Bankflation in Aotearoa

*Interest rates are the primary policy tool used by the Reserve Bank of New Zealand to control inflation. However, rising rates create a possible cover for banks to increase their profits through rising margins. As the cost-of-living crisis continues, surging bank profits impose costs across the economy, a dynamic we call **"bankflation"**.*

- *Cumulative "Big Four" bank profits have increased 80 percent in the last decade. Over that period, average annual profit increases have been running at triple the rate of average annual wage increases negotiated in bank worker collective agreements.*
- *NZ banks' net interest margins (the difference between lending and borrowing rates) are now at their highest level in 17 years. This means mortgagors, businesses and consumers endure relatively high borrowing rates, while depositors receive relatively low deposit rates.*

A recent report authored by FIRST Union, the NZ Council of Trade Unions and Action Station explored the contribution of rising profits to inflation. It argued that from mid-2021 to the end of 2022, profits contributed 55% of domestic inflationary pressure, while wages contributed only 28%.[1] Data on economy-wide profits remains limited in Aotearoa, however both the Annual Enterprise Survey and estimates based on Treasury's Tax Out-Turn data suggest that profits surged to record levels during this period.[2]

In mid-2021 the consumer price index (CPI) moved out of its 1-3 percent policy target range, initially driven by supply chain disruptions. By October 2021 the Reserve Bank of New Zealand (RBNZ) had started hiking the Official Cash Rate (OCR) in a bid to control inflation. The rate of inflation peaked in June 2022 but OCR hikes continued until May 2023, peaking at 5.5 percent. This is the most aggressive OCR hike in RBNZ history.

While some economic data appears to show the start of a decline in economy-wide profits in 2023,[3] profits in the banking sector have risen rapidly. Banks are among the primary beneficiaries of interest rates hikes, as rising interest rates provide a possible cover for disproportionate increases in banks' key lending rates. NZ banks' net interest margin (NIM) – the difference between the rates at which banks borrow and lend – has reached its highest point in 17 years (2.38 percent). We call this dynamic **"bankflation"**. This has followed a relatively long period of lower interest rates,[4] in which lending activity has increased significantly. NZ banks' balance sheets have more than quadrupled over this same 17-year period.

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[1] As measured by the GDP deflator. This report used a methodology previously deployed by the OECD, IMF and European Central Bank, among others. *See* "Profit-led inflation in Aotearoa" (28 August 2023) *FIRST Union*, *NZCTU and ActionStation*. https://union.org.nz/rising-profits-accounted-for-more-than-half-of-domestic-inflation-during-cost-of-living-crisis/

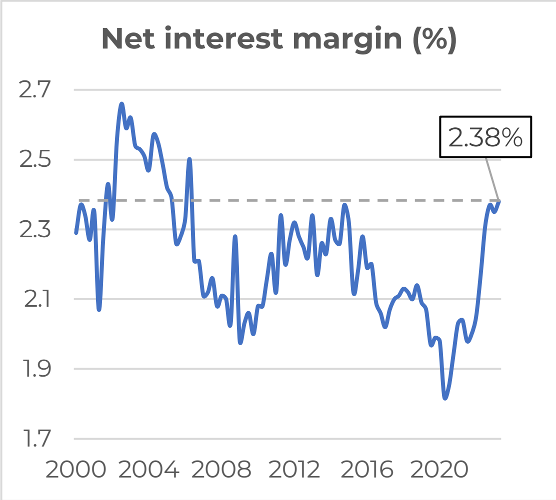
[2] These two datasets refer to different profit measures. The Annual Enterprise Survey measures "surplus before income tax", which is similarly to the standard GAAP measure of earnings before interest and tax, which grew $21 billion to $124 billion in the 2022 financial year. We can also estimate economy-wide profits using Treasury's Out-Turn Tax data on actual corporate tax paid (i.e. net profit after tax). This data suggests that in 2021 and 2022 net profit after tax increased by 60 percent.

[3] At the time of publishing, only 11 months of the 2023 financial year are available. Comparing this 11 month period with the corresponding 2022 financial year period appears to show a 8% decline in economy-wide profits. "Tax Outturn Data – May 2023" (5 July 2023) *The Treasury*. https://www.treasury.govt.nz/sites/default/files/2023-07/tax-history-may23.xlsx

[4] From mid-2008 to mid-2009 the OCR was dropped dramatically from 8.25 to 2.5 percent. Despite a few short-term hikes, by late 2016 it had been dropped to 1.75 percent, and dropped further in early 2020 to 0.25 percent.

Bankflation is the result of banks hiking margins under cover of rising interest rates, piling costs onto families and businesses. As overall inflationary pressures are receding, banking sector profits seem here to stay. Quarterly pre-tax bank profits reached a record $2.62 billion in December 2022,[5] declining slightly in early 2023 as banks increased their provisioning costs.

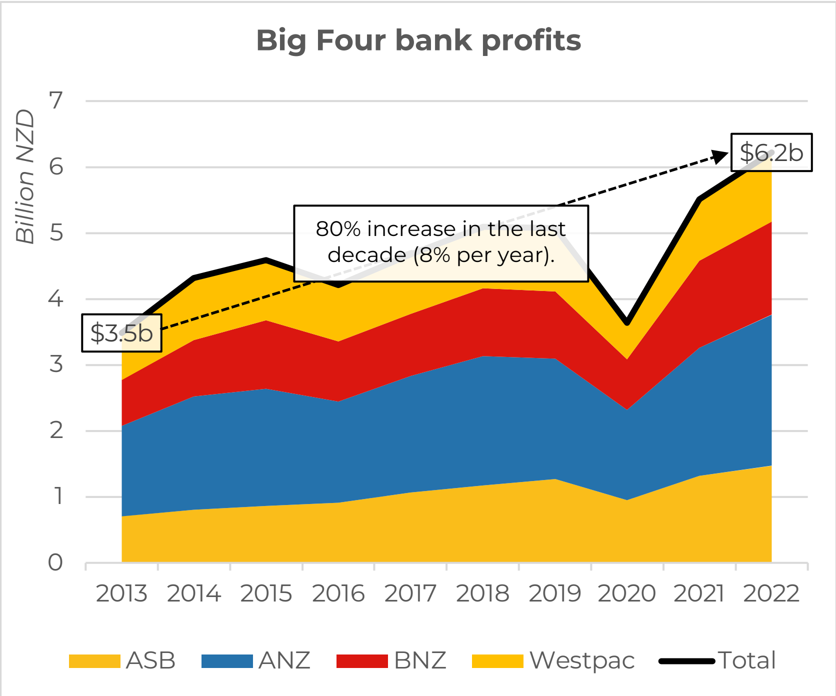
Despite the Global Financial Crisis and the Covid-19 pandemic, bank profits remain resilient in the long-term: doubling since 2013, tripling since 2006 and quadrupling since 2000.



The "Big Four": the winners of bankflation

In October 2022 ratings agency Standard and Poors described the NZ banking industry as "an oligopoly dominated by four large banks".[6] The big four offshore-owned[7] banks – ANZ, ASB, BNZ and Westpac – that make up 87 percent of the banking market are the primary winners of bankflation.

Complete 2023 financial data for the so-called "Big Four" is not yet available. However, in the decade to 2022 the Big Four banks' profits increased by 80 percent, generating almost $47 billion[8] in cumulative net profit after tax over this period. Of this, they delivered a cumulative $36 billion in dividends to their shareholders (a 77% distribution rate),[9] leaving very little capital left over for reinvestment to improve the quality or reduce the price of banking services for New Zealanders.



[5] "Income statement (S21)" (25 August 2023) *Reserve Bank of New Zealand*. https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-income-statement

[6] "ANZ Bank New Zealand" (24 October 2022) S&P Global.

[7] These banks have often been described as Australian-owned. However their Australian parent companies are subject to diverse offshore ownership. The largest shareholders of all four of their parent companies are the big three asset management firms – Blackrock, Vanguard and State Street.

[8] All financial data used in this document is taken from the S&P CapitalIQ database, supplemented with company financial reports.

[9] Distribution rates differ across the Big Four. Westpac has the highest rate of distribution across the decade long period at 97 percent ($8.5 billion distributed off $8.75 billion in net profit after tax).

These trends appear likely to continue over the coming years, with restrictive interest rates set to remain until late-2024.[10] In the 12 months from July 2023 to 30 June 2024 (the 2024 financial year), a further $132 billion in owner-occupier mortgage debt and $51 billion in residential mortgage debt will come up for refinancing.[11] This in turn will likely further lift bank profitability.

As a result of concerns about surging bank profits, in March 2023 the Commerce Commission initiated an inquiry into personal banking services. An August 2023 preliminary report looked closely at the three primary measures of bank profitability – return on equity, return on assets and net interest margin – over the previous decade.[12] On all three measures, NZ banks were consistently above the upper quartile of sampled countries for the last eight years. From 2015 to 2019 NZ banks had the highest return on equity across all sampled countries. This research confirmed existing RBNZ findings from the May 2023 Financial Stability Report, as well as FIRST Union research released in March 2023.

In July 2023 Treasury proactively released a number of documents from February and March, exploring the case for a windfall tax on large NZ banks.[13] They reviewed evidence around bank profits, and looked at recent examples of windfall taxes levied on banks in Canada (the only country whose banks had a higher average return on equity than NZ over the last decade) and Spain (the country with the lowest inflation in the Eurozone), as well as similar mechanisms used on energy producers in countries like the Netherlands, United Kingdom and Czech Republic.

Ultimately Treasury recommended against a windfall tax, on the basis that the "supernormal" profits generated by the large NZ banks seemed to be persistent across recent decades, and not tied to a specific event or set of circumstances (such as the pandemic). While we agree with the characterisation that NZ banks have persistently high levels of profitability, we can see a clear acceleration of those profits in the present environment. The monetary tightening process initiated in October 2021 to quell inflationary pressures (during which banks have disproportionately hiked their margins) constitutes a clearly identifiable set of events for the purposes of a windfall tax discussion.

The losers of bankflation: mortgagors, consumers, depositors and workers

Bankflation has impacts across the economy. This section looks at how rising margins impact (1) businesses and consumers through the increased cost of borrowing for essentials, (2) mortgagors through disproportionately high mortgage rates, (3) depositors who do not enjoy those high rates, and (4) bank workers, whose wages are rising at less than half the rate of bank profits.

Business lending has seen the sharpest increase in yields, from 3.2 percent before

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[10] Appendix 1, Statistical tables "Monetary Policy Statement" (August 2023) *Reserve Bank of New Zealand*, p55. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/monetary-policy-statements/2023/august/mpsaug23.pdf

[11] "Banks: Assets – Loans fully secured by residential mortgage by time until next repricing (S33)" (31 August 2023) *Reserve Bank of New Zealand*. https://www.rbnz.govt.nz/statistics/series/registered-banks/banks-assets-loans-fully-secured-by-residential-mortgage

[12] "Market study into personal banking services: Preliminary issues paper" (10 August 2023) *Commerce Commission Te Komihana Tauhokohoko*, pp 92 – 119. https://comcom.govt.nz/__data/assets/pdf_file/0032/324779/Preliminary-Issues-paper-Personal-banking-services-market-study-10-August-2023.pdf

[13] "Budget 2023 Tax Initiatives Information Release" (July 2023) *The Treasury*. https://www.treasury.govt.nz/sites/default/files/2023-07/b23-tax-4791084.pdf

OCR hikes to 7.8 percent in July 2023.[14] This primarily affects businesses on revolving credit, including farmers and residential builders. As well as businesses, this affects consumers across the economy. Rising food and housing costs remain the dominant areas of inflationary pressure across the consumer price index. While food prices have risen 20% since mid-2021, data from the Farm Expenses Price Index suggests interest rates have accounted for more than two-thirds of rising costs across all farms in the year to 30 June 2023.[15] Rising interest rates have also had a major impact on residential housing construction, with monthly building consents numbers down a third since their March 2022 peak.[16] Bankflation exacerbates these trends, affecting everyone in the market for food and housing.

Mortgagors are of course impacted by rising interest rates. This was exacerbated by the relatively long period of low interest rates from at least late-2016 (see Footnote 4) and ultra-low pandemic era interest rates. Across that period (Dec 16 to Dec 22), the house price index increased by 66 percent.[17] Yields have increased dramatically our $350-odd billion mortgage book, with average fixed loan yields up from 2.7% to 5% while average floating loans yields are up from 3.6% to 6.8%.[18] Indeed, the rates now being experienced by mortgagors are substantially higher than those at which many borrowers were stress-tested at during the ultra-low interest rate period.

Those mortgagors are particularly vulnerable. Recent research by Westpac economists suggested that someone who purchased an average-priced Auckland home in May 2021 on a two-year fixed mortgage rate could now be looking at another $1600 a month.[19] Average yields will continue to rise as more mortgage debt is refinanced, with a further $130 billion up for refinancing in the year to 30 June 2024. And, while the OCR appears to have halted its ascent in May 2023, bank mortgage rates have continued to rise, with banks continuing to raise rates after that.

This effect is particularly punitive in the NZ mortgage market, where short-term fixed mortgages predominate.[20] The lifetime effects of this are dramatic. In a submission to the Commerce Commission banking inquiry, Monopoly Watch calculated that an average Kiwi household would lose out between $450,000 and $1 million over their lifetimes because of excess margins paid to banks.[21]

Depositors also lose out to bankflation. The Reserve Bank has publicly rebuked banks for raising mortgage rates more than term deposit rates.[22] As Squirrel CEO David Cunningham states, “banks haven’t passed on interest rate increases to savings account holders at the same pace the OCR has climbed. In other words, Kiwis with money sitting in bank savings accounts (to the tune of about $75 billion) are supporting about $1.4b per annum of

[14] “Yields on loans (B6)” (7 September 2023) *Reserve Bank of New Zealand*. https://www.rbnz.govt.nz/statistics/series/exchange-and-interest-rates/yields-on-loans

[15] Calculated from Table 1.03, “Farm Expenses Price Index” (June 2023) *StatsNZ*. https://www.stats.govt.nz/assets/Uploads/Business-price-indexes/Business-price-indexes-June-2023-quarter/Download-data/business-price-indexes-june-2023-quarter-farm-expenses-price-index.xlsx

[16] “Building consents issued: July 2023” (30 August 2023) *StatsNZ*. https://www.stats.govt.nz/information-releases/building-consents-issued-july-2023/

[17] “Housing (M10)” (21 September 2023) *Reserve Bank of New Zealand*. https://www.rbnz.govt.nz/statistics/series/economic-indicators/housing

[18] *See* Footnote 14.

[19] Susan Edmunds “‘Average’ Auckland mortgage up $1600 a month for recent buyers” (10 July 2023) *Stuff.co.nz*. https://www.stuff.co.nz/business/money/300924376/average-auckland-mortgage-up-1600-a-month-for-recent-buyers

[20] By way of comparison, 70 percent of US mortgages are fixed for 30 years.

[21] Provided by direct communication with the authors.

[22] Bernard Hickey “RBNZ Governor Adrian Orr calls on banks to lift deposit rates as much as mortgage rates; says Gabrielle shows banks haven’t done enough on inclusion and resilience in regional areas” (22 February 2023) *Interest.co.nz*. interest.co.nz/banking/120029/rbnz-governor-adrian-orr-calls-banks-lift-deposit-rates-much-mortgage-rates-say/

higher bank pre-tax profits compared to two years ago."[23]

Finally, bank workers themselves are also losers of bankflation. While cumulative Big Four after-tax bank profits increased by 13 percent ($707 million) in the 2022 financial year, all Big Four banks resided over real wage cuts in collective bargaining during the same period. Looking back over a decade's worth of data, the average annual profit increases of the Big Four banks have been running at triple the rate of annual wage increases, negotiated in bank worker collective agreements.[24] Our primary membership covers branch staff, back-office operations and contact centre workers.

Nonetheless, industry-wide figures appear to show relatively healthy wage growth. The RBNZ bank income statement, for example, suggests that banks' personnel costs have increased 63 percent in the last decade, or 6.3 percent per year[25] – slightly lower than the 80 percent profit growth over the same period but in the same ballpark. Similarly, the Quarterly Employment Survey (QES) shows the financial and insurance industry (a broader grouping than just bank workers) has the highest wages of any industry, 40 percent higher than the average across all industries. At the beginning of 2022 wages in the industry were growing at 9.3 percent, almost double the then-national average (4.8 percent). The QES also suggests that male wages in the financial and insurance services industry are 29 percent higher than female wages, more than double the economy-wide average (12%).

These disparities seem to suggest a two-speed labour market, in which lower-paid bank worker wages are being squeezed while increased wages for those already very highly paid pulls up industry averages.

Bank workers are negotiating with the Big Four in 2023 and 2024, pushing back against bankflation. Visit https://actionstation.org.nz/publications/bankflation-in-aotearoa for campaign updates and to support their struggle!

End bankflation!

1. Industry bargaining

Workers from across the "Big Four" need to be able to bargain together to get the increases they need. This could be by way of a Fair Pay Agreement or a Multi-Employer Collective Agreement. The money is there, the "Big Four" just need a reminder of who it is that earns it for them.

2. Increase competition

FIRST Union is following the Commerce Commission banking inquiry. We have seen and support recommendations calling for the structural separation of Big Four banks, however common shareholdings may undermine a more competitive market. The entry of other major international players into the NZ banking industry may therefore be preferable.

3. Regulate margins

When bank margins surge in the middle of a cost-of-living crisis, banks exacerbate that crisis. RBNZ already keeps quarterly data on banks' net interest margins. Government should consider establishing a regulatory framework that allows for the limiting of net interest margins to support living standards.

4. Windfall taxes and levies

When the banking inquiry was first announced, FIRST Union called for an immediate 5% levy on bank profits. Despite Treasury's opposition to a windfall tax, the surge in bank profits experienced since RBNZ began hiking interest rates shows a clear set of events. We believe the case for additional taxes and levies on The Big Four banks remains strong.

[23] David Cunningham "The Reserve Bank signalled we were done – so why are mortgage rates still going up?" (2 August 2023) *Stuff.co.nz*. https://www.stuff.co.nz/business/opinion-analysis/300939556/the-reserve-bank-signalled-we-were-done--so-why-are-mortgage-rates-still-going-up

[24] Data for ASB covers a shorter time span because collective bargaining has begun there more recently.

[25] *See* Footnote 5.