Weaker Credit Growth In 2023 In New Zealand, Accelerating In 2024

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Key View

- Weakening economic growth momentum and high interest rates will take a toll on New Zealand's credit uptake in 2023, when we forecast loans growth to come in at 1.0% y-o-y, down from 4.1% at end-2022

- In 2024, we expect loans growth to accelerate to 3.0% y-o-y on the back of a stronger economic backdrop, looser monetary policy, and stronger sentiment.

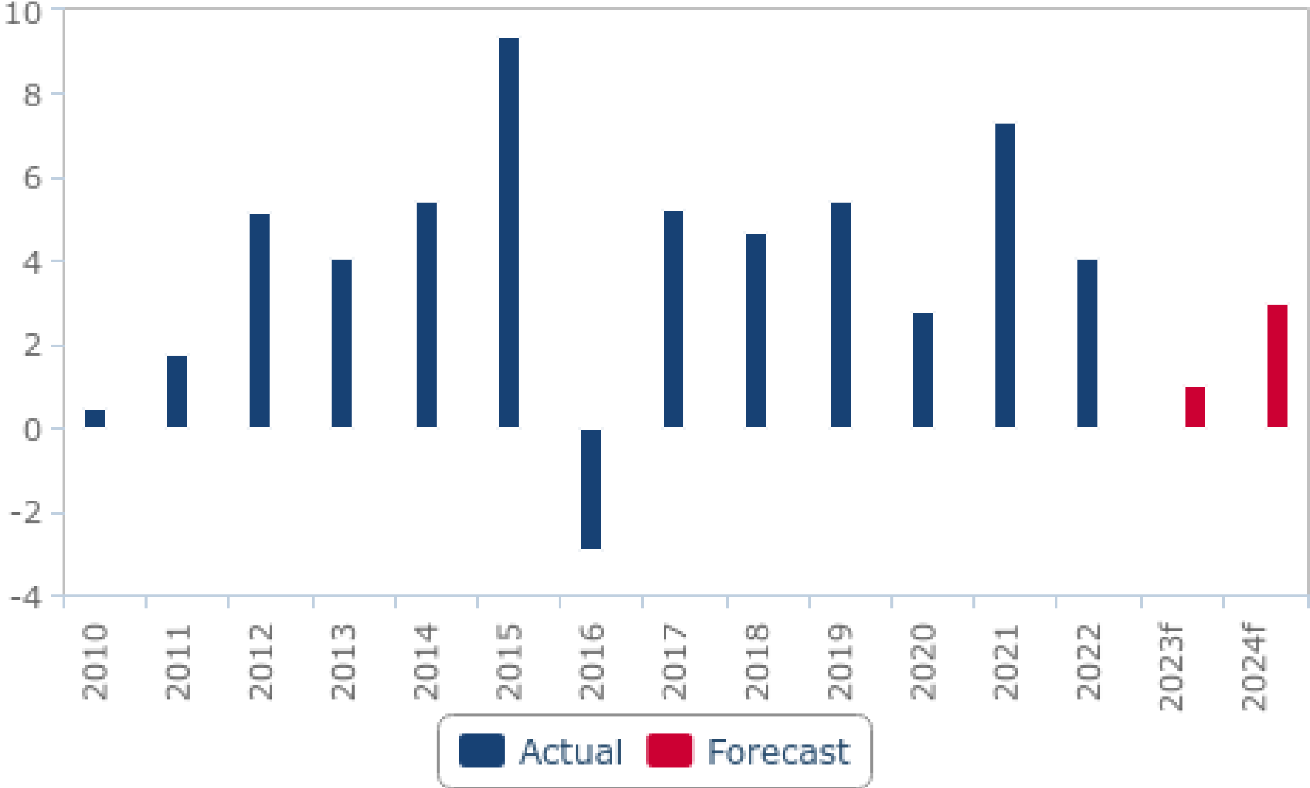
- Despite pockets of weakness in the real estate sector due to high interest rates, we believe that financial stability risks remain limited as key measures of banking stability indicate a healthy banking sector.

We anticipate slower client loans growth in New Zealand in 2023, but faster growth in 2024. Weakening economic growth momentum and high interest rates will continue to take a toll on credit uptake in H223. We forecast loans growth to come in at 1.0% y-o-y by the end of the year – down from 4.1% at end-2022 (*see chart below*) – which would be the slowest pace of growth since 2012. On a stronger note, a high interest rate environment will continue to support bank profitability, while financial stability risks will remain manageable owing to healthy bank balance

sheets. In 2024, we expect loans growth to accelerate to 3.0% y-o-y by the end of the year on the back of a stronger economic backdrop. Looser monetary policy and stronger sentiment as easing inflation allows policymakers to pivot to a monetary easing and workers stop losing purchasing power will see the economy pick up speed (to 1.6% from projected 1.0% growth in 2023), with positive implications for bank credit.

Decelerating Before Accelerating

New Zealand – Client Loans Growth, % y-o-y



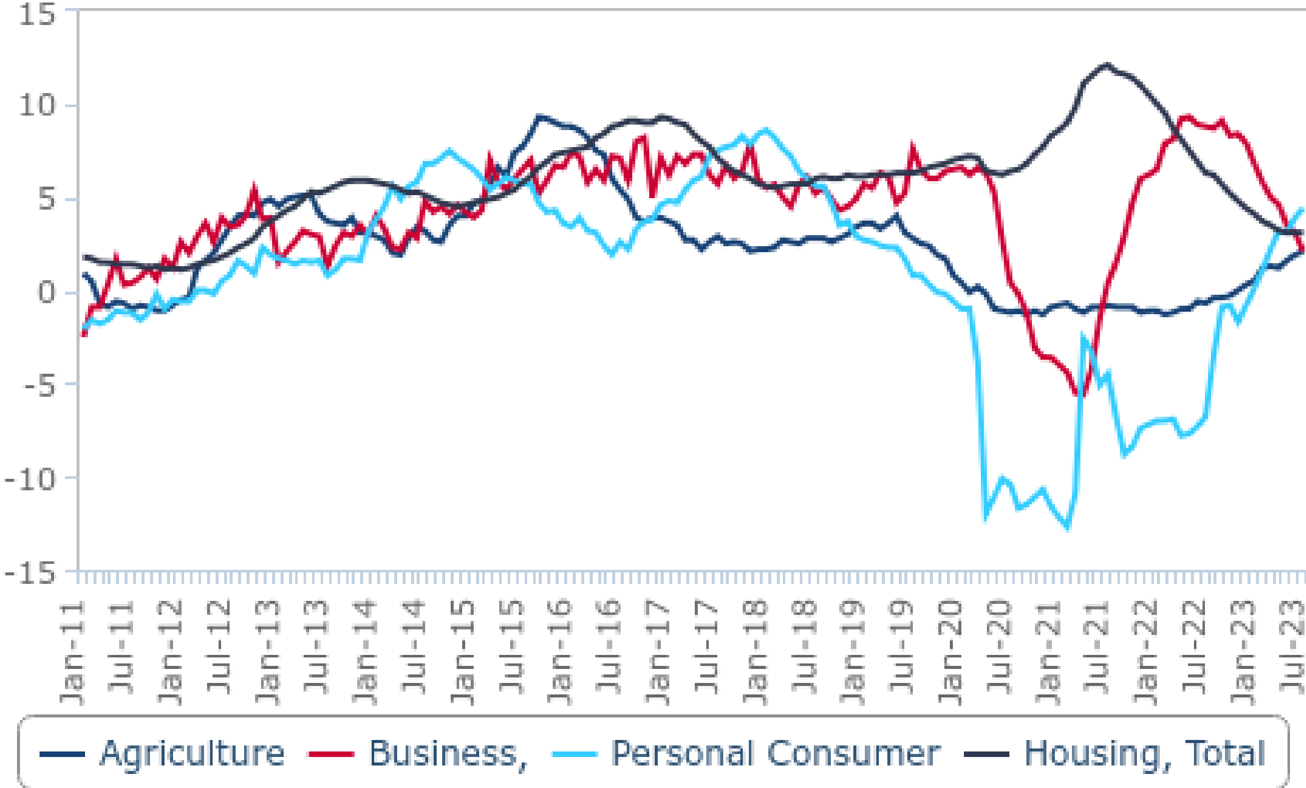
Source: Macrobond, BMI

While softening economic activity has not yet fully feed through to a broad-based slowdown in credit growth, this is, in some instances, merely a reflection of favourable base effects. For example, personal consumer loans have picked up over the past few months, but this is largely the result of a sharp contraction in personal loans in 2022 (as well as in 2020 and 2021, *see chart below*). In New Zealand dollar (NZD) terms, personal consumer loans dropped from NZD16.9bn at the end of 2019 to NZD13.9bn as of July 2023. Mortgage and corporate credit growth has been decelerating as borrowing becomes more

expensive. After peaking at 11.7% y-o-y in August 2021, mortgage credit growth slowed to 3.1% in July 2023, while corporate credit growth dropped from a June 2022 peak of 8.9% y-o-y to 2.1% in July 2023.

Slowdown To Become Broad-Based

New Zealand – Bank Lending, % y-o-y

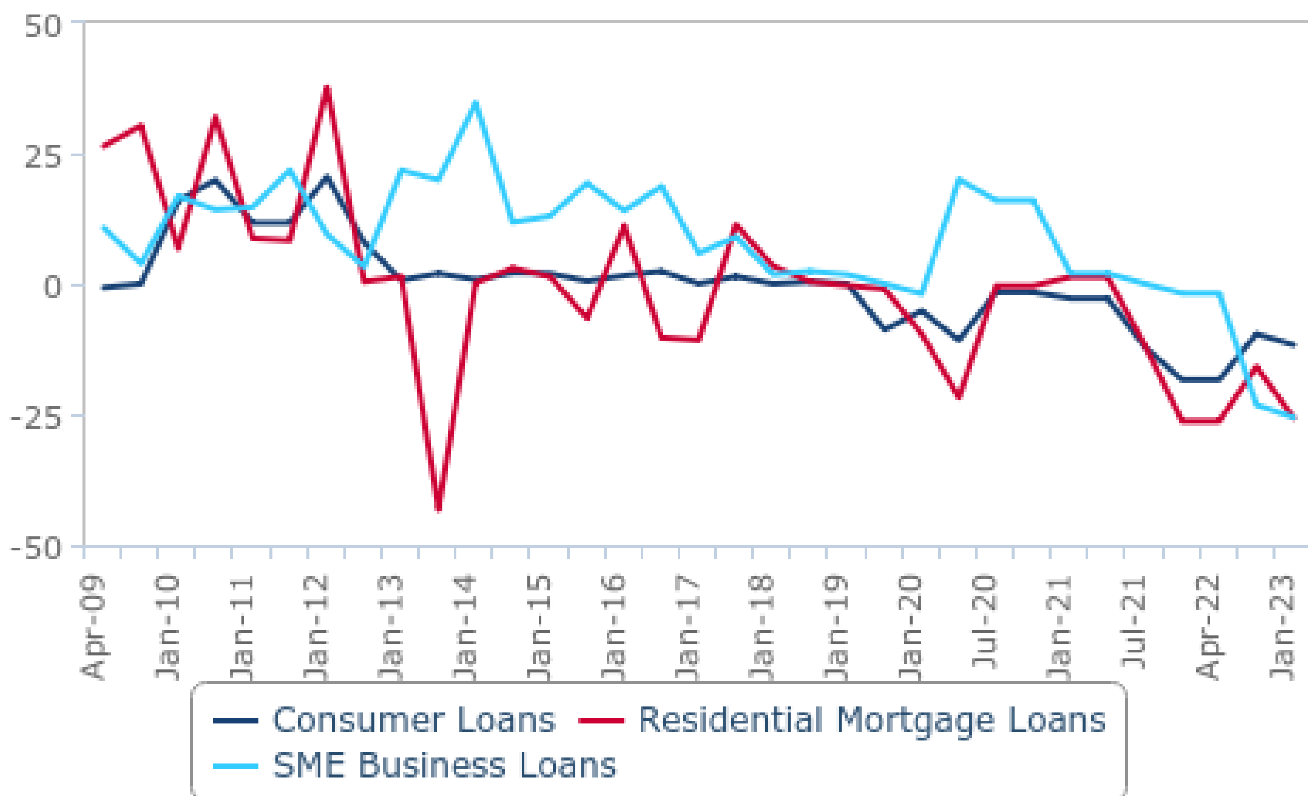


Source: Macrobond, BMI

Survey data suggest that banks remain pessimistic about the outlook for consumer loans (*see chart below*).

Weak Outlook For Loan Demand

New Zealand – Bank Expectations For Loans Demand For Next Six Months, %

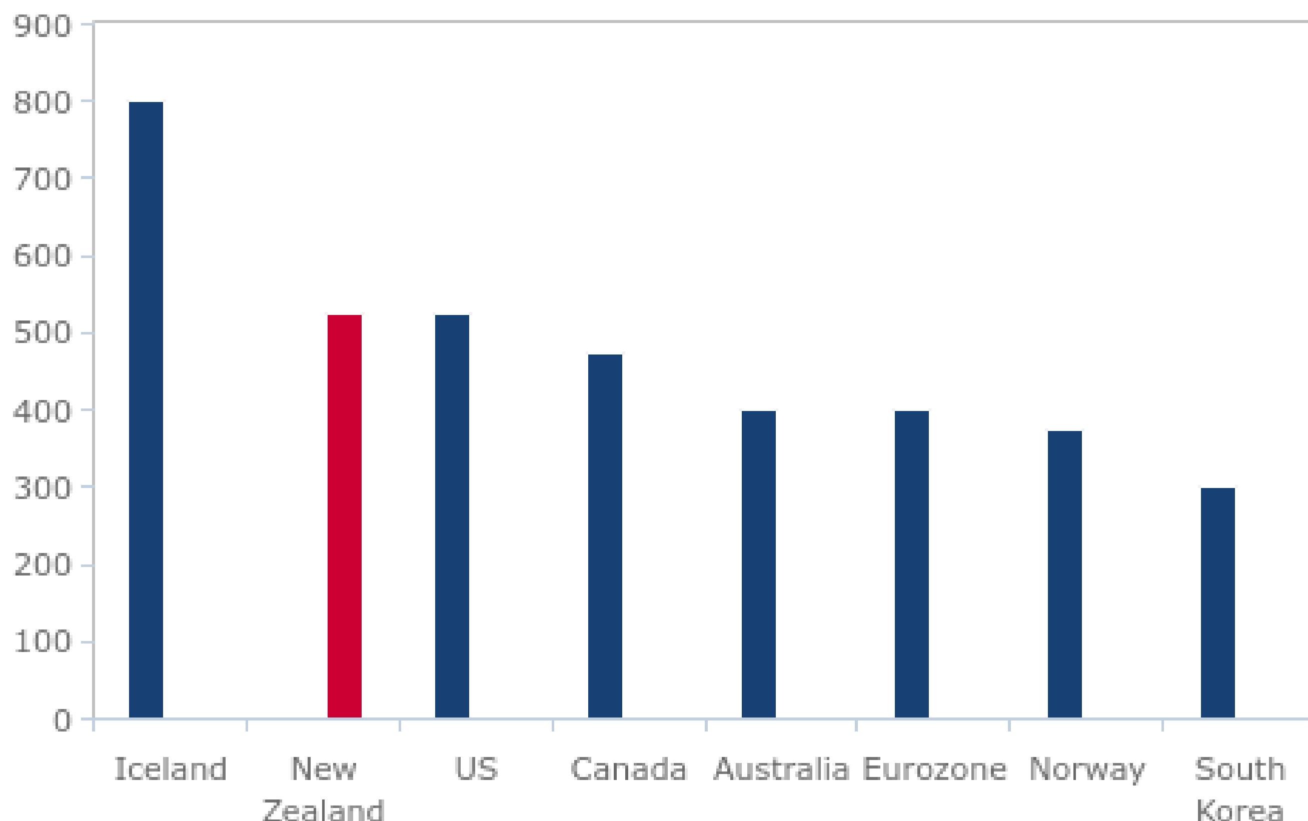


Source: Macrobond, BMI

We retain our view for the hiking cycle to have ended in New Zealand, but we do not expect any cuts before H124 at the earliest. High interest rate will curb borrowers' willingness and ability to increase leverage. The RBNZ's monetary tightening cycle has been much more aggressive than most other DM central banks (*see chart below*), and further tightening would risk tipping the economy into recession. Against a backdrop of still high inflation, weakening growth momentum means that policymakers in New Zealand will have to continue to try and strike a balance between fostering economic growth (or at least not stifling it) and curbing price pressures. This is why we believe that the RBNZ will leave the policy rate unchanged at 5.50% in H223, but we anticipate no cuts before the first half of 2024, at the earliest.

More Aggressive Than Most

Change In Selected DM Central Bank Policy Rate Since Latest Trough, bps

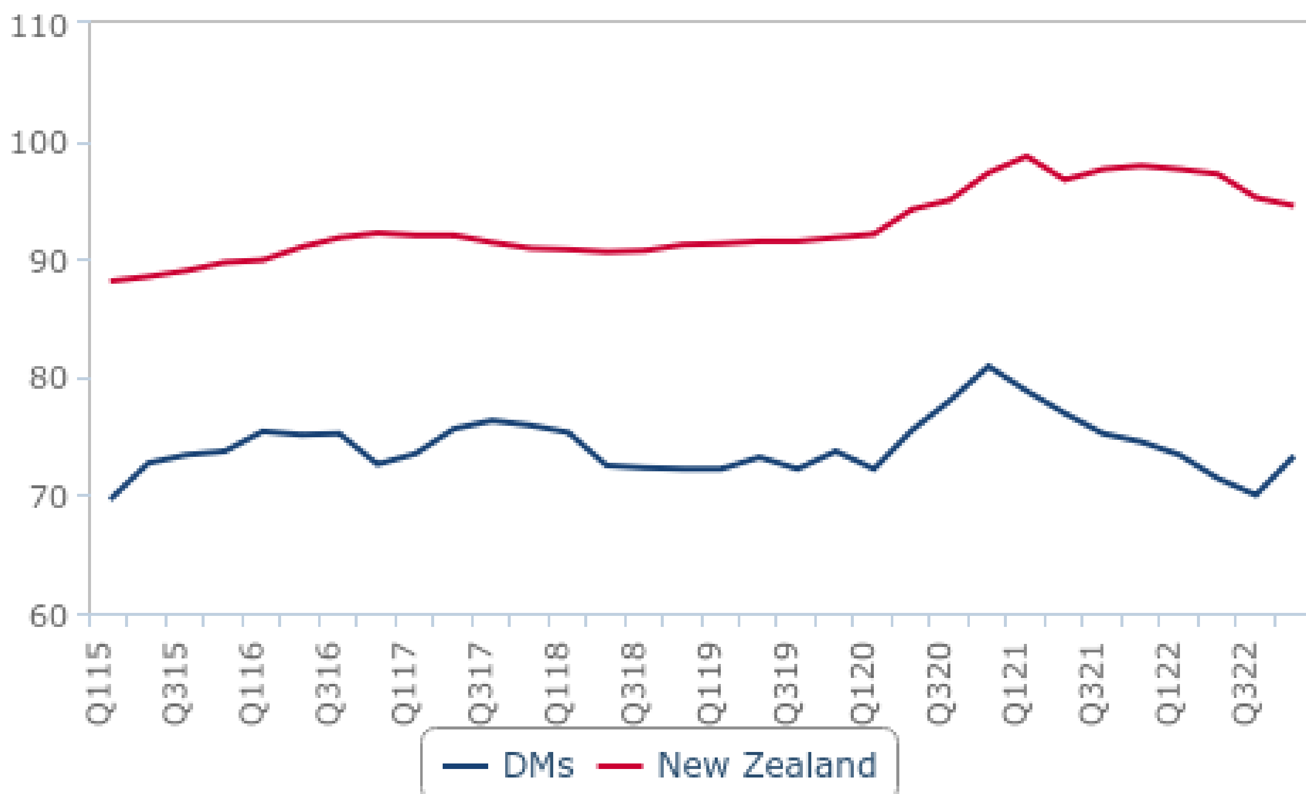


Source: Macrobond, BMI

Data from the Bank for International Settlements reveal that New Zealand families remain highly leveraged and, consequently, susceptible to adverse effects from higher interest rates. At 94.5% of GDP, the debt ratio of New Zealand households is a few percentage points higher than the developed market average of 73.3%, indicating that New Zealand families are highly leveraged compared to their developed market counterparts. As we do not anticipate any interest rate cuts before 2024, we believe that financial conditions will remain restrictive in the upcoming months, carrying negative implications for household finances, consumption, and credit demand.

New Zealand Families Are More Leveraged Than Their DM Counterparts

Household Debt, % of GDP

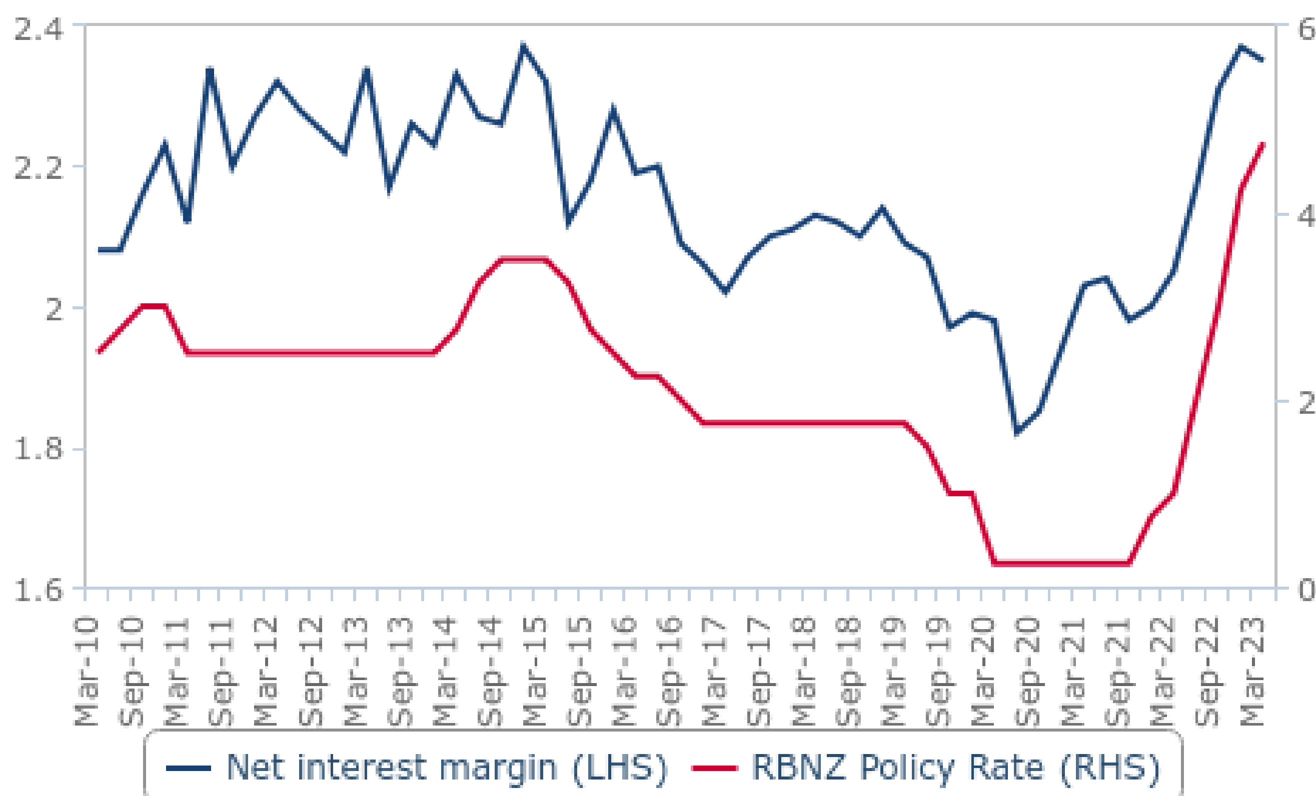


Note: Advanced economies include Austria, Australia, Belgium, Canada, Switzerland, Germany, Denmark, Spain, Finland, France, UK, Greece, Hong Kong, Ireland, Italy, Japan, South Korea, Luxembourg, Netherlands, Norway, New Zealand, Portugal, Sweden, Singapo

On a stronger note, we retain the view that the overall impact of high interest rates will be positive for bank profitability. This is because much of New Zealand's bank loans are at variable or short-term fixed interest rates, which ensures that interest revenues do not lag behind interest expenses during periods of rising rates. Indeed, higher/lower interest rates have traditionally led to higher/ lower net interest margins. For example, during the last rate-hike cycle in 2014, when the policy rate was raised by a cumulative 100bps, banks' net interest margins edged higher from 2.17% in Q1 2014 to 2.33% by the end of the year (*see chart below*).

Banks To Benefit From High Interest Rates

New Zealand – Policy Rate & Net Interest Margin, %

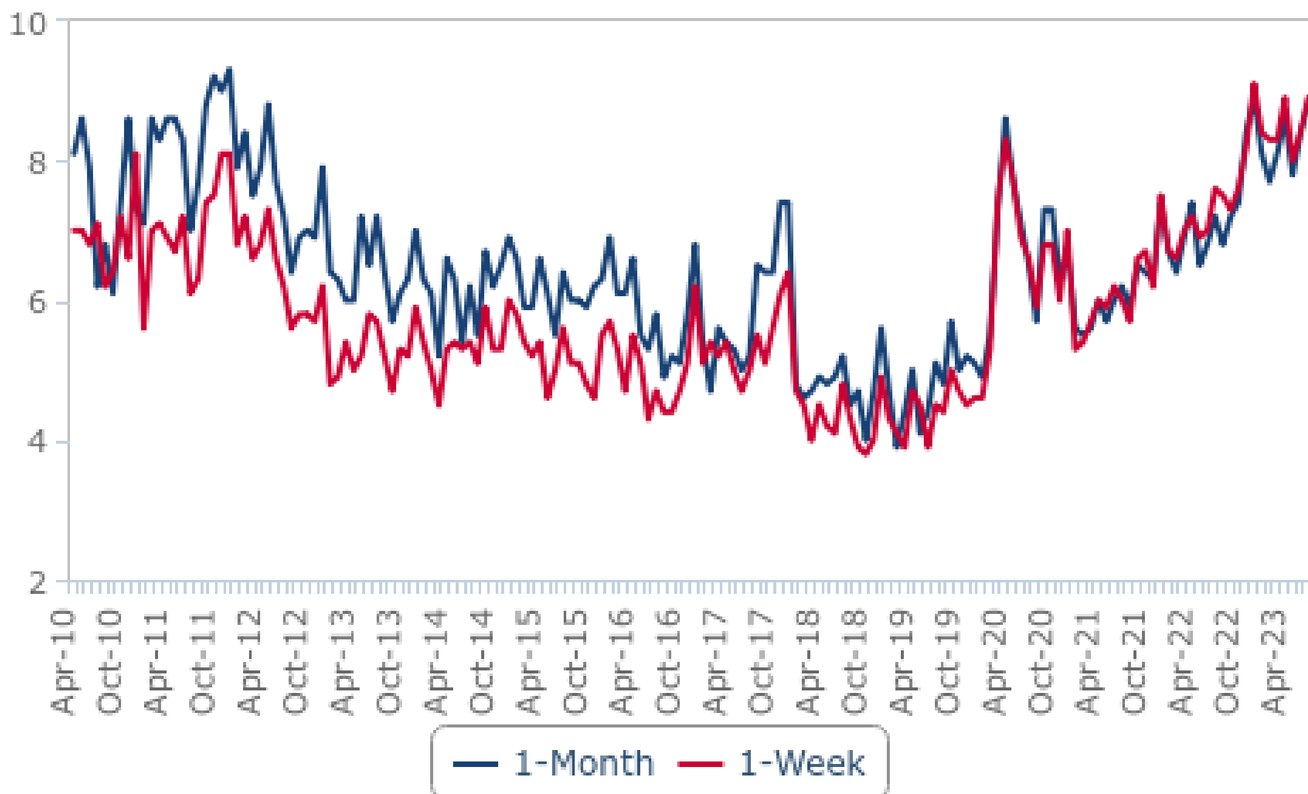


Source: Macrobond, BMI

The bigger source of banking vulnerability is the ongoing stress in New Zealand's real estate market. In July, more than 62.0% of outstanding loans were used to finance housing. There is also evidence suggesting that homeowners are facing increasing difficulty in paying off their debt. According to credit agency Centrix, some 19,500 households were behind in their mortgages in June, up 34% y-o-y, which was the highest level since the start of the COVID-19 pandemic in March 2020. We expect this number to continue rising in H223 and into 2024, as the impact of high interest rates continues to bite.

Financial Stability To Remain Intact

New Zealand – Mismatch Ratio



Source: Macrobond, BMI

Despite pockets of weakness in the real estate sector due to high interest rates, we believe that financial stability risks remain limited as key measures of banking stability indicate a healthy banking sector. The mismatch ratio – which measures liquid assets as a fraction of total funding – has been rising ever since the start of 2021. At nearly 9.0% in July, both the one-week and one-month measure of liquidity remained high by historic standards (*see chart above*). Second, the non-performing loan ratio stood at just 0.4% of total loans in Q223 according to our estimate, near record lows. Finally, all of New Zealand's major banks remain adequately capitalised, with a regulatory capital ratio above 17.0% as of Q223.

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