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Property Observer
25 February, 2016

Is Australia set for a credit crunch?
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According to leading economists and market commentators, liquidity has started to tighten in Australian markets in direct response to regulatory changes implemented by Australian Prudential Regulation Authority (APRA) across the banking sector forcing banks to hold more capital.

In addition, global and macro-economic factors are adding to the squeeze on liquidity and the impacts on the domestic property sector are far-reaching.

The writing has been on the wall for some time. In mid-2015 we could see market conditions driven by APRA were leading banks to reducing their appetite for construction and development.

So far in 2016, credit for the property sector has tightened even further, particularly from the banking market. All major banks have reduced funding on a loan to valuation ratio basis and also by limiting exposure to developer and construction clients. Some banks now openly state they will not underwrite to new clients in this sector.

The credit pricing has bottomed out.

The increase of margins is partly a way for the banks to respond to return on equity dilution through the increased capital requirements by APRA and potentially alleviate margin squeeze due to liquidity pricing movements on their balance sheets.

Examining Credit Default Swaps (CDS) shows the major banks experienced a blow out at the beginning of 2016 to levels not seen since 2012. As an example, in January, 2016 the CDS price for NAB credit was below 80 basis points and has spiked at around 136 basis points with a current level of around 125 basis points.

This is the first time since the onset of the GFC where we have seen margin pricing increases in the banking market, on property investment loans as well as development and construction loans. Whilst CDS pricing has been at above these levels post GFC, the banks have not increased margins, but at that time they were not dealing with APRA requirements and pressures on profitability.

This trend is growing and market indicators all point toward further margin increases in the short term and securing finance in the next six to 12 months will be critical as setting finance now will lock in margins at historic lows and avoid any potential credit crunch issues.

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