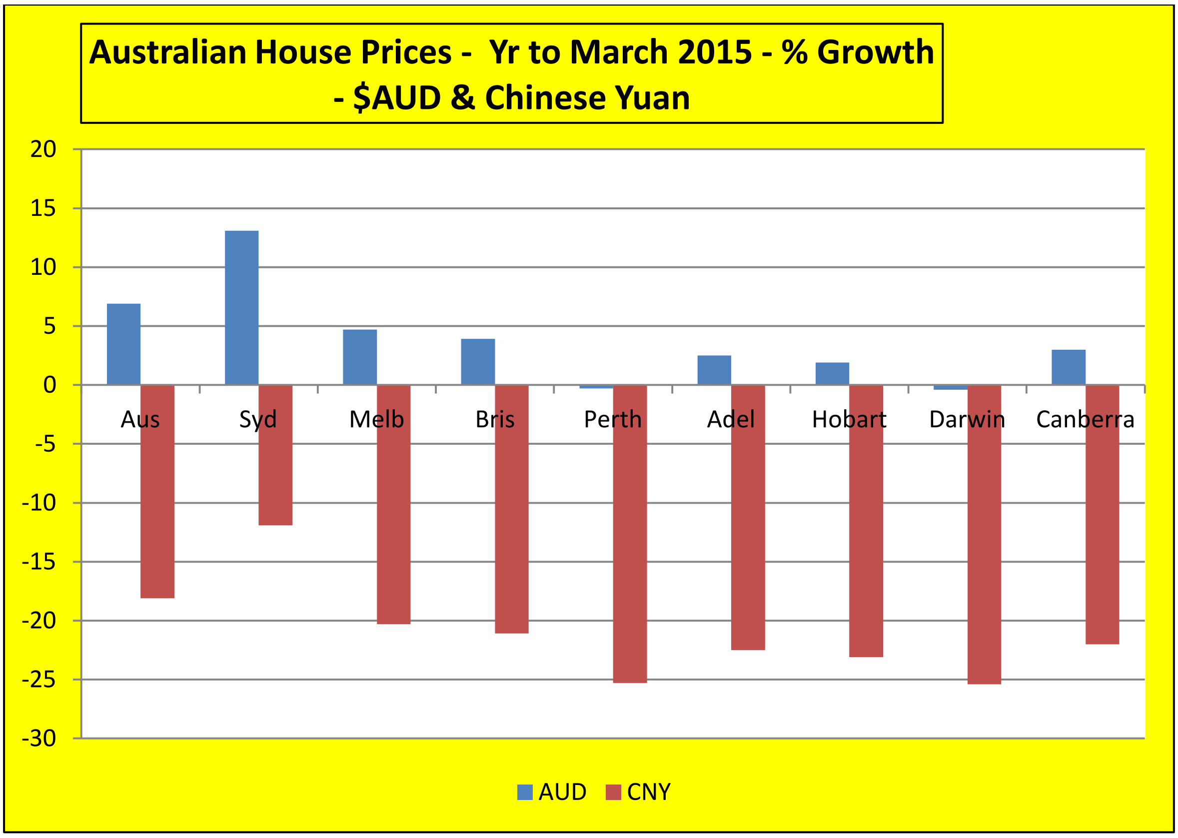
Australian Major Banks' response to the increased capital requirement of several billion dollars each against Residential Investment Property Lending (approximately 30% of Residential Mortgage Lending Portfolios) has been to raise variable investment interest rates by around 27bp-29bp. Whilst this is possibly only preliminary action, to Property Investors this is a relatively low additional cost. Against possible 5%-10% property price gains per annum over the medium to longer term, to date this is an insignificant cost, leaving net marginal 4.7% - 9.7% gain per annum. Would this change demand for Australian Residential Property, when say Chinese investors have seen Australian House prices decline in Yuan-Renminbi terms by 15% - 20% in the last 12 months? I would say not. Therefore it would be unlikely to have the desired effect of reducing investor appetite. It may however increase security of the Australian Banks Housing lending portfolios with the larger capital buffer, particularly in combination with any relevant macro-prudential lending controls and other Basel III related APRA capital requirements.



Sure they've gorged themselves on Residential Investment Property lending, to the extent say Westpac resembles more a Savings / Housing Lending Bank than a Commercial Trading Bank, but contrary to some popular opinion, the raising of interest rates is a correct and logical Banking response to the increased capital requirement on a specific business component.

Westpac was slower to raise the relevant interest rate given this authors expectation that it is deficient in its Computing Systems on a number of fronts. In this instance it was unable to distinguish between the owner occupied versus investor components of its Residential mortgage portfolio, something I would have thought APRA might have been aware of and been seeking Banks / Westpac improvement on.

The smaller AMP Banking has raised the relevant variable interest rate by 47bp, probably reflecting the higher concentration of Residential Investment Property lending in its total loan portfolio. It represents only 1% Banking market share at $3B of loans. It has also proposed a self imposed moratorium on Residential Investment Property lending until later in 2015.

APRA has indicated a preference for a limit of 10% growth in Residential Investment Property lending. The latest moves on capital should encourage this but again the attraction of Residential property to investors is strong as seen above in Chinese currency terms. The strength of the Renminbi and its Purchasing Power, replicated across the US in USD terms and probably similar in Indian Rupee terms, combined with the weakness in AUD, sustain this attraction. In the case of China, the state of its own Residential property market in terms of lack of affordability (perhaps worse than Australia), along with Equities Market volatility, add to the attraction of such assets as the Australian Residential property Asset Class. In fact there has been a $USD 800 Billion capital outflow from China in the last 12 months. Obviously not all of this is to Australia, but Australian Government encouragement of foreign investment is probably a case of ..”be careful what you wish for,” and it certainly says something for future medium to longer term price trends

At the same time Australian Building Approvals showed a decline in Residential non-housing approvals of 20% for June 2015, but retained 16% growth in the last year. Strong growth by anyone’s measure but I don’t believe increased supply like even this, dampens the likely medium to longer term (beyond say one year) Residential property price outcomes.

Capital Requirement

The range in increased capital required by Australia’s Major Banks through increased Investment Property lending Risk Weighting is approximately $2.3B - $4B, with ANZ at the low end and Westpac at around $3B. It is not insignificant and in combination with general Basel III and Australian Financial System Inquiry recommendations as recently espoused by APRA, represents large amounts of capital, albeit capital which may become accessible at least in part through international debt markets, as well as being addressed by asset sales and dividend plans etc.

Foreign Exchange - FX

Talking of Westpac and Computing Systems as well as Disruptions to Global and Australian Banking other than Basel III and capital requirements, Banks generally operate the FX Markets, in provision to all levels of Banking inclusive of Business Banking. The emergence of Non Bank Foreign Exchange Broking / Trading online, and some degree of Regulatory focus on these markets (eg US – Proprietary Trading limitations, US / EU / UK Market Participant Behaviour), potentially disrupts Banks income sources. These have typically been Trading incomes, exchange rate surcharges and various fees. Retail and SME Access to spot rate and alternative – Non Bank avenues to payment and funds retention, potentially, and perhaps should, Disrupt Banks FX activities.

The shaving of exchange rates on offer even up to Corporate level by Banks is extensive. Further, Transfer and Transaction fees charged by Banks are numerous and significant. Using Westpac as an example, the Corporate rate offered – AUDUSD as identified on its Corporate Banking web-page was recently 0.70 – at the time the spot rate was 0.74, a 6% surcharge. The Bank would also charge a flat Transfer fee in relation to any transfers conducted and I believe a latest initiative is to charge a 2.9% transaction fee as well on overseas payments. I find this incredibly non-competitive, when I, at a Corporate-SME, Personal-Business or Personal level can have access to spot rate transfers, and through Non Bank platforms. I believe they potentially risk pricing themselves out of a good proportion of at least FX transfers and payments. In addition they (Westpac) potentially need Technology - System / Platform upgrade to be able in C21 to provide Retail, Business and Corporate customers alike, access to more competitive on-the-spot rates at more competitive cost. Why in 2015 Bank / Westpac customers can't be given access to spot rate or approximately spot from branch or phone with systems linked to FX dealing, is largely beyond me. A 6% rate surcharge alone is greedy verging on usurious.

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