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The Sub-Prime Crisis:

The end of the beginning?

In the face of extreme adversity, Sir Winston Churchill famously said "Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning.' History subsequently proved Churchill to be correct in his stoic assessment of the situation.

However, drawing a line in the sand and deciding where we are in relation to the sub-prime crisis is a source of rich debate; in other words, are we now at the end, the beginning, or the end of the beginning? Experience in the Australian financial markets seems to be the case of two steps forward, one step back; which is occasionally and alarmingly mixed with the opposite step pattern. It seems that just as the 'glass half full' view starts to prevail, and as we embrace a potential point of inflection, another round of 'unforeseen circumstances' muddies the financial sentiment.

The 'flexing' of loan terms is reportedly on the rise, with businesses now poring over their loan contracts' fine print as banks enforce clauses that were inserted to provide margin stability in the event of extreme circumstances. 'Writedowns' and 'Credit loses' seem increasingly the norm, and have become a part of the everyday language for anyone discussing the financial services sector. The sheer scale of losses is almost difficult to comprehend, along with the pace at which these writedowns have occurred.

However, the solid foundations of the Australian economy, helped by the booming resources sector, arguably provide Australia with the resilience and stability required to steer through the choppy financial waters. Indeed, the simple fact that Australian banks have a limited global footprint will probably provide relief from the sub-prime fall-out, a positive outcome that was not envisaged as the Australian banks grappled with their individual international expansion plans.

Whichever side of the fence people currently sit on in terms of their outlook, one thing is certain: the sub-prime crisis is having a tangible effect on the behaviour of business banks in Australia. The bottom line here is that the cost of funding is now more expensive for business bank customers.

In East & Partners' latest Institutional Banking report, the percentage of the Top 500 companies experiencing an increase in their loan interest rate has risen from just 5.4 percent in October last year to an extraordinary 25.5 percent in April 2008.

Similarly, the share of businesses in the Corporate segment (those with annual turnover between A$20 and 340 million) which report an increase in their lending rates has grown almost three times from January to July this year.

During these timeframes, businesses in the Institutional and Corporate segments have experienced lending rate increases averaging 2.2 percent and 5.4 percent respectively.

It does appear that the turbulent times are set to continue, though Australian banks are better placed than their peers from around the globe to meet the challenges presented by the sub-prime crisis. However, even with this back-drop, the cost of funding for business customers in Australia will remain on the rise as banks look to adjust their margins to reflect the general strangle on liquidity.

In these uncertain times, it may be best to simply turn to more wisdom from Winston Churchill "For myself I am an optimist – it does not seem to be much use being anything else."

Institutional and Corporate Businesses Experiencing Loan Rate Increases