Easy credit no more: how shocks from Australian banks' inquiry may squeeze a nation

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By Jonathan Barrett and Tom Westbrook

SYDNEY (Reuters) - Australia's biggest banks are imposing stricter lending conditions on borrowers as damaging disclosures at an inquiry into financial-sector misconduct prompt fears the economy will be the victim of a new era of subdued credit growth.

Australia and New Zealand Banking Group last week said that in the wake of the Royal Commission, which has uncovered wide-spread examples of careless and at times fraudulent lending practices, it would likely be harder for customers to borrow money.

And National Australia Bank said net interest margins on its all-important mortgage book were falling; while Westpac Banking Corp told Reuters it had recently increased scrutiny of borrowers' living expenses, including asking them to disclose such items as gym memberships and pet insurance, when making loan assessments.

The inquiry has come at a time when there was already a push for increased controls on lending and new capital requirements. Those had helped spark a wave of divestments of cash-intensive wealth management, insurance and financial planning arms.

Borrowers have begun to feel the squeeze, according to Sydney real estate agent Peter Wong, as banks dig through credit histories and ask borrowers for bigger deposits.

"The residential sector has become very, very cautious and so, obviously, they're making sure that they dot their i's and cross their t's, and before it wasn't like that," said Wong, who runs an agency in inner-city Chinatown.

"I've got property on the market and I've had it on for over three months whereas previously, being a popular area, people would buy fairly quickly."

Australia has an oligopoly banking system - Commonwealth Bank of Australia sits alongside Westpac, NAB and ANZ making up the so-called "Big Four" - which collectively dominate property, investment and business lending, giving Australians limited options when seeking credit.

The banks withstood the financial crisis, and found ways to increase revenues and profits even during times when regulations were ratcheted up, such as a 2012-13 crackdown on investment and insurance product-selling practices.

But the first few months of the Royal Commission inquiry are creating more than just a reputational hazard, with the practices, structures and market dominance of the banks subjected to unprecedented scrutiny.

New regulatory controls are almost certain to be imposed, as examples of fraud and poor lending controls are revealed.

It all means that banks will not only find their ability to make money from lending squeezed, but they also face increased costs - especially as they hire more lawyers and compliance officers to cope with the immediate problems brought up by the Commission and to deal with tougher regulation in the future.

"You don't have to be Einstein to work out that credit growth slows down, do you?" said Brian Johnson, banks analyst at brokerage CLSA.

ANZ Chief Executive Shayne Elliott told analysts last week that lending conditions had changed. "(The) Royal Commission impact is real, people will still want to buy and own a home...but it will change the process and it probably will make it harder for people to be successful in their applications," he said.

ANZ did not respond to Reuters' questions sent on Friday. Westpac referred to the increased scrutiny of borrowers' expenses, while NAB directed Reuters to previous remarks.

NAB introduced stricter conditions for mortgage borrowers in February and lowered the sums it was prepared to lend, helping push its mortgage margins four basis points lower to 1.34 percent.

CBA directed Reuters to previous statements, which show the bank has been tightening its mortgage lending rules since 2015. It was also ordered last week to hold an extra A$1 billion ($753 million) in capital against its loans after Australia's banking regulator delivered a scathing report into the bank's risk-management culture amid allegations it has allowed money laundering to flourish.

"If credit slows down and margins don't improve, and I don't really see margins improving here...profits definitely do take a hit," said Omkar Joshi, portfolio manager at Regal Funds Management, which owns bank shares.

HONEY, I SHRUNK THE BANKS

The banks are core to the health of the Australian economy.

Australia's authorised deposit-taking institutions - a financial subsector the "Big Four" dominate - hold A$4.6 trillion in assets, according to papers filed by the Royal Commission, more than two-and-a-half times the size of Australia's economy as measured by gross domestic product.

Official lending statistics, which tend to be volatile, show personal and commercial lending has slipped 1.5 percent on a seasonally adjusted basis since December. Home prices, as measured across the capital cities of the nation's states and territories, fell 0.1 percent in April from a year earlier, the first negative reading since 2012, according to property consultant CoreLogic.

"You need to be careful there isn't an over-reaction because a bank can make or break an economy," said Anne Nalder, head of the Small Business Association of Australia.

She said any obstruction to obtaining credit had an immediate impact on business expenditure and hiring decisions, in an economy, especially as wages growth is modest.

REGULATOR-IMPOSED PANGS

To be sure, Australia's banks are not in the kind of trouble that led to rescues and emergency injections of cash in Europe and the United States during the financial crisis.

But the increased regulation and scrutiny will be a financial burden and the Australian banks have few defenders given the shocking nature of the revelations.

There have, for example, been disclosures that CBA charged the accounts of customers after they had died, while falsified mortgage documents were used at NAB to help people collect bonuses and beat sales targets. Even Australia's conservative government - which had resisted for years the calls for a Royal Commission - is now an active critic of their practices.

While borrowers and businesses fret over credit, there is at least one industry benefiting from the banks' day of judgment.

ANZ estimates it will incur about A$50 million in legal costs linked to the Royal Commission over a 12-month period. CBA has booked a combined A$575 million in charges and provisions in preparation for legal fees, remediation and potential penalties tied to the inquiry and, on another legal front, civil charges linked to a money-laundering case.

There is a huge demand for lawyers with relevant experience, said Jason Johnson, managing partner at Sydney-based Johnson, an executive search firm. "Major law firms, those that participate in the financial and regulation space, are having an absolute purple patch," he said.

($1 = 1.3282 Australian dollars)

(Reporting by Jonathan Barrett and Tom Westbrook in SYDNEY; Additional reporting by Paulina Duran; Editing by Martin Howell)

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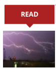
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