Banks, APRA's credit constraints and the coronavirus

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08 April 2020

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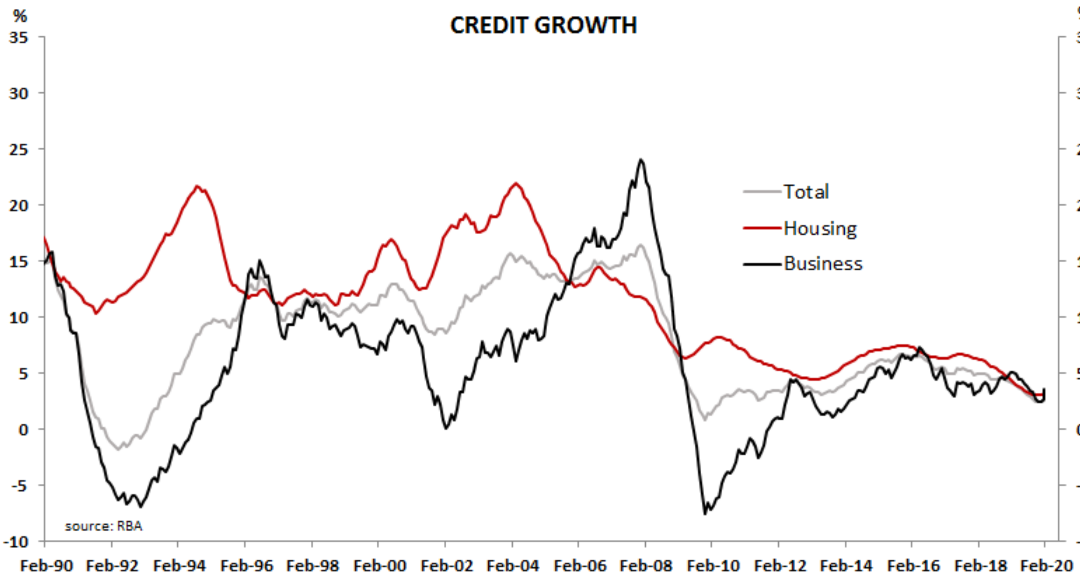
APRA has advised the banks that they may, temporarily, use a strong capital position for increased lending. They have also indicated that the banks might reduce dividends. This approach is indicative of APRA's focus on capital buffers without regard to the counter-cyclical role these buffers would provide in times of stress.

After an extended period of subdued growth, private credit finally showed encouraging growth in January and February 2020. As shown in Chart 1 both housing and business credit were growing.

Then the coronavirus impact emerged. A time of stress is now upon us.

Constraints on bank lending have been part of the establishment of substantial capital buffers set by APRA in the wake of the GFC over a decade ago. As a result, money growth has been slower than it would have been in the absence of APRA's directives to the banking sector. This has meant that reductions in interest rates by the RBA in recent years have had a minor impact on growth in lending. Essentially, APRA's directives have largely negated RBA monetary policy.

Chart 1



Action by the national cabinet, established with the emergence of the coronavirus, has been directed towards both the health issue and the continuation of business activity in Australia. Federal and state government spending has been committed on a large scale. Monetary policy, through interest rate reductions and provision of liquidity (cash) by the RBA, is expected to provide stimulus.

Banks are being encouraged to participate in efforts to prevent the Australian economy from falling into depression. APRA has advised the banks that they may, temporarily, utilise some of their current "unquestionably strong" capital positions to facilitate ongoing lending. It would appear that APRA will allow banks to grow lending as part of the national effort to get through the coming downturn. However, APRA's actions do not indicate a commitment to the counter-cyclical role that the capital buffers were intended to provide.

Return on equity of the banks has steadily declined to 10.9% in December 2019 which is well below the 15- year average of 13.0%. This is a result of low-interest rates, high operational expenses and low growth in lending. Lending growth has not been favoured by the capital requirements on banks and lending will still remain constrained. This will hamper banks' recovery of their return on capital as well as their role in the recovery process.