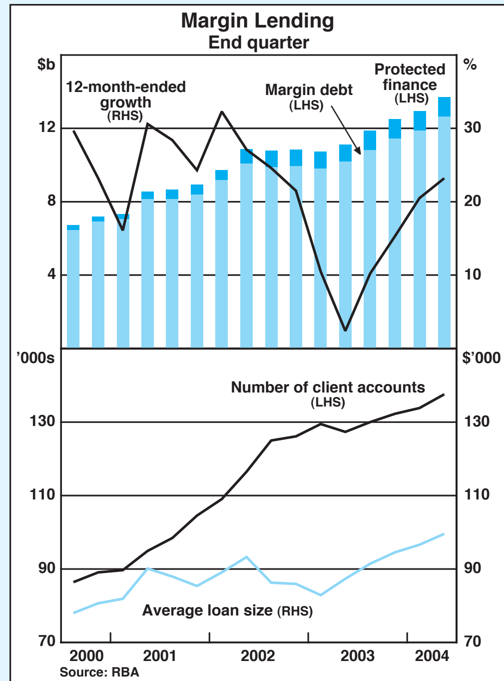
Box C: Recent Developments in Margin Lending

Following relatively subdued growth over 2002/03, margin lending for equities and managed funds has picked up strongly over the past year; the level of margin debt outstanding (including protected financing) increased by 23 per cent over the year to June 2004, to reach $13.7 billion (Graph C1).[1] The pick-up in margin lending has been supported by the recovery in the share market, and may also reflect a decline in the appeal of property investment. Despite its recent strength, however, margin lending is still small compared with other forms of household borrowing, accounting for around 13 per cent of non-housing personal debt and 2 per cent of total household debt.

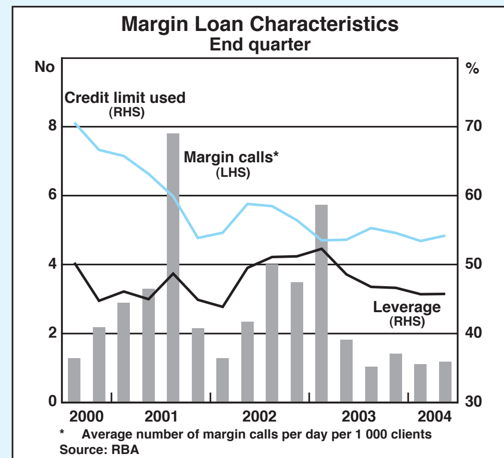
Much of the recent pick-up in margin lending is likely to have reflected increases in existing borrowers' debt levels, with the number of margin loan accounts rising more modestly over the period. As such, the average size of outstanding margin loans has increased markedly, from around $83 000 in March 2003 to almost $100 000 at present, which is the highest level since the survey's inception in 1999.

Although the level of margin debt has increased strongly over the past year, the value of assets securing the loans has risen more rapidly – helped by the strong performance of the Australian share market – and as a result the average leverage ratio has fallen to around its lowest level in two years (Graph C2). Average credit limit usage has also remained low during the past year. Together, these observations suggest that borrowers are, on average, being relatively cautious, perhaps mindful of earlier episodes of higher market volatility and more frequent margin calls.

Graph C1



Graph C2



1. See Box C in the May 2000 *Statement* for a description of margin lending. The data on margin lending are obtained from the RBA's quarterly survey of margin lenders, published in *Bulletin* Table D.10.

As at June 2004, direct holdings of Australian shares comprised 70 per cent of the assets underlying margin loans (up from around 60 per cent in 2002), with managed fund investments making up most of the remainder. Around 68 per cent of outstanding margin debt was at variable interest rates, with the predominant rate currently around 8 per cent. The remaining debt is at fixed rates with most of this in the form of loans on which interest has been prepaid (usually up to 12 months in advance). As interest on margin loans is tax deductible, prepayment enables investors to bring forward the tax deduction – which may be particularly beneficial near the end of the financial year – and typically also entitles them to a small discount on the usual fixed rate. Reflecting these possible advantages, growth in margin lending tends to be higher, and a greater share of new loans have interest prepaid, in the June quarter of each year.

The recent strength in margin lending may also reflect competition between margin lenders which has seen the introduction of new products and additional features and flexibility in existing products. For example, while it has always been possible for people to finance share investments by borrowing against their houses, some margin lenders have recently begun offering products which effectively combine a home equity loan with a traditional margin loan. While these products may provide a further means for investors to diversify their asset base, by increasing the overall leverage of the investment they have the potential to magnify both gains and losses, and hence present a greater risk to investors. Many margin loan providers now also offer geared savings plans, where the borrower's own periodic savings are combined with increases in the margin loan to purchase additional shares or managed fund investments. ✣