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Media Release

Corporate forward borrowing intentions fall to new low

(19 September 2006 – Australia) The 12 month forward borrowing intentions of Australia's Top 500 Corporates fell to new lows despite apparent confidence in the prospects for global economic growth, the latest banking survey by JPMorgan and East & Partners has revealed.

The joint report by JPMorgan and East & Partners, titled Australian Corporate, Commercial and SME Banking Survey (Vol 10: September 2006), surveyed over 2,770 Australian businesses including Top 500 Corporates, Commercial enterprises, and Small to Medium Sized enterprises (SMEs).

"The major feature of this survey continues to be the relentless diverging trend between increasingly cautious Top 500 Corporates and increasingly confident SMEs and Commercial enterprises," said Brian Johnson, banking analyst at JPMorgan.

The continuing weakness in Top 500 Corporate confidence and the negative impact on their 12 month forward borrowing intentions likely reflects:

- Continuing strong profitability and operating cash flows, thus reducing the requirement for incremental debt funding
- The adverse impact of the continuing strength of the A$ with Top 500 Corporate net exporters
- Concerns over the high price of oil, rising interest rates, rising commodity input prices, and rising unit labour prices
- Concerns over the sluggish performance of the NSW economy which is being masked at the national level by the surging resource driven WA economy
- Continued concerns regarding the "over-reliance" of the Australian economy on the strength of the domestic housing market

"Since surveying Top 500 Corporates in July 2006, the underlying market sentiment has likely deteriorated slightly given a sharp 16 percent decline in the August 2006 Consumer Confidence Index following the 25bp hike in the official cash rate to six percent on 2 August," said Mr Johnson.

"The extent of the collapse in the forward borrowing intention reading for Top 500 Corporates from 34.2 percent in November 2002 to 8.9 percent in July 2006 is of major concern and does not bode well for a rebound in Top 500 Corporate loan volume growth into CY2007.

"However, 12.5 percent of Corporate respondents who intend to borrow in the next 12 months cited 'acquisitions' as the purpose, suggesting the recent surge in domestic M&A activity will continue." he said.

In contrast, the 12-month forward borrowing intentions of Commercial Enterprises tracked even higher to 82.3 percent and SMEs surged to a staggeringly high 86.9 percent.

"The survey continues to suggest that the greatest growth (and thus potentially where the banks should be focusing their attention) is poised to come from the Commercial and SME segments of the market," said Mr Johnson.

"In the Commercial segment CBA and NAB forward share is rebounding while WBC and ANZ are lagging. SGB has made good progress. Despite some slippage, NAB dominates the intention to borrow measure in the SME segment," he said.

There is some risk of a major uptick in volatility in business lending market shares, particularly in the Commercial and SME segments, with many banks simultaneously moving to hire new Relationship Managers to harness the perceived opportunity to grow market share.

ANZ, WBC, SGB, CBA, Citibank and BankWest have all recently employed, or are attempting to employ, an additional 100 experienced business banking Relationship Managers each, which in conjunction with increased automation of business credit and approval processes could see Commercial/SME market shares increasingly volatile going forward.

"Much of the recruitment of new Relationship Managers is focused on hiring business originators who have been given a mandate to aggressively acquire new customers, in large part to replace the customers that banks are losing to other providers, which is a very expensive strategy," said Paul Dowling, principal analyst at East & Partners.

"Banks seem fixated with market share, particularly in business lending, and are pricing ever more competitively to win and retain customers, but this is a fairly blunt strategy than will only result in short term gains and shallow relationships if they don't provide service to these business customers," he said.

"Corporate and Commercial customers tend to be happier with the service banks are providing them than SMEs, which for all the rhetoric over the past couple of years still feel ignored by banks. This is why the SME segment continues to churn heavily and why a huge number now source their debt through brokers rather than banks," said Mr Dowling.

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