3. Domestic Financial Conditions

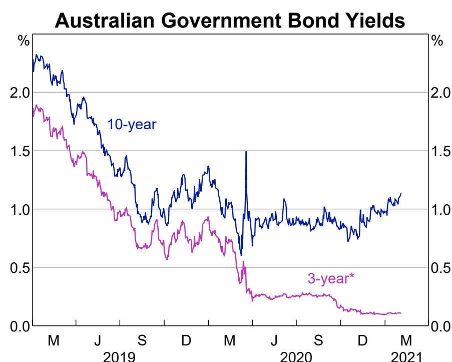
The Reserve Bank's policy measures announced in 2020 – including the reduction in the cash rate, the target for the yield on the 3-year Australian Government bond, the $100 billion bond purchase program, and the Term Funding Facility (TFF) – have lowered funding costs across the private and public sectors and are supporting balance sheets and asset prices. Interest rates on housing and business loans are at historic lows and the Reserve Bank's measures have also supported the availability of credit to households and businesses. On average, lending rates have declined broadly in line with banks' funding costs, although the extent of reductions in interest rates has varied across different types of housing and business loans. Demand for housing finance picked up in the second half of 2020, but demand for new business loans remains subdued. In February the Reserve Bank announced that it would purchase an additional $100 billion of bonds when the current bond purchase program is completed in mid April.

By lowering the structure of interest rates across the economy, the Reserve Bank's policy measures have contributed to a lower exchange rate than otherwise. Nevertheless, against the backdrop of a general improvement in expectations for a recovery in global growth, which has seen commodity prices rise markedly, the Australian dollar has appreciated since November. Australian equity prices have increased over recent months, but are slightly below the levels seen a year ago.

The 3-year government bond yield has remained at the target, and the bond purchase program has put downward pressure on long-end yields

The yield on the 3-year Australian Government Security (AGS) declined following the package of further policy measures announced in early November, and has remained consistent with the new target of around 10 basis points, supported by $9 billion of Bank purchases of the April 2023 and April 2024 bonds in the secondary market in November and early December (Graph 3.1).

Since the commencement of the $100 billion bond purchase program in early November, the Bank has purchased $55 billion of longer-term bonds under this program. Of these, as planned, 80 per cent has been allocated to AGS and 20 per cent to bonds issued by the state and territory borrowing authorities (known as semi-government securities, or semis). The effect of

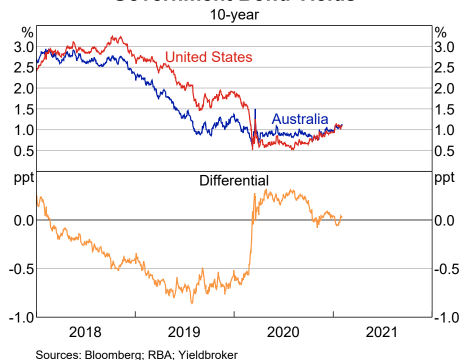


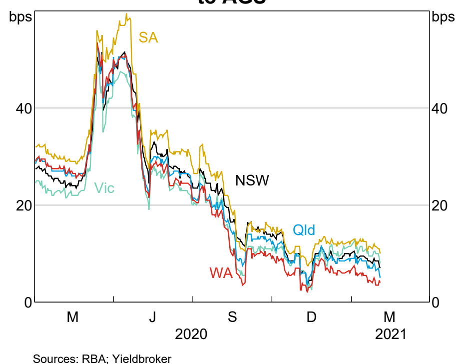
the program can be estimated by examining the cumulative response of bond yields to key news about the program. This suggests that the program has contributed to a decline of roughly 30 basis points in 10-year AGS yields and a narrowing of around 5–10 basis points in semis spreads to AGS. Also, the spread between the 10-year AGS yield and the equivalent US Treasury yield has narrowed by around 30 basis points when compared with the months before the market was anticipating a bond purchase program by the Bank (Graph 3.2). However, other factors also influence AGS yields, including economic developments domestically and offshore. As a result, the level of the 10-year AGS yield has risen over recent months, alongside a similar rise in US Treasury yields and global yields more broadly. This rise in global long-end yields has been driven in part by progress in the development and deployment of COVID-19 vaccines, and prospects for further US fiscal stimulus following the US election results. The $100 billion extension to the bond purchase program, announced on 2 February, was to a large extent anticipated by market participants and so it led to a very modest reduction in longer-term yields and spreads when announced.

Government bond markets are functioning well

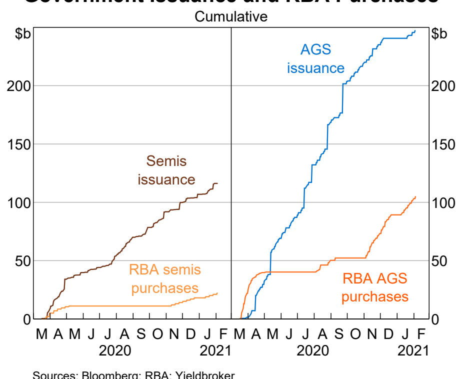
AGS and semis markets have continued to function smoothly over recent months, with bid-offer spreads remaining around their average levels of recent years. These are well below the elevated levels seen during the period of market dislocation in March and April last year, which the Bank helped to alleviate with purchases of bonds and provision of liquidity through open market operations (OMO). Spreads between the yields on semis and AGS remain near historical lows (Graph 3.3). In November, the ASX launched a new 5-year AGS futures contract, which should support the liquidity of bonds of that maturity.

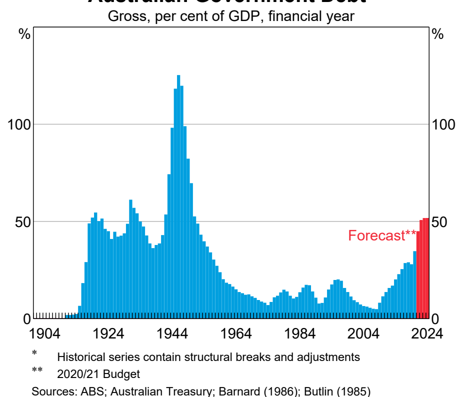
Funding conditions remained favourable for the Australian and the state and territory governments. Government bond yields remain near historical lows and markets have absorbed large volumes of issuance. The Australian Office of Financial Management (AOFM) has issued $160 billion of Treasury Bonds and $69 billion of Treasury Notes since the start of July 2020 (Graph 3.4). This pace of issuance is well above that of recent years, although issuance slowed over the fourth quarter of 2020 with the AOFM well ahead of schedule based on its expected funding requirements. Accordingly, following





the update of the 2020/21 federal budget in mid December, the AOFM announced weekly bond issuance will remain around $2–3 billion per week, which is well below the $4–5 billion per week seen earlier in the financial year. Demand at AOFM tenders has been consistently strong, including for the $6 billion syndicated tap in November 2020 of the existing 2041 bond line. While the projected increase in government debt for 2020/21 and the associated stock of debt outstanding are the largest as a share of GDP in a number of decades, they are not unprecedented (Graph 3.5). Moreover, the stock of debt as a share of GDP remains low compared with other advanced countries.





The TFF continues to provide low-cost term funding to the banking sector

The TFF is providing low-cost term funding to authorised deposit-taking institutions (ADIs) and an incentive for ADIs to increase lending to businesses, particularly small- and medium-sized enterprises (SMEs).[1] In November 2020, the interest rate on new TFF drawings was reduced from 0.25 per cent to 0.1 per cent, in line with the reduction in other policy rates.

The total funding allowance available under the TFF is around $185 billion as of February 2021, which is about 7 per cent of outstanding credit. This includes: drawings under the initial allowance; funding available under the additional allowance (linked to ADIs' new lending to businesses); and the supplementary allowance (added to the facility effective from October 2020).

In aggregate, ADIs have drawn around $86 billion in TFF funding to date. TFF drawdowns slowed after the window to access the initial allowance closed on 30 September, and drawdowns of the remaining (supplementary and additional) allowances have remained modest (Graph 3.6). This reflects the fact that ADIs remain well funded and the deadline for accessing these allowances is not until 30 June 2021. Many ADIs have indicated in liaison that they plan to take up most or all of their supplementary allowances, although some ADIs have indicated that they have access to sufficient private funding for their needs and will not draw all of their remaining allowances. The TFF is continuing to help keep funding costs and lending rates at historic lows.

Liquidity in the banking system and the size of the Bank's balance sheet have increased further

Liquidity in the banking system – as measured by exchange settlement (ES) balances held at the Reserve Bank – has increased further in

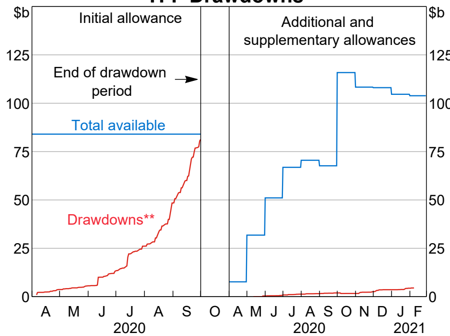
recent months (Graph 3.7). Since November, this has mainly reflected the effect of the Bank's purchases of government bonds (Graph 3.8). Government flows have also recently added to system liquidity because net government spending (which increases system liquidity) has exceeded net government issuance (which reduces system liquidity), following a period in which the reverse was true.[2]

Since the onset of the pandemic, ES balances have risen by around $130 billion, reflecting the Reserve Bank's government bond purchases as well as lending under the TFF. These large liquidity injections have reduced the demand by banks for funding in the Bank's OMO; as a result, the amount of liquidity provided via OMO has declined to its lowest level since 2013. Since the start of the pandemic, government flows have tended to reduce system liquidity, as net issuance of Australian Government bonds has exceeded net spending by the Australian Government over this period.

These developments are reflected in the Reserve Bank's balance sheet, which has almost doubled in size since the start of the pandemic and currently stands at around $335 billion. Growth in the Bank's assets has been driven by an increase in holdings of long-dated government bonds – as a result of the Bank's bond purchases – and an increase in securities held as collateral under the TFF (Graph 3.9). This has been partly offset by a decline in securities provided as collateral in OMO. On the liabilities side, ES balances have risen significantly (as discussed above). Deposits held by the Australian Government at the Reserve Bank have also grown substantially since the pandemic began, again because funds raised via government bond issuance have, to date, exceeded net spending by the Australian Government (Graph 3.10).

Graph 3.6

TFF Drawdowns*



* Until 30 September 2020, repos were applied against initial allowance until fully drawn, then against additional allowance. From 1 October 2020, repos applied against additional and supplementary allowances

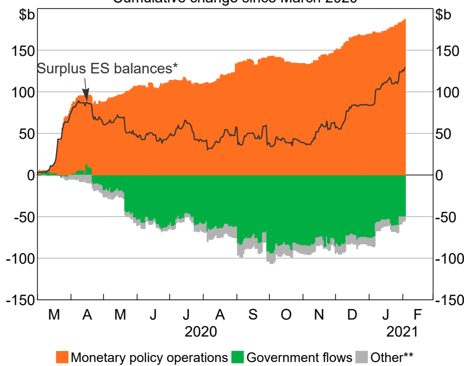
** Includes all settled, contracted and pre-processed repos to date

Sources: APRA; RBA

Graph 3.7

Exchange Settlement Balances

Cumulative change since March 2020



* Total ES balances net of contracted open repo positions

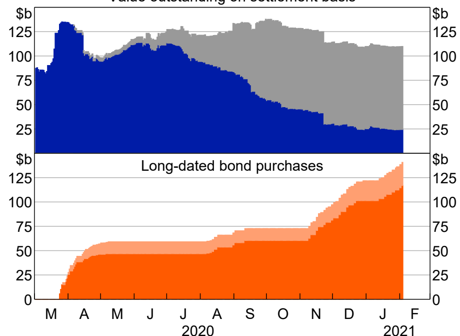
** Includes net banknote issuance and other RBA client flows

Source: RBA

Graph 3.8

Monetary Policy Operations

Value outstanding on settlement basis



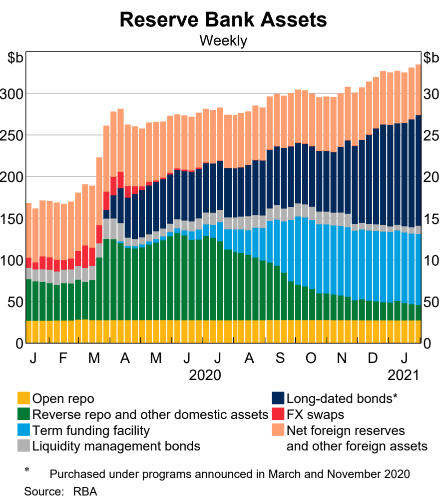
* Liquidity injections net of drains and maturities; contracted in OMOs, FX swaps and short-dated bond purchases

Source: RBA

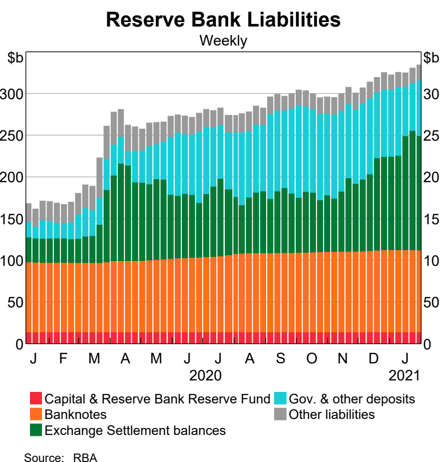
The cash rate declined further

Following the reduction of the cash rate target to 10 basis points at the Reserve Bank Board meeting in early November, the cash rate declined and is currently 3 basis points (Graph 3.11). Financial market prices imply that investors expect the cash rate to remain close to this level for a considerable period. The cash rate remains a little above the rate of remuneration on ES balances, which was reduced to zero in early November. This difference reflects the compensation required by the banks that lend excess balances in the overnight cash market to cover the associated transaction costs and credit risks. The cash rate has been trading below the cash rate target since March 2020. This was expected and is consistent with the experience of other countries that have significantly increased cash reserves in the banking system.

Graph 3.9



Graph 3.10

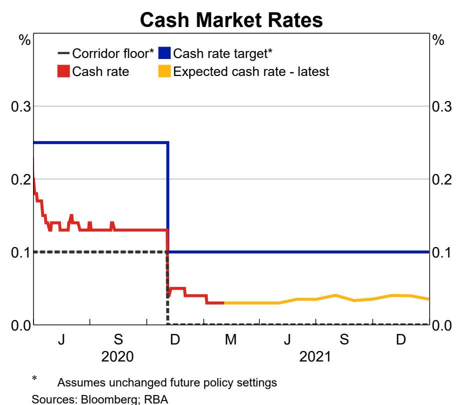


Activity in the overnight cash market has also remained subdued, consistent with very high ES balances (Graph 3.12). Indeed, since November transaction volumes in the overnight cash market have been below the thresholds required to calculate the cash rate based on actual transactions almost half the time. In these instances, the published cash rate has been determined on the basis of the robust fall-back arrangements built into the cash rate procedures. Under these arrangements, the cash rate was published based on the last published cash rate on all but 2 instances. In these cases, the published cash rate was set at a different rate that, in the expert judgement of the Bank as the cash rate administrator, better reflected current market conditions.[3]

Money market rates remain very low

Short-term money market rates are at historically low levels owing to the low level of the cash rate and the large amount of liquidity in the banking system (Graph 3.13). The rates on 3-month bank

Graph 3.11

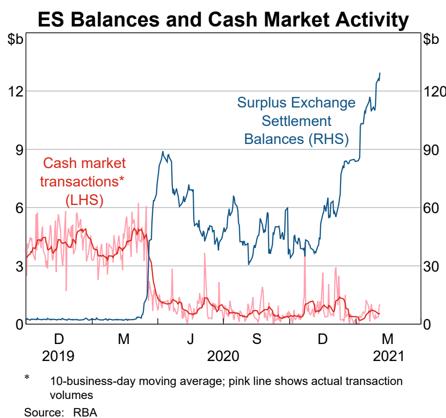


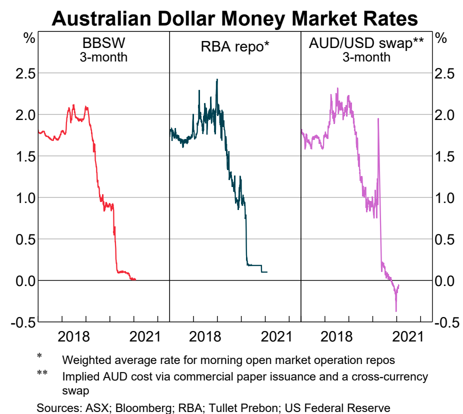
bills (BBSW) have edged lower to be around 1 basis point, slightly below the overnight indexed swap (OIS) rate. Following the reduction in the cash rate target and the remuneration on ES balances in November, repo rates at the Bank's daily market operations declined from 18 basis points to 10 basis points. Repo rates in the private interbank market also moved lower. The implied cost of borrowing Australian dollars via the foreign exchange swap market declined significantly into negative territory towards the end of the calendar year as liquidity in the foreign exchange swap market deteriorated. The implied cost has since retraced to be closer to zero. The temporary decline reflected abundant Australian dollar liquidity in the domestic money market and the propensity for offshore financial institutions to reduce the supply of US dollars towards the end of the calendar year to reduce the size of their balance sheets (see 'The International Environment' chapter); the reduced need by domestic financial institutions to swap US dollars into Australian dollars given lower offshore bond issuance also contributed.

RMBS issuance was primarily by non-ADIs in 2020

Issuance of asset-backed securities (ABS) in 2020 was lower than in recent years, owing to the low level of issuance by banks. ABS issuance by non-ADIs increased in 2020, particularly in the second half of the year. As of September 2020, around half of the stock of Australian ABS outstanding had been issued by non-ADIs (Graph 3.14). Spreads relative to benchmark rates on residential mortgage-backed securities (RMBS) issued by non-ADIs declined over the year, but remained elevated relative to pre-COVID levels. Nonetheless, benchmark rates also declined significantly over 2020, causing yields on RMBS to decline to historically low levels. Spreads on ADI RMBS fell below the levels observed at the beginning of 2020, consistent with the decline in RMBS issuance by ADIs.

Since the March announcement of the Structured Finance Support Fund (SFSF), the Australian Office of Finance Management (AOFM) has provided funding to securitisation warehouses and has invested directly in ABS in the primary and secondary markets. These measures supported the improvement of conditions in the ABS market since then. The AOFM has not intervened in primary or secondary markets since July, but continues to support the warehouse market and provide support via its forbearance special purpose vehicle.

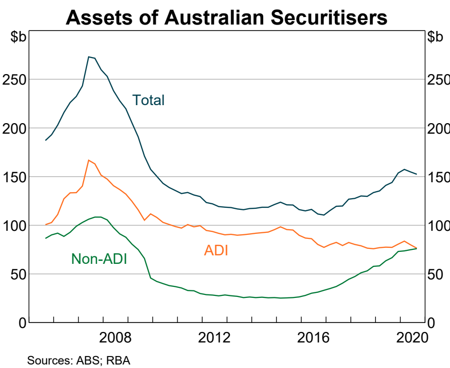


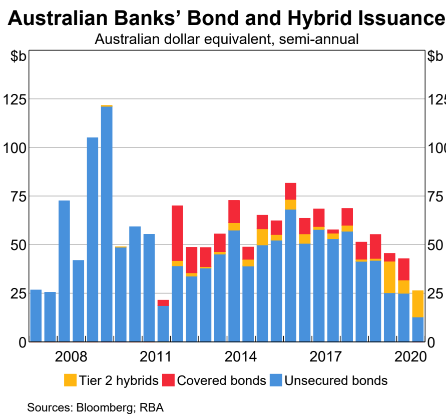


Banks' issuance of senior bonds was low, although the major banks continued to issue hybrid securities

Australian banks' issuance of senior unsecured bonds was very low in 2020 (Graph 3.15). The low level of bond issuance reflected the availability of low-cost funding from the TFF, strong deposit growth and the moderate pace of overall asset growth.

Banks continued to issue Tier 2 hybrid securities in 2020, raising $20 billion in this form. Hybrid securities have both equity and debt features and can be used to fulfil a part of regulatory capital requirements, which will increase in January 2024. Spreads on these Tier 2 hybrid issues were similar to those in 2019.

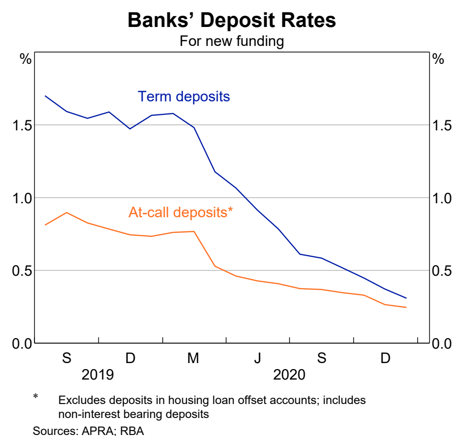




Deposit rates declined further

Banks have continued to respond to the plentiful supply of funding at low rates by reducing deposit rates, including following the November Board meeting. Rates for new retail and wholesale deposits have declined by 10 basis points since the end of September (Graph 3.16).

Over the past year or so, interest rates for new term deposits have declined by around 125 basis points, while rates for at-call deposits declined by around 50 basis points. The decline in the spread between interest rates on term deposits and other deposit rates is encouraging a shift by customers from term to at-call deposits. These changes have led to a rise in the share of bank deposits paying low interest rates (of between zero and 25 basis points). A little over one quarter of the debt funding of the major banks was estimated to be in the form of deposits paying interest of 25 basis points or less in the September quarter last year. This compares with around 15 per cent in late 2019. However, by value the majority of banks' deposits are still paying rates above 25 basis points, reflecting a sizeable share of deposits paying interest rates greater than 100 basis points.



Banks' overall funding costs declined to historically low levels

The Reserve Bank's policy measures have lowered banks' funding costs to historically low levels (Graph 3.17). Banks' non-equity funding costs are estimated to have declined by a similar amount to the cash rate since the end of February 2020. Much of the banks' wholesale debt and deposit costs are ultimately linked (either directly or via hedging) to BBSW rates, which have declined by around 80 basis points since the end of February 2020. Low-cost funding from the TFF and deposit inflows have reduced banks' need for new wholesale funding; while the cost of new 3-year bank bonds has declined, it remains higher than the rate on TFF borrowing. The additional policy measures announced by the Reserve Bank since late last year are expected to lower banks' funding costs a little further over the period ahead. This reflects the continued flow-through of the decline in BBSW rates to debt funding costs, ongoing reductions in banks' deposit rates and expected future drawdowns of the low-cost funding from the TFF.

The deposit share of banks' total funding (including equity) has increased by around 4 percentage points since the end of February 2020 (Graph 3.18). Government bond purchases by the Reserve Bank and the banking sector have contributed to deposit growth, for example as payments for bonds purchased from the private (non-bank) sector are credited to the deposit accounts of those selling these bonds.[4] The rising shares of low-cost funding from the TFF and deposits are in line with the reduction in the share of wholesale debt funding.

Interest rates on business loans declined to historical lows

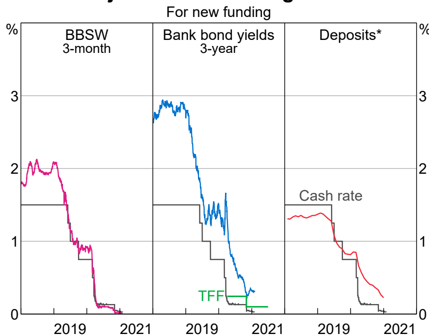
Following the Reserve Bank's decision to ease monetary policy further in November, a number of banks announced reductions in interest rates of between 30 and 75 basis points for new loans under the Government's SME loan guarantee scheme. A few banks announced reductions for some new loans to small businesses that are outside of the guarantee scheme.

More generally, since monetary policy was first eased in response to the pandemic, interest rates on outstanding business loans have declined to historical lows (Graph 3.19). Interest rates on variable-rate loans to large businesses have declined by 85 basis points since the end of February 2020. Interest rates on variable-rate loans to small and medium-sized businesses have declined by around 80 basis points over the same period. Most of the reductions

Graph 3.17

Major Banks' Funding Costs

For new funding



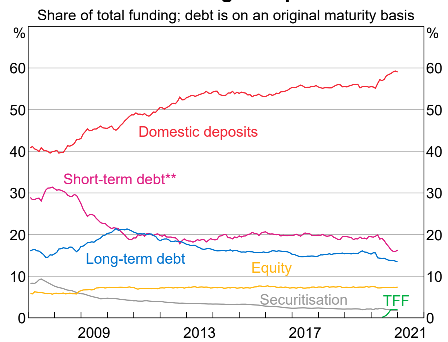
* RBA estimates; excludes deposits in housing loan offset accounts

Sources: AFMA; APRA; ASX; Bloomberg; major banks' websites; RBA; Refinitiv

Graph 3.18

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

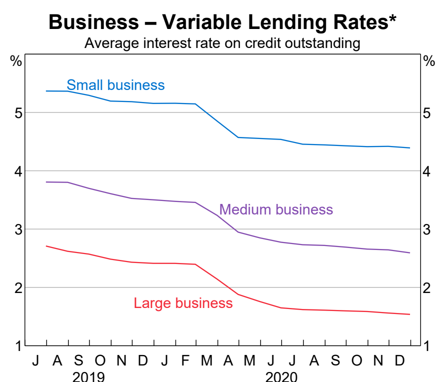
occurred between March and July 2020, although interest rates have drifted lower since then.

Interest rates on housing loans also declined

A number of lenders reduced their housing lending rates following the package of monetary policy measures announced in early November last year. While some small lenders passed on the 15 basis point reduction in the cash rate target to their standard variable rates (SVRs) in full, the majority of lenders, including the major banks, did not reduce their variable housing rates (Graph 3.20). Instead, interest rate cuts of late have predominantly been for fixed-rate housing loans (Graph 3.21). The major banks, along with some other lenders, announced reductions in advertised fixed home-loan rates of between 10 and 110 basis points following the November Board meeting. Although most fixed-rate loans are for 2- or 3-year terms, the largest reductions in advertised rates of up to 110 basis points were for loans with 4-year terms. Some new fixed-rate loans are being advertised with interest rates of below 2 per cent.

Over the past year or so, the interest rates paid by borrowers on housing loans have declined alongside the decline in banks' funding costs. Interest rates on outstanding variable-rate mortgages have declined by around 45 basis points since the end of February 2020 (Table 3.1). Much of that decline occurred in March and April last year, following the Reserve Bank's initial package of policy measures, as lenders reduced their SVRs by close to 30 basis points, on average. Outstanding variable rates have continued to drift down since then, reflecting ongoing competition for new high-quality borrowers and the associated effect of the elevated level of borrower refinancing.

The rates paid by borrowers on new fixed-rate loans have declined by around 85 basis points since the end of last February, to be around 55–75 basis points below new variable interest rates at the end of December. This has encouraged new borrowers to take out fixed-rate loans and existing borrowers to refinance their loans at very low fixed interest rates. The proportion of new loans funded at fixed interest rates remains high by historical standards, and the stock of fixed-rate housing loans has risen by about 5 percentage points since the start of 2020 to account for around 25 per cent of housing credit outstanding.



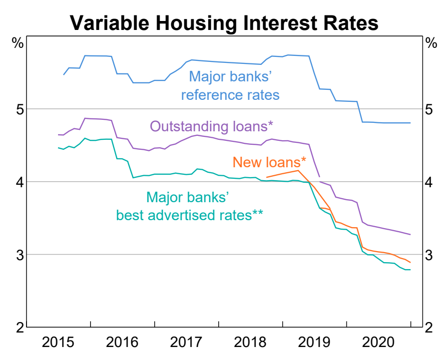


Table 3.1: Average Outstanding Housing Rates

December 2020

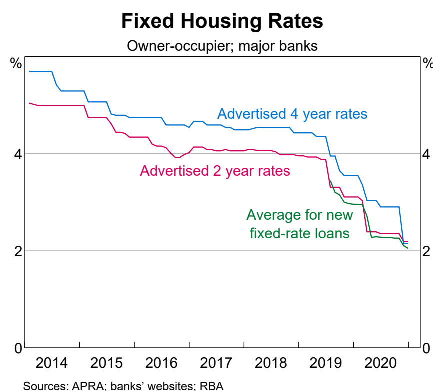
	Interest rate Per cent	Change since February 2020 Basis points
Variable-rate loans		
– Owner-occupier	3.15	–43
– Investor	3.51	–46
All variable-rate loans	3.27	–44
Fixed-rate loans		
– Owner-occupier	2.76	–96
– Investor	3.16	–85
By repayment type[(a)]		
– Principal-and-interest	3.08	–54
– Interest-only	3.70	–53

(a) Weighted average across fixed- and variable-rate loans

Growth in total credit has eased back to pre-pandemic levels

Total credit growth declined following the sharp rise in the early part of the pandemic (Graph 3.22; Table 3.2). This decline has mostly been driven by businesses repaying lines of credit that were initially drawn down over March and April to shore up liquidity positions during that especially uncertain period. Demand for business credit has been subdued since then (discussed further below). Meanwhile, growth in housing credit picked up a little in late 2020. This followed the easing of restrictions put in place to contain the virus, and has been supported by lower interest rates, government measures targeted at first home buyers and the HomeBuilder program.

The stock of personal credit outstanding fell even more noticeably during the pandemic. Around half of the decline in personal credit between March and September was due to the decline in outstanding credit card debt, reflecting lower credit card spending by households and borrowers repaying this debt. Borrowers' capacity to repay debt was boosted by superannuation withdrawals and govern-



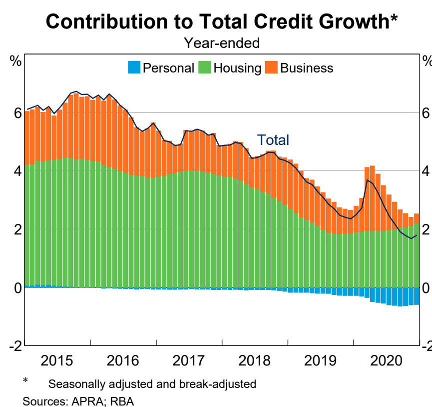


Table 3.2: Growth in Financial Aggregates

Percentage change[(a)(b)]

	Sep 2020	Three-month annualised Dec 2020	Jun 2020	Six-month annualised Dec 2020
Total credit	–0.5	1.9	2.9	0.7
– Household	2.0	3.4	1.7	2.7
– Housing	3.4	4.3	3.2	3.8
– Owner-occupier	5.1	6.1	5.5	5.6
– Investor	0.2	0.9	–0.6	0.6
– Personal	–14.0	–5.4	–14.7	–9.8
– Business	–5.3	–1.2	5.4	–3.3
Broad money	10.7	8.7	15.7	9.7

(a) Seasonally-adjusted and break-adjusted

(b) Sources: ABS; APRA; RBA

ment assistance payments. More recently, spending on credit cards has increased a little as movement restrictions to contain the virus have been eased.

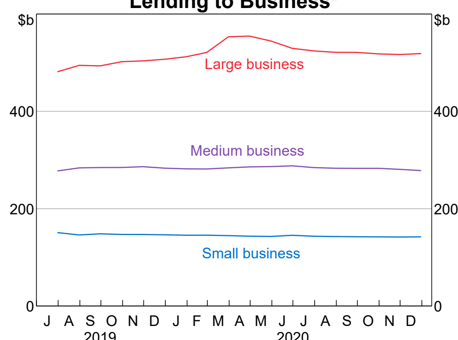
Business lending has been consistent with businesses' precautionary behaviour

Lending to businesses decreased over 2020, despite the sharp increase seen over March and April (Graph 3.23). Large businesses have, overall, gradually repaid the lines of credit that were initially drawn down as a precaution to shore up liquidity positions, and have taken out fewer loans for other purposes than in the period prior to the pandemic. Even so, the size of credit facilities available has increased significantly since the pandemic, suggesting that businesses are continuing to take a cautious approach to managing their access to liquidity. The volume of lending to SMEs has remained little changed over this time, with a pick-up in lending to the agriculture sector in 2020 offset by a decline in lending to other services (Graph 3.24).

Demand for new loans is subdued despite historically low interest rates. Commitments for new business loans have declined since April to levels well below those seen before the pandemic, although they have stabilised somewhat in recent months (Graph 3.25). Survey data and liaison with businesses and banks suggest that businesses have been reluctant to take on debt given the uncertainty about the economic outlook. Businesses have also made use of a range of temporary government and loan payment deferral initiatives, which have helped to build up liquidity buffers and lessened the need for new loans. Around 65 per cent of large businesses surveyed by the Australian

Graph 3.23

Lending to Business*



* Data cover financial institutions with $2 billion or more in business credit

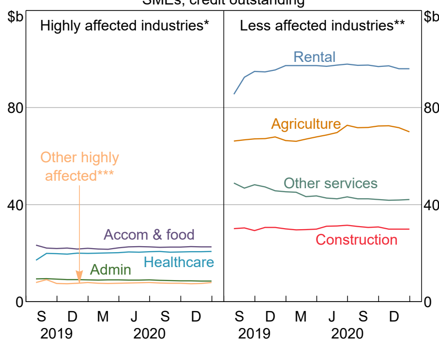
Sources: APRA; RBA

Bureau of Statistics in October reported that they had enough cash to cover their expenses for at least the next 6 months, up from 50 per cent in June. In both June and October, over 35 per cent of the smaller businesses surveyed reported that they had sufficient cash for at least the next 6 months. Prior to the pandemic, around half of businesses had less than a month's worth of cash on hand to meet expenses.

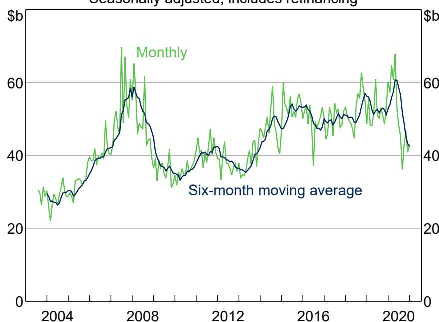
Within overall business loan commitments, however, those for new SME loans have increased a little of late, and are currently around the average level observed over the six months preceding the pandemic (Graph 3.26). Loan commitments for the purchase of property and for plant and equipment have contributed the most to the recent increase. Lending activity for plant and equipment has been supported by the Australian Government's enhancements to the instant asset tax write-off scheme announced in the 2020/21 budget.

Take-up of the Australian Government's $40 billion SME loan guarantee scheme, which was put in place in late March 2020, has been low to date. About $3 billion of loan commitments have been made to around 30,000 businesses under the scheme. In October 2020, the scheme was made more generous to prospective borrowers in terms of how much could be borrowed, the use of collateral to secure the loan, and the repayment terms. The availability of funding at low cost through the scheme will help to support new lending should the demand from businesses pick up.

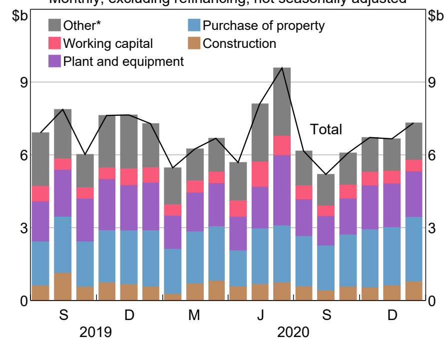
Most loan repayment deferral arrangements on SME loans that were offered by banks in 2020 have now expired. The vast majority of SME borrowers that had a deferral in place have resumed repayments. As of the end of December 2020, just over 1 per cent of all small business loans by number still had a loan



* Industries with the highest share of businesses reporting a fall in revenue of greater than 50 per cent in June ABS survey
** Top four industries by value of SME lending
*** Education and training; arts and recreation services; information media and telecommunications
Sources: APRA; RBA



* Adjusted for series break prior to September 2019
Sources: APRA; RBA



* Wholesale finance, acquisitions and general business purposes
Sources: APRA; RBA

repayment deferral in place, down from a peak of around 13 per cent in June 2020.

The supply of business credit tightened in response to the pandemic

The availability of credit to businesses tightened in 2020, mostly for those business that have been more affected by the pandemic. Banks have reported in liaison that much of the tightening has reflected the application of existing lending standards in a weaker economic environment. In addition, banks have required a greater degree of verification of borrowers' information to better understand whether it is reasonable to extend a loan, given uncertainty about the economic outlook. Some banks continue to be cautious about lending to particular sectors – such as tourism, retail and commercial property – and to customers that are new to the bank.

Surveys of small businesses indicate that access to finance became less difficult in the latter months of 2020 (Graph 3.27). However, at the same time, fewer businesses report that they have tried to access finance, consistent with subdued demand for credit. In late September, the Australian Government announced changes to responsible lending obligations intended to simplify the loan application process and reduce the extent of verification procedures. Enabling legislation was introduced to parliament in late 2020 and is currently under consideration. At the same time, ASIC has reiterated that consumer lending laws do not apply to small business lending.

Corporate bond issuance increased in 2020

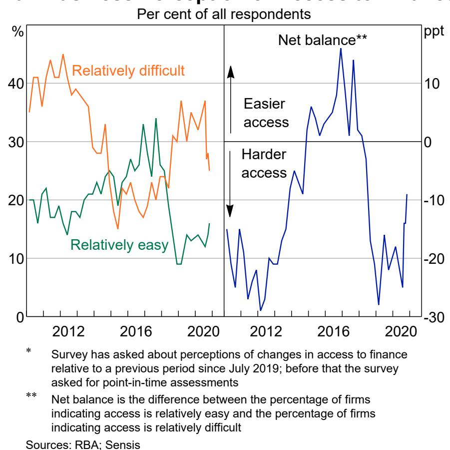
Bond issuance by non-financial corporations increased in 2020, driven by a pick-up in issuance from non-resource firms. Issuance in the domestic market was above average, and a much larger-than-usual share of bonds had a tenor of 10 years or longer (Graph 3.28). Liaison indicates that the low level of interest rates has increased demand for long-term bonds as investors have sought higher yields. Following a sharp increase early in 2020, corporate bond spreads declined over the second half of the year, to be around levels seen before the COVID-19 outbreak.

Demand for housing loans picked up as restrictions to contain the virus were eased

Housing credit growth picked up towards the end of 2020, returning to around the same pace of growth experienced prior to the pandemic

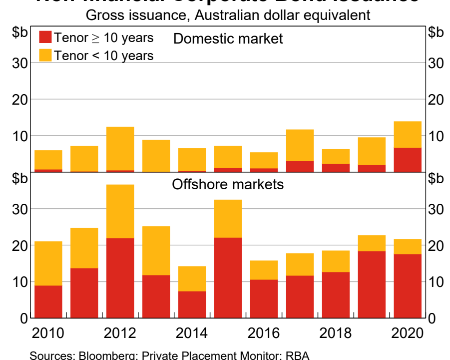
Graph 3.27

Small Business Perception of Access to Finance*



Graph 3.28

Non-financial Corporate Bond Issuance



(3¾ per cent on a 6-month-ended annualised basis). Loans to owner-occupiers have mostly driven the increase in late 2020, but investor housing credit also increased a little over the same period having declined over much of the year (Graph 3.29).

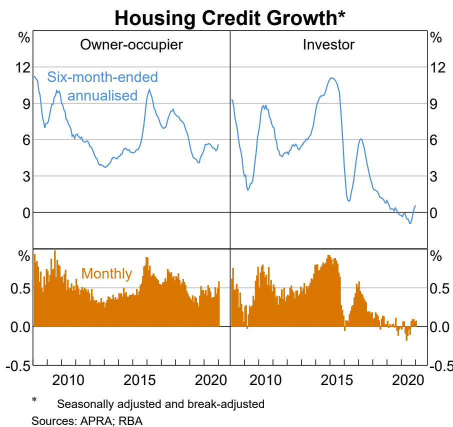
Commitments for new housing loans rebounded sharply over the second half of the year to be 30 per cent above the levels seen in March 2020 (Graph 3.30). Lower interest rates, government measures targeted at first home buyers and the HomeBuilder program have all supported demand for housing finance. The increase is also consistent with an improvement in some housing market activity indicators such as auction clearance rates and turnover (see 'Domestic Economic Conditions' chapter). Banks have indicated in liaison that the increase in housing market activity over the second half of 2020 in part reflects pent-up demand; borrowers who found it difficult to purchase a property when restrictions were in place have since been able to do so. In Victoria, commitments for new loans have also increased over recent months following a gradual easing of the restrictions that were put in place to contain an outbreak of the virus between July and September.

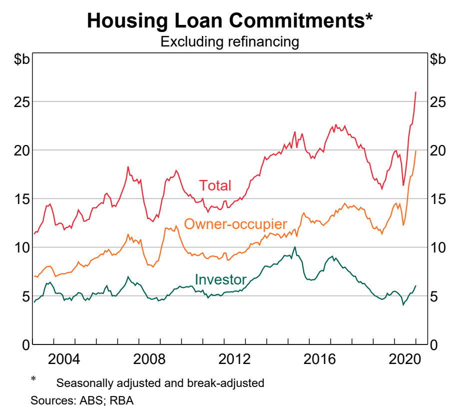
The availability of housing credit had tightened a little in response to the pandemic. However, in recent months, banks have begun to ease some requirements regarding additional information and have reduced the extent to which they have discounted highly variable sources of income (such as bonuses and commissions) when assessing a borrower's capacity to service a loan. Banks have also indicated more appetite for loans with higher loan-to-valuation ratios (LVRs).

Overall, the major banks' market share of housing lending has decreased since 2017, while the shares of both other ADIs and non-ADI lenders have increased (Graph 3.31). Since the middle of last year, non-ADI lenders' share of housing credit has decreased slightly, although even within this group there has been considerable variation, with some non-ADI lenders increasing their share of housing credit.

Payments into housing loan offset and redraw accounts were elevated throughout 2020

Mortgage borrowers have made substantial payments into offset and redraw accounts since March, amounting to 4 per cent of disposable income (around $40 billion) (Graph 3.32). The bulk of these funds have been placed into offset accounts (a type of deposit account linked to mortgages) and so do not reduce the measure of credit outstanding. Payments into redraw accounts, which do reduce the measure of





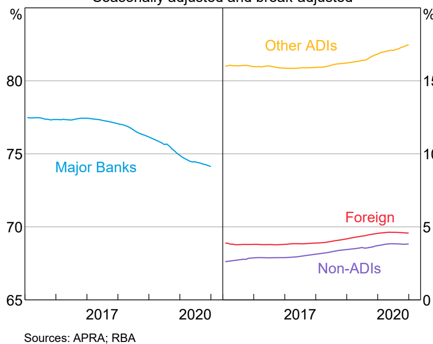
credit outstanding, have also increased noticeably. The increase in payments is likely to reflect a combination of reduced opportunities for spending, mortgage holders saving for precautionary reasons, and some borrowers depositing cash received from early release superannuation and fiscal payments into these accounts.

Net payments into redraw and offset accounts remain high but have eased a little over recent months, consistent with a tapering in fiscal payments, and a decline in the number of households that have accessed early release superannuation. The easing of restrictions in Victoria – allowing for more spending opportunities – may also have contributed.

Graph 3.31

Market Share of Housing Credit

Seasonally adjusted and break-adjusted



Sources: APRA; RBA

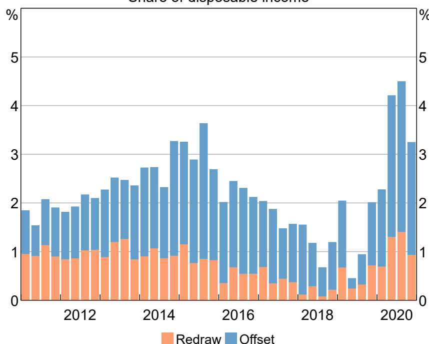
Over 2020, reductions in housing loan interest rates flowed through to borrowers in the form of lower interest payments (Graph 3.33). Since March, interest payments have declined by around ½ percentage point as a share of disposable income. This reflects the pass-through of the Bank's policy easing and borrowers refinancing to lower interest rates, as well as the strong growth in disposable income since that time.

The share of mortgage holders with a repayment deferral arrangement in place declined to 2 per cent at the end of December 2020, from a peak of 8 per cent at the end of June. Banks announced 6-month loan payment deferrals in March 2020 to provide support for borrowers impacted by the pandemic, most of which were due to expire between September and October. Since September, around 85 per cent of borrowers that have exited their deferral arrangement have agreed to resume full payments. The remaining share are mostly made up of borrowers who have had their deferrals extended, and a small share have had hardship arrangements put in place (2 per cent of those exiting deferral arrangements).

Graph 3.32

Flows into Offset and Redraw Accounts*

Share of disposable income



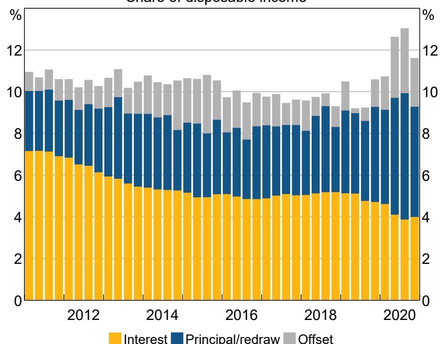
* Seasonally adjusted and break-adjusted

Sources: ABS; APRA; RBA

Graph 3.33

Flows into Housing Loan and Offset Accounts*

Share of disposable income**



* Seasonally adjusted and break-adjusted

Sources: ABS; APRA; RBA

Australian equity prices have risen but remain slightly lower than one year ago

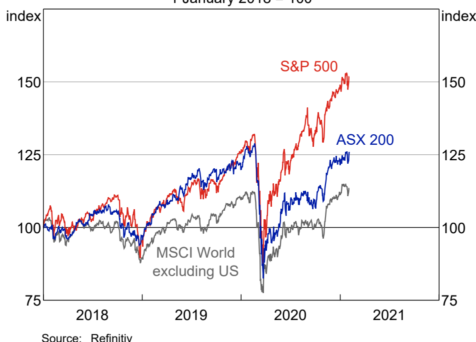
The ASX 200 has increased further over recent months to be around 2 per cent below its February 2020 peak on a total return basis, which takes dividends into account. The rebound in global equity prices since March last year reflects the recovery in the global economy and the related monetary and fiscal stimulus, along with an improvement in sentiment as effective COVID-19 vaccines have been developed (Graph 3.34). On a total return basis, the ASX 200 has performed broadly in line with other overseas equity markets. The stronger growth of the S&P 500 over the past year partly reflects the strength of technology stocks, which have a much larger weight in the US index.

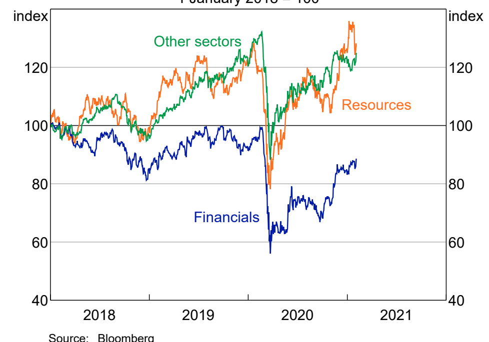
Equity prices in the resources sector are almost back to their previous peak in early 2020 and have contributed much of the rise in the ASX 200 since March (Graph 3.35). In recent months, major miners performed strongly on the back of higher iron ore prices, amid tighter than expected supply and increased demand for iron ore from China. Equity prices of oil companies increased alongside supply cuts from the Organization of the Petroleum Exporting Countries. The financial sector underperformed the ASX 200 index in recent months, consistent with developments in other advanced economies. It remains around 12 per cent below its February 2020 peak, in part reflecting substantial loan loss provisions. Equity prices for companies outside the financial and resources sectors are around 5 per cent below their peak in early 2020. The information technology sector has performed strongly over the past year, as companies have benefited from the shift to working from home and the pick-up in growth of online sales.

Listed companies issued over $65 billion of new equity in 2020, the most since 2009, as companies shored up their balance sheets again at a time of great uncertainty (Graph 3.36). Companies that were most affected by the pandemic, such as travel and industrial companies, raised significantly more capital than their historical average. More recently, some firms have raised capital for mergers and acquisitions. The value of pending mergers and acquisitions increased sharply in the December quarter, as firms seek to acquire competitors that have lower values of market capitalisation than before the outbreak of COVID-19.

The Australian dollar has appreciated since November

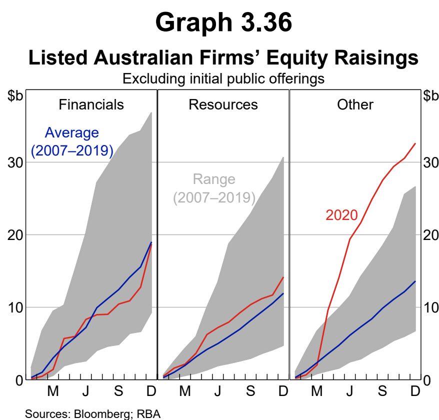
The Australian dollar has appreciated by around 5 per cent on a trade-weighted (TWI) basis since early November, and is higher than its level prior

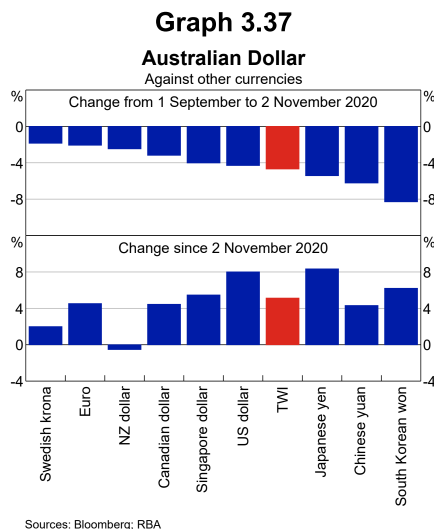




to the onset of the pandemic. The appreciation since November has been noticeable against the US dollar (Graph 3.37). This has occurred against the backdrop of the general improvement in expectations for the recovery in global growth, which has seen the US dollar depreciate and many commodity prices increase markedly (Graph 3.38). In particular, the price of iron ore has increased by around 30 per cent since early November and is around its highest level since 2013 (see 'The International Environment' chapter).

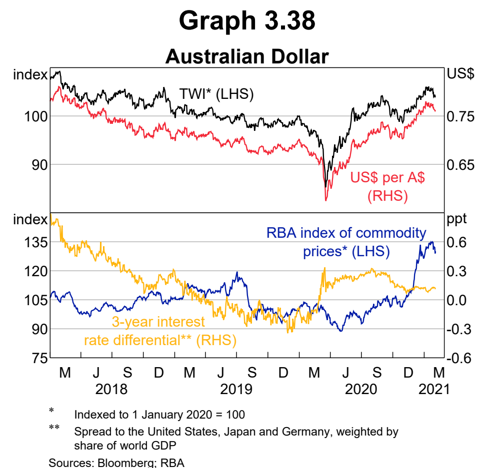
Interest rates on government bonds in Australia have been little changed relative to those in other major advanced economies since the previous *Statement*. However, Australian interest rates did decline relative to those abroad in the months leading up to the introduction of the Reserve Bank's package of policy measures introduced in November. Following the recent announcement of the extension to the bond purchase program, the Australian dollar has been little changed. However, given the lower structure of interest rates in the domestic economy associated with the Bank's policy measures over the past year, the exchange rate is lower than otherwise.





Australia has continued to experience net capital outflows

Australia continued to be a net lender of capital in the September quarter with capital outflows exceeding capital inflows (Graph 3.39). This is in line with Australia recording a current account surplus (see 'Domestic Economic Conditions' chapter). Outflows were related to a decline in the outstanding stock of debt issued abroad by Australian banks, consistent with their access to low-cost funding domestically from the TFF and the moderate pace of growth in their assets. Outflows also reflected superannuation and investment funds purchasing foreign equities. Partly offsetting this was inflows of capital to



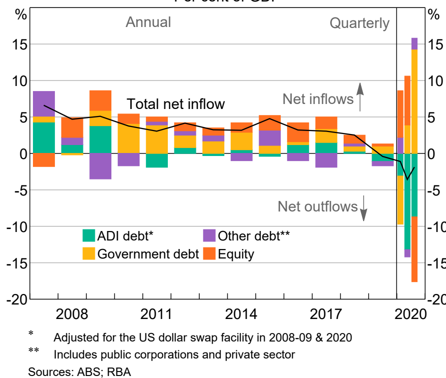
Australia from foreign purchases of Australian Government debt.

Despite a small increase in the September quarter, Australia's net foreign liability position remains around its lowest level as a per cent of GDP since the 1990s. The decline in the net foreign liability position over the past 4 years reflects the increase in the net foreign equity asset position that has occurred over this period as superannuation funds have increased their allocations to foreign equity (Graph 3.40).

Graph 3.39

Net Capital Flows

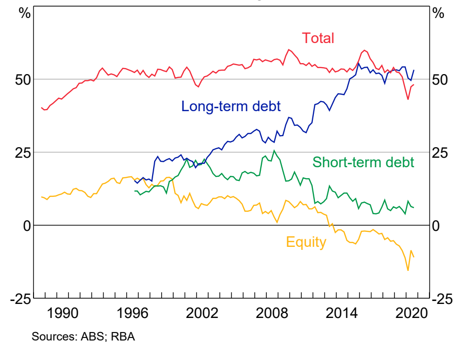
Per cent of GDP



Graph 3.40

Net Foreign Liability Position

Per cent of GDP



Endnotes

[1] See Alston M, S Black, B Jackman and C Schwartz (2020), 'The Term Funding Facility', RBA *Bulletin*, December, viewed 28 January 2021. Available at <https://www.rba.gov.au/publications/bulletin/2020/dec/the-term-funding-facility.html>

[2] For more information on the effect of government flows on system liquidity, see Robertson B (2017) 'Structural Liquidity and Domestic Market Operations', RBA *Bulletin*, September, viewed 28 January 2021. Available at <https://www.rba.gov.au/publications/bulletin/2017/sep/5.html>.

[3] Kent C (2020), 'The Reserve Bank's Operations – Liquidity, Market Function and Funding', speech to KangaNews, Sydney 27 July. Available at <https://www.rba.gov.au/speeches/2020/sp-ag-2020-07-27.html>

[4] For more information, see RBA (2020), 'Box D: Recent Growth in the Money Supply and Deposits', RBA Statement on Monetary Policy, August, pp 75–77, viewed 28 January 2021. Available at: <https://www.rba.gov.au/publications/smp/2020/aug/box-d-recent-growth-in-the-money-supply-and-deposits.html>.