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Reserve Bank capital requirements - Extra | December 5 2019 | Confidential to HUGO members

RBNZ listens, up to a point

In the end, the Reserve Bank's new capital requirements proved less onerous than originally threatened, with the year-long consultation exercise working as a softening up exercise. Most trading bank commentary welcomed what, a year ago, would have been regarded as an enormous additional impost.

The NZ Initiative and Business NZ, led by former Bankers Assn ceo Kirk Hope, called for a further round of consultation, particularly as the cost-benefit analysis that had been missing previously was only now available for the first time today. However, RBNZ governor Adrian Orr has swiftly ruled out any further consideration.

The key decisions are:

- a seven year rather than the initially proposed five year phase-in;
- no change to the requirement that the 'big four' Austrlaian-owned banks hold 16% Tier-1 capital, but slight relaxation in the definition to allow use of redeemable preference shares;
- smaller, NZ-owned banks to hold 14% tier-1 capital;
- Tier-2 capital can include long-term subordinated debt on less strict definitions than originally proposed.

Compliance failures will be met with an 'escalating supervisory response'.

S&P says that the changes "should not materially reduce the availability of credit in NZ across the board", although there are some concerns they will further reduce banks' appetite for high-risk, particularly dairy, debt. It also expects that ANZ is likely to need to raise additional capital because of its larger investment in NZ than its Australian-owned peers. "This is partly because in October this year, APRA proposed a more punitive capital treatment of the banks' investment into their banking subsidiaries if such investment exceeds 10% of the parent banks' level 1 CET1," S&P said.

The interest rate impact over seven years of the move is tiny, at an estimate 20.5 basis points and the RBNZ expects it to stunt annual GDP by 0.43%, although that analysis is in part predicated on the lower probability of a banking failure, which is arguable. The announcements have little or no impact on the wider fact that the RBNZ is now in a 'hold' phase with monetary policy. The OCR now looks most likely to remain unchanged throughout next year.

More angst in fuel study

Today's final report from the market study into transport fuels by the Commerce Commission contained no surprises in policy terms, but is notable for the deep disagreement that remains between fuel industry participants and the commission on profitability modeling. Business NZ was particularly strong in its criticisms, saying future market studies should deal carefully with the following issues:

- agreement over terms - disagreement over profitability assessment including the study "excluding factors such as international crude oil prices, currency movements and the level of taxes and levies on fuel". "Future market studies should ensure there is agreement ... on factors affecting profitability, and other terms";
- determining appropriate rate of return in contestable markets - BusinessNZ suggested the commission has less ability "to determine an appropriate rate of return in a contestable market" rather than in a natural monopoly industry. "Caution should be applied in future market studies of contestable markets";
- intervention in contracts - regulating wholesale supply contracts raises general concerns about govt intervention in commercial contracts. "Freedom to contract is a fundamental right that should not be intruded upon by the state."

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