

# focus



## Funding for Lending

In response to the economic shock of COVID-19 and part of Reserve Bank of New Zealand's (RBNZ) 'least regrets' strategy, a new 'tool' is being rolled out next week, which will see the major banks able to access funding at extremely low rates of interest. The impact of the Funding for Lending Programme (FLP) is likely to see term deposit rates fall even further, meaning savers either face receiving a negative real return on their savings or look for alternatives.

## ...The RBNZ has already slashed the OCR to a record low with further cuts possible in 2021...



### Simply put...

A bank is an intermediary between savers and borrowers. A bank receives money from savers, paying them one interest rate, and lends that money out to borrowers at a higher interest rate. The difference is the bank's margin and how a bank makes a profit (fees and other revenue sources aside).

What the RBNZ is trying to do with the FLP is to provide a funding source at the lowest possible interest rate (in this case the Official Cash Rate of 0.25%). The RBNZ has already slashed the OCR to a record low with further cuts possible in 2021. The hope is that the FLP (alongside the ultra-low OCR) will encourage banks to lower interest rates

for potential borrowers. Encouraging individuals, households and businesses to borrow is how the RBNZ intends to help the economic recovery.

There are two questions, however:

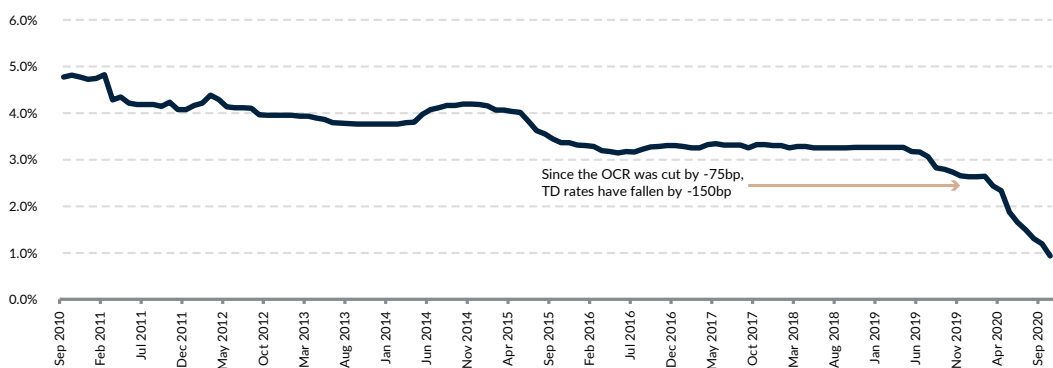
Will lower interest rates incentivise individuals, households and businesses to borrow more?

Is there any demand for lending outside of residential property?

### Funding

A bank funds its operations from shareholder funds, deposits (both call and term deposits) and debt markets (both locally and offshore). All of these funding avenues (except for deposits sitting

RETAIL INTEREST RATES: WEIGHTED AVERAGE LENDING AND DEPOSITS



Source: RBNZ, Forsyth Barr research



**...businesses are likely to remain cautious. Households, however, are another story...**

in cheque accounts etc) cost a bank some form of interest. Borrowing at the current 0.25% OCR would be extremely attractive. Even the mere suggestion of the FLP has seen term deposit rates fall significantly in recent months (see graph). Over the last year NZ\$13.6bn has exited term deposits from the big four<sup>1</sup> banks as interest rates have declined. The RBNZ is however concerned that lending rates have not fallen in comparison.

**Borrowers**

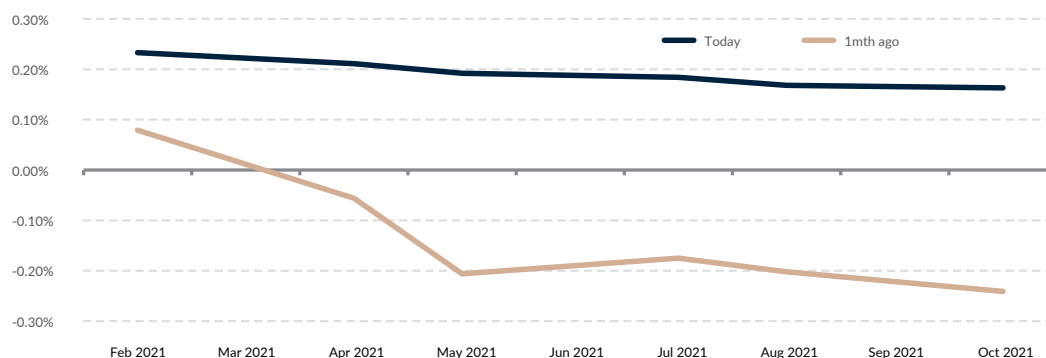
The RBNZ is clear that the measure of success of the FLP is not the scale of how much is borrowed (~NZ\$28bn could be) but what the impact on lending interest rates is. It would only take one bank to use the FLP and offer loans to its

clients at very low interest rates for competitive pressures to push all lending interest rates lower. If this occurs then the programme would be deemed a success.

The unanswered question around additional demand for debt remains unclear. With ongoing uncertainty around COVID-19 and its impact on economies, businesses are likely to remain cautious. Households, however, are another story with record house sales in recent months causing major headlines and headaches for the Government. There is no requirement for banks who use the FLP to lend to any one sector, which has led to concerns that the residential house price inflation may continue to rise.

1. ANZ, ASB, BNZ, WBC

**PROBABILITY OF AN OCR CUT**



Source: Bloomberg, Forsyth Barr research

**...a significant portion of the current NZ\$143bn term deposits may be trying to find a new home...**



With interest rates already low, the prospect of term deposit rates potentially heading towards 0%, a significant portion of the current<sup>2</sup> NZ\$143bn term deposits may be trying to find a new home. Will the destination be the equity market? Residential property? Or something else? It may prove that asset prices continue to rise for some time yet.



**Matt Sturmer**  
Senior Analyst,  
Fixed Income

**TERM DEPOSIT RATES**

	1yr	18mths	2yr	3yr	4yr	5yr
ANZ	0.85%	0.90%	0.90%	0.90%	0.90%	0.90%
ASB	0.75%	0.80%	0.80%	0.90%	1.00%	1.00%
BNZ	0.85%	0.85%	0.85%	0.90%	0.90%	0.90%
WBC	0.80%	0.80%	0.85%	0.85%	0.90%	0.90%

Source: Interest.co.nz (as at 2 December)

2. As at 30 September 2020

**Understanding that sudden changes in financial markets can cause concern or indicate opportunity, your Forsyth Barr Investment Adviser is available to provide you with advice and assistance at any time.**

0800 367 227

forsythbarr.co.nz

Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. This publication is not a recommendation or an opinion in relation to acquiring or disposing of (including refraining from acquiring or disposing of) any financial product. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.