AMCHAM
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Address to the American Chamber of Commerce

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Many thanks Stephen. Good afternoon and thank you for the warm welcome.

The Chamber has been an important part of the Australian business scene for 48 years now and it's a great pleasure to have the opportunity to address you today.

It comes at the end of a difficult two weeks for everyone involved in one of Australia's worst natural disasters.

On Tuesday I visited some of our branches in the affected areas where our staff have been working with many of our customers who were directly impacted by the fires. I wanted to see first hand the work we were doing to help the residents. In all the sadness, it was wonderful to see the community spirit and hard work people are putting in to assist one another.

It was also uplifting to see the amazing contribution by the business community of Australia, not only helping through financial donations, but providing services, manpower, logistics, and resources directly to the point of need.

I know the thoughts of all of us here today are with everyone who suffered as a result of these terrible fires.

It's a reflection of the close and enduring links between Australia and the United States that President Obama has offered his assistance and prayers for the victims.

Those links date back to the First Fleet and the three Americans who joined the voyage.

My favourite story involves Jacob Nagle.

Jacob had served with George Washington before he landed his First Fleet job on the Sirius.

Clearly he was an Australian at heart because on the way to Sydney he managed to get into serious trouble in Rio de Janeiro. Apparently the problem involved alcohol and women and Jacob woke up next morning minus his pants and his money.

Today of course, things have moved on and the economic and business relationship between the United States, Australia and the rest of the world is, perhaps, more profoundly significant than it has ever been – although, right now, some might say it still involves losing your pants and your money.

First, there are the fundamental and difficult issues in financial services which originated from Wall Street.

These are now dramatically reshaping banking and financial services globally and creating the most difficult set of economic conditions the world has faced since the Great Depression of the 1930s.

Looking back at the last year the depth of the crisis in financial services has become very clear - US$1 trillion in losses, 25 bank failures and 275,000 jobs lost in financial services – many in the United States.

In thinking about the United States however there is cause for optimism, even at this low ebb in the crisis.

That has come with the inauguration of President Barack Obama, just one month ago, and the promise of the regeneration of an America that many, in recent times, had worried was being lost.

In this regard, I was pleased to see the first visit abroad by President Obama's Secretary of State Hilary Clinton, was to Asia highlighting China as Washington's most important relationship.

So for me, the opportunity to address the Chamber today is important, and what I want to provide you with is a sense of how the world is viewing the global financial crisis; some views on how that might play out in Australia over the next year or two and my perspective of what it means for our region and banking in Australia.

First, although it's now quite obvious that 2008 was, in fact, a 'bloodbath', particularly in the northern hemisphere, I think it is very important that we retain perspective.

2008 was an extraordinary year for the whole world, but in some ways Australia has been insulated from the full impact of what has been happening.

I think that without spending time in the northern hemisphere, it's very hard for those of us living in Australia to understand the true depth of this crisis.

The expectations are that job losses could reach half a million people in financial services world-wide. And some have speculated that write offs by financial institutions globally could reach US$2 trillion. To give you some perspective on that, US$2 trillion is equivalent to the annual GDP of France or two-and-a-half times that of Australia.

Already, to restore confidence, governments across the world have had to support banks with capital and with day-to-day liquidity, as well as offering guarantees on deposits and guarantees on bank debt in an attempt to build confidence.

Whilst the turmoil was initially in the financial sector, it is now being felt in the real economy throughout the world.

Many advanced economies are in recession and there is a slowdown already taking place in the emerging markets.

Prospects for the world economy in 2009 look, in a word, bleak.

The world's 'advanced' economies, as a group, are likely to experience their first annual contraction in economic activity since the end of the Second World War – by the order of close to 2 per cent.

Importantly for Australia, growth in emerging economies is expected to slow more sharply than seemed likely just two or three months ago – probably to an average of 3.5 per cent.

Most industrialised economies will incur large budget deficits in 2009 and for some years ahead, as the result of conscious decisions to increase government spending or to cut taxes.

Government indebtedness is on the rise, in some cases sharply. Although contrary to the conventional wisdom of the past three decades, these policy responses are, in general, appropriate for the unusual circumstances in which most governments and central banks now find themselves.

While Australia is better positioned and has been remarkably resilient

so far, it has not given us immunity – nor will it this year.

The abrupt slowdown in the Chinese economy and the ensuing plunge in commodity prices has cast a shadow over prospects for the Australian economy in 2009.

Although Australia might, just, escape having consecutive quarters of negative GDP growth, given the emphasis which the Government has placed on avoiding this, it seems certain that Australia will experience a significant economic slow-down during 2009.

Today, the early signs are already with us. Retail sales growth is slowing, unemployment is rising, house prices are weakening in some areas, commodity prices have dropped and company profits are softer.

This is already playing out in what, as a banker, I think of as the three phases of an economic down-turn.

Last year we saw the high profile collapses and of a number of highly leveraged entities and workout plans put in place for others.

We are now into the second phase where we are seeing bad debts emerge from the commercial sector and from higher risk personal customers.

The third phase will be rising bad debts among mainstream personal customers, which I think we will see in the second half of this year and early 2010 as unemployment rises.

The House view is that we are expecting unemployment to rise from 4.5 per cent at the end of 2008 to over 6 per cent by the end of 2009.

Now, I hate to say I told you so …. but I did.

Last February, when I updated the market on ANZ's financial performance, I said it was "a bloodbath out there" … "armageddon".

At the time many suggested I was being too alarmist. But now everyone agrees with me, I will again buck the trend and say I have some renewed optimism.

Although I have said there will be a severe slowdown in Australia, I am less pessimistic than many and I believe there is cause for optimism that the down turn in Australia may not be as deep and as protracted as many now fear.

And that's good news in the context of the rest of the world.

So in the midst of all this bad news - and certainly with more bad news to come during 2009 - why do I see cause for optimism?

First, as I have said, in the US we have an energetic new President with a mandate to expand government spending and cut taxes.

Equally important, we have the Federal Reserve which, chastened by earlier errors and led by a student of the Great Depression, is injecting money into the financial system at a rate never seen before.

Like many other governments around the world, Australia is following suit.

The Reserve Bank has acted decisively, cutting its cash rate from 7.25 per cent to 3.25 per cent. This decline of 400 basis points in six months has bought the cash rate to a 44-year low and now more than offsets the increases we saw over the preceding six-and-a-half years.

The effect of this for households and for business is significant and, unlike many advanced economies where interest rates are at or near zero, there remains scope for further monetary stimulus here in Australia.

And while there is debate about the size and targeting of the Australian Government's fiscal stimulus package, there is no question that this action is both welcome and necessary in order to minimise the depth and extent of the downturn in Australia.

And as we think about the collective action taken by governments around the world to stimulate economic activity, therein lie further seeds of optimism for Australia.

The US$2.5 trillion in government stimulus packages that have been announced around the world have a significant portion earmarked for infrastructure – bridges, roads, port facilities, dams, hospitals and schools – all of which will require massive amounts of energy, steel and other commodities. This has to be positive for a resource-based economy such as Australia.

Of course, the great concern for Australia and for the world is the re-emergence of economic nationalism.

As The Economist magazine pointed out recently, trade encourages specialisation, which brings prosperity; global capital markets, for all their recent problems, allocate money more efficiently than local ones; and economic cooperation encourages confidence and enhances security.

And although the links which bind countries economies are undoubtedly under strain, I hope that the world has learnt the lessons of the Great Depression that economic nationalism exacerbates economic contractions.

Certainly though, America's leadership is crucial to ensuring the world continues to embrace open markets and it is encouraging that President Obama was opposed to the "Buy American" clause included by the politicians in the latest stimulus package.

With that proviso, I also believe pessimism about China is overdone.

While there are undoubted impacts from the downturn in manufacturing and exports, particularly in areas such as the Pearl River Delta, the Chinese Government has both the political will and the financial resources to manage its impact.

There are massive infrastructure projects already underway opening up China and underpinning the ongoing urbanisation of the country and the scale of this effort is not well understood.

And there are other options open to the Chinese Government to support the economy such as accelerating the massive recovery effort underway in Sichuan following last year's tragic earthquake.

For Australia, whose centre of economic gravity is now in Asia, this is significant.

Finally, Australia is also extremely fortunate to have a strong banking sector.

Today only 11 banks in the world are rated AA. Four of those eleven are Australian and they are now among the top 40 in the world by market capitalisation.

ANZ, for example, has overtaken leading European banks such as Fortis and Lloyds TSB, and even one of world's premier banks – Citigroup. We are now larger than Barclays and Germany's Deutsche Bank.

Let me amplify this point.

The Australian Government decided in October to guarantee Australian deposits and to guarantee term wholesale funding for banks, building societies, and credit unions that are regulated by the Australian Prudential Regulation Authority.

However, the four major Australian banks have not required any government capital and have not received one cent of taxpayer's money.

Quite the opposite in fact – as a result of the Government Guarantee on wholesale debt, the banks have so far paid the Australian Government $84 million in fees since the scheme was introduced in late November.

This is unlike the northern hemisphere, where banks have had governments effectively becoming shareholders with a number of the world's largest banks effectively being nationalised.

The major Australian banks are in a strong financial position and, as mentioned, have not required taxpayer funded support or bailouts of any sort.

This is a strength that, in the debate about banking and regulation, seems to have been lost.

In global banking of course, the game has already changed.

This game will reflect a 'new era of responsibility', as President Obama put it. One in which there will be much greater recognition of the duties banks have not only to their shareholders and staff, but the role they play in the economy and the countries in which they operate.

Certainly, investment banking as we came to know it on Wall Street since the early 90s - with bonus pools for investment bankers worth billions of dollars, taking risk rather than managing risk and ultra-thin capital levels – is over. Finished.

Banking, because it oils the wheels of commerce and of individual prosperity, has a special standing in the world. To reflect this, bankers must approach their job with a sense of responsibility.

But over the last two decades, we have seen emerge what I believe to have been one of the fundamental problems in banking today – that the world got to a point after so many years of easy economic growth that there were more banks and quasibanks than bankers.

I know some of you may think this is a traditional view, but having been a banker for 30 years and having managed my way through seven financial crises; I am absolutely convinced that there is no substitute for bankers who approach their job with a strong sense of prudence and duty, experience of good times and bad, and the experience to understand and see a crisis through.

Today, banks are becoming the slightly boring companies they should be, growing at a rate a little above GDP.

Larger capital requirements and fewer risks being taken will reduce the heady levels of earnings we have seen globally in the last decade but will create more stable, more resilient institutions.

For someone who has been in banking all my working life, I think of this as a return to normality.

That means a return to the importance of deposit taking in bank strategy; of more conservative underwriting standards; of margins that allow banks to operate in a safe and sound manner and to make money; of normal levels of credit losses; and to solid rather than stellar returns for shareholders.

This is perhaps what gives me a degree of optimism.

In Australia we have had 17 years of good times. The benchmark became unrealistic. We are now moving to a normalised benchmark and normal economic conditions where good companies continue to succeed but where bad companies fail.

Some responses to the global financial crisis will of course be much more enduring than the measures undertaken in response to the downturn in economic activity.

More regulation and supervision of banks and other financial institutions will become a permanent feature of the global landscape, as part of a broader reaction to the deregulatory ethos of the past three decades.

In Australia however, it is worth reflecting that we have had the benefit of good regulation and most importantly, good regulators.

To my mind, our regulators in Australia have, by and large, exercised what President Obama referred to in his inauguration address as a ‘watchful eye’.

The success of the Australian system and this ‘watchful eye’ that has been exercised by Australian regulators needs to be borne in mind by the Australian Government as it turns its mind to addressing the new regulatory environment that we will surely find ourselves in following the global financial crisis of 2008.

It will, be crucial to both the short- and longer-term prospects of the global economy that governments resist the pressures to over-regulate rather they should concentrate on compliance of existing regulation, which as Australia has demonstrated, can work.

However, with many banks around the world needing to be rebuilt after being hollowed out by bad practices, I believe the next two years will also be about the survival of the fittest.

In this environment, the gaps between strong and weak banks will widen further.

Stronger banks will attract more deposits; they will get the pick of new clients as other banks retreat from the market; and they will have the ability to re-price to reflect the higher cost of funds and risk.

At the opposite end of the spectrum, it will be difficult for weaker banks to fund their lending and the quality of their loan book will deteriorate as their best customers migrate to competitors.

What’s also obvious is that the companies that are on the front foot will have the most choice because the current crisis will offer rare opportunities.

US and European banks operating in the region are retreating to their home markets and are being forced to offload good clients and good assets to shore up their domestic businesses.

The effect of what's called de-leveraging - of companies and individuals reducing their levels of debt - will also create opportunities to secure existing customer business and business that we have not previously held.

This is why, today, ANZ has been able to announce that we will make $8 billion in new lending available during 2009 to support existing and new small and medium-size business customers.

Australia has around 2 million small and medium sized businesses. The vast majority of those businesses are well managed and in a sound financial position.

By maintaining lending, our banks are playing an important part in ensuring a strong small and medium sized business sector and to supporting economic growth and employment in Australia.

And of course, the other opportunity in this environment that we must be mindful of is that bank share prices, price earnings ratios and price-to-book multiples have been reducing which is creating potential opportunities in Australia, in Asia and in the rest of the world.

The relatively high rates of economic growth in Asia, and the opportunities there, are now blindingly obvious.

That is why it is so critically important we position ourselves as a nation and as business people to be able to capitalise on these opportunities - to deal with the issues that have emerged after 17 years of uninterrupted economic growth at the same time as setting out the long-term architecture for the future.

More and more, that architecture involves Asia as our foundation.

The past 18 months however has demonstrated the global nature of the economy and the financial system.

And it is clear that the leadership shown by the United States in regenerating America - its economy and its financial system and its place in the world will be an essential element to us surviving and thriving in these challenging times.

Many thanks for listening to me today.