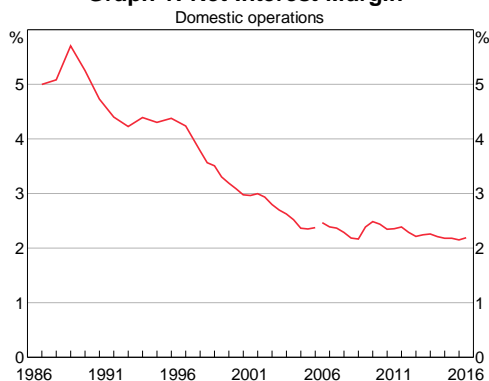


MAJOR BANK FUNDING DEVELOPMENTS

Graph 1: Net Interest Margin*

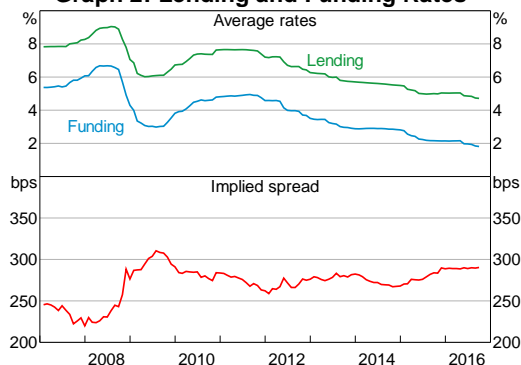


* From 1998 data are on a half-yearly basis; prior years are on a yearly basis; from 2006 data are on an IFRS basis; prior years are on an AGAAP basis; includes St George from 1993 and Bankwest from 2009

Sources: Banks' financial reports; RBA

- Banks' net interest margin is the difference between interest earned and interest paid, as a share of interest-earning assets.
- Banks' net interest margin fell between the early 1990s and the mid 2000s.
- The net interest margin has been little changed over the past decade.

Graph 2: Lending and Funding Rates*



* RBA estimates

Sources: APRA; Bloomberg; Financial Reports; RBA; UBS AG, Australia Branch

- Another measure is the difference between the average interest rate on loans and the average interest rate on debt liabilities.
- This implied spread has generally moved sideways for much of the past decade, but has risen over the past two years.

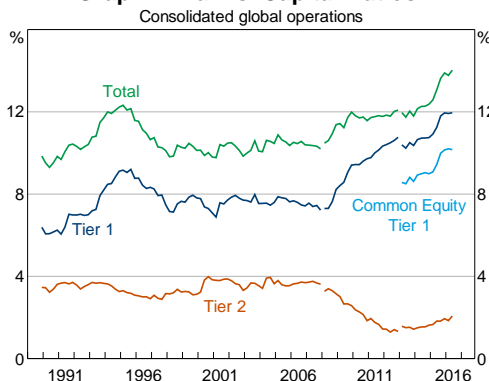
Graph 3: Liquid Assets



Sources: APRA; RBA

- The different patterns in the two measures above primarily reflect the fact that only the net interest margin measure includes interest-earning securities.
- These securities, which earn lower returns than loans, have increased as a share of the balance sheet over recent years.

Graph 4: Banks' Capital Ratios*



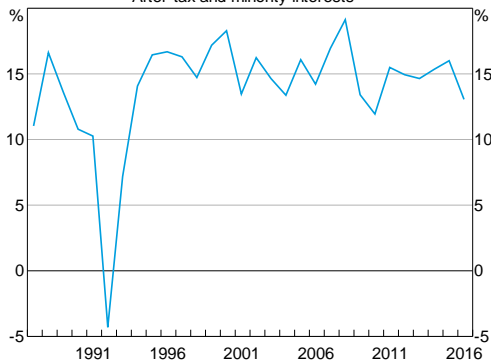
* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs

Source: APRA

- Major banks have increased their equity over the past year. Equity is a more costly form of funding.

Graph 5: Return on Equity*

After tax and minority interests**



* ANZ, NAB and Westpac report half yearly to March and September, while CBA reports to December and June. Data from June 2006 are quarterly aggregates.

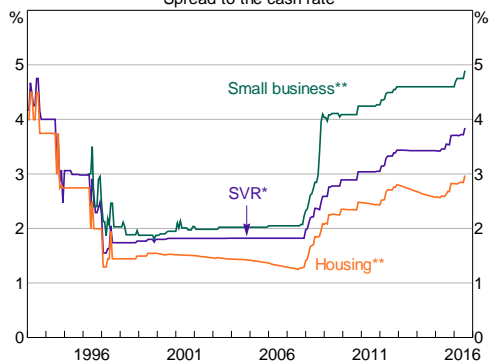
** From 2006 data are on an IFRS basis; prior years are on an AGAAP basis; includes St. George and, from 2009, Bankwest

Sources: APRA; bank results; RBA

- The major banks’ return on equity has averaged around 15 per cent over the past two decades.
- It is similar to the return on equity for Canadian banks, but higher than in the United States, Japan and Europe.

Graph 6: Variable Interest Rates

Spread to the cash rate



* Major banks’ average standard variable reference rate for housing

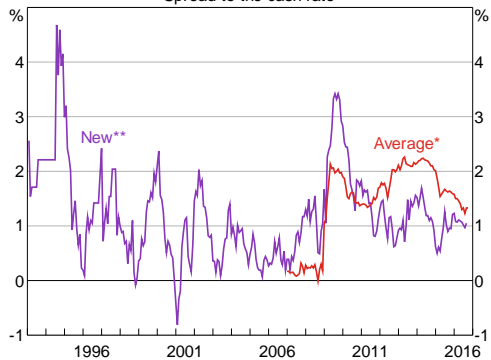
** RBA estimate of average rate paid on existing loans

Sources: ABS; APRA; Banks’ websites; Perpetual; RBA

- The spread between banks’ mortgage rates and the cash rate declined significantly in the 1990s, but moved higher by nearly two percentage points following the global financial crisis (GFC).
- The average mortgage rate actually paid has not risen by as much as the standard variable rate (SVR) since the GFC.
- The spread between the average interest rate paid by small businesses and the cash rate has increased by more than the spread on housing rates, reflecting a repricing of credit risk.

Graph 7: Long-term Debt Interest Rates

Spread to the cash rate



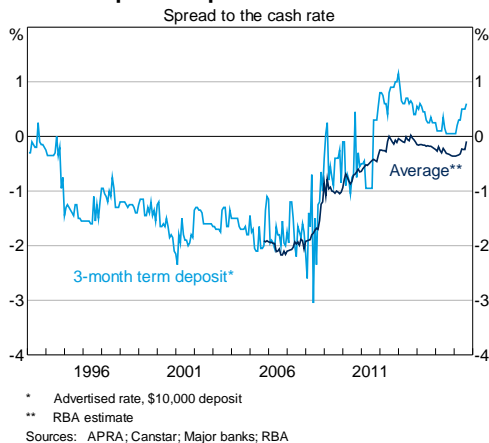
* RBA estimate; rate includes currency and interest rate hedges

** Domestic 3-5 year debt

Sources: Bloomberg; RBA; UBS AG, Australia Branch

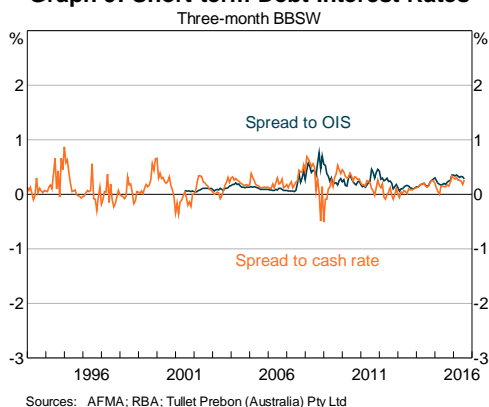
- During the GFC, the cost of new long-term debt rose sharply.
- The average spread on long-term debt outstanding is currently more than 1 percentage point higher than it was prior to the GFC.
- The cost of new long-term debt remains lower than the cost of outstanding long-term debt.

Graph 8: Deposit Interest Rates



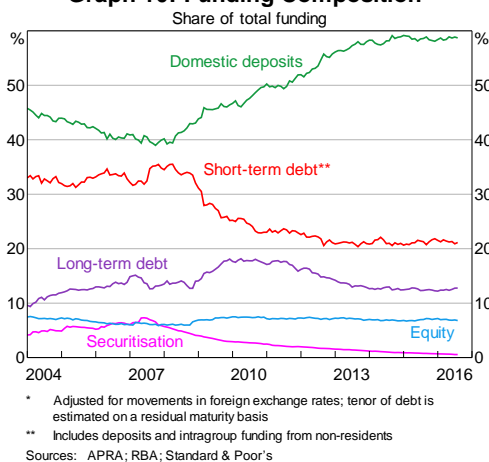
- Average interest rates on deposits have increased by around 2 percentage points relative to the cash rate since the GFC.

Graph 9: Short-term Debt Interest Rates



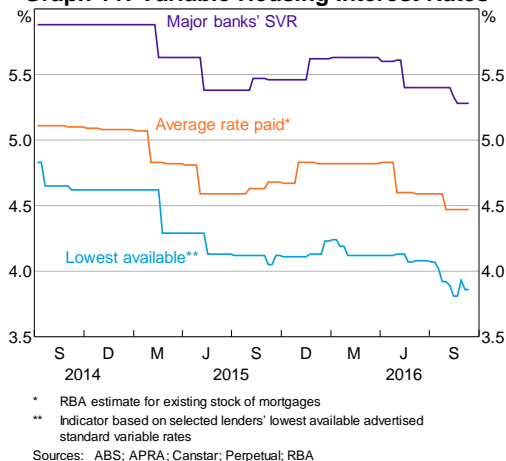
- The cost of short-term debt relative to the cash rate has been less variable than the cost of long-term debt relative to the cash rate.
- The spread between the cost of short-term debt and the market's expected cash rate (OIS – overnight index swap rate) has also been relatively stable over a long period of time.

Graph 10: Funding Composition*



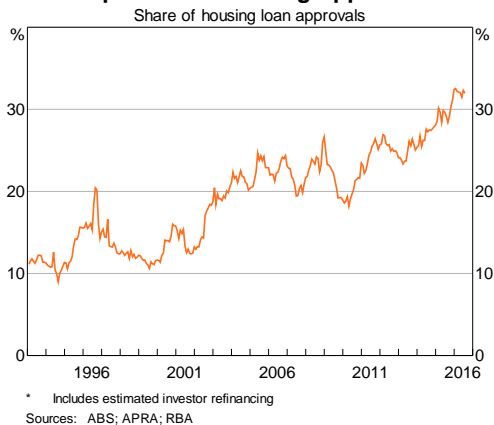
- The relative increase in deposit rates partly reflects banks' higher demand for this more stable form of funding.

Graph 11: Variable Housing Interest Rates



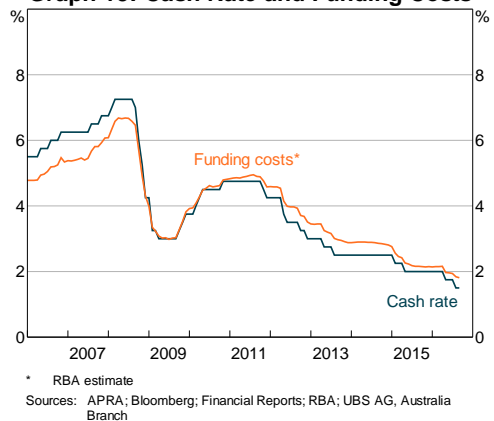
- The spread between the benchmark SVRs and the lowest available advertised rates has increased in recent years.
- The difference reflects both advertised and unadvertised discounts. It is not unusual for the discounts to be up to 1½ percentage points.
- Changes in discounts only affect new borrowers (and not the existing stock of mortgages).

Graph 12: Refinancing Approvals*



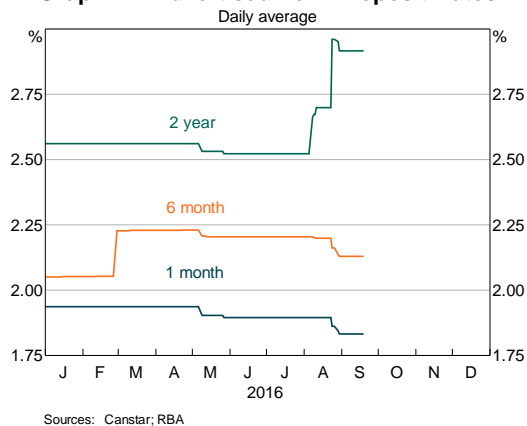
- Households have responded to increased discounting by refinancing more frequently.

Graph 13: Cash Rate and Funding Costs



- The RBA cash rate remains the main driver of bank funding costs, although the funding mix and spreads also change through time.

Graph 14: Advertised Term Deposit Rates



- Interest rates on term deposits with maturities of 1-3 years have increased this year, although these account for less than 2 per cent of bank funding.
- Interest rates on term deposits with maturities of 1, 3 and 6 months have declined recently.