Australia
Financial Sector Assessment Program Update

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Global Financial Crisis: When Will It End?

Recent market rally......

...Is this time different?

- Confidence is still fragile
  - Euro area crisis
  - China and EM slowdown
  - US fiscal cliff

Sources: CBO and Fund staff estimates.
# Key Challenges for Banking System

<table>
<thead>
<tr>
<th>US SIBs</th>
<th>European SIBs</th>
<th>Asian SIBs</th>
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<tbody>
<tr>
<td>Regulatory reform may lead to new financial landscape and business model&lt;br&gt;Slow housing market recovery a drag on balance sheet repair</td>
<td>Credit crunch and deleveraging in periphery&lt;br&gt;Liquidity improved, but sovereign-banking linkages remain&lt;br&gt;Capital strengthening and bank restructuring must continue</td>
<td>Profitability flat&lt;br&gt;Rapid loan growth raises asset quality concerns&lt;br&gt;Further large scale deleveraging by European SIBs could fuel funding risk&lt;br&gt;Capital positions remain strong, but confluence of negative headwinds could jeopardize stability.</td>
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IMF Response: The FSAP

- Launched in 1999 after Asia crisis
- Reshaped by the GFC
- Mandatory for 25 countries
FSAPs: Lessons From GFC

More flexible, tailored to country specific circumstances

Coverage of risks is wider

Assessments more robust, candid, and transparent

FSAP Coverage by Region
(As of end-August 2012)

- Africa: 41
- Asia: 23
- Europe: 79
- Middle East: 43
- Western Hem: 43
FSAP Components

Financial Stability
- Stability Assessment
- Stress Testing

Financial Oversight
- Microprudential Oversight
- Macroprudential Oversight: Systemic Risks

Crisis Management
- Crisis Preparedness
- Crisis Resolution
Key Themes from FSAPs

Some countries
- Vulnerable to sovereign risk
- Lack of adequate and high quality data

Many countries
- Non-banking sector poses increasing risk
- Liquidity risk due to wholesale funding
- Legal framework for financial oversight incomplete

Most countries
- Inadequate resolution frameworks and outdated financial safety nets
- Deficiencies in supervisory resources and independence
- Analysis of systemic risk in its infancy
FSAP Recommendations in Asia

China
- Move toward a more commercially oriented financial system
- Strengthen capacity of central bank and supervisory commissions to carry out their responsibilities
- Upgrade framework for crisis management and resolution arrangement, including introducing deposit insurance scheme

India
- Reducing the role of the state in financial sector
- Greater de jure independence of regulatory agencies
- Promote deeper fixed income markets

Japan
- Close monitoring and contingency planning of risks related to JGB market, sovereign funding pressures, regional bank vulnerabilities and credit risk
- Further improvements in regulatory and supervisory regime, including arrangements for cross-border risk monitoring and mechanisms for macroprudential oversight
- Broad-based financial reform plan to stimulate growth
How does Australia fare?
Job Well Done!

- Strong Economic Fundamentals and Policies
- Sound Financial System
- Well-coordinated Response to GFC
- Ample Policy Space for Downside Risks
- Intensive Supervision
Structural risks remain......

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<th>Wholesale and offshore funding</th>
<th>High household debt and house prices</th>
<th>Bank concentration and interconnectedness</th>
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<td>• Declining since GFC</td>
<td>• Low LTV (50%)</td>
<td>• High profits</td>
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<tr>
<td>• Largely hedged</td>
<td>• Large prepayment</td>
<td>• Diversified risks</td>
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<td>• Rising savings</td>
<td>• Implicit government support</td>
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......with some mitigating factors
But pressure to preserve profitability may encourage more risk taking by banks
Australia: Key FSAP Themes

Financial stability
- Continue to improve funding and maturity mix
- Require higher loss absorbency

Microprudential oversight
- Continue to conduct intensive supervision
- Devote more resources to stress testing

Crisis management
- Consider financial sector burden sharing
- Develop recovery and resolution plans