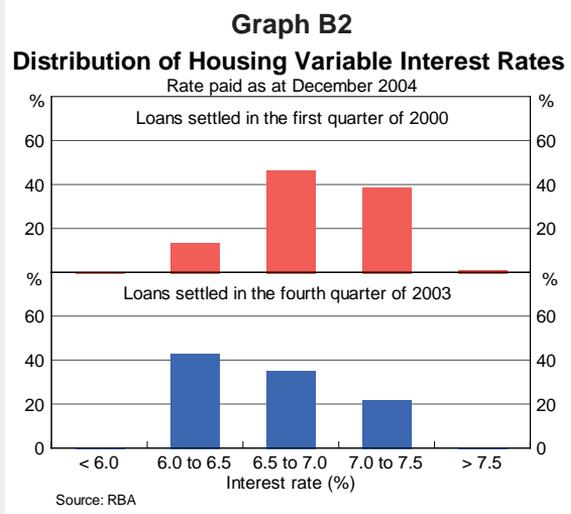
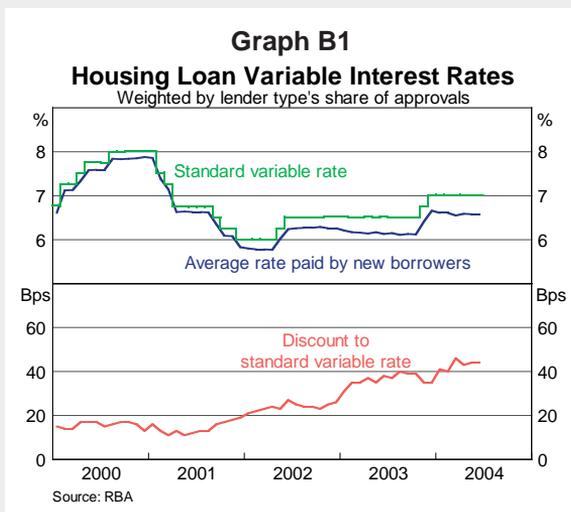


## Box B: Variable Interest Rates on Housing Loans

Competition in the housing loan market has led to a sharp increase in the discounting of mortgage interest rates. Whereas during the 1990s most housing loan borrowers were paying the standard variable interest rate, it now appears that about 80 per cent of borrowers taking out loans recently paid less than this rate; the weighted-average rate paid by new borrowers is now almost 50 basis points below the standard indicator rate quoted by lenders (Graph B1).<sup>1</sup> Through to mid 2001, the weighted-average variable rate paid by new borrowers was only marginally below the standard variable rate. This slight margin was probably attributable to some borrowers taking out basic variable-rate loans; these types of loans charge interest at a discount to standard variable rates, but typically have less flexible repayment options.

The shift in the distribution of mortgage rates paid clearly illustrates how lower rates have become more prevalent for new borrowers (Graph B2). In the absence of discounting, all variable-rate borrowers would be paying the same rate at every point in time regardless of when their loan was taken out. As at late 2004, however, even though



<sup>1</sup> Estimates in this Box are based on data on housing loans that have been securitised. Typically, a discount to the standard variable rate is constant for the life of a loan. As a result, information on loans extended and securitised before December 2004 and still outstanding in December 2004 can be used to infer the prevalence of discounting through time.

the standard variable rate was around 7 per cent, almost 80 per cent of loans taken out in the fourth quarter of 2003 were being charged interest rates of less than 7 per cent, and 40 per cent were being charged less than 6.5 per cent. In contrast, in the case of loans taken out in the first quarter of 2000, only about 15 per cent were paying rates below 6.5 per cent as at late 2004.

Partly explaining the greater prevalence of lower-rate loans is an increase in market share by non-bank lenders, which have generally offered lower interest rates on their product ranges. However, the bulk of the shift can be explained by borrowers moving to loans within the same institutional type that either have lower advertised rates, or for which they have been able to negotiate some discount. Banks have broadened their product range, often with lower-rate loans being offered. For example, they increasingly market product bundles, such as ‘professional packages’, which typically require customers to pay an annual fee of a few hundred dollars in return for more attractive interest rates and fee waivers on a range of bank products including home loans, credit cards and deposits. More generally, the growth of mortgage brokers, which market loans for a wide range of lenders, has made it easier for borrowers to compare products and has, therefore, increased competition.

While some of the measured increase in discounting over time has been offset by the aforementioned introduction of fees, it is clear that standard variable rates quoted by lenders increasingly overstate the typical cost of housing loans. It has also meant that the increase in interest rates for new borrowers in recent years has been significantly less than the increase in the cash rate resulting from monetary tightenings.