Finance Sector Employment on a Slippery Slope

Despite their consistently good profitability and cost/income ratios which KPMG's annual performance survey indicates are relatively favourable compared to their international peers, the announcements of staff reductions by the major Australian banks should probably not come as a surprise.

Three interrelated factors are driving bank attempts to cut labour costs. While one is perhaps cyclical, the others appear longer term in nature, and the interesting question is whether this will herald a downsizing of financial sector employment and activity as a whole, or a shift in its composition away from banks.

For historical context, total financial sector employment was a relatively constant share of total employment during the "noughties", at around 3.7 per cent. This was despite the ratio of financial institution assets to GDP increasing from 2.5 to 3.5 over the decade and the finance sector's share of value added (GDP) increasing from just under 9 to over 10 per cent.

In the 1990s, the employment share dropped from 4.7 per cent to 3.7 per cent, while assets/GDP increased from 1.7 to 2.5 times and share of value added increased from around 8 to around 9 per cent.

So, over the past decade, a rapidly expanding financial sector has not increased its share of total employment, and in the previous decade financial sector growth saw a declining share of total employment. If technological change has meant that high growth has just sustained sector employment, a slowing of growth seems likely to lead to reduced employment.

Thus, the first factor driving employment cutbacks in banking is the marked decline in banking sector growth rates following the Global Financial Crisis. Credit growth (including securitisation) has fallen from an average of 14.4 per cent p.a. in the four years prior to June 2008 to 2.9 per cent p.a. in the two years to November 2011.

Higher growth on the deposit side of bank balance sheets offset that effect for a while with M3 growth rate averaging 17.8 per cent p.a. in the two years to June 2009, as depositors returned to the major banks during the unsettled times and as banks tried to replace offshore funding with local deposits. But over the two years to November 2011 that growth rate dropped to an average of 7.4 per cent p.a.

Bank operational structures based on anticipation of ongoing high growth rates obviously needed reassessment.

A second factor is regulation. Bank CEOs have pointed to an increased cost burden from recent regulatory changes, and it is hard to dispute that these must involve some increase in costs. But any employment effect is primarily indirect as attempts by banks to pass on those costs reduce customer demand for their financial services. And it seems more likely that the slowdown in credit and monetary growth reflects the effects of economic conditions and uncertainty on customer demand for financial services than increased costs of regulation.

Moreover, any regulatory induced decline in banking may be offset by growth elsewhere in the financial sector, eventually providing employment opportunities elsewhere for bank ex-employees. Even if banks still maintain their share of intermediation, they may find that regulatory changes make it preferable to adopt a production process which relies more on outsourcing some activities. Mortgage broking comes to mind, although offshoring of some other activities will not help newly unemployed bankers.

Ongoing technological innovation is, of course, the third relevant factor. In the late 1980s and early 1990s the major banks, responding to deregulation, advances in technology, and a massive decline in profitability which threatened the survival of some, reduced branches and employment and earned the wrath of the Australian public. Technological advances are again causing a reassessment of labour requirements, with ever increasing growth of internet banking and “apps” which enable customers to interact with their banks on a virtual basis.

But in an environment where banks remain relatively profitable and financial sector pay remains absurdly high, look forward to a resurgence of the “banks are bastards” grumbling, which the banks had worked hard to get rid of over the last decade.

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