

## News & Views

### Correction: Illawarra merger one of mutuals

Last week's article on the merger between Community Alliance Credit Union into IMB was misrepresented. There is no proposal to demutualise Community Alliance Credit Union and no suggestion this is necessary. The merger partners consider their merger one by mutuals and the new entity will also be a mutual.

### Banks can't secure the net

Internet banking is now so integral to the economy, business and commerce that governments must step in to heavily regulate and secure it or banks must get off the net said long-time critic of internet banking Bill Caelli. According to East & Partners, 90 per cent of business banking customers go online to interact with their primary business bank, 62 per cent use a relationship manager, 59 per cent have a product specialist, 19.5 per cent use ATMs, 9.7 per cent use the branches and 4.8 per cent use a call centre. Adjunct Professor Caelli from QUT called for co-ordinated global action to provide secure web services. "There is a big discussion happening globally about web services such as internet banking. The question is, can you create large-scale secure transaction systems on the web and the answer is coming back as no. The world-wide web was not designed for this purpose," said Caelli.

### We need a 'people's bank'

Six influential economists have written an open letter to the government calling for the establishment of a basic 'people's bank' to break the market stranglehold of the big four banks. The economists want the prime minister and the treasurer to set up an inquiry into Australia's financial system. The big four banks have increased their share of the mortgage market from 80 per cent to 92 per cent over the last two years. A spokesman for Mr Swan said Australia's financial system had performed "very well" during the global financial crisis and the government was not contemplating a systemic review of the industry. One of the prominent economists, Christopher Joye, chairman of the former Prime Minister John Howard's 2003 Home Ownership Task Force, said "Everybody knows that providence has played a part in Australia's ability to skate through this crisis. When a coalition of top academic economists calls for a review to evaluate improvements to Australia's decades-old regulatory system, politicians should listen."

### Low LVRs protect borrowers

Twenty thousand households are in arrears on their mortgage, out of the approximately 2.4 million households in Australia that have a mortgage. That default rate is far less than a quarter of the default rate in the UK and just 15 per cent of the default rate in the USA. The average loan to valuation ratio of home loans with the Commonwealth Bank is currently about 32 per cent according to experts. That means that for a property worth about \$500,000 the average Commonwealth Bank borrower is \$160,000 in debt.

## National Market Ranges

### Home Loans

|                     |              |
|---------------------|--------------|
| Standard Variable   | 4.79 - 6.20% |
| Basic Variable      | 4.78 - 5.69% |
| 1 Yr Intro          | 3.29 - 5.59% |
| 3 Yr Fixed          | 5.95 - 7.69% |
| Investment Variable | 4.79 - 6.20% |

### Deposit Accounts

|                           |              |
|---------------------------|--------------|
| Cash Management \$10,000  | 0.01 - 4.00% |
| Cash Management \$50,000+ | 0.25 - 4.00% |
| Online Savings >\$5,000   | 0.10 - 4.60% |
| Savings >\$2,000          | 0.01 - 4.00% |

### Investment Accounts

Interest paid at maturity or per annum

|                   |              |
|-------------------|--------------|
| \$10,000, 90 Days | 1.00 - 4.55% |
| \$10,000, 1 Year  | 1.50 - 4.55% |
| \$10,000, 3 Years | 1.75 - 6.00% |

SEE PAGE 4 FOR THIS WEEK'S RATE MOVEMENTS

SEE PAGE 3 FOR A FEATURE ON BANKING COMPETITION

### Sun, sand and mortgage stress

Beachside suburbs have experienced property price falls of up to 36 per cent since the peak of the market in 2007. Often beach suburb prices have fallen more than twice as much as property prices in nearby suburbs. Property experts say owners of properties in beachside suburbs are often more indebted than other people and many people had overextended themselves. Many sales in Melbourne's bayside areas have been forced as a result of margin calls and unemployment in the finance sector said property valuer Greville Prabst. High priced suburbs have also not been supported by the government's stimulus packages because they are not the places where first home owners buy. "The growth witnessed in the current market is primarily in the first-home owner belt - properties up to \$600,000 - which aren't generally located in areas such as Brighton and Albert Park," said Prabst.

### ANZ outsources mortgages

ANZ will outsource much of its mortgage processing to Bangalore, India and move towards fully automated mortgage application processing. The previous state based processing of paper based mortgage applications by ANZ will be centralised at ANZ head office in Melbourne. ANZ is said to be lagging behind the other big three banks in moving from paper based mortgage applications to full automation. 248 ANZ jobs will be affected, mainly in Sydney, Brisbane and Perth.

## Melbourne auctions deliver for vendors

Auction clearance rates in Sydney on the weekend remained high at 63 per cent from a low volume of 231 auctions. That result is slightly down on the results from last week when 69.8 per cent of 253 properties put up for auction sold on the day. The results were an improvement on the results from the same weekend last year when 47 per cent of 241 properties were sold. Melbourne auctions continued to deliver for vendors with 81 per cent of 275 properties put up for auction selling on the day. Last week, 83 per cent of the 456 auctions held in Melbourne delivered a sale and on the same weekend last year 57 per cent of 392 properties sold at auction. In Brisbane, twenty seven per cent of 28 properties put up for auction sold on the day, down from 38 per cent of 51 properties last week and 27 per cent of 70 auctions on the same weekend last year.

## Bankrupts back in business after 1 year

Proposed new bankruptcy laws will allow first time bankrupts to access credit again after just 12 months as a bankrupt, down from 36 months currently. Banks are concerned that the new proposals could create a moral hazard in reducing the penalty associated with bankruptcy. Banks are also complaining to government about proposed new consumer credit laws that will contain 'unfair contract' provisions which mean that standard form contracts, such as those associated with financial products like cards and loans, could have to be rewritten.

## Super funds get into financial advice

Superannuation funds can now provide members with basic advice about which investment option is best suited to their needs. Finance minister Lindsay Tanner said the new rules would allow millions of ordinary Australians to get inexpensive financial advice. The financial planners association said the changes had been developed 'under the cloak of secrecy' to suit the industry fund movement. The new rules bar super funds from giving advice about new products or selling new products to customers. They are only permitted to give advice about the existing accounts of members.

## Interest Rates & The Economy

### Rates at 3 per cent for third month running

After weeks of mixed results, it came as no surprise to see the Reserve Bank hold the official cash rate steady at 3 per cent this month. Australia may have skirted the global recession, but the recovery remains fragile. The RBA is facing the tricky task of balancing the need to stimulate the economy, with the necessity to keep inflation at bay.

On the one hand, RBA governor Glenn Stevens noted that global conditions were looking more robust. "The global economy is stabilising, after a sharp contraction in demand during the December and March quarters. Downside risks to the outlook have diminished, with conditions in global financial markets improving this year and action to strengthen balance sheets of key financial institutions under way. Growth in China has strengthened considerably, which is having an impact on other economies in the region, including Australia," he said.

More positive news came from the Australian economy this week. According to one consumer sentiment index, consumer confidence in July has reached its highest level since December 2007, increasing by 9.3 per cent to 109.4. The more optimistic outlook has also affected the service sector, where activity has perked up for the first time in 15 months. According to one industry group, activity in services have

improved by 10.3 points to 50.2 points in June, moving into expansion territory for the first time in 14 months.

However, while economic conditions within Australia have not been as weak as expected, the construction sector and labour market continue to struggle. "Output has been sluggish and capacity utilisation has fallen back to about average levels, with some further decline likely over the rest of the year. Weaker demand for labour is leading to lower growth in labour costs," said Mr Stevens. Meanwhile, figures from the Australian Bureau of Statistics show the official jobless rate rose to 5.8 per cent in June, after hitting 5.7 per cent in May. Such figures indicate our economy has not yet turned the corner and further unemployment is likely to have a negative impact on economic growth.

A slowdown in economic growth would, however, bring down inflationary pressures. According to one key inflation gauge, inflation in June stood at 1.4 per cent, below the Reserve Banks' 2-3 per cent target range. However, a survey of consumer expectations of inflation this week showed consumer inflationary expectations reached a level of 3.2 per cent in July. Despite these mixed results, the RBA's current view is that the outlook for inflation leaves some flexibility to lower rates further if necessary. To assess how it might use that window of opportunity, it will continue to monitor economic and financial conditions closely.

## Next Week's Announcements

|      |        |  |
|------|--------|--|
| Mon  | 13 Jul | Aust Lending Finance (May)                           |
| Tue  | 14 Jul | Aust NAB Business Survey (June)                      |
| Wed  | 15 Jul | Aust Building Activity (2nd Quarter)                 |
| Thur | 16 Jul | Aust Merchandise Imports (June)                      |
| Fri  | 17 Jul | Aust International Trade Price Indexes (2nd Quarter) |

## Industry Analysis

### Huge credit union emerging in NSW

The boards of Hunter Mutual Credit Unions and the New England Credit Union (NECU) have agreed to ask their members to vote on a merger proposal early in 2010. The combined entity would become the largest inland credit union in Australia with 73,000 members, 28 branches, 240 staff and about \$1 billion in total assets. Hunter Mutual will retain its name, branches and staff. In recent years NECU has merged with Orana CU and Peel Valley CU.

### Fees eat up investment returns

Superannuation investors get better returns when they invest in low cost passively managed index funds than in actively managed funds according to new research by the prudential regulator APRA. The average actively managed super fund underperformed the passive benchmark index by 0.9 per cent per year during the five years to 2006, after fees were taken into account. Average fees for an actively managed fund were 0.9 per cent per year. The research from APRA also concludes that higher fee funds often produce lower returns for investors. "Higher management expenses leads to poorer net investment performance," said the APRA report.

Sources: InfoChoice, Australian Property Monitors, Herald Sun, Sydney Morning Herald, The Age, The Australian

## Small financial institutions weather the storm

Smaller financial institutions are defying predictions that they will be swept aside as consumers, spooked by the global financial crisis, rush to do business with the big banks. Two new reports show that regional banks, building societies and credit unions have had their incomes and earnings pegged back over the past year but they are still performing well in difficult conditions.

Earlier this month KPMG reported on its analysis of "second tier" institutions in the banking sector during the 12 months to the end of March. It found that while the results are significantly down on prior periods, "the sector continues to be a relevant and important provider of financial services."

KPMG partner Martin McGrath says: "These sectors have continued to be profitable. However, their ability to compete with the major banks is being sorely tested in these challenging markets"

Regional bank profitability has been affected by an increase in bad debt expense in business lending. The regional banks reported a decrease in profit after tax of 68 per cent during the first half of the 2009 financial year.

The Australian Prudential Regulation Authority reported that for the quarter ended March 31, the 131 credit unions and building societies it supervises reported total operating income of \$580 million, down 10.4 per cent on income of \$647 million in the March quarter 2008.

Aggregate net profit for the credit unions and building societies was 87.1 million, down 23.6 per cent on earnings of \$114 million in the March quarter 2008.

McGrath says: "While some of the falls in profit are significant, it is important to note that these institutions remain profitable and have generally strengthened their balance sheets. Contrast this in a global financial context with much larger overseas financial institutions which have posted large losses and, in some cases, are reliant on government support to survive."

### Deposit growth strong but not matching the big banks

KPMG says deposit growth has been strong for the smaller financial institutions. During the first nine months of the financial year credit unions increased deposits by 10.5 per cent, and regional banks by 4.2 per cent.

McGrath says: "Deposit growth is fundamental to the growth plans of credit unions and building societies. They have competed aggressively in this area and have benefited from the flight to cash by customers who have steered away from equity and property investments."

The growth in deposits has, however, fallen short of the 15.5 per cent growth recorded by the major banks, which continue to be aggressive competitors.

The APRA figures show that both credit unions and buildings societies are able to fund the bulk of their lending from deposits. Ninety per cent of credit union loans and 88 per cent of building society loans are funded by deposits.

Building society and credit unions managers point to this funding base as an important indicator of their stability. While some of them have used the capital markets for funding, all have been able to all back on traditional funding sources now that the capital markets are shut down.

### The right lending mix

Average loan growth over the nine months to the end of March was 4.3 per cent for credit unions and 7.7 per cent for building societies, with home loan growth the main contributor and business and consumer lending lagging.

McGrath says: "This increase in exposure to mortgage loans, as opposed to business and consumer lending, appears prudent given the deteriorating economic conditions."

All approved deposit taking institutions are beneficiaries of the government guarantee of deposits, which is provided free for retail deposits of less than \$1 million.

For deposits in excess of \$1 million, a fee of 1.5 per cent is charged to institutions rated below A, compared to one per cent for A rated and 0.7 per cent to AA rated institutions such as the four major banks.

McGrath says: "The guarantee is a two edged sword for the regionals, building societies and credit unions. The higher fee applies to two of the three regional banks and all of the building societies and credit unions making it more expensive for them to attract large cash deposits. This has impacted the regional banks' profitability in particular."

The outlook for the next year will largely depend on the sector's ability to access funding markets at competitive rates and the size of a likely increase in bad debt expense as the impact of job losses is felt.

"They are unlikely to be able to expand rapidly or aggressively take on the majors. Factors such as the differential pricing of the government guarantee place these institutions at an obvious disadvantage.

"However by continuing to focus on the strength of their balance sheets, serving their customers well and sticking to the markets they know well, there is no reason why the sector cannot continue to succeed," Mr McGrath said.

### Costs the achilles heel for small institutions

The APRA figures show that expenses are a weak spot for small financial institutions. Operating expenses of \$1.4 billion for credit unions in the year to the end of March represented 78.2 per cent of total operating income. For building societies expenses of \$484.7 million over the same period represented 73.9 per cent of operating incomes.

The big banks have much lower expense to income ratios and have been successful in continuing to push their cost ratios down. This will give them an important advantage in pricing.

## This Week's Rate Movements

### Home Loans - Standard Variable Rates

| Institution | Product       | Avail | Old Value | New Value | Date of Change | Change Value |
|-------------|---------------|-------|-----------|-----------|----------------|--------------|
| HSBC        | Variable Loan | B     | 5.84      | 5.74      | 06-07-2009     | -0.10        |

Key: (OO) - Owner Occupied (I) - Investment (B) - Both

### Home Loans - 1 Year Fixed Rates

| Institution                     | Product                   | Avail | Old Value | New Value | Date of Change | Change Value |
|---------------------------------|---------------------------|-------|-----------|-----------|----------------|--------------|
| A M O                           | AMO Fixed Rate Home Loan  | B     | 5.26      | 5.44      | 09-07-2009     | 0.18         |
| Australian Central Credit Union | Fixed Rate Home Loan      | B     | 5.79      | 5.59      | 08-07-2009     | -0.20        |
| Bank of Queensland              | Fixed Loan                | B     | 5.29      | 5.44      | 08-07-2009     | 0.15         |
| Yes Home Loans                  | Equity Access Fixed Rates | B     | 5.21      | 5.64      | 06-07-2009     | 0.43         |

Key: (OO) - Owner Occupied (I) - Investment (B) - Both

### Home Loans - 2 Year Fixed Rates

| Institution                     | Product                   | Avail | Old Value | New Value | Date of Change | Change Value |
|---------------------------------|---------------------------|-------|-----------|-----------|----------------|--------------|
| Australian Central Credit Union | Fixed Rate Home Loan      | B     | 5.89      | 5.99      | 08-07-2009     | 0.10         |
| Bank of Queensland              | Fixed Loan                | B     | 5.79      | 5.99      | 08-07-2009     | 0.20         |
| Big Sky Credit Union            | Fixed Rate Loans          | B     | 5.99      | 6.19      | 07-07-2009     | 0.20         |
| Community First Credit Union    | True Fixed Home Loan      | B     | 5.49      | 5.69      | 06-07-2009     | 0.20         |
| Easy Street Financial Services  | EasyHome Fixed            | OO    | 5.49      | 5.69      | 06-07-2009     | 0.20         |
| Yes Home Loans                  | Equity Access Fixed Rates | B     | 5.70      | 6.37      | 06-07-2009     | 0.67         |

Key: (OO) - Owner Occupied (I) - Investment (B) - Both

### Home Loans - 3 Year Fixed Rates

| Institution                     | Product                   | Avail | Old Value | New Value | Date of Change | Change Value |
|---------------------------------|---------------------------|-------|-----------|-----------|----------------|--------------|
| Australian Central Credit Union | Fixed Rate Home Loan      | B     | 6.59      | 6.69      | 08-07-2009     | 0.10         |
| Bank of Queensland              | Fixed Loan                | B     | 6.49      | 6.59      | 08-07-2009     | 0.10         |
| Big Sky Credit Union            | Fixed Rate Loans          | B     | 6.29      | 6.49      | 07-07-2009     | 0.20         |
| Community First Credit Union    | True Fixed Home Loan      | B     | 5.69      | 5.99      | 06-07-2009     | 0.30         |
| Easy Street Financial Services  | EasyHome Fixed            | OO    | 5.69      | 5.99      | 06-07-2009     | 0.30         |
| Yes Home Loans                  | Equity Access Fixed Rates | B     | 6.16      | 7.00      | 06-07-2009     | 0.84         |

Key: (OO) - Owner Occupied (I) - Investment (B) - Both

### Home Loans - 4 Year Fixed Rates

| Institution                     | Product                   | Avail | Old Value | New Value | Date of Change | Change Value |
|---------------------------------|---------------------------|-------|-----------|-----------|----------------|--------------|
| Australian Central Credit Union | Fixed Rate Home Loan      | B     | 7.09      | 7.19      | 08-07-2009     | 0.10         |
| Bank of Queensland              | Fixed Loan                | B     | 6.99      | 7.04      | 08-07-2009     | 0.05         |
| Yes Home Loans                  | Equity Access Fixed Rates | B     | 6.54      | 7.46      | 06-07-2009     | 0.92         |

Key: (OO) - Owner Occupied (I) - Investment (B) - Both

### Home Loans - 5 Year Fixed Rates

| Institution                     | Product                   | Avail | Old Value | New Value | Date of Change | Change Value |
|---------------------------------|---------------------------|-------|-----------|-----------|----------------|--------------|
| Australian Central Credit Union | Fixed Rate Home Loan      | B     | 7.19      | 7.29      | 08-07-2009     | 0.10         |
| Bank of Queensland              | Fixed Loan                | B     | 7.19      | 7.29      | 08-07-2009     | 0.10         |
| Yes Home Loans                  | Equity Access Fixed Rates | B     | 6.73      | 7.71      | 06-07-2009     | 0.98         |

Key: (OO) - Owner Occupied (I) - Investment (B) - Both

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