Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

2014 - 2015

Department/Agency: Reserve Bank of Australia
Question: BET 12-13
Topic: Funding of Banks and the cost of funds
Reference: Hansard page no. 53 - 01 June 2015
Senator: Bushby, David

Question:

Senator BUSHBY: That was going to be my next question. My next set of questions will be about funding of banks and the cost of funds. Just to get it straight: I understand that over a long period of time the NIM has narrowed. During the GFC, it significantly broadened or widened as people priced for risk that was uncertain. After things settled down a little bit, I believe it began to narrow again. I just want to know what has happened over the last year or two. Is it continuing to narrow or is it staying where it ended up, at a slightly larger margin than what it was prior to the GFC? What are the current trends?
Dr Edey: There are a couple of things I would like to say about that. First of all, I do not know enough about the very detailed recent trends—
Senator BUSHBY: Maybe you can take that on notice.
Dr Edey: I think what you are interested in are the little ups and downs. But the point that I have been trying to make is that the NIM is actually not the difference between the lending rate and the cash rate; the NIM is the difference between—
Senator BUSHBY: The cost of funds and the—
Dr Edey: the average cost of funds and the average lending rate. Broadly speaking, that difference has been fairly stable over the last six to eight years. The very detailed ups and downs I cannot help you with, but that is the broad picture. What often confuses people is that rates have gone up relative to the cash rate. So if you are measuring a margin as, say, the mortgage rate minus the cash rate, that has gone up because the whole rate structure has gone up relative to the cash rate. But that is not the same as the NIM concept.
Senator BUSHBY: I understand that. As I say, during the GFC, the NIM did actually become much larger because banks were pricing for unknown risk at that point because there was a lot of uncertainty around it, and after getting quite small prior to that because of the competition particularly coming from MBFIs funded by securitisation.
Senator WHISH-WILSON: Because you had the deposit guarantee as well to factor in.
Senator BUSHBY: That is right—I just wanted to know where that ended up, or where it is ending up. If you can take it on notice, if possible, you obviously do not have the detail today.
Dr Edey: Okay.
Senator BUSHBY: The other aspect of that was the cost of funds. I am interested in any information you have on trends in the banks' cost of funds, short-term and long-term wholesale, as well as deposits, and whether there is any return, to a great degree, of securitisation as a method of funding.
Dr Edey: That is really not my turf either, so I think we would have to take that on notice as well.
Senator BUSHBY: No problem. This one will not be in your area, but you might know anyway. I asked this morning of Treasury about their forecasts for real GDP growth, the use of the forecasts. They discussed the basis by which they arrived at those. Do you have the

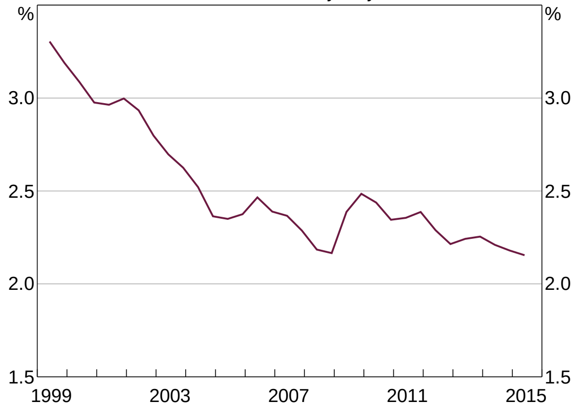
details of what the RBA's rates of forecasts are and are you able to tell me whether they are substantially different to that which Treasury has forecast?
Dr Edey: Those figures would be a matter of public record in our latest statement on monetary policy, which is only a couple of weeks old. I would have to refer you to that.

Answer:

Net Interest Rate Margins

Net Interest Margins (NIMs) have been declining across the industry, driven by the major banks. The net interest margin of the major banks (defined as net interest income over average interest earning assets) is currently 2.2 per cent (Graph). The banks report that margins on business lending and home lending are compressing.

Graph 1
Major Banks' Net Interest Margin*
Domestic, half-yearly



* From 2006 data are on an IFRS basis; prior years are on AGAAP basis; excludes St George Bank and Bankwest prior to the first half of 2009
Sources: Banks' Financial Reports; RBA

Banks' Funding Costs

The composition of bank funding has been broadly stable over the past year. Deposits continue to be the main source of funds, accounting for almost 60 per cent of funding liabilities (Graph). Banks' outstanding funding costs have declined over recent years, driven by reductions in the cash rate. More recently, the decline in funding costs has been most notable for new term deposits with long maturities. Conditions in wholesale funding markets remain favourable (Graph). Securitisation activity has been relatively strong over the past year compared to the period since 2008, but it remains a relatively minor source of funding. For a more comprehensive overview of developments in banks' funding costs, see Tellez, E (2015), '[Developments in Banks' Funding Costs and Lending Rates](#)', RBA Bulletin, March, pp 55-61.

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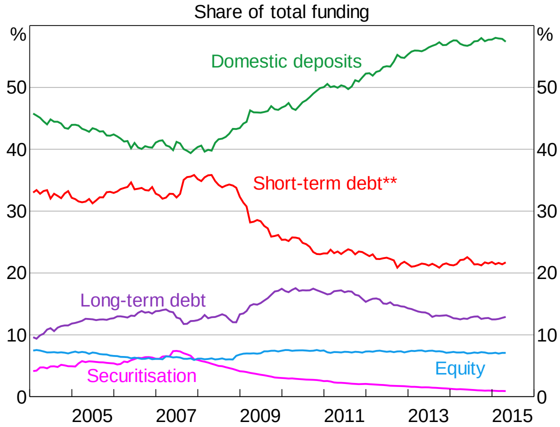
Graph 2

Funding Composition of Banks in Australia*

Share of total funding



* Adjusted for movements in foreign exchange rates; tenor of debt is estimated on a residual maturity basis

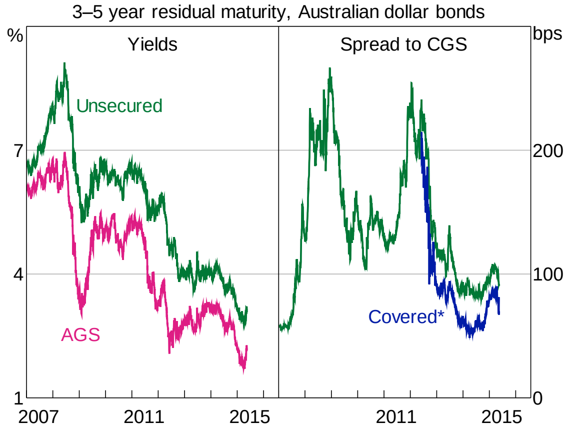
** Includes deposits and intragroup funding from non-residents

Sources: APRA; RBA; Standard & Poor's

Graph 3

Major Banks' Bond Pricing

3–5 year residual maturity, Australian dollar bonds



* Covered bond pricing interpolated to a target tenor of 4 years using bonds with a residual maturity between 2 and 10 years

Sources: Bloomberg; UBS AG, Australia Branch