Bank credit and house prices

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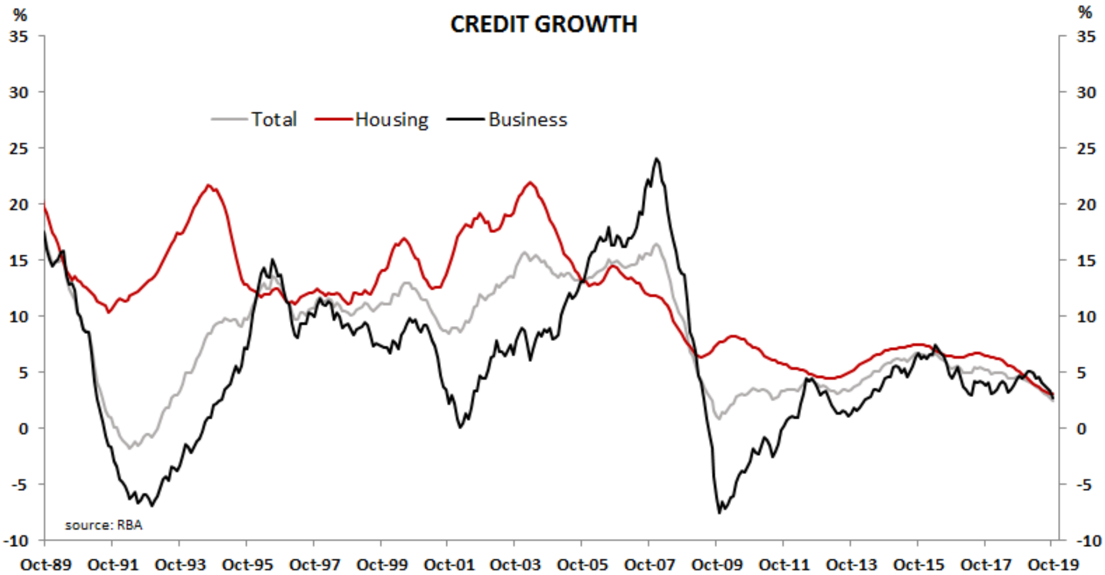
Banks are being restrained in their ability to lend while less-traditional lenders expanded their operations. A report from FAST, which is a NAB-owned mortgage aggregator, stated "Lenders owned by the four major banks saw the market share of business lending and equipment finance fall from 77% to 67% in the 2019 financial year. Non-bank lenders more than doubled their share from 5% to 11%".

This trend was established before the Hayne Royal Commission.

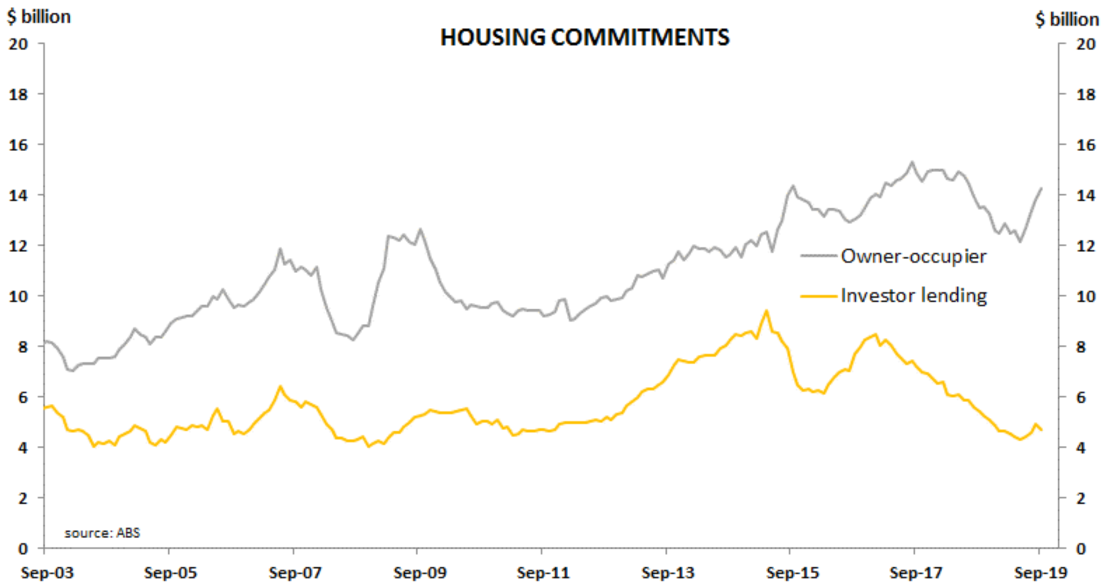
Data released at end October 2019 shows private credit growth in Australia continued to be very slow (Chart 1).

Chart 1 – Credit Growth



However, lending for owner-occupied housing is the one sector where growth rates have held up (Chart 2).

Chart 2 – Housing Finance by segment



Strong growth in non-bank lending for housing will continue. Major banks are restrained by the aftermath of the Haynes Royal Commission. They face APRA-imposed extended capital requirements and lending guidelines, Treasury's implementation of Royal Commission recommendations and, most recently, AUSTRAC legal action and ASIC investigations of bank conduct.

The emergence of non-bank lending as a significant part of the Australian economy has its consequences. Monetary policy has an effect on economic growth through changes in the demand for and supply of money. However, it is not as effective in the non-bank sector as only banks (and the RBA) can create money. Thus the effectiveness of RBA monetary policy, which should be very stimulatory with interest rates at 0.75%, is being limited.

One consequence is the tendency of bank credit to flow to the sector with the lowest capital requirements which, in this case, is owner-occupied housing. This is prompting a strong recovery in housing prices.

At the same time, lending for a broader business activity will remain constrained. It is the non-bank lenders which are moving aggressively into commercial lending. In time, lending to business will provide the impetus for greater economic activity as productive assets are financed.

In the interim, housing prices will rise as the low-interest rates continue and banks have an incentive to lend in this area.