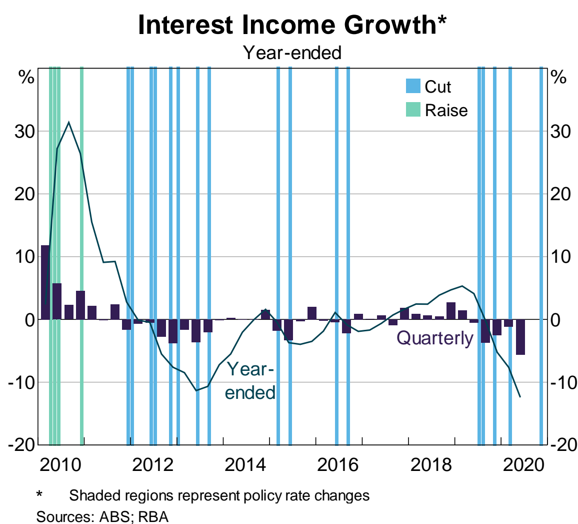
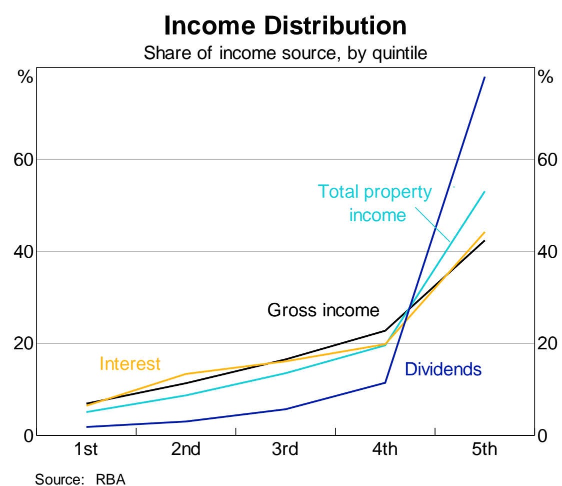
IMPACT OF MONETARY POLICY ON SAVERS, DEPOSITORS & SELF-FUNDED RETIREES

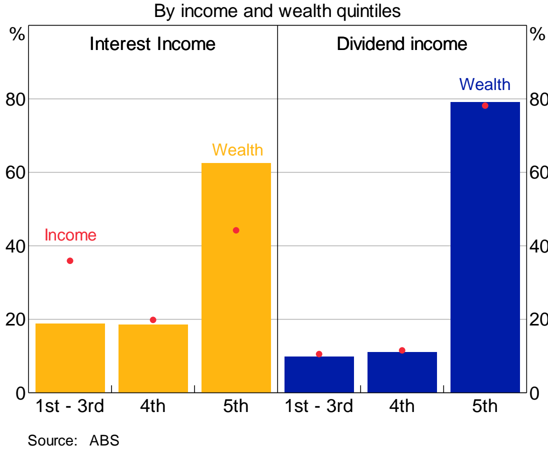
- Over the past five years household financial income (which includes from interest, dividends and superannuation) has grown well below longer-run averages, mainly reflecting lower interest rates.
- High-income and older households are likely to have been most affected because they receive a larger share of their income from these sources.
- Monetary policy stimulus has two-sided effects on the income and wealth of depositors and self-funded retirees (i.e. households that are ineligible for the Age Pension, ~40 per cent of households above retirement age).
- On the downside:
  - Interest income is a more important source of income for older households relative to younger households. Households 55+ are recipients of 2/3 interest income; share fairly stable for 15 years.
  - In 2018 (HILDA data):
    - 5 per cent of households with a head aged 65+ earned more than 20 per cent of their income directly from interest according to HILDA (superannuation is excluded from this estimate, if we include an estimate of imputed interest earned via super, the share of households would go up to around 20 per cent)
    - For those aged 65+, interest income on average is 7 per cent of gross regular income. For people aged 75-79 and over, interest income is 10 per cent of gross regular income (HILDA in 2017/18).
  - Households reliant on interest income are now required to draw down more of their savings than in the past to maintain the same cash flows.
- On the upside:
  - Net savers, including self-funded retirees, received significant indirect benefits through stronger economic conditions and higher asset prices. Housing accounts for around half of the wealth of households 65+ years.
  - Monetary stimulus supports employment. For young savers, unemployment has a far greater effect on income than low rates. FHB commitments have increased, which is a positive signal for younger households.
  - Low rates are also supporting government borrowing and subsequently the economic recovery.
- Separately, interest income partly offset by income support payments (though, possibly different households and most self-funded retirees are ineligible).
- Deeming rates were lowered to a range of 0.25-2.25 per cent. Deeming is an important consideration in the Age Pension income test. Retiree advocacy groups argue that current deeming rates are still too high given the current level of the cash rate, and could push retirees to consider riskier investments like equities.

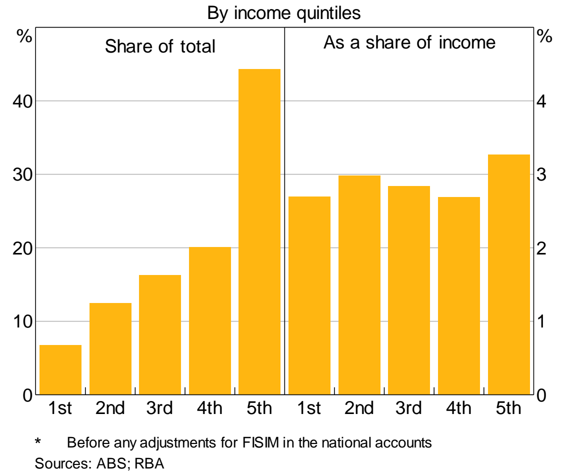


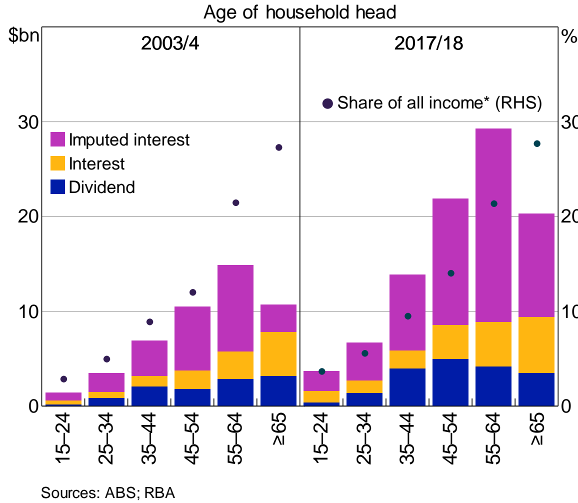
* Shaded regions represent policy rate changes
Sources: ABS; RBA

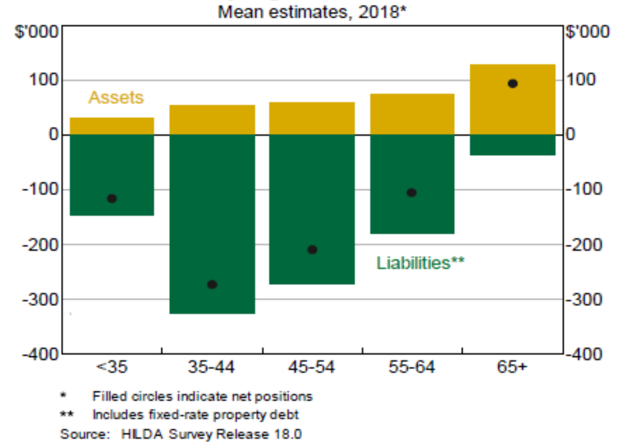


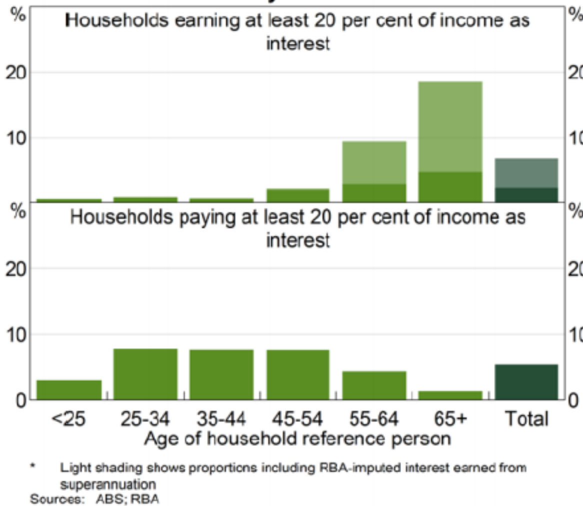
Source: RBA

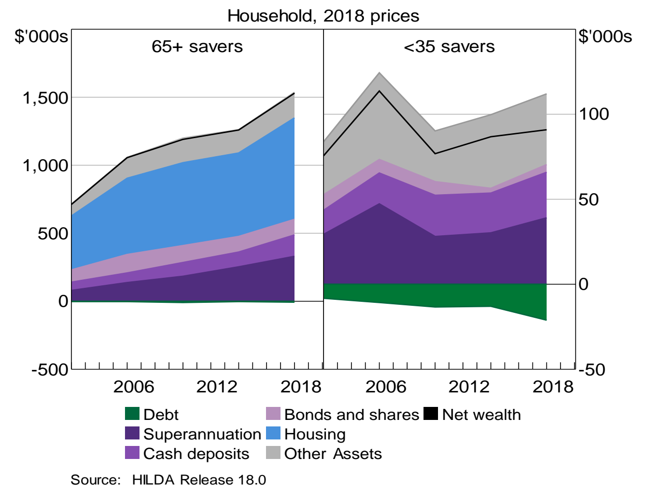












Households and National Accounts
23 November 2020

IMPACT OF LOW INTEREST RATES ON ASSET PRICES

Policy will support the economy and asset prices

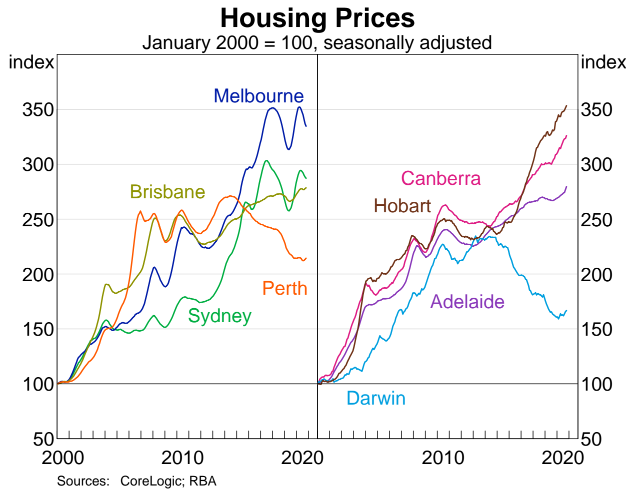
- The RBA's Term Funding Facility, bond purchases and lower interest rates across the yield curve will assist the recovery by:
  - Lowering financing costs for borrowers and supporting the supply of credit.
  - Contributing to a lower exchange rate.
  - Supporting asset prices and balance sheets:
    - ↑ asset prices → ↑ wealth → ↑ household spending.
    - ↑ asset prices → ↑ value of collateral → ↑ borrowing capacity for households/businesses → ↑ spending, especially for credit-constrained households.
    - Overall ↑ consumption and investment.
- Housing prices are likely to ↑ alongside other asset prices:
  - A permanent (temporary) 100 basis point reduction in the cash rate→ ↑ real housing prices 30 per cent (10 per cent) after about 3 years (Tulip and Saunders 2019).
  - Monetary policy appears to have larger effects in local areas in which housing supply constraints are binding, mortgage debt is higher and there are more housing investors (He and La Cava 2020).
  - Currently, much of the credit growth is coming from owner-occupiers.
- First home buyer activity has ↑ strongly in recent months, a positive indication of access to housing for younger households, according to loan commitments data.

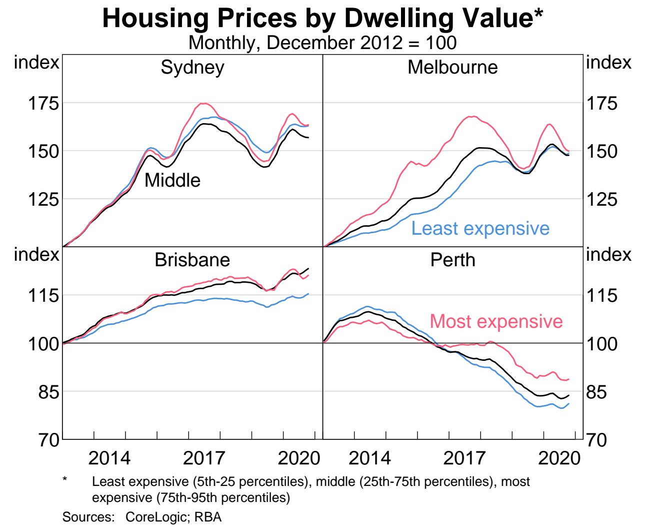
Some risks may increase due to low interest rates

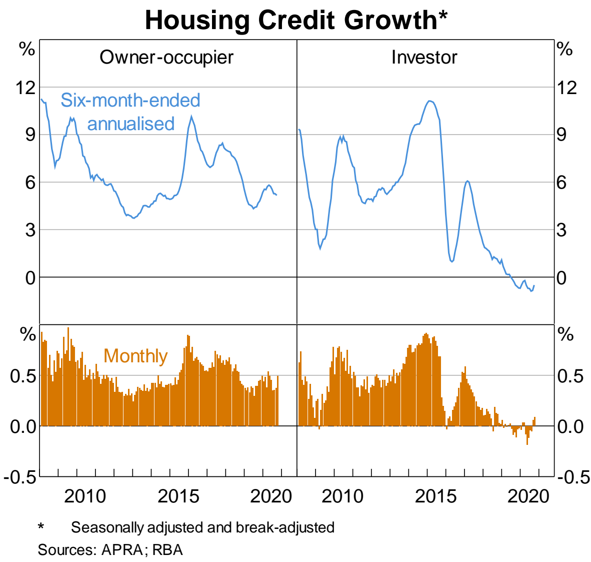
- High unemployment is the biggest risk to the economy, balance sheets and medium-term financial and macro stability, and lower interest rates can help reduce this risk.
- ↑asset prices can induce borrowers to take on too much credit if accompanied by (Borio & Lowe 2002):
  - Looser lending standards; and/or
  - Optimistic assessments of risk;
- new LVR lending above 85 per cent for housing ↑, but well below levels seen before 2015.
- partly ↑ share of loans to FHBs (smaller deposits than repeat buyers)
- If price rises induce large amounts of new property construction, this can create an overhang of excess supply, causing prices to fall further (Ellis, Kulish and Wallace 2014).
  - More of the loan book will be borrowers who bought near the price peak as new property purchases tend to increase during booms. Means more of the loan book is likely to be in negative equity.

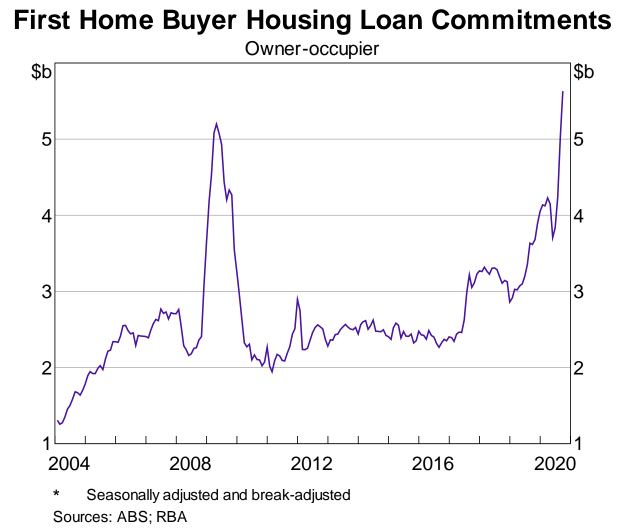
Australia's financial regulators will monitor and control risks

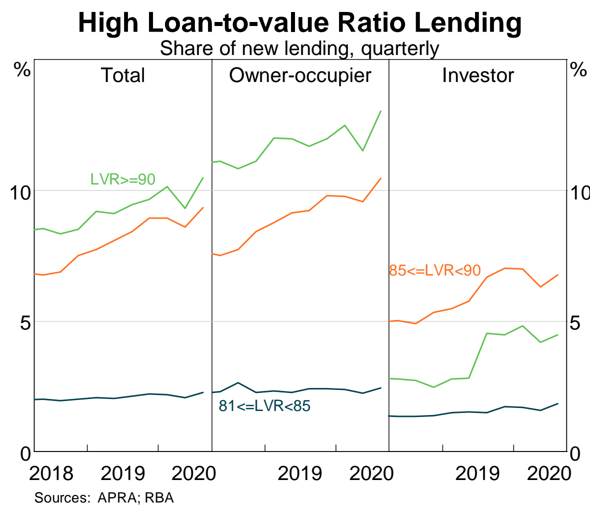
- CFR will act if needed.
- Since 2015, lending standards tightened substantially for both housing and commercial property. APRA and ASIC have both taken steps to reinforce sound lending for residential mortgages in particular.
- The RBNZ is planning on reinstating high LVR lending restrictions in March 2021.
  - High LVR lending has increased sharply in NZ and house price growth has been strong.
  - The restrictions were removed in May for what was meant to be 12 months; aim was to support credit supply and avoid impacting debt repayment holidays.

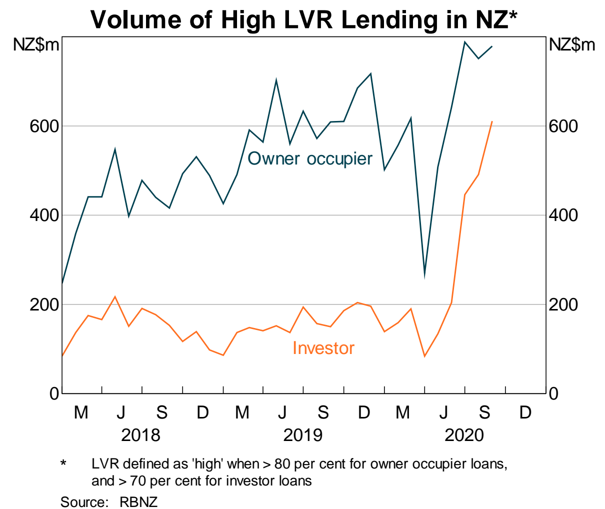












Economic Analysis and Financial Stability Departments
23 November 2020