Australian Securitisation Forum

National Australia Bank

AUSTRALIA

Economic and Mortgage Market Overview

ECONOMIC OVERVIEW

The Australian economy has benefited from 27 years of uninterrupted GDP growth. Real GDP growth averaged 2.3% in 2017 and in the first half of 2018 it has accelerated with year-on-year growth of 3.2% in the 1Q18 and 3.4% in the 2Q18. The Reserve Bank of Australia (RBA) is forecasting GDP growth to average 3.25% in 2018 and 2019.

In trend terms, the labour market grew by 3.3% or by a record 402.7k persons to 12.4m in 2017. 315.5k of this growth was in full-time jobs to 8.5m and 84.5k was in part-time jobs to 3.9m. This growth brought about a fall in the unemployment rate from 5.8% as at the end of 2016 to 5.5% as at the end of 2017, despite an increase in the participation rate from 64.7% to 65.5%. In 1H18, the rate of jobs growth moderated to 2.5%, but the unemployment rate has continued to edge lower to 5.3% whilst the participation rate has remained at a very high 65.5%. Jobs growth is expected in the year ahead and the RBA is forecasting the unemployment rate will fall further to 5¼% by June 2019.

The RBA is an inflation-targeting central bank and since the end of 2015, underlying inflation has been below the target band of 2%-3%. From a low of 1.4% in September 2016, underlying inflation has picked up to 1.9% as at June 2018. With an expectation of ongoing improvement in the labour market and a gradual increase in wages growth, the RBA expects underlying inflation will gradually increase from its current level to be 2% by June 2019 and 2¼% by June 2020.

As at September, the RBA's overnight cash rate was 1.50%, a rate which has been unchanged since August 2016. The RBA has repeatedly stated it expects the next move in the cash rate is more likely to be up than down , though there is not a strong case for a near-term adjustment in monetary policy. Following the RBA's September Board meeting, interest rate markets were pricing a 20% chance the RBA will lift the cash rate by 0.25% to 1.75% by September 2019.

The Commonwealth of Australia is rated AAA/Negative by Standard & Poor's, Aaa/Stable by Moody's and AAA/Stable by Fitch. Following the May 2016 release of the Government's 2016/17 Budget Outlook and the July 2016 election, S&P revised the outlook on its AAA rating from Stable to Negative. This change reflected S&P's view that without implementation of more forceful fiscal policy decisions, material government budget deficits may persist for several years with little improvement. In the Government's 2018/19 Budget Outlook released in May 2018, Australia's net debt is expected to peak at $341.0bn/18.6% of GDP in 2017/18. This is down from the previous 2017/18 Budget's estimated peak of $354.9bn/19.5% as at the end of 2017-18 and the 2016/17 Budget estimated peak of $375.1bn/19.8% as at the end of 2018-19.

MORTGAGE MARKET OVERVIEW

On the supply side of Australia's housing market, dwelling approvals were 224.2k in 2017, down from 234.1k in 2016, with the decline due to a lower level of apartment approvals (down from 115.8k to 105.4k) more than offsetting small rise in detached house approvals (from at 118.4k to 118.8k). In 1H18, dwelling approvals returned to growth with rolling 12 months approvals totalling 231.5k. Detached house approvals have continued to grow at a reasonably steady rate of 5% to 122.7k, while after declining between the 4Q16 to the 3Q17 periods, apartment approvals have begun to rise again to 108.8k.

The size of the Australian mortgage market stood at $1.77 trillion as at 30 June 2018. This is slightly below (96%) Australia's GDP as at 30 June, 27% of Australia's housing assets and 35% of the household sector's total stock of financial assets (including bank deposits). The size of the mortgage market is also 140% of household disposable income and 90% of the stock market's market capitalisation as at 30 June 2018. Banks have a 93% market share of the mortgage market, with the four largest banks having a 76% market share and the next three regional banks a 6% market share. Non-bank authorised-deposit taking institutions (ADIs - building societies and credit unions) and non-ADIs (mortgage originators not regulated by the Australian Prudential Regulation Authority - APRA) have a combined 7% market share of the mortgage market.

Largely as result of macroprudential supervision, the year-on-year (YoY) rate of housing credit growth slowed from a recent peak of 7.5% in the beginning of the 3Q15 to 5.6% as at 30 June 2018. Over this period, bank housing credit growth slowed from 8.4% to 5.0% whilst non-bank housing credit growth has risen from -2.8% to 13.8% after peaking at 25.6% in December 2017. YoY owner-occupier credit growth accelerated from 6.0% in the 3Q15, peaked at 9.1% in the 3Q16 and has since moderated averaging 8.0% in 1H18. Investor housing credit growth peaked at 10.8% in the 2Q15, but has since slowed to a nominal 1.6% as at the end of 2Q18. Over this period and following the Australian Prudential Regulation Authority (APRA) announcing a 10% growth limit of investor housing lending in 2015 and then a 30% limit on new interest-only lending in March 2017, mortgage lenders have differentiated their interest rates for owner-occupier and investor loans. This has been an important driver behind the managed slowing in the growth of investor housing lending.

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As at 1Q15, ADI P&I loans were 57% of new quarterly lending flows and 61% of the outstanding stock of total ADI mortgage loans. At the same time, ADI IO loans were 44% of new quarterly lending flows and 39% of the outstanding stock of total ADI mortgage loans. As at the end of 1Q18, ADI P&I loans were 80% of new lending flows and 69% of the outstanding stock of total ADI mortgage loans, while IO loans were 20% of new lending flows and 31% of the outstanding stock of ADI loans.

In addition to macroprudential measures being placed on ADI lending to investors and IO loans, underwriting standards have been tightened for both ADI and non-ADI lenders following targeted mortgage lending reviews undertaken in 2014 and again in 2016. Some of these measures include borrowers being subject to greater income and living expense verification, internal limits being applied on the volume of IO lending at loan-to-value ratios (LVRs) above 80%, and borrower interest rate serviceability buffers being applied to the higher of the loan product rate of at least 2% or a minimum floor rate of 7%.

Following the Basel Committee on Banking Supervision finalising its Basel III bank capital framework in December 2017, APRA issued a discussion paper in February 2018 proposing a number of revisions to its capital framework for ADIs (subject to both the internal ratings-based and standardised approaches for calculating credit risk). Whilst this discussion paper is indicative only, APRA has said its proposed new capital framework (to become effective from January 2021) will result in an increase in risk weightings for residential mortgage exposures. Increase risk weight requirements will come from higher risk weights for investment, IO loans, high LVR loans and other non-standard residential mortgages.

In March 2018, changes were made to the Banking Act 1959 providing APRA with new powers to make rules relating to non-ADI lenders. The justification for providing APRA with new powers over non-ADI lenders was to close a regulatory gap where APRA did not have an ability to manage financial system risks that might arise from non-ADIs. These new powers are considered to be “reserve powers” and are only to be used in exceptional circumstances, that is, when the activities of the non-ADIs are materially contributing to risks of instability of the Australian financial system. Non-ADIs captured under these new powers will have either monthly or annual reporting requirements (depending on their size) to APRA with effect from March 2019. In addition, non-ADIs which issue repo-eligible RMBS are also required to provide monthly reports of their securitisations to the RBA.

MORTGAGE MARKET FUNDING

For Australia’s four largest banks, mortgages account for approximately 47% of their domestic assets and 65% of their Australian loan portfolios. For the next three largest regional banks, mortgages account for 61% of their assets and 73% of their loan portfolios.

The Australian banking system is funded through a combination of domestic deposits (approximately 60%), short term debt (approximately 20%), long term debt (including covered bonds and securitisation – approximately 13%) and equity (approximately 7%).

Australia’s four largest Australian banks, three largest regional banks and a number of other banks have access to a broad range of wholesale capital market products, including senior unsecured, covered, RMBS and subordinated debt, not only AUD but also a number of other currencies as well.

There are currently 35 issuers of Australian collateral-back RMBS. Public market RMBS issuance in 2017 was an AUD equivalent of $36.7bn, which was a post-GFC record and up 92% from 2016 and up 53% from 2015. In 1H18 public market RMBS issuance was $12.9bn, which is down $1.9bn from 1H17. 1H18 issuance from the ADI sector was $6.2bn, down $4.6bn from the 1H17’s $10.8bn. 1H18 issuance from the non-ADI sector was $6.8bn, up $2.7bn from the 1H17’s $4.1bn. It is the first time in the post-GFC environment, issuance from the non-ADI sector has been larger than the ADI sector.

AUSTRALIAN FACT TABLES

Economic

	2016	2017	1H18
Real GDP Growth (%)*	2.5%	2.3%	3.0%
Unemployment Rate (end of Period)	5.8%	5.5%	5.4%
Underlying Inflation*	1.5%	1.9%	1.9%
Household Dwellings (AUD)	$6.2 trln	$6.6 trln	$6.6 trln
Outstanding Residential Loans (AUD)	$1.6 trln	$1.7 trln	$1.8 trln
YoY Residential Lending Growth (%)	6.3%	6.3%	5.6%
Housing Debt to Disposable Income Ratio	133.4%	139.1%	140.1%
Average Mortgage Interest Rates			
Owner-Occupier Borrower	4.50%	4.50%	4.50%
Investor Borrower	4.80%	5.10%	5.10%
RBA Cash Rate (end of period)	1.50%	1.50%	1.50%
National Hedonic Dwelling Price Growth (YoY%)	5.8%	4.2%	-0.8%

* Yearly average. 1H18 GDP Growth is the average between the 2Q17 and 2Q18.
Source: Australian Bureau of Statistics, Reserve Bank of Australia, CoreLogic, National Australia Bank

Mortgage Market Funding

<table>
<tr><td>Entities which can issue Residential Mortgage Loans</td><td colspan="4">Entities (Banks and ADIs and non-ADIs) holding an Australian credit licence.
The Australian Securities and Investments Commission assess licence applications and is the regulator responsible for consumer credit. Credit licensees' must comply with responsible lending requirements, the National Consumer Credit Protection Act 2009 and the National Credit Code amongst other things and annual compliance certificates confirming compliance are a licensee requirement.</td></tr>
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Source: Australian Prudential Regulation Authority, National Australia Bank

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