THE AUSTRALIAN

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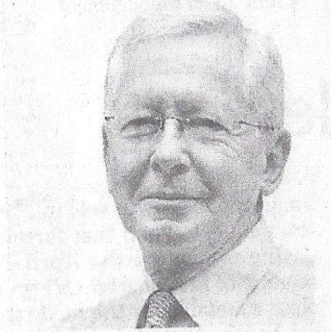
We owe more than money to our financially strong banking system



DON STAMMER

THE X FACTOR

Bank-bashing is a national sport, but the truth is otherwise

OVER the years, recurring themes in Australian attitudes have included fear of invasion, love of sport, a touching faith in government to solve a wide range of problems and a dislike of banks.

Some of these long-held views might have softened over time, but criticism of banks persists.

Investors who listen to both sides of this oft-heated debate can identify opportunities that benefit them as depositors or investors.

The antipathy towards banks reflects, in part, the increases in interest rates they charge relative to the cash rate. Banks say this simply reflects higher funding costs. Term deposits, which the banks now compete for strongly, now make up 45 per cent of banks' funding, compared with 30 per cent in 2007. Wholesale money, when available, costs more because of global financial strains.

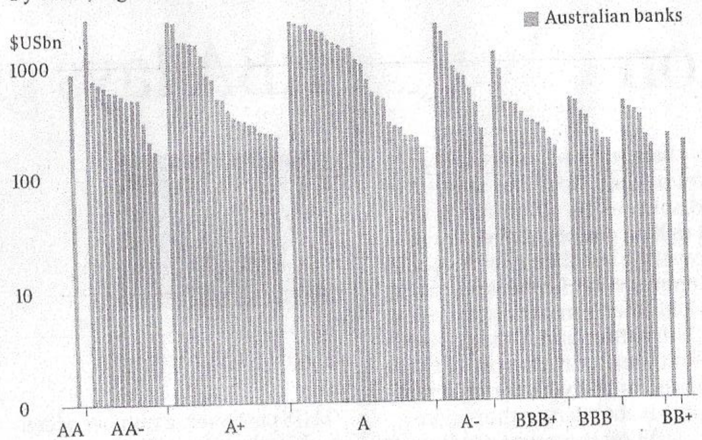
Also, bank profits are seen as excessive. Critics cite the headline profits of the big four banks totalling $12.1 billion over the six months to their latest reporting dates. But this includes $2.5bn from the writedown of bad and doubtful debt that banks had earlier taken into their accounts. During and since the global financial crisis, banks have raised a lot of extra capital to strengthen their balance sheets. Their return on equity remains close to its long-term average of 16 per cent a year.

In public discussions, little or no attention is usually given to the benefits a financially strong banking system has delivered to Australia. It's one of the reasons — along with China, the fiscal boost and our potent monetary policy — we came through the GFC relatively unscathed.

Since the GFC, the credit rating agencies have altered how they accredit ratings on banks. The four big Australian banks are now rated by Standard & Poor's as AA-. That's one step below the rankings they had held through to late last year, but our banks are strong and stable on a global comparison, as the chart shows.

Credit ratings of the largest 100 banking groups*

By asset, log scale



* Holding company ratings: predominantly Standard & Poor's local-term ratings, unless unrated, then Moody's senior unsecured

Sources: Moody's, Standard & Poor's, The Banker

Further good news for savers is that the banks are competing keenly for term deposits, usually with special offers to depositors who shop around. Fixed interest funds, and individual savers with large amounts of money to invest, are also showing a lot of interest in the bonds, including covered bonds (bonds backed by housing loans), the banks issue in wholesale markets in Australia.

The banks' financial strength and the franked dividends they pay have benefits for equity investors. But it's also important that investors in bank shares heed the warning the Reserve Bank of Australia made recently: "While the banks (have) continued to record robust profits in their latest half-year reporting periods, the slow credit growth environment is likely to limit the pace of future profit growth."

Investors in bank shares can enjoy the dividends they're receiving and perhaps allow for modest increases in dividend payouts over coming years, but they shouldn't be relying on a rapid expansion in the dividend stream.

Don Stammer is an adviser to the Third Link Growth Fund and Altius Asset Management. The view expressed are his alone. He owns bank shares.