13 March 2023

Select Committee on Cost of Living
PO Box 6100
Parliament House
Canberra ACT 2600

By email: costofliving.sen@aph.gov.au

Dear Committee

Cost of Living inquiry

The Australian Banking Association (**ABA**) welcomes the opportunity to provide this submission to the Senate Select Committee on Cost of Living's (**Committee**) inquiry into the cost of living pressures facing Australians, ways to ease the cost of living and the Government's fiscal policy response (**Inquiry**).

Banks are aware of the challenges Australians face in the current inflationary environment, which have arisen from a combination of the COVID-19 pandemic, high household savings, pent-up demand, and global factors, including supply chain constraints and the war in Ukraine. To curb inflation, the Reserve Bank of Australia (**RBA**), alongside other central banks globally, have responded by tightening monetary policy. The increases in the target cash rate have had flow-on effects to the cost of banking and living for Australian consumers.

While most mortgages are variable rate (approximately 70 per cent), many customers took advantage of the low interest rate environment during the pandemic and fixed all or part of their mortgage. These fixed mortgages are due to switch to a variable rate over the next two years. However, data from banks contained in this submission indicates that there is no 'mortgage cliff', and these products will rollover progressively during this period. Banks will closely monitor this process.

The ABA notes most customers will manage the higher cost of living and their mortgage commitments by changing their spending patterns, applying their accumulated savings to their higher repayments in anticipation of higher borrowing rates, or refinancing their mortgage. However, we understand that others may struggle.

ABA members are taking steps to support customers facing financial difficulty today, and over the long term. Banks have experienced hardship teams in place to assist customers and are proactively reaching out to customers due to roll over from a fixed rate mortgage to a variable rate well ahead of the change to support them during the transition. Banks also have a broad range of options available to assist customers, such as debt consolidation to make repayments more manageable and restructuring the length of a loan to spread payments over a longer period, which are outlined in this submission. We strongly encourage customers facing difficulty to proactively reach out to their bank.

We also note the growth in competition among banks, which are offering more incentives to mortgage holders to switch providers. Against this competitive backdrop, customers are urged to be proactive and ensure they are getting the best deal for their banking services.

Further detail on these points is provided in the Appendix. If any further information is required in relation to this submission, please contact Director, Business Engagement and Policy at

Yours sincerely

About the ABA

The ABA advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

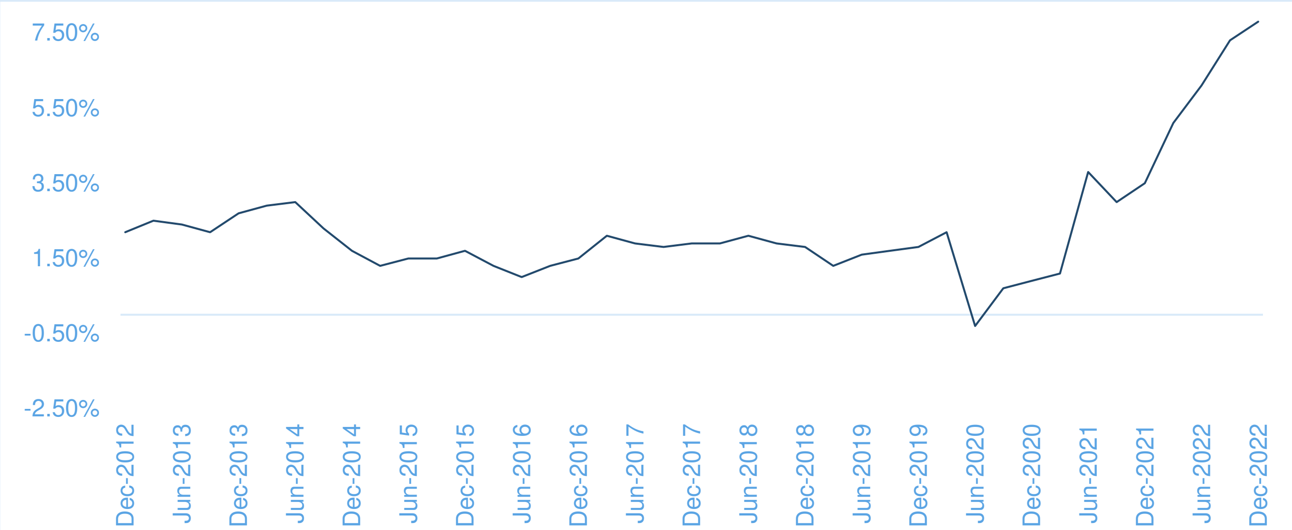
Appendix: Cost of living pressures facing Australians

The ABA welcomes the opportunity to provide a submission to the Inquiry. Our comments are limited to paragraph (a) of the Inquiry's terms of reference, being the cost of living pressures facing Australians.

COVID-19, inflation and housing have contributed to a higher cost of living

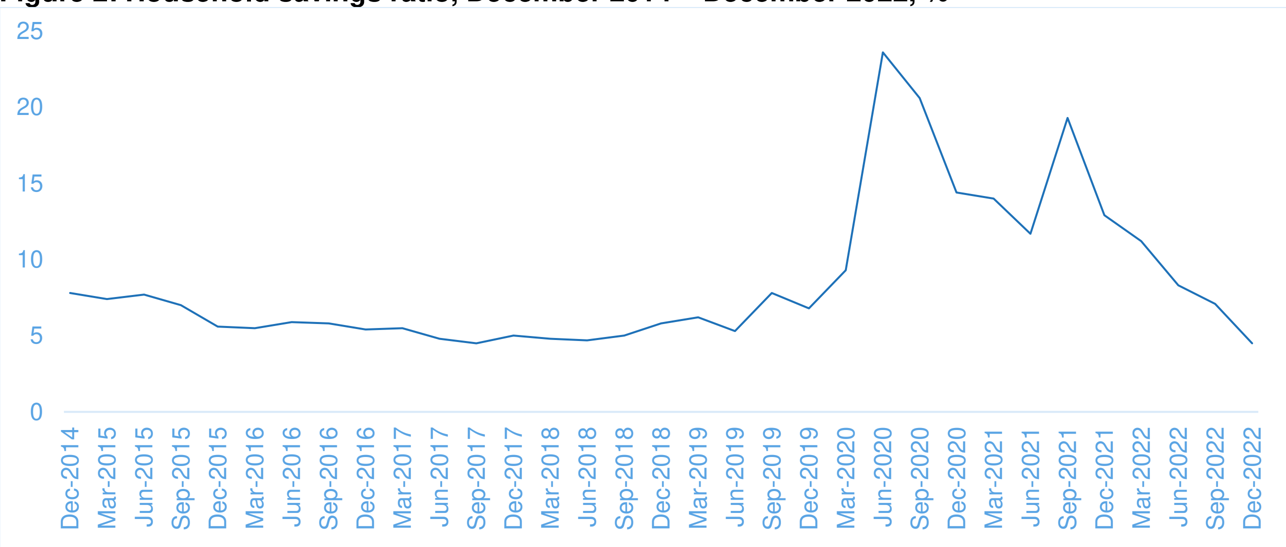
Australian households are facing some of the highest rates of inflation since September 1987. This inflationary environment is due to several factors, including the impacts of the pandemic and global supply-side shocks to the economy. This environment, coupled with households spending less during the COVID-19 pandemic, has created an increased household savings pool. Coupled with pent-up demand, households continue to spend even during a period of increasing rates (Figure 1) and higher prices of goods due to inflation, which is reflected by a falling household savings rate (Figure 2). It is of note that despite this, the stock of household savings continues to rise (Figure 3). This dynamic, against a backdrop of ongoing supply chain constraints, energy market disturbances and the war in Ukraine, have provided the conditions for the current inflationary environment.

Figure 1: CPI, Percentage change from corresponding quarter in previous year, December 2012 – December 2022, %



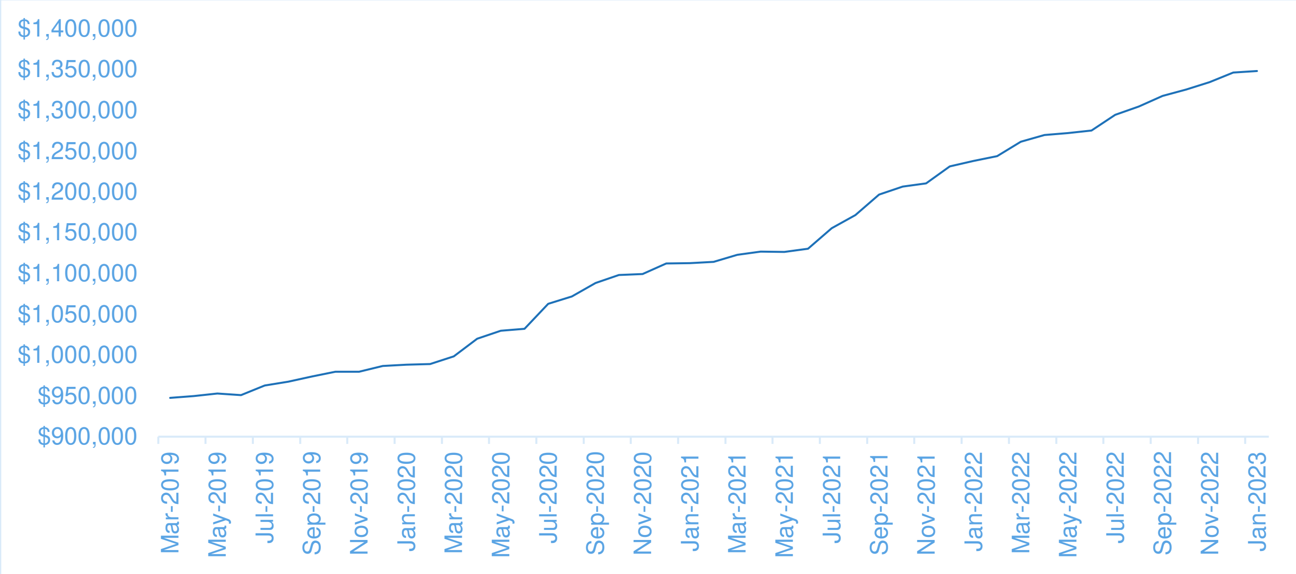
Source: ABS, Consumer Price Index, Tables 1 & 2; ABA

Figure 2: Household savings ratio, December 2014 – December 2022, %



Source: ABS, Australian National Accounts: National Income, Expenditure and Product; ABA

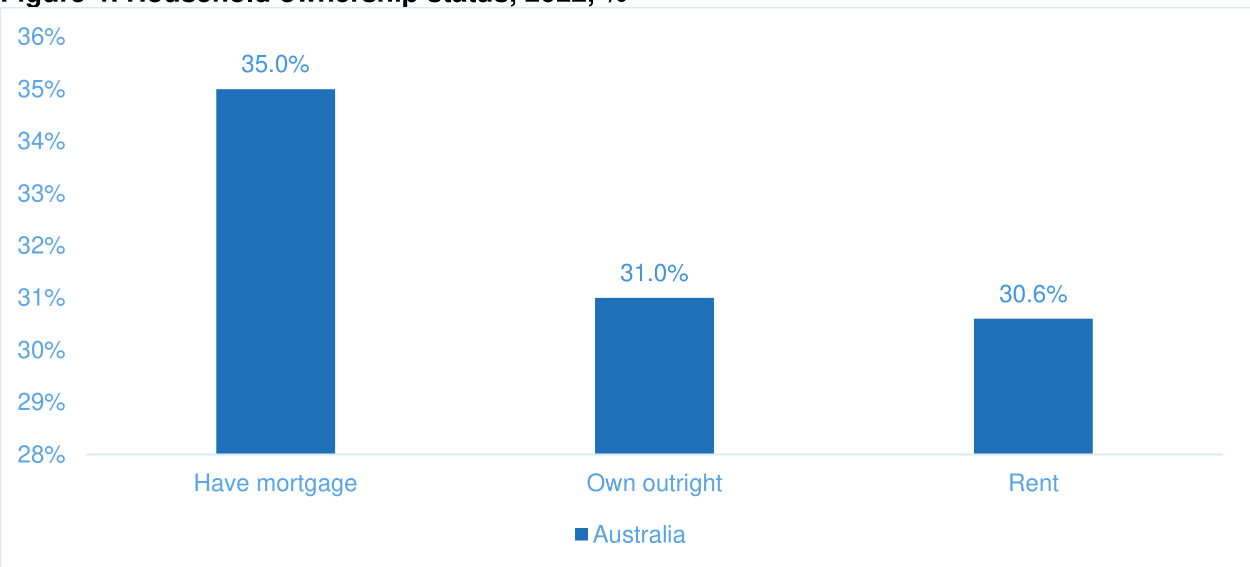
Figure 3: Deposits of Australian Households held by ADIs, March 2019 – January 2023, $m



Source: APRA, Monthly ADI Statistics; ABA

The current economic environment has also led to challenges within the housing market. In Australia, 31 per cent of the population lives in houses that are owned outright, while 35 per cent live in houses with a mortgage, and the near remainder in rentals, Figure 4.[1] This inflationary period, which has resulted in higher interest rates, has contributed to a decline in price of property, with aggregate data from five capital cities (Sydney, Melbourne, Perth, Brisbane and Adelaide) showing a drop of 9.3 per cent in the value of housing prices in the past year following a sustained period of high property prices over the pandemic.[2] While house prices have fallen, rental prices have risen. This rental market tightening, due to a lack of housing supply and return of immigration following COVID-19, has driven up demand and increased the cost to rent, further contributing to the cost of living impact on households.

Figure 4: Household ownership status, 2022, %



Source: ABS, Australian Census of Population and Housing; ABA

In response to inflationary pressures, central banks have increased the cash rate to curb consumer spending. In Australia, the RBA has lifted the cash rate 10 times, from 0.1 per cent to 3.6 per cent over the period of April 2022 to March 2023. Although now sitting at a 10-year high, the rate remains closer to the long-term average than what was observed through the COVID-19 pandemic period.[3] The combined effect of rising costs of essential goods, higher interest rates and property market impacts have made it

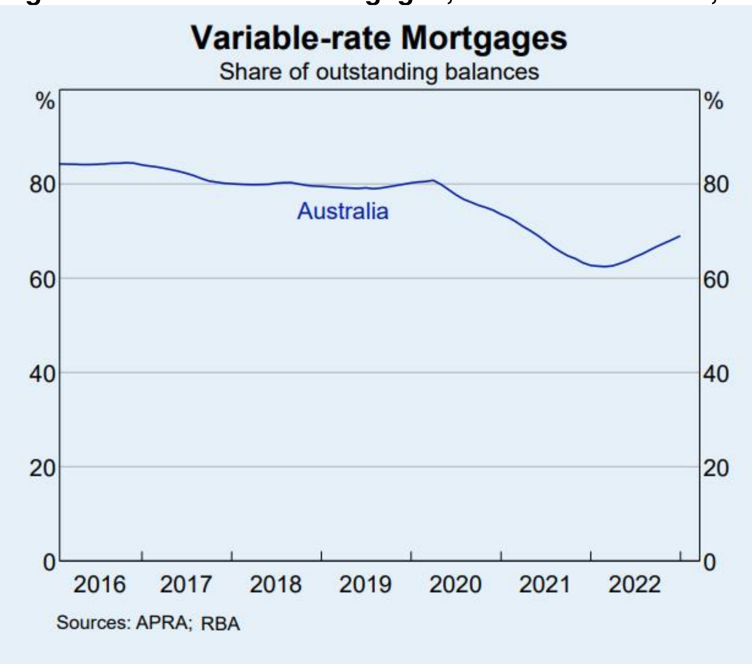
[1] ABS, Australian Census of Population and Housing, August 2022.
[2] CoreLogic, Daily Home Value Index, as at 7 March 2023.
[3] RBA, Cash Rate, March 2023.

difficult for some households to navigate this difficult period, with data showing that cost of living is a primary concern to households.

Data shows there is no 'mortgage cliff', with banks monitoring the progressive shift of loans from fixed to variable rate

During the COVID-19 pandemic, many mortgage holders took advantage of the low interest rates offered by banks and shifted from variable rate mortgages to fixing at least some portion of their mortgage. By mid-2021, fixed rate loans accounted for 46 per cent of new loan commitments, up from less than 15 per cent pre-COVID-19.[4] However, despite this shift, the majority of mortgages (around 80 per cent) have traditionally been on a variable rate (Figure 5), including during the period of COVID-19 when many Australians switched to fixed-rate loan where this figure dropped to 60 per cent. The number of variable rate mortgages since returned to around 70 per cent of total loans.[5]

Figure 5: Variable rate mortgages, Selected countries, 2016 - 2022



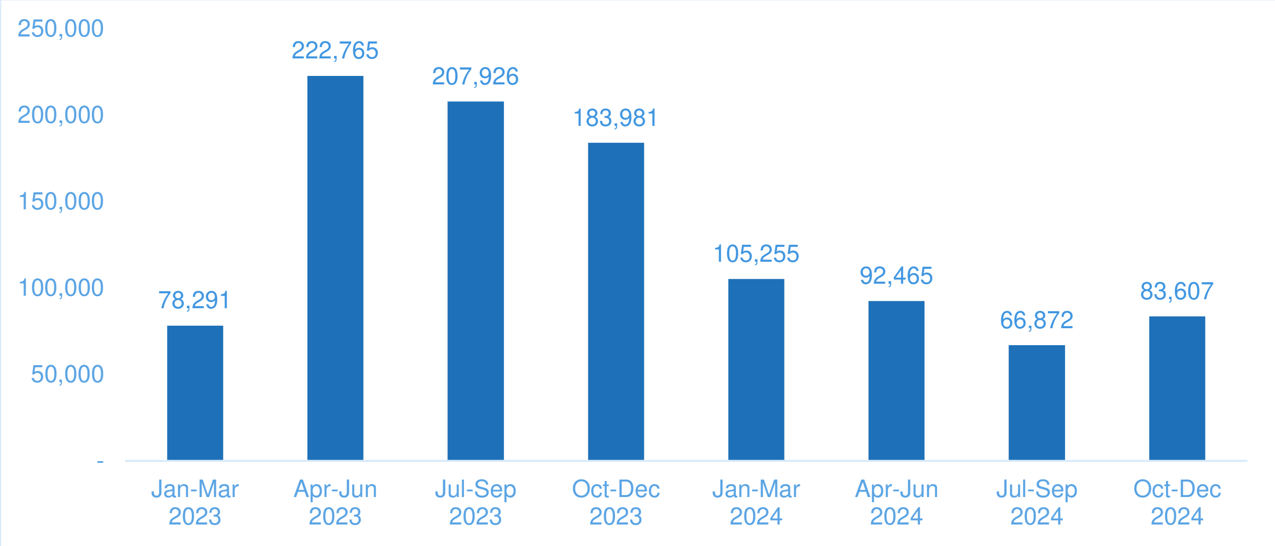
Source: APRA; RBA, Statement on Monetary Policy, February 2023

The average time period of fixed rate loans is between one and five years. Given the favourable rate environment during the pandemic, which led to an uptick in these types of loans across 2019 to 2021, many of the fixed rate mortgages entered into over COVID-19 are due to switch from a fixed to variable rate over the next 24 months. This change in mortgage rate structure, often referred to as a 'mortgage cliff', is more accurately described as a progressive rollover of mortgages from fixed to variable rates, due to occur over the next two years.

Data collected by the ABA from four of Australia's major banks at Figure 6 shows there are 692,963 mortgages due to end their fixed rate terms in 2023. This includes 78,291 (11%) in the first quarter of 2023, 222,765 (32%) in the second quarter, 207,296 in the third (30%) and 183,981 (26%) in the final quarter of the year[6], with further due to roll off in 2024. This means the transition will be steady. However, many of these customers who benefited from a low interest rate environment will soon experience an increase in their mortgage repayments; and some for the first time.

[4] RBA, Statement on Monetary Policy, February 2023.
[5] Ibid.
[6] 4 majors; ABA.

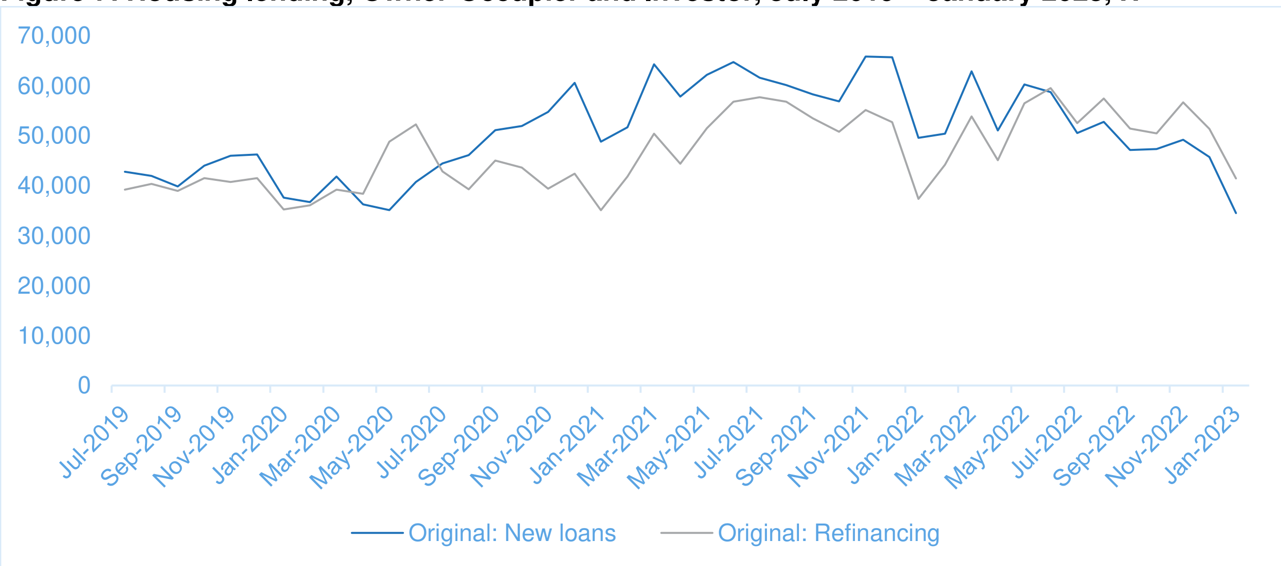
Figure 6: End of fixed-rate mortgages periods, Four majors, 2023 – 2024, N



Source: Four majors; ABA

This change in mortgage structure means that many customers are also considering whether their mortgage product is right for them. Due to the current economic environment and stability in the banking system, competition among banks has grown, leading to more product offerings and incentives directly benefiting customers with a mortgage. This competition has led to customers refinancing their mortgage to better suit their needs, with 308,961 mortgages refinanced over the last six months, or 2,370 Australians refinancing their mortgage every working day (Figure 7).[7] Of these, 214,916 switched between lenders, while 94,045 refinanced with their existing lenders, demonstrating that banks are also offering competitive deals to their existing customers to support and retain them. Against this backdrop, Australians are encouraged to contact their bank and get the best deal appropriate to their circumstances.

Figure 7: Housing lending, Owner-Occupier and Investor, July 2019 – January 2023, N



Source: ABS, Lending Finance, Tables 3 &13; ABA

Rate increases have also translated into higher rates of return for savings and deposits accounts, passed on by banks to customers across a range of term deposit products. While not every product or account will offer the same rate of return, banks have continued to increase their deposit account interest rates. In February 2022, no term deposit product of a major bank was returning interest greater than 0.30 per cent. By early March 2023, all major banks had at least one term deposit product offering 4.00 per cent, while some smaller banks had term deposit products offering across 3.00 to 4.00 per cent. Customers are encouraged to shop around to secure the best deal for their banking services during this period.

[7] ABS, Lending Indicators, Tables 3 and 13, February 2023.

Banks are taking steps to help customers facing financial difficulty

The ABA notes that most customers will manage the higher cost of living and their mortgage commitments through refinancing their mortgage, applying their accumulated savings to their increased repayments, or by changing their spending patterns. However, we understand that others may struggle. Banks are not yet seeing any significant increase in hardship, arrears or repossession cases, with levels remaining generally lower than those seen during the COVID-19 pandemic and over long-term trend.

Banks are taking steps to support customers who need help today, and into the future. ABA members have experienced hardship teams in place that assist customers on a case-by-case basis. This network of help within the banks is highly structured, organised and experienced. Banks are proactively reaching out to customers due to rollover from a fixed rate mortgage to a variable rate well ahead of the change to support them during the transition. Some banks are also providing tailored product offerings to assist customers facing difficult circumstances, such as reduced or no interest loans to those on low-incomes for essential purchases.

The ABA and banks have also run advertisements to alert customers who are experiencing financial difficulty to contact their bank and discuss their individual circumstances. The type of support offered by banks is broad and can include:

- Waiving of fees and charges, including for early access to term deposits;
- Debt consolidation to help make repayments more manageable;
- Restructuring existing loans free of the usual establishment fees;
- Emergency credit limit increases;
- Deferring upcoming credit card payments;
- Deferral of scheduled loan repayments, on home, personal and some business loans.

Banks have experienced teams in place dedicated to helping customers during times of financial difficulty. We strongly urge customers concerned to proactively get in touch with their bank.