Glenn Stevens: Inquiry into competition in the Australian banking sector

Opening statement by Mr Glenn Stevens, Governor of the Reserve Bank of Australia, to the Senate Economics References Committee inquiry into competition in the Australian banking sector, Sydney, 13 December 2010.

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The Reserve Bank has provided a submission to the Committee that details trends in lending, costs, margins, fees and other factual material the Committee may find of use. We of course will seek to answer any questions on that submission.

Perhaps I should note a few general points.

First, risk has been re-priced since early 2007. All of us are still adjusting to this change and its implications.

It is widely held that risk was under-priced for some years before then. That is to say, investors demanded very little risk compensation in their expected returns – perhaps in some cases because they didn't understand the risks. So financial institutions of all types could get ample funding cheaply, and this could be passed on to their borrowers. Business models that took particular advantage of low-cost wholesale funding and/or securitisation were able to provide a very competitive edge to certain markets, particularly (though not only) to markets for mortgage lending.

But investors around the world changed their attitude to risk in 2007 and 2008. The compensation they require for taking on risk has increased. Wholesale funding and securitisation are now more expensive. In the case of securitisation, costs have also risen in part because some investors have left the market altogether.

The increase in costs has affected all financial institutions, but to varying degrees. As such, it has also affected the competitive landscape. Some business models that did well in the earlier state of the world find it harder going now. Part of the competitive advantage they had has been eroded by market developments. The current relationship between variable mortgage rates and market funding costs is making it more difficult than it used to be for the lenders relying on securitisation to compete with the major banks.

This changed attitude to risk has affected the locus of competitive forces. Whereas four years ago the environment was one in which the competition among financial institutions to lend money was intense, more recently it has been the competition to *raise* money that has been intense. Various other things have happened that also have a bearing on the competitive landscape, but this is a very fundamental change in the state of the world.

That said, the market remains a good deal more competitive than it was in the mid 1990s and borrowers have access to a much larger range of products. Moreover, the overall availability of finance to purchase housing in particular seems to be adequate.

The second theme is that, the market price of risk having risen, various players want the public purse to take on some of this higher price through various forms of support or regulatory change.

The various ideas should, of course, be assessed on their merits. But an important high-level point is that, in some instances at least, it would appear the taxpayer is being asked to shoulder more risk, one way or another, in order to facilitate the provision of private finance.

Whether, and in which areas, that might be a good idea – and if so how much might be charged for such support – is of course for governments and legislatures to determine. Hopefully your inquiries will be able to assist this process.