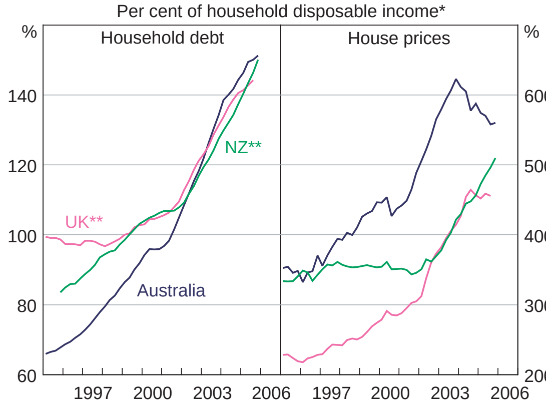
Box B: Competition in Household Lending in New Zealand and the United Kingdom

Graph B1

Household Financial Indicators

Per cent of household disposable income*

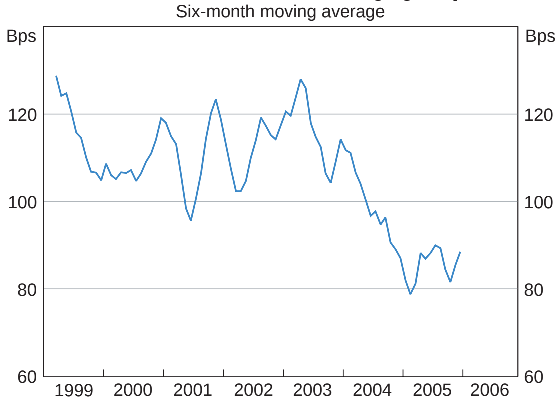


* Income is after tax and before the deduction of interest payments.
** Includes unincorporated enterprises.
Sources: ABS; Nationwide; RBA; RBNZ; REIA; REINZ; UK Office for National Statistics

Graph B2

New Zealand Fixed-rate Mortgage Spread*

Six-month moving average



* Average two-year mortgage rate paid less two-year swap rate
Source: RBNZ

The competitive pressures faced by banks in domestic household lending markets are also evident in other countries in which Australian banks have retail operations – most notably, New Zealand and the United Kingdom. Moreover, like Australia, these countries have both experienced rapid growth in household debt and house prices over the past decade (Graph B1).

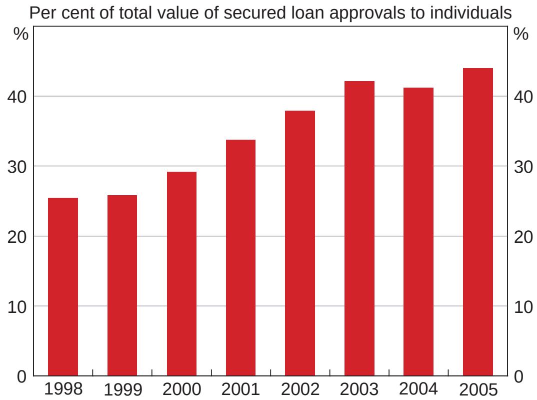
As in Australia, competition among lenders has been particularly strong in the housing loan market. In New Zealand, where Australian-owned banks have a dominant market share, this competition has been most intense in fixed-rate housing loans, which are more common than in Australia. For example, over the past three years, aggressive marketing and price discounts have compressed the spread between the average rate on new two-year fixed-rate housing loans and the two-year swap rate by around 30 basis points (Graph B2). This compression of margins was, in part, spurred by one bank competing more aggressively on the price of loans originated through its branch network after it withdrew from the broker market.

In the United Kingdom, where variable-rate mortgages are more popular, there has also been widespread discounting of home loan interest rates. While the spread between the standard variable home loan interest rate and the base rate has remained relatively stable over the past five years (between 1.6 and 2.2 percentage points), the UK Council of Mortgage Lenders estimates that less than 5 per cent of new housing loans (from all lenders) in the second half of 2005 were at the standard variable rate.

The availability of cheaper housing finance in both countries appears to have increased the propensity of borrowers to 'shop around' and refinance their existing mortgages at a cheaper rate. In the United Kingdom, for example, more than 40 per cent of banks' secured loan approvals to individuals in 2005 were for the purpose of refinancing, compared to less than 30 per cent at the turn of the decade (Graph B3). In part, this 'mortgage churn' has been facilitated by mortgage brokers, with industry estimates suggesting that broker-originated loans account for up to two thirds of new loans in the United Kingdom and over one third of new loans in New Zealand, with these shares having increased over the past five years.

Graph B3

UK Banks' Mortgage Refinancing



Source: Bank of England

The competitive environment in these countries has also seen banks expand into non-standard products, such as low-doc loans. The UK low-doc market has grown rapidly in recent years and, together with non-conforming loans, now accounts for an estimated 10 to 15 per cent of outstanding housing loans. The New Zealand low-doc market appears less well developed, though banks have made moves into this market. There has also been downward pressure on the margins that New Zealand banks earn on low-doc lending, with these loans often priced in line with undiscounted standard mortgages.

To varying degrees, strong competition is also evident in personal lending. In the United Kingdom, competition in the credit card market has been intense, with the credit card indicator rate having fallen by around 4 percentage points, relative to the base rate, since the mid 1990s. Moreover, competition has manifested itself in an increasing number of card issuers offering low-rate cards and free balance-transfer deals. More recently, some banks and other credit card issuers in the United Kingdom have begun to offer credit cards to borrowers with impaired credit histories, albeit at higher interest rates. Based on indicator rates, competition in the credit card market appears less intense in New Zealand than in the United Kingdom and Australia. Like other markets, however, a number of low-rate cards are on offer, with rates significantly below the indicator rate.