Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates, 2 June – 4 June 2009

Question: bet 109

Topic: Credit Crisis

Hansard Page: E49-50 (4 June 2009)

Senator Bushby asked:

Senator BUSHBY—My next question is regarding the banking system. I was looking through the *Economist* a couple of weeks ago and I note that there is a report there that there are encouraging signs that the worst of the credit crisis may be over. This is obviously speaking about the US market. They refer to the TED spread, which shows the difference between what banks and the US Treasury pay to borrow money for three months and noted that it continued its steady narrowing, standing at less than 0.6 percentage points on Monday, 18 May. This is its lowest level since August 2007. Is this reflective of the situation facing banks in Australia? Is the cost of borrowing falling here?

Mr Murphy—We can give you some stats on that. The TED is what the fed would use and then there is a Libor rate in the UK.

Senator BUSHBY—Which is also falling steadily.

Mr Murphy—Yes. Credit markets have improved, but it is nowhere near back to where it was pre-GFC. It is still quite expensive for fundraising. If you would like some statistics, we can take that on notice.

Senator BUSHBY—You can take that on notice and provide some statistics.

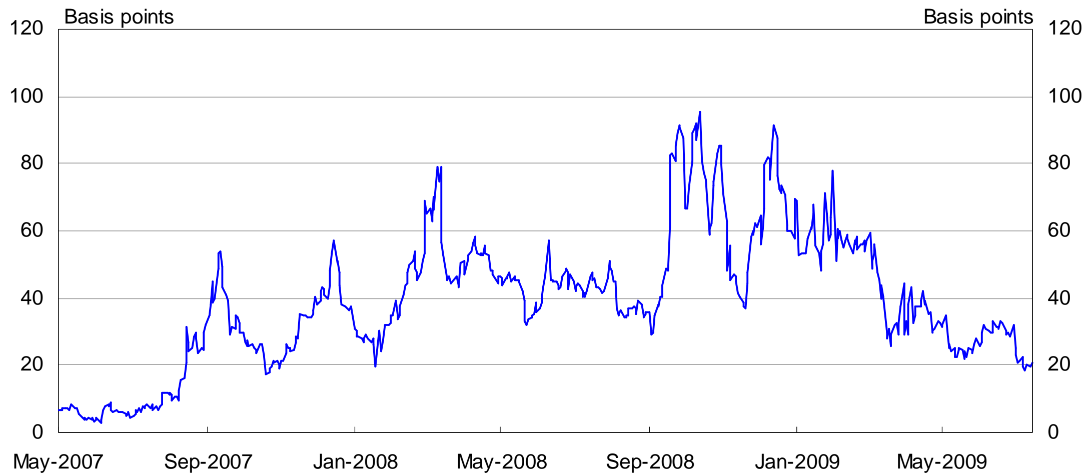
Mr Murphy—Certainly

Answer:

While conditions in financial markets, as measured by credit spreads, have improved over recent months, spreads remain above pre-crisis levels.

One indicator of financial market conditions is the spread between the 90-day bank bill rate and the 3-month overnight indexed swap (OIS). This spread has narrowed from its peak of around 95 basis points in mid-October 2008 to be on average around 20 basis points in the first two weeks of July. This is below the average since the crisis began of around 45 basis points, but above the pre-crisis levels of around 10 basis points (Chart 1).

Chart 1: Spread between the 90-day bank bill rate and the 3-month OIS.



Source: RBA and Thomson Reuters.

Note: Last data point is 14 July 2009.

In its June 2009 *Bulletin*, the Reserve Bank of Australia published a paper on "The Impact of Capital Market Turbulence on Banks' Funding Costs". In relation to the cost of banks' funding, the paper noted that:

> While most types of funding have become more expensive relative to pre-2007 benchmarks as a result of the capital market turbulence, the relative cost of each type of funding has been affected to varying degrees. With increases in liquidity, credit and term premia, the relative cost of capital market funding has generally increased more for long-term funding and securities that investors are less comfortable holding.

Overall, the paper estimated that the interest rate on major Australian banks' outstanding funding liabilities declined by an average of about 330 basis points from the first reduction in the official cash rate in September 2008 to the end of May 2009, compared to the 425 basis point decrease in the official cash rate over the same period.