

**Opening Comments to House of Representatives Standing
Committee on Economics
Inquiry into Competition in the Banking and Non-Banking Sectors
Sydney – 14 August 2008**

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Mr Thomson, other members of the Committee, thank you for the opportunity to appear here today.

We have provided a written submission to the Committee which looks at various aspects of competition in the financial sector. I won't take up the Committee's time by going through that submission in detail, but it might be worth highlighting some of the key points and the conclusion.

One way to analyse the competitiveness of the financial sector is to look for any signs that we would expect to see if the sector was not competitive.

For example:

1. if the overall provision of financing to the economy was inadequate;
2. or if the costs paid by households and businesses for financial services was high by international standards;
3. or if the availability of new financial products in Australia was less than overseas;
4. or if the profitability of financial intermediaries was unreasonably high.

When we look at the evidence in these key areas, we think it is quite reassuring:

- Financial intermediation in Australia has been growing at a fast rate – on average about twice as fast as the growth of nominal GDP. This is among the highest in the developed world. There is no suggestion therefore that the Australian financial sector has been unable to provide adequate access to finance for households and businesses.

- In the case of interest spreads charged by intermediaries, we find that they have declined substantially over the past 15 years, and as far as we can tell are in line with international norms.
- In the case of financial innovation, we have seen a marked increase in the availability of financial products over the past 15 years, and the range of products compares favourably with the experience overseas.
- When we look at bank profitability, we find that Australian banks are around the top of the international range. On the surface, this could indicate a lesser degree of competition than elsewhere. But when we look a bit deeper it seems that an important reason for the high profitability of Australian banks is their unusually low bad debt experience. Over the past decade or so, bad debts of Australian banks have been about half the long run average, and also around half the experience of overseas banks. This has been the result of the very strong domestic economy. It is also worth noting that other Australian industries have been very profitable over this period.

If we adjust for the unusually low bad debts of recent years, the profitability of Australian banks falls back to around the middle of the international range.

Overall, when we look at all the evidence, we think it is reasonable to conclude that the Australian financial sector is competitive, and that its performance measures up quite well across a range of international benchmarks.

Some commentators have recently been concerned that the financial turmoil of the past year has lessened the degree of competition. This is because the turmoil has made it harder for lenders who fund themselves in capital markets to compete. Some have argued that this requires some type of government intervention in the market, such as setting up a government guaranteed securitisation vehicle.

While it is true that lenders relying on securitisation have lost market share in recent months, it has always been the case that some phases of the economic cycle favour some forms of financing more than others. Securitisation had been strongly favoured over the previous five years of very low global interest rates; now it is at a disadvantage.

Our view of recent events is that they are cyclical in nature rather than a permanent change to the structure of the market, in the sense that when market conditions settle, securitisation will pick up again. As such, it would be premature at this stage to embark on proposals such as the setting up of new government bodies to support certain forms of financial activity.

The best way for the Government to promote a competitive financial sector in the long run is to ensure:

- first, that regulations do not unreasonably impede new entrants (since history shows that it is new entrants that drive competitive behaviour);
- second, that users of financial services have good access to information about the range and cost of services available. It is also important that this information be in a form that is easy to understand; and
- third, that switching between service providers be as costless and easy as possible.

I will end my opening remarks here, and Phil and I would be very pleased to answer any questions you may have.

Thank you.