3. Business and Household Balance Sheets

Overall, financial stability risks emanating from the domestic business and household sectors remain limited by the generally good condition of these sectors' balance sheets. This follows a period of softer demand for debt by both sectors since the global financial crisis.

Low gearing in the business sector has helped to mitigate some of the risks associated with the softening in business conditions and profitability over the past six months. Weaker conditions have been evident across a number of industries, but particularly the mining sector, following large falls in commodity prices last year. This has flowed through to parts of the non-mining sector, while some industries are also facing ongoing pressures from a persistently high exchange rate and softer consumer demand. This sometimes challenging environment has contributed to higher business failure rates, but despite this, the recovery in banks' business loan performance has continued, supported by the generally solid financial position of the business sector.

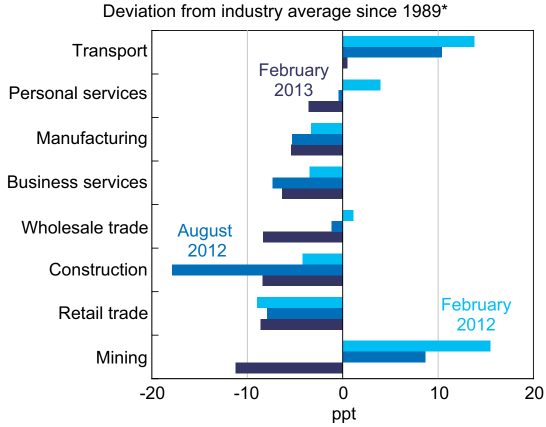
The household sector has continued to display a more prudent approach to its finances than in the period prior to the global financial crisis, characterised by a return to more normal saving patterns and reduced appetite for borrowing and investment risk. Many households have been taking advantage of the lower interest-rate environment to repay existing debt more quickly than required and to build mortgage buffers. Consistent with this, housing loan arrears rates have continued to improve across most parts of the country and other indicators of household financial stress remain low. Nonetheless, household indebtedness and gearing remain around historically high levels. It would therefore be undesirable from a financial stability perspective if households were to exhibit less prudent behaviour than they have over the past few years.

Business Sector

Business conditions and profitability

Overall conditions in the business sector have softened over the past six months. Survey measures imply that conditions are now a bit below average in most industries; reported conditions deteriorated sharply in the mining sector following falls in bulk commodity prices through much of 2012, although prices have subsequently recovered somewhat (Graph 3.1). The softening of conditions in the mining sector is also likely to have weighed on conditions

Graph 3.1
Business Conditions by Industry
Deviation from industry average since 1989*



* Three-month moving average
Sources: NAB; RBA

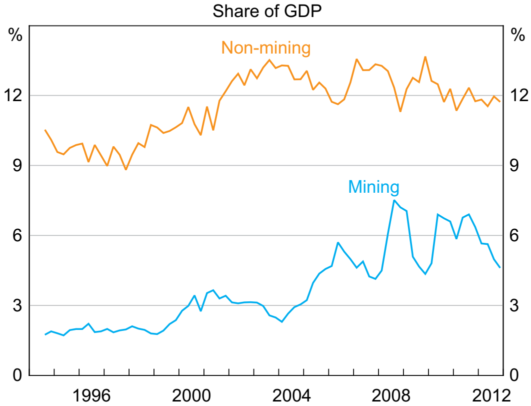
in related industries, such as business services (see also 'Box B: The Financial Condition of Companies Servicing the Mining Sector'). At the same time, the ongoing challenges of a high exchange rate and a return to more traditional borrowing and saving behaviour by households have weighed on the manufacturing, retail and wholesale trade industries.

This softening in conditions is consistent with business profitability moderating over the past year. The national accounts measure of non-financial corporate profits declined by 9 per cent over the year to the December quarter 2012. This was driven by mining firms, for which aggregate profits fell by about 25 per cent, to be slightly below their average share of GDP over the past decade (Graph 3.2). Profits of the non-mining sector rose by 2 per cent over this period, although there was considerable divergence across industries: profits fell sharply for manufacturing and wholesale firms, but grew solidly for transport companies. The share of large listed companies reporting losses remains somewhat elevated, but below its peak in the crisis period. Market analysts continue to downgrade their earnings expectations for the coming financial year, with these downgrades having been particularly sharp for the mining sector.

In contrast to larger businesses, surveys indicate that conditions experienced by small businesses improved slightly towards the end of 2012. National accounts data suggest that unincorporated businesses' profits declined by less than for corporates over the year to the December quarter 2012, which partly reflects the lower share of mining companies in the unincorporated sector. Data for unlisted companies from credit bureau Dun & Bradstreet suggest that profitability for construction firms declined the most over the past year and has trended down since 2007. The share of unlisted firms making losses declined by 1 percentage point in the 2011/12 financial year, but at 21 per cent it remained slightly above its decade average.

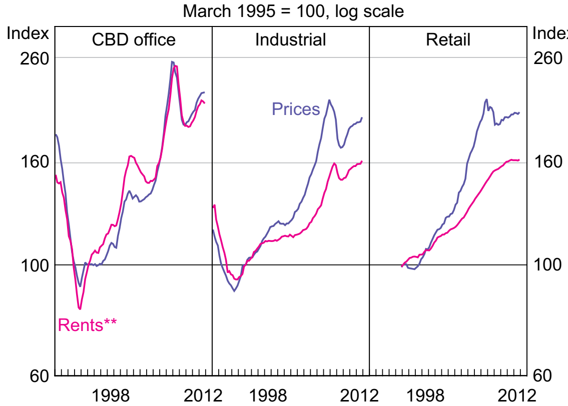
The difficult operating environment being faced by some businesses is also evident in the commercial property sector, a sector to which the banking system has sizeable exposures. The pace of the recovery in commercial property rents and prices slowed in 2012, and conditions generally remain weaker than prior to the crisis across the main market segments (Graph 3.3). In the CBD office market, where conditions had improved the most over the past few years, rents have fallen in recent quarters and vacancy rates have begun to increase again. The increase in office vacancy rates over the second half of 2012 was driven by weaker tenant demand across most capital cities, and followed large supply additions in the first half, particularly in Perth and

Graph 3.2
Private Non-financial Corporates' Profits*
Share of GDP



* Gross operating profits; inventory-valuation adjusted
Sources: ABS; RBA

Graph 3.3
Commercial Property*
March 1995 = 100, log scale

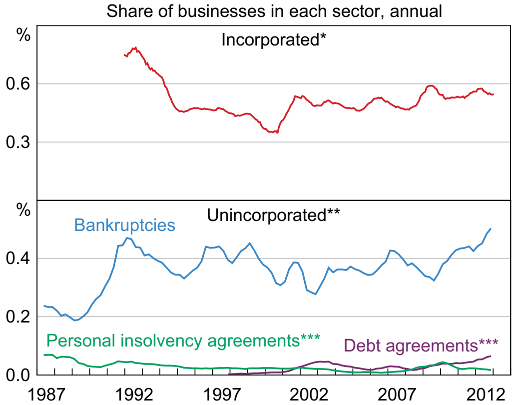


* CBD office and industrial are prime property, retail is regional (non-CBD) centres
** CBD office is effective rents, industrial and retail are face rents
Sources: ABS; Jones Lang LaSalle Research; RBA

Brisbane. While there is some new supply in the pipeline, private non-residential building activity has been fairly weak compared with the run-up prior to the financial crisis, and the outlook for construction in the near term is subdued: non-residential building approvals in the second half of 2012 were below their average level since the early 1990s as a per cent of GDP, and survey measures of investment intentions are weak.

In line with the general softening in business conditions and profitability, business failure rates have been above average recently. The bankruptcy rate among unincorporated businesses has drifted up over the past three years (Graph 3.4). This reflects both an increase in the number of bankruptcies and a decline in the number of unincorporated businesses, particularly self-employed construction workers. Other kinds of business-related personal administrations, as a share of unincorporated businesses, have collectively also drifted up over the same period. The insolvency rate for incorporated businesses is also elevated, though it is below recent peaks and still well below the level observed in the early 1990s. Incorporated business failures have been concentrated in the construction and services sectors, and by state have been highest in Queensland and New South Wales, and have been climbing in Western Australia. For both incorporated and unincorporated businesses, the share of failures attributed to economic conditions has increased in recent years, though most incorporated business failures are still attributed to other factors, such as weakness in business management.

Graph 3.4
Business Failures
Share of businesses in each sector, annual

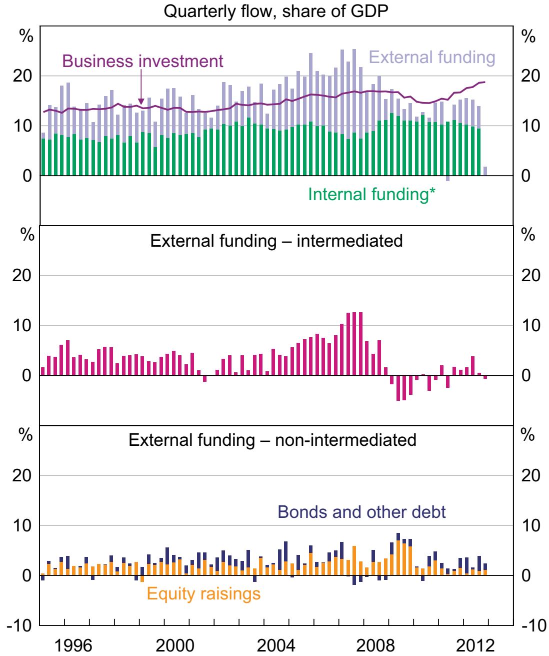


* Companies entering external administration
** Business-related personal bankruptcies and other administrations
*** Data are backcast before March 2003 to exclude non-business related administrations
Sources: ABS; ASIC; ITSA; RBA

Financing and balance sheet position

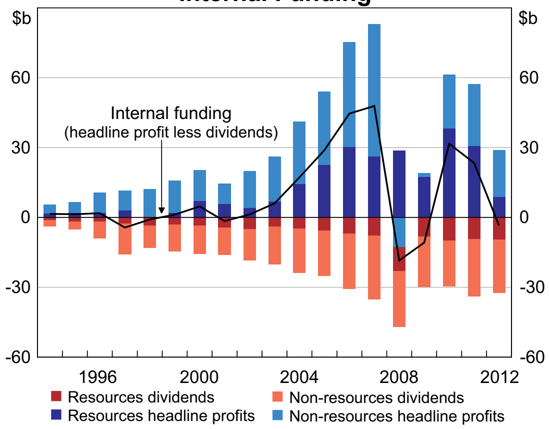
Firms' internal funding available to finance investment has declined alongside the decline in profitability. The quarterly flow of internal funding has slowed since the September quarter 2011, but it remains above its long-run average as a share of GDP (Graph 3.5). Among listed corporates, the mining sector drove most of the fall in internal funding (given the sector's sharp fall in profits), although retained earnings continue to be an important source of funding for that sector (Graph 3.6). The mining sector has also been able to access bond markets to help fund its large investment pipeline: mining firms accounted for more than half of all bond issuance

Graph 3.5
Business Funding
Quarterly flow, share of GDP



* Last observation is September 2012
Sources: ABS; APRA; ASX; Austraclear; RBA

Graph 3.6
Listed Non-financial Corporates' Internal Funding

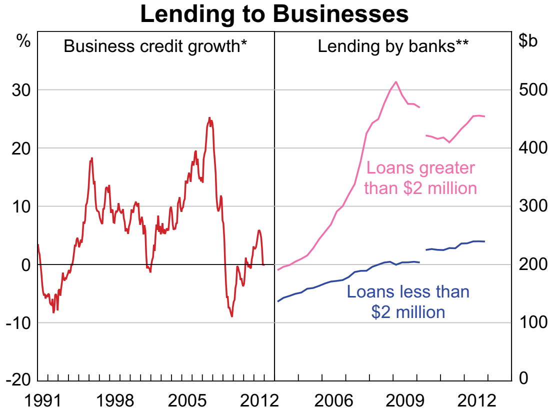


Sources: Bloomberg; Morningstar; RBA

by Australian non-financial corporates in 2012. Total issuance was quite strong in the year, at about 2 per cent of GDP, as firms took advantage of ongoing foreign appetite for corporate debt, yields at decade lows and the narrowest spreads over government bonds in several years.

In contrast to non-intermediated debt, growth in intermediated business credit has been subdued. After rising by about 3 per cent over the first half of 2012, business credit has been broadly flat since then (Graph 3.7). The recent weakness was evident across a range of industries, and for both small and

Graph 3.7
Lending to Businesses



* Six-month-ended, annualised
** Breaks in June 2010 due to loan reclassifications
Sources: APRA; RBA

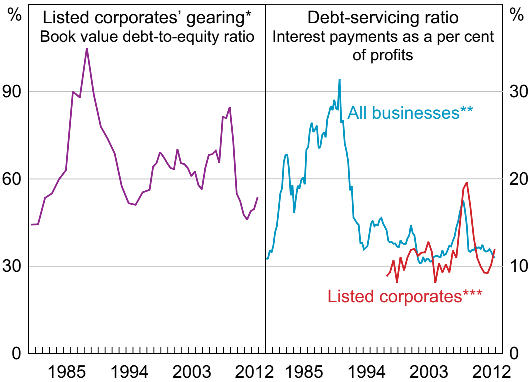
large loans; a split by (typically larger) incorporated businesses and smaller, unincorporated businesses suggests it was driven by a decline in incorporated business lending.

The overall weakness in business credit in recent quarters seems to be mainly due to weak demand rather than supply constraints. As noted, some larger businesses have been tapping bond markets instead of borrowing from banks, with businesses taking advantage of the more favourable terms they can obtain in bond markets than from financial intermediaries such as banks. In addition, liaison with firms indicates that many businesses are still seeking to pay down debt rather than increase borrowings. There are, however, reports that banks have tightened their lending standards to certain segments of the business sector in response to weaker outlooks, such as some parts of the mining sector. This may have resulted in unmet demand for intermediated credit in some sectors: smaller firms in more risky segments that traditionally do not have access to bond markets tend to be those that are reporting difficulty in obtaining finance.

Unlike in previous years, the continued deleveraging by some businesses in response to weak conditions has not been accompanied by strong equity raisings. Both IPOs and issuance of new equity by existing firms remained subdued in the second half of 2012, while buybacks continued to pick up and broadened beyond resources companies.

Deleveraging by many businesses in recent years has resulted in stronger balance sheets and has enhanced the resilience of the business sector to the current weaker conditions. In line with limited growth in business credit, business sector gearing has remained at relatively low levels (Graph 3.8). Among listed non-financial corporates, the aggregate gearing (book value debt-to-equity) ratio is estimated to have increased by 5 percentage points over the year to December 2012, to 54 per cent. The increase was mainly due to the bond-funded expansions of a few mining

Graph 3.8
Business Indebtedness



* Excludes foreign-domiciled companies
** Gross interest paid on intermediated debt from Australian-located financial institutions
*** Net interest paid on all debt; excludes foreign-domiciled companies
Sources: ABS; APRA; Bloomberg; Morningstar; RBA; Statex

companies; gearing was steady or fell for around half of listed firms. Infrastructure companies remain highly geared relative to the overall listed sector, reflecting business models that tend to rely more on debt financing. Aggregate leverage for listed real estate investment trusts (REITs) has declined from a peak of 113 per cent in the second half of 2008, to around 50 per cent in December 2012. Dun & Bradstreet data suggest that gearing in the unlisted business sector declined over the year to June 2012: the median gearing ratio for that sector fell to 31 per cent among the 2012 sample of firms, down from 39 per cent in 2011, and well below the pre-crisis average of 57 per cent.

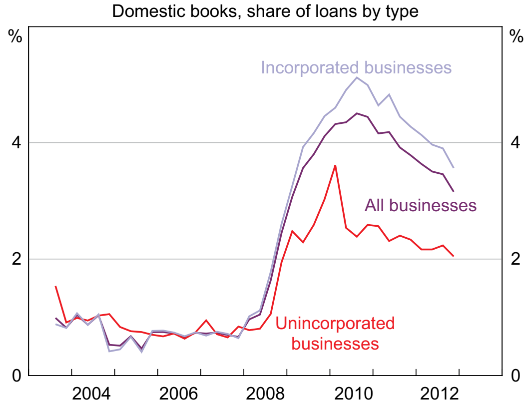
Consistent with low leverage and the recent falls in interest rates, the debt-servicing ratio (DSR) for the business sector overall remains below its long-run average level. However, the DSR for listed companies increased a little over the second half of 2012. This was driven by the increased debt and lower profitability of resources companies, with that sector's DSR rising to around 7 per cent, slightly above its average since the late 1990s. The DSR remains highest for infrastructure companies, reflecting their higher gearing, though at around 40 per cent this ratio remains well below its 2008 peak. The aggregate DSR for REITs has been relatively stable for the past 18 months at around 33 per cent, as the effect of declining indebtedness has offset a moderation in profits.

Loan performance

Although overall business conditions and profitability have weakened recently, banks' business loan performance has continued to improve over recent quarters, supported by the healthy condition of businesses' balance sheets (discussed above). As discussed in 'The Australian Financial System' chapter, the non-performing share of banks' business loans has continued to decline from its peak in 2010 (Graph 3.9). The recent decline was driven by loans to incorporated businesses, which had also accounted for much of the earlier increase. Data for the six months to September 2012 from the major banks' Pillar 3 reports show that performance improved most noticeably for loans to the construction, and property and business services sectors, partially offset by weaker performance of loans to the manufacturing sector. Despite the recent improvement, the share of non-performing loans is still above pre-crisis levels, and if the rate of business failures were to remain elevated it may limit further improvement in loan performance.

Much of the improvement in banks' business loan performance was accounted for by commercial

Graph 3.9
Banks' Non-performing Business Assets*
Domestic books, share of loans by type

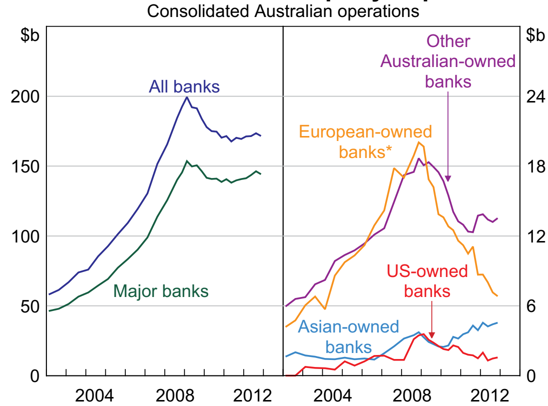


* Excludes lending to financial businesses and includes bills and debt securities
Sources: APRA; RBA

property loans, which make up around one-third of banks' total business lending. The performance of these loans has improved at a faster pace than that of other business loans, partly reversing their earlier disproportionate deterioration; the impairment rate on banks' commercial property exposures was around 3½ per cent in December 2012, down from a peak of about 6 per cent in September 2010. This decline in impairments was driven by a steep fall in the impairment rate for loans to retail property, partly reflecting the 2011 restructuring of the former Centro Property Group.

Following the sharp fall from their 2009 peak, banks' total outstanding commercial property exposures have been broadly unchanged since late 2010 (Graph 3.10). The major banks have, however, increased their exposures over the past 18 months: their outstanding loans are now just 6 per cent below their peak. This has been mostly offset by a continued reduction in commercial property exposures of European banks. Foreign banks have reportedly sold much of their distressed commercial property loan portfolios to hedge funds and other distressed debt investors. Domestic banks appear to have taken a measured approach to resolving some of their troubled exposures in order to avoid putting additional pressure on market valuations.

Graph 3.10
Banks' Commercial Property Exposures
Consolidated Australian operations



* Includes UK banks
Sources: APRA; RBA

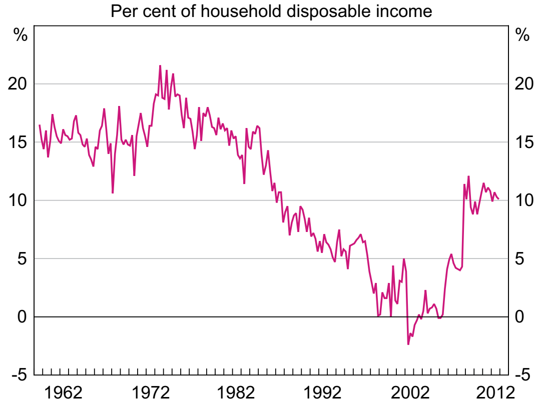
Household Sector

Saving and borrowing behaviour

In recent quarters the household sector has maintained the more prudent approach to its finances that has been evident over the past few years. One indicator of this is the household saving ratio, which has stabilised at around 10 per cent, well above the average for the past 20 years (Graph 3.11). This could be characterised as a return to more normal saving behaviour after the previous two decades of adjustment to disinflation, lower interest rates and financial deregulation. It is unlikely that the saving ratio will return to the higher rates of the 1960s and 1970s, partly because unincorporated enterprises – which tend to save more than employee households – were a bigger share of the economy at that time. Part of this shift in saving behaviour may reflect the changes in households' attitudes towards their finances that have been persistent since the financial crisis.

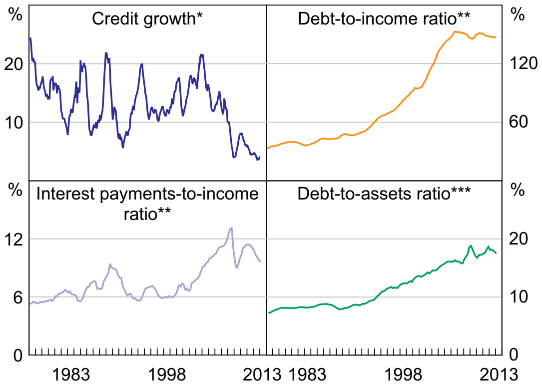
The more prudent approach to finances can also be seen in households' reduced appetite for taking on additional debt since the financial crisis (Graph 3.12). Household credit growth has been slower in the past five years – at an average annual rate of around 5½ per cent – than in the 20 years prior, when it averaged around 13½ per cent. Within household

Graph 3.11
Household Saving*
Per cent of household disposable income



* Household sector includes unincorporated businesses; net of depreciation
Source: ABS

Graph 3.12
Household Indebtedness

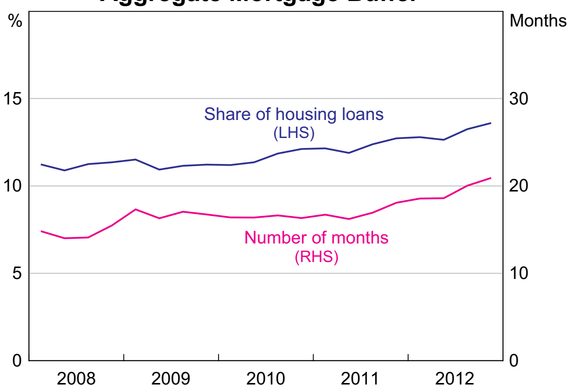


* Six-month-ended, annualised
** RBA estimates for March quarter 2013
*** RBA estimates for December quarter 2012 and March quarter 2013
Sources: ABS; RBA; RP Data-Rismark

credit, personal credit has declined over the past five years, with a large fall in margin loans partially offset by modest growth in credit card debt. Growth in housing credit has also slowed over this period, to a current annual rate of around 4½ per cent despite a moderate pick-up in the value of housing loan approvals in the past few years. The slower pace of credit growth has been outpaced by income growth in the past couple of years, resulting in the household debt-to-income ratio falling slightly, to 148 per cent, after peaking at 153 per cent in late 2006. Real household disposable income growth has recently slowed a little, however, to 2 per cent over the year to the December quarter 2012. This modest growth in income, combined with the decline in interest rates and slower credit growth, has reduced the share of disposable income used to make interest payments to an estimated 9½ per cent in the March quarter 2013. Household indebtedness and gearing are still around historically high levels though, so from the perspective of their financial resilience it would be preferable if households maintained this more prudent behaviour.

Contributing to the slower pace of credit growth is the fact that many households have been taking advantage of the lower interest rate environment to pay down their debt faster than required. Mortgage buffers – balances in mortgage offset and redraw facilities – are now estimated to be equivalent to around 14 per cent of the outstanding stock of housing loans (Graph 3.13). When interest rates fall, not all borrowers reduce their mortgage payments, resulting in an increase in prepayment rates. The increase in the rate of prepayment as a result of the decline in mortgage lending rates since late 2011 is estimated to have reduced the growth rate of housing credit by around ½ percentage point over 2012.

Graph 3.13
Aggregate Mortgage Buffer*



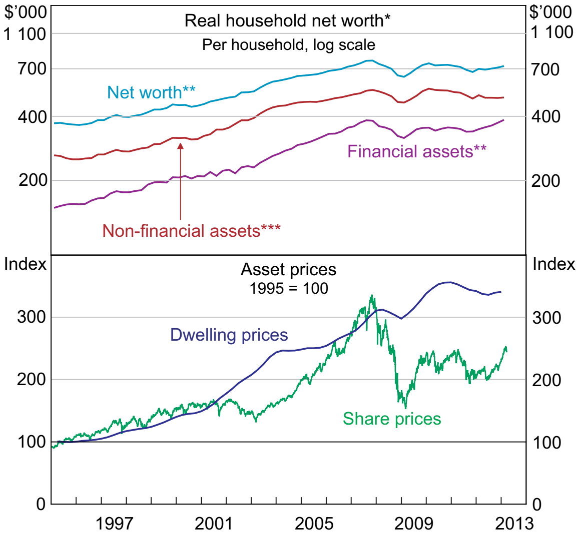
* Data are backcast before December 2010 to adjust for a reporting change by one bank
Sources: APRA; RBA

Measured a different way, in aggregate, households' mortgage buffers are equivalent to around 20 months of scheduled repayments (principal plus interest) at current interest rates. This provides considerable scope for many borrowers to continue to meet their loan repayments even during a temporary spell of unemployment or reduced income. As with housing loans, households have also been paying off credit card debt; net repayments on personal credit and charge cards have been above average in recent years and balances on personal credit cards have also slightly declined since mid 2012.

Wealth and investment preferences

The higher household saving ratio has contributed to the rebuilding of household wealth in recent quarters following the falls in asset prices over the few years prior (Graph 3.14). Real net worth per

Graph 3.14
Real Household Net Worth and Asset Prices

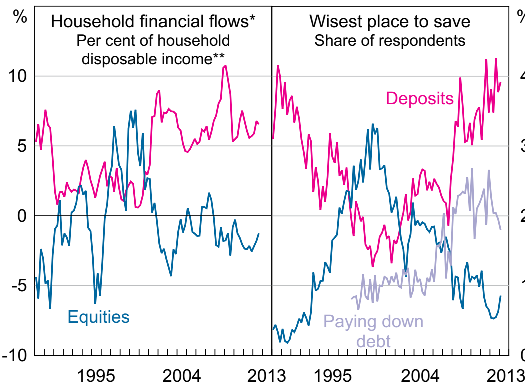


* In 2010/11 dollars; deflated using the household final consumption expenditure implicit price deflator
** RBA estimates for December quarter 2012 and March quarter 2013
*** RBA estimate for March quarter 2013
Sources: ABS; Bloomberg; RBA; REIA; RP Data-Rismark

household rose by an estimated 3½ per cent over the year to March 2013, to be about 6½ per cent below its 2007 peak. Most of the rise was in the financial assets component; continued net inflows into deposits and superannuation were accompanied by positive valuation effects associated with the recovery in share prices, particularly since the middle of 2012. There has also been a recent pick-up in the value of housing assets, with the average dwelling price rising by around 4 per cent since its trough in May 2012. After the weakness of the past few years, there are some signs that a recovery in housing markets now seems to be underway in most capital cities, with auction clearance rates and rental yields increasing throughout 2012 and in 2013 to date. Assuming household credit growth remains subdued, the recovery in dwelling and share prices is likely to reduce the household debt-to-assets ratio.

As yet there is little sign that the recent recovery in asset prices has encouraged households to shift away from their more cautious financial behaviour of recent years or to make less conservative investment choices. Data for the September quarter 2012 (the latest data available at the time of publication) showed a further net outflow from households' direct equity holdings over the past year, albeit less than in recent years, while flows into deposits remained close to their decade average (Graph 3.15). More recent survey data show most households continue to favour deposits as the 'wisest place' for their savings. Regardless of their financial preferences, from an investor protection perspective, it is always important for households to understand and appropriately manage the risks they take. The recent failure of a number of small finance companies that issued unlisted debentures to retail investors highlights some of the challenges in this area (see the chapter on 'The Australian Financial System' for more detail).

Graph 3.15
Households' Financial Preferences

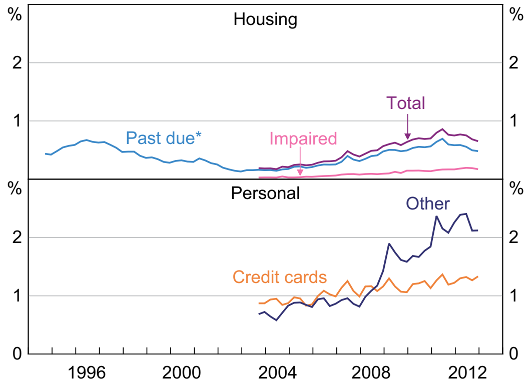


* Four-quarter moving average
** Includes income of unincorporated businesses; income is after interest, tax and depreciation
Sources: ABS; Melbourne Institute and Westpac

Loan performance and other indicators of financial stress

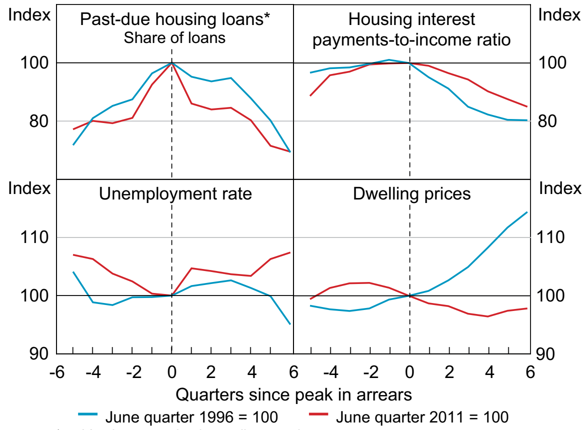
Despite a modest increase in the unemployment rate over 2012, the household sector continues to cope reasonably well with meeting its debt obligations. The non-performing share of housing loans – loans that are past due or impaired – has continued to fall since peaking in June 2011 (Graph 3.16). This decline has been driven by the continued fall in the past-due share of loans, to 0.5 per cent in December 2012. Some financial institutions have indicated that they

Graph 3.16
Banks' Non-performing Assets
Share of loans by type



* 90+ days past due but well secured
Source: APRA

Graph 3.17
Peaks in Housing Loan Arrears



* 90+ days past due but well secured
Sources: ABS; APRA; RBA; REIA; RP Data-Rismark

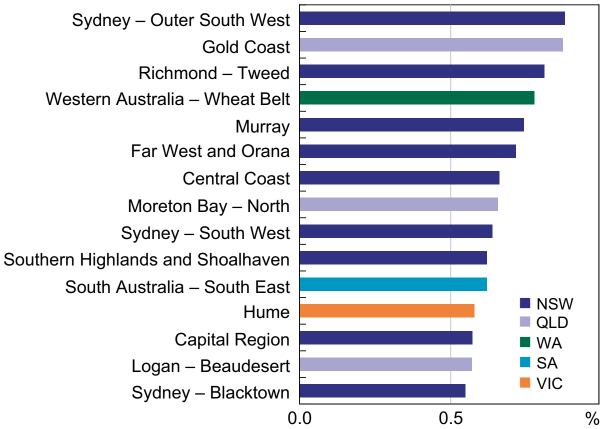
do not anticipate much, if any, further improvement in housing loan performance over the coming year, because the effect of lower interest rates is expected to be offset by that of ongoing softness in the labour market: forward-looking indicators point to only modest employment growth in the coming months. The non-performance rate for banks' credit card lending has drifted up a little in the past couple of years, while the rate for other personal loans has been broadly unchanged at a level that is higher than its average over the early to mid 2000s. While both these loan types are inherently riskier and less likely to be secured than housing loans, they only account for a small (and declining) share of total household credit. A sharp increase in these non-performance rates could, however, provide an early signal of borrower stress.

The fall in housing arrears since its 2011 peak is comparable to the fall seen after the previous peak in 1996, despite less favourable movements recently in some factors that can influence housing loan performance (Graph 3.17). In the current episode, since the peak in arrears dwelling prices have fallen, the unemployment rate has increased and the decline in the housing interest-servicing ratio has been slower and from a higher level than in 1996. Following the peak in arrears in 1996, dwelling prices rose strongly, the unemployment rate eventually declined, albeit from a higher level than in 2011, and the interest-servicing ratio of households fell sharply.

At least part of the recent decline in arrears is a reversal of flood-related payment difficulties for some borrowers, but there is also reason to believe that some households might have become more resilient to economic shocks. For example, products such as home equity loans, redraw facilities and offset accounts are more popular than in the 1990s. These types of loan products make it easier for households to build mortgage buffers, enhancing their ability to cope with income shocks. Survey data also suggest that those households that are financially constrained (unable to make payments for essential goods or services, or having to borrow money from family or friends) are currently holding a smaller share of total owner-occupier housing debt than in the late 1990s. As noted above, the changed sentiment of households towards their finances since the financial crisis has also contributed to a shift in their behaviour towards repaying debt.

At a regional level, data on securitised housing loans suggest that arrears rates have declined in all mainland states since mid 2011. However, there are pockets of weakness, with some regions – such as parts of Sydney's western suburbs – having had high arrears rates for a number of years (Graph 3.18).

Graph 3.18
Regions with the Highest Securitised Housing Loan Arrears Rates*
90+ days in arrears, share of loans by region, January 2013

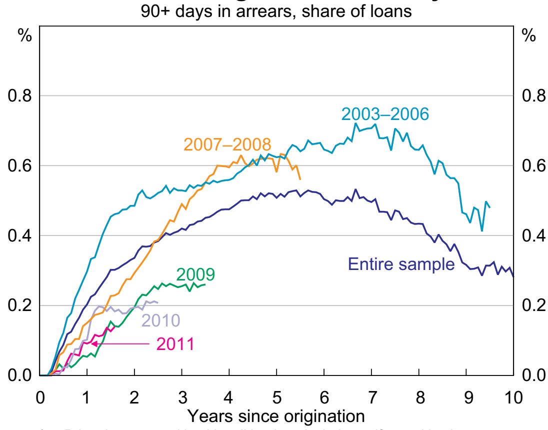


* Prime loans securitised by all lenders; includes self-securitisations; regions with at least 2 500 loans outstanding
Sources: ABS; Perpetual; RBA

Other regions with relatively high arrears rates include those that have had large dwelling price falls and/or that rely on tourism, a sector that has been under pressure recently from the persistently high exchange rate. Even in some of these regions, though, arrears rates have stabilised or started to fall in recent months; this has been particularly evident in parts of Sydney's western suburbs and south-east Queensland (including the Gold Coast). The arrears rate in Hobart increased sharply in late 2011 and early 2012, and although it has since improved, it remains relatively high. The increase was likely to have been driven by the increase in the unemployment rate in Tasmania at around the same time. While the January floods in Queensland and northern New South Wales may put some upward pressure on mortgage arrears rates in those areas, the effect on the aggregate arrears rate is expected to be even smaller than in the 2011 floods; in both flooding episodes, hardship relief packages (including 'payment holidays') were put in place by banks to help affected borrowers. These packages prevented short-term flood-related difficulties from becoming more ongoing problems, even if in some cases they temporarily boosted reported non-performance rates.

A large share of the housing loans currently in arrears nationally was originated during earlier periods of rapid dwelling price growth and above-average construction activity (Graph 3.19). These periods differed by state: the worst-performing loans tend to have been originated between 2003 and 2006 in New South Wales and between 2007 and 2008 in Queensland and Western Australia. Encouragingly, arrears rates on more recent loan cohorts are lower on average than for the overall loan pool. Even the 2009 cohort has performed well despite it including a high proportion of first home buyers (FHBs), whose typically higher loan-to-valuation ratios (LVRs) might be thought to increase their riskiness.

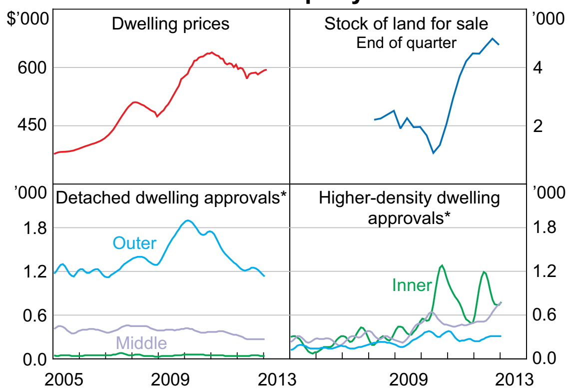
Graph 3.19
Securitised Housing Loan Arrears by Cohort*
90+ days in arrears, share of loans



* Prime loans securitised by all lenders; includes self-securitisations
Sources: Perpetual; RBA

Although housing loan arrears rates are currently low across most parts of Victoria, the outlook for the Melbourne property market appears to be softer than for other large cities and some banks have signalled that they will be alert to any signs of deterioration in asset performance. The current stock of land for sale is at a high level and building approvals data point to increases in the stock of housing, and potential oversupply, in some parts of Melbourne, particularly the inner-city apartment market (Graph 3.20). This is on top of previous strong supply of detached housing in the outer suburbs. The increase in the stock of housing is

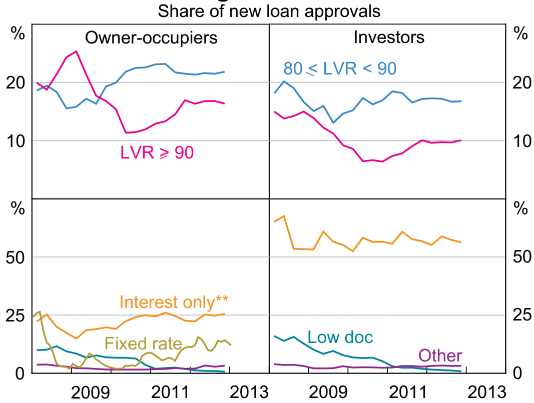
Graph 3.20
Melbourne Property Market



* 13-period Henderson trend
Sources: ABS; RBA; Research4/Charter Keck Cramer; RP Data-Rismark

Graph 3.21
Banks' Housing Loan Characteristics*

Share of new loan approvals



* LVR = loan-to-valuation ratio; 'Other' includes loans approved outside normal policies, and other non-standard loans
** Data are backcast before December 2010 to adjust for a reporting change by one bank
Sources: ABS; APRA; RBA

consistent with Melbourne dwelling prices declining further and recovering less of their earlier decline than prices in most other capital cities have done.

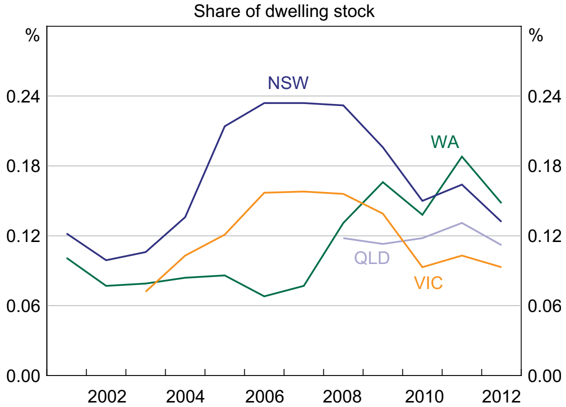
Available information suggests that the quality of new housing loans being written should support future loan performance. As noted in the chapter 'The Australian Financial System', a number of banks have recently responded to the decline in mortgage interest rates to below-average levels by increasing the interest rate buffers they use in assessing the capacity of households to service their mortgage. For example, it is now reportedly common for banks to test loan serviceability using interest rates around 1¾ to 2 percentage points higher than their discounted standard variable rates, whereas buffers around ¼ to ½ percentage point less than this were more common a year ago. Increasing these buffers limits the increase in borrowing capacity as interest rates fall, which implies that borrowers would be better able to manage the increase in repayments if interest rates were to rise.

Aside from this change in interest rate buffers, data on the characteristics of new housing loan approvals suggest that banks have broadly maintained the risk profile of their mortgage lending in recent quarters. By value, the share of new housing loan approvals with LVRs above 90 per cent has remained fairly steady at around 14 per cent since late 2011 (Graph 3.21). This is despite a fall in loan approvals to FHBs – which typically have higher LVRs – associated with changes in FHB incentives. The share of owner-occupier housing loan approvals at fixed interest rates has been a little above its long-run average in the past six months, at around 13 per cent; the average interest rate on new three-year fixed-rate mortgages is currently at its lowest level since the series began in the early 1990s, at around 20 basis points below the average discounted package rate on new variable-rate mortgages. Low-doc loans continue to decline as a share of the overall market, accounting for just 1 per cent of new loan approvals in the December quarter 2012. The decrease in low-doc lending over the past few years partly reflects the introduction of, and subsequent amendments to, the *National Consumer Credit Protection Act 2009*, which has strengthened the responsible lending obligations on lenders, such as those on verifying that borrowers can reasonably meet their debt commitments. The interest-only share of total housing loan approvals has been broadly steady in recent years, at around 35 per cent; many of these loans include features that encourage the building of mortgage buffers, such as redraw and offset facilities.

The increasing financial resilience of the household sector is evident across a range of other indicators, consistent with the overall improving trend in housing loan arrears. In 2012, applications for lender property possession – which typically occur after borrowers have failed to service their debt for a number of months – declined as a share of the dwelling stock, and are now below recent peaks in all the states for which data are available (Graph 3.22). Non-business related personal administrations – which include bankruptcies, debt agreements and personal insolvency agreements – as a share of the adult population also remain below recent peaks in all states and territories.

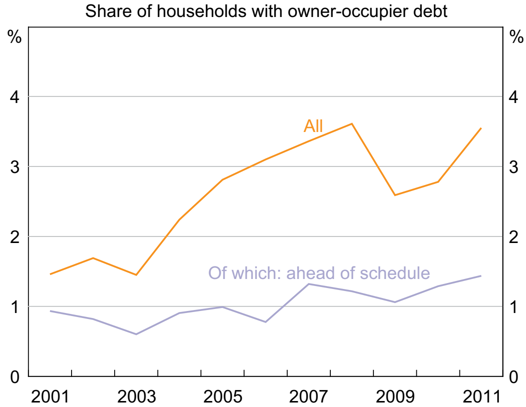
Consistent with these aggregate indicators, household-level data from the latest Household, Income and Labour Dynamics in Australia (HILDA) Survey (for 2011) continue to show that there is only a small share of highly geared borrowers and that most households are well placed to meet their debt obligations. For example, around 15 per cent of indebted owner-occupier households had a housing gearing ratio greater than 80 per cent in 2011, a share that has been broadly steady over the past few years. The subset of highly geared households that also have high DSRs – and are thus more vulnerable to interest rate increases and income shocks – was around 3½ per cent in 2011 and has likely fallen along with interest rates in 2012 (Graph 3.23). Of these households, around 40 per cent report that they have built up some buffer by being ahead of schedule on their mortgage repayments, suggesting that the share of households that are most vulnerable is even lower at around 2 per cent.

Graph 3.22
Applications for Property Possession*
Share of dwelling stock



* Includes applications for some commercial properties
Sources: ABS; RBA; state supreme courts

Graph 3.23
Households with High Gearing and Debt-servicing Ratios*
Share of households with owner-occupier debt



* Households with housing gearing above 80 per cent and a housing debt-servicing ratio greater than 50 per cent
Source: HILDA Release 11.0