

PwC Treasury Broadsheet

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from the world of treasury management –
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Interest rate risk management in a low rate environment

As you probably gathered from the swathe of economic commentaries in recent months, interest rates are at historical lows. Yep, got it, heard this one before. This is a statement which has been made repeatedly since the Global Financial Crisis and is likely to continue to be made for years to come. Inflation appears structurally lower than where it once was (due to globally integrated supply chains, productivity and technology advances) and central banks around the world have not been shy in using their monetary policy toolkit to avoid deflationary pressures. With signs that interest rates will continue to move lower and the RBNZ openly discussing unconventional stimulus measures, the management of interest rate risk takes on a changing dynamic from previous practices.

With wholesale interest rates proving to be lower for (much) longer, the contribution that interest rates have to an organisation's overall debt funding costs has continued to reduce, potentially implying a reduced emphasis on the management of wholesale interest rate risk. Not only that, but the *absolute volatility* of interest rate movements has also declined markedly. No longer will rates swing from 4% to 8% to cool an overheating economy. Historically, the wholesale component of all-up borrowing costs far outweighed funding credit margins and caused NZ-based treasuries to actively reduce and mitigate adverse impacts from sudden and large changes in floating interest rates. As BKBM approaches 1% (and potentially 0% or even negative over coming years), it is worthwhile re-examining the rationale surrounding active interest rate risk management.

Most corporate borrowers in New Zealand with a significant debt quantum will have a prescribed interest rate risk management framework, requiring a minimum amount of interest rate fixing and providing for an allowable maximum amount of interest rate fixing. The determination of these minimum and maximum interest rate fixing parameters was likely (hopefully) based on the following considerations:

- Risk tolerance and appetite of the organisation
- Underlying treasury and financial objectives
- Relationship between interest rate movements and underlying business activities / performance
- Pass through ability from higher interest costs
- Impact of higher interest costs on lending covenants
- Stress-test / scenario modelling on the impact to NPBT (or equivalent)

The risk tolerance question is arguably the most important aspect of policy parameter setting. Knowing how sensitive your business is to interest rate movements (e.g. what is the impact of a 1% increase in BKBM on NPBT), informs the materiality of the risk and facilitates a discussion surrounding risk tolerance. With interest rates at record lows, it may be that the impact of a 1% increase in BKBM is less impactful than over recent years, or it may be more impactful as although wholesale interest rates have declined, debt quantum has not.

Similarly, although interest rates have declined, what is the correlation with overall business performance? Is the business pro-cyclical with interest rate cycles or counter-cyclical? That is, have earnings and profitability moved in tandem with interest rates? A business whose performance mirrors interest rates may present natural offsets, informing the requirement to have high or low interest rate fixing minimums and maximums.

Treasury and financial objectives relating to interest rate risk management likely remain unchanged, but should be reviewed despite the low interest rate environment. Treasury functions will generally continue to act conservatively and proactively to produce financial results within expected ranges and minimise interest costs over a multi-year period. Interest rates may be low, however debt levels are generally higher, and *relative volatility* has increased - that is, a 10 basis point movement in a day now represents

a 10% movement in underlying interest rates). The ability or otherwise to pass through these interest rate movements to end customers remains an important consideration in setting interest rate policy frameworks.

Whilst at face value it may be desirable to reduce minimum interest rate fixing requirements and participate further in expected future reductions in BKBM, the aforementioned considerations should form part of an informed discussion into potential policy framework changes. There remains a clear distinction between interest rate *policy* and interest rate *strategy* and although strategy can change with market movements and outlook, the policy must be constructed to perform in all interest rate environments. Robust financial modelling and scenario testing supports the adoption of a policy which will meet treasury and financial objectives across all weathers, not just the current low interest rate environment.

The range of allowable interest rate risk management instruments within a policy should also be explored as mechanisms to achieve desired interest rate outcomes. Care does need to be taken, however, with the effectiveness of certain instruments in mitigating interest rate risk potentially compromised should interest rates become negative.

In summary, despite movements to record lows in interest rate settings and potential desires to amend policy parameters to suit targeted interest rate fixing levels, care must be exercised. *Policy* should not be confused with *strategy* and changes to existing interest rate frameworks require robust and thorough review prior to changes being implemented.

Authored by Alex Wondergem, alex.j.wondergem@pwc.com

The consensus agrees - your treasury reporting struggles are real

PwC recently published its bi-annual 2019 [Global Treasury Benchmarking Survey](#). The survey was completed by over 230 organisations across all continents, and included a healthy subset from across Australia and New Zealand. There were a raft of really interesting takeaways (which we obviously recommend you read), particularly relating to the emerging trends of technology in treasury.

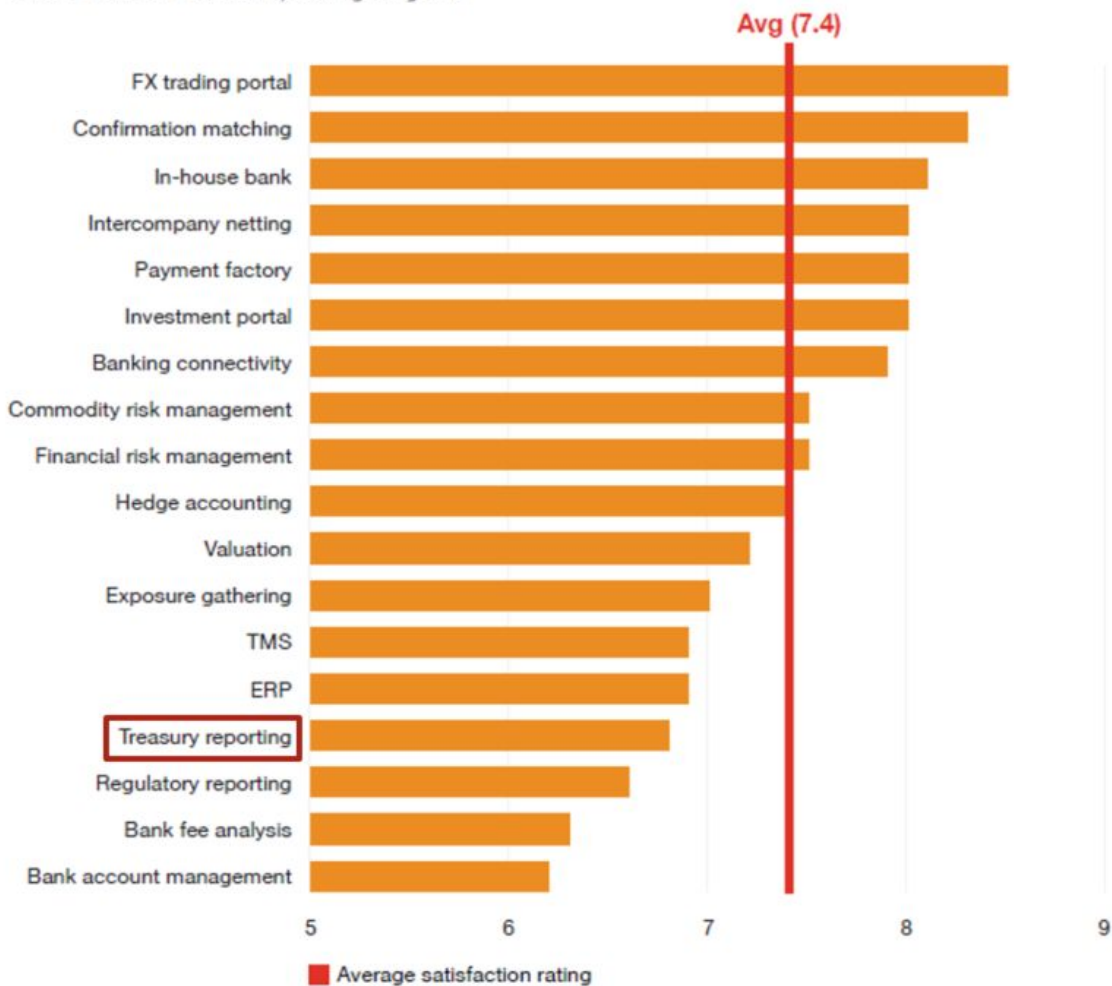
One thing which really struck us was the on-going struggle that organisations have with treasury reporting. It would seem that you are not the only one who finds the scramble to update monthly spreadsheets, or extract various system reports and stitch them together, both frustrating and overly convoluted. System generated reports are often too generic, only proving half the information or not providing any genuine insight. Spreadsheets require work arounds and carry the risk of human error, especially as the deadline on a reporting pack draws near.

Unsurprisingly then, we are beginning to see a real surge of tools and techniques to make this process easier. The most common approach (and one where we have been actively involved helping clients) is to leverage business intelligence (BI) tools (such as Power BI, Tableau or Qlik) that allow for much stronger flexibility and visualisation of treasury reporting. A real benefit here is the ability to reference multiple sources in real-time, schedule automatic updates and leverage databases that act as the single 'source of truth'. These tools reduce the reliance on spreadsheet handling, and can be used to build a 'suite' of reports that complement each other and provide a complete picture in one place. As well as streamlining the process for management or Board reporting, these tools can also be leveraged to provide insights on 'what needs to be done' or what should be front of mind.

On a scale of 1–10, how satisfied are you with the Treasury system used for each process?

Number of respondents: 190

Note: Chart below is zoomed in, showing rating 5-10



Separately, we've identified a real difference between the needs of small, medium and large organisations. In many cases, small and medium-sized treasury teams do not have the bandwidth, time or resources to build and maintain these types of tools or applications. At the other end of the spectrum, more sophisticated treasury teams often want extremely tailored and bespoke reporting capabilities that can be used to streamline operations, provide immediate insights and be stored centrally on top of (or alongside) existing technology architecture - hence strengthening the 'one source of truth'.

Finally, we are beginning to see an increase in organisations examining the feasibility of robotic process automation (RPA) within treasury and the broader finance function. As related to reporting, there is a natural tension here between direct data feeds and APIs versus creating an RPA process that gets data from one place, puts it somewhere else, then does something to it, etc. Our early observations are that while there is a range of RPA opportunities emerging across different parts of the treasury function, streamlined reporting tools are likely to work more effectively when data feeds are automated, or reports are pre-generated, rather than necessarily overlaying a 'robot' to produce your monthly report.

Authored by Tom Lawson, tom.f.lawson@pwc.com

The impact of IFRS 16 - leases

From 1 January 2019, most IFRS reporting entities that have lease arrangements will have or will soon be evaluating IFRS 16. To satisfy IFRS 16 the lessee must assess what the borrowing cost would be to theoretically “purchase” the right-of-use asset. The standard requires entities to bring leases on to the balance sheet which will have ramifications for such things as bank financial ratios and credit rating assessments. There will also be impacts on internal processes, systems and controls with systems being required to capture a lot of additional detailed information. Organisations need to plan ahead as investing early better ensures successful outcomes.

Our observations are that interpretations of the standard remain and learnings continue as work flows progress. This article provides some broad practical observations of the approach to deriving the incremental borrowing rate (IBR).

The foundation of the IBR calculation is the underlying debt funding curve of the lessee. The building blocks of this curve consider the underlying ‘shadow’ credit rating of the lessee (where the lessee is unrated). If the lessee were to debt fund the right-of-use asset, what would that borrowing rate be? PwC credit rating estimates are based upon credit rating agency methodologies and lessee financial statements. The shadow credit rating provides an objective, defensible assessment of how a bank lender would assess the credit quality of the lessee.

When it comes to property leases, there is a requirement to have a specific IBR for each property lease. The base IBR needs to be adjusted for the particular characteristics of the underlying asset. Adjustments are made based on such matters as the term of the lease, typology, location and quality of the property. This creates a direct relationship to the asset itself, a requirement of the standard.

Where leases have similar characteristics, such as vehicles leases there are opportunities to take a portfolio approach to the IBR assessment. An entity can apply this approach if it reasonably expects that the effects on the financial statements, of applying IFRS 16 to the portfolio, would not materially differ from applying IFRS 16 to the individual leases within that portfolio. Our observations of some practices we have observed are;

- Actual bank lending rates are used. Imperfections arise as these rates may not be current and the term of bank facility may not coincide with the duration of the lease arrangement.
- Bank lending rates could under or overstate the implied credit assessment of the lessee. The bank may have taken a strategic view on the positioning and pricing for that entity.
- A portfolio approach is undertaken to the property IBR assessment. Our view is that each property lease must be considered separately given their unique characteristics. For instance the same IBR should not apply for different locations, say city vs. regional.
- In determining the duration of the lease term the impact and likely exercising of lease renewals needs to be considered.
- Gearing and interest cover ratios will be impacted. Whilst bank lenders are taking a pragmatic approach, borrowers should be aware of these impacts ensuring that ratios are recalibrated to accommodate these IFRS changes.
- The shadow credit rating can have wider applications across the business, in particular cross checking of bank pricing and terms, debt capacity analysis and capital structure reviews.

Early awareness of the impact of IFRS 16 on your financial statements and bank financial ratios is an imperative. Should the implied finance rate not be disclosed within the lease arrangement then an objective assessment of the shadow credit rating of the lessee can be an important first step in assessing the IBR for your lease portfolio.

Authored by Brett Johanson, brett.a.johanson@pwc.com

The cost of regulatory change to borrowers and approaches to remedy

Borrowers need to be considering funding diversification

Proposed RBNZ regulatory changes, while not yet confirmed, are certain to be implemented to some degree. While the form of the final capital requirements is being debated, the implications remain unchanged and it is more than likely that bank debt will become more expensive. Our observation is that this is already occurring with banks pre-empting change (especially longer dated term lending / i.e. three years plus).

Borrowers should be aware of clauses which enable banks to seek compensation as a result of regulatory changes. In addition, greater emphasis is now placed on secured lending to provide capital relief from a regulatory standpoint, reducing borrowers' future funding flexibility.

Bank lending is expected to be more price sensitive and credit constrained in sectors deemed marginal or in sectors where a bank's return on equity (ROE) is already low. In our opinion, the increase in risk weightings will affect the number of lending banks willing to provide credit across all sectors.

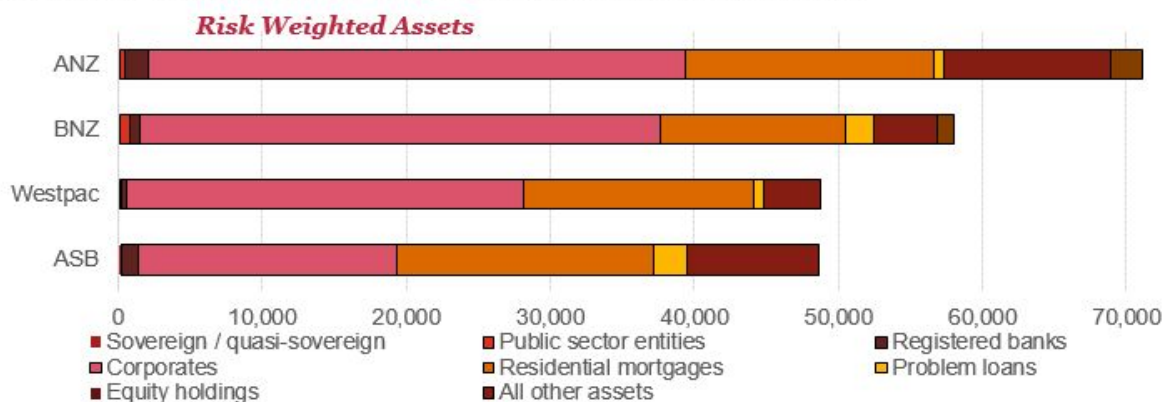
The winners under the proposed regulatory changes will be high credit grade borrowers, while industries with traditionally low ROE margins for banks (agricultural, smaller borrowers with less bargaining power and sub-investment grade borrowers) will most likely be the losers.

The RBNZ has estimated 40-60bps p.a. of funding cost increase against a much wider banking sector estimate of 60-140bps p.a. The increase is driven by additional common equity capital requirements (estimated to be between NZ\$14-20bn) which is, on average, an increase of 23% across existing large bank capital positions (as at 29 May 2019).

Chart 1: RBNZ capital proposal set to cause pain. Banks likely to hold more than minimum and will raise required capital over a shorter timeframe than proposed by the RBNZ. Source: RBNZ published 29 May 2019



Chart 2: Risk Weighted Assets (NZ\$m). Source: RBNZ published 29 May 2019



In response, banks have threatened a reduction in lending to risk weighted assets (RWA) in certain corporate sectors. Notwithstanding the current regulatory uncertainty, we have observed a notable increase in non-Australasian bank lending appetite.

NZ borrowers remain heavily reliant on the banking sector

The following outlines the current state of play for the NZ debt funding market and, in particular, those most likely to feel the consequences of regulatory change.

Small (<\$50m) and medium (\$50-\$250m) sized borrowers will be the most impacted by the proposed RBNZ changes given that >73% of debt is bank funded and concentrated within a three year maturity period, increasing refinancing risks. This could create a crowded refinancing window if bank lending appetite contracts.

Chart 3: Debt funding composition by borrower size (source: PwC debt survey)



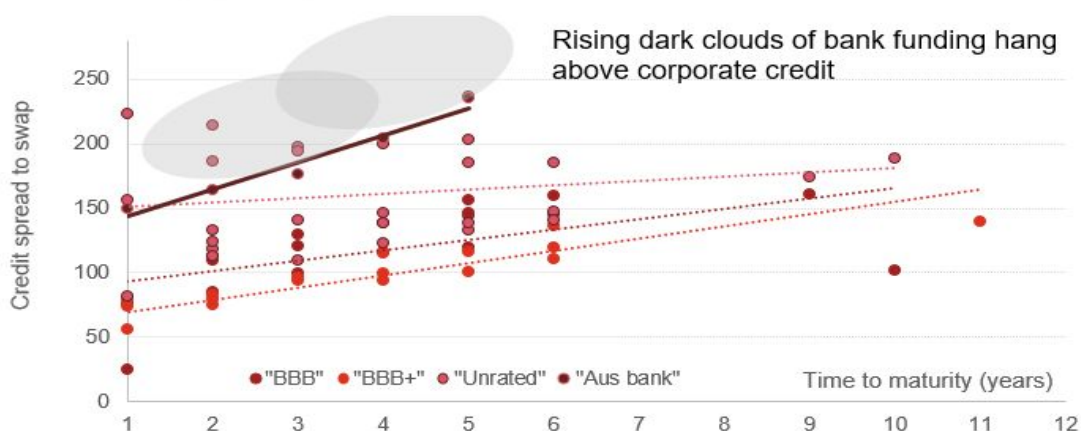
Bank debt funding by comparison dwarfs the amount of capital market debt for NZ businesses. In particular, listed NZDX investment grade (BBB- and above) and unrated bonds equate to only NZ\$8 billion of debt compared to NZ\$111 billion of bank lending to businesses (RBNZ published 29 May 2019).

In our opinion, NZ debt capital markets will increasingly be needed for funding diversification

When considered in the context of the ongoing regulatory capital review, there have been encouraging signs of strong investor appetite exhibited within the domestic debt capital market. A current lack of issuance in an environment of low and lowering wholesale interest rates are fuelling investor demand.

In our view, investment grade borrowers could easily convert >\$50m of bank lending into term placement. An investment grade NZDX issuer could fund in the retail bond market at significantly lower credit spreads when compared to bank debt. A 65bps decrease in credit spreads on \$50m issue is equivalent to a saving of \$325k p.a. and, importantly, reduces refinancing risk through term and diversification (funding five years).

Chart 4: NZDX listed corporate bond spread/maturities (investment grade/unrated)
 Source: Bloomberg 24 Jul 2019



Corporate bond spread differentials between unrated and investment grade (BBB) issuers (trend line) to Australasian bank debt funding is telling, both for investor demand and bank costs.

Comparatively, issuers can fund five years at 65 to 105bps p.a. lower than the respective bank term (note excludes issuance costs). Post RBNZ changes, these spreads are likely to widen as bank debt becomes more expensive (i.e. 'storm clouds' in the chart above). A lot depends here on the final RBNZ decision.

The current New Zealand environment of lower wholesale market interest rates and recent narrowing of investment grade credit spreads, in our view, reinforces that businesses should be considering their long-term debt funding strategies. The all-up cost of debt funding is at its lowest point for 10 years. How does this compare to your cost of bank debt (or equity)?

Are you paying too much for your debt?

Not all businesses will have sufficient scale to transact in the debt capital markets (DCM) - a minimum level of \$50m would be targeted. However, with bankers evaluating ROE hurdle rates on every piece of lending, what every business should be asking is "what is my credit risk grade?"

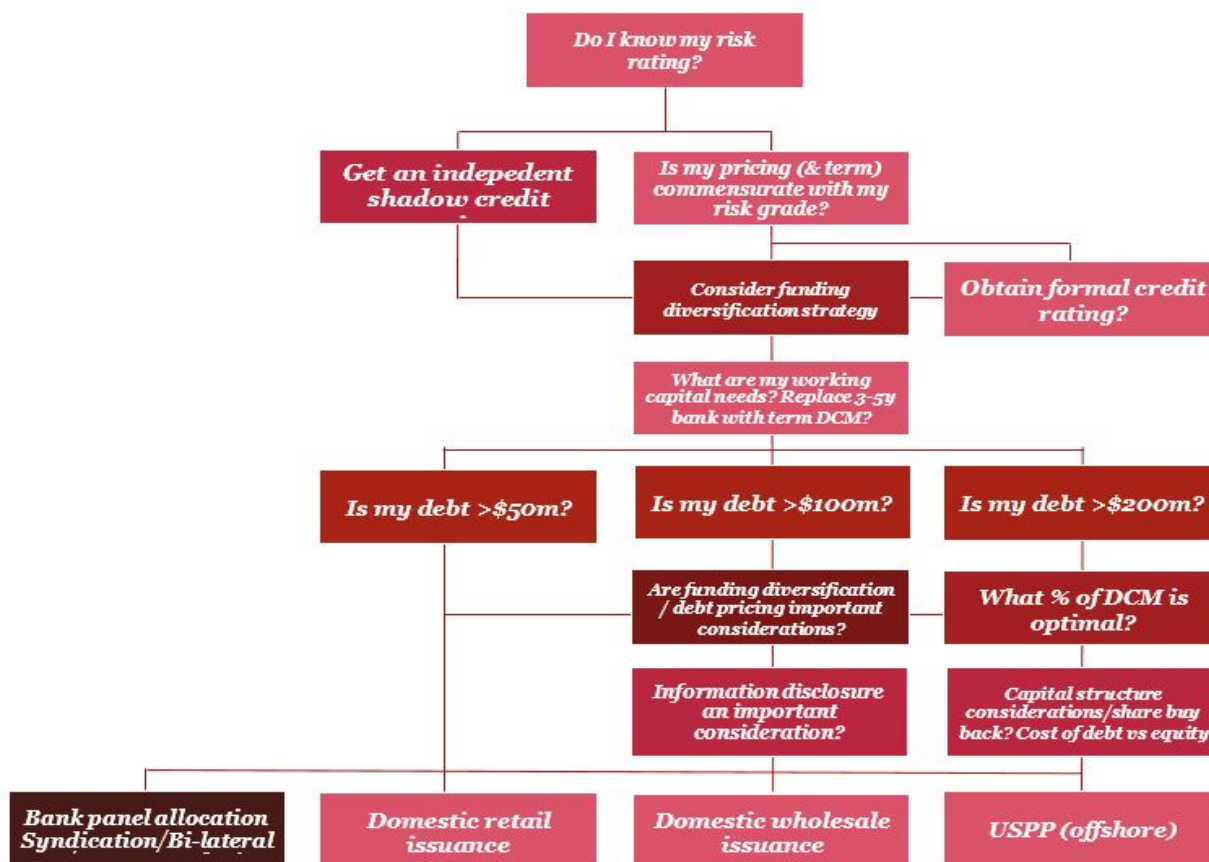
Understanding credit, business and solvency metrics provides meaningful insight into the creditworthiness of the business. That insight can drive capital structure decisions, particularly leverage and debt capacity. It also provides a focus on the relevant financial KPIs to attain an investment grade rating outcome. In our opinion, this is key in understanding a sustainable funding diversification strategy.

For businesses that are sole-banked, or for small borrowers, it can help shape constructive conversations in appropriate debt pricing and term given your risk. Being armed with credit rating information can lead to more meaningful bank negotiations.

For an unrated business, it can be useful to undertake a shadow credit rating assessment. Given the changing bank debt landscape, businesses should know their key funding metrics and know what levers it can / should pull in order to best position its debt pricing, or broaden its mix of funding sources.

What are my alternative funding options?

The following is not an exhaustive path of options, however, it highlights what borrowers should be considering in the current environment:



Authored by Jason Bligh, jason.p.bligh@pwc.com

The changing landscape of global central banks: trying to make sense of it all

Note: This discussion piece reflects the considerations of the author and not necessarily those of PwC NZ.

The last 30 to 40 years has seen an aggressive focus from global central banks on taming inflation, where setting short-term interest rates has been the primary (and now 'traditional') monetary policy tool. One could argue that they have been 'too successful' over the last 5 to 7 years, with low inflation despite reasonable economic growth globally and across most economies. Separately though, and more troubling, one could also argue that they have lost some of their influence - the core drivers of low inflation have been a function of globalisation, technological advances and competition, none of which are a function of interest rates or the price of money. They are disrupting the supply side of our economies, not the demand side, which is where monetary policy is most effective.

These dynamics have enabled the business cycle to run largely uninterrupted since the Global Financial Crisis - there has been little need for higher interest rates to squelch inflation and hence otherwise slow an overheating economy. Conversely, looser monetary policy has provided support to the business cycle at early signs of weakness (i.e. pro-cyclicality) and the monetary policy biases of central banks globally have generally been lower/looser in order to assist this.

One of the main problems though, is that at the same time, many developed economies are now suffering aging demographics, requiring significant long-term funding and return requirements as well as weakening the long-term demand outlook. A low market interest rate environment provides challenges

in achievement of these return objectives and does not really address the fundamental gap in demand (given older people consume less).

To complete a trifecta of key developments, an enormous disruption has presented itself over the last 12 or more months with the US President taking on China in trade, technology, security and a long list of potential escalations thereafter. The ongoing impact of uncertainty is weakening manufacturing sectors, reduced international trade and business investment continues to worsen as Trump sides with his extreme China “hawk”, Economic Advisor Peter Navarro, against the advice of his other inner counsel.

The combination of the above events is collectively influencing global central banks as they enter largely uncharted waters at a time of very limited ‘traditional’ monetary policy headroom to manoeuvre. Lack of firepower had always been a potential concern, with monetary policy settings globally never really having moved back to ‘normal’ post the Global Financial Crisis.

The additional context now is whether the entire monetary policy framework of adjusting short-term interest rates to influence inflation is still appropriate. The Reserve Bank of New Zealand (RBNZ) contends that “[monetary policy remains as effective as ever](#)”. However, a casual observation of the last 5 or so years would suggest probably not, as generating higher inflation has remained elusive despite record low interest rates. Similar to global peers, our RBNZ (and the Reserve Bank of Australia) is being challenged to design new ways of thinking, new tools and ways to effectively implement monetary policy to meet relevant and worthy objectives. For most observers, these developments are relatively uncomfortable - and may also represent a blurring of many factors typically not considered to be in the domain of central banks.

The first of these is the relationship between central banks and governments. Recent developments indicate and confirm the RBNZ and Treasury have been working closely to consider ‘unconventional’ monetary policy tools and their implementation. Conventional wisdom and practice has been the need for independence between the RBNZ and the Government (considered here to include the Treasury) to build credibility in its inflation targeting mechanism and allow for long-term stable inflation expectations (and also to remove perceptions of political interference [1]).

Confronted with the above complex (and largely unprecedented) set of events our own central bank is embarking towards a path of unconventional monetary policy - possibly not because it wants to - but probably because it has to. To reinforce the point - this is a global phenomenon and New Zealand is not leading the move; the US, Europe, Japan, UK, Sweden, Denmark, Switzerland have all embarked on quantitative easing and/or negative interest rates over the last 10 years. Domestically the groundwork is being set and communicated for over 12 months. Granted that until recently has this not appeared in a particularly forthcoming or transparent manner.

In terms of conventional monetary policy, it has not been helpful that the RBNZ has been interchangeable in their monetary policy outlook for the last 12 months - being too slow to recognise the global and domestic weakening late last year / early this year. The forced element of playing catch up in recent weeks has arguably created additional confusion and concern, possibly presenting a perception of things being worse than what they might actually be - in turn detracting from, rather than adding to, business confidence. Further, in undertaking its Regulatory Capital Requirements Review, the RBNZ has added uncertainty to businesses in some sectors as concerns rise about the cost and availability of credit. With these impacts added to government policy and regulatory uncertainty (whether real or perceived) New Zealand is approaching a global economic slowdown with its own reduced domestic momentum.

So where to from here?

Further cuts to the official cash rate (OCR) from the RBNZ seem inevitable even if these will not have a meaningful impact on lifting business/consumer confidence, economic growth and inflation outcomes. From what we observe, the decision of whether to invest (or not) by businesses is not really being determined by the cost of capital, but more so from the uncertain global backdrop. Further, we can

already see that many retail deposit and lending rates are not falling as far as the OCR and 90 day bank bill 'benchmark' rates (i.e. margins are widening).

We also cannot conclude and assume that the reductions in official interest rates - and with them some interbank deposit rates and wholesale benchmark rates - will stop at a zero floor / lower bound. They haven't elsewhere. It may be a valid question/criticism whether these cuts to and below zero elsewhere have had the desired impact on adequately stimulating economic growth and inflation in other countries - or have instead lead to other unintended consequences - however we also don't know for sure what the counterfactual would have been otherwise.

It is perceived the RBNZ would not reduce the OCR below approximately -0.35%. Again, while this may seem reasonable we cannot rely on this. Rates have gone lower elsewhere - and probably will go further lower again - in the likes of Europe, Sweden, Switzerland, Denmark, etc.

Additional New Zealand stimulus (if required) in the form of government fiscal expansion and infrastructure spending can occur at lower funding costs (subject to resource availability to implement these projects). Here the Government (via New Zealand Debt Management) sells NZ government bonds. The RBNZ could embark on quantitative easing, similar to what many other central banks have done, actively buying these government bonds; introducing more stimulus and liquidity into the financial system (while reducing the liquidity of available bonds). To the extent that the RBNZ may also need to buy some of the outstanding government bonds from non-resident holders, this would also drive a weaker currency [2].

This situation described - along with zero / negative short-term interest rates amidst aging demographics - sounds a lot like the experience of Japan for the last 10 or more years, and it probably is. The implication being many countries may be destined on this 'Japanisation' path for better or for worse. The main problem is that there is no easy way to combat the cumulative impact of demographic change within our current economic framework. Aging populations require considerable funding, and unfortunately this is likely to be an unavoidable determinant of future policy and practice.

The situation described of course creates the problem that long-term interest rates of returns are lower for the very investors who require them. These are the returns that are needed to fund the retirement commitments (think future Kiwisaver and other Superannuation fund withdrawals), and they are becoming more acute everywhere. Insurance companies and pension funds already need to hold long-term assets to offset their anticipated and contracted long-term financial liabilities and commitments. Result: creation of more downward pressure on already ultra-low long-term rates of return - even as these commitments get larger.

The resulting impact of these dynamics would be yield curves at zero/negative short-term interest rates and long-term interest rates perhaps somewhere around zero (although not necessarily negative) with this outcome being 'forced' for a number of the reasons described above.

Cue another problem, the banking sector needs an upward sloping yield curve to function properly and maintain profitability. The only thing worse than *overly profitable* banks is *unprofitable* banks. Japan (via its central bank yield curve control policy) has managed to engineer a workable upwards sloping yield curve through the tactical buying/selling of bonds to assist financial sector functionality. Contrast that with Germany and many other European nations where 10 to 30 year government bond yields are negative (-0.5% to -1.0%). One look at the performance of Europe's major banks confirms this.

Back to the New Zealand context, alongside all of these monetary policy, demographics, domestic and international economic developments we have the financial stability arm of the RBNZ making regulatory capital requirements more stringent for NZ registered banks. This is already seeing longer-term bank lending margins move higher on uncertainty and bank return on capital requirements. A slowing economy and softer company earnings could impact on credit risks/margins moving further higher, particularly those of a longer maturity term where uncertainty is greater. This may enable credit to act as an 'equaliser', providing higher/positive returns, along with a higher risk (even if these not necessarily fully appropriately priced).

“Marty, I’ve just got back from 2039...”

When you step back, we may be moving into a period where low/zero/negative interest rates are ‘offset’ by higher credit spreads, helping to generate the returns to fund long-term retirement commitments. We may also have to accept reduced future funded retirement benefits, along with higher premiums/costs, and potentially higher taxes. Central banks may also be moving down a path of more proactive stances on behalf of the governments and the people they serve to achieve these ends. Neither monetary nor fiscal policy can adequately do the job independently. Coordination is better than not being coordinated.

The reality is also that our own central bank already buys and sells overseas securities to help manage FX reserves and portfolios. The brief of a central bank may be becoming wider and less to do with solely fighting (or supporting) inflation. Engineering financial circumstances to support economic conditions consistent with the impact of longer-term demographics may be in the offing on a coordinated domestic basis. This framework requires a leap of faith to accept but there may not be an alternative. It also threatens to create a world of directly competing central banks (which President Trump would argue already exists), the likes of which small countries like ours are unlikely to win.

Excessively loose monetary policy, including negative rates and quantitative easing helps to generate growth through inflating asset prices and encouraging investment. However evidence suggests it tends to mainly do the former. The framework described could work in achieving a semblance of success for 15-20 years. However, it is also difficult to see how it could be a permanent solution by creating wealth out of thin air. This situation does not intuitively seem sustainable and at the end you typically end up with lots and lots of debt. There is no assurance of permanently generating sufficient return for long-term commitments, risk and demographics via an engineered yield curve and credit environment.

In summary, the intention of this article is to be open-minded and shine a light on to some of the fundamental and tectonic shifts happening in our economic architecture. In short, the financial world gets increasingly complicated as interest rates approach zero and one cannot simply see it as “just another floor” to move through. It can be argued that monetary policy, in its current form, is less fit for purpose. Rather, there are other developments going on where monetary policy (and the activity of our own RBNZ and other central banks) may be better used for other wider purposes (such as controlling the shape of the yield / credit curves), implemented in a different manner. This will require coordination and a leap of faith. However, that may be a better alternative than lessening relevance of the status quo. There are indications of our own Reserve Bank may already be moving in such a direction.

A completely fanciful outlook perhaps, but finding more plausible alternatives given present and recent past events and occurrences, is even more challenging...

Authored by Chris Hedley, chris.m.hedley@pwc.com

Note: we will be publishing a more targeted research series to our retained clients over coming weeks and months that looks at how the above factors are expected to impact risk management decisions in the years ahead.

[1] Closer links between the NZ Government and central bank might be interpreted as contravening this, however there is also an argument that central banks have already lost inflation credibility. The global context has been in need of an alternative monetary policy framework and target for some time. We may now be in the process of developing a different monetary policy approach and public financial architecture with it. Further, while potential political interference is currently an issue in the US, the same risks do not appear to hold for New Zealand. One could also consider that a central bank historically has been the bank of the government - and is there to serve the people – so it is not too fanciful to consider the Reserve Bank as an arm supporting the government’s objectives. At least that might be better than a central bank working against the interests of the government and the people.

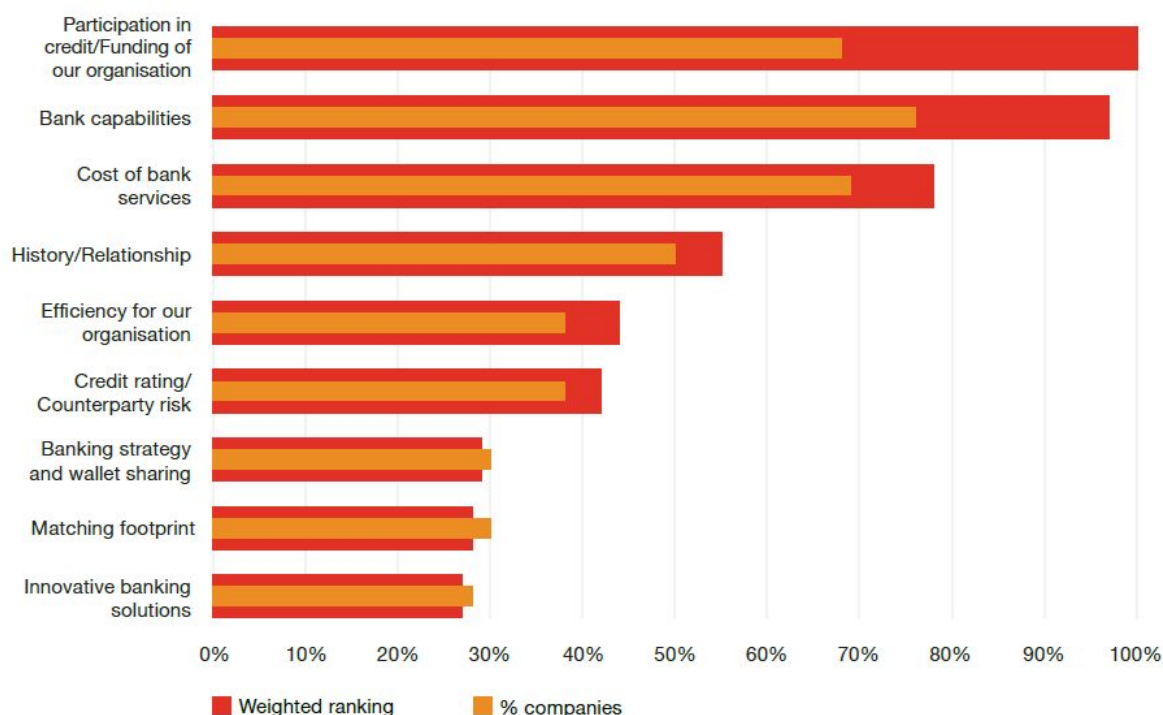
[2] However, over time most other countries may be moving down a similar path so the FX impact might not be permanent

The importance of long-standing banking relationships

The PwC [2019 Global Treasury Benchmarking Survey](#) revealed that companies rate a bank's ability to participate in long-term funding as the most important criteria when selecting banking partners. Furthermore, a high weighting is put on banks that have sufficient capabilities and provide services at a competitive cost. As highlighted above, this reinforces the benefits of having a diversified set of banking relationships to create competitiveness, expand exposure to different service offerings and reduce counterparty credit risk.

When selecting a banking partner, what are your most important criteria?

Number of respondents: 197



While creating competitiveness is an effective strategy to validate 'fair' bank pricing and fees, it can often overshadow the importance of establishing long-term banking relationships. **Only 30 percent of 197 survey respondents consider their banking strategy and wallet share when selecting a banking partner** (refer above). This creates a question of whether treasurers are adequately considering the importance of sustaining long-term banking relationships with the GFC now fading from memory.

As financial institutions concentrate efforts on bringing in a larger share of the customer's wallet, this can also prove valuable for the customer by gaining access to better rates ("relationship pricing"). Separately, having a long-term trusted relationship with your bank (that is familiar with your financial status and history) often pays off when you are planning for future projects and identify opportunities. Furthermore, for those that can remember, it often proves invaluable if/when an economic slowdown (or crisis) were to arise.

As pointed out in the Survey, **corporations with long-standing established bank relationships were served much better in the crisis than those without them.** It is therefore important to have some security that their business with their bank is strategic, and will be able to continue even as bank margin pressures emerge or economic uncertainty increases. As highlighted by the earlier article on bank

capital above, this provides an idea of what companies should be thinking about their banking arrangements as an organisation seeks to add funding diversification.

Another key topic that the Treasury Benchmarking Survey brings attention to is the importance of prioritising a systematic regular review of bank relationships. **A notable one-third of respondents only review their banking relationships on an ad-hoc basis or not at all.** A constructive review would include the estimated wallet shared compared to the financing support received and the investment made by the bank on new technology solutions.

While transacting with multiple banks is a good way to reduce counterparty exposure and gain competitive tension, the importance of trusted, long-standing banking relationships should not be overlooked or forgotten. Furthermore, even when these exist, it is still healthy to ensure that the relationship is reviewed on an ongoing basis to ensure greater transparency with your bank(s).

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