3. Domestic Financial Conditions

The policy measures implemented by the Reserve Bank since the onset of the pandemic have lowered funding costs across the Australian economy to very low levels. These measures include the reductions in the cash rate, the use of forward guidance, the Term Funding Facility (TFF), the yield target and the bond purchase program. In September, the Bank extended the bond purchase program, by buying $4 billion per week until at least mid February.

From late September, Australian Government bond yields had risen markedly alongside increases in sovereign bond yields globally, to be around the levels reached earlier this year. This reflected rising inflation expectations both domestically and offshore and, related to this, expectations that central banks would begin to reduce stimulus earlier than previously expected. The rise also embodied an increase in risk premia as uncertainty about the inflation outlook and future interest rates increased. The rise in yields had been associated with a marked increase in volatility and a noticeable reduction in bond market liquidity, particularly for shorter-dated bonds. The yield on the April 2024 Australian Government bond had been close to zero for much of August and September but rose to over 75 basis points in October. Implied market expectations for the cash rate also rose alongside the broader move higher in yields, with the expected timing of the first cash rate increase now around mid 2022. At its November meeting, the Reserve Bank Board decided to discontinue the yield target of around 10 basis points for the April 2024 bond, after taking into account the upward revisions to the staff's inflation forecasts and the associated shift in the distribution of possible cash rate outcomes under the Bank's forward guidance, as well as the reduced effectiveness of the yield target in assisting to hold down the general structure of interest rates in Australia as expectations of the future cash rate path shifted.

Banks' overall funding costs remain close to historic lows, notwithstanding the recent rise in yields, and overall lending rates continued to edge down over recent months, reaching new lows. Demand for housing finance remained high in the September quarter, while growth in business debt picked up to well above its average pace of recent years, driven by borrowing by larger firms. In response to the risks associated with rising household indebtedness, in October the Australian Prudential Regulation Authority (APRA) increased the serviceability assessment rate that it expects banks to use to assess prospective borrowers' loan applications. While this action will increase the resilience of borrowers, the effect on overall credit growth is expected to be modest. This is because most borrowers do not borrow at their maximum capacity, and the reduction in maximum loan sizes for affected borrowers will be small.

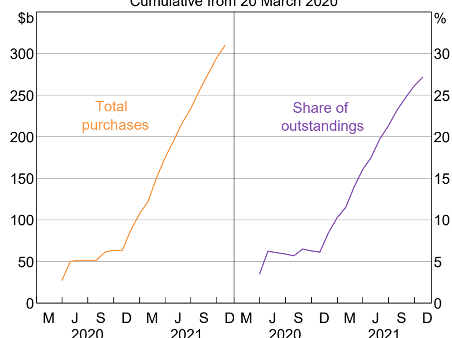
The Australian dollar has appreciated a little of late but remains below the levels seen earlier in the year. It reached year-to-date lows in mid August before retracing this move alongside the increase in yields on Australian Government bonds relative to those in the major advanced economies.

The bond purchase program has been extended, with purchases of $4 billion per week until at least February 2022

Following completion of the first two phases of the bond purchase program in early September, the Reserve Bank Board decided to extend government bond purchases at a pace of $4 billion per week. This was a reduction from $5 billion per week, as announced at the July Board meeting. At its September meeting, the Board also decided to purchase bonds at this pace until at least mid February 2022, in response to the delay in the economic recovery and the increased uncertainty associated with the Delta outbreak. Purchases announced for the period from September 2021 to February 2022 were broadly in line with market expectations and so government bond yields were little changed following the announcement. The Bank has purchased $234 billion of longer-term government bonds since November 2020 under the bond purchase program, consisting of $186 billion of Australian Government Securities (AGS) and $48 billion of semi government securities (semis). Overall, since March 2020, the Bank has purchased around $315 billion of government bonds under the bond purchase program and in support of the yield target and market functioning. The Bank currently holds 32 per cent of outstanding AGS and 16 per cent of outstanding semis (Graph 3.1). By mid February 2022, these shares are projected to increase to around 36 per cent and 18 per cent, respectively.

AGS yields have increased alongside global bond yields

Yields on long-term AGS increased by around 80 basis points since their lows in August, to be back around the levels seen earlier in the year (Graph 3.2). Shorter-dated AGS yields also increased significantly over the past month. These movements have occurred alongside similar moves in international markets, although the moves in AGS yields have been larger than in US yields. In particular, 10-year AGS yields are now around 25 basis points above those of US Treasuries. The government bond market is less liquid in Australia than in the United States, which tends to result in larger moves in AGS yields during periods of volatility, as was also the case earlier this year. The increase in yields globally reflects rising inflation expectations in a number of major markets and, related to this, expectations that central banks will begin to reduce stimulus earlier than previously expected (see chapter on 'The International Environment'). Risk premia have also risen alongside a higher perceived risk of upside surprises to inflation and policy rates. Break-even inflation rates – which are measured as the difference between nominal and inflation-indexed bond yields and account for both inflation expectations and risk premia – have increased in Australia, although they remain lower than in a number of other major economies (Graph 3.3). While the Delta outbreak had weighed on the economic outlook and bond yields in preceding months, real yields in Australia have now increased substantially, supported by increasing vaccination rates and the easing of lockdowns.



* Includes purchases made: under the bond purchase program; to support market function; and to support the yield target

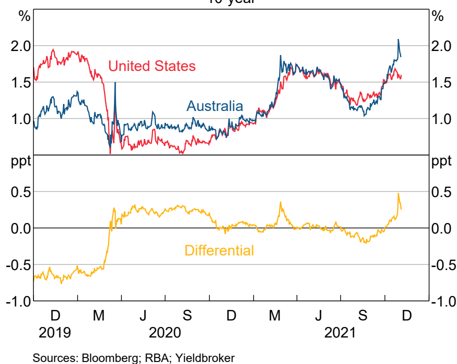
Sources: AOFM; Bloomberg; RBA; state and territory central borrowing authorities

The yield on the April 2024 bond also increased sharply and the yield target was discontinued

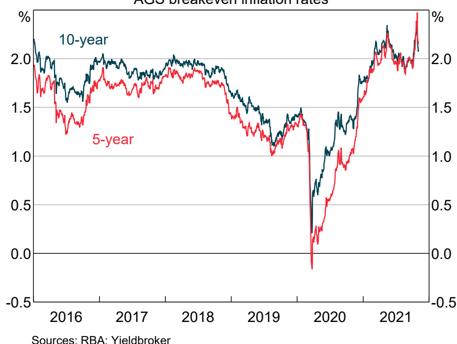
The yield on the April 2024 bond was close to zero in August and September, amid strong demand for short-term risk-free assets, but it increased sharply in October. The initial increase to almost 20 basis points occurred alongside the broader increase in yields globally, with selling of the April 2024 bond by investors who could achieve substantially higher returns by purchasing slightly longer-dated bonds. While there had been no demand to borrow the April 2024 bond from the Reserve Bank at that point, in mid October the Reserve Bank increased the fee it charges counterparties to borrow the April 2024 bond, making any short-selling of the bond more costly. The Reserve Bank also purchased $1 billion of the bond at auction, after which the yield declined to be closer to the target of around 10 basis points. In late October, the yield on the April 2024 bond increased again following the release of the stronger-than-expected September quarter CPI. The yield then moved sharply higher with no further purchases of the April 2024 bond by the Reserve Bank (Graph 3.4).

The Board decided to discontinue the target of 10 basis points for the yield on the April 2024 bond at the November meeting, taking into account upgraded staff forecasts (see chapter on 'Economic Outlook') and the associated shift in the distribution of possible cash rate outcomes, as well as the shift in market pricing reflected in other term interest rates in Australia. The April 2024 yield was little changed at around 70 basis points immediately following the Board announcement before falling to around 65 basis points over the following days, while longer term yields fell by around 10 basis points.

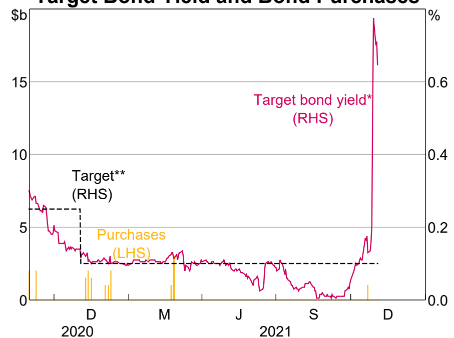
Swap rates around the three-year tenor had already moved noticeably above the April 2024 AGS yield earlier in 2021, but then rose sharply over October, alongside the broader



Sources: Bloomberg; RBA; Yieldbroker



Sources: RBA; Yieldbroker



* Yield target bond is the April 2023 Treasury bond until 20 October 2020, and the April 2024 Treasury bond until 2 November 2021

** Target was discontinued on 2 November 2021

Sources: RBA; Yieldbroker

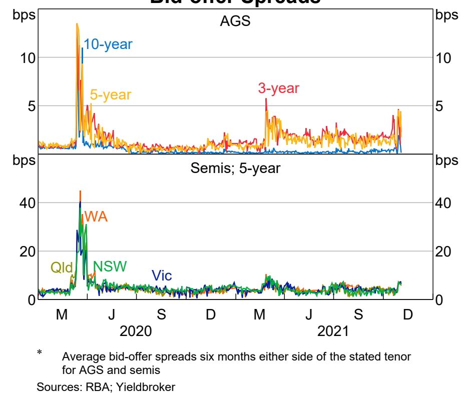
increase in yields as the outlook for inflation and thus market expectations of future policy rates increased domestically and offshore (Graph 3.5). This meant that the yield target had become less effective in assisting to hold down the general structure of interest rates in Australia, with the higher swap rates flowing through to yields on bank and corporate bonds, which typically price off these swap rates.

Market functioning was strained as bond yields rose

Similar to the situation in February and March of this year, bid-offer spreads across the yield curve widened alongside the significant increase in yields (Graph 3.6). This widening was most pronounced for shorter-dated AGS, where uncertainty around the outlook for inflation and the cash rate, as well as the yield target, led to a significant deterioration in market liquidity in the days leading up to the November Board meeting. The sharp movement in yields led to stop-loss selling by some leveraged investors, further contributing to market volatility, while turnover was relatively low in comparison to the earlier episode of strain in February and March. In the days following the November Board meeting, bid-offer spreads for shorter-dated AGS narrowed noticeably, although they remained higher than they were in the preceding months.

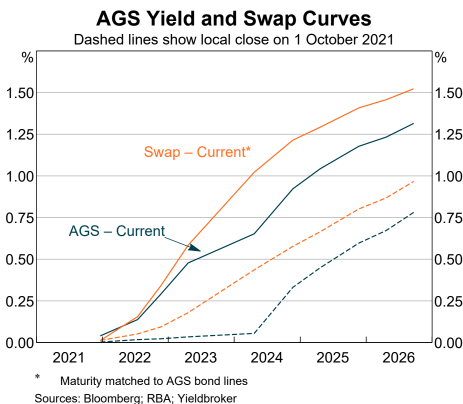
For longer-dated AGS, the increase in bid-offer spreads was more modest and short-lived.

Demand to borrow AGS and semis from the Bank increased in October and early November, particularly for bonds with residual maturity around three to seven years, although securities borrowing remained below the $15 billion peak seen in June (Graph 3.7). By lending bonds back into the market for short periods the Bank supports the functioning of government bond markets.



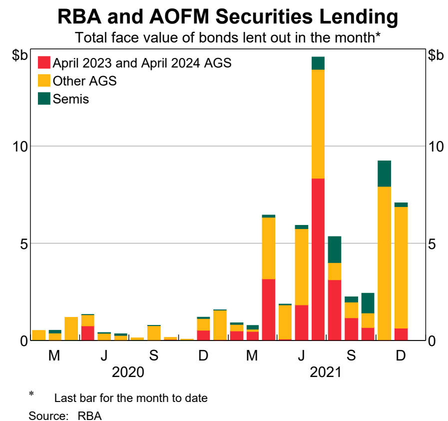
* Average bid-offer spreads six months either side of the stated tenor for AGS and semis

Sources: RBA; Yieldbroker



* Maturity matched to AGS bond lines

Sources: Bloomberg; RBA; Yieldbroker



* Last bar for the month to date

Source: RBA

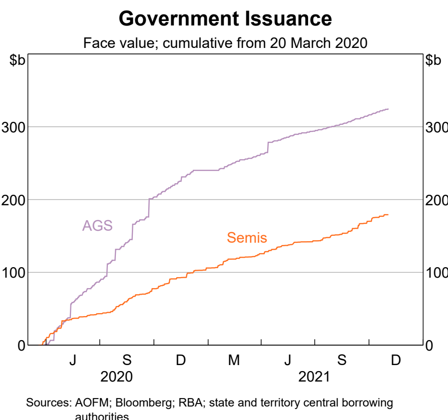
The pace of government bond issuance has picked up

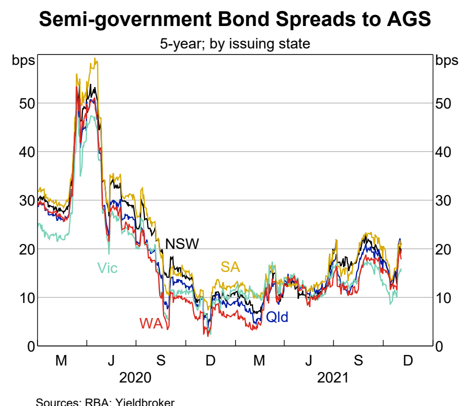
Bond issuance by the Australian Office of Financial Management (AOFM) has risen since late August (Graph 3.8). Nonetheless, AOFM issuance remains below the implied pace of issuance based on the AOFM's annual funding guidance for 2021/22. Issuance by the state and territory borrowing authorities has also increased over recent months, and some state authorities now appear to be ahead of their implied funding schedules. Demand has been strong at both AGS and semis auctions.

Spreads between the yields on semis and AGS narrowed over September and October to be around levels seen earlier in the year, with market liaison indicating robust demand for semis in both the primary and secondary markets, including from banks (Graph 3.9). In part, this reflected additional demand from banks for government bonds, in order to meet liquidity requirements following APRA's announcement in mid September that the Committed Liquidity Facility (CLF) will be phased out by the end of 2022.[1] This change reflected the substantial increase in government debt and Exchange Settlement (ES) balances since the start of 2020, such that the value of these high-quality liquid assets available is sufficient for banks to meet their liquidity requirements without relying on the CLF.[2] Semis spreads to AGS widened a little in late October and early November, alongside the broader increase in yields and bond market volatility, although spreads remain historically low.

Market participants' expectations for the cash rate have risen

Activity in the cash market remains subdued due to the high level of system liquidity. The cash rate has remained at 3 basis points over the past three months. While expert judgement was used to determine the cash rate on all but three days over this period, on most days there were still transactions in the cash market, predominantly at 3 basis points. Market expectations for the cash rate have risen alongside the broader move higher in yields and the revised outlook for inflation. The expected timing of the first cash rate increase implied by market pricing is now around mid 2022. Prices for overnight indexed swap (OIS) contracts imply that market participants expect the cash rate to increase to around 1½ per cent by the end of 2023 (Graph 3.10).





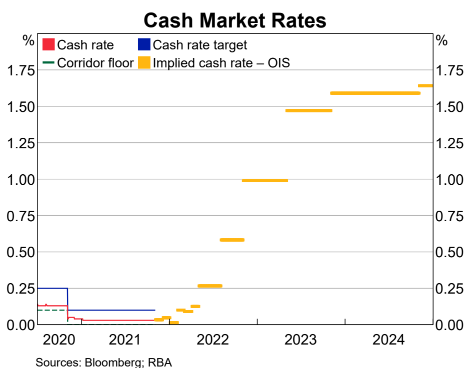
Short-term money market rates remain at very low levels

Short-term money market rates remain near historical lows given the low level of the cash rate and the high level of liquidity in the banking system (Graph 3.11). Bank bill swap rates (BBSW) and the cost of Australian dollar funding from offshore short-term issuance (via the foreign exchange swap market) moved a little higher over the past three months but remain very low. Repurchase agreement (repo) rates at the Bank's regular open market liquidity operations (OMO) remain at 10 basis points. In October, the Bank changed the frequency of its liquidity operations from daily to weekly, reflecting limited use of the facility given the high level of liquidity currently in the financial system. Short-term liquidity obtained at OMO averaged around $700 million per week through the quarter, well below the weekly average of around $10 billion prior to the pandemic.

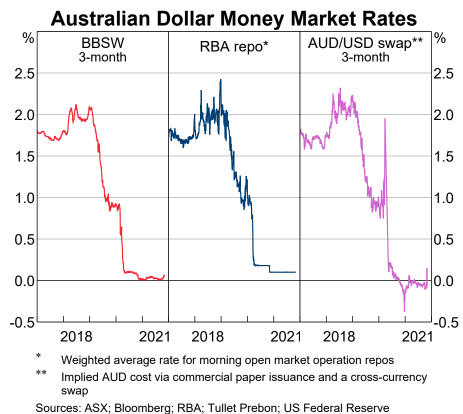
The Bank's balance sheet and liquidity in the banking system have continued to increase

The Bank's balance sheet has continued to grow over recent months, and currently stands at around $590 billion – more than triple its size prior to the pandemic (Graph 3.12). Growth in the Bank's assets since the middle of the year has reflected an ongoing increase in holdings of AGS and semis, owing to the Bank's bond purchases. This has been only partly offset in recent months by a continued decline in funds lent via OMO, given the high level of liquidity in the system, as well as a decline in open repos in September after the Bank removed the requirement for institutions to hold such repos with the Bank.[3] Correspondingly, on the liabilities side, ES balances have continued to rise (Graph 3.13). Liquidity in the banking system – as measured by surplus ES balances – is currently around $380 billion, compared with around $2 billion–$3 billion in the period before the pandemic.

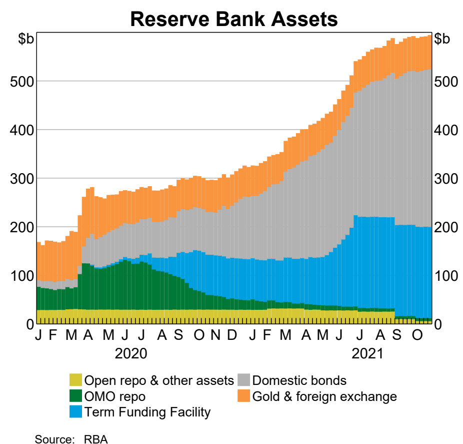
Graph 3.10



Graph 3.11



Graph 3.12



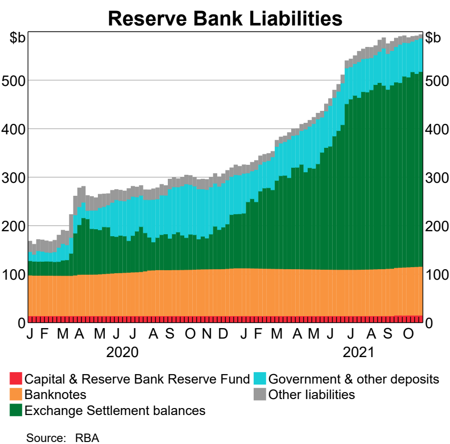
Bank bond issuance and yields have increased

Australian banks raised $30 billion in bond markets in the three months to the end of October (Graph 3.14). This resulted in a rise in bank bonds outstanding (after taking account of bond maturities) since the end of August (Graph 3.15). The stock of bank bonds outstanding has been declining since mid 2018 – this was especially the case during the drawdown phase of the TFF, which provided banks with ready access to alternative low-cost term funding. Recent months also saw a return to notable volumes of covered bond issuance.

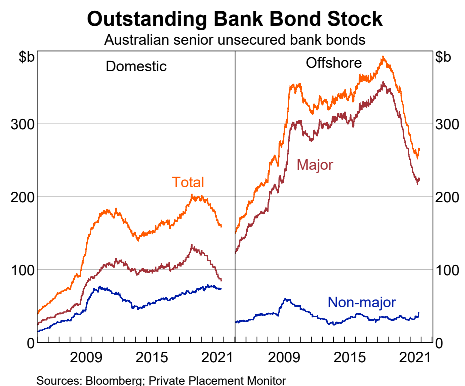
Bank bond issuance in 2021 has been at an average tenor of eight years. Banks are likely to be seeking funding at relatively long tenors to avoid additional maturities close to the periods when most TFF funding will need to be refinanced, as well as to take advantage of favourable pricing. Recent issuance has also been largely in offshore markets, which are typically deeper and more liquid for long-term funding.

Bank bond yields in secondary markets have increased recently, but remain low by historical standards (Graph 3.16). The rise is in line with the increase in three-year swap rates, though the spread to swap has also increased a little.

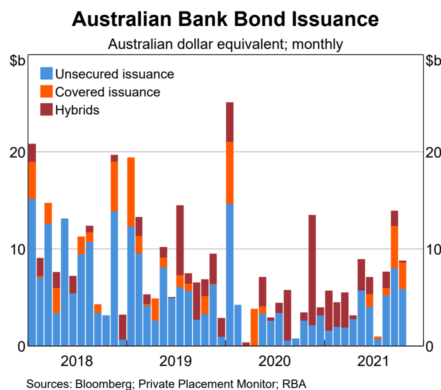
Graph 3.13



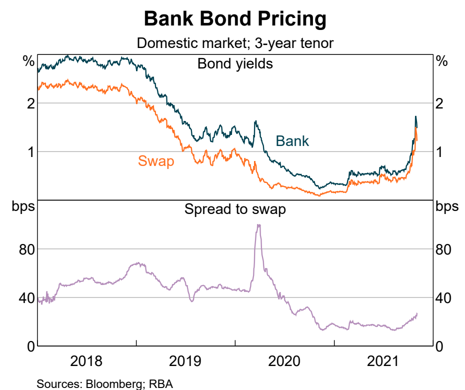
Graph 3.15



Graph 3.14



Graph 3.16



RMBS issuance is at a post-GFC high

The volume of residential mortgage backed securities (RMBS) issued in the September quarter increased to the highest level since the global financial crisis (GFC), reflecting a sharp pick-up in bank issuance, driven by the non-major banks (Graph 3.17). The first RMBS issuance by a major bank in over a year also occurred in the quarter. The pick-up in bank issuance follows the end of the TFF drawdown period. Issuance by non-banks also picked up further in the quarter, to a new high. Non-bank issuance volumes have been elevated during the pandemic, benefiting from strong demand as investors sought alternatives in the absence of much issuance by banks. Meanwhile, pricing on RMBS remains at the tightest levels seen in the post-GFC period.

The share of deposits paying low interest rates has increased further

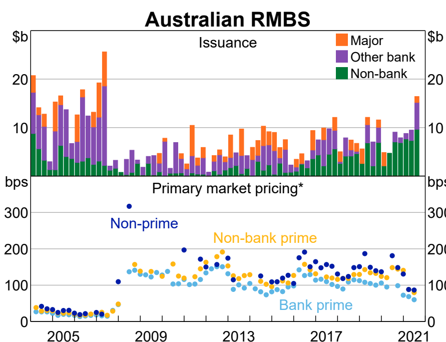
Deposit rates for new funding have continued to edge lower, after declining sharply over 2020 (Graph 3.18). Interest rates paid on outstanding term deposits have decreased by around 5 basis points since the end of June 2021, as maturing higher-rate deposits are replaced with lower-rate new term deposits. The decline in the spread between interest rates on new term deposits and other deposit rates is continuing to encourage a shift by customers from term to at-call deposits.

These developments have led to an increase in the share of deposits with the major banks that are paying low interest rates (between zero and 25 basis points). In the September quarter, nearly 40 per cent of the debt funding of major banks was in the form of deposits paying interest rates of 25 basis points or less (Graph 3.19). This compares with a little over one-third at the end of February 2021 and around 15 per cent in late 2019. Even so, some bonus savings accounts paying interest rates higher than 1 per cent (if certain conditions are met) are still on offer, particularly at non-major banks.

Banks' overall funding costs are around historical lows

Notwithstanding the recent rise in market yields, banks' non-equity funding costs have been around historical lows after declining a little following banks' final TFF drawdowns. The TFF has provided banks with low-cost funding for three years, and so will continue to support low funding costs until mid 2024. In addition, banks' funding costs have also benefited from the strong growth in low-rate deposits over the past year or so. Deposits now account for around

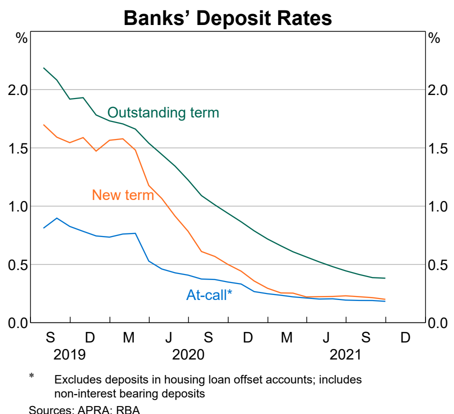
Graph 3.17



* Face-value weighted quarterly average of the primary market spread to bank bill swap rate for AAA-rated notes

Sources: Bloomberg; KangaNews; RBA

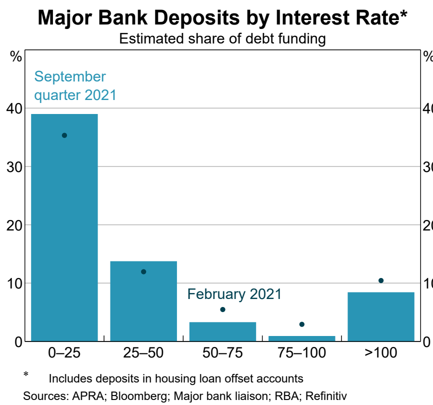
Graph 3.18



* Excludes deposits in housing loan offset accounts; includes non-interest bearing deposits

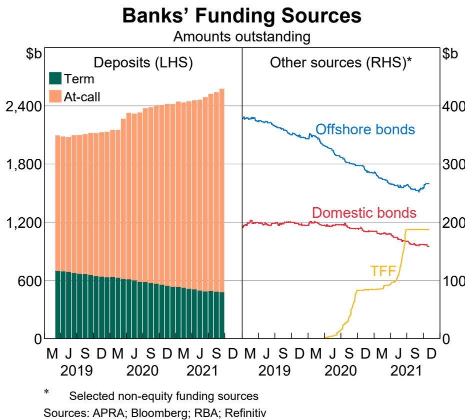
Sources: APRA; RBA

60 per cent of banks' total funding – around 5 percentage points higher than before the pandemic (Graph 3.20). This growth has been driven, in part, by the Reserve Bank's purchase of government bonds from non-banks, which then deposit the proceeds with banks. The purchases under the bond purchase program will continue to contribute to the growth of low cost funds for banks in the period ahead. In addition, because banks drew significantly on the TFF, they largely refrained from issuing new bonds during the TFF drawdown period, while outstanding bonds continued to mature. Funds from maturing bonds also contributed to deposit growth.



* Includes deposits in housing loan offset accounts

Sources: APRA; Bloomberg; Major bank liaison; RBA; Refinitiv



* Selected non-equity funding sources

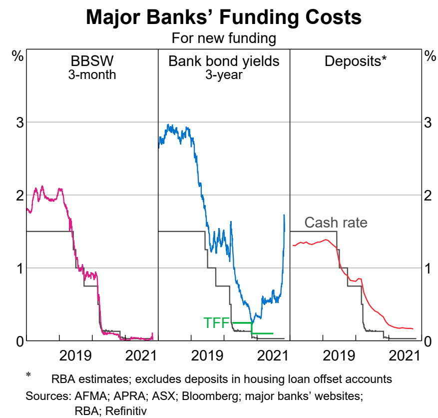
Sources: APRA; Bloomberg; RBA; Refinitiv

Further declines in overall funding costs are expected to be limited. Bank bond yields have increased in recent months making it more costly to issue new debt (Graph 3.21). This will, in time, contribute to upward pressure on average funding costs. In the short term, banks' outstanding funding costs will tend to follow movements in BBSW, which has also increased slightly, as the cost of wholesale deposits and debt funding is linked directly or indirectly to it.

Interest rates on new housing loans are also around historical lows …

Interest rates on new variable-rate loans have continued to edge down over recent months, and in September were 60 basis points lower than at the end of February 2020. Interest rates on new fixed-rate loans have been substantially lower than the interest rates on new variable-rate loans (by around 65–70 basis points) over the same period. As a result, the proportion of borrowers taking out fixed-rate loans has increased since the start of 2020, but variable-rate loans still account for two-thirds of the stock of total mortgages.

Pricing of short-term fixed-rate housing loans remains competitive. However, after a period of strong growth in fixed-rate loans, competition in housing loans may be shifting back towards



* RBA estimates; excludes deposits in housing loan offset accounts

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

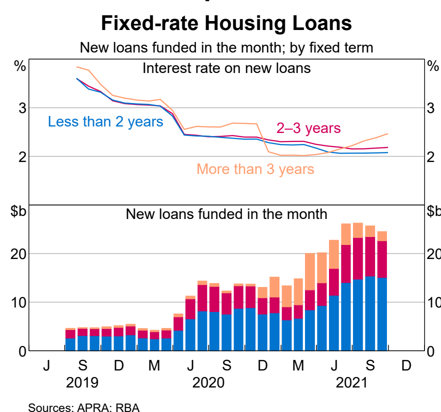
variable-rate loans. A number of banks have recently lowered rates on 'basic' variable-rate mortgages (which do not include features like offset accounts) to below 2 per cent. In contrast, banks have continued to increase rates on longer-term fixed-rate housing loans (loan terms of more than three years) in response to the rise in swap rates at those maturities (Graph 3.22). This has led to only a small rise in the average fixed rate paid on new loans because the share of new lending for longer-term fixed rate loans is relatively small and has been declining. Despite recent increases, interest rates on longer-term fixed-rate loans remain at low levels.

… and interest rates on outstanding housing loans have continued to decline

Interest rates on outstanding housing loans have continued to decline over recent months (Graph 3.23). Interest rates on outstanding variable-rate mortgages have declined by around 60 basis points since the end of February 2020, while interest rates on outstanding fixed-rate mortgages have declined by around 145 basis points (Table 3.1). Further declines are likely for a time, as the very low level of new lending rates encourages new housing borrowing and existing borrowers continue to refinance to lower loan rates. In particular, borrowers reaching the end of their fixed-rate period have been able to obtain more favourable interest rates now on offer. Banks continue to compete for new customers by offering cashback deals of around $2,000–$3,000 for refinancing. Housing loan commitments for external refinancing are now at historical highs.

Interest rates on business loans also edged lower in recent months

Interest rates on outstanding business loans continued to drift lower in recent months (Graph 3.24). Since February 2020, interest rates on variable-rate loans have declined by around 100 basis points for small and medium-sized enterprises (SMEs) and 95 basis points for large businesses. Over the same period, interest rates on fixed-rate loans have declined by around 90 basis points for SMEs and 60 basis points for large businesses. Liaison with banks suggests that increased competition in the business lending market has led to downward pressure on lending rates, particularly for loans to businesses that performed well throughout the lockdowns.



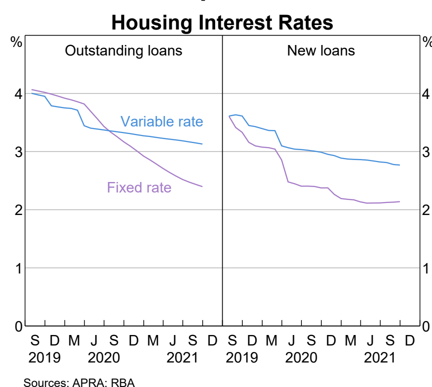


Table 3.1: Average Outstanding Housing Rates

September 2021

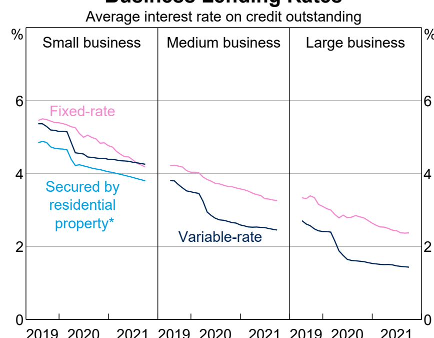
	Interest rate (per cent)	Change since February 2020 (basis points)
Variable-rate loans		
– Owner-occupier	3.02	–56
– Investor	3.34	–62
All variable-rate loans	3.13	–58
Fixed-rate loans		
– Owner-occupier	2.26	–147
– Investor	2.64	–137
All fixed-rate loans	2.40	–146
By repayment type[(a)]		
– Principal-and-interest	2.78	–84
– Interest-only	3.40	–82

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

Sources: APRA; RBA

Growth in total credit has picked up noticeably over 2021

Total credit growth has increased over 2021, to be around 7½ per cent in September on a six-month-ended annualised basis (Graph 3.25; Table 3.2). The pick-up in total credit growth has been driven by faster growth in both housing and business credit, while personal credit has continued to decline. In monthly terms, the rate of growth in total credit has slowed since June, largely reflecting an easing in business credit growth, although it remains higher than earlier in the year.



In six-month-ended annualised terms, owner-occupier housing credit growth increased to 10 per cent in September, while investor housing credit growth increased to 3¼ per cent. Demand for housing credit continues to be supported by low interest rates, strong activity in housing markets and government policy measures targeted at first home buyers. Lockdowns appear to have had some effect on demand for loans in New South Wales and Victoria, although these effects will unwind following the easing in restrictions in recent weeks.

Growth in business credit picked up strongly to 8¾ per cent in September on a six-month-ended-annualised basis. Demand for business loans also remained strong, particularly in industries that have been less affected by lockdowns.

Personal credit declined by 5½ per cent in September on a six-month-ended annualised

Table 3.2: Growth in Financial Aggregates

Percentage change[(a)]

	Three-month annualised		Six-month annualised	
	June 21	Sept 21	Mar 21	Sept 21
Total credit	**6.9**	**7.9**	**3.2**	**7.4**
Household	6.9	6.7	4.4	6.8
– Housing	7.6	7.8	5.2	7.7
– Owner-occupier	10.0	10.2	7.3	10.1
– Investor	3.1	3.2	1.7	3.2
– Personal	–2.0	–8.7	–5.2	–5.4
Business	7.0	10.4	0.7	8.7
Broad money	**8.9**	**10.5**	**6.1**	**9.7**

(a) Figures are break-adjusted and seasonally-adjusted

Sources: ABS; APRA; RBA

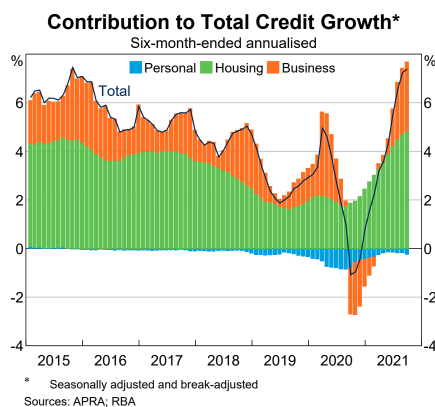
basis. Much of the recent decline was driven by lower credit card debt, consistent with consumers having had reduced opportunities for spending during lockdowns at the same time that government payments were supporting incomes.

Demand for housing loans remained high

Housing credit growth picked up to be 7¾ per cent on a six-month-ended annualised basis in September. Growth has increased for both owner-occupiers and investors over 2021, although owner-occupier credit growth has eased a little in monthly terms since the middle of the year (Graph 3.26).

Commitments for housing loans remain at high levels, but have declined somewhat since June, driven by reductions in commitments to owner-occupiers and first home buyers. The decline in commitments to first home buyers is consistent with the end of the HomeBuilder program in March and the increase in housing prices. Investor commitments have continued to increase, albeit at a slower pace than earlier in

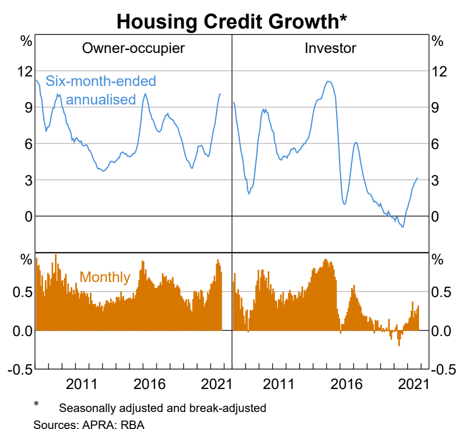
Graph 3.25



* Seasonally adjusted and break-adjusted

Sources: APRA; RBA

Graph 3.26



* Seasonally adjusted and break-adjusted

Sources: APRA; RBA

the year (Graph 3.27). Owner-occupier commitments declined in New South Wales and Victoria recently, which may, in part, have reflected the effects of the lockdown on housing market turnover in those states.

In early October, in response to risks associated with high and rising household indebtedness, APRA increased the serviceability assessment rate that it expects lenders to use to assess prospective borrowers' loan applications.[4] The serviceability rate was increased by 50 basis points, thereby reducing maximum loan sizes by around 5 per cent. In this way, it constrains the availability of credit to those borrowers that are seeking to borrow at, or very close to, their maximums. The effect on the flow of new housing credit is likely to be modest. This is because most borrowers do not borrow at their maximum capacity, and the reduction in maximum loan sizes for affected borrowers will be small.

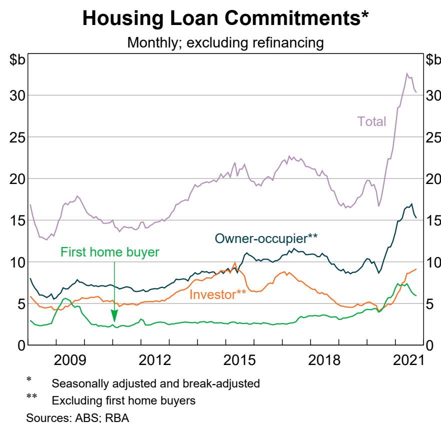
Payments into housing loan offset and redraw accounts increased sharply

Payments into housing loan offset and redraw accounts increased sharply in the September quarter, to be around the peak level seen in mid 2020, after declining earlier in 2021. As in 2020, the recent rise in these payments is likely to reflect the effects of lockdowns – in particular, the reduced consumption opportunities alongside the government payments supporting incomes. Since the onset of the pandemic, mortgage borrowers' payments into offset and redraw accounts have been substantial, totalling about 3½ per cent of disposable income (around $83 billion) (Graph 3.28).

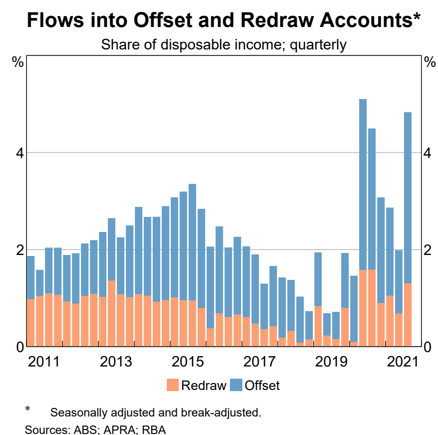
Reductions in housing loan interest rates since March 2020 have flowed through to borrowers in the form of lower interest payments. As a result, interest payments have declined by around 1 percentage point as a share of disposable income, despite outstanding housing credit increasing over the same period. This reflects the combined effect of the pass-through of the Bank's policy easing, borrowers refinancing to lower interest rates and growth in disposable income.

In response to the recent COVID-19 outbreaks, many banks reintroduced a range of support measures, including payment deferrals for affected mortgagees. However, the share of mortgage holders with a repayment deferral in place at the end of the September quarter was less than 1 per cent of the stock of housing credit, compared with a peak of around 11 per cent in mid 2020.

Graph 3.27



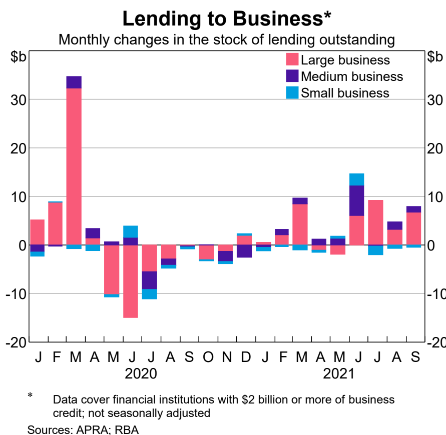
Graph 3.28



Lending to businesses has picked up

Business lending has picked up over recent months (Graph 3.29). The increase of late has been most pronounced for lending to large businesses, while the volume of lending to medium-sized firms increased slightly over the September quarter. Lending to small businesses was little changed. Commitments for new business loans have increased in six-month moving-average terms in the September quarter, to be around their average of the few years before the pandemic.

The increase in demand for business lending throughout the first half of 2021 was consistent with messages from bank liaison that there had been a little more appetite for business borrowing up to June, in response to the improved economic conditions. More recently, liaison suggests that demand for new loans remains strong from several industries that have been less impacted by lockdowns. Banks also expect demand for loans to pick up as restrictions ease, with firms positioning themselves for an expected recovery in spending. At the same time, some businesses still have little immediate need to borrow, in part because of the cash buffers they accumulated in 2020.



In April, the government introduced the SME Recovery Loan Scheme (an extension of the SME Guarantee Scheme), under which the government will partly guarantee certain SME loans. The SME Recovery Loan Scheme was initially open only to firms that had received JobKeeper payments in the March quarter of 2021 or had been affected by the floods in New South Wales in March 2021. From 1 October, the government expanded the scheme to all SMEs adversely affected by the pandemic. The new scheme offers more generous terms than the original scheme, including for interest rates. Nonetheless, take-up to September, the latest period for which data are available, remained low, in part reflecting subdued demand for financing from SMEs in the current environment.

In contrast to last year, the supply of credit to businesses does not appear to have tightened in response to recent lockdowns. Banks have indicated in liaison that they are seeking more opportunities to lend to businesses, and that competition between lenders has increased recently.

Many banks reintroduced deferral arrangements for loan payments of up to three months for small business customers affected by lockdowns and other COVID-19-related restrictions. The take-up of deferral arrangements has been very low compared with last year, with around ½ per cent of the value of SME lending subject to deferrals as of September. Of these deferred loans, more than 90 per cent of borrowers were located in New South Wales or Victoria.

Growth in broader measures of business debt also increased

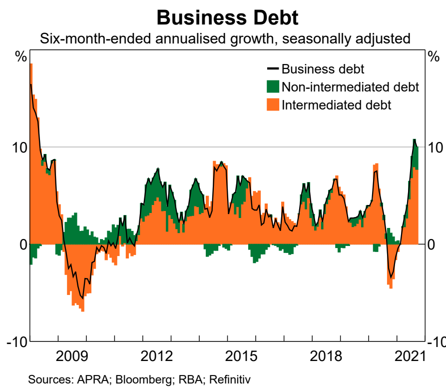
Growth in a broader measure of business debt has picked up strongly since March, to be well above its average pace over the past decade (Graph 3.30). In recent months, this growth has been broadly based across sources of debt. As well as the pick-up in growth in business credit, syndicated lending to large businesses (by

entities that do not report to APRA) has also increased, in part driven by loans for mergers and acquisitions (M&A). Growth in non-intermediated debt has also risen as corporate bond issuance remained high in the September quarter. Australian corporations raised around $30 billion through the issuing of corporate bonds in the past six months (Graph 3.31); two-thirds of this funding was raised offshore.

Australian equity prices remain close to the recent peak

The ASX 200 decreased in September before partially retracing the move to be around 2 per cent below its mid August peak on a total return basis (which takes dividends into account) (Graph 3.32). The decline in September occurred alongside declines in global equity prices, reflecting rising inflation expectations and, relatedly, a faster expected withdrawal of monetary policy stimulus, as well as concerns around growth in China. Overall, though, equity prices remain high and are well above pre-pandemic levels.

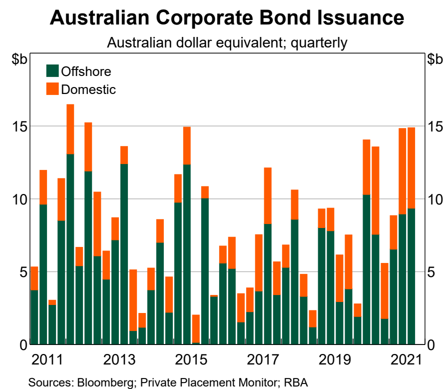
In Australia, stocks in the materials sector declined following sharp falls in the price of iron ore. By contrast, energy stocks have increased substantially as coal, oil and LNG prices have risen. The financials sector has outperformed the broader market in recent months as the economic outlook for Australia has improved due to the increase in local vaccination rates; travel-related stocks have also been supported by increasing vaccination rates and the lifting of lockdowns.

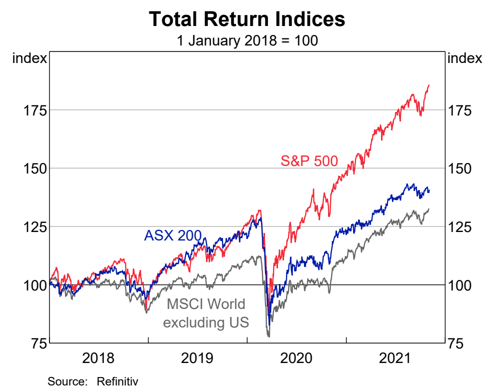


Capital markets activity is at a record level

So far in 2021, there have been over 900 M&A deals announced, with a total deal value of around $260 billion (Graph 3.33). While it is unclear whether all of these deals will be accepted, 2021 is likely to be a record year for M&A in the Australian market.

To the end of the September quarter in 2021, there were 137 initial public offerings (IPOs) for a total value raised of around $6 billion





(Graph 3.34). This is significantly higher than the average over the past decade and is the highest level seen since 2014. In addition, Australian companies have raised around $32 billion in secondary offerings, slightly above the average over the past decade.

Profits and dividends of Australian companies are at a record level

Aggregate underlying profits of ASX 200 companies increased to a record level in the first half of 2021. The increase in profits reflected a rebound from initial COVID-19 pandemic effects and strong earnings growth across a number of sectors. Most sectors returned to pre-pandemic earnings levels over this period, with the materials sector posting its highest level of profits in history as a result of elevated commodity prices, most notably iron ore (Graph 3.35). A number of banks reported higher profits for the six months to June 2021, mainly reflecting decreased provisions for credit impairments and the writing back of earlier provisions, in line with the improved economic outlook. Owing to uncertainty surrounding lockdowns, many companies downgraded earnings guidance for the upcoming financial year and some removed guidance altogether.

Overall dividends were at their highest level in history, helped by record dividends paid by some mining companies (Graph 3.36). Many companies have also announced share buybacks, although they remain low compared to dividends, as has been the case historically. Many of the announced buybacks were for banks, following restrained capital distributions over the recent past.

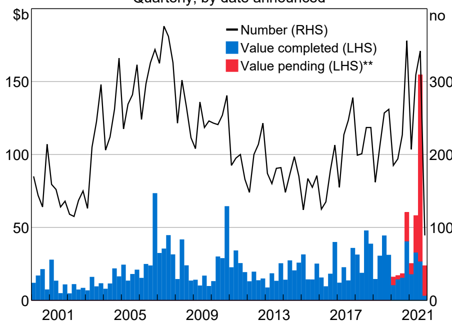
The Australian dollar has appreciated of late but remains lower than its levels earlier in the year

The Australian dollar reached year-to-date lows in mid August alongside concerns around slowing momentum in the Chinese economy, before appreciating more recently. This

Graph 3.33

M&A by Listed Australian Companies*

Quarterly, by date announced



* Excludes the Telstra–NBN transaction and BHP Ltd's acquistion of BHP Plc; latest observation is quarter to date

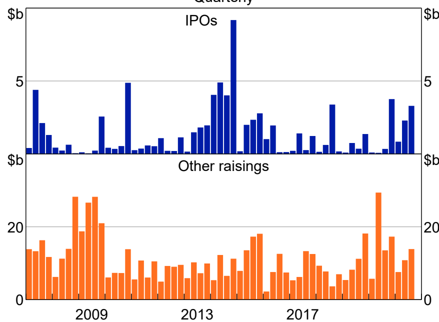
** Includes transactions announced in the past two years but not completed

Sources: RBA; Refinitiv

Graph 3.34

Australian Equity Raisings*

Quarterly



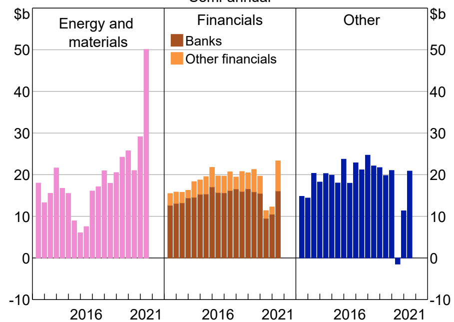
* All listed companies

Sources: ASX; RBA

Graph 3.35

ASX 200 Underlying Profits*

Semi-annual



* Underlying results adjust for one-off items such as asset revaluations.

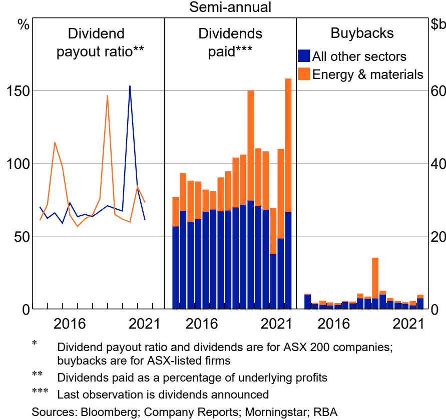
Sources: Bloomberg; company reports; Morningstar; RBA

appreciation has been broadly consistent with an increase in yields on Australian Government bonds relative to those of the major advanced economies (Graph 3.37). The yield differential on Australian Government bonds had declined for a time, but this reversed noticeably over the past month or so. The RBA Index of Commodity Prices remains below its levels in the middle of the year.

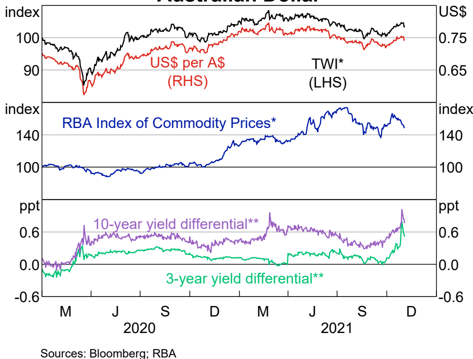
Australia continued to be a net lender of capital in the June quarter

Net capital outflows increased in the June quarter, consistent with the widening of Australia's current account surplus. Net outflows of capital over recent years have been the result of an increase in domestic savings relative to investment (Graph 3.38). Private savings have risen over the past couple of years, increasing notably during the pandemic. At the same time, investment has declined as a percentage of GDP over a number of years to levels that are similar to those in other advanced economies. This reflects a decline in private investment following the mining investment boom, during which capital inflows from overseas were used to help finance the expansion of capacity in the mining sector.[5]

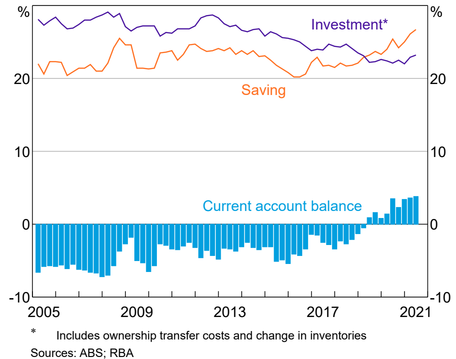
In the June quarter, net outflows continued to reflect portfolio investment as Australian investment funds (such as superannuation funds) increased their holdings of foreign equities (Graph 3.39). A decline in gross flows of foreign investment into Australia over recent years has also contributed to the net capital outflow. While net capital outflows have increased over recent years, Australia's stocks of gross foreign assets and liabilities remain large. This reflects flows of both foreign investment into Australia and Australian investment abroad. Australia's net foreign liability position remains around its lowest level in a number of decades as a percentage of GDP. ✠



* Dividend payout ratio and dividends are for ASX 200 companies; buybacks are for ASX-listed firms
** Dividends paid as a percentage of underlying profits
*** Last observation is dividends announced
Sources: Bloomberg; Company Reports; Morningstar; RBA



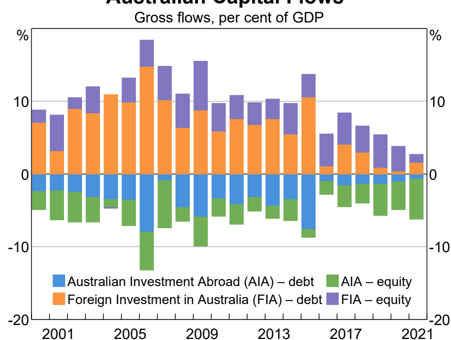
Sources: Bloomberg; RBA



* Includes ownership transfer costs and change in inventories
Sources: ABS; RBA

Graph 3.39

Australian Capital Flows*



* Excluding derivatives, 2021 value only includes March and June quarters

Sources: ABS; RBA

Endnotes

[1] See APRA (2021), 'APRA Phases Out Reliance on Committed Liquidity Facility', Media Release, 10 September. Available at <apra.gov.au/news-and-publications/apra-phases-out-reliance-on-committed-liquidity-facility>.

[2] APRA introduced the CLF in 2015 to enable banks to meet their liquidity requirements given the low level of government debt in Australia at the time. Under the CLF, the Reserve Bank provides a commitment (in exchange for a fee) to provide funds (against collateral) to banks in a period of liquidity stress. See RBA, 'Committed Liquidity Facility'. Available at <https://www.rba.gov.au/mkt-operations/committed-liquidity-facility.html>.

[3] To ensure the smooth functioning of the payment system, financial institutions are required to hold sufficient ES balances to meet their after-hours payments needs. Given the high liquidity environment, in September 2021 the Bank removed the requirement for certain financial institutions to obtain this liquidity via open repos with the Bank.

[4] See RBA (2021), 'Chapter 5: Mortgage Macroprudential Policies', *Financial Stability Review*, October. See also APRA (2021), 'APRA Increases Banks' Loan Serviceability Expectations to Counter Rising Risks in Home Lending', Media Release, 6 October. Available at <apra.gov.au/news-and-publications/apra-increases-banks%E2%80%99-loan-serviceability-expectations-to-counter-rising>.

[5] See Black S, B Chapman and C Windsor (2017), 'Australian Capital Flows', RBA *Bulletin*, June. Available at <https://www.rba.gov.au/publications/bulletin/2017/jun/3.html>