Aussie Banks Seen Set to Dodge Debt Cost Pain After Moody's (2)

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By Ruth Liew

(Bloomberg) -- Australia's four biggest banks will likely escape having to pay more to borrow from bond investors despite Moody's Investors Service slashing their credit scores.

That's the view of some credit analysts and investors after Westpac Banking Corp., Australia & New Zealand Banking Group Ltd., Commonwealth Bank of Australia and National Australia Bank Ltd. were all downgraded to Aa3 from Aa2 Monday. Borrowing costs have fallen this year. The average yield premium of financial industry bonds issued locally over government debt has fallen about 16 basis points to 94 in the past 12 months, according to a Bloomberg AusBond index.

Surging home prices in cities like Sydney along with rising household debt and sluggish wage growth pose a threat to lenders, according to Moody's. But the four banks likely won't have to pay more to issue debt for now, as they remain in the "rare company" of lenders around the world that hold AA level ratings, said Vivek Prabhu, Sydney-based head of fixed income at Perpetual Ltd.

"Any further downgrade would take them into the A rating band and could lead to a more meaningful increase in the cost of wholesale debt funding if this were to occur," he said.

Australian banks are lenders to some of the most indebted people on the planet. The combination of eye-watering house prices and anemic wage growth has pushed the ratio of household debt to disposable income to 189 percent -- one of the highest levels globally. Every basis point paid to borrow counts for the lenders, who source about two-thirds of their funding from deposits and the rest from debt markets from Australia to the U.S.

Australians piling on mortgage debt has been a key concern of Moody's, Frank Mirenzi, a senior analyst, told Bloomberg TV Tuesday. "We just don't know how these mortgages will perform during a real downturn," he said.

Responsible Lending

Moody's decision comes after S&P Global Ratings last month downgraded the credit ratings of almost all of Australia's financial institutions on similar concerns about the risks of a property market downturn. However, it spared the four biggest banks on the expectation of government support in the event of a crisis.

The cost to insure Australian banks' debt rose about 2 basis points following Moody's cut. Still, the downgrade is "unlikely to have a meaningful outcome on pricing given S&P ratings remain the low mark," Westpac credit analysts wrote in a June 20 note. Deutsche Bank credit analysts also said Moody's actions "should not materially impact banks' credit instrument pricing."

Greg Medcraft, chairman of the Australian Securities and Investments Commission, said the corporate regulator has held concerns about the property lending sector "for a while now" as record-low interest rates and booming prices see Australians "getting in over their heads" in debt. Responsible lending practices will remain a key focus for the regulator, he said.

"You've got to think interest rates won't stay where they are forever," he said. "If you can't afford to pay off the principal, maybe you should rent."

--With assistance from Garfield Reynolds.

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