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Instalment Credit Boom in Australia 10 pages

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The instalment credit boom in Australia has resulted in doubling the volume of credit outstanding from 1953 to 1955. Although financing of producer goods has expanded, the major expansion has been the financing of household goods and automobiles as the supplies have become more readily available. The forthcoming general introduction of television should provide a further stimulus to this boom. This growth has come at a time when the immigration program and public and corporate investment projects have been placing excessive demands on Australian resources.

By June 1955, the volume of instalment credit had become equivalent to 24 per cent of total bank loans. Both because of its size and its recent rate of expansion, the Australian authorities have endeavored to bring this form of credit under regulation. The Australian States, which have legal jurisdiction in this field, have not been prepared to take coordinated restrictive action; accordingly, the Commonwealth authorities have attempted to use central-banking channels to reduce bank lending for this purpose. Additional measures were required to curtail the expansion of credit by the finance houses; to this end, the Prime Minister in 1955 requested the finance companies to agree on a voluntary basis to limit the increase in their credit and introduce down-payment and maturity limitations.

Post-war growth in instalment credit

Instalment credit in Australia has grown vigorously since the end of World War II. Between 1945 and 1951, the volume of outstanding credit grew from about £A. 6 to £A. 93 million (see Table 1). In the years immediately after the war, credit grew rapidly as a result of the backlog of war-deferred demand for consumer goods. In 1951, the post-Korean wool boom produced a further rapid expansion; high export incomes contributed to rising local incomes and produced a rush of imports in 1951-52. However, wool prices fell sharply in the second half of 1951 and the Australian economy found itself greatly overstocked with imported goods. During the slight recession and the financial stringency which then developed, consumer spending was restrained. As a result, outstanding instalment credit grew only from £A. 93 in mid-1951 to £A. 112 million in mid-1953. From late 1949, when the Australian currency was devalued, until 1953 sharply rising prices account for a substantial proportion of the growth in outstanding credit.

The rapid expansion in economic activity after the middle of 1953 was accompanied by a particularly sharp growth in the volume of instalment credit. In fact, the increase in outstanding credit from £A. 112 million in June 1953 to £A. 255 million in February

1/ This note is based in part on statistical and factual material supplied by the Commonwealth Bank of Australia.

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Table 1

Australia: Estimated Instalment Credit Outstanding at end of June a/

(In millions of Australian pounds)

	Finance companies b/	Retailers c/	Total	Per cent increase for recent years
1938	—	—	20.1	—
1939	—	—	19.5	—
1940	—	—	16.5	—
1945	3.6	2.0	5.6	—
1946	6.6	3.2	9.8	—
1947	13.1	6.0	19.1	—
1948	21.8	10.3	32.1	—
1949	33.7	14.4	48.1	49.8
1950	52.1	18.2	70.3	46.2
1951	(69.7)	22.9	(92.6)	31.7
1952	(78.3)	(23.8)	(102.1)	10.3
1953	87.6	(24.2)	(111.8)	9.5
1954	131.0	(32.8)	(163.8)	46.5
1955	179.5	(42.5)	(222.0)	35.5
1956 (Feb.)	205.1	(50.0)	(255.1)	14.9

Sources: Estimates of P. S. Shrapnel and N. Runcie, "Hire Purchase in Australia," Economic Monograph No. 181, August 1955 and Commonwealth Statistician. Figures in the parentheses are explained in the footnotes.

a/ Includes hiring (service) charges and insurance.

b/ Covers businesses which finance the sale of goods by retail but do not retail merchandise themselves. Since March 1954, the figures have included retail transactions initially financed by retailers but subsequently assigned to finance houses. The Commonwealth Statistician began publishing the series on a quarterly basis in March 1953 and on a monthly basis in January 1956. Estimates for earlier years were based on H. W. Arndt and P. S. Shrapnel, "Consumer Credit in Australia, 1945-51," Economic Record, May 1953 for years 1945 to 1951. The authors made estimates for 1952 and 1953 to link the two series.

c/ The Commonwealth Statistician published estimates of instalment-credit sales financed by retailers only for March 1954. Estimates for earlier years were based on the article in the Economic Record; subsequent estimates based on ratio of about 80 per cent of instalment-credit debt held by finance companies which is consistent with the statistics for March 1954.

1956 was probably the most rapid expansion in such credit in any country in the world during this period. Since prices of durable consumer goods were relatively stable at this time, the growth in instalment credit reflected a rise in volume as well as in sales value. This very large expansion was stimulated by the high level of employment and by the success of the finance companies in obtaining substantial sums of new funds from the public.

With this growth, instalment credit has become an increasingly important factor in the Australian economy. In terms of total consumer expenditures, outstanding balances rose from 3.6 per cent in June 1949 to 8.0 per cent in June 1955 (see Table 2). The percentage of household and other durable goods expenditures financed by credit rose from 10.6 per cent in June 1949 to 22.5 per cent in June 1955. Furthermore, the volume of outstanding credit rose from an equivalent of 11 per cent of bank loans in June 1949 to 24 per cent in June 1955. In fact, since 1953, instalment credit has grown more rapidly in Australia than in the United States. For example, it rose from 2.2 per cent of Australian national income in 1953 to 3.9 per cent in 1955; the comparable rise in the United States was from 4.9 to 5.4 per cent. 1/ This rise in the Australian figures came after a four-year period from 1950 to 1953 when the percentage was unchanged at about 2.2 per cent of national income.

Apparently, financing of household goods by credit is almost as common in Australia as in the United States; but the percentage of car sales on credit is substantially lower. 1/ In Australia, the finance companies supply about 80 per cent and retailers about 20 per cent of outstanding credit. Credit for most of the producer goods, for commercial and private automobiles, and for about half the volume of household goods is provided by the finance companies; retailers are primarily important in financing household goods. Automobile financing comprises about 43 per cent of credit outstanding, all other consumer goods 29 per cent and other producer goods 28 per cent.

1/ Shrapnel and Runcie, op. cit., present these figures on outstanding credit as per cent of national income:

	Cars a/		Other consumer goods		Total	
	U.S.	Australia	U.S.	Australia	U.S.	Australia
1949	1.8	0.9	1.3	0.9	3.1	1.8
1951	2.3	1.1	1.4	1.0	3.7	2.1
1953	3.2	1.3	1.7	0.9	4.9	2.2
1954	3.4	1.8	1.8	1.3	5.2	3.1
1955	3.6	2.3	1.8	1.6	5.4	3.9

a/ U.S. excludes cars sold to businesses; in Australia, all passenger cars.

Table 2

Australia: Selected Financial Statistics
(end of June figures)

	1949	1950	1951	1952	1953	1954	1955
1. Total instalment credit (In millions of Australian pounds)	48.1	70.3	92.6	102.1	111.8	163.8	222.0
2. Per cent of consumption expenditures a/	3.6	4.7	5.0	4.7	4.8	6.4	8.0
3. Per cent of expenditures of selected consumer goods b/	10.6	10.5	12.4	12.2	14.0	18.4	22.5
4. Per cent of bank loans	10.9	14.2	15.5	13.4	14.4	20.8	24.1

Source: Special compilation of Commonwealth Bank.

a/ Expenditures on food, clothing, footwear, drapery, hardware, electrical goods, furniture, tobacco, cigarettes, beer and similar items as estimated in Australian national income white paper.

b/ Expenditures on clothing, footwear, drapery, hardware, furniture, electrical goods and all motor vehicles.

Instalment credit terms

In Australia, statutory control of instalment credit terms rests with the individual State Government. They have legislation affecting instalment credit but, until recently, the laws were mainly concerned to define the rights of parties. Even in the few cases where regulation of credit terms have recently been introduced, the standards established fall far short of customary practices of the trade. For example, credit terms for motor vehicles have customarily provided for minimum down-payments of 33 to 50 per cent and for a maximum of 30 months. For household goods, down-payments customarily are about 10-15 per cent with 24 to 36 month maturities.

An attempt was made to get the States to agree to take legislative action to restrict instalment credit, but the Premiers rejected this proposal in 1955. Thereafter, the Federal authorities sought to restrict instalment credit within their limited authority. On July 5, 1955, the Governor of the Commonwealth Bank announced that the trading banks had been asked "not to grant new or additional advances for the purpose of expanding instalment selling" and that the finance companies were asked to apply funds raised outside the banking system to reduce bank borrowings.

In October 1955, the Prime Minister got the finance houses voluntarily to agree to limit the growth of credit and to accept down-payment and maturity standards. The finance companies could choose one of three formulae to determine the maximum volume of credit on June 30, 1956:

a. 10 per cent above the level for September 30, 1955;

b. 10 per cent above the volume for the month of September, 1955; or

c. 10 per cent above the average for the twelve months ending September 30, 1955.

In addition, the following terms for cars and trucks were agreed to, effective October 15:

	Minimum down-payment	Maximum term (month)
New cars, station wagons and trucks	33-1/3	30
Used cars and station wagons -- up to 2 years	33-1/3	24
up to 10 years	33-1/3 or 40	24 or 30
over 10 years	50	18
Used trucks -- up to 2 years	50	24
up to 10 years	50	18

A deposit of 15 per cent on household goods was also included. However, the finance companies have not accepted this term as binding because the Prime Minister did not obtain a similar agreement from retailers. 1/

Sources of instalment-credit funds

The recent expansion in the resources of the finance companies has been rapid. Between 1951 and 1955, the assets of 24 companies have grown from £A. 42 million to £A. 131 million and their loans from £A. 39 million to £A. 118 million (see Table 3). The growth of their funds has come from three major sources -- shareholder capital, bank loans and borrowing from the public. Between 1951 and 1955, capital and reserves were maintained at about 29 per cent of total liabilities, bank loans declined from 20 to 17 per cent and borrowing from the public remained at about 30 per cent.

1/ Neil Runcie, "Hire Purchase Charges," Voice (Australian periodical), May 1956.

Table 3

Australia: Balance Sheet of Instalment-Credit Finance Companies, 1951-1955

(In millions of Australian pounds)

	24 companies 1951	1952	1953	1954	1955	36 companies 1955
1. Assets:						
a. Outstandings	38.9	45.4	54.1	78.9	96.3	118.1
b. Other assets	3.1	4.0	4.3	7.1	7.7	12.4
Total assets	42.0	49.4	58.4	86.0	104.0	130.6
2. Liabilities:						
Capital and reserves	12.2	14.5	16.5	24.3	29.7	35.5
Bank loans	8.5	9.4	11.9	19.2	17.6	18.8
Borrowing from public:						
Short-term	4.7	4.6	7.8	8.4	9.8	17.1
Long-term	8.3	11.2	10.0	13.7	21.2	28.5
Total	13.0	15.8	17.8	22.1	31.0	45.6
Other liabilities	8.3	9.8	12.1	20.3	25.8	30.7
Total liabilities	42.0	49.4	58.4	86.0	104.0	130.6

The finance companies have maintained their capital position by offering new shares to the public and by adding to reserves out of current operating profits. Between 1951 and 1955, the ordinary and preference shares of 24 companies increased from £A. 8.7 to £A. 20.2 million and reserves from £A. 3.5 to £A. 9.5 million. Total new capital issues amounted to about £A. 12 million between June 1946 and June 1952 and to £A. 15 million from June 1952 to March 1956. After showing little growth from 1951 to 1953, new capital issues jumped sharply in 1954 and again in 1955 following the expiration of capital issues controls in December 1953. The buoyancy of the shares on the stock market, reflecting the consistently good profits performance of the larger companies, has stimulated interest in the stocks. For example, Rowan has calculated that the shares of finance companies on the Sydney Exchange rose by 6 per cent during a period when the index of industrial stocks fell by 29 per cent. 1/ Further, Runcie has calculated that the published profits after taxes of 35 finance companies in 1955 represented 14.9 per cent of shareholders funds compared with following percentages for other businesses 2/:

1/ D. C. Rowan, "Australia's Hire-Purchase Boom," The Banker (London), October 1955, p. 251.

2/ Neil Runcie, op. cit.

	Per cent
Mining	22.1
Durable consumer goods	12.7
Retail trade	10.1
Manufacturing	9.3
Banks	6.1
All businesses	10.1

Furthermore, the rapid expansion in instalment-credit business has produced large capital gains for investors.

In addition, these companies have made substantial borrowings from the public secured through debentures and notes for specified time periods running from 3 months up to 20 years approximately in accordance with the following rate schedule:

	Per cent
Three months	3-1/4
Six months	3-3/4
Nine months	4
Twelve months	4-1/4
Two years	5
Three years	5-1/2
Four to six years	6
Seven to twenty years	6-1/2

These rates rise to about 8 per cent for smaller companies, and higher rates are offered for unsecured deposits. It is estimated (on the basis of published company statements) that total new funds raised by all finance companies through debentures and notes amounted to £A. 31 million between July 1954 and March 1956.

The deposit rates offered by finance companies are much more favorable than those offered by the trading banks on time deposits. For example, the banks rates on deposits during 1955 were:

	Per cent
Three months	1-1/4
Six months	1-1/2
Twelve months	1-3/4
Two to three years	2

While there is no evidence of a shift of deposited funds from the banks to the finance companies, new funds seem to be attracted to the finance houses.

The spread between bank and finance house rates in part reflects the fixed structure of interest rates in Australia. The maximum bank overdraft rate was only recently raised from 5 to 6 per cent and current rates vary around a 5-1/2 per cent average. With an established maximum on loans, the time deposit rates have been fixed at between 1-1/4 and 2 per cent. Since the interest-bearing deposits of the Australian banks amount to about £A. 300 million, it would be expensive for the banks to compete for marginal accruals by offering higher rates. Furthermore, the finance companies are in a favorable competitive position, since the interest they pay represents only a small proportion of the interest charged to consumers.

Direct borrowings from the banks by the finance companies rose from £A. 8.5 million in 1951 to a peak of £A. 19 million in 1954. Following the Commonwealth Bank's requests to the trading banks to curtail their loans to finance companies, the total declined to £A. 17.6 million by the end of 1955. It is thought that the rates charged on these loans remain near the maximum rates allowable on advances.

Earlier, banks had been more important suppliers of funds to finance companies. In fact, as late as 1949-50, about half the funds available to 16 finance houses came from bank loans, according to estimates of Shrapnel and Runcie. 1/ In 1950-51, however, a major change in financing was inaugurated when the largest finance company began to borrow directly from the public at fixed rates of interest against securities or on deposit. Although it was encouraged by the reinstatement of Capital Issues Control from February 1951 to December 1953, this method of raising funds proved increasingly popular; for example, the Commonwealth Bank reported in June 1953 that "companies are showing increasing preference for this type of finance." 2/

The banks do only a limited volume of direct lending to consumers. One bank with a consumer-credit department recently formed a wholly-owned subsidiary to handle this business. In addition, two banks hold large but not controlling interests in finance companies. Further, the Industrial Finance Department of the Commonwealth Bank has done a substantial instalment credit business, but it has restricted its activity to producers goods and, since February 1955, no longer finances retail sales of automobiles.

Recent slowing down in finance-house credit expansion

The total volume of outstanding credit of the finance houses declined slightly during the first two months in 1956 from £A. 206.9 million at the end of December to £A. 205.1 million at the end of

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1/ Shrapnel and Runcie, *op. cit.*, p. 4.

2/ *Commonwealth Bank Report*, 30 June 1955, p. 18.

February. This fall compares to a rise of £A. 10 million in the first quarter of 1955. It is too early to estimate whether the maximum goals set by the Prime Minister last fall will be exceeded on June 30. However, there was a slowing down in the quarterly rate of increase during 1955. In comparison with the preceding quarter, the quarterly increase averaged about 10 per cent in 1954 and about 7 per cent in 1955.

The slowing down in the credit expansion since last fall can be attributed to three sets of measures taken by the authorities. In the first place, the finance houses' agreement with the Prime Minister to limit their expansion materially reduced their need for new funds; as a result, they have not been as active in obtaining new funds as they had previously been. In the second place, the excise taxes imposed in the April budget were designed both to reduce the Treasury's need to borrowing from the public and to curtail consumer spending on durable goods. Finally, the decision of the authorities to abandon the former pegged yields on Treasury securities has, among other things, improved the position of the Government in competing for funds in the market.

Concluding observations

The recent extraordinary growth in instalment credit contributed to Australia's external economic difficulties in 1955 and 1956 in at least two important ways. In the first place, it augmented consumption expenditures at a time when Australia's resources were becoming strained by large and growing public and corporate investment demands. This demand contributed to internal price rises and to the balance-of-payments difficulties.

In the second place, the expansion of instalment credit was at the expense of other claimants for funds from the banking system and the public. In a country seeking to carry out a heavy immigration program and extensive public and private investment projects, the disproportionate growth of funds flowing into financing consumer goods purchases tended to aggravate Australia's basic economic difficulty in the post-war period -- the excessive demands upon the country's available resources. The restrictive measures taken within the past nine months in Australia have been designed to keep under restraint the growth of instalment credit, as well as other forms of credit, in the face of the current levels of employment and demand.

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Addendum: A great deal of confusion has just been introduced into the situation in Australia by the decision of the instalment-credit houses not to extend beyond June 30, 1956, their voluntary agreement with the Prime Minister to limit the growth of such credit.

The Financial Times of July 3, 1956, reports that the major Australian credit firms have proceeded to announce a marked easing of instalment-credit terms on automobiles (page 2). For new cars and station wagons down-payments of only 25 per cent and 36 months terms have been introduced to replace the former limits of 33-1/3 per cent deposit and 30 months term. This action would seem to eliminate one of the principal restraints which the Australian authorities have been able to impose on this type of credit.