FSC FINANCIAL SERVICES COUNCIL

Australian capital markets compare well

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The efficiency of the financial system is a key determinant of how quickly an economy grows.

How funds find there way through the economy to meet the needs of business and individuals is affected by the structure of the financial services sector.

This is as important for small and medium sized businesses as it is for large corporates.

Regulatory structures built from the bottom up in response to minor crises or to serve specific micro-economic goals can, over time, develop into a macro-economic system that is not as efficient as a top down approach would provide.

The Financial System Inquiry has rightly identified the impact of Australia's regulatory structure on capital allocation and access to capital for all sized firms as a critical issue for examination.

It is important then to compare Australia's capital markets structure at a macro level to similar markets around the world.

While there have been some comments on the availability of funding for small and large businesses in Australia, there has been little in depth research and analysis.

The Financial Services Council commissioned the Capital Markets Cooperative Research Council to evaluate the effectiveness and efficiency of Australia's capital markets.

Australia's capital market performs well when compared to a global benchmark financial system the United Kingdom, a scale comparable market Canada and a regional comparable market South Korea.

Australia's small corporate bond market is often sited as a negative feature of our economy that constrains access to capital. Howeve,r our research reveals that there appear to be no regulatory or structural impediments to the operation of the corporate bond market in Australia.

When compared to the three markets, Australia's corporate bond market valued at $209 billion is smaller than the UK and Canada, but not substantially so, and it has grown rapidly over the past few years.

The major point of difference is that the corporate bond market in Australia is dominated by financial institutions with non-financial corporations accounting for about a quarter of the total.

However, given the comparative ease with which firms can get access to debt through the finance sector, there does not appear to be a funding gap.

It is reasonable for banks and other lenders to act as efficient intermediaries for debt issuance whilst large businesses can access bonds in other markets if necessary.

Access to funding for small business is also an area where capital markets efficiency is important.

There have been suggestions that Australia's large investment in equities means that small businesses may find it more difficult to fund investment through debt.

However, debt to equity ratios in Australia are actually high relative to other countries for both small medium and large sized companies. And Australia's debt to equity ratio for small businesses is substantially higher than for the UK and Canada.

This indicates that economy wide, there is not a funding gap for businesses of any size.

The impact of superannuation on bank access to capital has also been raised as a distortion in Australia's financial system. Again there has been little analysis or research on this issue.

Large amounts of superannuation assets are re-routed to the banking system.

This occurs through equity and fixed income investments and cash holdings.

The superannuation sector had $215 billion in bank deposits at September 2013.That constitutes 14.2 per cent of the funds in the super system.

The RBA in its FSI submission points out that the level of superannuation funds held as bank deposits is actually above the OECD average for pension funds.

Further, superannuation funds hold over one quarter of bank balance sheet equity.

The argument that superannuation funds deprive Australian banks of capital can therefore be set aside.

As superannuation grows, demand for domestic non-listed equity investment will increase.

This demand is likely to drive the supply of securitised assets thereby providing alternative funding for mortgages.

Superannuation funds have already eclipsed the capitalisation of the domestic exchange.

However, their appetite for further domestic equity investment will not be diminished.

Rather, the enduring demand for equity investment amongst superannuation funds will drive the supply of non-listed equity investments.

As funds find it difficult to meet their goals directly from domestically listed equities, they are likely to move into other products with similar characteristics.

This new supply is likely to be provided by banks and other lenders through securitisation.

In the approach to 2030, Australian banks and other lenders will securitise mortgages and sell the packages to superannuation funds.

The re-emergence of securitisation will provide an alternative source of mortgage funding.

The reputation of securitisation was damaged in the US during the GFC due to poor product design and lax regulation of rating agencies. It is important to note that the securitised mortgage market in Australia did not face the same crisis as in the US.

Australia's $1.7 trillion superannuation system is an effective aggregator and allocator of capital. Its compulsory nature has ensured Australians have saved three times more over the last 22 years than they would have without it.

In turn, the pool of savings has invested back into the Australian economy directly and indirectly.

It is no mere coincidence that Australia's 22 years of uninterrupted economic growth has coincided with the establishment and growth in our superannuation system.

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