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Macroprudential measures announced in Australia

APRA yesterday announced a series of new measures aimed at reinforcing sound lending practices by financial institutions in Australia (see APRA media release). These measures are a response to increasing concern by Australia's Council of Financial Regulators (consisting of the RBA, APRA, ASIC and Treasury) around the risks to financial stability and economic growth posed by strong house price appreciation. With recent price gains fuelled by investor activity, it is no surprise that the measures are focused squarely on investment lending.

As foreshadowed, there have been no overall system wide limits imposed, and no caps or quotas imposed on lending in aggregate or on specific categories of lending. Instead the measures put forward by APRA have concentrated on three broad areas.

Greater scrutiny of high-risk lending. High-risk lending is deemed to include high loan-to-income ratios, high loan-to-valuation ratios, lending on an interest-only basis to owner-occupiers for lengthy terms, and lending at very long terms. Large volumes of these loans may attract supervisory action by APRA.

10 per cent growth threshold on property investor loans. Strong or accelerating growth in a bank's book of investor loans may indicate a significant increase in risk. Growth in this category which exceeds an annual rate of 10 per cent will likely result in supervisory action.

Enhanced affordability tests for new borrowers. Assessments of loans made to new borrowers should include minimum serviceability standards, including an interest rate buffer of 2 per cent above the loan rate, with a minimum assessment rate of 7 per cent. Lending at close to these levels may attract supervisory action.

In our assessment these measures represent a multi-faceted attempt to target the specific nature of regulators' concerns in the investor sector of housing credit, while at the same time seeking to protect new owner-occupier entrants to the market (or at least those with sufficient deposits to meet serviceability standards). In this sense the measures represent

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a significant shift from the blanket restrictions implemented in New Zealand and other markets.

One potential challenge of implementation is the definitional requirements that such an approach requires, namely what exactly defines an investor loan made for the purpose of purchasing property, or what defines an investment property as such. While the regulators and banks will have their own classification requirements in place, the emergence of a price differential for investor lending relative to non-investor lending may encourage both individuals and banks to classify themselves as falling outside of this definition. This problem is a common one whenever restrictions on a specific class of financial activity are imposed, with a long history of individuals and companies coming up with creative ways to circumvent them. Overall however these concerns are not likely to be immediate issues, and as such the measures will likely prove effective in reining in excessive and overly speculative lending in the property sector.

As noted in our preview earlier in the month, the implications for the economic outlook are largely incremental. Many of the headlines post the announcement have focused on the possibility of a reduction in the cash rate now that measures are in place to limit the impact on the housing market. However, the cash rate remains an economy-wide tool, and as such a further series of reductions in the cash rate would only be embarked upon if activity were sufficiently weak across the entire economy, and/or if external factors were likely to pose a significant obstacle to growth going forward. In our view, with the US expansion continuing and Chinese demand holding up for now, these factors have yet to emerge. Recent weeks have also shown that the exchange rate can easily move lower on the merest of nudges from RBA officials and global market sentiment, without any movement in the cash rate required to achieve this.

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