

**Broadening Australia's economic engagement  
with China: a banker's perspective.**

Mike Smith  
Chief Executive Officer  
Australia and New Zealand Banking Group Limited

---

Thank you Warwick, and good morning to you all.

I'd first like to thank the Minister for State Development, the Honourable Ian Macdonald for his remarks.

I'd also like to acknowledge Lord Mayor Clover Moore, MP for her vision in hosting this event; and His Excellency Shaofang Qiu, Consul-General of the People's Republic of China in Sydney and Shiqiang Wu, Chairman, China Chamber of Commerce who are also with us today.

We are all here today as part of the City of Sydney's Chinese New Year Celebrations.

This year of course is the Year of the Rat.

People with a rat sign are known for their great leadership and pioneering skills, intelligence, passion and ambition.

They are meticulous but practical, and they're highly organised. They help themselves to find the answers to questions but will also help those in need.

While we can't all be fortunate enough to be born under the sign of the rat, we will all need the characteristics to help navigate the year ahead.

Put simply, it's tough out there - particularly in the major financial centres of New York and London.

Many of you will have seen my comments this week on the global economic environment.

Sub-prime and associated write downs by major banks now exceed \$140 billion. For those of you who are confused by the terms write down and provision, they are bank speak for losses.

At the moment, write downs in the last year are more than the most Gross National Product of New Zealand.

Last year we saw a run on one major lender in the United Kingdom – the first run on a British bank in over a century. That lender – Northern Rock was nationalised by the British Government earlier this week.

But as the US sub-prime crisis flows through the global financial system, the ripple effects are also being felt here in Australia.

Liquidity has tightened in financial markets leading to higher interest rates for banks and in turn business and retail borrowers. Those pressures are not over globally, and they are not over in Australia.

In turn, this liquidity is placing pressure on some corporates and there is incredible volatility in the share market.

Over a decade ago, Warren Buffet - perhaps the world's best known investor - said: *“creditworthiness is like oxygen: you don't notice it when it's around”*.

Today, Warren Buffett's words sound eerily perceptive.

Despite the uncertainty, I do want to be very clear – the Australian economy and the Australian banking system are in good shape and are not running out of breath.

In this environment of tight liquidity and scarce financial capital, there is a welcome role for sovereign funds that now hold much of the new wealth being generated in the world.

Australia needs to think carefully about this in considering policy on sovereign funds and what is and isn't in the national interest.

In fact, our economy and our banking system are probably weathering the current turmoil better than just about any other Western financial system.

Across in Asia, I don't expect economies as a whole to be seriously affected by the deepening slowdown in the US economy, as they have become much less reliant on the US.

And while China is likely to experience its own modest slowing, Asia is in a much stronger macroeconomic position than it was a decade ago with a healthier balance of payments and rising income levels which are lifting domestic demand.

Asian GDP, led by China, is forecast to remain 3 to 4 times higher than OECD countries. The compound effect of this growth is that Asia accounted for just 20 per cent of global GDP in 1980. Today, it is close to double that.

The point of broadening out my talk to discuss the global economic situation is to reinforce a long held view I have about the importance of China to Australia's future.

Of course China's importance to the world economy is not new.

For 18 of the last 20 centuries, China has been the largest economy in the world.

In 1890 – over a century ago – a quarter of the globe was ruled from London.

Then we moved from the European century to the American century.

Today, we are at another turning point. One in which by 2015, China will once again be the world's largest economy.

I believe one of the key issues for Australia in the decade ahead is in embracing our place in Asia – in business, between governments and among the people of the region ... in every facet of society.

At a national level the Rudd Government understands the opportunity Australia has in China and as part of the region, and, together with state governments, is creating a new vision of engagement that will position us well in the future.

And so the theme of this of this conference - *"looking beyond the resources sector"* is timely, as the progress we make in accelerating our broader engagement with Asia is going to be directly related to the future success of our economy and our businesses.

As you can tell, as a British/Irish banker who has arrived in Australia by way of China, I'm quite passionate about this - after all, the reality is we are part of Asia.

It is very clear that China sees Australia as strategic. That while we are an important trading partner and a reliable supplier of raw materials and energy, the relationship between the two countries is much more than that.

Part of the closeness lies in Australia's willingness to engage with China.

Nearly 40 years ago Australia was the first country to recognise China.

Today, Australia has the only leader in the western world to speak Mandarin.

Part of the closeness lies in the bridge between the two countries developed by Chinese expatriates and the Chinese who have studied in Australia.

Australia is already the leading destination for the education of a new generation of Asian people. Australia is currently home to 90,000 Chinese students, 50,000 from India, 25,000 from Singapore and 20,000 from Malaysia.

To put this in perspective, more Chinese students are educated in Australia than in the US.

Half of Australia's population growth is from migrants and Asia accounts for over 40 per cent of that.

At ANZ, like many Australian organisations, we are already incredibly multi-cultural. Among our top ten surnames are five Asian names.

However, and my colleague Warwick Smith will be pleased to hear this, I'm happy to report Smith still tops the list!

Of course, much of our wealth and economic growth is already coming from Asia. That's most obvious with the success of our resources industry.

This is no accident either. China has 21% of the world population and 7% of the world's arable land.

It's a political and economic imperative for China to be engaged with world trade in order:

- to earn the foreign currency to feed its people;
- import the technology to develop its economy;
- to tap foreign capital and expertise to modernise its infrastructure; and
- obtain raw materials to feed its industry.

However, it is also important to understand that China's growth is not dependent on the US or Europe. The growth is being driven by a once in a lifetime investment in infrastructure and that, in fact, Asian export markets are more important to China than the US export market.

In *"looking beyond the resources sector"* today we will have the opportunity to hear how many Australian's are exploring the opportunities that this truly unique event in world history are creating.

Whatever the businesses opportunities in China, there is one common thread, – that is the importance finance and financial services plays in their success.

As the former Chief Executive of The Hong Kong and Shanghai Banking Corporation and now the Chief Executive Officer of Australia and New Zealand Banking Group, both with significant investments in China, I know something of opportunity in banking in China and something of what we need to do as a bank to support the growth aspirations of business in China.

In a recent study, the McKinsey Global Institute estimated that the continuing reform of the Chinese financial system could not only raise GDP by as much as 17 percent, or \$320 billion a year, but also help spread China's new wealth more evenly.

The Chinese Government understands this and has prioritised the reform and development of the financial services sector in parallel with roads, ports, railways, air links, and energy infrastructure as a vital component of balanced growth.

As a result, we are seeing significant reform of China's domestic banks which dominate its financial system, accounting for around 70 percent of its financial assets and providing more than 95 percent of new corporate financing last year.

In our new world, it's worth remembering that the largest bank in the world by market capitalisation is not Citibank; it's not Bank of America; and it's not HSBC.

As of July 2007, it was a Chinese bank - the Industrial and Commercial Bank of China. In fact today, the top 3 banks in the world by market capitalisation are Chinese.

At the same time, Chinese banks are also seeking foreign investors and this has seen a growing role for foreign banks.

Many foreign banks, including ANZ, are making minority investments in Chinese banks and financial services companies.

ANZ is now Australia's largest foreign direct investor in China with over \$1 billion in capital invested in our partnerships in Shanghai and Tianjin and in our network of branches and representative offices in Shanghai, Beijing and Guangzhou.

It includes 20% stakes in the Shanghai Rural Commercial Bank and the Bank of Tianjin.

These are not just financial investments of course, but partnerships allowing domestic Chinese banks to build capability in business and retail banking, technology systems and in risk management to accelerate the progress of Chinese banks toward being world class.

For us and other financial services firms who have made investments in China, including the Commonwealth Bank and National Australia Bank, the opportunity is immense.

By the end of this year, 13 percent of China's urban families, or almost 25 million households, will be defined as middle class, with this proportion set to double in the next three years.

Until recently, Chinese consumers only paid cash for their purchases.

With greater deregulation, consumer credit and credit cards are more available and, because of this, spending and borrowing are on the rise.

Our presence is also playing a significant role assisting the flow of Australian investment into China and establishing Australian business in China.

This is a huge and growing opportunity for Australian financial services companies to engage with Asia and to grow in the region.

At present though, the major Australian banks on average generate little more than 1% of their earnings from Asia, despite the fact that it is right on our doorstep.

In contrast, the top 10 European Banks generate around 11% of their earnings from Asia Pacific.

For ANZ, it won't come as any surprise to you then that we have set out a medium term aspiration for Asia to contribute around 20% of ANZ earnings by 2012.

We will do that by:

- Deepening our franchise, customer base and expanding our capabilities
- Broadening our focus to include mass affluent retail customers and local corporate customers
- Having a clear focus on core geographies. We want to be a top tier domestic bank in Malaysia, Vietnam and Indonesia; and becoming a leading foreign bank in Greater China.

Over the medium term that will reconceive ANZ as bank with global quality and regional significance - what I call a "super regional" bank.

We have a good foundation but like many Australian businesses, we need to set a new aspiration to become more outward looking and truly be part of the region, or we risk missing out on being part of Asia's growth story.

I have already spoken about this earlier, but let there be no mistake – this century is Asia's century - the century where our region becomes the engine of global growth.

Of course, growth is not guaranteed to any country. It takes leadership, training, skill and most importantly courage.

So the thought I want to challenge us with at this Summit is how we foster that national culture of creativity and enterprise that builds political, business and community linkages with China so that we become an integral part of its future success.

The opportunity is there.

Thank you.