Rising asset prices in the face of credit constraints

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03 February 2020
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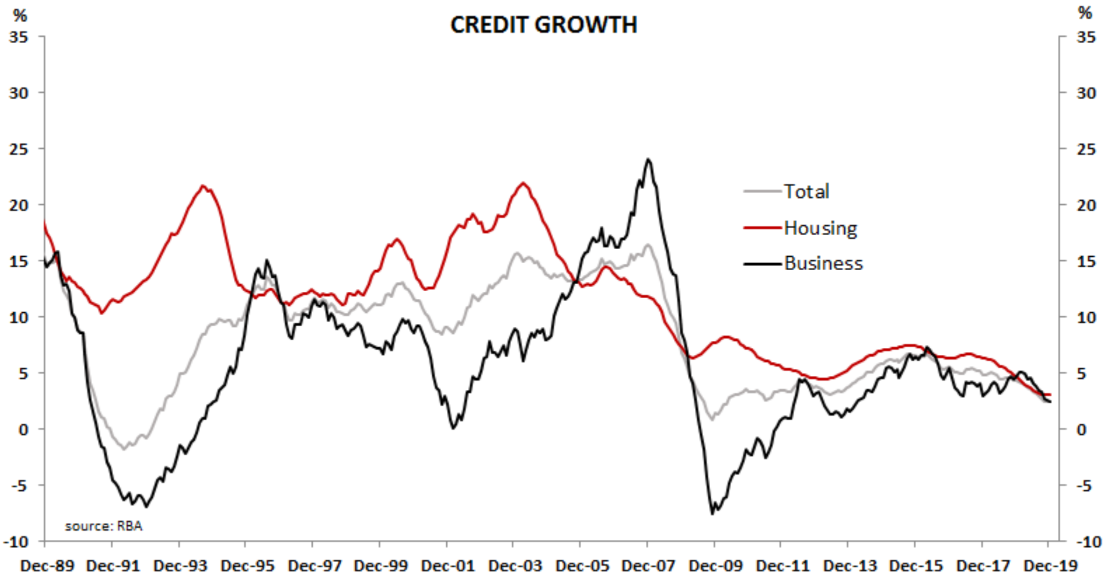
Despite very low official interest rates at 0.75%, lending for owner-occupied housing is the only sector experiencing material growth. Growth in investor loans remains negative while business lending by banks is growing at a very low rate. Additionally, any growth is in lending for large businesses and lending for small businesses is not growing.

In aggregate, money growth is very slow. This means that the reductions in interest rates by the RBA are not having any impact on lending. Bank lending is being restrained by other means.

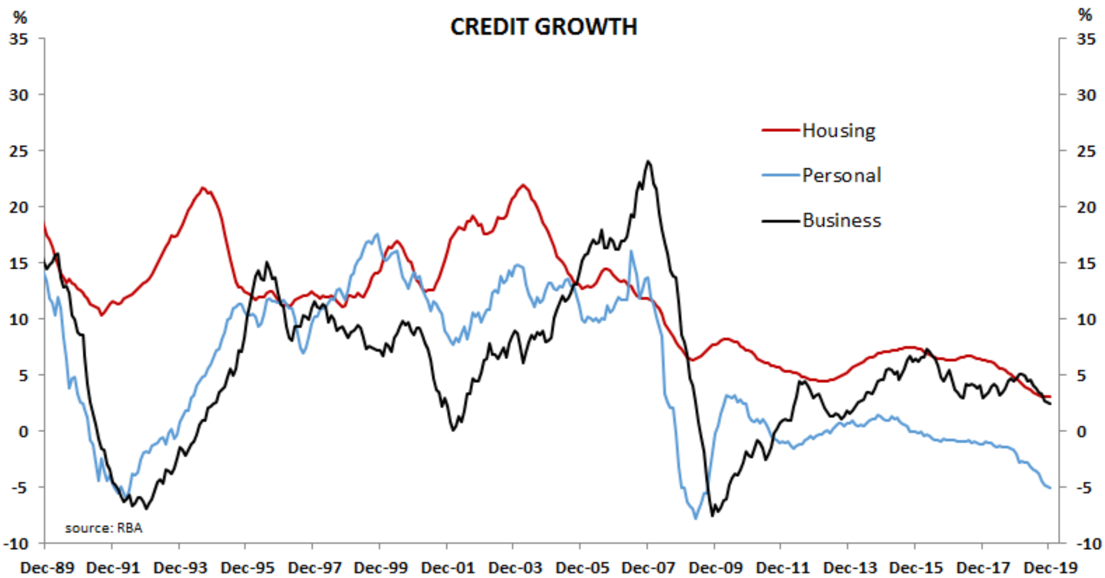
Private credit data to end December 2019 shows continuing very slow growth in Australia.

Chart 1



Lending for personal purposes is declining (Chart 2).

Chart 2



Not all lenders are facing constraints. Non-bank lending continues growing at the expense of bank lending. The membership of the Australian Finance Industry Association (AFIA) provides an indication; the AFIA has over 100 members, including the major banks and 45 associate members. New pay-day lenders have emerged while restraints on major banks continue to be put in place.

For example, APRA recently imposed an additional $0.5 billion capital requirement on Westpac as a result of operational risk requirements which arose from its AUSTRAC transgressions. This lifted the total additional operational risk capital of the four majors in recent months to $3 billion. The additional capital required to support existing loans has reduced the capacity of banks to expand lending elsewhere.

Effectiveness of RBA monetary policy, which is very stimulatory with interest rates at 0.75%, is thus being impaired. However, bank credit is flowing into sectors with low capital requirements. "Inflation of financial assets prices is an immediate effect of low interest rates while it takes much longer for the effect in the real economy to show up in the form of low lending rates." [1] Asset prices, including owner-occupied housing, are being buoyed by low interest rates. This is not confined to Australia; it is global. Asset prices will rise as low interest rates continue even as bank lending to the real economy remains constrained.

Lending for broader business activities, especially small business, is not favoured by the capital requirements banks face. As a result, bank lending will remain constrained in this area.

However, non-bank lenders are increasingly moving into the sector. These non-bank lenders are also expanding their personal lending books.