Box C: Trends in Intermediation

About 17 per cent of household and business borrowing is funded directly through capital markets, compared with 11 per cent a decade ago. In recent months, this process of disintermediation has been partly reversed as businesses have resorted to borrowing from banks with capital markets largely closed, and as the temporary absence of securitisation markets has seen a larger share of household borrowing being funded directly from the balance sheets of financial intermediaries.

### Table C1: Funding of Business and Household Debt

<table>
<thead>
<tr>
<th></th>
<th>Outstandings ($ billion)</th>
<th></th>
<th>Per cent of total outstandings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total debt</td>
<td>596</td>
<td>1 956</td>
<td>100</td>
</tr>
<tr>
<td>Borrowed by:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Businesses</td>
<td>318</td>
<td>867</td>
<td>53</td>
</tr>
<tr>
<td>– Households</td>
<td>278</td>
<td>1 089</td>
<td>47</td>
</tr>
<tr>
<td>Funded by:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Intermediaries</td>
<td>529</td>
<td>1 620</td>
<td>89</td>
</tr>
<tr>
<td>– Securitisation</td>
<td>19</td>
<td>196</td>
<td>3</td>
</tr>
<tr>
<td>– Corporate debt</td>
<td>49</td>
<td>141</td>
<td>8</td>
</tr>
</tbody>
</table>

Sources: ABS; APRA; RBA

The share of business borrowing that is funded directly through capital markets rose from about 15 per cent in 1998 to a peak of about 25 per cent in mid 2005 (Graph C1). This was mainly due to strong growth in bond and hybrid security issuance by large corporates; smaller businesses continued to rely on banks for funding as the fixed costs and minimum practical size for capital market funding are prohibitively high. Demand from corporates for debt funding, a switch by banks away from traditional lending to facilitating customers’ participation in capital markets, and strong
demand for debt securities from institutional investors all contributed to the shift towards non-
intermediated debt.

The onset of the capital market turbulence in mid 2007 saw corporate bond and hybrid
security issuance fall sharply, as investors were only willing to purchase highly rated debt. With
the fall in corporate debt issuance being largely offset by an increase in borrowing from banks,
the share of business borrowing that is non-intermediated has fallen by 5 percentage points to
16 per cent. The share of business borrowing that is securitised – largely small business loans
and equipment finance – has risen slowly over the past decade to a little over 2 per cent. This too
has contracted slightly over the past nine months.

The value of loans to households directly funded through capital markets has grown rapidly
over the past decade. The outstanding value of securitised housing loans – funded by both
residential mortgage-backed securities (RMBS) and asset-backed commercial paper (ABCP) –
has grown at an average annual rate of around 25 per cent since March 1998, rising from 8 per
cent of housing loans outstanding to peak at 24 per cent in mid 2007. While total housing credit
growth was strong through the late 1990s and early 2000s, the rapid growth of the share funded
by securitisation was driven by institutional investors’ demand for highly rated debt securities
which resulted in relatively cheap funding for mortgages through securitisation. With this
accessible source of funding, specialist mortgage originators and smaller banks gained market
share with highly competitive interest rates. The value of personal loans that are securitised has
also increased, but remains a small share of total personal loans outstanding.

Asset-backed securities have been at the forefront of the difficulties in credit markets. Since
July 2007, there has been virtually no issuance of RMBS and a reduced amount of ABCP has
been rolled over. Combined with the rapid repayment of securitised mortgages, at about 25 per
cent each year, the share of outstanding housing loans funded through securitisation has fallen
to around 18 per cent. New housing lending has been financed largely on the balance sheets of
financial intermediaries, particularly the five largest banks. This has occurred through increases
in their share of the housing finance market, and through loans to fund warehouse facilities used
by smaller lenders.

With most commentators expecting little securitisation this year, the share of lending funded
directly through capital markets is likely to fall further. But with the underlying drivers of
the shift towards capital market funding – intermediaries’ lending growing faster than their
deposits, strong demand for highly rated bonds from institutional investors, and a sophisticated
and successful securitisation industry – still in place, it is likely that securitisation will recover.
Issuance of debt securities by large corporates would also be expected to pick up in calmer
markets.