Budget & Banking

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It will be interesting to see how the market digests this news.

Assuming no cost recovery, the proposed levy only has a moderate impact on fair value. Its quantified and it's over a specified period, so the impact in most analyst models will be pretty well defined.

The announcement around giving the competition regulator a more active mandate however is harder to properly quantify. In our opinion the banks have done an adequate job of balancing their obligations to shareholders with the social responsibility of funding the economy responsibly **(not to mention employing a couple of hundred thousand people)**, that said they continue to be treated as populist punching bags.

For us we think that the new ACCC mandate could end up being a lot more troubling than the levy. Is this a first step towards posing the question of whether banking is a form of social infrastructure where profits and risks should be well defined if not centrally mandated. Ultimately APRA are already monitoring the system as a whole and are actively providing directives around balance sheet composition and indeed the composition of credit growth. If such a scenario were to transpire, banks would be effectively reduced to sales and marketing conduits, operating within centrally mandated and clearly defined boundaries). The banking lobby has the political cache of a red-headed step child. Can they fight back even if they want to? I would put it to you that regulatory risk for the sector has never been higher. The potential impact of this on valuations should be higher than a well-defined cash hit of the levy in my opinion.

All of that said, as a credit manager our main focus is on the structural integrity of the Australian banking sectors asset base. None of this changes the reality of households carrying high absolute levels of debt which continue to leave the Australian financial system vulnerable to external shocks. The market value of equity is important in protecting the rest of the capital structure, as such anything which has a meaningful negative impact on how the market values said equity is credit negative, in that it impacts on a bank's ability to use its equity to manage risks relating to asset performance.

In our own credit modelling we use a price to book multiple which sits at a healthy discount to market price to book multiples, however this is more a function of very conservative assumptions around provisions and capital requirements, this is not a forecast but rather defines a conservative level which gives us comfort when allocating capital to the sector.
All eyes now on APRA's interpretation of unquestionably strong.

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