



MASTER BUILDERS
A U S T R A L I A

SUBMISSION TO
THE SENATE INQUIRY INTO
COMPETITION WITHIN
THE AUSTRALIAN BANKING SECTOR

NOVEMBER 2010

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building australia



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1 INTRODUCTION

- 1.1 This submission is made by Master Builders Australia Ltd (Master Builders).
- 1.2 Master Builders Australia is the nation's peak building and construction industry association, federated on a national basis in 1890. Master Builders Australia's members are the nine Master Builder State and Territory Associations.
- 1.3 Over the past 120 years the association has grown to represent over 30,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry body that represents all three building and construction sectors: residential, commercial and engineering.

2 THE BUILDING AND CONSTRUCTION INDUSTRY

- 2.1 The building and construction industry is a major driver of the Australian economy. It makes an essential contribution to the generation of wealth and the welfare of the community, particularly through the provision of shelter. At the same time, the wellbeing of the building and construction industry is closely linked to the prosperity of the domestic economy.
- 2.2 According to the ABS, the value of work done by the building and construction industry was \$152.5 billion in 2009, excluding \$20 billion of smaller renovations work. Residential building work done was \$43.3 billion, non-residential building \$32.5 billion and engineering construction \$76.7 billion. At May 2010 the construction industry employed 1,014,100 people.
- 2.3 The cumulative construction task over the next decade will require work done to the value of \$2.2 trillion. The residential building sector will require nearly \$1 trillion worth of work and the non-residential building and engineering construction sectors combined more than \$1.1 trillion worth. The construction workforce currently represents close to 9 per cent of the total Australian workforce with the number of jobs expected to increase by more than 200,000 to around 1.2 million employees by 2020.

3 PURPOSE OF THIS SUBMISSION

- 3.1 Master Builders would like to make some comments in relation to competition within the Australian banking system.
- 3.2 The matter of competition within the Australian banking sector was referred to the Senate Economics Committee for inquiry and report by the Senate on 28 October 2010. The move follows the banks reporting strong profit results and a public policy debate kicked off by the Shadow Treasurer about the role of the banks in the Australian economy post the global financial crisis. The terms of reference of the inquiry are sweeping and will consider the impact on competition of "too big to fail" banks, non-bank lenders, fees and charges, and how the banking sector might evolve in the wake of the financial crisis.
- 3.3 The Terms of Reference for the inquiry are - competition within the Australian banking sector, including: (a) the current level of competition between bank and non-bank providers;(b) the products available and fees and charges payable on

those products;(c) how competition impacts on unfair terms that may be included in contracts;(d) the likely drivers of future change and innovation in the banking and non-banking sectors;(e) the ease of moving between providers of banking services; (f) the impact of the large banks being considered 'too big to fail' on profitability and competition; (g) regulation that has the impact of restricting or hindering competition within the banking sector, particularly regulation imposed during the global financial crisis; (h) opportunities for, and obstacles to, the creation of new banking services and the entry of new banking service providers; (i) assessment of claims by banks of cost of capital; (j) any other policies, practices and strategies that may enhance competition in banking, including legislative change; (k) comparisons with relevant international jurisdictions; (l) the role and impact of past inquiries into the banking sector in promoting reform; and (m) any other related matter.

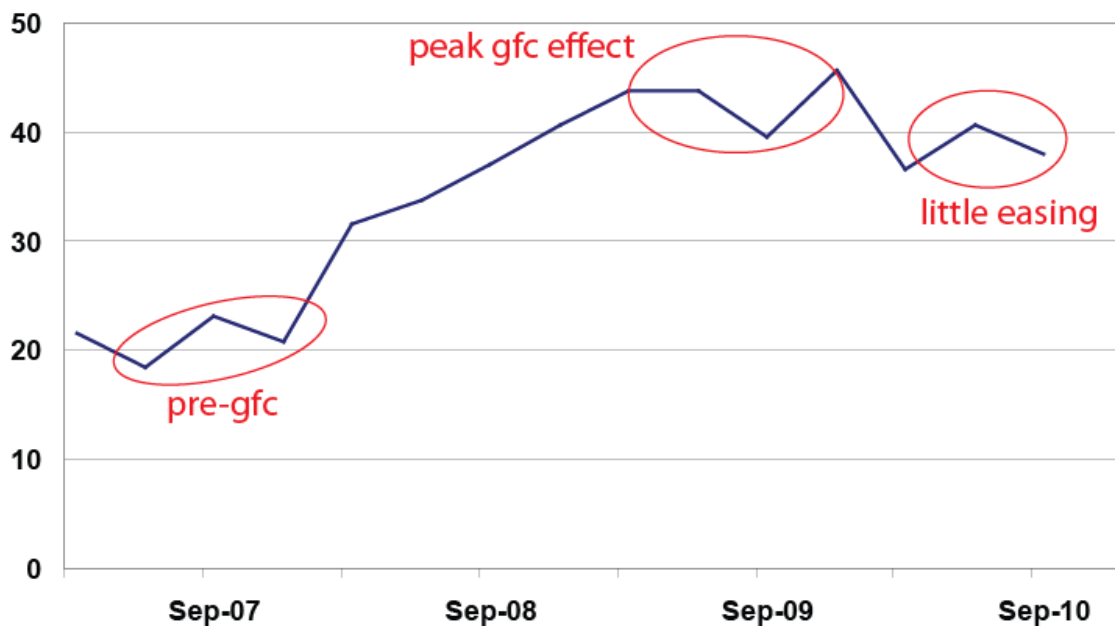
4 FINANCE AND THE BUILDING & CONSTRUCTION INDUSTRY

- 4.1 Australia's sound financial position enabled the Government to employ an aggressive fiscal stance that helped cushion the worst effects of the global financial crisis and mitigate the economic downturn. Effective and timely measures provided critical stimulus needed to insulate the economy from the worst effects of the global financial crisis, particularly unemployment. The Government's strong focus on building and construction stimulus measures was appropriate given the industry's labour intensive nature and strong linkages throughout the domestic economy. The strategy has proved successful in terms of cushioning the downturn in the Australian economy.
- 4.2 Nonetheless, credit flows have yet to normalise and restrictions on finance brought about by the global financial crisis continue to affect much of the building and construction industry. A lack of credit continues to act as a major impediment against the ability of clients and contractors to kick start new private sector projects. Small businesses in the building and construction industry have been particularly affected by banks' reluctance to lend. Also, small business lending rates are higher than they would otherwise have been because the banks did not fully pass on official rate reductions in the latter part of 2008 and early 2009. Subsequently, as the Reserve Bank raised official interest rates borrowing costs have increased.
- 4.3 Commercial and industrial sectors were the worst hit by the global financial crisis and economic downturn. Difficulties with cash flow and accessing credit from banks and other lending institutions remain as issues as tough lending criteria continue to be imposed on builders and developers. Problems relating to debt and asset valuation have been limiting the capacity to obtain credit and the economic downturn caused delays of some projects and forced tenants and building owners to commission less refurbishment and building works.
- 4.4 Over one quarter of respondents surveyed in Master Builders' latest national quarterly survey were concerned that availability of finance was having a large or major constraining effect on their business. Although down on recent highs, this figure is still up sharply on survey results of 18 months-two years ago prior to the global financial crisis.

Master Builders Australia National Quarterly Survey – Detailed Results in Response to Question: “What effect is availability of finance having on your business?”

	Mar '07	Jun '07	Sep '07	Dec '07	Mar '08	Jun '08	Sep '08	Dec '09	Mar '09	Jun '09	Sep '09	Dec '09	Mar '10	Jun '10	Sep '10
Major effect	1.5	0.7	1.0	2.2	3.9	4.2	2.5	4.8	14.0	12.0	8.8	16.5	9.3	10.6	9.6
Large effect	5.2	5.8	8.9	7.5	12.4	15.8	21.5	25.0	18.0	21.3	23.6	19.3	19.4	18.5	17.1
Moderate effect	14.8	12.6	17.8	15.0	23.1	21.8	26.3	23.9	24.5	25.2	17.8	20.0	11.0	21.4	16.3
Slight effect	34.4	28.4	26.6	21.8	26.8	27.4	20.7	20.7	16.0	12.3	16.4	18.4	28.4	21.8	29.2
No effect	44.0	52.6	45.7	53.5	33.8	30.9	29.0	25.6	27.4	29.1	33.4	25.8	31.9	27.7	27.8
Index	21.5	18.4	23.2	20.8	31.5	33.8	37.0	40.7	43.8	43.7	39.5	45.6	36.5	40.7	37.9

What effect is availability of finances having on your business



5 GENERAL COMMENTS ABOUT BANKING COMPETITION

- 5.1 Australia has world-class banks and a very good financial system. In a sense, Australia suffered its financial system meltdown 20 years ago. The resultant improvements since, have served Australia well, most recently during the global financial crisis when the banking system survived a very severe “stress test”.
- 5.2 Given recent events on the world stage, it is understandable that many countries are looking to rebuild financial systems but Australia must resist the temptation to “re-regulate” for the sake of it.
- 5.3 The four major banks hold a uniquely dominant position in Australia. After BHP, the big four banks are the second, third, fourth and fifth largest companies in Australia in terms of capitalisation. They account for around 85 per cent of all loans in existence with the other 52 banks accounting for the remainder.

- 5.4 Profit levels are very strong and have increased in the last year or so after benefiting from government support. The fact that the government reduces bank shareholder risk would suggest that earnings should be closer to say 10 per cent return on equity rather than the 15 to 20 per cent currently being achieved.
- 5.5 The ease with which the banks seem to raise their rates above official rate rises supports other arguments that suggest Australia has inadequate competition in the banking industry. Oligopoly has led to market failure and the need for reform.
- 5.6 Before the global financial crisis an active securitisation market allowed all lenders to obtain funds based on the quality of their assets. The collapse of the market for residential mortgage-backed securities meant the ability of many small lenders to compete also collapsed. The Government attempted to inject competition into the mortgage market by investing \$16 billion in triple-rated RMBS but support in favour of the banks at the expense of the securities market means that competition is inadequate.

6 MASTER BUILDERS' RECOMMENDATIONS

- 6.1 Master Builders recommends that the Productivity Commission conduct an independent inquiry into the banking system to improve competition within the Australian banking system.
- 6.2 Master Builders recommends that the Reserve Bank of Australia be asked to produce regular reports on bank net interest margins, return on equity and profitability, and small business lending conditions.
- 6.3 Master Builders believes that the Treasury and the Reserve Bank of Australia should investigate ways to further improve the liquidity of the residential and commercial mortgage backed securities. The Australian Office of Financial Management (AOFM) has purchased around one quarter of the residential mortgage- backed securities (RMBS) issuance in 2010 to September. While conditions in the securitisation market have improved, conditions remain challenging, with the market spreads on AAA-rated RMBS tranches at around 140 bps above bank bill rates. According to bank sources, an increase in AOFM's holding of RMBS will reduce market spreads.
- 6.4 Master Builders recommends that the Australian Prudential Regulation Authority (APRA) should explore whether the risk-weightings on business loans secured by residential properties are punitive. Currently, APRA requires the banks to apply a risk weighting of 50-70 per cent for small business whereas regional banks have to apply a risk weighting of 100 per cent for small business.
- 6.5 Master Builders recommends that government extend guarantees to small business loans. Most OECD countries have small business loan guarantee programs, with the exception of Australia and New Zealand.
- 6.6 Master Builders proposes that the Government should examine whether there are other incentives that might reasonably encourage participation of banks in the Australian market outside the four major banks, especially foreign banks, regional banks and non-bank lenders. Any measures adopted need to be market-based with limited extra regulation.