

Explaining the Implicit Subsidy Calculation Regarding Australia's Major Banks

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Introduction

The following is an explanation of **Macroeconomics'** estimation of the implicit subsidy that benefits Too-Big-To-Fail (TBTF) financial institutions in Australia, i.e. the Four Major Banks. This analysis was requested by the **Customer Owned Banking Association (COBA)** as part of COBA's second-round submission of the Financial System Inquiry.

The Task

Macroeconomics was tasked by **COBA** with estimating the TBTF subsidy in the Australian context using the IMF methodology as set out in Chapter 3 of the International Monetary Fund (IMF)'s Global Stability Report released in April 2014. While the IMF has suggested using three methodologies, we chose one methodology based on linking credit ratings to each banks' actual cost of capital. This we judged to be the most straightforward and easily reproduced of the IMF methodologies. There were also established international estimates based on the credit rating approach which we were able to draw upon in our work.

Summary of Results

Macroeconomics has estimated that the subsidy benefitting the major banks from their TBTF status at an average annual value of between **\$2.9 and \$4.5 billion**. This is set out in the table below based on the orthodox application of the IMF methodology to Australia's TBTF banks.

Table 1 : Summary of Implicit Subsidy Calculation

Institution	Uninsured Liabilities	Credit Rating Discount			Implied Subsidy		
	\$ billion	bps			\$ billion		
		Low	Average	High	Low	Average	High
ANZ	\$311	22 bps	28 bps	34 bps	\$0.7	\$0.9	\$1.1
CBA	\$340	22 bps	28 bps	34 bps	\$0.7	\$0.9	\$1.1
NAB	\$348	22 bps	28 bps	34 bps	\$0.8	\$1.0	\$1.2
WBC	\$340	22 bps	28 bps	34 bps	\$0.7	\$0.9	\$1.1
Total	\$1,339				\$2.9	\$3.7	\$4.5

Sources: Macroeconomics, APRA, Annual Reports (2013), IMF 2014, Moodys 2014 and Soussa 2000.

Calculation and Key Assumptions

The implicit subsidy calculation applies a credit rating uplift factor to the stock of major bank liabilities benefitting from the TBTF status (total stock of uninsured liabilities).

Calculating the credit rating uplift: Credit rating agencies apply a two notch uplift to the major banks based on 'policy' factors. We then estimated the funding advantage gained by the major banks from this advantaged position by estimating the average margin derived in three international studies / datasets (namely, IMF 2014, Moodys 2014 and Soussa 2000) and by calculating the margin using 2014 Australian financial data. We estimated that the TBTF guarantee provides a **22-34 basis points** cost of funding advantage, on average, to the major banks.

Calculating the stock of uninsured liabilities: For the purposes of this study we use the total stock of deposits, bonds and notes on issue as reported by the major banks in their 2013 annual reports. However, we have removed from the liability base liabilities which already enjoy a government guarantee, i.e. liabilities covered by the Financial Claims Scheme (FCS) of the Australian Government. The FCS currently covers around \$600 billion in deposits held by the Major Banks.

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ATTACHMENT : DETAILED TABLES

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Table 2 : Liabilities of Major Banks

\$ million	Total selected liabilities (1+2-3)	1. Bonds and notes	2. Deposits and other borrowings	3. Financial Claim Scheme Deposits
ANZ	\$310,915	\$359,013	\$56,968	\$105,066
CBA	\$339,571	\$115,291	\$425,276	\$200,996
NAB	\$348,446	\$103,970	\$347,829	\$103,353
WBC	\$340,167	\$121,555	\$380,208	\$161,596
Total	\$1,339,098			

Source: 2013 Annual Reports.

Table 3 : Financial Claim Scheme Deposits

\$ million	Total Deposits
Total guaranteed deposits	\$722,800
Market share of deposits held by Big Four banks	79%
Total deposits held by Big Four banks	\$571,012
	Portion of total deposits from households
Australia and New Zealand Banking Group Limited	18%
Commonwealth Bank of Australia	35%
National Australia Bank Limited	18%
Westpac Banking Corporation	28%
	Implied guaranteed household deposits
Australia and New Zealand Banking Group Limited	\$105,066
Commonwealth Bank of Australia	\$200,996
National Australia Bank Limited	\$103,353
Westpac Banking Corporation	\$161,596

Source: <http://www.apra.gov.au/adi/Publications/Pages/monthly-banking-statistics> for June 2014.

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Table 4 : Credit Ratings of Major Banks

	Standard & Poors		Moody's		Fitch	
	Final Rating	Support Upgrade	Final Rating	Support Upgrade	Final Rating	Support Upgrade
ANZ	AA-	2 notches	AA2	2 notches	AA-	None
CBA	AA-	2 notches	AA2	2 notches	AA-	None
NAB	AA-	2 notches	AA2	2 notches	AA-	None
WBC	AA-	2 notches	AA2	2 notches	AA-	None
Macquarie	A	2 notches	A2	2 notches	A	None
Suncorp Metway	A+	1 notch	A1	1 notch	A+	None
Bendigo & Adelaide	A-	1 notch	A2	1 notch	A-	None

Source: Credit Rating Agencies as at 20 August 2014.

Table 5 : Implied Credit Margins

Country	IMF		Macroeconomics		Soussa		Moody's		Average	
	2012-2013		2014		1920-1999		2014			
	Advanced Economies		Australia		Fifteen OECD Countries		United States			
	Low	Upper	Low	Upper	Low	Upper	Low	Upper		
ANZ	29	32	20	44	21	28	19	32	22	34
CBA	29	32	19	44	21	28	19	32	22	34
NAB	29	32	21	44	21	28	19	32	22	34
WBC	29	32	19	44	21	28	19	32	22	34

Source: IMF 2014, Bloomberg L.P., Soussa 2000 and Moody's.