4. Domestic Financial Conditions

The Reserve Bank's package of policy measures announced in March – including the reduction in the cash rate, the target for the yield on the 3-year Australian Government bond, the Term Funding Facility (TFF) and open market operations – has lowered funding costs and contributed to a plentiful supply of liquidity in the Australian financial system. This has flowed through to historically low interest rates on housing and business loans and supported the availability of credit to households and businesses. Financial markets have also continued to function smoothly after the period of dislocation in March and April. Banks drew down most of their initial allowances from the TFF ahead of the end-September deadline for accessing this allowance. Nonetheless, demand for new business loans remains subdued, consistent with the uncertain economic outlook. Australian equity prices have increased in recent months, but remain well below their mid-February peak.

In September, the TFF was expanded and extended, and in early November, a further package of policy measures was announced comprising: a reduction in the cash rate target, the 3-year Australian Government bond yield target and the interest rate on new drawings under the TFF to 0.1 per cent; a reduction in the interest rate paid on Exchange Settlement balances held with the Reserve Bank to zero; and the introduction of a $100 billion government bond purchase program. Together, these measures will further lower the structure of interest rates in Australia. This will support the economy by lowering borrowing costs, delivering a lower exchange rate than otherwise, and supporting asset prices and balance sheets.

The 3-year government bond yield has declined recently

The yield on the 3-year Australian Government Securities (AGS) bond remained consistent with the target of around 0.25 per cent from late March until mid September, supported by the Bank's purchases of government bonds in the secondary market (Graph 4.1). Since late September, the 3-year AGS yield had declined, reflecting market participants' expectations of further easing in monetary policies. Following the reduction in the 3-year yield target in early November, the 3-year AGS yield declined further, consistent with the new target of around 10 basis points. Over the past couple of months, yields on 10-year AGS also declined noticeably, reflecting market expectations for a further reduction in short-term interest rates as well as expectations that the Reserve Bank would announce a bond buying program targeting longer-maturity bonds. The announcement in November of a further package of policy measures saw 10-year AGS yields decline further. At the same time, US Treasury yields have moved higher, so 10-year AGS yields are now broadly in line with 10-year US Treasury bond yields (Graph 4.2).

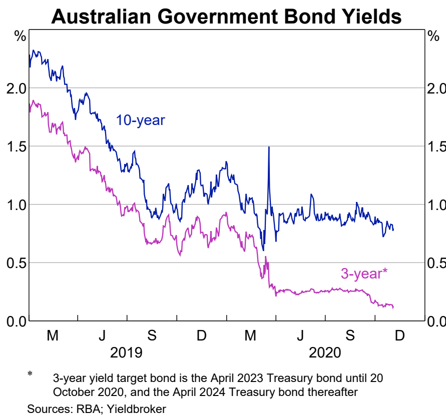
From March to May this year, the Bank purchased around $50 billion of AGS and bonds issued by the state and territory borrowing authorities (known as semi-government securities, or semis), to support smooth market functioning and achievement of the target for

the 3-year AGS yield. In August and early September, the Bank purchased a further $12 billion of AGS in the secondary market in support of the 3-year yield target. These purchases were concentrated in the April 2023 and April 2024 bonds. The 3-year yield target applies to the bond with residual maturity closest to three years, which changed from the April 2023 to the April 2024 bond in mid October.

On 5 November, the Reserve Bank commenced purchases of AGS under the $100 billion bond purchase program announced as part of the package of further measures at the November Board meeting. Under the program, $100 billion of government bonds will be purchased over a period of approximately six months, with weekly purchases of around $5 billion. The allocation of bond purchases is planned to be around 80 per cent AGS and around 20 per cent semis. The focus of purchases will be bonds with residual maturity of around 5 to 10 years, but may also include bonds outside of this range, depending on market conditions; any purchases related to achieving the 3-year bond yield target will be separate from the $100 billion bond purchase program. The Bank will closely monitor the impact of its bond purchases on market functioning and will adjust auctions if necessary, including their size, composition and timing.

Graph 4.1

Australian Government Bond Yields



* 3-year yield target bond is the April 2023 Treasury bond until 20 October 2020, and the April 2024 Treasury bond thereafter

Sources: RBA; Yieldbroker

Government bond markets are functioning well and continued to absorb large volumes of issuance

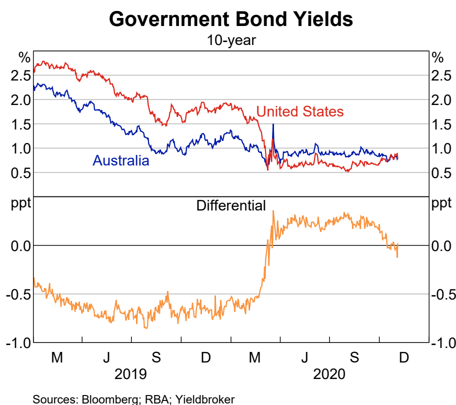
AGS and semis markets have continued to function smoothly in recent months, with bid-offer spreads remaining around average levels, and well below the elevated levels seen during the market dislocation in March and April. Spreads between yields on semis and AGS fell by around 5 basis points following the November Board announcement, to be at historically low levels (Graph 4.3).

Funding conditions remained favourable for the Australian and the state and territory govern-

Graph 4.2

Government Bond Yields

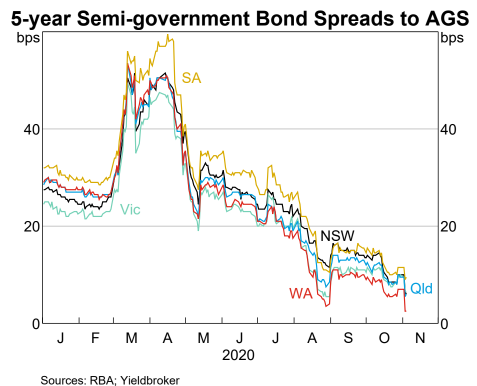
10-year



Sources: Bloomberg; RBA; Yieldbroker

Graph 4.3

5-year Semi-government Bond Spreads to AGS



Sources: RBA; Yieldbroker

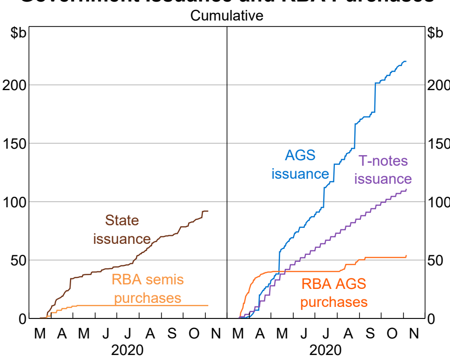
ments. Government bond yields are at record lows and markets have absorbed large volumes of issuance. The Australian Office of Financial Management (AOFM) has issued $88 billion of Treasury Bonds and $38 billion of Treasury Notes since the start of August, in addition to the $103 billion of AGS and $45 billion of Treasury Notes issued in the preceding three months (Graph 4.4). This pace of issuance is well above the issuance in recent years. Demand at AOFM tenders has been consistently strong, including for the two largest AOFM syndications on record, which raised $25 billion and $21 billion of the new 2026 and 2031 bonds, respectively. The next three largest AOFM syndications occurred in the preceding three months and were also met with strong demand. These syndications also put the AOFM well ahead of schedule on its funding requirements. Accordingly, following the handing down of the 2020/21 federal budget in early October, the AOFM announced that it plans to scale back the weekly pace of issuance. While the projected increase in government debt for 2020/21 and the associated stock of debt outstanding are the largest as a share of GDP in decades, they are not unprecedented (Graph 4.5). Moreover, the stock of debt as a share of GDP remains low compared with other advanced countries.

Take-up of the TFF ahead of the initial allowance deadline was strong …

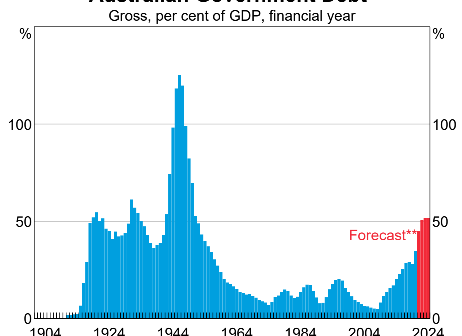
The TFF provides low-cost term funding to authorised deposit-taking institutions (ADIs) and an incentive for ADIs to increase lending to businesses, particularly small- and medium-sized enterprises (SMEs). Under the TFF announced in March 2020, ADIs have had access to three-year funding at an interest rate of 0.25 per cent. Take-up of the TFF accelerated ahead of the 30 September 2020 deadline for ADIs to draw down on their initial allowance. Almost all of the funding available under the $84 billion TFF initial allowance was drawn down (Graph 4.6); the large Australian banks, regional banks and smaller ADIs drew down close to all of their initial allowances, while foreign ADIs used nearly three-quarters of their allowances.

… and the TFF has been expanded and extended, and the interest rate on new drawings has been reduced

Following the Board's decision at the September Board meeting, a new TFF supplementary allowance has been available to all ADIs since 1 October 2020 (Graph 4.7). The supplementary allowance is fixed at 2 per cent of an ADI's overall credit over the three months to July 2020 ($57 billion in aggregate for all ADIs) and can be

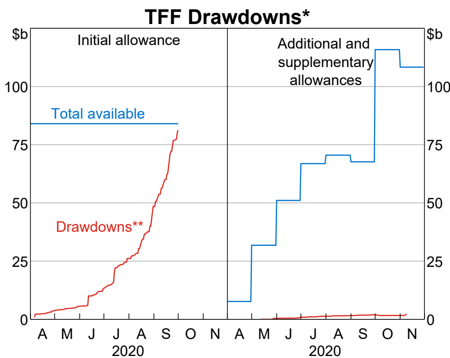


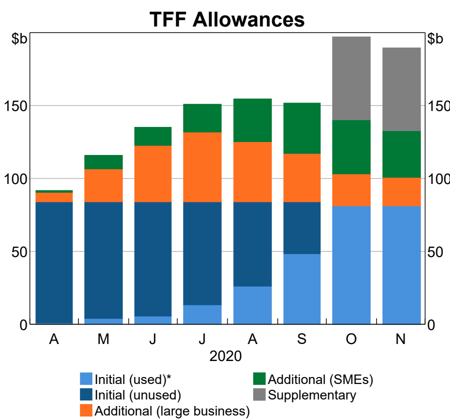
Sources: Bloomberg; RBA; Yieldbroker



* Historical series contain structural breaks and adjustments
** 2020/21 Budget
Sources: ABS; Australian Treasury; Barnard (1986); Butlin (1985)

accessed until 30 June 2021. Furthermore, the drawdown period for the additional allowance based on ADIs' new lending to businesses has been extended by three months until 30 June 2021. The introduction of the supplementary allowance brings the total funding allowance under the TFF to around $190 billion as of November, compared with $150 billion in August and $90 billion at the program's inception. At the November Board meeting, the Board decided to reduce the interest rate on new drawings under the TFF to 0.1 per cent.

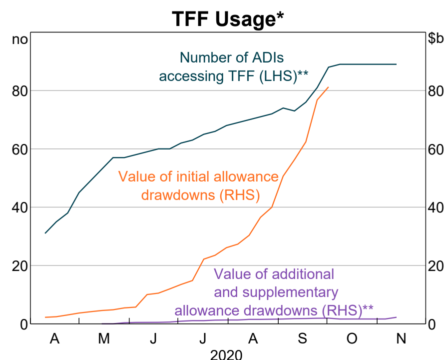




To date, 89 ADIs have accessed the TFF (around two-thirds of eligible ADIs). Take-up of the additional allowance has been modest since the inception of the scheme, because ADIs were required to draw their full initial allowance before accessing their additional allowance and because the deadline for accessing the additional allowance is some time away (Graph 4.8). ADIs have indicated that they are well funded and are considering how they will use their supplementary allowances. Similar to the approach taken by ADIs to the initial allowances, liaison with ADIs suggests that further TFF drawings are likely to be spread out across the remaining allowance period, but weighted towards the end. Consistent with this, drawdowns since the 30 September initial allowance deadline have so far been infrequent and relatively small. The TFF continues to support low funding costs across the economy by providing the banking sector with low-cost term funding.

Liquidity in the banking system remains high

The level of liquidity in the banking system – as measured by banks' exchange settlement (ES) balances held at the Reserve Bank – remains high as a result of the Reserve Bank's package of



policy measures (Graph 4.9). In recent months, increased use of the TFF and, to a lesser extent, purchases of government bonds by the Reserve Bank have added to liquidity in the system (Graph 4.10).[1] Offsetting this, liquidity obtained by banks via daily open market operations has continued to decline, as in aggregate banks have replaced this shorter-term repurchase agreement (repo) funding with longer-term funding provided by the TFF.

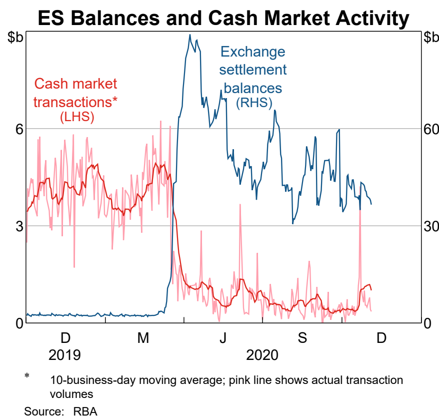
The Bank's balance sheet has expanded

The package of policy measures is also reflected in a very large increase in the Reserve Bank's balance sheet. The balance sheet is around $110 billion larger than it was prior to the onset of COVID-19. The increase in assets held by the Reserve Bank has been driven by the Bank's increased holdings of long-dated government bonds as a result of bond purchases as well as an increase in securities provided as collateral by ADIs accessing the TFF (Graph 4.11). On the liabilities side, this has been mirrored by an increase in ES balances as the policy measures have substantially increased liquidity in the banking system (Graph 4.12). There has also been an increase in government deposits held at the Reserve Bank to around $100 billion from around $20 billion before the pandemic. This reflects the fact that, to date, proceeds from government bond issuance have exceeded net government outlays. By mid 2021, the size of the Bank's balance sheet is expected to have nearly tripled since the beginning of 2020, reflecting the comprehensive set of policy measures to support the economy in the wake of the COVID-19 crisis.

The cash rate declined further

Over recent months the cash rate had remained around 13 basis points, a little above the rate of remuneration on ES balances of 10 basis points

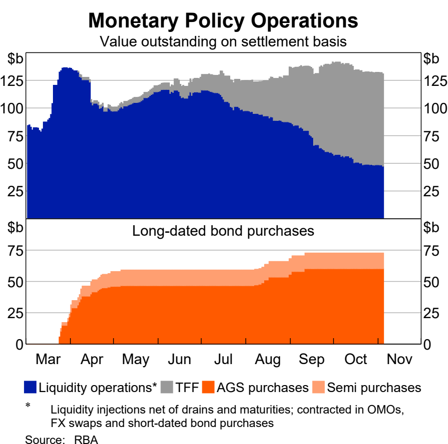
Graph 4.9



* 10-business-day moving average; pink line shows actual transaction volumes

Source: RBA

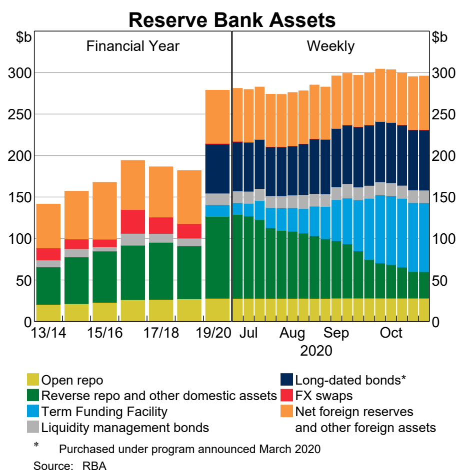
Graph 4.10



* Liquidity injections net of drains and maturities; contracted in OMOs, FX swaps and short-dated bond purchases

Source: RBA

Graph 4.11



* Purchased under program announced March 2020

Source: RBA

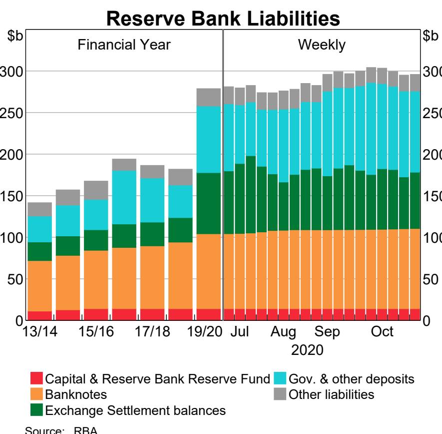
(Graph 4.13). Following the reduction of the cash rate target to 10 basis points at the Reserve Bank Board meeting in early November, the cash rate declined further, to 4 basis points in early November. Financial market prices imply that investors expect the cash rate to remain around its current level. The fact that the traded cash rate has been below the cash rate target was expected and is consistent with the experience of other countries that have significantly increased cash reserves in the banking system. The traded cash rate has remained a bit above the rate of remuneration on ES balances held with the Reserve Bank (which was 10 basis points from March until early November, and was reduced to zero at the November Board meeting). This difference reflects the compensation banks generally require to cover the transaction costs and credit risks associated with lending their excess balances in the overnight cash market, rather than holding them at the Reserve Bank.

Activity in the overnight cash market has also continued to be subdued as a result of the plentiful supply of ES balances (Graph 4.9). Indeed, on multiple occasions since March, transaction volumes in the overnight cash market have been below the thresholds required to calculate the cash rate based on actual transactions. In these instances, the published cash rate has been determined on the basis of the robust fall-back arrangements built into the cash rate procedures. Under these arrangements, the cash rate was published based on the last published cash rate based on sufficient transactions, except for two instances where the published cash rate was set at a different rate that, in the expert judgement of the Bank as the cash rate administrator, better reflected current market conditions.[2]

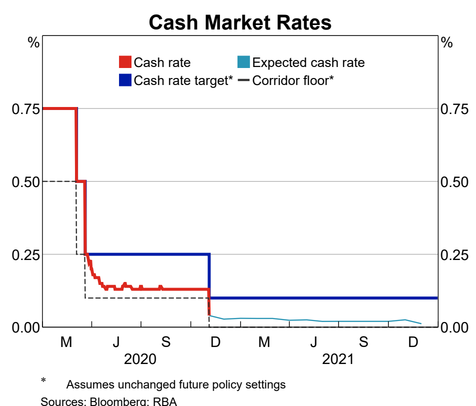
Money market rates remain very low

Short-term money market rates are at historically low levels owing to the low level of the cash rate and the large amount of liquidity in the banking system (Graph 4.14). The rates on 3-month bank bills (BBSW) have recently edged lower to be around 3 basis points, broadly in line with the overnight indexed swap rate (OIS). Prior to the new policy measures announced at the November Board meeting, repo rates at the Bank's daily open market operations had been held steady at 18 basis points, while repo rates in the private interbank market had been reported to have moved lower to be around 13 basis points for 3-to-6-month terms. Following the reduction in the cash rate target and the remuneration on ES balances in November, repo rates at the Bank's daily market operations

Graph 4.12



Graph 4.13



declined to 10 basis points. The implied cost of borrowing Australian dollars via the foreign exchange swap market has continued to decline in recent months, to be around –6 basis points.

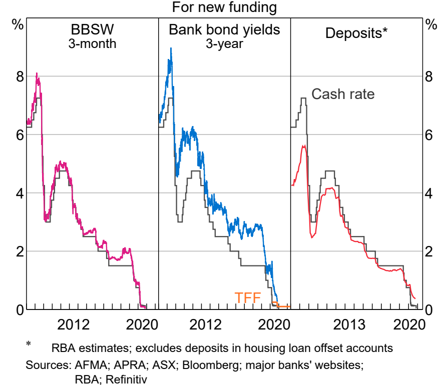
Banks' funding costs are at historic lows

The Reserve Bank's package of policy measures has worked to lower banks' funding costs to historically low levels (Graph 4.15). Banks' non-equity funding costs are estimated to have declined by around 60 basis points between end February and end September. Much of the banks' wholesale debt and deposit costs are ultimately linked (either directly or via hedging) to BBSW rates, which have declined by around 75 basis points since the end of February. Low-cost funding from the TFF and deposit inflows have reduced banks' need to seek new wholesale funding, with the cost of new 3-year bank bonds remaining higher than the rate on TFF borrowing. The policy measures announced by the Reserve Bank in September and November are expected to further lower banks' funding costs over the period ahead.

Large deposit inflows in recent months have seen the deposit share of banks' total funding (including equity) increase by around 4 percentage points since the end of February (Graph 4.16). Government bond purchases by the Reserve Bank and the banking sector have contributed to deposit growth, for instance as payments for bonds purchased from the private (non-bank) sector are credited to the deposit accounts of the sellers.[3] The increase in deposits also reflects a decline in short- and long-term bank debt outstanding.

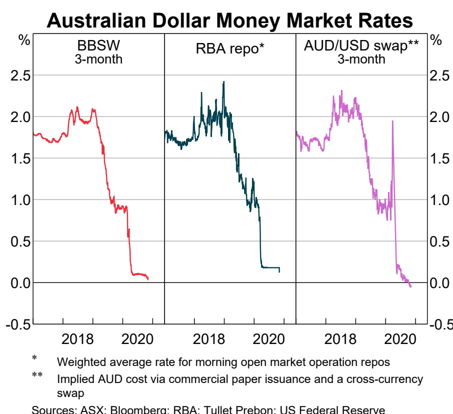
Australian bank bond issuance has been low

Most of the decline in the outstanding stock of bank bonds reflects maturities of bonds issued in offshore markets by the major banks (Graph 4.17). Australian banks have engaged in less bond issuance recently. This is because they



* RBA estimates; excludes deposits in housing loan offset accounts

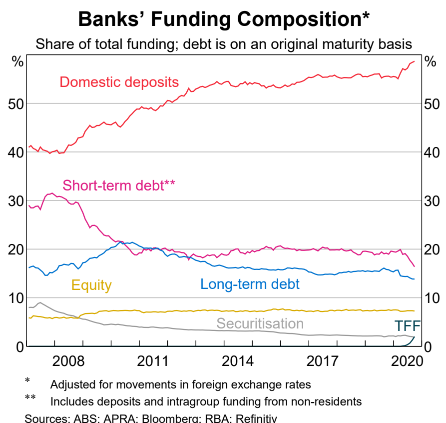
Sources: AFMA; APRA; ASX; Bloomberg; major banks' websites; RBA; Refinitiv



* Weighted average rate for morning open market operation repos

** Implied AUD cost via commercial paper issuance and a cross-currency swap

Sources: ASX; Bloomberg; RBA; Tullet Prebon; US Federal Reserve



* Adjusted for movements in foreign exchange rates

** Includes deposits and intragroup funding from non-residents

Sources: ABS; APRA; Bloomberg; RBA; Refinitiv

can instead access low-cost funding from the TFF – $83 billion of which had been drawn by early November – and because of the slow pace of asset growth compared with earlier years. Nonetheless, major banks issued around $5 billion worth of Tier 2 hybrids in August, with the spreads on these securities similar to those achieved in 2019. Hybrid securities have both equity and debt features and can be used to fulfil a part of regulatory capital requirements.

Non-banks continued to issue residential mortgage-backed securities

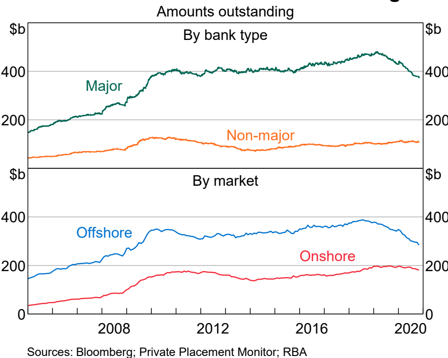
Issuance of residential mortgage-backed securities (RMBS) increased in the September quarter, driven by $7 billion issued by non-ADIs (Graph 4.18). Several of these deals were 'non-conforming' RMBS, consisting of mortgages made to traditionally riskier borrowers. Spreads on deals issued by non-ADIs remain elevated compared with pre-COVID levels, but have declined from their peak earlier this year.

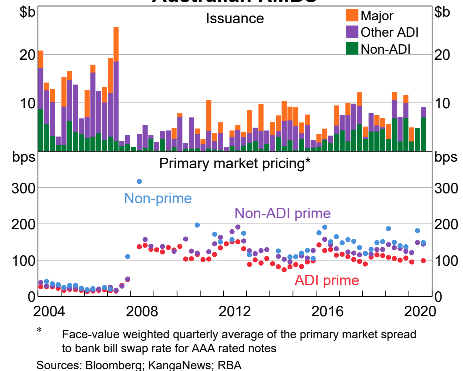
Since the March announcement of the Structured Finance Support Fund (SFSF), the AOFM has provided funding to securitisation warehouses and invested directly in the primary and secondary asset-backed securities (ABS) market. These measures supported the improvement of conditions in the ABS market around the middle of the year. The AOFM has not participated in primary or secondary markets since July, but continues to support the warehouse market.

Deposit rates have declined further

Banks have continued to respond to the plentiful supply of funding at low rates by reducing deposit rates. Interest rates for new term deposits declined by around 95 basis points between end February and end September, while rates for new at-call deposits declined by around 40 basis points over the same period. The decline in the spread between interest rates on term and other deposit rates is supporting a shift from term to at-call deposits by customers.

These changes have led to a rise in the share of bank deposits paying low interest rates (between zero and 25 basis points) (Graph 4.19). A little over one quarter of the debt funding of the major banks is in the form of deposits paying interest of 25 basis points or less. This compares with around 15 per cent a year ago. On average, the share of low-rate deposits in total debt funding of the other banks is estimated to be a little lower than that of the major banks. However, most deposits are still paying rates above 25 basis points, reflecting a sizeable share of deposits at interest rates greater than 100 basis points.





Interest rates on business loans are at historic lows

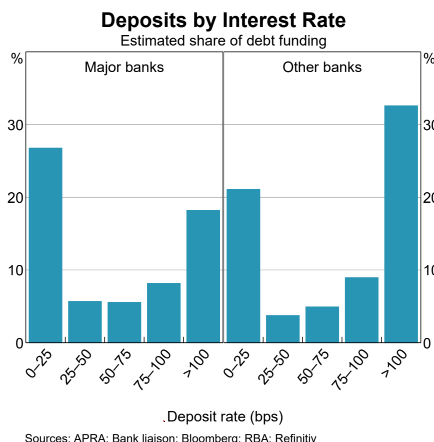
The cash rate reductions and other policy measures announced in March have also flowed through to lower interest rates on outstanding business loans. Interest rates on variable-rate loans to large businesses declined by 80 basis points between end February and end September (Graph 4.20). Interest rates on variable-rate loans to small and medium-sized businesses declined by 70–75 basis points over the same period. Following the Reserve Bank Board's decision to ease monetary policy further in early November, a number of the major banks announced interest rate reductions for loans to small businesses; many of the reductions apply to loans under the Australian Government's $40 billion SME loan guarantee scheme.

Housing interest rates are at historic lows

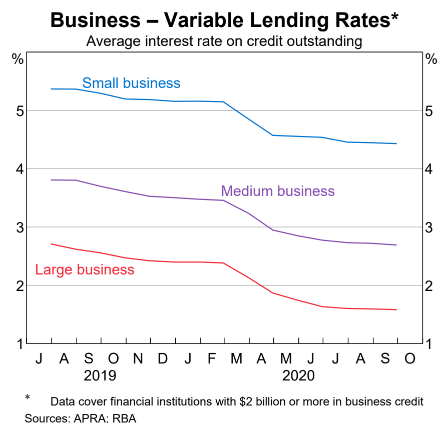
A large share of the decline in funding costs since March 2020 has flowed through to housing interest rates paid by borrowers. While SVRs declined by an average of 29 basis points between end February and end September, the average rate paid on outstanding variable-rate loans declined by around 40 basis points. This decline in the average actual rates paid reflects both the decline in lenders' SVRs and ongoing competition for high-quality borrowers, with lenders offering particularly low interest rates to new and refinancing borrowers (Table 4.1; Graph 4.21). A few small lenders announced a reduction to standard variable rates (SVRs) in the days immediately following the Board's decision to further ease monetary policy in early November.

Refinancing has been a significant driver of the downward drift in housing rates over the past year or so. While the demand for new housing loans initially declined with the onset of the pandemic, external refinancing activity has been very strong. Since March, the major banks have captured a larger-than-usual share of refinancing by offering very low rates on fixed-rate loans and offers of cash rebates to refinance from another lender. While refinancing activity has declined since its peak in May, competition for borrowers is ongoing, with some lenders continuing to offer cash rebates to refinance from another lender. This competition for high-quality borrowers has also meant that some households with existing loans have been able to negotiate a lower interest rate with their current lender.

Rates for new fixed-rate housing loans declined by around 70 basis points between end February and end September, alongside a



Sources: APRA; Bank liaison; Bloomberg; RBA; Refinitiv



* Data cover financial institutions with $2 billion or more in business credit

Sources: APRA; RBA

Table 4.1: Average Outstanding Housing Rates

September 2020

	Interest rate Per cent	Change since February 2020 Basis points
Variable-rate loans		
– Owner-occupier	3.20	–38
– Investor	3.56	–40
All variable-rate loans	3.32	–39
Fixed-rate loans		
– Owner-occupier	3.01	–71
– Investor	3.39	–62
By repayment type[(a)]		
– Principal-and-interest	3.18	–44
– Interest-only	3.80	–43

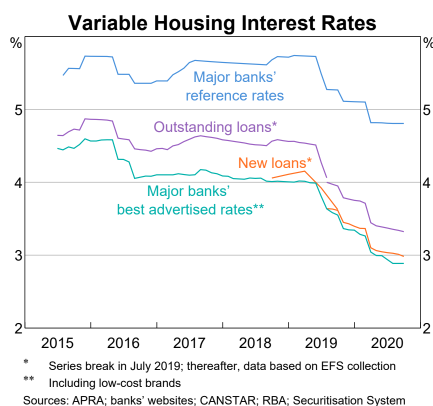
(a) Weighted average across fixed- and variable-rate loans

Sources: APRA; RBA

decline in the fixed interest rates derived from interest rate swaps (the benchmark for pricing fixed-rate loans) (Graph 4.22). The interest rates on new fixed-rate loans were around 55–65 basis points below new variable interest rates at the end of September. The proportion of loans at fixed interest rates has increased sharply since March and the stock of fixed-rate housing loans has risen accordingly, to around 25 per cent of housing credit outstanding. A number of banks lowered fixed-rates on a number of home loan products following the Board's decision to further ease monetary policy in early November.

Total credit growth has slowed sharply

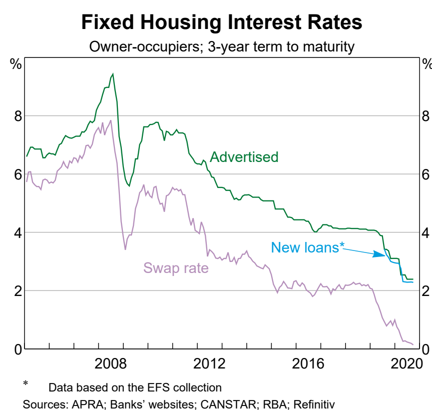
Despite the reductions in interest rates, total credit growth has slowed since earlier in the year, largely reflecting reduced demand for business and personal credit (Table 4.2; Graph 4.23). In monthly terms, the stock of total credit outstanding was little changed over August and September, following a few months of small declines. Business credit outstanding



* Series break in July 2019; thereafter, data based on EFS collection

** Including low-cost brands

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



* Data based on the EFS collection

Sources: APRA; Banks' websites; CANSTAR; RBA; Refinitiv

Table 4.2: Growth in Financial Aggregates

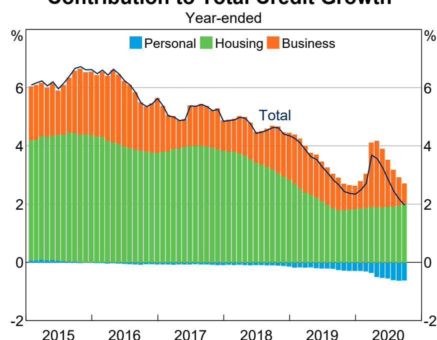
Percentage change(a)

	Jun 2020	Three-month annualised Sep 2020	Mar 2020	Six-month annualised Sep 2020
Total credit	–1.2	–0.5	4.8	–0.8
– Household	1.0	1.9	2.4	1.4
– Housing	2.8	3.3	3.6	3.0
– Owner-occupier	5.3	5.0	5.7	5.2
– Investor	–1.4	0.4	–0.2	–0.5
– Personal	–19.1	–13.3	–8.6	–16.3
– Business	–5.0	–5.2	9.7	–5.1
Broad money	16.9	11.1	10.1	14.0

(a) Seasonally-adjusted and break-adjusted

Sources: ABS; APRA; RBA

declined in recent months, retracing the sharp increase seen over March and April (discussed further below). Meanwhile, growth in total housing credit increased slightly in recent months, as demand for housing has picked up a little (discussed further below). Credit supply by some ADIs had tightened slightly early in the pandemic, mostly reflecting the application of existing lending standards in an environment of weaker economic conditions and considerable uncertainty. More recently, though, some of the tightening in credit supply has eased.



The stock of personal credit outstanding continued to decline, although the pace of decline has slowed in recent months. Around half of the decline in personal credit since March was due to a decrease in outstanding credit card debt. Some of this decline owed to lower credit card spending by households early in the pandemic. Spending on credit cards has increased a little over recent months, as measures to contain the virus have been eased. Borrowers' capacity to repay this debt has also reportedly been boosted by superannuation withdrawals and government assistance payments.

Demand for new business loans remains subdued …

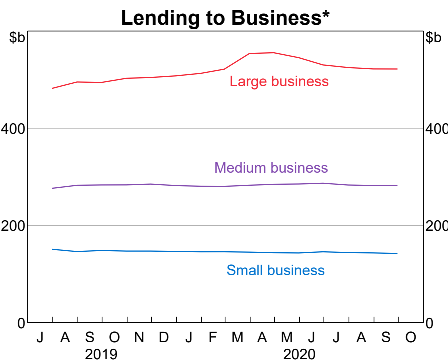
Lending to large business decreased further in recent months, as large businesses continued to repay revolving credit facilities (Graph 4.24). Businesses overall have now repaid the lines of credit that they drew down over March and April to shore up liquidity positions in response to the pandemic. Even so, the size of unused credit limits available is significantly higher than before the pandemic. This reflects repayment of

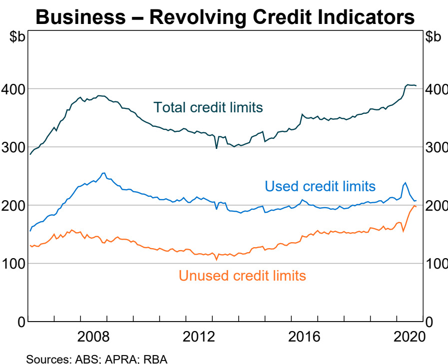
existing credit lines as well as an increase in overall credit limits (Graph 4.25). The volume of lending to SMEs has remained little changed over this time.

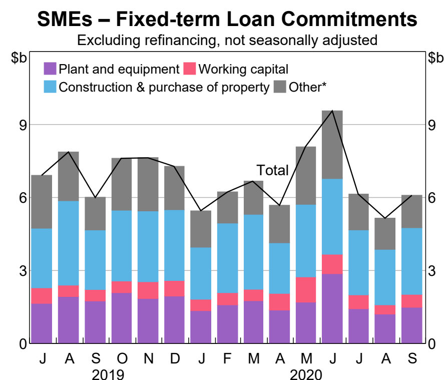
Despite historically low interest rates, demand for new loans appears to be low. Survey data and liaison with businesses and banks suggest that businesses are reluctant to take on debt given considerable uncertainty about the economic outlook, and have instead sought to shore up their liquidity positions. Consistent with this, about 60 per cent of businesses surveyed by the ABS in August identified uncertainty about the future state of the economy as a significant factor influencing investment decisions. In contrast, about half as many businesses indicated that access to external finance significantly influenced their investment decisions. A survey in October showed that around three quarters of businesses had not sought any additional funds over the prior six months. The most commonly cited reason for not seeking funds was that the business had sufficient funds. Businesses have made use of a range of temporary government and loan payment deferral initiatives to build up liquidity buffers in response to the pandemic, which has lessened the immediate need for new loans.

Commitments for new fixed-term loans to SMEs have declined since June in non-seasonally adjusted terms, particularly for plant and equipment (Graph 4.26). Lending activity for this category was likely to have been boosted before the end of the financial year by the Australian Government's instant asset write-off scheme. The Australian Government recently announced an expansion of this scheme in its 2020/21 budget, which should support business investment and lending activity.

Take-up of the Australian Government's $40 billion SME loan guarantee scheme has remained low to date, with about $1.9 billion of loan commitments having been made to around 21,000 businesses under the scheme. Changes to the scheme came into effect in







October that make it more flexible and so take-up could pick up in the period ahead. From October, businesses were able to borrow under the scheme for a wider range of purposes including investment (rather than being limited to working capital). Lenders can take security (but not against residential property) for loans under the scheme and SMEs will be able to borrow up to $1 million for up to five years (up from $250,000 and three years previously). Overall, the low take-up to date is consistent with a lack of demand for credit in general. A number of banks announced reductions to business loan rates under the SME loan guarantee scheme, following the Reserve Bank Board's decision to ease monetary policy further in early November. The quantity of funds potentially available at low cost through the scheme remains supportive of new lending should demand from businesses pick up.

About 11 per cent of small business loans were subject to loan repayment deferrals as of September, down from around 20 per cent in June, with four-month extensions being made available on a case-by-case basis.

… and the supply of business credit has tightened a little in response to the pandemic

Although the weakness in business credit growth appears to be driven mostly by demand, the availability of credit to businesses has tightened in response to the pandemic. Banks have indicated in liaison that much of the tightening reflects the application of existing lending standards in the weaker economic environment. Banks are also requiring a greater degree of verification of borrowers' information to better understand whether it is reasonable to extend a loan. Banks have noted the challenge of making assessments in an uncertain environment, and are providing more guidance to frontline staff on when it is appropriate to look through current weak financial positions of firms when assessing new loans. Some banks are also cautious about lending to particular sectors – such as tourism, retail and commercial property – and to businesses that are new to the bank.

Consistent with this, recent surveys and liaison with small businesses indicate that access to finance has become a bit more difficult due to the pandemic, and that fewer businesses have tried to access finance in recent months. In late September, the Australian Government announced changes to responsible lending obligations intended to simplify the loan application process and reduce the need for extensive verification procedures, and clarified again that consumer lending laws do not apply to small business lending.[4]

The Australian Government announced in October that the $540 million Australian Business Growth Fund had been formally established to provide longer-term equity funding to SMEs. The fund is expected to shortly begin engaging with SMEs that are seeking equity funding. The fund will take a minority interest in selected businesses, providing each between $5 million and $15 million of funding. To be eligible, businesses must have revenue between $2 million and $100 million and a good track record of revenue growth and profitability.

Meanwhile, Australian corporate bond issuance remained high in recent months

While demand for business credit remains subdued, demand for non-intermediated debt has been robust. Non-financial corporate bond issuance remained high in the September quarter, following an increase in the June quarter (Graph 4.27). Bond issuance has been particularly high among firms outside the resource sector. A diverse range of firms issued bonds in recent months, including from the infrastructure, automotive, grocery and transportation sectors.

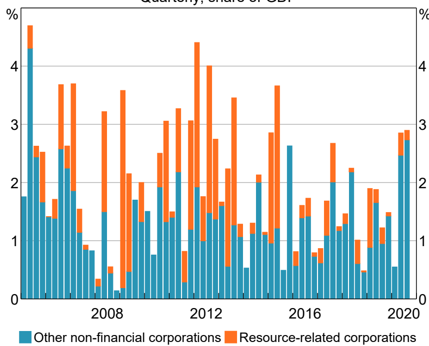
Corporate bond spreads in secondary markets declined over recent months (Graph 4.28). For A rated non-financial corporations, spreads to AGS returned to levels seen before the COVID-19 outbreak. Spreads for BBB rated corporations declined, but remained somewhat higher than levels seen at the beginning of the year. Nonetheless, with government bond yields at record lows, corporate bond yields are very low by historical standards.

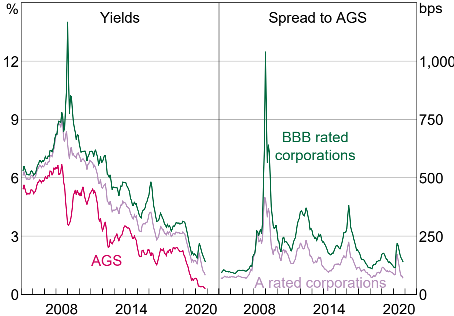
Demand for housing loans has picked up recently …

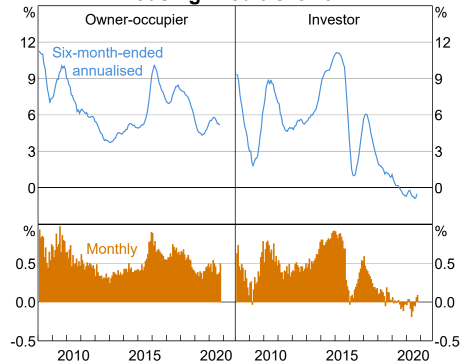
After slowing earlier in the year, growth in owner-occupier housing credit picked up a little and investor housing credit stopped falling in recent months (Graph 4.29). This is consistent with other indicators of increased demand for housing.

Commitments for new housing loans increased over the September quarter to be above the levels seen in March (Graph 4.30). This largely reflected a sharp increase in owner-occupier commitments; investor commitments for new loans have also increased, but to a lesser extent. The increase in commitments is consistent with the improvement in some housing market activity indicators such as auction clearance rates, turnover and new listings. Banks have indicated in liaison that the recent increase in housing market activity is, in part, likely to reflect pent up demand, as borrowers who found it difficult to purchase a property when restrictions were in place have now been able to do so. Lower interest rates, government measures targeted at first home buyers, and the HomeBuilder program are also supporting the demand for housing finance. A further 10,000 places for the First Home Loan Deposit Scheme and an increase in property price caps announced as part of the Australian Government 2020/21 budget will provide further support to demand for housing.

Although demand for investor credit strengthened a little towards the end of the





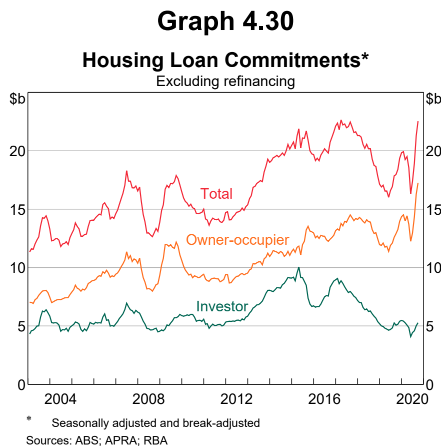


September quarter, it remained weak by historical standards. This is likely to reflect investors' sensitivity to the uncertain outlook for housing prices, as well as the decline in advertised rents and high vacancy rates in Sydney and Melbourne.

… and following an earlier tightening, the supply of housing finance has eased a little

The availability of housing credit tightened in response to the pandemic, mostly reflecting the effect of applying existing credit standards to the weaker and uncertain environment. Lenders required more recent verification of income and were a bit more cautious about lending to borrowers with high loan-to-valuation ratios (LVRs), or to those employed in sectors most adversely affected by the pandemic.

However, recently, some banks have begun to ease some requirements regarding additional information. They have also reduced the discounts they apply to highly variable sources of income (such as bonuses and commissions) when assessing a borrower's capacity to service a loan. Banks have also indicated a bit more appetite for higher LVR loans. Approval rates for housing loans are said to have remained high and banks report in liaison that the slight easing in lending requirements has resulted in some additional loan approvals. In addition, the Federal Government's recently proposed changes to responsible lending obligations will simplify and speed up the loan application process, but banks will still be required to comply with APRA's lending standards of 'sound credit assessment and approval criteria'.



Payments into housing loan offset and redraw accounts remained at a high level in the September quarter

Mortgage borrowers continued to make large payments into offset and redraw accounts in the September quarter (Graph 4.31). Since March, these payments have amounted to around 5 per cent of disposable income. The bulk of these funds have been placed into offset accounts (a type of deposit account linked to mortgages) and so do not reduce the measure of housing credit outstanding. The increase in payments is likely to reflect a combination of reduced opportunities for spending, mortgage holders saving for precautionary reasons, and some borrowers depositing cash received from early release superannuation and social assistance payments. Further restrictions in Victoria to contain the spread of the virus, including the move to Stage 4 restrictions in August, may have contributed to borrowers that were still employed placing additional funds into offset and redraw accounts as spending opportunities were significantly curtailed.

At the same time, reductions in housing loan interest rates have continued to flow through to borrowers in the form of lower interest payments. Since March, interest payments have declined by around 0.75 per cent of disposable income, mostly reflecting pass-through of the Bank's policy easing in March and borrowers refinancing to lower interest rates, but also the strong growth of disposable income (Graph 4.32).

The share of mortgage holders with a repayment deferral arrangement in place

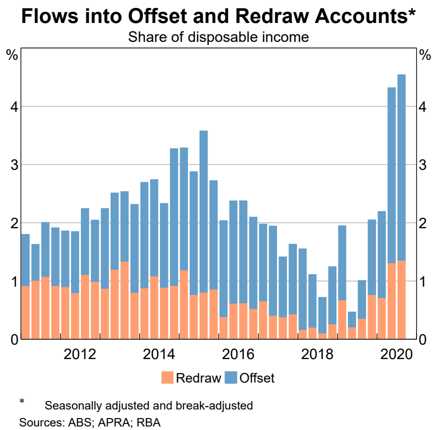
declined from 8 per cent at the end of the June quarter to 5½ per cent at the end of the September quarter. Moreover, one in five of those borrowers had continued to make partial or full mortgage payments.

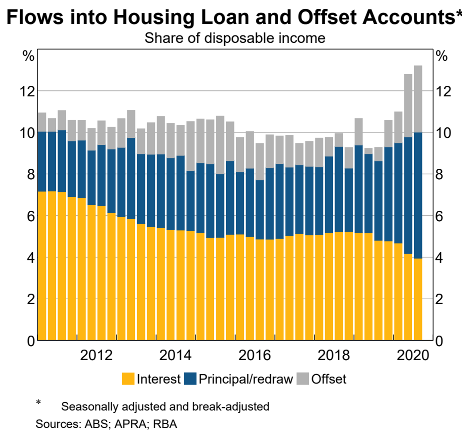
Australian equity prices remain lower than at the start of the year

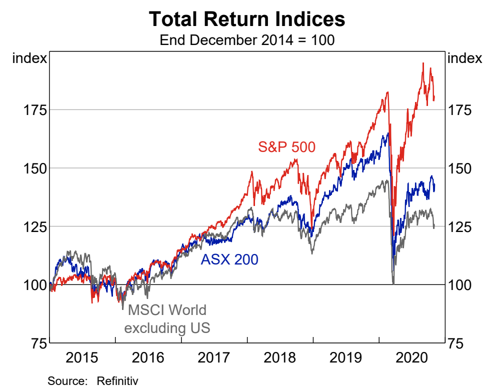
The ASX 200 has increased over recent months. Taking into account dividend payments, the Australian equity market has performed broadly in line with other overseas markets and remains around 15 per cent below its mid-February peak (Graph 4.33). By contrast, the US market reached a new high in September before retracing some of these gains to return to around its mid-February peak. Option-implied volatility for the ASX 200 has declined to be well below its peak in March, but above its average of the past few years.

Equity prices outside the resources and financial sectors increased by around 5 per cent since the start of August (Graph 4.34). The information technology sector rallied by around 20 per cent, as companies continued to benefit from the shift to many people working from home, and some of these IT firms announced intentions to expand globally. The consumer discretionary, real estate, and health care sectors were also strong performers over recent months, buoyed by a gradual reopening of the economy. Share prices of financial companies decreased over the two months to October but have increased over recent weeks. Prices in the resources sector decreased by around 5 per cent, alongside a decline in oil and iron ore prices.

Issuance of new equity by listed companies has slowed in recent months compared with issuance during the height of the pandemic. In total, listed entities raised around $13 billion from July to September, down from $29 billion in the previous quarter (Graph 4.35).







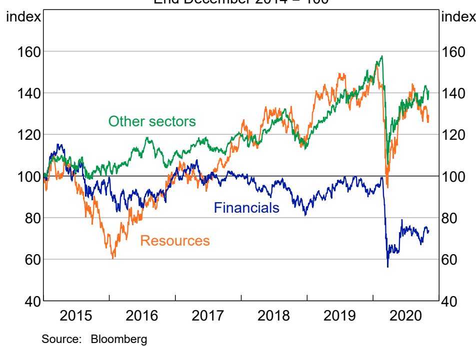
Profits of Australian listed companies fell

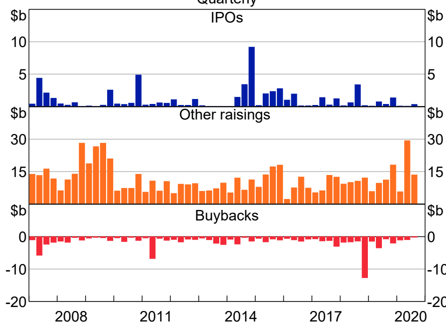
Profits of ASX 200 companies in the first half of 2020 declined significantly from a year ago, owing to the economic effects of COVID-19 (although national accounts data suggest that the profits of Australian businesses increased in aggregate). Dividends declared by non-resource firms fell significantly, while dividends declared by resources firms declined less sharply.

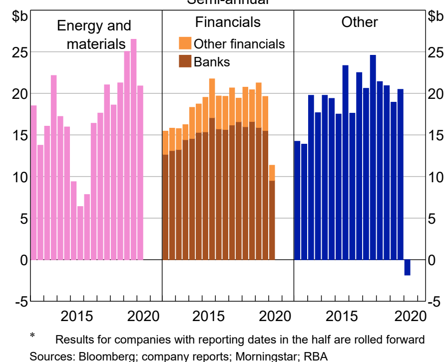
Listed companies outside the resources and financial sectors were the most sensitive to the economic effects of COVID-19, and these firms recorded losses in aggregate (Graph 4.36). A few companies in the industrials sector, including toll road operators and aviation companies, reported substantial losses as COVID-19-related restrictions led to reduced demand for their services. The real estate sector reported significantly lower profits, reflecting the effect of adverse property revaluations, rental waivers and deferrals. However, some real estate firms noted that foot traffic at shopping centres had returned to pre-COVID-19 levels by the end of June. Underlying profits of healthcare companies were slightly lower, as elective surgeries were postponed to prioritise the treatment of COVID-19 patients.

Underlying profits for the energy and materials sector decreased relative to the same period last year. The profits of energy firms declined owing to the lower level of oil prices in the half. Profits in the materials sector declined due to lower copper, coal and aluminium prices. Nonetheless, some firms in the materials sector benefited from robust Chinese demand for many commodities and strong demand for gold more broadly.

Underlying profits for companies in the financial sector were lower relative to the same period last year. Banks reported lower profits, partly reflecting provisions for expected credit losses arising from the economic effects of the COVID-19 pandemic and narrower net interest margins, while insurers were affected by increased claims and investment losses. ✠







Endnotes

[1] Graph 4.10 is shown on a settlement basis as of 5 November so it does not include the Bank's AGS purchases (under the $100 billion government bond purchase program) made on 5 November 2020, which will settle on 7 November 2020.

[2] Kent C (2020), 'The Reserve Bank's Operations – Liquidity, Market Function and Funding', Online speech to KangaNews, Sydney 27 July. Available at <https://www.rba.gov.au/speeches/2020/sp-ag-2020-07-27.html>

[3] For more information, see RBA (2020), 'Box D: Recent Growth in the Money Supply and Deposits', *Statement on Monetary Policy*, August, pp 75–77. Available at <https://www.rba.gov.au/publications/smp/2020/aug/box-d-recent-growth-in-the-money-supply-and-deposits.html>

[4] The proposed changes to responsible lending obligations would, in most cases, allow lenders to rely on the information provided by borrowers, replacing the current practice of 'lender beware' with a 'borrower responsibility' principle. Notwithstanding these changes, lenders will still be required to comply with APRA's lending standards of 'sound credit assessment and approval criteria'. Responsible lending obligations will remain in place and be heightened for small value credit contracts (for example, payday loans) and consumer leases. The Government will consult publicly with stakeholders before finalising any legislation required to implement the reforms.