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Budget 2017: Are Australia's banks on the road to nationalisation?

Treasurer Scott Morrison may have turned banks from profit machines into pieces of social infrastructure **Mark Graham**

by **Jonathan Shapiro**

When shares in the big four banks opened trading on Wednesday, the immediate focus was on the $6 billion of profits the government would extract via a levy on liabilities.

But on closer inspection, that should be the least of shareholders' worries. The sum of the measures announced on Tuesday go way beyond a tax grab - they may be a lurch towards the transformation of our largest financial institutions from profit making machines to a form of social infrastructure.

Some investors are seriously asking whether we have entered a realm where profits and risks of the banking system, will be "well defined" if not "centrally mandated".

Why so? The banks are now being told who to lend to, how to lend, what to charge and how to pay their top people.

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In addition to the levy, effectively a tax on the wholesale funds of the largest lenders, the budget revealed plans to increase powers over executive compensation, and to the competition watchdog to undertake an enquiry into mortgage pricing.

The budget also revealed the government's intention to "modernise" the Banking Act of 1959, to grant the prudential regulator more power to manage systemic risks.

The Australian Prudential Regulation Authority already exerts considerable power and has in the past two and a half years imposed specific limits on the types and amounts of loans that banks can write. They will now be extended to the smaller non-bank sector.

Andrew Papageorgiou of Realm Investments, which invests in major bank debt believes that the extension of the ACCC mandate, along with other changes means "regulatory risk for the sector has never been higher".

This, he said, should have a impact on valuations beyond the "well defined cash hit of the levy."

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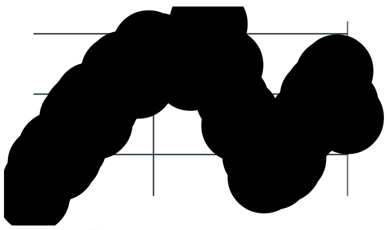

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If the government did introduce and use powers that influenced bank lending and pricing decisions they "would be effectively reduced to sales and marketing conduits, operating within centrally mandated and clearly defined boundaries," he said.

While bank share prices took a belting on Tuesday following *The Australian Financial Review's* report on the levy, bank credit spreads didn't budge. Nor did they overnight when the levy was confirmed.

Killing politically toxic birds

Often the interests of lenders and shareholders of the banks are at odds. For instance, higher capital requirements protect lenders but shareholders give up in the form of dilution or lower dividends.

But lower equity valuations do come at a cost to debt investors, as the higher they are, the more buffer they provide to those further down the capital structure.

In this context, former Queensland premier Anna Bligh's lament that the market response to the bank levy would undermine confidence in the sector may have been an exaggeration, but it was not complete nonsense.

Douglas Morton, the head of research at Northern Trust Capital Markets placed a sell on the Australian banks. Even though the levy may be mitigated by home loan repricing, the ACCC mortgage pricing enquiry "could potentially tie the hands of the banks who (at the very least) may see interbank liquidity severely constrained as a result of these plans," he said in a note.

The expansion of the APRA oversight is "the tone has been set for a significantly tightened environment for the Australian banks", which were beginning to relatively less valuable and less profitable compared to other banks.

Few would deny that the measures announced on Tuesday were partly, if not entirely politically motivated, given the disdain for the banks.

As fixed income analyst Sean Keane told clients, the Treasurer was able to "kill a number of politically toxic Australian birds with a single, and very well aimed, stone."

The big picture questions are how far will the government and its agencies go in taking power away from the banks, and whether this push is good or bad for the financial system, the economy and the nation.

It will take more than one trading session to know the answers.

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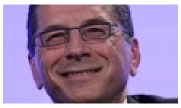
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