RESERVE BANK OF AUSTRALIA

Speech

New Financial Statistics: The Value of Sound Data in Troubled Times

Marion Kohler
Head of Domestic Markets

Address to the Australian Financial Markets Association
Online – 17 September 2020

Introduction

Thank you to the Australian Financial Markets Association for hosting our meeting here in this virtual venue! I'd like to acknowledge the Traditional Owners of the lands that we meet on today, and pay respect to Elders past, present and future, and extend that respect to any First Nations people joining us today.

Today I want to talk about a new financial data collection – the Economic and Financial Statistics collection, or EFS for short – and its value to the Reserve Bank during this turbulent time.[1]

The EFS is the outcome of a large effort to modernise Australia's financial sector data. This was a joint effort over a number of years by: the Australian Bureau of Statistics, the Australian Prudential Regulation Authority, the Reserve Bank of Australia and, importantly, the finance industry. We have worked in close consultation with financial institutions, including with those that are members of the Australian Financial Markets Association. And I would like to acknowledge here the collaborative spirit that we have encountered from all of you during this extensive project.

For just over a year now, the data from the new EFS collection have been available to compile key macroeconomic indicators for Australia. One example is the financial aggregates, which are produced by the Reserve Bank. These statistics allow us to assess the financial and economic activity of households and businesses.

The EFS data have enhanced the quality of information available to policymakers and the wider community. For example, they have deepened our understanding of how monetary policy flows through to lending rates, and of the provision of finance to small- and medium-sized businesses (SMEs). But the data has really come into its own during the COVID-19 crisis period. Our

understanding of how the financial sector is responding to this unprecedented event has been greatly enhanced by the new data. And it has highlighted the value of sound data in troubled times. Before I give you a few examples of this, let's briefly recap the current environment.

The domestic economy experienced a severe downturn in the first half of this year as a result of the global pandemic. Activity contracted by 7 per cent in the June quarter, the largest quarterly fall on record. Many Australians have lost their jobs and most businesses are struggling.

Globally and here in Australia, governments and central banks have undertaken extraordinary monetary and fiscal policy measures to support their economies through this event. As you will be aware, in March the Reserve Bank put in place a comprehensive package of policy measures. Without going into detail,[2] the package is designed to keep funding costs low across the economy and support the provision of credit, especially to SMEs.

These policy measures have to date broadly achieved what they were set out to do. We know this because the data from the EFS collection has allowed us to monitor these developments closely and in a timely manner. For example, we can see how the recent policy measures have flowed through to household and business lending rates. We can also see how business and household credit have changed. The EFS collection has allowed us to glean much more detailed insights into these questions, and I will take you through some of these insights now.

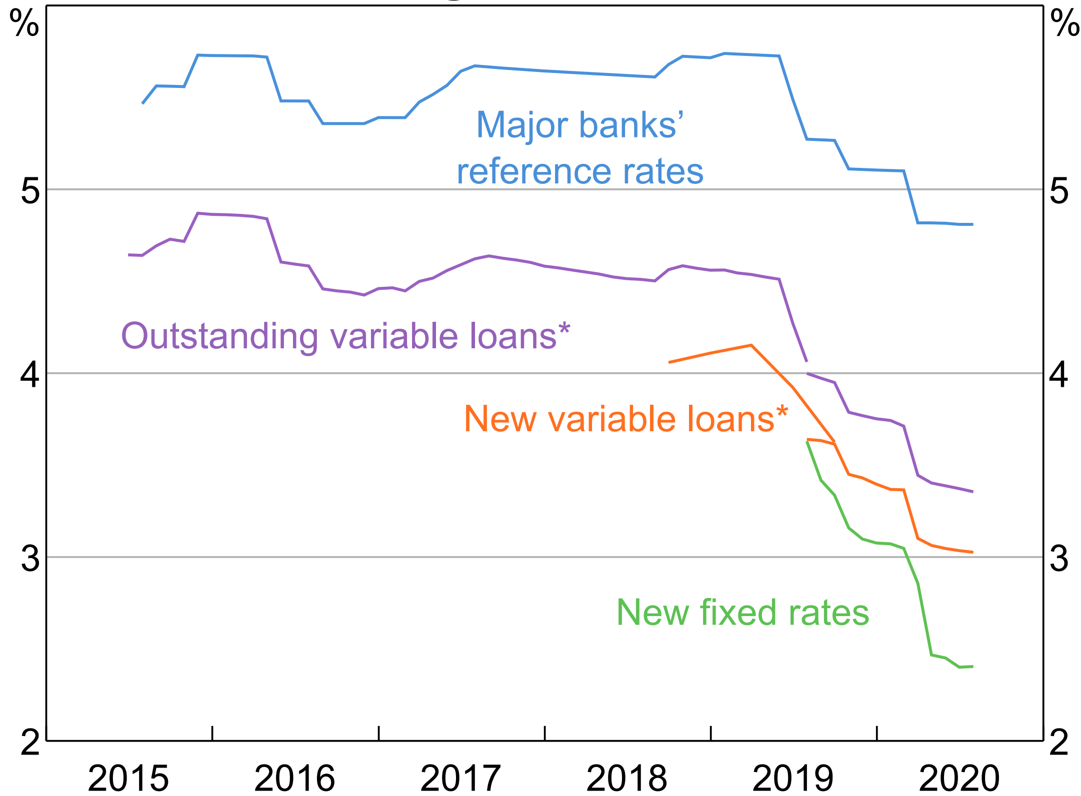
Interest Rates

Let me first turn to the interest rates faced by households and businesses. The new EFS data give us more *detailed* information on lenders' interest rates. This includes interest rates for new and existing housing loans, as well as loans to SMEs.

We also have better *coverage* of lenders' interest rates. The lenders reporting account for a larger share of the market than was previously the case. And they report interest rates for all loans extended to customers (and not just a subset of loans). The data also include some non-bank lenders in addition to banks. Non-bank lenders tend to lend to a wider range of borrowers. For instance, some of these lenders specialise in providing mortgages to borrowers that require low-documentation loans (because they are self-employed) or that have impaired credit histories.

Graph 1 shows variable housing interest rates. You can see the new EFS data (starting in the middle of 2019) next to data from previously available sources. Variable housing interest rates have declined since March, when the cash rate target was cut by a total of 50 basis points. Indeed, a little over half of the reduction in banks' funding costs since March has been passed through to variable housing lending rates. These rates are as low as they have ever been.

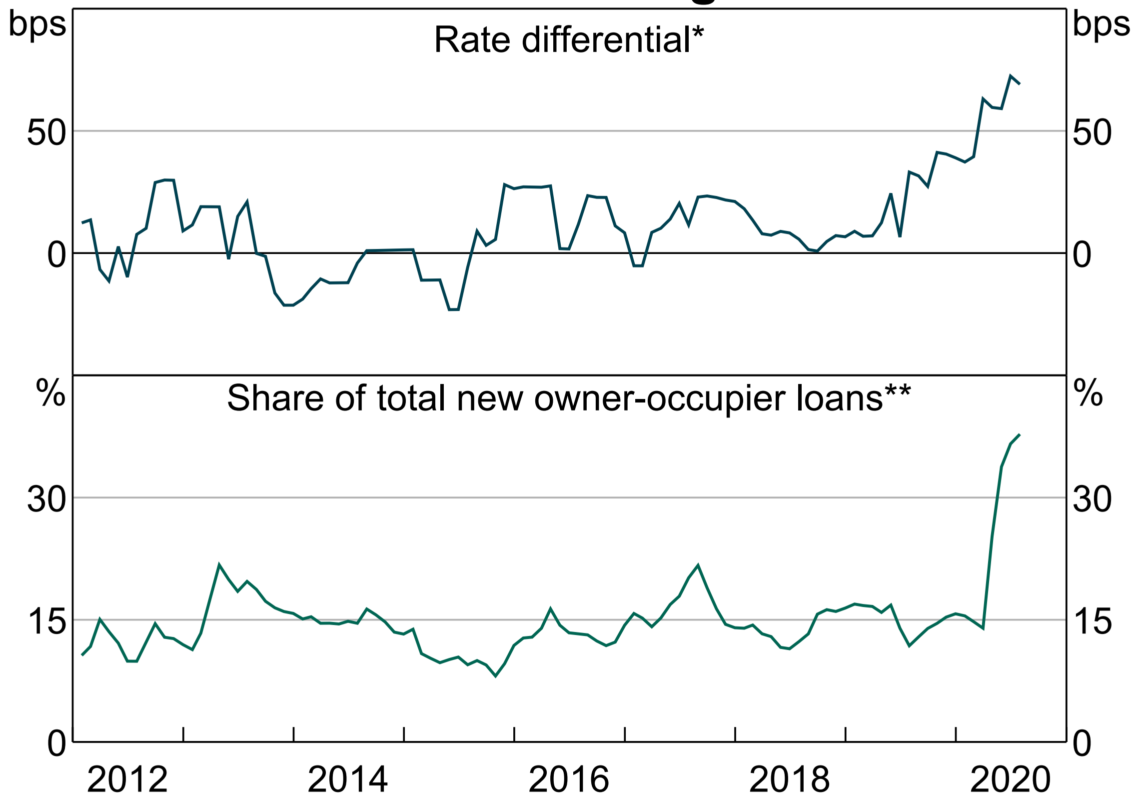
Banks lowered their standard variable rates by about 30 basis points in March, following the reduction in the cash rate. Actual interest rates on outstanding variable-rate housing loans have declined by a little more than that, because lenders have been competing strongly for high-quality borrowers. Existing borrowers can get a lower interest rate by negotiating a better deal with their current lender, or by switching lenders for a new loan. Many borrowers have been doing this, in order to take advantage of the very low level of interest rates.



We also now have more comprehensive data on mortgages with a fixed interest rate. Interest rates on *new* fixed-rate loans have declined by around 65 basis points since February this year. This is almost double the decline for *new* variable-rate loans. The decline in fixed interest rates has occurred alongside declines in swap rates, which are the relevant pricing benchmark for fixed-rate loans. Swap rates have declined with the forward guidance for low policy rates for the next few years. The provision of low cost funding to banks at a fixed rate through the Term Funding Facility is also likely to have contributed to lower swap rates.

You can see on Graph 1 that, in level terms, the interest rates on fixed-rate loans are now about 60–70 basis points below new variable interest rates. The top panel in Graph 2 shows the difference between fixed and variable rates. This is the highest it's been in over a decade. Not surprisingly, the share of housing loans originated with fixed interest rates has risen sharply as a result (which you can see in the bottom panel). A large proportion of the increase in new fixed-rate housing loans is due to borrowers refinancing their mortgages at these lower rates. Fixed-rate housing loans now account for around one-quarter of housing credit outstanding.

Graph 2



* Rate differential between variable and fixed rate loans for owner-occupiers; major banks' package rates less advertised 3-year fixed rate to April 2009; thereafter, major banks' best advertised variable rate less advertised 3-year fixed rate

** Seasonally adjusted loan approvals data until September 2019; thereafter, loans funded in the month (non-seasonally adjusted)

Sources: APRA; CANSTAR; major banks' websites; RBA

The cash rate reductions have flowed through in full to interest rates on outstanding business loans. Here is a graph of interest rates on business loans, split by the size of businesses (Graph 3). It shows that interest rates on business loans have also declined to historically low levels. Interest rates on variable rate loans to large businesses have declined by 80 basis points since the end of February. For SMEs, variable rates are lower by 70–75 basis points over that period. So interest rates for businesses have declined by much more than the cash rate reductions.

This graph also shows that smaller businesses pay higher interest rates for finance than larger businesses. A key reason for that difference is that banks typically assess that smaller businesses have higher-risk profiles as a result of more volatile revenue streams. [3]

Graph 3

The EFS interest rate data have greatly enhanced the *transparency* of the rates paid by borrowers in Australia. You can find published statistics on the Lenders' Interest Rates page on the Reserve Bank's website. [4] They are also used in the Mortgage Calculator on the Australian Securities and

Investments Commission's Moneysmart website. These data can help consumers and businesses to make more informed choices about their finances. As I mentioned earlier, in recent months many borrowers have reduced their mortgage rate by negotiating a better deal with their current lender or switching to a different lender.

Business Credit

Let's have a look now at how the policy measures are flowing through to business credit. The EFS collection gives us better statistics on the provision of finance to businesses. We now have a more comprehensive measure of credit outstanding by business size. The reported level of banks' business lending is higher as a result. Graph 4 shows these new business lending data by business size. Using the EFS data we know that large businesses drew on lines of credit in March and April and held these funds as deposits. Some of this was drawn for precautionary purposes, and about three quarters has since been repaid. You can see this clearly in the top line (in red).

In contrast, the volume of lending to SMEs has been little changed since the onset of the pandemic. This could reflect a lack of demand for new loans, due to the heightened uncertainty for many small businesses in the current environment. Some businesses may be reluctant to take on new debt, as this uncertainty affects their expectation of future revenue and so their ability to repay debt. But banks are also more cautious about lending to businesses. In particular, to new businesses and to businesses in those sectors most affected by the pandemic.

Graph 4

There are also a number of initiatives helping SMEs to cover their operating costs at this time. These initiatives have probably lessened the need for bank credit. This includes the JobKeeper program and the Boosting Cash Flow for Employers program. Commercial banks and landlords have also offered support to businesses during these challenging times, by deferring loan payments and granting rent reductions.

Lenders can access additional funding under the Reserve Bank's Term Funding Facility if they expand their business credit, particularly to SMEs. For every extra dollar of loans a lender has made to SMEs, they are then given access to an additional five dollars of funding from the Reserve Bank. For every extra dollar lent to large businesses, they gain access to one additional dollar of funding. The data from the EFS collection are used by the Reserve Bank to provide a timely and reliable way to calculate these additional allowances.

Housing Credit

With the EFS collection, for the first time, we have been able to track statistics for each stage of the housing finance process. This includes when a borrower applies for a housing loan and when the lender and borrower formally commit to finance. These data have been invaluable during the COVID-19 period. We have been able to observe the impact of the pandemic on lending to households with very little delay. Overall, we find that lenders have still been lending. And this is in

the face of disruptions, for instance due to workplace closures and the handling of a high volume of requests for loan payment deferrals.

Housing loan applications have risen in recent months, as you can see in Graph 5.[5] This might seem surprising. After all, the measures put in place earlier this year to contain the COVID-19 outbreak led to a significant reduction in housing market activity. But the rising level of housing loan applications is consistent with the very large volumes of refinancing activity of late.

Graph 5

You can see that on this graph here, which shows housing loan commitments – the stage when a borrower has accepted the offer of a loan by a bank (Graph 6). The left-hand side of the graph shows that many borrowers are refinancing their housing loans, particularly for owner-occupiers. This is to take advantage of the very low level of interest rates (including fixed interest rates). Banks are also offering cash backs for refinancing a loan held with another lender. So the policy package put in place in March is working to lower borrowers' interest rates and ease their loan payment burdens as housing loans are refinanced. Lending for new housing loans – on the right-hand side – has also picked up recently. This follows some improvement in housing market activity in recent months, as the mobility restrictions that had been put in place earlier to contain the COVID-19 outbreak had eased across much of the country.

Graph 6

More frequent loan payments data from the EFS collection have helped us to track the effects of the pandemic on households' spending patterns. Graph 7 shows households loan payments as a share of disposable income – this includes interest payments and payments against the principal, including those into offset or redraw accounts. You can see that loan payments have risen in recent months. Most of this has reflected a rise in offset account balances (a type of deposit account linked to mortgages). This is consistent with borrowers saving for precautionary reasons due to the uncertain economic outlook. Borrowers also have had reduced opportunities for spending in response to mobility restrictions. Indeed, we know that the increase in funds held in offset accounts was particularly strong in April and May. At the same time, some borrowers may have been depositing the cash received from the early release of superannuation or social assistance payments into their offset accounts.

Graph 7

You can also see what central banks refer to as the 'cash flow channel of monetary policy' at work on this graph. That is, borrowers' interest payments as a share of their income (the yellow bars) have declined in recent years. This shows that the Reserve Bank's package of policy measures has worked to lower the interest rates paid by borrowers on their loans. Reductions in interest payments in

recent months are also consistent with the recent declines in fixed interest rates, and the increasing number of borrowers refinancing to lower-rate products.

Personal Finance

Households also have access to credit via personal finance. Personal finance is extended to households for consumption purposes. It includes products like credit cards and personal loans (such as for a holiday, furniture or whitegoods).

As you can see in Graph 8, personal credit has contracted sharply over the past six months or so, alongside the introduction of the COVID-19 containment measures in March. A large part of this reflected a decline in the amount of credit card debt outstanding, the yellow bars. This is consistent with the decline in personal credit card transactions that occurred in March and April, as retail sales and household consumption declined. That is, people were spending less and so were accumulating less credit card debt. Repayments on credit card balances also declined during that period, but by less than the decline in new transactions. Taken together, these developments have worked to reduce the stock of outstanding credit card debt.

Graph 8

But the decline in the stock of personal credit is not a new phenomenon. Rather, it is an acceleration of a structural decline that has occurred over the past decade or so. Much of the decline has reflected a reduction in the stock of overdraft accounts (also known as 'revolving credit') and credit card debt outstanding. This has occurred alongside increasing use of cheaper mortgage offset and redraw accounts. These accounts offer a line of credit that can be used for any purpose, and so are a close substitute for products such as credit cards. For instance, a household could redraw from their mortgage, for which they are currently charged an interest rate of around 3–4 per cent. Those funds could then be used to repay balances outstanding on a credit card, which attract on average interest charges of around 16–17 per cent.

Conclusion

The EFS collection has been a complex multi-year project. Getting better data is not easy! But this project is already paying off. It has provided policy makers and the general public with more detailed, reliable yet timely statistics. Since March, the EFS collection has given us an early read on the economy and the effectiveness of the Reserve Bank's policy measures during unusually uncertain times. The data show that the Bank's policies have helped to lower interest rates for borrowers to historic lows and support the provision of credit.

Endnotes

[1] I would like to thank Megan Garner for her excellent assistance in helping to prepare these remarks. Indeed, I draw heavily on M Garner (2020), 'Insights from the New Economic and Financial Statistics Collection', RBA *Bulletin*,

September.

[2] A number of recent speeches have discussed the policy measures put in place, see Lowe (2020), Debelle (2020) and Kent (2020).

[3] See Lewis M and Q Liu (2020), 'The COVID-19 Outbreak and Access to Small Business Finance', RBA *Bulletin*, September.

[4] Updates are published monthly. The lenders participating in this part of the collection account for around 95 per cent of credit outstanding.

[5] These data cannot yet be adjusted to take into account seasonality, as we only have a very short time series.

The materials on this webpage are subject to copyright and their use is subject to the terms and conditions set out in the Copyright and Disclaimer Notice.
© Reserve Bank of Australia, 2001–2020. All rights reserved.

The Reserve Bank of Australia acknowledges the Aboriginal and Torres Strait Islander Peoples of Australia as the Traditional Custodians of this land, and recognises their continuing connection to Country. We pay our respects to their Elders, past, present and emerging.