

# The global financial crisis and its impact on the Australian economy

Presentation to Singapore clients

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- The global financial crisis won't be 'over' until the doubts about the solvency of money centre banks are removed
    - that is likely to require the commitment of hundreds of billions of dollars of additional government funds, and more bank nationalizations
    - it remains a complex and politically fraught task
    - and the global economy won't begin to turn around until this task has been accomplished
  - The current global downturn has more in common with pre-war depressions than with the typical post-war recession
    - economic activity is contracting unusually sharply and many countries (especially those whose exchange rates have appreciated) will experience deflation
  - 'Orthodox' economic policies will not reverse the current downturn
    - there are some medium-term risks associated with monetary policy 'quantitative easing' and large budget deficits, but they are outweighed by the near-term risks associated with doing nothing
  - China will be the first major economy to engineer an upturn in growth
    - but China on its own cannot turn the global economy around
  - In the aftermath of the global financial crisis, national financial systems will be subject to much more stringent regulation
    - among the consequences of which will be less freely available credit, and hence much more subdued recoveries in asset prices

# Global economic forecast summary

	Real GDP growth (%)			
	2007	2008	2009 (f)	2010 (f)
United States	2.0	1.3	-2½	1¾
Japan	2.4	-0.7	-3¾	½
Euro area	2.5	0.7	-2	½
United Kingdom	3.0	0.7	-2½	½
Canada	2.7	0.6	-1¼	1
<i>'Advanced' economies</i>	<i>2.4</i>	<i>0.8</i>	<i>-2¼</i>	<i>1</i>
China	13.0	9.1	7	8½
Other East Asian economies	6.0	3.5	¼	4¼
India	9.3	7.2	5¼	7
Russia	8.1	5.6	1	3¼
Latin America	5.6	4	1	2½
<i>'Emerging &amp; transition' economies</i>	<i>8.4</i>	<i>6.1</i>	<i>3</i>	<i>5¼</i>
<i>World</i>	<i>4.8</i>	<i>2.9</i>	<i>0</i>	<i>2¾</i>

Note: Regional and global aggregates weighted using purchasing power parities.  
Sources: IMF; ANZ.

# Australia is unavoidably exposed to the global financial crisis and the sharp downturn in the global economy

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- Australia has a large current account deficit (on its transactions with the rest of the world) which it has been financing largely through overseas borrowings by local and foreign banks
  - such borrowings have become more difficult and (relatively) more expensive
  - foreign banks (especially those now under the control of governments) are likely to become less willing to lend abroad (including to Australia)
  - Australian banks don't have sufficient capital to replace all the lending previously undertaken by foreign banks or securities markets
- 'Terms of trade' gains (mainly due to rising commodity prices) have boosted Australia's national income by 2% pa (or nearly 15%) since 2001
  - the sharp fall in commodity prices since mid-2008 (which has further to run) will detract significantly from national income in 2009 (as well as adversely affecting employment and investment)
- Deep recessions in many of Australia's major trading partners will inevitably affect the volume of Australia's exports
- Australian share prices have fallen by at least as much as share prices overseas, adversely impacting household and business finances
  - Australian households and businesses are now emphasizing 'balance sheet repair' rather than spending
- Australian business confidence is inevitably affected by the almost relentless tide of 'bad news' from overseas

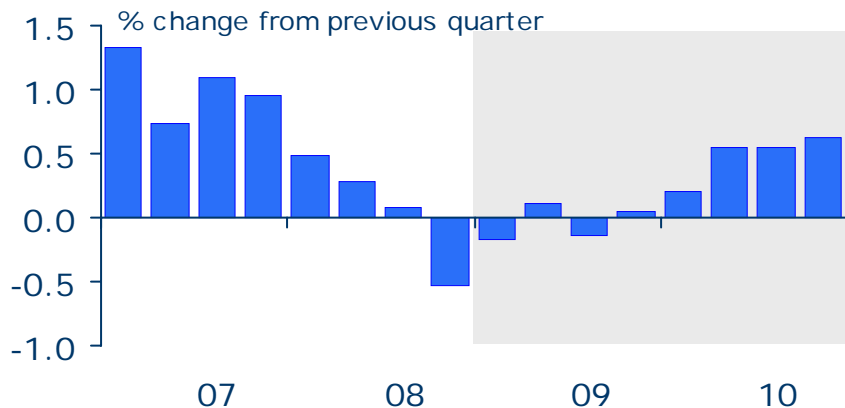
... but that doesn't mean that Australia's outlook is as bleak as other countries, or will be as bad as 1990-91

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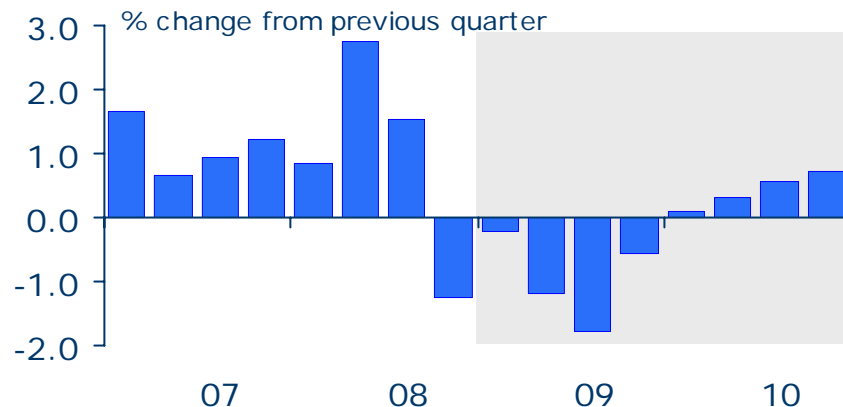
- Most of the factors which have precipitated such severe downturns in the US and Europe are not present to anything like the same degree in Australia
  - Australia's banking system is still in good shape – making profits, not needing capital injections from governments, and continuing to lend (albeit on more demanding terms)
  - despite being 'expensive' relative to incomes, Australian house prices haven't fallen significantly (except at the top end), and there are some good reasons to expect that they won't
- The large fall in the A\$ is of considerable assistance in two ways -
  - in cushioning the impact of sharp falls in commodity prices
  - and in reducing the risk of deflation
- Monetary policy is working more effectively in Australia than in many other countries
  - interest rates paid by most borrowers have actually fallen, in some cases significantly
- Fiscal policy is being activated earlier into the downturn than in previous Australian recessions, and earlier than in the downturns now being experienced in other countries
  - and the measures being taken in Australia have in many respects been better designed than those in other countries

# On all benchmarks, Australia has entered a recession for the first time in nearly 20 years

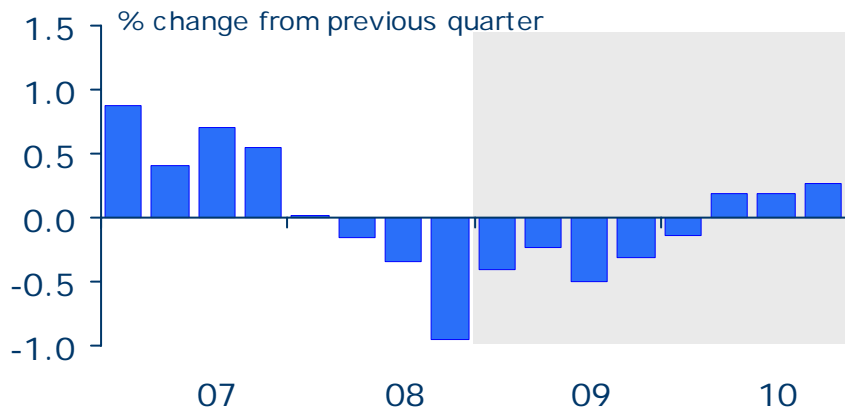
### Real gross domestic product (GDP)



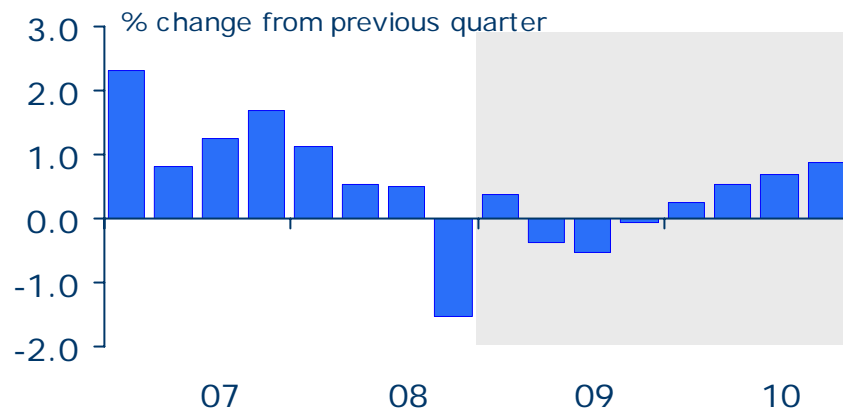
### Real gross domestic income (GDI)



### Real per capita GDP



### Real gross national expenditure (GNE)



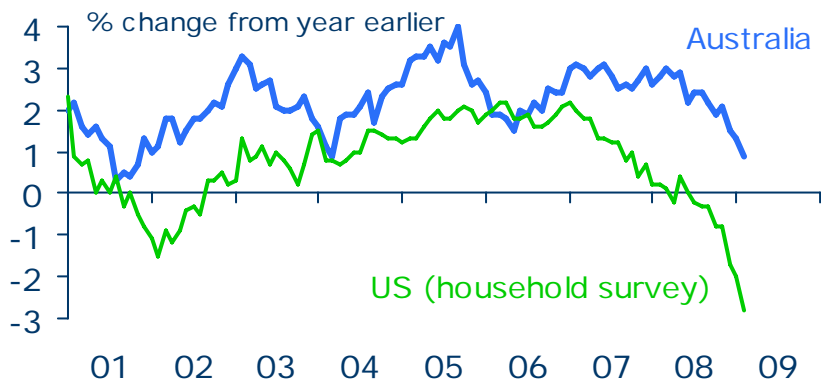
Note: Real gross domestic income is real GDP adjusted for changes in the terms of trade (export relative to import prices). Shaded areas denote ANZ estimates or forecasts. Sources: ABS; ANZ.



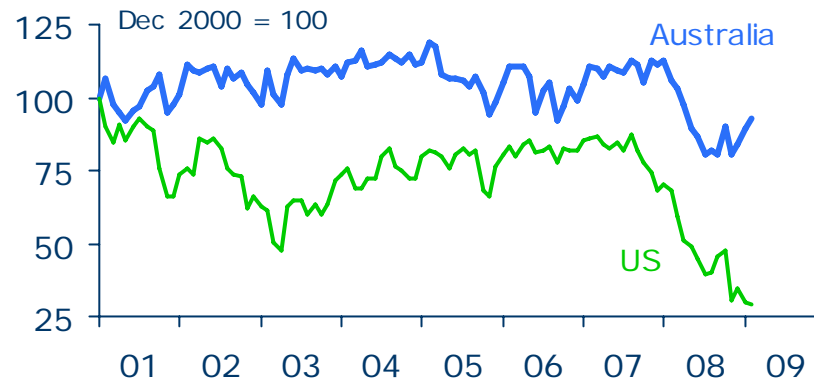
However there is no reason to believe that Australia's recession will be as severe as that now under way in the United States

## Australian and US labour market and household spending

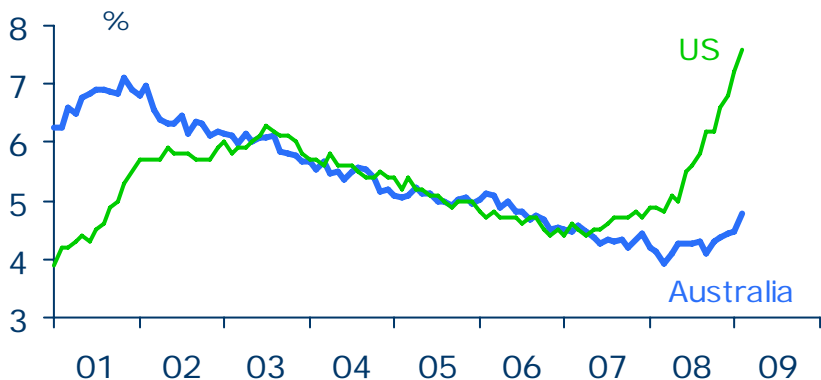
### Employment



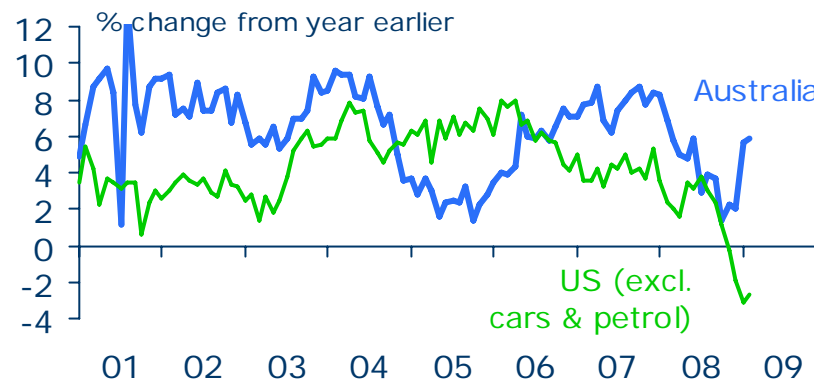
### Consumer confidence



### Unemployment rate



### Retail sales



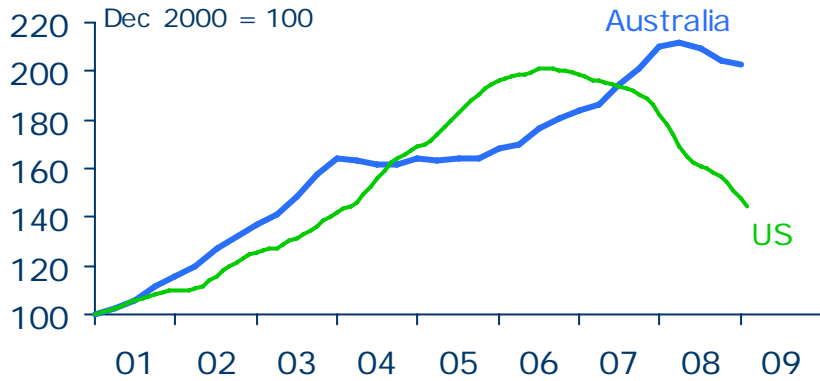
Sources: ABS; US Bureau of Labor Statistics; The Conference Board; Roy Morgan Research; US Commerce Department; ANZ.



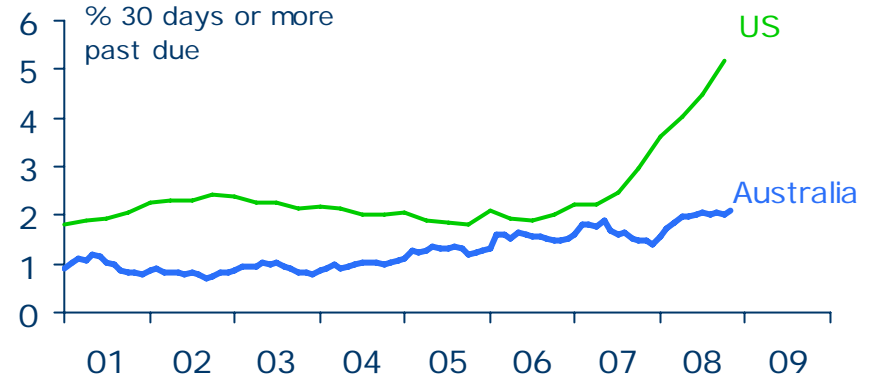
# Australia's housing market has not come under anything like the same stress as the US (and more recently Europe)

## Australian and US housing markets and household finances

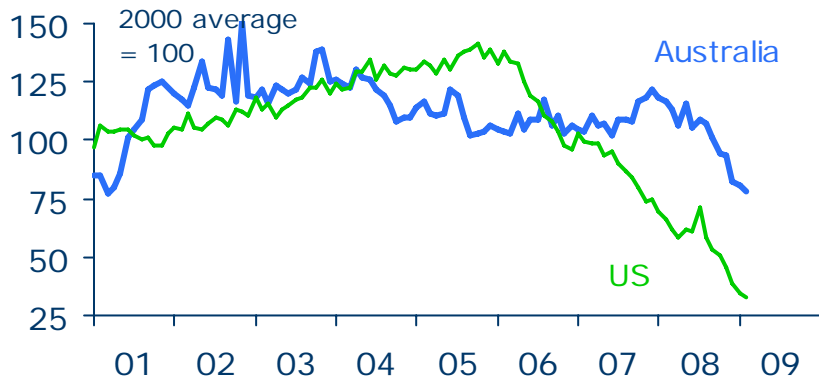
### House prices



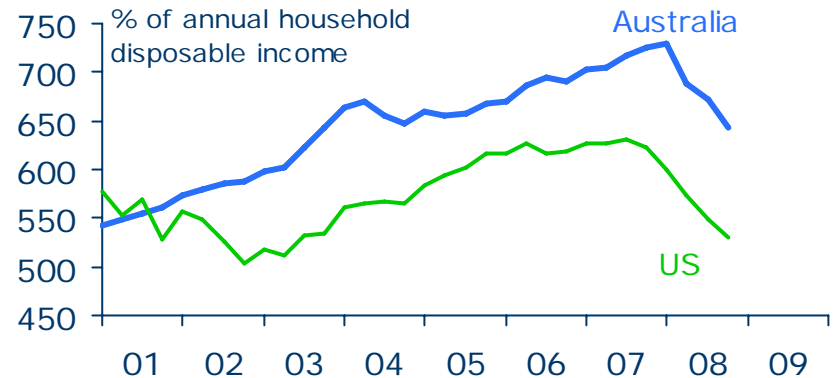
### Mortgage delinquency rates



### Housing approvals



### Household net worth

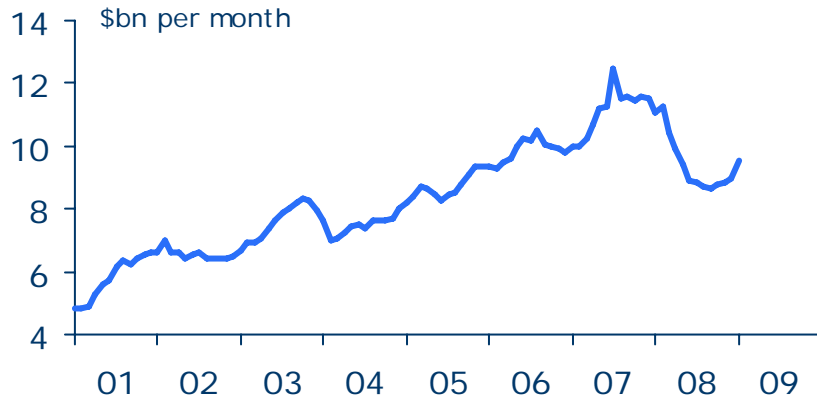


Note: Australian mortgage delinquencies are for securitized mortgages only. Sources: ABS; S&P; US Federal Reserve; Mortgage Bankers' Association of America; US Commerce Department; ANZ.



Rising demand from first home buyers vs falling demand from (and lending to) investors will tend to put a floor under prices

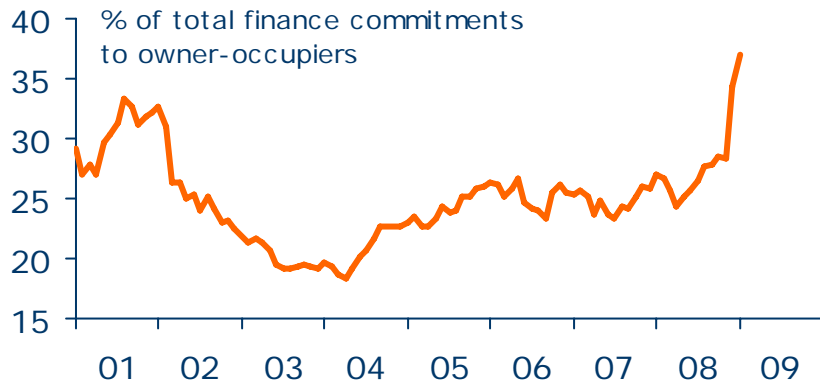
**Housing finance commitments to owner-occupiers**



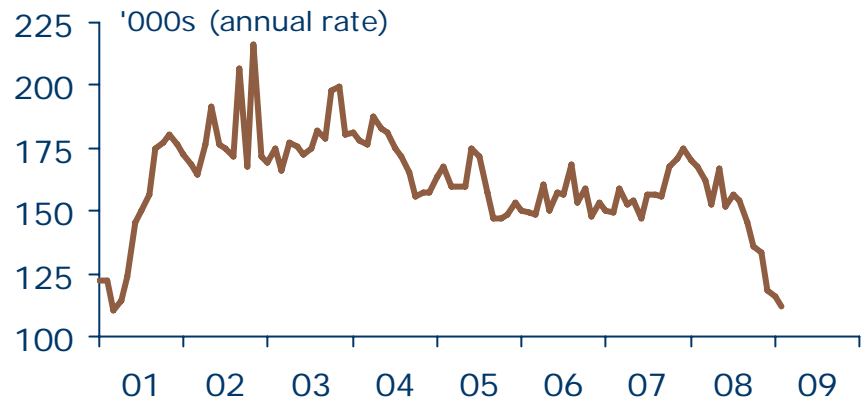
**Housing finance commitments to investors**



**First-time buyers as a pc of total commitments to owner-occupiers**



**Residential building approvals by local governments**

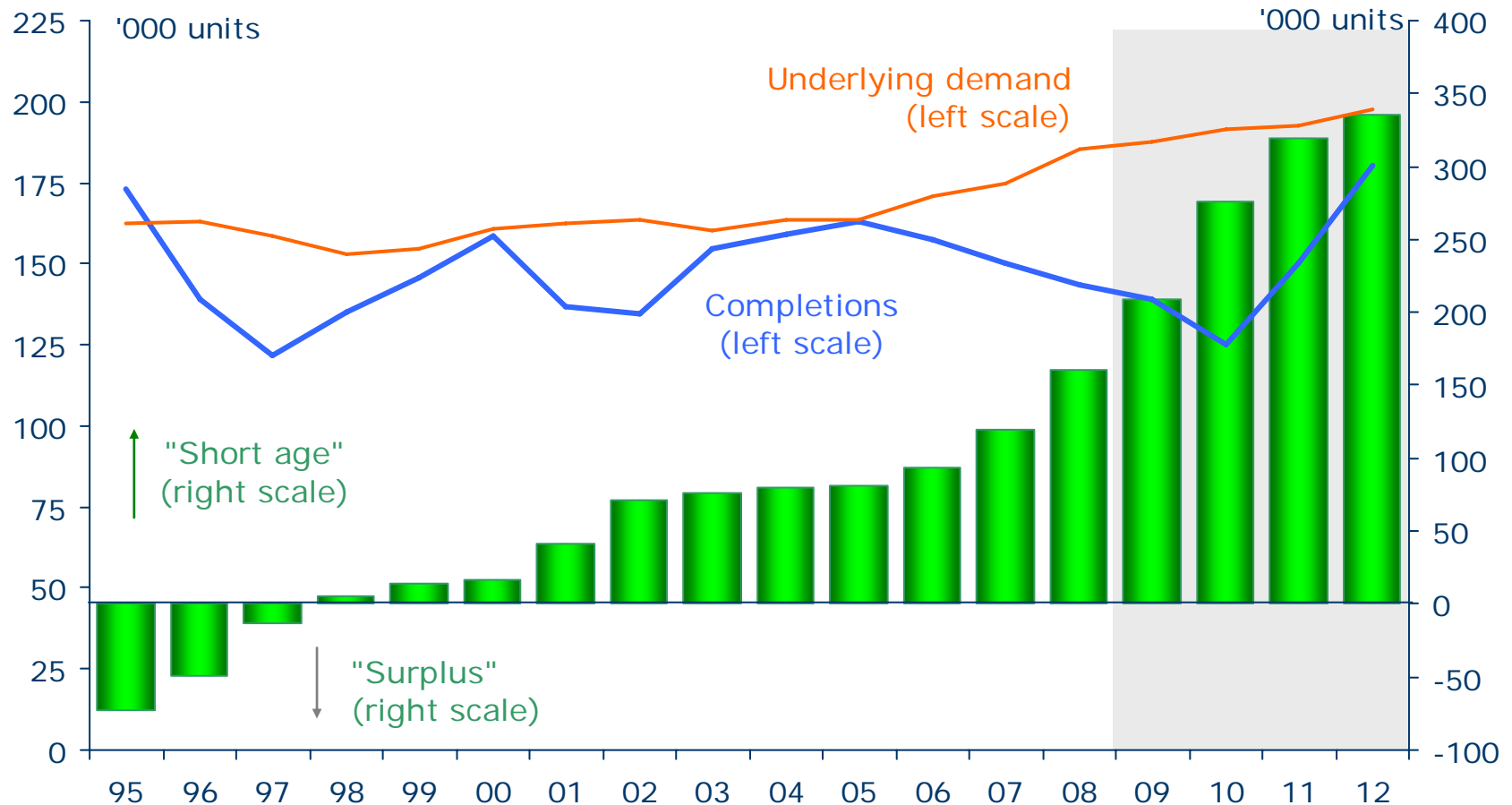


Sources: ABS; ANZ.



# The mis-match between physical supply of new housing and underlying demand for it will continue to increase

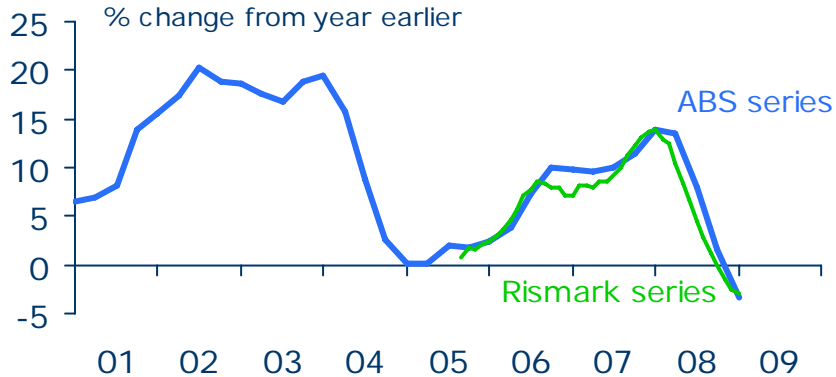
## Housing supply and underlying demand



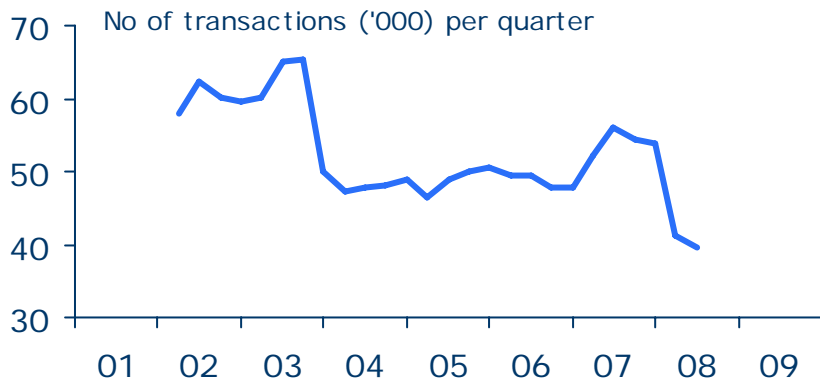
*Note:* 'Surplus' or 'shortage' is the cumulative difference between completions and underlying demand from an historical starting point and is highly sensitive to the selected starting point. The direction of movements in this measure is more significant than the level. *Sources:* ABS; ANZ.

# Relatively small house price declines reflect absence of 'forced' sellers; large declines concentrated in ritzier suburbs 11

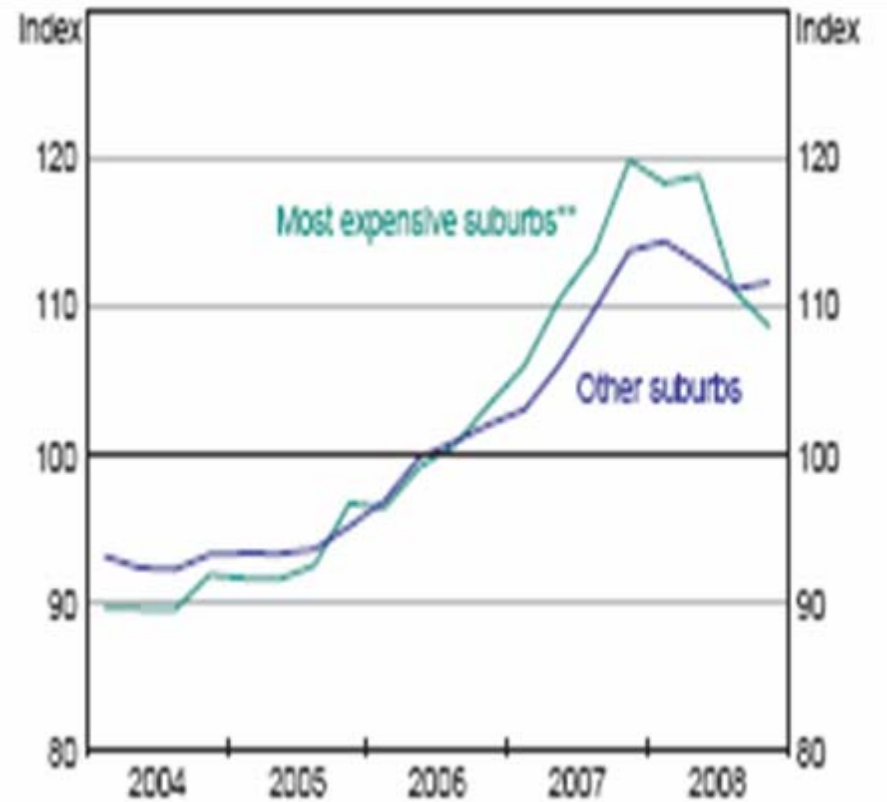
## Australian capital city house prices



## Turnover of established dwellings



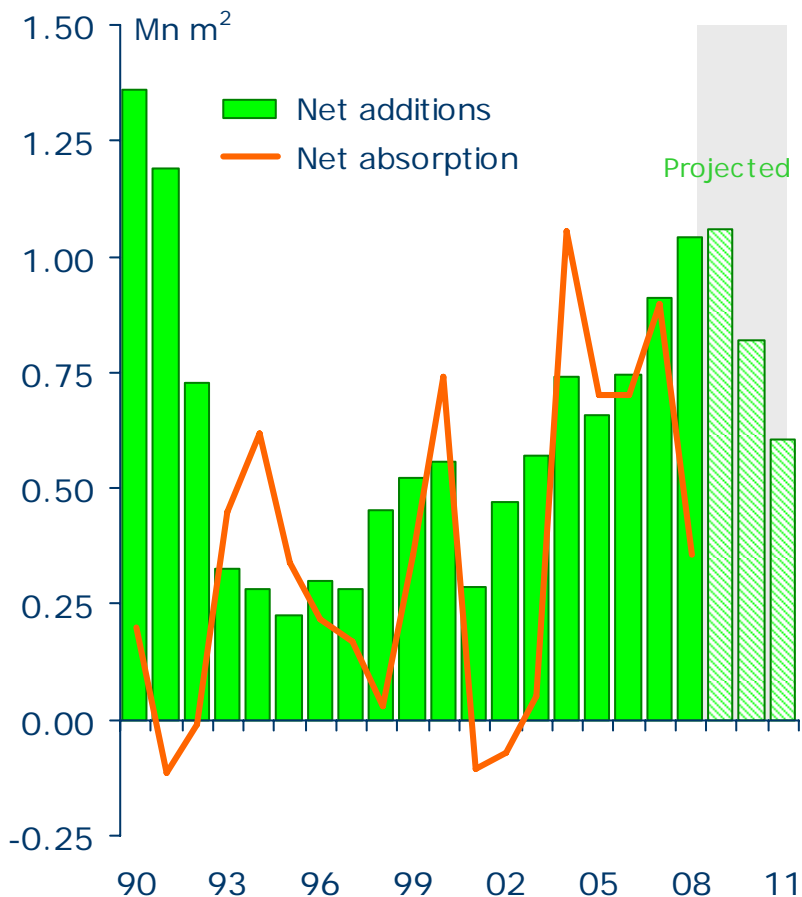
## House prices in 'expensive' vs other suburbs



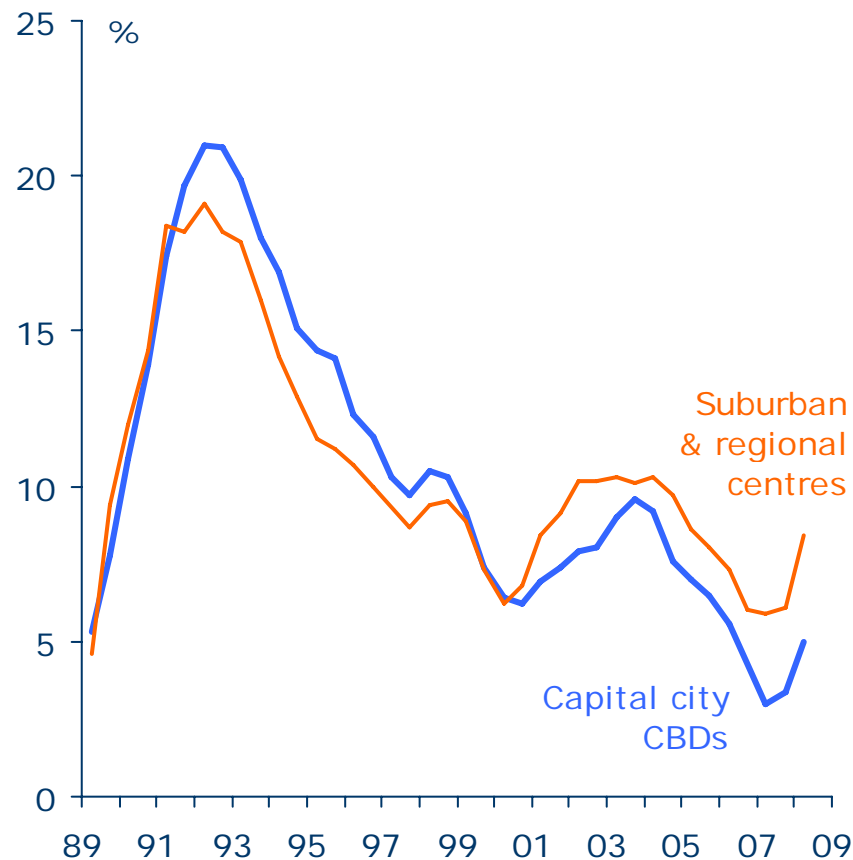
\*\* Most expensive 20% of suburbs

By contrast, office property supply is likely to grow more quickly<sup>12</sup> than demand over the next few years

Office supply and demand



Office vacancy rates

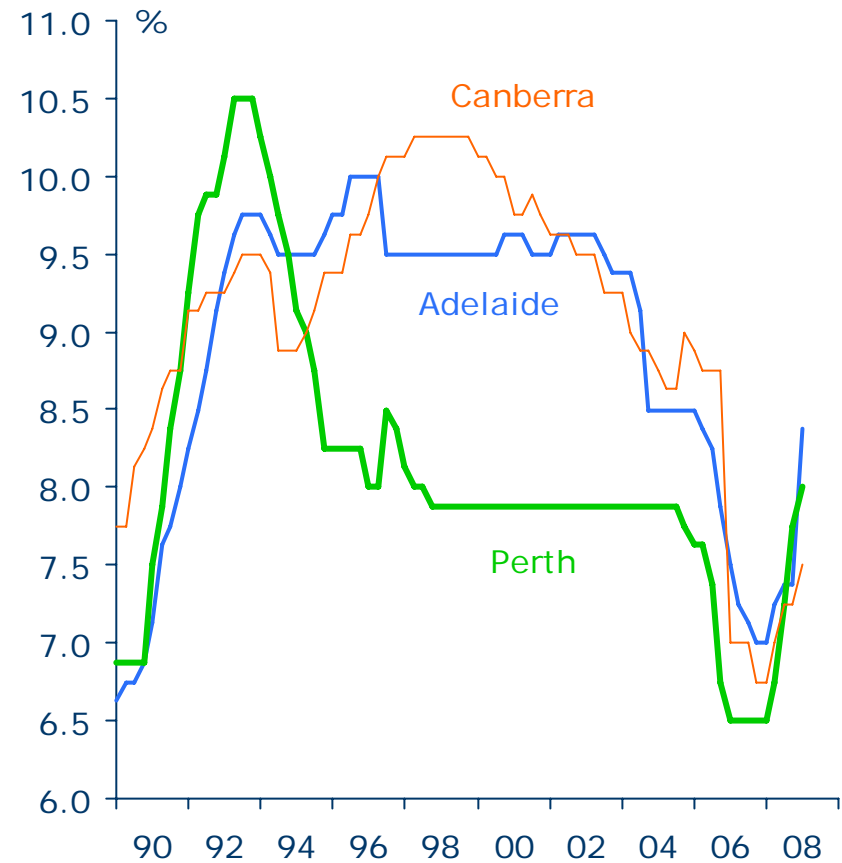
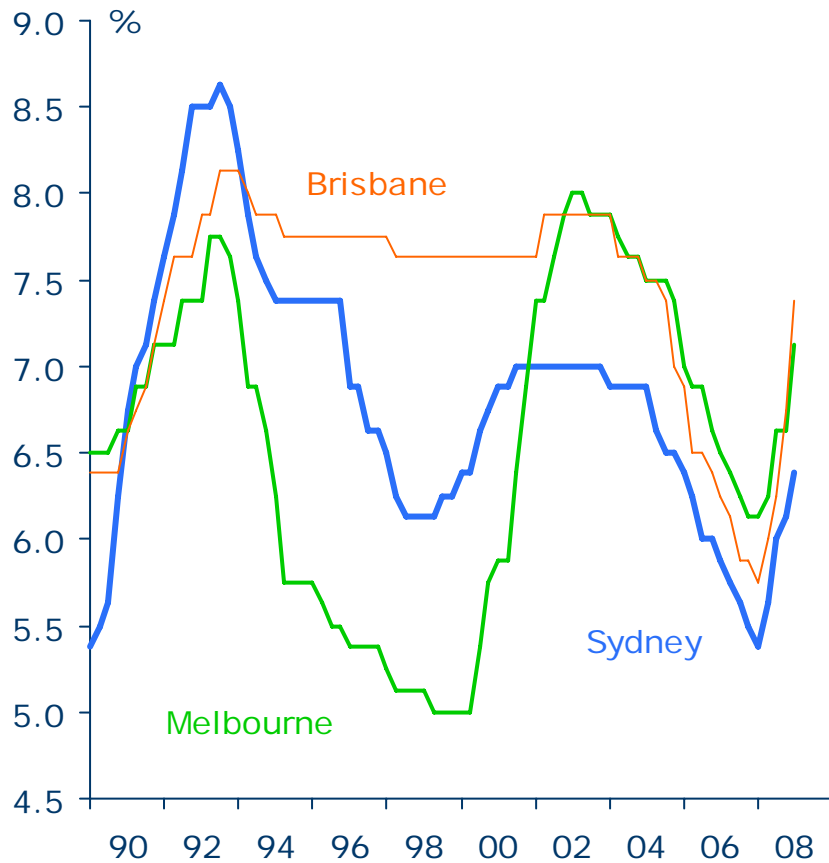


Sources: Property Council of Australia Office Market Report (January 2009).



# Prime office yields have already risen 100-150 basis points (on a very thin volume of transactions)

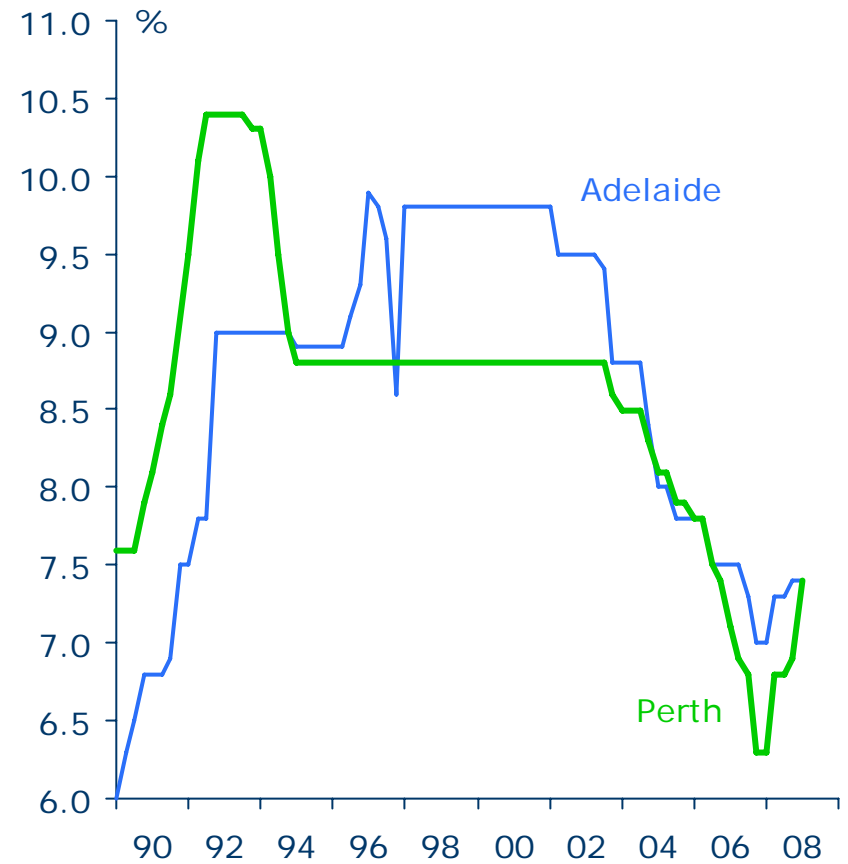
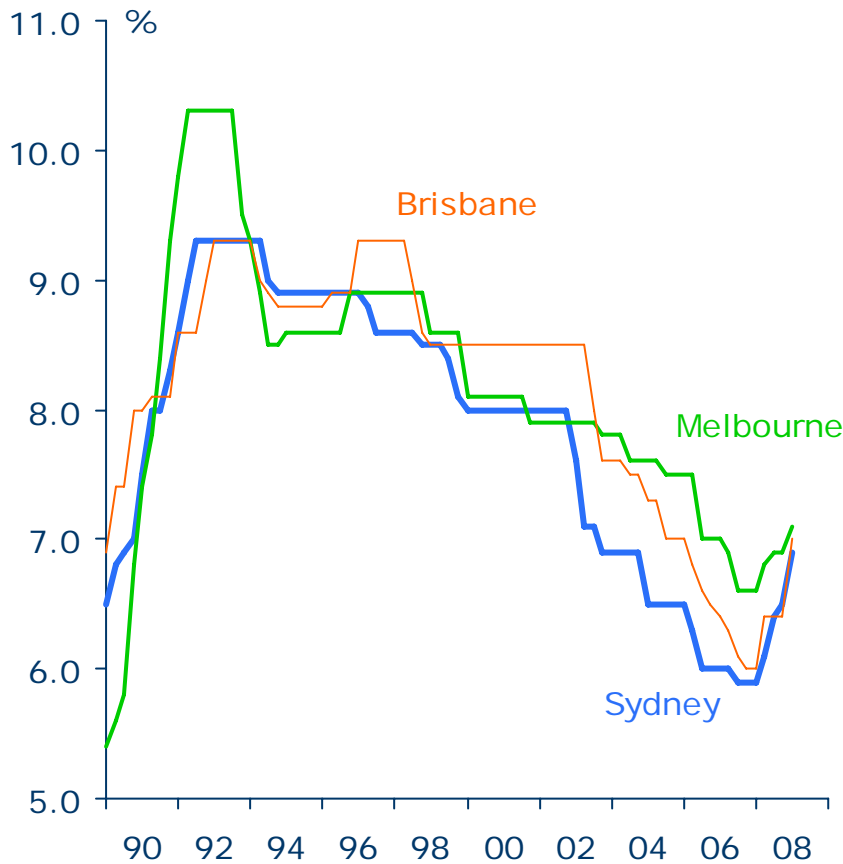
## Prime CBD office yields



Source: Jones Lang LaSalle.

# Retail property yields have also increased by 50-100 basis points since the end of 2007

## CBD retail yields

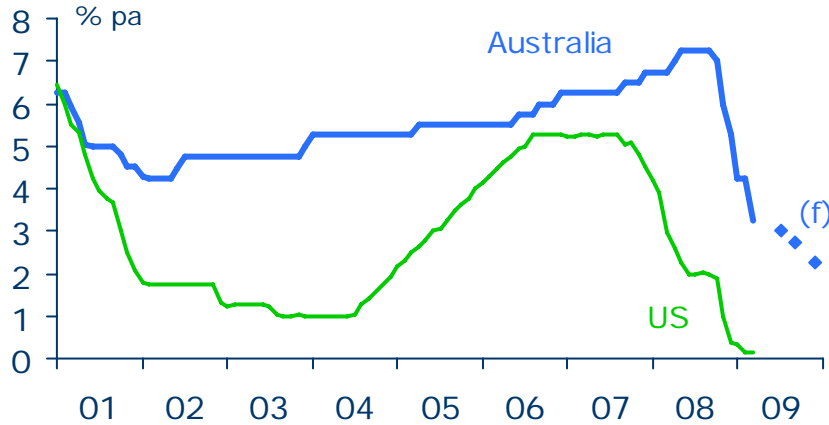


Source: Jones Lang LaSalle.

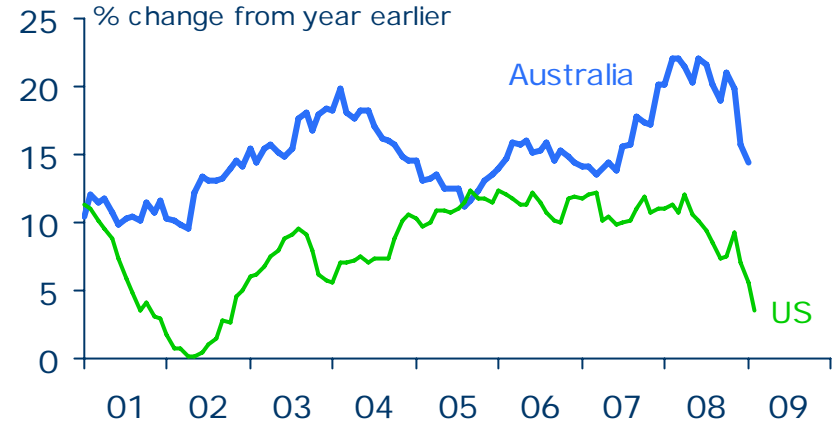


# Monetary policy is 'working' more effectively in Australia than in the US, in part because the banking system is in better shape <sup>15</sup>

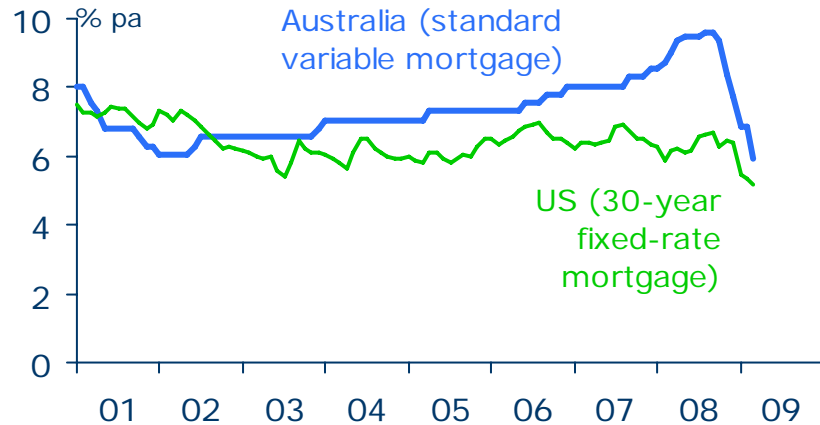
## Official interest rates



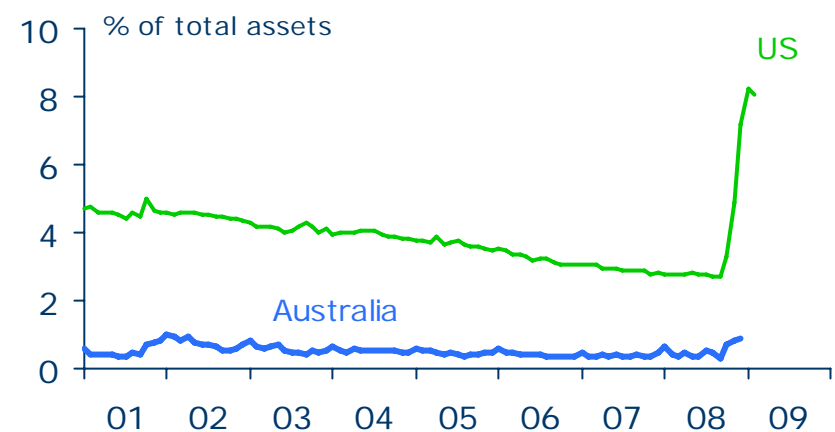
## Bank lending



## Most common mortgage rates



## Bank cash holdings

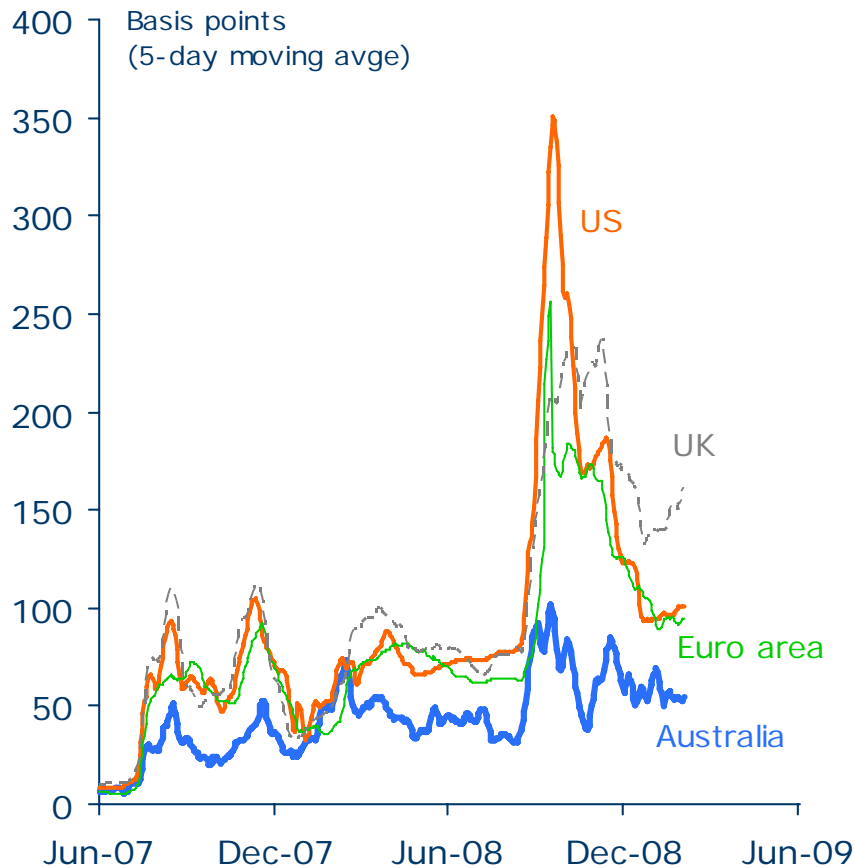


*Note:* 'Cash' includes deposits with the central bank. US banks are subject to required to hold cash reserves against their transactions account balances and thus typically hold a higher proportion of their assets in cash than Australian banks which are no longer subject to such requirements. *Sources:* RBA; US Federal Reserve; Datastream.

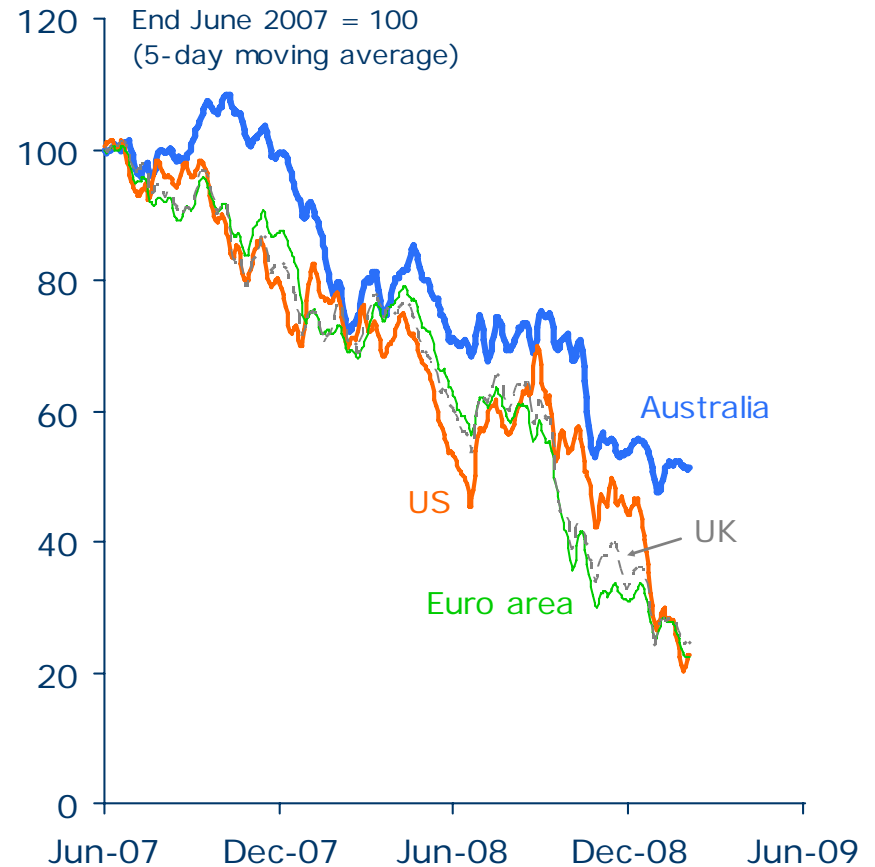


# Australian banks have been affected by the global financial crisis, but much less than their American or European peers

## Spreads between 3-month bank wholesale funding cost and official cash rates\*



## Bank share prices



\* Strictly speaking, the spread between the 3-month Libor (or in Australia bank bill swap rate) and the 3-month overnight index swap (OIS) rate which measures market expectations of future changes in the official cash rate.  
Sources: Bloomberg; Thomson Financial Datastream.

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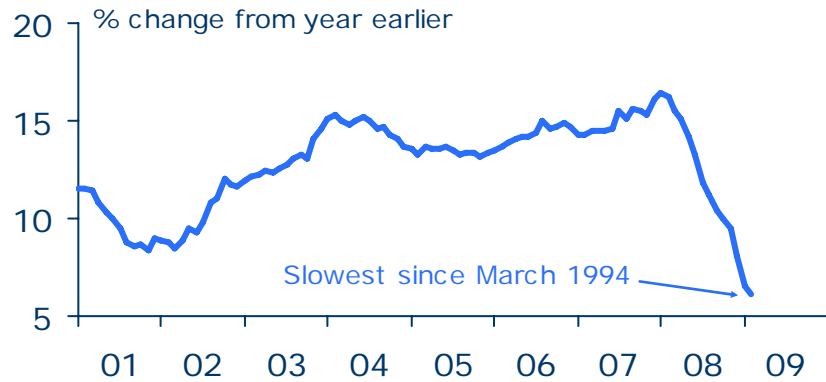
## ***Global Finance's 50 safest banks***

1. KfW (Germany)
2. Caisse des Depots et Consignations (CDC) (France)
3. Bank Nederlands Gemeenten (BNG) (Netherlands)
4. Landwirtschaftliche Rentenbank (Germany)
5. Rabobank (Netherlands)
6. Landeskreditbank Baden-Wuerttemberg-Foerderbank (Germany)
7. NRW Bank (Germany)
8. BNP Paribas (France)
9. Banco Santander (Spain)
10. Royal Bank of Canada (Canada)
- 11. National Australia Bank (Australia)**
- 12. Commonwealth Bank of Australia (Australia)**
13. Banco Bilbao Vizcaya Argentaria (BBVA) (Spain)
14. Toronto-Dominion Bank (Canada)
- 15. Australia & New Zealand Banking Group (Australia)**
- 16. Westpac Banking Corporation (Australia)**
17. Banco Espanol de Credito S.A. (Banesto) (Spain)
18. ASB Bank Limited (New Zealand)
19. HSBC (United Kingdom)
20. Credit Agricole (France)

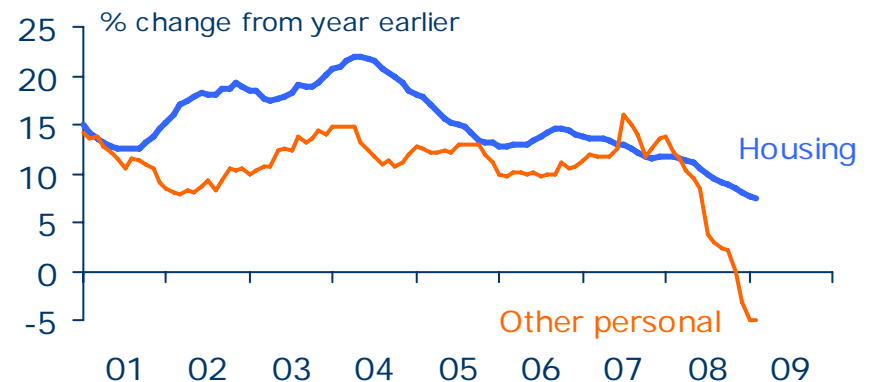
# Nonetheless both the demand for and supply of credit to Australian households and businesses is slowing

## Credit provided to the Australian private sector

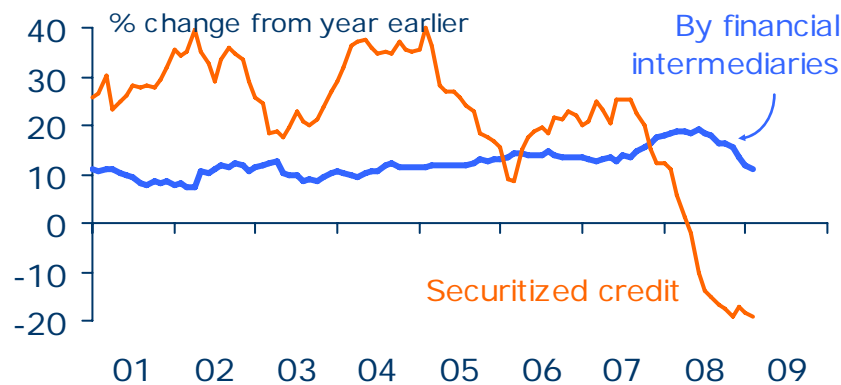
### Total credit



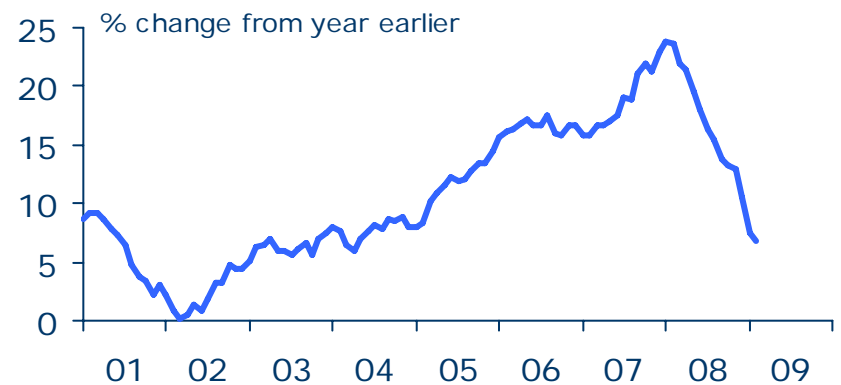
### Credit to households



### Credit by source



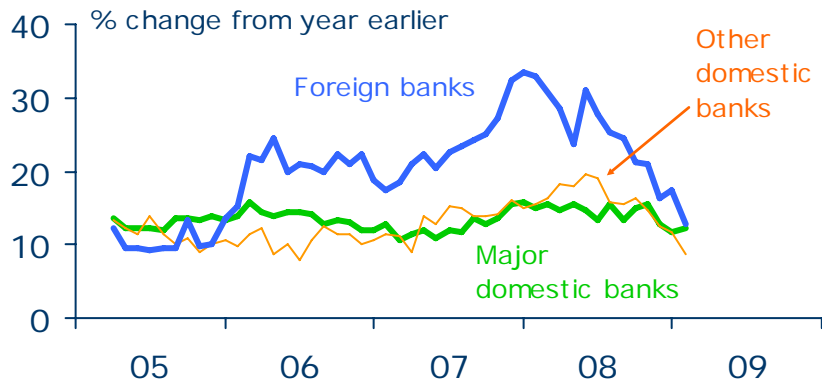
### Credit to business



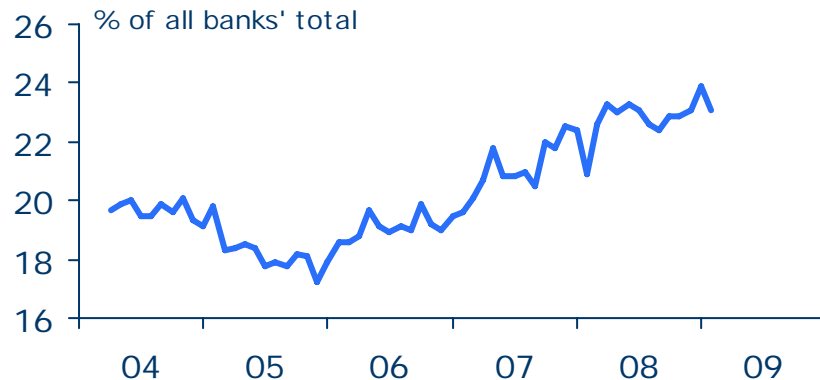
Source: Reserve Bank of Australia.

# Withdrawal of foreign banks would add to pressure on credit availability in Australia

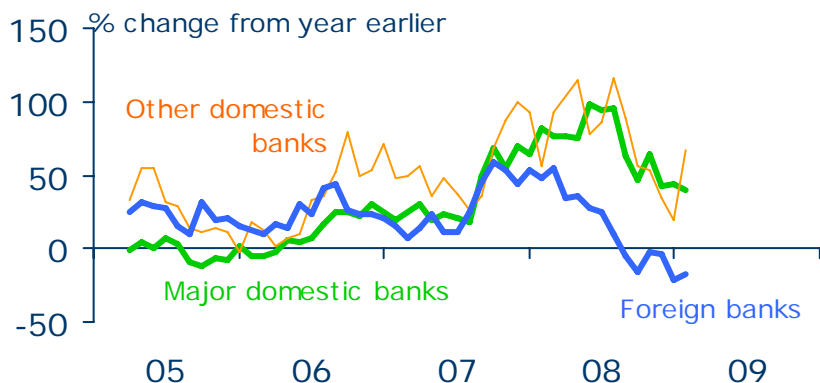
## Growth in gross loans, advances & acceptances



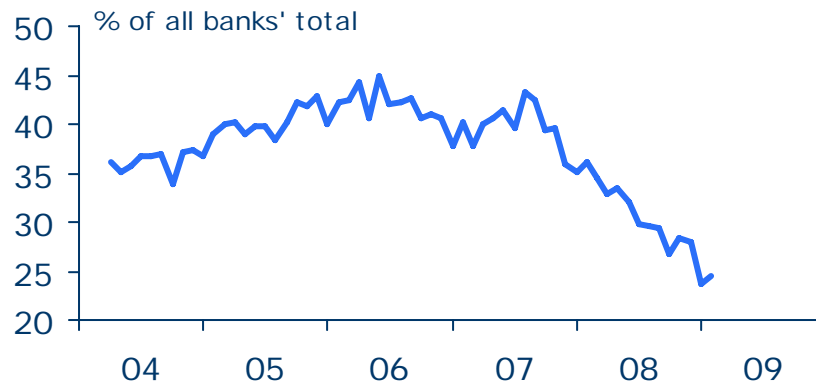
## Foreign banks' share of non-housing loans



## Growth in securities holdings



## Foreign banks' share of securities holdings

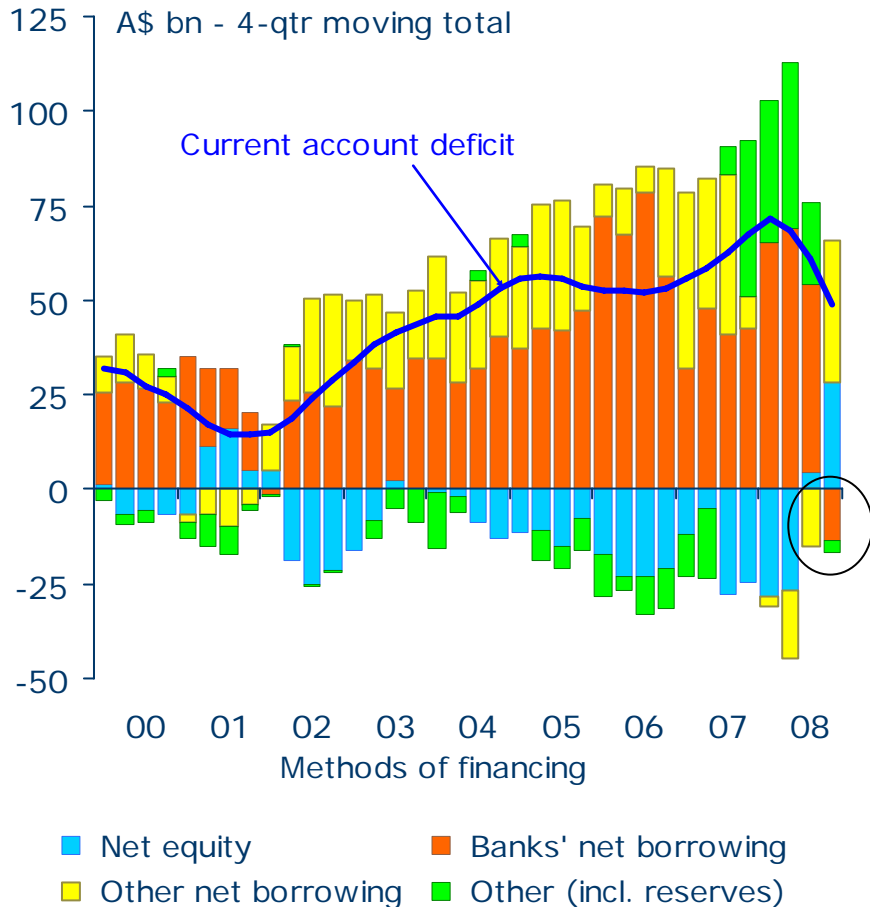


Note: SGB included in 'other domestic banks'; BWA in 'foreign banks'. 'Foreign banks' comprises branches and subsidiaries of foreign banks operating in Australia. Source: APRA monthly data.

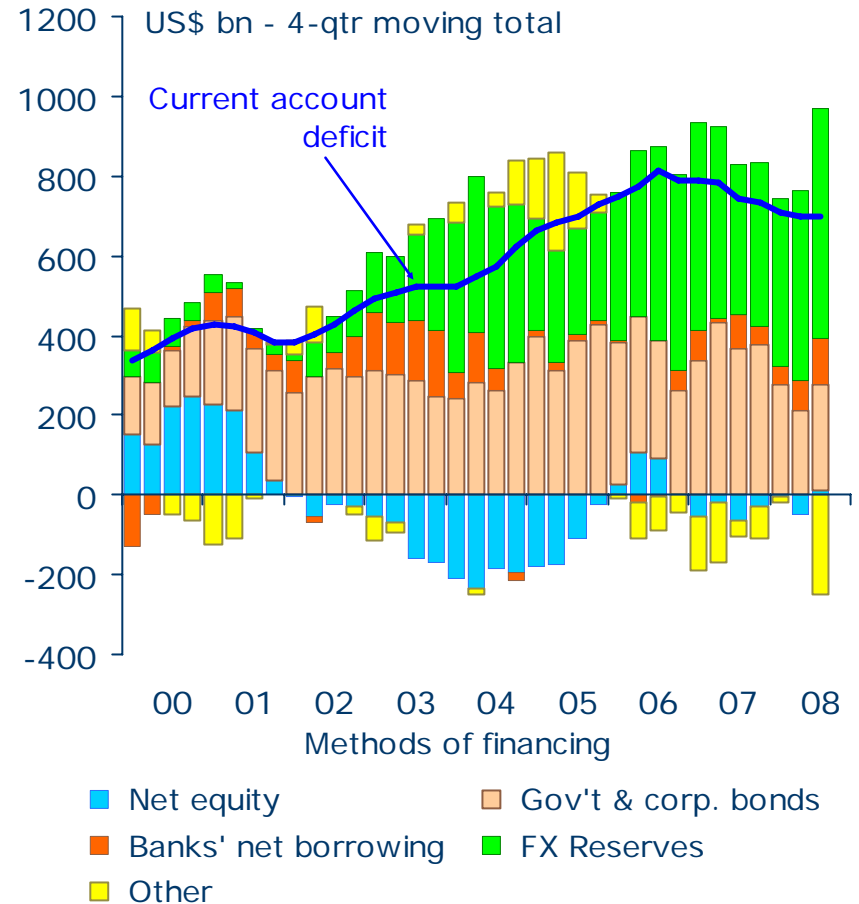


# Australia's current account deficit has (until 2008) been financed largely through overseas borrowing by banks <sup>20</sup>

## Financing Australia's current account deficit



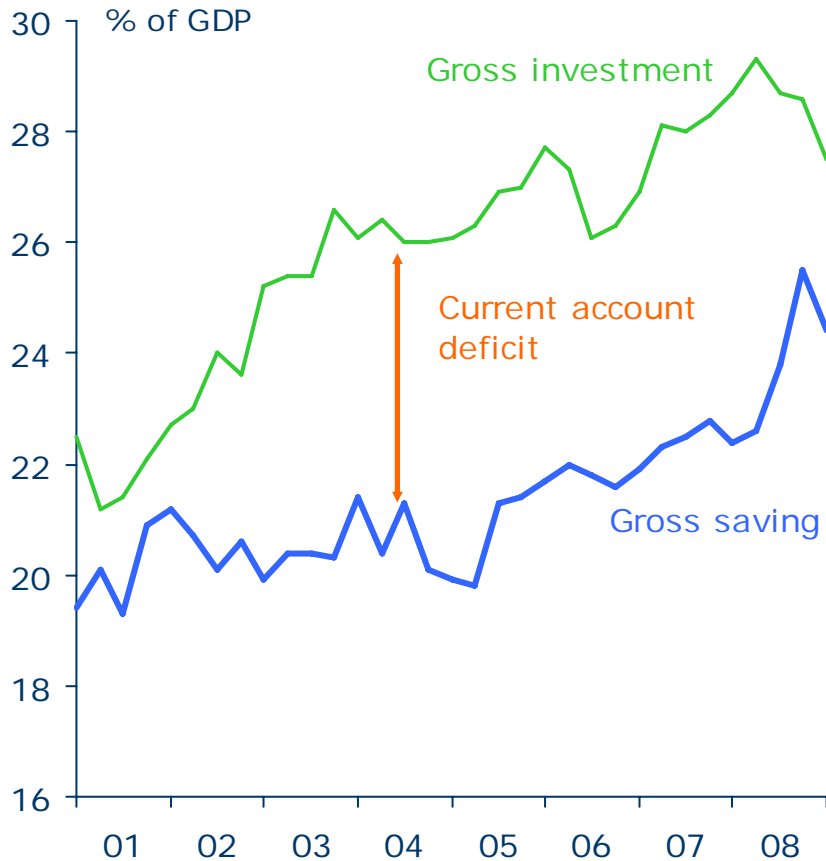
## Financing the US current account deficit



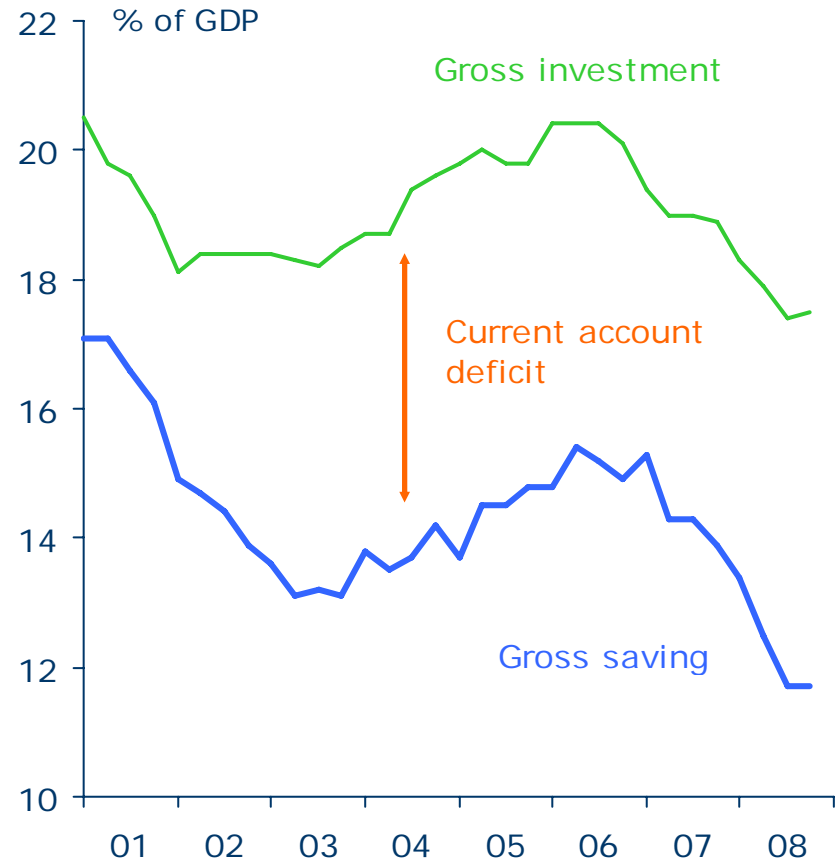
# Australia's current account deficit has been due largely to rising investment, not to falling saving as in the US

## Gross saving and investment as pc of GDP

### Australia



### United States

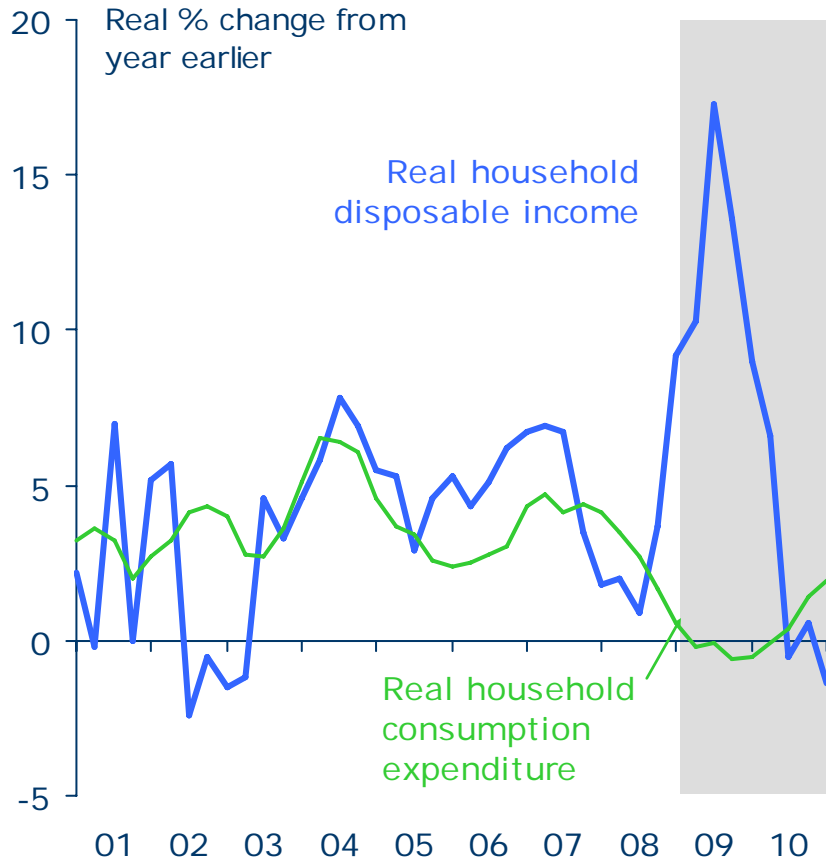


Sources: US Bureau of Economic Analysis; ABS; ANZ.

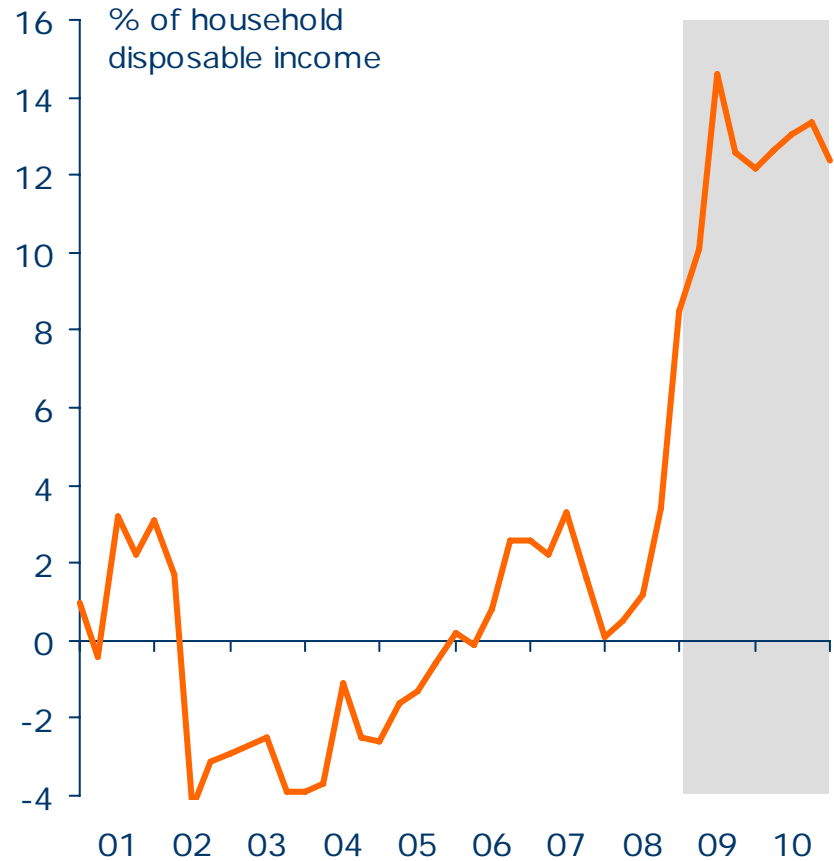


Cash handouts, interest rate cuts, and lower petrol prices will boost household incomes substantially – but a lot of it will be saved

### Household disposable income and spending



### Household saving rate

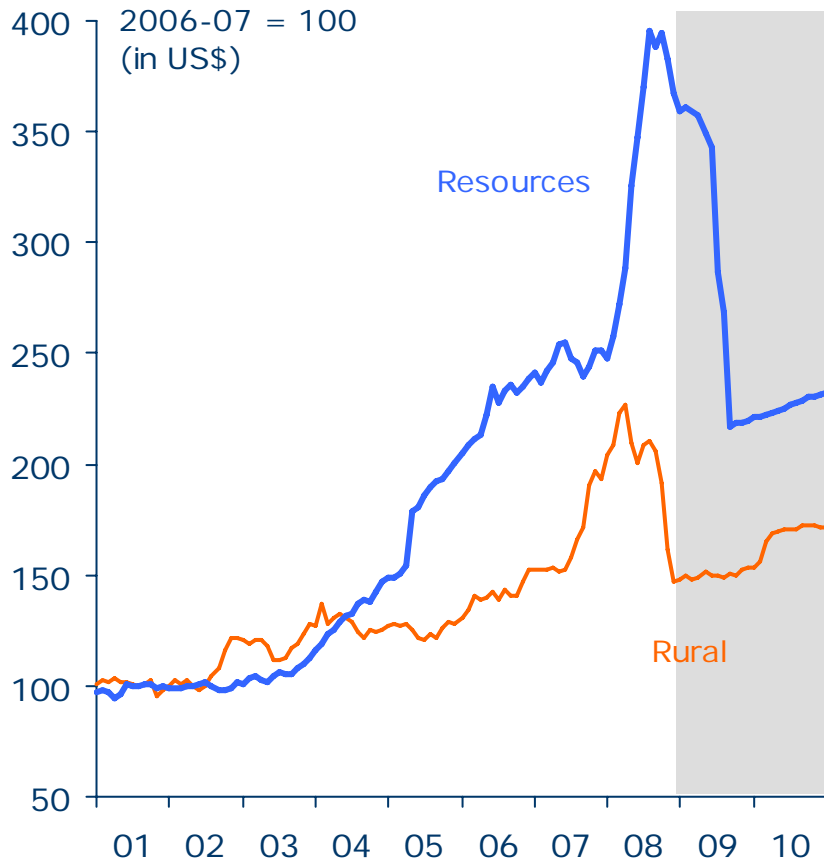


Sources: ABS; ANZ.

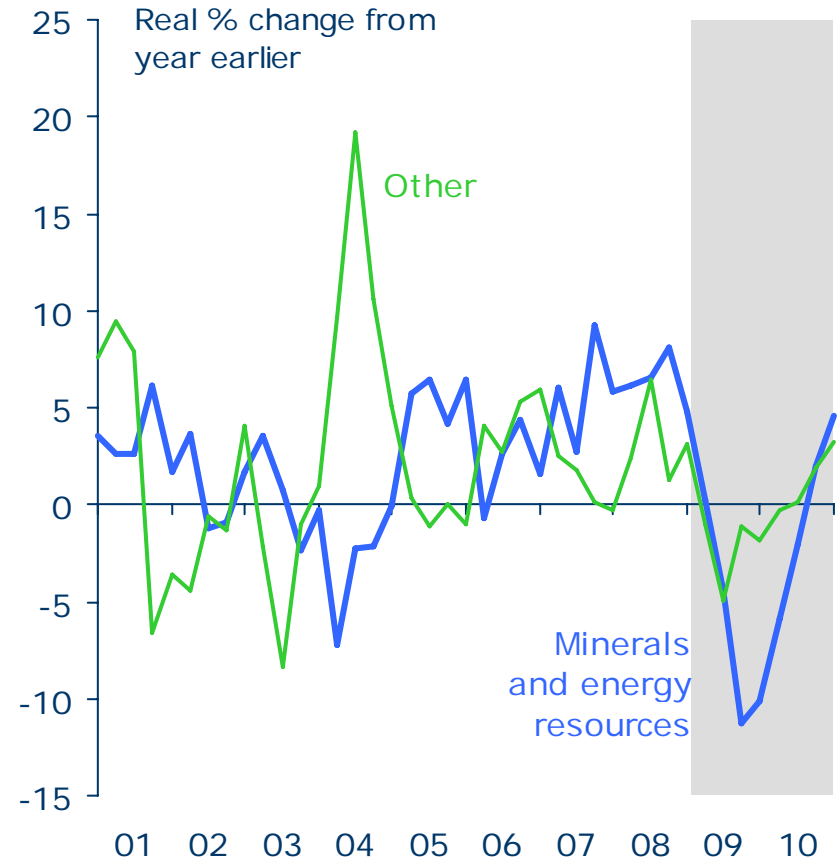


# Export commodity prices and export volumes will fall sharply in 2009

## Export commodity prices



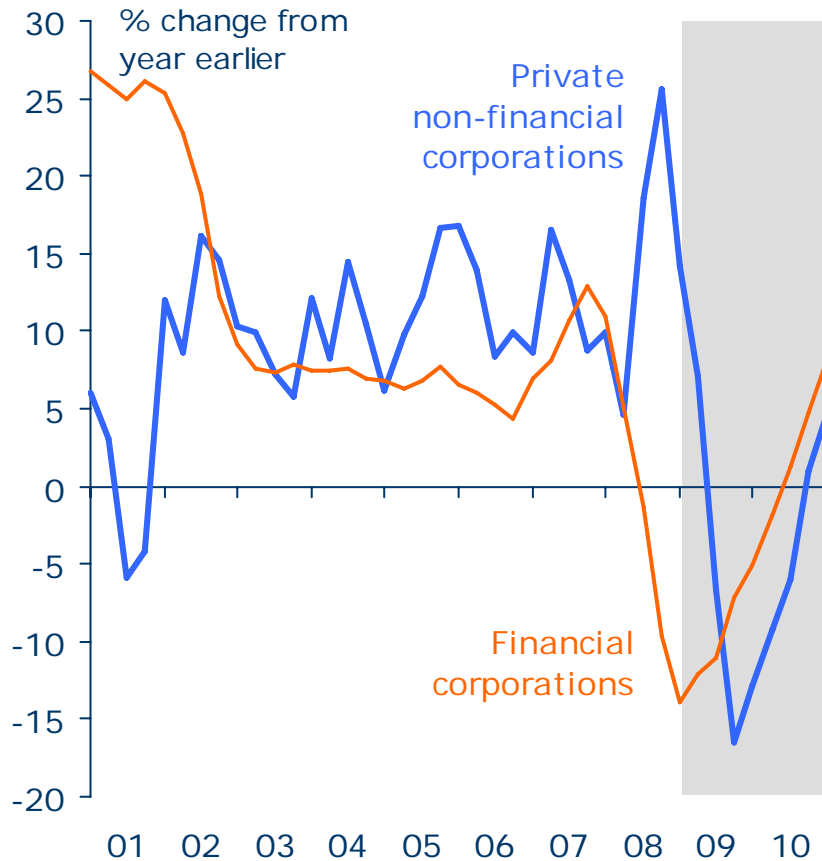
## Export volumes



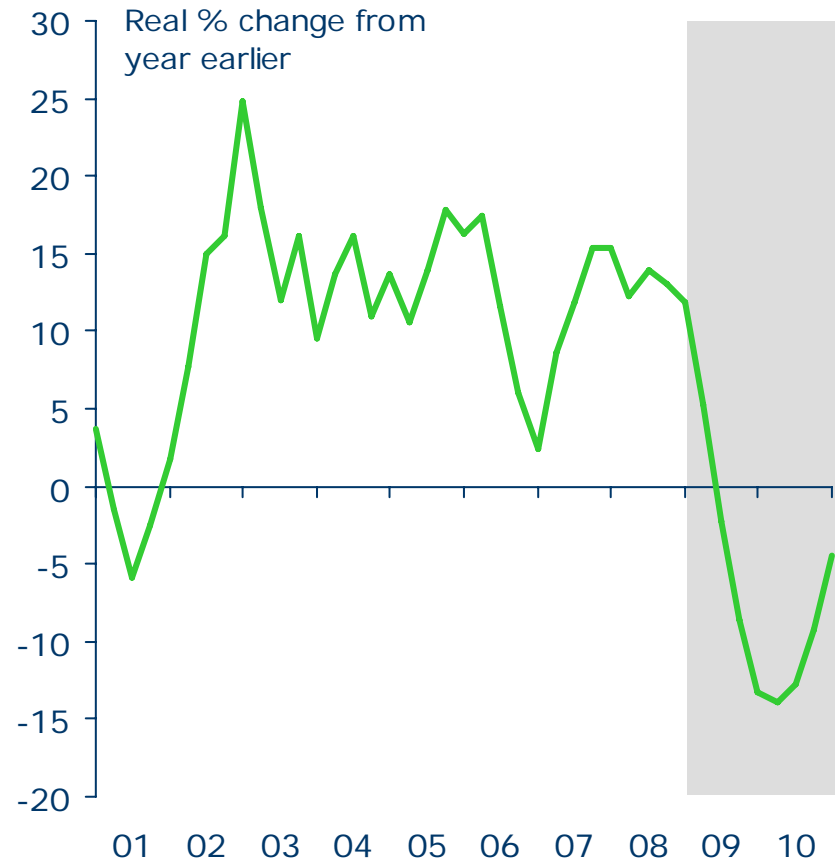
Sources: RBA; ABS; ANZ.

# Corporate profits are likely to fall sharply, in turn prompting significant reductions in capital investment

## Corporate 'gross operating surplus'



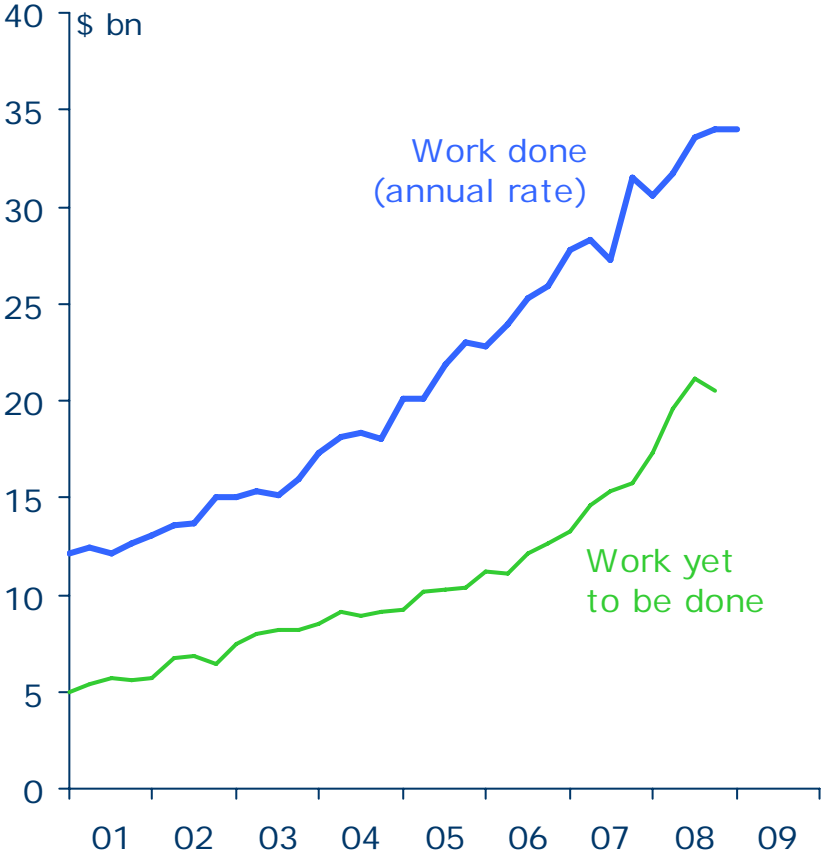
## Business investment



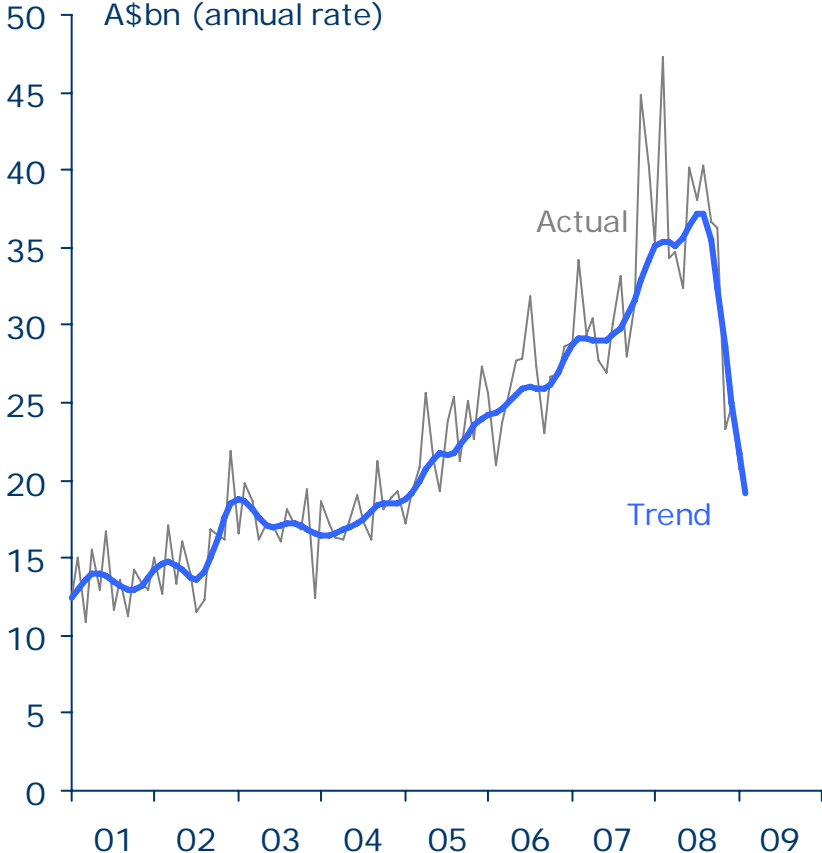
Note: 'gross operating surplus' is the national accounting equivalent of profits before interest, tax, depreciation and amortization (EBITDA) and, for financial corporations, provisions. Sources: ABS; ANZ.

# Non-residential building activity will decline sharply during 2009 25

### Non-residential building work done and yet to be done on current projects



### Non-residential building approvals

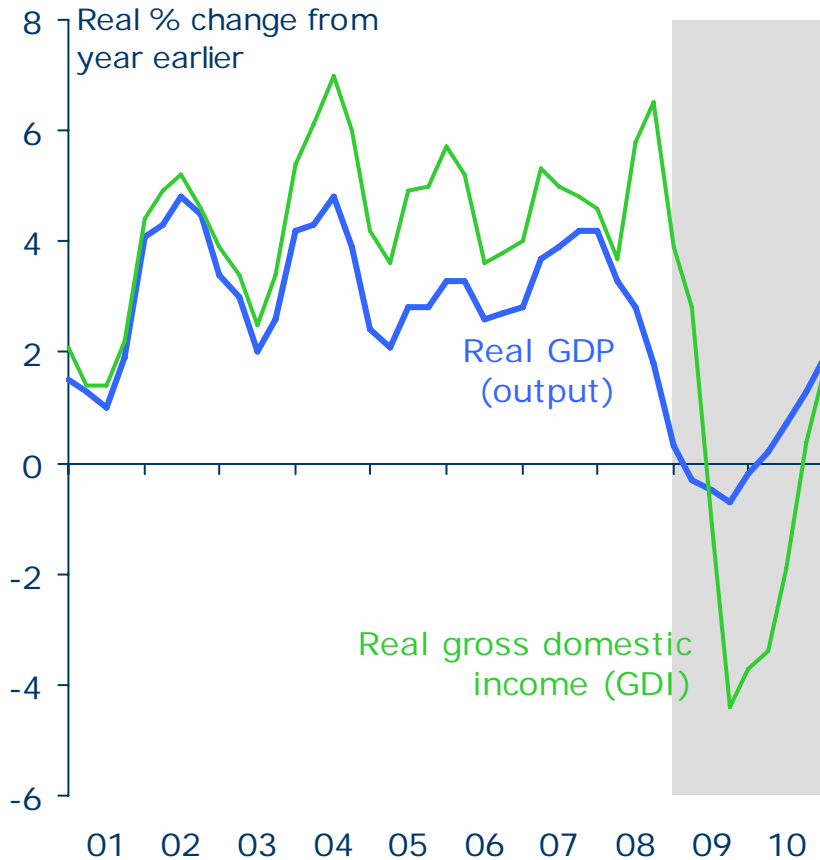


Sources: ABS; ANZ.

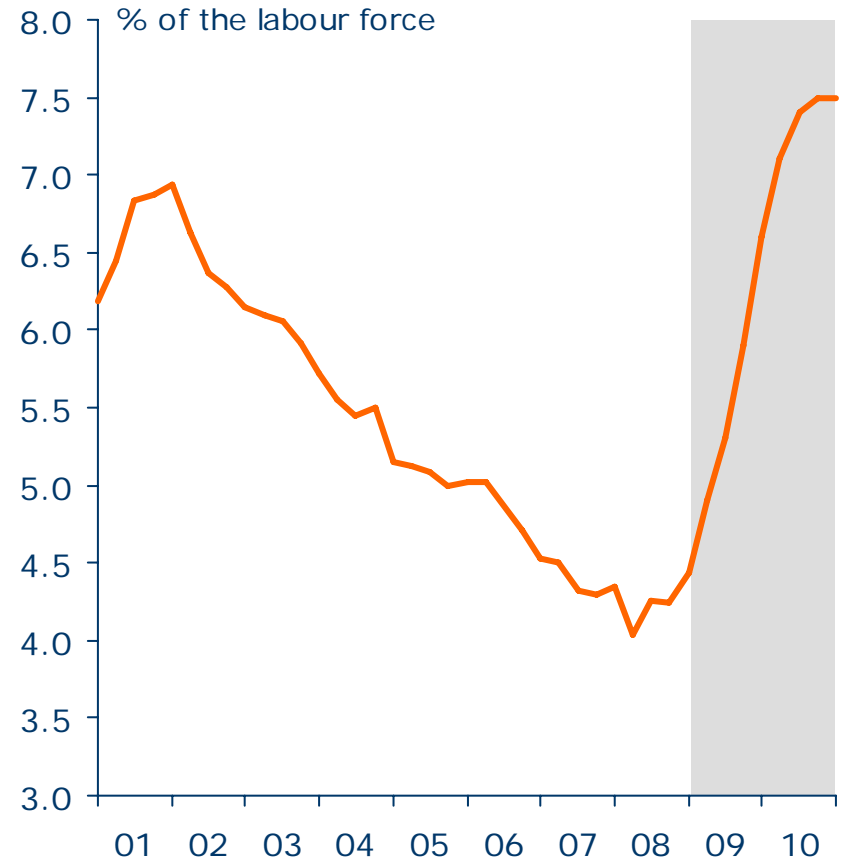


# Australia will experience a recession (on most definitions) during 2009, with only a slow recovery in 2010

## Gross domestic product and income



## Unemployment

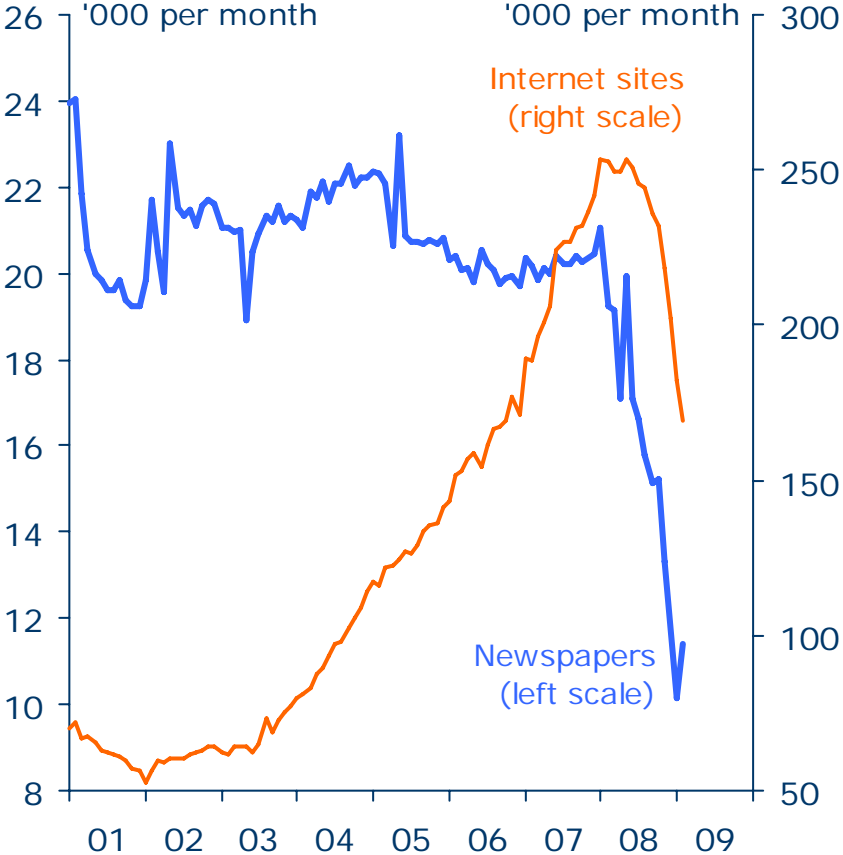


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

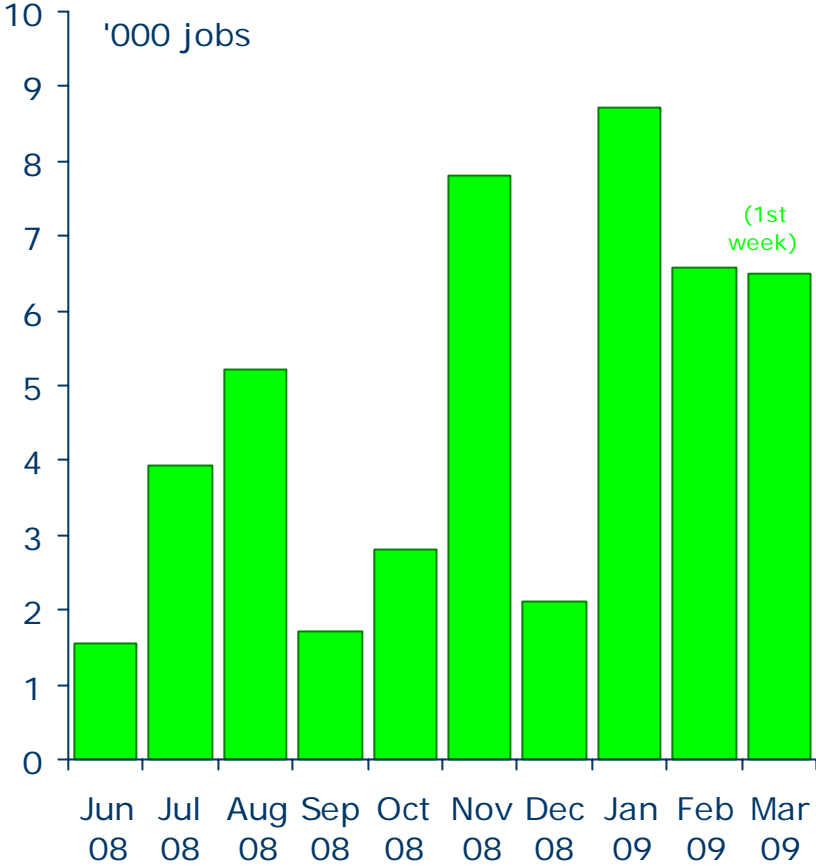


# New hiring has declined dramatically and lay-off announcements have increased sharply <sup>27</sup>

**Job advertisements**



**Layoff announcements**

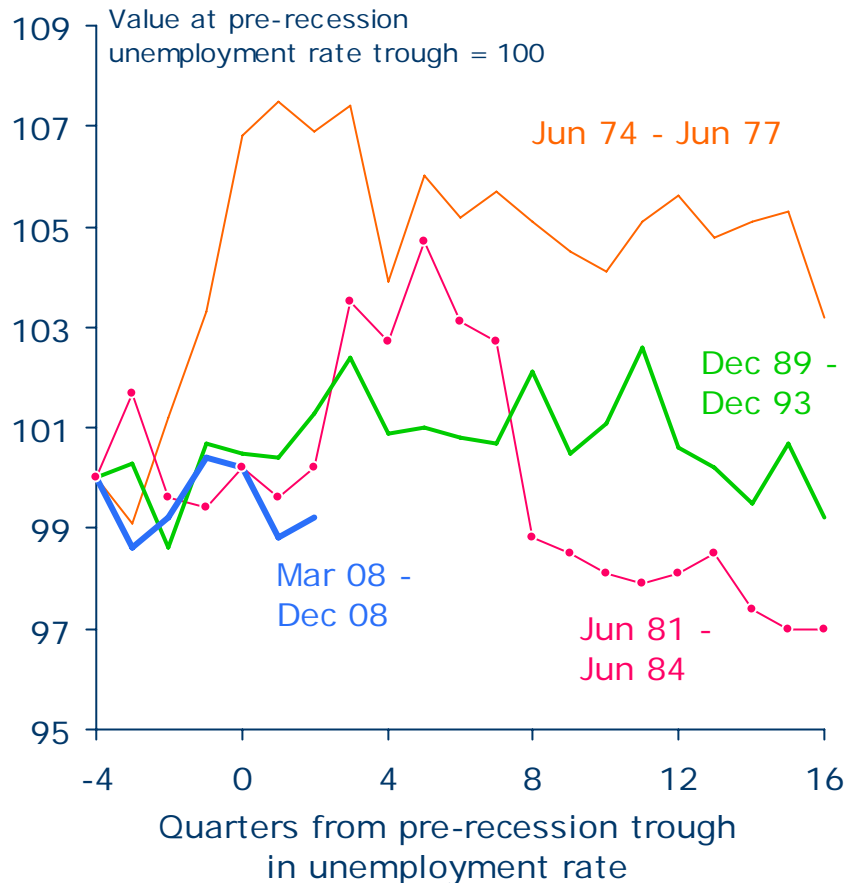


Sources: ANZ; media reports.

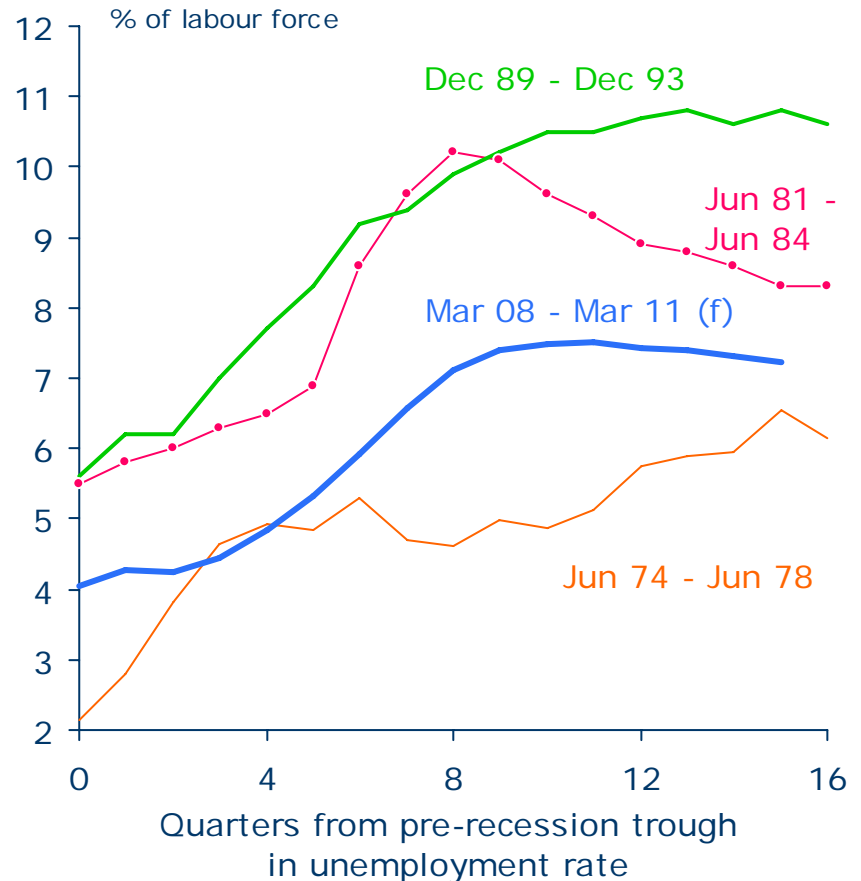


# Employees haven't priced themselves out of jobs in the way that they did prior to previous recessions

## Real unit labour costs before and during recessions



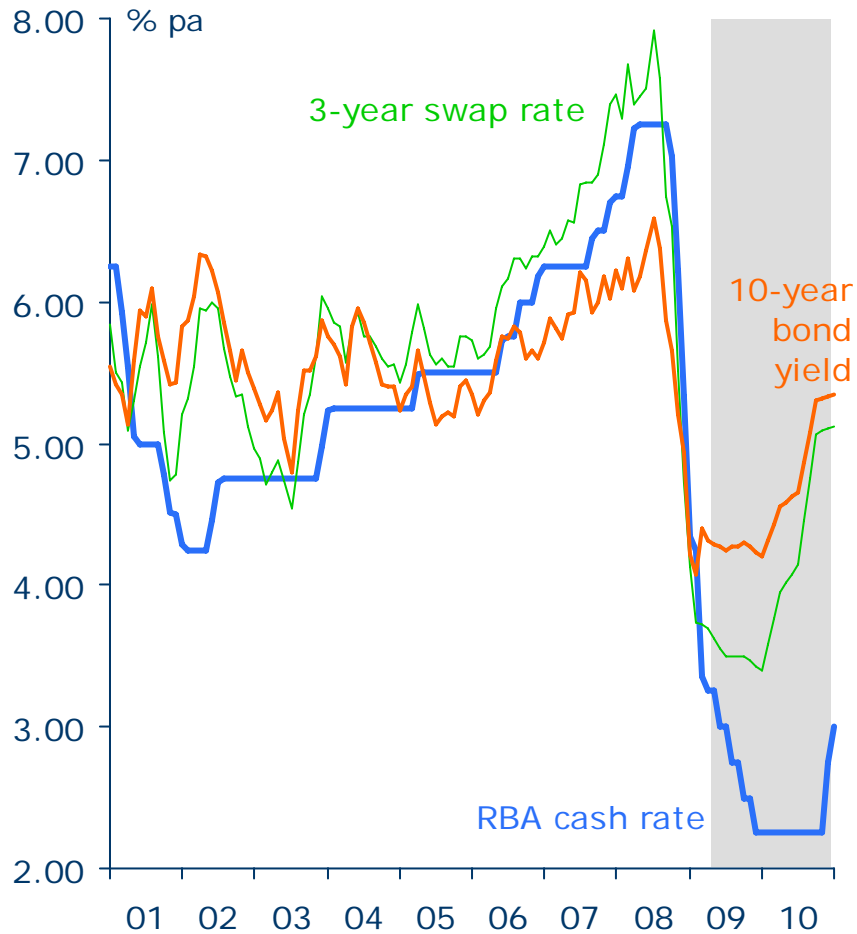
## Unemployment rate during recessions



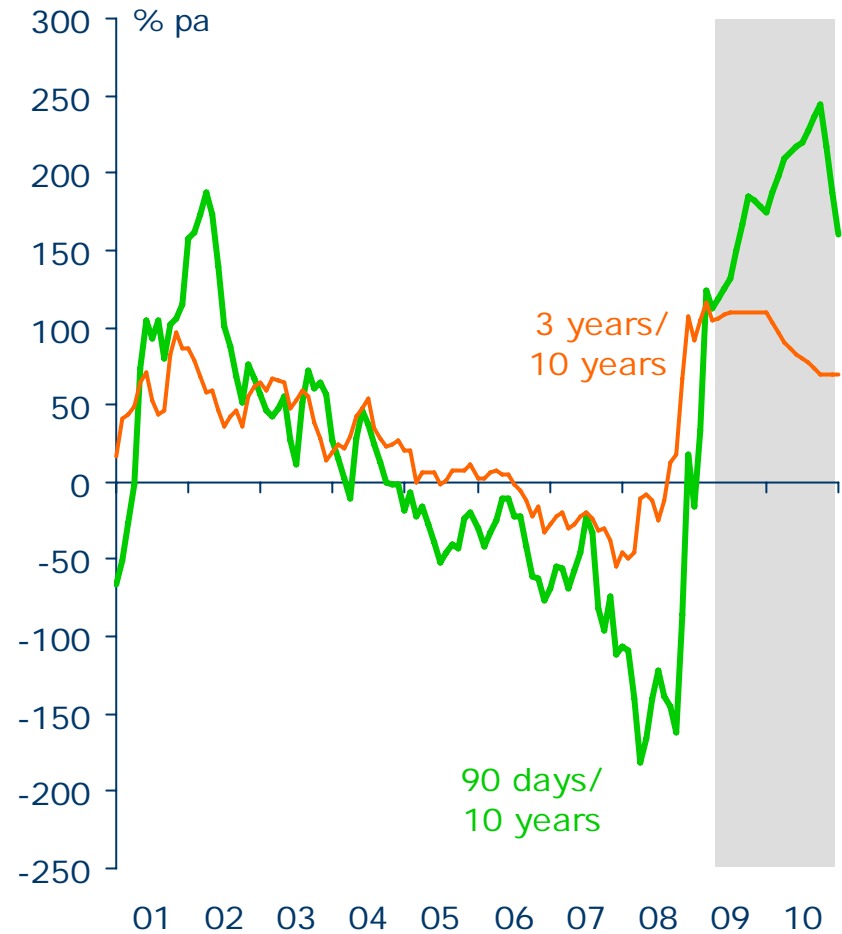
*Note:* real unit labour costs are employee compensation plus other 'on-costs' per unit of output produced, deflated by an index of output prices. *Sources:* ABS; ANZ.

Though short rates will fall further, term yields have 'priced' that and will come under some pressure from rising issuance

Interest rates



Yield curve

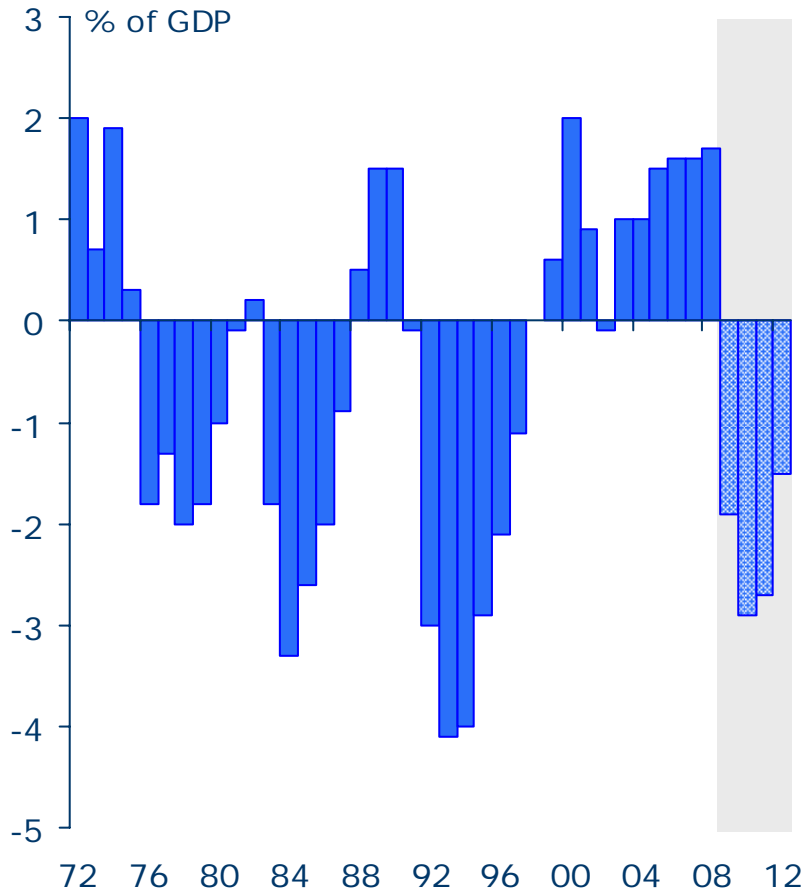


Sources: RBA; Datastream; ANZ.

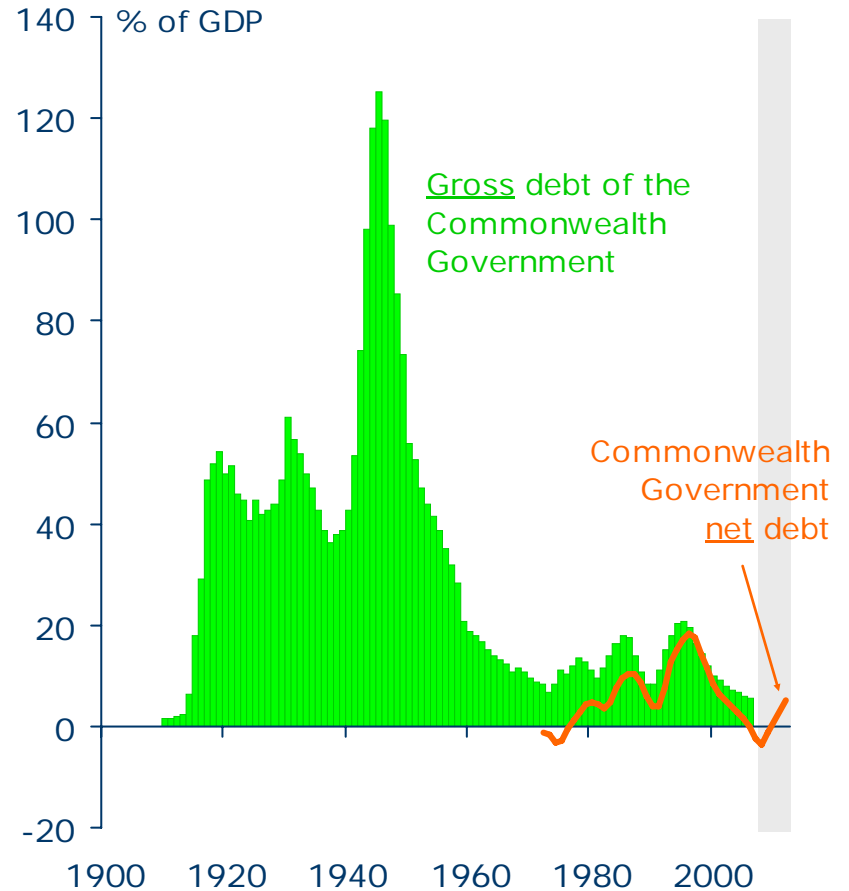


# Like governments overseas, the Australian government is going into deficit – but the resulting public debt is quite modest

### Australian government cash balance



### Australian government net debt



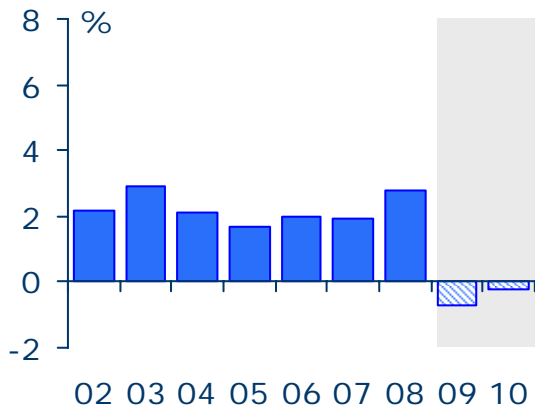
Sources: *Mid-Year Economic & Fiscal Outlook* (November 2008); *Updated Economic & Fiscal Outlook* (February 2009); Alan Barnard, 'Government Finance' in Wray Vamplew (ed.), *Australians: Historical Statistics* (1988); RBA, *Statistical Bulletin* (Table E10).



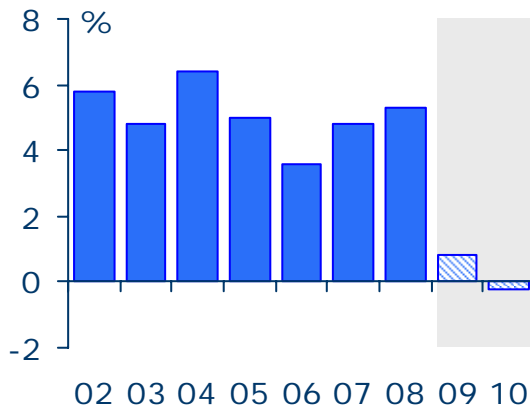
# Regional growth variations will narrow as the 'resource boom' States come back to the pack

## Growth in real gross State product

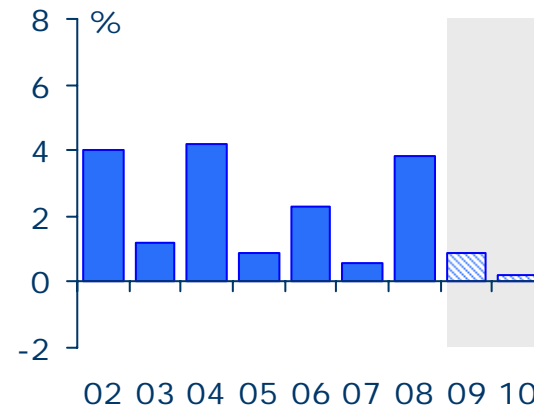
### New South Wales



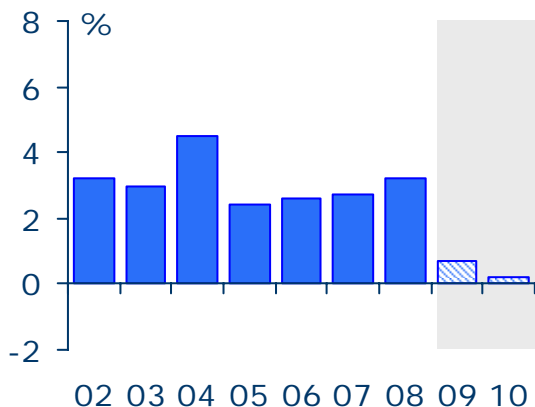
### Queensland



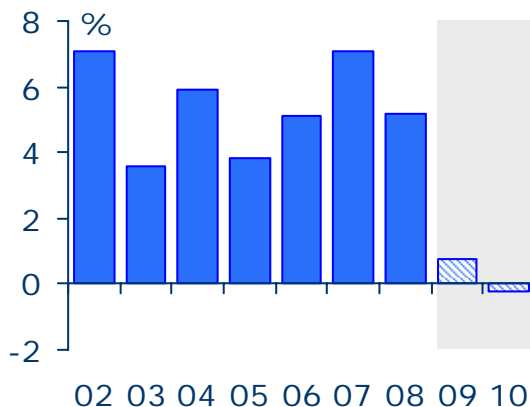
### South Australia



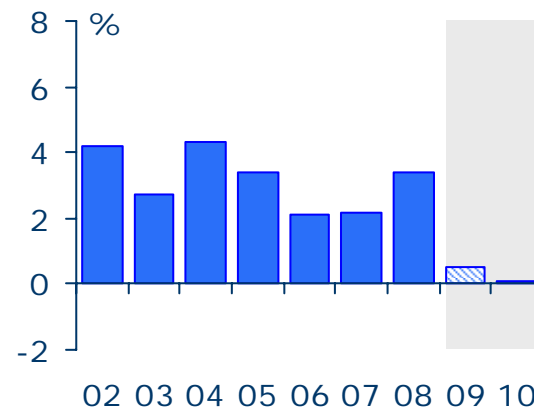
### Victoria



### Western Australia



### Tasmania



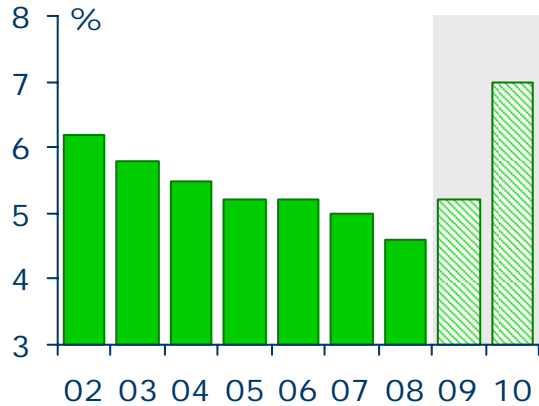
Note: Forecasts are for fiscal years ended 30 June. Sources: ABS, ANZ Economics & Markets Research.



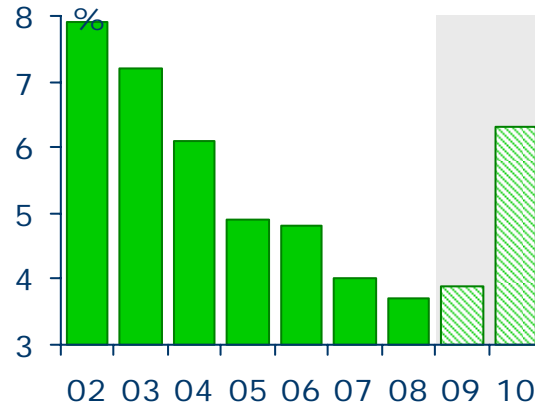
# Unemployment will rise fastest in Queensland and WA, though will be highest in New South Wales and Victoria

## Unemployment rates by State

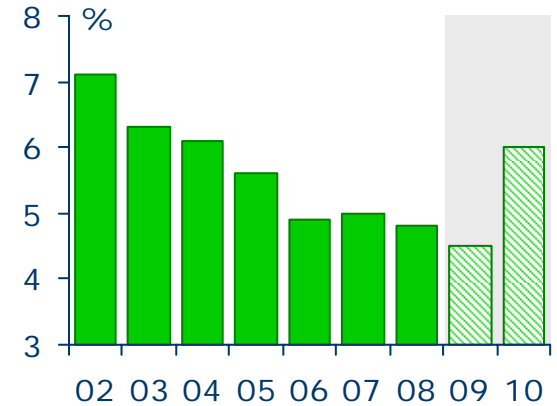
New South Wales



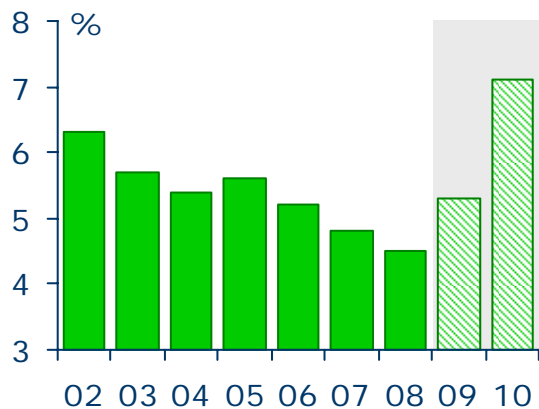
Queensland



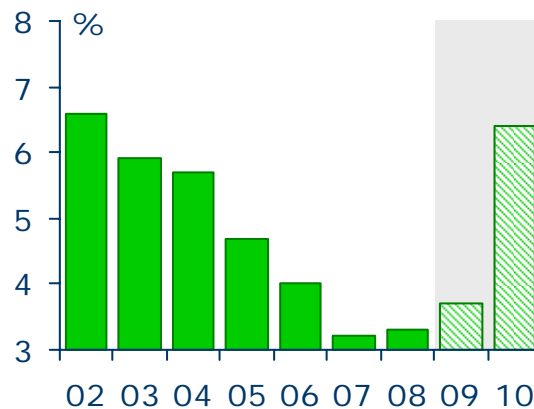
South Australia



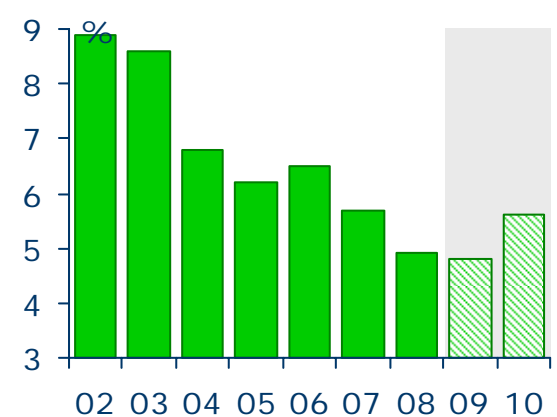
Victoria



Western Australia



Tasmania



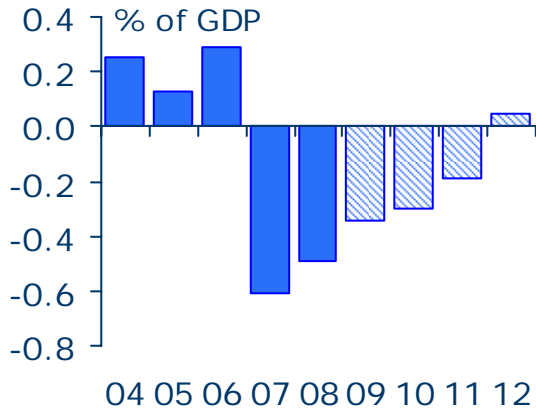
Note: Forecasts are for fiscal years ended 30 June. Sources: ABS, ANZ Economics & Markets Research.



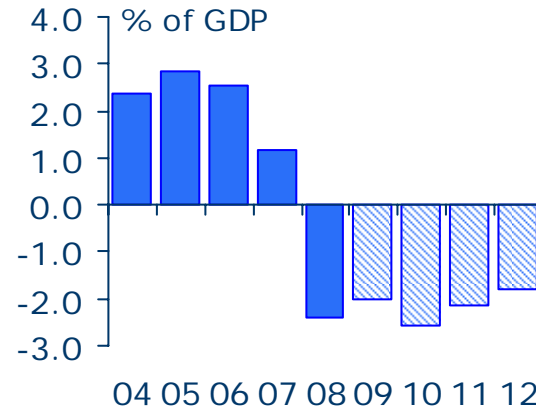
# State government financial positions, especially in the 'resource boom' States, are deteriorating

## State non-financial public sector cash balances

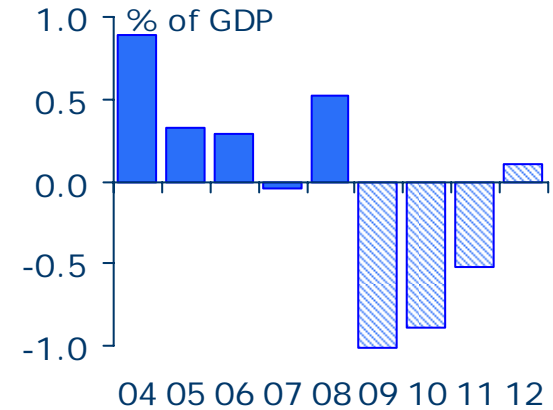
**New South Wales**



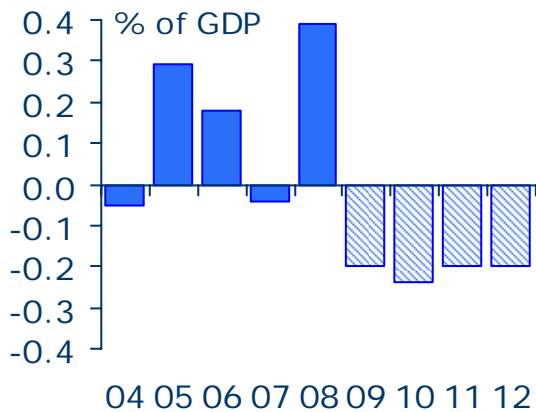
**Queensland**



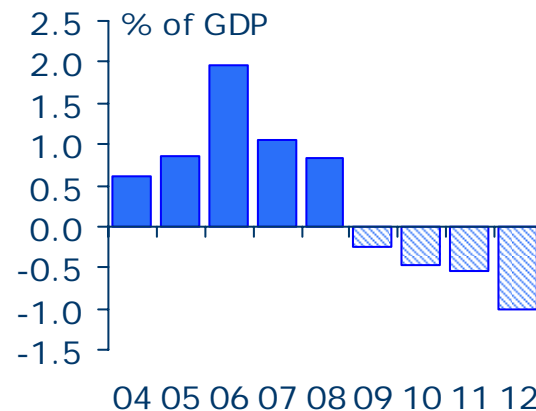
**South Australia**



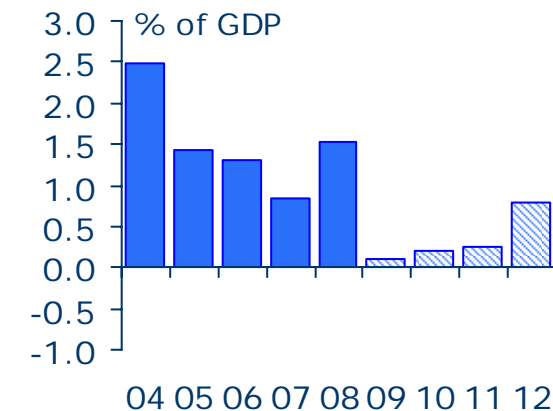
**Victoria**



**Western Australia**



**Tasmania**

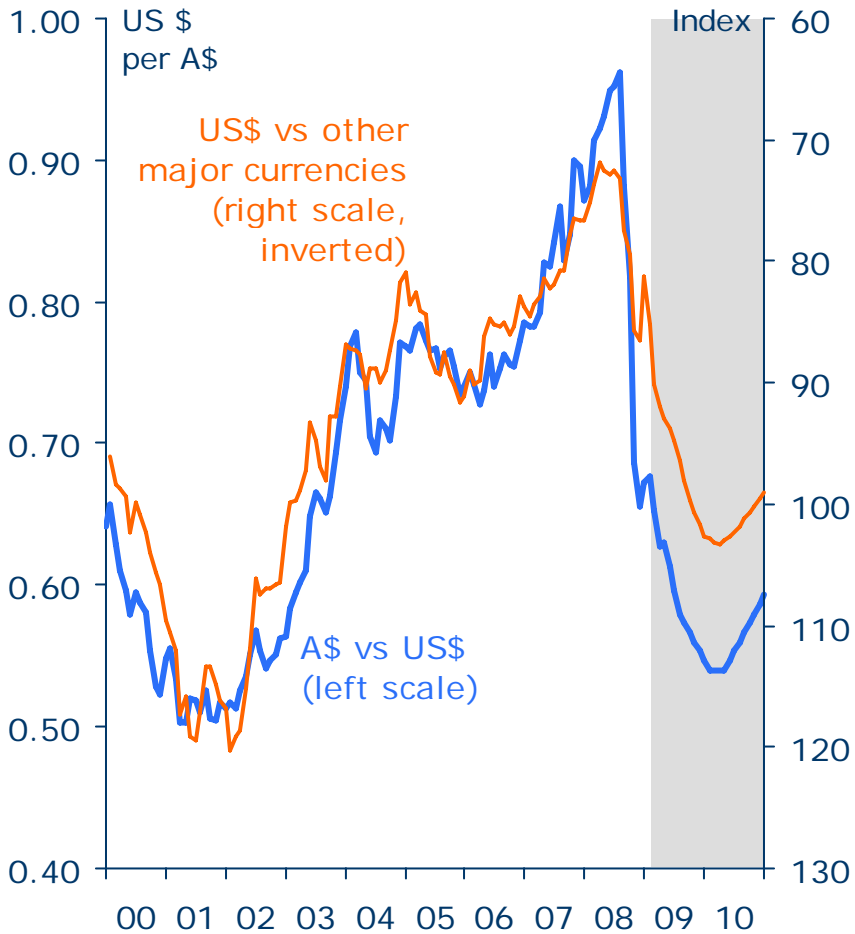


Sources: State Treasuries, Budget Papers and (December 2009) Mid-Year Budget reviews. Includes non-financial GBEs; does not include revisions released by Queensland in February 2009.

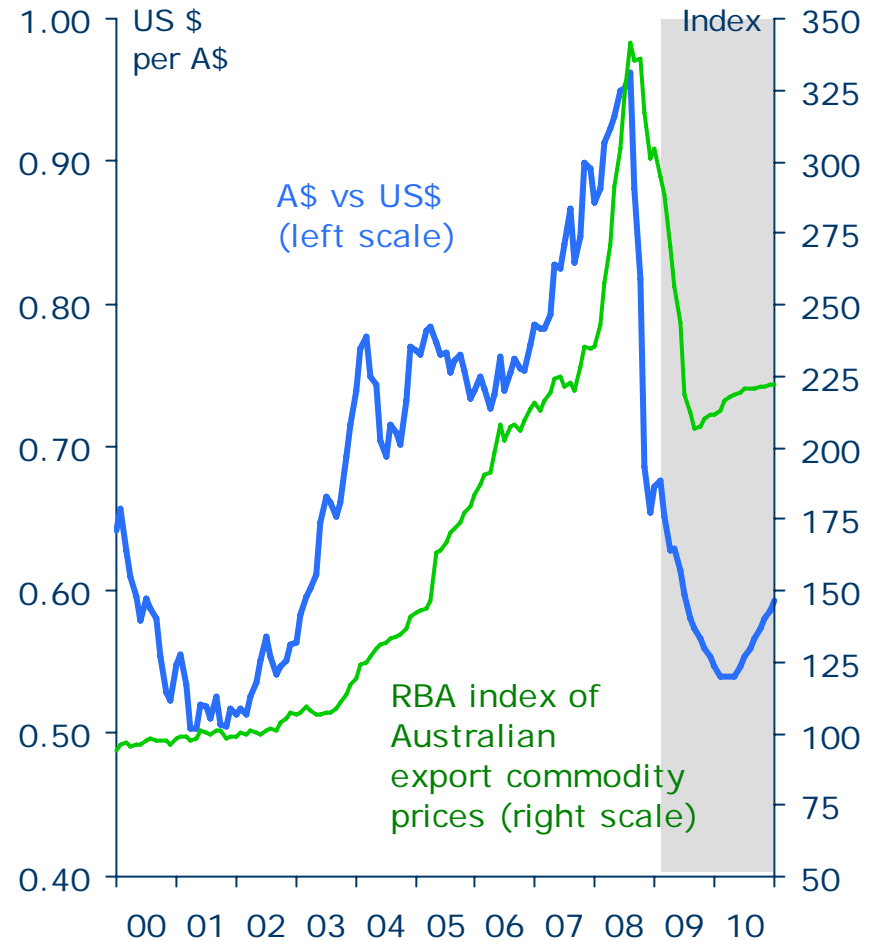


# The A\$ will fall further against a resilient US\$ - though this will help cushion the economy and resist deflation 34

### A\$ vs US\$



### A\$ & commodity prices



Sources: Datastream; US Federal Reserve; RBA; ANZ.



# Australian forecast summary

	Economic forecasts			
	2007	2008	2009 (f)	2010 (f)
Australian real GDP growth (%)	4.0	2.2	-1/2	1
Australian real GDI growth (%)	4.9	5.0	-1 <sup>3</sup> / <sub>4</sub>	- <sup>3</sup> / <sub>4</sub>
Unemployment rate (year end, %)	4.3	4.5	6 <sup>1</sup> / <sub>2</sub>	7 <sup>1</sup> / <sub>2</sub>
Inflation (year end, %)	3.0	3.7	3 <sup>1</sup> / <sub>4</sub>	2 <sup>1</sup> / <sub>2</sub>
Housing starts ('000)	154	146	120	150
Current account balance (% of GDP)	-6.3	-4.2	-4.4	-6.5

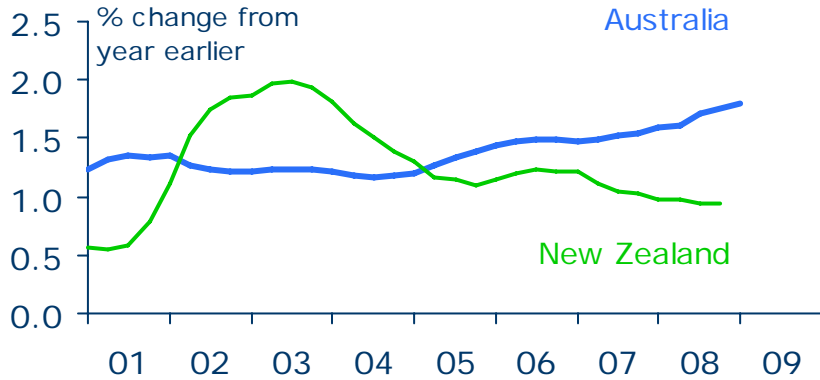
  

	Financial market forecasts				
	Dec 08	Jun 09	Dec 09	Jun 10	Dec 10
RBA cash rate (% pa)	4.25	2.75	2.00	2.00	3.00
10-year bond yield (% pa)	4.00	4.25	4.20	4.15	5.12
A\$-US\$	0.65	0.60	0.55	0.55	0.60
A\$-¥	63	59	56	59	66
A\$-€	0.52	0.50	0.50	0.51	0.52
A\$-NZ\$	1.13	1.33	1.33	1.29	1.29
A\$-S\$	0.94	0.94	0.91	0.90	0.95
A\$-Rupiah	7285	7160	6340	6250	6570
A\$-Dong ('000)	12.3	10.3	10.0	10.1	10.6

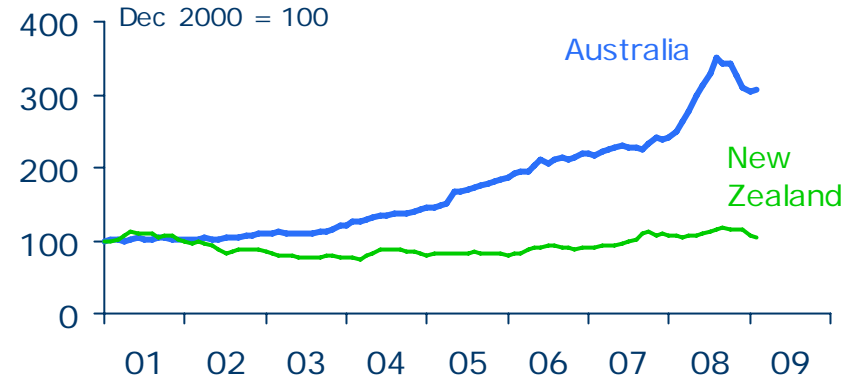
Growth drivers have been weaker in NZ than Australia (in addition to NZ having had higher interest rates for longer)

## Australian and New Zealand growth and risk factors

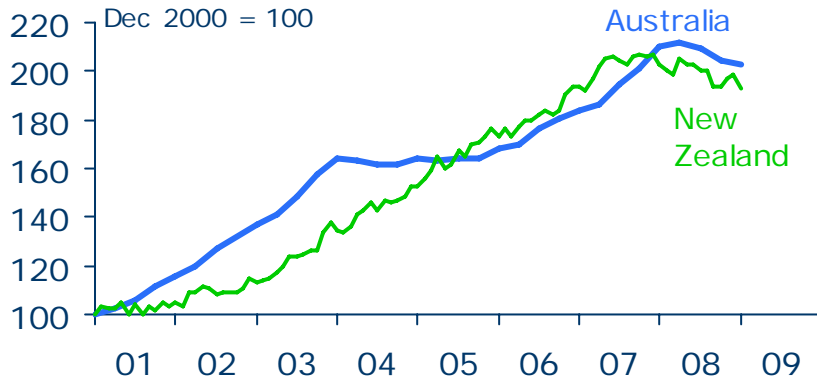
### Population growth



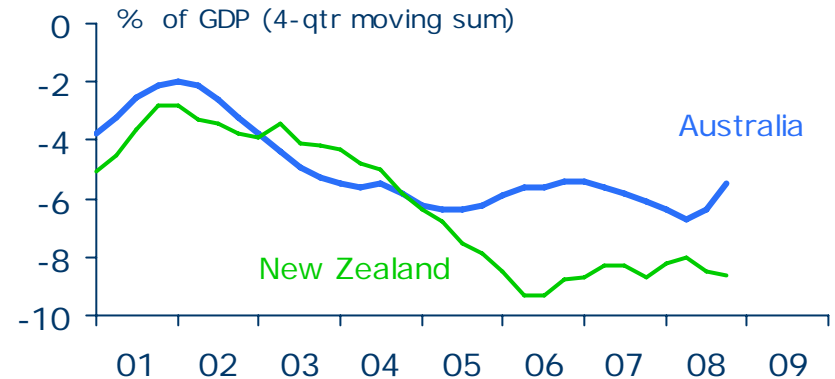
### Commodity prices



### House prices



### Current account balance

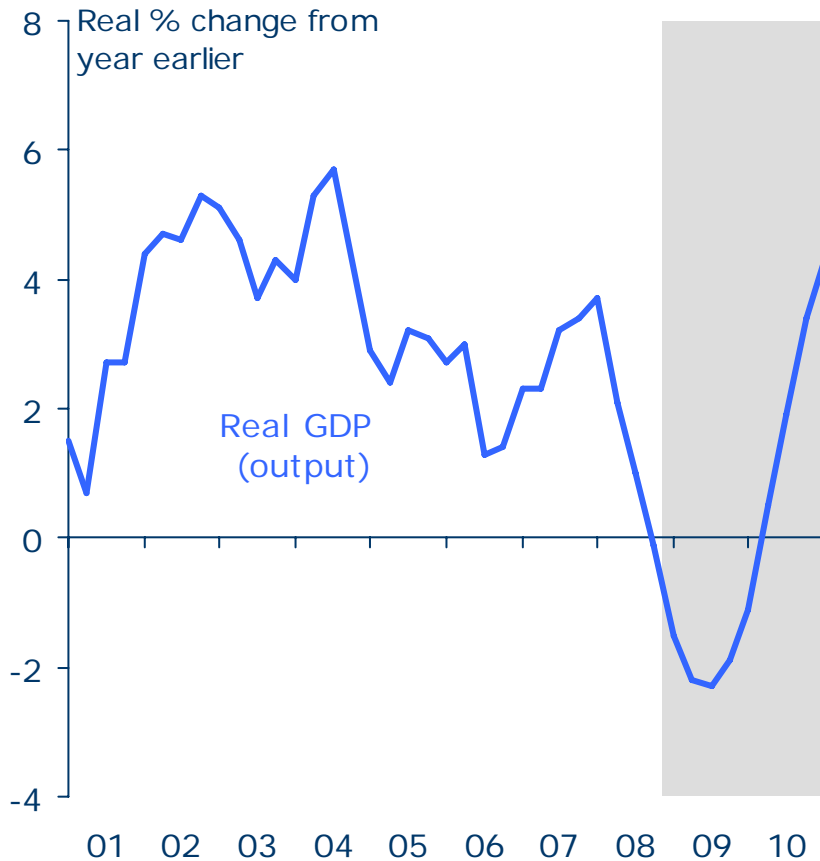


Sources: Statistics New Zealand; REINZ; ABS; RBA; ANZ

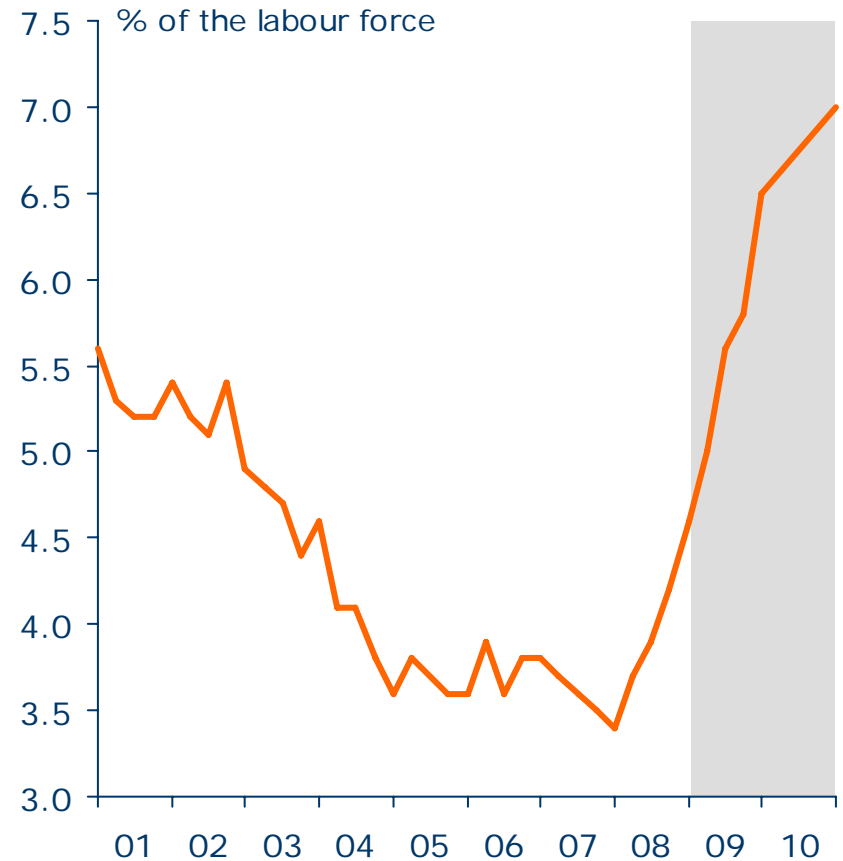


New Zealand has been in recession since the beginning of 2008, and is unlikely to return to positive growth until later this year <sup>37</sup>

### New Zealand real GDP



### New Zealand unemployment

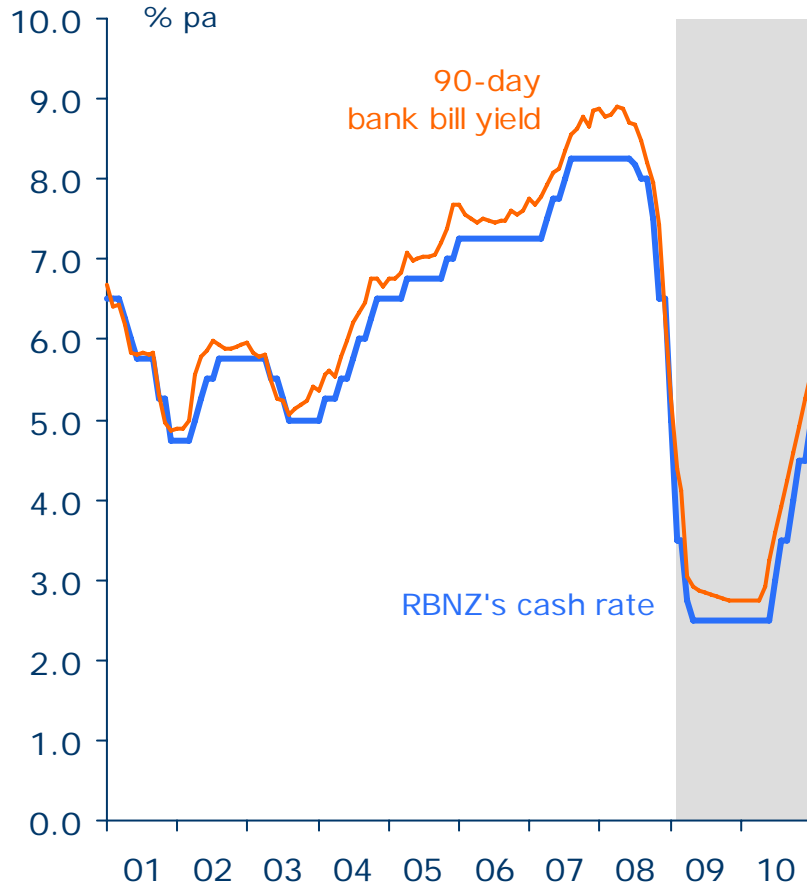


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.



# New Zealand interest rates will fall a little further but more of the pressure will be absorbed through the exchange rate

## Short-term interest rates



## New Zealand dollar



## New Zealand forecast summary

	Economic forecasts			
	2007	2008 (e)	2009 (f)	2010 (f)
NZ real GDP growth (%)	3.1	½	-2¾	2¼
Unemployment rate (year end, %)	3.4	4.6	7¼	7½
'Underlying' inflation (year-end, %)	3.2	3.4	2½	2¼
Current account balance (% of GDP)	-8.2	-9	-7½	-6

	Financial market forecasts				
	Dec 08	Jun 09	Dec 09	Jun 10	Dec 10
RBNZ cash rate (% pa)	5.00	2.50	2.50	3.00	5.00
10-year bond yield (% pa)	4.65	4.60	4.80	5.20	5.90
NZ\$-US\$	0.58	0.45	0.41	0.43	0.46
NZ-¥	55	45	42	46	51
NZ\$-€	0.45	0.37	0.37	0.39	0.41
NZ\$-S\$	0.82	0.71	0.68	0.70	0.73
NZ\$-Rupiah	6440	5400	4750	4860	5095

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