



RESERVE BANK OF AUSTRALIA

Banks' Funding Costs and Lending Rates

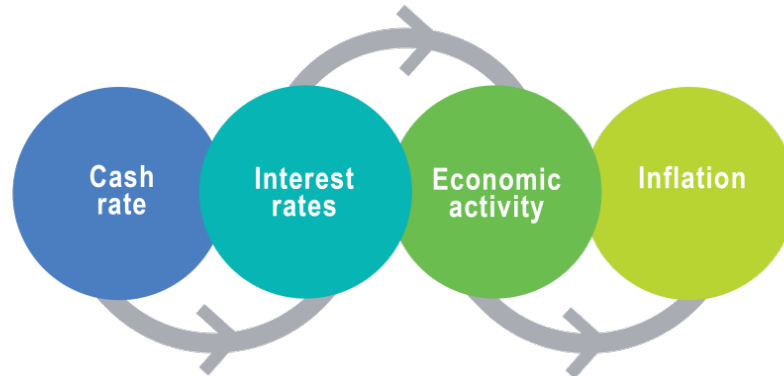
Emma Doherty (Domestic Markets)

Education



Why are banks' funding costs and lending rates important for monetary policy?

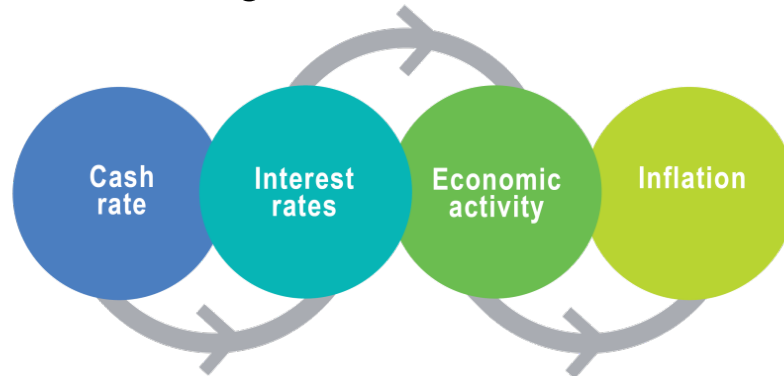
- Banks' interest rates can influence the behaviour of businesses and households and ultimately economic activity





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- Monetary policy settings influence the cost of banks' funding and, consequently, their lending rates





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- Banks' interest rates can influence the behaviour of businesses and households and ultimately economic activity
- Monetary policy settings influence the cost of banks' funding and, consequently, their lending rates
- So banks' funding costs and lending rates are an important part of the transmission mechanism



What are banks' funding costs?

- Banks collect funds from savers and use these funds to make loans to borrowers



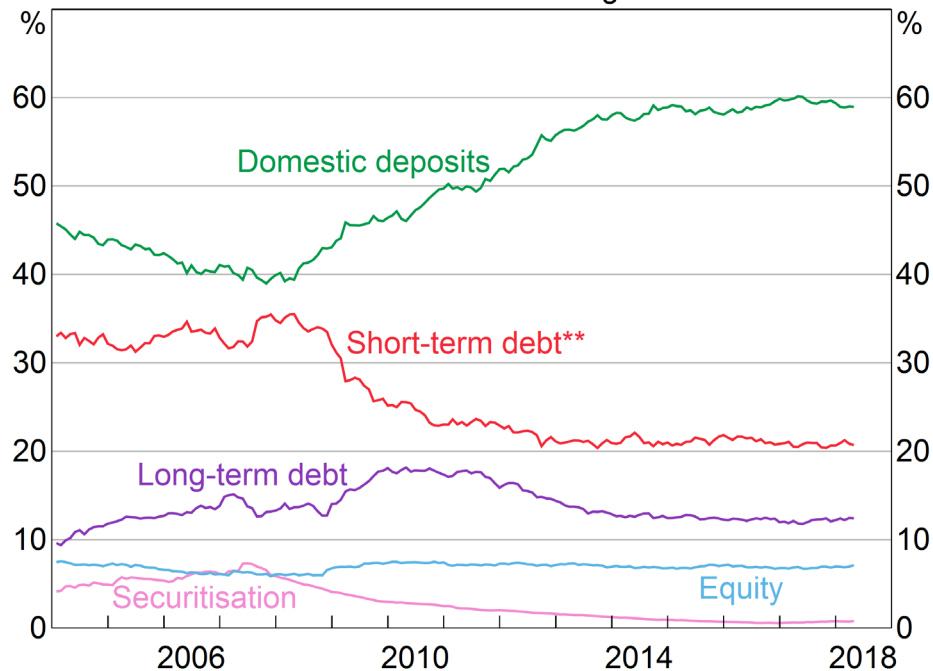
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- Banks collect funds from savers and use these funds to make loans to borrowers
- Main types of bank funding:
 - Deposits
 - Debt securities
 - Equity securities



Funding Composition of Banks in Australia*

Share of total funding



* Adjusted for movements in foreign exchange rates; tenor of debt is estimated on a residual maturity basis

** Includes deposits and intragroup funding from non-residents

Sources: APRA; RBA; Standard & Poor's



What are banks' funding costs?

- Banks collect funds from savers and use these funds to make loans to borrowers
- Main types of bank funding:
 - Deposits
 - Debt securities
 - Equity securities
- Funding costs = average rate a bank pays to attract funds

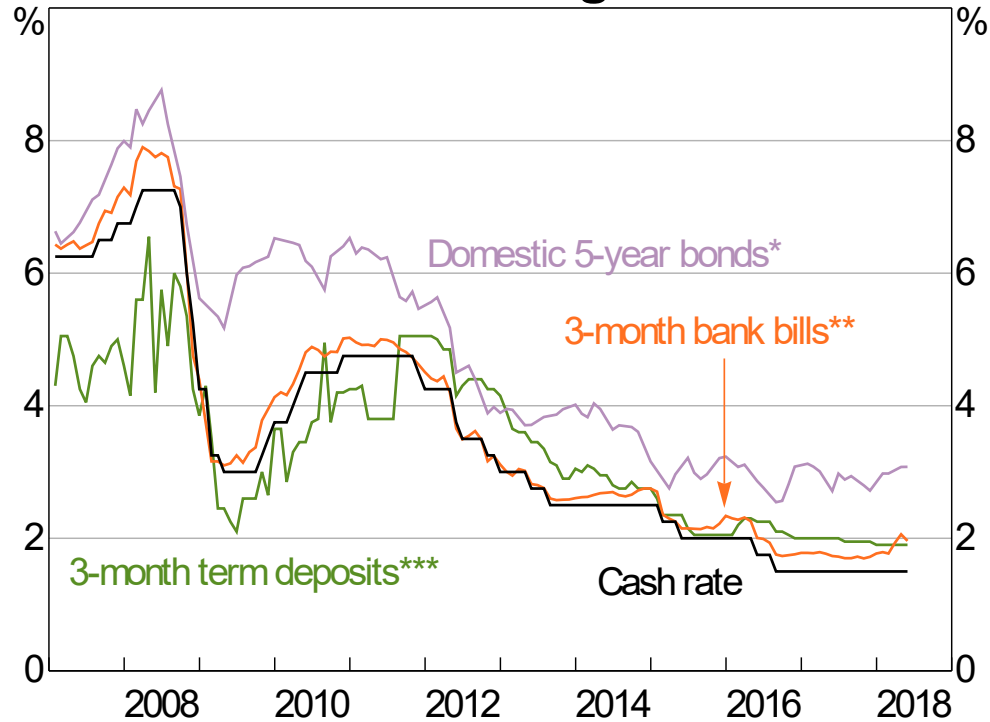


What influences bank funding costs?

- Cash rate
 - Cash rate changes typically transmitted quickly to other market reference rates
 - But extent and timing of pass-through from cash rate to the cost of different funding components differs



Market Funding Rates



* Issued by the major Australian banks

** Monthly average

*** Average advertised rate for a \$10 000 deposit

Sources: ASX; Banks' websites; Bloomberg; RBA



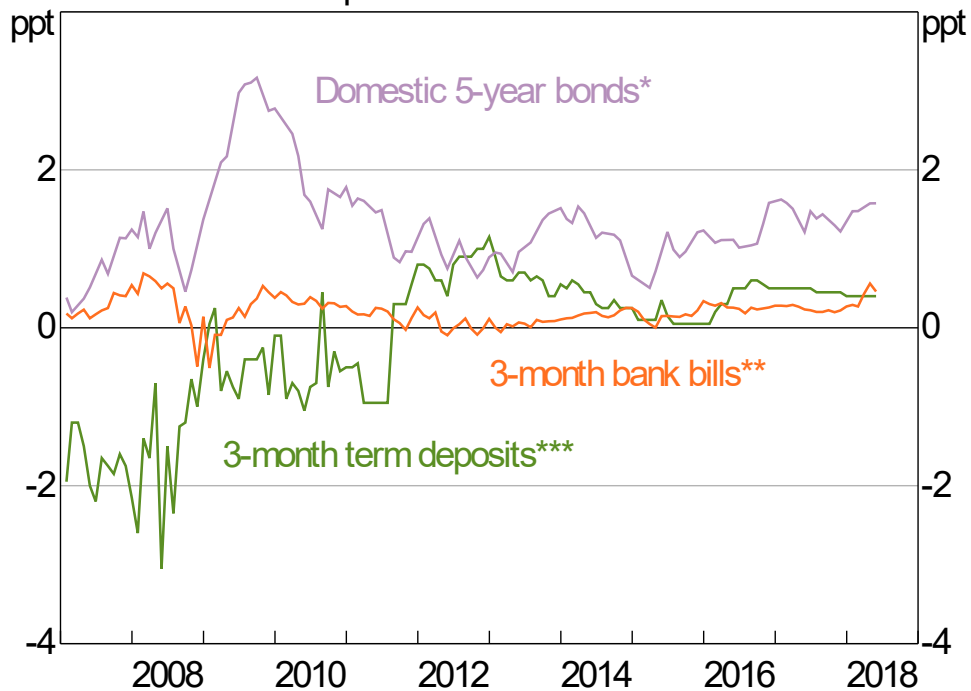
What influences bank funding costs?

- Cash rate
 - Cash rate changes typically transmitted quickly to other market reference rates
 - But extent and timing of pass-through from cash rate to the cost of different funding components differs
- Other factors
 - Changes in interest rates in offshore markets
 - Changes in demand for or supply of particular types of bank funding
 - Changes in the mix of funding types



Market Funding Rates

Spread to the cash rate



* Issued by the major Australian banks
** Monthly average
*** Average advertised rate for a \$10 000 deposit
Sources: ASX; Banks' websites; Bloomberg; RBA



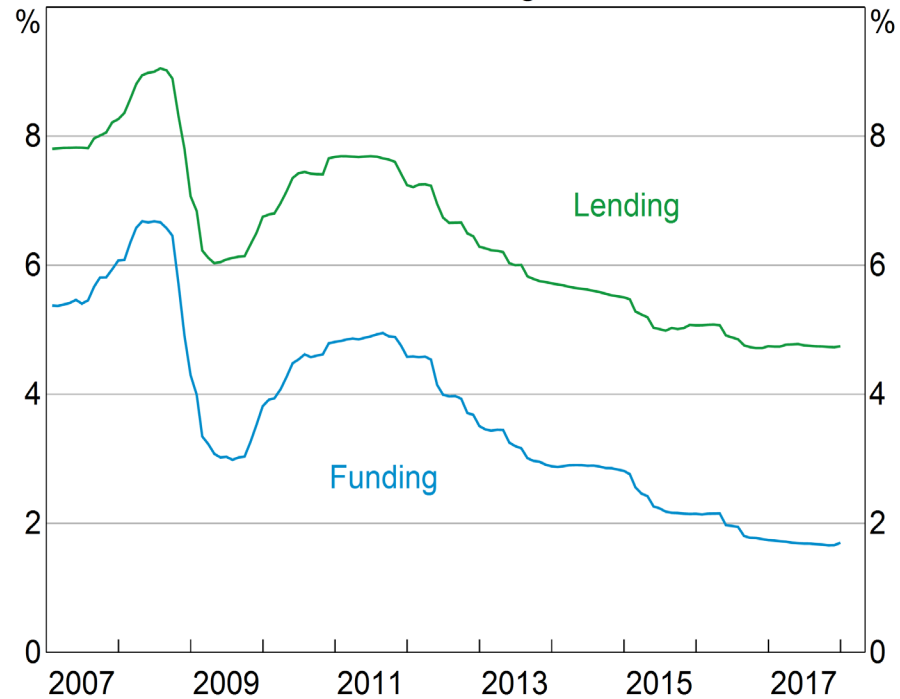
What influences bank lending rates?

- When faced with a change in funding costs, banks can respond in various ways, including by changing lending rates



Major Banks' Lending and Funding Rates*

Outstanding

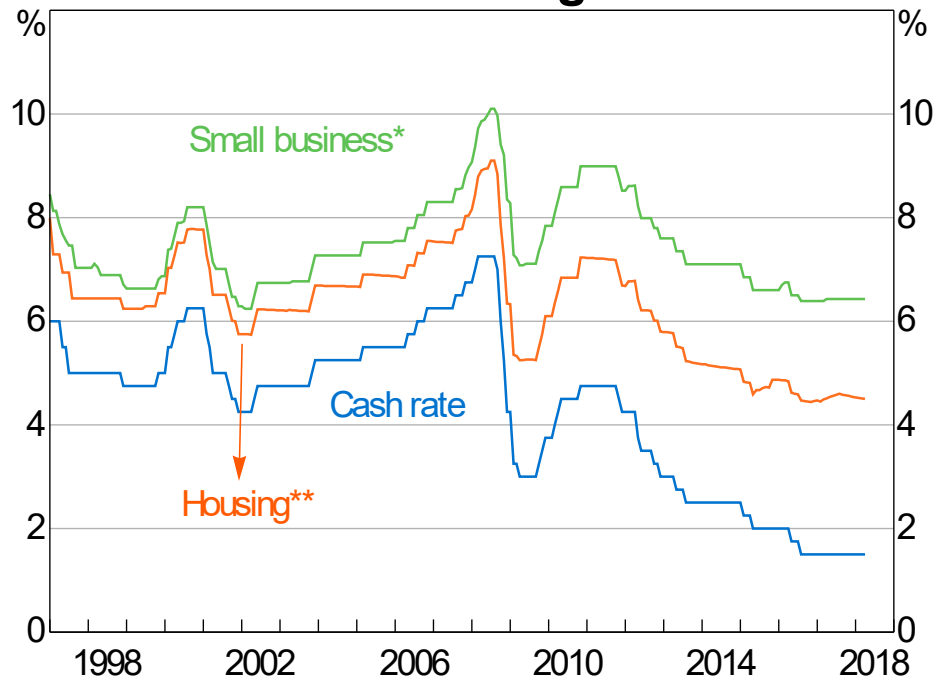


* RBA estimates

Sources: APRA; Bloomberg; Financial Reports; RBA; UBS AG, Australia Branch



Variable Lending Rates



* Average across major banks' advertised rates for loans secured by residential property

** RBA estimate prior to June 2015, data from Securitisation Database from June 2015

Sources: APRA; Banks' websites; RBA; Securitisation Database



What influences bank lending rates?

- When faced with a change in funding costs, banks can respond in various ways, including by changing lending rates
- Factors other than funding costs also influence lending rates
 - assessment of the riskiness of particular types of lending
 - competition



What influences bank lending rates?

- When faced with a change in funding costs, banks can respond in various ways, including by changing lending rates
- Factors other than funding costs also influence lending rates
 - assessment of the riskiness of particular types of lending
 - competition
- In practice, we tend to see average lending rates track average funding costs quite closely...
- ... but at times other factors are important



Key messages

- Banks' interest rates are an important part of the transmission mechanism
- The cash rate acts as an anchor for the broader interest rate structure for the domestic financial system
 - it influences banks' funding costs and, in turn, their lending rates
- But other factors can also affect funding costs and lending rates
- the RBA monitors funding costs and lending rates closely, and the Board takes developments in banks' funding costs and lending rates into account
 - along with other information – when determining the appropriate cash rate setting