APRA

INFORMATION PAPER

Countercyclical capital buffer

DECEMBER 2021

Disclaimer Text

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Executive summary

APRA released an information paper on its macroprudential policy framework in November this year, outlining the objective of macroprudential policy to mitigate risks to financial stability at a system-wide level. The countercyclical capital buffer ('CCyB') is one of a broad range of macroprudential policy tools, outlined in the information paper, that APRA can use to mitigate financial stability risks. It is a component of the capital framework for authorised deposit-taking institutions (ADIs) that is adjustable to the economic and financial cycle. The primary purpose of the countercyclical capital buffer is to increase the resilience of the financial system during periods of heightened systemic risk. This extra resilience, in the form of more capital, can then be used by banks during a downturn to absorb losses while continuing to lend.

APRA closely monitors the systemic risk environment to inform decisions on macroprudential policy. In doing so, APRA considers various indicators of systemic risk, such as credit growth and leverage, growth in asset prices, lending conditions and financial resilience. To inform APRA's assessment of the risk outlook, APRA draws upon data reported by regulated entities, supervisory and market intelligence, and the views and analysis of other members of the Council of Financial Regulators (CFR). Over 2021, APRA and the CFR became increasingly concerned with financial stability risks associated with increasing shares of new mortgage lending at high levels of debt-to-income, alongside rapid increases in housing prices and rising credit growth. However, beyond rising high debt-to-income lending, there have been no signs of a significant weakening of lending standards.

In addressing the increase in systemic risk APRA chose to use a targeted credit-based response, rather than increase the CCyB. This targeted approach acknowledged the heightened period of economic uncertainty as multiple states were subject to restrictions to contain the spread of COVID-19. Raising the CCyB may have a more significant impact on the cost and access to credit of households and businesses more adversely impacted by COVID-19. Capital levels of ADIs are already unquestionably strong, with APRA's stress tests indicating that at a system-wide level ADIs are quite resilient to severe downside risks. Thus, throughout 2021, APRA decided to maintain the countercyclical capital buffer at zero per cent of risk-weighted assets. Instead, APRA increased the serviceability buffer, specifically targeting risks of increasing indebtedness in new housing lending.

APRA is closely monitoring current conditions to assess whether further macroprudential policy actions are necessary. If current risks within residential mortgage lending continue to build, APRA would consider the need for further targeted macroprudential measures. However, if systemic risks were to rise further, and become more broad-based, APRA may consider broader macroprudential tools, including raising the CCyB to a level above the current default setting.

On 29 November 2021, APRA published an information paper finalising reforms to the ADI capital framework. This release confirmed that the default level of the CCyB will be 1 per cent of risk-weighted assets for both IRB and standardised ADIs. The CCyB can be varied by APRA in the range of 0 – 3.5 per cent. APRA also provided guidance to ADIs that the level of the CCyB would be set at its default rate of 1 per cent upon commencement of the new

capital framework on 1 January 2023. Currently there is no indication of a material increase in financial stress that would support the CCyB being set lower than the default setting.

Glossary

Term	Definition
ABS	Australian Bureau of Statistics
ADIs	Authorised deposit-taking institutions, which includes banks, building societies and credit unions.
APRA	Australian Prudential Regulation Authority
APS110	Prudential Standard APS 110 Capital Adequacy
Capital conservation buffer	An additional layer of Common Equity Tier 1 Capital above the minimum regulatory requirement that can be utilised in times of stress to absorb losses, subject to constraints on dividends and other distributions. See APS 110 for further information.
Countercyclical capital buffer	An extension of the capital conservation buffer that can be imposed by APRA to protect the banking sector from systemic risk.
Credit	Credit provided by financial institutions operating domestically.
Credit-to-GDP gap	The difference between the credit-to-GDP ratio and its long term trend.
GDP	Gross domestic product
LVR	Loan-to-value ratio
RBA	Reserve Bank of Australia
SME	Small and medium enterprise

Chapter 1 - Countercyclical capital buffer decision

APRA requires banks to hold capital to ensure that they can absorb losses, maintain the confidence of their creditors, and continue to lend, even during a downturn. Capital protects bank creditors, including depositors, and ensures that the banking system can continue providing its essential payment and lending functions. Most capital requirements for authorised deposit-taking institutions (ADIs) are not varied by APRA over the economic and financial cycle.

The countercyclical capital buffer ('CCyB'), which has been part of APRA's capital adequacy framework since 2016, is different. The CCyB is an additional amount of capital – currently equivalent to between 0 and 2.5 per cent of risk-weighted assets – that APRA can require ADIs to hold at certain points in the economic and financial cycle. APRA's primary objective when adjusting the countercyclical capital buffer is to proactively build the resilience of the banking sector during periods of increasing systemic risk. The buffer can be released to absorb losses during periods of stress to reduce the risk of the supply of credit being impacted by capital shortages. This can help mitigate risks to financial stability at a system-wide level. APRA set the level of the countercyclical capital buffer applying to ADIs at zero per cent upon its introduction on 1 January 2016.[1]

APRA has maintained the CCyB at zero per cent in 2021. APRA also provided guidance that the CCyB would be set at the default rate of 1 per cent on the commencement of the new capital framework on 1 January 2023.

Financial stability risks have been building over 2021. Current very low interest rates have provided support to the Australian economy. Rapidly increasing housing prices have contributed to a large increase in the share of new lending at high levels of debt-to-income. This increases the sensitivity of the financial system to future shocks, including in the event of increases in interest rates.

At the same time, over the year, there has been ongoing uncertainty due to COVID-19, with lockdowns affecting large parts of the country. While some of that uncertainty has reduced due to high vaccination rates that have been achieved domestically, downside risks remain. Furthermore, while most parts of the economy are expected to bounce back after recent lockdowns, the negative effects of COVID-19 are likely to linger for some time for some parts of the economy, even after health risks diminish.

APRA and the CFR are continuing to closely monitor these counterbalancing risks. In doing so, APRA balances its policy priorities of ensuring that mortgage lending remains prudent and leaning against systemic risks while allowing ADIs to continue to provide support for parts of the economy negatively impacted by COVID-19. In early October, as lockdowns were being lifted, and expectations were that the economy would bounce back, APRA considered

[1] See Media Release: APRA announces countercyclical capital buffer rate for ADIs, 17 December 2015.

that the balance of risks had shifted sufficiently to warrant targeted macroprudential action. APRA announced an increase in the serviceability assessment rate to at least 3.0 percentage points (an increase from 2.5 percentage points previously) over the loan interest rate for all ADIs. This 50 basis point increase in the buffer will reduce maximum borrowing capacity for the typical borrower by around 5 per cent.

This targeted measure was preferred, over raising the CCyB, to directly increase the resilience of more marginal borrowers to future shocks, such as from rising interest rates or a reduction in income. Raising the CCyB would increase capital requirements applicable to all types of lending, including existing and non-housing lending, and may have a more significant impact on the cost and access to credit of households and businesses including those more adversely impacted by COVID-19. Furthermore, ADIs were already well capitalised and had been increasing capital levels during the pandemic.

APRA is closely monitoring current conditions to assess whether further macroprudential policy actions are necessary. In doing so, various factors are considered to identify emerging threats to financial stability including: credit growth and leverage; growth in asset prices; lending conditions; financial stress and financial resilience. These have been shown empirically to provide an indication of emerging systemic risks. APRA also considers the economic environment, the broader operating environment, and other prudential measures, when considering changing the level of the CCyB.

Housing credit growth has accelerated over the past six months, supported by low interest rates and government policies. The increase in housing credit growth reflects higher turnover of existing properties, increased construction and higher average loan sizes. Housing loan commitments remain elevated, but have declined somewhat since June driven by reductions in commitments to owner-occupiers and first home buyers. Business credit growth has also increased in recent months in line with increasing business investment due to expansionary economic conditions and government tax incentives.

While bank lending standards overall remain robust, shares of new mortgage lending at high debt-to-income levels have risen sharply this year. Around one in four new loans approved in the September quarter were at more than six times the borrowers' income. In contrast the share of higher LVR lending declined over the year, partly due to a smaller share of first home buyers. Business lending standards eased a little over the year, however this partly reflected a reversal of the tightening of lending standards at the beginning of the pandemic.

Furthermore, housing price growth increased sharply over the first half of 2021 and has remained strong over the latter half of the year. Over the year to November 2021, national housing prices rose by 22 per cent, the highest annual growth rate since 1989. In contrast, conditions in commercial real estate markets have continued to vary across property segments. Lockdowns and the continued shift towards online retail have been a headwind for retail property valuations. Office valuations have been largely unchanged as the impact of weaker expectations of future growth in rents have been offset by low interest rates and ongoing strong foreign demand. In contrast, the accelerated transition to online retail has increased demand for industrial property, such as logistics and warehousing space, with valuations in this segment strongly rising over the year.

Measures of financial stress, including non-performing loans, remain low. The stronger than expected economic recovery during the first half of 2021, elevated savings buffers, broad-

based housing price appreciation, targeted fiscal stimulus measures, and deferrals of loan repayments have all helped to prevent a large rise in financial stress.

At present, rising asset prices and housing credit growth, alongside rising shares of new mortgage lending at high debt-to-income, are an increasing concern. Rising housing prices in themselves do not necessarily present a financial stability risk. However, if shocks occur when housing prices are very high and households are highly leveraged, this can increase the probability of large housing price falls and the financial system's sensitivity to these falls. Notably, APRA does not target the level or growth rate of housing prices; consistent with APRA's mandate, the objective of macroprudential policy is to promote financial system stability.

There are a number of additional measures APRA may use if systemic risks continue to rise as outlined in APRA's information paper on the Macroprudential Policy Framework, released in November 2021.[2] Should concentrations of high debt-to-income lending continue to rise in a manner that increases financial stability risks, APRA may consider the need for further targeted macroprudential measures. If systemic risks were to become more broad-based, APRA may consider broader macroprudential tools, including raising the CCyB to a level above the current default setting. (This would be in addition to the changes to the default level of the CCyB as part of the new capital framework.) These are dynamics that APRA is monitoring closely in conjunction with other CFR agencies.

APRA released its capital framework for ADIs on 29 November 2021.[3] The information paper confirmed that the default level of the CCyB will increase to 1 per cent under the revised framework. The higher default setting will allow for greater buffer usability to absorb losses and support new lending in periods of stress. Current indicators of systemic risk suggest that the CCyB would be set at its default level of 1 per cent for all ADIs on 1 January 2023.

In line with the new capital framework and macroprudential policy framework, APRA will also be revising its approach to operating the CCyB during 2022. Beginning in 2022, APRA will release an annual information paper at the end of each year on its systemic risk assessment and macroprudential policy decisions, including the CCyB and other macroprudential policy tools. This new systemic risk assessment will replace the annual CCyB information paper.

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[2] See Information Paper: Macroprudential Policy Framework, 11 November 2021

[3] See Media Release: APRA finalises new bank capital framework designed to strengthen financial system resilience, 29 November 2021

Chapter 2 - Systematic Risk Assessment

The following section summarises APRA's current assessment of the systemic risk environment to identify areas of heightened risk to financial system stability which may require a macroprudential policy response. This assessment is informed by a set of core systemic risk indicators within four key risk areas: credit growth; asset prices; lending conditions; and financial stress (listed in the table below). This section focuses on APRA's assessment of developments that have driven countercyclical capital buffer decisions over the past year.

There is no mechanical link between any indicator and the level at which APRA sets the buffer. Changes in some or all of these indicators do not always reflect changes in systemic risk. However, core indicators help to inform APRA's judgement on the systemic risk outlook and the appropriate setting for the CCyB alongside other macroprudential measures. Other considerations, including the wider prudential context and the macroeconomic outlook are also important. This flexible approach is in line with that used by most of the countries that have a countercyclical capital buffer as part of their bank capital framework.

Risk Area	Core Indicators
Credit growth	Credit–to-GDP gap Housing credit growth Investor housing credit growth Business credit growth Commercial property exposures growth Household debt-to-income annual change
Asset prices	Housing price growth Commercial property price growth
Lending indicators	Higher-risk residential mortgage lending Business lending conditions Loan pricing and margins
Financial stress	Non-performing loans Return on equity

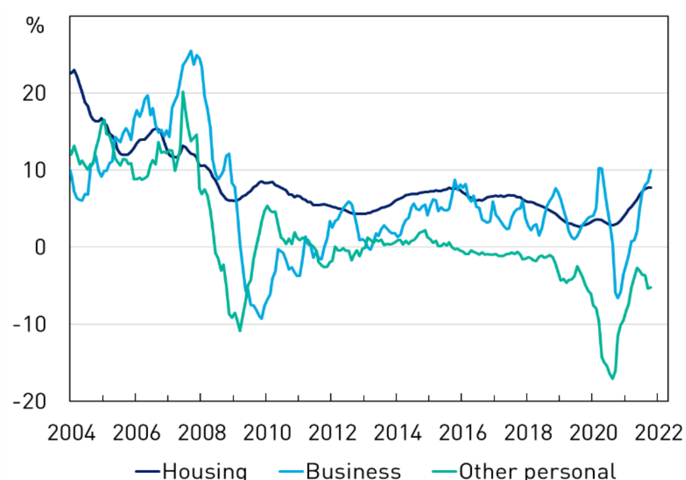
Credit growth

Total credit growth increased by 5.7 per cent over the 12 months to October 2021. More recently, credit growth has accelerated to its fastest pace in six years, increasing 7.9 per cent in annualised terms over the six months to October 2021. Recent increases in credit growth have become more broad-based; housing credit growth has remained strong, and business credit has also picked up in line with stronger economic conditions. High levels of housing loan commitments, consistent with high turnover and strong asset price growth, suggests

that credit growth may remain elevated or continue to rise in the near-term. This presents risks to the household sector, particularly if housing credit growth materially outpaces growth in incomes.

Credit growth

Six-month annualised rate



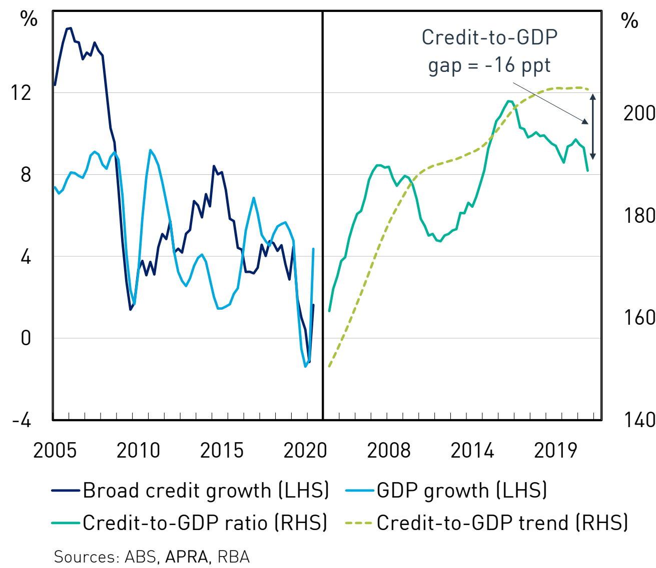
Source: RBA

The credit-to-GDP gap, defined as the difference between the credit-to-GDP ratio and its long-run trend, reduced by 5 percentage points over the year to June quarter 2021 to -16 (see graph below).[4] A credit-to-GDP ratio significantly above its long run trend (a positive gap) is an indicator of excessive credit growth. Strong credit growth in Australia over recent decades has given the credit-to-GDP ratio a strong upward trend that is not indicative of prudent credit growth. Accordingly, APRA does not place a heavy weight on the credit-to-GDP gap when setting the level of the CCyB. Heightened volatility in GDP growth data due to COVID restrictions has further reduced the reliability of this metric in indicating levels of systemic risk.

[4] The long-run trend is calculated using a one-sided Hodrick-Prescott filter, a tool used in macroeconomics to establish the trend of a variable over time. For more information see Basel Committee, Guidance for national authorities operating the countercyclical capital buffer, December 2010.

Credit and GDP

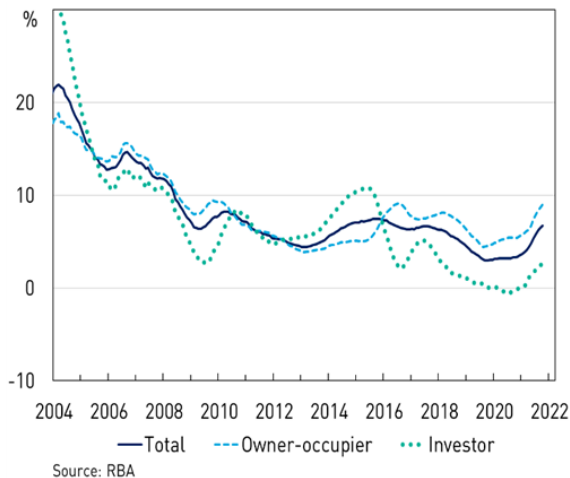
Last data point is June 2021



Housing credit increased 6.7 per cent over the 12 months to October 2021. More recently, housing credit growth has picked-up to around recent peak-levels observed in 2015, increasing by 7.7 per cent in six-month annualised terms. In the first half of 2021, stronger housing credit growth was driven predominantly by lending to owner-occupiers; owner-occupied credit growth increased to 10.4 per cent in six-month annualised terms over this period. More recently, investor credit growth has also picked up from low levels. High housing credit growth has been supported by accommodative monetary policy and government policy measures, and reflects higher housing turnover, higher asset prices and elevated housing construction levels.

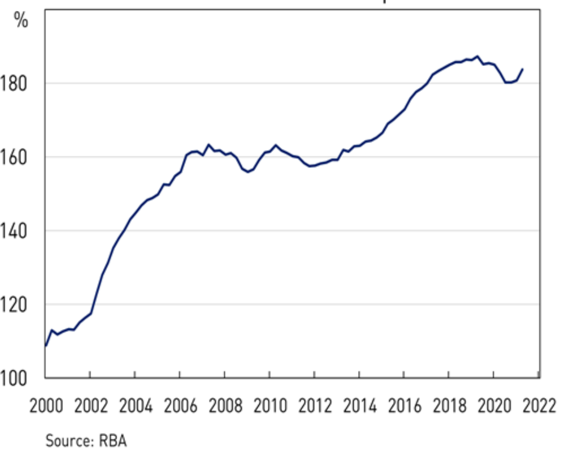
Housing credit growth

Annual



Household debt to income

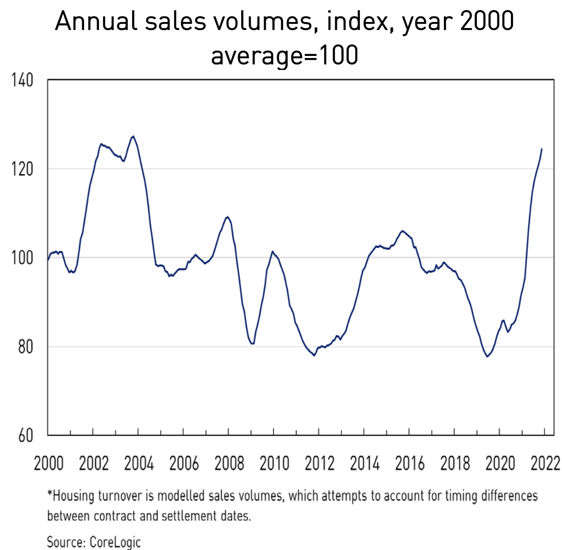
Share of annualised household disposable income



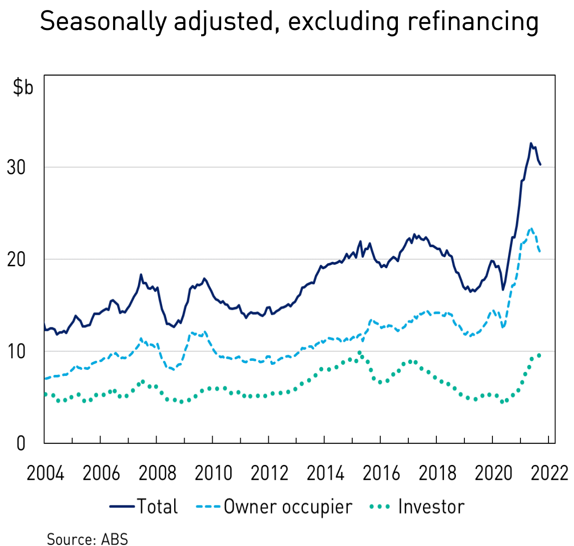
Housing turnover and loan commitments remain elevated compared to historical levels, despite both reducing slightly over the September quarter. If housing loan commitments remain around current levels, housing credit growth is likely to continue to rise well in

excess of growth in household incomes in the period ahead. Given already high levels of household debt, if this trend is sustained, risks associated with household indebtedness are likely to further increase.

Housing turnover*



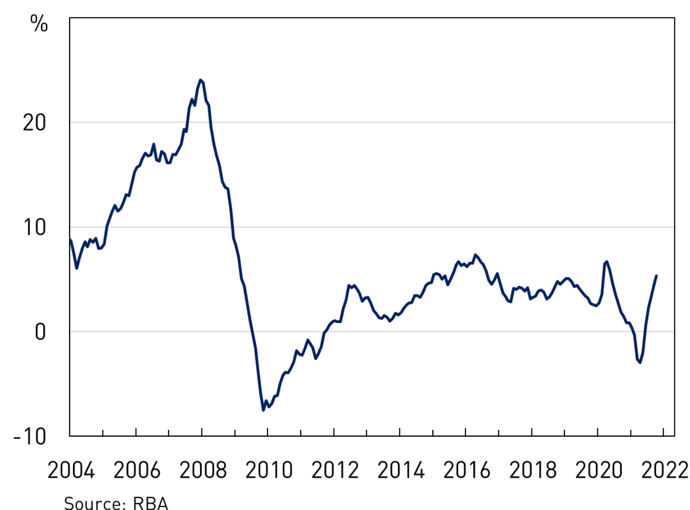
Housing loan commitments



Business credit grew by 10.0 per cent in annualised terms over the six months to October 2021. A strong pick-up in business credit over recent months occurred alongside solid investment growth, reflecting improving economic conditions and as firms responded to government tax incentives.

Business credit growth

Annual



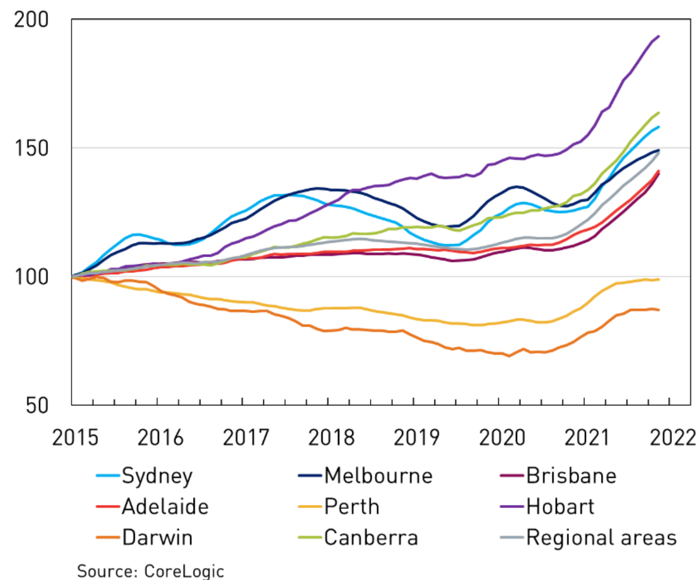
Asset prices

Housing prices have surged during the past year. At the national level, prices increased by 22 per cent over the year to November 2021, the fastest annual rate of growth since June

1989. Housing market momentum accelerated over the first half of 2021 and has remained strong over the second half of the year. These pricing dynamics have reflected a range of current influences on the housing market including historically low mortgage rates, government incentives, elevated household savings, and pent up demand from lockdowns in 2020.

Housing price indices

December 2014 = 100

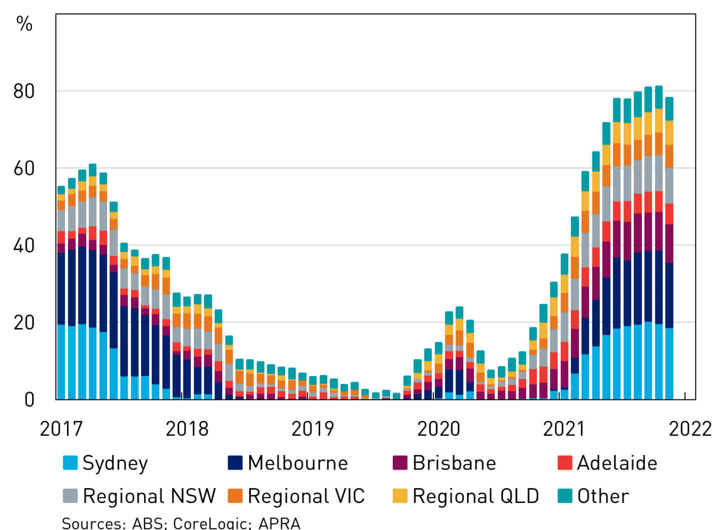


Source: CoreLogic

Growth in housing prices has been broad-based across capital cities and regional areas. Housing prices are currently at their historic peak in around 78 per cent of areas across the country and many areas have continued to experience strong price growth in recent months. In the two largest housing markets, Sydney and Melbourne, housing prices have risen by 26 per cent and 17 per cent respectively over the past twelve months.

Share of area with housing prices at peak

Hedonic home value index, SA3 regions, weighted by 2020 population



Sources: ABS; CoreLogic; APRA

Housing price growth has also been broad-based across both detached dwellings and apartments. Growth in the detached dwelling segment has been particularly strong, consistent with a change in preferences towards increased living space since the start of COVID-19.

APRA will continue to closely monitor the housing market for potential signs that future housing price growth is contributing to the accumulation of financial stability risks. Continued strong housing price growth may amplify the risks associated with a subsequent downturn by increasing the riskiness of new lending (as new borrowers are required to take on larger debts) or by leading to larger future housing price corrections.

In contrast to the broad-based momentum in the housing market, conditions in **commercial real estate** (CRE) markets have varied across property segments. Industrial property valuations have risen by around 39 per cent over the year to September 2021 and rents in this segment have also increased. The strong growth in this segment has been driven by high demand for industrial property, such as logistics and warehousing space, as a result of the accelerated transition towards online retailing induced by the pandemic.

Conversely, lockdowns and the longer-term shift towards e-commerce have contributed to weak conditions persisting in retail property markets. Since the start of the pandemic, declines in rents and increases in vacancy rates for retail property have been most pronounced in the CBD regions of major capital cities and for discretionary retailing. Conditions in neighbourhood centres, which are more focused on non-discretionary retail (e.g. supermarkets), have however been relatively favourable over the same period.[5] Many previously scheduled retail developments have now been postponed and some may not become feasible again when conditions improve. Over the year to September 2021, valuations for retail property declined by around 7 per cent and rents fell by close to 6 per cent.

Office property markets have also continued to face headwinds from the structural shift towards increased remote working. Additionally, vacancy rates increased over the year to September due to new office completions across CBD markets. Landlord incentives to attract and maintain tenants have continued to increase in recent quarters, particularly in markets with higher vacancy rates and supply additions. These factors have continued to subdue growth in office property valuations and weighed on rents throughout the past year. Valuations for prime CBD offices increased by around 5 per cent over the year to September 2021, while office rents declined by 5 per cent.

The outlook for office property prices over the next twelve months is unclear. Survey expectations suggest real estate professionals are becoming more optimistic about the near-term outlook.[6] At the same time however, a strong pipeline of office construction is scheduled for completion in Sydney and Melbourne during 2022. Demand for office space also remains uncertain over the longer term due to the competing forces of increased remote working and higher floor space requirements to accommodate greater ongoing social distancing.

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[5] RBA FSR October 2021

[6] NAB Commercial Property Survey Q3-2021

Lending conditions

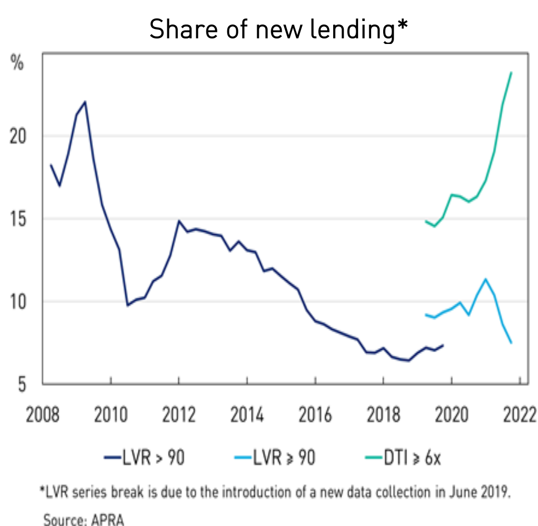
Changes in lending standards were mixed over the year to September 2021, but remain sound overall. There has nevertheless been an increase in the share of some types of relatively high risk new housing lending. While the share of housing lending at high loan-to-valuation ratios (LVR) declined, the share of loans written at high debt-to-income (DTI) multiples increased. Similarly, business lending standards were broadly unchanged, although more recently signs of easing have been observed in corporate and CRE lending.

Within **residential mortgage lending**, high LVR (≥90 per cent) originations declined by 2.9 percentage points, to 7.5 per cent of new lending in the 12 months to September 2021. Meanwhile, the share of new loans written at high DTI multiples (≥6) increased substantially over the year, from 16.3 per cent in September 2020, to 23.8 per cent in September 2021.

High LVR (≥90) lending has been steadily declining since the end of 2020. Changes in the borrower composition of new lending have contributed to the reduction. In particular, a decline in the share of commitments to first home buyers (FHB), which on average borrow at higher LVRs, drove around one-fifth of the decline in high LVR lending from the March to September quarter. The greater share of new commitments to investors, which tend to have lower LVRs at origination, also contributed to the overall reduction in high LVR lending.

Higher-risk housing lending

Share of new lending*

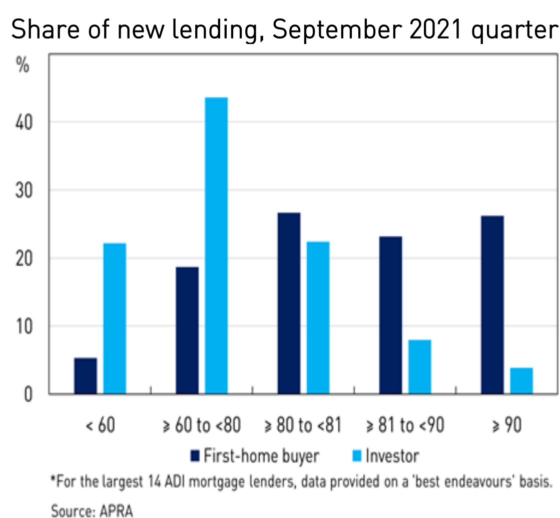


*LVR series break is due to the introduction of a new data collection in June 2019.

Source: APRA

Distribution of loan-to-value ratio*

Share of new lending, September 2021 quarter

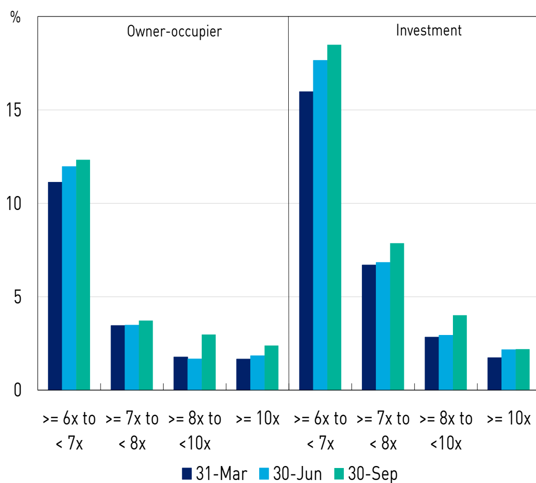


*For the largest 14 ADI mortgage lenders, data provided on a 'best endeavours' basis.

Source: APRA

A significant increase in **high DTI** (≥6x) lending over the year was observed across all borrower types. This was driven in part by low interest and serviceability assessment rates, and higher asset prices increasing maximum loan amounts available to borrowers and average loan sizes. In addition, an increase in the share of new lending to investors (who tend to borrow at higher DTIs, but also tend to have higher incomes and larger liquidity buffers compared to high DTI owner-occupiers) also contributed to increased high DTI lending. To reduce risks associated with very highly indebted borrowers, APRA increased the serviceability buffer used in banks' loan assessments to at least 3.0 per cent in October 2021.

Share of high DTI lending by loan purpose*

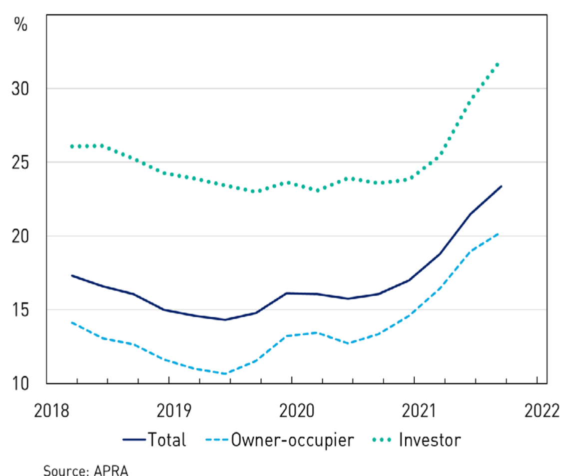


*For the largest 14 ADI mortgage lenders, data provided on a 'best endeavours' basis.

Source: APRA

High DTI share of new lending

DTI>=6 times



Source: APRA

Business lending standards were reported to have eased slightly in 2021 across certain segments. Interest margins have also narrowed for a number of banks across corporate and SME lending, due to stronger competition and high levels of liquidity.

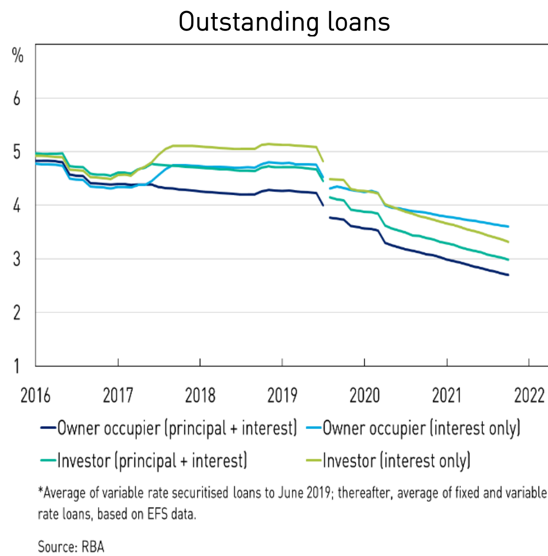
CRE lending conditions improved in aggregate in 2021, although the improvement has been uneven across CRE segments. In particular, lending conditions improved for industrial investment and residential development. However, conditions remain challenging for lending to sub-prime offices and retail assets (particularly those located in CBDs). Increased caution from ADIs in these segments follows the structural shift to working from home, and the hastened transition towards online retail due to COVID-19.

Lending interest rates on outstanding loans have fallen to record lows over the past year for both housing and business credit as new borrowers have borrowed at historically low interest rates, and existing borrowers have been able to refinance at lower rates. In mortgage lending, many ADIs raised fixed-term rates modestly this year – particularly for longer tenure products (3-5 years) – while reducing variable rates on some products to attract new business.

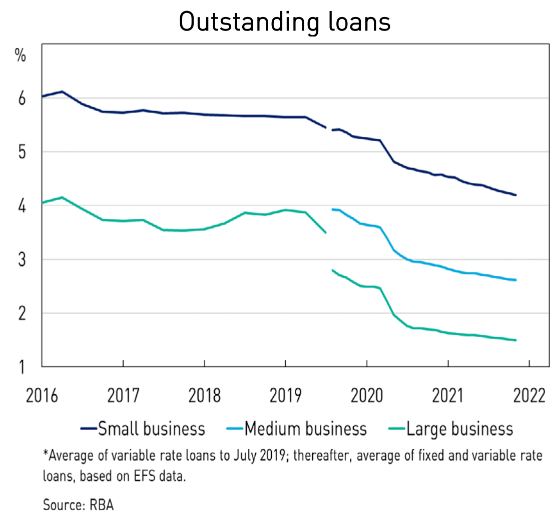
Sustained low mortgage rates may present financial stability risks in the medium term to the extent that it is associated with higher household indebtedness. While lenders' serviceability assessments reduce the risk that borrowers are unable to service their debt in the event of future interest rate increases, high levels of leverage can increase systemic risks by amplifying macroeconomic shocks. APRA's recently released macroprudential policy framework information paper has outlined potential policy tools to mitigate these risks.

There have also been large declines in lending rates for outstanding business loans since February 2020, with SME interest rates declining by 80-95 bps during the period.

Housing interest rate*



Business interest rates*

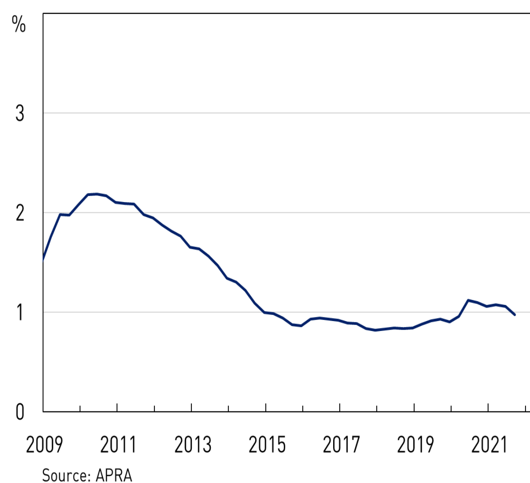


Financial stress

The aggregate **non-performing loan** (NPL) ratio for banks remained above pre-pandemic levels over the year to September. However, both housing and business NPLs are low overall, with around 1.0 per cent of housing loans and 1.2 per cent of business loans classified as non-performing in the September quarter. The faster than expected recovery in the first half of 2021, strong household and business balance sheets, and targeted fiscal stimulus have all helped to prevent a large rise in financial stress during recent lockdowns.

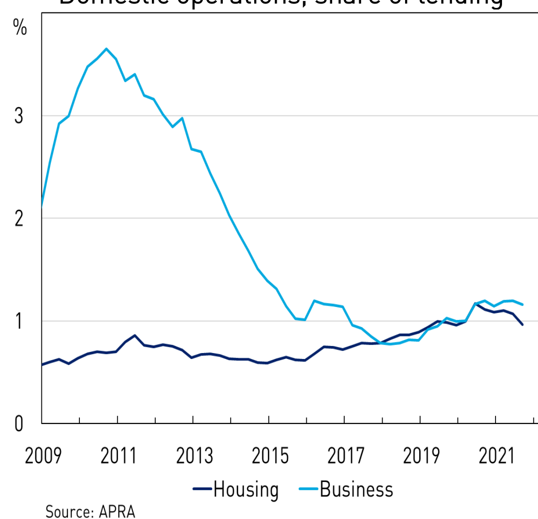
Aggregate non-performing loans

Consolidated global operations, share of lending



Non-performing loans by lending type

Domestic operations, share of lending



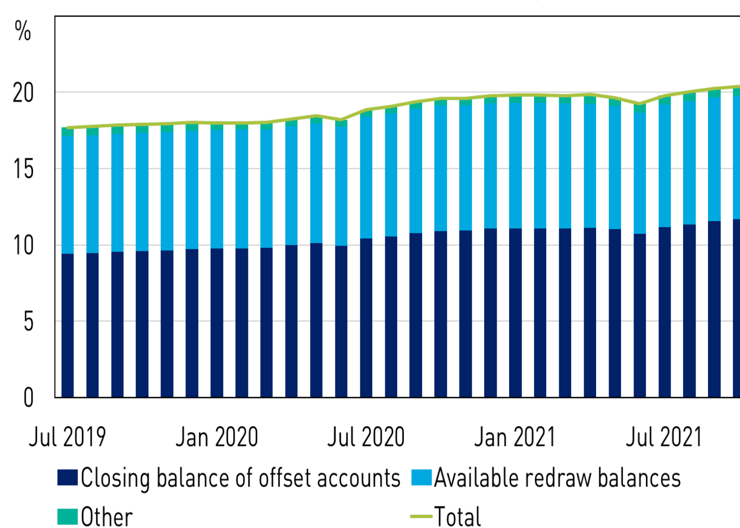
In response to these lockdowns, APRA temporarily reinstated regulatory support to ADIs for loans with repayments deferred due to COVID-19.[7] While a number of ADIs took advantage of this concessional capital treatment, less than 1 per cent of both housing and SME loans were subject to deferral at the end of October 2021. By comparison, deferrals in May 2020 accounted for more than 10 per cent of housing loans and 18 per cent of SME loans. Insights received from ADIs indicate this largely reflects less precautionary behaviour by households and businesses, although changes to approvals processes and alternative options for assisting customers at some banks may also have contributed to lower take-up in the second round.

These low levels of NPLs and deferrals reflect the improvement in household and business finances at an aggregate level since the start of the pandemic. Both household disposable income and business gross operating profits have remained above pre-pandemic levels throughout the past year. Household financial resilience has also been supported by elevated savings buffers, with the household savings ratio remaining above December 2019 levels throughout the pandemic.

This increase in savings has enabled households with a mortgage to maintain higher mortgage prepayment buffers compared to pre-pandemic levels. Mortgage prepayments as a portion of loans outstanding rose from 18 per cent to 20 per cent from February 2020 to October 2021. Furthermore, broad-based housing price growth has also helped strengthen the balance sheet of property owners' and the share of housing loans in negative equity has declined to an unusually low level.[8]

Mortgage repayment buffers

Share of loans outstanding

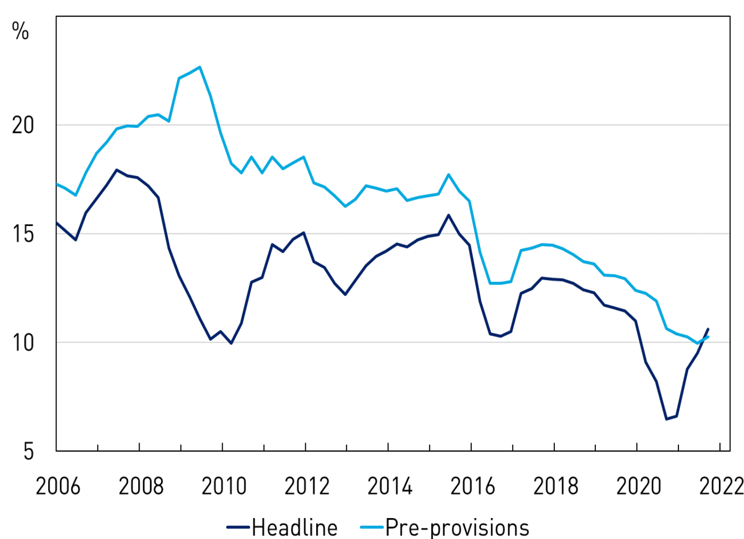


Source: APRA

[7] See Media Release: APRA announces further regulatory support for loans impacted by COVID-19, 19 July 2021

[8] RBA FSR October 2021

Limited household and business financial stress has also supported the overall resilience of the Australian financial system. Despite some short-term impacts from lockdowns in the September 2021 quarter, **banking system profitability** improved over the year, largely driven by a material reduction in provisions for future credit losses. Industry return on equity was around 10 per cent over the year to September 2021, compared to around 6 per cent a year earlier. The reduction in provisioning over the past four quarters is consistent with the stronger-than-anticipated economic recovery in late 2020 and the first half of 2021, as well as the sizeable increase in household savings and mortgage prepayments since the start of the pandemic.



Other considerations

In addition to the above risk areas, APRA also considers the economic environment, the broader operating environment, and existing levels of banking system resilience when assessing the overall level of systemic risk and setting the countercyclical capital buffer.

The global economy has continued its robust recovery from the pandemic induced economic downturn throughout the past year. During the first half of 2021, activity became increasingly expansionary in many countries, supported by accommodative policy measures, elevated household savings, increasing labour demand, and recovering global trade. The easing of social distancing restrictions, and widespread progress on COVID-19 vaccine deployment provided further boosts as the global economy transitioned from recovery to expansion. While this expansion has continued into the second half of 2021, the outlook remains uncertain. Key risks to the outlook include the recent increase in global inflation pressures and associated rise in interest rate expectations, pressures on Chinese property developers which could slow China's growth, and lingering risks from COVID-19.

Domestic economic activity rebounded strongly in late 2020 and the first half of 2021. Aggregate output and employment returned to pre-pandemic levels earlier than anticipated, while both consumer and business confidence were comfortably above their long run trends.

However, the domestic emergence of the 'Delta' COVID-19 strain and return to extended lockdowns in some states presented a temporary setback to the economy. While GDP contracted and employment decreased in the September quarter, the economy is expected to recover relatively quickly due to high vaccination rates and the easing of restrictions. However, it remains unclear how the uptick in activity will play out across different sectors of the economy. Furthermore, the emergence of new strains of the virus or a sharp rise in severe COVID-19 health outcomes as restrictions are eased present plausible downside risks to the economic recovery in 2022.

The banking system has remained well capitalised throughout the past year and ADI capital ratios are, in aggregate, comfortably above regulatory requirements. Common Equity Tier 1 (CET1) and total capital ratios rose over the year to September and are now at historically high levels (12.6 per cent and 18.5 per cent respectively). These strong capital positions have reflected both an increase in retained earnings, due to improved profitability and APRA's dividend guidance during 2020, and a reduction in risk-weighted assets. However, capital ratios are likely to fall somewhat during 2022 as ADIs increasingly return excess capital to shareholders in the form of share buybacks and increased dividends. The banking industry is also well-positioned to meet the requirements of APRA's new ADI capital framework from 1 January 2023.

Banking system capital ratios

Share of risk-weighted assets

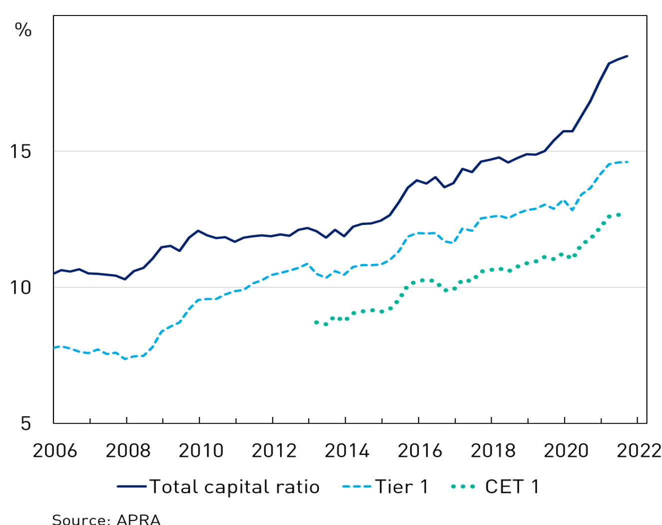


Table of indicators

Risk	Core indicators	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18	Mar 19	Jun 19	Sep 19	Dec 19	Mar 20	Jun 20	Sep 20	Dec 20	Mar 21	Jun 21	Sep 21
Credit growth and leverage	Credit-to-GDP gap (broad)**	3	3	2	-1	-5	-6	-8	-8	-7	-9	-9	-10	-11	-11	-13	-14	-11	-11	-10	-11	-12	-16	Not yet available
	Housing credit growth*	7%	6%	6%	7%	7%	7%	6%	6%	6%	5%	5%	4%	3%	3%	3%	3%	4%	3%	3%	4%	5%	7%	8%
	Investor housing credit growth*	1%	2%	3%	6%	6%	5%	3%	2%	2%	1%	1%	1%	0%	0%	0%	0%	0%	-1%	-1%	1%	2%	3%	3%
	Business credit growth*	6%	5%	3%	6%	3%	2%	5%	4%	3%	2%	6%	7%	4%	1%	3%	4%	10%	5%	-6%	-4%	1%	5%	8%
	Commercial property exposures growth*	16%	11%	6%	4%	5%	5%	2%	7%	6%	3%	3%	3%	5%	3%	1%	3%	9%	9%	3%	2%	3%	7%	9%
	Household debt to income - annual change**	6	7	7	7	7	7	6	6	5	3	2	2	1	1	-1	-1	-1	-5	-5	-5	-4	1	Not yet available
Asset prices	Housing price growth*	-1%	0%	6%	11%	11%	9%	4%	0%	-1%	-2%	-4%	-7%	-10%	-7%	2%	13%	13%	3%	-3%	3%	16%	25%	25%
Lending conditions	LVR≥90 share of new housing lending	11%	11%	11%	10%	10%	9%	9%	9%	8%	8%	8%	8%	9%	9%	9%	9%	10%	9%	10%	11%	10%	9%	7%
Financial Stress	Aggregate NPL ratio	0.9%	0.9%	0.9%	0.9%	0.9%	0.9%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	0.9%	1.0%	1.1%	1.1%	1.1%	1.1%	1.1%	1.0%
	Return on Equity - quarterly	5%	12%	11%	13%	11%	13%	13%	13%	11%	12%	11%	12%	9%	12%	11%	11%	1%	9%	4%	11%	10%	11%	8%

* Six-month-ended annualised growth; expressed in per cent

** Expressed in percentage points

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