Bank Bashing in Australia and China

The differences and the similarities

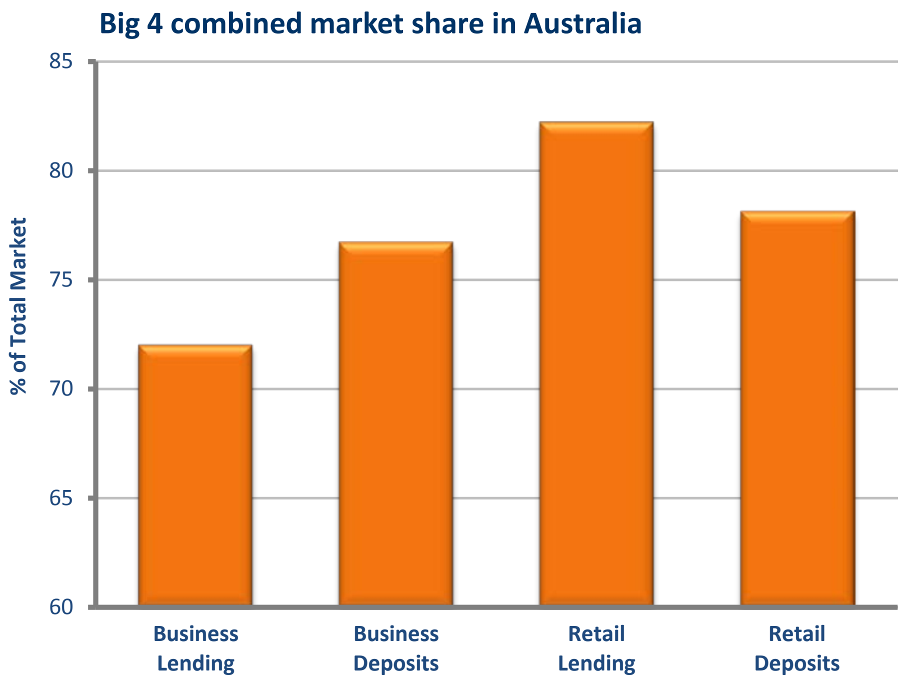
China's Premier Wen Jiabao said in April that Chinese banks make money "far too easily" when other sectors suffer and the big-four bank monopoly should be broken up. In Australia, the attacks on rising bank interest rates outside of the Reserve Bank cycle has led to a phoney war between the four major banks and the Treasury. Is it a coincidence that banks in two of the world's better-performing economies are under government scrutiny?

In both countries, the big-four are accused of behaving like cartels: The failure to lend to Small and Medium-sized Enterprises (SMEs) is causing angst in Canberra and Beijing alike. Fears about the bursting of property bubbles as house prices in both countries are at record highs are also similar themes.

But there the similarities seem to end. Under a free market economy, Australia's four bank majors, which have a combined market capitalisation of $260 billion and account for almost 87 per cent of the home loan market, have a funding advantage derived from scale and reach. They can offer more competitive deposit rates and tap the capital markets at lower cost than smaller rivals. The introduction of financing innovations such as structured capital and covered bonds, markets that are only opened to larger players, create a virtuous funding circle that continues to build scale.

In China, the big banks have inadvertently benefited from a regulatory environment that also has driven scale. Strict regulations on interest rates and new loans have limited the supply of money and credit. With limited supply, the larger banks have dominated. In 2011, net earnings of Chinese commercial banks jumped 36.3 percent and returns of equity topped 20 percent. (By comparison, Australia's Big Four posted a 12.8 percent increase in net profit with returns of equity reaching about 15 percent). However as the Chinese banks massively improved their profitability, their market share has fallen. In 1998, the big four, then government-owned, accounted for 71.8 percent of loans, but this dropped to 43.2 percent in 2011.

Loss-making SMEs in need of capital were driven to weaker private lenders, which led to the proliferation of a common but illegal practice in China known as shadow banking. These underground lending and investing networks caused a scandal last year in Wenzhou, south-eastern China, where a 28-year-old farmer's daughter was put on trial for raising $55.7 million from the public with promises to pay back high interest rates. The case led to the near-collapse of the local underground banking system, an important source of funding for private companies and a major contributor to economic growth.



According to a Global Finance survey, Australia's Big Four ranked among the world's safest with NAB and CBA tying for 12th place. While none of the Chinese banks were in the top 20, the sector's problems of non-performing loans and inefficiencies may be over-stated.

Bank bashing in the U.S., UK and other Eurozone markets continues in earnest as a recrimination from failure, so why, on the back of economic success, is it so popular in Australia and China?