

## Banks fire back at "unaffordable" interest rate demands by government

AFR, Phillip Coorey and Jacob Greber, 4 August 2016

The big banks have rejected as unaffordable Turnbull government demands that they pass on Tuesday's interest rate cut in full but have agreed they need to do a better job explaining themselves. The banks push back came as former bank boss David Murray warned of a European-style banking system if banks kept having their returns stripped. The sector reacted after Prime Minister Malcolm Turnbull, backed by Treasurer Scott Morrison, demanded on Wednesday that the banks pass on the full rate cut from the day before and, if not, explain why or risk exposing themselves further to calls for a Royal Commission.

"They should pass it all on. They should do that, and if they are not prepared to do it, as appears to be the case, then their chief executives should explain very clearly to the Australian people and their customers why they have not done so,' Mr Turnbull said. They operate with a very substantial social licence and they owe it to the Australian people and their customers to explain fully and comprehensively why they have not passed on the full rate cut and they must do so".

Mr Turnbull does not support a Royal Commission but with just a one seat majority in Parliament, he faces a continued politically popular push by Labor and some of the independents. His message on Wednesday, which saw shares in all four big banks fall, was designed to jolt them into helping him ease the political pressure for a Royal Commission by being more transparent. Refusal to pass on rate cut in full is not a basis for a Royal Commission but, unexplained or unjustified, it fuels public resentment.

None of the big four passed on in full amount of Tuesday's 25 basis points cut to the official cash rate and, despite the Prime Minister's urging, not all were prepared to defend themselves in detail on the record.

They argued they face growing pressures which are driving up their funding costs from increased regulation at home and abroad, including new capital adequacy requirements, as well as fierce competition for deposits. Low official interest rates are delivering a double whammy by squeezing margins on mortgages while driving savers away from term deposits towards higher yielding assets like stocks and property.

### Elevated costs

ANZ Chief Executive Shayne Elliott said Mr Turnbull's point was "well made" and "we must to do better as an industry in explaining these dilemmas and the drivers of the decisions we make with all our stakeholders".

"Inevitably there is a dilemma we face in making every interest rate decision. We know individual home loan customers customer want a competitive, low interest rate. On the other hand, we are facing elevated wholesale funding costs and there higher regulatory capital costs with additional requirements for mortgages imminent," he said. "And as interest rates fall, there is also a real need to keep depositors in the banking system through attractive deposit rates. After all they are a major source of funds for lending. Shareholders are also being impacted with ANZ's dividend down 7 per cent in the first half of the financial year."

Said one industry source: "They're fleeing to other assets, the term deposit uplift hasn't happened."

Steven Munchenberg, chief executive officer of the Australian Bankers Association, said the banks had "made it clear for the past eight years that the Reserve Bank cash rate rate did not determine the cost of funds for banks".

"Two-thirds of bank funding comes from deposits and the costs of deposits has been going up which is good news for savers and people with a mortgage are enjoying record low mortgage rates". Commonwealth Bank will make its reasons for not passing on the full amount apparent when it releases its annual results on Wednesday next week.

Mr Murray told The Australian Financial Review the banks did not pass on the full rate cut because "they can't" and "all this jumping up and down about social licence and so on isn't going to do anything". He agreed the banks "need experts in the markets commenting on what's going on with the cost funds" to better explain themselves but warned "if you want us to look like a European banking system, keep stripping their returns". Mr Murray agreed with the reasoning given by the banks, saying "their costs are sticky and they can't pass on all of the rate cuts fully".

He disagrees with the need for a Royal Commission and said one of the dangers would be a recommendation that interest rates would once more be fixed.

By the close of trading Wednesday, Commonwealth Bank of Australia shares fell 2 per cent, ANZ Bank dropped 1.9 per cent, NAB Bank shed 2.8 per cent and Westpac lost 2.5 per cent.

Mr Turnbull last warned the banks they were imperilling their social licence in April when he gave them a spray at a Westpac function. Mr Turnbull told the scandal-plagued institutions to clean up their act. The speech prompted Labor to bring forward its announcement of a Royal Commission. The government instead brought forward its plan to beef up the powers and resources of the regulators.

On Tuesday, Labor leader Bill Shorten vowed to keep the pressure on the government to hold a Royal Commission into the Financial Services Sector. When all four banks subsequently refused to pass on the full 25 basis points rate cut, it was regarded by some as a sign of cockiness now that the election was over.

Mr Morrison said he welcomed the banks also lifting their deposit rates on Tuesday "but there is no reason on the issue of overseas funding costs for the banks to not pass that fully on, and to have retained the benefit of that rate cut for the banks themselves".

Opposition leader Bill Shorten said Mr Turnbull's "empty talk on the big banks is weak and pathetic". "Yet again he has just wagged his finger at them and delivered another empty lecture. He is too weak and his government is too divided to stand up to the banks," he said. Confidence and trust in the financial services industry has been eroded by a wave of unethical and illegal behaviour. That's why Labor wants a Royal Commission. "The decision by the banks to hold back the rate cut from hard-working Australians does nothing to help their credibility." "Mr Turnbull will give the big banks another empty lecture and a tax cut. I'll give the banks a Royal Commission."