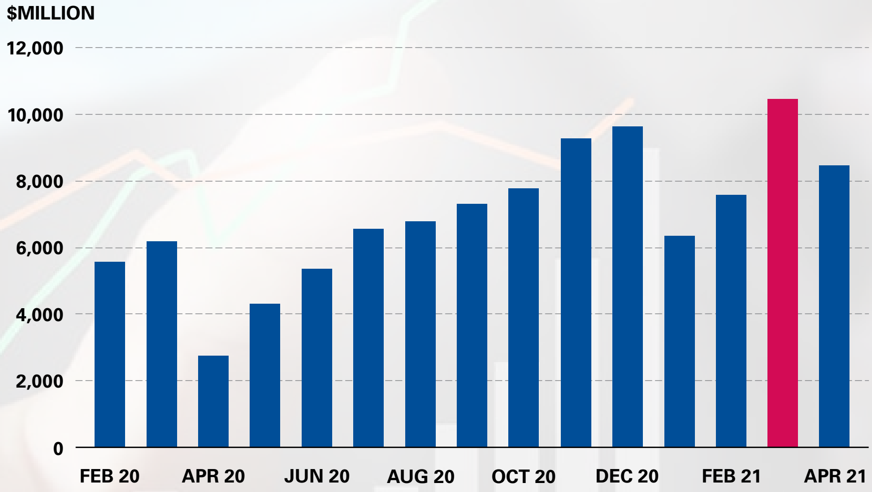
Kiwibank 12.08%

ASB 6.94%

TABLE 2: Analysis of gross loans

Entity[41] Quarterly analysis	31 Mar 21 quarter ended $Million	31 Dec 20 quarter ended $Million	% Increase (Quarterly)	Entity[41] Annual analysis	31 Mar 21 quarter ended $Million	31 Mar 20 quarter ended $Million	% Increase (Annual)
ANZ	138,403	135,691	2.00%	ANZ	138,403	136,324	1.53%
ASB	100,329	98,647	1.70%	ASB	100,329	93,819	6.94%
BNZ	91,704	89,844	2.07%	BNZ	91,704	90,068	1.82%
Heartland	3,749	3,720	0.78%	Heartland	3,749	3,794	-1.18%
Kiwibank	24,716	23,959	3.16%	Kiwibank	24,716	22,052	12.08%
SBS	4,073	4,073	0.01%	SBS	4,073	4,190	-2.79%
TSB	6,373	6,243	2.09%	TSB	6,373	6,174	3.22%
Co-op	2,708	2,665	1.61%	Co-op	2,708	2,571	5.34%
Westpac	91,419	90,154	1.40%	Westpac	91,419	87,931	3.97%
Total	**463,475**	**454,996**	**1.86%**	**Total**	**463,475**	**446,922**	**3.70%**

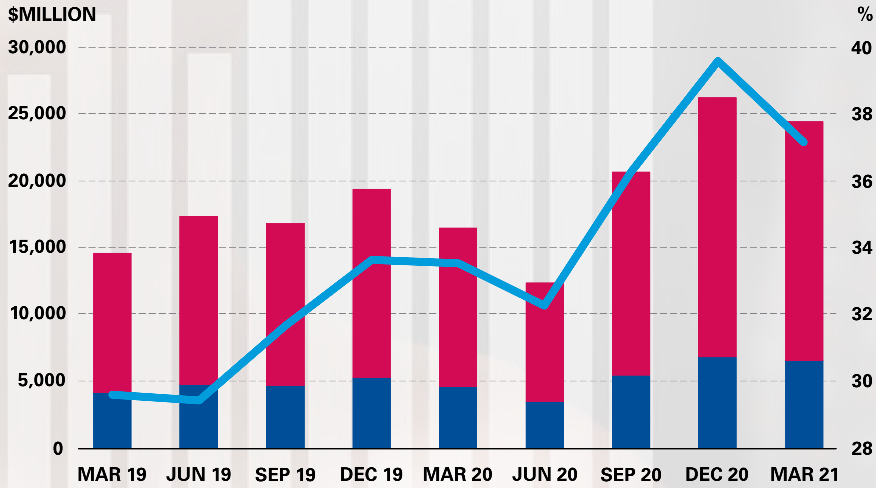
1 TOTAL MONTHLY MORTGAGE LENDING



MONTHLY MORTGAGE LENDING
PEAK IN MORTGAGE LENDING

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

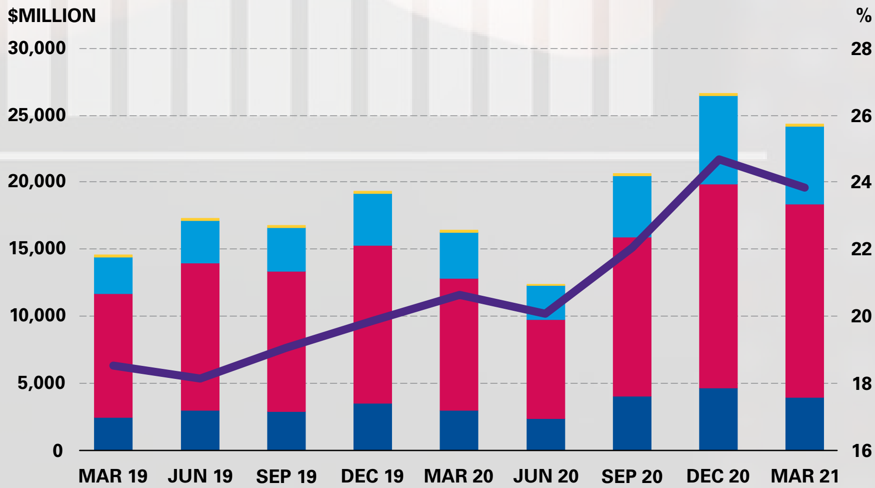
2 NEW MORTGAGE LENDING BY PAYMENT TYPE



INTEREST ONLY (INCLUDING REVOLVING CREDIT) (LHS)
PRINCIPAL AND INTEREST (LHS)
PROPORTION OF NEW LENDING INTEREST ONLY – INVESTOR (%) (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

3 NEW MORTGAGE LENDING BY BORROWER TYPE



FIRST HOME BUYER (LHS)
OTHER OWNER OCCUPIER (LHS)
INVESTOR (LHS)
BUSINESS PURPOSES (LHS)
INVESTOR LENDING (%) (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS

Asset quality

Individually assessed provisions

7.40%

down $35.0 million

Driven by

ANZ	$23.6M
BNZ	$13.3M

TABLE 3: Impaired asset expenses	$Million
March 2021	-$76.6
December 2020	-$126.0
September 2020	$188.6
June 2020	$478.0
March 2020	$749.3
December 2019	$90.1

We saw a stark increase in the level of impaired asset expenses in March 2020 amid the uncertainty caused by the beginning of the Covid-19 pandemic.

The worst case scenarios that had been initially forecast have not eventuated so banks are starting to release these provisions.

Some banks started this release in the last quarter with others releasing this quarter.

Collectively assessed provisions

3.88%

down $94.4 million

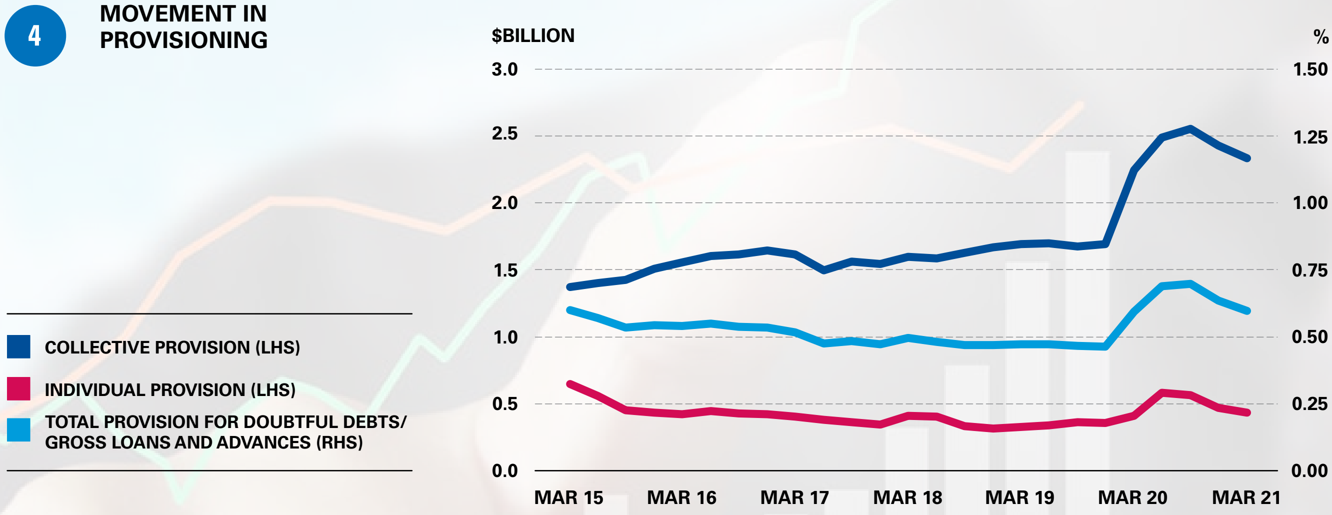
Driven by

ANZ	$37.9M
ASB	$24.3M
Westpac	$18.1M

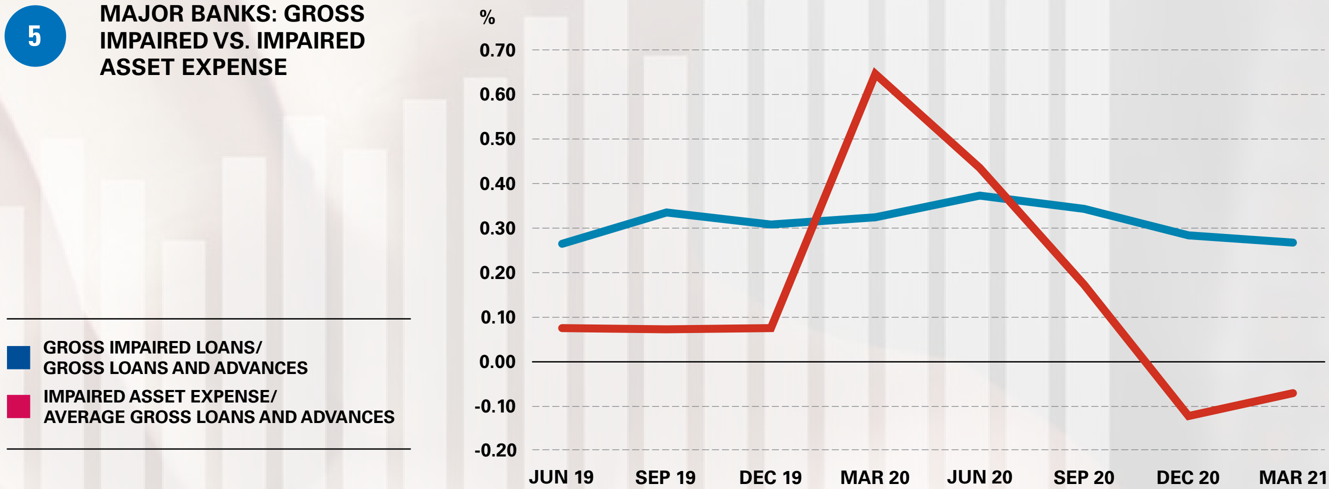
TABLE 4: Movement in impaired asset expense/ Average gross loans

Entity[41]	31 Mar 21 quarter ended (%)	Movement during the quarter (bps)	Movement for the 12 months (bps)
ANZ	-0.17%	-14	-81
ASB	-0.06%	-5	-71
BNZ	0.04%	17	-49
Heartland	0.52%	8	-17
Kiwibank	0.01%	4	-27
SBS	-0.13%	-22	-257
TSB	-0.11%	-14	-140
Co-op	-0.30%	-35	-133
Westpac	-0.05%	34	-92
Average	**-0.07%**	**4**	**-74**

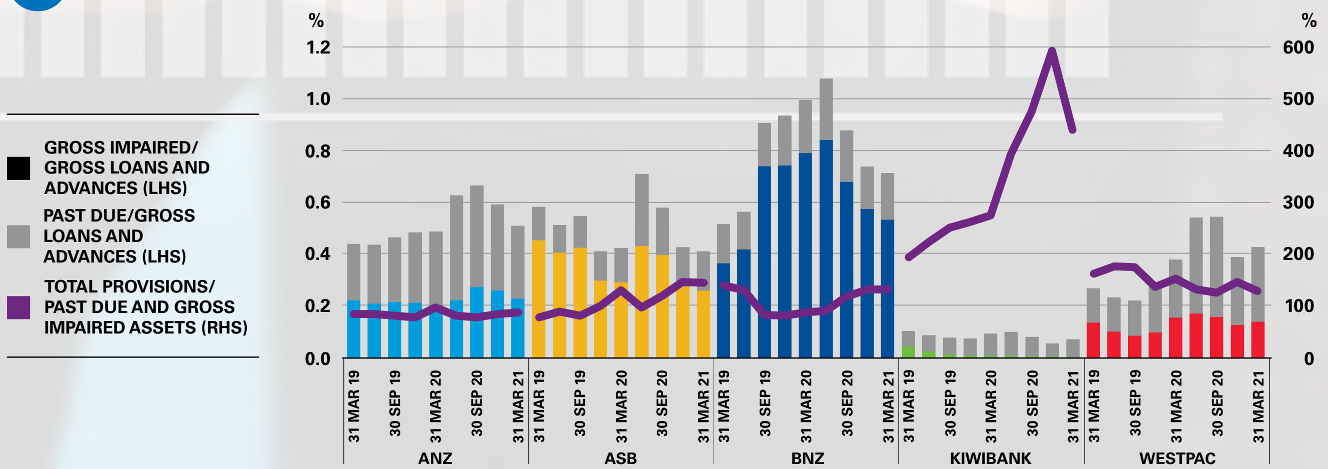
4 MOVEMENT IN PROVISIONING



5 MAJOR BANKS: GROSS IMPAIRED VS. IMPAIRED ASSET EXPENSE



6 MAJOR BANKS: PAST DUE AND GROSS IMPAIRED ASSETS VS. GROSS LOANS AND ADVANCES



Major banks - Quarterly analysis

Entity[41]	Size & strength measures							
	30 Jun 19	30 Sep 19	31 Dec 19	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21
	Total assets[42] ($Million)							
ANZ	166,292	170,492	170,385	183,424	181,688	180,087	186,404	183,811
ASB	107,075	111,167	109,464	116,042	113,464	115,064	117,967	121,115
BNZ	105,313	109,111	108,289	118,501	114,452	112,310	117,287	114,314
Heartland	4,139	4,206	4,262	4,315	4,315	4,288	4,358	4,297
Kiwibank	22,734	23,584	24,086	25,249	25,510	26,645	27,283	27,546
SBS	4,791	4,863	4,948	4,942	4,836	4,842	4,839	4,832
TSB	7,920	8,075	8,130	8,179	8,332	8,575	8,761	8,789
Co-op	2,855	2,927	2,948	2,980	3,008	3,048	3,064	3,122
Westpac	101,464	106,762	107,111	120,525	114,223	113,187	117,160	114,726
Total	**522,582**	**541,187**	**539,622**	**584,157**	**569,827**	**568,047**	**587,123**	**582,552**
	Increase in gross loans and advances (%)							
ANZ	0.77	0.35	0.92	0.98	-0.02	-1.92	1.51	2.00
ASB	0.91	1.40	0.83	1.03	0.09	2.41	2.58	1.70
BNZ	1.56	1.07	0.41	1.41	-1.36	-0.30	1.43	2.07
Heartland	2.94	0.88	1.82	1.23	-2.03	-0.62	0.72	0.78
Kiwibank	2.89	1.63	3.57	1.91	1.51	3.06	3.86	3.16
SBS	1.24	1.05	1.63	0.58	-1.36	-0.36	-1.10	0.01
TSB	3.77	2.72	-0.33	-0.16	-0.28	0.58	0.81	2.09
Co-op	0.77	0.98	1.08	1.32	-0.31	1.14	2.83	1.61
Westpac	0.79	1.75	1.68	1.80	-0.29	1.47	1.34	1.40
Average	**1.13**	**1.10**	**1.07**	**1.27**	**-0.28**	**0.31**	**1.78**	**1.86**
	Capital adequacy (%)							
ANZ[43]	13.50	13.60	13.60	13.90	14.00	14.40	15.00	15.90
ASB[43]	14.00	13.50	14.20	13.60	14.00	14.20	13.90	14.80
BNZ	13.70	13.90	14.40	14.10	14.60	14.90	15.50	16.00
Heartland	13.50	12.90	12.60	12.90	12.70	13.40	14.00	14.40
Kiwibank	14.50	13.50	13.20	13.00	12.60	12.30	13.30	13.20
SBS	14.30	14.20	14.20	13.80	14.30	14.90	15.20	15.70
TSB	14.50	14.60	14.60	14.30	14.90	15.10	15.10	15.00
Co-op	16.60	16.70	16.40	16.30	16.90	16.90	17.00	16.90
Westpac[43]	16.70	15.90	15.90	15.90	16.60	17.10	17.60	18.20
	Net profit ($Million)							
ANZ	504	392	367	422	327	220	367	563
ASB	282	310	252	192	130	270	321	348
BNZ	313	160	238	129	187	209	303	357
Heartland	20	18	17	17	9	21	12	18
Kiwibank	20	25	27	17	-12	24	31	40
SBS	8	8	6	-4	8	10	12	12
TSB	14	13	12	-8	9	12	11	11
Co-op	2	2	3	-1	3	4	5	4
Westpac	284	280	203	132	107	238	300	290
Total	**1,447**	**1,207**	**1,125**	**896**	**770**	**1,008**	**1,361**	**1,643**

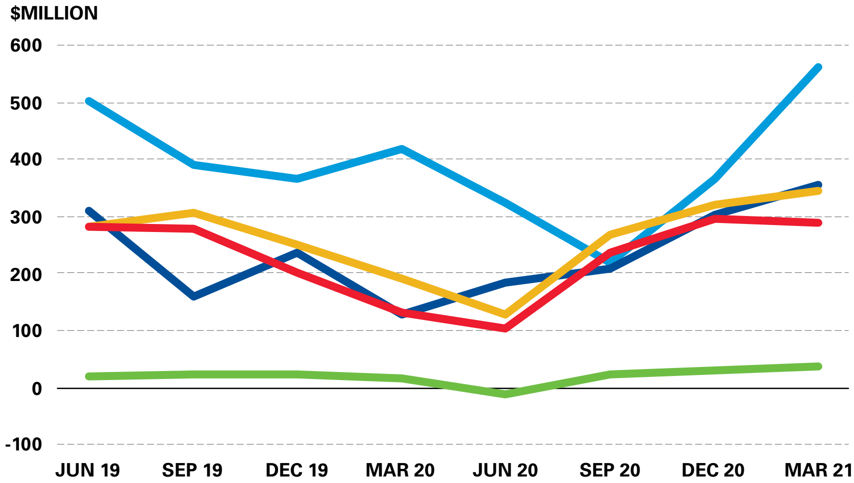
Entity	Profitability measures							
	30 Jun 19	30 Sep 19	31 Dec 19	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21
	Interest margin[44] (%)							
ANZ	2.20	2.00	2.10	2.10	1.90	1.90	1.90	2.10
ASB	2.00	1.90	1.90	2.00	1.80	1.80	1.90	2.10
BNZ	2.10	2.10	2.10	2.10	2.00	2.00	2.00	2.10
Heartland	4.50	4.60	4.50	4.60	4.60	4.50	4.60	4.80
Kiwibank	2.10	2.00	1.90	2.00	1.90	1.90	2.00	2.10
SBS	2.50	2.50	2.50	2.50	2.40	2.40	2.50	2.70
TSB	1.80	1.80	1.80	1.80	1.60	1.70	1.70	1.80
Co-op	2.20	2.20	2.20	2.20	2.20	2.20	2.30	2.40
Westpac	2.10	1.80	1.90	1.90	1.70	1.80	2.00	2.00
	Non-interest income/Total assets[42] (%)							
ANZ	0.67	0.68	0.31	0.85	0.33	0.29	0.18	0.53
ASB	0.64	0.67	0.57	0.53	0.51	0.58	0.54	0.56
BNZ	0.79	0.45	0.30	0.65	0.40	0.35	0.42	0.72
Heartland	0.44	0.42	0.38	0.32	0.38	0.28	0.42	0.32
Kiwibank	0.83	0.86	0.90	0.92	0.53	0.63	0.27	0.26
SBS	0.75	0.78	0.82	0.70	0.68	0.74	0.82	0.65
TSB	0.27	0.29	0.29	0.25	0.22	0.22	0.22	0.20
Co-op	0.71	0.66	0.71	0.50	0.67	0.69	0.60	0.58
Westpac	0.59	0.70	0.37	0.59	0.32	0.35	0.28	0.48
Average	**0.67**	**0.63**	**0.41**	**0.68**	**0.39**	**0.39**	**0.34**	**0.55**
	Impaired asset expense/Average gross loans and advances (%)							
ANZ	0.07	0.13	0.05	0.64	0.23	0.27	-0.03	-0.17
ASB	0.14	0.05	0.04	0.65	0.59	0.15	-0.01	-0.06
BNZ	0.12	0.18	0.14	0.53	0.46	0.31	-0.13	0.04
Heartland	0.38	0.50	0.47	0.69	1.48	0.05	0.44	0.52
Kiwibank	0.08	0.03	0.06	0.28	0.56	0.03	-0.03	0.01
SBS	0.29	0.35	0.48	2.44	0.39	0.09	0.09	-0.13
TSB	-0.06	0.05	0.03	1.29	-0.01	-0.05	0.03	-0.11
Co-op	0.13	0.03	0.10	1.03	0.12	0.09	0.05	-0.30
Westpac	-0.03	-0.08	0.10	0.87	0.54	-0.04	-0.39	-0.05
Average	**0.08**	**0.08**	**0.08**	**0.67**	**0.44**	**0.17**	**-0.11**	**-0.07**
	Operating expenses/Operating income (%)							
ANZ	34.29	45.63	44.88	33.93	43.97	54.60	44.39	34.29
ASB	37.72	35.89	43.48	38.09	49.46	38.55	36.97	37.66
BNZ	35.47	61.11	40.38	58.00	41.97	41.65	39.83	32.75
Heartland	40.16	42.77	45.02	40.78	48.39	40.28	61.61	43.47
Kiwibank	78.57	78.13	79.01	75.76	91.00	78.94	70.89	65.25
SBS	62.14	64.21	65.58	56.07	59.78	59.36	58.31	61.87
TSB	54.14	54.46	60.00	80.68	66.31	60.76	62.80	68.38
Co-op	80.00	82.09	75.48	75.77	74.52	74.65	70.59	81.61
Westpac	39.91	41.82	47.07	42.68	50.79	44.14	45.34	41.67
Average	**39.21**	**47.89**	**46.61**	**44.25**	**48.95**	**47.85**	**44.13**	**38.53**

7

MAJOR BANKS: NET PROFIT

- ANZ
- ASB
- BNZ
- KIWIBANK
- WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

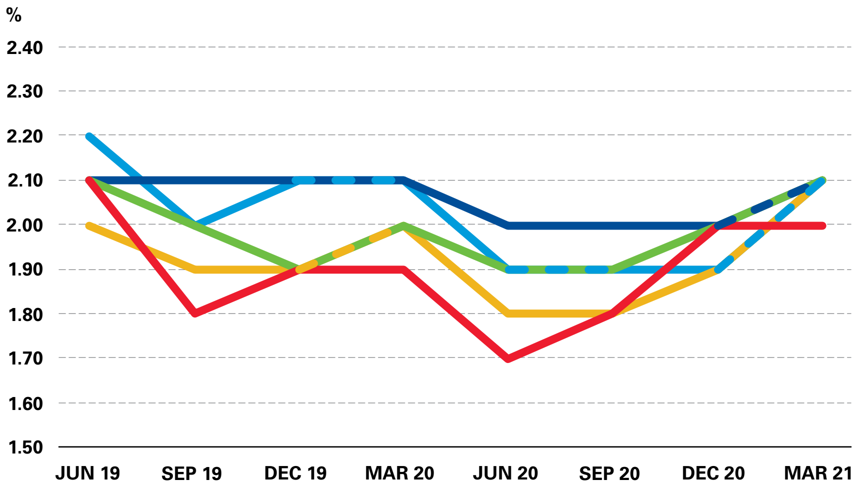


8

MAJOR BANKS: INTEREST MARGIN

- ANZ
- ASB
- BNZ
- KIWIBANK
- WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

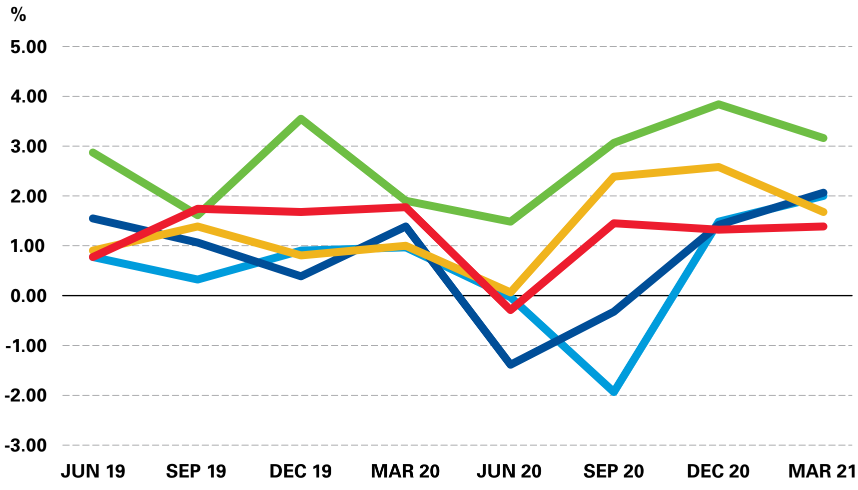


9

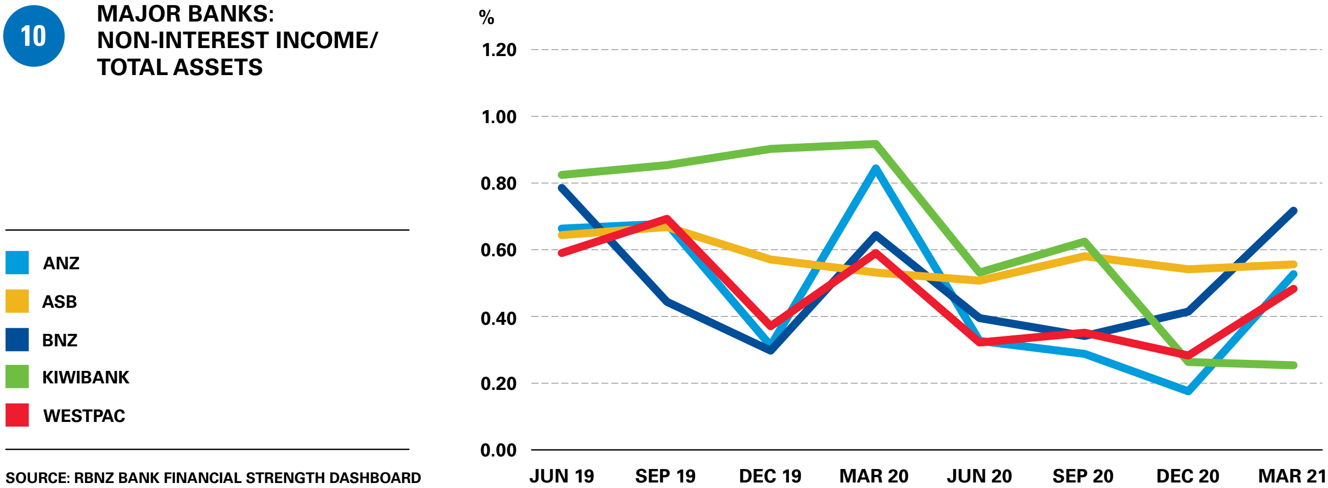
MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES

- ANZ
- ASB
- BNZ
- KIWIBANK
- WESTPAC

SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

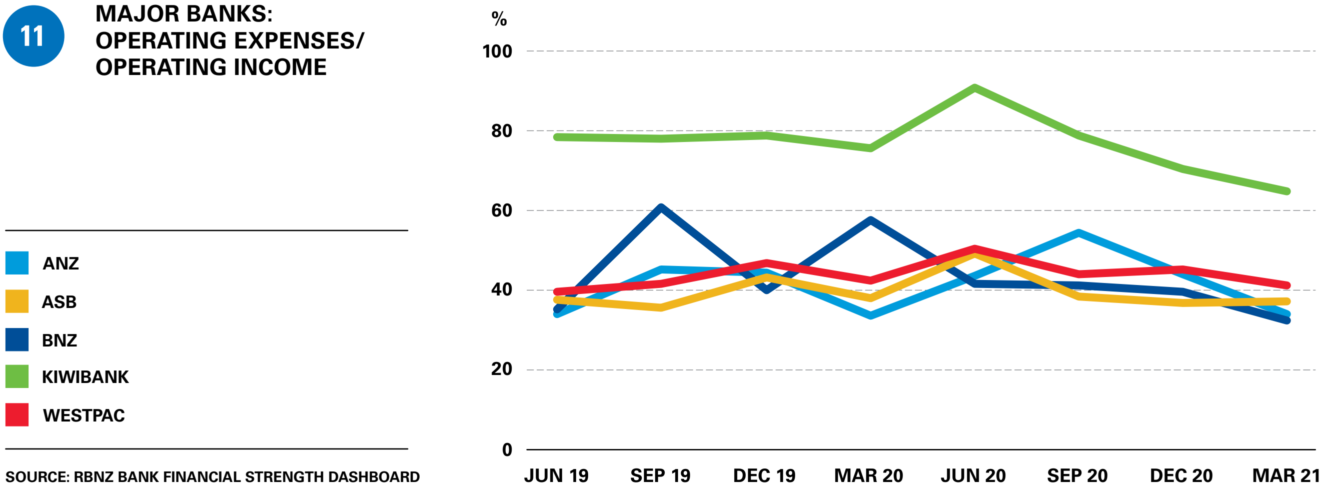


10 MAJOR BANKS: NON-INTEREST INCOME/ TOTAL ASSETS



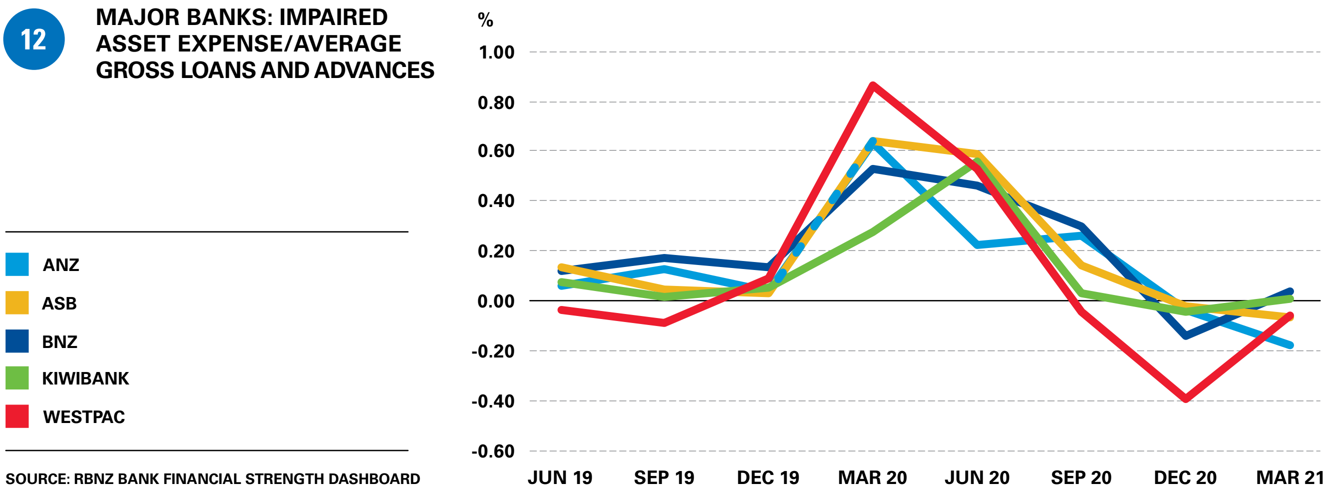
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

11 MAJOR BANKS: OPERATING EXPENSES/ OPERATING INCOME



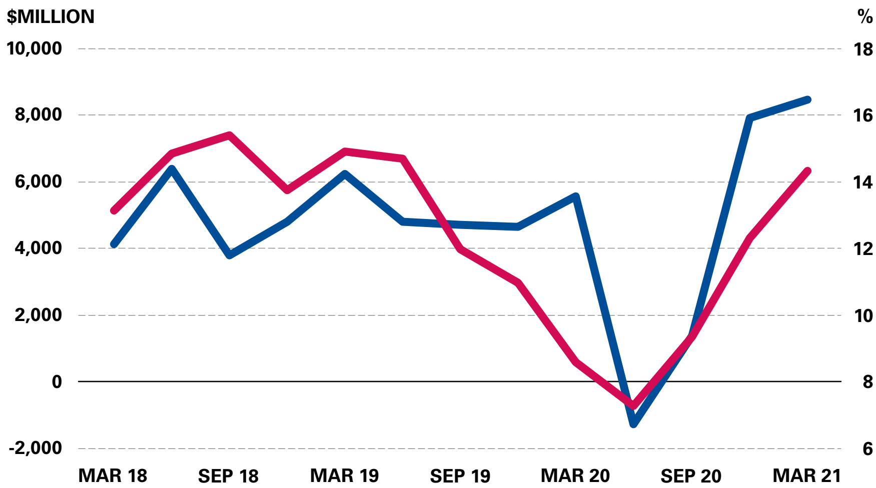
SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

12 MAJOR BANKS: IMPAIRED ASSET EXPENSE/AVERAGE GROSS LOANS AND ADVANCES



SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

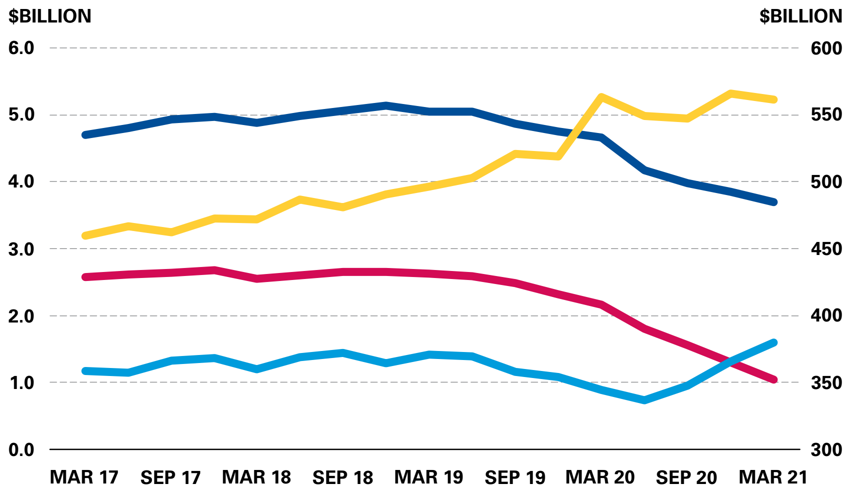
13 GROWTH IN GROSS LOANS AND ADVANCES VS. RETURN ON EQUITY



GROWTH IN GROSS LOANS AND ADVANCES (LHS)

RETURN ON EQUITY (RHS)

14 MAJOR BANKS: INTEREST EARNING ASSETS COMPARED TO INTEREST INCOME AND EXPENSE



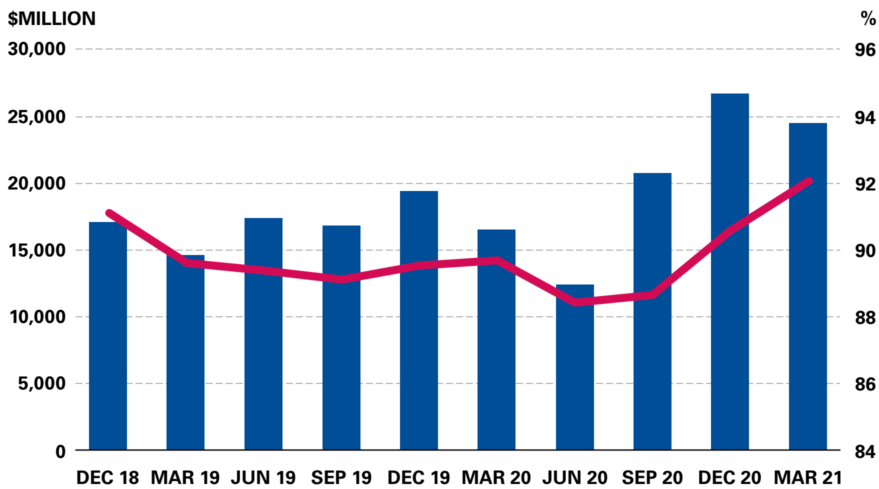
INTEREST INCOME (LHS)

INTEREST EXPENSE (LHS)

NET PROFIT (LHS)

TOTAL ASSETS (RHS)

15 LVR ANALYSIS OF RESIDENTIAL MORTGAGES



NEW MORTGAGES (LHS)

PROPORTION OF NEW MORTGAGES WITH LVR OF 80% OR BELOW (RHS)

SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS


Summary Report

A year ago

Cameron Bagrie
Managing Director
Bagrie Economics

Cameron is the Managing Director of Bagrie Economics and also runs a couple of other private businesses. He has worked as an economist for 25 years. He was formerly Chief Economist at ANZ and spent time working at The New Zealand Treasury after completing university studies.

A year ago, economic forecasts were being thrown around like confetti.

The unemployment rate could have gone to 10%, up from 4%.

The economy shrank 1.2% in the March quarter 2020 and a further 11% in the June quarter. Net core crown debt was projected to rise to 53.6% of gross domestic product (GDP) in the Government's 2020 Budget.

The predictions proved to be overly pessimistic and New Zealand is now on a reasonable footing, albeit with a fair bit of uncertainty remaining. One size does not fit all for the road ahead.

The economy has bounced back. The biggest fall in GDP in the June 2020, was followed by the largest ever rise (13.9%) in the September quarter. Unemployment is now 4.7% and finding staff is now some firms' biggest problem.

Being Covid-19 free with a strong health response has been a major reason.

But on top of that you can add:

- The benefit of having a big moat and low population density.
- A recovering global economy, and particularly a key trading partner. China is one of few countries where the economy is bigger than it was pre-Covid-19.
- Being a food producer and keeping the supply chain open. The world needed to eat. Commodity prices rose as opposed to fell.
- An extraordinarily large policy response including the $63 billion Covid-19 relief and recovery fund, up to $100 billion for the Large Scale Asset Programme from the Reserve Bank of New Zealand (RBNZ), Funding for Lending Programme to provide cheap funding to banks, record low interest rates, and an array of other initiatives to support the economy. The kitchen sink was thrown at a $300 billion plus economy in GDP terms, with turnover of more than $700 billion.
- A fair bit of luck. Covid-19 hit heading into the tourism off-season. During winter more New Zealanders normally travel overseas than foreigners come in. It is a different story during summer. By summer we had the rest of the economy open acting as an offset to tourism woes.
- Adaptability. Firms showed remarkable ability to adjust during various lockdowns.
- The substitution effect. Money previously spent overseas was recycled into the domestic economy.
- The benefit of having a strong economy on multiple levels heading into an almighty shock. Government debt was around 20% of GDP pre-Covid-19. Bank balance sheets were strong, and banks were well capitalised. One of the lessons of the global financial crisis was the importance of having a strong banking sector. This gave New Zealand ammunition to fire in defence.
- The big supporting the small. The Government used their balance sheet. Banks used their capital buffers. Landlords offered rent relief. Councils pared back rate rises. Not everyone, but lots of people and entities stepped up.

The lingering after-effects of Covid-19 continue. We are only a lockdown away from a different economic trajectory. The economy is still smaller than what it was pre-Covid-19 and unemployment higher. There are still more than 190,000 people receiving the jobseeker benefit, up from 150,000 in early 2020.

Covid-19 has accelerated changes that would have happened anyway including moves to a more digital economy, working from home, e-commerce, and bank branch closures.

Economists are talking about the 'K' shaped recovery with some firms on the top side of the K and others on the downside. Macroeconomics and the broader economic backdrop can only take businesses so far. Microeconomics and the performance of businesses themselves are a huge influence on this recovery.

Tourism continues to struggle and will do so for years. Net migration – a previous big driver of growth through population – has gone from 5,000 per month to 600.

Activity is uneven across the economy. Housing related sectors and construction have fared better than those exposed to border restrictions.

There is still a lot of uncertainty over the path ahead for the economy.

There is still a lot of uncertainty over the path ahead for the economy.

Vaccine rollout is welcome and helps manage risk, but does not eliminate it. New Zealand remains dependent on expectations of a stronger global economy. Supply chain disruptions are problematic, but the hope is that pressure will ease in 2022.

Both the Treasury and RBNZ are projecting solid growth and low unemployment, though heavily conditional on a range of assumptions. A large amount of Government spending continues to support the economy and monetary policy, via an array of mechanisms including low interest rates, which is still incredibly stimulatory.

Aside from navigating a range of economic challenges and Covid-19 uncertainties, a key area to watch over the coming years is balance between the economic and social ledger. Some balance needs to be restored.

Housing, income inequality / poverty, and the cost of living are the key issues worrying households, not the economy according to the IPSOS Issues Monitor[45].

Housing is a concern to 60% of New Zealanders. Double digit house price growth has been partly a consequence of the Covid-19 policy response, but has also accentuated housing's unaffordability and the perceived gap between the 'haves' and the 'have nots'.

The Government has acted, clamping down on landlords and ramping up housing supply initiatives.

The RBNZ is also warning about unsustainable house price movements, but also that "asset valuations are vulnerable to a rise in discount rates reflected in long-term yields, which have already crept up but could do so more sharply if inflationary expectations rise further"[46].

Lower interest rates have contributed to rising asset prices. Interest rates might be low, but they are off their lows and the long-term trend of lower interest rates looks to have come to an end. That could present some challenges.

New Zealand has coped incredibly well with the Covid-19 pandemic, far better than initially feared. Parts of the economy are, however, more vulnerable to future downturns than before the pandemic and we have an array of social challenges that cannot be divorced from the economic outlook and need addressed.

The hope is that housing – an asset than is more than four times the size of the economy and will have a huge bearing on the outlook – achieves the fabled soft landing and house price appreciation goes from double digit to low single digit.

A lot depends on whether inflation pressures are transitory and not sticky. The latter will up the ante on interest rates moving up. Businesses are seeing a lot of pressure on costs. The economy is hitting capacity constraints which is seeping into rising inflation from areas such as wages. Those are good developments, but could result in higher interest rates, sooner rather than later.

We know from history and from the 1980s that it can take time for the full fallout of an economic shock to seep into the economy. Sectors such as main street retailing are battling e-commerce challenges. Working from home is changing demand for office space. Vacancy rates are rising. Climate change is demanding action. The Government is talking about transforming the economy, which raises questions over how, and to what? Disruption is everywhere.

The economy cannot remain permanently hooked to central government and central bank stimulus. Government debt will need to be repaid to restock the kitty. Another shock could require the Government to use its balance sheet again.

There are many challenges the economy and society will need to navigate going forward. In a world dominated by disruption, the biggest certainty is uncertainty. The current position of solid growth and low unemployment is a good starting point though. Keep an eye on inflation and interest rates. The world has become very reliant on low interest rates and conditioned to low inflation. I would say overly reliant and too conditioned. Surprises on both fronts could prove challenging for asset prices.

IFRS 9 provisions: Modelling uncertainty

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Dhayaparan is a quantitative risk consultant with valuable experience in provisioning and credit risk models, statistical analyses tools, and financial services' prudential guidelines.

Aotearoa is amongst a small number of nations globally currently with zero community cases of Covid-19. The Government's low tolerance coupled with its elimination strategy has helped the local economy to somewhat withstand the pandemic and return to 'status quo' for most. The prominence of the Government's support throughout the pandemic and the resilience of the New Zealand economy may have significantly dampened the expected loan delinquencies in the recent periods. Whilst financial institutions seem more confident about the state of the economy, management have been quite prudent with the level of provisions held.

Let it (provision) go!

In recent headlines, we have seen New Zealand financial institutions' profits have taken a turn for the better. It goes without saying that the level of loan loss provisions held by financial institutions have a direct impact on their periodic profits. The recent Reserve Bank of New Zealand (RBNZ) Dashboard[47] release indicated that most banks have started releasing significant levels of provisions over the most recent two quarters (December 2020 and March 2021).

In total, New Zealand financial institutions have seen a net release of $202.6 million in impairment expense across this period.

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Whilst there have been many claims that the economy has returned to a state better than the onset of the pandemic, financial institutions have been taking a more cautious approach with respect to the level of provisions held. This is more apparent when we analyse the quarterly coverage ratio[48] as seen in Figure 16.

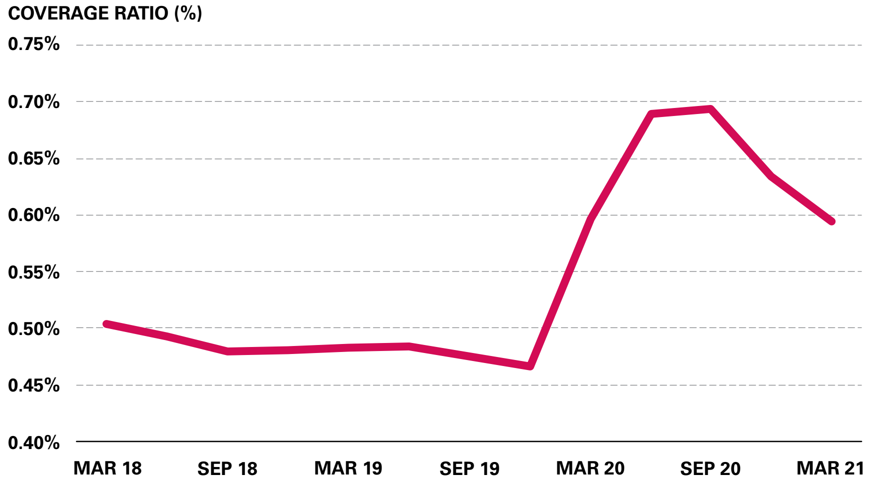
16 SEE FIGURE 16 – PAGE 27

In the quarterly results preceding the onset of the pandemic (March 2020), we can see that coverage ratios have been fairly consistent with minimal movements. As expected, the pandemic introduced a shock in the loan loss provisions (and coverage ratio) for most of 2020. Since December 2020, financial institutions have reacted to the better economic conditions experienced by New Zealand and hence the reduction in coverage ratios. However, it would seem from the pace of the release, that most financial institutions' senior management might be taking a balanced approach with the releases as there still some uncertainties with respect to the future economic outlook.

The pandemic introduced a shock in the loan loss provisions (and coverage ratio) for most of 2020.

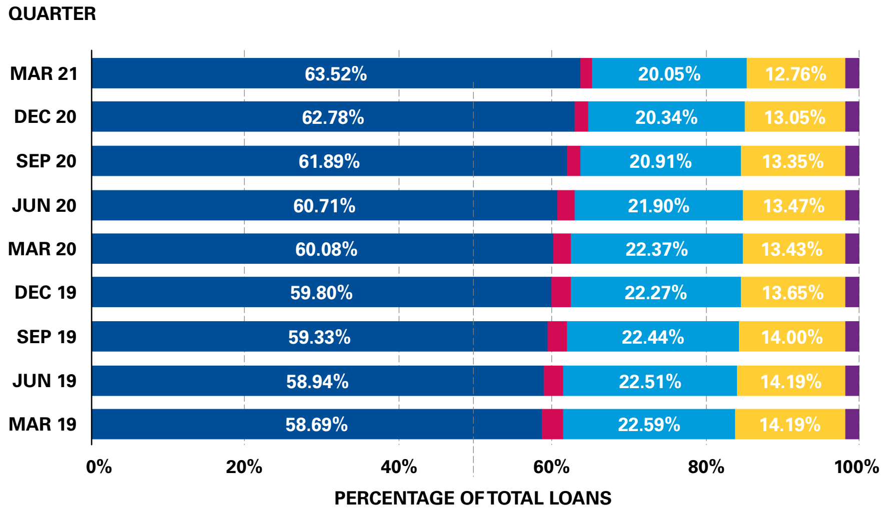
16 WEIGHTED AVERAGE COVERAGE RATIOS BY QUARTERLY RESULTS

WEIGHTED AVERAGE COVERAGE RATIO



17 NZ BANKS PORTFOLIO COMPOSITION BY QUARTER

- HOUSING
- CONSUMER
- BUSINESS
- AGRICULTURE
- OTHER



Another significant contributor in the overall provisions, apart from the improved economic conditions, has been the growth rate in the various portfolios within each financial institutions' loan book. The latest lending sector statistics[49] by RBNZ shows that the housing loan growth rate has been particularly strong in the recent months with the annual growth rate peaking at 11% for the month ended April 2021. The housing loan book usually attracts a lower level of provision due to the secured nature of the loan. Given that financial institutions have access to cheaper funding and the heightened demand of consumers wanting to purchase a home, these banks now have a lending mix which is increasingly weighted on the housing loan portfolio. In contrast, personal loans, which attract a higher level of provision due to the unsecured nature, saw a steep reduction in the annual growth rate for most of 2021.

The latest lending sector statistics by RBNZ shows that the housing loan growth rate has been particularly strong in the recent months with the annual growth rate peaking at 11% for the month ended April 2021.

One may hypothesise that homeowners may have drawdown on their existing mortgage as it is a much cheaper lending alternative for them. Figure 17 illustrates the portfolio composition by quarters of the New Zealand registered banks.

17 SEE FIGURE 17 – PAGE 27

Forward-looking models in the world of volatility and uncertainty

The predictive models supporting the loan loss provisioning process were built to adhere to one of the key fundamental NZ IFRS 9 *Financial Instruments* requirements of calculating a point-in-time forward-looking Expected Credit Loss (ECL) estimate. In a span of approximately one-year, economic indicators moved from one extreme to another and have caused the models to deal with high level of volatility and uncertainty. These models have never been trained to read across sudden contraction and expansion of the economy as most financial instructions' historical data used for the modelling exercise comes from a benign period. In addition, these predictive models were not designed to consider the effects of active government intervention. As such, management have become more cautious when analysing the outputs of the forward-looking provision models as it may in some cases not align with their expectation. In theory, NZ IFRS 9 is expected to result in volatility in the level of provisions as economic indicators change.

In a span of approximately one-year, economic indicators moved from one extreme to another and have caused the models to deal with high level of volatility and uncertainty.

We have noticed a stark difference with how management dealt with the changes in provisions in different instances of economic movements.

When the pandemic hit early last year, banks were (largely) not hesitant to increase the level of provisions for expected credit losses which relied on their existing models and were willing to add model overlays to account for uncertainties. A year later, the economic conditions have improved significantly, and models are indicating a massive release in provisions. However, management are seen to be 'not extremely comfortable' releasing large amount of provisions. Financial institutions appear to be releasing provisions intermittently while taking a wait-and-see approach.

Whilst government interventions have played a significant role over the last year in dampening the short-term impacts of the delinquent loans, there are still some potential lagging effects of borrowers' capabilities to repay their loan commitments.

Whilst government interventions have played a significant role over the last year in dampening the short-term impacts of the delinquent loans, there are still some potential lagging effects of borrowers' capabilities to repay their loan commitments.

In Centrix's latest monthly outlook, the credit bureau has seen a big surge of approximately 10% in the number of households in hardship since the RBNZ's mortgage deferral scheme ended in March 2021[50]. These will, however, not have a direct impact on a customer credit rating nor would it trigger a significant increase in credit risk when considering the ECL estimates.

Separately, the Trans-Tasman bubble which was initially seen to be serving mostly the reunion of families have now extended to tourists coming to Aotearoa to spend their winter holidays here. This is definitely an excellent opportunity for the tourism industry to get back on its feet compared to the rough year it has recently experienced. However, the recurring cases in Australia and the less than ideal managed isolation and quarantine (MIQ) processes have made the sustainability of the travel bubble highly questionable. On top of that, the availability of the vaccine for the wider Kiwi population and the efficacy of it makes it harder and harder for us to claim that the pandemic is truly behind us.

Given the various uncertainties which could impact the wider economy, it may seem that the intermittent provision release may well be substantiated. Financial institutions are supplementing the extreme model outputs with model overlays stemming from management judgement and heuristic knowledge of their loan books.

Given the various uncertainties which could impact the wider economy, it may seem that the intermittent provision release may well be substantiated.

Where do we go from here?

Since the pandemic, most financial institutions would have implemented certain monitoring procedures to understand the effects of the change in economic indicators (such as GDP or Unemployment rate) against the performance of their loan portfolios.

There are certainly a few considerations with respect to credit outcomes that financial institutions may want to consider given the uncertainty of the economic environment and its resulting loan loss provisions.

The need for reliable behavioural information

Traditionally, most financial institutions have relied on credit indicators (e.g. days past due, payment behaviours, annual financial information etc) to seek insights about a borrower's likelihood to repay their credit obligations. Whilst this is important information, such data is deemed to be latent indicators which could mask the true credit risk of any given exposure. There has been a push for financial institutions to rely on alternate data about their customers to ensure appropriate level of provisions are calculated, such as information relating to periodic income, changes in purchasing behaviours and liquidation of term deposits. All of these can provide information related to the customer's capacity to repay their obligations. In the first instance, financial institutions will need to expand their critical data elements to capture this information as part of their lending process while also putting a lot of focus on ensuring the data elements are updated frequently. This can be used as part of the Significant Increase in Credit Risk (SICR) process used to indicate if an exposure should be calculated for Stage 1 (expected losses in the next 12 months) or Stage 2 (expected losses in the estimated lifetime).

Forecasts to be updated more frequently

Financial institutions tend to focus on precise estimates for year-end and half-year financial reporting compared to other quarterly reporting periods (i.e. Q1 and Q3). Given the rapidly changing economic environment and resulting impact on credit exposures, we would expect senior management to drive more precise estimates for other periodic reporting, be it quarterly or even monthly. Management should consider adjusting their macroeconomic forecast and recalibrate their scenario weighting to reflect the environment coinciding with the reporting period. This would then keep to the underlying premise of the NZ IFRS 9 requirements of calculating a point-in-time forward-looking estimate of ECLs and avoiding the 'cliff' effect as seen prior to the implementation of NZ IFRS 9.

In the current climate, there is a possibility that the true impact of the pandemic is yet to unfold now that the mortgage deferral programmes have ended.

In the current climate, there is a possibility that the true impact of the pandemic is yet to unfold now that the mortgage deferral programmes have ended. Also, the potential recurring lockdowns and global supply chain issues could adversely affect the wider economy too. On the other hand, we could expect the economy to only perform better as vaccinations occur nationally and globally and hence we could potentially see more intermittent release of provisions moving forward. These uncertainties need to be appropriately considered and disclosed by both management and boards to arrive at the unbiased probability weighted expectation of credit losses.

Customer vulnerability

Brett Huntley
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Brett joined KPMG in June 2019 from the UK has 18 years' banking and financial services experience holding roles in wealth management, remediation, 1st and 2nd line risk.

When we first published an article about customer vulnerability in the *FIPS June 2020 Quarterly Results*, there was still a great deal of uncertainty about the economic impact of the Covid-19 pandemic and the associated disruptions. Despite the post-lockdown bounceback here in New Zealand, there was concern that this was not sustainable and the economic predictions were still reasonably pessimistic.

Customer vulnerability was not a phrase used in everyday banking-related conversations pre-Covid-19, but the current environment is quite different. Customer vulnerability is a topic of high importance which is more frequently discussed, not only in banks but on both social and traditional media platforms and by the regulator.

What have we learned through the recent pandemic and changed accordingly about banking processes and the needs of vulnerable customers?

Vulnerability is not new; however, it has not been well understood or addressed in earlier times.

Perhaps the first and most obvious response is that vulnerability is not new; however, it has not been well understood or addressed in earlier times.

For example, previously an angry or aggressive customer may have been asked to leave a banking hall or discontinue a phone conversation and be labelled as an 'aggressive customer'; that same customer is now understood to possibly be suffering excess stress due to a job loss, bereavement or mental health condition. This greater understanding has been used to implement support processes and customer advocates within banks, including partnerships with specialist support charities. These organisations and charities also help banks understand the impact of stress, bereavement, abuse and mental health issues on customers so that they can tailor their customer support packages and staff training appropriately. This leads to improved levels of trust, disclosure of personal circumstances and better outcomes for both the customer and the bank.

The economic impacts of the Covid-19 pandemic initially highlighted the financial insecurity of many New Zealanders and how quickly vulnerability can be exposed.

The economic impacts of the Covid-19 pandemic initially highlighted the financial insecurity of many New Zealanders and how quickly vulnerability can be exposed. Before the pandemic, New Zealanders were forecast to save -1.23% of their income[51] and the Commission for Financial Capability report in April 2020[52] showed only 26% households could be considered financially secure. It also showed that 40% of households were receiving a Covid-19 wage subsidy and 1 in 4 were in financial arrears.

A lack of savings makes people much more vulnerable to any change in circumstances, especially a shock such as a global pandemic. The sooner any potential vulnerabilities are identified and addressed, the better the experience will be for both the bank and the customer. The mortgage deferral programme[53] implemented by the Reserve Bank of New Zealand (RBNZ) last year was a great example of how giving the banks the ability to flex policies to give customers some breathing space helped avoid potentially very distressing experiences for customers.

An ASB report[54] in March 2021 showed that their customers were 8% better off than a year ago, possibly demonstrating that New Zealanders have seen the value of having a financial buffer. However, the economic impact of the pandemic has been cushioned by extensive Government intervention including wage subsidies and the mortgage deferral programme.

Recent unemployment figures are better than expected, but the underutilisation rate is 12.2% which is higher than 10.5% in March 2020[55] which indicates that people are potentially not earning as much as they were pre-pandemic. This would make them vulnerable to any changes in their budget such as increased prices/interest rates or an unexpected event, for example, unforeseen vehicle expenses or a serious illness.

A number of reports have illustrated that, on the whole, New Zealanders' financial literacy is reasonably low. This was highlighted by many people misunderstanding the mortgage holiday and business finance support schemes[56] introduced by the Government, RBNZ and banks referenced earlier. The term used more frequently (and more accurately) is mortgage deferral.

For many, being able to suspend their mortgage payments without it negatively affecting their credit rating was a lifeline at the beginning of the pandemic, but there were also many people who did not fully understand the implications and that by adding the interest payments to the end of the term would result in them paying more over time.

We have also seen recent examples in the media which have highlighted how a vulnerability can be exposed through bereavement. Already, the banks involved have recognised that there was a gap in the way that they handled their deceased estates and committed to review their bereavement process.

At KPMG, we encourage banks to utilise data and analytics to proactively identify where issues could occur and encourage customers to regularly review whether their banking arrangements are still fit for purpose. For example, triggering a financial review where products are being used regularly in a way that they were not designed for or the customers' financial profile has altered materially.

There is a joint responsibility between the customer and the bank to ensure adequate knowledge and understanding of the financial products that a customer uses. The ideal situation is where there is a good relationship and open channels of communication so that the customer can keep the bank informed of changes and the bank can respond appropriately. Covid-19 has shown us that changing circumstances can expose underlying customer vulnerabilities quickly, so the banks need to be able to address these quickly.

Banks should think about their existing frameworks and ask if these are sufficient to proactively identify customer vulnerability without relying on a set of guides or rules from the regulators. The banks who are already doing this well are standing out and are creating a competitive advantage; recent examples include gambling transaction blocks on credit cards, to support being provided to victims of domestic and financial abuse. There is still more to come and we anticipate seeing banks further the partnerships they are creating with specialist charities that can help vulnerable customers, from mental health to domestic and financial abuse.

The regulators' view

We have already seen the Financial Markets Authority (FMA) publish a detailed information sheet with a number of expectations of providers. More recently, the Council of Financial Regulators (CoFR) has published a framework to support the understanding of characteristics of vulnerable customers. This framework encourages firms to 'consult widely in developing their own terminology, procedures, and processes for assisting vulnerable consumers'[57].

This framework has been strongly influenced by research conducted in the UK and builds on the work published by the UK Financial Conduct Authority (FCA) in 2015. However, this framework will not provide the 'how-to' guide for banks and therefore leaves a gap of how to achieve good outcomes for vulnerable customers which banks should start to think about when designing their fair conduct programmes.

Summary and next steps

We have seen significant improvements in New Zealand, but the banks are at different maturity stages and need to do some self-assessment against the good practice seen globally and close any gaps. Any new framework needs to be right-sized for each of the banks' customer bases and needs. This can only be achieved by listening to these customer needs through specific focus groups and understanding what the data shows.

How banks can change the world

Simon Wilkins
Partner – KPMG IMPACT
KPMG

Simon leads KPMG's Sustainable Value practice in New Zealand which covers a range of services to help deliver long-term value in financial, environmental, social and ethical terms. Simon is the New Zealand leader for KPMG IMPACT which is a global network of experienced professionals working together to deliver industry leading practices, research and trusted solutions to address the biggest issues facing our planet. Through KPMG IMPACT, the aim is to deliver growth with purpose, have a real and positive impact, and help governments, businesses and investors contribute to the United Nations (UN) Sustainable Development Goals (SDGs), so all our communities can thrive and prosper.

Dr. Charles Ehrhart
Director – KPMG IMPACT
KPMG

Dr Ehrhart has more than 20 years of professional experience working with governments, the UN, civil society and the private sector for sustainable development and an end to poverty in our world of plenty. For the past 12 years, Charles has focused on the challenges of mitigating and adapting to climate change. Charles currently works for KPMG New Zealand as Director, Sustainable Value. His primary interests are adaptation to climate change, sustainable land use, the transformative potential of environmental entrepreneurship, the role of green economic growth in nationally determined contributions to mitigate climate change (INDCs) and public-private partnerships for climate action.

Mandating change

The release of the Climate Change Commission's final advice to Government on 31 May 2021, disclosed to the public on 9 June 2021, sheds light on New Zealand's roadmap to a carbon-neutral and climate-resilient economy by 2050[58]. The Commission's advice includes practical steps to achieve this ambition, spanning each sector of the economy.

Among its recommendations is the rapid phase out of emissions-intensive technologies, such as fossil fuel vehicles and coal-fired industrial heat processing, and the equally rapid uptake or expansion of renewable energy-powered transport and industry. The Commission also augmented its draft advice on agriculture and the adoption of sustainable on-farm practices to reduce the agriculture sector's emissions (which currently contribute close to half of New Zealand's gross emissions).

No transition to a climate-safe future will transpire in the absence of widespread capital re-allocation.

While the Government has until the end of the year to respond, banks and other finance providers should pay careful attention: no transition to a climate-safe future will transpire in the absence of widespread capital re-allocation. Capital must be shifted away from business-as-usual investments that risk locking our economy into a high emissions trajectory and into 'green' practices, technologies and infrastructure.

To perform this transition-enabling role, the financial sector first needs to understand the climate-related risks – which range from physical risks such as droughts to transition risks including shifting consumer preferences, carbon prices, and legal challenges – hidden in core business models and portfolios.

The New Zealand Government has taken the initiative to drive this understanding through the financial sector. We are the first country in the world to introduce legislation requiring major asset holders to identify and report on their climate-related risks. The Financial Sector (Climate-related Disclosure and Other Matters) Amendment Bill (the Bill) received broad cross-party support in the first reading in Parliament in April 2021. If passed, it will require around 200 entities, including banks, insurers, listed companies and 'large' fund managers, to make climate-related disclosures in accordance with the climate standards issued by the External Reporting Board (XRB).

The XRB's standards will align with the Task Force on Climate Related Disclosures (TCFD), widely regarded as international best practice for climate-related financial reporting and already well-known in New Zealand. However, the financial sector's motivation for following TCFD guidance currently stems less from the potential to play an enabling role in achieving the Government's climate ambitions, and more from the reality that climate change poses significant risks to complacent financial institutions.

Complacency is a real concern.

Complacency is a real concern for the Reserve Bank of New Zealand (RBNZ). Acting as kaitiaki (guardian) of our financial system, it has been pushing the message that climate change is a "direct challenge to financial stability"[59] since the development of the TCFD in 2017. Since then, it has been encouraging New Zealand banks and other financial institutions to keep ahead of the curve on climate-related reporting.

How are New Zealand's banks performing?

Investors and banks are under increasing pressure to understand and publicly disclose climate-related risks (in particular, greenhouse gas inventories). Banks are requesting significantly more climate-related information from their customers as part of pre-lending and refinancing applications. Some, including ANZ and Westpac, are going a step further and are already publicly reporting against each of the four major categories of the TCFD framework; governance, risk management, strategy and metrics and targets. Meanwhile, there is growing support for climate action among shareholders. According to New Zealand Shareholders Association CEO Oliver Mander, more people are "talking about climate change and environmental reporting and disclosures"[60].

Investors and banks are under increasing pressure to understand and publicly disclose climate-related risks.

Talk, however, is part of the problem. By international comparison, we are lagging behind in climate-related reporting. The majority of large New Zealand organisations provide limited or no information on what climate change might mean to them. A 2020 KPMG report indicates just 23% of 5,000 organisations that were reviewed have adopted TCFD reporting, and those that have are doing so inconsistently[61]. Scenario analysis, which is essential to the TCFD framework, is proving especially difficult for many, and yet, is most useful for financial institutions in safe-guarding the medium- to longer-term resilience of their portfolios. Insufficient and poor-quality climate-related information from debtors and equity issuers makes it very difficult for financial institutions to assess their own climate-related risks. In turn, this may be resulting in the systemic overvaluation of emission-intensive activities.

What will the XRB offer?

The fact that New Zealand's financial sector is some way off achieving parity with its international counterparts on climate-related reporting was a key driver of the Government's leadership on mandatory climate-related reporting. The XRB's standards are intended to inject clarity and consistency into the field of climate reporting in New Zealand. The hope is to significantly increase not just the quality, but also scale of climate-related reporting by New Zealand businesses. This will, in theory, see the financial sector improve the quality of its own climate-reporting – leading to a more efficient allocation of capital that steers us to a more sustainable future.

The XRB has been working with stakeholders, including entities impacted by the Bill and Māori to apply a te ao Māori lens to the Standards, to ensure they are workable in a New Zealand context. Notably, this includes work with the Ministry for the Environment on scenario analysis. The XRB is scheduled to release its draft reporting standards from July 22. Annual climate statements will be required for financial years commencing in 2022 once the Bill has passed. This means the first mandatory disclosures will be made in 2023.

Becoming agents of change

Banks and other financial institutions are positioned to be true agents of change in New Zealand's climate transition. The relationship between banks and customers has the potential to change significantly with the introduction of the Bill, as banks increasingly require non-financial information from the latter. They can, however, evolve their role from a product and services provider to a proactive transition partner, identifying, for example, how best to support smaller organisations with limited reporting capacity.

Stepping into a more active role is not new for financial institutions. Harkening back to the pre-digital era, banks were, physically, a central pillar to the local community, society and economy. Local businesses in particular have relied on banks' guidance and, as the landscape becomes more complex, businesses will be more reliant on this macro expertise than ever. The central position of financial institutions in the economy means they can consolidate insights across multiple sectors in a way that few other entities can. Collaboration will be key. To offer the most robust insights, banks should explore how they can share information to gain a fuller picture of different sectors.

For the most part, this will data that banks are already required to report. Banks with agriculture-heavy portfolios, for example, will need to investigate exposure to credit risks as the industry adapts to market changes. Insurers, on the other hand, may concentrate more on environmental climate risks from weather and natural disasters.

For New Zealand's financial sector, this is new territory with an impending deadline, so insights and learnings from the global stage will be critical. While TCFD guidelines are global, banks in Canada and Australia have placed particular focus on the impact of their lending portfolios in prevalent local industries such as mining and agriculture[62].

Ultimately, the central position of trusted financial institutions to both society and the economy means that the banking sector has significant influence to effect positive change. The question is: will it rise to meet the challenge?

The current climate

While the Zero Carbon Act has shone a spotlight on climate change – and it is likely that this focus will continue to be high on the regulatory agenda over the coming three years – this scope will expand.

At the start of June 2021, the Taskforce on Nature-related Financial Disclosures was launched, aiming to complement the TCFD, but broaden the scope to include other nature-related risks such as plastics in the oceanic food chain and loss of soil fertility[63]. This will have considerable consequences for New Zealand, both for the country and for our interaction with climate change responses.

These developments also reflect the shift to 'stakeholder capitalism'. Just as financial reporting is no longer sufficient on its own, those capable of exerting influence depending on a business's results are no longer just in the boardroom. Consumers and investors alike are increasing pressure on businesses to put substance behind their ethics and sustainability claims.

There is also tangible business opportunity in this new order. A report from The Economist Intelligence Unit, commissioned by the World Wide Fund for Nature (WWF), shows an enormous 71% rise in online searches for sustainable goods globally over the past five years[64]. Closer to home, the responsible investment market in New Zealand was worth $153.5 billion back in 2019, an estimated 52% of the total professionally managed funds or assets under management[65].

The effects of Covid-19 have made businesses think more broadly about their purpose. From employee well-being, to supporting communities, to more inclusive working practices, banks – like many other businesses – have started evolving to be purpose-led. The profit-driven nature of financial institutions is long-established, but these two paradigms do not need to be mutually exclusive.

As the RBNZ Governor put it, Covid-19 is akin to climate change in that it "highlights interdependencies between economic prosperity, environmental sustainability, and social inclusion"[66]. The financial sector should strive to learn from the Covid-19 crisis in order to better prepare us for the road ahead.

Changing the world

Lip service will not create a market-leader. The new, mandated changes will require compliance; to be a true driver of change, banks will need to shift from passive to active engagement with these issues. Becoming a proactive transition partner for clients can result in reputational benefits, increased customers, and most importantly, greater progress towards a more sustainable and resilient economy.

The road ahead is not easy. It promises disruption to the way we value businesses, the way we work and the way we report back to society. Few, if any, financial institutions are already doing what is needed; and the deadline for reporting is not far away.

But, at KPMG, we are confident that New Zealand has the expertise and access to global networks needed to rise to this critical challenge. Banks can drag their feet and view the upcoming legislation as a burden. Or, they can view their central position as an extraordinary opportunity to lead vital change and set New Zealand on a path to long-term prosperity.

Business failures in a post Covid-19 economy

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KPMG

Leon leads the KPMG Restructuring and Insolvency practice. Leon is a Chartered Accountant, Barrister and Solicitor and Licensed Insolvency Practitioner. He has extensive experience in a range of financial advisory, transactions and restructuring engagements. Leon and his team help stakeholders of underperforming businesses by providing independent reviews on performance, recovery options and value enhancement strategies. He has undertaken many financial analysis assignments, reporting to both management and financial institutions on cash flow, working capital, capital structure and financial performance.

Alton Pollard
Director – Deal Advisory
KPMG

Alton is Head of Debt Advisory for KPMG and an expert in restructuring and turnarounds. He has over 25 years of experience working in banking, finance and advisory roles in New Zealand and internationally. As a banker, he worked on some of the largest restructuring transactions in the New Zealand market in recent years and was involved in some high-profile restructurings in Europe following the Global Financial Crisis (GFC). Since joining KPMG in 2019, Alton has advised corporate clients in various degrees of financial distress as well as debt related matters including project finance, corporate debt raisings to finance acquisitions, buyouts, growth, recapitalisations and refinancings.

David Ossa
Associate Director – Deal Advisory
KPMG

David is a Chartered Accountant with financial advisory and restructuring experience working in a range of assignments in the private and public sectors in the UK, Hong Kong and New Zealand. David has ample experience in reviewing the financial and operational performance of distressed / insolvent businesses; advising companies and stakeholders on options to restructure businesses' financial liabilities; and in the case of formal insolvency proceedings, realising and maximising the value of the assets for the benefit of creditors and stakeholders.

Despite the Government's successful efforts to contain Covid-19 and avoid a health emergency within New Zealand's borders, it is Covid-19's wide-ranging economic impact that is promising to test the country's economic resilience.

Over the last decade, and prior to Covid-19, applications for winding up and actual insolvencies had been on the decline, averaging a 14% decrease per annum. The pandemic put pause on creditor enforcement activity and this, combined with generous economic stimulus from the Government, has resulted in a 32% decrease in applications in 2020 compared to 2019.

A recent note issued by the World Bank Group, which explores the early impact that the pandemic has had on business insolvency filings in several economies across the world, showed a similar trend to that experienced in New Zealand. The cumulative number of business insolvency filings from Q2 and Q3 of 2020 showed a decline compared to the same quarters of 2019 (except for Hong Kong). Australia, Italy, Lithuania and Singapore show the highest declines (about 50%)[67]. As in New Zealand, this is believed to have been largely driven by fiscal support programmes. According to International Monetary Fund (IMF) calculations, US$9 trillion in fiscal support was injected globally by May 2020[68].

Since the beginning of the pandemic, the New Zealand Government has provided an unprecedented level of support for businesses to navigate the economic challenges associated with Covid-19.

According to the Ministry of Social Development, 58% of jobs (excluding sole traders) received support from the original Covid-19 Wage Subsidy available throughout the period March to June 2020. Other forms of fiscal support included low interest loans for small businesses under the Small Business Cashflow Scheme (SBCS) and tax refunds via a temporary loss carry-back scheme.

Since the beginning of the pandemic, the New Zealand Government has provided an unprecedented level of support for businesses to navigate the economic challenges associated with Covid-19.

The Government also implemented temporary changes to the Companies Act 1993 focused on providing relief to directors from liability for breaching their duties regarding trading whilst insolvent (nearing insolvency); and on protecting businesses from creditors initiating enforcement actions (Business Debt Hibernation provision). These measures are subject to defined criteria linked to disruption caused by Covid-19 and are due to expire (Business Debt Hibernation in October 2021) or have now expired (Safe Harbour in September 2020).

Private sector-led initiatives have included rent relief from landlords, payment holidays from creditors and debt enforcement freezes / mortgage holidays from lenders. Furthermore, and in order to remain competitive, businesses in impacted industries such as retail, manufacturing, hospitality and construction have had to reconsider their business strategies.

Examples of this include:

- seeking cost reduction opportunities (enforced annual leave, salary sacrifices, etc);
- re-evaluating their business models (alternative customer base, diversification of products / services, messaging and training, flexible workplace settings, etc); and
- reviewing their operations (executing restructuring plans, evaluating store footprints, moving manufacturing / production facilities offshore, etc).

Survival in a post Covid-19 economy

Although certain industries that were under structural pressure prior to Covid-19 such as retail and education have performed better than expected, historical evidence suggests that this may only represent a delay in business failures rather than avoiding them altogether. For instance, in 2008 and 2009 post GFC, applications for winding up were at historical highs, recording volumes of 1,800 liquidation applications per annum.

The question remains: how long it will take for issues to emerge in a post-pandemic economy?

The question remains: how long it will take for issues to emerge in a post-pandemic economy? Evidence from previous crises indicates that it could be at least three years before we see the full effects of the pandemic on the economy. For example, during the GFC, unemployment in New Zealand went from 3.6% at the end of 2007 to where it remained at approximately 6% between 2010 and 2013. Similarly, after an increase in corporate insolvencies in 2008, business failures continued to surge in 2012 before returning to more normal levels in subsequent years.

In the first quarter of 2021, insolvency appointments have slowly started to come back (45% increase compared to the fourth quarter of 2019); however, these are mostly for small businesses and driven by the Inland Revenue Department. Enforcement remains an unfavoured option for lenders, especially if other alternatives are available, due to the adverse attention that could follow such action. In fact, according to the Reserve Bank of New Zealand (RBNZ)[69], combined bank and non-bank lending in some sectors has increased in recent months. Total housing lending increased by $3 billion (1%) in April 2021 (down from the growth recorded in March 2021 of $3.7 billion, which was the largest monthly percentage increase since April 2007. Annual growth was recorded at 11%). Business lending has also increased; in March 2021 it increased by $198 million (2%) and remained relatively stable in April 2021 (down by 0.05%); however, annual growth decreased by -5.3%. Similarly, agriculture lending has continued to decrease, falling by $227 million (-0.4%) in April 2021 (with annual growth dropping to -1.5%).

Debt market conditions

The level of impaired or non-performing loans held by New Zealand banks is at historically low levels due to the stronger than expected economy, low interest rates and high asset valuations. The major banks have generally been supportive of existing clients; however, credit conditions have become tighter for new lending proposals. Bank appetite remains robust for companies in relatively defensive sectors such as healthcare, manufacturing and property, but lending appetite is more limited for borrowers in more volatile industries such as retail, tourism, hospitality and construction.

As the sustainable finance market matures, banks are increasingly targeting transactions that support sustainability objectives or with strong Environmental, Social, and Corporate Governance (ESG) characteristics.

The Business Finance Guarantee Scheme, under which the Government effectively underwrites 80% of loans advanced (up to a $5 million maximum loan amount), has had good uptake with over 3,000 small to medium-sized businesses borrowing over $2.5 billion. This Scheme is scheduled to end on 30 June 2021 and is unlikely to be extended.

The impact of imminent increases in capital requirements on registered banks by the RBNZ is expected to constrain bank credit appetite in some sectors and may result in increases in loan pricing as banks seek to maintain equity returns to the extent possible.

The impact of imminent increases in capital requirements on registered banks by the RBNZ is expected to constrain bank credit appetite in some sectors and may result in increases in loan pricing as banks seek to maintain equity returns to the extent possible. The New Zealand debt market has, however, become more diversified in recent years, with a number of domestic and international credit funds financing deals that are outside bank appetite. This is reflected in the recent increase in non-bank lending growth and number of deals that larger corporates have done directly in the bond market.

Medium-term outlook

The expectation is that there will be several businesses that will struggle to survive in a post Covid-19 economy, especially those in industries dependent on the opening of the borders such as tourism, aviation and tertiary education or those in services industries reliant on face to face contact such as hospitality, beauty and in-store retailing.

Business failure is expected to be highly influenced by any inflationary pressure and associated interest rate rises and any house price deterioration which could impact the consumer wealth effect. Added to this, there has been an early shift in bank and Government policies. Fiscal support programmes have started to tail off and there is higher scrutiny around bank provisioning levels which could impact bank behaviours in relation to distressed assets and impaired loans.

The Covid-19 shock has not yet fully tested the New Zealand economy and there remains significant challenges ahead.

The Covid-19 shock has not yet fully tested the New Zealand economy and there remains significant challenges ahead. Businesses' ability to weather the storm will be partly dependent on the success of the vaccine roll out, the likelihood of future lockdowns and the recovery of international travel. While evidence suggests that risks typically don't surface for some time after a crisis, early Government policy (in the form of fiscal stimulus or changes in insolvency regulation) could mean the difference between survival and failure for businesses in a post Covid-19 economy.

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41. This data represents the top New Zealand level banking-licenced entity and is referred to using the brand in common usage, and as per the RBNZ Bank Financial Strength Dashboard. ANZ represents Australia and New Zealand Banking Group Limited – ANZ New Zealand; ASB represents Commonwealth Bank of Australia New Zealand Operations; Heartland represents Heartland Bank Limited; SBS represents Southland Building Society (trading as 'SBS Bank'); TSB represents TSB Bank Limited; Co-op represents The Co-operative Bank Limited; and Westpac represents Westpac Banking Corporation – New Zealand Banking Group.
42. For quarters ended 31 December 2017 and earlier, total assets excluded intangible assets. From 31 March 2018, intangible assets are no longer deducted as this information is not available in the RBNZ Dashboard. Total Assets = Total Assets - Intangible Assets.
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