

# Decoupling the OCR

## What does it mean for SME's?

Important steps have been taken over the past couple of months resulting in Australia's major banks isolating their interest rate decisions from that of the Reserve Bank of Australia (RBA).

These changes were initiated in December last year with ANZ boss Mike Smith declaring he would make his decision on rate changes on the second Friday of every month rather than the first Tuesday of every month in step with the RBA. When the RBA this month held the OCR, ANZ stepped out and increased its interest rates, with the other 3 major Australian banks following suit soon after.

### Politics

As retail bank rates are highly political and sensitive, the move signals a new determination among the banks to get back to setting lending rates based on their real costs of funding.

While the RBA has confirmed that funding costs have risen in the last few months, supporting the Banks' reasoning for their rate increases, it has also initiated a detailed review of bank funding costs. Treasurer Wayne Swan meanwhile has not been so understanding in applying his now standard rhetoric around unhappy consumers to look to other lenders for a better deal.

### Just change?

Despite Mr Swan's advice to change banks, it is not quite as simple as that for SME's and Micro Businesses.

Changing banks as a personal customer is tough enough; the barriers to change for smaller businesses, however, are much bigger, throw in a credit relationship and it becomes almost impossible in an environment where 90 percent of business lending is owned by the Big Four providers.

East's market monitoring numbers have evidenced this in a sustained fall in customer churn – switching bank for a majority of this market has ceased for the moment to be a realistic option.

### What happens to SME's

Banks have to be able to continue to attract funding and have been very successful in the Australian market recently in replacing significant volumes of wholesale funding with domestic deposits. SME and Micro businesses have become a critical source of deposits as they continue deleveraging and de-risking their balance sheets.

An environment in which banks have to slow or reduce their lending is not one that would be productive for the Australian economy with enormous flow through effects on employment, productivity and innovation. Smaller businesses need to consider using their net deposit relationships with their banks to secure access to credit if and where they need it.

While businesses do not welcome paying any extra percentage points on their loans, markets are confronting a new norm in the cost of credit intermediation and utilising their deposit relationships to secure access is becoming critical.

#### Exhibit 1

#### Interest Rate Change for SME's in Last Six Months – Loans

	April 2008	April 2009	April 2010	April 2011
Up	33.1	68.8	35.6	23.3
<i>Average % Change</i>	2.4	2.8	2.2	1.9
Down	2.7	—	—	—
<i>Average % Change</i>	0.5	—	—	—
No Change	64.2	31.2	64.4	76.7
TOTAL	100.0	100.0	100.0	100.0