Address to Australian Banking & Finance Leaders Series

Melbourne – 10 August 2010

Mike Smith, Speaking Notes

Good afternoon and thank you for the warm welcome.

Let me also thank Australian Banking and Finance magazine for giving me the opportunity to talk to you today.

The formal title of my address was “Opportunities and risks in a post-GFC world”.

But what I really want to do in my address this afternoon is share with you my perspective on why the global environment is “unusually uncertain” as Fed Chairman Ben Bernanke recently described it; and to talk briefly about the opportunities we have here in Australia to shape the future at a time of continuing uncertainty.

Having set the scene, I also want to leave plenty of time for questions because I think that’s the real benefit of these sorts of lunches.

Now August of course marks the month, three years ago, when the first concerns started to emerge about Northern Rock, which were followed weeks later by a run on the Building Society and a full blown liquidity crisis.

In the year after that, we saw the collapse of Bear Sterns and by August - two years ago - the crisis was just about to hit Wall St with the collapse of Lehman Brothers, the near failure of AIG and the largest US banks having to be supported by the US Government.

While there’s reason to think the worst of the crisis in the financial system is over, it’s worth remembering that US bank failures this year have already surpassed a fairly bleak milestone of 100.

In fact, the pace of US bank closures is well ahead of that of 2009, which saw 140 US banks shut amid the recession and mounting loan defaults.

And while the crisis was clearly “Made in the USA”, it’s worth remembering that it was banks in Europe that were first hit by the crisis and yesterday, three years ago, it was the European Central Bank that began making massive emergency loans to banks.

While recent stress tests on European banks were modestly encouraging, some banks with large funding gaps are still likely to struggle and in my view they’ll have to shrink further, sell out or break themselves up.

This year the most significant financial crisis since the 1930s also spread from private to sovereign entities.

Four months ago, Europe was facing its own Bear Sterns moment as the market lost confidence in Greek Government debt.

As the Greek crisis worsened, policy makers began to use the word - contagion.

The Greeks, as we know, have always been trendsetters ….. and attention quickly turned to other European countries with unsustainable levels of government debt, a group now unflatteringly described as PIIGS – Portugal, Ireland, Italy, Greece and Spain.

European leaders responded with a $160 billion package that was supposed to bring the crisis to a halt.

While the worst might be over for now, we've continued to see just how nervous markets are about the significant amounts of debt that are outstanding with implicit or explicit sovereign guarantees.

Even France and Germany have rising deficits. In the UK, budget cuts are starting and eventually the US will need to cut its deficit as well.

Certainly the sovereign crisis in Europe has established a new theme in global markets - a perception that we've moved into a period of political risk.

This is associated with concerns that Western governments are unwilling or unable to reform their economies and that they are rushing to re-regulate without fully understanding the wider economic implications.

The recent characterisation of the outlook by Chairman Bernanke as "unusually uncertain", which I mentioned at the start of my talk, reflects the disruptive combination of consumer, business and government de-leveraging, re-regulation, structural unemployment and other changes; and the series of national and global realignments that are now taking place …. but are perhaps not yet fully appreciated.

Given this, perhaps bankers like me have been a little quick to call the environment that we're now in the 'new normal' because, in what are really the early stages of adjustment after seven years of good times, it's probably fairer to call this the 'new abnormal'.

Although this is a somewhat depressing set of circumstances if you're in the US or in Europe, let's not forget that we've avoided the Armageddon scenario – a meltdown of the financial system and another Great Depression.

And here in Australia we're very fortunate that the major emerging market countries are growing strongly again.

This includes most of Asia - notably China and India - which are expected to achieve high growth rates, broadly in line with their potential.

While the Government in China has taken steps to slow growth, including curbs on bank lending and property speculation, Asia is expected to remain the world's best performing region with growth of almost 8% excluding Japan – more than twice the global average.

And economies like Australia, that have strong trade links with China, are directly benefiting from this growth.

At the same time, Australia's linkages with its other major trading partners in the region are deepening – particularly in South Korea, in Japan and in India.

The Asia story is not just a China or an India story - over time the emerging nations of Vietnam and Indonesia are also going to play an important role in the region's economic growth.

Together, this is resulting in what I think of as a fundamental shift in the world's economic and political tectonic plates.

By this I mean that the status of Asia - particularly China and India – has been permanently elevated by the events of the past three years and the region is now going to be the engine for global growth for many years to come.

The shift was highlighted by the Lausanne Institute for Management Development's recent annual rankings of the world's most competitive countries.

The results were surprising to some, but to us more obvious, with Singapore and Hong Kong emerging first and second and overtaking, for the first time in decades, the US which slipped to number three.

At the same time, a new bloc of countries has emerged that are not only gaining steadily in competitiveness but are becoming more and more self-sufficient and assertive.

Australia was 5th in the latest ranking – up from 7th; Taiwan moved from 23rd to 8$^{th;}$ and Malaysia climbed from 18th to 10th.

So while it's easy to take a dark view of the decade to come, we should also recognise that the world today is primed for change and filled with opportunity, particularly here in Australia and throughout Asia.

In banking, we've remained strong through the crisis through good regulation, a prudent approach to risk, and careful management of our balance sheets.

However, there are a number of opportunities facing us here in Australia.

First, with the stimulus packages now over, we need to recognise that in a lower growth world, with strong competition and higher funding and regulatory costs, our business's cost structure is built for a bull market that simply isn't coming back.

I would note however on the issue of regulatory costs, that while these will rise, the news hasn't been as bad as many of us here in Australia feared - the easing of Basel III capital and liquidity proposals removes much of the uncertainty about the likely shape of new regulation and at lower cost than many of us feared.

Nevertheless, today we can't afford to simply fine-tune our business models or fiddle with our cost base – the pressures we'll face as a result of the global realignments that are taking place are just too great.

We need to change – we need to remove cumbersome legacy structures and do things in new and different ways.

The opportunity however is not just about greater efficiency.

I believe the real danger with the crisis and with the "unusually uncertain" environment that we're now facing, is that businesses become static: they're afraid to move; they're afraid to innovate; they're afraid to be creative and that they're afraid to invest.

Here in Australia, while we have to understand we're not going back to "normal" and we need to be more efficient, we also need to realise that we're not a prisoner of circumstance.

We need to embrace globalisation and use the fast growing markets in Asia to invest in organic and strategic growth to differentiate our business over the medium and long term.

I think by now most of you know I'm positive about the opportunity ANZ has in Asia. In fact, I'm not only positive, I'm convinced about it.

Australia's geographic position, the size of our resources and agricultural sectors, our trade, our cultural and educational linkages - together they give us an absolutely unique opportunity in Asia.

Our history in Asia, and our existing business footprint in Asia, makes this very real for ANZ and it's why we are now making real progress in building a super regional bank.

With the pressures on many European and US banks that I spoke about earlier, we're perfectly positioned to take advantage of the opportunities that I believe will continue to emerge.

Finally, I want to mention the role of something that's not often talked about in banking and that's innovation.

By innovation I mean the process by which we create value for customers by harnessing knowledge and technology to organise ourselves better to support customers and to develop new products and services.

When I first arrived in Australia almost three years ago I said that one of the key questions we faced was how we create differences for our customers which are at least equal to, if not better than, global banking leaders. For example, how does our internet banking compare with the USA's Wells Fargo? How do our ATMs functionality compare with Spain's Santander?

Today, the stakes are continuing to rise with a number of technology-enabled business trends profoundly reshaping banking - emerging internet technologies, increased computing power and fast, pervasive digital communications – they're providing new ways to deliver banking services as well as new ways to structure our businesses.

If ANZ is to deliver on its super regional aspiration, we simply can not look at our domestic competitors. We have to benchmark ourselves against best of breed globally and continue to invest in technology and innovation.

But in order to move faster, I have to say that we're going to make these investments much more strategically than we have in the past.

So in an environment of "unusual uncertainty", I believe this is a time of opportunity where we need to resist the pressure we face for short term earnings per share growth and build shareholder value for the medium and long term.

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