

# 3. Domestic Financial Conditions

Financial conditions for households and large businesses are more accommodative than a year ago, following three reductions in the cash rate in 2019. Government and corporate bond yields declined over 2019 across all maturities and remain around historic lows. Consistent with the low level of the cash rate, banks' funding costs are at historically low levels, as are housing and business interest rates. Financial market prices imply that market participants expect that the cash rate will be reduced by a further 25 basis points around the middle of 2020.

There has been a pick-up in owner-occupier housing loan commitments since May 2019, alongside the stronger conditions in some housing markets. Growth in housing credit extended to owner-occupiers has also increased over this period, although, at the same time, the stock of credit extended to investors declined. To date, only a small share of borrowers have actively reduced their scheduled loan payments following the mortgage rate reductions in 2019 and total loan payments have increased. Growth in business debt has slowed, despite accommodative financial conditions for large businesses. Small businesses' access to funding remains difficult. Australian equity prices increased over the past year, and reached a historically high level in January, but have declined more recently as concerns about the economic effect of the coronavirus have increased. The value of the Australian dollar has depreciated of late and is around its lowest level in some years.

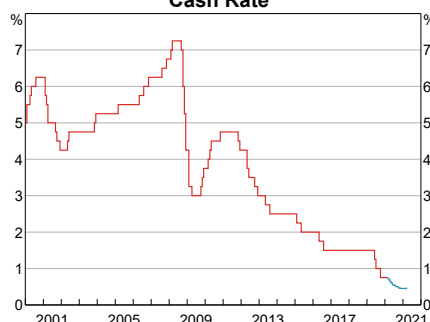
## Investors expect a cash rate reduction around the middle of the year

The Reserve Bank Board reduced the cash rate target by 75 basis points in 2019, to 0.75 per cent. Financial market prices imply that participants expect that the cash rate will be lowered by another 25 basis points around the middle of 2020 (Graph 3.1).

## Government bond yields remain low

After declining for much of 2019 to reach historic lows, yields on Australian Government Securities (AGS) fluctuated near this low level in recent months (Graph 3.2). This was in line with developments in yields on government bonds in other advanced economies, which reflected evolving perceptions about downside risks to the global economy. The spread between US Treasury and AGS yields has been little changed over the past year, after declining substantially over preceding years, and remains close to its multi-decade low; the AGS 10-year yield is

**Graph 3.1**  
**Cash Rate\***



\* Data from March onwards are expectations derived from interbank cash rate futures  
Sources: ASX; Bloomberg

currently around 60 basis points below the 10-year US Treasury yield.

### Short-term money market spreads have been little changed overall

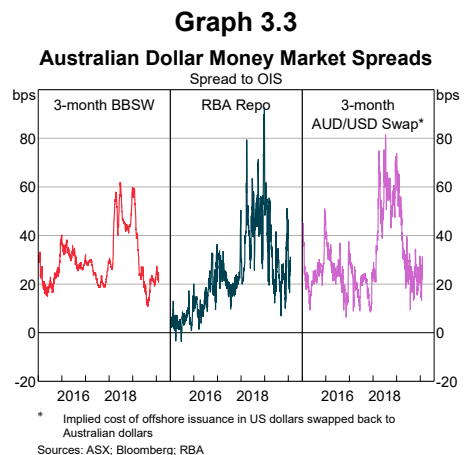
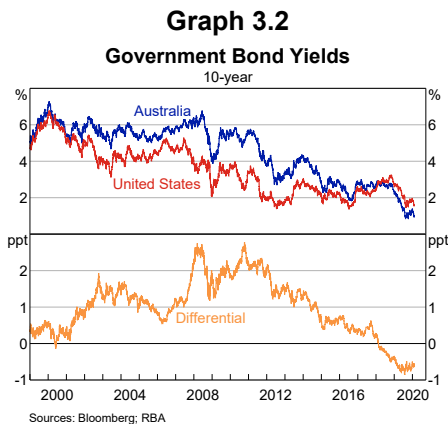
Short-term money market spreads have been little changed overall in recent months (Graph 3.3). In December, the spread between interest rates in the markets for repurchase agreements (repo) and overnight indexed swaps (OIS) increased temporarily to around 50 basis points, as demand for repo funding over the turn of the year increased. Spreads have since narrowed, to be around 25 basis points above OIS. In contrast, there was little evidence of year-end funding pressures in other short-term funding markets, with spreads of interest rates to OIS in the markets for bank bills and foreign exchange (FX) swaps little changed over that period. The supply of short-term liquidity into US money markets by the US Federal Reserve has contributed to stability in the FX swap market. The cash rate continued to trade at the Reserve Bank Board’s target.

### Banks’ demand for new wholesale funding was low in the past year

Australian banks’ demand for new wholesale funding was lower in 2019 than in recent years, largely reflecting lower growth of their balance

sheets and the associated reduced need for additional funding. The composition of their new wholesale funding was also different to prior years. The banks issued around \$83 billion worth of bonds in the year, which was the lowest level of issuance since 2011 (Graph 3.4). By contrast, banks’ issuance of Tier 2 hybrid securities picked up significantly in the second half of 2019. This followed an announcement by the Australian Prudential Regulation Authority (APRA) in July 2019 that major banks would be required to increase their total capital by the beginning of 2024. Hybrid securities have both equity and debt features and can be used to fulfil a part of banks’ regulatory capital requirements. The total value of bonds and hybrids issued in 2019 was more than offset by the value of securities that matured or were called, such that net issuance was negative in the year.

The December quarter saw the strongest issuance of asset-backed securities (ABS) since 2007 (Graph 3.5). The strength of issuance in the quarter was driven by non-authorized deposit-taking institutions (non-ADIs) and was broadly based across residential mortgage-backed securities (RMBS) and other ABS. Prices for new deals, expressed as a spread to bank bill swap (BBSW) rates, were relatively stable over the year.



## Banks' funding costs have declined to historic lows

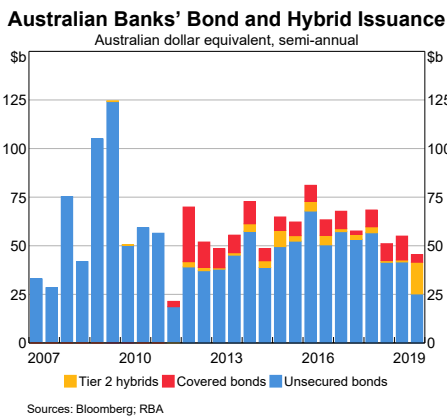
Banks' (non-equity) funding costs have declined to historically low levels (Graph 3.6). This largely reflects the effect of reductions in the cash rate on wholesale debt costs and (retail and wholesale) deposit rates. Much of the major banks' wholesale debt and deposit costs are ultimately linked (either directly or via hedging) to BBSW rates, which declined by more than the cash rate over 2019. Bank bond yields declined over the year, owing to a decline in both reference rates and spreads (Graph 3.7). In the past year, the cost to Australian banks of raising

long-term debt (in US dollars or Australian dollars) has been similar to that paid by comparable foreign banks raising finance in the same currency.

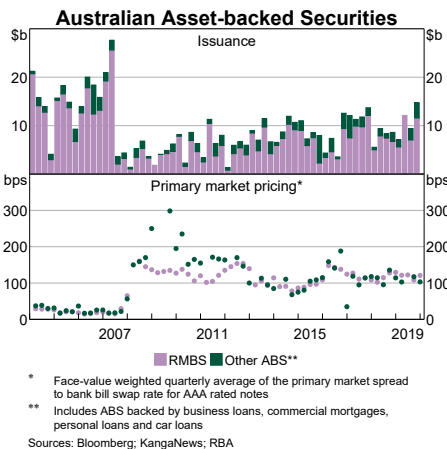
## Retail deposit rates are at historic lows

Banks have passed through most of the reductions in the cash rate to retail deposit rates. Banks are estimated to have lowered the interest rates on at-call retail deposits by an average of 60 to 70 basis points since May last year. The major banks are estimated to have reduced their term deposit rates by around 100 basis points in 2019. However, as is typical, the interest rates on many transaction accounts (which are usually close to zero) did not change following the reductions in the cash rate.

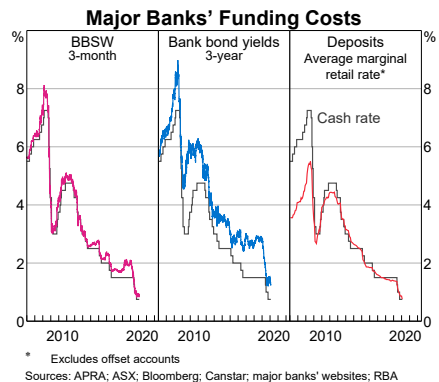
**Graph 3.4**



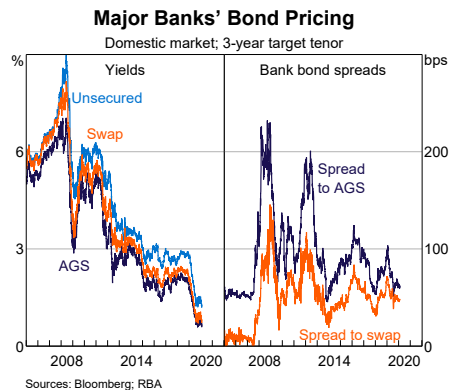
**Graph 3.5**



**Graph 3.6**



**Graph 3.7**



Following the reductions in the cash rate last year, the major banks are estimated to be paying low interest rates (between zero and 25 basis points) on a little over one-quarter of their deposit funding, compared with around 10 per cent before the reductions in the cash rate (Graph 3.8). However, a little over half of all deposits (by value) currently receive interest over 1 per cent.

### Housing lending rates are also at historic lows

A large share of the 75 basis point reduction in the cash rate in 2019 has been passed through to mortgage rates paid by households. By December, interest rates on outstanding variable-rate housing loans had declined by almost 70 basis points (Graph 3.9; Graph 3.10; Table 3.1).

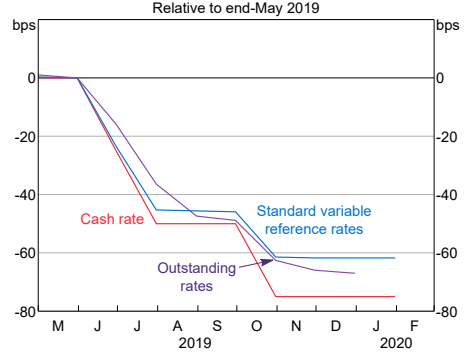
Lenders lowered their standard variable rates (SVRs) by an average of 60 basis points following the reductions in the cash rate, which automatically flowed through to all variable-rate loans. The average rate paid on outstanding loans declined by more than this, reflecting strong competition for high-quality borrowers and households switching away from interest-only loans (which generally have higher interest rates). If this downward drift continues, by around mid 2020 the average rate paid on

outstanding variable-rate mortgages will have declined by 75 basis points since May last year (other things equal).

The fact that average mortgage rates paid have declined by more than SVRs reflects two trends. First, interest rates on new loans (to new borrowers or to existing borrowers that refinance their loan with another lender) tend to be lower than those on existing loans, amid strong competition for high-quality borrowers. Also, in this environment some households with existing loans have been able to renegotiate a lower rate with their current lender. On average, rates on existing loans remain substantially

**Graph 3.9**

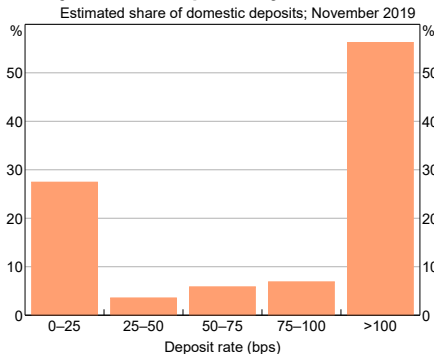
#### Major Banks' Variable Housing Rates



Sources: APRA; major banks' websites; RBA; Securitisation System

**Graph 3.8**

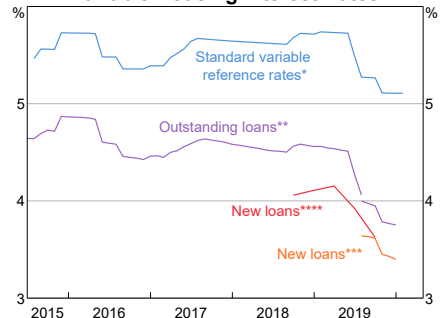
#### Major Banks' Deposits by Interest Rate



Source: RBA estimates based on major bank liaison

**Graph 3.10**

#### Variable Housing Interest Rates



\* Data to January; average across major banks' rates  
 \*\* To July 2019, average of securitised loans. Data from July to December 2019 based on the EFS collection  
 \*\*\* Data to December; based on the EFS collection  
 \*\*\*\* Data to September quarter; quarter-average APRA data  
 Sources: APRA; major banks' websites; RBA; Securitisation System

**Table 3.1: Average Outstanding Housing Rates**

December 2019

	Interest rate Per cent	Change since May 2019 Basis points	Change since December 2018 Basis points
Variable principal-and-interest loans			
– Owner-occupier	3.60	–64	–67
– Investor	4.02	–65	–69
Variable interest-only loans			
– Owner-occupier	4.12	–64	–67
– Investor	4.30	–78	–82
All variable loans	3.83	–68	–73
Fixed rate <sup>(a)</sup>			
– Owner-occupier	3.80	–	–
– Investor	4.06	–	–

(a) Data from the Economic and Financial Statistics collection, available from July 2019.

Sources: APRA; RBA; Securitisation System

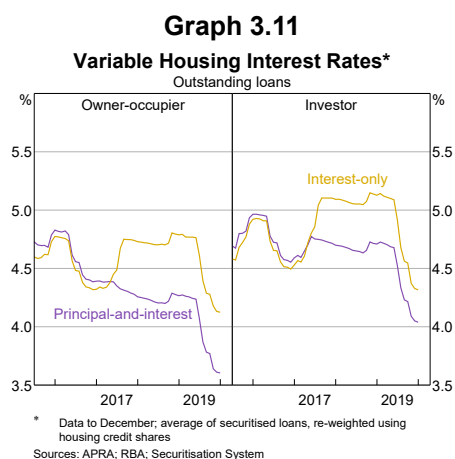
higher than rates on new loans (see ‘Box C: Do Borrowers with Older Mortgages Pay Higher Interest Rates?’). The Reserve Bank has started publishing more comprehensive data on mortgage interest rates that has become available with the new Economic and Financial Statistics (EFS) collection (see ‘Box D: Enhancing the Transparency of Interest Rates’).

The second reason for the drift lower in outstanding variable rates is that households are continuing to switch from interest-only loans to principal-and-interest loans (which tend to have lower interest rates) (Graph 3.11). This switching is estimated to have decreased major banks’ outstanding interest rates by nearly 5 basis points over the past year.

Rates for fixed-rate housing loans have also continued to decline. Over the past year, the major banks have reduced their advertised rates for new 3-year fixed-rate loans by around 100 basis points. This decline is consistent with a similar decline in swap rates, often used as a benchmark for pricing fixed-rate loans.

### Households’ total mortgage payments picked up in the second half of 2019

The decreases in interest rates following the reductions in the cash rate mean that minimum required mortgage payments for households with variable-rate mortgages – which account for around 80 per cent of the stock of outstanding housing credit – have declined. When mortgage rates decline, households pay less in interest. They also have the option of



reducing their scheduled repayments, given that the minimum required repayments have declined. However, if they choose to maintain their payments at the same rate, they will repay their loan principal at a faster rate than previously.

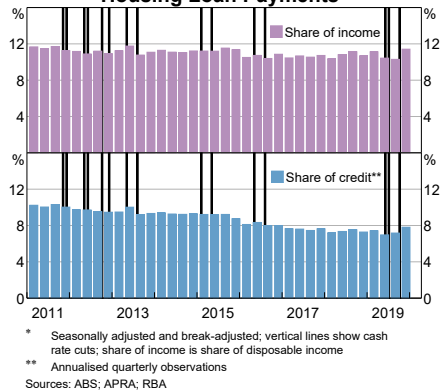
Over time, households have tended to reduce their payments in response to lower interest rates, albeit with some lags. Over the past decade, total loan payments have declined as a share of credit alongside declines in interest rates (Graph 3.12). Total loan payments include both the component that covers the interest and ‘principal and excess’ payments. ‘Principal’ refers to the amount that the borrower is contractually required to pay regularly in order to pay down the loan principal. The additional or ‘excess’ payments beyond that are typically sizeable and can be paid into an offset account or the loan account itself. Offset accounts (from which funds can be withdrawn at any time) and the ability to redraw excess payments from loan accounts have become more common than in the past. This has enabled households to adjust their spending patterns even if they choose to maintain their scheduled payments. Measuring principal and excess payments against credit outstanding provides an indication of the rate at which loans are being repaid. Measuring total loan payments against household disposable income (before interest payments) puts them in the context of household cash flows.

Total housing loan payments – interest, plus principal and excess payments – rose in the second half of 2019 (Graph 3.12). That occurred despite the decline in interest payments following the reductions in the cash rate last year, and reflected a rise in principal and excess payments (Graph 3.13). While the measure of total loan payments is volatile from quarter to quarter, the rise in the second half of 2019 meant that principal and excess payments were higher than they had been for a few years. This may partly reflect the recent tax refunds for

low and middle income earners. It is also consistent with data from lenders and information from liaison, which continue to suggest that only a small share of borrowers have actively adjusted their scheduled mortgage payments since mid 2019. Historically, adjustments to scheduled payments can take some time, and they may still come to pass. It should also be noted that with the transition to the EFS collection, there may be higher-than-usual uncertainty attached to the data on loan payments around the time of the move away from the previous collection of data.

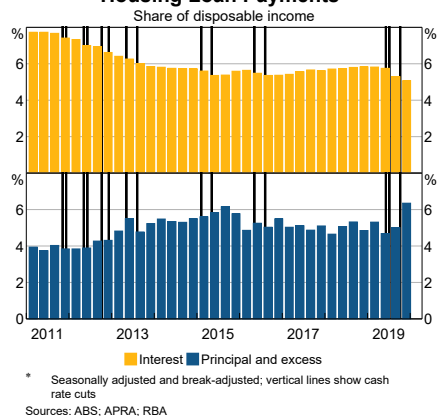
**Graph 3.12**

**Housing Loan Payments\***



**Graph 3.13**

**Housing Loan Payments\***



## Housing loan commitments have increased

Consistent with stronger conditions in some housing markets, housing loan commitments have increased strongly since May 2019 (Graph 3.14). These data are now being collected through the new EFS collection, which measures loan commitments (a commitment by the bank to extend finance that is accepted by the borrower). This replaces the previous concept of loan approvals, which captured the commitment by a bank to extend finance, whether or not the applicant had accepted the loan. While the new commitment measure is slightly lower than the old approval measure – largely because it covers slightly fewer reporting institutions – it does not alter the characterisation of recent trends in housing finance.<sup>[1]</sup>

The increase in housing loan commitments since May has been driven by a sharp rise in owner-occupier loan commitments. Investor loan commitments have increased a little over the same period. The increase in overall loan commitments has been broadly based across states and lenders.

The First Home Loan Deposit Scheme, launched by the Australian Government in January 2020, provides a guarantee to participating lenders for

eligible first home buyers that have a deposit between 5 per cent and 20 per cent of the value of a property. This will allow eligible first home buyers to purchase a home without needing to pay for lenders mortgage insurance. The scheme has income and price caps, and will support up to 10,000 loans a year. Around 5,000 first-home buyer loans have been reserved for this program to date.

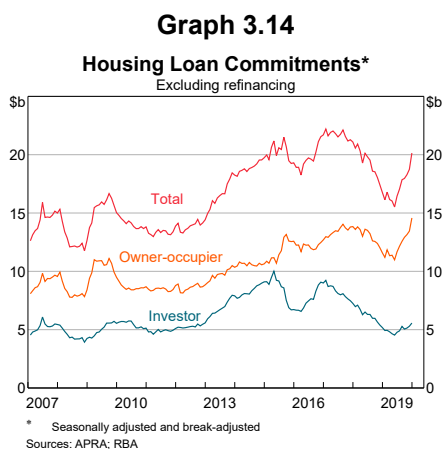
## Credit growth is slow, but owner-occupier housing credit growth has picked up

Total credit growth slowed to around 2½ per cent on a six-month-ended annualised basis at the end of 2019, from 4 per cent at the start of 2019. This was driven by slower growth in business credit and a decline in investor housing credit (Graph 3.15; Graph 3.16; Table 3.2). However, owner-occupier housing credit growth has increased in recent months. Growth in housing credit extended to owner-occupiers was around 5½ per cent on a six-month-ended annualised basis in December, up from around 4½ per cent in mid 2019. The stock of investor housing credit has declined modestly since early 2019 although it was unchanged in December.

Non-major ADIs have been the largest contributor to housing credit growth in recent months, while the contribution from major banks has picked up slightly from very low levels (Graph 3.17). Housing credit extended by non-ADIs is growing relatively quickly, albeit at a slower pace than in 2018.

## Business debt growth has slowed, despite accommodative funding conditions

Despite accommodative funding conditions for large businesses, growth in business debt slowed in 2019 (Graph 3.18). This owed largely to slower growth in intermediated lending to businesses (which includes business credit and



**Table 3.2: Financial Aggregates**

Percentage change<sup>(a)</sup>

	Three-month-ended annualised		Six-month-ended annualised	
	Sep 2019	Dec 2019	Jun 2019	Dec 2019
Total credit	2.7	2.3	2.3	2.5
– Housing	3.1	3.4	2.9	3.2
– Owner-occupier housing	5.5	5.7	4.3	5.6
– Investor housing	–0.9	–0.2	–0.1	–0.6
– Personal	–5.6	–6.1	–4.3	–5.8
– Business	3.6	1.6	2.4	2.6
Broad Money	3.3	3.6	5.1	3.5

(a) Seasonally-adjusted and break-adjusted

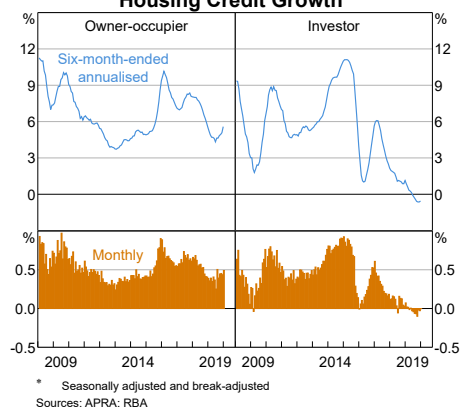
Sources: ABS; APRA; RBA

syndicated lending). The growth of credit extended by foreign ADIs remains higher than the major banks and other Australian ADIs.

The slowing in the growth of intermediated lending to businesses is consistent with the decline in business loan commitments (including refinancing) over the past six months (Graph 3.19). This decline reflected lower loan commitments from major banks and foreign banks. Under the new EFS collection, these data are now measured on the basis that the bank is committed to extending the loan, and the business has accepted the bank’s offer of finance. The previous measure of loan approvals

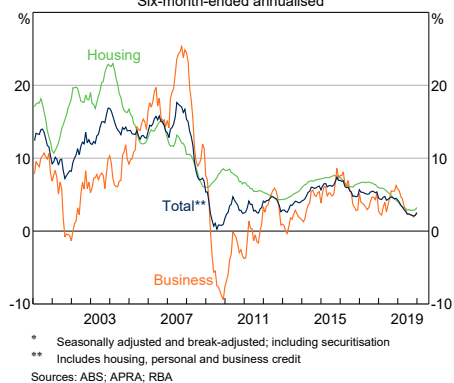
**Graph 3.16**

**Housing Credit Growth\***



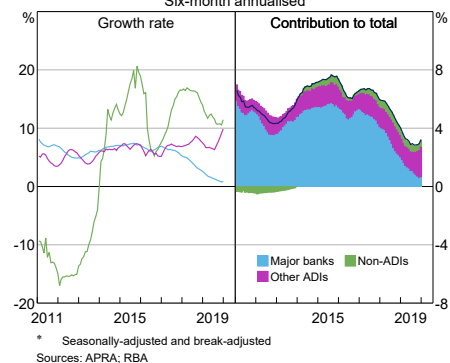
**Graph 3.15**

**Credit Growth by Sector\***  
Six-month-ended annualised



**Graph 3.17**

**Housing Credit Growth\***  
Six-month annualised





was based on just the commitment by the bank to extend the loan and, in some cases, businesses may not have taken up that option. Another change is that these data measure gross commitments, which include refinancing.

### Small businesses' access to funding remains difficult

The level of loans extended to small and medium businesses has been little changed over the past year or so (Graph 3.20). The EFS collection provides information on credit outstanding by business size, and identifies a higher level of banks' business lending as the measure of credit outstanding is more comprehensive.<sup>[2]</sup>

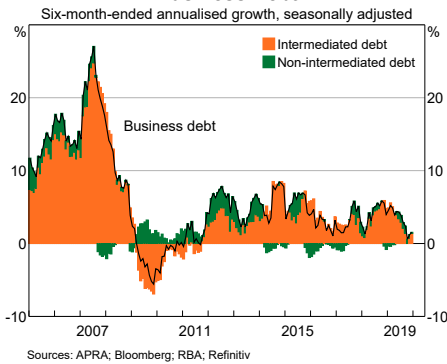
The EFS data show that credit outstanding to small and medium businesses has been little changed over the past few months. This is in contrast to lending to large businesses, which increased over that time.

Small businesses have reported in surveys that their access to finance has become more difficult over the past couple of years (Graph 3.21). This is consistent with banks reporting that, while their appetite to lend has not changed, they have chosen to apply to small business loans the additional verification of income and expenses which they are required to apply when assessing housing loan applications. This is because the personal and business finances of small business owners are often interlinked and so banks often apply consumer lending standards to such loans. However, the Australian Securities and Investments Commission's updated guidance on responsible lending obligations – released in December 2019 – reiterated that these obligations for verification should not apply to lending for business purposes.

The government has agreed to terms with six commercial banks to launch a \$540 million Business Growth Fund. The intention is for the fund to invest between \$5 million and \$15 million in eligible small-to-medium-sized

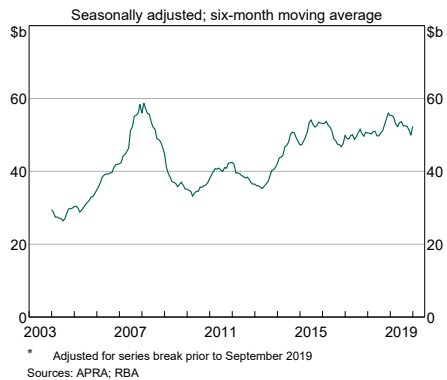
**Graph 3.18**

**Business Debt**



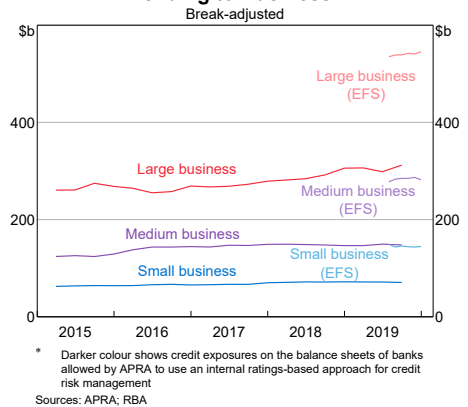
**Graph 3.19**

**Business Loan Commitments\***



**Graph 3.20**

**Lending to Business\***



businesses. These investments would be in the form of long-term equity, whereby the fund would take a stake of between 10 and 40 per cent.

### Interest rates on business loans have declined to record low levels

The new EFS collection provides more frequent and more disaggregated data on the lending rates paid by businesses; data is monthly instead of quarterly and broken down into small, medium and large businesses, instead of large and small business loans (see 'Box D: Improving the Transparency of Interest Rates').

Interest rates on loans to large businesses – which tend to move with BBSW rates – are estimated to have declined over recent months, and are at very low levels (Graph 3.22). Lending rates for medium-sized businesses have also declined in recent months. (Both of these series are new, so earlier data – which combined the interest rates on loans for many of these businesses into the 'large business loan' category – are not comparable.<sup>[3]</sup>) The EFS data suggest that lending rates on outstanding loans to small businesses decreased by around 10 basis points following the 25 basis point reduction in the cash rate in October, after

declining broadly in line with the cash rate in June and July.

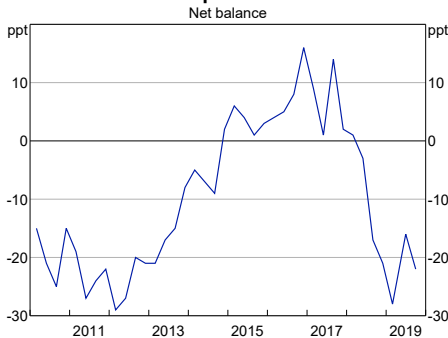
### Australian equity prices increased over the past year

The ASX 200 increased by around 25 per cent since the start of 2019, and has performed broadly in line with overseas markets when dividend payments are taken into account (Graph 3.23). The ASX 200 reached a new high in January before declining by around 2 per cent following increased concerns about the economic impact of the coronavirus outbreak.

Share prices are higher than they were at the start of 2019 in each of the major sectors of the ASX 200 (Graph 3.24). The 'other' sectors

**Graph 3.21**

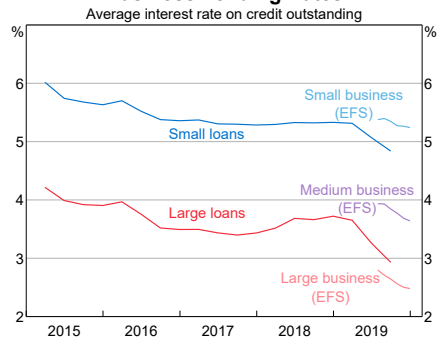
### Small Business' Perception of Access to Finance\*



\* Net balance is the difference between the percentage of firms indicating access is relatively easy and the percentage of firms indicating access is relatively difficult; from July 2019, survey asks about change in access relative to a previous period  
Sources: RBA; Sensis

**Graph 3.22**

### Business Lending Rates



Sources: APRA; RBA

**Graph 3.23**

### Total Return Indices



Source: Refinitiv

performed particularly strongly, led by healthcare and information technology companies. Share prices of resource companies have increased by around 20 per cent, supported by higher iron ore and oil prices. By contrast, banks' share prices underperformed the broader market. Concerns about the adverse effect of the coronavirus outbreak on arrivals from China and on Chinese demand for commodities has led to a recent sharp decline in equity prices of firms in the travel, tourism, education and resource sectors.

Price-to-earnings ratios increased over 2019, consistent with the decline in interest rates, which increases the discounted value of future earnings (Graph 3.25). Estimates of the equity risk premium (such as the difference between the forward earnings yield and the real 10-year government bond yield) suggest that it is broadly in line with its average of the past few years.

### The Australian dollar is around its lowest level in some time

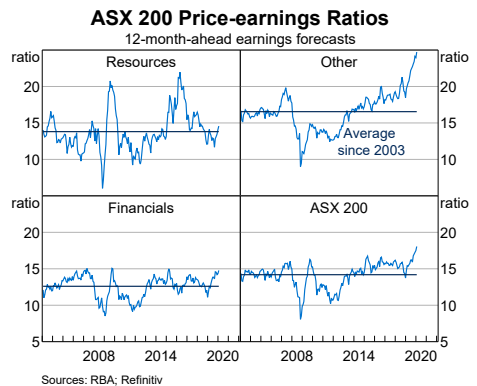
The Australian dollar is around its lowest level since 2009, having depreciated by around 6 per cent since late 2018 on a trade-weighted (TWI) basis (Graph 3.26). The depreciation over the past year or so is consistent with the noticeable decline in Australia's interest rate

differentials, as government bond yields in Australia declined by more than those in major advanced economies, while commodity prices were a little lower overall. More recently, the Australian dollar depreciated alongside falls in commodity prices as concerns increased about the effect of the coronavirus on the Chinese economy.

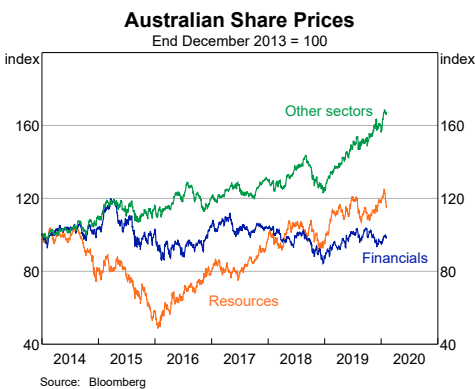
### Australia was a net lender of capital for a second consecutive quarter

Gross capital outflows exceeded capital inflows in the September quarter, resulting in Australia being a net lender of capital for a second consecutive quarter (Graph 3.27). This is consistent with Australia recording a current

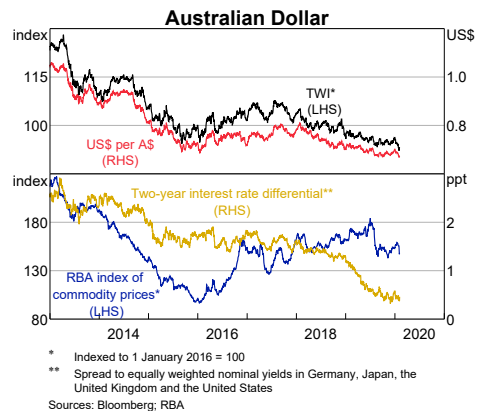
**Graph 3.25**



**Graph 3.24**



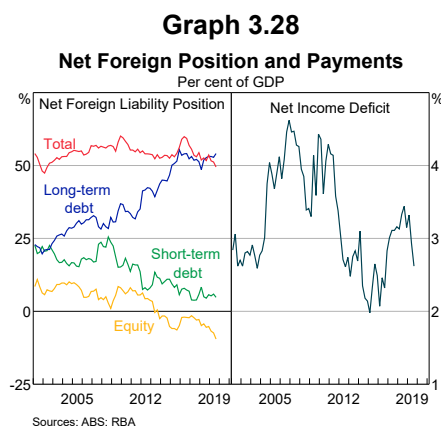
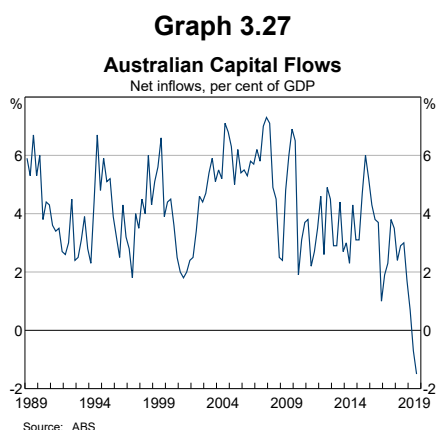
**Graph 3.26**



account surplus in the quarter (see ‘Domestic Economic Conditions’ chapter). There were net outflows from banks and other financial institutions, such as superannuation funds, which were partly offset by net inflows to the government, as occurs when foreign residents buy Australian government bonds.

Australia’s net foreign liability position has continued to gradually decline as a share of GDP and is around its lowest level since 2002 (Graph 3.28).<sup>[4]</sup> The decline has occurred

alongside an increase in Australia’s net foreign equity asset position, which has offset increases in net debt liabilities. The net income deficit, which is comprised of payments and receipts made on the net foreign liability position, has narrowed over the past few quarters. Payments on the stock of debt have declined because of lower interest rates, and equity receipts have remained high alongside the growing stock of equity assets held abroad. ✨



## Endnotes

- [1] For more details, see the ABS Information Paper 5601.0.55.002: ‘Upcoming changes to Lending to Households and Businesses, Australia, 2019’. Available at <<https://www.abs.gov.au/ausstats/abs@nsf/mf/5601.0.55.002>>.
- [2] In general, businesses with turnover greater than or equal to \$50 million are classified as large businesses. For businesses with turnover less than \$50 million, when the lender has an exposure of more than \$1 million, the business is classified as medium. When the exposure is less than \$1 million, the business is classified as small. This definition applies to both the new credit data and the new interest rate data for

businesses. The previous measure of business lending was based on prudential data reported by a limited number of banks, and did not include business lending for some business purposes.

- [3] Previously, small business loans were defined as those loans that were less than \$2 million, while all larger loans were defined as large business loans.
- [4] Debelle G (2019), ‘A Balance of Payments’, Address to the Economic Society of Australia, Canberra, 27 August.