**Senate Standing Committee on Economics**

ANSWERS TO QUESTIONS ON NOTICE

**Treasury Portfolio**

Budget Estimates, 2 June – 4 June 2009

**Question: bet 142**

**Topic: Terms of Trade**

**Hansard Page: Written**

**Senator Bushby asked:**

1. To what level do you expect the Terms of Trade as a result of the current financial challenges to fall and how does this compare with historical averages?

2. What proportion of the cash rate reduction over recent months was passed through to each of variable home mortgages, small business loans, overdrafts and credit cards? Why has there been less pass through on non-mortgage products?

**Answer:**

1. The global recession has seen a turnaround in demand for commodities, with global industrial production falling sharply. Prices for Australia's key commodity exports have declined significantly.

The 2009-10 Budget forecasts the terms of trade to fall by 13¼ per cent in 2009-10, taking the index back to around 2006-07 levels of 99 index points.

This is still above historical averages for the series. The terms of trade averages around 75 index points for the entire history of the series. Over the 1990s, the terms of trade averaged around 65 index points.

2. The official cash rate has been reduced by from 7.25 per cent in early September 2008 to 3.00 per cent as at the end of April 2009, a reduction of 425 basis points. Over this period, lending rates have fallen by:

- 385 basis points for the standard variable mortgage rate;
- 300 basis points for the small business residentially-secured variable term rate;
- 300 basis points for the small business residentially-secured variable rate overdraft;
- 285 basis points for the small business small overdraft; and
- 205 basis points for standard rate credit cards.

It is difficult to provide a definitive empirical explanation for why lenders have passed through different amounts of interest rate reductions to different lending products.

One factor that is likely to be important is that over the same period there has been a significant repricing of risk in financial markets. It follows that, as loans secured by residential property are regarded as less risky than unsecured personal or business loans, a higher rate of pass through of interest rate reductions would be expected on these loans.