3. Domestic Financial Conditions

The policy measures implemented by the Reserve Bank since March 2020 continue to underpin very low interest rates in the Australian economy. These measures include the reductions in the cash rate, the use of forward guidance, the yield target, the bond purchase program and the Term Funding Facility (TFF). Banks accessed most of their TFF allowances before it closed to new drawdowns on 30 June. The scheme will be providing a substantial source of low-cost funding for the next 3 years. In July, the Bank announced that it would continue the bond purchase program following the completion of $200 billion of purchases under the program in September, purchasing $4 billion of government bonds per week from early September until at least November. In recent months, banks' funding costs and lending rates have declined a little further to new lows.

Long-term Australian government bond yields have declined over recent months, returning to be close to levels seen in the early months of the year. This has occurred alongside declines in bond yields globally. The Board's decisions to retain the yield target for the April 2024 bond (rather than extend it to the November 2024 bond), and reduce the pace of purchases under the bond purchase program from early September, had little effect on market pricing. Conditions in Australian government bond markets have remained stable, while money market rates remain near historical lows.

The Australian dollar has depreciated over recent months and is below its levels at the start of the year. The depreciation occurred at the same time as the US dollar appreciated against a range of currencies following the June Federal Open Market Committee (FOMC) meeting and as yields on Australian government bonds declined relative to those of the major advanced economies. On the other hand, prices of Australia's key commodity exports recently reached their highest levels in almost a decade.

The bond purchase program will be extended, with the pace of purchases to be $4 billion per week from early September

At the July Board meeting, the Board decided to continue purchasing government bonds after the completion of the current program in early September, at a pace of $4 billion per week (adjusted from $5 billion per week) until at least November. The Board will maintain a flexible approach to the rate of bond purchases, reviewing it in light of the expected progress towards full employment and the inflation target.

The Bank has purchased $179 billion of longer-term bonds since November 2020 under the bond purchase program, consisting of $142 billion of Australian Government Securities (AGS) and $37 billion of semi-government securities (semis) (Graph 3.1). It now holds 28 per cent of outstanding AGS and 14 per cent of outstanding semis. These shares are projected to increase to a little more than 30 per cent and a little more than 15 per cent respectively by mid November.

Long-term AGS yields declined over the quarter

Yields on long-term AGS have declined by around 60 basis points since early May, a slightly larger fall than seen in US Treasury yields, with the spread between 10-year AGS and US Treasury yields now a little below zero (Graph 3.2). The 10-year AGS yield is currently around its lowest level since the sharp rise in bond yields in late February. The declines in yields partly reflected downward revisions to longer-term inflation expectations in June, although a larger part of the reduction owed to a decline in measures of real rates, with increasing concerns about outbreaks associated with the Delta variant of COVID-19 weighing on market sentiment in July. There was little market reaction to the July Board announcement that the bond purchase program would continue at a pace of $4 billion per week from September until at least mid November. Most market participants were anticipating a more flexible approach to future bond purchases by the Bank, and the announced pace of purchases was within the range of market expectations.

The Board's decision to retain the April 2024 bond as the bond for the yield target had little effect on market pricing

Overall, the yield on the April 2024 bond has declined a little over the past 3 months, and is currently around 4 basis points (Graph 3.3). Government bond yields rose in response to the June FOMC meeting and the stronger-than-expected domestic labour force release; the yield on the April 2024 bond rose to around 10 basis points for a period. However, yields drifted down again towards the end of July as increasing concerns globally around the Delta variant of COVID-19 led market participants to push-back their expectations for policy rate increases and also increased demand for risk-free assets. The decision at the July Board meeting to retain the April 2024 bond as the yield target bond (rather than extend it to the November 2024 bond) had been widely anticipated by market participants.

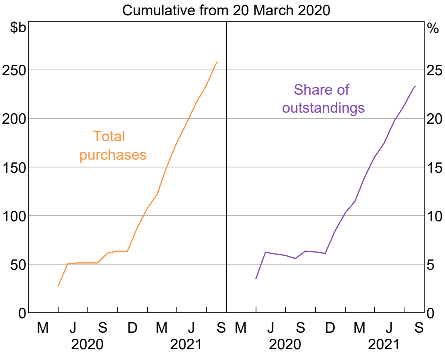
Bond markets have been functioning smoothly

The AGS and semis markets have continued to function smoothly. Bid-offer spreads across the yield curve have remained stable and around the levels seen over the past year, although AGS spreads in the 3-year and 5-year segments are a

Graph 3.1

RBA Purchases of AGS and Semis*

Cumulative from 20 March 2020



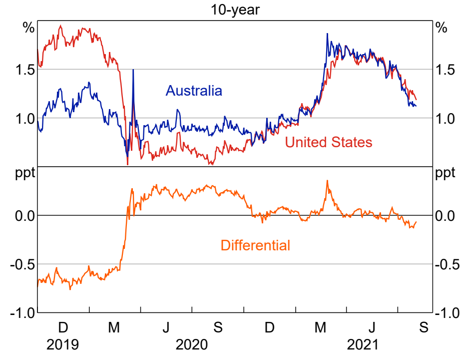
* Includes purchases made: under the bond purchase program, to support market function; and to support the yield target

Sources: AOFM; Bloomberg; RBA; state and territory central borrowing authorities

Graph 3.2

Government Bond Yields

10-year



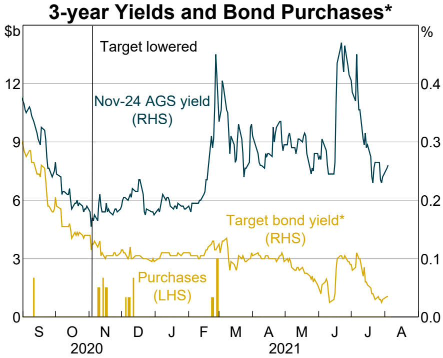
Sources: Bloomberg; RBA; Yieldbroker

little elevated compared with their levels over the second half of 2020 (Graph 3.4).

Demand to borrow AGS from the Bank had risen in recent months. There were $15 billion of securities borrowed in June – more than double the previous highest monthly total – although borrowing eased in July. The majority of borrowing from the Bank was for the current or previous yield target bond (the April 2024 and April 2023 bonds), with most of the other borrowing conducted for bonds with a residual maturity of between 4 and 8 years (Graph 3.5). The increased borrowing activity is related to the Bank's ongoing bond purchases, which has seen its ownership share of bonds on issue increase. In particular, borrowing activity has been elevated in the April 2024 and April 2023 bonds, with the Bank having purchased 60 per cent and 39 per cent of the outstanding bonds, respectively. By lending these bonds back into the market for short periods the Bank supports market function without affecting the yields on these bonds.

Graph 3.3

3-year Yields and Bond Purchases*

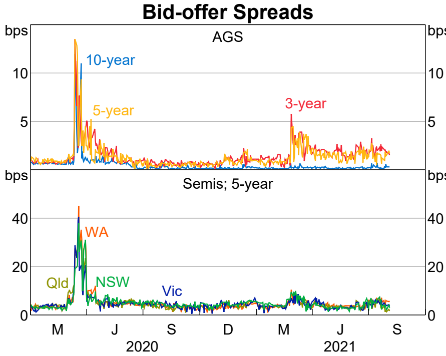


* Target bond is the April 2023 Treasury bond until 20 October 2020, and the April 2024 Treasury bond thereafter

Sources: RBA; Yieldbroker

Graph 3.4

Bid-offer Spreads



Sources: RBA; Yieldbroker

Government bond issuance has slowed

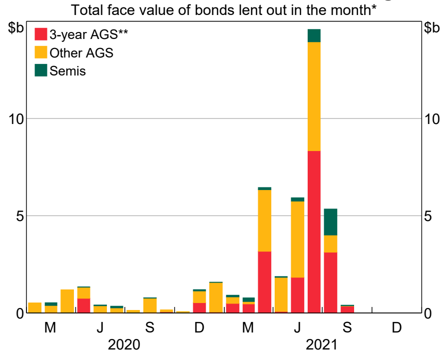
Bond issuance by the Australian Office of Financial Management (AOFM) and the state and territory borrowing authorities slowed into the end of the financial year, with borrowing authorities generally ahead on their annual funding tasks (Graph 3.6). Issuance has continued at a measured pace since then. Reflecting stronger-than-expected revenues, funding requirements for governments in the current financial year were generally revised lower than previous projections. Meanwhile, cash positions remain elevated. However, funding requirements for the period ahead remain subject to a considerable degree of uncertainty, as highlighted by the recent lockdowns and associated fiscal responses.

Spreads between the yields on semis and AGS remained relatively low. At the same time, AOFM and semi-government auctions and syndications continue to find solid demand.

Graph 3.5

RBA and AOFM Securities Lending

Total face value of bonds lent out in the month*



* Last bar for the month to date

** April 2023 and April 2024 bonds

Source: RBA

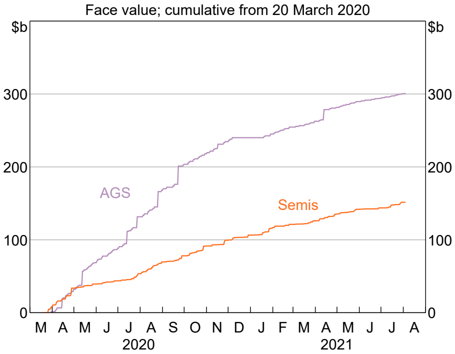
Cash market activity remains subdued

Activity in the cash market remains subdued because of the high level of system liquidity. The cash rate has remained at 3 basis points over the past 3 months, with expert judgement relied upon to determine the cash rate on most days during this period. Market expectations for the cash rate have declined a little from early May, and prices for overnight indexed swap (OIS) contracts imply that market participants on average expected the cash rate will remain around its current level over the next year before rising to around 50 basis points over 2023 and 75 basis points by late 2024 (Graph 3.7).

Graph 3.6

Government Issuance

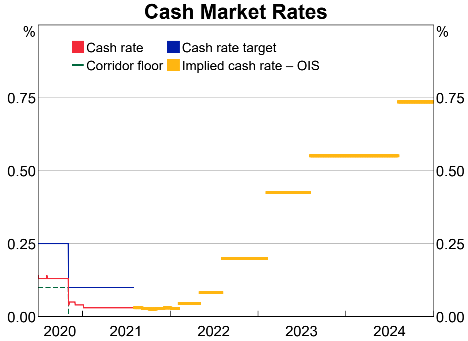
Face value; cumulative from 20 March 2020



Sources: AOFM; Bloomberg; RBA; state and territory central borrowing authorities

Graph 3.7

Cash Market Rates



Sources: Bloomberg; RBA

Short-term money market rates remain at very low levels

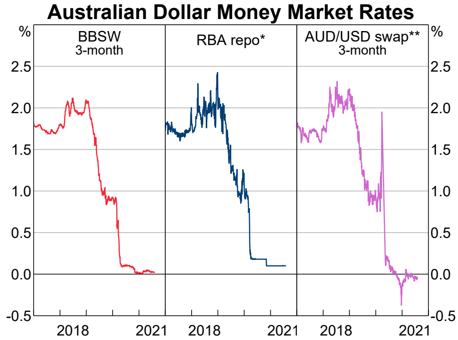
Short-term money market rates remain at historically low levels given the low level of the cash rate and the high liquidity in the banking system (Graph 3.8). Bank bill swap rates (BBSW) have edged lower over recent months, with the 3-month BBSW rate currently at 2 basis points. The cost of Australian dollar funding from offshore short-term issuance (via the foreign exchange swap market) also declined slightly. Repo rates at the Bank's daily open market operations remain at 10 basis points, while repo rates in the private repo market are close to zero for terms of up to 3 months. Demand for short-term liquidity at the Bank's daily open market operations has averaged around $200 million per day through the quarter, around half the average of the preceding six months and well below the daily average of around $2 billion prior to the pandemic.

Most of the available funding from the TFF was taken up

Drawdowns of remaining funding available from the TFF picked up significantly ahead of the deadline at the end of June. The facility has provided $188 billion in funding to banks out of $213 billion of total allowances available – this is equivalent to around 4 per cent of overall bank

Graph 3.8

Australian Dollar Money Market Rates



* 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 funding and around 6 per cent of credit outstanding. Given the term to maturity of 3 years on funds provided, the scheme will be a substantial source of low-cost funds to the banking system for the next 3 years.

By bank type, the major banks and mid-sized Australian banks drew all of their available allowances, while small banks and foreign banks drew a little over half. For more information on the TFF, including some details regarding use by the 10 banks with the largest drawdowns, see 'Box C: Use of The Reserve Bank's Term Funding Facility'.

The Bank's balance sheet and liquidity in the banking system have continued to increase

The Bank's balance sheet has tripled in size since the onset of the pandemic as a result of the Bank's policy measures. Since the previous *Statement*, the balance sheet has increased by $150 billion to around $560 billion. Over this period, growth in the Bank's assets has reflected a large increase in funds lent under the TFF and a rise in holdings of AGS and semis, owing to the Bank's ongoing bond purchases (Graph 3.9). Funding provided via open market operations declined further. On the liabilities side, exchange settlement (ES) balances have risen significantly as a result of the Bank's policies (Graph 3.10). Liquidity in the banking system – as measured by surplus ES balances – is currently around $350 billion compared with around $2 billion–$3 billion in the period before the pandemic.[1]

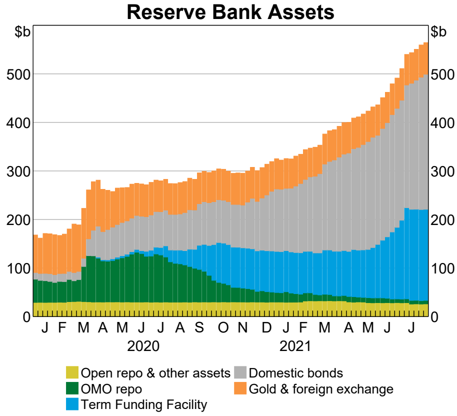
Bank bond issuance picked up, although it remained low

Bank bond issuance picked up in recent months, but remains low in the year to date (Graph 3.11). The average tenor of recent issuance is around six years, with a large share being raised offshore. Banks sought, and are likely to continue to seek, funding at relatively long tenors beyond the period where TFF funding has been drawn. For these longer tenors, overseas markets are typically deeper and more liquid.

Bank bond yields remained low by historical standards, with typical 3-year tenor bonds attracting yields of around 55 basis points in the domestic market (Graph 3.12). The spread to swap rates (for converting fixed to floating rate interest payments) has been little changed at low levels since the beginning of the year, so movements in yields have followed movements in the swap rate. The low yields on bank debt reflect a number of factors, including the Bank's

Graph 3.9

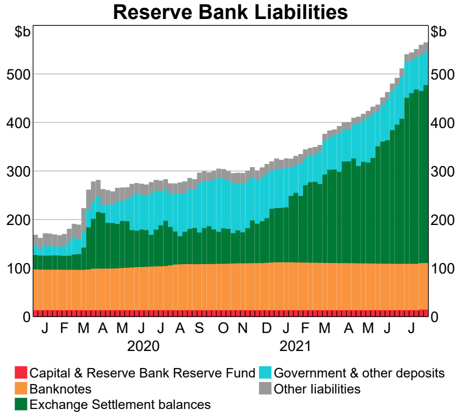
Reserve Bank Assets



Source: RBA

Graph 3.10

Reserve Bank Liabilities



Source: RBA

package of policy measures and, relatedly, low issuance of bank bonds throughout the pandemic.

Issuance of RMBS from non-banks remained high

Issuance of residential mortgage backed securities (RMBS) remained high in the first half of 2021, driven by issuance from non-banks (Graph 3.13). The low level of bank issuance is consistent with banks' ready access to alternative funding sources, including the TFF. Even so, in July Macquarie Bank issued the second-largest RMBS since the Global Financial Crisis, at $3.8 billion.

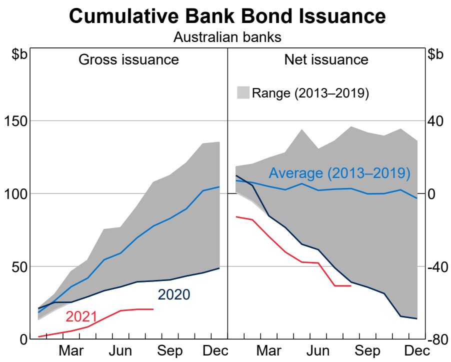
RMBS spreads to benchmark rates remained well below pre-pandemic levels as investors sought alternative investments to bank bonds. Ongoing demand from private investors has meant that the AOFM's Structured Finance Support Fund (SFSF) has not made any new investments to support RMBS since November 2020. Moreover, the SFSF's position in several securitisation warehouses – typically used by non-banks – has been replaced by private investors.

Deposit rates have declined a little further

Deposit rates have edged a little lower in recent months, after declining sharply over 2020. Since the end of February 2020, interest rates for at-call deposits have fallen by a little over 55 basis points and interest rates for new term deposits have fallen by around 125 basis points (Graph 3.14).

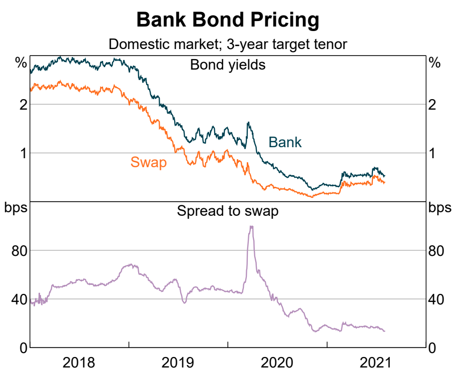
Liaison with major banks earlier in the year indicated that around half of outstanding deposits were paying interest of between zero and 25 basis points. With deposit rates at historically low levels, some banks have indicated that there is limited room to lower deposit rates much further. Nevertheless, low rates on new term deposits are leading to a gradual reduction in outstanding term deposit rates as maturing higher-rate deposits get replaced, thereby contributing to further declines in funding costs for banks.

Graph 3.11



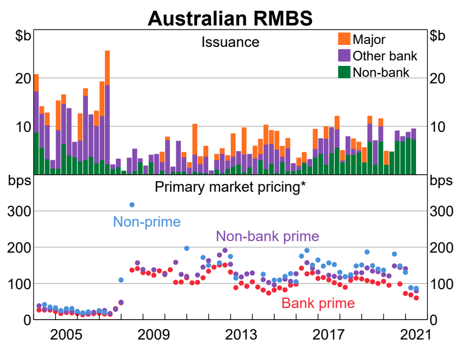
Sources: Bloomberg; Private Placement Monitor; RBA

Graph 3.12



Sources: Bloomberg; RBA

Graph 3.13



* Face-value weighted quarterly average of the primary market spread to bank bill swap rate for AAA-rated notes
Sources: Bloomberg; KangaNews; RBA

The final TFF drawdowns have led to a further decline in banks' overall funding costs

Banks' non-equity funding costs declined a little further in recent months as banks drew down much of the remaining TFF allowances (Graph 3.15). The TFF has provided banks with low-cost funding for 3 years and so will continue to support low funding costs until mid 2024.

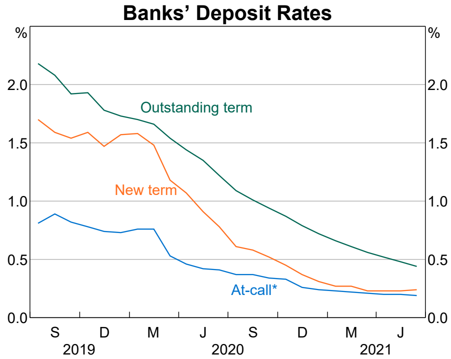
Over the past year or so, banks' funding costs have also benefited from the strong growth in low-rate deposits, which has been driven in part by the Reserve Bank's purchases of government bonds from non-banks (Graph 3.16). The continuation of the bond purchase program, following the completion of the current bond purchase program in September, will continue to contribute to low funding costs for banks. In addition, because banks have been drawing significantly on the TFF, they have largely refrained from issuing new bonds. Hence, the outstanding stock of bank bonds has declined as existing bonds have matured. Those funds from maturing bonds have contributed to deposit growth. Deposits now account for around 60 per cent of banks' total funding – around 5 percentage points higher than before the pandemic.

Interest rates on new housing loans are at historical lows

Interest rates on new variable-rate loans – which account for 70 per cent of the stock of total mortgages – have continued to edge lower over recent months, after declining significantly in 2020.

Interest rates on new fixed-rate loans remain substantially lower than the interest rates on new variable-rate loans (by around 60–75 basis points). In recent months, some banks have increased their rates on longer-term fixed-rate housing loans, leading to a small rise in the average advertised rates for terms of 3 to 5 years, in response to a rise in swap rates at this maturity. Even so, the increase in longer-term

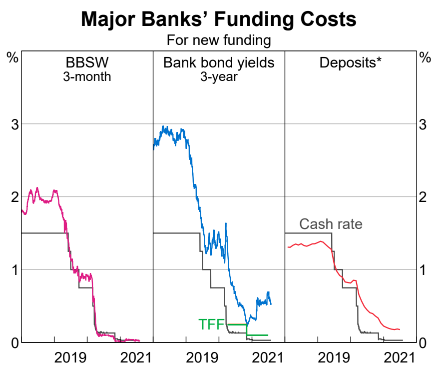
Graph 3.14



* Excludes deposits in housing loan offset accounts; includes non-interest bearing deposits

Sources: APRA; RBA

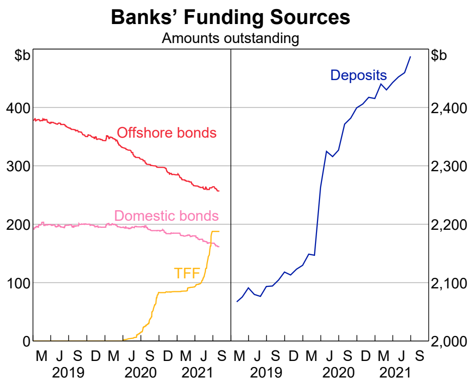
Graph 3.15



* RBA estimates; excludes deposits in housing loan offset accounts

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

Graph 3.16



Sources: APRA; Bloomberg; RBA; Refinitiv

Table 3.1: Average Outstanding Housing Rates

June 2021

	Interest rate (Per cent)	Change since February 2020 (Basis points)
Variable-rate loans		
– Owner-occupier	3.07	–51
– Investor	3.41	–56
All variable-rate loans	3.19	–53
Fixed-rate loans		
– Owner-occupier	2.38	–135
– Investor	2.76	–125
All fixed-rate loans	2.52	–134
By repayment type[(a)]		
– Principal-and-interest	2.88	–74
– Interest-only	3.52	–71

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

Sources: APRA; RBA

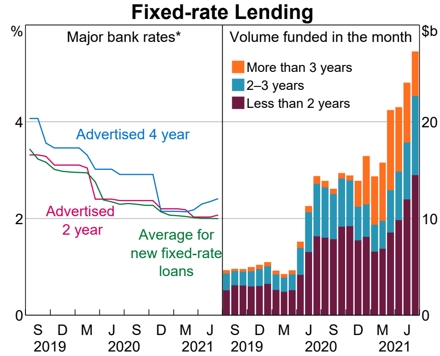
fixed rates has been modest to date and interest rates on these loans remain at low levels after declining sharply last year (Graph 3.17).

Longer-term fixed-rate loans account for a small share of the overall stock of housing credit, despite the share having increased earlier this year as banks offered particularly attractive interest rates for these loans. In recent months, the share has declined a little as new borrowers have been attracted to the lower rates on offer at shorter terms. Overall, the effect of recent increases in longer-term fixed-rate housing loans on mortgage rates is small, and shorter-term fixed rates remain around historical lows.

Interest rates on outstanding housing loans have continued to decline

Interest rates on outstanding housing loans have continued to decline over recent months. This is likely to continue for a time, as the very low level of new lending rates encourages new housing lending and ongoing refinancing by existing borrowers at lower rates. Borrowers reaching the end of their fixed-rate period have been able to obtain more favourable interest rates now on offer. Interest rates on outstanding variable-rate mortgages have declined by around 55 basis points since the end of February 2020, while interest rates on outstanding fixed-rate mortgages have declined by around 135 basis points (Table 3.1; Graph 3.18).

Graph 3.17



* Owner-occupier loans

Sources: APRA; banks' websites; RBA

Interest rates on business loans have declined to historical lows

Interest rates on outstanding business loans continued to drift lower in recent months (Graph 3.19). Since February 2020, interest rates on variable-rate loans to small- and medium-sized enterprises (SMEs) and large businesses have declined by around 95 basis points and 90 basis points, respectively. Interest rates on fixed-rate loans to SMEs and large businesses have declined by around 80 basis points and 55 basis points over the same period, respectively. The more recent declines in outstanding interest rates have been mostly for small business fixed-rate loans, and there is elevated refinancing activity among businesses to access the lower interest rates on offer.

Growth in total credit has increased further over recent months

Total credit growth increased over recent months to be around 5½ per cent in 6-month-ended-annualised terms in June (Graph 3.20). The increase in total credit was driven by both a pick-up in business credit and strong demand for housing credit. An increase in the pace of growth of bank deposits has led to a pick-up in the growth of broad money in June.

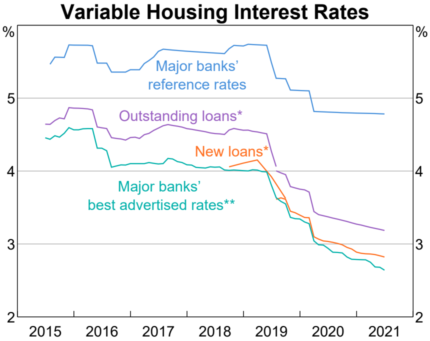
Owner-occupier housing credit strengthened over the quarter to be 8½ per cent higher in 6-month-ended-annualised terms. Investor housing credit also picked up over recent months, and is more than 3¼ per cent higher in 6-month-ended-annualised terms. Demand for housing credit continued to be supported by low interest rates, strong activity in housing markets and government policy measures targeted at first home buyers. Credit growth has been particularly strong for non-bank lenders, which have benefitted from favourable conditions in securitisation markets that provide the bulk of their funding.

Growth in business credit picked up strongly in the month of June, to be 4½ per cent higher on a 6-month-ended-annualised basis. The pick-up in business lending was consistent with improvements in economic conditions over the first half of 2021 and an increase in business confidence. However, this increase in the stock of outstanding business credit largely predates recent lockdowns due to COVID-19 outbreaks. These may reduce demand for credit for a time, although some firms may draw upon lines of credit to shore up liquidity.

The pace of decline in personal credit eased in the June quarter. Much of this reflected an

Graph 3.18

Variable Housing Interest Rates

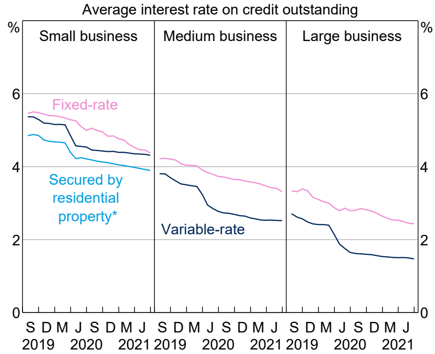


* Series break in July 2019; thereafter, data based on EFS collection
** Including low-cost brands
Sources: APRA; banks' websites; CANSTAR; RBA; Securitisation System

Graph 3.19

Business Lending Rates

Average interest rate on credit outstanding



* Small business loans secured by residential property can have fixed or variable interest rate terms and are included in the fixed-rate and variable-rate lines
Sources: APRA; RBA

Table 3.2: Growth in Financial Aggregates

Percentage change(a)

	3-month annualised		6-month annualised	
	Mar 21	Jun 21	Dec 20	Jun 21
Total credit	**3.9**	**7.0**	**0.8**	**5.5**
Household	5.1	6.9	2.9	6.0
– Housing	5.8	7.4	4.0	6.6
– Owner-occupier	7.8	9.3	5.8	8.5
– Investor	2.5	4.1	0.7	3.3
– Personal	–4.0	–1.1	–9.8	–2.6
Business	1.5	7.7	–3.2	4.5
Broad money	**4.1**	**8.4**	**9.1**	**6.2**

(a) Seasonally adjusted and break-adjusted

Sources: ABS; APRA; RBA

increase in spending on credit cards alongside the recovery in economic conditions as restrictions to contain the virus had eased.

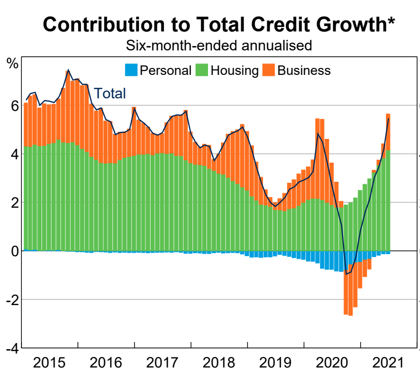
Demand for housing loans has increased

Housing credit growth picked up over the June quarter to be 6¾ per cent on a 6-month-ended-annualised basis. Growth has increased for both owner-occupiers and investors (Graph 3.21).

Commitments for housing loans increased further in the quarter to new highs. Housing loan commitments to first home buyers have been steady at a high level, while commitments to other owner-occupiers and investors increased further in the quarter (Graph 3.22).

In late 2020 and early 2021, growth in housing credit had been driven by increases in loan commitments for the purchase of new dwellings or housing construction. More recently, credit growth has been increasingly driven by commitments for purchases of existing dwellings (Graph 3.23). The levelling-off in loan commitments for construction activity has followed the closure of the Australian Govern-

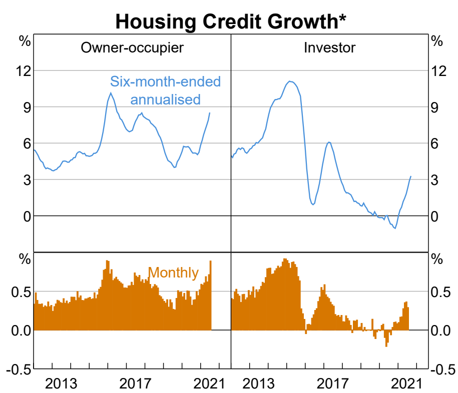
Graph 3.20



* Seasonally adjusted and break-adjusted

Sources: APRA; RBA

Graph 3.21



* Seasonally adjusted and break-adjusted

Sources: APRA; RBA

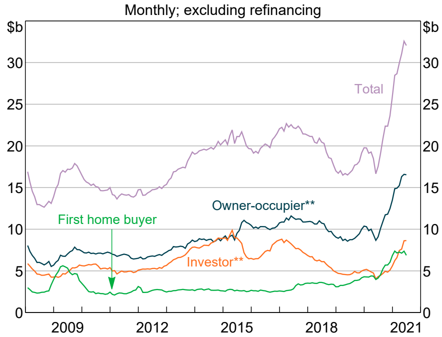
ment's HomeBuilder scheme at the end of March. While this scheme is likely to have brought forward some demand, reports from liaison indicate that demand for new housing remains above pre-pandemic levels.

Banks have noted in liaison that they expect demand for housing credit to remain strong in the coming months, given the recent strength in housing market activity and low level of interest rates. Government policy measures targeted at first home buyers will also support demand, with new places available in the Australian Government's first home buyer deposit guarantee schemes from 1 July 2021. Housing finance activity may slow for a time if measures to contain the recent outbreaks of COVID-19 are in place for an extended period.

Graph 3.22

Housing Loan Commitments*

Monthly; excluding refinancing



* Seasonally adjusted and break-adjusted

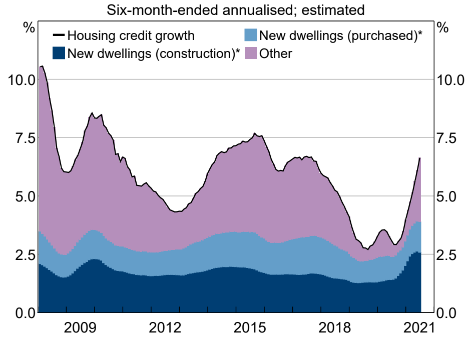
** Excluding first home buyers

Sources: ABS; RBA

Graph 3.23

Contribution to Housing Credit Growth

Six-month-ended annualised; estimated



* Estimated using housing loan commitments for the construction and purchase of new dwellings as a share of housing credit outstanding

Sources: ABS; APRA; RBA

Given the environment of rising house prices and low interest rates, it is important that lending standards are maintained. In June, the Council of Financial Regulators concluded that, while there have been signs of some increased risk taking, overall lending standards remain sound. In other developments, the implementation of the Australian Government's updated mandatory comprehensive credit reporting requirements from 1 July 2021 will enhance the ability of lenders to assess borrowers' creditworthiness. Similarly, the increased availability of consumers' banking data through the Consumer Data Right program (open banking) will facilitate sharing of data between consumers and lenders.

Payments into housing loan offset and redraw accounts have declined

Net payments into offset and redraw accounts have declined from the high levels of last year (Graph 3.24). The decline in payments since mid 2020 has been consistent with the increase in consumption in the first half of 2021, a tapering in fiscal payments and the removal of access to early-release superannuation at the end of 2020. Since the onset of the pandemic, mortgage borrowers' payments into offset and redraw accounts have been substantial, totalling about 3½ per cent of disposable income (around $54 billion).

Reductions in housing loan interest rates since March 2020 have flowed through to borrowers in the form of lower interest payments (Graph 3.25). As a result, interest payments have declined by around ¾ percentage point as a share of disposable income, despite outstanding housing credit increasing over that period. This reflects the combined effect of the pass-through of the Bank's policy easing, borrowers refinancing to lower interest rates and growth in disposable income.

In response to the recent COVID-19 outbreaks, many banks have made available a range of support measures, including payment deferrals for affected mortgagees and business borrowers. The Australian Prudential Regulation Authority (APRA) also reinstated the regulatory support for loans affected by the lockdowns, as was the case in mid 2020.

Lending to businesses had picked up

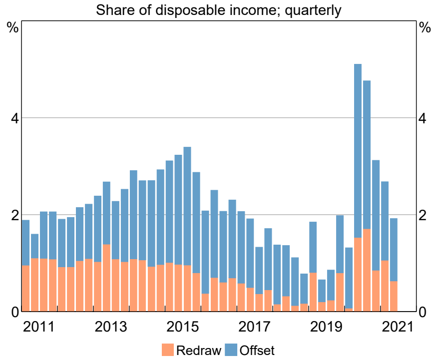
Business lending had picked up over recent months (Graph 3.26). Lending to large businesses had increased since the start of 2021, and the volume of lending to SMEs increased in the June quarter. Commitments for new business loans, which are volatile, increased sharply in June, but remain well below pre-pandemic levels in trend terms.

Liaison with banks suggested there had been a little more appetite for business borrowing up to June, consistent with the improvement in economic conditions over the first half of this year. Surveys conducted by the ABS in early 2021 indicated that some businesses accessing support in the March quarter expected to seek additional funds in the period ahead. However, economic uncertainty continues to weigh on some industries, and more recent restrictions to contain the spread of COVID-19 are likely to adversely affect a range of businesses. As a result, firms may be reluctant to take on new debt to expand their business, although some may draw on credit lines to shore up liquidity positions. Nonetheless, many businesses still have little immediate need to borrow, including for precautionary purposes, in part because of the cash buffers they had accumulated in 2020. These messages were reinforced in July by participants at the Reserve Bank's annual Small Business Finance Advisory Panel – drawn from small businesses across Australia – which provided valuable perspectives on the financial conditions facing small businesses.

Graph 3.24

Flows into Offset and Redraw Accounts*

Share of disposable income; quarterly



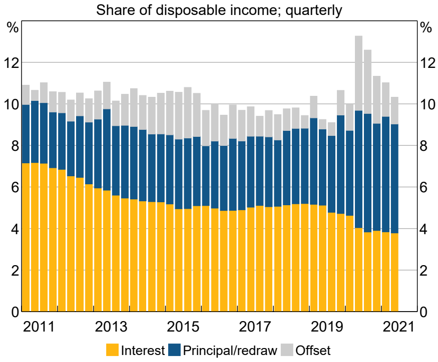
* Seasonally adjusted and break-adjusted

Sources: ABS; APRA; RBA

Graph 3.25

Flows into Housing Loan and Offset Accounts*

Share of disposable income; quarterly



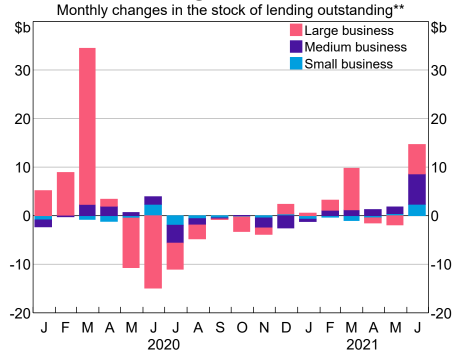
* Seasonally adjusted and break-adjusted

Sources: ABS; APRA; RBA

Graph 3.26

Lending to Business*

Monthly changes in the stock of lending outstanding**



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

** Not seasonally adjusted and not break-adjusted

Sources: APRA; RBA

The volume of new loan commitments extended to SMEs increased up to June, and the volume of commitments extended in the 2020/21 financial year was only marginally lower than in the previous year (Graph 3.27). Commitments for the purchase of property and construction picked up in June. Lending for machinery and equipment has been supported by the Australian Government's enhancements to the temporary full expensing scheme, which provides an incentive to invest in these assets. Meanwhile, total SME refinancing activity was higher in the 2020/21 financial year compared with the year prior, as some businesses availed themselves of the lower interest rates on offer.

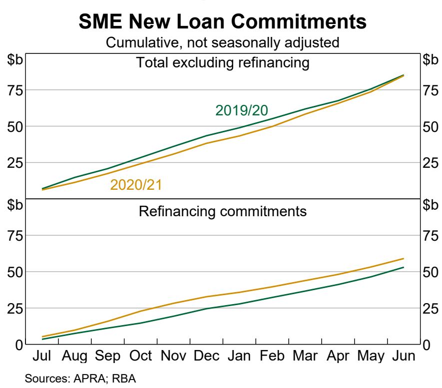
The Australian Government's $40 billion SME Guarantee Scheme, which started in late March 2020 and was enhanced in October 2020, closed to new applications at the end of June 2021. Overall, take-up of the scheme was modest, with around $6½ billion of loan commitments made to around 66,000 businesses. In April, the government introduced the SME Recovery Loan Scheme, which is an enhanced and extended loan guarantee scheme for SMEs that had received JobKeeper payments in the March quarter of 2021. This scheme is more flexible for borrowers in terms of the maximum loan size, the ability to refinance existing loans and the repayment terms. Further, advertised interest rates under the new scheme are generally lower than comparable products under the original scheme.

Banks reported in liaison that they are seeking more opportunities to lend to businesses, including smaller businesses. In part, this reflects the earlier improvement in economic conditions relative to 2020 and an increase in competition between lenders. However, some banks remain cautious about businesses that continue to be adversely affected by the pandemic.

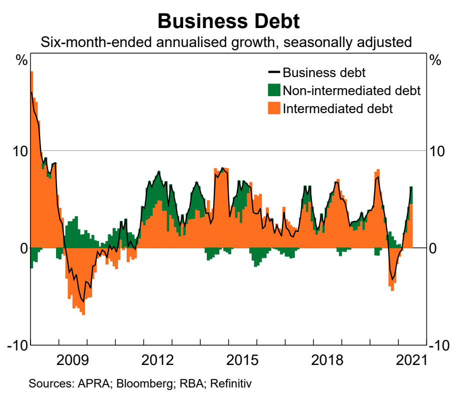
Growth of broader measures of business debt had also increased

Growth in a broader measure of business debt picked up over the first half of 2021 to be above its average pace over the past decade (Graph 3.28). Until recently, this increase had been driven by an increase in syndicated lending to large businesses by entities that do not report to APRA. In June, however, the growth was broad based across other sources of debt, including business credit and bond issuance. Australian corporations raised around $23 billion via corporate bond issuance in the first half of 2021 (Graph 3.29); two-thirds of this funding was raised offshore.

Graph 3.27



Graph 3.28



Australian equity prices have increased this year

The ASX 200 increased further over recent months to be around 9 per cent higher than its February 2020 peak on a total return basis, which takes dividends into account. The rebound in global equity prices since March last year reflects the recovery in the global economy along with an improvement in sentiment as effective COVID-19 vaccines have been developed and administered (Graph 3.30). The ASX 200 has been at record levels in early August, with little reaction in aggregate to COVID-19 Delta outbreaks and related restrictions.

In general, the sectors that saw the highest price increases in the first few months of the year have seen the weakest performance over recent months (Graph 3.31). Information technology (IT) stocks have seen the largest gains, supported by a fall in long-term government bond yields. By contrast, financials have underperformed the market as growth expectations have waned. So far in 2021, the price of mining materials stocks has increased by around 17 per cent, buoyed higher by rising commodity prices.

Capital market activity has been strong in 2021 thus far

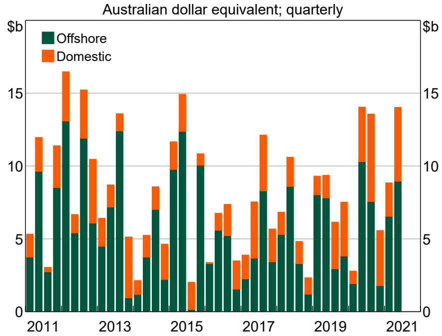
In the first half of 2021, there were 292 merger and acquisition (M&A) deals announced for a total value of around $48 billion (Graph 3.32). This is significantly larger than the average for the first half of a year over the past decade, and the highest level since 2007 when there were a total of $53 billion worth of deals announced in the first half of the year.

In the first 6 months of 2021, there were 69 initial public offerings, which raised $3.6 billion (Graph 3.33). This is the strongest start to the year since 2014.

Graph 3.29

Australian Corporate Bond Issuance

Australian dollar equivalent; quarterly

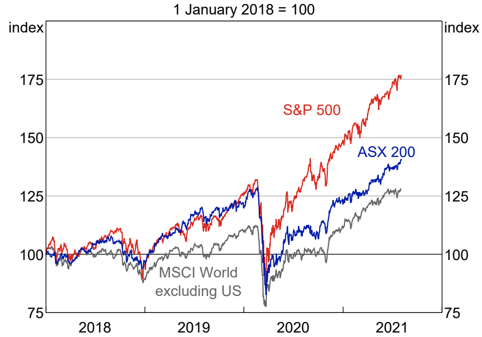


Sources: Bloomberg; Private Placement Monitor; RBA

Graph 3.30

Total Return Indices

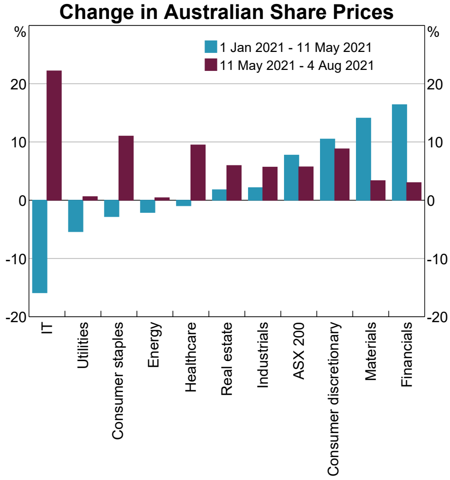
1 January 2018 = 100



Source: Bloomberg

Graph 3.31

Change in Australian Share Prices



Sources: Bloomberg; RBA

The Australian dollar has depreciated

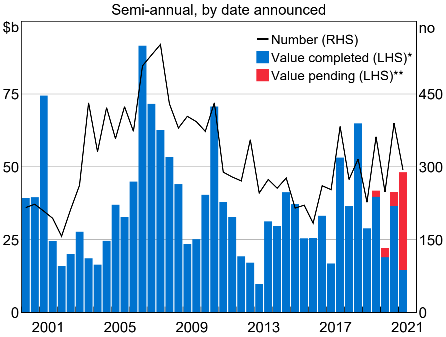
After moving in a narrow range since the start of the year, the Australian dollar has depreciated over the past few months on a trade-weighted basis and against the US dollar (Graph 3.34). It depreciated in the period following the June FOMC meeting, and is close to its lowest levels this year.

Yields on shorter-term Australian government bonds have declined a little relative to those of the major advanced economies over recent months, partly reflecting the rise in yields on shorter-term US government bonds following the June FOMC meeting (Graph 3.35). The differential on longer-term yields has also declined. The depreciation of the Australian dollar over recent months has occurred despite prices of Australia's commodity exports having been around their highest levels in a decade. This may reflect an expectation that the very high level of commodity prices will not persist. Consistent with this, the investment intentions of major mining companies in Australia have not increased in response to higher commodity prices and more recently the prices of some commodities have declined. The exchange rates of some other commodity-exporting economies, such as the Canadian dollar and Norwegian krone, have also depreciated over recent months.

Graph 3.32

M&A by Listed Australian Companies

Semi-annual, by date announced



* Value of deals announced in quarter that are eventually completed

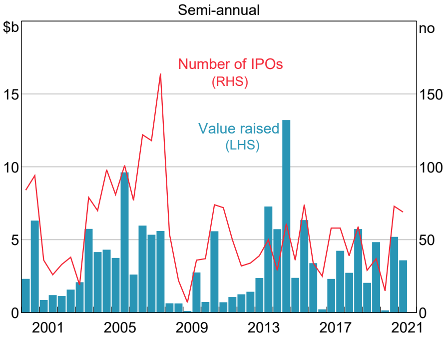
** Includes transactions announced in the past 2 years but not yet completed

Sources: RBA; Refinitiv

Graph 3.33

IPOs in Australia

Semi-annual

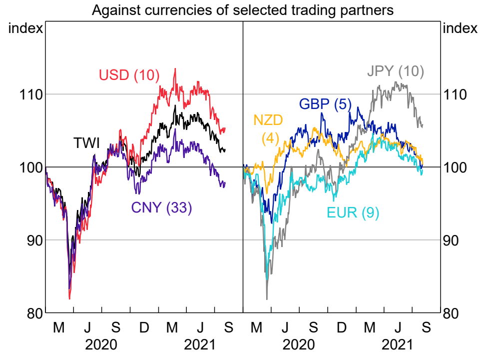


Sources: ASX; RBA

Graph 3.34

Australian Dollar*

Against currencies of selected trading partners

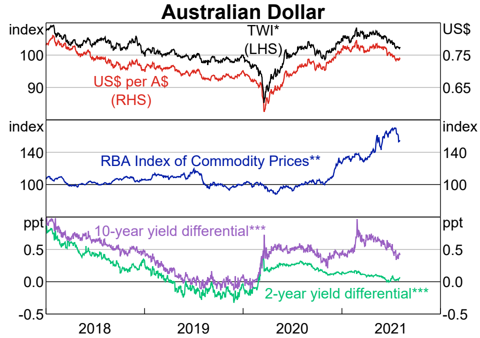


* Indexed 1 January 2020 = 100, TWI weights in parentheses

Sources: Bloomberg; RBA

Graph 3.35

Australian Dollar



* Trade-weighted index, indexed to 1 January 2020 = 100

** Indexed to 1 January 2020 = 100

*** Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP

Sources: Bloomberg; RBA

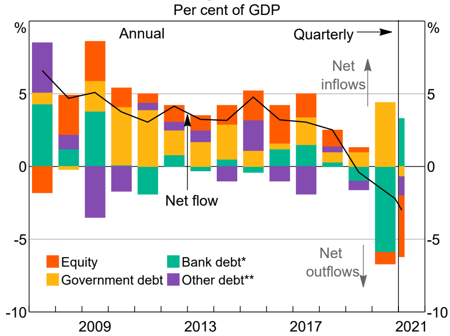
Australia continued to be a net lender of capital in the March quarter

Net capital outflows increased in the March quarter as Australia's current account surplus widened. Net outflows reflected portfolio equity investment as Australian superannuation and other investment funds continued to purchase foreign equities (Graph 3.36). The increase in the value of Australia's foreign equity holdings over recent years – which primarily reflects asset valuation effects – has contributed to a widening in Australia's net foreign equity asset position (Graph 3.37). Partly reflecting this, Australia's net foreign liability position remains around its lowest level in a number of decades as a percentage of GDP. ✠

Graph 3.36

Net Capital Flows

Per cent of GDP



* Authorised deposit taking institutions, adjusted for the US dollar swap facility in 2008–09 & 2020

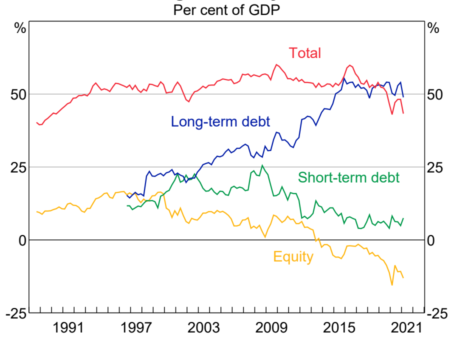
** Includes public corporations and private sector

Sources: ABS; RBA

Graph 3.37

Net Foreign Liability Position

Per cent of GDP



Sources: ABS; RBA

Endnotes

[1] Surplus ES balances are total ES balances net of contracted open repo positions. See RBA, 'Domestic Market Operations and Standing Facilities'. Available at <https://www.rba.gov.au/mkt-operations/domestic-market-ops-and-standing-facilities.html>.