



*The following is an unedited version of the contributed editorial opinion by Philip Chronican, CEO ANZ Australia published in the Sydney Morning Herald, 23 April 2012.*

## **Integrity and transparency on bank funding costs**

ANZ's decision to set variable interest rates for mortgage and small business lending on a monthly basis has sparked a great deal of debate in recent months.

At a time many people are feeling uncertain and worried about the global economy and their future, these views are understandable and they reinforce the significant responsibilities that banks have when making commercial decisions.

While nothing is likely to remove the anger many people feel about decisions on interest rates, banks like ANZ are serious-minded institutions and they make decisions based on a strong factual basis. While some challenge this, it is not possible to be in business for 177 years, serve eight million customers and provide almost \$600 billion in lending if you are not.

In recent days, questions have been raised over whether ANZ could justify the increase in mortgage and small business lending rates of 6 basis points (0.06 per cent) that it announced on 13 April.

First, it is useful to point out that following ANZ's earlier decision in February to increase interest rates by 6 basis points other Australian banks increased their interest rates by between 9 and 15 basis points. ANZ's cumulative increase of 12 basis points has meant that although it has increased rates more slowly, its mortgage and small business lending rates remain in line with our competitors.

Although that may be reassuring for customers, it doesn't answer the question as to whether the increase was justified.

Much has been made of comments by the Reserve Bank of Australia on bank funding costs in the minutes of its April monetary policy meeting issued on 17 April. The comments have been used selectively by some to reflect particular perspectives and ANZ's integrity has been called into question.

Banks raise funds to lend to customers from two main sources – from customer deposits and in wholesale markets from domestic and international investors.

In the six month period from 1 October 2011 to 31 March 2012, the average cost of ANZ's \$75 billion stock of term wholesale funding increased every month, except in December 2011 when credit markets froze because of the European sovereign debt crisis and wholesale markets were closed globally.

As less expensive funding (costing on average 72 basis points above the three month bank bill swap rate) matured and was replaced with more expensive funding (on average 165 basis points above) reflecting the current conditions in global markets, ANZ's average cost for term wholesale funding increased by 15 basis points from 116 basis points above the three month bank bill swap rate to 131 basis points.

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We accept that for most people this sounds complex however we believe it is important that we are transparent on these additional costs. The Reserve Bank however highlighted its understanding of the situation on 17 April when it said: "Corporate bond spreads had narrowed further and were now significantly lower than at the beginning of the year, though still higher than in the middle of 2011, particularly for banks."

While much is made of wholesale funding, the primary source of lending is customer deposits. In announcing the outcome of our monthly interest rate review in April, ANZ stated that: "Increased competition for deposits, particularly term deposits, is currently the most significant driver of rising funding costs."

In the six months since 1 October 2011, the difference between the Reserve Bank's overnight cash rate and the average amount that ANZ pays to depositors has also risen, up 28 basis points from 0.41 per cent to 0.69 per cent above the cash rate.

This was also highlighted by the Reserve Bank on 17 April: "As a consequence of banks competing aggressively for term deposits, their cost had risen materially relative to the cash rate."

The bottom line is that, taking into account ANZ's funding mix of deposits and short and long term wholesale funding, our funding costs are up 18 basis points over the past six months while ANZ's variable interest rates have risen by 12 basis points.

When ANZ moved to set interest rates on a monthly basis last year, we promised to be more transparent about bank funding costs with a view to increasing understanding about the commercial situation we faced. We did this as an institution that is serious about its responsibility to balance shareholder needs against those of customers, the need to support continued growth in the economy and the wider interests of the community.

We accept the decisions we make in an environment where funding costs are rising are not popular or easy, and in an uncertain economic environment many people have strong views about these decisions. It is however difficult to have an informed public debate about these issues when people of influence in the community are not aware of key facts or are willing to misrepresent them.

ANZ does make decisions with integrity and using a sound base of facts which we will continue to share with our customers and with interested stakeholders including at our forthcoming half year financial results which will be announced on 2 May.