RESERVE BANK OF AUSTRALIA

Financial Stability Review

October 2026

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Financial Stability Review

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Financial Stability Assessment

Overall assessment

The Australian financial system has a good degree of resilience. Most borrowers – households and businesses – are well positioned to manage through a period of slowing economic growth and declining housing prices. Bank lending standards have remained prudent in recent years and Australian banks have established large capital buffers to absorb significant loan losses if they were to arise under extreme-but-plausible scenarios. Non-bank lending activity in Australia has supported favourable business credit conditions over recent years; as the rapid growth in the domestic private credit market has been from a low base, concerns over credit quality in segments of this market raise more issues for investor protection than financial stability. In sum, while cyclical domestic risks continue to be closely monitored, they are not assessed as posing systemic financial stability risks at present.

At the same time, threats to global financial stability continue to mount. Geopolitical risks are underscored by two ongoing conflicts and, over the medium term, intensifying strategic competition among major powers. Sovereign debt in some large overseas economies continues to trend higher from already elevated levels, and the increased participation in these markets by leveraged and price-sensitive investors is being closely monitored. Low risk premia in major equity and credit markets have contributed to buoyant financial conditions for businesses, but these risk premia could move sharply higher in response to an adverse shock potentially in a disorderly manner. One possible trigger could be a shift in sentiment towards the AI investment boom, which is increasingly fuelled by expectations of sustained rapid earnings growth and a debt-financing cycle that is becoming more opaque and circular. Alongside growing operational vulnerabilities – which are attracting significant attention from regulators domestically and abroad – these external factors are the most prominent threats to financial stability in Australia.

Key messages for industry

Overall, the Australian financial system is well positioned to absorb shocks but continued focus and action is required from industry to ensure this remains the case.

- In an environment of rapid technological change, increased concentration and connectedness, strengthening ***operational resilience*** requires ongoing action across the financial system. There is a varying level of preparedness across the system and it is essential that operational resilience is given due focus including by critical service providers such as operators of financial market infrastructure.
- To maintain ***financial resilience***, it is important that lending standards remain sound in the face of ongoing strong competition in lending. It is also important that as the superannuation sector grows, its liquidity risk management practices continue to strengthen.
- ***Overall risk management and recoverability planning must continue to evolve to meet new challenges.*** The growing risk that financial and non-financial risks crystallise together suggests industry needs to prepare for scenarios that are more multifaceted than in the past. This includes the ability to respond and recover quickly from a wide range of eventualities. Consideration of more extreme scenarios and stress tests, and more rigorous crisis simulations and other crisis preparedness activities – including at the industry-wide level and across regulators and government – are particularly pertinent in this environment. CFR agencies will continue to work with industry on preparedness initiatives.

The international economy and financial system have weathered several shocks in recent years with limited lasting disruption, but threats to international financial stability continue to mount.

The apparent resilience in the international financial system over recent years has been encouraging, but longer-term threats to financial stability are intensifying, including from those originating outside the system. The global macro-financial environment is vulnerable to external shocks.[1] Conflicts in the Middle East and, to a lesser extent, Ukraine continue to disrupt global supply chains, and near-term resolutions to both conflicts are difficult to foresee. More broadly, geopolitical tensions beyond these regions appear likely to remain elevated for the foreseeable future. The pace of technological development is also intensifying. This brings with it not only opportunities for productivity-enhancing investment, but also the risk of significant operational disruptions, including from the complexity of integrating new technologies into existing systems and from the use of new technologies by malicious actors. AI is a current example and quantum decryption will become an increasing threat if post-quantum cryptography is not implemented early enough.[2] Meanwhile, longer-term shifts in climate patterns, and an increased frequency and severity of extreme weather, also contribute to a more challenging environment.

These external factors, combined with the increasing complexity and interconnectivity of the domestic and international financial systems, could be making a system-wide shock more likely and its potential consequences more severe. In particular, the potential for financial and non-financial risks to interact in complex and novel ways is a growing focus of

financial system regulators in Australia and internationally. One area of related attention is the growing concentration of common service providers within and to the financial sector, which means that the effects of a major operational disruption at one service provider could cascade across a wide range of entities. The evolution in the geopolitical and cyber risk landscapes also raises the prospect that opportunistic cyber-attacks on key institutions occur at a moment of generalised financial stress, potentially interacting in a way that undermines confidence in the financial system and results in system-wide consequences that are complex to manage.

Recent developments related to global sovereign bond markets, the AI investment boom, low market risk premia and operational resilience are also reinforcing risks to international financial system stability.

Sovereign debt in some large overseas economies is trending higher from already elevated levels, and the recent increase in government bond yields will increase debt-servicing costs. The rise in government bond yields over recent months has been driven by a number of factors, including a rise in expected policy rate paths as well as competition for debt funding from AI-related corporate bond issuance. While the absence of credible medium-term fiscal frameworks in several large advanced economies has yet to elicit a major focus from financial market participants, it is possible that debt sustainability concerns begin to mount if bond yields continue to rise without a commensurate increase in long-term growth expectations. Price-sensitive investors are once again accounting for a large share of activity in government bond markets (as central bank purchases have abated), and these participants are requiring higher compensation for risk. Some, including hedge funds, are using significant amounts of leverage in these markets to profit from small arbitrage opportunities. This raises the prospect of increased volatility – and potentially a disruptive sell-off – in core bond markets that are central to the operation of the global financial system. While the upward move in sovereign bond yields has generally been orderly to date, a disorderly repricing in government bond markets could have adverse spillover effects into other asset classes. Elevated sovereign debt burdens also mean that the capacity of some governments to respond to economic shocks with fiscal support is more limited.

The rapid pace of developments in AI are boosting expectations for earnings growth and productivity, but may also be increasing risks to financial stability via operational and financial risk channels. Over the medium term, AI has the potential to support productivity growth and strengthen operational resilience by improving the cyber defence capabilities of banks, financial market infrastructures (FMIs) and other financial institutions. But rapid advancements in AI could also worsen the cyber threat landscape before these defensive capabilities are fully developed, increasing the likelihood that underlying operational vulnerabilities could be exposed. This includes how AI capabilities interact with the development of other emerging technologies, such as quantum computing. The net impact of AI on cybersecurity will depend on a number of factors, including how quickly and thoroughly firms respond. Even prior to the emergence of frontier AI models this year, the threat of system-wide operational disruptions had already been rising over recent years due to worsening geopolitical conflicts and the growing prevalence of common service providers – including from outside the financial sector (see 4.1 Focus Topic: Operational Risk and Financial Stability).[3]

The exposure of financial market participants to the AI investment boom is increasing at a time when risk premia in global equity and credit markets are low by historical standards. Compressed risk premia in major markets have supported financing conditions for businesses, but also leave them vulnerable to sharp repricing if there were to be a sudden shift in global risk appetite. One trigger could be a shift in sentiment about the outlook for AI-related profitability of 'hyperscalers' (large AI-related companies) with the effect amplified by rising concentration and leverage in equity markets, particularly in the United States. To fund the surge in AI-related investment, a number of large firms have increasingly turned to both on and off-balance sheet leverage, which could create hidden and opaque interlinkages. Some arrangements now involve circular financing models where hyperscalers provide vendor financing for key customers (see Box: Funding the AI investment boom). Over time, this could lead to a further build-up of vulnerabilities in the financial system.

Stability risks arising from activity in global private credit markets have also grown, although spillovers to the core banking system have been limited. Investor concerns over asset quality in several international private credit funds have remained elevated following the high-profile defaults of some private credit borrowers in late 2025 and early 2026. For some private credit funds, the concerns centre around their exposure to sectors perceived as negatively affected by AI and some funds in the sector more broadly have had to enforce limits on investors redeeming their capital. These developments have drawn attention to vulnerabilities in segments of the private credit market, though stress has been largely idiosyncratic so far. In major advanced economies, linkages between private credit funds and the core of the financial system are estimated by authorities to be growing from a low base, though limited data availability make it challenging for authorities to monitor the sector.

External shocks to the Australian financial system could transmit through various channels, depending on the context.

In the event of a period of severe global market stress, financial conditions in Australia are likely to tighten. A further escalation in geopolitical tensions or adverse policy or macro-financial developments – including in relation to sovereign debt sustainability or a deterioration in expectations for AI profitability – could trigger disorderly asset price corrections, particularly where investors have been using leverage to boost returns. This could impair market functioning and elicit a sustained increase in risk aversion across global financial markets. Australia is unlikely to be immune should international funding conditions abruptly tighten, given that equity risk premia, corporate bond spreads and sovereign bond term premia in Australia tend to move closely with those in other advanced economies. While large Australian corporations have taken steps over recent years to mitigate offshore refinancing risk and banks have similarly reduced their exposure to offshore funding risk, such a shock would likely affect access to financing by businesses and financial institutions.[4]

A major operational disruption – originating in Australia or overseas – has the potential to interact with traditional financial risks in complex ways. Depending on the circumstances, the event could undermine public confidence in the Australian financial system and could quickly translate to financial stress and economic disruption if payments were to stop flowing for a time and people temporarily lost access to their funds. If an outage occurs at a common service provider – such as an FMI or key technology provider – the effects could be widespread. Unlike financial risks, whose emergence is likely to be largely confined to the

regulated financial sector, operational risks to financial stability can originate from a much broader range of entities including common utility or technology providers, over which supervisors have limited oversight. If an operational outage impaired the provision of liquidity to the financial system, this could severely affect the crisis response (see 4.1 Focus Topic: Operational Risk and Financial Stability). Furthermore, in the event that a major shock severely affected the economy of a key trading partner, the cash flows of Australian exporters would be affected with downstream consequences for employees, creditors and suppliers, although any depreciation of the exchange rate would provide some offsetting support to the economy over time.

Domestic cyclical developments do not pose systemic risks to financial stability in Australia at present, but are being closely monitored.

Most Australian borrowers appear well positioned to manage ongoing cost pressures and declining housing prices. Most households have substantial cash flow and saving buffers, which supports overall resilience in the system. Under adverse-but-plausible scenarios for housing price declines, most borrowers would still have equity buffers in their property given the preceding run-up in prices and prudent lending standards. This provides these borrowers the option of making the decision – though difficult and disruptive – to sell their property to pay off their loan fully if they experience acute financial stress. Most businesses are also expected to remain resilient in the period ahead, although smaller businesses and those in more energy-intensive or cyclical industries with fewer buffers, such as transport, hospitality and construction, are more vulnerable to cost pressures. This is particularly the case if a significant weakening in aggregate demand were to make it harder for them to raise prices to cover their higher costs. In short, while there are pockets of stress in the household and business sectors, both sectors display a good level of resilience overall, as reflected in low loan arrears.

Banks are well positioned to weather a material deterioration in the housing market and a softening in economic conditions more broadly. Banks have maintained prudent lending standards, and the high quantity and quality of capital in the banking system means banks could absorb losses from an adverse macroeconomic shock while continuing to extend credit.

As abroad, regulators in Australia have somewhat less visibility of risks from non-bank lender activity (including private credit), though the financial stability implications of this sector are currently limited by its relatively small size and limited interconnections with Australian banks. Non-bank lenders have provided an alternative source of financing for businesses in Australia, accounting for around 10 per cent of total business debt outstanding. Within this cohort of lenders, private credit funds have expanded over recent years but from a small base and, importantly, banks' exposures to them remain limited. Relative to the US private credit industry, Australian private credit funds are less exposed to companies disrupted by AI, though are more exposed to real estate, including construction and development. While investors in Australian private credit funds may face heightened risks of lower-than-expected (or negative) returns in a downturn, and this could affect the supply of new financing to real estate construction in particular, the implications for the broader stability of the financial system would be limited. However, there are a number of investor-protection issues relating to

opaque valuation practices and uneven standards of governance and risk management that the Australian Securities and Investments Commission is addressing (see Box: Private credit in Australia).

The Australian financial system is well placed to absorb financial shocks, but continued action is required to safeguard overall resilience.

Operational resilience requires ongoing action.

- Improving operational resilience has become a prominent focus of regulators, banks, FMIs, superannuation funds and other financial institutions. This includes the development of robust contingency and recovery plans and crisis response capabilities. There is, however, a varying level of preparedness for operational disruptions across the financial system.
- In an environment of rapid technological change, increased concentration, rising interconnectedness and heightened geopolitical risk, maintaining and building operational resilience will require ongoing vigilance across the financial system. This includes action by highly critical service providers such as FMIs.[5] Austraclear is a particular focus for the RBA in its supervision activities at present given Austraclear's central role in the financial system and the issues identified in relation to its operational resilience, including the ability to maintain critical services during a prolonged outage.[6]

Capital and liquidity resilience must be maintained.

- It is important that lending standards remain sound in the face of continued strong competition in lending so that resilience is not eroded in an environment more prone to shocks.
- The superannuation sector has been an important source of resilience and stability in the broader financial system over the years, but ongoing work to strengthen liquidity risk management practices is warranted as the sector continues to grow in size and as a larger share of superannuation balances become accessible to members.

A broader strengthening of risk management practices will be an important counterweight to growing financial stability risks, particularly external shocks.

- As structural and cyclical risks to financial stability are mounting, particularly from overseas, the financial sector must position itself to be able to maintain continuity of service across a range of adverse scenarios. It is possible that financial and non-financial (particularly operational) risks crystalise in complex ways in the future. Robust and creative use of scenario analysis, stress testing, crisis simulations and other crisis-preparedness activities are particularly valuable in this environment. The member agencies of the Council of Financial Regulators are increasingly engaging with regulated entities, industry groups and government on a range of crisis scenarios, including scenarios that consider a broader range of possibilities than in the past, with particular focus on geopolitical shocks and multi-day operational outages at critical infrastructures.

Box: Key global and domestic vulnerabilities

The RBA's conceptual framework for assessing financial stability focuses on identifying and monitoring vulnerabilities. Vulnerabilities are characteristics of the financial system that increase the likelihood that risks will materialise and/or increase the severity of adverse outcomes. The probability and nature of individual risks[7] to financial stability and the transmission of shocks through the financial system are also considered in the assessment. However, having a particular focus on vulnerabilities allows policymakers to better identify actions that can be taken to enhance the financial system's overall resilience. The framework also considers resilience of the system to vulnerabilities. Resilience involves actions or characteristics of financial institutions, participants in the financial system or the financial system structure that dampen the negative effect of shocks when risks materialise.[8]

Figure 1 sets out key global and domestic vulnerabilities. It is not an exhaustive list of vulnerabilities.

Figure 1: Key Global and Domestic Vulnerabilities of the Financial System

Vulnerabilities	Associated risks	Resilience considerations
Operational resilience		**Source:** Domestic Global
More complex and interconnected financial system Reliance on common material service providers	Cyber-attack or operational outage disrupts critical services Disruption to payments and other financial market infrastructures Contagion through common service providers and critical infrastructure	Governance, risk culture and risk management practices Regulatory coordination arrangements Information sharing across financial institutions, regulators, and security authorities (including business continuity plans)
Global equity and credit markets		**Source:** Global
Compressed risk premia and elevated prices Concentrated and opaque exposures to the AI investment cycle Material participation in markets by leveraged non-bank financial institutions	Sharp and disorderly price adjustments Forced deleveraging and asset fire sales Spillovers across equity and funding markets	Liquidity preparedness Enhanced data collection Capital to absorb losses
Sovereign debt markets		**Source:** Global
High and rising government debt Greater reliance on leveraged and price-sensitive investors	Shifts in investor confidence, sharp repricing Forced deleveraging by leveraged investors Spillovers to Australian funding markets	Liquidity preparedness Central bank liquidity facilities
Households and businesses		**Source:** Domestic
High household leverage and asset prices	Labour market shock Challenges to debt serviceability Extended housing market downturn	Sound lending standards Household equity and liquidity buffers Bank capital and loan loss provisioning
System liquidity		**Source:** Domestic
Concentrated holdings of liquid assets in markets that may not perform well in stress Growing role of superannuation industry in the Australian financial system	Unexpected liquidity calls on superannuation funds Inability to monetise bank debt and semi-government securities in stress	Liquidity preparedness and liquidity risk management practices Superannuation funds are currently in the accumulation phase Central bank liquidity facilities

Source: RBA

Endnotes

1 The different characters of these threats were set out in Jones B (2023) 'Emerging Threats to Financial Stability – New Challenges for the Next Decade', Speech at the Australian Finance Industry Association Conference, Sydney, 31 October. For an overview of the implications of a more shock-prone environment for Monetary policy, see Bullock M (2026), 'Monetary Policy in an Era of Shocks', Speech at the Anika Foundation Fundraising Lunch, Sydney, 28 July.

2 At its June 2026 meeting, the Payments System Board (PSB) discussed the emerging risks from advances in classical and quantum computing, and the approaches to strengthening cryptographic protections in card payments. The PSB also endorsed consulting on strengthening cryptographic practices as part of the Review of Payments System Regulation to further assess risks, uncertainties and regulatory options. The PSB also reaffirmed its expectation that industry maintains strong momentum in its cryptographic uplift efforts. See RBA (2026), 'Payments System Board Update: June 2026 Meeting', Media Release No 2026-14, 4 June.

3 Lwin J and G Holland (2026), 'Geopolitical Risk and Financial Stability', RBA *Bulletin*, 9 June.

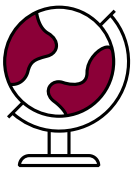
4 For an overview of how international shocks can transmit to the Australian financial system, see RBA (2025), '4.1 Focus Topic: How Overseas Shocks Can Affect Financial Stability in Australia', *Financial Stability Review*, October.

5 This includes critical payments systems operated by the RBA, such as the Reserve Bank Information and Transfer System (RITS). The assessment of RITS, published in June 2026, noted that while significant expenditure and effort have been made by the RBA to enhance RITS's operational risk management, the focus on operational risk must continue given the more challenging external environment. See RBA (2026), 'Assessment of the Reserve Bank Information and Transfer System', June.

6 See RBA (2026), 'Assessment of ASX Clearing and Settlement Facilities', September.

7 Risks are potential adverse events that result in losses (financial and/or non-financial) to financial system participants or otherwise affect the provision of financial services.

8 See RBA (2025), '4.1 Focus Topic: A Conceptual Framework for Assessing Financial Stability', *Financial Stability Review*, April.



Chapter 1
The Global Macro-financial Environment

Summary

The international financial system and global economy have weathered several shocks in recent years with limited lasting disruption. These have included the outbreak of the pandemic, high inflation, large moves in interest rates and energy prices, shifts in global trade policy, supply chain disruptions, bank runs and conflicts in Europe and the Middle East. In part, this resilience reflects buffers in financial sector, household and corporate balance sheets that have strengthened since the global financial crisis (GFC), and more adaptable supply chains. More recently, robust growth in current and expected future revenues in the AI and broader technology sector has supported growth in some economies, as well as strong gains in equity markets, though the sustainability of these developments is a key source of uncertainty to the outlook.

At the same time, elevated geopolitical tensions, intensifying technological disruption and operational risk, and growing vulnerabilities in key sovereign bond and risk asset markets, could pose serious challenges to the global financial system. If crystallised, these threats could also spill over to Australia, via disruptions to critical services and/or a disorderly adjustment in core international financial markets.

- **Operational vulnerabilities have continued to grow in response to increasing cyber-attack capabilities and the reliance of financial services on common service providers, including those that sit outside the regulatory perimeter.** The emergence of frontier AI models has increased the complexity of the international cyber threat landscape that was already heightened due to activity by state-sponsored and other malicious actors. While advances in technology can help to strengthen resilience in some circumstances, the pace of technological disruption and reliance of financial institutions on a small number of critical technology service providers is also increasing operational vulnerabilities in the financial system. This concentration means that a targeted cyber-attack or operational outage could have system-wide implications.
- **Vulnerabilities in overseas sovereign bond markets persist.** Government debt burdens are elevated in major advanced economies and expected to rise further, and higher bond yields are increasing government debt servicing costs. Meanwhile, leveraged non-banks have continued to increase their participation in sovereign bond markets. Any stress event could therefore be amplified by a rapid unwinding of positions by leveraged participants, which could impair market functioning, including in closely linked repo markets.

- **Risk premia in global equity and credit markets remain low by historical standards, and the exposure of these markets to the AI investment boom continues to grow.** Compressed risk premia might leave major global markets vulnerable to sharp repricing if there were to be a sudden shift in global risk appetite. Along with a worsening in geopolitical tensions or disorderly repricing in sovereign bond markets, a notable potential catalyst could be a deterioration in expectations for AI adoption or profitability. The growing leveraged participation in equity markets associated with AI-related exposures could further exacerbate such volatility. At the same time, the growing funding needs of the AI investment boom have widened the range of investors and financial institutions exposed, while opaque and circular funding models have become increasingly common.

Despite broad-based resilience, pockets of stress have emerged in other areas of the global financial system. Recent developments have exposed vulnerabilities in some private credit markets, although stress has generally been concentrated in specific funds and direct links to the core financial system have been limited to date. Large banks, corporates and households in advanced economies have generally remained in a solid financial position, though persistent cash flow pressure from energy costs, trade disruptions and tightening financial conditions could weigh on more vulnerable borrowers. In China, deleveraging in parts of the household and real estate sectors has continued, with longstanding financial imbalances likely to remain a focus for policymakers for some time.

1.1 Global risk landscape

Over recent years, the international financial system has weathered many shocks.

The global macro-financial environment continues to be defined by elevated geopolitical tensions, policy uncertainty and a rapid pace of technological innovation.

- The geopolitical environment remains highly fluid, marked by the stop-start nature of the conflict in the Middle East, ongoing hostilities in Ukraine, and the resulting market volatility and commodity supply-chain disruptions. Trade policy uncertainty has further raised the risk of disruption to trade flows.
- Cyber risks also remain elevated amid ongoing international tensions, while competition to develop frontier AI capabilities is increasingly taking on a geopolitical dimension.
- Fiscal sustainability remains a concern in major advanced overseas economies reflecting expected increases in expenditure related to defence, ageing populations and climate change.
- Rapid technological advances are changing the operational risk landscape, with growing adoption of AI in financial services and the prospective widespread use of decentralised-finance innovations, such as stablecoins and decentralised ledger technology, introducing new links between financial and operational risk.
- The outlook for monetary policy has shifted, with rising inflation risks leading most advanced economy central banks to tighten policy or signal a bias to do so in the future.
- Global momentum in financial regulation continues to shift towards a more pro-growth posture. While financial stability considerations remain at the forefront of global discussions, the shift in posture raises medium-term risks associated with global regulatory divergence and trade-offs between growth and resilience.

At the same time, the global financial system has appeared quite resilient to date.

- The global economy has weathered a series of sizeable shocks. While global energy and commodity prices generally remain above their pre-conflict levels, the impact of energy and trade disruptions has been partly mitigated by factors such as redirected trade routes and strategic use of inventories, alongside a reduction in global oil demand, particularly in China. While some of these developments may signal the global economy has become more resilient to shocks, others, including the inventory drawdown, may only temporarily mitigate risks to inflation, activity and financial stability.
- Likewise, despite repeated bouts of volatility, major global financial markets have continued to function in an orderly fashion and investors seem prepared to accept risk premiums that are lower than historical norms. In part, this could reflect market participants' expectations of support from policymakers in response to shocks, alongside confidence in the durability of the AI boom and in the underlying resilience of the core financial system following the post-GFC reforms.
- Meanwhile, expectations of demand for AI services and related investment have remained robust and have continued to support growth in some economies, as well as equity market outcomes.

Taken together, there remains the potential for more severe and persistent shocks to materialise and pose threats to macro-financial stability. For example, further energy market disruption remains a prominent risk, with energy prices rising sharply again in September in response to developments in the Middle East, and aspects of the AI boom could threaten financial stability through operational and financial channels.

1.2 Key vulnerabilities that could affect financial stability in Australia

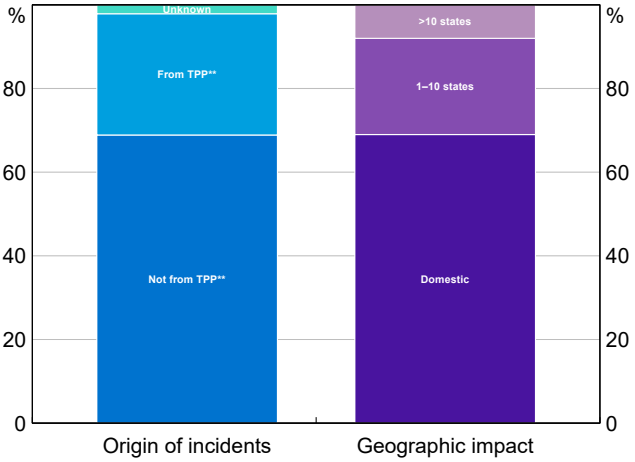
Heightened geopolitical tensions and rapid technological advances have exacerbated operational vulnerabilities throughout the financial system.

Advances in AI capabilities and access to AI models by different actors have increased the complexity of the cyber threat landscape. The launch of frontier AI models (such as Anthropic's Mythos in April), and widespread advances in agentic AI have increased the potential speed, scope, frequency, sophistication and severity of cyber-attacks, while the faster and more frequent patching required to address cyber vulnerabilities also heightens operational risks.[1] In addition, the experimental nature of many of these advances and related testing has recently led to several incidents, including of frontier models bypassing controls, leading to unintended harmful security breaches. At the same time, these models have the potential to strengthen resilience by improving the cyber defence capabilities of banks and other key financial institutions. The net impact on cyber security in the financial system will ultimately depend on a number of factors, including future AI capability improvements, costs and reliability, the accessibility of advanced models by different actors, and the ability of institutions to identify and address vulnerabilities.[2]

More broadly, the rapid adoption of AI across the financial sector has the potential to yield both benefits and risks for financial institutions. Financial institutions are increasingly adopting AI to enhance efficiency and productivity in areas such as credit risk assessments, trading and portfolio management, fraud detection, regulatory compliance and customer services. However, increasing AI adoption introduces other risks such as herd behaviour and market correlation, and risks around model accuracy, data management and governance.[3] Use of AI also has the potential to accelerate the development of other emerging technologies, such as quantum computing, that pose both threats to and opportunities for the financial system.[4] To support the responsible adoption of AI by financial institutions and help manage related benefits and risks, the Financial Stability Board (FSB) released a consultation report in June outlining practices covering governance arrangements and the management of risks through the AI lifecycle.[5]

As financial systems have become more operationally complex, interconnected and reliant on common service providers, the potential impact of cyber-attacks and operational outages has increased. Greater digital interconnectedness across financial system participants is expanding potential attack surfaces, while heightened geopolitical tensions have increased cyber threat activity directed at critical infrastructure.[6] At the same time, the growing deployment of AI and other innovative technologies in banks' operations is increasing reliance on complex internal systems and external service providers, including across borders, creating new operational dependencies and (in some circumstances) high concentration. The small number of non-substitutable providers of cloud, data and AI services increases the risk that an operational outage or cyber incident could simultaneously disrupt multiple financial institutions, with the potential to lead to, or exacerbate, financial stress with systemic consequences for financial stability.[7] A joint report from European supervisory authorities has indicated that almost one-third of major information and communications technology (ICT) incidents in the euro area that affected financial entities in 2025 originated at third-party providers (Graph 1.1).[8] Globally, regulators are prioritising initiatives alongside industry to strengthen operational resilience in the financial system, including by adapting risk management frameworks, enhancing incident response and coordination arrangements, and monitoring the rollout of AI tools in the broader economy and their implications for the cyber threat landscape. Strengthening operational resilience across the financial industry has also been a focus of regulators in Australia for a number of years. For a discussion of these vulnerabilities and a summary of initiatives underway, see 4.1 Focus Topic: Operational Risk and Financial Stability.

Graph 1.1
Major Euro Area ICT Incidents*
Share of 3,383 incidents

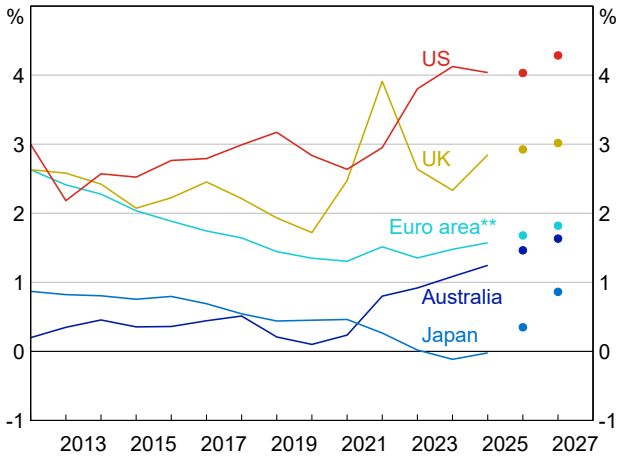


* Major ICT incidents are ICT incidents that have a high adverse impact on the network and information systems that support critical or important functions of financial entities.
** Third Party Provider (TPP).
Sources: EBA; EIOPA; ESMA.

Vulnerabilities in global sovereign bond markets persist, amid rising yields and growing participation by leveraged non-bank financial institutions.

Government bond yields have risen further in some advanced economies, including Japan, the United Kingdom and the United States. The increase in shorter-term yields reflects expectations of monetary policy tightening in response to near-term inflationary pressure. The rise in longer-term yields has been largely driven by increasing real yields. In part this reflects increased demand for capital from strong AI-related investment and expectations of higher productivity growth, which could be associated with a higher equilibrium level of longer-term interest rates. At the same time, some measures of term premia have risen. While the absence of credible medium-term fiscal frameworks in several large advanced economies has yet to elicit a major focus from financial market participants, government debt burdens are elevated and are projected to rise further in response to higher defence spending needs and ageing populations. In addition, higher interest rates are increasing debt servicing costs and net interest payments relative to GDP are expected to rise further in many advanced economies (Graph 1.2). The ongoing pressure on sovereign balance sheets may impact the ability of national governments to provide fiscal support in the event of a prolonged and severe economic shock impacting businesses and households. Were debt sustainability concerns to escalate, global sovereign bond markets could be subjected to a disorderly repricing, which could spill over to a wide range of asset markets, including in Australia.

Graph 1.2
Government Net Interest Payments*
Per cent of GDP



* Earliest observation 2012. Latest observation 2027. Includes net interest payments on all general government debt, including federal, state/regional and local government debt. OECD forecasts shown by points.
** Euro area includes Austria, Belgium, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Netherlands, Portugal, Slovakia, Slovenia and Spain.
Source: OECD.

Increasing participation by leveraged and price-sensitive investors in sovereign bond markets could amplify market volatility and impair market functioning if positions unwind rapidly. Highly leveraged hedge funds have become increasingly important participants in key sovereign bond markets, as highlighted in recent assessments by several central banks.[9] Hedge fund leverage is near record highs, with total repo borrowing by US hedge funds over US$3 trillion, a figure close to 10 per cent of US GDP. Hedge funds typically use zero or near-zero haircut repo financing, which allows them to obtain funding against government bonds with limited collateral buffers, including to fund positions in relative value trades.[10] While these arrangements support market liquidity in normal conditions, they may increase the risk of rapid deleveraging during periods of heightened volatility. In episodes of volatility over recent years, this risk appeared mitigated by the availability of central bank liquidity facilities or interventions in sovereign bond markets to support orderly market functioning (e.g. during the US Treasury market volatility in April 2025 and the UK gilt market stress in 2022).[11] While the recent upward

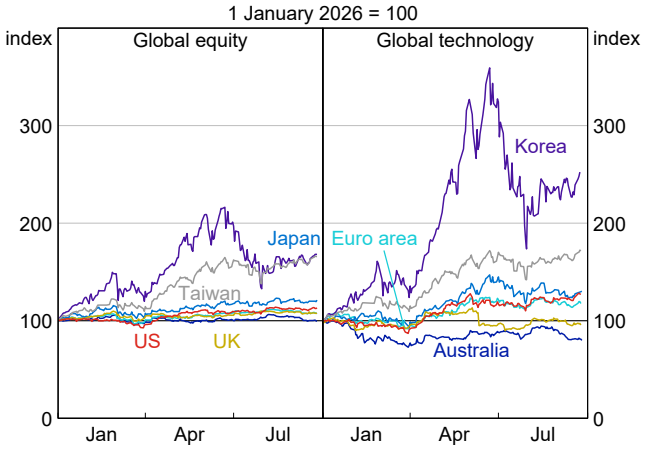
adjustment in global long-term yields has generally proceeded in an orderly manner, as leveraged investors exert a larger influence on sovereign bond market trading activity, there is a heightened risk that any disruptions could amplify volatility and impair market functioning, including in closely linked repo markets.

Risk premia in global equity and credit markets remain compressed, while exposures to the AI investment boom are growing.

Conditions in global equity markets have been supported in part by AI-related growth expectations. Despite a global macro-financial environment that has been prone to frequent shocks, conditions in major global equity markets have remained largely benign, with measures of aggregate market volatility and equity risk premia lower than historical norms. Valuations have been supported by stronger-than-expected earnings results, particularly in the technology, energy and financials sectors, and an easing in investor concerns that the conflict in the Middle East would have a highly disruptive and persistent effect on global economic activity. The performance of a small group of AI-exposed technology and semiconductor firms has been a key driver of equity market movements since 2025, particularly where AI-related firms comprise a large share of total market capitalisation, including in South Korea, Taiwan and the United States (Graph 1.3). While advances in AI adoption may support earnings growth across the corporate sector over time, current equity prices reflect very strong expectations regarding future adoption and productivity rates, revenue growth and profitability. If these expectations are not realised, or if increasing competition reduces returns on AI-related investment, highly valued AI-exposed firms could be susceptible to sharp repricing.

Growing participation from leveraged investors in equity markets has contributed to recent volatility in AI-related stocks, particularly in north-east Asia. AI-related equities experienced significant volatility in July, reflecting a range of investor concerns, including: the outlook for continued revenue growth in the sector, the sharp rise in debt-financed infrastructure investment expenditure, and rising competition from China. Equity market volatility was particularly pronounced in South

Graph 1.3
Global Equity and Technology Indices*



* Earliest observation 1 January 2026. Latest observation 25 September 2026.
Sources: Bloomberg; LSEG.

Korea and Taiwan, reflecting the heavy concentration towards AI-related stocks in those markets and, in the case of South Korea, rapid growth in retail investors' positions in single-stock leveraged exchange-traded funds (ETFs) linked to AI-related equities.[12] In July, regulators in South Korea began introducing a range of measures to limit the risks from these products to retail investors and markets, which have since helped to mitigate volatility.[13] Authorities in a number of countries have also cited increased risks to orderly market functioning from hedge fund participation in equity markets, which is leveraged and, in some cases, highly concentrated in AI-related stocks, and so could amplify market moves in a stress event. In July, Situational Awareness, a US-based hedge fund, suffered major losses on its leveraged positions in AI-related equities after initial market movements forced the fund to unwind positions to meet margin calls. These fire sales were reported to contribute to further market volatility and losses at other financial institutions.

Strong corporate bond issuance in recent months has been driven by increased borrowing from the AI industry (Graph 1.4). Investment grade bond issuance has been strong in 2026, particularly in the United States, where issuance in the year to August was around 50 per cent higher than the same period in 2025. The ongoing shift of the AI industry towards debt financing, including bond issuance in public markets, has contributed materially to the strong issuance, and has increased the exposure of a range of financial market participants to the AI investment boom (see Box: Funding the AI investment boom). Speculative grade issuance across a range of sectors has been notable, with many borrowers able to refinance debt at accommodative spreads and/or extend upcoming maturities, although firms are also increasingly turning to private markets for funding. While corporate bond spreads have widened slightly for some issuers amid the substantial increase in AI-related issuance in recent months, they have narrowed in aggregate since the March 2026 *Financial Stability Review* and, overall, remain low by historical standards.[14] Several advanced economy central banks have highlighted that smaller and more highly leveraged firms remain vulnerable to less favourable financing conditions and abrupt changes in investor sentiment.[15]

A severe global market stress, whether it originates in overseas sovereign bond or risk asset markets, could sharply tighten financial conditions in Australia with potential consequences for financial stability.[16] A sudden and disruptive increase in global equity risk premia, credit spreads or sovereign bond term premia could sharply increase domestic financing costs, restrict Australian firms' and financial institutions' access to funding and liquidity in global markets, and lead to substantial losses in the value of financial assets. If severe enough, it could also limit credit availability in Australia and have consequences for the real economy. However, Australian companies, banks and superannuation funds have taken steps to mitigate their exposure to shocks in global financial markets in recent years, including through hedging and building significant liquidity buffers. Any depreciation of the exchange rate could also play a shock-absorbing role for the Australian economy.

Box: Funding the AI investment boom

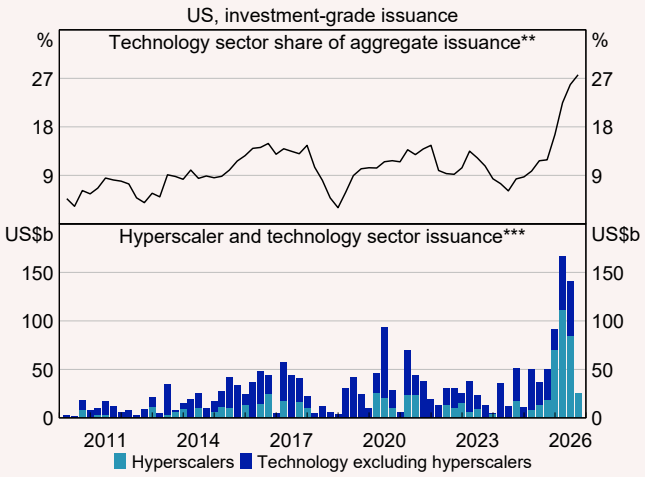
AI-related companies are increasingly using debt to fund large-scale projects, with the implication that investors in private and public markets are becoming more exposed to the sector. Surging demand for AI-related services, and an expectation that this demand will continue, has led to unprecedented investment to develop AI models and applications, manufacture the required advanced semiconductor and computing hardware, and build data centres and related infrastructure. While the technology industry has historically relied more heavily on funding from venture capital, equity and internal cashflows, the scale of current investment plans has required AI firms to increasingly turn to debt funding, including corporate bonds, private credit, bank loans and credit facilities, and asset-backed financing. Debt funding is expected by some market analysts to account for over one-third of planned capital outlays.[17] With the industry rapidly issuing large volumes of debt, its importance in public and private credit markets is expected to grow, mirroring the trend observed in equity markets and expanding the range of investors exposed to the AI investment boom. Nearly 30 per cent of US investment-grade corporate bond issuance in the first half of 2026 came from technology-related firms (Graph 1.4). While this still represents a modest share of total US corporate investment-grade debt outstanding, this is expected to grow materially as debt markets help fund part of as much as US$7.7 trillion in AI capital outlays estimated by 2030.[18]

In aggregate, leverage is contained and balance sheets generally remain healthy at present, although funding arrangements vary along the AI value chain. Among publicly listed AI-related firms, balance sheet leverage has remained at low levels despite the increase in debt issuance, although leverage is expected to rise as capital outlays begin to exceed available cash flows at some firms (Graph 1.5).[19] Large AI-related firms, such as hyperscalers, are generally viewed as lower risk; this is because they often have alternative revenue streams, such as e-commerce or advertising, to support debt servicing. Other AI-related sectors, including hardware and semiconductor manufacturers, as well as some software providers, also remain in a generally solid financial position, with interest coverage ratios (ICRs) improving in 2026 as revenues and income grow. In contrast, there are pockets of higher-risk firms in the AI value chain (e.g. data centre construction, utility and neocloud providers), with concentrated customer bases or weaker balance sheets, that face different financing constraints and options. For example, to secure access to power, data centre developers are increasingly obtaining large bank-sponsored letters of credit that guarantee the costs of grid and generation upgrades required to connect new facilities. Similarly, developers and neocloud providers, lacking the balance sheet capacity to deliver large-scale AI infrastructure projects, can seek support from larger firms, such as residual-value or lease-payment guarantees, to facilitate the necessary funding.[20] These arrangements allow the investments to go ahead while limiting the risks borne by investors if projects are unsuccessful. However, they also create additional contingent exposures and further interconnect developers, lenders, infrastructure investors and hyperscalers through a common set of AI-related projects.

Graph 1.4

Technology Sector Corporate Bond Issuance*

US, investment-grade issuance

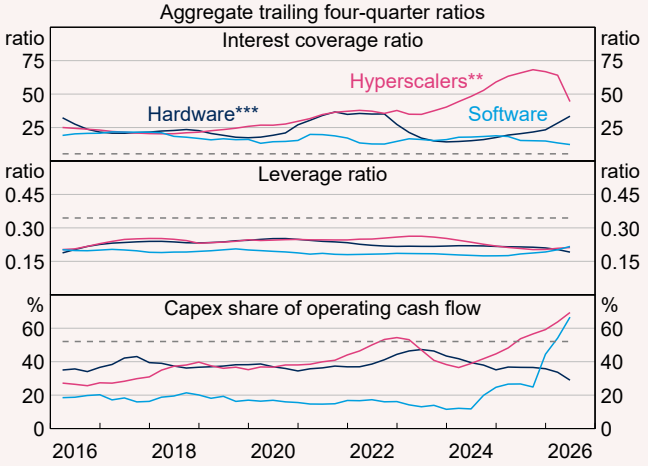


* Issuance by US non-financial corporations. Earliest observation March 2010. Latest observation 17 July 2026. Technology includes computers and electronics.
** Four-quarter moving average.
*** Hyperscalers include Alphabet, Amazon, Meta, Microsoft, Oracle and NVIDIA.

Sources: Dealogic; RBA.

Off-balance sheet financing through special purpose vehicles is becoming an increasingly common way to fund large AI infrastructure projects, which could create hidden exposures and opaque interlinkages. In addition to debt funding, the AI industry has been increasingly using off-balance sheet arrangements to finance large projects, such as data centres. A typical arrangement would see a separate entity established, such as a special purpose vehicle or joint venture, to build and own an infrastructure project. A range of sponsors including private credit funds, banks and other institutional investors would then provide funding into the vehicle, while the AI firm (usually a hyperscaler) would enter into a long-term agreement to lease capacity or access the resources of the entity. With these contractual cash flows, the entity can issue substantial debt offerings, often at investment grade ratings.[21] While this type of funding arrangement had been fairly uncommon in the technology sector, it is widely used in the energy and transport sectors to fund long-lived assets with highly predicable cash flows (such as airports and power plants). These arrangements predominately reside outside of hyperscalers' balance sheets at present, however their financial obligations to these projects are becoming significant, with estimates ranging from US$1 to 1.5 trillion.[22] More broadly, these models create complex interlinkages along the AI supply chain, as their exact structure and scale can often be opaque, making it difficult for investors to fully assess risks and exposures in the industry.

Graph 1.5
AI-related Firm Balance Sheets*
Aggregate trailing four-quarter ratios



* Earliest observation March 2016. Latest observation June 2026. Dashed lines indicate aggregate long-run average benchmark for US non-financial corporations calculated March 2000 to June 2026. Benchmark ICR excludes firms with interest expenses less than $500,000 USD.
** Includes Alphabet, Amazon, Meta, Microsoft, Oracle and NVIDIA.
*** Includes semiconductors.
Sources: Bloomberg; RBA; S&P Global Market Intelligence.

Were the scale and speed of AI-related financing to be sustained in coming years, financial stability vulnerabilities could build. If capital expenditures grow in line with current market expectations, considerable external financing of AI-related investment would increase credit exposures across banks, bond markets, private credit and other institutional investors. While long-term earnings projections assume broad adoption of AI technologies and strong revenues, the timing, scale and distribution of these benefits remains uncertain. If returns fall short of expectations, several features of the AI investment boom could potentially lead to losses among lenders and investors. Notably:

- **Circular financing arrangements.** The structure of external financing for firms involved in the AI infrastructure build-out can often be opaque as noted above. In addition, some companies are engaging in vendor financing arrangements where large AI technology firms facilitate funding opportunities for their customers, which in turn support revenue flows along the AI value chain. For example, some cloud providers have invested in AI developers who subsequently use those providers' infrastructure to train and deploy their models. Similarly, chipmakers have provided financial support to neocloud firms who subsequently purchase their products.[23]
- **Potential for overinvestment.** By some measures, the expansion in data centre and related AI infrastructure investment is unprecedented in scale and speed relative to previous investment booms.[24] Should demand for AI fall short of expectations, or if there are delays in adoption of AI technologies, large debt-funded infrastructure projects could fail to generate revenue necessary to service debt commitments.

- **Debt maturity and asset-life mismatches.** Like other large infrastructure companies, hyperscalers have issued debt with longer maturities, including 20–30 years, to finance their AI projects. However, this can finance capital expenditure on hardware with uncertain economic lives, such as chips and cooling systems, which may become obsolete as technologies advance rapidly, and substantially depreciate the value of the collateral before the debt matures.
- **Locked-in commitments for key inputs.** The development and operation of AI-related infrastructure requires a range of specialised hardware inputs, as well as ongoing supplies of water and electricity. AI firms are increasingly entering into long-term locked-in contracts to secure access to hardware and resources for the establishment of new data centres.[25] While these arrangements reduce supply chain challenges, the sector is locking in extensive commitments amid considerable uncertainty about future AI demand, technological developments and energy requirements, reducing firms' flexibility to adapt if conditions evolve differently than expected.

1.3 Other developments

Risks in international private credit markets are growing, although spillovers have been limited.

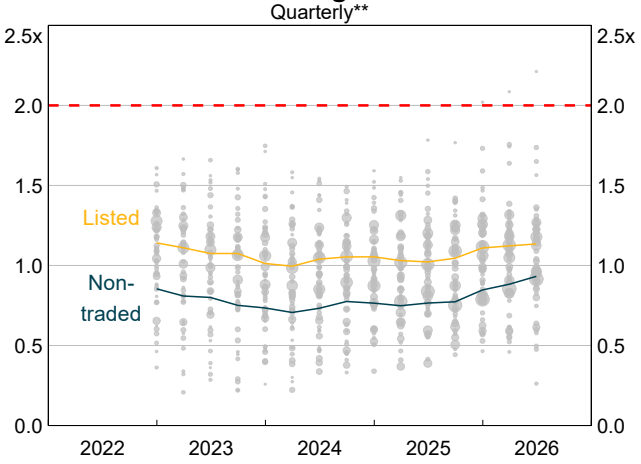
Recent developments have exposed vulnerabilities in segments of the private credit market, though stress has been largely idiosyncratic. Concerns over asset quality in private credit have remained elevated following high-profile private credit defaults (including First Brands, Tricolor and Market Financial Solutions) in late 2025 and early 2026. These defaults increased scrutiny of underwriting standards, valuation practices, the opacity of lending arrangements and linkages with other parts of the financial system. In early 2026, several private credit funds with significant exposures to the software industry experienced a sharp increase in redemption requests due to growing concerns about AI-related disruption to the business models of some software firms. Non-traded funds in the United States collectively received over US$15 billion in redemption requests, or around 12 per cent of their total net asset value in the June quarter of 2026. Although redemption requests have remained elevated since, redemption limits (or gates) have so far helped to contain liquidity pressures and the need for forced asset sales. As of June, around 60 per cent of these redemption requests remained unfulfilled.[26] Further shifts in investor sentiment could trigger further redemption flows (even with gates in place), which could increase the exposures of liquidity providers such as banks, or slow down inflows into new funds.

Overall linkages between private credit funds and the core of the financial system are small, but continue to expand. Bank lending to private credit funds is relatively limited, with exposures representing less than 0.5 per cent of bank assets in the United States, euro area, United Kingdom, Japan and Hong Kong.[27] The majority of these bank commitments are secured, mitigating lenders' exposure to fund-related stresses.[28] Leverage ratios at business development companies (BDCs), a subset of private credit funds representing around one-fifth of total private credit assets, have largely remained well below regulatory maximums, which should further mitigate wider spillovers from disruptions in the sector (Graph 1.6). However, life insurers, particularly those acquired by private equity firms, have increased their exposure to illiquid and non-traditional assets such as private credit loans and other forms of structured credit, driven by the attractiveness of higher yields and, for some investors, improved asset-liability matching from longer-term private credit investments. Some estimates suggest that private credit assets may account for around 10 per cent of life insurer portfolios in North America.[29]

Graph 1.6

BDC Leverage Ratios*

Quarterly**



* Earliest observation December 2022. Latest observation June 2026. Ratio of long-term debt-to-equity for US BDCs. Point size corresponds to the AUM of each BDC. Dashed line indicates maximum leverage ratio in the US mandated by the Small Business Credit Availability Act (2018).

** Sample coverage varies across quarters due to differences in SEC disclosures and data availability.

Sources: RBA; SEC.

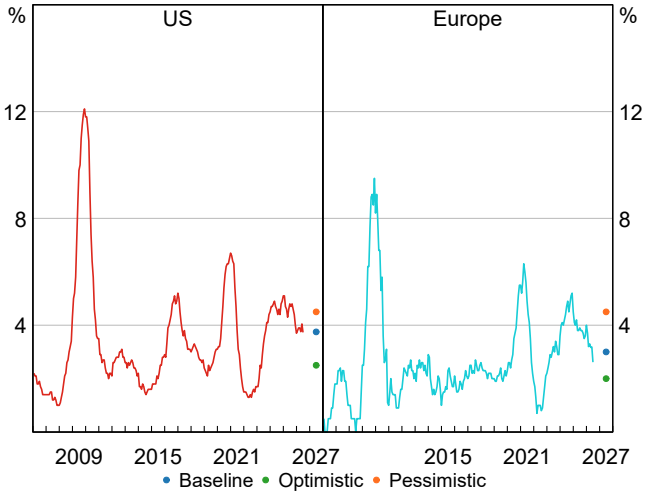
While international private credit does not appear to represent a systemic concern in isolation, a number of risks are building. Several central banks and international bodies have assessed that private credit markets do not currently pose a systemic financial stability risk, due to their modest size and limited linkages to banks.[30] However, should their assets under management continue to grow rapidly, so too will their interconnections with the rest of the financial system. Some private credit funds have also built up concentrated exposures, particularly to the software sector, which represents around 20 per cent of BDC portfolios.[31] This concentration could amplify any repricing triggered by AI-related disruption, increasing liquidity pressures at funds and the likelihood of fire sales or fund wind-ups. In addition, while some private credit funds have been in existence for decades, the resilience

of many funds has not been tested through a full credit cycle. Some lending practices in private credit could also obscure the timely recognition of borrower stress. For instance, the use of payment-in-kind arrangements to defer interest repayments later in the loan term could mask current borrower stress and contribute to a build-up of long-term credit risk. Limited public disclosure and inconsistent reporting standards between different fund types may also make it difficult for investors and regulators to assess emerging risks, hindering effective oversight. International bodies have continued to highlight the importance of closing such data gaps and enhancing visibility into private markets to improve regulators' understanding and monitoring of these risks.[32]

Most corporates and households in advanced economies have remained in a solid financial position, but persistent cost pressures could weigh on more vulnerable borrowers.

International corporate balance sheets have generally remained healthy despite ongoing cost pressures, but this resilience could be tested in some trade-exposed and energy-intensive sectors. Across advanced economies, non-financial corporates have demonstrated a degree of adaptability in the face of increased geopolitical tensions, ongoing trade and energy disruptions, and the related cost pressures. For listed firms, aggregate earnings remained strong in the second quarter of 2026, supported by profits in the technology and energy sectors. Earnings expectations for 2027 have been revised up since the March 2026 *Financial Stability Review* across most advanced economies, particularly Canada and the United States. Debt serviceability has also improved for publicly listed firms, with increases in median ICRs across most major economies in the first half of 2026, despite the challenging environment. However, cost pressures on firms, particularly in energy-intensive and trade-exposed sectors, remain elevated. Looking ahead, supply-chain disruptions could lead to more pronounced cost pressures, testing these firms' ability to pass through higher costs to customers. Renewed trade policy uncertainty may also weigh on trade-exposed sectors in some advanced economies, including manufacturing in Canada and the euro area. Narrowing profit margins would then weaken firms' debt-servicing capacity. Ratings agencies are projecting only a modest rise in default rates for speculative-grade debt in the United States and Europe by mid-2027; a significant deterioration is expected only if more challenging scenarios were to materialise (Graph 1.7).

Graph 1.7
Corporate Debt Default Rates*
12-month ahead forecasts**

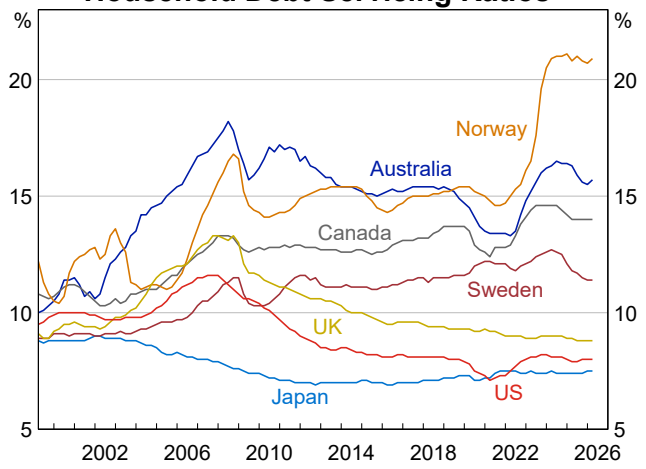


* Default rates are 12-month trailing, issuer-weighted default rates for speculative-grade corporate debt rated by S&P and includes bonds and loans. Earliest observation January 2006. Latest observation June 2026. Forecast scenarios are for June 2027.
** Forecast scenarios are calculated by S&P Global Ratings; baseline scenario assumes resilient economic growth, stable financing conditions and easing energy market disruptions. Optimistic scenario assumes a faster resolution of geopolitical tensions, lower energy prices and stronger economic and earnings outcomes. Pessimistic scenario assumes prolonged energy market disruption, higher inflation, tighter financial conditions and weaker economic activity.
Sources: RBA; S&P Global Ratings.

Household balance sheets have also been resilient in aggregate, but the environment remains challenging. Household balance sheets remained healthy overall at the start of 2026, having been supported by gains in housing and equity markets across most advanced economies. However, ongoing conflicts in the Middle East and Ukraine, and the resulting supply-chain disruptions, continue to impose pressure on household finances. Higher energy prices have increased fuel, utility and transport costs for households, although a range of temporary policy measures globally have helped soften the initial pass-through of the shock. Several advanced economy central banks have also raised policy rates or signalled an end to policy easing, and markets expect many of them to tighten policy in the months ahead. Following a general decline in debt-servicing ratios over recent years, the tightening in global financial conditions means households may experience more persistent

debt-servicing pressure (Graph 1.8). This could erode household resilience and worsen existing pockets of household stress, particularly among low-income and highly indebted households. However, there is little evidence of a deterioration in household balance sheets since the March 2026 *Financial Stability Review*, with no material rise in consumer credit or mortgage delinquency as of June. Central banks continue to assess that the ability of households to weather these pressures remains dependent on the resilience of labour markets and employment outcomes. Partial survey data in the United States and euro area indicate that households are anticipating a worsening in their financial situation and employment conditions over the coming year.

Graph 1.8
Household Debt Servicing Ratios*



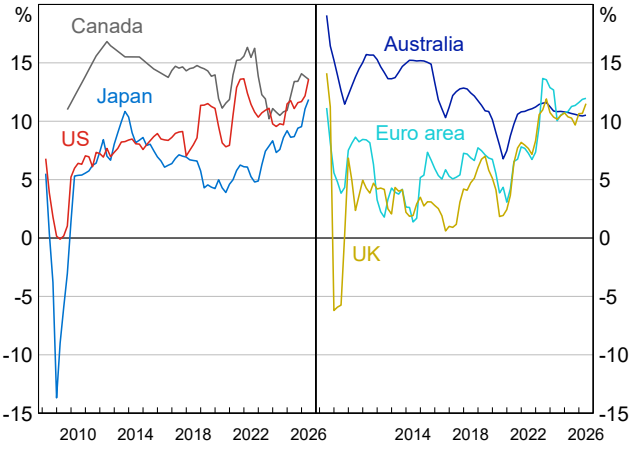
* The debt servicing ratio is defined as the ratio of interest payments and amortisations of principal to gross disposable income plus interest payments. It is calculated under the assumption that debt, excluding the effects of loan-level features such as offset accounts and redraw facilities, is repaid in equal instalments over the average loan maturity (assumed to be 18 years). Includes non-profit institutions serving households. Earliest observation March quarter 1999. Latest observation March quarter 2026.

Source: BIS.

Strong profitability has supported the financial health of large banks in advanced economies, but risks from the external environment could pose challenges in the period ahead.

Large banks in advanced economies remain well placed to absorb severe-but-plausible shocks, supported by robust earnings, sound asset quality and capital and liquidity positions that remain above regulatory requirements. The profitability of large banks in advanced economies strengthened further in the past six months, supported by trading and fee income amid increased client activity in the June quarter connected to the AI investment boom (Graph 1.9). Capital ratios have been generally supported by organic capital generation, and recent stress test results suggest that large banks would be able to absorb losses and continue to meet minimum capital requirements under severe downturn scenarios. Liquidity coverage ratios also remain well above regulatory minimums. Banks' asset quality remains strong, with non-performing loan ratios generally near multi-year lows across advanced economies. However, the ongoing conflict in the Middle East is weighing on the outlook for banks. While large banks' direct exposures to the region are limited, a further escalation in geopolitical tensions could have second-round effects that lead to higher inflation and interest rates, and a weakening in macroeconomic conditions. This may weigh on asset quality, particularly for energy-intensive, trade-exposed or interest-rate sensitive borrowers.

Graph 1.9
Return on Equity by Region*



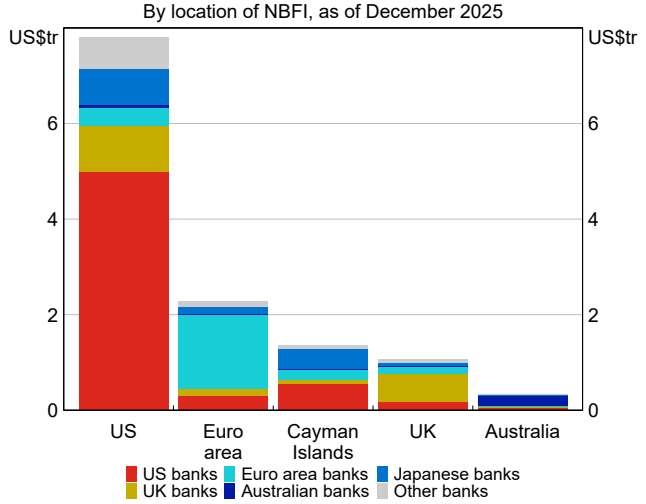
* Data for each region consists of banks deemed to be systemically important to the domestic economy by the local regulator. Earliest observation 31 March 2008. Latest observation 30 June 2026.

Sources: RBA; S&P Global Market Intelligence.

Banks are becoming more exposed to the rapid surge in AI-related investment and their linkages to non-banks continue to grow. While direct AI exposures on the balance sheets of large international banks are not yet material, revenues from trading, investment banking and other fee-generating activities may prove vulnerable if there is a sharp adjustment in AI-related valuations, investment activity or broader market sentiment. Banks have also increased lending to data centres and related infrastructure, as well as indirect exposures through non-bank financial intermediaries (NBFIs) and other counterparties with concentrated AI-related positions. More generally, banks' exposures to

NBFIs have continued to grow. The scale, opacity and concentration of these interconnections, particularly with US-based NBFIs, increases the risk that stress in parts of the NBFI sector, including hedge funds and private credit markets, could spill over to banks (Graph 1.10).

Graph 1.10
Bank Exposures to NBFIs*
By location of NBFI, as of December 2025



* Each bar represents BIS-reporting banks' consolidated total claims on NBFIs resident in the jurisdiction, with colours identifying the reporting banks' home jurisdiction.
Sources: BIS; RBA.

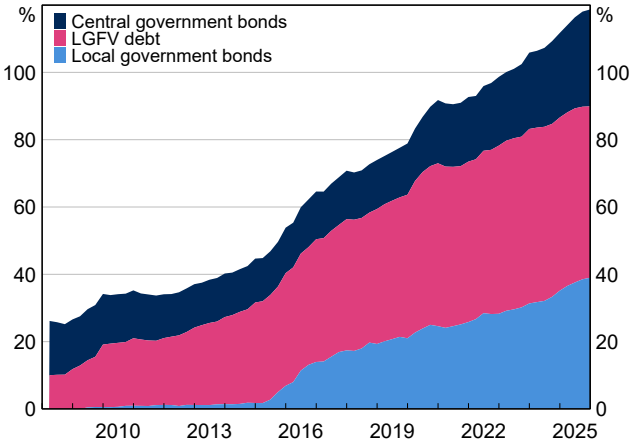
At the same time, several jurisdictions have progressed their regulatory modernisation initiatives. Several jurisdictions (including the United States, United Kingdom, European Union and New Zealand) have announced regulatory proposals aimed at simplifying bank capital frameworks to support economic growth.[33] While most proposals are expected to broadly preserve existing regulatory standards, any major regulatory divergence across jurisdictions or a material weakening in capital requirements could increase the risk of regulatory arbitrage and reduce the banking system's ability to absorb losses during a period of stress. The FSB Standing Committee on Supervisory and Regulatory Cooperation is conducting work to establish principles to guide regulatory and supervisory modernisation initiatives across jurisdictions to ensure that regulatory outcomes remain aligned.[34]

Chinese authorities continue to progress reforms in parts of the domestic financial system, with spillover risks to the global and Australian financial systems limited by relatively modest direct links.

Longstanding structural imbalances in the Chinese economy remain, though acute risks to the financial system have been managed in recent years and most debt in China is domestically owned, which decreases the risk of a 'sudden stop'. Authorities have made some progress in addressing financial sector vulnerabilities:

- A debt swap program, transferring hidden debt from local government financing vehicles (LGFVs) onto the balance sheet of local governments, has reduced LGFV debt growth, default risk and therefore acute risks to financial stability in China. That said, overall government debt continues to grow as a share of the economy, including for LGFVs (Graph 1.11). Unlike many other emerging market economies, this debt is principally held domestically and issued in domestic currency, which reduces the risk of a disorderly sudden stop in the flow of capital.
- Deleveraging and restructuring in the real estate sector continues, although conditions remain generally weak. Authorities continue to indicate little appetite to meaningfully stimulate the sector as they seek to shift to a new model of real estate development that focuses on quality housing development, with a goal to improve living standards. A number of major developers remain under severe financial stress. With property prices well below their peaks, households have deleveraged in aggregate, and sought to shift into accumulating wealth through financial assets, notably term deposits.
- Banks' net interest margins have remained generally stable in aggregate, but below the 1.8 per cent threshold recommended by authorities. Bank capital ratios have declined marginally recently but remain adequate in aggregate. Since 2023, more than 1,150 small and regional banks have been merged into larger institutions, amalgamated or closed, reducing one immediate risk of stress in the banking system.

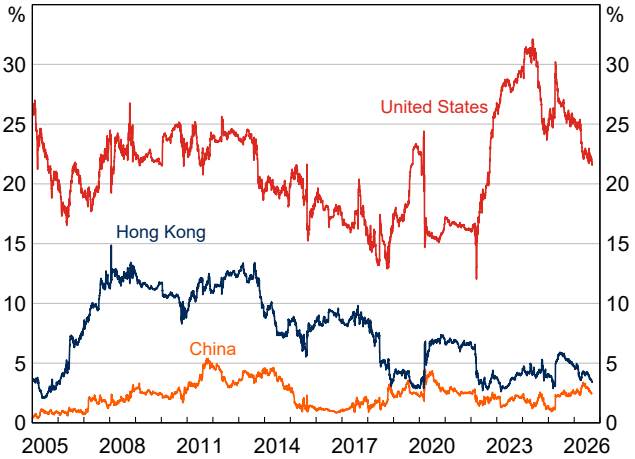
Graph 1.11
Chinese Government Debt*
Share of GDP



* Earliest observation March 2008. Latest observation December 2025.
Sources: CEIC Data; RBA; WIND.

Australia has little direct exposure to China's financial system. Relatively modest two-way investment between Australia and China limits direct spillovers of a financial system shock, as Australia has little reliance on China for funding, banking exposures to China have declined over the past decade, Chinese investment flows into Australian real estate have declined over time and Australian ownership of Chinese assets remains small. The connectedness between China's financial markets and those of other countries (including Australia) is also relatively small, suggesting that Chinese financial conditions generally have little direct impact on global markets (Graph 1.12).[35]

Graph 1.12
Connectedness to Australia
Per cent of variance in ASX 200 returns contributed by selected other international equity markets*



* Two-year rolling window. Earliest observation 1 January 2005. Latest observation 14 September 2026.
Sources: Bloomberg; RBA.

China-related shocks – from any number of sources – are most likely to be transmitted to the Australian financial system through macroeconomic channels or via global financial markets. Most notably, a sizable decrease in Australian goods and services exports to China, could create stress for Australian exporters and their suppliers which could then affect their providers of finance. Potential sources of such an export shock include a material slowdown in Chinese demand, a disruptive resolution to global macro-financial imbalances, or a further escalation in geopolitical tensions. The mining sector comprises a large share of Australia's trade exposure to China, though also has features that could mitigate financial stability risks, including production that is generally low cost (giving it a comparative advantage over foreign competitors), relatively low leverage, high cash buffers, and high rates of hedging that can dampen the effects of changes in commodity prices. The Australian dollar would also likely depreciate in this environment, which would partly mitigate the contractionary effects on the domestic economy. An alternative stress transmission channel from a major China-related shock could result from a surge in global risk aversion triggering the crystallisation of vulnerabilities in global financial markets (see section 1.2 Key vulnerabilities that could affect financial stability in Australia).

Endnotes

1 Among other things, AI 'lowers barriers for malicious actors and increases the speed and complexity of attacks, shrinking the window between vulnerability discovery and exploitation ever more quickly'. For more details, see Five Eyes (2026), 'Five Eyes Cyber Security Agencies Statement', June.

2 Bank of England (BoE) (2026), *Financial Stability Report*, July.

3 RBA (2024), '4.1 Focus Topic: Financial Stability Implications of Artificial Intelligence', *Financial Stability Review*, September.

4 For an overview of the risks and opportunities quantum computing poses to the financial system, see Auer R, A Dupont, L Gambacorta, JS Park, K Takahashi and A Valko (2024), 'Quantum Computing and the Financial System: Opportunities and Risks', BIS Paper No 149, October.

5 FSB (2026), 'Sound Practices for Financial Institutions' Responsible AI Adoption: Consultation Report', June.

6 For example, a cyber incident targeting a small UK power generator in August led to a temporary shutdown in operations. In addition, water and wastewater facilities in several US states were targeted in a series of coordinated cyber-attacks in July and August, causing disruptions to operational control and monitoring systems. For a discussion of previous attacks on critical financial infrastructure, see Jones B (2026), 'Geopolitics and the Financial System: Some Echoes From History', Speech at the Australian Banking Association's Conference, Melbourne, 17 June.

7 For example, on 15 August, Mastercard experienced a temporary outage that disrupted card and mobile wallet payments in several countries, including Australia. The outage was attributed to a scheduled system update.

8 European Supervisory Authorities (2026), '2025 Report on Major ICT-related Incidents', June.

9 For example, see Bank of Canada (BoC) (2026), *Financial Stability Report*, May; BoE, n 2; Bank of Japan (BoJ) (2026), *Financial System Report*, April; European Central Bank (ECB) (2026), *Financial Stability Review*, May; Federal Reserve (Fed) (2026), *Financial Stability Report*, May; and Reserve Bank of New Zealand (RBNZ) (2026); *Financial Stability Report*, May.

10 Bank of International Settlements (BIS) (2025), 'Unpacking Repo Haircuts and Their Implications for Leverage', 2 December.

11 Choudhary R, S Mathur and P Wallis (2023), 'Leverage, Liquidity and Non-bank Financial Institutions: Key Lessons from Recent Market Events', RBA *Bulletin*, June.

12 Trading of single-stock leveraged ETFs began in late May, following approval of these products by South Korean financial authorities in April.

13 The announced measures included temporarily suspending new listings of single-stock leveraged ETFs and limiting retail investors' access to these products by raising the minimum balance required in brokerage accounts. See Financial Services Commission (2026), 'Financial Authorities Prepare and Announce Measures on Single-Stock Leveraged Products (ETFs and ETNs)', Press Release, 16 July.

14 There is limited evidence to date that AI-related borrowing is crowding out other issuers in funding markets. However, if AI-firm capital expenditures continue to expand as expected and absorb a larger share of public and private markets, other borrowers may find future capacity to issue in these markets reduced. Further, if sentiment around AI-related earnings deteriorates, this could place broader pressure on credit conditions.

15 See BoC, n 9, p 20; BoE, n 2, pp 97–101; and ECB, n 9, 'Section 1.3' and 'Special Feature B: Rising bankruptcies, resilient loan books: unpacking euro area corporate credit risk'.

16 RBA (2025), '4.1 Focus Topic: How Overseas Shocks Can Affect Financial Stability in Australia', *Financial Stability Review*, October.

17 For example, of the US$2.9 trillion Morgan Stanley forecast for 2025–2028 global capex on data centres, a significant share was expected to be sourced from credit markets, including private credit (US$800 billion), public debt issuance (US$200 billion) and securitised credit (US$150 billion). See Morgan Stanley Research (2025), 'Bridging a $1.5tr Data Center Financing Gap', 16 July.

18 See Goldman Sachs (2026), 'Tracking Trillions: The Assumptions Shaping the Scale of the AI Build-Out', 1 May; McKinsey & Company (2025), 'The Cost of Compute: A $7 Trillion Race to Scale Data Centers', *McKinsey Quarterly*, 28 April; S&P Global Ratings (2026), 'Credit Outlook for Hyperscalers: A Temperature Check', September.

19 Balance sheet analysis includes 126 publicly listed AI related firms categorised as part of the AI value chain in the Bloomberg Thematic Universe. It does not include resource suppliers or foundation models and AI labs that are privately owned. The six hyperscalers included are Amazon, Microsoft, Alphabet (Google), Meta, Oracle and NVIDIA.

20 For example, Google LLC guaranteed all lease payment obligations of Fluidstack, a neocloud provider, under a 15-year lease for Hut 8 Corp.'s River Bend data centre campus, supporting the project's ability to raise investment-grade financing. See Hut 8 (2025), 'Hut 8 Signs 15-Year, 245 MW AI Data Center Lease at River Bend Campus with Total Contract Value of $7.0 Billion', Press Release, 18 December.

21 For example, the financing of Meta's Hyperion AI data centre project raised approximately US$30 billion through a joint venture between Meta and Blue Owl Capital, which issued investment grade debt backed by a sequence of leases from Meta. See Meta (2025), 'Meta Announces Joint Venture with Funds Managed by Blue Owl Capital to Develop Hyperion Data Center', Press Release, 21 October.

22 Moody's Ratings (2026), 'Hyperscalers' Reported AI-Related Lease Commitments May Understate Economic Risk', *Sector In-Depth*, 23 February; Goldman Sachs (2026), 'More Signs of AI-Related Bifurcation', *Global Credit Trader*, 6 August; Eren E, I Krohn and K Todorov (2026), 'Financing the AI Infrastructure Boom: On- and Off-balance Sheet Borrowing', BIS *Quarterly Review*, 16 March.

23 For example, advanced chip producer NVIDIA recently announced a US$500 billion funding package with a series of private investors to provide capital for AI infrastructure development. See NVIDIA (2026), 'NVIDIA Partners With Apollo, BlackRock, Blackstone, Brookfield, Goldman Sachs and KKR to Establish AI Compute Infrastructure Financing Platforms to Mobilize Over $500 Billion of Third-Party Capital', Press Release, 10 August.

24 BIS (2026), *Annual Economic Report*, 28 June.

25 See OECD (2025), 'Competition in Artificial Intelligence Infrastructure', 14 November.

26 Robert A Stanger & Co (2026), cited in Wirz M (2026), 'Investors Seek to Pull Nearly $16 Billion From Private-Credit Funds', *Wall Street Journal*, 2 July.

27 Data from these five jurisdictions represent the bulk of private credit funds' assets globally. See FSB (2026), 'Report on Vulnerabilities in Private Credit', 6 May.

28 In the case of recent defaults of private credit borrowers, alleged fraud affected the availability of collateral provided, leading to some losses for banks.

29 FSB, n 27.

30 For example, see ECB, n 9, 'Box D: Stress in global private credit markets and its implications for euro area financial stability'; Fed, n 9; IMF (2026), 'Global Financial Stability Report', April.

31 BIS (2026), 'AI Disruption in Private Credit: Exposure to Software Firms in BDCs', BIS *Bulletin* 128, 14 July.

32 FSB, n 27.

33 See BoE (2026), 'Financial Stability in Focus: The Bank Capital Framework', July; European Banking Authority (EBA) (2026), 'The EBA Proposes Simplifications to the EU Bank Capital Framework in a Holistic Manner to Strengthen Its Efficiency', Press Release, 16 June; Fed (2026), 'Agencies Request Comment on Proposals to Modernize the Regulatory Capital Framework and Maintain the Strength of the Banking System', Press Release, 19 March; RBNZ (2025), '2025 Review of Key Capital Settings', 17 December.

34 See Bowman MW (2026), 'Modernizing Financial Regulation', Speech at the Bank Policy Institute London Conference, London, 17 June; and FSB (2026), 'FSB Work Programme for 2026', 3 February.

35 One notable exception was an unexpected depreciation of the RMB in August 2015, leading to uncertainty in China's economic outlook, in turn triggering a decrease in global equity prices. See RBA (2015), 'Chapter 2: International and Foreign Exchange Markets', *Statement on Monetary Policy*, November.



Chapter 2
Resilience of Australian Households and Businesses

Summary

Household and business borrowers continue to display a high level of resilience overall, and loan arrears remain low, despite financial pressures picking up this year in response to higher inflation and interest rates. Lending competition among bank and non-bank lenders remains strong and it is important that lending standards remain prudent so that household and business resilience is not undermined.

- **The strong financial positions of most Australian households and businesses have helped them weather the rise in cost pressures this year.** Inflation has been elevated in 2026, reflecting domestic capacity pressures and higher input costs due to the Middle East conflict. As a result, the Monetary Policy Board has increased the cash rate by 100 basis points to help return inflation to target. While some households continue to experience hardship, the estimated share of mortgagors in severe financial stress or in arrears has, so far, remained low, supported by the strong labour market and mortgagors' savings and equity buffers. Most businesses have also navigated the rise in cost pressures, having entered the year with generally strong balance sheets and contained debt levels. Bank loan arrears rates for businesses remain low. However, the share of companies entering insolvency is still elevated relative to longer-term averages in some sectors, such as hospitality and construction, where the operating environment remains challenging, particularly for smaller firms. Broader spillovers to the financial system from insolvencies have been contained due to these firms' limited bank debt and small size. Fundamentals continue to improve across most commercial real estate (CRE) markets and there remains little evidence of financial stress among owners of Australian CRE, despite higher interest rates and uncertainty.

- **Most borrowers appear well placed to manage ongoing cost pressures amid declining housing prices.** While cash flow pressures are expected to persist, the outlook presented in the August *Statement on Monetary Policy* suggests that the share of mortgagors in severe financial stress – where mortgage payments and spending on essentials exceeds their income – will remain well below its 2024 peak. Recent tax changes affecting housing, as well as the higher level of the cash rate, have contributed to lower demand for housing credit in recent months and a decline in housing prices following a number of years of strong housing price growth. Most household borrowers are expected to remain resilient in this context, including under a range of adverse scenarios. Even in a scenario where housing prices were to decline by a further 20 per cent, most borrowers would still have positive equity buffers given the earlier run-up in housing prices and prudent lending standards. Most businesses are also expected to remain resilient to higher costs. However smaller businesses and those in more energy-intensive or cyclical industries with fewer cash buffers (such as transport, hospitality and construction) are more vulnerable to cost pressures, particularly if a further significant weakening in aggregate demand in the economy were to make it harder for them to raise prices to cover their higher costs.
- **It is important that prudent lending standards are maintained to support continued resilience in the Australian financial system.** While competition in housing lending remains strong, housing credit growth, particularly for investors, has eased, higher-risk lending continues to be contained and lending standards remain sound. Prudent lending standards are important to preserving the ability of borrowers and lenders to withstand shocks. For businesses, credit growth and lending competition remains strong across banks and non-banks. This has supported businesses' access to credit, which has helped some firms manage a challenging period. There is little evidence that this lending poses a risk to financial stability, though data gaps remain in some segments of non-bank lending. The RBA, together with the other Council of Financial Regulators (CFR) agencies, will continue to closely monitor potential vulnerabilities in the household and business sectors that could emerge over time.

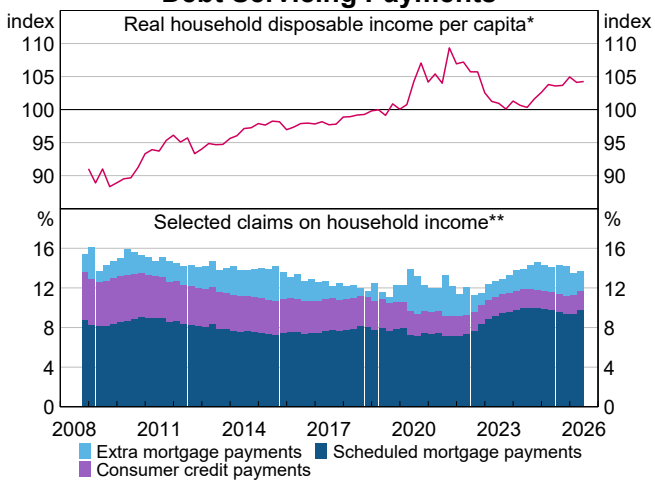
2.1 Households

Cost pressures have increased since the start of the year, particularly for lower-income households, but the financial position of most households remains strong.

On a per capita basis, real household disposable income declined slightly over the first half of 2026, but remains higher on average than in 2023 and 2024 (Graph 2.1). The recent decline in real disposable income per capita – that is, income per person after tax and interest payments and adjusted for inflation – was mostly driven by higher inflation and increases in interest rates. These factors have different impacts on different types of households. All households' budgets have been affected by high inflation eroding purchasing power. However, this is more likely to cause stress for lower-income households, many of whom are renters, because their expenses tend to make up a larger share of their disposable income.[1] On top of inflationary pressures, mortgage holders are also directly affected by increases in the cash rate. Against this backdrop, enquiries to the National Debt Helpline increased modestly over the first half of 2026.

Graph 2.1

Household Income and Debt Servicing Payments



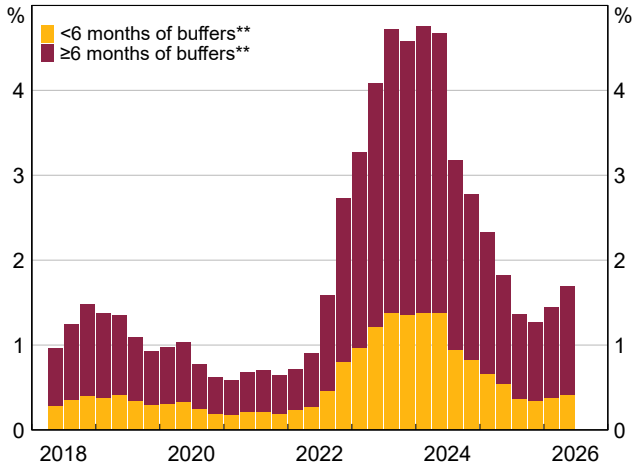
* 2019 average = 100. Household disposable income excludes interest payments and per capita denominator is resident population excluding foreign students. Earliest observation December 2008. Latest observation June 2026.
** Share of household disposable income, including interest payments. Earliest observation December 2008. Latest observation June 2026.
Sources: ABS; APRA; RBA.

While financial pressures have increased for borrowers, most continue to have sufficient income to meet their scheduled mortgage repayments and essential expenses. The estimated share of variable-rate owner-occupier borrowers experiencing a cash flow shortfall – where income is not sufficient to cover scheduled mortgage repayments and essential expenses – increased a little over the first half of 2026, but remains relatively low at around 2 per cent (Graph 2.2). Lower-income borrowers are more likely to be in this group. In addition to cutting back their spending to mostly essential items and trading down in quality for some goods and services, these households have had to make other difficult adjustments to continue servicing their mortgages, such as selling assets and working additional hours. However, most borrowers in a cash flow shortfall are estimated to have savings that would enable them to cover their cash flow shortfall for at least six months, assuming they adjusted their consumption down to essential levels.[2] Consistent with this, the share of loans in formal hardship arrangements increased but remains low.

Graph 2.2

Borrowers with Cash Flow Shortfall*

Estimated share of variable-rate owner-occupier borrowers



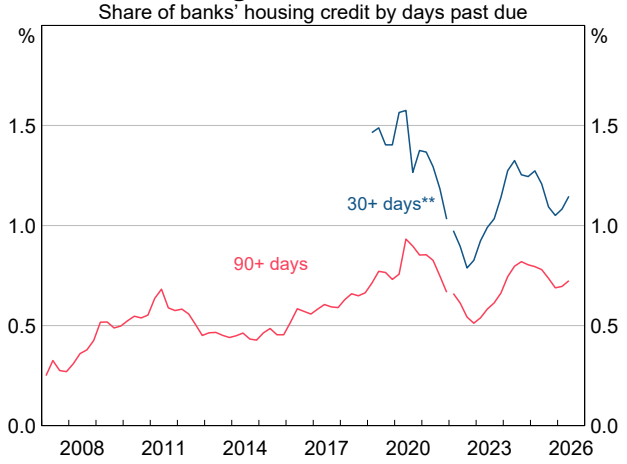
* Estimates of borrowers with minimum scheduled mortgage payments and essential expenses (HEM) exceeding their income. Excludes borrowers in arrears.
** Buffers expressed relative to borrower's cash flow shortfall.
Sources: ABS; Melbourne Institute; RBA; Securitisation System.

Arrears rates remain low despite a recent pick-up. The share of housing loans more than three months behind on their repayments has increased a little over the year to date but remains around pre-pandemic levels (Graph 2.3). Arrears rates for borrowers with lower incomes, high loan-to-value ratios (LVRs) or high loan-to-income (LTI) ratios – who tend to be more vulnerable to financial stress – remain higher than for other borrowers but have not picked up significantly since the start of the year. These cohorts represent a very small share of overall borrowers. Arrears rates for first home buyers also remain low. Information from liaison with banks suggests hardship or arrears for participants in the Australian Government 5% Deposit Scheme remain contained. This scheme allows first home buyers to take out high LVR loans through a government guarantee, without having to pay lenders mortgage insurance.[3] Ongoing strength in the labour market has supported households' ability to service their debts.

Graph 2.3

Housing Loans in Arrears*

Share of banks' housing credit by days past due



* Well-secured loans prior to March 2022; both well-secured and not well-secured loans thereafter. Earliest observation March 2007. Latest observation June 2026.
** Series only available from March 2019.
Sources: APRA; RBA.

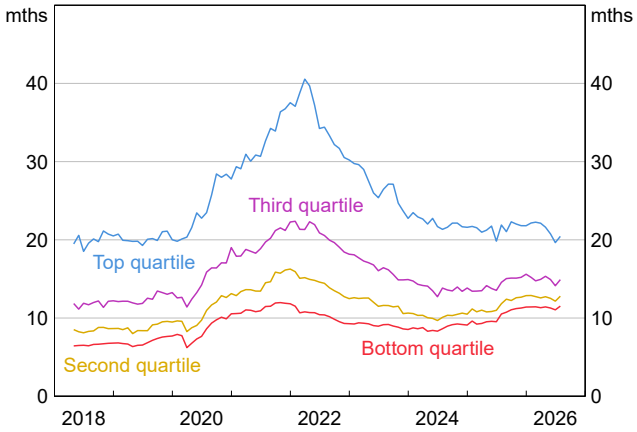
While risks to the economic outlook have risen, most indebted households appear well placed to weather a wide range of adverse outcomes.

Borrowers' large liquidity buffers can help them withstand shocks to their incomes or expenses. Most mortgagors hold large savings buffers in offset and redraw accounts, with the median borrower able to cover over a year of scheduled mortgage payments at current interest rates from these buffers, a stronger position than before the pandemic (Graph 2.4). To date, there has not been a meaningful increase in the share of borrowers who are persistently drawing down on these buffers to manage cash flows (Graph 2.5).

Graph 2.4

Median Mortgage Prepayments*

Variable-rate owner-occupier loans, by income quartile

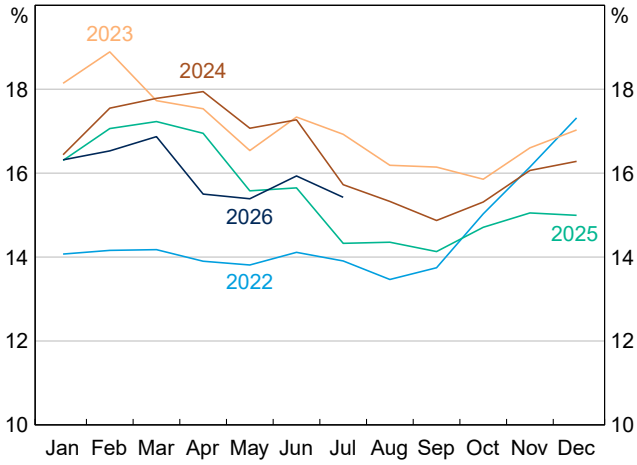


* Number of months that prepayments (offset and redraw balances) can cover minimum scheduled mortgage payments. Income quartiles based on the distribution of variable-rate owner-occupier borrower incomes. Income quartile upper bounds for July 2026 are $121,000 for the bottom quartile, $179,000 for the second quartile and $259,000 for the third quartile. Earliest observation April 2018. Latest observation July 2026.
Sources: ABS; RBA; Securitisation System.

Graph 2.5

Withdrawals from Mortgage Prepayments*

Share of variable-rate owner-occupier loans, by calendar year

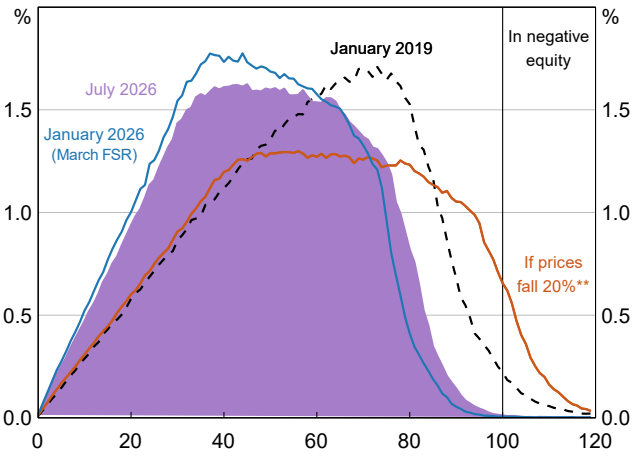


* Share of borrowers that reduce their offset and/or redraw balances over preceding three consecutive months.
Sources: RBA; Securitisation System.

Despite recent declines in housing prices, most borrowers still have large housing equity buffers. This reflects the strong growth in housing prices that had occurred over several years, alongside continued prudent lending standards. Housing prices have declined in recent months as housing market sentiment has weakened, reflecting the somewhat restrictive stance of monetary policy and changes to negative gearing and capital gains tax discount policies. Despite this, most household balance sheets remain strong, with less than 1 per cent of borrowers estimated to owe more on their loan than the value of their property (negative equity).[4] Recent buyers and those who took out higher LVR loans are more likely to be in negative equity. This includes first home buyers participating in the Australian Government 5% Deposit Scheme. However, the potential risks to financial stability from these borrowers are mitigated by the structure of the scheme and the typical low-risk characteristics of most first home buyers.[5] While downside risks to housing prices remain, the RBA's Securitisation System data suggest that even in a scenario involving a large uniform fall in housing prices of 20 per cent from current levels, only around 5 per cent of mortgages would fall into negative equity (Graph 2.6).[6, 7] Negative equity is insufficient to trigger default if borrowers remain able to service their loans, which remains the case for the vast majority of these households. Borrowers also tend to continue servicing their loan if they can, reflecting in part the full recourse nature of most Australian mortgages. However, if a borrower becomes unable to service their loan and had to make the difficult and disruptive decision to sell their home, the vast majority would have enough equity to repay their loans in full.[8]

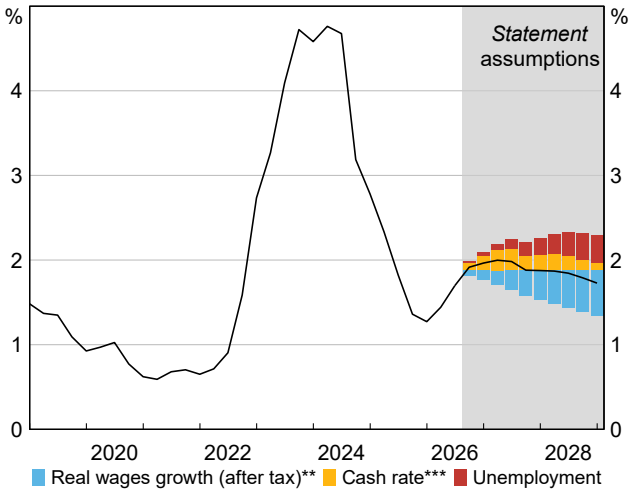
Cash flow pressures on mortgagors are expected to persist, but the share of borrowers with a cash flow shortfall is expected to remain well below the peak in 2024. Based on the economic outlook presented in the August *Statement*, the estimated share of variable-rate owner-occupier borrowers experiencing a cash flow shortfall is projected to remain around its current level of a little under 2 per cent for some time (Graph 2.7). Even though interest rates are above their previous peak during 2023–2024, instances of stress are expected to peak at a lower level. This is because some of the households estimated to have been in cash flow deficit in 2023–2024 are expected to have experienced significant income growth since then. In addition, borrowers that have taken out loans in recent years have faced loan servicing capacity requirements greater than those faced by pandemic-period borrowers and well above current interest rates. This reflects both the increase in actual interest rates and the increase in the serviceability buffer required by the Australian Prudential Regulation Authority (APRA) from 2.5 to 3 percentage points in late 2021.

Graph 2.6
Outstanding LVR Distribution*
Share of balances



* Loan balances adjusted for redraw and offset account balances; property prices grown forwards using SA3 price indices.
** Price fall scenarios apply uniform 20 per cent declines to current property values.
Sources: ABS; Cotality; RBA; Securitisation System.

Graph 2.7
Borrowers with Cash Flow Shortfall*
Estimated share of variable-rate owner-occupier borrowers



* Estimates of borrowers with mortgage payments and essential expenses (HEM) exceeding their income. The sum of the bars does not exactly equal the estimate (line) due to small interaction effects between the individual factors.
** Factor represents the growth of trimmed mean inflation and WPI.
*** Cash rate implied by market pricing as at August 2026 *Statement*.
Sources: ABS; Melbourne Institute; RBA; Securitisation System.

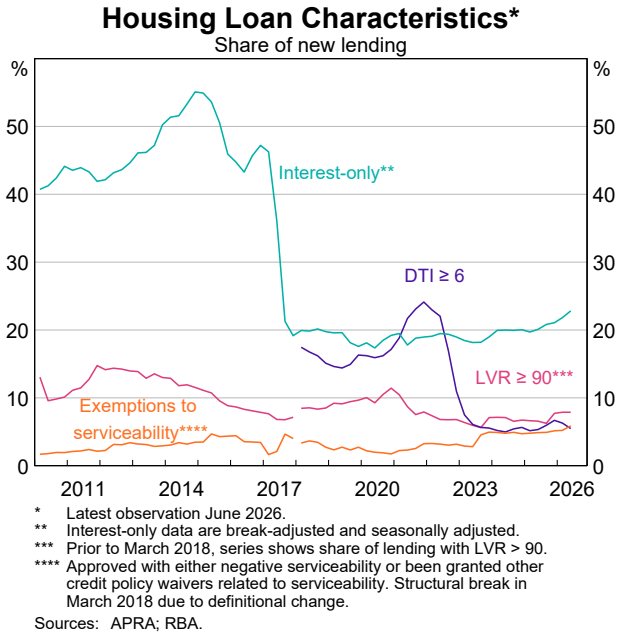
Overall, most household borrowers are expected to remain resilient under a range of adverse scenarios. The RBA uses scenario analysis to inform our assessment of how negative shocks could affect the financial position of Australian households (see 4.2 Focus Topic: Informing Our Financial Stability Assessment Using Scenarios). In a very adverse downturn – for example, a shock that may originate from overseas, where the unemployment rate increases to 6.3 per cent, inflation increases to 7 per cent, and the cash rate rises to 5.6 per cent – the share of mortgagors at a higher risk of defaulting on their loans is estimated to increase to around 5 per cent, only a little higher than the peak in 2023.[9] In this scenario, around two-thirds of these borrowers are estimated to have insufficient income to cover their expenses but have enough buffers to service their debts and essential expenses for at least six months. Additionally, even if housing prices decline by a further 20 per cent, few households are in negative equity in this scenario. Being in positive equity gives borrowers the option to make a decision – though difficult and disruptive – to sell their property to fully pay off their loan if they experience acute financial stress, rather than falling behind on their payments.[10]

Although higher-risk lending to households is expected to slow in aggregate over the next year, the RBA and other CFR agencies continue to monitor housing-related vulnerabilities closely.

Lending standards have remained sound in recent years, and credit growth has started to moderate over recent months. Riskier forms of lending – such as high DTI and high LVR lending – are currently contained and expected to remain so as tighter financial conditions, elevated uncertainty and tax changes weigh on housing credit growth (Graph 2.8). The aggregate share of new high DTI lending remains well below APRA's recently implemented limits of 20 per cent. The share of high LVR lending has increased since the expansion of the Australian Government 5% Deposit Scheme in October 2025 but remains low overall as first home buyers only account for a small share of overall housing credit. The share of new lending originated on interest-only terms has increased over the past year, though by itself this increase is not cause for concern.[11]

The share of new lending issued with exemptions to serviceability requirements increased only slightly over the first half of 2026.[12]

Graph 2.8

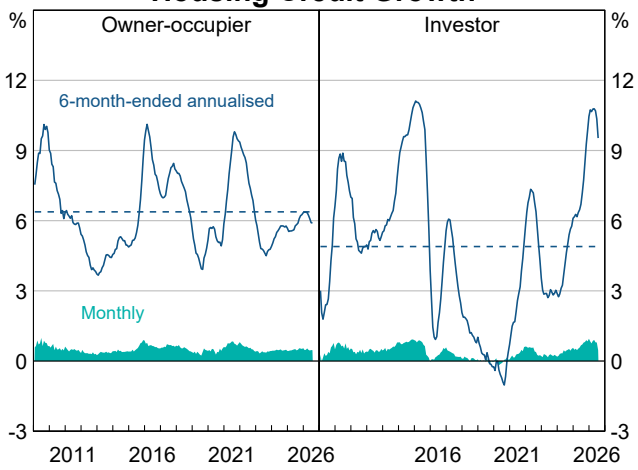


* Latest observation June 2026.
** Interest-only data are break-adjusted and seasonally adjusted.
*** Prior to March 2018, series shows share of lending with LVR > 90.
**** Approved with either negative serviceability or been granted other credit policy waivers related to serviceability. Structural break in March 2018 due to definitional change.
Sources: APRA; RBA.

New lending to investors has moderated from elevated levels, though investors remain an important driver of housing market dynamics. Investor credit growth picked up strongly over 2025 but has slowed recently and is expected to moderate further in the period ahead in response to tax changes, tighter monetary policy settings and softer housing prices (Graph 2.9). Historically, investor activity has tended to have a greater influence on housing price dynamics than owner-occupier activity. In periods of declining housing prices, investors may be less willing to enter the market and more inclined to sell properties to limit losses.[13] This can amplify price declines and contribute to a more pronounced downturn than would otherwise occur. That said, like other borrowers, most investors have considerable equity positions in their properties and have historically exhibited lower rates of arrears and default than owner-occupiers. Investor incomes also continue to be supported by growth in rents.

Graph 2.9

Housing Credit Growth*



* Seasonally adjusted and break-adjusted. Dashed lines are the averages from 2009 onwards for each series. Earliest observation January 2009. Latest observation July 2026.

Sources: ABS; APRA; RBA.

In the context of the current environment and outlook, the RBA supported APRA's recent position to keep macroprudential policy settings unchanged, given their important role in guarding against a material build-up of vulnerabilities and supporting the ongoing resilience of the Australian financial system. While APRA's DTI limits are unlikely to be binding at the system level or constrain credit over the period ahead given the outlook for interest rates, these limits still serve as an important guardrail to limit upswings in the credit cycle.[14] APRA's serviceability buffer, which requires lenders to assess a prospective borrower's ability to service their mortgage at an interest rate 3 percentage points above their current loan rate, also plays an important role in ensuring that new borrowers across the system are well placed to withstand shocks to their incomes, expenses or repayments. In September, the RBA provided financial stability advice to the CFR in line with the approach set out in the CFR Charter and Memorandum of Understanding between APRA and the RBA.[15] Against a backdrop of increasing competition among lenders, the CFR will continue to closely monitor financial stability implications arising from lending practices.

2.2 Businesses

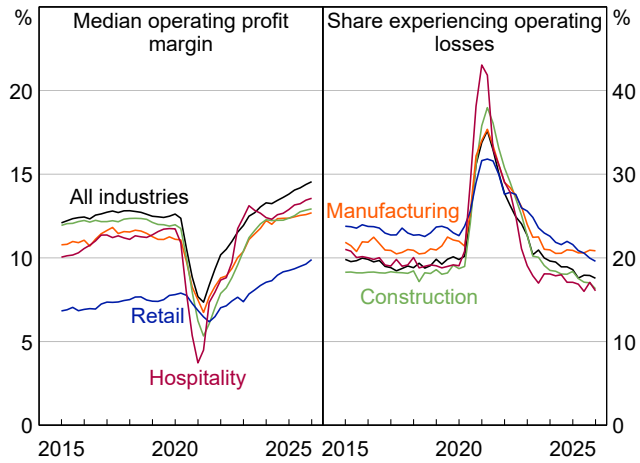
Most businesses appear well placed to manage elevated cost pressures, having entered this year with strong balance sheets and a good degree of resilience.

More small and medium sized firms' (SMEs) operations were profitable in late 2025 than before the pandemic (Graph 2.10, left panel). While these data are only available up to December 2025 and predate the increases in the cash rate, the escalation of conflict in the Middle East and the associated increase in energy and other input prices in 2026, they suggest most firms had been able to slightly improve their operating margins over recent years, despite strong input cost growth. Consequently, the share of SMEs making operating losses had decreased (Graph 2.10, right panel). As operating margins exclude interest costs, this measure does not reflect the effect of changes in interest rates (see below).[16]

More recent surveys since the escalation of conflict in the Middle East indicate elevated cost pressures and prolonged uncertainty have weighed on some firms' profitability. This is particularly the case in the retail, construction and discretionary services sectors. Information from the RBA's liaison program suggests that while businesses are trying to pass on cost increases to their customers (which in some cases include other businesses), this is in some cases limited by consumer price sensitivity. It appears to have been easier for firms in the transportation and construction sectors to pass on cost increases, but more difficult for firms in sectors more reliant on discretionary spending and subject to strong competitive pressures. Some firms, including many smaller businesses, have also had to adjust their operations to reduce costs and support margins.

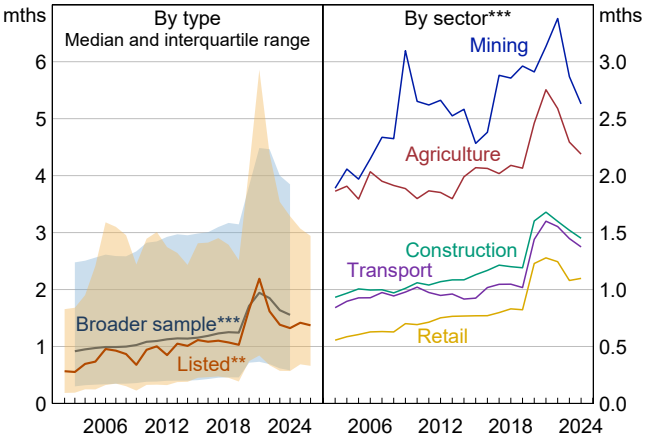
Above-average cash buffers can help firms manage cost pressures and an uncertain trading environment. Cash buffers as a share of expenses increased during the pandemic and, although they have since fallen, they appear to remain above their longer-run average levels for many businesses (Graph 2.11). While data for unlisted companies are lagged, data on businesses' deposit account balances and information from liaison both suggest that SMEs have not meaningfully drawn down their buffers in recent years. Cash buffers help support resilience, especially for smaller firms that may experience greater difficulty in obtaining short term liquidity, as well as for firms with less flexible cost bases such as those in the transport and construction sectors.

Graph 2.10
SMEs Operating Profit Margins
Year-ended measures



* ATO tax data of ~250,000 GST-remitting companies. Operating profits as year-ended operating revenue less operating costs and wages; not including government payments (e.g. JobKeeper); seasonally adjusted. Earliest observation December 2014. Latest observation December 2025.
Sources: ABS (BLADE); RBA.

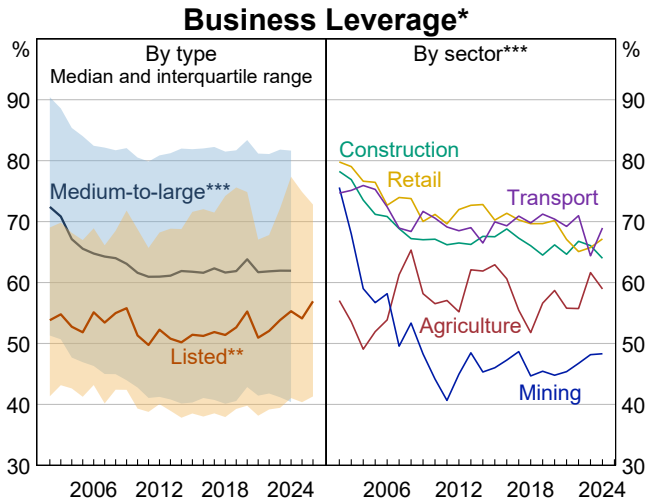
Graph 2.11
Business' Cash Buffers*



* Buffers measured as ratio of cash holdings to monthly expenses. Earliest observation 2002.
** Listed data are based on private non-financial ASX-listed companies. Latest observation June 2026.
*** Broader sample data are ATO tax data of around 200000 businesses. Latest observation 2024.
Source: ABS (BLADE); Morningstar; RBA.

Leverage generally remains contained across the corporate sector, which gives businesses more flexibility to manage shocks. Aggregate corporate leverage has been stable, around longer-run average levels (Graph 2.12), and the level of debt held by relatively more indebted listed companies has decreased since the pandemic. Lower leverage enhances resilience by increasing firms' capacity to access additional funding during periods of stress, including to manage unexpected cost increases or temporary weakness in demand. Information from liaison suggests that some firms had taken on more debt, pre-emptively increasing their working capital, to bring forward purchases ahead of anticipated future cost increases associated with higher energy prices. In addition, lower leverage reduces the vulnerability of business balance sheets to increased interest rate expenses. Information on small businesses' leverage is limited, as many obtain loans by borrowing against the business owner's residential property.[17] Liaison suggests previous housing price growth had supported their balance sheet position in these cases.

Graph 2.12



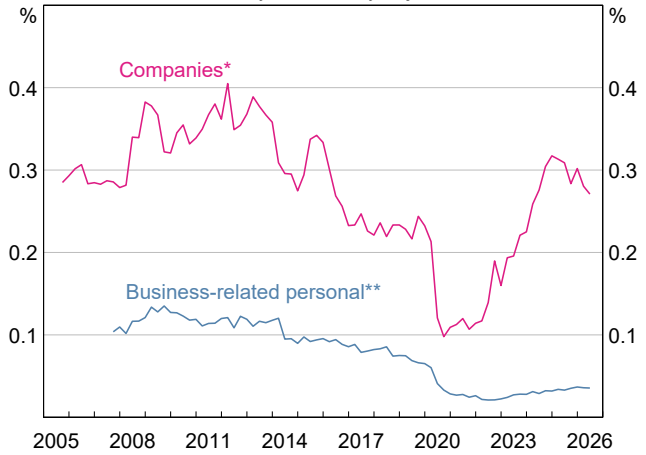
* Leverage defined as ratio of liabilities to assets. Earliest observation 2002.
** Listed data are based on private non-financial ASX-listed companies. Latest observation June 2026.
*** Medium-to-large data are ATO tax data of around 9000 medium-to-large businesses with annual turnover greater than $20 million. Latest observation 2024.
Source: ABS (BLADE); Morningstar; RBA.

Most lenders' ongoing willingness to lend to businesses has supported their ability to manage a challenging period. Information from liaison suggests that most lenders have not materially changed their willingness to supply business credit this year outside of some small reductions in appetite for new lending to the transport industry, given its direct exposure to higher energy prices. Heightened competition for business loans, as well as other factors including automation of loan approval processes, have improved access to credit over the past couple of years, including for smaller businesses.[18] This has helped them manage temporary cash flow pressures and refinancing risks. While strong business credit growth and strong competition have not been associated with a broad decline in lending standards to date, the RBA, together with other CFR agencies, is monitoring this closely as it is important that this remains the case (see below). For the segment of business lending provided by private credit funds, recent liaison information suggests there has been some tightening of financial conditions and an increased sensitivity to project risk. This may affect access to funding for some businesses who usually rely on these lenders (including some residential property developers). While visibility over private credit lending is limited, it remains a small share of total business debt and linkages with the banking system have been assessed as limited (see Box: Private credit in Australia).

Prior to the increase in pressures in 2026, stress in the business sector had appeared to be easing.

Total company insolvencies as a share of operating companies declined over the past year and are around their longer-run average (Graph 2.13).[19] The recent administration of one large builder and developer will result in a temporary spike in the September quarter insolvency figures when they are available, reflecting the large number of subsidiaries involved (Graph 2.13 shows data to June quarter 2026). Firm-specific factors relating to excessive risk-taking over recent years appear to have played a key role in this insolvency. Personal insolvencies of business owners have stabilised at low levels. Firm viability had been supported by easing cash flow pressure and recovering domestic demand through to the beginning of 2026. Since insolvency represents the final stage of severe financial stress for firms, the current insolvency rate does not yet capture the full effect of weaker economic conditions.

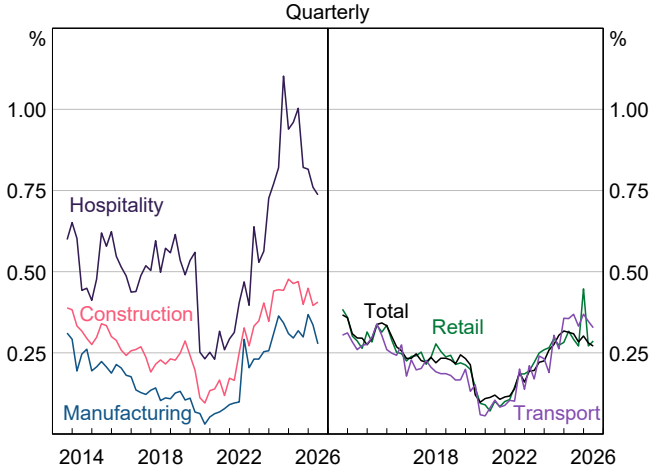
Graph 2.13
Business Insolvency Rates
Quarterly; seasonally adjusted



* Calculated as a share of operating companies. Earliest observation September 2005. Latest observation June 2026.
** Calculated as a share of total operating businesses. Earliest observation September 2007. Latest observation June 2026.
Sources: ABS (BLADE); AFSA; ASIC; RBA.

However, company insolvencies remain elevated in some industries, particularly hospitality, construction and transport (Graph 2.14). These industries are more exposed to the recent wage and input cost pressures. In the construction sector, elevated insolvencies also reflect the typically thin margins of some businesses. Consistent with this, information from the RBA's liaison program indicates that for these industries the number of businesses seeking guidance from community and industry organisations remains elevated; support managing unpaid tax debt remains a common query. The Australian Taxation Office (ATO) had provided some temporary debt restructuring support for businesses affected by higher fuel prices earlier this year, but has more recently returned to resuming its debt collection.[20]

Graph 2.14
Company Insolvency Rates by Industry*
Quarterly



* Company insolvencies as a share of operating companies in the industry; seasonally adjusted. Latest observation June 2026.
Sources: ABS (BLADE); ASIC; RBA.

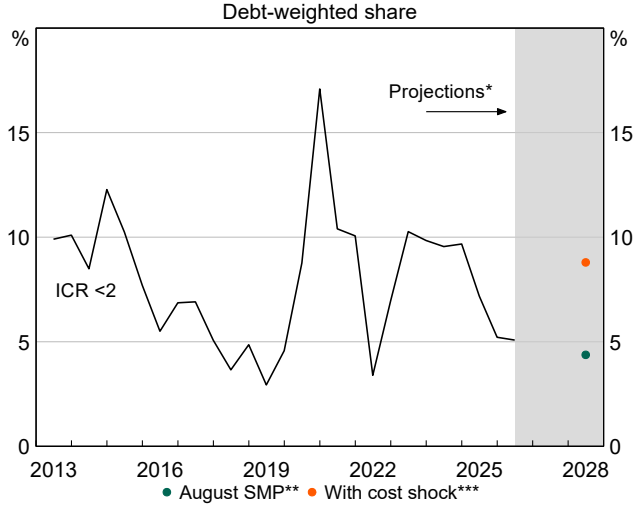
Financial stability risks from insolvencies remain contained. Banks' exposure to insolvent companies remains limited, as most insolvencies to date have involved small companies or companies with little bank debt.[21] Consistent with this, banks are well placed to manage any losses. Business non-performing loans (business NPLs) are mostly well secured and remain below the highs seen during the global financial crisis (see Box: Businesses' exposure to the energy shock by sector and Chapter 3: Resilience of the Australian Financial System).[22]

Financial pressures are expected to increase over the period ahead, especially for smaller businesses and those in more energy-intensive or cyclical industries, though many appear well placed to manage these.

Larger companies are expected to remain resilient to higher interest rates and expenses. Changes in borrowing costs typically take some time to pass through to interest expenses of larger firms because many of them issue fixed-rate debt or hedge their interest rate exposure.[23] The debt-weighted share of ASX-listed firms with a low interest coverage ratio (ICR) – a group historically associated with greater risk of insolvency – is projected to be little changed over the period ahead and remain low by historical standards (Graph 2.15).[24] This is based on the market expectations of interest rates as of the August *Statement* and the forecast of GDP growth in the *Statement* which is for subdued but positive growth, which is likely to support moderate growth in earnings. More broadly, corporate balance sheets generally remain a little stronger than normal, suggesting that most larger companies would be resilient to macroeconomic uncertainty, tighter-than-expected financial conditions (including in the event of a shock originating from overseas) or weaker-than-expected demand (see 4.2 Focus Topic: Informing Our Financial Stability Assessment Using Scenarios).

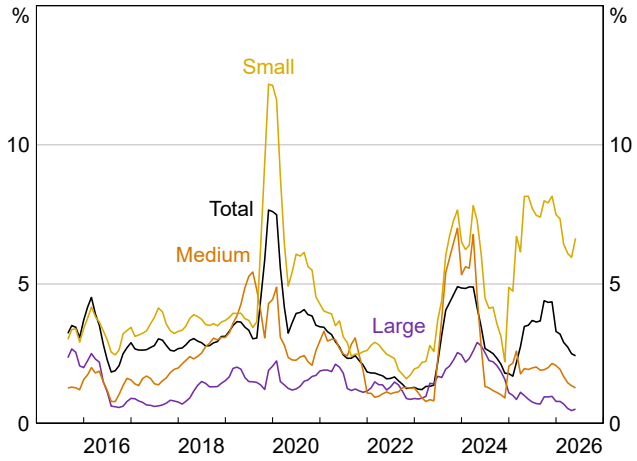
Cash flow pressures are expected to increase for some smaller businesses and those in more cyclical industries. Pass-through of cash rate increases is likely to be faster for smaller businesses than larger corporates. This is in part because many smaller businesses take out variable-rate business loans secured with a residential property mortgage. Indeed, measures of overdue trade credit (considered an early indicator of stress) suggest that smaller businesses are already experiencing higher cash flow pressures than larger businesses (Graph 2.16). The incidence of financial stress is expected to remain higher in the period ahead for smaller businesses, particularly in the construction, hospitality and retail industries, where uncertainty and weaker demand could weigh on discretionary spending amid rising input costs. Stress relating to higher energy input costs is more likely to be concentrated in firms with very high energy intensities and lower buffers, like transport (see Box: Businesses' exposure to the energy shock by sector). Information from liaison suggests lenders are not expecting increased stress to result in a significant increase in business NPLs, given firms' relatively strong balance sheets and prudent lending standards (see below).

Graph 2.15
ASX-listed Companies with Low ICR
Debt-weighted share



* ICR defined as earnings over interest expenses. Firm-level modelling of earnings based on specific scenario assumptions, adjusted for historical interest rate pass-through.
** Scenario based on the market expectations of financial conditions and GDP growth forecasts in the August *Statement*.
*** Scenario based on a 5 per cent increase in operating costs and same operating revenues as the August *Statement* scenario.
Sources: Morningstar; RBA.

Graph 2.16
Share of Trade Credit Severely Overdue*
By business size



* Share of trade credit 91+ day overdue; seasonally adjusted three-month moving average. First observation October 2015. Latest observation June 2026.
Sources: Equifax; RBA.

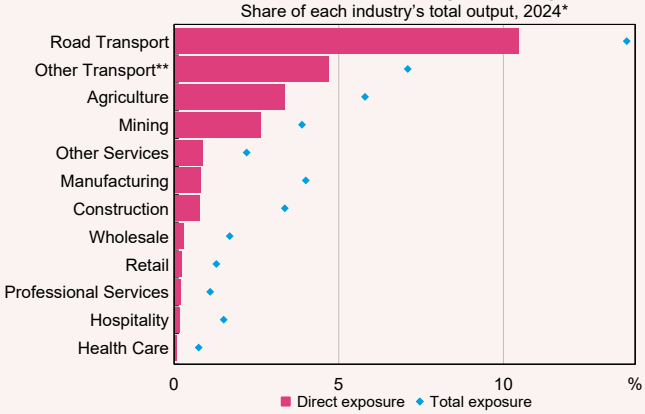
Box: Businesses' exposure to the energy shock by sector

Businesses' direct exposure to energy expenses varies considerably by sector. The continued conflict in the Middle East has driven significant increases in the cost of energy and other oil-derived products such as plastics and fertilisers.[25] For most businesses, energy such as petrol, diesel, natural gas, and electricity accounts for less than 5 per cent of total expenses. However, this share can be much higher for firms in energy-intensive industries including transport (particularly road transport), mining and agriculture, and especially for smaller firms. To demonstrate this, we focus below on firms' specific exposure to fuel inputs, as defined by input-output tables from the Australian Bureau of Statistics.

Indirect exposure to this price shock is larger when considering the full supply chain. When accounting for the fuel intensity of a sector's intermediate inputs, including transportation costs, total fuel exposures are much larger than direct exposures (Graph 2.17). Firms that are dependent on fuel-intensive inputs (e.g. in construction) or are otherwise highly exposed indirectly to fuel costs (e.g. manufacturing and hospitality) and are also unable to adjust their supply chain may continue to face challenges as the shock continues to propagate through the economy. Firms also have exposure to fuel shocks through direct and indirect exposures to oil-derived inputs (such as fertiliser and plastics), but this additional channel is not included in this analysis.

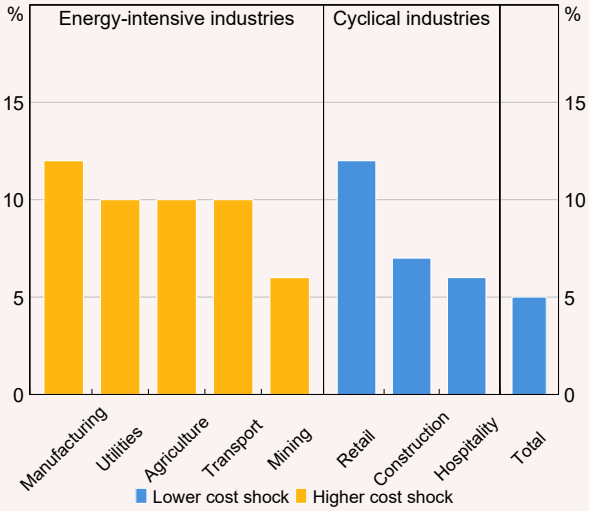
Near-term stress is more likely to be concentrated in energy-intensive firms. To consider the potential impact of recent input cost increases on businesses' operating margins, we estimate how a shock to firm operating costs (with shock size reflecting industry energy exposure) could increase the share of firms making an operating loss using administrative tax data.[26] This share is expected to increase the most in energy-intensive industries, such as manufacturing as well as those in the retail industry (reflecting narrower margins), and particularly for smaller firms (Graph 2.18). This pressure will be felt particularly where firms are less able to pass on higher costs to their customers due to demand conditions or competitive pressures. If there were to be greater pass-through of higher costs, this could be an additional source of financial stress for downstream businesses that are more indirectly exposed. This is particularly relevant for firms in sectors such as retail, hospitality and construction, which tend to operate at lower margins and where the incidence of financial stress is already higher than in other sectors. While there is some evidence of construction companies adjusting their prices, broader pass-through of energy costs to consumer prices is expected to progressively occur until early 2027.[27]

Graph 2.17
Fuel Exposures by Industry
Share of each industry's total output, 2024*



* Direct and total (including supply chain effects) exposures to petroleum and coal product manufacturing as measured by the national accounts input-output tables 9 and 10, expressed as a percentage of each industry's total output.
** Transport, postal and warehousing ANZSIC division excluding road transport.
Sources: ABS; RBA.

Graph 2.18
Change in the Number of Loss-making Firms Under Cost Shocks
Share by industry with negative operating profit margin*



* Changes from baseline data as of December 2025 (see Graph 2.10), relative to the number of firms in each industry. Higher non-wage operating expenses cost shock (10 per cent) applied to energy-intensive industries and lower cost shock (5 per cent) applied to cyclical industries and all firms. Profits measured as year-ended operating revenue less operating costs and wages; not including interest expenses; not including government payments (e.g. JobKeeper); includes ~250,000 GST-remitting companies.
Sources: ABS (BLADE); RBA.

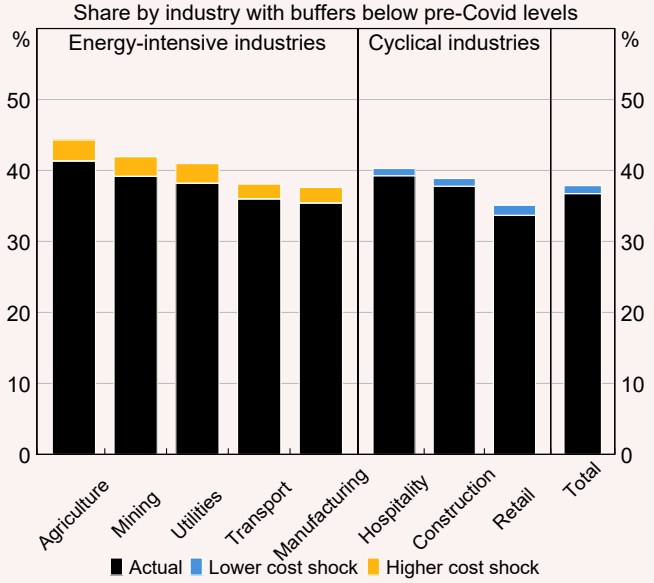
Above-average financial buffers can support resilience for many energy-intensive firms. The cost shocks considered above are estimated to result in only a modest increase in the share of firms with cash buffers below pre-COVID levels in most sectors. In most sectors, a majority of firms would still have cash buffers above their pre-pandemic levels (Graph 2.19).

Financial stability risks from the current energy price shock on businesses are likely to remain contained. While overall outstanding bank credit exposures to high energy-intensity sectors are material, and lenders have increased monitoring since the escalation of conflict in the Middle East, liaison information suggests that lenders do not expect credit quality to decline significantly beyond recent increases in NPLs (Graph 2.20). Further, many loans to smaller businesses tend to be well secured with real estate. Beyond direct implications for lenders, small businesses tend to spend more (relative to turnover) on both energy inputs and wages than other firms, so they may be more likely to adjust employment if they are unable to manage potential shocks through other margins. Nevertheless, survey measures suggest these energy-intensive small businesses tend to have a small number of employees and represent a small share of total employment, limiting potential spillovers to broader labour market conditions. Beyond potential employment effects, these pressures may also continue to affect consumers through higher prices (where stronger demand allows businesses to pass on higher costs). As noted above, the strong financial position of most households is expected to support their resilience to such pressures.

Graph 2.19

Firms with Lower Cash Buffers Under Cost Shocks*

Share by industry with buffers below pre-Covid levels



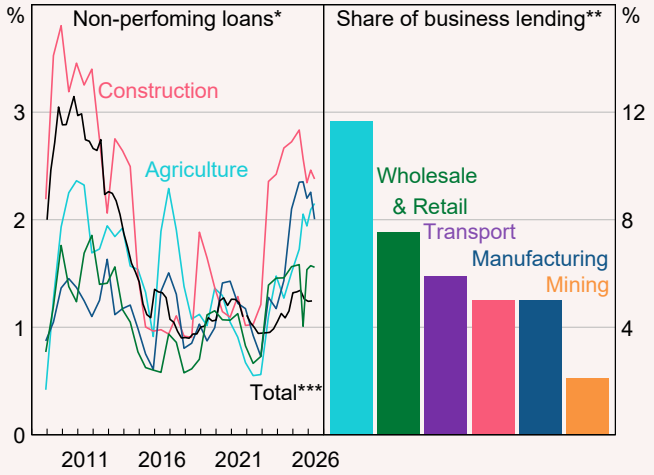
* Data as of 2024, with pre-covid baseline calculated as the firm's median cash buffer level between 2010 and 2019. Higher cost shock models a 10 per cent increase to non-labour costs. Lower cost shock models a 5 per cent increase to non-labour costs.

Sources: ABS (BLADE); RBA.

Graph 2.20

Business Credit by Industry

Select industries, share of banks' non-financial business credit



* Consolidated operations; share of industry exposures from NAB and CBA Pillar III disclosures. Observations December 2008 to June 2026.

** Outstanding credit as of July 2026. Data cover banks with $2 billion or more of business credit; not seasonally adjusted or break-adjusted.

*** Total business NPLs, excluding CRE. Series break in March 2022 due to changes in reporting methodology.

Sources: APRA; RBA.

The subdued economic outlook and sound overall lending standards are expected to limit the build-up of vulnerabilities relating to increases in business leverage, but CFR agencies will continue to closely monitor this.

Business leverage remains low overall despite increasing over the past few years and the slowing economic outlook is expected to limit future growth. Business credit growth remains strong and has been above its post-GFC average for a couple of years, though that was a period of relatively subdued business credit growth. Historically, business leverage in Australia has been sensitive to changes in the outlook for demand. Accordingly, the outlook for slowing economic growth presented in the August *Statement* suggests that any increase in aggregate leverage is likely to be limited. Consistent with this, liaison with lenders suggest credit demand is expected to ease.

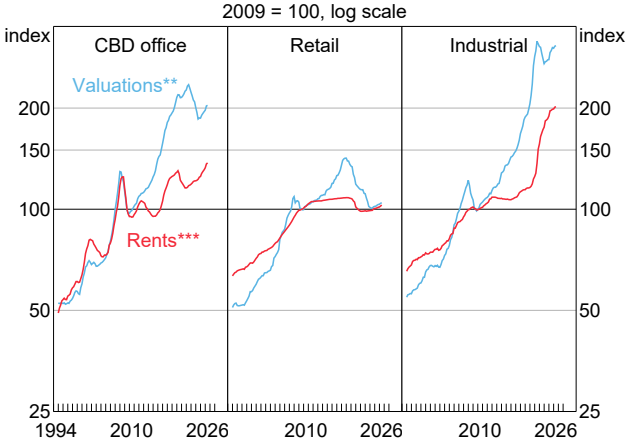
Lending standards remain sound overall, and the RBA, together with other CFR agencies, will continue to monitor for any build-up in vulnerabilities. While data limitations make comparison of business lending standards over time challenging, there is little evidence that the recent strength in business credit growth and strong competition between lenders was accompanied by a material overall easing in lending standards. Liaison indicates competition remains strong but has not led to meaningful changes in banks' lending criteria or risk appetite. Previous process improvements reported over the past couple of years, including automation, had facilitated an increased supply of credit to some smaller businesses and self-employed borrowers.[28] CFR agencies' monitoring of developments extends beyond regulated entities like banks to include business credit supplied by non-bank financial institutions (NBFIs). Information on some non-bank lenders is more limited, in particular for private credit firms. If losses on private credit deals picked up, these would be passed through to their investors and potentially cause stress for those with large exposures. However, systemic impacts would likely be limited by the sector's small size (see Chapter 3: Resilience of the Australian Financial System).

2.3 Commercial real estate

Fundamentals have continued to improve across most Australian CRE markets and investor demand remains strong, despite higher interest rates and elevated uncertainty.

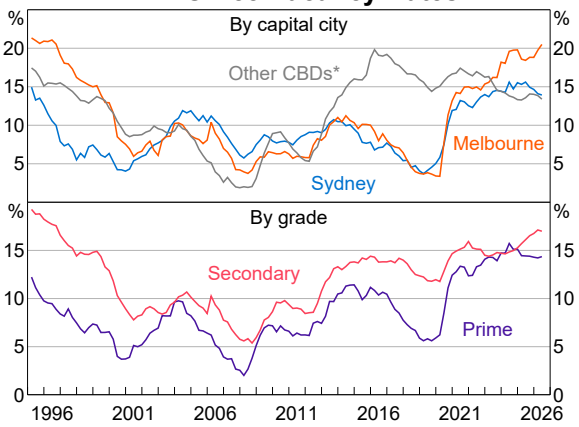
Fundamentals have continued to improve across most CRE markets over the first half of 2026, though some pockets of weakness persist (Graph 2.21). While higher interest rates, inflationary pressures and elevated uncertainty have increased risks to the outlook, the Australian CRE sector is well positioned to face these headwinds and valuations continued to improve across most markets. Ongoing tenant preference towards prime office space is supporting increased valuations and rents in the office sector, though conditions remain weaker in some markets, including lower-grade office properties and those located in areas with high vacancies, such as parts of Melbourne (Graph 2.22). Valuations and rents continue to rise gradually in the retail sector, consistent with declining vacancy rates across most retail asset types and geographies. Looking ahead, higher interest rates and cost pressures on the retail industry (discussed above) may weigh on demand for retail assets. Fundamentals remain strong in the industrial sector, reflecting ongoing demand for warehousing and distribution centres, though new supply has seen growth in valuations and rents ease.

Graph 2.21
Commercial Property*
2009 = 100, log scale



* CBD office and industrial are prime property; retail is regional (large) centres. Earliest observation December 1994. Latest observation June 2026.
** JLL Capital Value Indicator.
*** CBD office is effective rents; industrial and retail are face rents.
Sources: ABS; JLL Research; RBA.

Graph 2.22
CBD Office Vacancy Rates

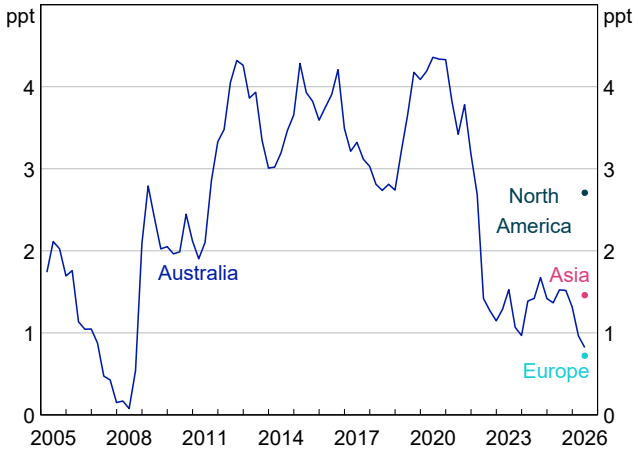


* Adelaide, Brisbane and Perth. Earliest observation March 1995. Latest observation June 2026.
Sources: JLL Research; RBA.

Investment in the construction of data centres in Australia has picked up strongly over recent years, mainly funded by debt.[29] The strong growth in investment is supported by growing demand from global hyperscalers, and liaison contacts expect this trend to continue in the years ahead. While visibility is limited, available information suggests that Australian companies that operate data centres have so far mostly relied on both foreign and domestic debt rather than equity funding – in particular, syndicated loans involving private equity firms and domestic and foreign banks – as has been the case in overseas markets including the United States.[30] Risks from data centre investments to the domestic financial system are limited to date. Domestically raised debt related to data centres remains relatively small compared with overall business funding, and liaison suggests Australian lenders have generally remained quite attentive to risk in their approach to lending for the construction of data centres. However, the relatively high reliance on debt and rapidly growing size of this sector could introduce some vulnerability to the broader financial system over time (see Box: Funding the AI investment boom).

Australian CRE has been a relatively attractive asset class for investors and liaison suggests this is expected to remain the case. Domestic transaction volumes have been strong so far in 2026, in particular in the retail and industrial sectors. Foreign investors have maintained their exposure to Australian CRE, accounting for close to one-quarter of transactions by value over the past year. In liaison, lenders exposed to CRE cite a number of factors for Australian CRE's attractiveness to overseas investors, including a stable economy and transparent institutions. Liaison contacts also note that some foreign investors are seeking to redirect their capital to Australian CRE, away from other markets (such as the United States) due to geopolitical tensions and weaker confidence. Moreover, Australian CRE yields remain attractive relative to returns in some comparable markets, such as Europe (Graph 2.23). These factors, as well as growing global demand for data centres, have the potential to continue to support Australian CRE markets through inflows of foreign capital.

Graph 2.23
Spreads on CRE Returns
Capitalisation rate to risk-free rate*



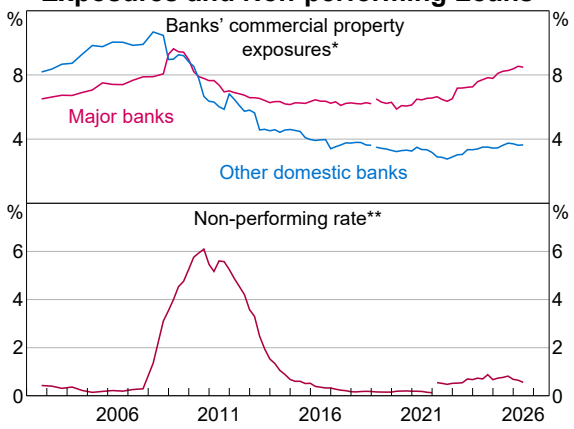
* Spread is calculated as cap rate less the yield on the 10-year government bonds of the respective region. North America covers Toronto and US. Europe covers Berlin, Frankfurt, Hamburg, London, Madrid, Moscow, Munich, Paris and Stockholm. Asia covers Beijing, HK Island, HK Kowloon, Melbourne, Osaka, Seoul, Shanghai, Singapore, Sydney and Tokyo. Earliest observation March 2005. Latest observation June 2026.

Sources: Bloomberg; MSCI; RBA; Real Capital Analytics.

While banks' exposures to CRE have continued to increase, risks to the financial system remain contained and there is little evidence of financial stress among owners of CRE.

After declining for more than a decade after the GFC, CRE loans have increased as a share of Australian banks' assets in recent years, driven by growth in lending by the major banks particularly in the industrial sector (Graph 2.24). Liaison suggests a significant share of this has been increased lending to existing customers deemed by the banks to be lower risk, and this has helped contain default rates at low levels (see below).

Graph 2.24
Banks' Commercial Property Exposures and Non-performing Loans



* Share of assets. Excludes overseas exposures and foreign banks. Series break in March 2019. Earliest observation September 2002. Latest observation June 2026.

** Share of commercial property exposures. Excludes overseas exposures. Prior to 2022, data reported as impairment rates. Earliest observation September 2002. Latest observation June 2026.

Sources: APRA; RBA.

There has continued to be little evidence of financial stress among owners of Australian CRE. Specifically:

- **ASX-listed A-REITs maintain solid financial positions reflecting improving fundamentals.** Earnings have improved over the past couple of years and leverage remains stable. ICRs have continued to improve on average, although have declined a little over the first of 2026 for some funds, reflecting the pass-through of higher borrowing costs to interest expenses. Liaison suggests that A-REITs maintain manageable debt levels and many have hedged a large share of their debt for the year ahead.

Additionally, strong competition among lenders (see below) have allowed some CRE investors to refinance their loans at favourable rates, partially offsetting the impact of higher interest rates.

- **The share of banks' CRE loans classified as non-performing remains low** (Graph 2.24). Liaison with banks suggests that while there are some signs of stress among some CRE owners, CRE loan quality is generally expected to remain strong.
- **Liaison with non-bank lenders also suggests that their CRE loan performance generally remains sound.** While data on non-bank lender loan quality is limited, particularly among lenders with significant exposures to lower quality assets or riskier borrowers, systemic risks from non-bank lenders appear limited by the sector's small size (see Chapter 3: Resilience of the Australian Financial System).

Ongoing strong competition in CRE lending could undermine future resilience if it leads to a further and more material deterioration in lending standards.

Competition in CRE lending remains strong from both bank and non-bank lenders, particularly for higher-quality projects. Liaison with lenders suggests that higher construction costs and affordability constraints have reduced the pool of feasible projects, increasing competition for the projects that remain viable. Strong competition had led to some easing in lending terms over recent years, but standards appear to have been largely unchanged more recently. For instance, some lenders had loosened loan covenants, or lowered presale requirements for residential developments, although other terms have generally remained unchanged.[31] This easing had been somewhat offset by lenders being more discerning on project fundamentals (including location) and by engaging with established builders and developers. Some non-bank lenders have reported a moderation in lending competition more recently, particularly for higher-risk projects. However, information remains more limited on lending by non-bank lenders, and private credit firms in particular. A further and more material easing in CRE lending standards would increase the risk that credit is extended to riskier borrowers, undermining the resilience of the sector.

Endnotes

1 Renters are much more likely to experience stress than mortgage holders. HILDA data, while available up to 2022 only, suggests that around 15 per cent of renters experienced a cash flow deficit compared with around 4 per cent of mortgage holders. A larger share of households in the first income quartile are renters (40 per cent), while very few are owner-occupier mortgagors (7 per cent).

2 The median estimated shortfall for borrowers in a deficit is estimated to be around 6 per cent of income.

3 The arrears rates of recently originated loans may understate their eventual performance because these loans have had less time to experience adverse income or expenditure shocks and transition into arrears. Loan seasoning effects imply that newer loans typically exhibit lower arrears rates than more seasoned loans, see Morgan R and E Ryan (2024), 'Recent Drivers of Housing Loan Arrears', RBA *Bulletin*, July.

4 The RBA uses the Securitisation System dataset to estimate the share of borrowers in negative equity. This share is adjusted to account for the biases in the Securitisation System dataset identified by Hughes A (2024), 'How the RBA Uses the Securitisation Dataset to Assess Financial Stability Risks from Mortgage Lending', RBA *Bulletin*, July. With or without adjustment, the share of borrowers in negative equity remains below 1 per cent.

5 Like all recent borrowers, scheme participants had their mortgage applications assessed at interest rates 3 percentage points higher than their offered rate due to APRA's serviceability buffer. This will support participants' ability to make scheduled mortgage payments. First home buyers have also historically experienced more favourable labour market outcomes and stronger income growth than other borrowers. More generally, scheme participants are unlikely to transmit stress to the broader financial system because their overall share of lending is low, and as the Government guarantees up to 15 per cent of the property value in the case of default.

6 Housing price at risk modelling suggests that the combination of previous strong housing price growth and high housing prices relative to fundamentals, including incomes and high user costs, mean downside risks to prices are currently elevated. For more information on the user cost of housing, see Fox R and P Tulip (2014), 'Is Housing Overvalued?', RBA Research Discussion Paper No 2014-06.

7 This scenario uses the Securitisation System dataset and applies a uniform 20 per cent decrease to current housing values, assuming all else remains the same. It does not consider the broader macroeconomic implications of declines in housing prices.

8 Home loan defaults usually occur when negative equity is accompanied by inability of the borrower to service the loan. For evidence of this in Australia, see Bergmann M (2020), 'The Determinants of Mortgage Defaults in Australia – Evidence for the Double-trigger Hypothesis', RBA Research Discussion Paper No 2020-03.

9 The scenario uses a labour market deterioration similar in magnitude to the 2008/09 downturn.

10 Having low or negative equity can affect a household's ability or willingness to make the difficult decision to sell their property to fully pay off their loan when facing financial stress. Low or negative equity increases a mortgagor's likelihood of both falling into arrears and transitioning from arrears into foreclosure. See Bergmann, n 8.

11 Interest-only loans can enable a borrower to accumulate larger liquidity buffers or manage cash flow for a given loan size during the interest-only period because minimum repayments are smaller, though this comes at the expense of slower equity accumulation and a potentially large increase in minimum repayments at the end of the interest-only period. Interest-only lending can potentially be riskier from a systemic perspective to the extent that it contributes to unsustainable increases in housing prices or leverage, or if it is accompanied by an increase in other riskier types of borrowing including higher LVR or higher DTI lending.

12 In certain circumstances, lenders are permitted to apply an exemption to serviceability requirements, including, for example, in cases of like-for-like refinancing. In late 2023, the share of loans granted exemptions increased sharply to about 5 per cent of new lending. This followed an APRA open letter clarifying how they expect banks to manage exemptions, and coincided with a period of heightened refinancing activity. Information from liaison suggests many exemptions were for borrowers applying to refinance their loans but who no longer passed the new and stricter serviceability assessment after successive interest rate increases.

13 See Lowe P (2019), 'The Housing Market and the Economy', Address to the AFR Business Summit, Sydney, 6 March 2019. However, grandfathering of recent negative gearing changes, where existing investors are still able to negatively gear their investment, could motivate some borrowers to hold on to their properties to maintain this ability.

14 In addition to weaker demand at this stage of the cycle, serviceability requirements mean that higher (lower) rates also decrease (increase) the maximum size of a loan a borrower can service on a given income, all things equal.

15 See CFR (2026), 'Quarterly Statement by the Council of Financial Regulators', Media Release No 2026-05, 3 September; CFR (2025), 'Charter'; RBA (2025), 'Memorandum of Understanding Between the RBA and APRA'.

16 Operating margins exclude interest, tax, depreciation, and amortisation expenses.

17 In Graph 2.12, we focus on businesses with more than $20 million in annual turnover; businesses below this threshold can report zero-interest, at-call, related party loans as debt rather than equity. This distorts the ability to identify the true leverage of a small business. See ATO (2025), 'Debt and Equity Tests: Guide to "At Call" Loans', 18 November.

18 See Harvey N, S Lai and J Spiller (2025), 'Small Business Economic and Financial Conditions', RBA *Bulletin*, October.

19 The longer-run average refers to the average total company insolvency rate calculated using data from 2005–2019. In cumulative terms, total company insolvencies have risen back to around their pre-pandemic trend. However, the pre-pandemic trend is a conservative benchmark because it does not account for strong growth in the number of operating companies over the past five years. Higher growth in the number of companies means that for a given insolvency rate, the absolute number of insolvencies will remain elevated above historical averages (even after detrending).

20 From April to 30 June 2026, the Australian Taxation Office (ATO) provided temporary tax relief for businesses impacted by fuel supply issues, including payment plans and remission of interest charges. See ATO (2026), 'ATO Fuel Response Payment Plan', 1 July.

21 Around 75 per cent of companies that entered insolvency over the 2024/25 financial year had less than 20 full-time employees, and around 70 per cent had no debt owing to secured creditors (the type of debt most likely to be owed to banks). See RBA (2025), '4.3 Focus Topic: The Recent Increase in Company Insolvencies and its Implications for Financial Stability', *Financial Stability Review*, April.

22 Loans are typically classified as non-performing if payments are more than 90 days past due or if banks no longer expect to realise the full economic benefit of a loan, which generally includes when a business borrower enters insolvency. For more details, see RBA (2025), 'Box: The Recent Increase in Banks' Non-performing Business Loans', *Financial Stability Review*, October.

23 Indeed, latest available data to June 2026 show that average interest rates on outstanding listed company debt had remained stable since December 2025. This reflects the remaining effect of the decreases to interest rates in 2025 and early effects from the increases over 2026.

24 An ICR of two is used as a threshold indicative of weaker debt servicing capacity and historically associated with an increased risk of insolvency. We use a slightly more conservative threshold than some other peer central banks (e.g. the Bank of England monitors an ICR threshold of 1.5 in its *Financial Stability Review*).

25 For details on the channels through which increases in energy prices can affect output and inflation in Australia, see RBA (2026), 'Chapter 3: In Depth – The Impact of Higher Global Energy Prices on the Australian Economy', *Statement on Monetary Policy*, May.

26 We apply the lower cost shock (5 per cent of non-labour operating costs) to firms with lower direct energy exposure and a medium cost shock (10 per cent) to firms in industries more directly exposed to reflect the greater near-term impact on margins.

27 RBA (2026), *Statement on Monetary Policy*, August.

28 See Jennison S, J Spiller and P Wallis (2026), 'Recent Changes in Credit Markets and Their Implications for Monetary Policy', RBA *Bulletin*, February.

29 Industrial sector data exclude data centres, which are classified as a separate asset class within commercial real estate, though sector-level data are more limited.

30 See Speed B (2026), 'Data Centre Financing in Australia', RBA *Insight*, September.

31 In February 2025, APRA clarified that its 2017 letter on commercial property lending standards did not constitute minimum presale requirements. This guidance had previously been misinterpreted by some lenders as a requirement for qualifying presales equivalent to at least 100 per cent of committed debt. Some lenders interpreted this clarification as guidance supporting an easing in standards, though liaison contacts generally note lower presale requirements in the industry have been mainly driven by heightened competition and an optimistic outlook on the property market. See APRA (2025), 'APRA Clarifies Its March 2017 Letter Regarding Commercial Property Lending', February; APRA (2017), 'Letter to ADIs: Commercial Property Lending', March.

Chapter 3
Resilience of the Australian Financial System

Summary

The Australian financial system has a good degree of resilience to financial shocks. It is well positioned to continue providing financial services to Australian households and businesses even in the event of an adverse economic downturn or a material repricing of risk in international markets. However, efforts to uplift operational resilience and crisis preparedness across the system remain crucial in light of the pace of technological change and ongoing geopolitical tensions. Our key assessments are as follows:

- **Banks have maintained prudent lending standards, are well capitalised and have large holdings of liquid assets.** Risks from credit quality remain contained, most troubled loans are well secured, and banks maintain solid loss provisions. Banks' reliance on offshore debt funding has declined since the global financial crisis, reducing their exposure to stress events in international markets.
- **Operational resilience is a significant and growing focus for regulators, banks and other financial institutions.** Building and maintaining resilience requires a concerted and sustained effort across the financial system given the scope for material operational disruptions. This includes action from critical service providers such as financial market infrastructures (FMIs). Operational risk is a particular focus of FMI supervisors, including in relation to Austraclear and RITS.
- **Rapid progress in frontier AI capabilities has also made cyber threats more complex and dynamic, increasing the risks to financial stability from operational vulnerabilities.** Cyber-attacks have the potential to cause systemic disruptions, including through financial institutions' exposure to common service providers.
- **The superannuation sector has been a source of stability for the broader financial system, including following international shocks, but risk management challenges will grow over time.** The historical resilience of the sector partly reflects institutional arrangements, such as restrictions on early withdrawal, limits on leverage, and compulsory defined contributions that provide much of the sector with stable net inflows. However, the sector is going through a period of structural transition. A larger share of assets is being invested overseas (increasing foreign exchange hedging needs), operational vulnerabilities are receiving greater focus and more members will be moving to the decumulation phase over time, increasing the demand for liquidity. Efforts to strengthen liquidity and operational risk management practices are warranted as the sector continues to grow.

- **Non-bank lenders are a growing source of credit for households and businesses, though the sector's systemic impact remains limited by its small size.** Strong demand for Australian securitised assets over recent years has supported funding conditions for many non-bank lenders and helped to support credit availability. Private credit funds, though still relatively small, have also experienced strong growth in assets under management in recent years. While Australian banks have relatively limited exposure to private credit funds, the Australian Securities and Investments Commission (ASIC) has identified and is addressing investor protection issues that have emerged in parts of the Australian private credit industry. These include opaque valuation practices and uneven standards of governance and risk management.
- **Insurance affordability is not an imminent threat to financial stability, but it remains a challenge and the implications for financial stability could increase over time.** The share of households finding home insurance unaffordable could rise to 25 per cent by 2050, increasing the exposure of mortgage lenders to climate risks.

3.1 Banks

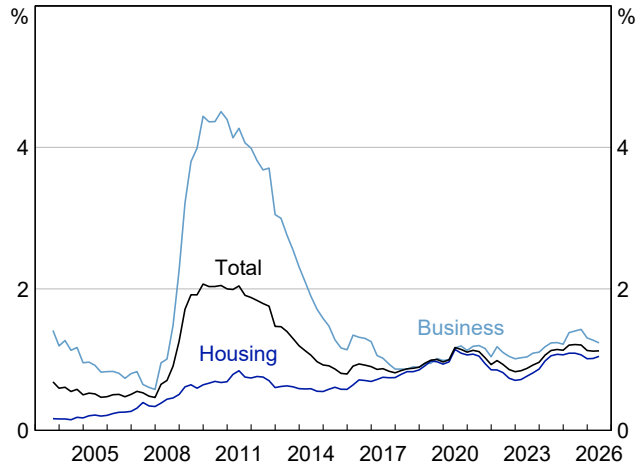
Risks to banks from credit quality remain well contained.

Credit quality improved slightly over the year to June, but banks expect this to partly reverse in the period ahead as pressure on some borrowers grows. The recent decline in the share of non-performing loans (NPLs) primarily reflects a drop in business NPLs, consistent with resilient economic growth and a decrease in the overall business insolvency rate over the past year (Graph 3.1). However, conditions have remained challenging in some industries, particularly hospitality, construction and transport, and cost pressures have proven persistent across the economy (see Chapter 2: Resilience of Australian Households and Businesses; Box: Businesses' exposure to the energy shock by sector). Liaison suggests that business NPLs are expected to pick up as these pressures continue, although not significantly. While most household borrowers remain in a strong financial position, housing NPLs increased slightly in the June quarter and banks generally expect modestly weaker housing loan performance going forward. Hardship requests have increased recently due to persistent pressure on household budgets, including from inflation and higher interest rates (see Chapter 2: Resilience of Australian Households and Businesses).

Graph 3.1

Banks' Non-performing Loans*

By lending category, share of credit type



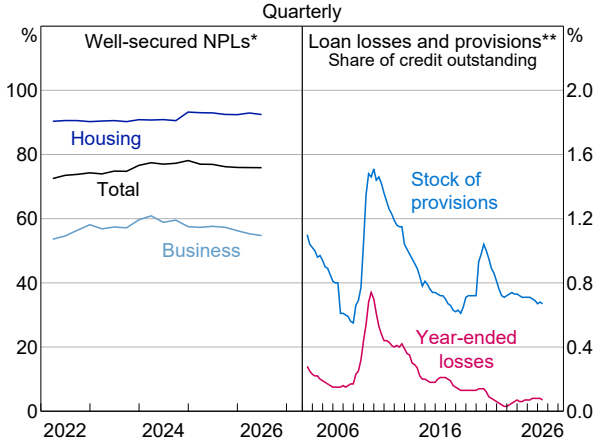
* NPLs include loans in 90+ days arrears and Total series includes Housing, Business, and a minor share of Personal loans. Earliest observation 30 September 2003. Latest observation 30 June 2026.

Source: APRA; RBA.

While lending has grown strongly in recent years, banks have generally maintained prudent lending standards throughout this period. Housing lending picked up strongly over 2025, driven by investors, but it has moderated more recently, and lending standards have remained sound. Business credit has also been growing strongly, supported by increased competition among banks, improvements in loan application processes and the growth of specialist non-bank lenders.[1] In liaison discussions with the RBA, banks have reported a modest easing of requirements for some business and commercial property lending over the past year. But there is no indication of a broad relaxation in lending standards. Recent increases in business loan impairments at some banks have largely reflected idiosyncratic developments. Liaison suggests Australian banks have generally remained attentive to risks in parts of the construction sector, including data centres (see Chapter 2: Resilience of Australian Households and Businesses).

Strong collateralisation limits the potential for loan losses, and banks have also maintained solid provisions. Over 90 per cent of housing NPLs and over 50 per cent of business NPLs were considered well secured in June 2026 (Graph 3.2).[2] This means banks anticipate no credit losses from most of their troubled lending because a sale of the associated collateral would repay the loan in full. While this can be highly distressing and disruptive to the borrower when it involves the sale of a family home – as is the case for mortgages and many small business loans – it limits the potential for transmission of stress through the financial system. Housing prices have declined over 2026 but given gains over recent years and prudent lending standards, even after a very large fall in prices only a small share of borrowers would be in negative equity and expose banks to losses if they were unable to make their repayments (see Chapter 2: Resilience of Australian Households and Businesses). Banks also hold loss provisions of around 0.7 per cent of total credit outstanding, providing a substantial buffer when compared with recent historical loan losses.[3]

Graph 3.2
Banks' Collateral and Loan Losses
Quarterly



* Well-secured NPLs are non-performing loans that are not classified as unsecured, as a share of NPLs. Earliest observation 31 March 2022; latest observation 30 June 2026. Data on loan security are available from March 2022.

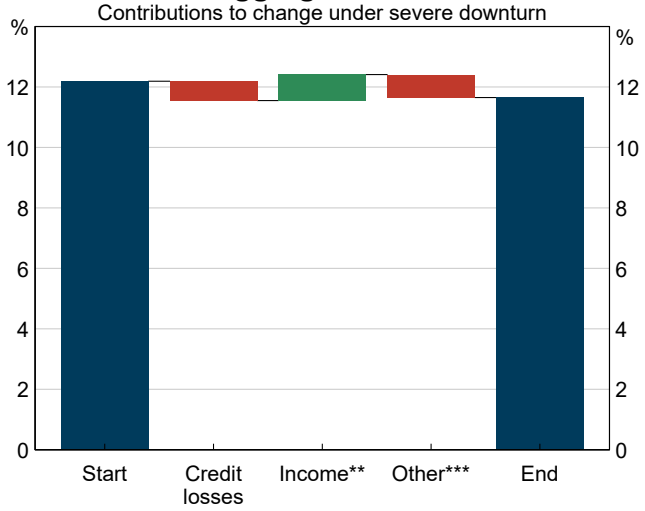
** Loan losses over the past year are current losses over the previous four quarters as a share of credit outstanding at the beginning of that period. The stock of provisions comprises collective and individual provisions as a share of current credit outstanding. Earliest observation 30 June 2003; latest observation 30 June 2026.

Sources: APRA; RBA; Rodgers (2015).

Australian banks remain well placed to support the economy even in the event of a very adverse domestic economic downturn or a shock to international markets.

Strong profits and the high quantity and quality of capital in the banking system mean banks could absorb large losses from a very adverse shock while continuing to extend credit. The banking system's ratio of Common Equity Tier 1 (CET1) capital – the highest quality of regulatory capital – to risk-weighted assets remained high and well above regulatory requirements at 12.4 per cent in June 2026. In a very adverse economic downturn scenario that includes a 3 percentage point fall in GDP growth and a sharp 20 per cent collapse in housing prices, the banking system's CET1 capital ratio is estimated to decline to around 11.6 per cent, with very few banks expected to use a substantial amount of their capital buffers (the capital held above regulatory requirements) (Graph 3.3; see 4.2 Focus Topic: Informing our Financial Stability Assessment Using Scenarios).[4] This means that even under this scenario, the banking system would have sufficient capital to continue lending to households and businesses. The resilience of Australian banks reflects both a strong starting capital position and strong profitability as net interest income is projected to provide a substantial buffer to prevent larger falls in banks' capital ratios even in a considerable downturn.

Graph 3.3
Banks' Aggregate CET1 Ratio*
Contributions to change under severe downturn



* Estimated peak-to-trough change over a four-quarter projection period using Garvin et al. (2022). Scenario includes a 20% peak-to-trough fall in house prices and commercial property prices. GDP growth falls by 3%, unemployment rises to 6.3% and the cash rate rises to 5.6%.

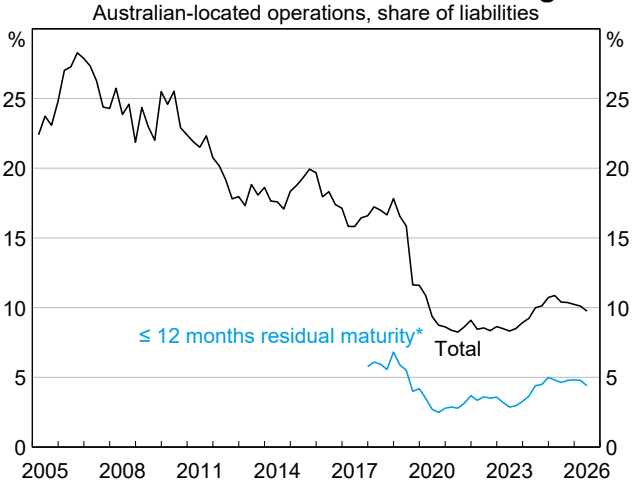
** Retained earnings before credit losses.

*** Primarily reflects higher risk weights increasing risk-weighted assets, with a small contribution from balance sheet growth.

Source: APRA; RBA.

Banks have reduced their reliance on offshore funding over time, which has improved their resilience to international shocks. Stress in international financial markets – such as a sharp repricing of risk – can transmit to Australian banks by potentially impairing their ability to rollover offshore wholesale funding on maturity (see Chapter 1: The Global Macro-financial Environment).[5] However, the share of banks' funding sourced from international wholesale debt markets has declined substantially over the past two decades as Australian banks replaced it with more stable domestic household deposit funding (Graph 3.4). In addition, just over half of offshore debt funding has a maturity greater than 12 months, further mitigating rollover risk.

Graph 3.4
Banks' International Debt Funding
Australian-located operations, share of liabilities



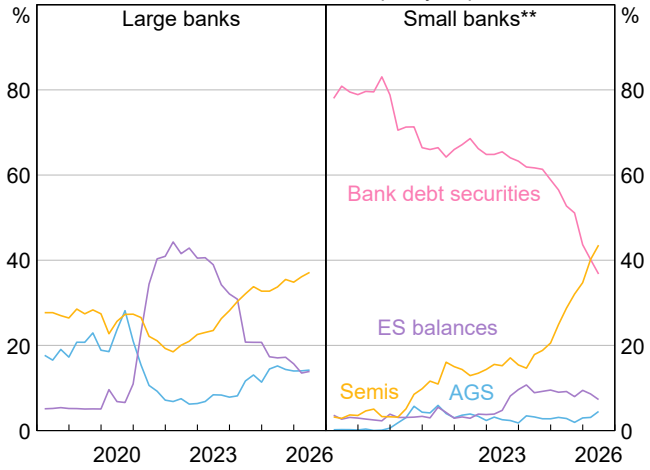
* Australian-owned banks' debt securities only. Earliest observation 31 March 2005. Latest observation 30 June 2026.
Sources: APRA; RBA.

Ongoing regulatory refinements are helping to maintain the broader resilience of the banking system. In June, the Australian Prudential Regulation Authority (APRA) finalised a simplified pathway for banks' accreditation for the internal ratings-based (IRB) approach to calculating risk-weighted assets.[6] For some medium-sized banks, the IRB approach is likely to offer more efficient use of capital while incentivising investment in more advanced risk management capabilities.

Banks hold large reserves of liquid assets, and it is important they can be quickly converted into cash during a liquidity stress event.

Banks continue to hold large amounts of liquid assets well above regulatory liquidity minimums. However, regulators are considering the ongoing suitability of the existing liquidity risk framework following rapid deposit runs experienced in the United States and Switzerland in recent years.[7] APRA has announced it will consult on proposed changes to its liquidity management standard (APS 210).[8] Over the past few years, exchange settlement (ES) balances held at the RBA – which banks use for settling payments with other banks – have been declining, consistent with the transition to an 'ample reserves' system for monetary policy implementation.[9] Large and medium-size banks have increased their holdings of government debt securities, especially state government debt (semis) (Graph 3.5). Smaller banks have also increased their state government debt holdings over the past two years, primarily to reduce their reliance on bank debt securities and improve the diversification and quality of their liquid asset holdings. These changes have increased the importance of state government debt for banks' liquidity management. Although some government debt markets could become strained in the event of severe stress in international markets (see Chapter 1: The Global Macro-financial Environment), banks' holdings of Australian government and state government debt securities also function as eligible collateral for accessing additional liquidity from the RBA.

Graph 3.5
Banks' Liquid Assets*
Share of total assets held for liquidity requirements



* Selected categories of liquid assets; large banks report under the liquidity coverage ratio (LCR) framework, while small banks report under the minimum liquidity holdings (MLH) framework.
** For small (MLH) banks, ES balances include settlement funds due from clearing houses, RBA, major banks and other locally incorporated LCR ADIs.
Source: APRA; RBA.

It is important that banks are ready to convert assets that they hold for liquidity purposes into cash when necessary. Banks (and other eligible counterparties) can borrow from the RBA against eligible collateral to increase their ES balances when needed through weekly open market operations (OMO). This allows banks to manage their liquidity needs, including raising liquidity during or in anticipation of periods where market functioning may be impaired, supporting both their own resilience and broader market stability. If eligible counterparties cannot find liquidity on suitable terms in private markets or via RBA OMO, they are expected and encouraged to use the RBA's overnight standing facility. The RBA and APRA consider the use of this facility by banks to be consistent with routine liquidity management activities.[10]

Strengthening operational resilience across the financial system is critical for financial stability.

Operational resilience remains a prominent focus for financial institutions and policymakers. Increasing complexity and interconnections of operations across the financial system have heightened the potential for operational disruptions to have systemic consequences, leading to and/or exacerbating financial stress (see 4.1 Focus Topic: Operational Risk and Financial Stability). Maintaining resilience requires ongoing adaptation to a rapidly evolving threat environment marked by technological and geopolitical disruption. At the entity level, APRA's operational risk management standard (CPS 230), which was introduced in July 2025, has spurred banks and other financial institutions to uplift their operational resilience.[11] At a broader level, initiatives are underway to enhance operational resilience of the Australian financial system as a whole – it is important that this remains a central focus.[12] This includes resilience in the superannuation sector and critical service providers such as FMIs and entities integral to the payment system (see section 3.2 Non-bank financial institutions).

Rapid progress in frontier AI capabilities has made the cyber threat landscape more complex and dynamic, increasing the risks to financial stability from operational vulnerabilities. Frontier AI is accelerating known cyber, technology and operational risks, by increasing the speed, scale and sophistication of cyber threats, including attacks, scams and fraud. In addition, the experimental nature of many of these advances and related testing has recently led to several incidents, including of frontier models bypassing controls, leading to unintended security breaches. AI also has the potential to accelerate the speed of development of other emerging technologies, such as quantum computing, that have implications for the security of the financial system. At the same time, AI tools also have the potential to strengthen resilience by improving operational efficiency, risk management and cyber defence capabilities of banks and other financial institutions. APRA and ASIC recently issued public letters to alert their regulated entities to the increasing scale and sophistication of cyber-attacks due to improvements in AI technologies.[13] Cyber-attacks have the potential to cause disruptions at a systemic level, including through financial institutions' exposure to common service providers. Similarly, the faster and more frequent patching required to address cyber vulnerabilities also heightens operational risks. APRA has found substantial variation in the maturity of operational resilience and risk management practices across financial institutions and has called on them to strengthen capabilities relating to information security, governance frameworks and risks from third-party providers. Recent industry roundtables organised by regulators have further emphasised the need to move quickly and that collaboration across the financial sector will be critical for building resilience.[14]

3.2 Non-bank financial institutions (NBFIs)

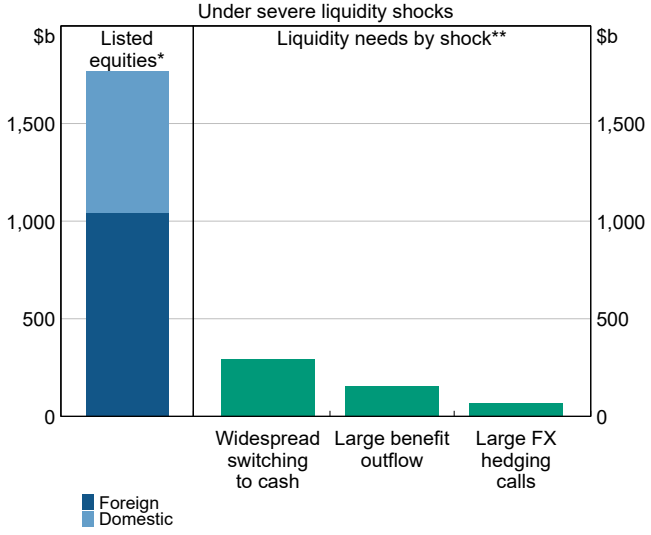
While the superannuation sector has been an important source of stability in the broader financial system over many years, ongoing work to strengthen liquidity and operational risk management practices across the sector is warranted.

The institutional arrangements of superannuation in Australia have supported the resilience of the broader financial system. The superannuation sector has historically supported market functioning during periods of stress in domestic and international markets partly because of restrictions on early withdrawal (which allow funds to adopt long investment horizons), limits on leverage, and steady net inflows resulting from compulsory defined contributions. The system also supports household balance sheets, contributes an important source of long-term funding to businesses, and mitigates risks to the government balance sheet from an ageing population. At the same time, the sector is undergoing a period of transition, as greater focus turns to meeting member needs in the decumulation phase.

Results from APRA's inaugural System Risk Stress Test suggests the superannuation sector could likely withstand a severe-but-plausible adverse scenario involving financial and operational stresses that affected both banks and superannuation funds over the course of a year.[15] During the stress test, all participating funds maintained adequate cash and liquid assets to satisfy the scale of member withdrawals and requests to switch investment options, though with unequal effects across members. The results suggest that the superannuation sector is positioned to remain an important source of support for the banking system during extended periods of market stress, including if an international shock tightens conditions in offshore funding markets (see Chapter 1: The Global Macro-financial Environment).

Superannuation funds' considerable holdings of liquid international risk assets appear sufficient to prevent disruption to domestic markets from short-term calls on liquidity. For instance, members switching from risk assets into cash at four times the quarterly volume observed at the start of the COVID-19 pandemic could be largely funded out of international equity portfolios in the short term without requiring liquidity to be raised through the fire sales of domestic risk assets, even if this coincides with a considerable fall in international equity prices (Graph 3.6).[16] The same applies to liquidity calls in case of a historically large outflow of assets from the superannuation system. In line with the experience during the initial COVID-19 shock, liquidity requirements from funds' foreign exchange hedges are not particularly material in a short-run scenario because hedge maturities are typically staggered and only a small share of these hedges requires funds to post margin daily.[17] Liaison with superannuation funds suggests that liquidity needs due to member switching, outflows and foreign exchange hedging have been reasonably consistent over time (and mostly managed without disruption) following periods of market volatility. Funds also hold some operational cash reserves.

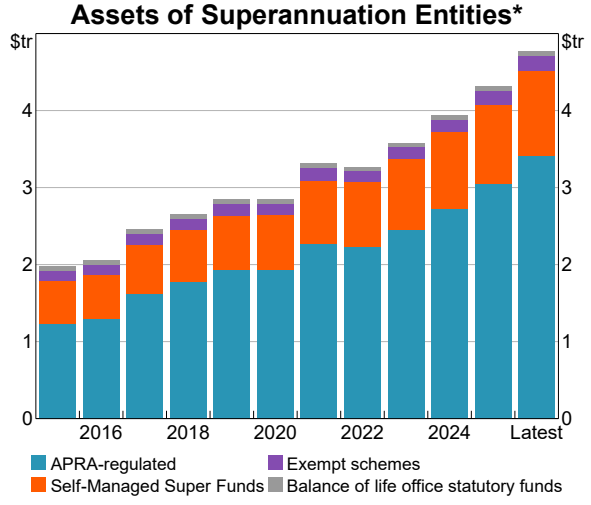
Graph 3.6
Superannuation Sector Liquidity
Under severe liquidity shocks



* Listed equities holdings are as of June 2026.
** 'Widespread switching to cash' shows switching from growth assets to cash roughly equivalent to 4 times switching during the March 2020 quarter. 'Large benefit outflow' shows a 20 per cent outflow of investments in the retirement phase withdrawn from the system. 'Large FX hedging calls' approximates realised losses from funds FX hedges for a sustained 20 percent depreciation in the AUD over a month.
Sources: APRA; RBA.

As the superannuation sector grows, it is important that liquidity risk management practices in the sector continue to strengthen. The sector currently accounts for around one-third of Australian financial system assets, and assets under management are expected to continue growing until at least the 2050s, further increasing the sector's size relative to domestic markets (Graph 3.7). The share of offshore investments – already around half of assets under management by APRA-regulated funds – is also likely to continue to grow over time, which will increase foreign exchange-related liquidity needs (when the Australian dollar depreciates) for superannuation funds and so may add to liquidity risks. In addition, a growing share of members are set to move into the decumulation phase, which will increase their ability to withdraw capital from risk assets during market shocks. Liaison with industry points to overall, though uneven, progress on liquidity risk management over recent years. But as liquidity needs grow, there could be more potential for the sector to inadvertently amplify system stress. Ongoing enhancements to liquidity risk management practices will help to ensure that superannuation funds can continue to meet the liquidity needs of their members without undermining the resilience of the Australian financial system in severe-but-plausible stress scenarios.

Graph 3.7



* Earliest observation June 2015. Latest observation is June 2026. Observations for prior years are as at June of the same year.

Sources: APRA; RBA.

Widespread operational disruption in the sector, or a loss of member confidence that leads to large scale withdrawals from a number of funds, could cause disruptions but these are difficult to quantify. Liaison with superannuation funds suggests the introduction of APRA's CPS 230 standard on operational risks management has led to an overall uplift in funds' operational resilience (see 4.1 Focus Topic: Operational Risk and Financial Stability). While this progress has been welcome, the possibility of an operational issue that disrupts much of the superannuation sector – such as an outage at a common third-party provider and limited ability to replace services – remains a potential vulnerability. The risk of large-scale withdrawals from the system due to a loss of confidence, though difficult to model, might also increase over time given the growing share of Australians above the preservation age (after which retiree lump-sum withdrawals are permitted). Substantial differences in the age profile of members across funds mean some funds will be more exposed to the risk of lump sum withdrawals than others.

Regulatory changes and increasing demand for retirement income products are likely to support growth of the annuity insurance market in Australia, which in turn can support financial system resilience if these commitments are prudently managed. In March 2026, APRA announced changes to the capital treatment of annuities and other longevity products to improve the availability of retirement income products. Greater adoption of annuities – which provide a regular guaranteed income stream in exchange for an up-front payment – could support the resilience of household income as the share of Australians in retirement continues to increase over the next few decades. Annuities reallocate longevity risk from households to insurers. While the annuities market in Australia is currently very small by international comparison, it is important that growth in the industry is accompanied by robust standards of capital, liquidity and operational risk management.

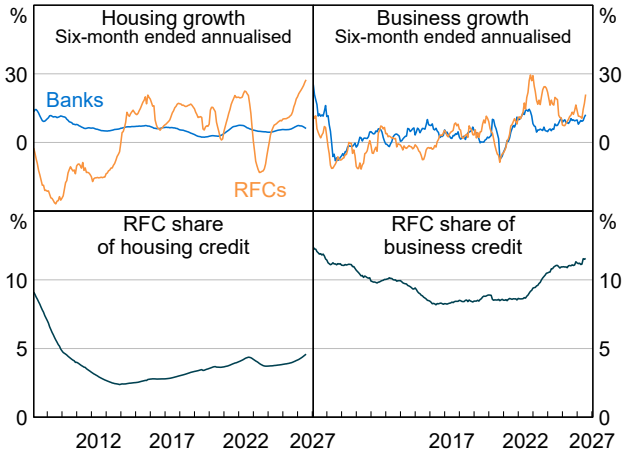
Strengthening the resilience of FMIs is a priority for financial stability in Australia.

FMIs provide services that are essential to the functioning and stability of the financial system, but their central role and limited substitutability can concentrate risk. Austraclear, a securities settlement facility operated by ASX, is systemically important to the Australian financial system. Financial institutions use it to settle transactions in Australian Government Securities, semi-government securities and other wholesale debt instruments. The RBA relies on Austraclear to settle securities transactions arising from its domestic market operations and liquidity facilities. ASX's central counterparties also rely on Austraclear to settle Australian dollar margin obligations. A prolonged disruption to this facility could constrain access to liquidity, impair the functioning of markets and transmit stress across the financial system. (For more detail on the interaction between operational and financial risk, see 4.1 Focus Topic: Operational Risk and Financial Stability.) The RBA's assessment of the ASX clearing and settlement facilities for 2025/26 found that ASX is yet to establish adequate contingency arrangements that would support Austraclear's critical services during a prolonged outage.[18] Strengthening these arrangements is therefore a priority for the RBA's supervision of ASX. The RBA has also identified improvements that are needed to strengthen the operational resilience of the RBA's real-time gross settlement system – RITS. While the RBA has invested significant resources and effort to enhance operational risk management for RITS, the focus on operational risk must remain a priority given the more challenging external environment.[19]

Non-bank lenders have continued to grow as a source of finance in the Australian economy, though risks to system-wide stability remain contained.

Non-bank lenders are an important source of finance for some households and businesses, but their share of total credit in Australia remains relatively small (Graph 3.8). Non-bank lenders often focus on borrower segments requiring more complex financing needs or credit assessments, meaning they often complement rather than compete directly with banks. Despite strong growth over the past decade, non-bank lenders still only account for around 6 per cent of financial system assets, limiting their systemic importance. This includes some private credit funds, who typically lend to larger and mid-sized businesses and commercial real estate projects on behalf of investors (see Box: Private credit in Australia). In liaison with the RBA, non-bank mortgage lenders noted that upcoming changes to negative gearing and capital gains tax and restrictions on borrowing to finance residential property for self-managed super funds were expected to reduce demand for credit and could weigh on growth in non-bank mortgage lending going forward.

Graph 3.8
Housing and Business Credit*



* Seasonally adjusted and break-adjusted. The Registered Financial Corporations (RFCs) series includes non-bank lenders with more than $400 million in assets (including lenders consolidated within banking groups), and does not include superannuation funds or insurers. Earliest observation January 2008. Latest observation July 2026.

Sources: APRA; RBA.

Strong demand for Australian asset-backed securities from foreign investors has supported funding conditions for some non-bank lenders. Securitisation is a key source of funding for some non-bank lenders as they are prohibited from funding themselves by taking deposits. Spreads on non-banks' primary issuance of residential mortgage-backed securities have narrowed considerably over the past three years, underpinning strong growth in non-bank lending over the same period. Liaison suggests decreases in funding costs have partly reflected increased demand from foreign investors who appear to be attracted by the relatively stable domestic economic environment in Australia and good credit quality on non-bank originated mortgages. Available data suggests non-bank lenders' mortgage arrears rates are only marginally higher than those of banks. A sharp repricing of risk in international markets (see Chapter 1: The Global Macro-financial Environment) could tighten non-bank funding conditions, though non-bank lenders also report ample warehouse funding capacity (revolving facilities obtained from banks).

The available evidence suggests that non-bank lenders have not been taking meaningfully more risk on their lending activity as their funding conditions have eased over recent years. Liaison with non-bank lenders suggests that some lenders have eased selected lending standards over this period, though the experience has been uneven and there is little evidence that this has materially changed the risk profile of their overall lending portfolios.

The general insurance sector is not currently a source of financial stability concern, but increasing underinsurance could undermine resilience in the longer term.

The general insurance sector remains well capitalised and profitable. The sector's capital ratios are well above APRA's prescribed capital amount. Profits have been supported by growth in premiums and favourable conditions in the reinsurance market over the past year, but margins continue to be under pressure from frequent extreme weather events affecting insured assets.

Insurance affordability remains a challenge and could have larger implications for financial stability over time. APRA released its Climate Vulnerability Assessment stress test in March 2026, which suggests that the proportion of households facing unaffordable home insurance could almost double by 2050, increasingly exposing mortgage lenders to climate risks.[25] Insurance costs for businesses (including on commercial properties) have also grown strongly. A report from a government inquiry into small business insurance is expected to be published at the end of October 2026.

Box: Private credit in Australia

In Australia, private credit markets have grown in recent years, but their small size and structure mean they do not pose a system-wide financial stability risk at present. Private markets occupy an important place in funding some types of growth in the economy and have grown significantly in Australia over the past decade. Even so, the largest of the available estimates suggest it still only accounts for around 10 per cent of total business debt and less than 2 per cent of financial system assets.[20] Australian private credit funds are typically concentrated in real estate lending, including for construction and development.[21] This means that these funds are more exposed to stress in the property sector, as demonstrated by the large number of funds with exposures to the recent insolvency of a larger property developer (see Chapter 2: Resilience of Australian Households and Businesses). While this insolvency has led to increased redemption requests from investors and tightened funding conditions for some Australian funds, liaison with funds suggests most loans continue to perform and are well collateralised. Domestic private credit funds also generally have low leverage and are much less exposed to software and technology companies disrupted by advancements in AI than the typically more highly leveraged private credit funds overseas (see Chapter 1: The Global Macro-financial Environment).

However, the opaque practices of some private credit funds can expose individual investors to unknown risks. ASIC issued a statement in June 2026 calling on private credit funds to ensure asset valuations were timely and robust, as part of a broader effort to lift investor protection standards and transparency across the private credit sector. ASIC has noted that approaches vary substantially across the sector.[22]

Australian banks' exposures to both domestic and international private credit are small, limiting the potential for the transmission of stress through the financial system. Banks are most commonly exposed to private credit through loans and committed credit facilities to funds – including short-term facilities that bridge the period between when investments are made and investors' committed capital is called.[23] While direct measures of banks' exposures to private credit funds are not separately identifiable, broader exposures to non-bank financial institutions provide an upper limit on banks' drawn exposures to domestic and international private credit funds of 2.8 per cent of banks' assets, with the actual exposure likely to be much smaller.[24] Banks also have off-balance sheet exposures to private credit funds, such as undrawn credit lines or contingent funding arrangements. But the upper limit for these exposures is still only equivalent to less than 2 per cent of banks' assets, with the actual exposure again likely to be considerably smaller. While banks are indirectly exposed to global private credit markets if an increase in defaults leads to a broader increase in global risk aversion, these measures suggest the direct links between Australian banks and domestic and international private credit funds are not of systemic importance. This is consistent with information from liaison with banks and the broader financial sector, which suggests Australian banks have generally been conservative in their dealings with private credit funds.

Endnotes

1 See Jennison S, J Spiller and P Wallis (2026), 'Recent Changes in Credit Markets and Their Implications for Monetary Policy', RBA *Bulletin*, February.

2 A loan is considered well secured if the bank judges that the fair value of any collateral (after accounting for the costs involved in taking possession of and selling the collateral) is sufficient to cover the outstanding loan balance, including any accrued interest and fees.

3 For information on the calculation of loan losses, see Rogers D (2015), 'Credit Losses at Australian Banks: 1980–2013', RBA Research Discussion Paper No 2015-06.

4 The adverse scenario includes a 3 per cent fall in GDP, a 20 per cent fall in housing and commercial real estate prices, an increase in the unemployment rate to 6.3 per cent, and an increase in the cash rate to 5.6 per cent.

5 See RBA (2025), '4.1 Focus Topic: How Overseas Shocks Can Affect Financial Stability in Australia', *Financial Stability Review*, October.

6 The IRB model is one of two methods to calculate credit risk-weighted assets under Basel III; the other is a standardised model. The IRB model is more complex, granular and precise, and can allow for lower risk-weighted assets given improved risk management practices. For more information, see APRA (2026), 'APRA Finalises New IRB Accreditation Pathway for Banks', June.

7 The Basel Committee on Banking Supervision's (BIS) report on its post-2023 liquidity work program highlights the need to recalibrate liquidity requirements and to subject them to regular stress testing. The report also underscores the importance of banks' operational readiness to access central bank liquidity facilities. In response, several central banks in advanced economies are exploring ways to improve the availability of these facilities and reduce the stigma associated with their use. See BIS (2024), 'The 2023 Banking Turmoil and Liquidity Risk: A Progress Report', October.

8 See Lonsdale J (2026), 'Remarks to the 2026 AFR Banking Summit "Here and Now"', Sydney, 16 March.

9 See Kent C (2024), 'The Future System for Monetary Policy Implementation', Bloomberg Australia Briefing, Sydney, 2 April; Kent C (2025), 'The RBA's Monetary Policy Implementation System – Some Important Updates', Speech at KangaNews Debt Capital Markets Summit, Sydney, 2 April; and Jacobs D (2026), 'The Road to Ample – Towards a Demand-driven Liquidity Regime', Speech at the RBA, Sydney, 25 August.

10 APRA and RBA (2025), 'Joint APRA-RBA Statement on Use of the RBA's Overnight Standing Facility', Media Release No 11-2025, 2 April.

11 See APRA (2025), 'APRA's New Prudential Standard on Operational Risk management Comes into Force', Media Release, 1 July. APRA has also recently imposed licence conditions where a regulated entity is found to have persistent operational risk management weaknesses.

12 See RBA (2026), 'Box: Initiatives to Enhance Operational Resilience in Australia', *Financial Stability Review*, March.

13 See APRA (2026), 'APRA Letter to Industry on Artificial Intelligence (AI)', 30 April; and ASIC (2026), 'ASIC Calls for Urgent Cyber Uplift as AI Accelerates Cyber Threats', Media Release, 8 May.

14 See APRA (2026), 'Insights from the APRA-ASIC Industry Roundtables', Information Paper, 27 August.

15 See APRA (2026), 'System Risk Stress Test', Information Paper, 30 June.

16 In a scenario where members switch out of risk assets or withdraw funds in response to a fall in international equities, the resulting liquidity calls would also be smaller because switching and withdrawal requests would be settled at the already lower daily unit prices.

17 See RBA (2021), 'Box C: What Did 2020 Reveal About Liquidity Challenges Facing Superannuation Funds?', *Financial Stability Review*, April.

18 RBA (2026), 'Assessment of ASX Clearing and Settlement Facilities', September.

19 See RBA (2026), 'Assessment of Reserve Bank Information and Transfer System', June.

20 See Alvarez and Marsal (2025), 'Australian Debt Market Review 2025'; and EY-Parthenon (2026), 'Annual Australian Private Debt Market Overview', March 2026.

21 See ASIC (2025), 'Private Credit in Australia', Report No 814, 9 September.

22 See ASIC (2026), 'ASIC Puts Private Credit on Notice, Ahead of 30 June Valuations and Reporting', 18 June; and ASIC (2025) 'Advancing Australia's Evolving Capital Markets: Discussion Paper Response Report', Report No 823, 5 November.

23 See FSB (2026), 'Report on Vulnerabilities in Private Credit', 6 May.

24 These upper estimates include exposures to all foreign non-bank financial institutions as more detailed data on exposure to international private credit funds are not available, and so substantially overestimate actual exposures to private credit funds only.

25 See APRA (2026), 'Mind the Gap: An Insurance Climate Vulnerability Assessment', Information Paper, 24 March.

Chapter 4
Focus Topics

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4.1 Focus Topic: Operational Risk and Financial Stability

Operational risk, including the threat of cyber-attacks, is an increasingly important consideration for financial stability. Growing system-level vulnerabilities, including greater interconnectedness and concentrated reliance on common service providers, increase the risk that operational disruptions at one institution or infrastructure provider could quickly spread across the financial system and undermine confidence. This Focus Topic examines how operational risk differs from (but interacts with) traditional financial risks and considers the implications for how authorities assess, monitor and manage these risks. It also explores how operational disruptions can create and amplify financial stress. Strengthening operational resilience will require ongoing action across the financial system.

The threat that operational risks pose to financial stability is growing.

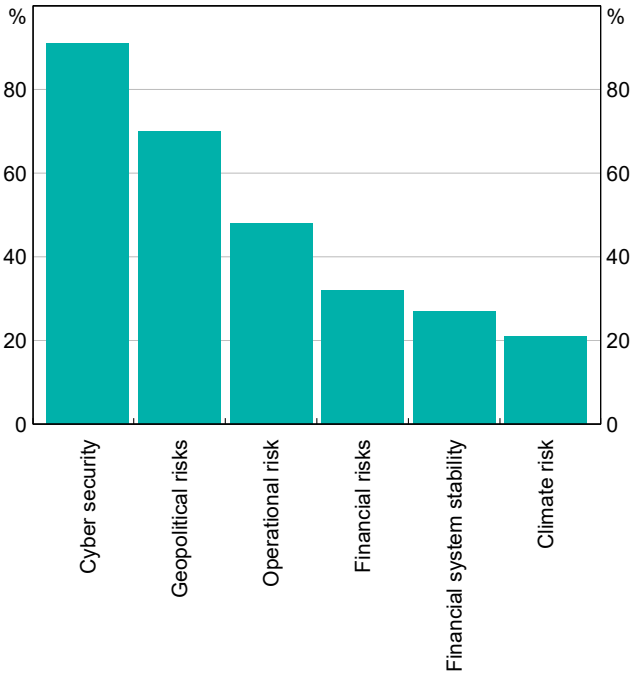
Operational risk encompasses a wide range of non-financial risks that can disrupt the critical operations of financial institutions, financial market infrastructures (FMIs) and the financial system more broadly. Under the Basel capital framework, operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The crystallisation of these risks has the potential to generate severe shocks across the financial system and amplify episodes of financial stress. Major operational disruptions can also impair the provision of critical financial services that households, businesses and financial institutions depend on to access their funds, make payments and meet their financial obligations.

The rapidly evolving external threat environment has contributed to a greater focus on operational risks by financial regulators and central banks globally, including in Australia. Rapid advances in frontier AI capabilities, together with broader technological developments, are reducing the cost and technical expertise required to conduct sophisticated cyber-attacks against financial institutions and FMIs.[1] At the same time, heightened geopolitical tensions have increased the likelihood of state-sponsored physical or digital attacks on the critical infrastructure that supports the financial system, including the electricity and telecommunications network.[2] An Australian Prudential Regulation Authority (APRA) survey conducted in 2025 found that cyber, geopolitical and other operational risks were perceived to be the most significant threats facing APRA-regulated entities (Graph 4.1.1).[3] This complex threat environment increases the risk that severe financial and operational shocks – including from cyber and geopolitical threats – occur at the same time. Longer-term shifts in climate patterns, and the increasing frequency and severity of extreme weather events, also pose physical risks to critical infrastructure.

Graph 4.1.1

Australian Financial Institutions' Key Business Risks

Over the next two years from March 2025, share of regulated institutions rating critical or high



Source: APRA.

Entity-level technology choices and governance arrangements can also affect operational risk, particularly during periods of significant change. Financial institutions and FMIs are simultaneously managing legacy technology while undertaking large-scale transformation programs to modernise critical infrastructure and adopt new technologies. Legacy systems can increase the risk of operational failures and cyber vulnerabilities, making transformation necessary to reduce risk. However, transformation programs can themselves strain internal capacity and increase the risk of implementation failures, operational errors and unanticipated disruptions. In such an environment, effective risk governance, clear accountabilities, and staged sequencing become increasingly important to an institution's ability to deliver change safely, identify emerging vulnerabilities and respond effectively to operational disruptions.

The likelihood that operational incidents become systemic is increasing. Growing system-level vulnerabilities, including increasing interconnectedness and concentrated reliance on material service providers, heighten the potential for operational failures in one part of the financial system to quickly spread across multiple financial entities and undermine system-wide confidence.[4] In turn, this can amplify the effects of operational disruptions and propagate widespread financial stress. Given the evolving geopolitical and cyber landscape, policymakers are also attuned to the risk that nefarious actors may seek to time the launch of cyber-attacks on critical financial institutions or infrastructure to coincide with heightened periods of financial market volatility. In such cases, should there be existing strains in market funding conditions or the disruption impairs resilience buffers, the shock is likely to be exacerbated in severity.

A key regulatory priority is to strengthen operational resilience across the Australian financial system.

Strengthening broad-based operational resilience across the financial industry has been a focus of regulators in Australia for a number of years. Operational resilience is an expansive concept, requiring financial institutions, FMIs and participants in the broader financial system to prevent, adapt, respond to and recover from operational disruptions.[5] This multifaceted framing recognises that while some disruptions may occur even with strong preventative defences, critical operations must be managed in a way that allows for swift recoverability and for key services to continue to be available through periods of disruption.

Consistent with its financial stability mandate, the RBA has an important role in responding to the evolving operational risk landscape, in partnership with agencies on the Council of Financial Regulators (CFR). Historically, operational risk was viewed primarily as an idiosyncratic risk affecting individual institutions and therefore largely the domain of microprudential supervisors such as APRA. However, the growth of system-wide vulnerabilities, together with the escalating threat environment, have elevated operational risk from a firm-level concern to a broader financial stability issue. This has been reflected in various programs of work with industry, including the Industry Resilience Initiative, which seeks to strengthen the resilience of the payments system as one element of the CFR's geopolitical risk program (see below).[6]

Operational risk differs from traditional financial risk in ways that matter for how it is measured, monitored, and addressed.

Unlike financial risks, which are largely contained within the regulated financial sector, operational risks to financial stability can originate from a much broader range of entities. Incidents can arise at material service providers and propagate through complex supply chains and operational dependencies, requiring authorities to consider a broader set of entities beyond the regulated financial sector. This can be challenging because many critical service providers operate internationally or outside the typical regulatory perimeter, limiting visibility over vulnerabilities they may pose. Moreover, smaller entities can play an outsized role in operational risk. A prolonged disruption at a small third party that provides critical services to many financial institutions could have system-wide impacts. In contrast, smaller entities are less likely to represent critical nodes for the transmission of systemic *financial* risk, allowing financial risk monitoring effort to focus mainly on the largest institutions.[7] These challenges are compounded by the gaps in operational risk maturity that can often exist between larger, regulated institutions and smaller or non-financial entities.

The complex and rapidly evolving nature of operational risk makes it harder for regulators to measure and monitor than traditional metrics of financial risk. The RBA closely monitors a range of financial indicators, such as liquidity and leverage ratios, at both the aggregate level and across households, businesses and financial institutions. These traditional risk metrics are well established and can reveal clear trends in financial vulnerabilities that require mitigating action to promote financial stability. In contrast, monitoring operational vulnerabilities is considerably more challenging because there are few standardised indicators that can reliably measure operational risk from a financial stability perspective and that apply equally to a diverse range of institutions. These assessment challenges reflect the breadth, complexity and diversity of operational risks facing individual entities and interdependencies that can be difficult to identify across the financial system. Where data do exist, there are often concerns about their quality and comparability, and their relevance for financial stability can be difficult to ascertain particularly given the limited historical experience of systemic operational events. Rapid advances in novel technologies – including frontier AI models – further add to this uncertainty. One response to these challenges has been to collect better quality data. For example, APRA has started collecting data on material service providers used by regulated entities, which can help to map out the key concentration risks and interconnections in the system. Another response is to adapt the monitoring approach to the unique nature of operational risk, including through greater emphasis on forward-looking scenario analysis and operational and cyber stress tests.

The features that distinguish operational risk from financial risks necessitate additional considerations for safeguarding financial stability. These include:

- *Building resilience*: When seeking to build resilience to traditional financial shocks, policymakers typically focus on ensuring that financial institutions have sufficient capital and liquidity buffers to absorb severe-but-plausible shocks. While these buffers can also help to absorb the effects of operational shocks – where they create or amplify financial stress – interactions with liquidity and capital are not the only way that operational risk can manifest in systemic disruptions. The focus of operational resilience is therefore on ensuring that critical operations can be maintained through periods of disruption and be restored within acceptable tolerances if they are interrupted. This includes maintaining redundancy, contingency arrangements, and business continuity plans that are frequently stress tested and robust to a range of scenarios.
- *Crisis response and recovery*: While every crisis is different, the response to an operational disruption can differ from a crisis response that is exclusively financial in nature. Indeed, some operational disruptions could impair the very systems used to implement traditional financial sector crisis responses such as additional liquidity provision by central banks. For example, a major operational disruption at a systemically important securities settlement facility could impair the flow of collateral and liquidity through the financial system in a period of stress. Restoring a base level of critical services in a timely fashion and recovering affected systems as swiftly as possible are key priorities for market participants and infrastructure providers.[8] In extreme cases, authorities or operators of infrastructure may need to temporarily

suspend critical financial services or market activity while underlying operational issues are resolved (e.g. via a bank holiday).[9] Such decisions can be highly complex, requiring judgements about which systems should remain operational, which should be suspended, and how services can be safely resumed. Operational disruptions can occur quickly and with little warning (e.g. technology outages affecting payment systems), underscoring the importance of well-established coordination frameworks and crisis response arrangements.

- *Coordination*: Operational disruptions can often originate from outside the financial system – for example, technology failures at material service providers, cyber-attacks, geopolitical events, or severe weather. This means that a broader range of authorities may need to be involved in the vulnerability assessment, crisis response and recovery compared with traditional financial shocks emanating from firms inside the regulatory perimeter. This could present coordination challenges, especially in crisis scenarios where multiple financial and operational risks are triggered at once. Certain operational risks, particularly cyber threats, are predominantly cross-border and can quickly spread across jurisdictions. Managing these risks requires close cooperation across industry, agencies and government in Australia and internationally (see below).[10]
- *Communication*: One of the ways the RBA contributes to financial stability is by communicating its assessment of risks to the financial system through speeches and publications such as the *Financial Stability Review*. As part of its supervisory and regulatory responsibilities, the RBA also publishes assessments of systemically important financial market infrastructure.[11] Public communications build awareness of issues that could affect the financial system and this supports more informed decision-making by financial institutions, households, businesses and policymakers to manage these risks. However, this approach can be more challenging for certain operational risks. In some cases, disclosing detailed information about operational vulnerabilities, critical infrastructure or key points of concentration could increase the risk of disruption if that information were exploited by malicious actors, including through cyber-attacks.[12] In these cases, the RBA and other regulators work directly with relevant parties to address these risks – for example, through the work the CFR is leading with industry in response to geopolitical and cyber risks (see below).[13]

The RBA is increasingly viewing operational risk through a financial stability lens.

Alongside the RBA's regulatory responsibility to ensure critical FMIs are managed in a way that promotes financial stability in Australia, the RBA also assesses the resilience of the Australian financial system as a whole, taking a system-level perspective. To examine the implications of operational risks for financial stability, the RBA employs the framework described in the April 2025 *Financial Stability Review*.[14] Within the framework, rather than focus exclusively on risks (i.e. shocks that might occur, which tend to be difficult to control or predict), emphasis is on identifying operational vulnerabilities that could lead to shocks having system-wide effects, along with any offsetting features that improve system resilience. That is, we focus on what regulators, government and industry can control. In this way, the framework supports the identification of concrete actions that can be taken to address vulnerabilities and strengthen resilience in the financial system.

Institution-level operational resilience is foundational to system resilience. Assessments at the institution level are carried out by APRA for its regulated entities, by both the RBA and the Australian Securities and Investments Commission (ASIC) in their respective supervisory roles for certain key FMIs, and by ASIC across its regulated population, including financial market operators, market participants and other entities subject to ASIC's operational resilience oversight.[15] The RBA also manages operational risk in its role as a provider of critical settlement services through the Reserve Bank Information and Transfer System (RITS).

The operational resilience of the financial system also depends on non-financial institutions in sectors such as telecommunications and energy. In Australia, the Department of Home Affairs (DHA) is responsible for critical infrastructure policy. The DHA administers the *Security of Critical Infrastructure Act 2018* (SOCI Act) framework, which establishes security and resilience obligations for entities that own or operate designated critical infrastructure assets, including in sectors that

underpin the functioning of the financial system. The April 2025 power outages across the Iberian Peninsula in Spain provided a reminder of how the failure of critical infrastructure can affect an economy and the importance of resilient financial infrastructure. The outage caused economic activity to decline by almost half its daily level and the disruption would have been worse had the functioning of key financial infrastructure also been compromised.[16]

System-level vulnerabilities can amplify and propagate the effects of operational disruptions …

System-level operational vulnerabilities are characteristics of the financial system that can amplify the effects of operational incidents and cause stress to become more widespread. The two most important are (i) concentration and lack of substitutability and (ii) complex and opaque interconnections.[17]

Concentration and lack of substitutability

The reliance on a small number of providers of a given critical service across the financial system means that multiple entities can be affected at the same time by a disruption. This can include a shared reliance on critical service providers from outside the finance sector (e.g. cloud computing), national infrastructure (e.g. electricity and communications), or FMIs (such as payments, clearing and settlement systems) underpinning the operation of the financial system. Concentration risks are larger where entities are unable to, or have difficulty in being able to, switch to an alternative provider. For example, many key IT services such as cloud computing and storage are provided by a small number of providers, and while their scale and market-leading capabilities can help to bolster their IT security, it also contributes to a lack of substitutability and has the potential to connect financial institutions to a common vulnerability.[18] Some of the largest regulated entities in Australia have around 150 service providers supporting critical operations, with many providers used by multiple entities, if not the whole industry. Many of these are located overseas and outside of the Australian regulatory perimeter.[19] As noted above, APRA now requires entities to report their dependencies on service providers, which will enable a better understanding of where reliance on particular service providers is concentrated, to support better management of systemic risks. APRA's operational risk management standard (CPS 230), which commenced on 1 July 2025, also requires entities to manage their own risks associated with the use of service providers.

A prolonged outage at a critical FMI could severely impact the broader financial system. While the safe and efficient operation of FMIs contributes to financial stability and economic growth, they also concentrate risk (including due to the limited substitutability of their services). This exposes the flow of payments to risks from single points of failure. A prolonged outage at an FMI could disrupt the movement of collateral and liquidity and undermine confidence in the ability of institutions to transact in financial markets (discussed below). Reflecting the systemic importance of these entities, the RBA and ASIC place a strong emphasis on ensuring that FMIs manage operational and financial risks effectively while continuing to provide services that are safe, efficient and transparent.[20]

Complex and opaque interconnections

Growing operational interconnectedness and complexity across the financial system is also increasing system-wide operational vulnerabilities. The links between financial institutions, FMIs and material service providers could rapidly transmit the impact of an operational incident from one institution to another. For example, this could occur if the inability of disrupted institutions to send payments creates settlement issues for their counterparties. During cyber-attacks, operational contagion can also spread through IT and network connections across entities. In such a scenario, institutions may choose to disconnect themselves from affected entities to protect their own systems from the cyber-attack, or pause operations to prevent problems from escalating, which in turn can create operational disruptions elsewhere in the system. These operational interconnections can arise from counterparty relationships, outsourcing and third-party relationships and can be difficult to monitor given the complexity of the financial system.

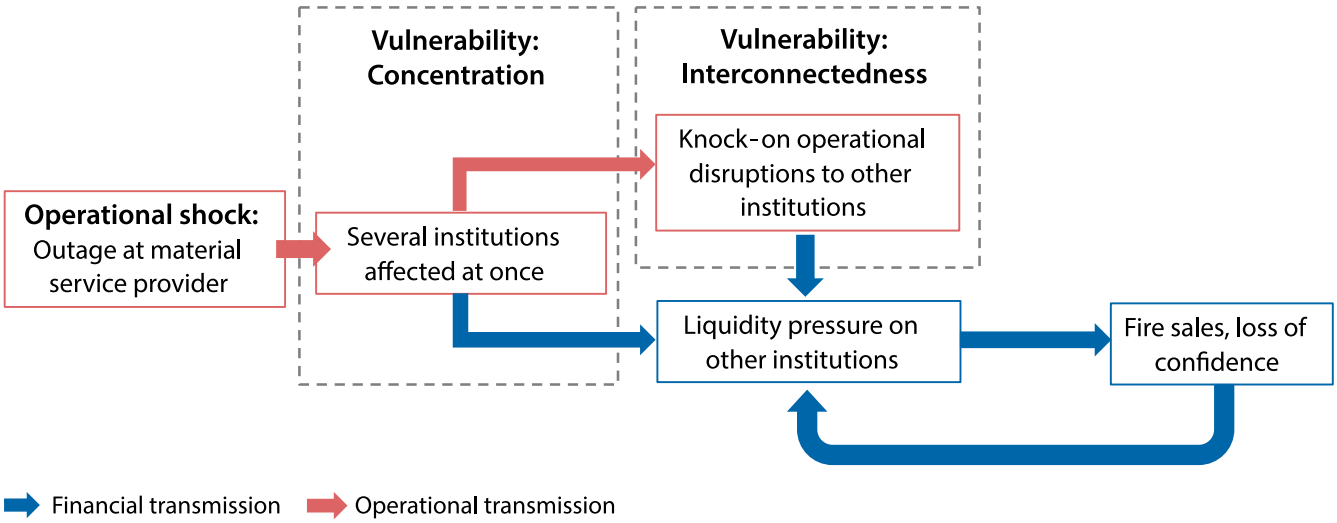
… and create financial stress.

Operational incidents can generate liquidity stress in the financial system by disrupting the flow of payments between financial institutions. Banks rely on incoming payments to fund outgoing obligations, meaning that a disruption at one institution can create liquidity stress for others. For example, consider a stylised example of a cyber-attack that causes an operational outage at a common material service provider, as shown in Figure 4.1.1. Multiple institutions use this provider for critical services ('concentration'), with the outage preventing those institutions from making payments. In turn, this creates liquidity pressure at firms who were expecting to receive those payments to meet their own payment obligations.[21] In severe cases, liquidity shortfalls could lead to fire sale dynamics in asset markets, thereby transmitting stress more broadly in the financial system.

A broader loss of confidence could cause market participants to retreat from transacting in financial markets and reduce their counterparty exposures to entities perceived to have similar vulnerabilities to the most affected institutions, thus spreading the impact through the system. Precautionary behaviour of this sort could substantially tighten financial conditions. Certain types of operational incidents, such as cyber-attacks, could also erode confidence in the stability of key infrastructure or access to funds. Confidence is likely to erode more the longer a disruption lasts.

Figure 4.1.1: Example of Operational Incident that Creates Financial Stress

Outage at material service provider to the banking system that prevents affected firms from sending payments



Source: RBA

APRA's inaugural System Risk Stress Test illustrated how operational incidents can temporarily impair financial resilience and amplify financial stress.

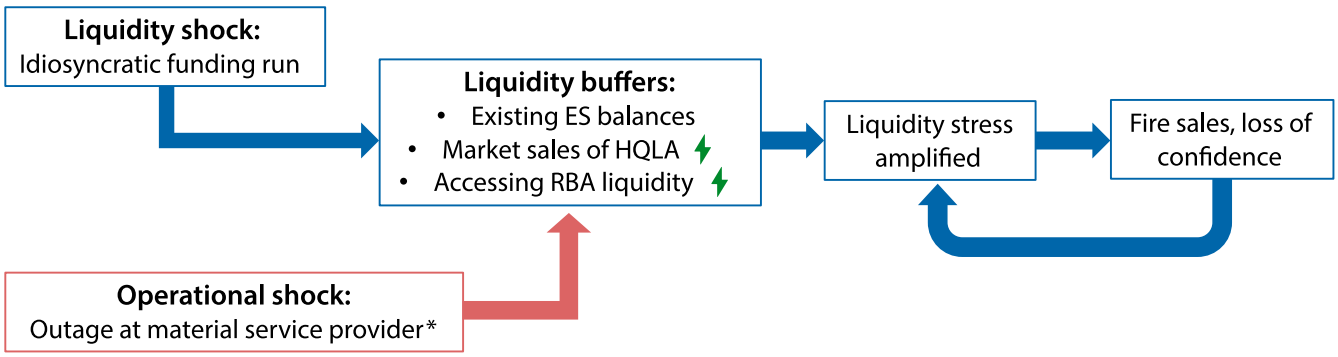
Over a number of years, CFR agencies have worked to understand the implications of multiple forms of stress occurring at the same time. APRA's inaugural System Risk Stress Test examined the financial resilience of the largest banks and superannuation funds to an extreme-but-plausible liquidity shock.[22] The test also considered how resilience changed when a severe operational incident occurred at the same time. The operational incident was a short-lived outage of a material service provider that temporarily prevented settlement of debt securities transactions. This incident would have implications for liquidity conditions in financial markets because debt securities, specifically bonds issued by the Australian and state and territory governments, account for a large share of banks' high-quality liquid assets (HQLA). Figure 4.1.2 shows a stylised example of key aspects of the scenario, while also incorporating other possible sources of contagion, such as fire sales and confidence loss, that may be present in some situations.

Traditional sources of financial resilience may be less effective, or unavailable, during an operational disruption. In the absence of the operational outage, participating banks in the stress test responded to the liquidity shock by drawing down their cash balances and converting other liquid assets into cash by selling them or by accessing liquidity offered by the RBA.[23] That is, banks' liquid assets acted as a buffer against the unanticipated liquidity shock. However, this response was impaired by the operational outage; banks could draw on their existing ES balance but could not monetise a large share of their other liquid assets during the outage. This included access to liquidity offered by the RBA through open market operations, reflecting that these facilities require the settlement of the securities that are used as eligible collateral. This meant banks relied more heavily on their existing cash balances to make payments, with ES balances run down faster than otherwise.

Financial stress can be most acute if operational shocks occur when the system is already under strain. APRA noted that the liquidity stress would likely have been more severe if the outage had occurred later in the stress test period after liquidity buffers had already been eroded. In this case, or with a more prolonged outage, banks may have been forced to liquidate other investments quickly, which can transmit stress more broadly in the financial system and further amplify liquidity stress. Such a scenario is relevant given the

Figure 4.1.2: Example of Operational Incident that Amplifies Existing Financial Stress

Liquidity shock combined with outage at material service provider that prevents banks from monetising liquid assets



* prevented settlement of debt securities transactions for duration of the outage

Source: RBA

heightened risk of cyber-attacks that are timed opportunistically to create maximum disruption, as was seen during the financial market volatility in April 2025.

Initiatives to enhance operational resilience in Australia.

In recognition of the growing threat from operational risks, strengthening operational resilience has become a key focus for financial institutions, FMIs and CFR agencies in recent years.

Banks and other financial institutions have elevated operational risks – including cyber and geopolitical threats – as a strategic risk and devoted resources accordingly (Graph 4.1.1). This includes investment in defensive AI capabilities, the establishment of specialist geopolitical risk teams, and the development of contingency plans for geopolitical scenarios such as sustained electrical grid outages.[24]

Investments in resilience by individual institutions have also been supported by APRA and ASIC's regulatory initiatives. Ensuring the resilience of individual APRA-regulated entities to operational risk and disruptions is the focus of APRA's standard, CPS 230. Key aspects of this standard include increasing requirements to maintain and test internal controls, with a focus on good governance; improving business continuity planning; and enhancing institutions' oversight of external service providers. Both APRA and ASIC recently issued public letters outlining their expectations of regulated entities regarding frontier AI preparedness and collaborated on a series of industry roundtables to better understand how entities are responding to these risks.[25]

Enhancing the operational resilience of the payments system has been a key focus for the RBA and other CFR agencies, reflecting the system's critical role in supporting financial stability. This includes the following initiatives and activities:

- The RBA and APRA oversee the Industry Resilience Initiative, which aims to ensure the continuity of payments services if a major institution experiences a prolonged outage.
- The RBA, government agencies and members of the payments industry are collaborating to address recommendations relating to incident coordination identified from the 2024 tabletop cyber-attack simulation exercise. This includes developing a Payments Crisis Coordination Framework (PCC Framework), which outlines the roles and responsibilities of key industry and government stakeholders in coordinating a response to a cyber security crisis affecting the Australian payments sector. The PCC framework will be published on the CFR website later this month.
- The RBA is undertaking work to strengthen the resilience of the critical payments systems it runs, including through investments in cyber resilience and the modernisation of core technology infrastructure.[26]
- A strategic focus of the Payments System Board is strengthening payments system resilience. Consistent with this, the RBA has a program of work aimed at identifying system-wide vulnerabilities in the payments system and assessing ways to improve resilience, including to future threats such as those posed by quantum computing.[27] APRA is also increasing its focus on quantum computing.[28]
- The RBA is working with the DHA to promote the increased resilience, against all hazards, of assets that are used in connection with the operation of critical payment system assets, under the SOCI Act. An independent review of the Act was delivered in January 2026, with all six recommendations accepted in principle and reforms now being progressed through a two-tranche implementation program.[29]

CFR agencies also have a large program of inter-agency work to enhance the operational resilience of the financial system more broadly, including by strengthening crisis preparedness and response capabilities. This includes the following initiatives:

- The RBA is leading the CFR's Cyber Operational Resilience Intelligence-led Exercises (CORIE) program.[30] CORIE assists in raising cyber resilience testing capabilities and highlighting cyber resilience strengths and weaknesses across systemically important financial institutions and market infrastructures. The program has increased its resources to provide a more comprehensive view of the cyber threat landscape to participants and to test a larger number of entities each year.
- The RBA and other CFR agencies are participating in a wide range of crisis response exercises, including government scenario exercises designed to

strengthen cross-agency, government and industry coordination and enhance industry resilience to large-scale cyber-attacks and operational outages.

- CFR agencies are conducting work to understand the landscape of material service providers to the financial system.

Operational resilience must remain a focus for financial institutions and FMIs.

In an environment of rapid technological change, heightened geopolitical risk and growing concentration and connectedness, strengthening operational resilience will require ongoing action across the financial system. Preparedness varies across sectors. Financial institutions, FMIs and other critical service providers must continue to strengthen prevention, contingency and recovery arrangements, and test their ability to maintain or rapidly restore critical services under severe scenarios.

Endnotes

1 Frontier AI models also offer opportunities to improve cyber defence capabilities. However, the need for entities to patch software vulnerabilities more quickly and more often can itself be a source of operational risk in the form of errors, outages and disruption across interconnected systems. See Chapter 3 in Bank of England (2026), *Financial Stability Report*, July. APRA and ASIC have noted that defensive AI is promising but still developing. See APRA and ASIC (2026), 'Insights from the APRA-ASIC Industry Roundtables', Information Paper, 27 August.

2 For an assessment of the threat posed by state-sponsored cyber actors, see Australian Signals Directorate (2025), 'Annual Cyber Threat Report 2024–25', October. Lwin and Holland describe the RBA's framework for assessing how geopolitical risk could affect financial stability. See Lwin J and G Holland (2026), 'Geopolitical Risk and Financial Stability', RBA *Bulletin*, June. See also Jones B (2026), 'Geopolitics and the Financial System: Some Echoes from History', Australian Banking Association's Conference – Banking 2026, Melbourne, 17 June.

3 This Focus Topic considers cyber risks as a key source of operational risk rather than as a distinct risk category. Geopolitical risk is also a key source of operational risk, though there are a wide range of potential geopolitical events and scenarios, with the importance of operational risk vis-à-vis other risks depending on the scenario. This may differ to how respondents considered these risks in APRA's survey results shown in Graph 4.1.1. Beyond cyber, geopolitical and climate risks, operational risks can also stem from sources such as implementation errors during technology transformation, fraud, and human error. For more details, see APRA (2025), 'APRA 2025 Stakeholder Survey Report', June.

4 Material service providers are those on which an entity relies on to provide critical services – for example, third parties providing electricity or critical cloud computing services, or FMIs such as individual payments systems and securities settlement facilities. It is also important to consider the fourth and fifth parties that the material service provider relies on in providing their services.

5 This definition is from Adeney R, A Hitchins, C Lane, H Mehta and A Quashie (2024), 'Operational Resilience in a Macroprudential Framework', BoE Financial Stability Paper No 50.

6 See Lwin and Holland, n 2; and Jones, n 2.

7 The crystallisation of financial risks at smaller institutions can also pose challenges to financial stability. For example, a deposit run on a small bank may trigger runs at other banks perceived to have similar characteristics, leading to broader contagion and a loss of confidence across part of the banking system.

8 For catastrophic incidents, the DHA provides guidance on what critical services should be prioritised for recovery.

9 During the 1893 banking crisis in the Australian colonies, the Victorian government implemented a five-day bank holiday.

10 This includes through participation in international groups and forums such as the Bank for International Settlements (BIS), the Financial Stability Board's assessments of vulnerabilities and the Trans-Tasman Council on Banking Supervision's work on strengthening crisis preparedness arrangements.

11 RBA (2026), 'Payments and Market Infrastructure Assessments', March.

12 In some cases, public disclosure of vulnerabilities of critical infrastructure may not be permitted based on national security grounds.

13 CFR (2025), 'CFR Initiatives on Systemic Risks and Vulnerabilities', December.

14 RBA (2025), '4.1 Focus Topic: A Conceptual Framework for Assessing Financial Stability', April.

15 The RBA oversees RITS, including the Fast Settlement Service that settles payments in the New Payments Platform, and periodically assesses RITS against the Principles for Financial Market Infrastructures. The RBA contributes to the oversight of key international FMIs and messaging networks that are critical to the Australian financial system, including through cooperative oversight arrangements for entities such as Continuous Linked Settlement (CLS) and the Society for Worldwide Interbank Financial Telecommunication (SWIFT).

16 See Jones B (2025), 'Anti-fragility and the Financial System', Opening Remarks to FINSIA: The Regulators, Sydney, 12 September.

17 As discussed in Adeney *et al*, n 5, there are other system-level vulnerabilities relevant to operational risk. For example, if common AI models are used across financial institutions, the correlated model outputs could increase the likelihood of herding behaviour that amplifies the effects of operational and financial shocks.

18 See Douglas O, E Kandelas, and E Orum (2024), 'Migration to Public Cloud: Risks and Regulatory Requirements for Clearing and Settlement Facilities', April.

19 APRA (2025), 'System Risk Outlook', November.

20 In recognition of the important role that FMIs play, international standards have been developed for managing risks and ensuring efficiency and transparency at systemically important FMIs. See BIS Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions (2012), 'Principles for Financial Market Infrastructures', April. ASIC and the RBA are responsible for implementing the standards in Australia.

21 It is assumed that other institutions do not rely on the provider or have sufficient operational resilience to maintain, or quickly recover, their critical services (e.g. by substituting to an alternative service provider).

22 See APRA (2026), 'System Risk Stress Test', Final Report, June.

23 This discussion focuses on banks rather than superannuation funds given these funds were only modestly affected by the outage at the common material service provider, largely reflecting its timing early in the scenario and their limited reliance on the segment as a primary source of liquidity.

24 See Jones, n 2.

25 APRA (2026), 'APRA Letter to Industry on Artificial Intelligence (AI)', 30 April; ASIC (2026), 'ASIC Calls for Urgent Cyber Uplift as AI Accelerates Cyber Threats', Media Release, 8 May; and APRA and ASIC, n 1.

26 This includes ongoing modernisation of RITS and implementing recommendations from the Deloitte report assessing the operating environment supporting it. See RBA (2023), 'Strengthening the RBA's Payments Infrastructure', Media Release No 2023-23, 30 May; and RBA (2025), 'Corporate Plan 2026/27', August.

27 RBA (2026), 'Payments System Board Annual Report', September.

28 APRA (2026), 'APRA Corporate Plan 2026-27 – Our Strategic Objectives', August.

29 The overarching aim of the recommendations is to reduce complexity and confusion, simplify operation of the SOCI Act, and make the framework more agile and responsive to emerging threats. Tranche 1 of reforms addresses immediate risk and intervention settings. Tranche 2 improves the underlying architecture so the Act is clearer, more targeted, easier to operate and better able to support assurance of practical security and resilience outcomes.

30 See CFR (2022), 'Cyber Operational Resilience Intelligence-led Exercises (CORIE) Framework', July.

4.2 Focus Topic: Informing Our Financial Stability Assessment Using Scenarios

The RBA uses scenario analysis to better understand how a wide range of events could affect the economy and financial system, including how financial, monetary policy and macroeconomic developments could interact. In the context of financial stability, scenario analysis exercises help inform our assessment of the level of resilience in the financial system and identify vulnerabilities that could amplify a negative economic or financial shock. While the use of scenario analysis is not new, in the prevailing shock-prone global environment it has become an increasingly valuable tool for both policymakers and financial institutions. For example, scenario analysis can help us think through the possible consequences of risk events that have not yet happened. Such analyses help inform our assessment of risks and vulnerabilities relating to households, businesses, and banks in Chapters 2 and 3 of the *Financial Stability Review*. This Focus Topic provides a more conceptual view of the tools available and how we incorporate the results in our financial stability assessment.

Scenario analysis is a flexible tool that can be used to examine how a range of events could impact the stability of the financial system.

Scenario analysis helps inform our assessment of financial stability. The RBA's financial stability assessment framework examines the level of *net vulnerabilities* in the financial system – that is, the level of vulnerabilities after taking into account offsetting factors that can mitigate the impact of a shock.[1] One way to inform our assessment of net vulnerabilities is to conduct *scenario analysis*, which takes a possible path, usually adverse, and models the effect on individual households, businesses, banks and other parts of the financial system. Among other things, this allows us to estimate the share and type of households or businesses experiencing financial stress, and any impact on bank capital ratios. The tools we currently use for financial stability scenario analysis focus on modelling the effects of shocks that are macroeconomic and financial in nature. See 4.1 Focus Topic: Operational Risk and Financial Stability for our approach to understanding shocks from operational sources.

In the context of financial stability, understanding the distributional effects of shocks is particularly important, as aggregate outcomes can mask significant vulnerabilities within specific sectors or groups. Scenario analysis for financial stability purposes is often conducted using unit-record data at the household, loan or firm-level. These granular data can help us identify pockets of vulnerability for groups of households and businesses, even when overall or aggregate measures might convey a general picture of soundness.

Scenario analysis is flexible and can be used to explore a range of financial stability questions, including analysing the interaction between monetary policy and financial stability. The RBA publishes a baseline forecast of the expected path for the economy, on the technical assumption that the cash rate follows financial market pricing, in its quarterly *Statement on Monetary Policy*. Using this central forecast to analyse vulnerability indicators helps to inform assessments of how the expected macroeconomic outlook and monetary policy settings could affect the incidence of stress in the economy and any implications for financial stability. Another application of financial stability scenario analysis is for stress testing, which takes severe-but-plausible scenarios informed by the risk outlook at the time, and examines the effect on overall resilience of the financial system. Analysing these tail events helps the RBA and partner agencies on the Council of Financial Regulators (CFR) to identify, monitor and address vulnerabilities in the financial system and strengthen crisis readiness plans. Sharing these insights more broadly through RBA publications such as the *Financial Stability Review* supports more informed decision-making by households, businesses and lenders, including in relation to the likelihood or consequences of adverse events.

Our current approach to financial stability scenario analysis does not routinely incorporate behavioural adjustments or feedback loops between the financial system and real economy. This has some advantages, as it makes the models simpler to run and easier to understand, but could also miss important interactions. For example, an increase in the share of households facing financial pressure could lead to lower aggregate consumption as they pull back on spending, which impacts businesses and labour market conditions. Banks may subsequently tighten lending standards, which could lead to lower spending and could then be transmitted back to businesses. To account for this known limitation, we consider very severe scenarios, which can allow for the impact of these second-round effects.[2]

Scenario analysis can help us think through the potential consequences of risk events that have not happened before.

During a stress event, financial vulnerabilities can amplify the effect of a negative shock, while buffers (such as savings and other liquid assets) can dampen the effect. For example, during the global financial crisis (GFC), many mortgagors were highly leveraged – particularly those in the United States – and banks did not always properly assess borrowers' ability to continue paying their loans.[3] When housing prices fell and unemployment rose, these vulnerabilities amplified the shock across the financial system in the United States and globally. During both the GFC and the COVID-19 pandemic, Australian households and businesses avoided widespread defaults. The maintenance of sound lending standards and associated buffers in Australia, along with policy responses to these events, served us well in these episodes. However, we must remain vigilant for potential vulnerabilities in our system.[4]

In the Australian context, scenario analysis is especially important since we have not had the same experience with significant stress events as some other countries, such as a very large decline in housing prices. This is where stress testing using a variety of scenarios is helpful, with these scenarios often informed by experiences in other countries and incorporating assumptions about how conditions could evolve. The types of scenarios we have assessed include the effects of a pronounced deterioration in labour market conditions on households, the impact of a 'higher-for-longer' cash rate path on both households and businesses, the effect of a trade war, and the effect of a prolonged pandemic causing severe stress.[5] While we cannot anticipate every possibility, with a range of scenarios, we can capture the main effects of many different events and look for common areas of vulnerability. Scenario analysis results are not precise, due to data and model limitation, but they provide insights as to where vulnerabilities may be present.

The RBA considers a variety of scenarios and approaches depending on the current risk environment.

In this section, we create a new stress scenario to illustrate how the RBA uses scenario analysis tools to evaluate the resilience of households, businesses and banks. This scenario is deliberately much more pronounced than the adverse scenarios considered in the May 2026 *Statement on Monetary Policy*, in order to stress test borrowers and lenders from a financial stability perspective.[6] In the scenario, households, businesses and the banking sector face a very adverse shock: the unemployment rate increases to 6.3 per cent, GDP falls by 1.4 per cent, housing prices fall by 20 per cent from current levels, inflation increases to 7 per cent and the cash rate increases to 5.6 per cent. This scenario assumes current geopolitical tensions worsen and risks materialise, leading to further negative supply shocks.

For households, a key vulnerability indicator is the share of borrowers in a cash flow shortfall, where income cannot cover debt payments and essential expenses. Households in shortfall are more likely to have difficulties servicing their loans. Our assessment focuses first on those with mortgages, which account for more than 90 per cent of household debt, before turning to renters and outright homeowners.

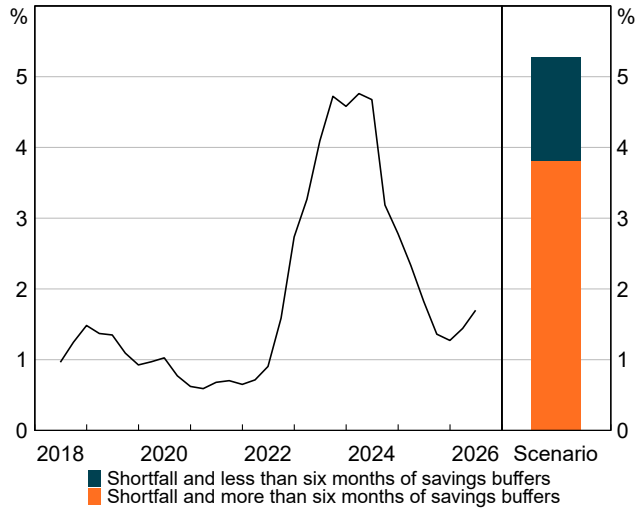
Loan-level data on mortgages from the RBA's Securitisation System is used to simulate the effect of this very adverse scenario on mortgage holders.[7] In this scenario, the share of mortgagors in a cash flow shortfall increases to about 5 per cent, but remains contained, just surpassing the peak observed in 2023 (Graph 4.2.1). This modelling can also incorporate offsetting factors that increase resilience, such as savings or housing equity. Savings buffers can enable a household to temporarily manage a cash flow shortfall until they are able to adjust expenditures or find more work. Households with sufficient housing equity have the option – though difficult and disruptive – to sell their property to repay the loan. About two-thirds of borrowers in cash flow shortfall have sufficient savings buffers to cover at least six months of mortgage payments and essential expenses. The borrowers most likely to enter foreclosure, where the lender takes possession of the property, are those in a cash flow shortfall, with low savings buffers and in negative equity. The share of borrowers with all three of these characteristics is less than 1 per cent of mortgagors, even in this very adverse scenario.

We can also use household-level data from the Melbourne Institute's HILDA survey to understand how the effects differ for renters and homeowners, providing insights into the broader economic impact.[8] HILDA surveys household wealth every four years, providing a rich, though less frequent, picture of household finances. The share of mortgagors in cash flow shortfall in HILDA analysis for 2022 data roughly doubles in the downside scenario. While the level differs somewhat from the Securitisation System data analysis, due to differences in definitions and coverage, the proportional increase is broadly equivalent. Renters, who tend to be younger and have smaller savings buffers, are generally more likely to be in cash flow shortfall than homeowners (Graph 4.2.2). While renters are not heavily affected by interest rate changes, since they hold little debt, increases in unemployment and inflation affect them more than other types of households, leading to an increase in the share in cash flow shortfall. Homeowners who have paid off their mortgage in full (outright owners) show the smallest proportional increase under the very adverse scenario, since most hold little debt and households in this group are more likely to be retired, reducing the impact of the unemployment shock. Given the limited amount of debt held by renters and outright owners, stress in these groups is less likely to affect financial system stability.

Graph 4.2.1

Borrowers with Cash Flow Shortfall*

Share of variable-rate owner-occupier borrowers, very adverse scenario**



* Estimates of borrowers with minimum scheduled mortgage payments and essential expenses (HEM) exceeding their income. Excludes borrowers in arrears.

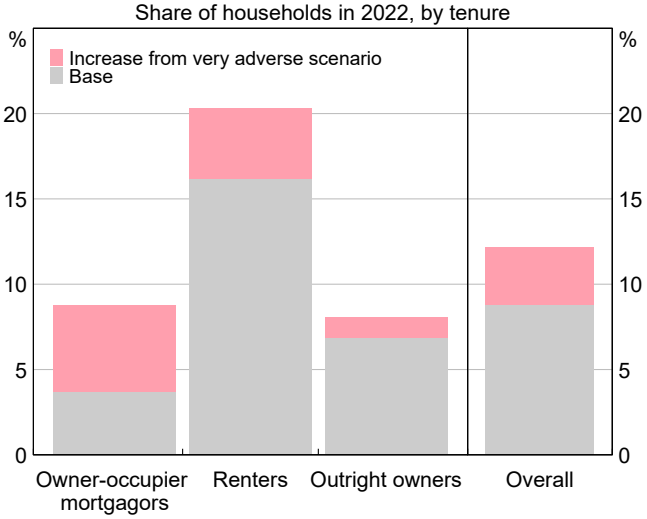
** Very adverse scenario where the cash rate increases to 5.6 per cent, inflation increases to 7 per cent, and unemployment increases to 6.3 per cent.

Sources: ABS; Melbourne Institute; RBA; Securitisation System.

Graph 4.2.2

Households with Cash Flow Shortfall

Share of households in 2022, by tenure



Sources: HILDA Release 24.0; Melbourne Institute; RBA.

For businesses, where data availability is more limited, we consider measures of company debt serviceability and profitability. To evaluate debt serviceability, we use the interest coverage ratio (ICR), defined as a firm's earnings divided by its interest expenses. An ICR less than two, indicating earnings are less than double the interest payments amount, has been found to be associated with a higher likelihood of company insolvency.[9] For the timeliest analysis, we use publicly listed company-level data to generate scenarios based on company ICRs. In addition, we rely on tax data covering a broader (although more lagged) sample of businesses to estimate the effects of a shock on operating profit margins and cash buffers.

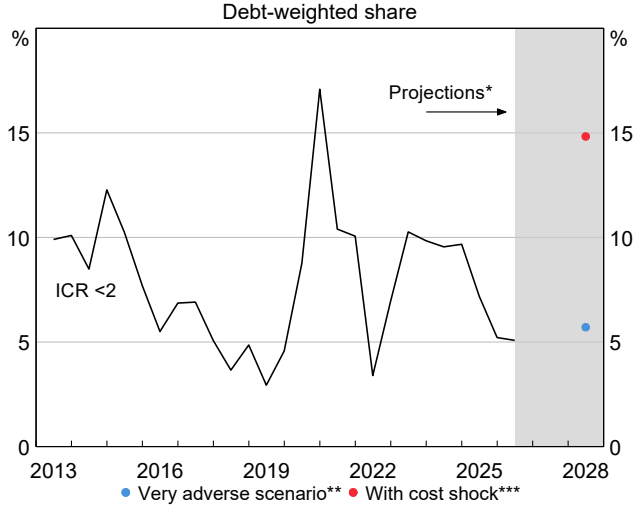
Focusing first on publicly listed companies, the debt-weighted share with a low ICR is based on projecting interest expenses and earnings using financial market and economic forecasts. Graph 4.2.3 shows how the share of listed companies with a low ICR changes when considering the very adverse scenario discussed above, as well as with an additional 10 per cent increase in operating costs to more specifically simulate a Middle East conflict-related scenario that leads to a broad-based increase in input costs. One source of resilience for many large corporates is that they issue fixed-rate debt or hedge their interest rate exposure. This slows the pass-through of higher interest rates in the scenario to interest expenses and limits upward pressure on the share projected with a low ICR. Even in the extreme scenario with broad-based cost increases, the share of firms with a low ICR remains below the levels reached at the peak of the pandemic stress.

Smaller non-listed firms are more vulnerable to these scenarios, as are firms in certain industries. Given the wide variation in the types of firms across the business sector, it is useful to consider the potential effect of a shock on different industries and sizes of firms. Smaller firms are more likely to experience stress than large, publicly listed companies because they have fewer options to access alternative financing or make adjustments in a downturn. However, smaller firms also account for a substantially smaller share of total business debt than larger companies and so are less likely to transmit stress through the financial system. Historically, most business insolvencies have been small firms with little bank debt and few employees, limiting the broader transmission of stress (see Chapter 2: Resilience of Australian Households and Businesses).

Graph 4.2.3

ASX-listed Companies with Low ICR

Debt-weighted share



* ICR defined as earnings over interest expenses. Firm-level modelling of earnings based on specific scenario assumptions, adjusted for historical interest rate pass-through.
** Scenario based on GDP falling by 1.4 per cent and cash rate increasing to 5.6 per cent.
*** Scenario based on a 10 per cent increase in operating costs and same operating revenues as the very adverse scenario.

Sources: Morningstar; RBA.

Businesses also have different exposures to different shocks, which we can analyse using granular tax data.[10] For example, in 'Box: Businesses' exposure to the energy shock by sector' we show how energy-intensive sectors, such as agriculture and mining, are more directly exposed to higher fuel prices associated with the Middle East conflict. Other businesses, such as those in manufacturing and retail, are mainly exposed indirectly through input cost pass-through. Therefore, when constructing the Middle East-related scenario described in the Box, we applied a larger cost shock for businesses in high energy-intensity sectors.

For the banking sector, we use a stress-testing model to examine the impact of a very adverse macroeconomic downturn on the solvency of banks. The approach uses a top-down stress testing model, where a scenario is applied to a set of large banks and changes in capital ratios are estimated based on a combination of regulatory data and data from the RBA's Securitisation System.[11] In the model, decreases in capital ratios are driven by higher credit losses and increases in banks' risk-weighted assets, though these effects are partly offset by banks retaining more earnings to recapitalise during periods of stress. This approach

allows for funding cost and liquidity contagion effects between banks. As shown in Chapter 3: Resilience of the Australian Financial System, the Australian banking system remains resilient to a very adverse macroeconomic shock. The model can also be used for more severe stress scenarios or 'reverse' stress tests to understand how large a shock needs to be for the effect on banks' capital ratios to impair their ability to continue lending.

The RBA's analysis is complementary to stress testing done by the Australian Prudential Regulation Authority (APRA). As the regulator for financial institutions, APRA uses multiple approaches to stress test banks and some other regulated entities.[12] First, APRA-led stress tests take a bottom-up approach – regulated entities use their own internal data and tools to analyse the impact of a scenario provided by APRA. Some of these exercises focus on specific industries, while others look at the system as a whole. APRA also conducts top-down stress testing analysis, to assess resilience, either alongside APRA-led tests or in response to emerging risks. APRA uses the results to assess capital adequacy, support supervisory activities and inform prudential policy, including aspects of the capital framework. Consistent with the RBA, APRA finds that banks could withstand a severe downturn.

Stress testing is a key part of risk management for banks. APRA also reviews entities' own stress tests and asks them to consider a range of shocks, including downside macroeconomic scenarios, idiosyncratic liquidity events, or systemic events affecting funding markets. These scenarios can be used to aid in capital management, inform recovery planning, and improve banks' overall understanding of risk. Depending on the objective of conducting the stress test, different scenarios and data are used. In today's shock-prone global environment, stress testing has become especially useful. As noted in APRA's advice to banks, insurers and superannuation funds in June 2026, entities are expected to strengthen stress-testing capabilities to prepare for severe geopolitical shocks, and technology-related risks such as cyber-attacks or AI.[13]

Scenario analysis is only one part of our financial stability assessment toolbox.

Scenario analysis is used together with other tools to inform our financial stability assessment. As discussed in this focus topic, scenario analysis can provide a framework for thinking through a wide range of financial stability risks. However, simple approaches can miss interaction and contagion effects, and some types of scenarios, such as operational disruptions, do not fit well in this framework. As such, we use a variety of tools to assess net financial vulnerabilities. Alongside scenario analysis, this includes continuous monitoring of a wide variety of data and vulnerabilities indicators, structural modelling, discussions with lenders through our liaison program, and regular meetings to share insights with our partners in the CFR.

We are exploring ways to capture the effects of operational shocks in our scenario analysis frameworks, such as cyber-attacks or outages at material service providers. Operational resilience has become increasingly relevant to financial stability, with a growing likelihood of operational disruptions at financial institutions and financial market infrastructures (FMIs) that can create or amplify financial stress (see 4.1 Focus Topic: Operational Risk and Financial Stability). As quantitative data on operational risk is more limited, this necessitates a different approach to scenario analysis.

Endnotes

1 See RBA (2025), '4.1 Focus Topic: A Conceptual Framework for Assessing Financial Stability', *Financial Stability Review*, April.

2 Further work by RBA staff aims to explicitly incorporate feedback loops in our scenario analysis.

3 For more information on the GFC and the experience in Australia, see RBA (2026), 'The Global Financial Crisis', RBA Explainer.

4 Compared with other countries, Australia fared relatively well during the GFC, largely due to limited banking system exposure to the United States and a proactive policy response. Similarly, the impact of the COVID-19 pandemic on the Australian financial system was limited in part by large household savings buffers, generally prudent lending standards, and government support. Historically, the Australian economy has experienced many ups and downs, but data are limited and the economy is very different today. See, for example, Bullock M (2026), 'Monetary Policy in an Era of Shocks', Speech at the Anika Foundation Fundraising Lunch, Sydney, 28 July. For a discussion of household stress in mining-exposed regions, see RBA (2019), 'Box B: Housing Price Falls and Negative Equity', *Financial Stability Review*, April.

5 See RBA (2024), '4.1 Focus Topic: Scenario Analysis of the Resilience of Mortgagors and Businesses to Higher Inflation and Interest Rates', *Financial Stability Review*, March; RBA (2023), 'Box B: Scenario Analysis on Indebted Households' Spare Cash Flows and Prepayment Buffers', *Financial Stability Review*, April; Graph 2.8 in RBA (2025), 'Chapter 2: Resilience of Households and Businesses', *Financial Stability Review*, October; and RBA (2022), 'Box D: Stress Testing and Australian Bank Resilience', *Financial Stability Review*, October.

6 See section 3.5 in RBA (2026), 'Chapter 3: Outlook', *Statement on Monetary Policy*, May.

7 For more information on the Securitisation System, see RBA, 'About the Securitisation System'. This is loan-level data that covers about one-quarter of the total mortgage market. There are known biases in the Securitisation System data, which are accounted for in the RBA's overall assessment of resilience. For more information, see Hughes A (2024), 'How the RBA Uses the Securitisation Dataset to Assess Financial Stability Risks from Mortgage Lending', RBA *Bulletin*, July.

8 For more information on the HILDA survey, see the Melbourne Institute of Applied Economic and Social Research website. The HILDA Survey Disclaimer Notice applies to RBA content using HILDA data. The RBA's approach to stress testing Australian households using HILDA is described in Bilston T, R Johnson and M Read (2015), 'Stress Testing the Australian Household Sector Using the HILDA Survey', RBA Research Discussion Paper No 2015-01.

9 An ICR of two is used as a threshold indicative of weaker debt servicing capacity and historically associated with an increased risk of insolvency. We use a slightly more conservative threshold than some other peer central banks (e.g. the Bank of England monitors an ICR threshold of 1.5 in its *Financial Stability Review*).

10 Generally, we consider static shocks (i.e. changes in one variable only with no effects over time) because of the lag and the noise in the broader firms' tax data. These methods allow us to flexibly target any scenario based on businesses' exposures.

11 The process is described further in Garvin N, S Kurian, M Major and D Norman (2022), 'Macrofinancial Stress Testing on Australian Banks', RBA Research Discussion Paper No 2022-03; and RBA (2022), n 5.

12 For more detail, see APRA (2026), 'Box B: How APRA Uses Stress Testing to Reinforce Financial Resilience', APRA *System Risk Outlook*, May.

13 See APRA (2026), 'APRA Sets Out Minimum Expectations to Strengthen Industry Readiness for Geopolitical Shocks', Media Release, 17 June; APRA (2026), 'System Risk Stress Test', Information Paper, June; and APRA (2020), 'Stress Testing Assessment: Findings and Feedback', Letter to Authorised Deposit-taking Institutions, February.

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