M POINT FINANCIAL SOLUTIONS

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What's Driving Australian Mortgage Interest Rates?

Mortgage interest rates in Australia have increased by up to 20 basis points in recent months, despite a steady cash rate. Domestic mortgage rates are heavily influenced by a combination of factors in addition to the official cash rate, and two main factors are the banks' exposure to domestic and offshore debt capital markets, as well as interest rates paid on deposits.

Banks make a net interest margin by charging borrowers a higher rate of interest than they pay on deposits and wholesale funds. If funding costs increase, the banks will typically look to pass through these costs to borrowers in the form of higher borrowing interest rates.

Why have some lenders increased mortgage rates recently when the RBA is on hold?

The RBA has not changed the target cash rate since August 2016, yet we have seen numerous regional and second tier banks such as Suncorp, AMP and Bank of Queensland increase their mortgage rates recently. These banks have cited the increase to their wholesale funding costs from the recent increase in the 3 Month BBSW funding rate, and their need to pass on these costs to borrowers so their margins can be maintained.

The BBSW rate is the primary short-term reference lending base rate used in debt capital markets. On average BBSW has been 20bps wider than the RBA cash rate since 2003; however, it has recently spiked and currently sits 56bps wider than usual levels, effectively adding 36bps in additional wholesale funding costs.

Another factor driving an increase in rates has been the decline in deposit growth, forcing the banks to obtain higher levels of funding from more expensive domestic and offshore debt capital markets.

Will rising rates in the US drive up mortgage rates in Australia?

In the Australian economy, total bank loans exceed total deposits, resulting in the banks' reliance on both domestic and offshore debt capital markets to fund the shortfall. When the balance sheets of the four major banks are consolidated together, 80.5% of total funding is sourced from deposits and the remaining 19.5% is sourced from wholesale debt capital markets. As a result higher US rates does have an impact on domestic mortgage rates.

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How are deposit rates impacting mortgage rates?

The recent changes in mortgage interest rates have been relatively small when compared to the fall in deposit rates. Deposit holders have suffered a considerable decline in interest rates, supporting the spread between deposits and mortgage rates. The fall in deposit rates has limited further upward moves in mortgage interest rates, partially absorbing higher funding costs and the additional costs from the higher BBSW funding rate. Mortgage holders have benefited to the detriment of deposit holders.

What is the most likely driver of mortgage rates in Australia going forward?

An increase in the cash rate would have a significant and direct impact on mortgage rates. However, we anticipate that there will be no change to the cash rate, potentially for another 12 months or longer. Higher deposit rates are probably the most likely to surprise the market, particularly if the current slowdown in deposit growth continues. Given deposit funding is such a large component of total funding, any increase in cost will have a proportionally larger increase in overall funding costs and place upward pressure on mortgage rates.

What should borrowers do?

The general public has a right to question why bank loans are so expensive when the RBA cash rate is so low. It is a confusing situation but one that is allowing the entry of new players and new more flexible loan products.

The focus of the royal commission is making borrowing significantly harder as the majors tighten lending practices. This clearly represents opportunity for alternative lenders to enter the market and provide borrowers more flexible and better-priced loan structures.

Generally the only way to access these alternate lenders is through your broker. Here at M Point Finance we have relationships with a number of alternative lenders who are very competitive and can offer a compelling finance solution. Don't hesitate to give Andrew a call on 0418850890 to see how he can assist with your financing needs.