

The Australian economy

Presentation to Economics & Politics students
from the
University of Delaware

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Melbourne
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www.anz.com/go/economics

economics@

Welcome to ANZ

- Formed in 1951 through the merger of the Bank of Australasia (founded 1835) and Union Bank of Australia (founded 1837)
 - with antecedents going back to Launceston, Tasmania in 1828
- Australia's 5th largest listed corporation (market capitalization A\$51.8bn or US\$40bn as at 31 Dec 2006)
- Australia's 3rd largest bank (loan assets averaging A\$269bn, US\$200bn) in 2005-06
 - over 3mn personal customers serviced through 781 branches
 - over 200,000 business clients
- The largest bank in New Zealand
 - following the A\$5bn acquisition of the National Bank of New Zealand (from Lloyds TSB) in 2003
- Widespread representation in Asia and the Pacific
 - represented in every East Asian economy (except Brunei, Burma, Laos and North Korea)
 - the largest bank in most Pacific Island states (exc French colonies)
- Net profit after tax of A\$3.7bn (US\$2.75bn) in 2005-06
 - representing 20.1% RoE
 - cost-to-income ratio of 45.6% (down from 65.8% ten years ago)
- 32,257 employees (full-time equivalent)

The Australian and US economies - some similarities and differences

Similarities

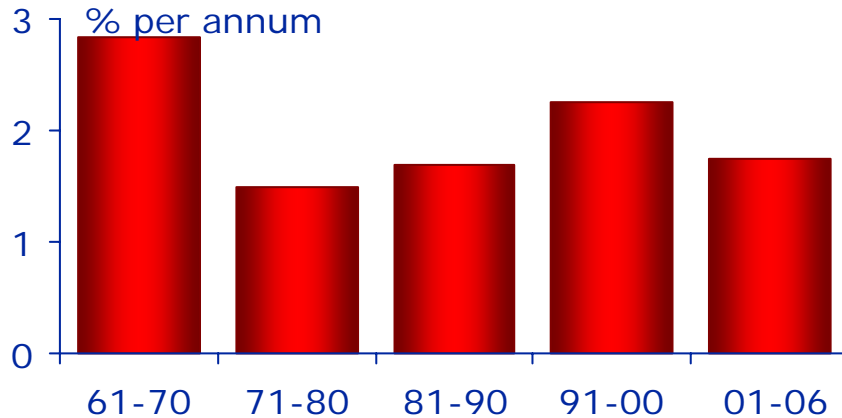
- British common law tradition
- Federal system
- Government accounting for about one-third of GDP (less than in Europe, more than in Asia)
- Over 70% of GDP in services
- High rates of home and motor vehicle ownership
- High rates of urbanization yet strong emotional attachments to rural areas
- Ownership of equity increasingly concentrated in institutional shareholders
- Similar perspectives on world affairs (particularly at present)

Differences

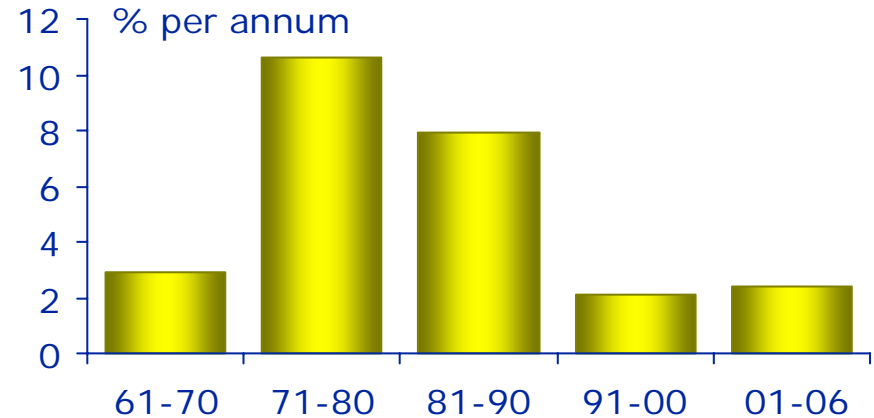
- Scale - Australia less than 7% of US population and GDP
- No separation of executive from legislature
- Complex fiscal relationships between Federal and State governments
- Stronger egalitarian tradition and (historically) greater reliance on State intervention
- Greater dependence on exports (19% of GDP cf. US 11%)
- Banking system much more concentrated and important in financial intermediation
- Different corporate governance structures
- Compulsory private pensions

Australia has attained stronger and more stable growth with lower inflation and unemployment

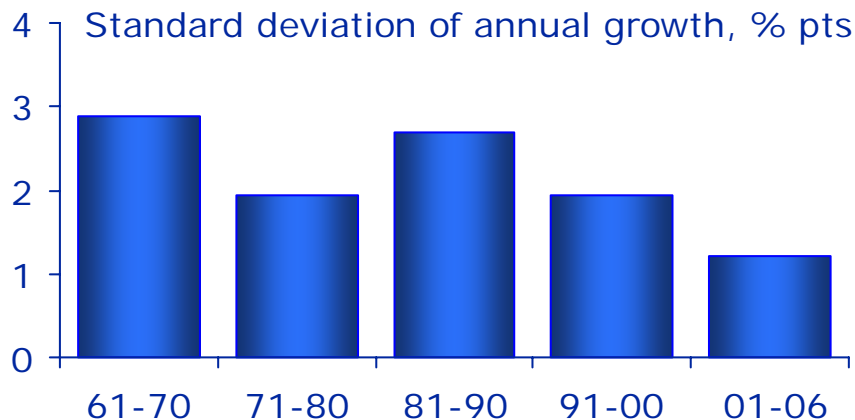
Real per capita GDP growth



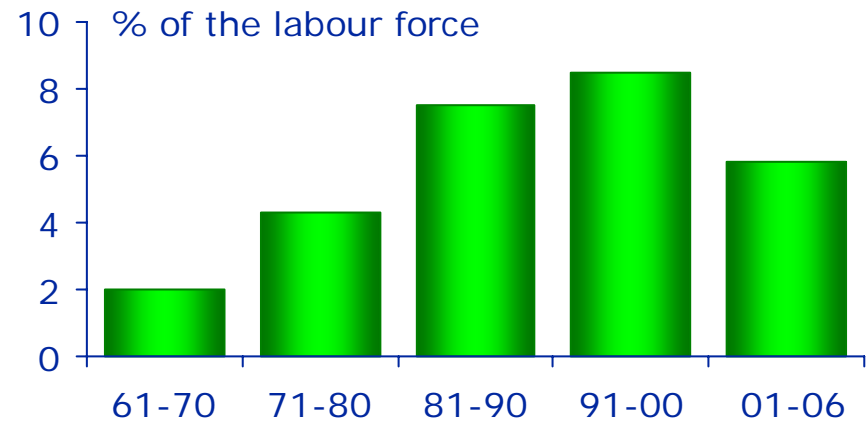
Inflation



Volatility of per capita growth



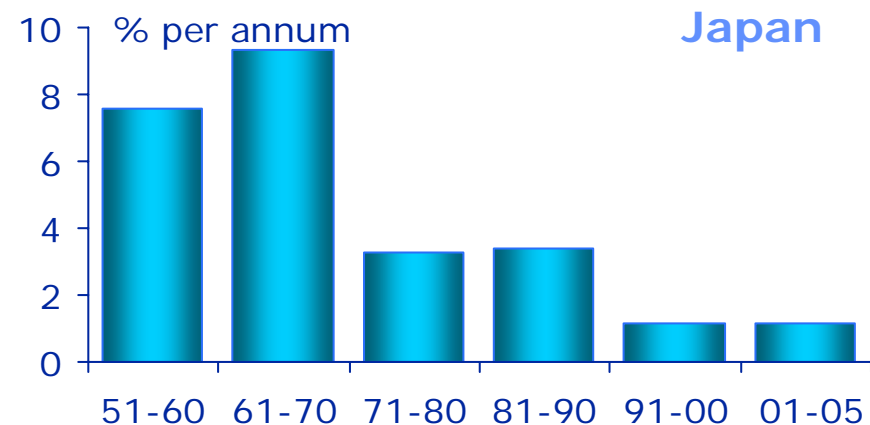
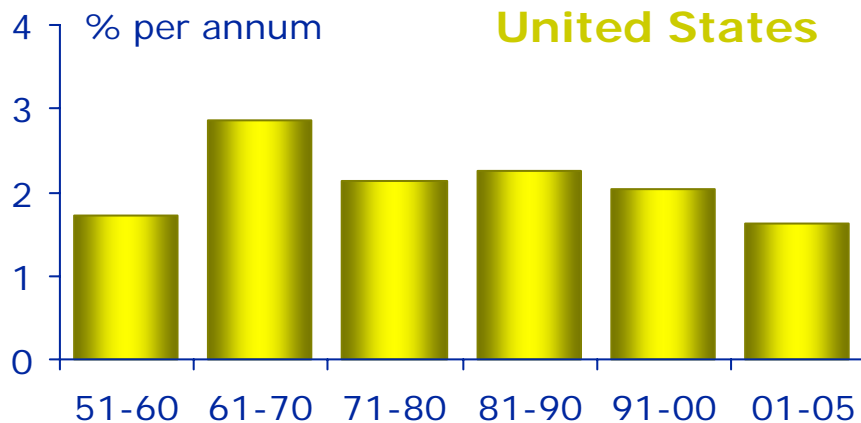
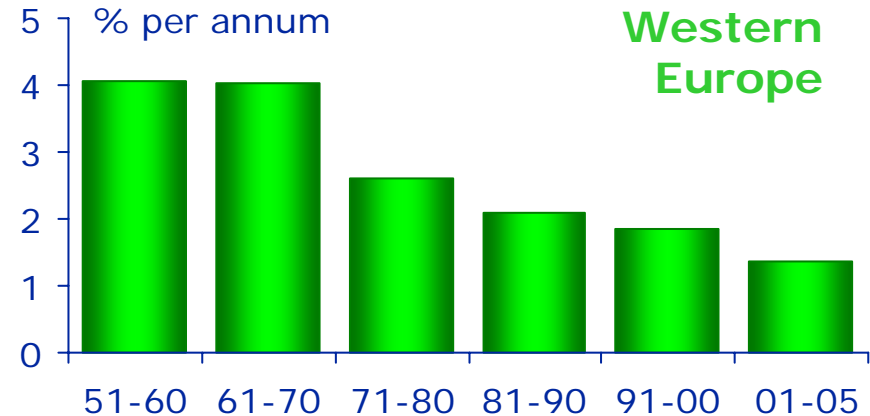
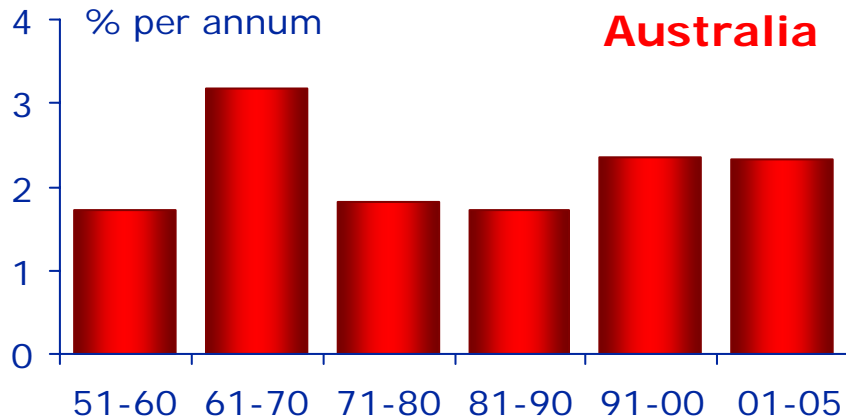
Unemployment



Sources: Australian Bureau of Statistics;
Economics@ANZ.

Australia is one of few Western economies where per capita GDP growth hasn't trended down

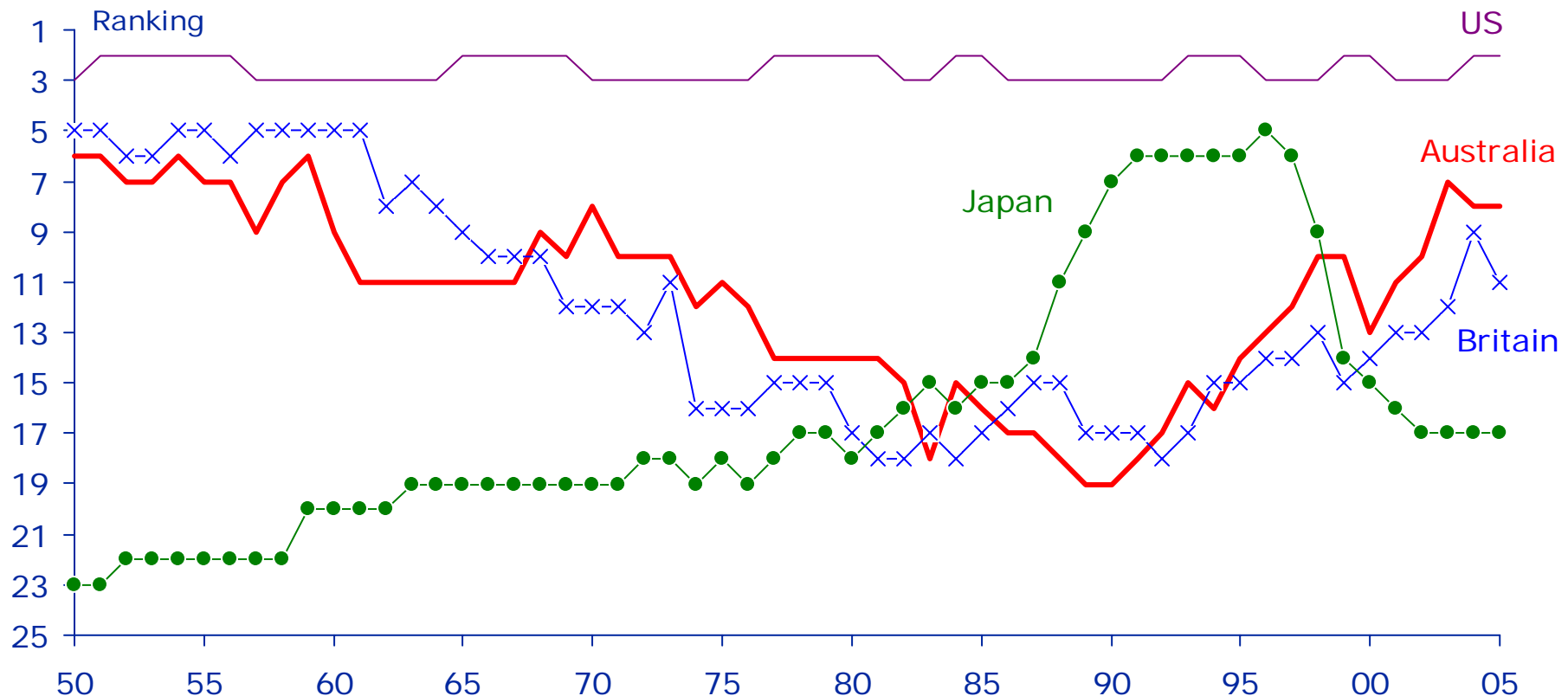
Per capita GDP growth, 1950-2005



Source: University of Groningen and The Conference Board, *GGDC Total Economy Database 2006*; Economics@ANZ.

Sustained growth, reforms and terms of trade gains have lifted Australians' living standards

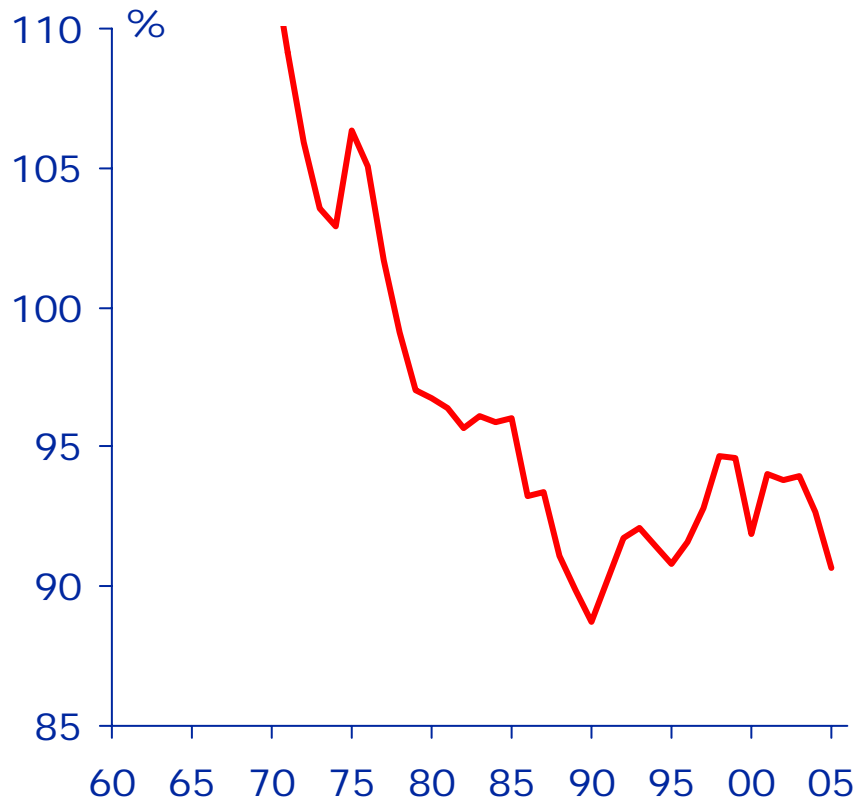
Australia's ranking among OECD countries in terms of GDP per capita



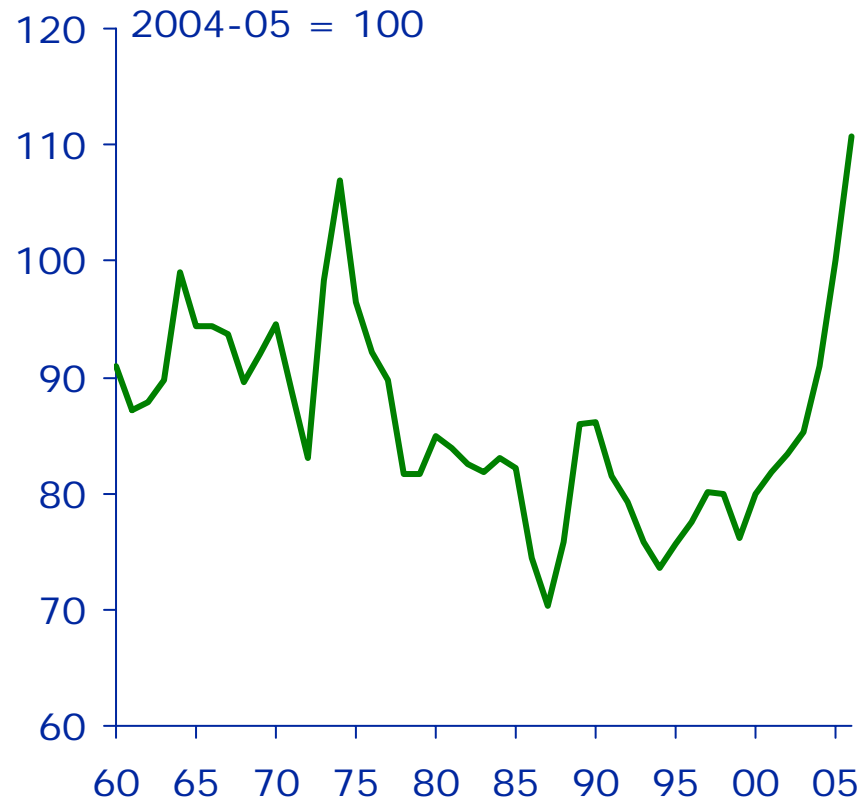
Note: GDP is in 2005 US\$ at PPP exchange rates.
 Source: GGDC Total Economy Database January 2006.

Recent gains in Australian living standards owe more to rising terms of trade than productivity

Labour productivity as
% of OECD average



Ratio of export to import
prices (terms of trade)



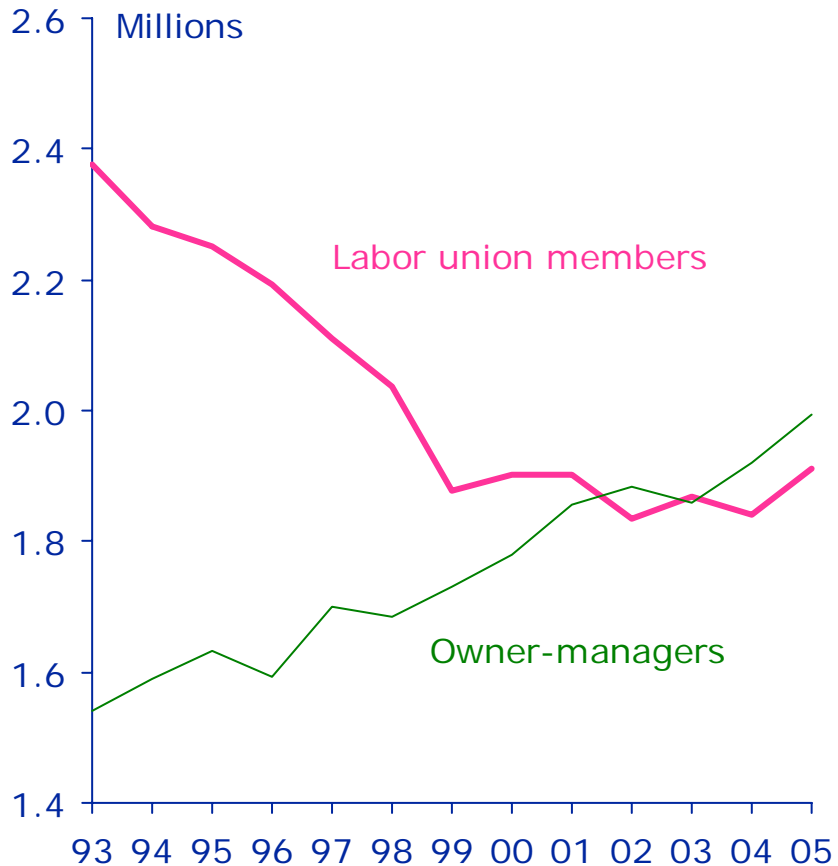
Sources: GGDC Total Economy Database 2006;
Australian Bureau of Statistics.

Australia's economic reform agenda

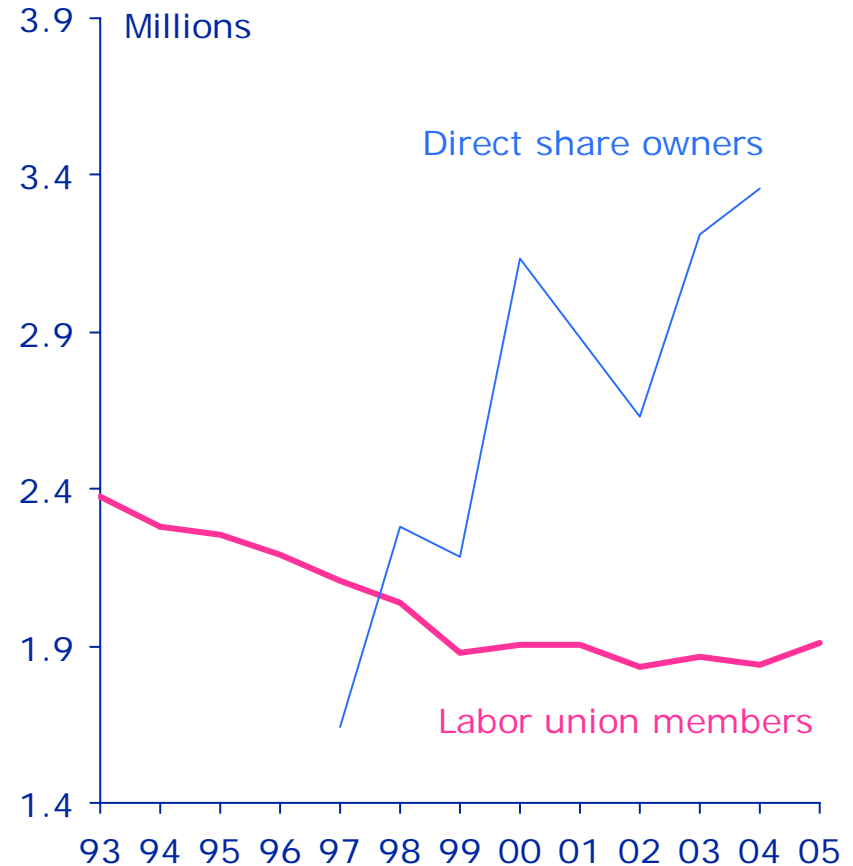
- **Macro-economic stability**
 - control of inflation through establishment of an independent central bank with a flexible inflation target
 - sustainable fiscal policy based on eliminating structural budget deficits and reducing public sector debt
- **Financial deregulation**
 - a relatively clean 'float' of the exchange rate
 - removal of regulatory controls over interest rates
 - enhanced prudential supervision
- **International trade and investment liberalization**
 - reduction in tariffs and other trade barriers
 - removal of (most) restrictions on cross-border investment
- **Indirect and business tax reform**
 - reductions in tax rates combined with broadening of tax base
- **Fostering of competitive domestic markets**
 - deregulation, privatization, removing barriers to market access
- **Labour market deregulation**
 - abandonment of 'centralized wage fixation' and wage indexation
 - gradual trend towards 'enterprise bargaining'
- **Not trying too hard to 'pick winners'**
 - markets, not officials, decide what gets produced, by whom

The changing nature of Australia's labor market encapsulates the spirit of the reform agenda

Union members and owner-managers of businesses



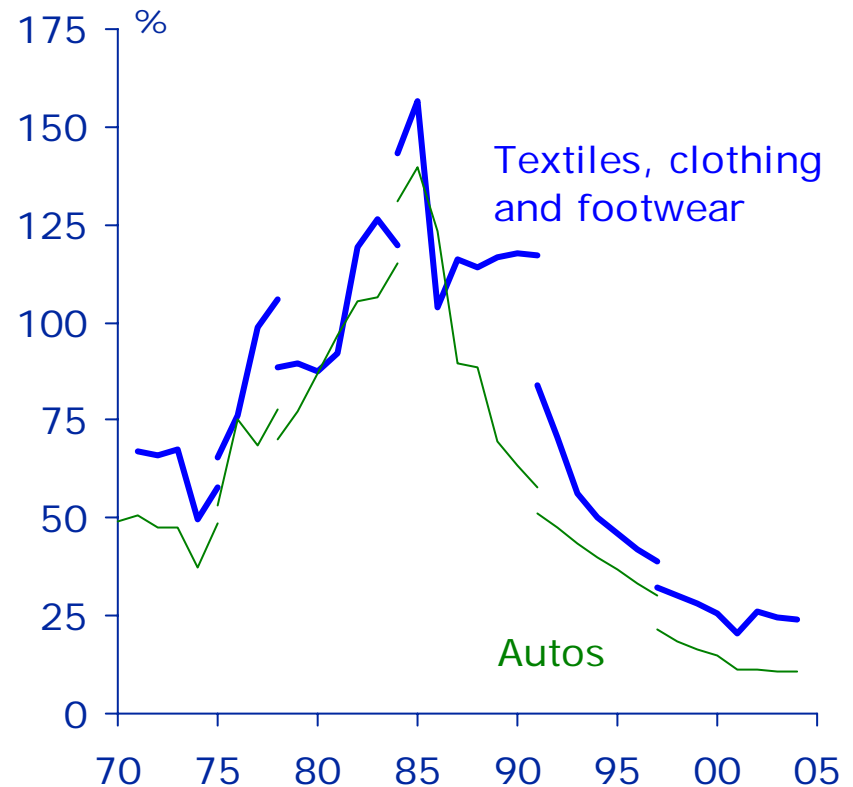
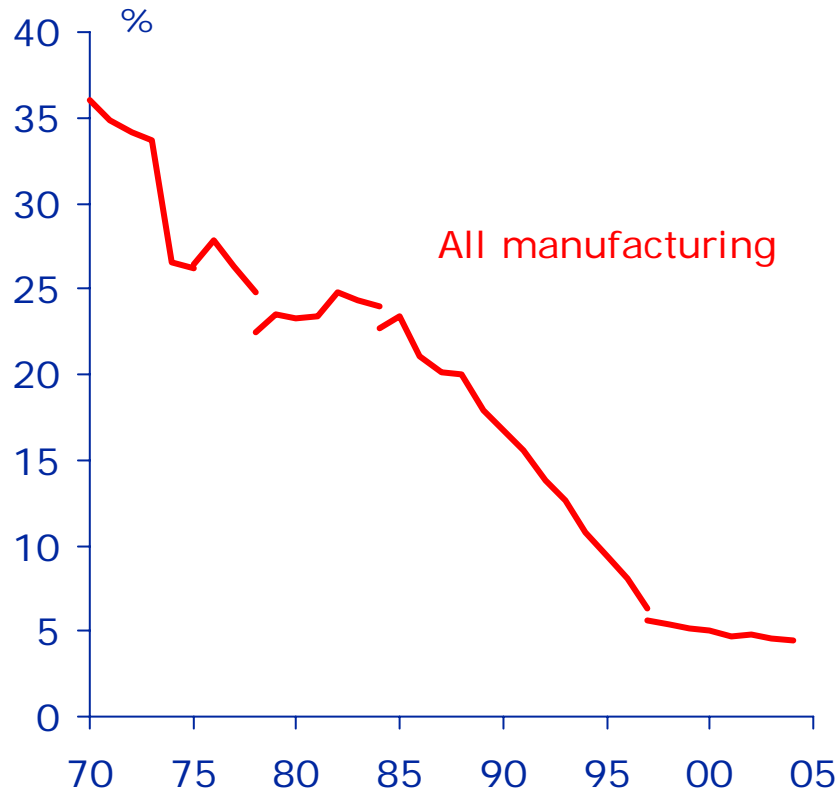
Union members and direct share owners



Sources: ABS; Australian Stock Exchange.

Since the mid-1980s Australia has dismantled protection of most of its manufacturing sector

Effective rates of tariff protection

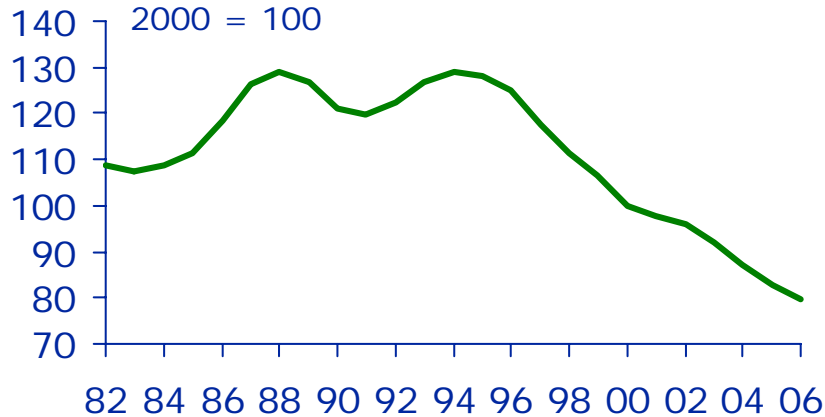


Note: 'Effective' rate of protection takes account of measures affecting the cost of inputs and value-adding factors of production. Series breaks reflects periodic revisions to industry inputs and outputs due (eg) to changing technology and relative prices.

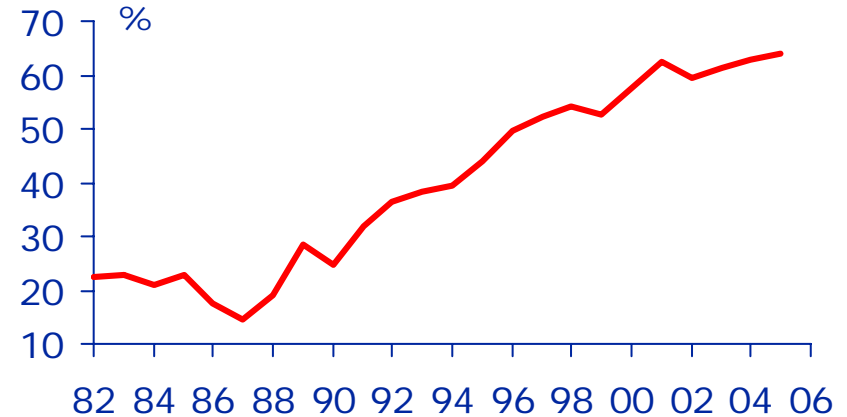
Source: Productivity Commission, *Trade & Assistance Review* (Annual).

Australia's auto industry experience illustrates the benefits of reducing trade barriers

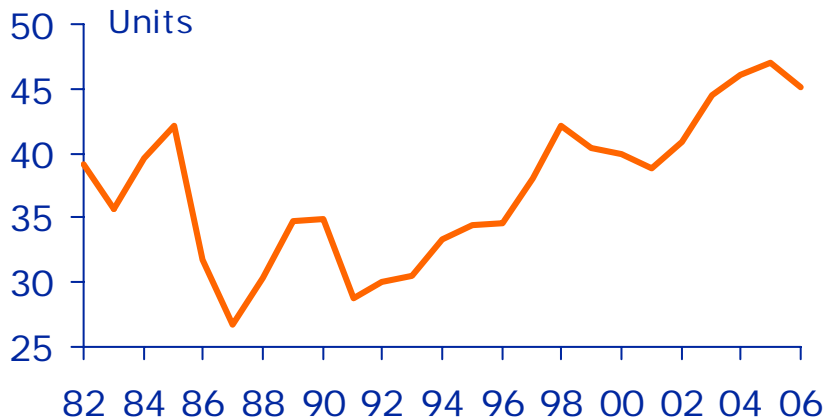
Auto prices in real terms



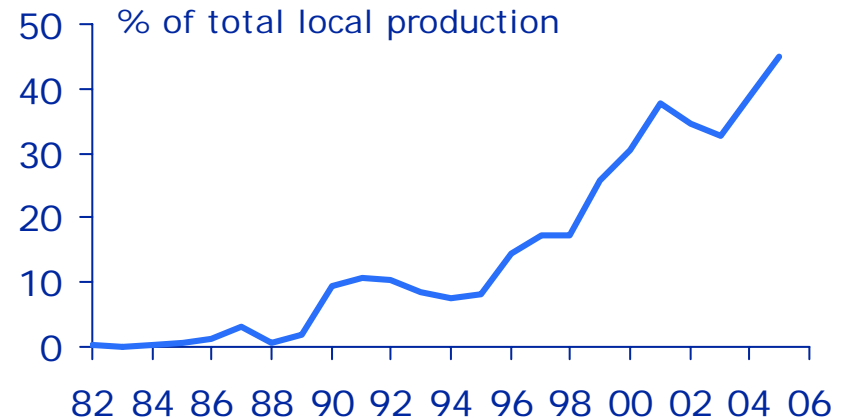
Import penetration



Auto sales per '000 population



Auto exports

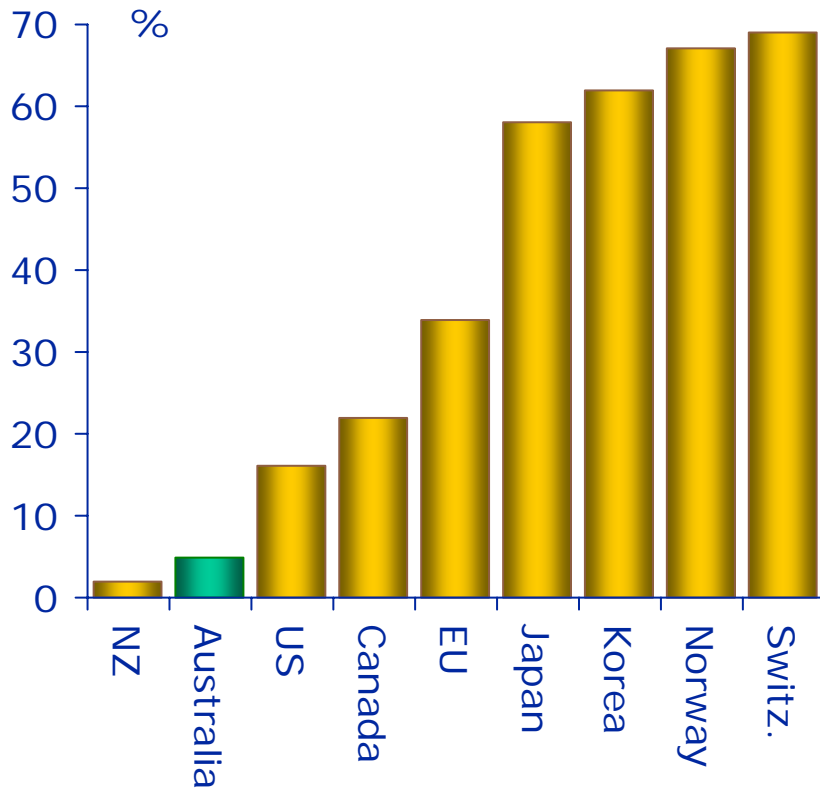


Sources: Australian Bureau of Statistics; Australian Automotive Intelligence Yearbook; Economics@ANZ.

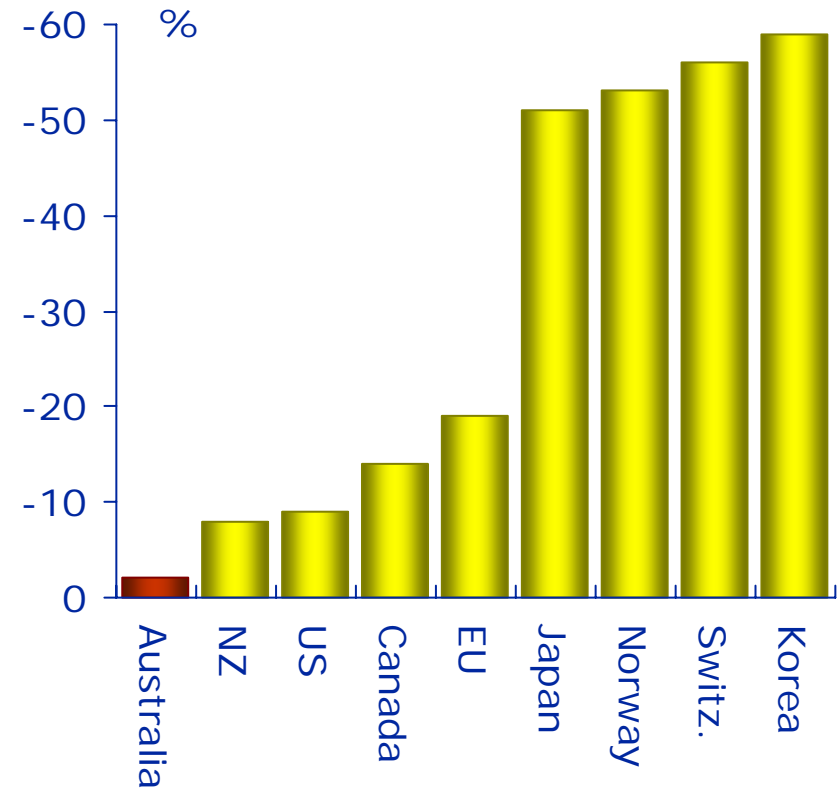
Australia doesn't subsidize rich farmers at the expense of taxpayers and consumers

Measures of support for agriculture, 2003-05

Producer subsidy equivalents



Consumer subsidy equivalents

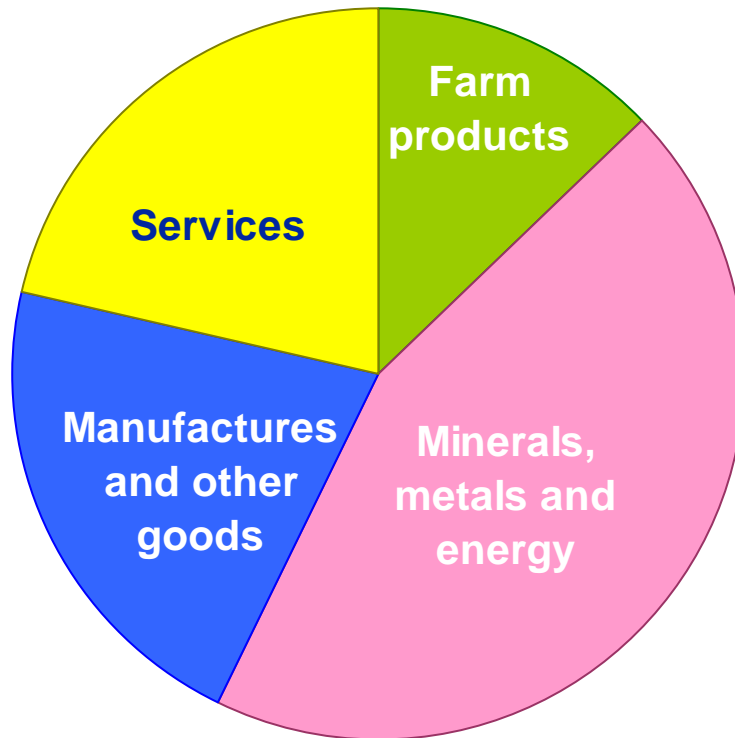


Source: OECD.

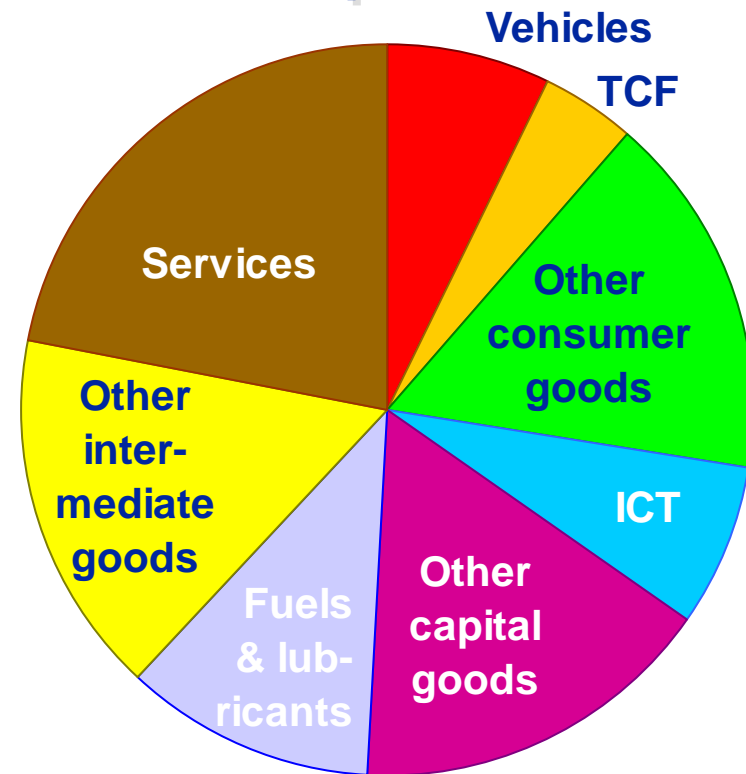
Unusually for an industrialized country Australia exports commodities and imports manufactures

Composition of Australian trade, 2005-06

Exports



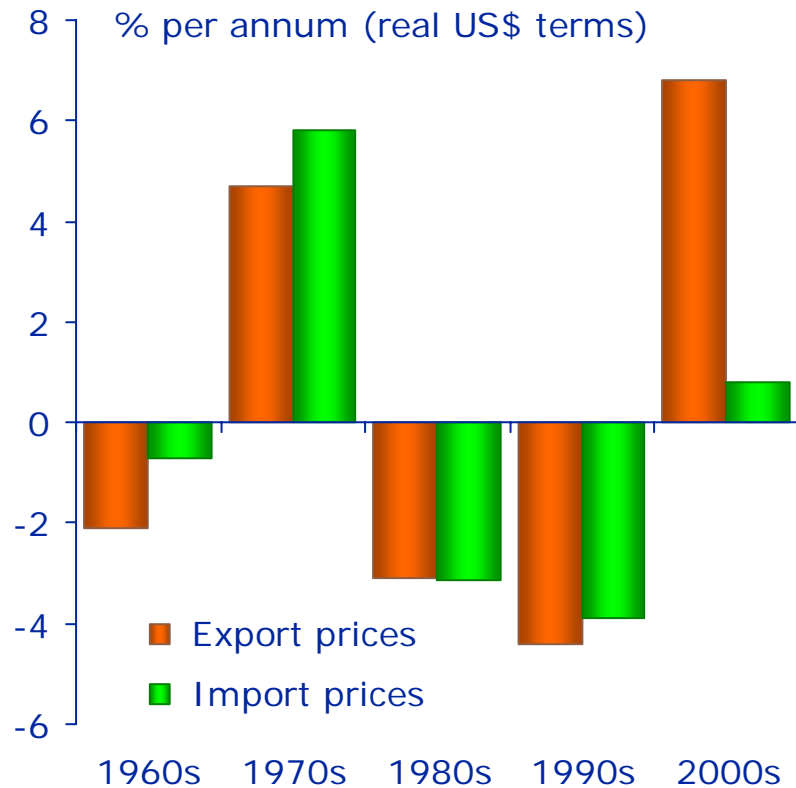
Imports



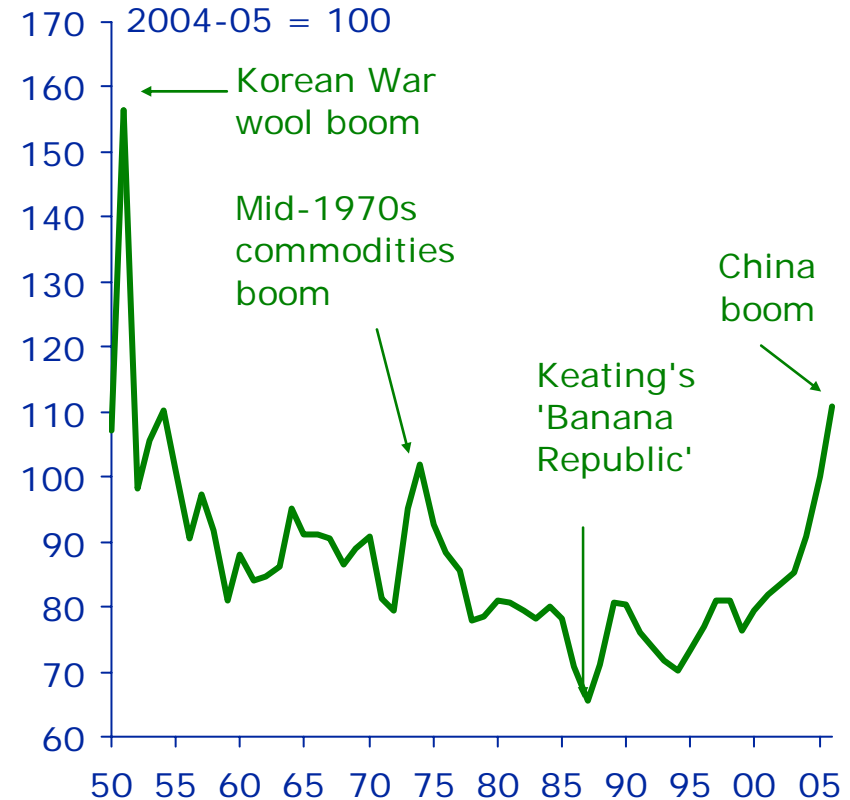
Source: Australian Bureau of Statistics.

China's global impact on *relative* prices is this hugely beneficial for Australia

Long-term price changes for Australian exports and imports



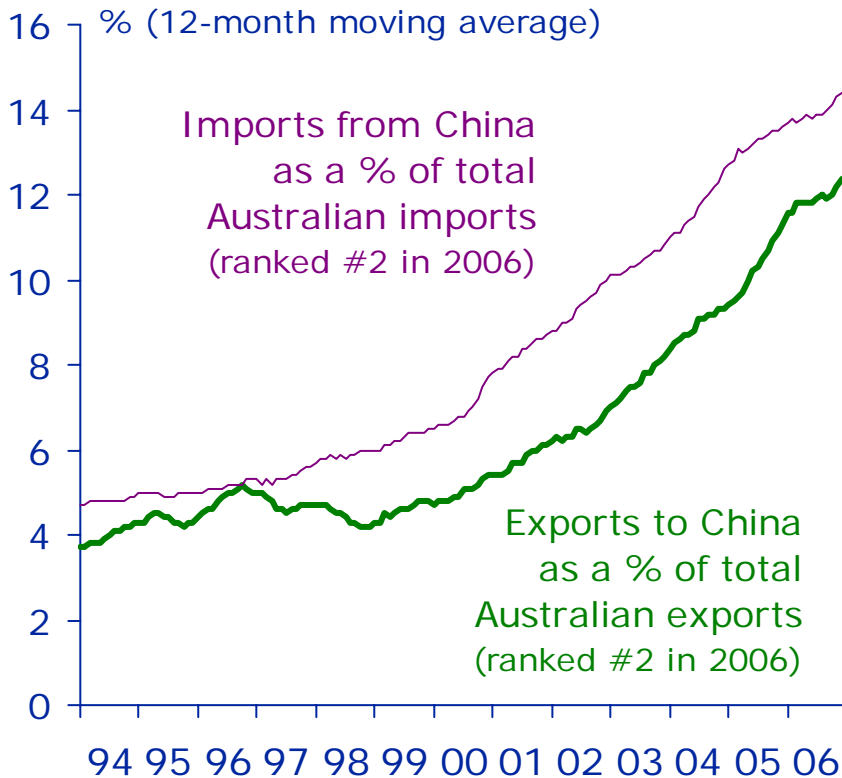
Ratio of Australian export prices to import prices



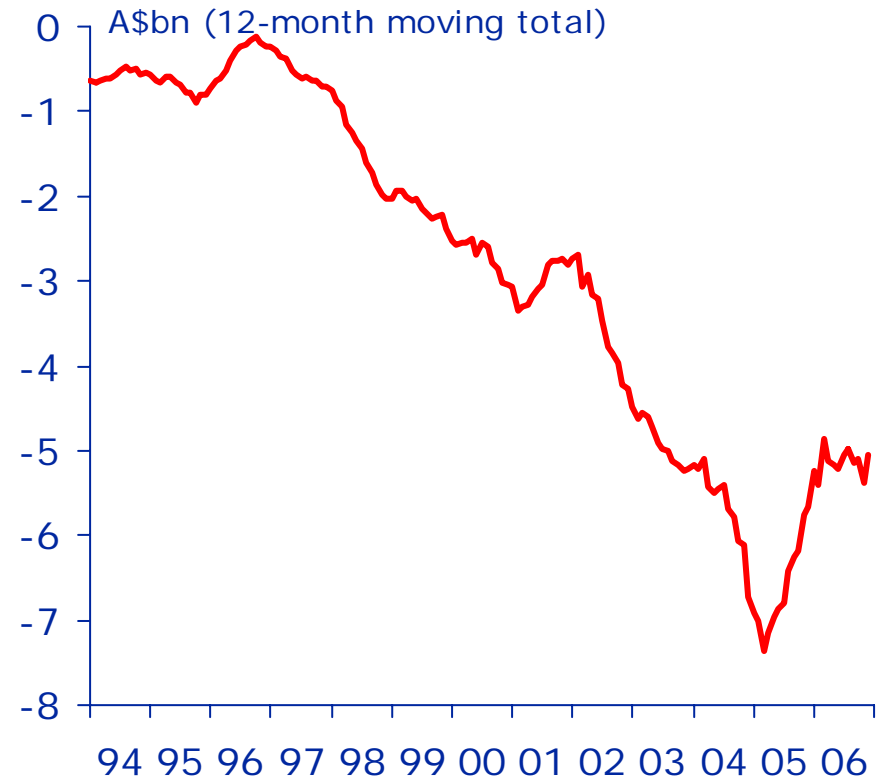
Note: the 'terms of trade' is the ratio of export to import prices; it is a measure of the international 'purchasing power' of Australia's exports. *Sources:* ABS; US BEA; Economics@ANZ.

China is now one of Australia's top 3 trading partners, and the bilateral deficit is shrinking

Australia's merchandise trade with China



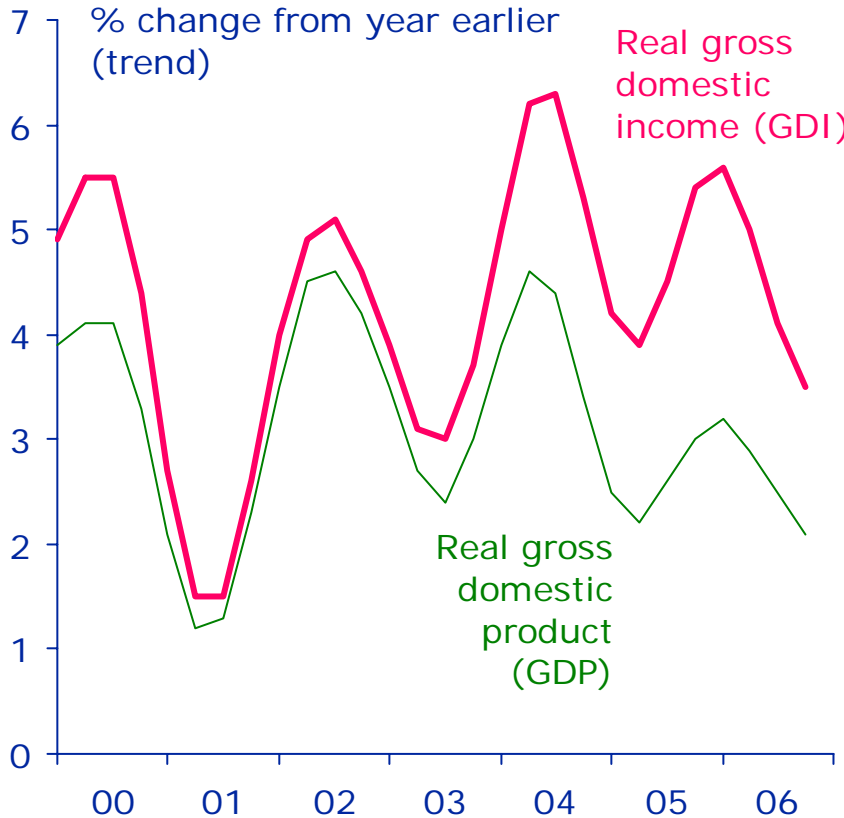
Australia's merchandise trade balance with China



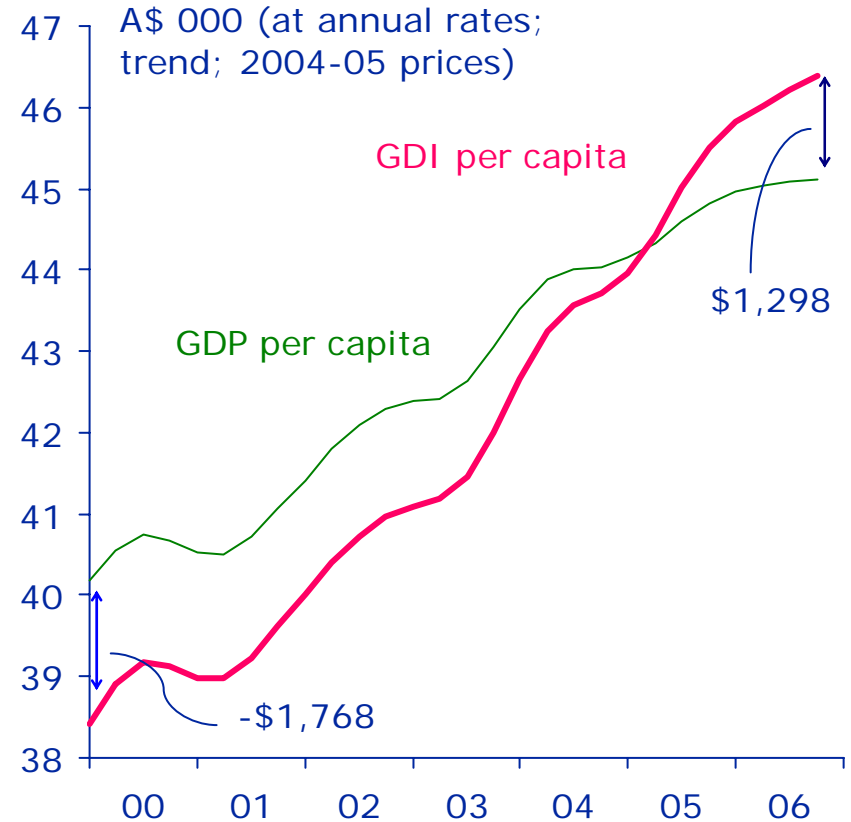
Sources: Australian Bureau of Statistics;
Department of Foreign Affairs and Trade.

'Terms of trade' gains since 1999 have been worth A\$3,066 pa to each Australian, on average

Real gross domestic product and income



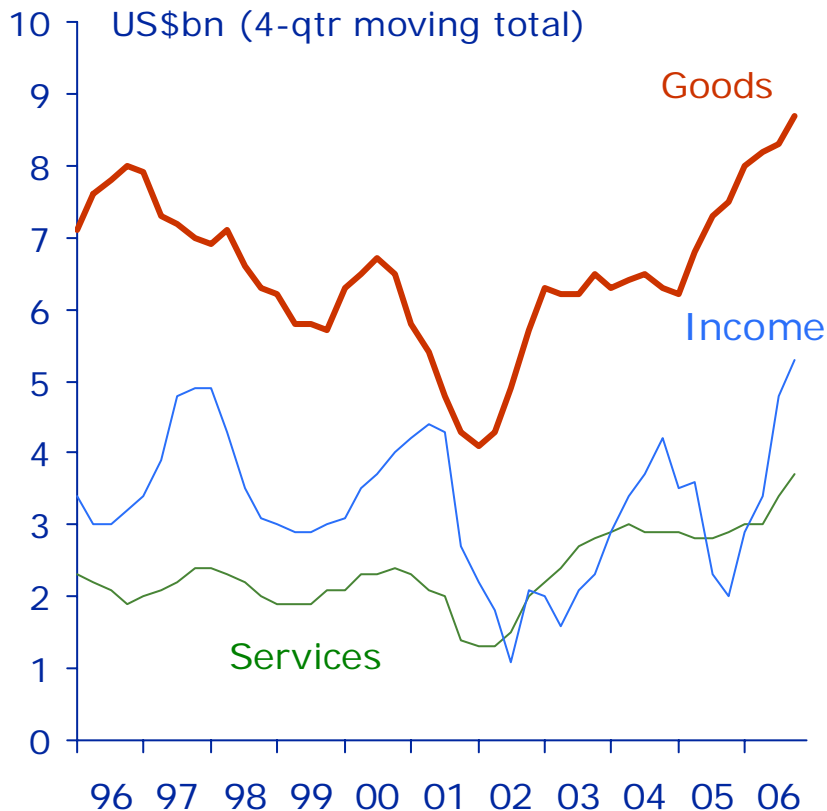
Real gross domestic product and income per capita



Note: Gross domestic income (GDI) is GDP adjusted for changes in the terms of trade (ratio of export to import prices). Sources: ABS; Economics@ANZ.

Australia is one of the few countries with whom the US runs persistent surpluses

US external balances with Australia



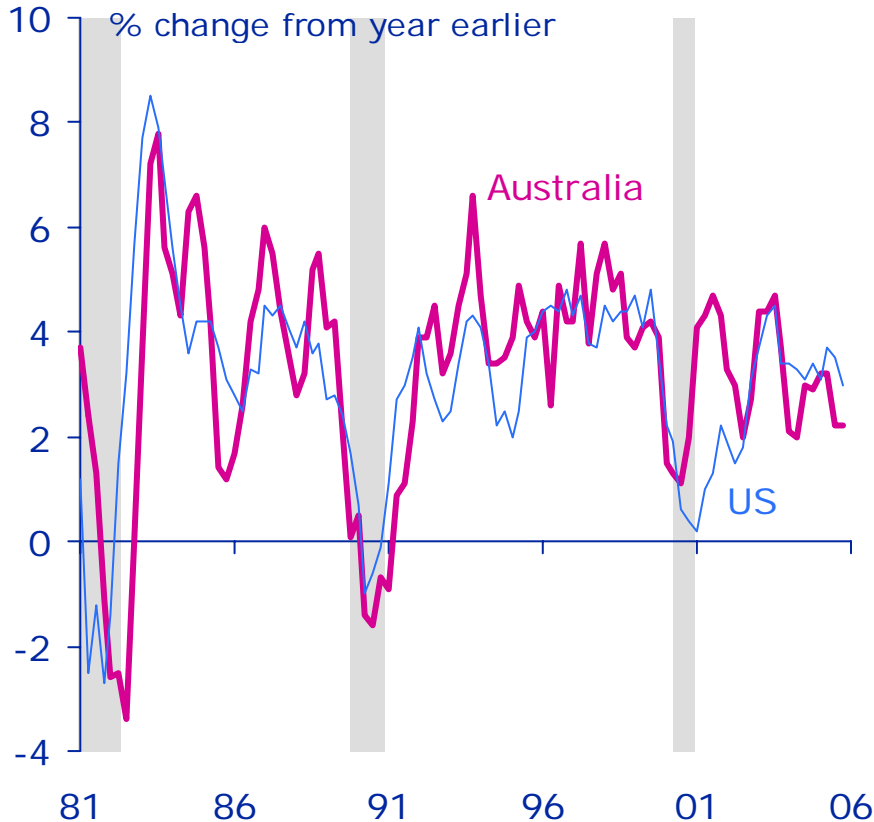
Source: US Bureau of Economic Analysis

Some remaining US barriers to imports from Australia

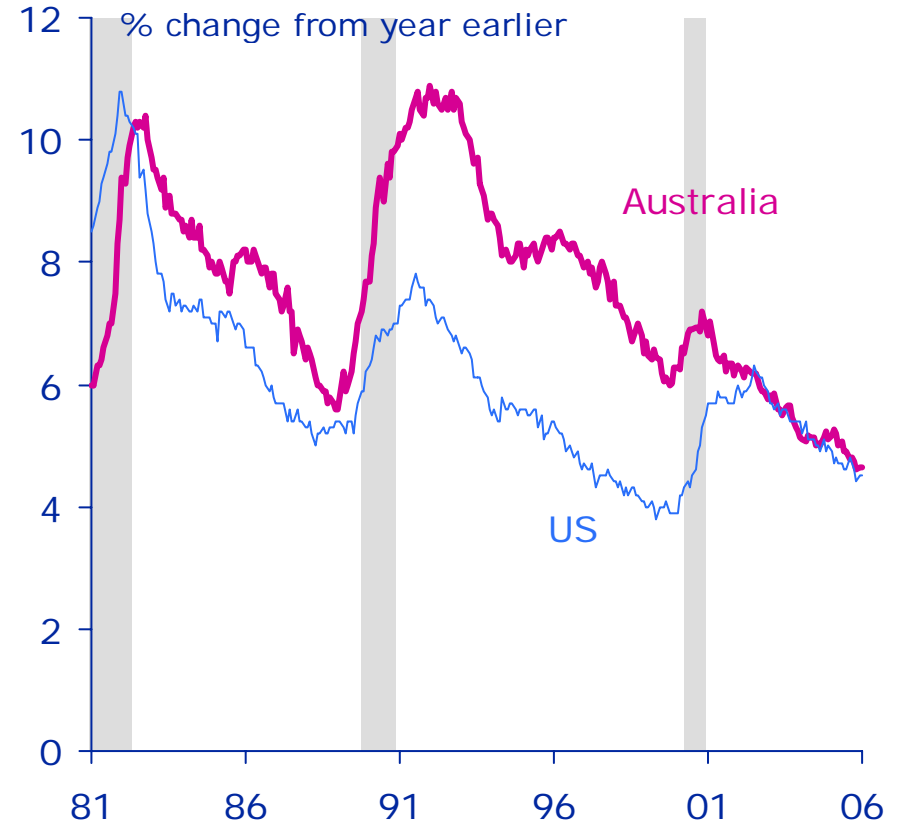
- **Beef – 26% tariff on imports of over 378,214 tonnes pa**
 - quota will rise to 448,634 tonnes and over-quota tariff will fall to zero by 2024(!) under AUSFTA
- **Cheese – 10% tariff on imports of over 750t of 'cheddar'**
 - duty-free quota will rise by 3% pa under AUSFTA but above-quota tariff remains at 10%
- **Sugar – tariff of US33.9¢ per kg (~ 117% at current market prices) on imports of over 87 408 t pa (7½% of total US imports)**
 - no change under AUSFTA
- **Jones Act prohibition on use of Australian-built fast ferries on US coastal routes**

The Australian and US economic cycles have been unusually divergent this decade ...

Real GDP growth



Unemployment rate

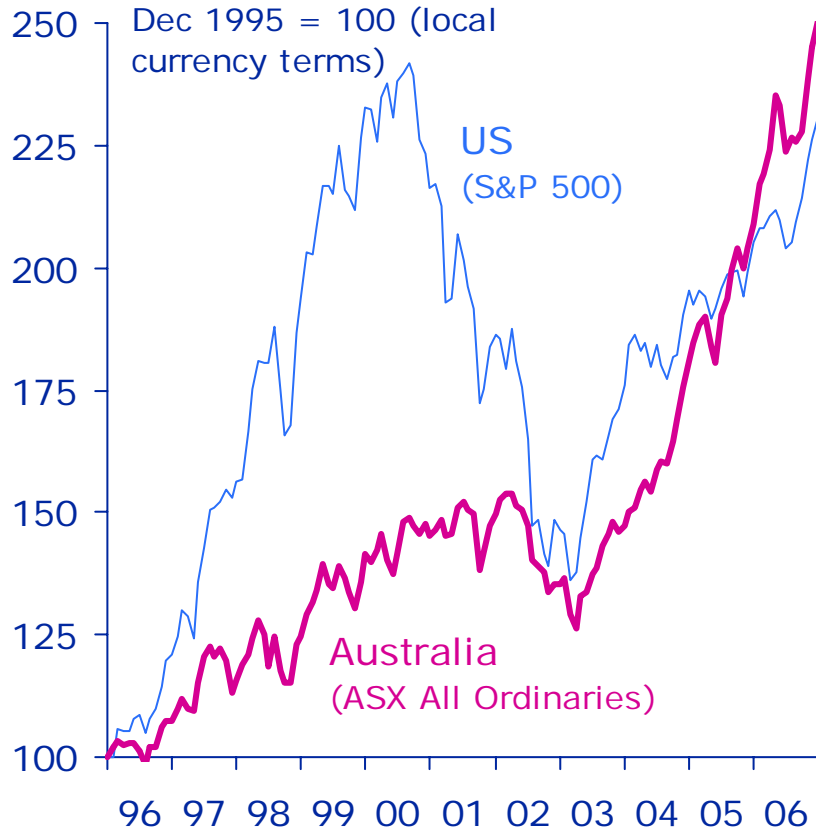


Note: shaded periods denote US recessions as designated by National Bureau of Economic Research.

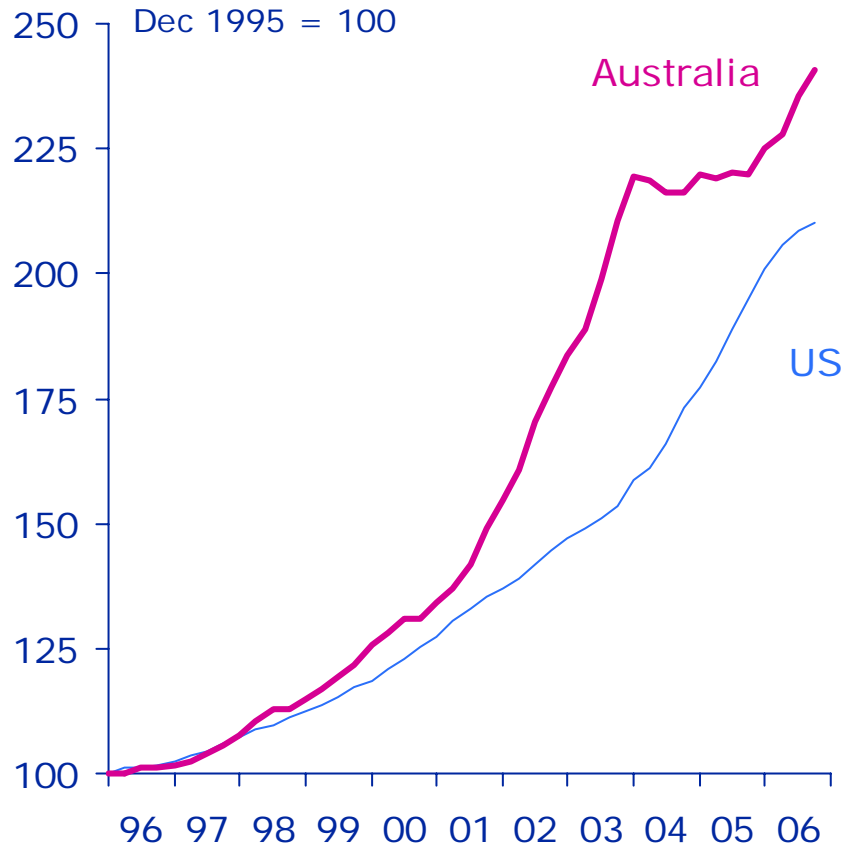
Sources: Australian Bureau of Statistics; US Bureau of Economic Analysis and Labor Statistics.

... in large part because of differences in the behaviour of asset markets ...

Share prices



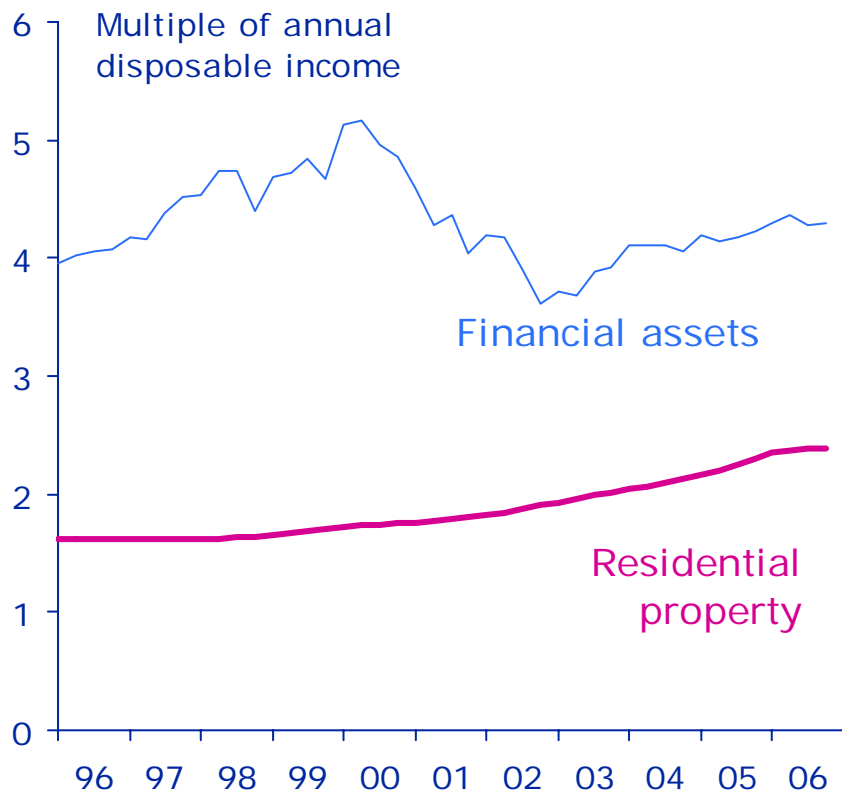
House prices



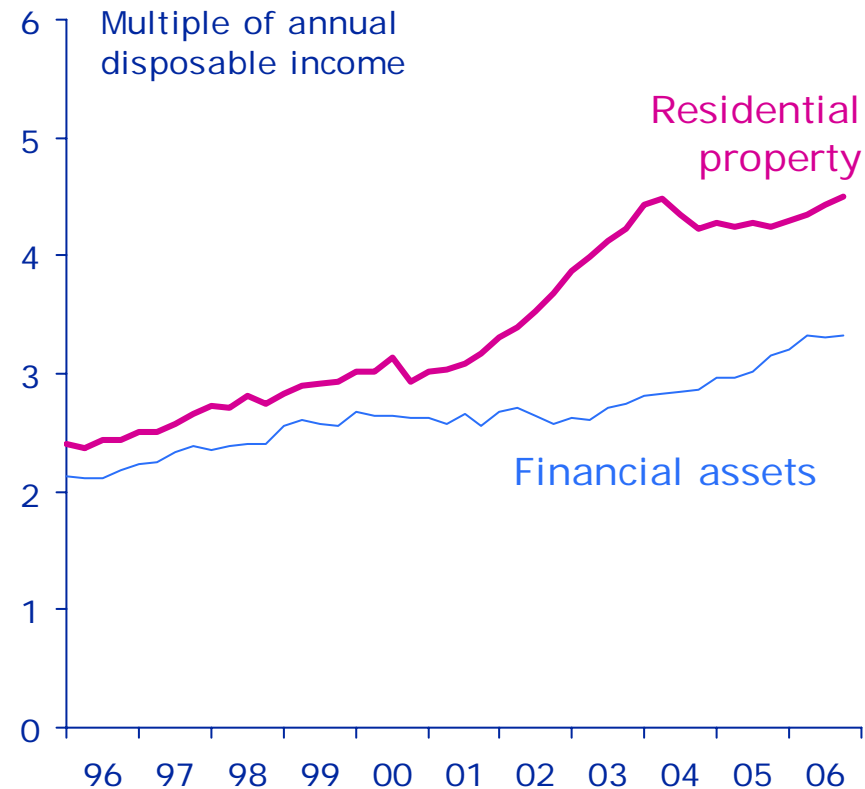
Sources: Thomson Financial Datastream; US Office of Federal Housing Enterprise Oversight; Australian Bureau of Statistics; Economics@ANZ

... and differences in the relative exposure of households to different classes of assets

US household wealth



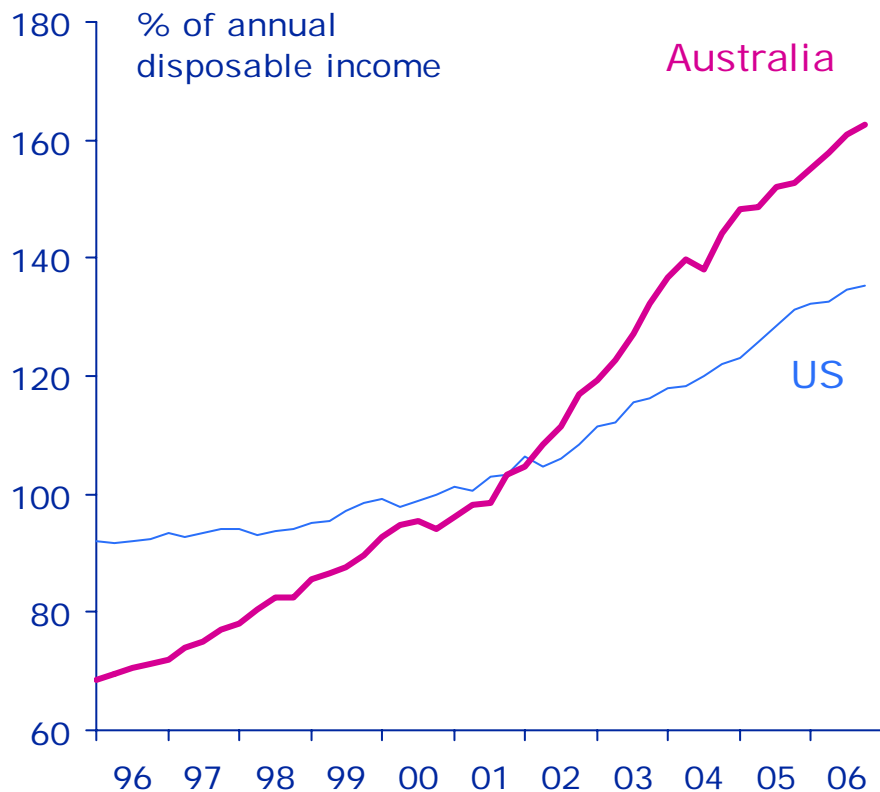
Australian household wealth



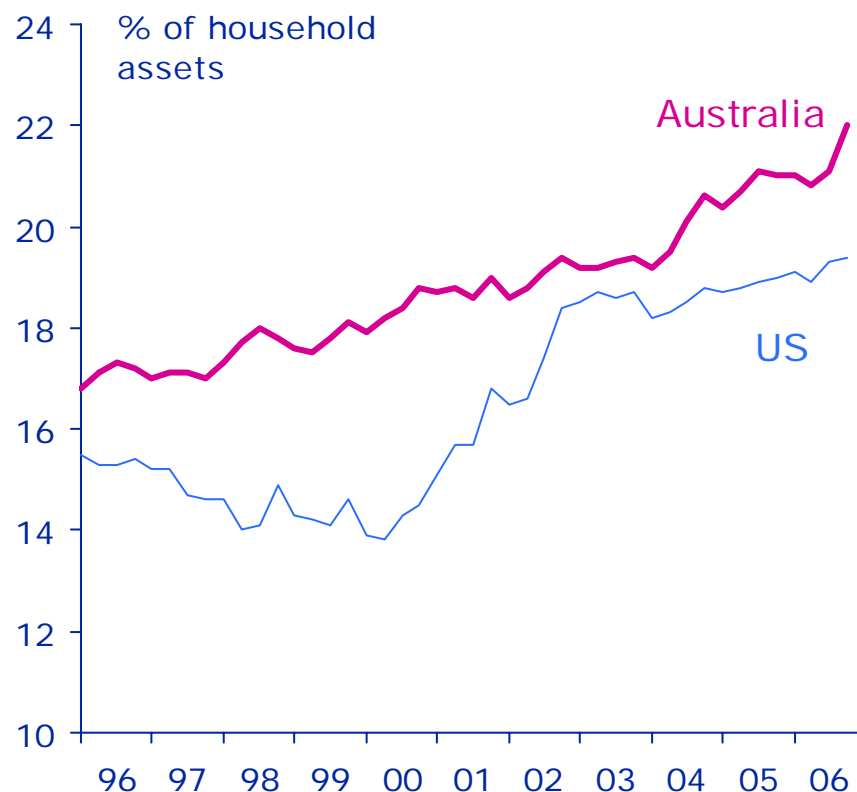
Sources: US Federal Reserve; Australian Bureau of Statistics; Economics@ANZ

Australian households have become more financially leveraged than American households

Household debt as a p.c. of disposable income



Household debt as a p.c. of household assets



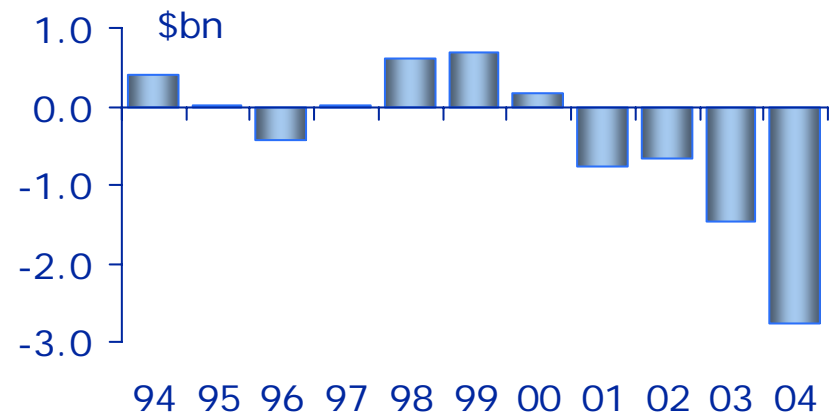
Sources: US Federal Reserve; Australian Bureau of Statistics; Economics@ANZ

Changes in Australia's tax system in 1999 added to the appeal of 'geared' property investment

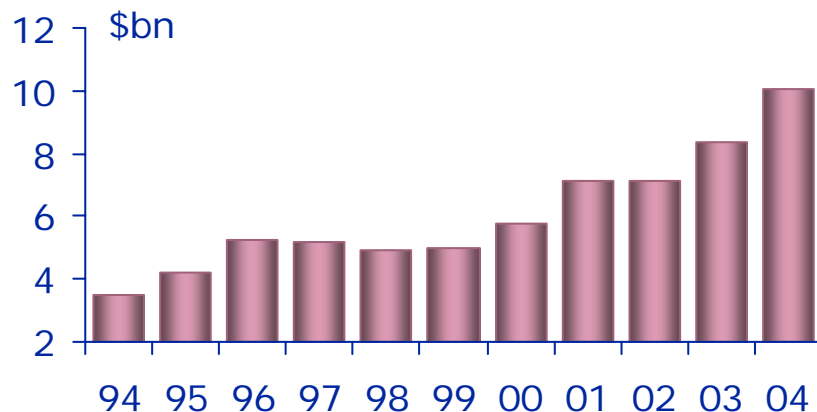
Taxpayers with rental income



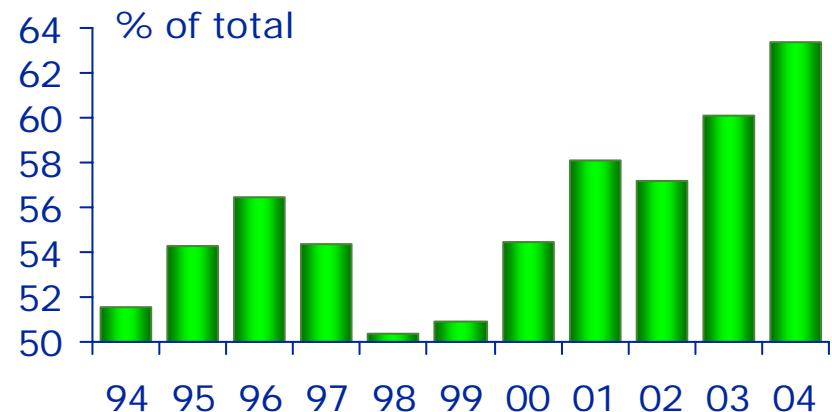
Net rental income



Interest paid by property investors



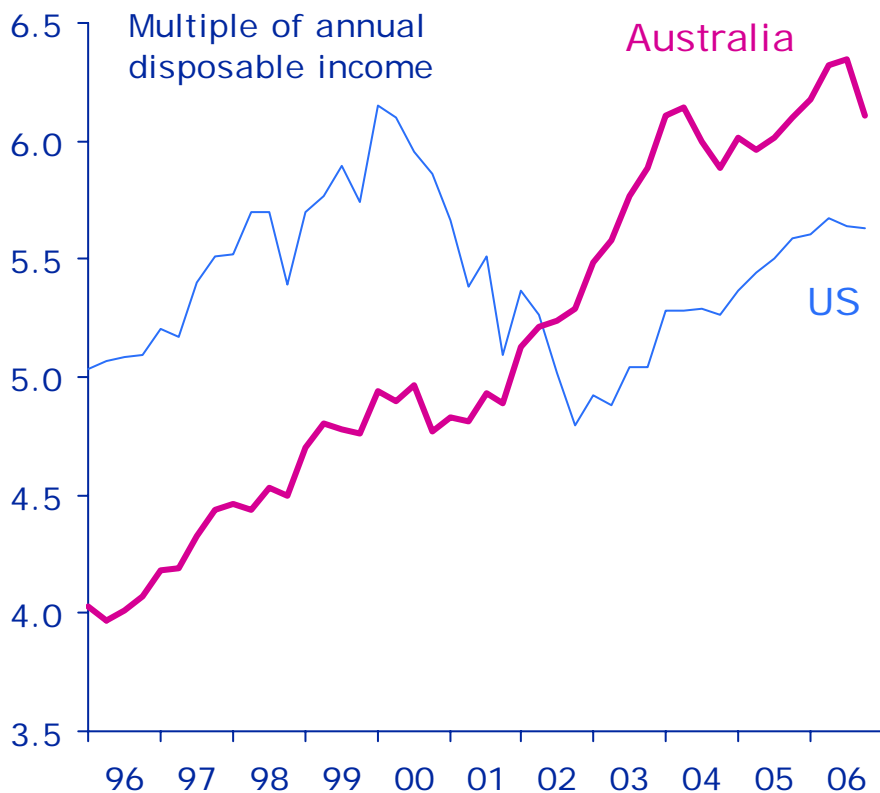
Loss-making property investors



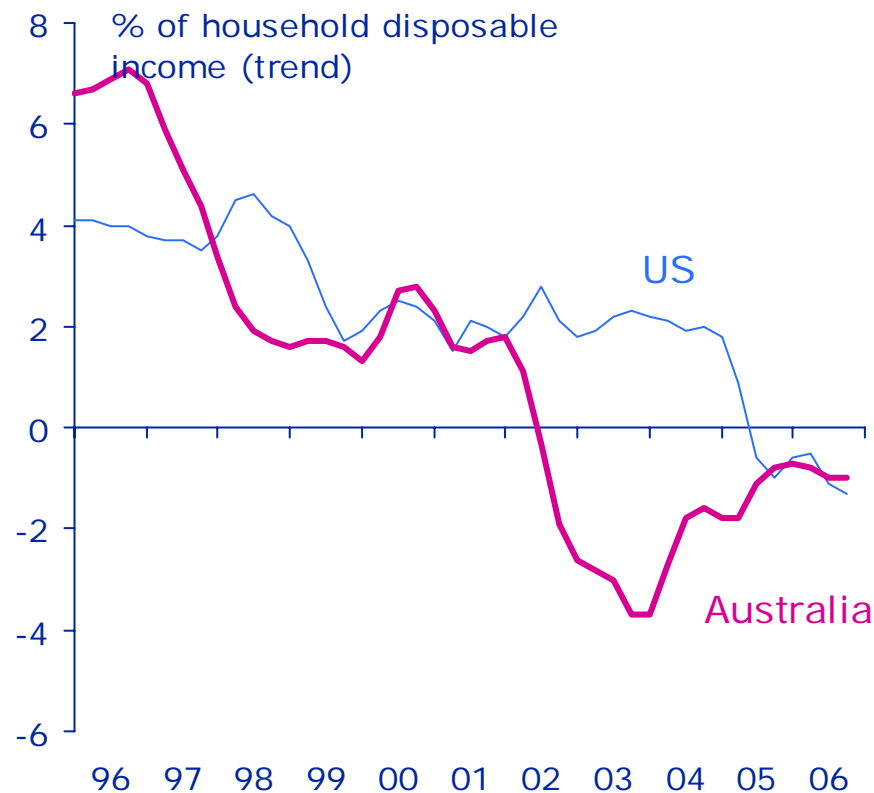
Note: Data are for fiscal years ended 30 June.
Sources: Australian Taxation Office; Economics@ANZ.

Australian household finances weren't much affected by the 2000-02 share price crash

US and Australian household net wealth



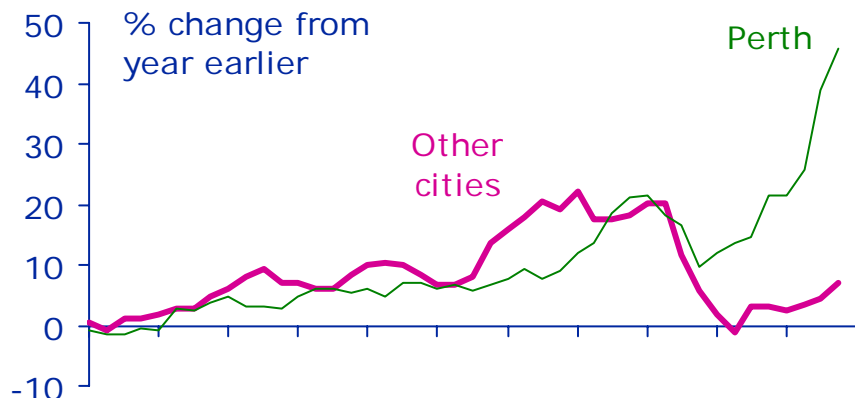
US and Australian household saving



Sources: US Federal Reserve; US Bureau of Economic Analysis; Australian Bureau of Statistics; Economics@ANZ

With the housing boom now over, Australian households are 'consolidating' their finances

Capital city house prices



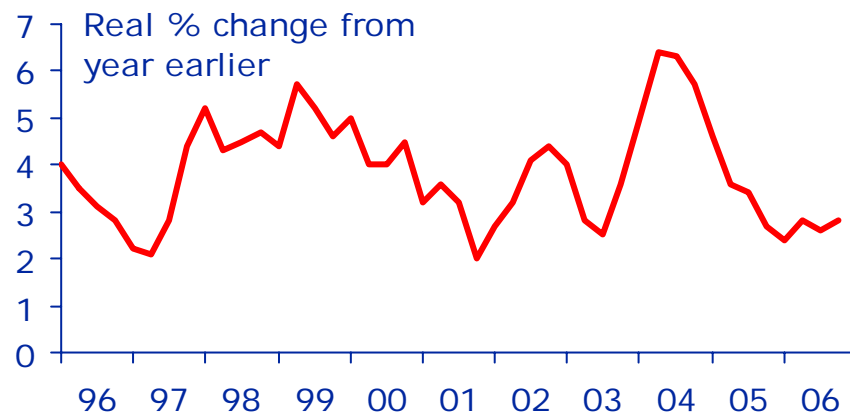
Household borrowing



Household interest payments



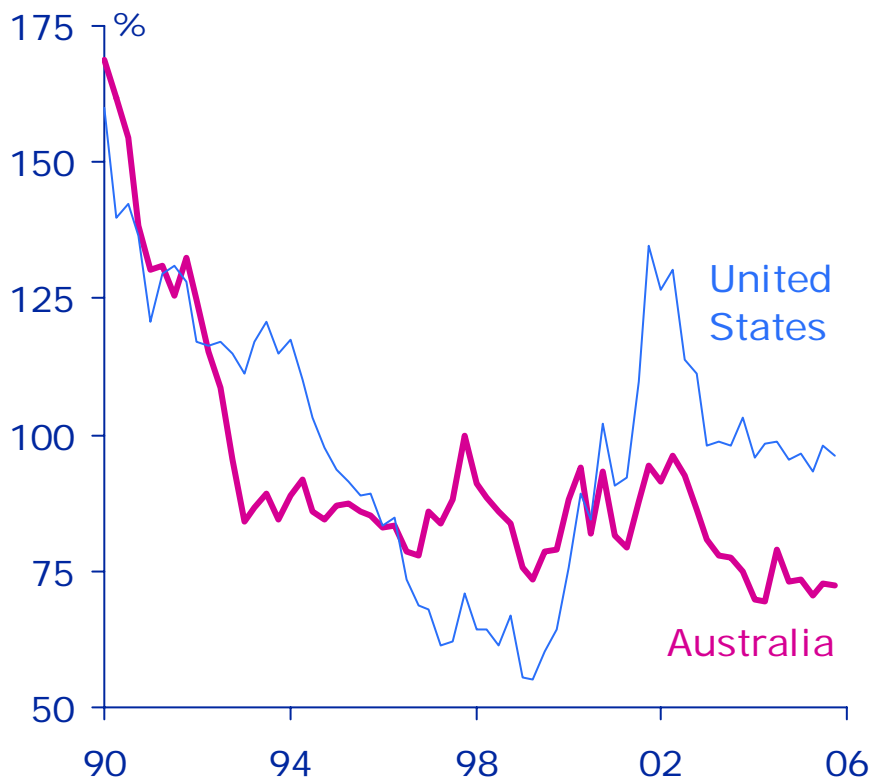
Consumer spending



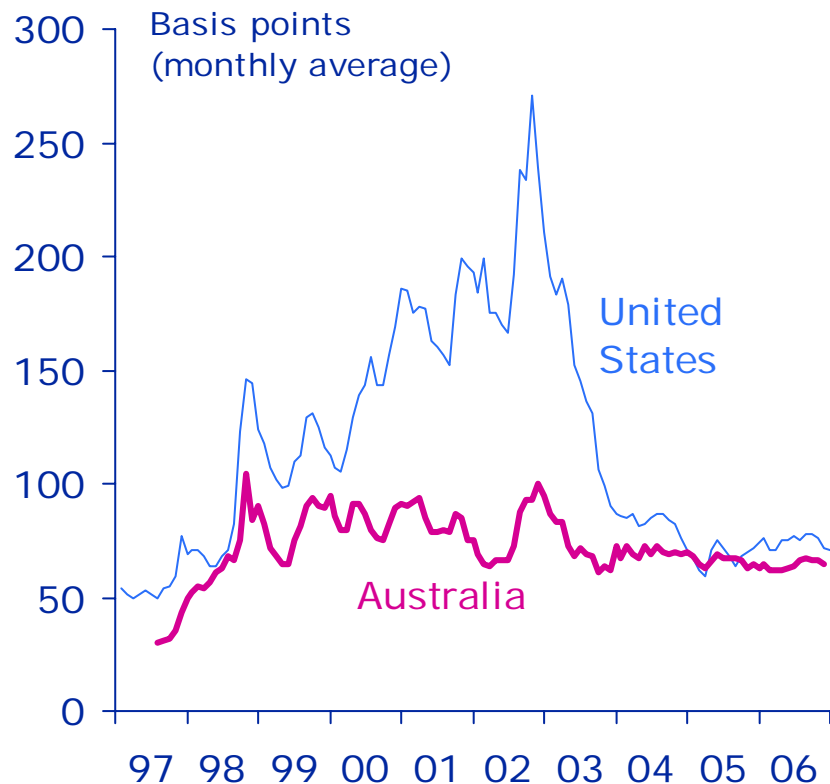
Sources: ABS; Reserve Bank of Australia;
Economics@ANZ

Australian corporate finances were also much less affected by the 2000-2002 equities crash

Non-financial corporate sector debt-equity ratio



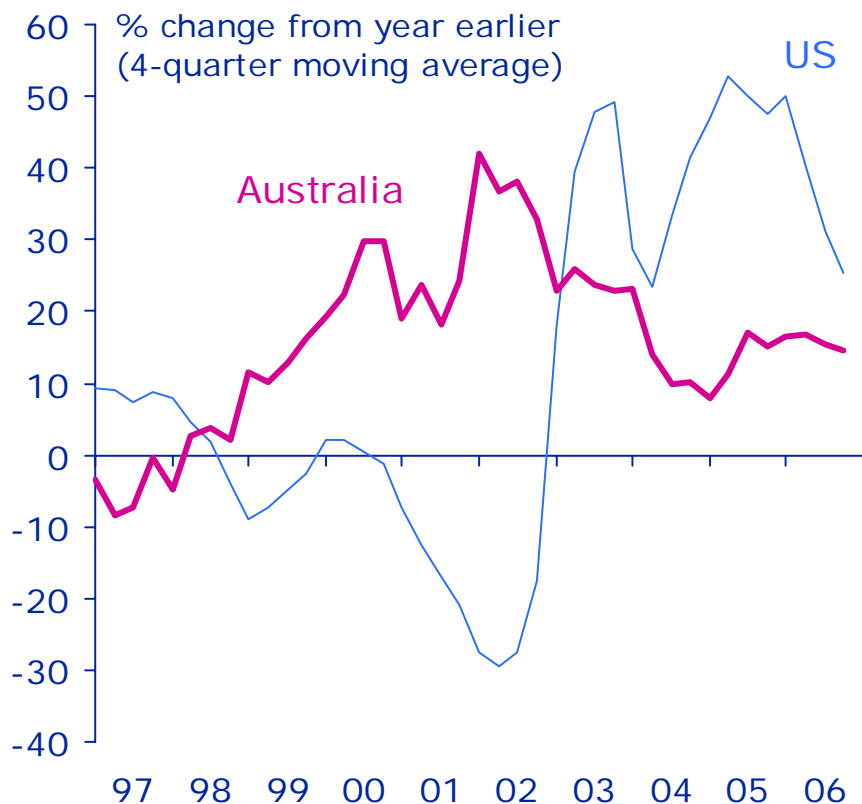
Corporate bond yield spreads - 2-4 year A-rated



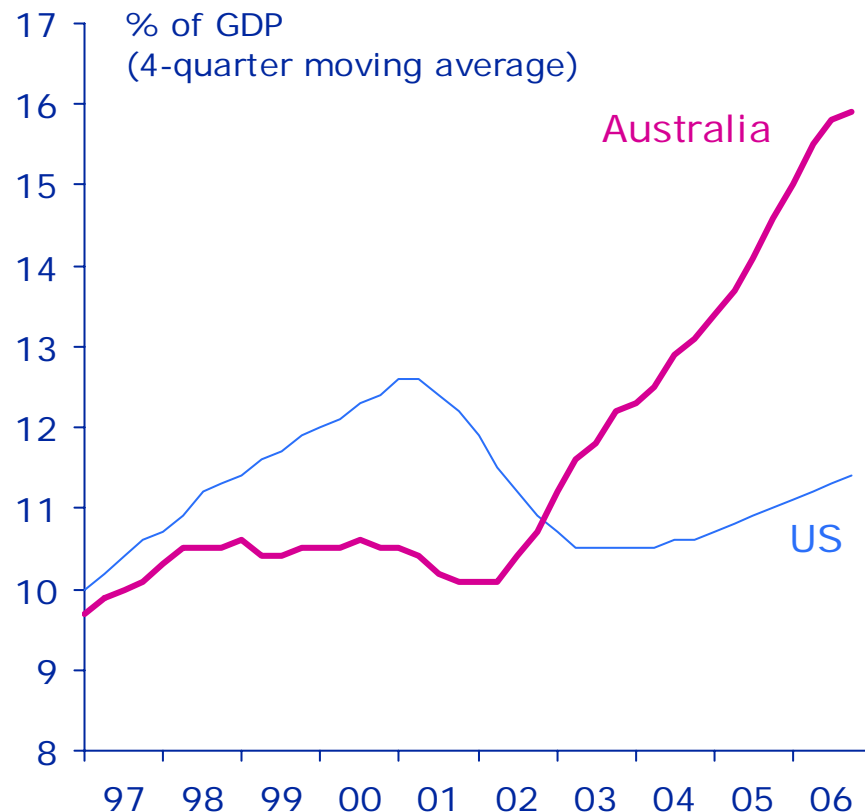
Note: Corporate bond yield spreads are to 3-year government bond yields. Sources: ABS; US Federal Reserve; US Bureau of Economic Analysis; Thomson Financial Datastream; UBS Warburg; Lehman Brothers; Economics@ANZ.

The cycle in business profits and capital spending has been less dramatic in Australia than in the US

US and Australian corporate profits



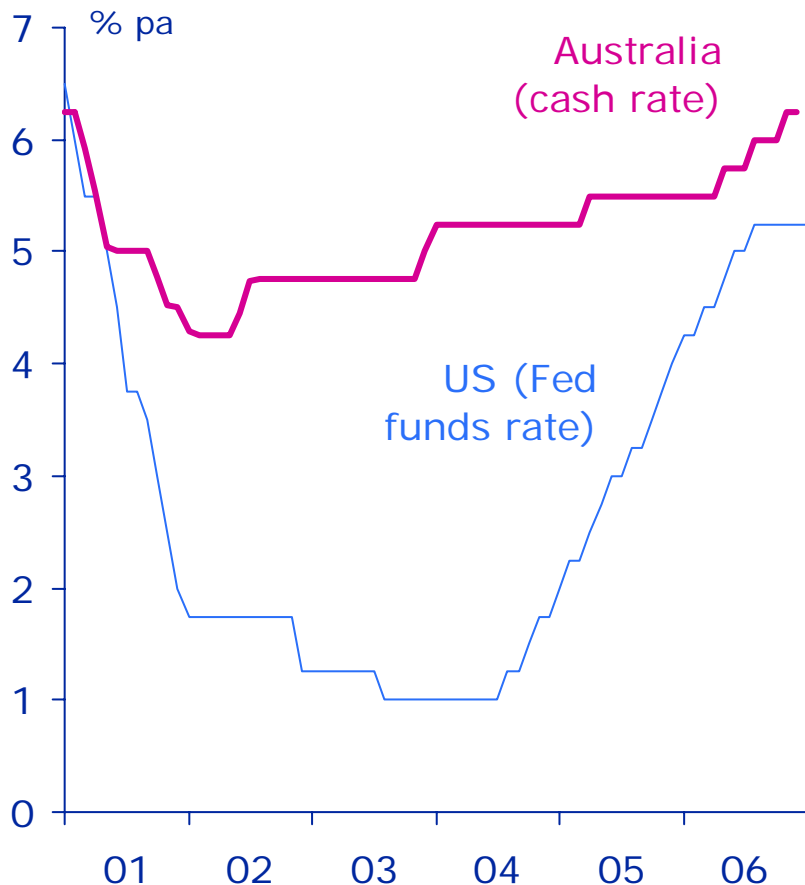
US and Australian business investment



Note: Profits are pre-tax and exclude the financial sector. Sources: US Bureau of Economic Analysis; Australian Bureau of Statistics; Economics@ANZ

Divergent business cycles have seen the RBA and the Fed pursuing different monetary policies

Policy interest rates



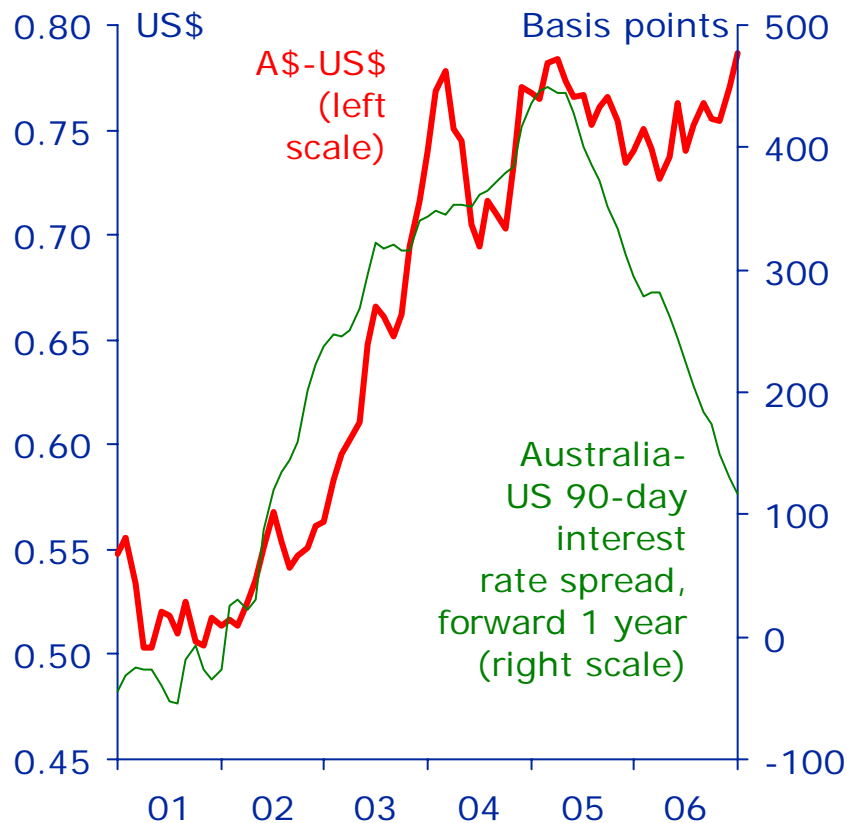
Sources: RBA; Federal Reserve.

- The Reserve Bank of Australia didn't cut rates as aggressively as the Fed in 2001
 - the 'tech wreck' had much less economic impact in Australia
- The RBA raised rates four times in 2002 and 2003
 - while the Fed was still cutting
- The RBA raised rates only three times between August 2004 and August 2006
 - while the Fed raised rates 17 times
- The RBA raised rates again in November 2006
 - while the Fed remained 'on hold'
- Changes in monetary policy have a much higher profile in Australia
 - because most mortgages are at variable interest rates

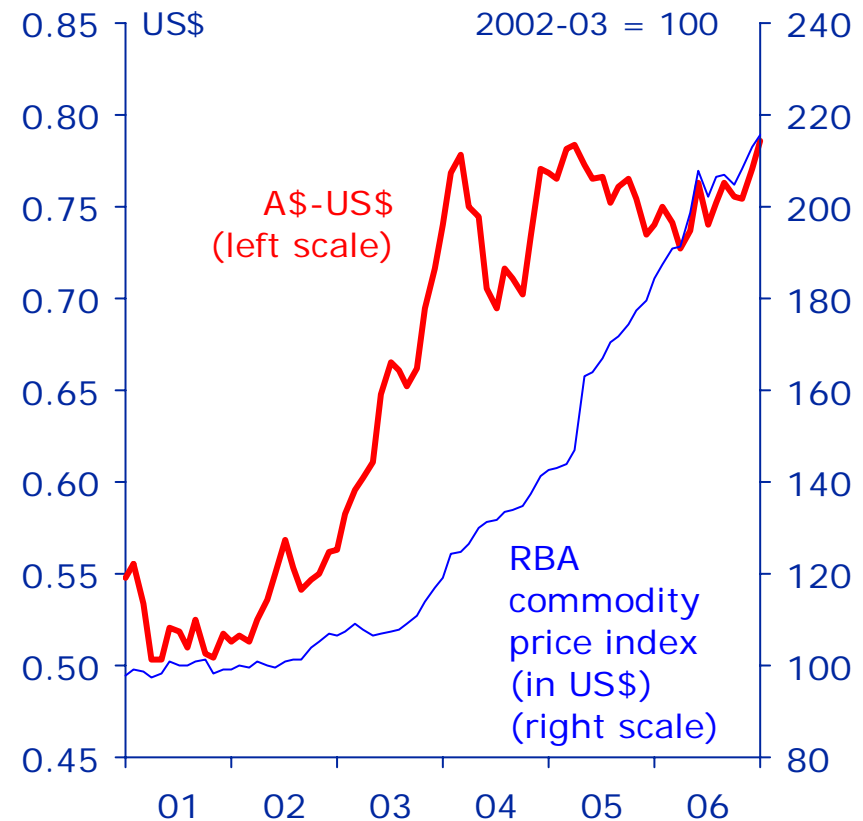
The resources boom is keeping the A\$ stronger than it otherwise would have been

Economic influences on the value of the A\$

Interest rate spreads



Commodity prices

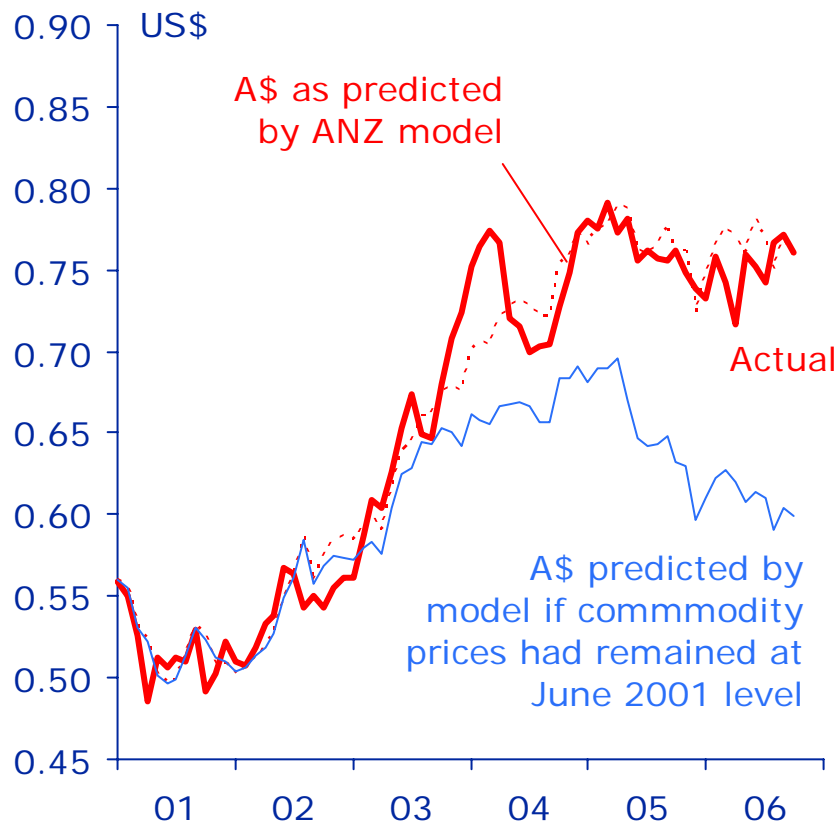


Sources: Datastream; Reserve Bank of Australia.

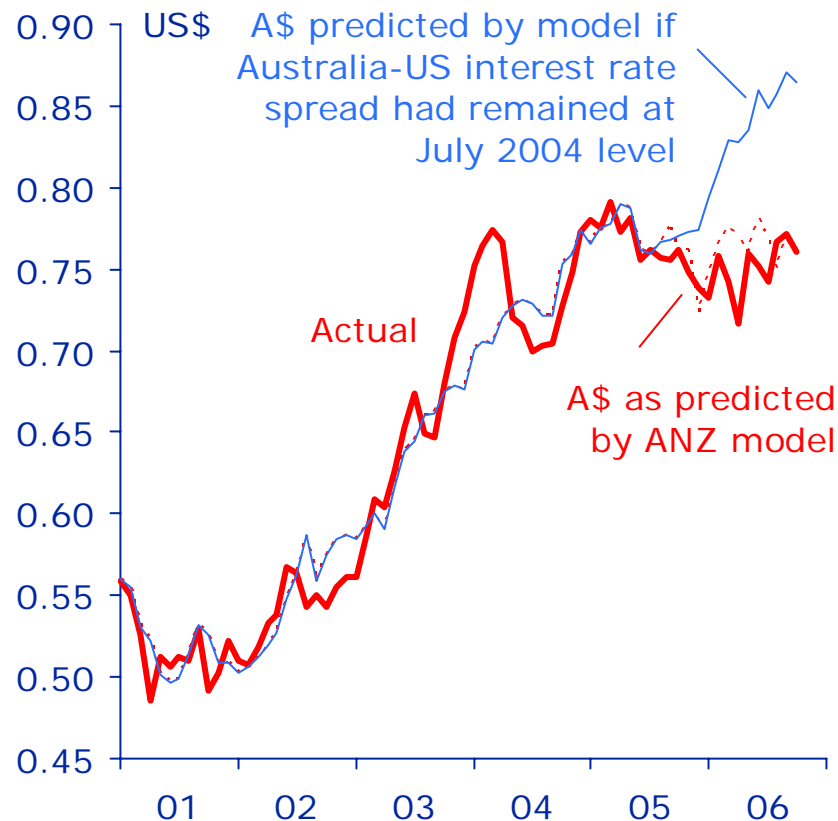
Commodity prices and interest rate differentials have been working in opposite directions on the A\$

Alternative hypothetical scenarios for the A\$

If commodity prices hadn't risen since June 2001



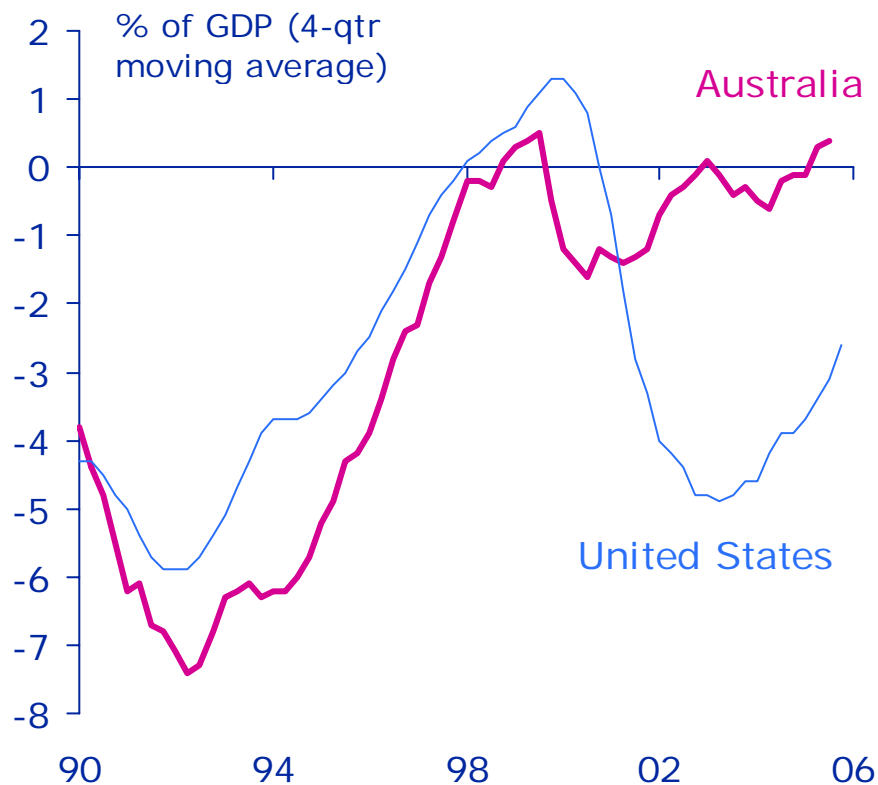
If the interest rate spread on the A\$ hadn't narrowed since July 2004



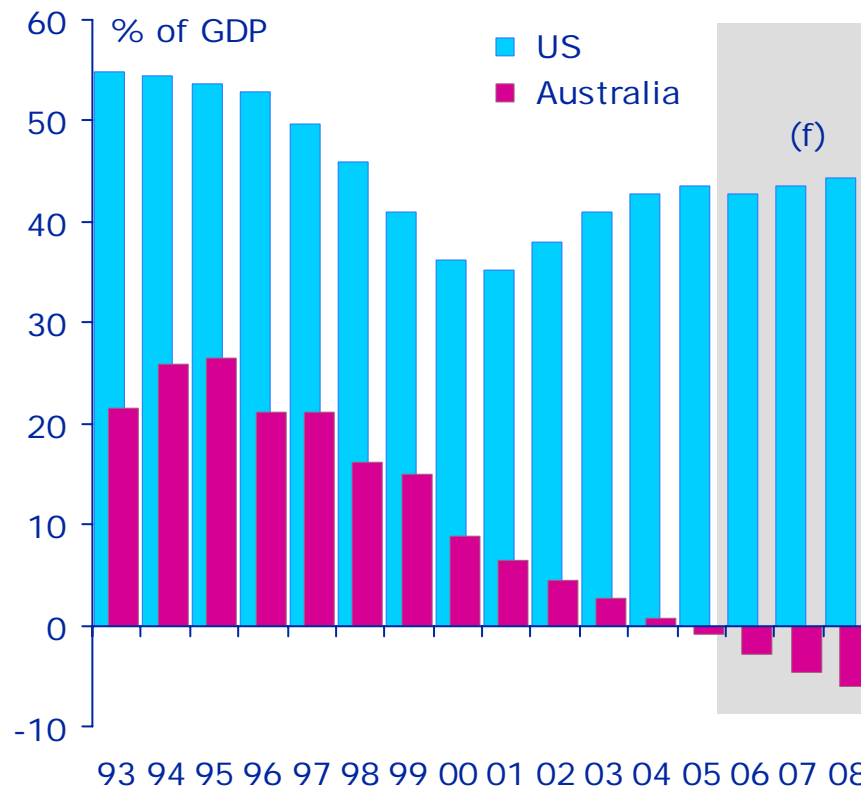
Sources: Datastream; Reserve Bank of Australia; Economics@ANZ.

Another key set of differences between the US and Australia has been in public finance

Net lending by governments



General government net financial liabilities

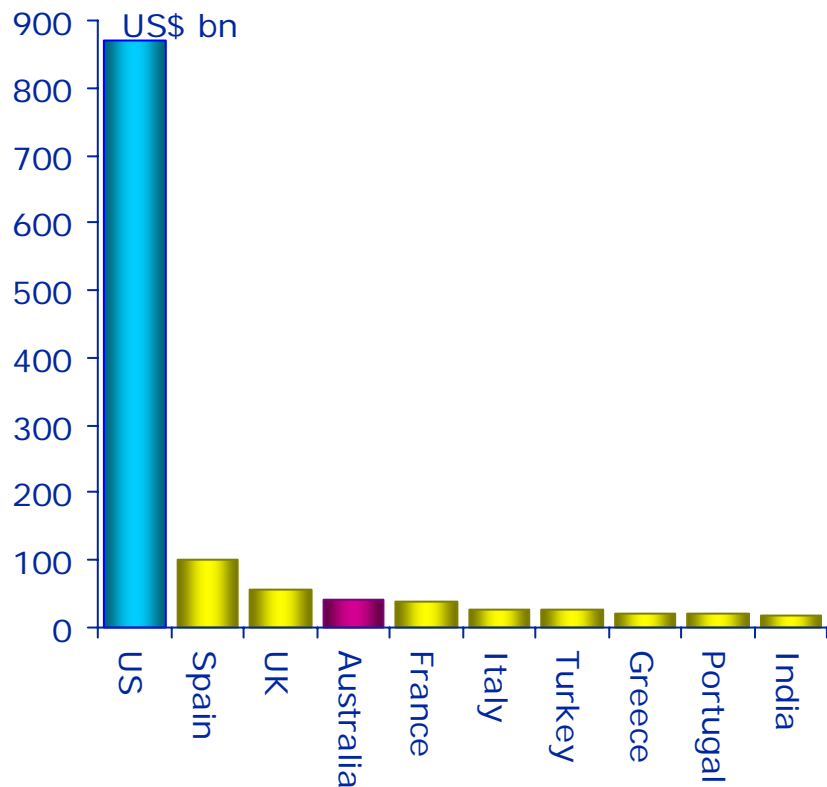


Sources: US Bureau of Economic Analysis; Australian Bureau of Statistics; OECD *Economic Outlook* (No. 76) November 2005 database.

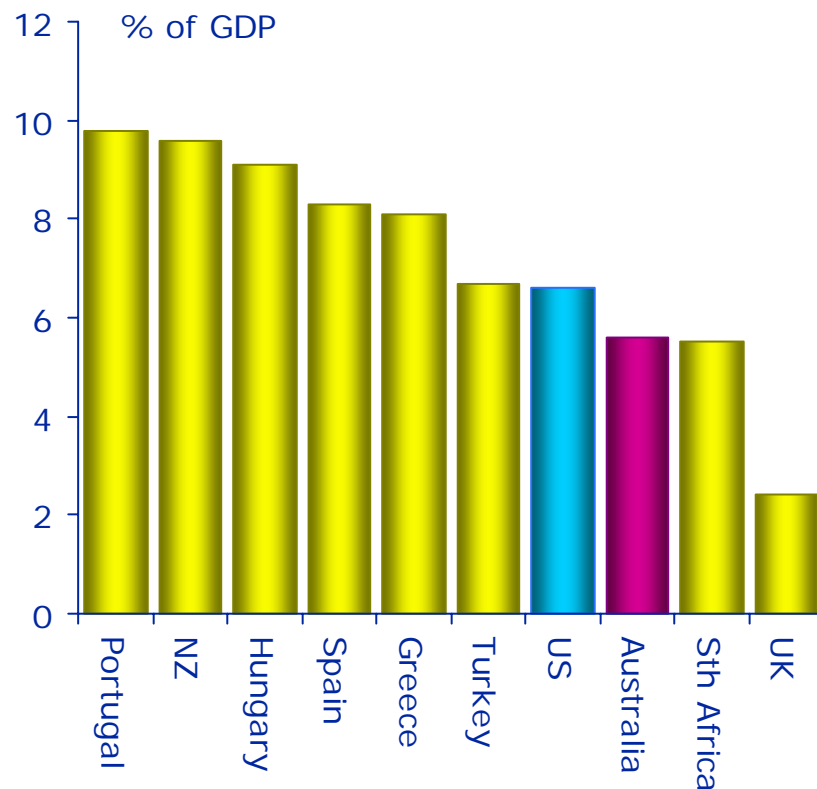
Australia and the US have among the largest current account deficits in the world ...

Current account balances, 2006

In US\$ billions



As a % of GDP

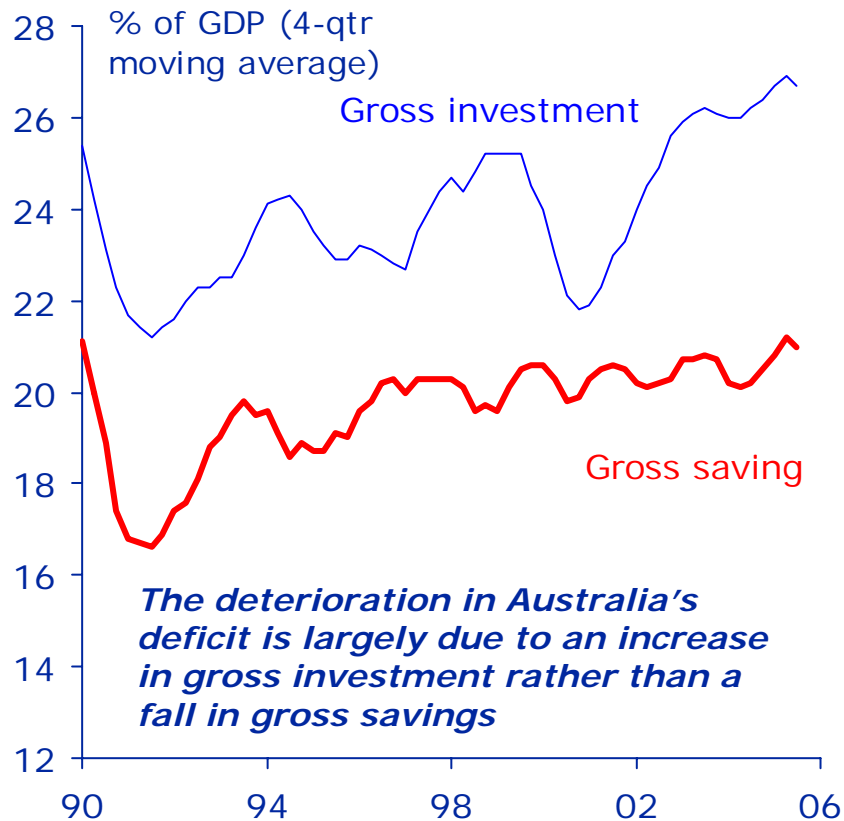


Source: IMF World Economic Outlook
September 2006 data base.

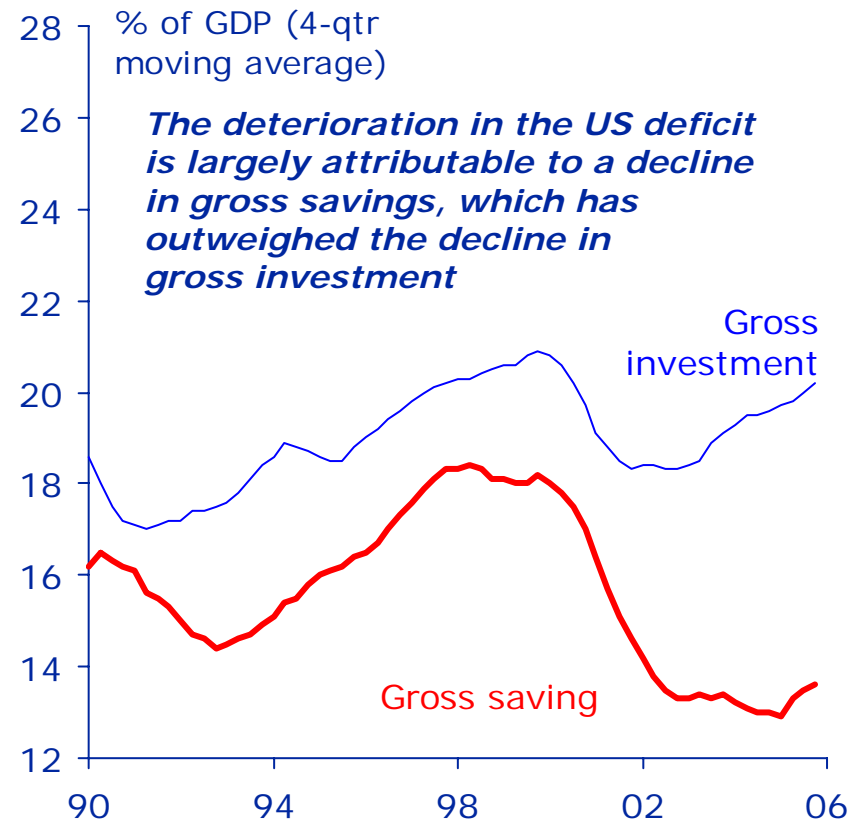
... but Australia's and the US deficits have different fundamental origins ...

Saving and investment as a share of GDP

Australia



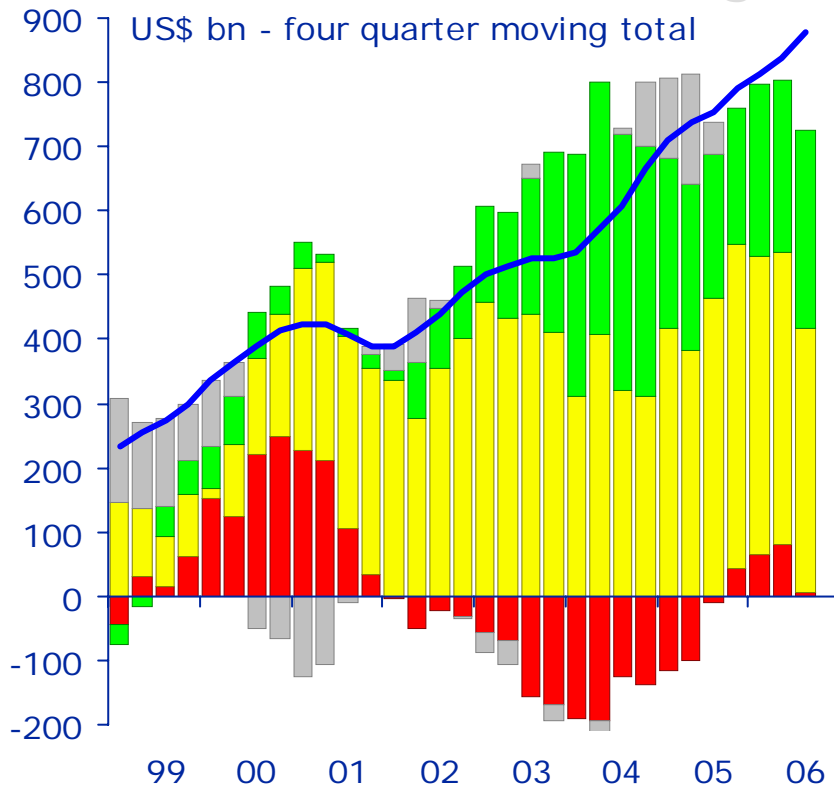
US



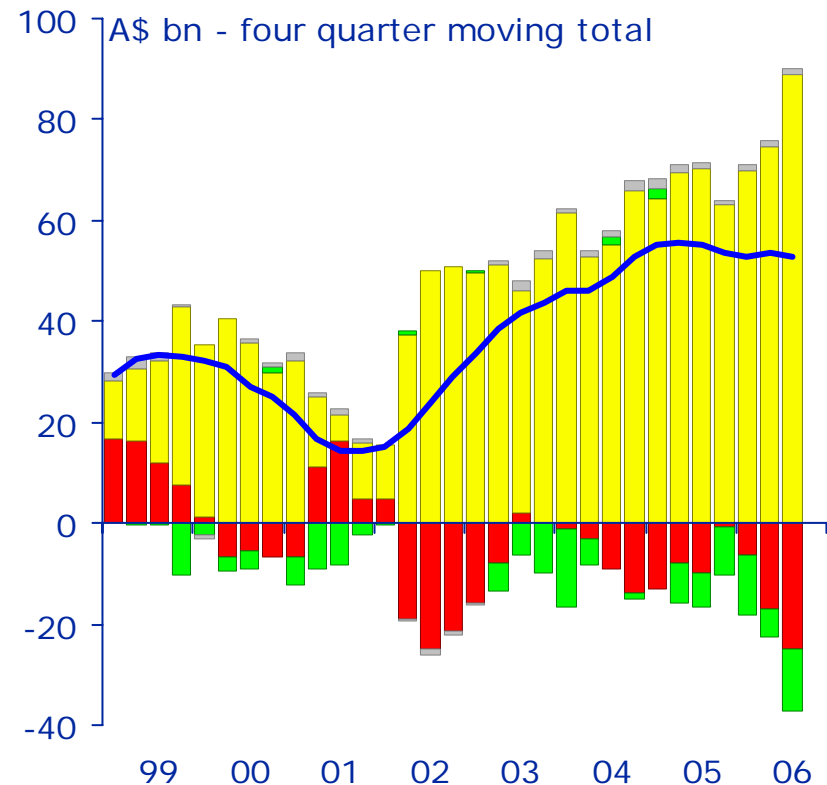
Note: The current account deficit is equal to the difference between gross saving and investment. Sources: ABS; US Bureau of Economic Analysis; Economics@ANZ.

... and have been financed through rather different channels

US current account deficit and its financing



Australia's current account deficit and its financing



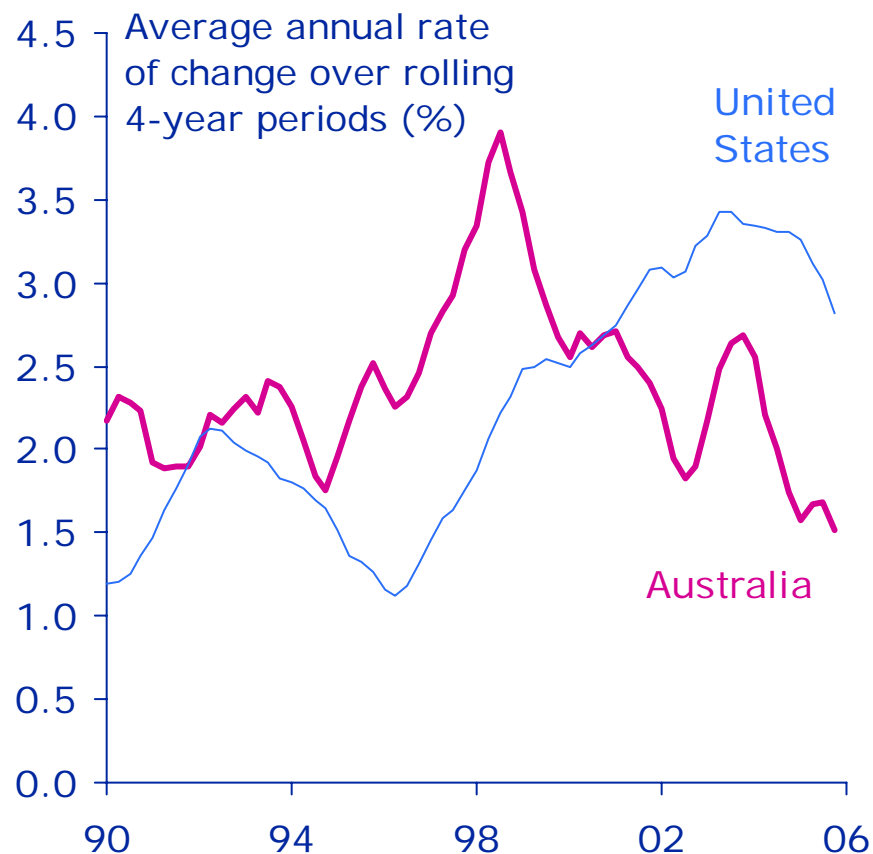
Sources: US Bureau of Economic Analysis; Australian Bureau of Statistics; Economics@ANZ.

Australia's longer-term outlook remains promising

- **Bipartisan commitment to good economic management**
 - both major parties endorse balanced budgets 'on average over the course of the cycle', central bank independence and a predominant role for competitive markets in allocating resources (some differences regarding labour relations)
- **Considerable scope for further productivity gains**
 - despite rapid growth during the 1990s, the *level* of Australian productivity is still 18-25% below US and best European equivalents
- **Better-placed than most Western nations to deal with demographic change**
 - younger demographic profile (thanks to immigration program)
 - more tightly targeted public pensions plus compulsory private pensions plus very low level of public debt
- **Well-placed to benefit from emergence of China as a regional and global economic power**
 - reliable and competitive supplier of commodities and services
 - only a few industries vulnerable to competition from China
- **Emerging network of trade agreements**
 - agreements now in place with NZ, Singapore, Thailand and US
 - negotiations mooted or underway with China, Japan, ASEAN, Gulf Co-operation Council and Chile

Australia's 'productivity miracle' appears to have evaporated

Labour productivity



Note: labour productivity is output per hour worked in the non-farm business or market sector.

Sources: ABS; US Bureau of Economic Analysis

Possible reasons for the productivity slowdown

- **Stage of the business cycle**
 - 'less productive' labour being taken on as full employment nears
 - With profits so strong, businesses less focused on efficiency gains
- **Adverse developments in particular sectors**
 - surge in employment and investment in mining sector yet to be reflected in increased output
- **Absence of any substantial productivity-growth enhancing reforms since late 1990s**
 - benefits of earlier reforms may be fading
- **Increase in productivity-stifling regulation since 2001**
 - 'security' & corporate governance

Some continuing issues and challenges for the Australian economy

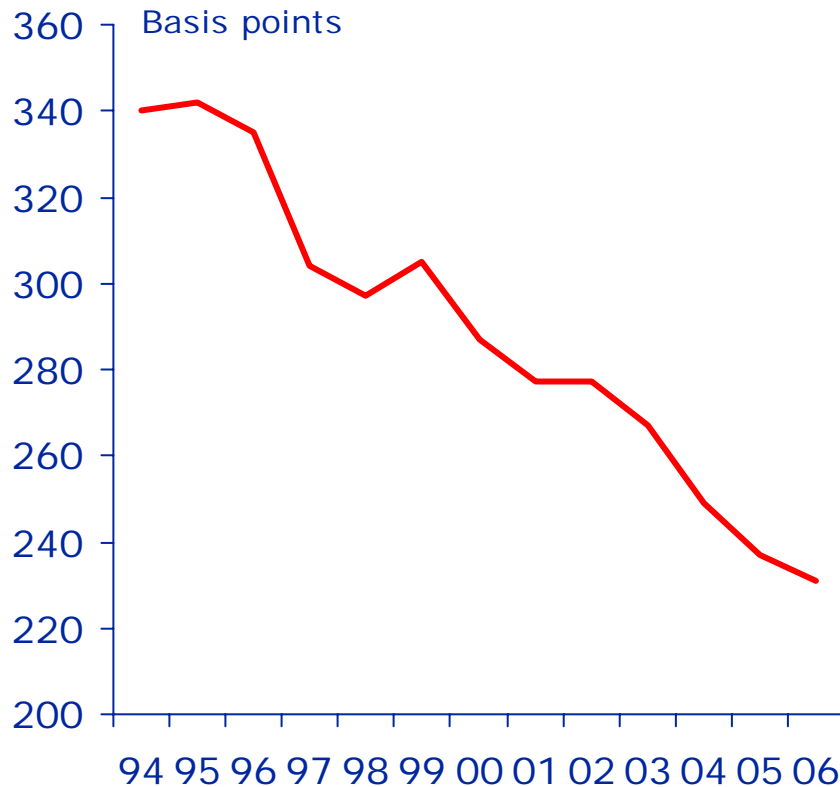
- **Fading of some of the factors which have driven rapid growth over the past half-dozen or so years**
 - in particular, the investment boom and rapid productivity growth
- **Emerging capacity constraints**
 - after 15 years of continuous growth Australia is beginning to encounter skilled labour shortages, physical capacity constraints and infrastructure bottlenecks
- **Lack of scale and distance from major world centres**
 - Australia represents barely 1% of world GDP, and unlike other small countries isn't sufficiently close to large affluent markets to be a natural 'base' for many manufacturing or services activities
- **Poor track record in innovation**
 - relatively low R&D effort, and poor linkages between universities and industry
- **Uncompetitive income tax system**
 - Australia's personal tax system is very complex with lots of concessions, exemptions and distortions favouring particular taxpayers or types of income and spending over others
- **Environmental sustainability**
 - Australia has major problems with availability and reliability of water, salinity, soil degradation

Strategic and other challenges for Australian banks in the next few years

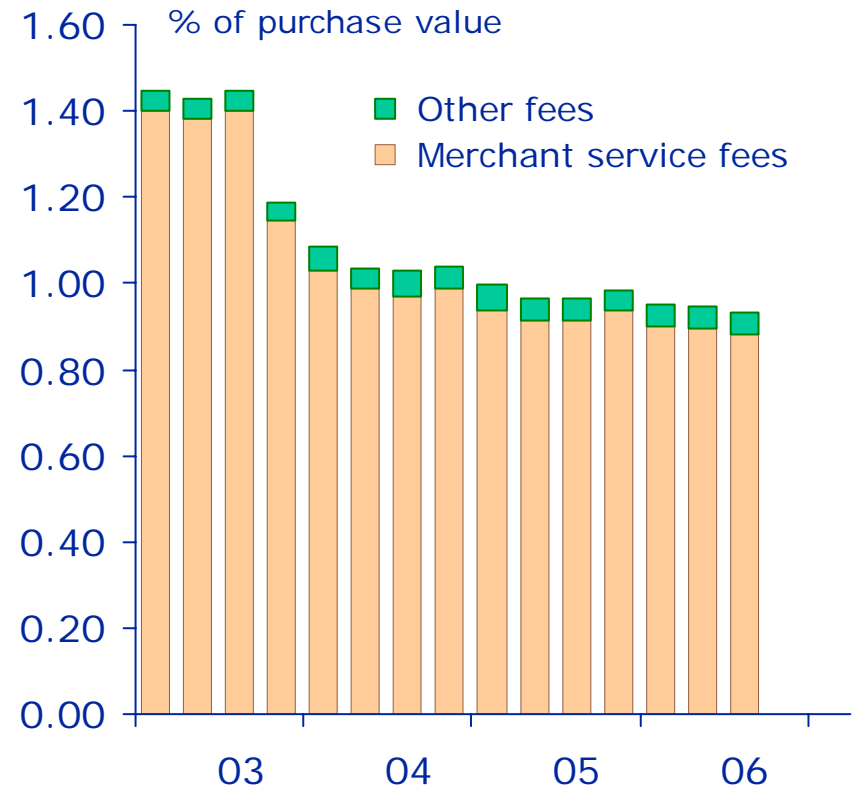
- **Generating revenue growth**
 - growth in lending to households (50% of total domestic asset growth over past decade) has peaked
 - competitive / regulatory pressure on credit card fees and margins
- **Competition in new areas**
 - particularly small business lending
- **Making a success of 'wealth management'**
 - most banks have made substantial investments in this space
 - but face formidable competition from large and experienced international funds managers and smaller domestic 'boutique' operators
- **Funding balance sheet growth**
 - as retail deposits have become less attractive as a household savings vehicle, banks have become more dependent on wholesale deposits and offshore borrowing
- **Maintaining credit quality**
 - despite efforts to achieve growth in revenues
- **Rebuilding standing in the community**
 - banks have had considerable difficulty achieving an appropriate balance among the interests of different stakeholders

Competition and regulatory pressure putting downward pressure on key income sources

ANZ's net interest margins



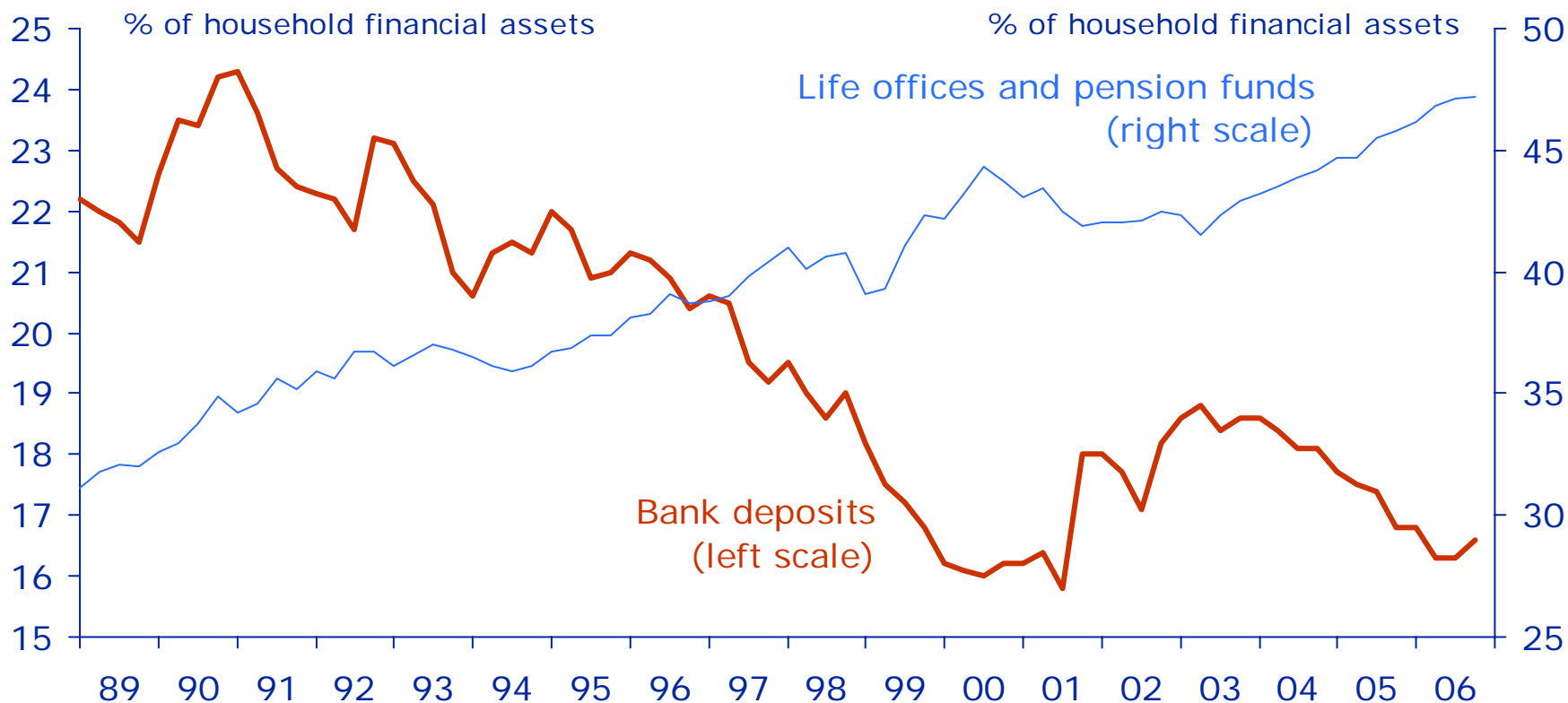
Banks' credit card fees



Source: ANZ Annual Reports;
Reserve Bank of Australia

Households are holding a declining proportion of their assets in the form of bank deposits

Components of household financial assets



Source: ABS Financial Accounts.