House of Representatives Standing Committee on Economics

Question on Notice – Reserve Bank of Australia
Mr Craig Kelly MP

1. In the hearing, the following exchange occurred:

   Mr Kelly: You mentioned that the number of self-employed people has declined. Do you have any of those numbers off the top of your head?
   Mr Lowe: I do in my briefing but I probably can't get them straight away. Luci, do you have those? There has been an increase in some types of self-employment—say, the Uber driver and those in the gig economy. I can get that data for you and send it through.

   Therefore, can you please provide the data regarding the number of self-employed people in Australia?

Answer:

- Based on data from the Australian Bureau of Statistics (ABS Catalogue No. 6291.0.55.003), there were a little over 2 million self-employed persons in May 2020 (the most recently available data). This has declined from a peak of a little under 2.2 million self-employed persons in August 2019.

- The share of all employed persons who are self-employed has steadily fallen since the mid 2000s, from 19–20 per cent around two decades ago to 16–17 per cent more recently.

Questions in Writing – Reserve Bank of Australia
Dr Andrew Leigh MP
Deputy Chair, House of Representatives Standing Committee on Economics

2. Recently, Singapore's central bank, the Monetary Authority of Singapore, has joined the US Federal Reserve to express concerns over the impact of large scale corporate insolvencies on economic recovery. The MD of the MAS, Ravi Menon, stated on corporate bankruptcies: "We want to make sure that the process is well-managed and orderly so from that perspective, we can expect to see some business closures and that is not entirely bad … But if it gets very large and disorderly, and it creates a lot of dislocations in supply chains and worker lay-offs and so on, then it's a serious problem."
(Source: https://www.channelnewsasia.com/news/business/singapore-economy-remains-dire-recovery-slow-mas-annual-report-12937816)

a) Can you outline the views of the Governor and/or the Reserve Bank of Australia on the likely impacts on corporate insolvencies in the Australian context?

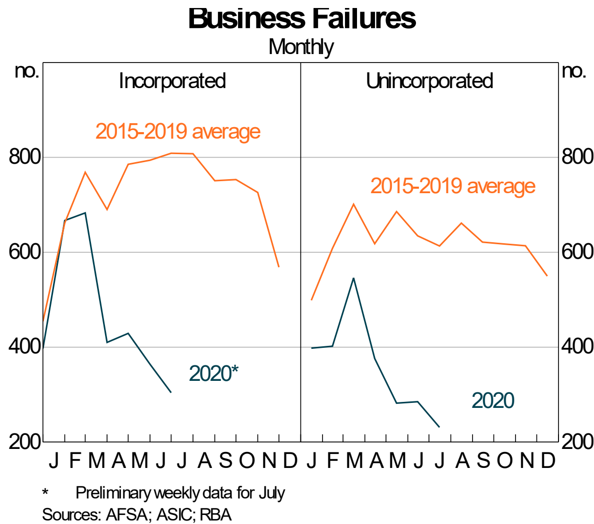
b) Has the RBA done research or modelling on the scale of insolvencies in the Australian context?

c) If so, can data on those effects be shared with the committee, including by firm size, industry type, and geographic region?

Answer:

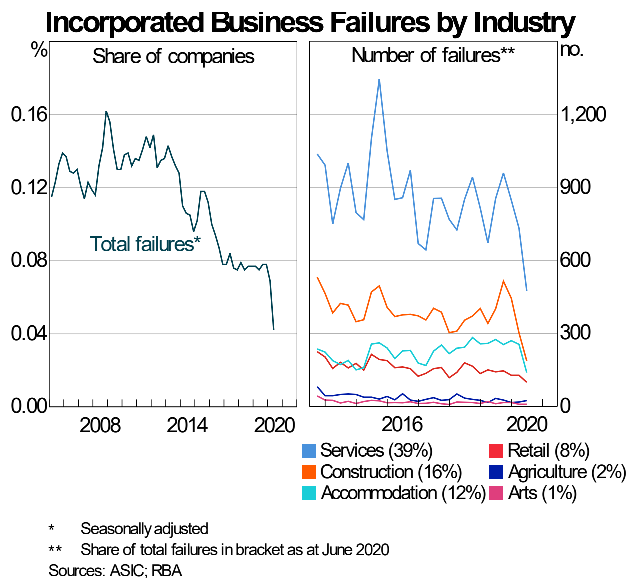
a) Business closures are a standard feature of a well-functioning economy and can be associated with a process of creative destruction and economic dynamism. An economy that is responding to new opportunities will see some businesses close while others open. When the economy is close to full employment that is part of the process of driving economic growth. However, an economic downturn that causes widespread insolvencies can lead to significant disruption and loss of otherwise viable businesses. An increased rate of business failure will cause job losses and supply chain dislocations, and potentially lead to adverse spillover effects via trade credit networks, at least temporarily.

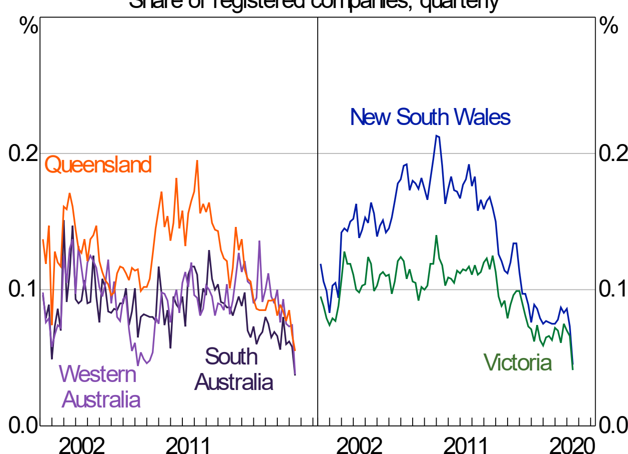
b) RBA staff regularly monitor and report on corporate insolvencies in the RBA *Financial Stability Review*. Corporate insolvencies are currently below levels seen in recent history (Graph). This is due to both a high level of income support from the Government and private lenders, as well as insolvency moratoriums.



RBA staff have also undertaken some `stress testing' work on the non-financial business sector. This research relies on firm-level data to model business exits. Some early estimates were described in the April 2020 Financial Stability Review. The analysis suggests that a decline in annual business turnover of, for example, 20 per cent would lead to an increase in the annual business exit rate to 9½ per cent from around 8 per cent (including failures as well as takeovers, etc.). This would be an increase of around 35,000 business exits. However, this estimate is based on historical data and does not explicitly account for government policy measures designed temporarily to raise business cash flow or the insolvency moratoriums. For more information on the modelling, see a related Research Discussion Paper in 2016.

c) Timely indicators of corporate insolvency by industry and region are publicly available via the ASIC website. Estimates are provided in the two graphs below.





3. As part of the first Coronavirus Economic Response series of measures, the Government implemented temporary relief for individuals regarding bankruptcy laws, and for directors and corporations on insolvent trading provisions under the Corporations Act. There is public discussion about those measures potentially being extended by the Government.

a) Was the Reserve Bank consulted about the first measure or about extending it?

b) Has the RBA conducted modelling or research regarding the macroeconomic effects of bankruptcies and insolvencies that are delayed by these measures? And if so, can data on those effects be shared with the committee, including by firm size, industry type, and geographic region?

Answer:

a) The RBA has been kept informed but not consulted about the design of these policies.

b) RBA staff have undertaken some firm-level research into the macroeconomic effects from businesses that are having persistent problems in repaying debts (or 'zombie firms'). This research is based on historical data and does not cover the COVID-19 period. As such the research does not look at the effects of the insolvency moratoriums on the economy. Estimates from this early stage research suggest that zombie firms are less productive than other viable firms and hence act as a drag on growth in the economy. Zombie firms also have strong negative spillover effects on other viable firms. Industries with relatively high shares of zombie firms have relatively low levels of growth in output, employment and productivity, as well as low levels of business dynamism (measured by business entry and exit rates). This is true controlling for a broad range of firm and industry-level characteristics. Some rough back-of-the-envelope estimates suggest that, if all zombie firms were eliminated from the economy, the average growth of the viable firms would almost double.

4. Many businesses – particularly small and medium-sized enterprises – that are struggling with declining revenues and cash flow may not seek out advice from professional service providers to assist them in accessing government programs, restructuring and/or turning around their businesses, or winding up their activity in a less damaging fashion (for the business owners and their creditors). Some stakeholders advocate for vouchers or forms of subsidy to help ensure businesses receive appropriate advice.

   Does the RBA have a view on benefits or downsides of such assistance in principle?

Answer:

This is not an issue on which the RBA has any expertise and we have not done any work on the optimal design of financial advice.

5. Recently the OECD stated in its Australia Economic Snapshot: "Expanded loan guarantees, coupled with accelerated insolvency processes, could reduce scarring for entrepreneurs and facilitate a more dynamic recovery." (Source: https://www.oecd-ilibrary.org/sites/ea3fd805-en/index.html?itemId=/content/component/ea3fd805-en). Can you elaborate on the RBA's views on scarring for entrepreneurs in the current context, including any reference to loan guarantees or accelerated insolvency processes?

Answer:

There is no internal research that directly links scarring effects to loan guarantees or insolvency processes. There is extensive overseas evidence that recessions can have long-run effects on the likelihood of business entry and the size of start-up firms (e.g. Moreira (2016) and references therein). This research is consistent with the hypothesis that there will be some scarring effects on entrepreneurs in the current economic downturn, especially if there is an increase in zombie firms that may restrain firm entry.

6. The Reserve Bank administers the Term Funding Facility that provides funds to lenders at the current overnight cash rate for three years on the understanding it will be loaned to businesses and households in need. The RBA recently stated that take-up was "increasingly steadily" (Source: https://www.rba.gov.au/publications/smp/2020/aug/pdf/00-overview.pdf).
   Can the RBA provide data on the take-up by lender (or lender type) and size, by month? Is the take-up rate below estimates of the RBA and/or Treasury?

Answer:

The Term Funding Facility (TFF) provides a guaranteed source of low-cost funding for the banking system, and so helps to support the supply of credit and lower interest rates for households and businesses. Through the TFF, authorised deposit-taking institutions (ADIs) have access to three-year funding at a fixed interest rate of 0.25 per cent. The TFF is also structured to provide an incentive for ADIs to increase their lending to businesses, especially small and medium-sized enterprises (SMEs).

All ADIs that extend credit are eligible to participate in the TFF. This includes more than 130 Australian banks, credit unions, building societies and foreign bank branches and subsidiaries operating in Australia. The amount that each ADI can borrow under the TFF is the sum of two allowances:

- Initial allowance: This was fixed at the start of the scheme to be equivalent to 3 per cent of each ADI's total credit outstanding. ADIs can access their initial allowance until 30 September 2020

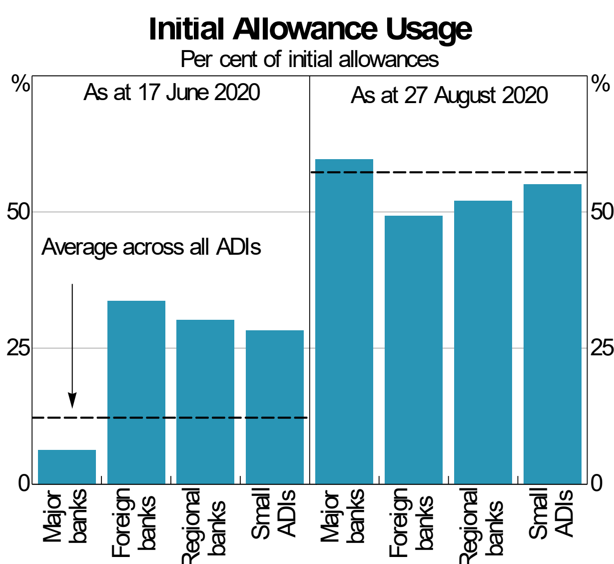
- Additional allowance: ADIs can access additional funding under the TFF if they expand credit that they provide to businesses, particularly for SMEs (those with turnover of less than $50 million). For every extra dollar of loans an ADI makes to large businesses, ADIs can access one additional dollar of funding from the Reserve Bank. For every extra dollar lent to SMEs, they have access to an additional five dollars of funding. ADIs are able to draw on their additional allowance, which is updated monthly, until 31 March 2021.

Take-up of the TFF was gradual in the first months of the scheme. During this time, many ADIs experienced significant inflows of low-cost deposits, and they had also accessed low-cost short-term liquidity from the Reserve Bank's expanded open market operations, which had increased in size and maturity. Combined with expectations of modest credit growth, plentiful short-term liquidity meant that the demand for additional funds by many ADIs was modest.

The RBA did not estimate a path for take-up of the TFF, but the take-up of the TFF in recent months has been in line with our earlier liaison with various ADIs. Drawdowns of the TFF have picked up more recently as ADIs increasingly take up their initial allowance before the window for accessing that part of the facility closes on 30 September. To date, the overall take-up of the TFF relative to the initial allowance has been consistent with the experience of similar term funding schemes overseas, such as the Bank of England's term funding facilities.

ADIs have drawn around $50 billion of the TFF funding since the scheme opened in April 2020. By number, around half of all eligible ADIs have accessed the facility. By value, ADIs have drawn 58 per cent of their initial allowances. Of the ADIs that have accessed the TFF, on average they have drawn around two-thirds of their initial allowance, although there is considerable variation across ADIs. For confidentiality reasons, the Bank does not publicly release information on individual institutions in terms of take-up of the TFF, or aggregated information where a small number of contributors means that an individual institution might be identifiable.

Average take-up to date has been broadly similar across different types of lenders. The graph below shows two snapshots in time, to provide an indication of how take-up has changed in recent months. Take-up of the initial allowance has increased in recent months for all lender types, but particularly so for the major banks (from 6 per cent of initial allowances in June to 60 per cent in August).



Take-up of the additional allowance has been modest so far. This reflects the fact that ADIs only begin drawing down their additional allowance once they have fully drawn their initial allowance.

For further information on the TFF, see Box E in the August 2020 *Statement of Monetary Policy*. Data on TFF drawdowns and allowances can also be found in RBA Statistical Table A3 'Monetary Policy Operations – Current – A3'. The tab 'Term Funding Facility' includes weekly cumulative drawdown data, value of total funding allowance and a breakdown of the funding allowance. The RBA Statistical Tables can be found here: https://www.rba.gov.au/statistics/tables/.

7. The European Central Bank's has a similar scheme that offers loans at rates as low as –1% to banks that are willing to expand lending to small and medium-sized businesses. According to some commentary, "[t]his offer has helped drive the interest rate faced by small and medium-sized businesses as low as 2%, well below the 4.5% sometimes charged in Australia. If the Reserve Bank offered part of the Term Funding Facility at a negative interest rate for banks that expanded lending to small businesses, it would likely see some expansion" (Source: https://theconversation.com/small-businesses-are-being-starved-of-funds-heres-how-to-make-their-loans-cheaper-143834).

Has the RBA considered adopting the ECB approach in an Australian context? What is the RBA's view on such an approach?

Answer:

Through the TFF, authorised deposit-taking institutions (ADIs) have access to three-year funding at a fixed interest rate of 0.25 per cent. This rate is aligned with other key policy rates – the cash rate target and the 3-year Australian Government Bond yield target. The Reserve Bank Board and the Governor have indicated that negative interest rates are extraordinarily unlikely in Australia. The main potential benefit is downward pressure on the exchange rate. But negative rates come with costs too. They can cause stresses in the financial system that are harmful to the supply of credit, and they can encourage people to save rather than spend. The Reserve Bank Board continues to review overseas experience with other monetary options and continues to consider possible adjustments to the parameters for existing programs, including the TFF. For further information, see a speech by Governor Lowe on 21 July 2020.

In terms of the TFF, our assessment is that this facility is working well and is contributing to the plentiful supply of liquidity at low cost in the Australian financial system. Australian banks' funding costs have declined to historically low levels. The interest rate on TFF drawdowns – fixed at 25 basis points per year for three years – is substantially lower than other sources of ADI funding for a similar term. The direct effect of the TFF on funding costs is relatively modest, as total TFF allowances account for a modest portion of ADIs' non-equity funding. However, the TFF also works through indirect channels to lower ADI's funding costs and improve funding conditions. The availability of a low-cost funding alternative in an environment of modest additional funding needs has lessened the demand by ADIs for other sources of funding. As a result, the TFF – jointly with the RBA's other policy measures – has contributed to the downward pressure on funding costs more broadly since February.

The historically low banks' funding costs have flowed through to interest rates on housing and business loans, which are also at historic lows. Interest rates on variable rate loans to SME businesses have declined by 70-75 basis points since the end of February. Interest rates on new fixed housing loans have also declined sharply over this period, declining by around 65 basis points.

The cost of finance does not appear to be a constraint for SMEs. Low demand for new SME business loans appears to reflect businesses' reluctance to take on debt, given weakness in current economic conditions and considerable uncertainty about the economic outlook. The need for debt finance is likely to have been lessened by the various short-term initiatives that are helping many businesses (particularly SMEs) to cover operating costs. This includes the government's income support measures, loan payment deferrals offered by banks and flexibility on rental payments for commercial tenants that have been significantly affected by COVID-19. Nonetheless, the availability of credit to businesses appears to have tightened a little also. To date, much of this reflects the application of existing standards in an environment of weak economic conditions and great uncertainty. In addition, banks are requiring a greater degree of verification of borrowers' information, and some banks are cautious about lending to new customers and to sectors significantly affected by the pandemic (such as smaller retailers, tourism and commercial property).

31 August 2020
Reserve Bank of Australia