Australian Banks ─ Recent Developments and Trends

The Australian financial system is well placed to weather the current world financial market turmoil. In contrast to many banking systems around the globe, Australian banks have continued to perform strongly and are soundly capitalised. They have strong credit ratings and minimal exposure to US sub-prime related assets or to market risk from trading activity. Their non-performing loans remain relatively low by both international and historical standards. Australia's banking sector is also well served by its regulatory regime.

- **Strong Performance.** The Australian banking system remains highly profitable by international standards. Over the most recent six-month reporting period, headline profits after tax and minority interests for the five largest banks were up around 12 per cent on the level of last year and were double those of five years ago.(1) Some decline in total profits is anticipated, with several large banks recently announcing higher provisioning expenses for the second half of the current financial year. Despite this, the annualised post-tax return on shareholders' equity for the five largest banks over the second half of 2008 is expected to be about 15 per cent, not that far below the average of the past decade.(2)
- **High Credit Rating.** Australian-owned banks have been viewed favourably by world's major rating agencies. Each of the four major Australian banks (ANZ, Commonwealth Bank, National Australia Bank, Westpac) is rated AA by Standard & Poor's, with these ratings having recently been affirmed. Among the world's 100 largest banks by assets, there are 12 banks that are AA rated or above, and four of these are Australian.(3) Moreover, unlike some of the large financial institutions abroad and several foreign-owned banks operating in Australia, no Australian-owned bank has had its rating downgraded since the beginning of the global financial crisis.(4)
- **Minimal Sub-prime Housing Loans.** The non-conforming housing loan market in Australia (the closest equivalent to the sub-prime market in the USA) has remained small, with authorised deposit-taking institutions having virtually no presence in this market. According to the RBA latest *Financial Stability Review*, non-conforming loans account for less than one per cent of housing loans outstanding in Australia ─ compared with around 12 per cent in the USA. Even on prime housing loans, arrears rates have been significantly lower in Australia than in the USA and UK.
- **Small Trading Activities Income.** The Australian banks have traditionally not relied heavily on income from trading activities for profitability. For the four major banks and St. George Bank, trading income accounted for an average of about 6 per cent of their total income in the latest half year(5), which is well below the equivalent share for some of the large globally active banks. Australian banks have had small unhedged positions in financial markets, with the value-at-risk for the five largest banks equivalent to 0.03 per cent(6) of shareholders' funds in the latest financial year.
- **Low Non-performing Loans.** While provisioning charges have increased, the Australian banking system continues to experience a low ratio of non-performing loans (NPL). As at June 2008, these NPL assets accounted for around 0.7 per cent(7) of banks' on-balance sheets assets. These figures have risen from the very low levels seen in recent years but remain considerably below comparable figures for many developed economies. The NPL ratio for the USA was 1.7 per cent in March 2008 (the latest data available from the IMF), Japan (1.4 per cent), Canada (0.9 per cent) and Hong Kong (0.8 per cent)(8).
- **Strong Supervisory Response.** The IMF in its latest *Article IV Consultation* stated that Australia's supervisory response to the credit market turmoil has been timely and appropriate.(9) The RBA has supplied the necessary liquidity support through exchange settlement accounts and by raising the range of securities accepted for repo lending. Australian Prudential Regulation Authority (APRA) has also intensified its monitoring of asset quality, capital adequacy, and the liability structure of banks.
- **Government's Guarantee Scheme.** The Commonwealth Treasury of Australia has announced the fee structure for large deposits and wholesale funding of deposit-taking institutions for the Government's guarantee will come into effect from 28 November 2008.(10) The guarantee will ensure that Australia's banks are able to raise the funds they need to provide home loans and lend to small business. Under the guarantee, the 99.5 per cent of depositors with less than A$1 million will continue to benefit from the guarantee free of charge. For deposits over A$1 million and wholesale funding a fee will now apply to access the guarantee. The application of a fee will help to ensure the ongoing stability and effective operation of Australia's financial markets.

(1) Reserve Bank of Australia (RBA): Speech – *The Financial Cycle and Recent Developments in the Australian Financial System*, 13 August 2008, page 2; (2) Ibid, page 2; (3) The Banker Magazine, ANZ Economics Research; (4) RBA, *Statement on Monetary Policy* 10 November 2008, page 50; (5) RBA, *Financial Stability Review* (FSR) September 2008, page 25;(6) Ibid, page 25; (7) Ibid, page 23; (8) IMF, *Global Financial Stability Report*; October 2008; (9) IMF, *Australia – 2008 Article IV Consultation: Concluding Statement*, 1 July 2008; (10) Treasurer of the Commonwealth of Australia, Press Release, 28 November 2008