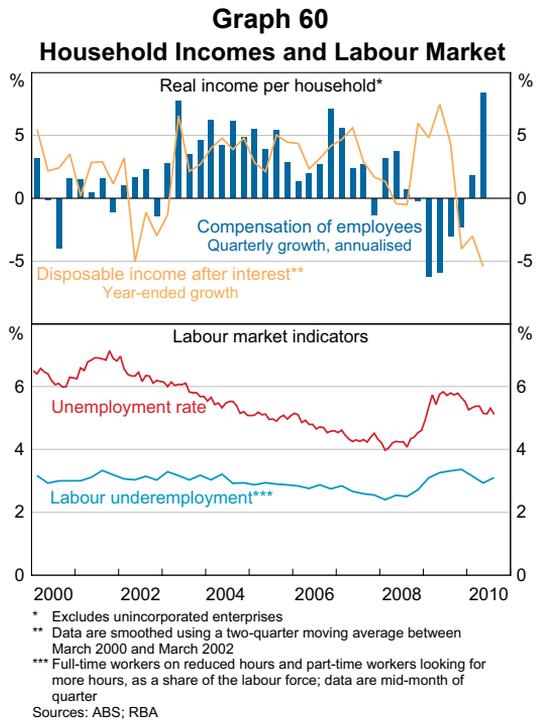


# Household and Business Balance Sheets

The aggregate financial position of the household and business sectors remains sound, with economic growth boosting employee incomes and profits as support from policy measures wanes. These developments should in turn limit further increases in indicators of financial stress, which remain fairly low compared with previous downturns and international experience. Households and businesses continue to exhibit a somewhat more cautious approach to debt than prior to the crisis, and there are signs that the housing market has cooled. For businesses, debt funding availability for most sectors appears to be improving a little after a marked tightening in supply in 2008 and 2009.

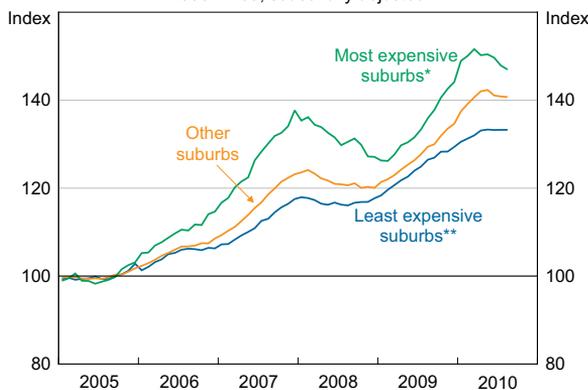
## Household Sector

Over the past year the financial position of households has been subjected to divergent forces. The weaker labour market associated with the economic slowdown over 2008 and 2009 weighed on employment income, though with fiscal and monetary policy measures more than offsetting this weakness, real disposable income per household grew at an annual rate of around 5 per cent over much of 2009 (Graph 60). More recently, employment income has bounced back strongly, but the unwinding of stimulatory policy measures has subtracted from disposable income, which on a real per household basis declined around



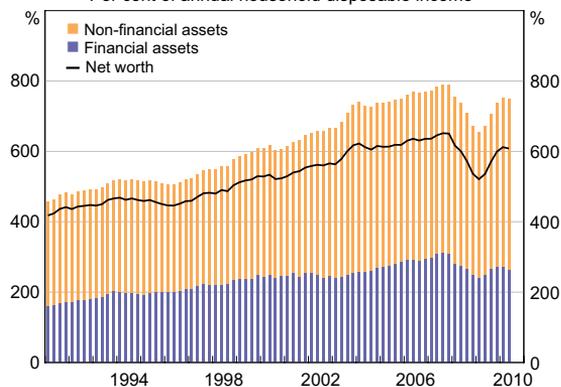
5 per cent in the year to June 2010. During the first two quarters of the year income from employment increased at an average annualised rate of 5 per cent, and strength in this income source looks likely to continue: labour market conditions have continued to firm and forward-looking indicators – such as job advertisements and hiring intentions – are positive.

**Graph 61**  
**Capital City Dwelling Prices**  
 2005 = 100, seasonally adjusted



\* Most expensive 20 per cent of suburbs  
 \*\* Least expensive 20 per cent of suburbs  
 Sources: RBA; RP Data-Rismark

**Graph 62**  
**Household Assets and Net Worth**  
 Per cent of annual household disposable income\*



\* Before the deduction of interest payments; includes unincorporated enterprises  
 Sources: ABS; RBA

**Graph 63**  
**Housing Loan Approvals\***  
 Per cent of housing credit outstanding



\* Excludes owner-occupier refinancing and investor approvals for new construction and by 'others'  
 Sources: ABS; RBA

On the assets side of household balance sheets, growth in dwelling prices has tapered off in recent months, particularly in more expensive suburbs; even so, median dwelling prices were still around 4 per cent higher in August than at the start of the year (Graph 61). The household sector's asset position has also been bolstered by ongoing accumulation of financial assets, though recent declines in share prices have been a drag on households' wealth; since the end of 2009 the ASX 200 index has fallen by around 4 per cent, and remains around 32 per cent below its late 2007 peak. In June, household net worth was around six times annual disposable income, around the same as at the start of the year, and a substantial recovery from the trough in March 2009 (Graph 62).

The cooler housing market in recent months has been associated with an easing in household borrowing. Among owner-occupiers, loan approvals for first-home buyers have slowed to levels similar to those prevailing for much of the past decade, as temporary additional government subsidies expired (Graph 63). Demand by other owner-occupiers has also slowed since the start of the year, in response to declining affordability stemming from increased dwelling prices and interest rates, while investor activity has been fairly steady. Overall, the annualised pace of housing debt growth was 7 per cent over the six months to July 2010, down from 9 per cent in the six months prior, and well below the average annual increase of 14 per cent in the ten years to July 2009.

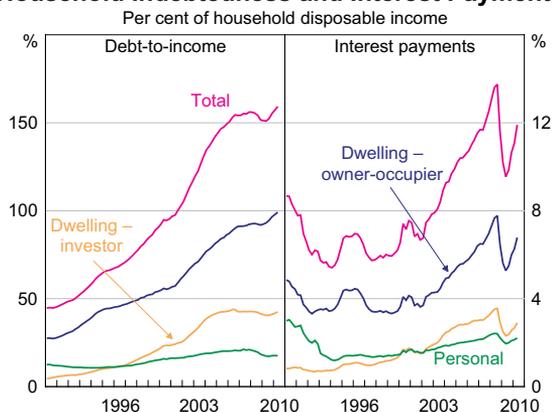
Although the pace of debt accumulation has moderated over recent years, aggregate household indebtedness and gearing remain at historically high levels, and the household sector's interest servicing ratio is also returning to higher levels (Graph 64). Together, these developments mean that the household sector remains sensitive to possible future negative shocks to incomes, interest rates and housing prices. Dwelling price-to-income ratios rose significantly between the 1980s and the early 2000s, likely explained by the structural changes of disinflation and deregulation that occurred over

that time. Since then, during a period of strong population growth in Australia, price rises nationally and in capital cities have on average been broadly in line with growth in incomes. Measures of rental yields have also been steady for much of the country over the past decade. Nonetheless, many markets have experienced very strong capital growth in recent years, particularly Melbourne, and the recent slowing in price appreciation is a welcome development for the resilience of household finances.

Despite being more indebted, households' debt-servicing ability is currently strong, supported by ongoing income growth. Data from the Household, Income and Labour Dynamics in Australia (HILDA) survey imply that almost two thirds of households with owner-occupier debt faced repayments smaller than 30 per cent of their disposable income in 2008 (when interest rates were higher than at present) (Graph 65). The proportion that had debt-servicing ratios greater than 30 per cent was higher than earlier in the decade, but this appears to mainly reflect increases in interest rates rather than increased indebtedness. HILDA survey data also suggest a well-established pattern of around half of all indebted owner-occupier households being ahead of their scheduled repayments, with most others tracking on schedule.

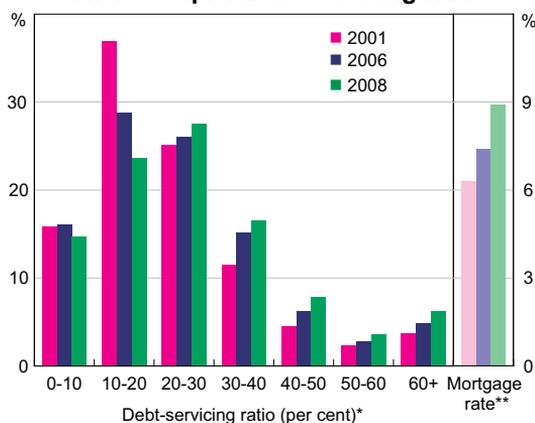
Contributing to the improved financial position of the household sector in recent years has been an apparently more cautious approach to finances, though some indicators suggest that more recently this conservatism has been waning. Survey data from the Melbourne Institute show an increase in the proportion of households that are saving, with 49 per cent of households reportedly saving 'a little' or 'a lot' in September 2010, up from 45 per cent in September 2008. Over 2009, households had been saving a greater proportion of their incomes than had been the case for much of the past decade, although the saving rate has fallen more recently as stimulus payments ended (Graph 66). Households' more conservative approach to allocating savings seen over the past couple of years remains evident:

**Graph 64**  
**Household Indebtedness and Interest Payments\***



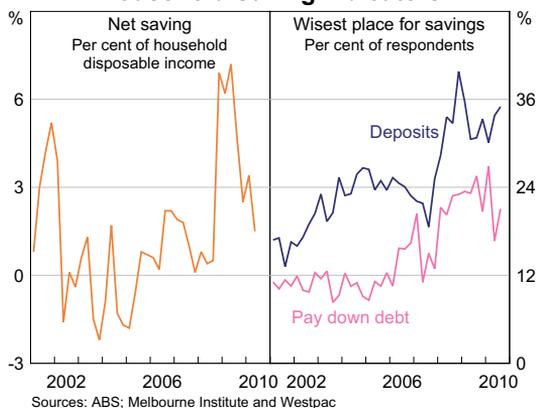
\* Excludes unincorporated enterprises; income is after tax and before the deduction of interest payments  
Sources: ABS; RBA

**Graph 65**  
**Owner-occupier Debt-servicing Ratios**



\* Principal and interest repayments on owner-occupier mortgage debt only; per cent of indebted owner-occupier households  
\*\* Average interest rate on variable housing loans; as at September  
Sources: HILDA Release 8.0; RBA

**Graph 66**  
**Household Saving Indicators**



Sources: ABS; Melbourne Institute and Westpac

deposits remain a preferred place for savings (partly reflecting the attractive rates available at present), and paying down debt also remains more popular than usual.

Signs of financial stress in the household sector remain fairly limited, with the improvement in the labour market further underpinning households' debt-servicing capacity despite higher interest rates. Loan arrears rates have drifted up since the end of 2009, but remain fairly low relative to a number of other countries. The rate of non-performing housing

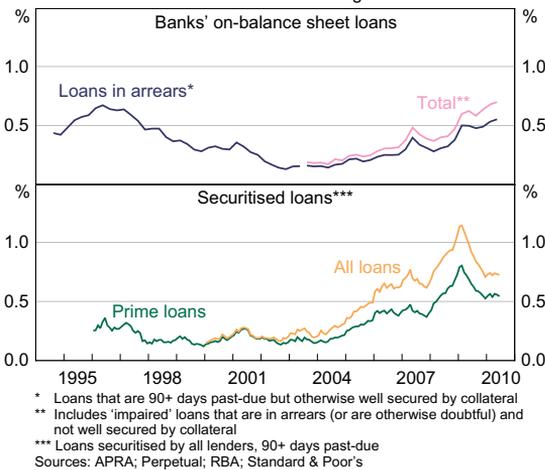
loans on banks' balance sheets was 0.7 per cent at the end of June, marginally higher than the start of the year; the bulk of these loans remain well secured (Graph 67). The arrears rate for securitised loans – which has been affected by reduced securitisation of new loans – is currently also around 0.7 per cent, little changed since the start of the year.

Whereas a few years ago the incidence of loan delinquency was highly concentrated in western Sydney, the limited available data suggest that a greater geographical dispersal of arrears has developed over the past 12 to 18 months, without any particular concentration of problem loans emerging. A small number of regions in western Sydney remain represented among the most affected areas, though at lower arrears rates than was previously the case, while other more affected regions include areas in coastal parts of New South Wales and Queensland, and south of Perth.

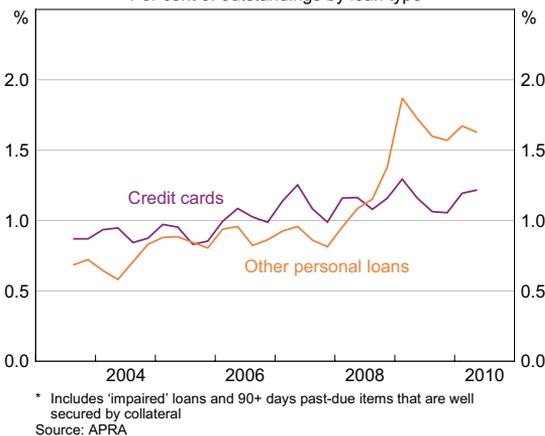
Other indicators of financial stress suggest that household financial circumstances are, in aggregate, relatively strong. The rate of non-performing credit card loans has been little changed in net terms for the past three years, at around 1.2 per cent, while the non-performance rate on other types of personal loans has declined by around 0.1 of a percentage point over the past year, and currently stands at around 1.6 per cent (Graph 68). The rate of bankruptcies and other personal administrations has declined a little over the first part of 2010, after peaking in late 2009. Across most states, the rates of mortgagees' applications for property possession remain well below those seen in recent years, although there has been some pick-up in recent monthly figures in a number of states (Graph 69).

While the outlook for loan delinquencies is largely dependent on developments in the economic environment, the underlying risk profile of the household sector ought to have been helped by the tighter lending standards applied over the past few years. Across new loans approved by banks, the proportion of high loan-to-valuation ratio (LVR) mortgages continued to decline into the

**Graph 67**  
**Non-performing Housing Loans**  
Per cent of outstandings



**Graph 68**  
**Banks' Non-performing Personal Loans\***  
Per cent of outstandings by loan type



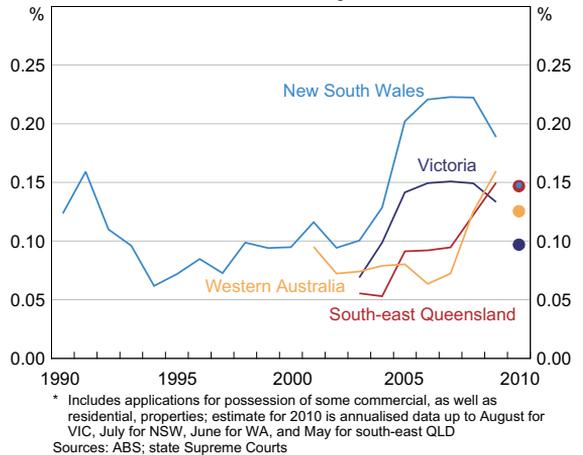
June quarter, and the proportion of interest-only loans remained fairly stable (Graph 70). The peak in approvals for high-LVR loans was associated with the surge of first-home buyers over the first part of 2009, at a time when housing loan interest rates were around historically low levels and government grants had been temporarily raised. The entry of such a large group of new borrowers with little housing equity was an unusual development, but although housing interest rates have increased by around 150 basis points over the past year, liaison and available data suggest little evidence to date of worse loan performance among this group than earlier cohorts of first-home buyers displayed.

The availability of mortgages underwritten to laxer lending standards – such as low-documentation and non-conforming loans – has fallen with reduced competition in the mortgage market and restricted funding for securitisations. The amount of outstanding low-documentation loans has been fairly constant over the past couple of years, and as a share of outstanding housing loans has declined from around 8 per cent in March 2008 to around 7 per cent in June 2010. Securitised non-conforming loans – the closest Australian equivalent to US sub-prime loans, and which were never offered by authorised deposit-taking institutions – have declined as a share of loans outstanding from around 0.8 per cent to around 0.3 per cent over the same period. If this improvement in the composition of the outstanding loan pool is sustained, on the back of higher-quality new lending, this should further boost the household sector’s resilience in the face of future downturns. On the other hand, some lenders have begun to raise their maximum LVRs again, so any further improvement in the average quality of new loans could be fairly modest.

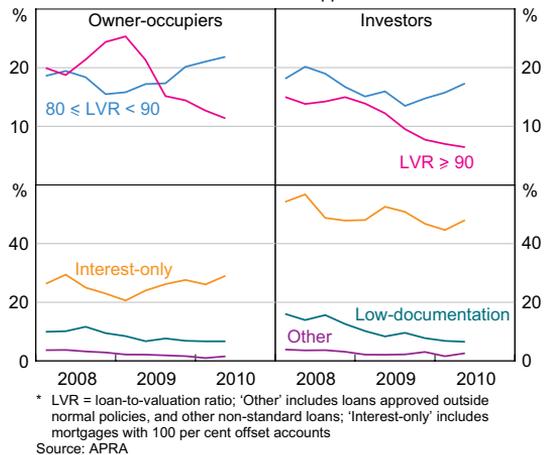
## Business Sector

Aggregate earnings of the business sector have recovered strongly from the downturn seen in 2008 and 2009. National accounts measures of profits

**Graph 69**  
**Applications for Property Possession\***  
Per cent of dwelling stock



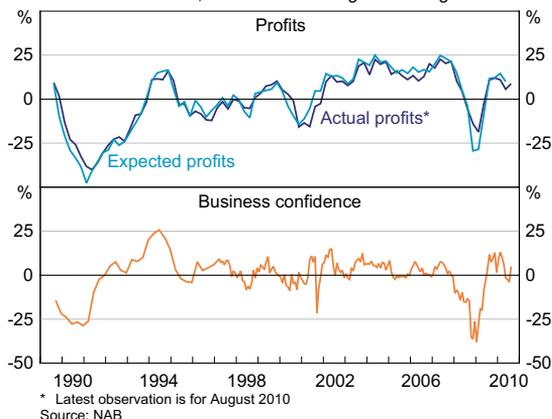
**Graph 70**  
**Banks' Housing Loan Characteristics\***  
Share of new loan approvals



for the sector as a whole were 18 per cent higher in the June quarter 2010 than in the same period a year earlier. Survey measures of expected profits are generally at or above their long-run averages, even though overall business confidence has declined a little since the start of 2010 (Graph 71).

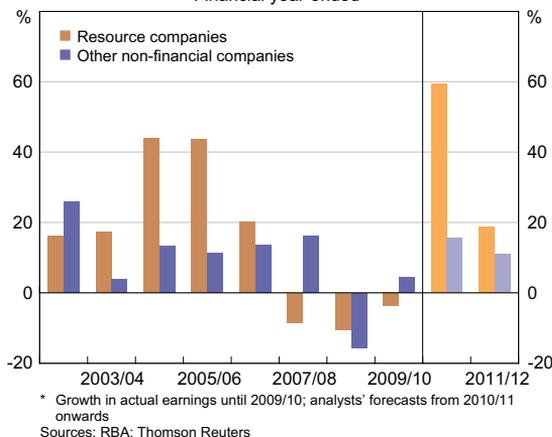
There continue to be substantial divergences in earnings across industries. The outlook for mining companies' profits is stronger, driven by higher commodity prices; share market analysts are

**Graph 71**  
**Business Conditions Surveys**  
 Net balance, deviation from long-run average



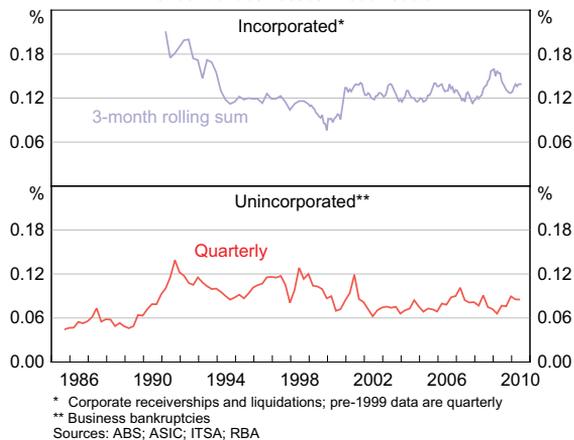
\* Latest observation is for August 2010  
 Source: NAB

**Graph 72**  
**ASX 200 Earnings Growth\***  
 Financial year-ended



\* Growth in actual earnings until 2009/10; analysts' forecasts from 2010/11 onwards  
 Sources: RBA; Thomson Reuters

**Graph 73**  
**Business Failures**  
 Per cent of businesses in each sector



\* Corporate receiverships and liquidations; pre-1999 data are quarterly  
 \*\* Business bankruptcies  
 Sources: ABS; ASIC; ITSA; RBA

therefore forecasting listed resource companies' earnings to increase by around 60 per cent over the 2010/11 financial year (Graph 72). Profit growth for firms in other non-financial sectors has been slower but steadier over recent years: after some weakness in late 2008 and early 2009, analysts' earnings growth expectations are around 15 per cent for the coming financial year for large ASX-listed companies in these sectors. Among unlisted firms, partial credit bureau data indicate that the deterioration in profit performance over 2008 and 2009 was particularly marked in some consumer-dependent industries such as retail trade and services, as well as the real estate sector.

Failure rates for both incorporated and unincorporated businesses have been fairly stable over 2010, and are a little higher than a year ago (Graph 73). Business failure rates remain around their long-term averages, and are still substantially below the levels seen in the early 1990s.

Strong profitability both prior to, and during, the downturn has been an important factor in the business sector's resilience. A steady source of internal funding has helped firms to operate in a more difficult environment for debt finance, with internal funds having averaged around 10 per cent of GDP for the past year or so (Graph 74). Earlier strong profits had, in aggregate, also limited the build-up of a reliance on external funding sources – particularly debt – which further mitigated the impact of reduced debt availability during the recent downturn.

The balance sheet adjustment necessitated by the crisis was assisted by large equity raisings, equivalent to around 6 per cent of GDP in the six months to December 2009. The availability of substantial amounts of equity capital during this period likely reflects a number of factors, including the relative strength of the Australian economy through the financial crisis, the large institutional presence in the local equity market, and the strong share market rally over much of 2009. More recently, net equity

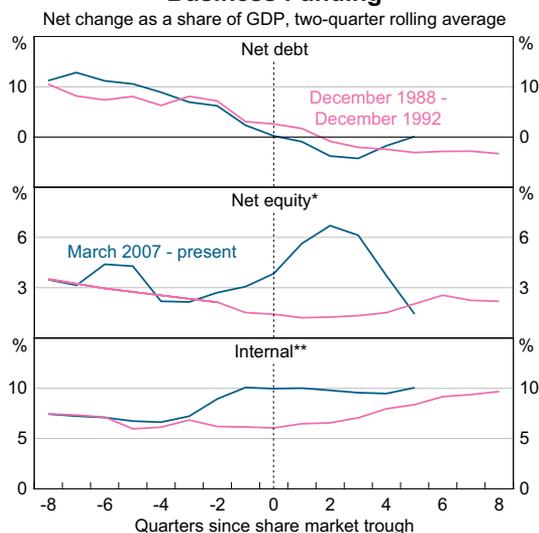
raisings have been more subdued, with raisings of only \$12 billion since the start of 2010 compared with \$55 billion over the same period in 2009 when many companies were actively deleveraging.

Debt funding remains subdued, with wholesale issuance still quite modest and business credit growth remaining weak. Non-financial companies have issued around \$15 billion of corporate bonds since the start of 2010, compared with around \$23 billion over the same period in 2009. Outstanding business credit has been fairly stable in net terms over recent months, compared with a contraction of around 5 per cent in the six months to December 2009. While weak demand for credit has partly explained this very low pace of growth in recent years, it also reflects tighter financing conditions as banks' risk appetites decreased. However, as discussed in 'The Australian Financial System' chapter, there are indications that credit availability is improving, and industry liaison suggests that competition among lenders for some market segments is beginning to pick up.

Looking forward, the funding position is likely to vary across industries. Resource companies look relatively better placed to source funds from outside the banking system: the strong profit outlook for this sector is likely to be supportive for potential equity raisings, as well as provide a steady stream of internally generated funds with which they can fund investment (Graph 75). This is further supported by the practice of firms in this sector of paying out a relatively small share of earnings as dividends – around 30 per cent over the past five years. In contrast, non-resource firms paid out an average of around 90 per cent of earnings as dividends over this period, and instead were relying more on external sources to fund balance sheet expansion.

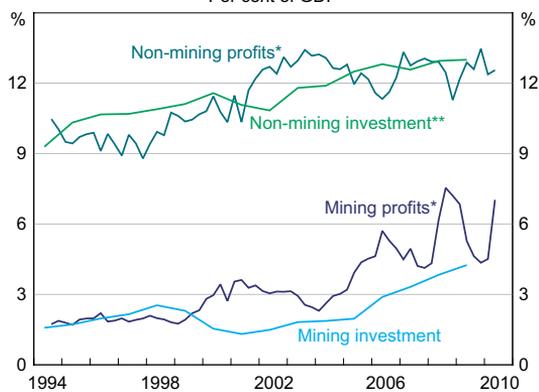
Average interest rates paid on business loans have risen further over the course of 2010, and are now around their longer-run average levels: rates on large business loans are 160 basis points above the 2009 low, while rates on small business loans are

**Graph 74**  
**Business Funding**



\* Annual average prior to June 1990  
\*\* Excludes unincorporated enterprises, includes public non-financial corporations  
Sources: ABS; ASX; Austraclear; RBA

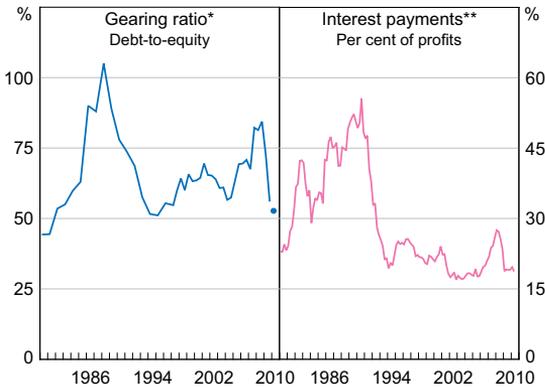
**Graph 75**  
**Business Profits and Investment**



\* Gross operating profits; inventory-valuation adjusted; excludes unincorporates  
\*\* Excluding livestock; adjusted for second-hand asset transfers between private and other sectors  
Sources: ABS; RBA

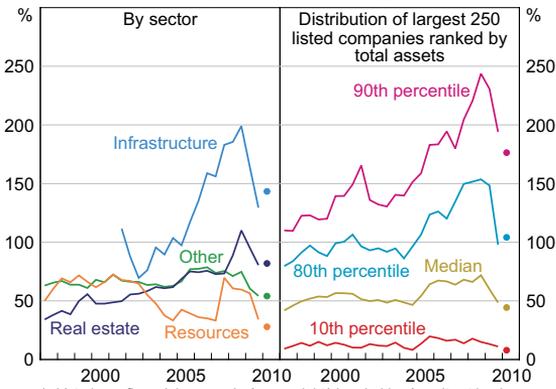
105 basis points higher. In aggregate, the business sector appears well placed to handle these increases, in part because of the deleveraging that has occurred since 2008. Based on the financial accounts of listed companies that have reported in recent months, the aggregate debt-to-equity ratio of these firms has continued to decline over

**Graph 76**  
**Corporate Sector Finances**



\* Listed non-financial companies' gross debt/shareholders' equity at book value; excludes foreign companies, includes real estate companies; latest observation includes only companies that have reported to June 2010  
 \*\* ABS data prior to 1994, RBA data thereafter; profits are measured as non-financial corporations' gross operating surplus  
 Sources: ABS; Morningstar; RBA; Statex

**Graph 77**  
**Listed Companies' Gearing Ratios\***



\* Listed non-financial companies' gross debt/shareholders' equity at book value; excludes foreign companies, includes real estate companies; latest observation includes only companies that have reported to June 2010  
 Sources: Morningstar; RBA

the past year, and is currently around 55 per cent compared with around 85 per cent in December 2008 (Graph 76).

Gearing ratios of highly leveraged companies continued to fall in the June half 2010 (Graph 77). Whereas the company at the 90th percentile of gearing had a debt-to-equity ratio close to 250 per cent as at December 2008, this had fallen by around 70 percentage points through to June 2010. Smaller declines were seen across more moderately geared companies, and the median gearing ratio is now around its lowest level for more than a decade. By industry, aggregate gearing remains highest among infrastructure firms; the first half of 2010 has seen a slight increase in gearing in this sector, reflecting continued write-downs by a small number of firms. For the bulk of the listed sector, though, aggregate gearing ratios have either stabilised or declined a little.

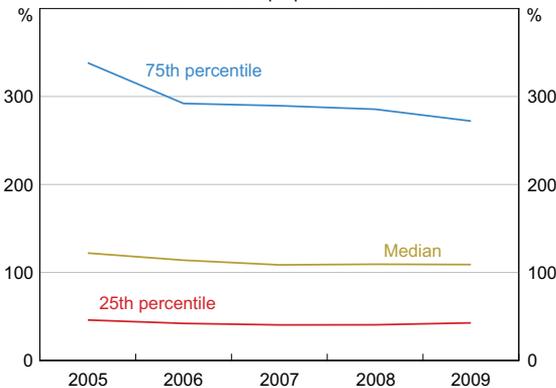
Partial credit bureau data for unlisted companies (covering around 5 000 firms, generally smaller than listed companies) indicate that deleveraging in this sector has been less extensive than for its listed counterpart. The median ratio of total liabilities (a broader measure than debt) to net worth has moved a little lower over the past five years, and was around 110 per cent in the 2009 financial year; again, deleveraging has been more marked among highly geared firms (Graph 78). The share of unlisted firms reducing their gearing ratio has been consistently around 55 per cent over this time (Graph 79).

Although more of these deleveraging firms were simultaneously contracting their balance sheets in 2009 than 2008, the general pattern has been that most unlisted firms were still expanding their balance sheets over this period.

The non-performing domestic business loan ratio has continued to increase over the year to June. Across all types of non-financial businesses, this rose to 4.4 per cent in June, though the pace of increase appears to have slowed. The upward trend

**Graph 78**

**Distribution of Unlisted Company Gearing Ratios\***  
Total liabilities as a proportion of net worth



\* Excludes firms with reported negative gearing ratios  
 Sources: Dun & Bradstreet (Australia); RBA

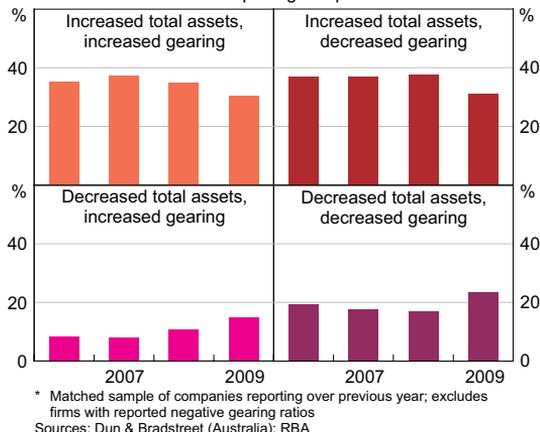
has been mostly driven by loans to the incorporated sector, where the rate of non-performance was 4.7 per cent, up from 3.8 per cent a year earlier (Graph 80). Within this, around half of the increase in problem loans appears to be due to banks' exposure to commercial property. The rate of non-performing loans to smaller unincorporated businesses has improved over the past year to be 2.6 per cent in the June quarter.

## Commercial Property

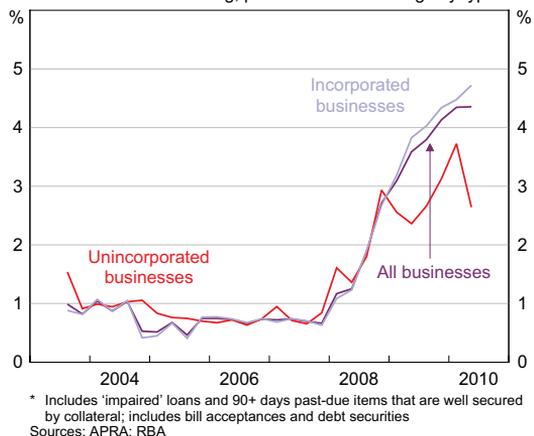
Conditions in the commercial property sector have broadly stabilised over 2010, with the declines in prices and rents seen in most sectors since 2008 appearing to have run their course (Graph 81). The office sector had been particularly affected during the downturn, with both prices and rents falling around 25 per cent (in nominal terms) from their peaks, but these have been steadying over recent quarters as the economy has strengthened. The improving economic outlook has also been associated with a steadying in approvals for commercial property developments, after these fell by around 40 per cent from their 2008 high (Graph 82). Actual work done on commercial property development is still weak, however, partly because financing conditions remain difficult.

Banks' Australian commercial property exposures declined further over the first half of 2010, to be 11 per cent lower than the March 2009 peak. Over half of this fall was attributable to declines in lending by the major banks and another third was due to the foreign banks; though relative to the size of their portfolios, the reduction in lending was larger for foreign banks. This mainly reflected the conscious efforts of a number of US and European institutions to wind down their Australian exposures, given challenges in their home markets and elevated impairments on their commercial property exposures. More recently, though, some foreign banks appear to be recovering their appetite for the commercial property sector, with a significant

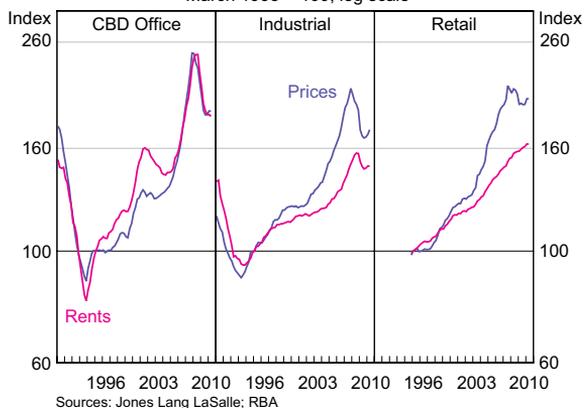
**Graph 79**  
**Unlisted Companies' Balance Sheets**  
Share of reporting companies\*



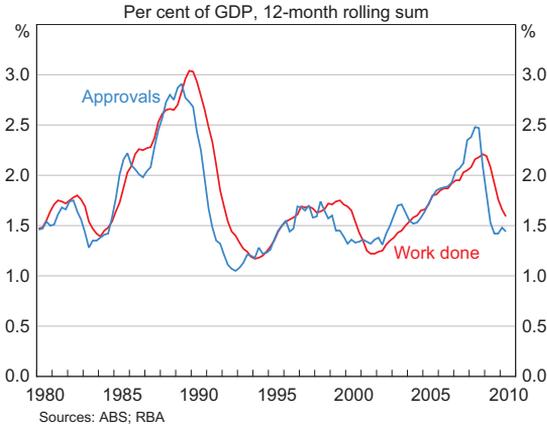
**Graph 80**  
**Non-performing Business Assets\***  
Banks' domestic lending, per cent of outstandings by type



**Graph 81**  
**Commercial Property**  
March 1995 = 100, log scale



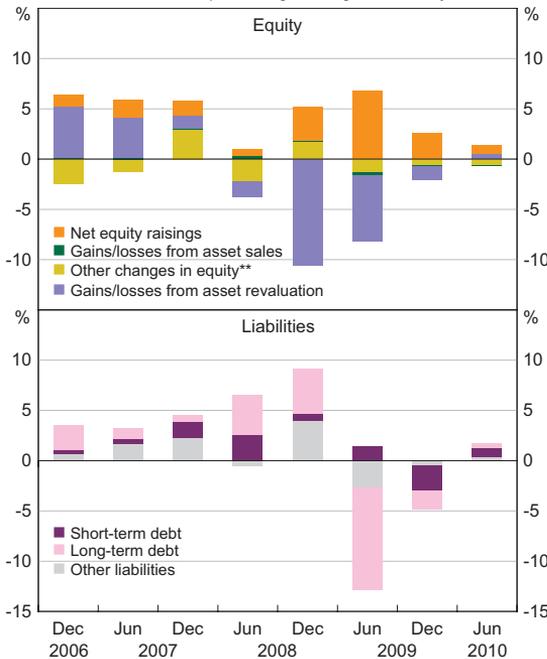
**Graph 82**  
**Commercial Property Construction**



number increasing exposure limits (though not yet actual exposures) over the June quarter, in contrast to the broad-based reductions seen in the previous four quarters.

Recent developments in the balance sheets of listed real estate investment trusts (REITs) have reflected the stabilisation in debt funding availability and property prices. In the most recent half year, listed REITs, in aggregate, have reported a slight upward revaluation in assets, in contrast to the previous four half years of (at times substantial) downward asset revaluations (Graph 83). These declines, combined with an inability to refinance maturing debt, had prompted substantial equity raisings by REITs over late 2008 and 2009, of around \$18 billion. Equity raisings have slowed in more recent periods, associated with a slowing in net repayments of debt, and the June half saw the first increase in net borrowings since December 2008. ↘

**Graph 83**  
**REIT Balance Sheet Adjustments**



\* Constituents as at half year end; change relative to total assets at start of each period

\*\* Includes retained earnings

Sources: ASX; Morningstar; RBA; company reports