

### 3. Household and Business Balance Sheets

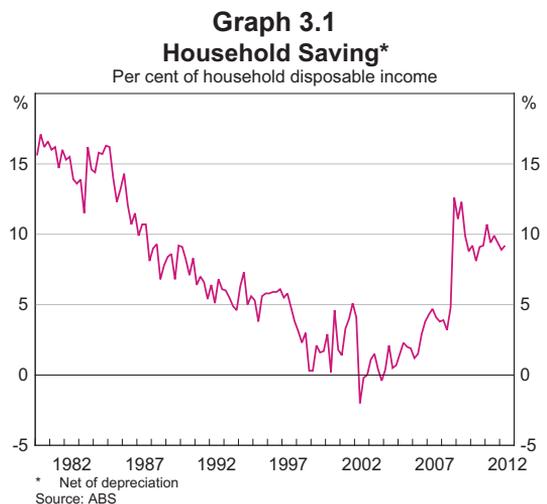
The household sector has continued to consolidate its financial position in 2012. The household saving ratio appears to have stabilised at a level significantly above that recorded in the 1990s and early to mid 2000s, and households have been actively shifting their portfolios towards more conservative assets such as deposits. Household borrowing has also slowed in recent years to a pace that is more in line with income growth and many households are choosing to repay their existing debt more quickly than required. Though there are some isolated pockets of weakness, aggregate measures of financial stress remain low. However, with aggregate indebtedness still around historically high levels, a continuation of the recent borrowing restraint would help strengthen the financial resilience of households.

Overall, business balance sheets are in good shape, with gearing and debt-servicing ratios at relatively low levels, though profits have moderated recently. The dispersion in economic conditions across sectors has continued in recent quarters, with firms in some industries facing challenges associated with the high level of the exchange rate and the weak housing market as the Australian economy goes through a period of structural change. These pressures are evident in banks' business loan performance: inflows of newly impaired business loans remain elevated and, associated with this, the non-performance rate on banks' business loans has declined only modestly from its peak a couple of years ago.

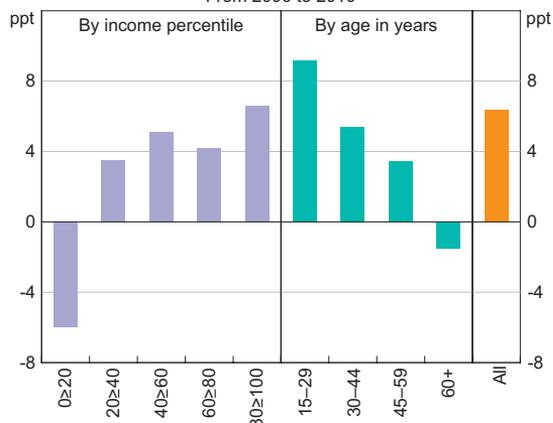
#### Household Sector

The household sector's more prudent financial behaviour has continued in 2012. The saving ratio has averaged around 9½ per cent of disposable income for the past few years, well above its level of five to ten years ago (Graph 3.1). Disaggregated household-level data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey show that this increase in saving was broad based across most income and age groups, with the exception of retirees, who typically dissave and are disproportionately represented in the lowest income quintile, as well as other households with low or temporarily low incomes (Graph 3.2).

The higher rate of saving has partly been motivated by a desire to rebuild wealth following the falls in asset prices over recent years. Real net worth per household has declined by 11½ per cent from its



**Graph 3.2**  
**Change in Median Saving Ratios\***  
 From 2006 to 2010



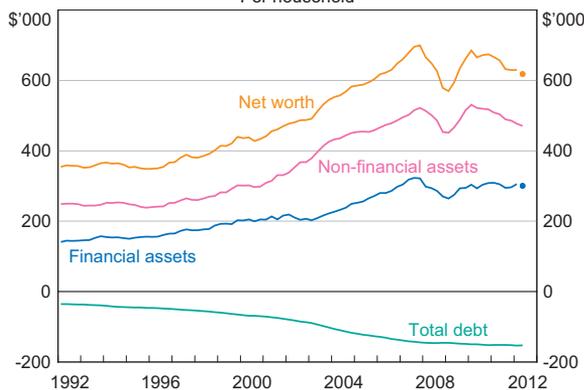
\* Population weighted and using income measures equivalised across different household structures  
 Source: HILDA Release 10.0

2007 peak, in contrast to the strong growth in the years leading up to that point (Graph 3.3). Much of the decline has reflected weakness in housing values. Average housing prices are around 6 per cent below their 2011 peak nationally, and even further below their peaks in Melbourne and south-east Queensland, where earlier overdevelopment locally may have weighed on prices. While prices nationally have stopped falling in recent months, any future recovery is unlikely to produce housing price growth much faster than income growth, as was seen through much of the 1990s and 2000s, because that

earlier period was one of adjustment to the structural decrease in nominal interest rates and liberalisation of the banking system.

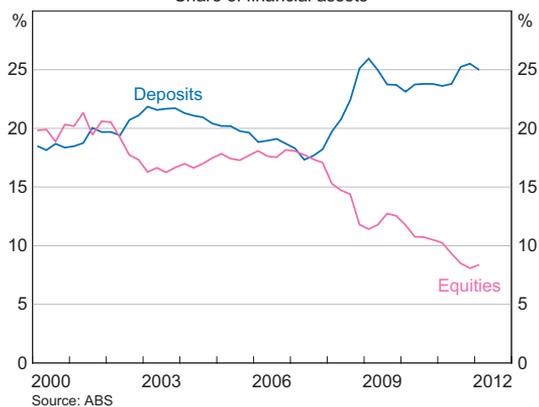
Households' more circumspect financial behaviour is also related to a decrease in their appetite for risk and riskier assets. For example, on top of the effect of declining equity prices, households have actively reduced their equity holdings. As a result, the share of households' financial assets held directly in equities (i.e. outside superannuation) has roughly halved, from 18 per cent in 2007 to 8½ per cent in March 2012 (Graph 3.4). In contrast, the share of deposits has increased from 18 to 25 per cent over that period. Disaggregated data from the latest HILDA Survey also show that between 2006 and 2010 the proportion of households owning equities directly fell slightly, to 34 per cent; the decline was seen across most age and income groups. Overall, real financial assets per household have been flat in recent years as the growth in deposits and superannuation assets has been roughly offset by the fall in the value of equity holdings. While households appear to have become more risk averse in recent years, it is not always clear that they fully account for the complexity inherent in some financial products. For example, there have recently been a number of hybrid securities issued by banks and other companies aimed at retail investors. The

**Graph 3.3**  
**Real Household Assets\***  
 Per household



\* In 2009/10 dollars; deflated using the household final consumption expenditure implicit price deflator; dots are RBA estimates for June quarter 2012  
 Sources: ABS; RBA

**Graph 3.4**  
**Household Assets**  
 Share of financial assets



Source: ABS

Australian Securities and Investments Commission, through its MoneySmart consumer awareness website, has warned about the risks associated with these types of securities, which combine debt and equity features, relative to standard debt instruments like corporate bonds.

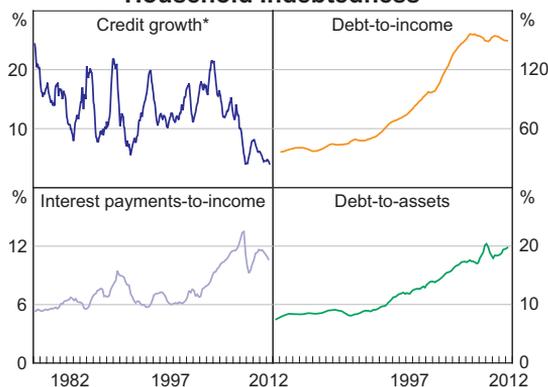
Household credit growth has been much slower in recent years than over the previous couple of decades, and in recent months has slowed further (Graph 3.5). It has also been more in line with income growth, such that the household debt-to-income ratio has been broadly flat at around 150 per cent since 2006. Soft demand for both owner-occupier and investor housing credit has resulted in, and reflected, lower housing prices. Data on housing loan approvals suggest that housing credit growth is likely to remain modest in the near term. Appetite for other forms of borrowing also remains low. Credit card debt was broadly steady over the year to July, while the stock of other forms of personal credit has generally been declining. Despite the easing in household credit growth in recent years, household gearing is around a historically high level, reflecting the fall in the value of housing assets.

Subdued credit growth, lower interest rates and modest income growth over the past year have led to a further fall in the ratio of household interest payments to disposable income. At 10½ per cent in the June quarter, this ratio is now at its

decade average. Real household disposable income increased by around 4 per cent over the year to the June quarter 2012, underpinned by solid growth in compensation of employees. Even so, households' sentiment towards their financial position remains weak, despite the unemployment rate remaining at a relatively low level in recent months. Forward-looking indicators, such as surveys of business hiring intentions, point to modest growth in employment in the period ahead.

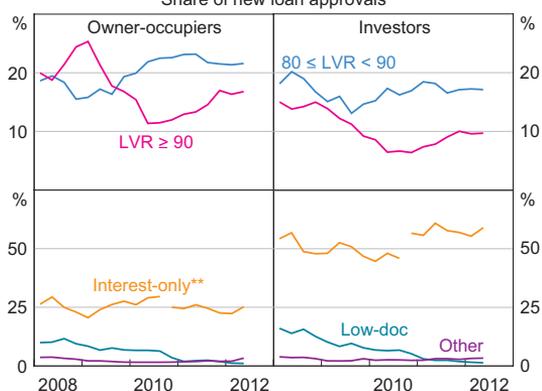
The risk profile of new housing loans has been lower in recent years compared with the earlier period of strong growth in household borrowing. Lending standards are tighter now than prior to the financial crisis, and liaison with the major banks indicates that they have been broadly unchanged over the past six months. The share of bank lending that is low-doc remains low, at less than 2 per cent of banks' loan approvals and around 5 per cent of outstanding housing credit (Graph 3.6). The share of new loans with loan-to-valuation ratios (LVRs) above 90 per cent is also lower than around the onset of the financial crisis, at around 14½ per cent, though it has increased noticeably over the past couple of years. Part of this can be attributed to first home buyer (FHB) incentives; for example, some demand was pulled forward ahead of the expiry of the New South

**Graph 3.5**  
**Household Indebtedness**



\* Six-month-ended, annualised  
Sources: ABS; RBA

**Graph 3.6**  
**Banks' Housing Loan Characteristics\***  
Share of new loan approvals



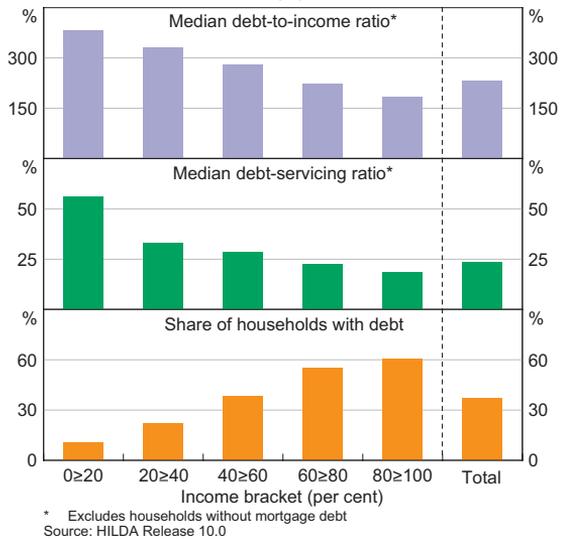
\* LVR = loan-to-valuation ratio; 'Other' includes loans approved outside normal policies, and other non-standard loans; 'Interest-only' includes mortgages with 100 per cent offset accounts  
\*\* Series break due to changes in data management at one of the major banks  
Source: APRA

Wales FHB stimulus at the end of 2011. Many banks have recently changed how they estimate living expenses in their debt-serviceability calculations, moving from using the Henderson Poverty Index to the Household Expenditure Measure, which is based on the ABS Household Expenditure Survey. The new measure was designed to be a more accurate estimate of households' living expenses. The impact of the change will vary for different borrowers; for couples, it will generally reduce their borrowing capacity, while for singles it will generally increase it. The available evidence suggests that using the new measure will result in only minor changes to the availability of credit overall.

Some households are using their increased saving to pay down debt more quickly than required, which has contributed to the slower aggregate pace of debt accumulation. Data from the major banks and the HILDA Survey indicate that around half of borrowers are repaying their mortgages ahead of schedule and are thereby building up buffers they could temporarily draw on to stay current on their loan if their income were to fall. The size of these buffers can be quite substantial (see 'Box B: Households' Mortgage Prepayment Buffers').

Given the large share of households with mortgage prepayment buffers, along with relatively low unemployment and moderate income growth, most households appear well placed to meet their debt obligations. According to the latest HILDA Survey, around 70 per cent of owner-occupier housing debt is held by higher-income households (those in the top 40 per cent of the income distribution) that typically have lower debt-to-income and debt-servicing ratios (DSRs) (Graph 3.7). Only a relatively small share of low-income households (in the bottom 20 per cent of the income distribution) has housing debt; those that do, however, tend to be quite indebted, with high DSRs. This is partly explained by this group containing people with temporarily low incomes, for example, because they were unemployed or between jobs when the Survey was taken.

**Graph 3.7**  
**Owner-occupier Housing Debt**  
2010

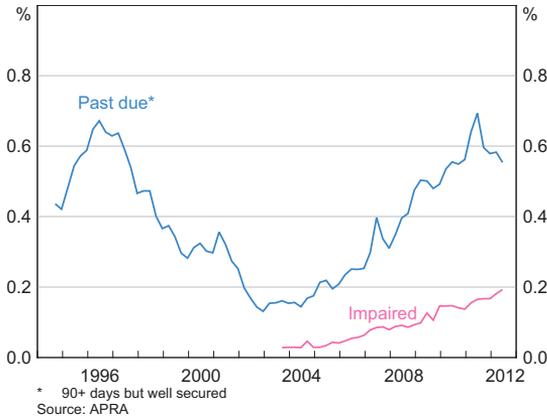


The recently released Census data show that in 2011 only a small share of indebted owner-occupiers met standard vulnerability criteria, broadly consistent with trends seen in recent years in the HILDA Survey. For instance, slightly under 10 per cent of indebted owner-occupier households had high DSRs (above 50 per cent) and 6½ per cent had both high DSRs and were in the lowest 40 per cent of income earners.

Consistent with these survey-based measures, aggregate indicators of financial stress confirm that the household sector has been coping reasonably well with its debt level. The past-due share of housing loans has eased somewhat since its peak in mid 2011, to be a little below 0.6 per cent (Graph 3.8). Although this arrears rate is low by international standards, it remains above its historical average. The non-performance rates for banks' credit card (1.3 per cent) and other personal (2.2 per cent) loans have increased slightly in recent quarters, but remain a little below recent peaks.

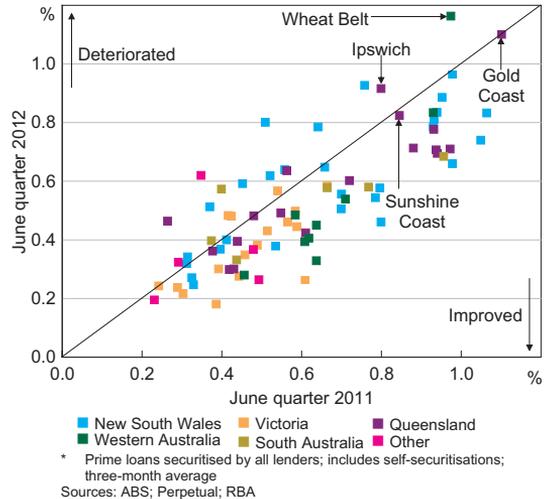
According to the 2011 Census, the geographic regions that had the highest incidence of potential mortgage vulnerability, as measured by the share of households that had high DSRs and were in

**Graph 3.8**  
**Non-performing Housing Loans**  
 Share of outstandings



the lowest 40 per cent of the income distribution, were western Sydney, parts of the New South Wales coast, south-east Queensland and parts of Melbourne (Graph 3.9). Partly consistent with these data, arrears on securitised loans suggest that some of the same regions have a higher-than-average share of borrowers experiencing some degree of financial stress, although even in these regions, arrears rates have generally declined over the past year (Graph 3.10). They include parts of Sydney's western suburbs, where arrears rates have been

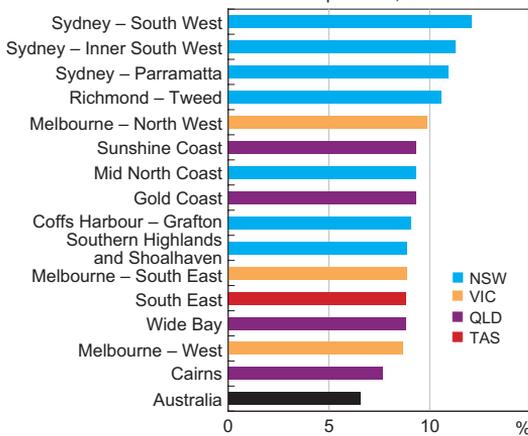
**Graph 3.10**  
**Securitised Housing Loan Arrears by Region\***  
 90+ days in arrears, share of outstandings



high for some time, as well as regions that rely on tourism, a sector that has been under pressure more recently from the high exchange rate. This second group of regions includes areas of Queensland, particularly around the Gold Coast and Sunshine Coast, and some coastal areas of New South Wales and Western Australia. Many of the loans in arrears in these regions were originated in the few years leading up to the crisis, when housing prices in these areas were still growing quickly and construction was relatively strong (Graph 3.11). Although arrears rates on housing loans in Victoria are currently quite low, there is some chance they could rise, due to a potential oversupply of property in some segments, particularly inner-city Melbourne apartments and houses at the south-eastern fringe. Overall, the Melbourne residential property market has been experiencing below-average auction clearance rates and a run-up in the stock of land for sale at the same time as actual sales fell; these factors could weigh on prices in the future.

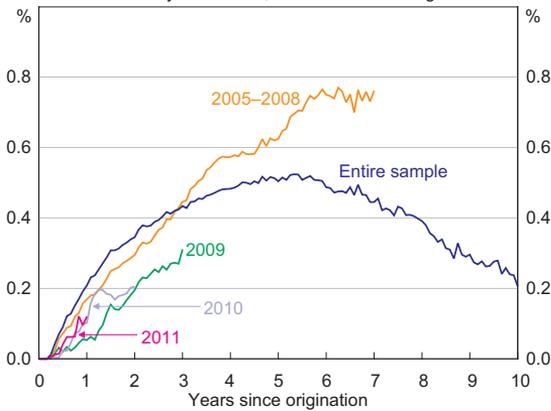
This geographic pattern in arrears rates has also been broadly consistent with court applications for lender property possession; applications have declined since their peaks in most states and the improvement has been greatest in both New South

**Graph 3.9**  
**Mortgage Vulnerability by Region\***  
 Share of households with owner-occupier debt, 2011



\* Households in the lowest 40 per cent of income earners with debt-servicing ratios greater than 50 per cent  
 Sources: ABS; RBA

**Graph 3.11**  
**Securitised Housing Loan Arrears by Cohort\***  
 90+ days in arrears, share of outstandings



\* Prime loans securitised by all lenders; includes self-securitisations  
 Sources: Perpetual; RBA

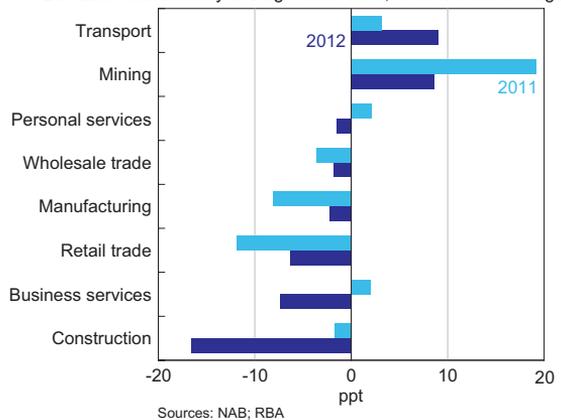
Wales and Victoria. Bankruptcy rates have generally fallen since 2009, although there was an increase in Queensland in the year to the June quarter. Overall, the number of households whose financial difficulties have deteriorated to the extremes of bankruptcy or lender property possession is very low in absolute terms; in aggregate, applications for property possession have been running at about 0.15 per cent of dwellings on an annualised basis. Moreover, although there are some regions with higher shares of borrowers in financial stress, the larger banks' residential mortgage portfolios are well diversified geographically and should be resilient to distress in particular regions. This implies that there are some limits to the potential for such an event to feed back onto the real economy via distress in the financial system.

### Business Sector

Economic conditions continue to vary significantly across industries; mining and mining-related businesses, such as those in the transport industry, are experiencing quite strong conditions, while conditions are weaker in some non-mining sectors, particularly the commercial property and construction sectors, as some firms face challenges associated with the high level of the exchange rate and the weak housing market (Graph 3.12).

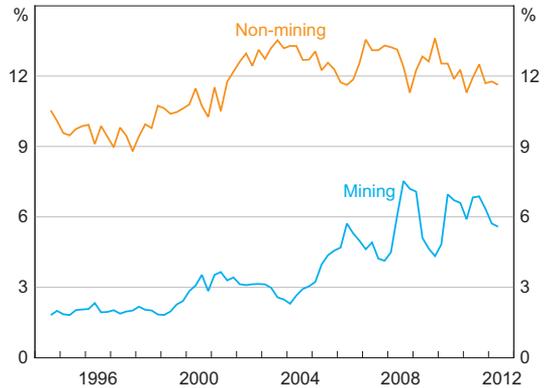
While volatile, measures of profitability are broadly consistent with this pattern. According to ABS data, average annual growth in mining profits has been about 8½ per cent over the past five years compared with 3½ per cent for the non-mining sector. Reflecting this, mining sector profits have recently been above their decade average as a share of GDP, while the GDP share of non-mining profits has been below average (Graph 3.13). However, recent falls in prices for bulk commodities have weighed on business conditions in the mining sector and could affect mining profits in the near term. The sectoral divergence over the past few years has also been evident in the performance of listed companies;

**Graph 3.12**  
**Business Conditions by Industry**  
 Deviation from industry average since 1989, three months to August



Sources: NAB; RBA

**Graph 3.13**  
**Private Non-financial Corporates' Profits\***  
 Share of GDP

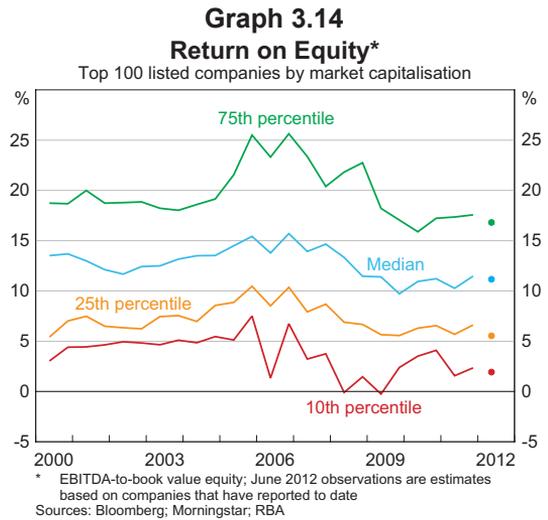


\* Gross operating profits; inventory-valuation adjusted  
 Sources: ABS; RBA

although mining profits have softened in the most recent reporting season, profits remain at a high level, particularly relative to other sectors. While aggregate profitability remains solid, the median return on equity of listed companies is a little below average and there appears to be a larger-than-usual segment of poorly performing firms (Graph 3.14). Of the top 100 listed companies, 8 reported a loss in 2011, compared with 4 each year on average over the past decade. Around half of these loss-making firms have little or no debt, however, limiting the potential flow-on effect to the financial system.

Small businesses continue to report more subdued conditions; this partly reflects that they are concentrated in industries such as construction that have been under pressure. Credit bureau data show that the share of unlisted firms making losses was broadly steady at around a quarter in 2011. Survey measures of small business profitability remain below average. National accounts measures of both unincorporated and incorporated business profits declined over the year to the June quarter 2012.

Data on bank exposures by industry indicate how much the varying business conditions might affect the financial system. Property-related lending continues to account for the largest share of banks' business loans, at around 30 per cent (though only



around 9 per cent of banks' assets), even though the amount outstanding has fallen in recent years. This is also true for most individual banks, including the major banks, though to a lesser extent than for some of the smaller banks (Table 3.1). Given the importance of the commercial property sector to the banking system and its tendency to be higher risk, it is discussed separately below. The remainder of banks' business exposures is relatively diversified across sectors. It is notable that banks have very little lending to the mining sector; this sector has relatively low leverage and tends to borrow more

**Table 3.1: Major Banks' Business Lending**  
Exposures as at end March 2012<sup>(a)</sup>

Sector	Share of total Per cent
Property	25
Utilities, telecommunications & other	22
Wholesale & retail trade	13
Agriculture, forestry & fishing	10
Manufacturing	8
Transport & storage	7
Business services	5
Construction	4
Accommodation, cafes & restaurants	4
Mining	2

(a) June 2012 for CBA  
Sources: APRA; RBA; banks' Basel II Pillar 3 reports

from offshore bond markets when debt funding is needed rather than from local banks. The construction and manufacturing sectors are quite cyclical, but Australian banks have relatively small exposures to them.

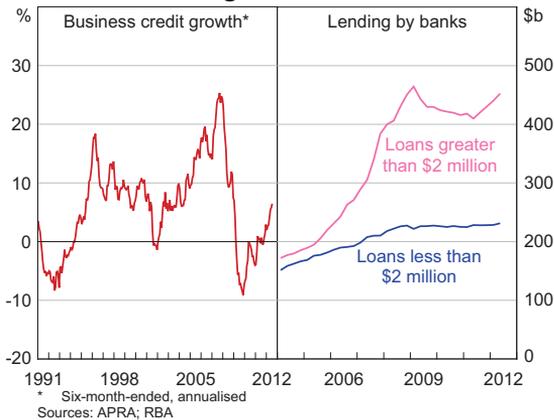
Following a period of significant deleveraging over recent years, there are signs that businesses' appetite for debt may be starting to recover. Business credit grew by 6½ per cent in annualised terms over the six months to July after declining for much of the previous three years (Graph 3.15). While volatile, the recent pick-up was evident across most industries, and like the previous decline, it was mostly driven by the borrowing behaviour of larger businesses, particularly listed companies. This is consistent with the pattern in banks' business lending by size of facility: the outstanding value of loans that are larger than \$2 million has increased by 10½ per cent since June 2011 after declining over the previous 2½ years, while the outstanding value of loans less than \$2 million each has been broadly unchanged since 2009.

The supply factors that contributed to weak credit growth in recent years appear to have eased; liaison with businesses suggests that the availability of finance has improved for many firms over 2011 and 2012. Even so, credit conditions remain tight for some firms, particularly property developers

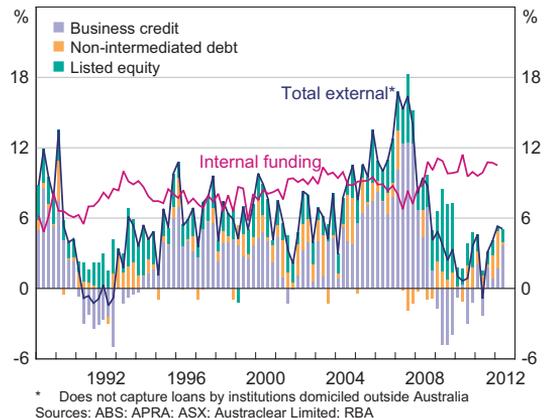
and those in the construction sector. Despite the recent pick-up in credit growth, liaison with banks suggests that demand for credit is still fairly soft. One reason for this is that businesses' internal funding remains quite strong. Solid aggregate profit levels combined with lower interest payments and below-average dividend payout ratios have resulted in internal funding of non-financial corporates averaging around 10 per cent of GDP in recent years, compared with a long-run average of about 7½ per cent (Graph 3.16). Much of this internal funding has been concentrated in the mining sector, where it is helping fund that sector's sizeable investment program, though the recent falls in prices for bulk commodities could undermine mining firms' profitability, as noted earlier.

Rather than borrow from local banks, resources companies have instead contributed to solid corporate bond issuance over the first half of 2012. Demand from foreign investors remains strong, with about 80 per cent of bond issuance being offshore and denominated in foreign currency, mainly US dollars. The most recent available data from 2009 show that Australian non-financial corporates hedged around 60 per cent of their foreign currency debt through derivatives at that time; in addition, for resources companies, much of their foreign currency exposure is naturally hedged as many of

**Graph 3.15**  
**Lending to Businesses**



**Graph 3.16**  
**Business Funding**  
Per cent of GDP

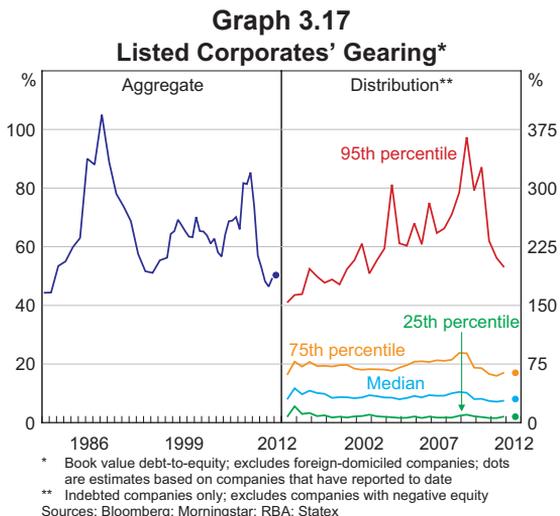


these firms are exporters or have significant foreign operations with US dollar revenues. Consistent with global market conditions, Australian corporate bond spreads remain quite wide. But with yields at relatively low levels, debt remains a comparably attractive source of funding for businesses.

Reflecting the recent pick-up in debt raising, businesses' total external funding increased over the past year, to around 5 per cent of GDP in the June quarter. This is still lower than pre-crisis levels: external funding accounted for about 20 per cent of total business funds raised over the past year, compared with an average of about 40 per cent in the years leading up to the crisis. Net equity raisings have been fairly subdued in recent quarters, partly due to increased buyback activity and businesses choosing to switch from equity to debt funding after a period of deleveraging. Consistent with this, preliminary data suggest that average book-value gearing of listed non-financial companies increased slightly over the year to June 2012, from about 46 to 50 per cent (Graph 3.17). Nonetheless, leverage remains low by historical standards. The distribution of gearing ratios also remains quite wide: leverage of the most highly geared firms is around average levels, whereas the median gearing ratio is below the level typically seen over the past decade. Among the highly geared firms, infrastructure and real estate companies are over-represented, reflecting business models that tend to rely more on debt financing.

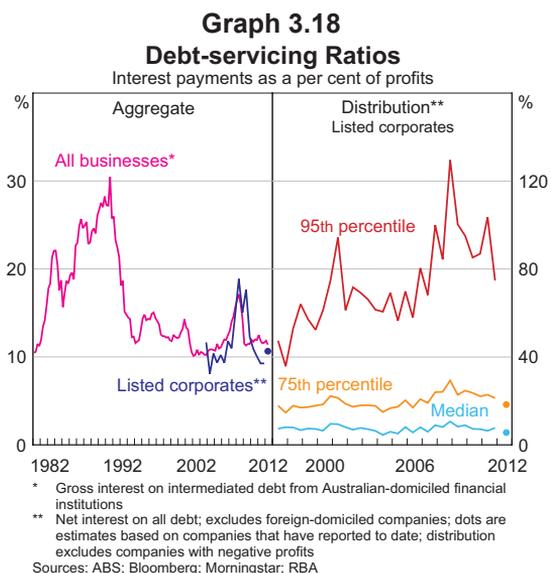
Credit bureau data indicate that smaller businesses' median gearing also increased slightly in 2011 after decreasing over the previous few years. Smaller businesses tend to have lower leverage than larger businesses; many of them do not use any debt finance and those that do tend to be less geared than indebted larger businesses.

Business balance sheets remain more liquid than they were prior to the financial crisis, but of late there has been no tendency to shift further in this direction. Average cash holdings have declined a little recently, and growth in business deposits at banks has slowed, averaging about 6 per cent over



the year to July 2012, compared with 12 per cent over 2011.

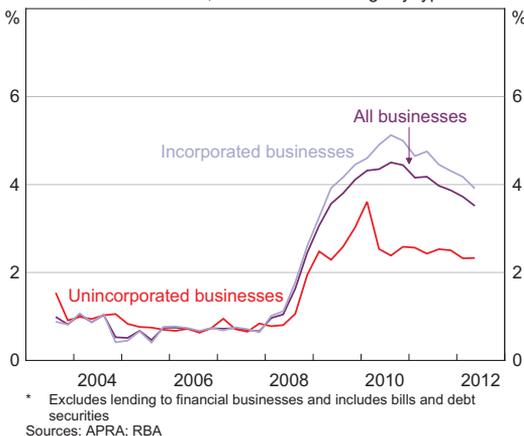
Reflecting businesses' low leverage, solid profitability and below-average interest rates, aggregate DSRs remain relatively low (Graph 3.18). In addition, many firms earn interest revenue in net terms; around one-fifth of listed companies earn interest revenue in excess of their interest payments. As with leverage, although the average DSR has declined from its 2008 peak, the distribution is still relatively wide. Ratios for a number of listed



firms are high; most of these companies are in the manufacturing or property sectors, and they generally have high debt levels and are experiencing below-average earnings. Almost all of these companies have no outstanding bonds, implying that their debt is primarily sourced from banks; that said, their total debt is only a small share of business credit. Of the top 100 listed firms, 5½ per cent of those with outstanding debt recorded a loss in 2011 compared with an average of around 4 per cent over the past decade. Although some of these loss-making firms may have difficulty servicing their debts out of current cashflows, many have buffers that they are able to access and accordingly are not in arrears.

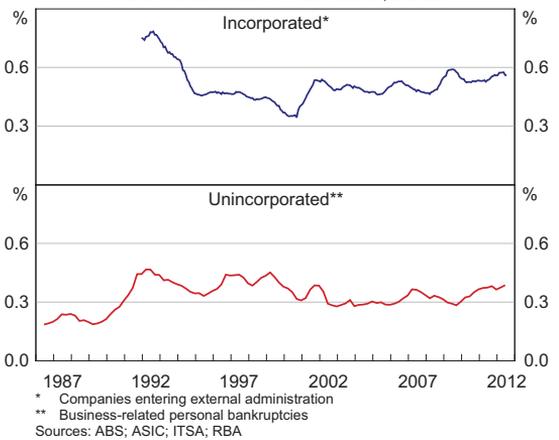
As discussed in 'The Australian Financial System' chapter, the share of banks' business loans that is non-performing decreased over the first half of 2012, but remains higher than average (Graph 3.19). Data from the major banks' Pillar 3 reports indicate that the property and business services and construction sectors have the highest non-performing assets ratios. Despite the economy growing at around trend and relatively strong overall profit levels, business failure rates have been a little above average over the year to date (Graph 3.20). This implies that the segment of poorly performing firms is currently larger than the aggregate data alone would suggest.

**Graph 3.19**  
**Banks' Non-performing Business Assets\***  
 Domestic books, share of outstandings by type



Many of these firms are located in Queensland and are experiencing challenging conditions associated with the high exchange rate and the weak property market there. The business failure rate has also risen in Western Australia over the past few years, though it remains low compared with other states and is currently below its recent peak. Nationally, failures have been concentrated in the services and construction sectors, and relatively more have been attributed to economic conditions in recent years.

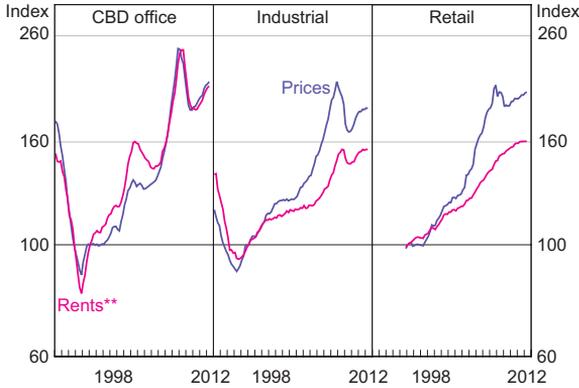
**Graph 3.20**  
**Business Failures**  
 Share of businesses in each sector, annual



## Commercial Property

Overall, conditions in the commercial property market continued to improve in early 2012, though they remain softer than prior to the financial crisis and building activity has also been weak by historical standards (Graph 3.21). The strength of the recovery since the crisis has varied across market segments; conditions have improved more in the prime CBD office market than in the industrial and retail sectors. This may partly reflect the more pronounced cycle in the CBD office sector, as well as the pressures that some parts of the non-mining business sector have been under. For example, rental and price growth for some retail properties, particularly in non-prime locations, have been weak recently given the patchy retail conditions.

**Graph 3.21**  
**Commercial Property\***  
 March 1995 = 100, log scale



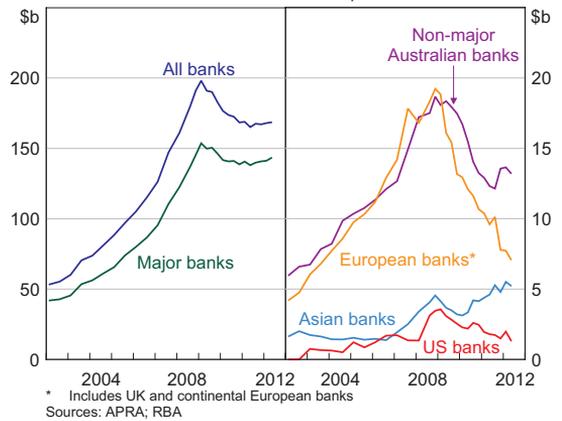
\* CBD office and industrial are prime property, retail is regional (non-CBD) centres  
 \*\* CBD office is effective rents, industrial and retail are face rents  
 Sources: ABS; Jones Lang LaSalle Research; Property Council of Australia; RBA

While liaison with construction companies and developers suggests that access to credit remains tight, large developers report that they are able to progress most projects with bank funding or the assistance of domestic or foreign investors. Smaller developers indicate that they continue to face tight credit conditions through lower LVR limits, and other stricter terms and conditions. Liaison with the banks and partial data suggest that, as for residential property, areas that are more reliant on tourism (such as the Gold Coast and Sunshine Coast in Queensland) are facing greater challenges, including oversupply and declining valuations.

As noted earlier, banks have large exposures to the commercial property market (including developers of residential property), with lending to that sector accounting for about one-third of their business loans and a disproportionate share – slightly less than half in recent years – of business loan impairments. Consistent with the improvement in conditions, the performance of banks’ commercial property exposures improved slightly over the year to June 2012, but the impairment rate remains above that for banks’ total business lending. In aggregate, banks’ outstanding commercial property lending was broadly unchanged over the year to June (Graph 3.22). Australian-owned banks recorded

a small rise in exposures, broadly offsetting a further decline in the exposures of foreign-owned banks. European-owned banks, in particular, continued to run down their commercial property exposures, which are now down about 65 per cent from their early 2009 peak. This may be because of the higher impairment rate these banks have experienced on their commercial property portfolios, as well as some of these banks being under pressure to deleverage given the difficulties their parent groups are facing in Europe. Non-bank sources of finance for commercial property remain constrained, with little issuance of commercial mortgage-backed securities in recent years.

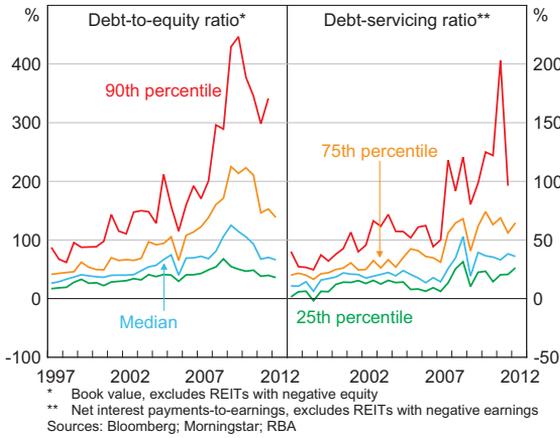
**Graph 3.22**  
**Banks’ Commercial Property Exposures**  
 Consolidated Australian operations



\* Includes UK and continental European banks  
 Sources: APRA; RBA

The financial position of Australian listed real estate investment trusts (REITs) has continued to improve, but they are no longer deleveraging as quickly as they did immediately after the crisis (Graph 3.23). The sector’s deleveraging has been concentrated in intermediated debt, with non-intermediated debt levels stable over much of the decade. After recording large losses over 2008 and 2009, mostly due to property write-downs, the sector’s profitability has stabilised at levels experienced around the mid 2000s. Consequently, their aggregate debt-servicing requirements have also declined. Nonetheless, the distribution of leverage across REITs is wide and the gearing ratios of the most highly

**Graph 3.23**  
**Australian Listed REITs**



geared firms (around the 90th percentile) remain elevated, due to falls in equity valuations. Many of these highly leveraged REITs have also experienced low or negative profits recently and, accordingly, high debt-servicing requirements. Overall, loss-making REITs tend to be small and only account for a low share of business credit.