Bank Funding in 2024

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Abstract

Bank funding costs are important in the transmission of monetary policy as they are a key determinant of the rates that households and businesses pay on loans. Bank funding costs increased only modestly in 2024, largely because the cash rate remained unchanged. The composition of banks' funding shifted towards deposits over the same period, continuing a trend seen since the global financial crisis. Banks also managed the final maturities of the Term Funding Facility, issuing wholesale debt into favourable funding conditions. This article updates previous research published by the RBA on developments in the composition and costs of banks' funding.

Introduction

Banks fund their assets – such as loans – with a combination of debt, deposits and equity. Bank funding costs are important in the transmission of monetary policy because they are affected by the path of the cash rate and because they are a key determinant of the rates that banks charge households and businesses on loans (RBA 2017). This article examines trends in the composition and cost of banks' funding over 2024.[1]

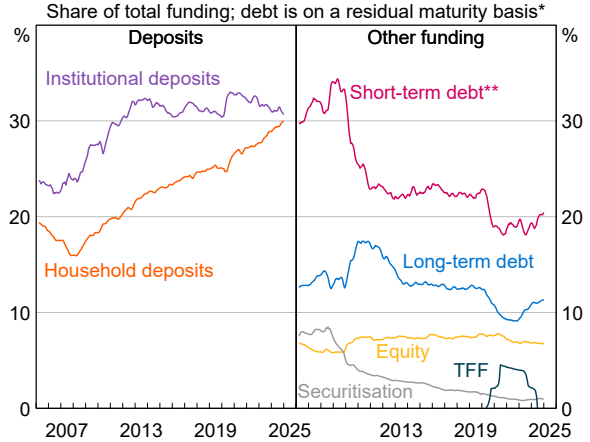
In Australia, banks' assets and liabilities tend to be related to short-term variable rates such as bank bill swap rates (BBSW) (Brassil, Cheshire and Muscatello 2018). These rates are, in turn, significantly influenced by the level of the cash rate and expectations of its future path. Funding costs increased by 20 basis points over 2024 as the cash rate target remained at 4.35 per cent and short-term market interest rates moved in a fairly tight range. Banks also managed the repayment of the final tranche of the Term Funding Facility (TFF) during this period, which contributed a little to the increase in funding costs.

Bank funding costs have risen by somewhat less than the cash rate since May 2022. This has contributed to lending rates also being lower relative to the level of the cash rate compared with recent history. The share of funding from wholesale debt remains well below levels observed prior to the global financial crisis (GFC), although banks have issued higher volumes of short and long-term debt since the COVID-19 pandemic (including to replace funding from the TFF) (Graph 1).

Graph 1

Bank Funding Composition

Share of total funding; debt is on a residual maturity basis*



* Three-month rolling average except for the TFF; debt is adjusted for movements in foreign exchange rates.
** Includes deposits and intragroup funding from non-residents.
Sources: ABS; APRA; Bloomberg; LSEG; RBA.

Funding composition

The composition of banks' funding has shifted more towards deposits since the GFC (RBA 2023). Much of this growth has been in household deposits. The share of funding from institutional deposits increased sharply following the GFC but has been relatively stable since 2012. Since the pandemic, banks have returned to issuing higher volumes of short- and long-term debt, including to replace funding from the TFF that had rolled off by mid-2024. However, the share of funding from short- and long-term debt remains well below levels observed prior to the GFC.

Deposits

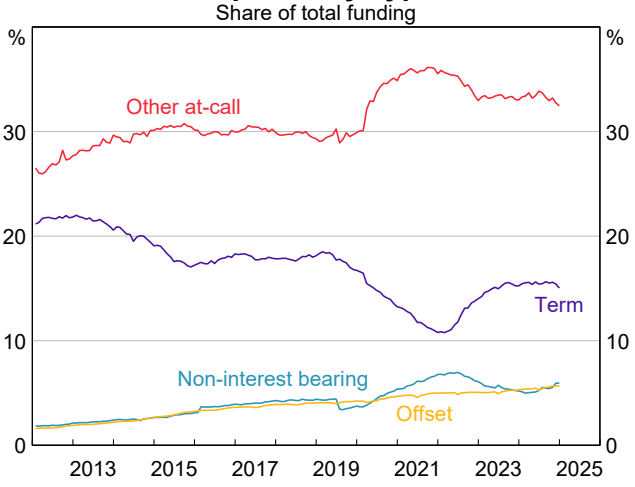
The total deposit share of bank funding increased by around ¾ percentage point over 2024, continuing the post-GFC trend increase in deposits as a share of funding. The shift towards deposits in the years following the GFC was driven by a significant repricing of the liquidity risk associated with wholesale debt funding and the structural decline in the securitisation market after the crisis (Debelle 2010; ACCC 2023). It was also further incentivised by prudential regulations that consider deposits to be a more stable source of funding.

Banks substantially increased the interest rates they offered following the GFC to attract more deposit funding (Edey 2010). Household deposits accounted for most of the increase in deposits, which have risen 14 percentage points as a share of total funding since the GFC. The share of institutional deposits has been more stable in recent years after rising by 10 percentage points in the years following the GFC. The lower growth relative to household deposits may be partly due to institutional depositors having a broader range of market-based cash investment alternatives that also earn interest.

The increase in the deposit share of funding was supported by deposit creation. Growth in credit, including over the pandemic period, expanded bank balance sheets (Kent 2018).[2] Deposits were also created during the pandemic period by government bond purchases by the RBA and the decline in the stock of banks' outstanding wholesale debt (RBA 2020; Carse, Faferko and Fitzpatrick 2023). Much of the deposit creation from this period was concentrated in at-call deposits (including non-interest-bearing accounts and offset accounts), which collectively made up almost half of total bank funding at their peak in early 2022 (Graph 2).

Conversely, the term deposit share of funding decreased during the pandemic as the cash rate fell and the spread between rates on new term deposits and at-call deposits narrowed. Term deposit volumes increased over the recent tightening phase alongside higher term deposit rates, reflecting increases in longer term interest rates and banks seeking more stable deposit funding ahead of their TFF maturities. Household deposits continued to grow strongly, supported by credit growth (RBA 2024a) and population growth.

Graph 2
Deposits by Type
Share of total funding

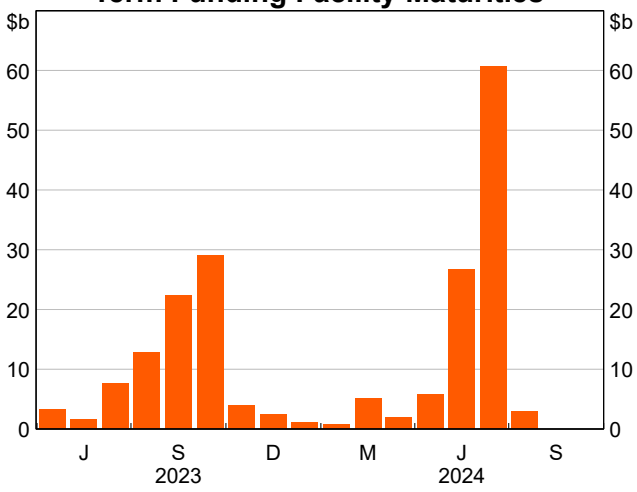


Sources: ABS; APRA; Bloomberg; LSEG; RBA.

The Term Funding Facility

The RBA introduced the TFF in March 2020 to provide low-cost three-year funding to banks as part of a broader package of other pandemic policy measures. This helped to reinforce the benefits of the lower cash rate and reduced the funding costs of banks, in turn helping to reduce interest rates for borrowers (RBA 2024b). Banks faced a sizeable task replacing TFF funding as it matured, with large repayments concentrated in late 2023 and mid-2024 (Graph 3). Banks responded by issuing wholesale debt and attracting more term deposits. Banks were able to take advantage of favourable conditions in wholesale markets over 2022 and 2023 and returned to issuing wholesale debt well ahead of scheduled TFF maturities, following subdued issuance over the pandemic period.

Graph 3
Term Funding Facility Maturities



Source: RBA.

Wholesale funding

Debt securities are an important funding source for banks, though they have comprised a smaller share of their liabilities since the GFC. Banks can use these instruments to diversify their funding mix, including through longer tenors and offshore markets, supporting their lending and liquidity management.

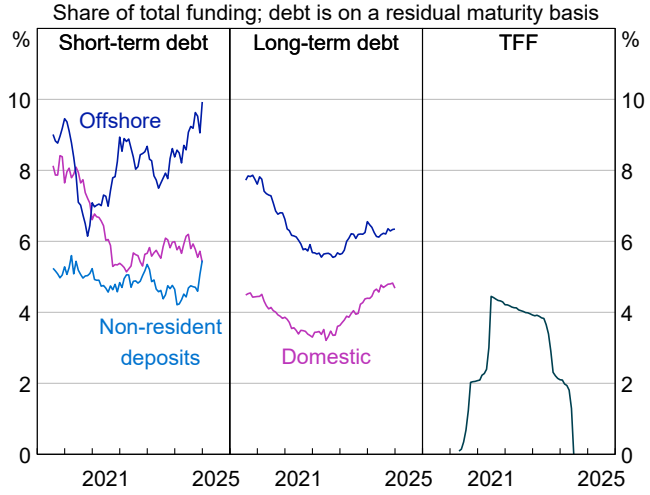
Banks reduced their use of short-term debt (those maturing within 12 months) in the wake of the GFC, and after the introduction of the Net Stable Funding Ratio (NSFR) in 2018, which encouraged more stable funding sources (Johnson 2022). There was a modest pick-up in banks' offshore short-term debt issuance over 2024, partly due to the final maturities of the TFF; banks used short-term debt to help manage their flow of funds around the times of the TFF maturities. In addition to issuing short-term debt instruments (such as certificates of deposit) domestically, large banks accessed deep, liquid overseas money markets to meet their needs through instruments such as US commercial paper.

Long-term debt issuance (those maturing in more than 12 months) by banks remained strong in 2024, following record issuance in 2023. Issuance was high in both nominal terms and relative to GDP, supported by strong investor demand and narrow credit spreads.
Banks seeking to replace TFF funding also added to issuance volumes. Around half of all bank bond issuance in 2024 was domestic, which is above the post-GFC average of around 40 per cent (Graph 4). The domestic market deepened over 2024 as stronger investor demand supported larger issuance volumes and at longer tenors.[3] The long-term debt share of bank funding has increased by around 2 percentage points since early 2022.

Graph 4

Wholesale Debt by Type

Share of total funding; debt is on a residual maturity basis



Sources: ABS; APRA; Bloomberg; LSEG; RBA.

In September 2024, the Australian Prudential Regulation Authority (APRA) proposed that Additional Tier 1 (AT1) capital be replaced with more reliable and effective forms of capital (APRA 2024). AT1 securities are a type of hybrid security that have some features of equity and debt; they comprised less than 1 per cent of total funding in December 2024.[4] APRA has proposed that AT1 capital be replaced with a mix of common equity and Tier 2 subordinated debt (with differing approaches for small and mid-sized banks compared with large banks). Subject to consultation on prudential standards in 2025, these changes would apply from 2027.
The effect on banks' overall funding costs is likely to be small.

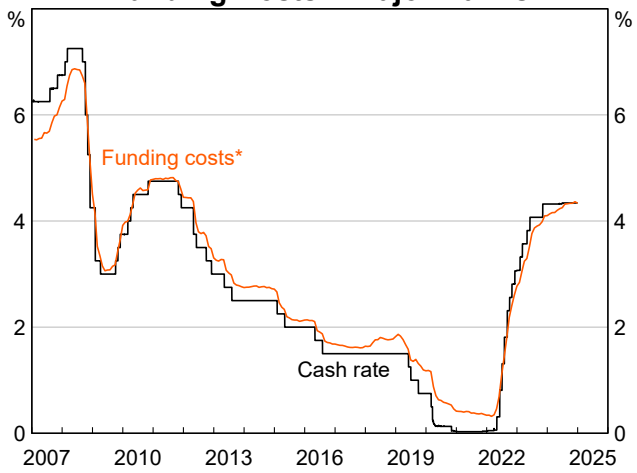
Funding costs

Major banks' funding costs increased only modestly over 2024, reflecting a small increase in the average rate paid on at-call deposits and fixed-rate term deposits and wholesale debt rolling over to higher rates (Graph 5). However, the effect of moving away from earlier low fixed-rate funding had largely passed through to bank funding costs prior to 2024 because much of this funding was hedged to short-term variable interest rates.

Overall, since May 2022, deposit rates have increased more slowly than the cash rate. Hence, funding costs were somewhat lower relative to the cash rate in 2024 than observed in the period since the GFC. This partly reflected the abundance of deposits (as discussed above), which are typically cheaper than wholesale debt.

Graph 5

Funding Costs – Major Banks



* RBA estimates of the overall outstanding hedged debt and deposit costs for the major banks.

Sources: ABS; AFMA; APRA; ASX; Bloomberg; LSEG; major bank liaison; major banks' websites; RBA; Securitisation System; Tullett Prebon; US Federal Reserve.

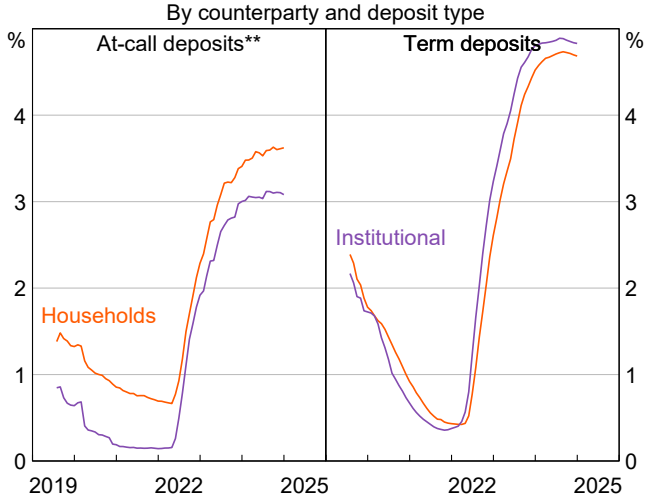
The cost of all non-equity funding sources increased a little over 2024:

- **At-call deposit** rates increased by around 15 basis points over 2024. Banks offer a variety of at-call deposit accounts: some accounts such as those used for regular transactions pay very little or no interest, while others may pay relatively high rates but place restrictions or conditions on depositors accessing their funds. Advertised rates on at-call accounts were little changed over the year, although some banks reduced the base interest rate on conditional savings accounts while keeping the (higher) bonus rate of interest unchanged. For households, the higher average rate paid could reflect households shifting into higher paying accounts, or more households receiving the bonus rate of interest. The share of balances meeting the conditions required to receive the bonus rate increased a little at some banks over the past 12 months – roughly four-fifths of funds held in conditional savings accounts received the bonus rate in 2024. Households receive higher rates overall on at-call accounts than institutional depositors, although this is primarily due to mortgage offset accounts receiving a high rate of implicit interest (Graph 6).[5] Excluding offset accounts, the average rate on household at-call deposits is a little under 3 per cent, which is around 20 basis points lower than for institutional depositors.
- Outstanding **term deposit** rates increased modestly over 2024, although by December were a little below their peak in mid-2024. The spread between new term deposit rates and BBSW rates declined over 2024, reducing the relative cost of new term deposits for banks, in line with commentary in banks' profit reporting that competition for deposits lessened somewhat over the year. Banks offer institutional depositors higher rates on their term deposits than household depositors on average, in part because institutional depositors have access to alternative market-based products to manage their short-term liquidity.

Graph 6

Outstanding Deposit Rates*

By counterparty and deposit type



* All banks with more than $4 billion in deposits.
** Includes deposits in loan offset accounts and non-interest bearing deposits.

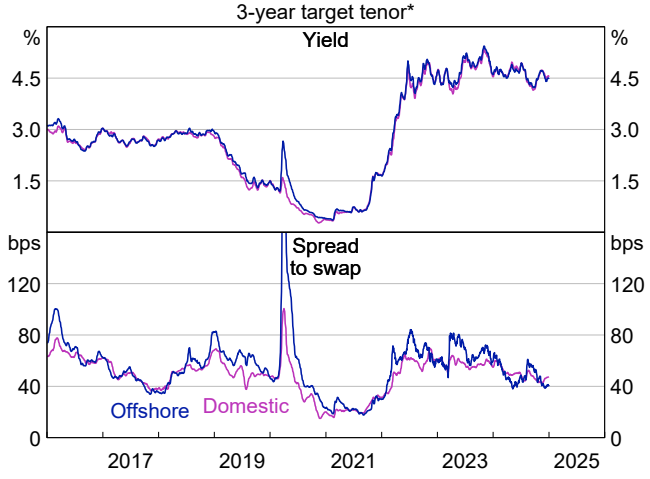
Sources: APRA; RBA.

- **Wholesale debt** continued to roll over to higher rates in 2024, although some of the effect would have already passed through to banks' funding costs via hedging.[6] Despite the absolute higher rates, the spread between bond yields and the three-year swap rate declined by around 10 basis points, implying debt became relatively more attractive to issue over 2024 (Graph 7). As discussed above, banks issued significant volumes of wholesale debt into favourable funding markets in 2024, particularly in Australia.

Graph 7

Major Bank Bond Pricing

3-year target tenor*



* Smoothed seven-day moving average; offshore spread to swap truncated in early 2020 when it peaked at 210 basis points.

Sources: Bloomberg; RBA.

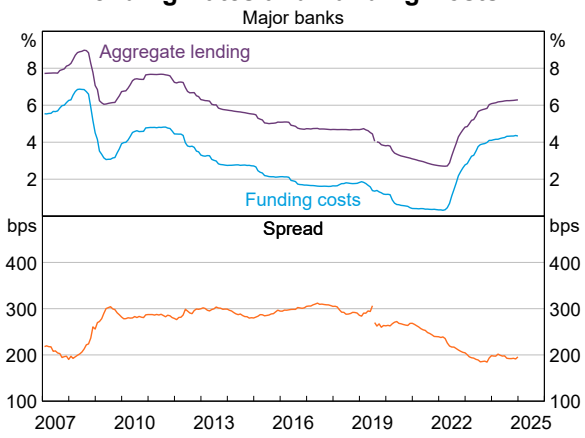
- The repayment of the final tranche of the **TFF** in 2024 also contributed to the increase in funding costs, as banks replaced the TFF with higher cost sources of funding such as wholesale debt. It is estimated that the replacement of all TFF funding contributed around 15 basis points to the rise in total funding costs over 2023 and 2024 (RBA 2024b). However, some banks had hedged at least a part of the TFF into floating rates, so they already faced higher costs when the cash rate increased.

The Council of Financial Regulators (CFR), in consultation with the Australian Competition and Consumer Commission (ACCC), is undertaking a review into the state of the small and medium banking sector, with a focus on competition.[7] The Issues Paper released in December 2024 noted that there has been little difference in the average level of outstanding funding costs of major banks and smaller banks in recent years (CFR and ACCC 2024). Historically, the major banks had lower funding costs than other banks, though this gap closed around 2017. However, funding costs vary significantly within the small and medium banking sector: some smaller banks have funding costs similar to larger banks, while others face funding costs 100–150 basis points higher. Smaller banks tend to face higher costs for issuing new wholesale debt, because investors demand higher returns to compensate for the additional risk as reflected in smaller banks' lower credit ratings. Smaller banks also typically spend a greater share of their income on operating expenses than the major banks, which partially accounts for the generally higher returns of larger banks.

Lending spreads and net interest margins

Banks' lending spreads – the difference between lending rates and funding costs – were little changed in 2024, after declining in recent years (Graph 8). Spreads compressed during the period of very low interest rates as banks could not reduce rates on all liabilities while rates on assets declined (Brassil 2022). The lending spread declined a little further over the tightening phase as competition in mortgage lending put downward pressure on mortgage rates (Ung 2024). Lending spreads stabilised at this lower level in 2024, in line with mortgage rates remaining little changed.

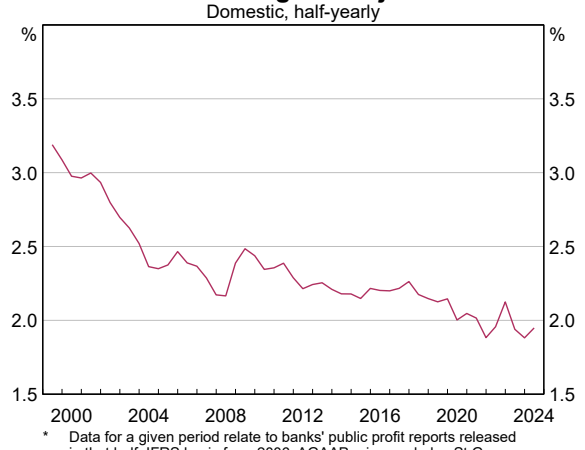
Graph 8
Lending Rates and Funding Costs*
Major banks



* Average outstanding lending rates; series break at July 2019, data thereafter is from the EFS collection; spread is the month-end difference in aggregate lending and funding costs.
Sources: ABS; AFMA; APRA; ASX; Bloomberg; CANSTAR; LSEG; major bank liaison; major banks' websites; RBA; Securitisation System; Tullett Prebon; US Federal Reserve.

Alongside the decline in lending spreads, banks' net interest margins (NIMs) – which measure the difference between interest income and interest expenses, divided by interest-earning assets – have also declined (Graph 9). Although major bank NIMs increased modestly in 2022, they have more recently declined to around their pre-pandemic level. Market commentary suggests that competition remains a headwind, although some banks have noted they are prioritising margin preservation over loan growth.[8] The long-term decline in the level of interest rates has likely had a small negative impact on NIMs. However, the effect in Australia has been less than in peer economies. This follows from the fact that interest rate risk on banks' assets is typically well matched to interest rate risk on liabilities for Australian banks, including because of their hedging (Windsor, Jokipii and Bussiere 2023).[9]

Graph 9
Net Interest Margin – Major Banks*
Domestic, half-yearly



* Data for a given period relate to banks' public profit reports released in that half; IFRS basis from 2006, AGAAP prior; excludes St George Bank and Bankwest prior to the first half of 2009.
Source: RBA.

Conclusion

In 2024, banks' funding mix continued to shift towards deposits, which is a lower cost source of funding on average than wholesale debt. Banks replaced funding from the TFF without difficulties and this process only added a little to banks' non-equity funding costs. Overall, banks' funding costs increased only modestly over 2024, with the cash rate target unchanged and market interest rates remaining within a tight range. Banks' lending spreads were also little changed in 2024 after declining in recent years.

Endnotes

* Duke Cole is from Domestic Markets Department and Venura De Zoysa and Christopher Schwartz completed this work while in Domestic Markets Department. The authors would like to thank Tekla Bastian and Peter Wallis for their assistance.

1 For a discussion of funding costs and composition as the cash rate increased over 2022 and 2023, see De Zoysa, Dunphy and Schwartz (2024).

2 Lending by banks creates deposits as the funds made available to the borrower are deposited in the banking system, either in the borrower's account or in another account when those funds are used by the borrower. The other transactions also tend to create deposits if the government bond or wholesale debt is ultimately sourced from a non-bank investor. For more information on the creation of deposits and money, see Kent (2018).

3 Following the GFC, banks mainly issued offshore because those markets offer a greater capacity to absorb large issuance and a deeper pool of investors looking for funding at longer tenors than is available domestically (Johnson 2022).

4 AT1 securities are categorised as either short- or long-term debt throughout this article.

5 The implicit interest earned on offset accounts is the mortgage rate linked to the product and does not attract income tax, unlike interest received on other deposit accounts. This makes offset accounts a highly attractive place to store savings for households with mortgages. Offset accounts have largely replaced overdraft facilities secured by residential property as the primary tool for mortgagors to manage their short-term liquidity needs (Jennison and Miller 2025).

6 For more information on Australian banks' hedging practices, see Box A in De Zoysa, Dunphy and Schwartz (2024).

7 Small and medium banks include all authorised deposit-taking institutions (ADIs) except the major banks and branches of foreign banks. The Issues Paper uses a different measure of funding costs to this article. The measure in this article is more timely and allows for more detailed disaggregation but is only available for the four major banks. The trends in the two series are broadly similar, although there is a levels difference.

8 While the lending spread is typically the primary driver of NIMs, they also include interest earned on non-loan assets such as securities. Banks' reported NIMs also capture the actual cost of hedging, while the lending spread measure in Graph 8 uses the RBA's model estimate of hedging costs.

9 Australian banks typically seek to align the repricing profile of their assets and liabilities. This means changes in gains or losses on one side of the balance sheet when interest rates change are mostly offset by opposite moves on the other side of their balance sheet. Larger banks would then typically hedge any residual interest rate risk using derivatives.

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