

**Address to ANZ CCI Annual Economic Breakfast
Perth – 23 March 2010**

Mike Smith

Speaking Notes

Good morning to you all.

It really is a great pleasure to be back in Perth.

I must say I enjoy coming to the West. Here the importance of Asia to the Australian economy is self-evident everywhere I look and to everyone I speak to.

In the Eastern States, the reality of our economic and cultural linkages to Asia has been slower to dawn on people.

Some people I have met here in Perth tell me the Eastern States are slower all round – but I am sure that's not true

But for me, it feels very familiar over here. I'm a banker who has spent most of his career in Asia.

And despite our Melbourne headquarters it's a great place for ANZ which is becoming what I call a 'super-regional bank' focused on the Asia Pacific region.

The logic here is obvious.

- Growth in trade and capital flows between Asia and Australia are tracking at over 20 percent per annum.
- There is approximately \$60 billion in direct foreign investment into Australia from the Asian region.
- More than 50% of our domestic Corporate and Institutional banking clients depend on Asia for more than 25% of their business and 80% have some connection with the region.

ANZ is already the leading bank for Corporate and Institutional clients in the Natural Resources sector in Australia and New Zealand.

Our aim now is to become the bank of choice for Natural Resources and Infrastructure in Asia Pacific.

We are already the largest, in fact we now rank as one of the largest in the world.

Natural Resources currently account for \$80 billion or about 30% of Australian and New Zealand exports.

It's another reason why we feel at home here in the West.

Last year, partners in the \$43 billion Gorgon LNG project gave the go-ahead for what will be Australia's biggest resources development - nearly doubling Australia's LNG output.

Outside the oil and gas sector, ANZ has identified more than a dozen opportunities in Western Australia's mining sector that could help fast-developing Asian nations, particularly China, meet their needs for commodities to fuel their growth.

Warren has already given you an overview of the economic outlook - and as we all know, Western Australia is well placed.

Australia might not quite have a two-speed economy just yet - but Western Australia will lead the nation in GDP growth this financial year and next.

GDP growth in the West is expected to be more than 4% in the year ending June 2011. This compares with growth of about 3% in the non-resource states of New South Wales and Victoria.

This growth is being fuelled by Australia's "rocks and crops" exports – in this State iron ore, LNG and wheat spring quickly to mind.

Demand for these exports is not limited to our traditional trading partners in Asia – China, Japan and South Korea but over time to the emerging nations in the "VIP suite" – that is Vietnam, Indonesia and the Philippines.

Their economies may be smaller and at an earlier stage of development than China but these countries also have large, rapidly urbanising populations.

ANZ is one of Australia's largest investors in Indonesia – so it was good to see the Indonesian President in Australia earlier this month for talks with the Government and the business community.

Despite the state of the global economy, Asia's continued growth is no surprise.

Back in early 2009, while I was deeply concerned about the prospects for the US and European economies, I expressed optimism about the prospects for Asia.

Despite recent steps to temper growth in China, Asia is expected to remain the world's best performing region with growth of almost 8% excluding Japan.

As we all know, there's ample evidence that the global economic downturn has not been as severe in our region, which is recovering much faster than the US and European economies.

With the significance of problems in the US and Europe now well understood, the influence of China, and indeed the rest of Asia, is resulting in what I think of as a fundamental shift in the world's economic and political tectonic plates.

The status of Asia - particularly China and India – has been elevated by the events of the past two years and the region is now going to be the engine for global growth for many years to come.

In that context, it's easy to be overly optimistic.

For Australia - because of its linkages to Asia and the size of its resources and agricultural sectors; because of the action by the Government and Reserve Bank to stimulate the economy; and because of the strength of the Australian banking sector - the downturn has been shorter than we originally anticipated.

But I'd like to briefly add a note of caution.

Although there's been a very strong recovery in asset markets over the past 12 months, that recovery is much less apparent in real economic activity around the world which remains subdued at best.

Growth in world GDP is expected to average about 2.5% and just 1 to 2 percent this year in the most advanced economies - the weakest level of growth of the modern era.

There are good reasons for caution about the outlook.

My own view is that having experienced what I think of as a major financial earthquake triggered by the collapse of Lehman Brothers in 2008, we are going to see further aftershocks and volatility this year as the global financial crisis works its way through the system.

- Although the global banking system has stabilised, many of the world's largest banks in the US and Europe are effectively in the hands of their governments.

It's worth remembering that the IMF is still predicting write-offs by global banks will total US\$3.4 trillion.

So far, write-offs total just over US\$1.7 trillion. My own view was that write offs would be around \$2 to \$2.5 trillion and that remains my forecast.

- It's also likely that bank balance sheets - and their capacity to lend in some countries - will be constrained by regulatory reforms.

Care needs to be taken here to ensure the inevitable regulatory changes are carefully considered and do not unnecessarily impact the recovery and economic growth. My view is that much of the problem in the US and UK has not been caused by inadequate regulation rather inadequate supervision.

- At the same time, individual businesses and households are continuing to repair their own balance sheets by constraining investment and spending.
- Over the past year, government stimulus has helped fill this gap and has underpinned much of the recovery.

But now, with businesses and households continuing to show caution, government deficits are worryingly large in countries such as the UK and the US and the need for fiscal tightening has the potential to stall economic growth.

- As we have seen, markets are naturally showing some nervousness about the very significant amounts of debt that are outstanding with implicit or explicit sovereign guarantees.

Take for example the recent problems with Dubai World, the challenges facing the EU with the Greek fiscal crisis, and the difficulties in Iceland and Ireland.

- At the same time, central banks are now beginning to withdraw emergency liquidity supplied during the crisis and interest rates are now in an upward cycle.

In my view, the combination of fiscal tightening, market nervousness and monetary policy exit strategies - will certainly see more volatility this year, as the earthquake experienced by the global financial system and world economy gives way to smaller after-shocks.

Having said this, as someone who has spent much of the last 30 years working in Asia, our region is remarkably well placed to continue to lead world economic growth.

That's especially true here in the West where linkages to Asia through resources and agriculture are so strong. I therefore continue to be optimistic about our future

Thank you for the opportunity to speak to you today – and Dixie, I hope there'll be some time now for questions.