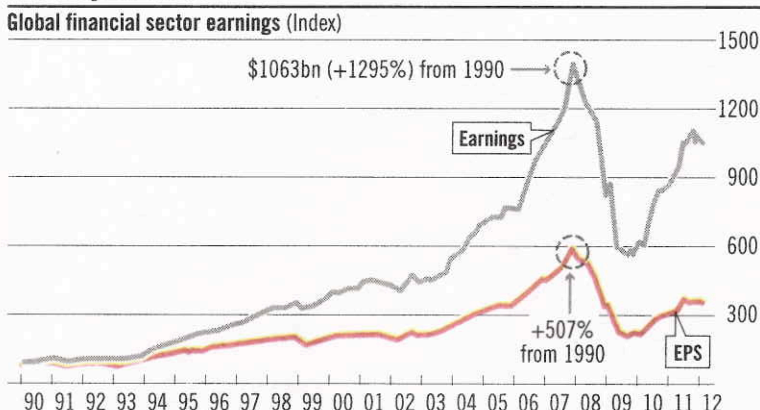
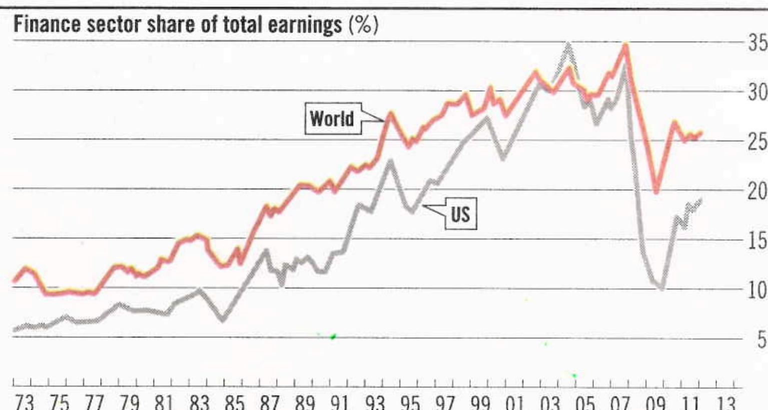
# Can banking take us all down?

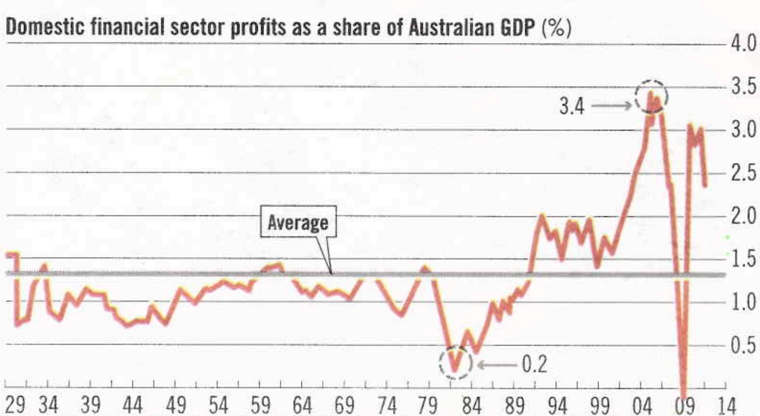
Job losses in the banking and finance industry are startling and continuing. This is steadily depressing the wider economy.

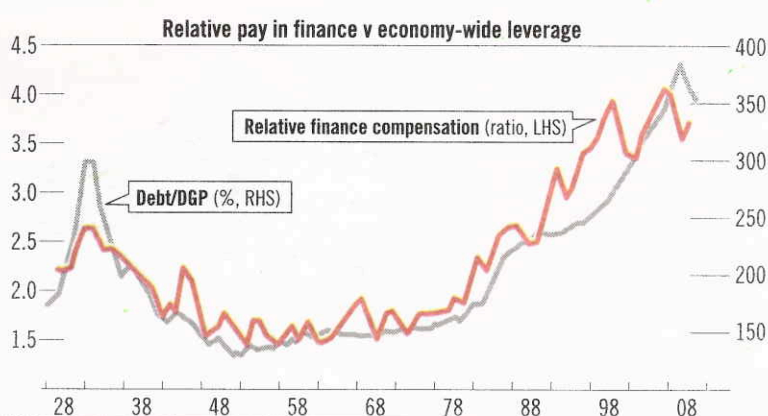
Andrew Cornell

## Money worries




SOURCE: MORGAN STANLEY

"When I was growing up," remembers Gerard Minack, global developed market strategist for Morgan Stanley, "the best suburbs were full of doctors and lawyers and the owners of companies. Now they're full of bankers. That's just not a natural state of affairs."

Residential property prices, at least in particular suburbs and beach retreats, have in the view of many, not just Minack, been supported by a near two decade bull run for the financial services industry. And not just housing. The market in a whole universe of premium goods and services, from luxury cars to European suits, watches, holidays, they've all been buoyed by an industry that thrived on borrowed money.

And now the world is saving, not borrowing.

Minack has recently released two reports on the end of what has been called the financial services' super cycle: *A Great Future Behind It* and *The End of the Big Rise?* It's a crucial story not just for bankers and bank investors but the whole food chain of goods and services favoured by this sector.

"The clearest beneficiary of the credit super-cycle was credit providers," Minack writes. "The finance sector was the single most important contributor to the 20-year earnings boom that started in the early 1990s. It was also a boom for employees in finance. With the credit super cycle now working in reverse, it seems that finance is a sector with a great future behind it."

In the second report he notes: "Australia has been the best-performing developed economy through the past two decades. This stellar performance went hand-in-hand with – and, more importantly, was assisted by – a tremendous increase in domestic leverage, particularly by households . . . The rise in leverage also had sector-specific benefits, notably for housing construction, finance and retail."

Schadenfreude is a powerful human emotion and the simple response for all those who have paid for the bankers' lifestyle – that is, their customers, shareholders and anyone affected by the 2008 financial crisis – might happily sit back and watch the culling at the investment banks, the fire sales of northern beach houses, the cancelling of Porsche orders.

The schadenfreude is global. As the *Financial Times* noted in an editorial this week, many in the West still believe that while bankers caused our problems they are "not sharing them. We suffer privations, they get bonuses". The truth though is that "investment banking, at least, is in a slow-motion train wreck. The fact that some bankers are still in the buffet car squabbling over the last bottles of champagne is a distraction".

The *FT* emphasised the point Minack makes: the good times for banks were built on borrowing, on leverage, and "take that away, and all kinds of things start to unravel".

Just look at the slew of capital market reviews released this week by global monitor Dealogic. For the first quarter of 2012, global syndicated loan volume was down 21 per cent year on year; syndicated loan activity for Europe, Africa and the Middle East was the lowest in 15 years, 23 per cent down year on year; global equity capital market activity was down 24 per cent year on year.

(If the world wasn't basking enough in bankers' misfortune already, a Monash University study for WorkSafe Victoria found workers in the financial services sector – accountants, brokers, insurers and bankers – were a very unhealthy lot, smoking, drinking and getting sick more than others in similar sectors. For those who believe the sector escaped unscathed from the financial crisis, WorkHealth noted that the poor health of workers "may be a result of the long hours worked, especially in the wake of the global financial crisis, higher levels of stress, and the sedentary nature of the work".)

The great ebbing of the tide for financial services is playing out first in the sharemarket. First and foremost, the sector is a play on credit growth in an economy. When that falls, so too do earnings and remuneration.

"Earnings in the finance sector handsomely outpaced non-financial sectors," Minack says in *A Great Future Behind It*. "From 1990 to 2007 non-financial sector earnings increased seven-fold. This meant that finance-sector earnings accounted for an unprecedented share of total listed-sector profits – over one-third of total earnings at the peak."

While the deleveraging impact will not be as pronounced in Australia because the impact of the crisis was not as severe – and the Reserve Bank of Australia leaned against credit growth in the early part of the century – the collateral damage will still be immense because of the weight of the sector in Australia. The total financial services sector represents 35 per cent of the market capitalisation of the ASX Top 200 stocks.

Without high credit system growth, however, the valuations on which that investor relationship has been built are shaky. For example, investment bank Nomura announced recently that "while banks' relatively more defensive earnings and supportive yields are likely to continue to underpin 2012 sector performance, we note that funding pressures and the potential for deterioration in credit quality leaves bank earnings exposed. Based on our revised forecasts, we believe 2012 financial year consensus for bank earnings is about 2 per cent too high".

To the extent the banks are looking to offset lower lending growth it is with productivity improvements that will, inevitably, mean job losses. Indeed, Westpac Banking Corp has been letting the market know it should be judged on the pace of productivity efforts by the decline in staff employed in the last year.

> **Job losses in the commercial and investment banks are into the tens of thousands. This is playing into the property market.**
> Nick Waterworth, Watermark Search International

Already job losses in the commercial and investment banks in Australia are into the tens of thousands. Nick Waterworth, managing partner of specialist financial services and IT search firm Watermark Search International, says the trend is already playing into the property market.

"The sector is looking to reduce costs and it is doing that by hiring less, letting staff go, cutting bonuses – and that is having a snowball effect on confidence," he says.

"There is a lot of nervousness and that is playing out in sectors where salaries are spent, such as property. There is a generation of bankers and those in the professional services sector that supports banking who are now looking for new opportunities – but they have very specialists skills. Some of those bankers in the 40- to 55-year-old bracket will probably not get an executive position at the same level again."

Waterworth hesitates to predict the longer-term outlook for employment in the sector – and he points to how rapidly the employment recession of the early '90s switched when Juan Antonio Samaranch, then president of the International Olympic Committee, famously pronounced in 1993 "and the winner is Siddy".

"But there is no doubt there is a white collar recession, a financial services, stockbroking, professional services, retail recession in place now and it is particularly concentrated in Sydney because that's where the banking and investment banking is," he says.

The major accounting firms, for example, have announced successive waves of retrenchment. KPMG chief executive Geoff Wilson blamed lower volumes of work in financial services and large deals.

And so it ripples through Mosman, the bellwether for bankers' property where sales volumes are slumping back to levels last seen in the wake of the Lehman Brothers collapse. In Sydney last year just one house sold for more than $20 million, bought by a cash-rich buyer from Asia. That was the same number as 2009 when the financial crisis was at its height. Since 2007 the number of houses selling in the $10 million price bracket has been steadily declining, with a mere 24 mansions sold last year compared with 35 in 2007.

That's hardly unexpected, according Christopher Joye, a director of Rismark International and Yellow Brick Road Funds Management and one of Australia's most respected mortgage market analysts. "The financial services industry, which was one of the principal drivers of demand in the dearest suburbs in Australia's non-resources states, has now quite radically altered its future growth expectations," he wrote recently. "I would venture that this new 'air pocket' in housing demand is most relevant to non-resources states, and to homes valued at between, say, $3 million and $10 million."

Bank of America Merrill Lynch economist Saul Eslake forecasts "credit growth is likely to be lower than nominal GDP growth for the foreseeable future [at least five years] which in turn means almost by definition that credit providers will shrink as a share of GDP.

"And assuming that there is some productivity growth in the financial services sector, financial services employment will shrink as a share of total employment – same story as manufacturing for the past 35 years – although whether that means slower growth in remuneration for financial services professionals will depend on how the 'pie' is carved up between employees and shareholders. And perhaps customers as well," he says.

"I think the total value of residential real estate will grow more slowly than nominal GDP [although] I suspect the impact on cars, suits etc will be pretty marginal."

Those sectors though are alert: "The performance of the financial sector has a strong bearing on BMW sales, as do property values," says BMW Group Australia head of corporate communications Piers Scott.

"Immediately after the GFC, the market became particularly challenging, though we continued to lead the premium segment globally and here in Australia. In such instances it is important to give strong consideration to residual values and 'whole-of-life' costs as luxury car purchases need to appeal to both the heart and the head."

It's a warning of the tougher market ahead for all sectors that benefited from an extraordinary bubble in banking profits and bankers' salaries.