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CAN YOU BANK ON IT?

If the Reserve Bank of Australia (RBA) meets the expectations of some economists and raises the cash rate two or three times during 2011, what will your bank do?

Will they lift rates in line with the RBA increase or will they break away and lift rates independently of the official cash rate?

Since the mid 1990s it has become common practice for banks to move their indicator rates within hours of a change to the official cash rate. Yet in recent months their increases have gone beyond the official rate hikes, triggering strong public and political criticism.

Head of the National Australia Bank, Cameron Clyne, says any link between the two events is a perception the banking sector has created for itself by consistently adjusting rates in line with RBA changes. "If the banks continue to move in line with the RBA, up or down, then we are continuing to compound the view that in fact our funding is related to those moves in the cash rate," says Clyne.

But that's not true, he claims. Other factors play a greater part in determining bank rates, such as funding costs which have risen sharply in the wake of the global financial crisis (GFC). Short-term money market rates have risen well above increases in the cash rate and there has been a significant increase in long-term funding costs. These pressures prompted banks to lift their full-doc variable-rate mortgages by some 40-60 basis points more than the cumulative increase in the cash rate since 2007.

What's more, the bank chiefs who spoke at the Senate inquiry into the banking system in December 2010 believe funding costs are still above where they were before the GFC. For its part, the RBA's submission acknowledged the average cost of the major banks' funding was "90 to 100 basis points higher relative to the cash rate than it was in mid 2007."

Snapshot



Competition winners

A lack of competition among the banks is also cited in the bank debate.

In the wake of the GFC, the majors snapped up smaller banks and non-bank lenders — Commonwealth Bank took over Bankwest and became a strategic shareholder in Aussie Home Loans; Westpac snared St George and RAMS home loans. But the banks argue competition is not about the number of players in the market, but their ability to attract deposits to help fund their lending.

In fact, the figures show those without debt and with money to deposit are the winners here. Competition for term deposits is so strong that RBA figures show rates are now being set 70 basis points higher than the debt price, compared with 60 basis points lower before the GFC.

Switching banks

But if you still carry debt, then you might be one of the growing number who are looking to switch providers.

A recent study by Core Data found that 23 per cent of the 15,000 mortgagees interviewed said they were starting to look around for a new lender. If you extrapolate those figures out to the 4.4 million Australians with a mortgage, then you are looking at about a million people interested in switching!

Of course not everybody will make the move, but the bid by the Federal

Government to bar exit fees on all new mortgages from next year should make it significantly easier in the future. Exit fees can vary from less than \$1,000 to as high as \$7,000. However, it may also mean that low starting rates become a thing of the past if customers can move their loan to the next bank before the first can make any profit.

Too much bank regulation can also have a negative impact. If the majors are forced to keep mortgage rates low, then they will ration the amount of lending, as they have done in the past. This will impact those who are less creditworthy and small businesses that need bank funding in order to grow and create jobs.

Where to next?

While there is plenty of whingeing about bank profits, the after tax return on equity for the big four has averaged 15 per cent over the last 10 years and has dropped from the highs of 2007, so it's hardly excessive. The US, England, France and Germany, to mention just a few, all wish their major banks had remained profitable through the GFC!

Given there is no strict connection between the RBA cash rate and the banks' costs in funding mortgages, we might expect when rates eventually fall, the banks will deliver greater cuts for their customers. But perhaps you shouldn't hold your breath!



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