The Australian Perspective on Financial Intermediation Services

statistics for informed decision making

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Outline

- SNA and a history
- Measurement methodology
- Behaviour of index during global financial crisis
- Analysis
- Alternative approaches
- The future

SNA

- SNA 68
  Notional Industry
- SNA 93
  Risk free
- SNA 08
  Service free

SNA

"One traditional way in which financial services are provided is by means of financial intermediation. This is understood to refer to the process whereby a financial institution such as a bank accepts deposits from units wishing to receive interest on funds for which the unit has no immediate use and lends them to other units whose funds are insufficient to meet their needs. The bank thus provides a mechanism to allow the first unit to lend to the second. Each of the two parties pays a fee to the bank for the service provided, the unit lending funds by accepting a rate of interest lower than that paid by the borrower, the difference being the combined fees implicitly charged by the bank to the depositor and to the borrower."

SNA 08 6.163

Economic measurement

- Mid point RR approach
  - SNA recommends a RR approach - no hard rules
- Consistent across all economic measures
- Financial Crisis

Australian Bureau of Statistics

History CPI

- Significant household expense (7.1 % of CPI)
- Until 1997 interest included in the CPI
- Experimental index for Financial services produced from 2000 to 2005

What are we trying to measure ?

- Movements in prices paid by households for the acquisition of financial services

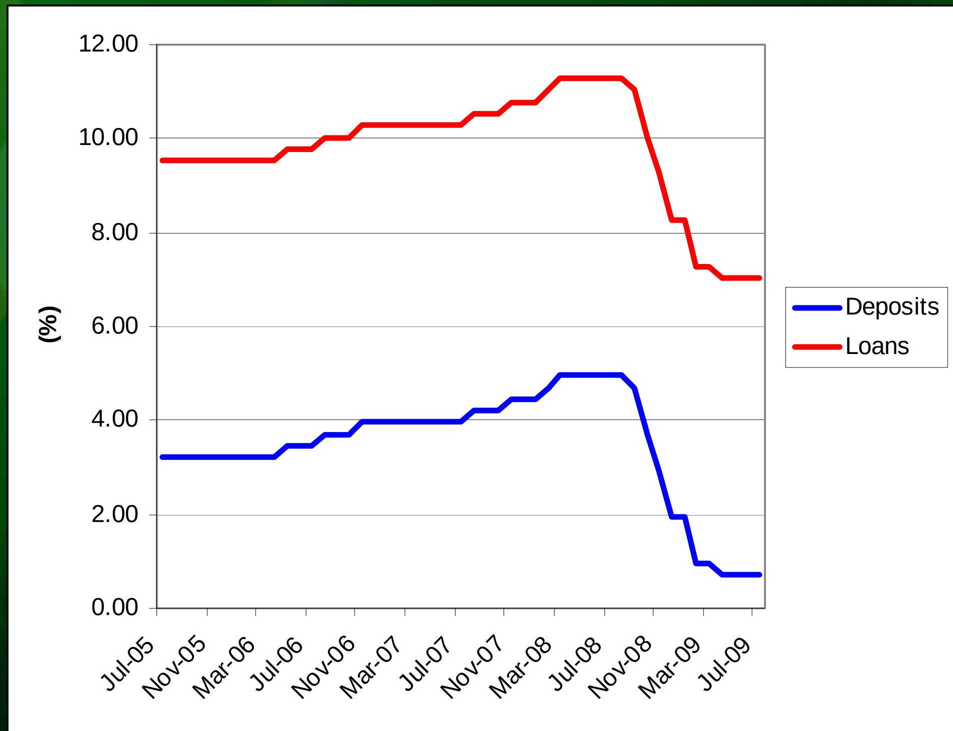
- Financial services (7.1%)
  - Deposit and loan facilities (3.9%)
  - Other financial services (3.2%)

- Deposit and loan facilities
  - Direct fees and charges
  - Indirect fees and charges

Deposit and loan facilities

Direct fees

Interest rate margins



Methodology

- Based on the system of national accounts (SNA93/08)
- Financial intermediation services indirectly measured (FISIM)
- Product of the balance on the account and the difference between the interest rate payable or receivable and a reference rate of interest
- Reference rate: Service free rate of interest
- ABS: “mid-point reference rate”

Reference rate

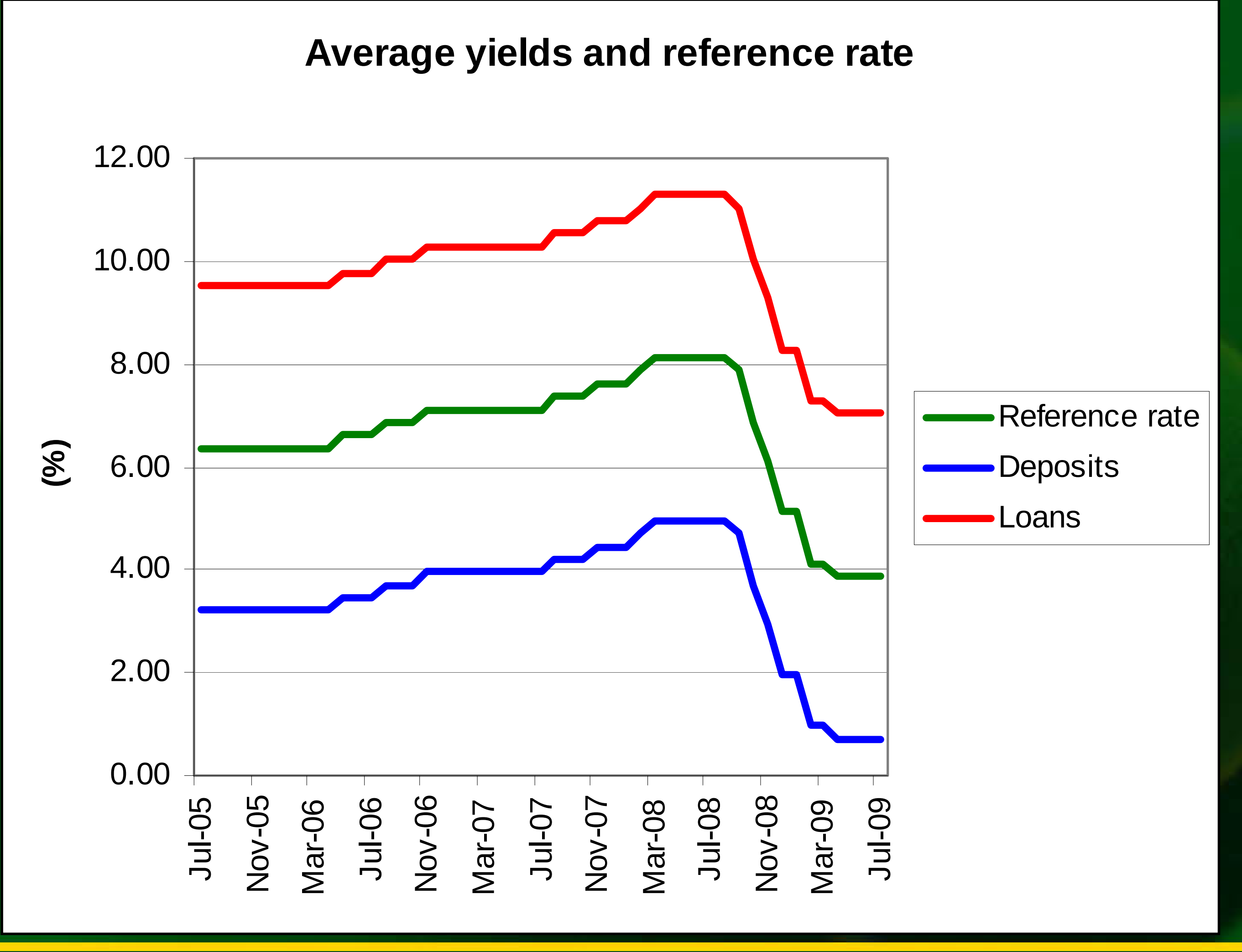
- Interest flows and balances from a number of financial institutions
- Calculate average interest rate on all deposit products

  / all loan products
- Reference rate = mid-point of deposit and loan interest rates
- Separate reference rate for each institution

- Y_D
- Y_L

- $RR = (Y_D + Y_L)/2$

Reference rate

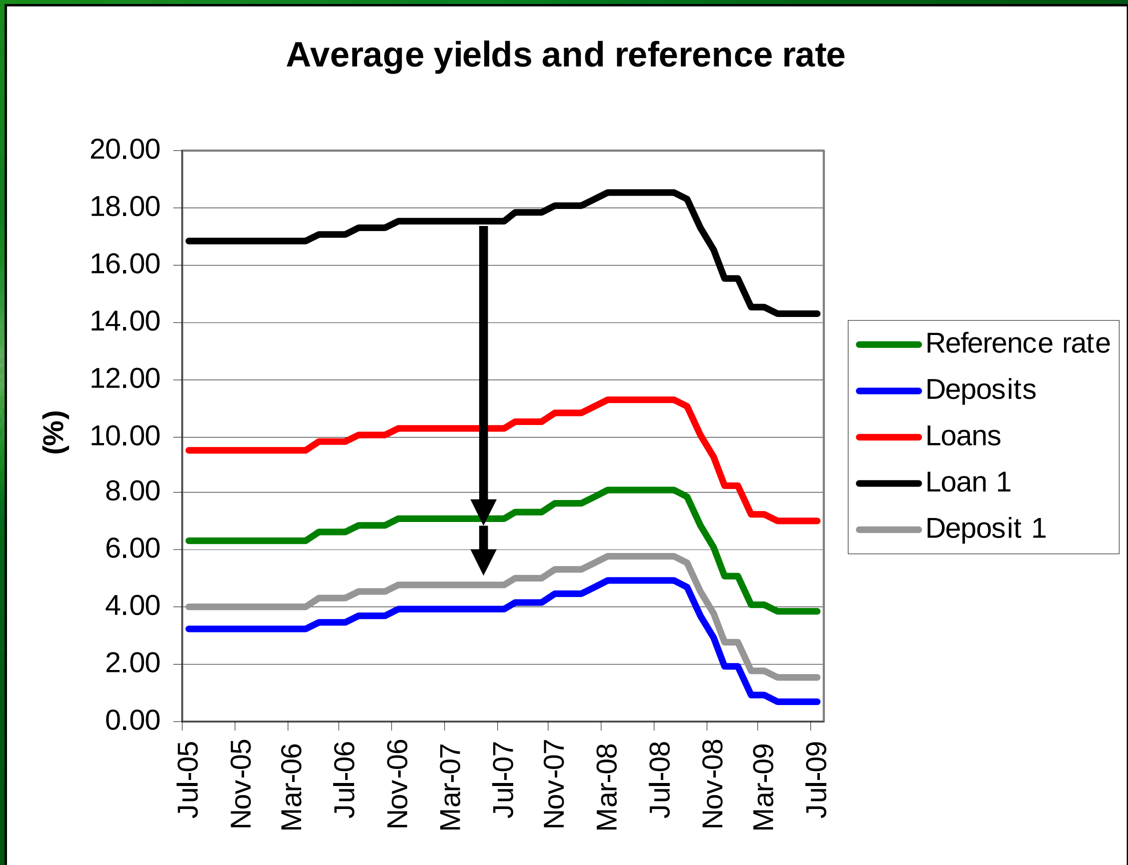


Interest margins

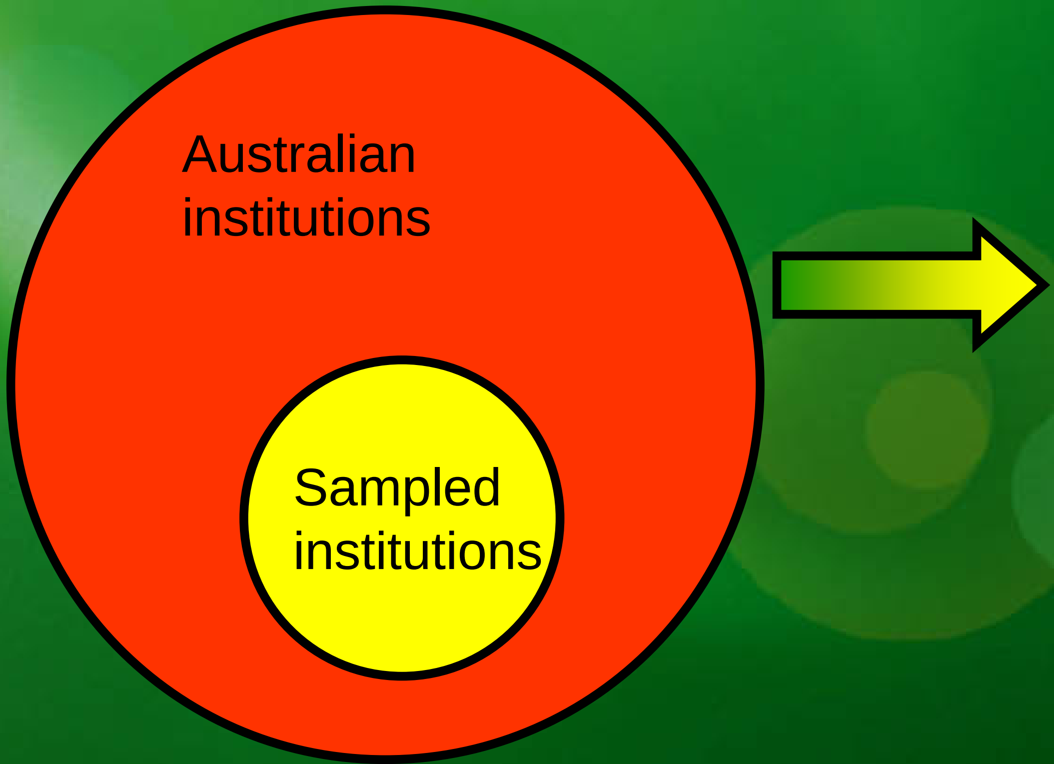
- Sample products
- Base period balance increased by CPI
- Calculate average interest rate (yield) on each type of account
- Calculate difference between product yield and reference rate
- Multiply by indexed balance to determine interest margin on product
- Sum interest margins on all products

- i
- $B_i * CPI_t / CPI_0$
- Y_i
- $Y_i - RR$ (loans)
- $RR - Y_i$ (deposits)
- $\%M = (Y_i - RR)$
- $\$M_i = \%M *$ Base bal loans
- $M = \Sigma \$M_i$

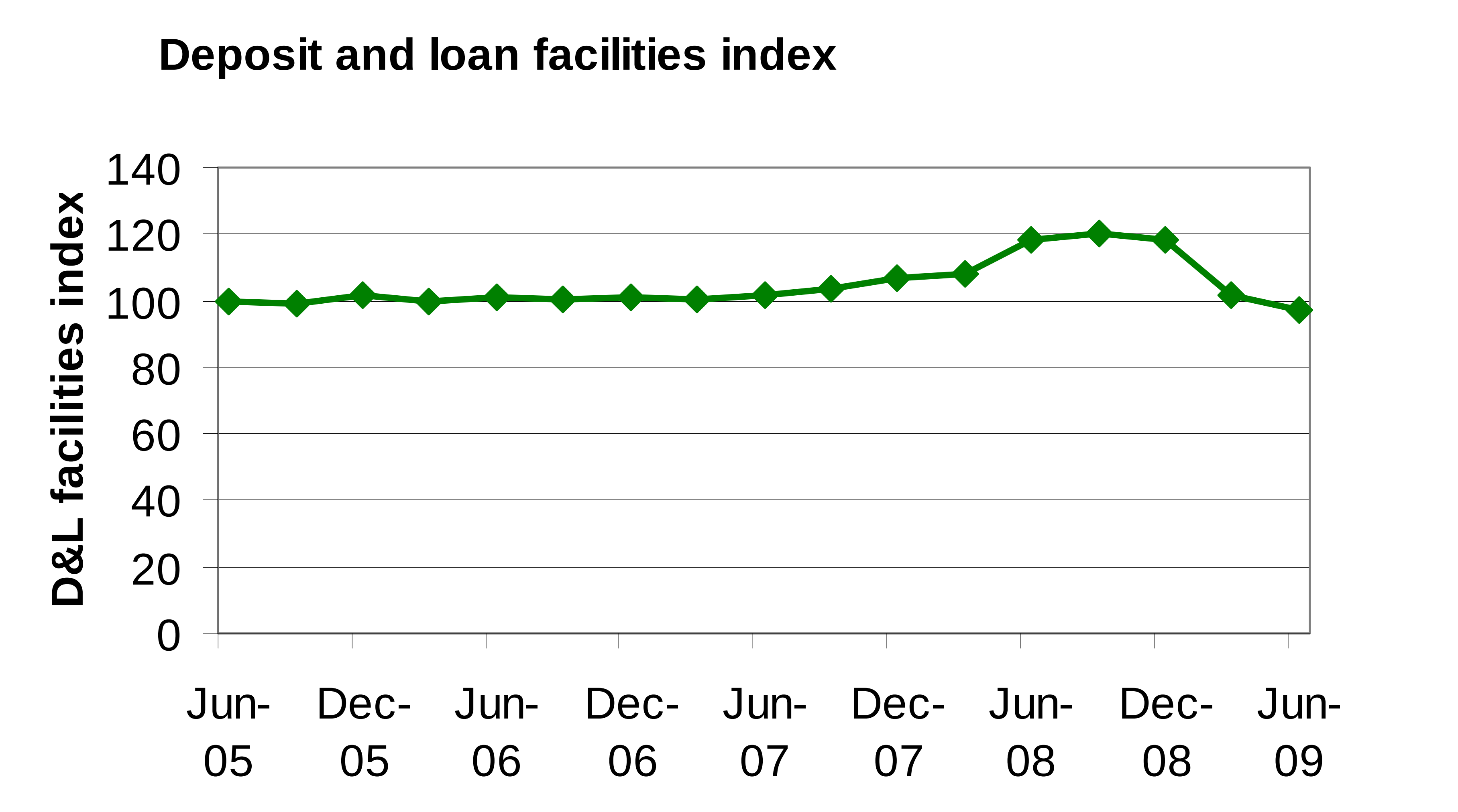
Interest margins



Base period weights

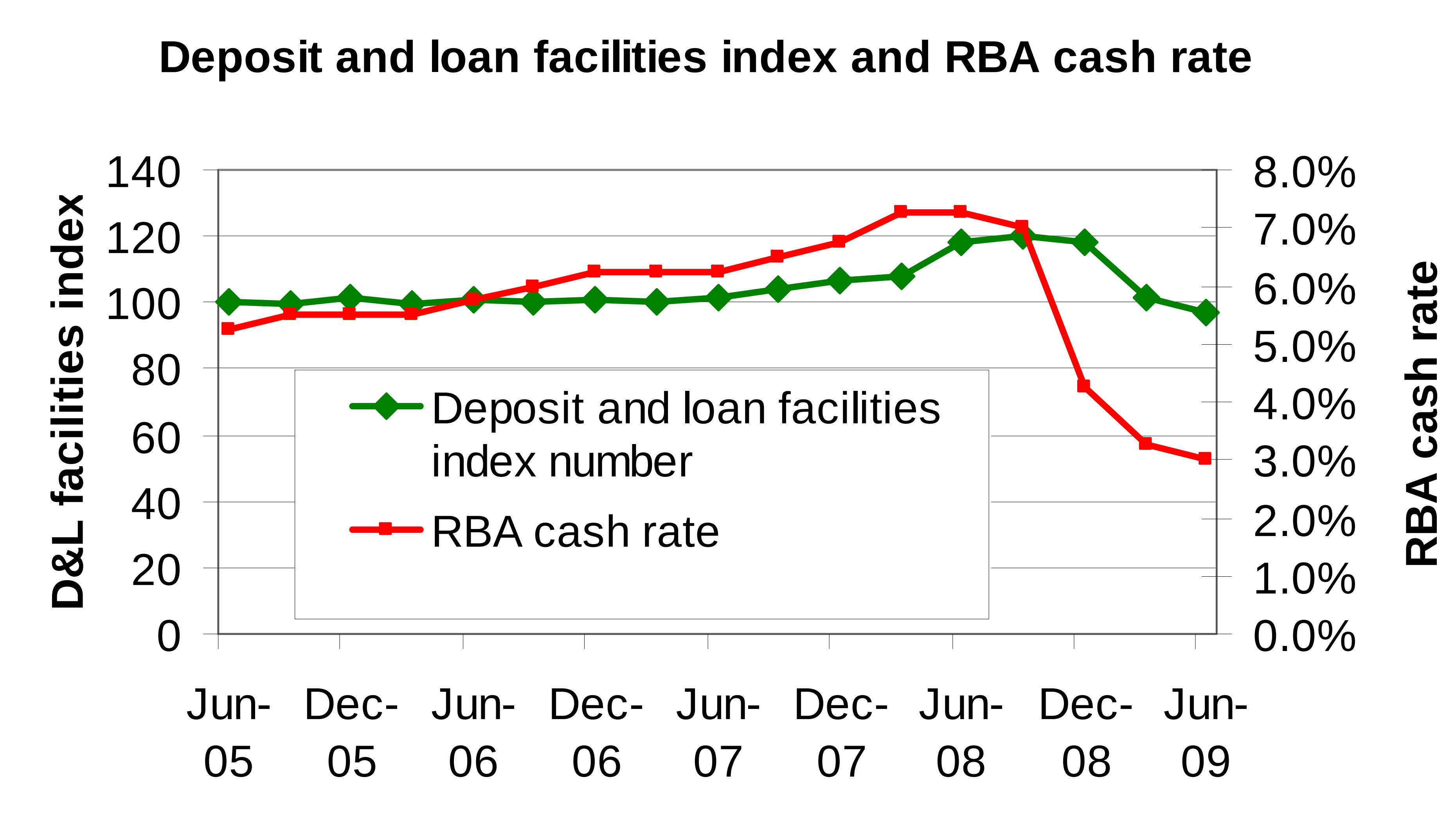


Results

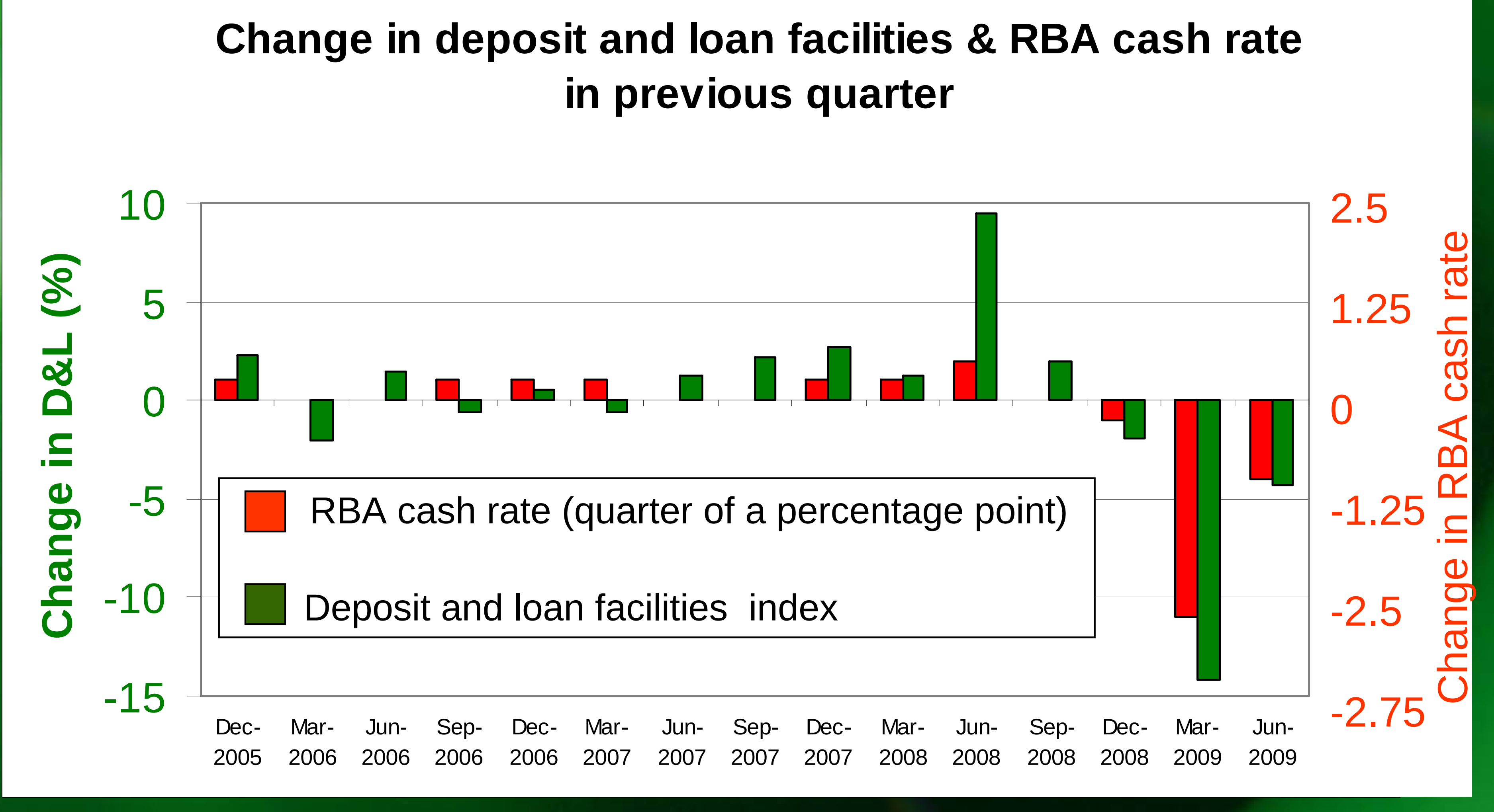


Deposit and loan facilities index
D&L facilities index
140
120
100
80
60
40
20
0
Jun-05
Dec-05
Jun-06
Dec-06
Jun-07
Dec-07
Jun-08
Dec-08
Jun-09

Results


Deposit and loan facilities index and RBA cash rate
D&L facilities index
RBA cash rate
140
120
100
80
60
40
20
0
8.0%
7.0%
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
Deposit and loan facilities index number
RBA cash rate
Jun-05
Dec-05
Jun-06
Dec-06
Jun-07
Dec-07
Jun-08
Dec-08
Jun-09

Results



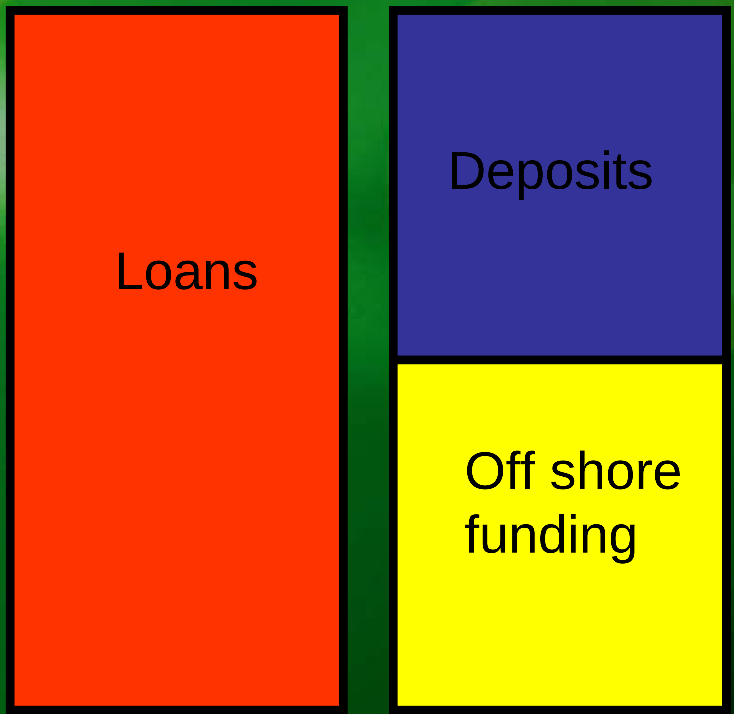
Change in deposit and loan facilities & RBA cash rate in previous quarter
Change in D&L (%)
10
5
0
-5
-10
-15
Change in RBA cash rate
2.5
1.25
0
-1.25
-2.5
-2.75
RBA cash rate (quarter of a percentage point)
Deposit and loan facilities index
Dec-2005
Mar-2006
Jun-2006
Sep-2006
Dec-2006
Mar-2007
Jun-2007
Sep-2007
Dec-2007
Mar-2008
Jun-2008
Sep-2008
Dec-2008
Mar-2009
Jun-2009

Effect of the GFC

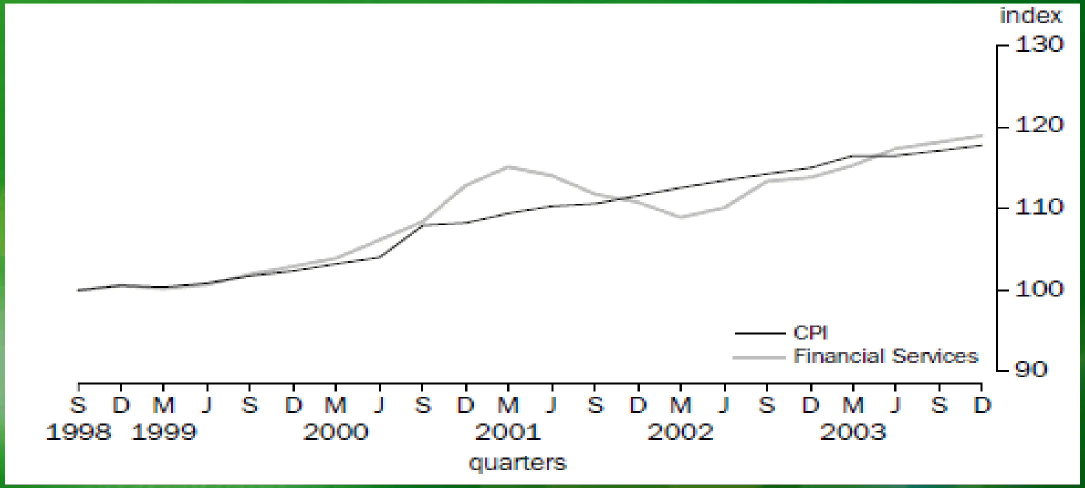
- GFC
  - caused banks to increase interest rates in excess of RBA rate rises
  - RBA rapidly changed interest rates
  - an increase in cost of offshore funds
  - increased deposit rates
  - securitisation
- Prior to GFC
  - interest rates were already rising to combat domestic inflation

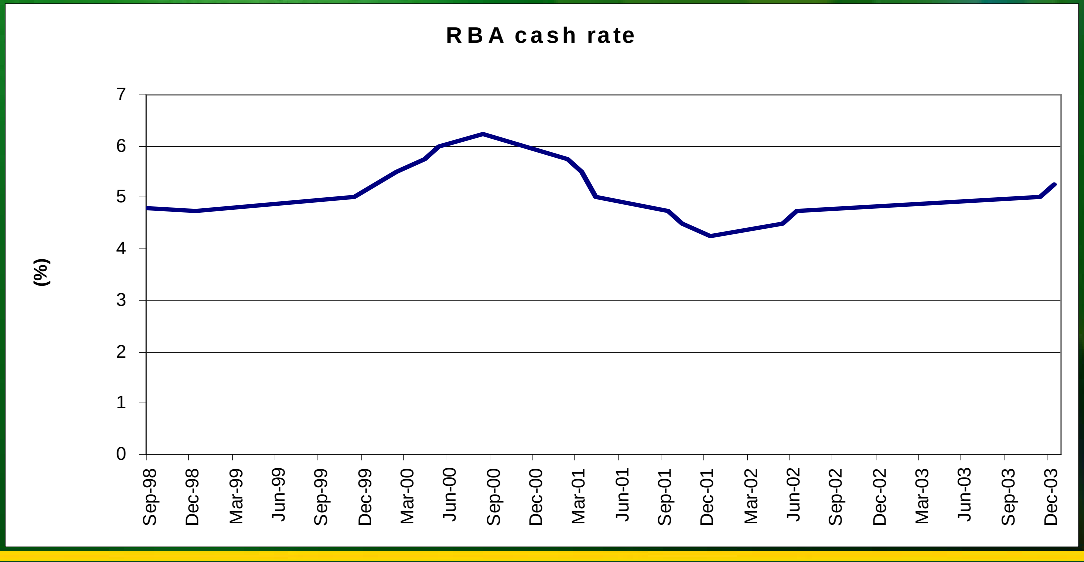
Other concerns

- Banks increased cost of funds not reflected in reference rate



Experimental series





Financial services index tracking interest rates prior to GFC

Australian Bureau of Statistics

Summary of observations

- Lack of sensitivity of transaction account yield to RBA cash rate causing tracking of cash rate
- In times of volatile interest rates index is volatile
- Results consistent with methodology
- Index also affected by increase in interest rates above the cash rate
- Product representativity is important and should be updated regularly

Cost to the consumer

- Does the methodology/choice of RR, accurately capture the cost to the consumer for financial services ?

Alternatives

- Original approach based on system of national accounts (SNA93)
- Difficulties in national accounts
- Alternative reference rates
- Alternative approaches
- Consistency/Cohesion ?

Exogenous reference rates

- RBA cash rate
- 90 day bank bills
- Changing products in reference rate

The future

- CPI 16th series review
- *Issues to be considered during the 16th series CPI review*
- Public submissions
- Public consultation

Alternative methodologies, some initial work

- Alternative methodologies deliver alternative results but general behaviour is similar to census index
- Do not offer less volatile alternatives
- Inconsistent with other ABS statistics and current international stance
- Practical difficulties
- Remain involved in international debate

Fixed rate products

- Fixed rate home loan: rate rise is delayed
- Reduces average loan rate squeezes margin
- Leads to a negative movement until delay is equalised
- Reverse movement to cash rate

- Term deposit: rate rise is delayed
- Reduces average loan rate squeezes margin
- Leads to a positive movement until delay is equalised
- Correlated to cash rate

Australian Bureau of Statistics