Bank tax – A bad idea but good for direct lenders!

The bank tax was a surprise item in this year's federal budget that blindsided market participants. The new tax only applies to the big four commercial banks and Macquarie. It is effectively a 6 basis point levy on bank liabilities including, corporate bonds, commercial paper, certificates of deposit, hybrids and sub-debt. It includes Tier 2 capital, but excludes Tier 1 capital. Bank deposits under $250,000 are excluded from the tax (which is important because then the Government can claim that they are not taxing the interest earnings of ordinary Australians).

The justification from the Government for the tax is that the banks should pay for their implicit 'too big to fail' guarantee from the Government. There is good evidence that the perceived guarantee materially reduces major bank borrowing costs. The ratings agencies include an 'uplift' to bank ratings to reflect this perceived Government support.

The South Australian Government in their budget have replicated the Commonwealth's bank tax. This is an additional 6 basis points on top of the 6 basis point federal bank tax and will be assessed on South Australia's relative share of GDP. There are constitutionality issues being asked in respect of the imposition of the South Australian bank tax, and it is also being opposed by the SA opposition. Should the SA tax become law, and survives the inevitable high court challenge, it will be interesting to see if other states follow suit.

Ultimately, the advent of this new tax, with limited prior consultation, gives rise to uncertainty. With the question being asked "what stops future governments from increasing the rate of the tax in the future?" This uncertainty can flow through to the cost of funding for banks and onto higher bank loan margins for borrowers. Further, the perceived political uncertainly has implications for the willingness of backs to commit to pricing over longer tenors.

Whilst the tax is not necessarily a net positive for the country as a whole, there is some advantage that will flow through to superannuation funds and other non-bank institutional investors who engage in direct lending. These lenders are not subject to the tax and, hence, have an immediate advantage compared to the major banks. This is particularly telling for longer term loans.