Box D: Recent Growth in the Money Supply and Deposits

There has been a significant increase in the money supply since February, reflecting strong growth in deposits. Large deposit inflows in March and April reflect the banking sector's provision of credit to the economy, changes to the composition of banks' funding related to changes in preferences of investors and a contribution from the Reserve Bank's purchases of government bonds. Deposit and money growth have slowed more recently.

Deposits and money are primarily born of credit

Measures of money grew strongly over March and April this year, reflecting growth in deposits at authorised deposit-taking institutions (ADIs; Graph D.1). Deposit and money growth are typically driven by new lending by the banking sector. Lending creates deposits as the funds made available to a borrower find their way into a deposit somewhere in the banking system, either as a deposit in the borrower's account, or in another account when the borrower uses those funds to make a purchase.[1]

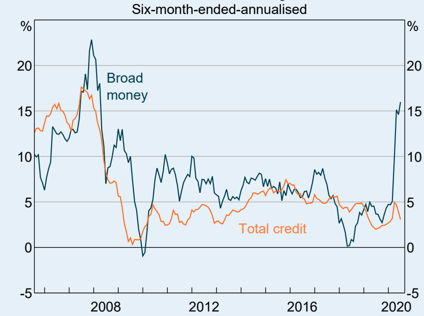
Business credit growth has created deposits

The banking sector recently extended more credit to the economy, which created new deposits in the banking system in the manner discussed above. Over March, much of this lending was to businesses, which in part reflected large companies drawing on lines of credit and holding these funds as deposits at the lending bank (Graph D.2). This borrowing was sizeable; new non-financial business deposits accounted for around one-quarter of the total increase in deposits over March. It appeared to have been motivated by precautionary reasons, as businesses looked to shore up liquidity positions at the onset of the COVID-19 outbreak. A large part of the rise in credit to large businesses has since been repaid.

Graph D.1

Credit and Broad Money Growth*

Six-month-ended-annualised

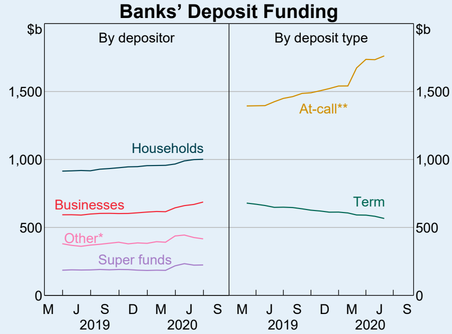


* Seasonally adjusted and break-adjusted

Sources: ABS; APRA; RBA

Graph D.2

Banks' Deposit Funding



* Includes deposits from the government and financial institutions that are not superannuation funds

** Includes deposits in housing loan offset accounts and non-interest-bearing deposits

Sources: APRA; RBA

The increase in banks' holdings of government debt has created deposits

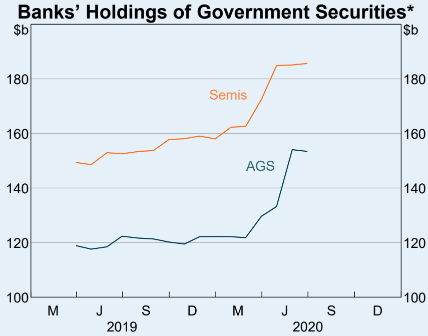
The purchase of government bonds by the banking sector can add to deposits in a similar way to the extension of credit to businesses and households.[2] Banks have purchased some of the newly issued state government debt. In the first instance, those borrowed funds are held by the state governments as a deposit with a commercial bank until the funds are spent.[3] In addition, when the banking sector purchases state government debt in the secondary market from the private (non-bank) sector, it credits the deposit account of the seller to pay for the transaction. In both cases, new deposits are created. Deposits have risen in recent months, as banks' holdings of state government debt have increased and as state governments have issued debt (Graph D.3).

Banks' holdings of Australian Government Securities have also risen recently, alongside an increase in Australian Government borrowing, which has contributed to the rise in bank deposits. However, the process of deposit creation is slightly different when the banking sector purchases debt issued by the Australian Government, since the Reserve Bank is the banker for the Commonwealth of Australia. When the Australian Government borrows from the banking sector, it holds the borrowed funds as a deposit at the Reserve Bank until the funds are spent. As the Australian Government spends these funds in the economy, such as in the form of JobKeeper payments to businesses, it adds to deposits held by businesses and, subsequently, to deposits of the household sector through employees of those businesses.

A decrease in the stock of bank bonds has contributed to bank deposits

The stock of outstanding bank debt has decreased since the end of February. Ample funding from other sources has meant that the banking sector has repaid more debt than it has issued. Some of that funding has come from the take-up of the Reserve Bank's Term Funding Facility. Some of the recent reduction in outstanding bank debt has also reflected the banking sector repaying debt held by superannuation funds, and the stock of deposits held by superannuation funds has risen accordingly. This occurred as superannuation funds sought to improve their liquidity positions through March and April, ahead of withdrawals related to the Government's scheme for early release of superannuation, and as part of their management of the liquidity impact from margin calls.[4] These changes have added to the stock of deposits, as banks repaid debt by crediting the deposit account of the lender from which the funds are borrowed. These developments have seen the share of banks' overall funding from deposits increase since February this year, while the share of debt funding has declined (Graph D.4).

Graph D.3



* Excluding holdings by banks' subsidiaries, foreign branches and other related entities

Sources: APRA; RBA

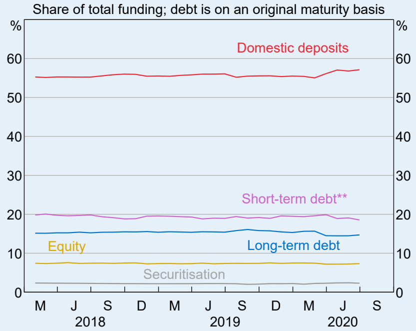
The Reserve Bank's purchases of government bonds have created deposits

As part of the package of monetary policy measures announced in mid March, the Reserve Bank began to purchase government debt from the private sector, to support the three-year yield target and address market dysfunction. Around $50 billion of government bonds were bought from March to early May, and around $1 billion in early August. These bonds were purchased by the Reserve Bank from a panel of commercial banks via auction, and were paid for with newly created money credited into banks' Exchange Settlement Accounts (these balances do not count as deposits, as they are not held with the private banking sector). Some of these bonds sold by commercial banks would have been purchased from non-bank investors, generating a flow of funds into non-bank investors' deposit accounts.[5]

Graph D.4

Banks' Funding Composition*

Share of total funding; debt is on an original maturity basis



* Adjusted for movements in foreign exchange rates
** Includes deposits and intragroup funding from non-residents
Sources: ABS; APRA; Bloomberg; RBA; Refinitiv

Deposit and money growth have slowed more recently

Large businesses have repaid a large part of the funding obtained by tapping into their lines of credit earlier in the year. This repayment has contributed to a slowing in deposit growth recently as well as a decline in business credit. In addition, since late April, the Reserve Bank's bond purchases have also been scaled back significantly. ✠

Endnotes

[1] For more information, see Doherty E, B Jackman and E Perry (2018), 'Money in the Australian Economy', RBA *Bulletin*, September, and Kent C (2018), 'Money – Born of Credit?', Remarks at the Reserve Bank's Topical Talks Event for Educators, Sydney, 19 September. Available at <https://www.rba.gov.au/publications/bulletin/2018/sep/money-in-the-australian-economy.html> and <https://www.rba.gov.au/speeches/2018/sp-ag-2018-09-19.html>

[2] This is not the case when a state or the federal government borrows money from the private (non-bank) sector. In this case, the funds are paid for using deposits from households and businesses, and, in time, government spending redistributes these deposits in the economy.

[3] The Reserve Bank's monetary aggregates do not include deposits from government entities. However, these deposits are included in measures of banks' different types of funding.

[4] This scheme allows for individuals to access up to $10,000 tax-free in each of the 2019-2020 and 2020-2021 financial years. Around $29 billion in withdrawals have been processed to-date.

[5] In the case where the Reserve Bank buys bonds that were not on-sold to banks from non-bank investors, no new deposits are created.