

The Australian Economic Story

The Society of Actuaries in Ireland

4 March 2014

Presenter:

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The Australian Economic Story

Agenda

1. Australian Economic backdrop – The ‘Lucky Country’
2. The current economic climate and Australia’s place in a global economy
3. Property and Banking Sectors – could it happen in Australia?
4. Life in Australia – an Irish expat perspective!

Australian Economic Backdrop

»» The 'Lucky Country'

Australia 101

- ▶ A country / continent, the 6th largest country in the world.
- ▶ Population of c. 24 million
- ▶ Population density of 3/km² (233/243), world average 53/km²
- ▶ A diverse country
 - Expansive deserts
 - Rainforests and wet tropics
 - Coastal plains and fertile farmland
 - Alpine region greater in size than European alpine region
 - Geographically isolated
 - Unpredictable weather
 - Multicultural and educated population

Australia and Europe



Australia and Europe area comparison

Australia's area: 7.7 million sq km

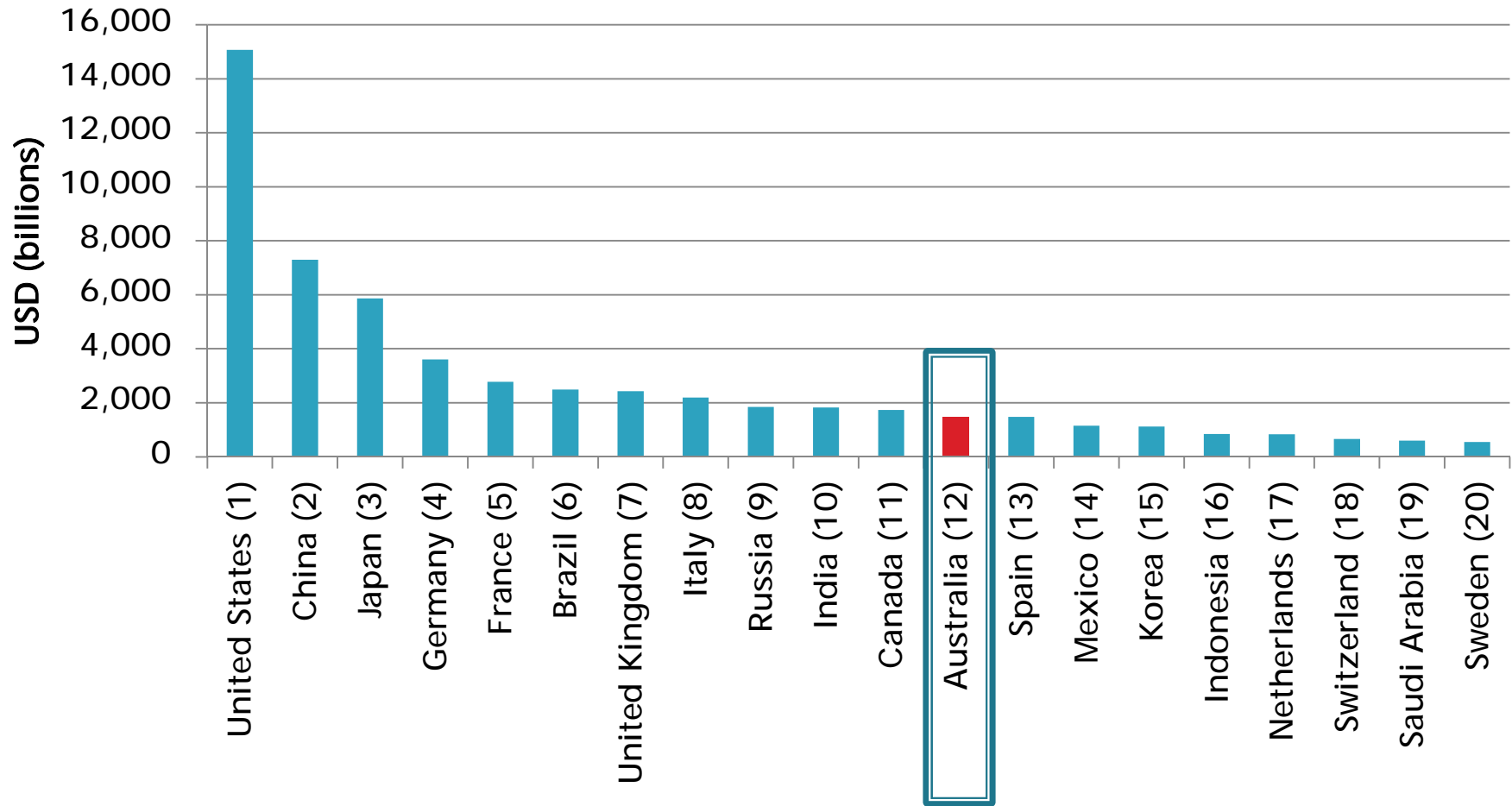
Europe's area (shown): 3.5 million sq km

Darwin to Perth 4396 km • Perth to Adelaide 2707 km • Adelaide to Melbourne 726 km
Melbourne to Sydney 887 km • Sydney to Brisbane 972 km • Brisbane to Cairns 1748 km



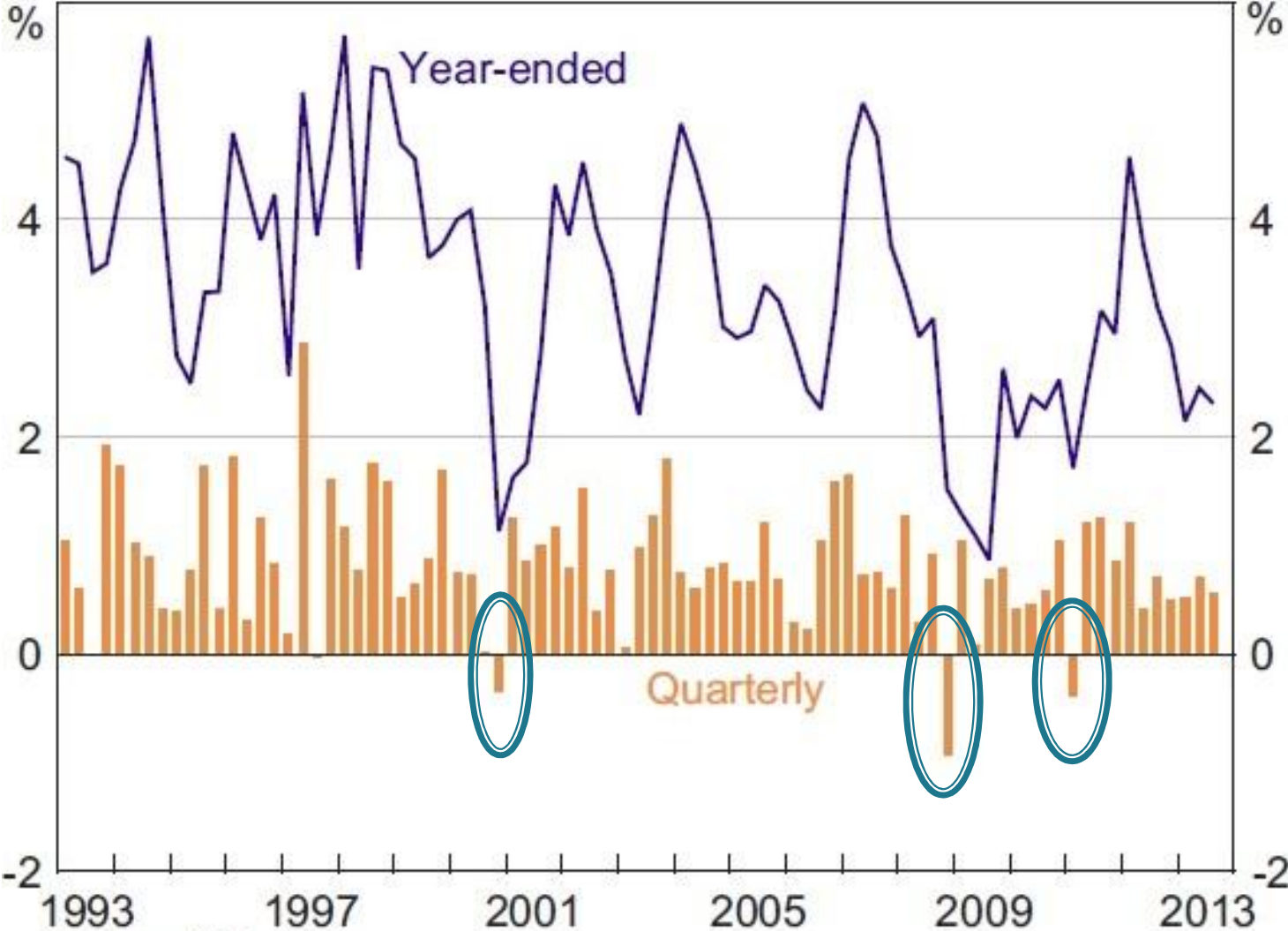
Global GDP rankings

Top 20 countries by GDP (2011)



Source: IMF

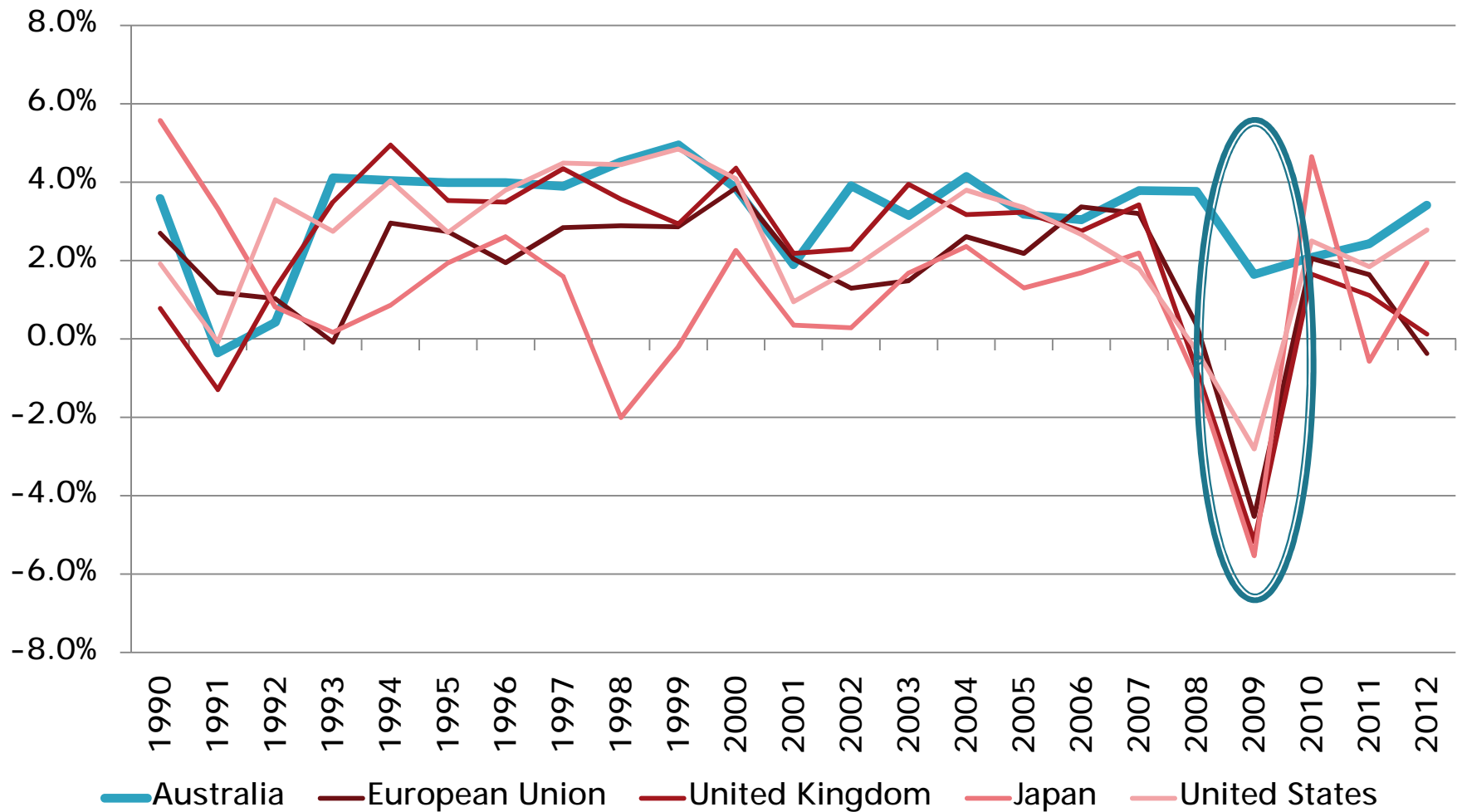
GDP Growth – Australia



Source: ABS

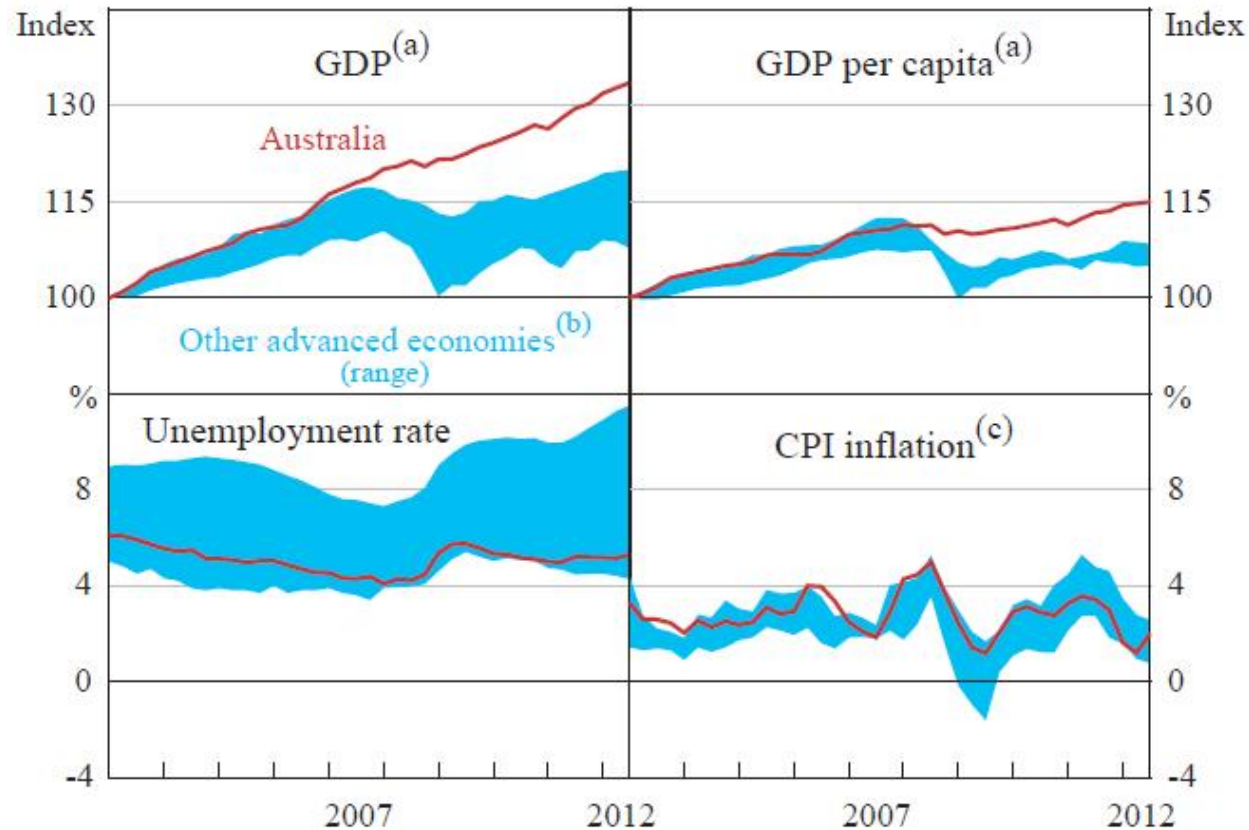
Source: RBA

Annual GDP Growth - Developed Economies



Source: World Bank

Relative Economic Performance



- Notes:
- (a) March quarter 2003 = 100
 - (b) Canada, euro area, Japan, NZ, UK and US
 - (c) Year-ended; excludes Japan

Sources: ABS; Eurostat; Statistics New Zealand; Thomson Reuters; US Census Bureau

Source: RBA

Australia through the 'GFC'

- ▶ Avoided 'great recession' for a number of reasons:
 - Strong fiscal position coming into 2008.
 - Government fiscal stimulus:
 - individual (tax rebate cash hand-outs), First Home Owner Grant
 - Infrastructure and building programs e.g. schools, roads programs
 - Lowered Cash rate from 7.25% to 3.00% to cushion fallout
 - Chinese stimulus had a huge impact on Australia over this time.
 - Australian dollar weakens – exports more attractive, particularly minerals at an important time.
 - Well regarded regulation in banking/lending sector and limited low-doc / sub-prime residential lending limited arrears and defaults.

Australia's place in a global economy

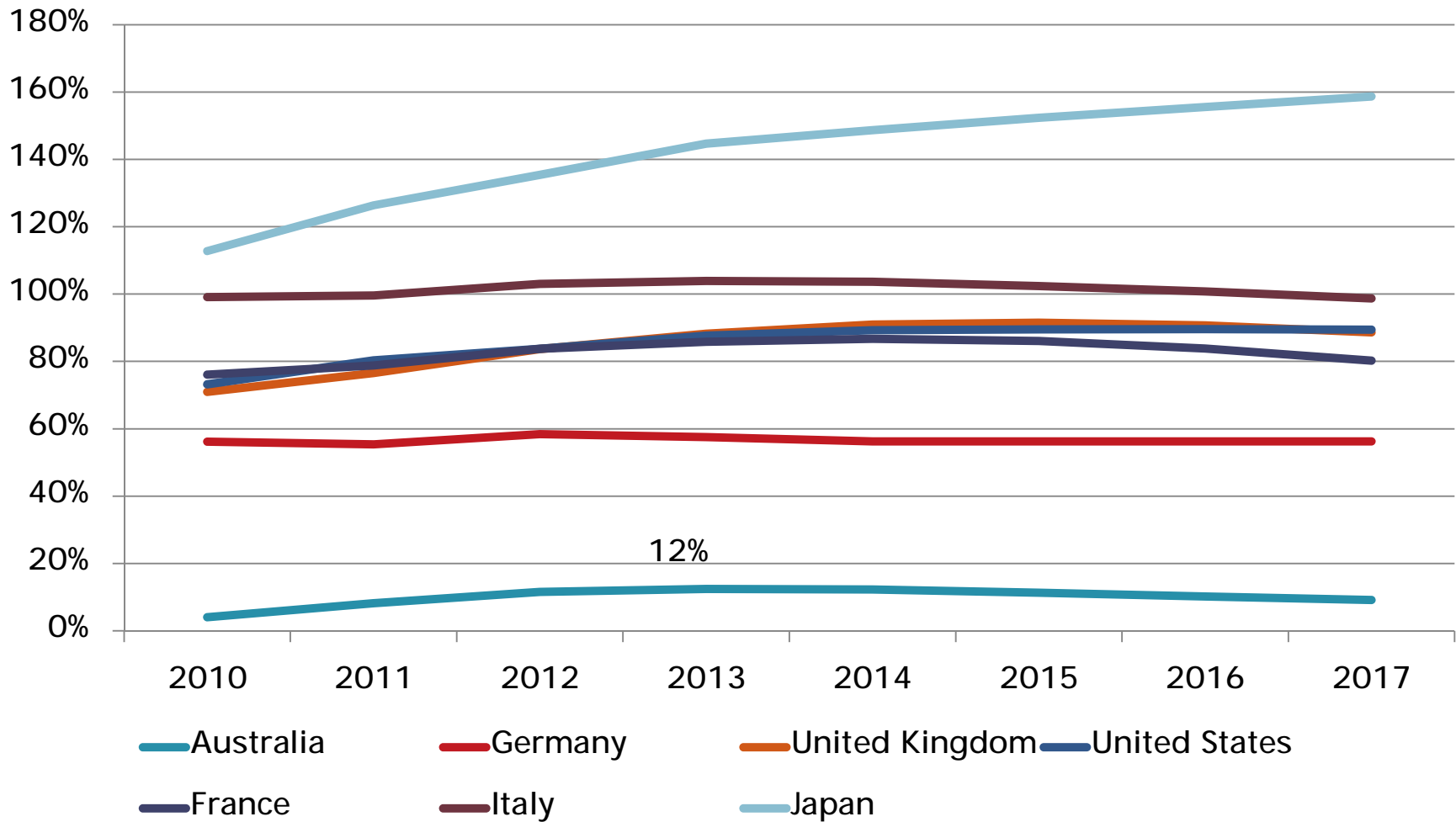
»» The Current Economic Climate

The current state of affairs

- ▶ Australian economy remains resilient, despite those calling for impending recession:
 - Positive GDP growth c. 2.5% area
 - Low(ish) unemployment of c. 6%
 - Healthy government balance sheet, net debt expected to peak at 20%
 - Monetary policy accommodation with a cash rate of 2.5%
 - Population growth to drive demand
 - Plentiful (but finite) supply of natural resources

However, plenty of challenges in the years ahead

Net Debt to GDP



Source: IMF

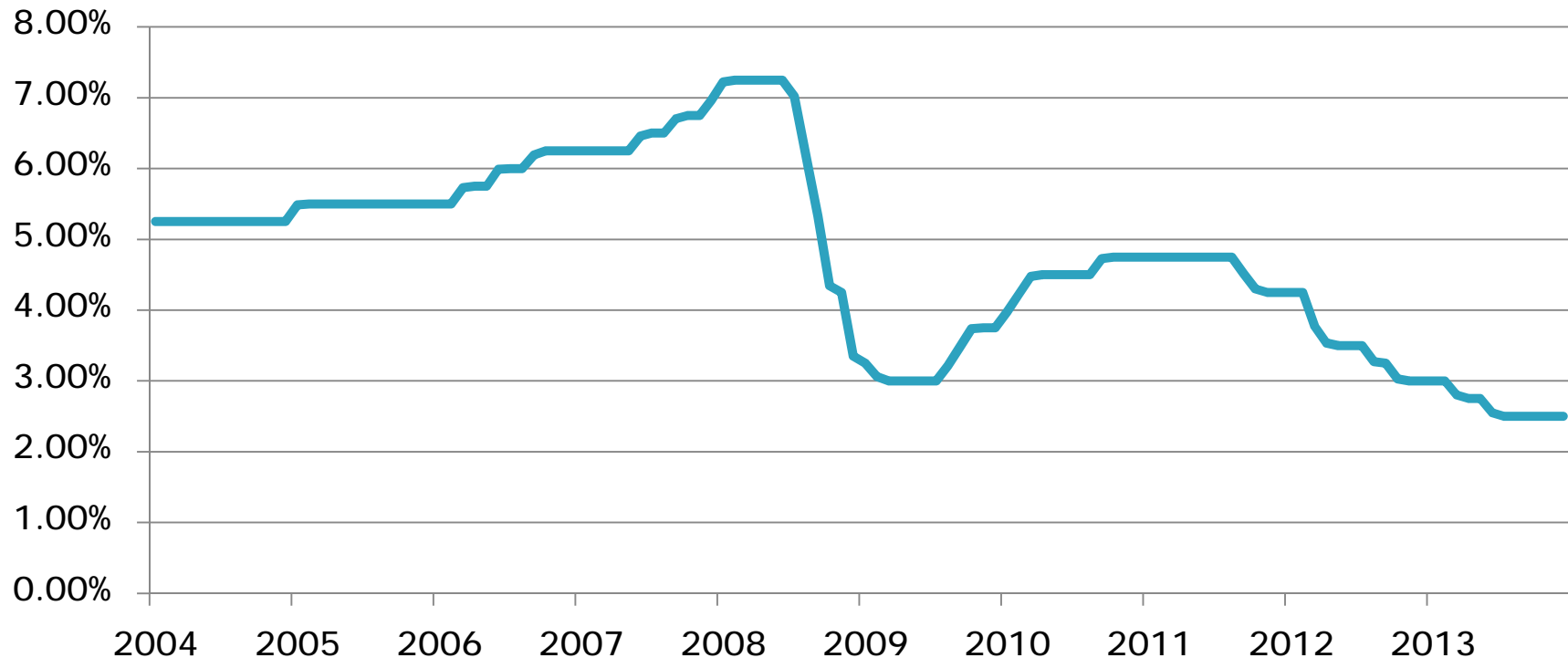
Country Credit Rating

- ▶ Australian retains AAA credit rating with 3 main credit rating agencies. Outlook is *stable* with all 3 agencies
- ▶ Only 10 countries globally retain AAA ratings with a 3 major agencies. Some comments from rating agencies

Positives	Negatives
Fiscal and Monetary Policy Flexibility	Dependence on China/Resources
Public policy stability	Leveraged Private Sector
Economic resilience	High levels of External Debt
Flexible labour and product markets	Contingent risks from banking sector

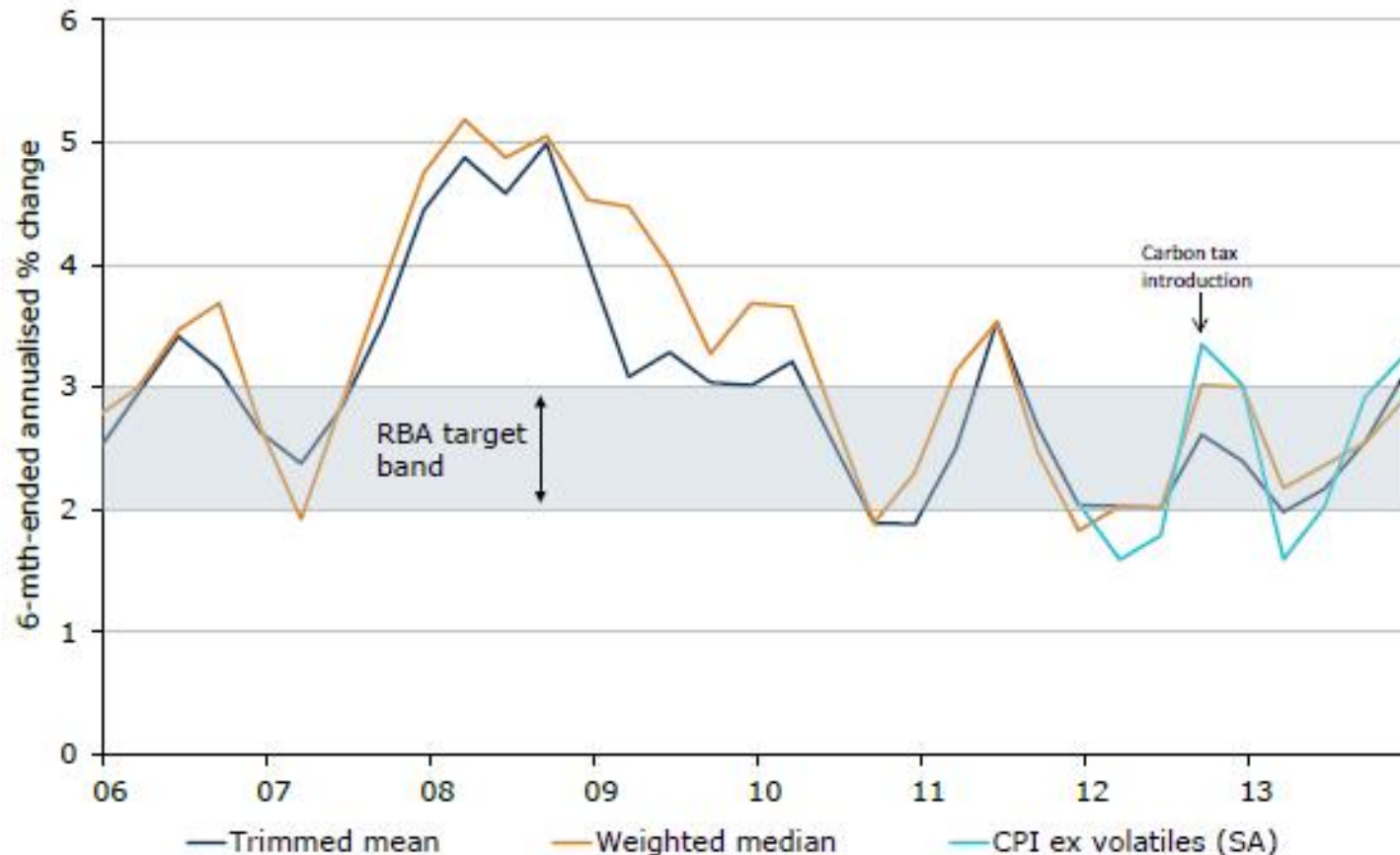
Interest Rates and Monetary Policy

- ▶ Reserve Bank of Australia's (RBA) mandate is price stability. Targets inflation of c. 2–3%.
- ▶ Cash rate of 2.5% currently at an all time low



Inflation

- ▶ Most Developed economies grappling with low inflation.



- ▶ Inflation increasing in Australia and at the upper level of the RBA's target

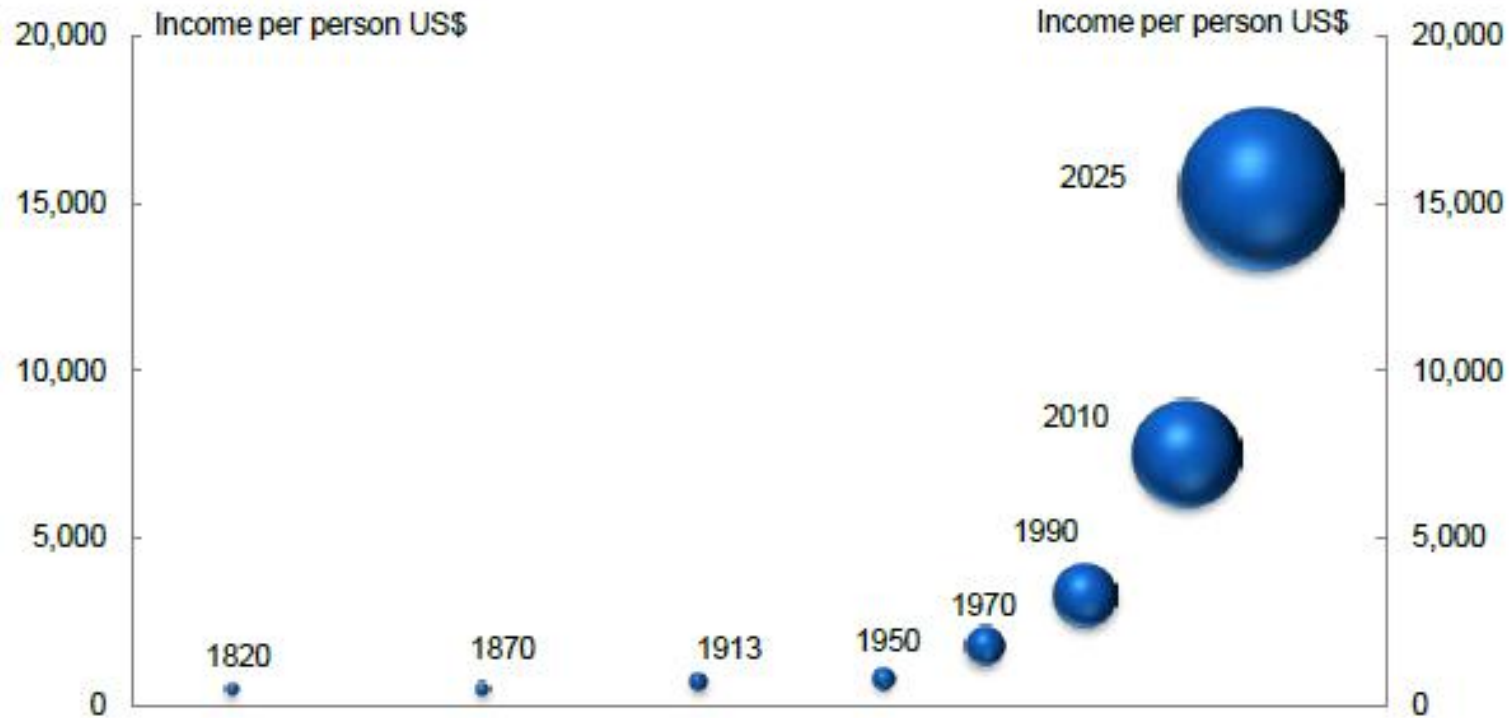
Source: ANZ

The 2 speed economy

- ▶ Australian economy operating on 2 levels in recent years

Full Speed Ahead	Laggards
Commodity exports and mining services	Traditional Industry and manufacturing
Construction and Engineering	Retail
Energy	Tourism
WA, QLD and NT	NSW, VIC & SA

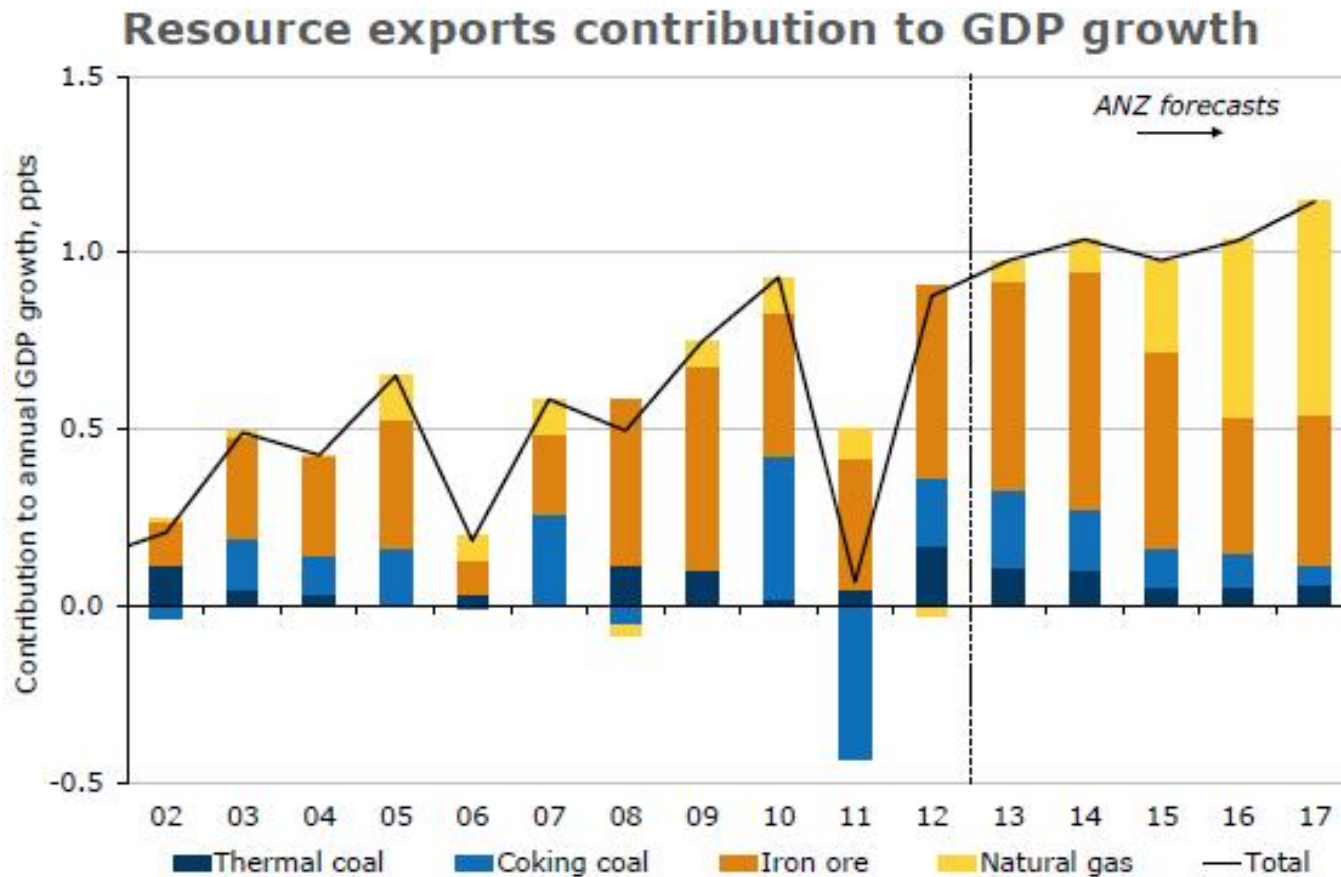
The Rise of Asia



- ▶ In the past 20 years
 - Chinese and Indian economies increased by six times over and tripled share of the global economy
- ▶ By 2025
 - Asian region will account for almost half of the worlds output

Commodities – Mining and Iron Ore

- ▶ Mining, energy and resources contribute a significant amount to Australian GDP:



Source: ANZ

Liquefied Natural Gas (LNG)

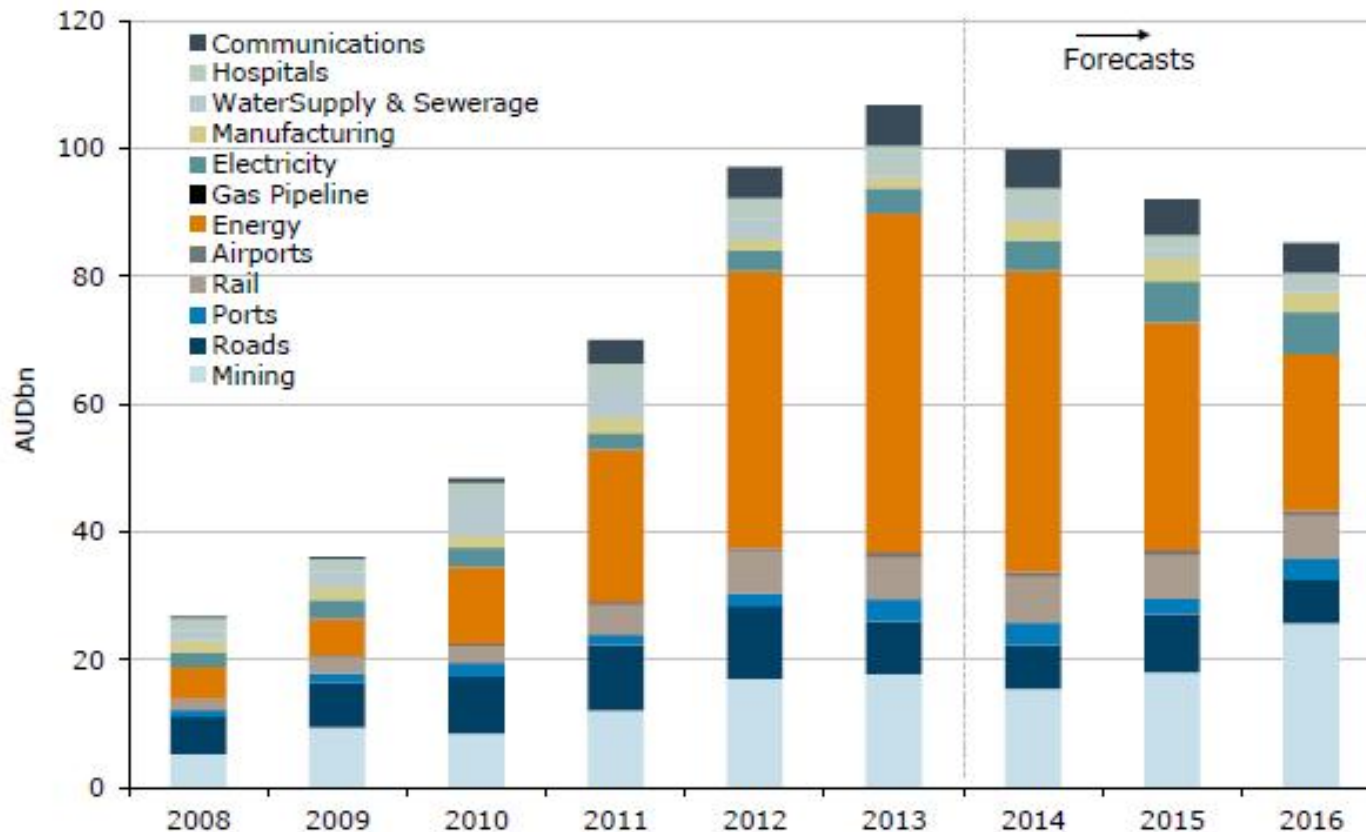
- ▶ Liquefied Natural Gas takes up to 1/600th of volume of gas in gas form.
 - ▶ Gas is compressed, frozen and shipped in liquid form onboard LNG tankers.
 - ▶ Re-gasified at destination terminal.
-
- ▶ Emerging Asia has a significant demand for importing energy
 - ▶ Australia currently ranked in top 3 producers
 - ▶ Destined to overtake Qatar as number 1 by 2017.
 - ▶ In Australia – 3 plants are operating, 7 are under construction and more are planned – total investment approaching \$200bn



Source: Bureau of Resources and Energy Economics, Australia

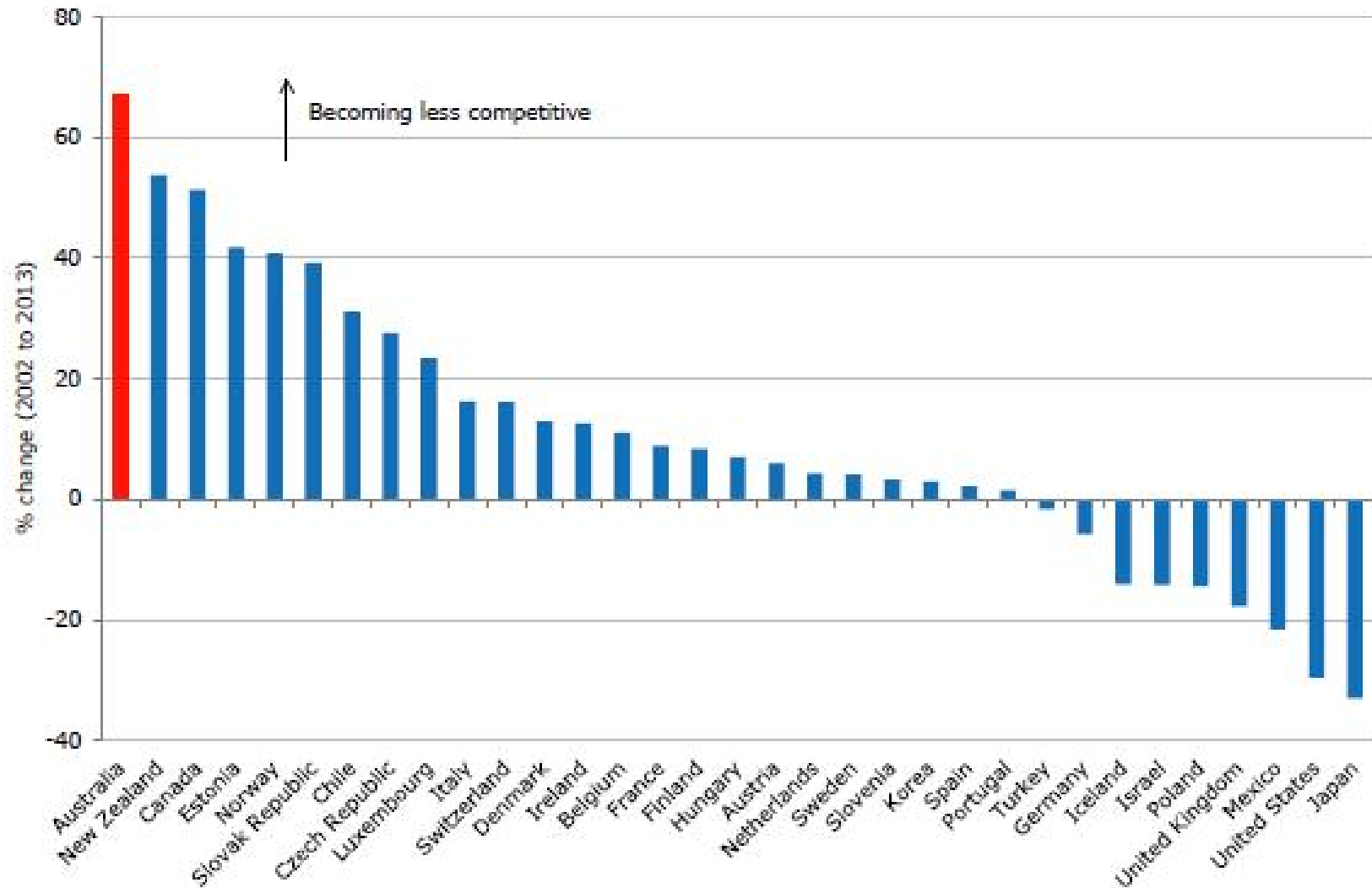
Investment pipeline

- ▶ Annual investment pipeline still strong...BUT declining over coming years



Source: ANZ

Traditional Industry and competitiveness



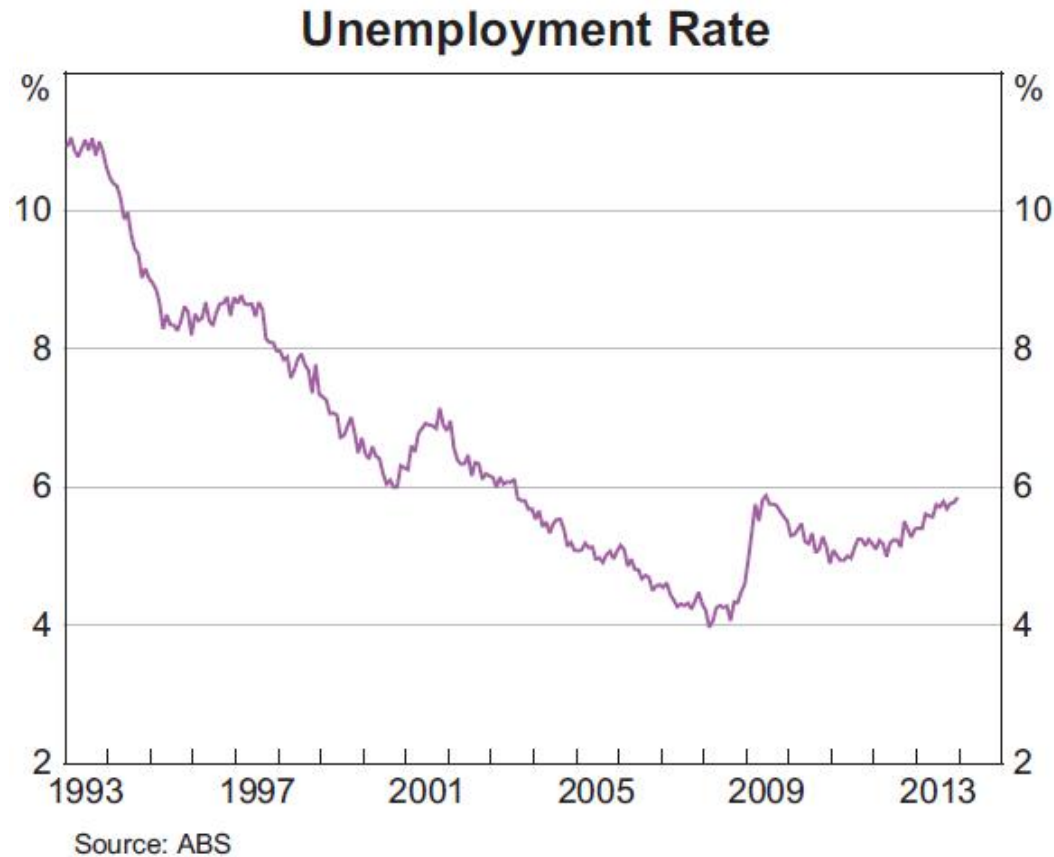
Source: ANZ, OECD

The auto industry

- ▶ The Australian auto industry has fallen victim to competitive pressures
- ▶ Toyota recently announced it will stop making cars by 2017.
- ▶ Follows on from similar Ford and GM announcements last year.
- ▶ First time since 1925 that no cars manufactured in Australia
- ▶ Total of c. 50,000 jobs affected
- ▶ Rationale for move
 - Economies of scale no longer present – plants too small
 - Cost of production and wages too high versus cheaper imports
 - Appreciation in A\$ - no longer possible to compete

Labour Market and Unemployment

- ▶ Unemployment rate, at c. 6% remains well below developed market averages.



Source: RBA

Summary

- ▶ Australian economy has demonstrated flexibility and resilience when compared to other developed economies over the past decade:
- ▶ Luck or prudent economic management?
- ▶ Certainly demonstrated prudent monetary and fiscal policies over last 10 years
- ▶ Country also currently benefitting from 'what it has' and 'where it is'
- ▶ Challenges remain for the future:
 - Continued reallocation of labour across industry and restoring productivity
 - Diversify economy from dependence on resources and energy
 - Capitalising on opportunity presented by emerging Asia
 - Manage banking and property sector and private sector leverage

Property and Banking Sectors

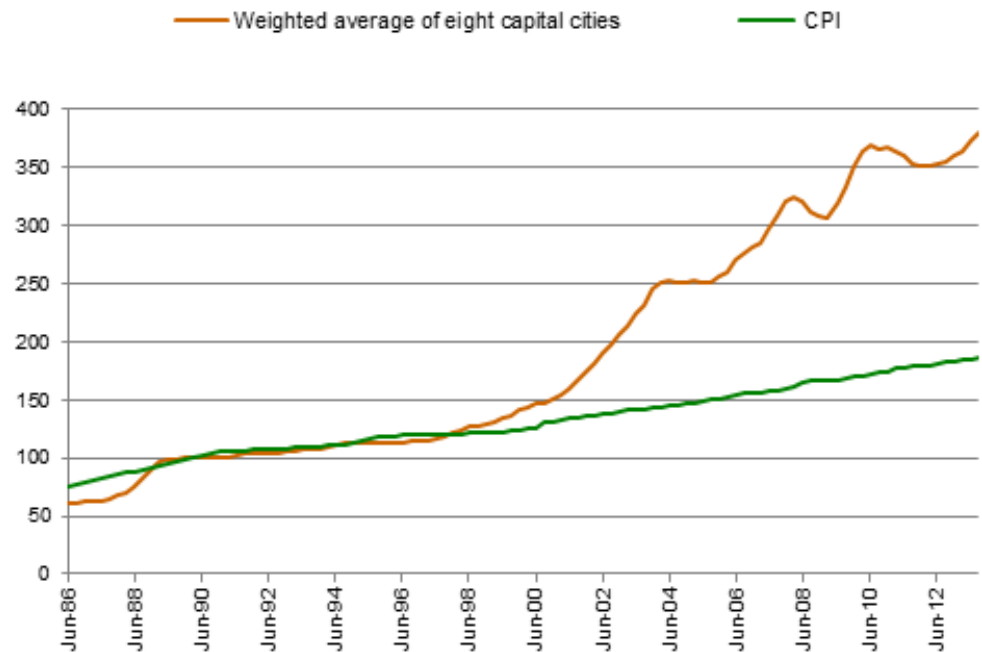
»» Could it happen in Australia?

Residential Property Market

- ▶ To many, Australia's property market seems to be in perpetual upward motion.
 - What is driving this? (Can attempt to answer this one!)
 - How will it end? (Cue crystal ball.....)

Capital city median prices

Capital city	Houses	Units
Sydney	\$775,000	\$557,000
Melbourne	\$625,000	\$481,000
Brisbane	\$470,000	\$383,000
Adelaide	\$405,000	\$325,000
Perth	\$537,250	\$439,000
Hobart	\$350,000	\$255,000
Darwin	\$595,000	\$449,500
Canberra	\$570,000	\$432,000
Australian Capitals	\$575,000	\$480,000

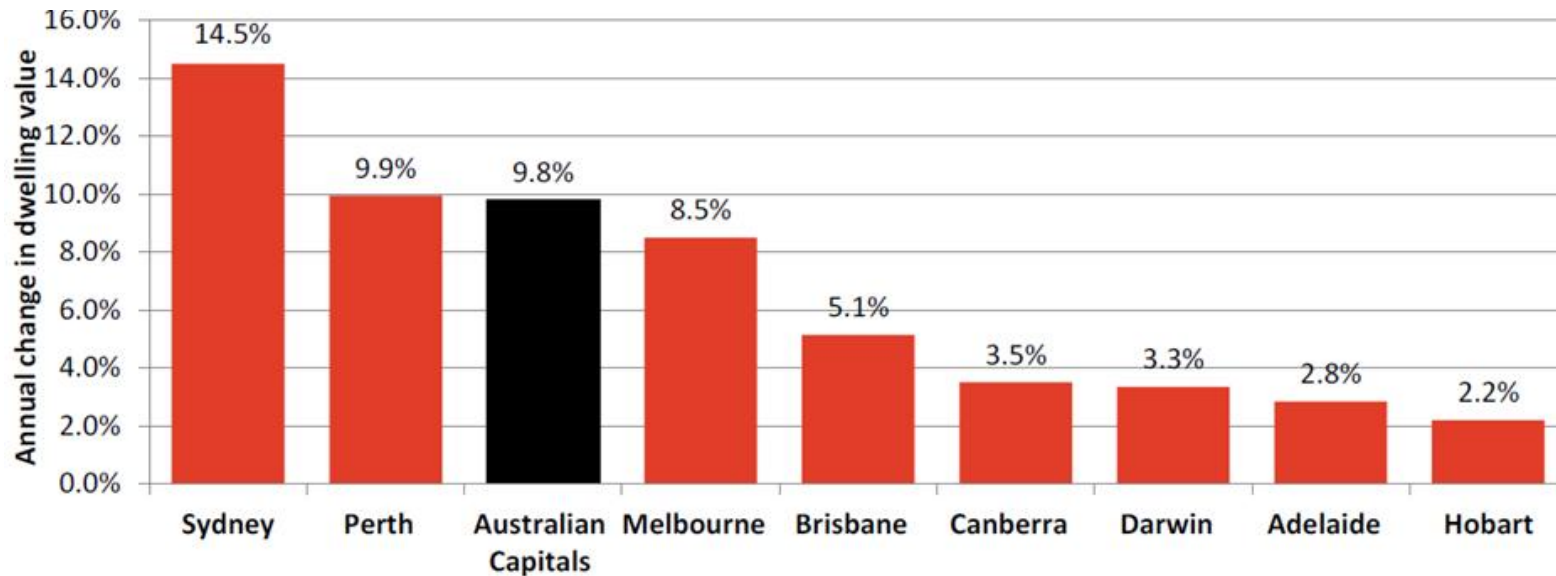


Note: Base year 1989/90=100.
Source: Australian Bureau of Statistics.

Source: S&P / RP Data

© Standard & Poor's 2014.

Residential Property Market – 2013



- ▶ Home prices now 3.5% higher than previous peak across major capitals (compared to Ireland at currently 40-45% below peak).
- ▶ Sydney market c. 11% above previous peak
- ▶ Average annual growth of 4.5% over the last decade
 - Perth 7.9% p.a.
 - Darwin 9.0% p.a.

Source: RP Data

Residential Property Market – Drivers

- ▶ Population growth.
- ▶ Record low interest rates improving affordability.
- ▶ Government stimulus over 2008 - 2010
- ▶ Investor demand: negative gearing negative cashflow is tax deductible against other personal income tax liabilities
- ▶ Pent up demand over recent years
- ▶ Supply constraints at major capital cities
- ▶ Self Managed Superannuation Funds (Manage your own pension)
- ▶ Home ownership – Australian Dream / National obsession

What could go wrong?

- ▶ Increasing unemployment
- ▶ Sharp increase in interest rates impacting affordability.
- ▶ External Shock
- ▶ Abrupt end to current commodity cycle and sharp decrease in exports to China etc.
- ▶ China shadow banking system and credit concerns, decline in GDP
- ▶ Australian Banking system problems

No escaping fact that Australian property is expensive

Banking Sector

- ▶ Dominated by 4 main banks, combined Market Cap of almost A\$400bn, and a total of c. 27% weight in Australia's benchmark ASX 200 equity index.
 - Australia & New Zealand Bank (ANZ) - \$86bn
 - Commonwealth Bank of Australia (CBA) - \$122bn
 - National Australia Bank (NAB) - \$80bn
 - Westpac Bank (WBC) - \$102bn
- ▶ Combined net worth over 1.5x size of the Irish economy (€160bn GDP in 2012)
- ▶ Fortunes of Australia closely tied to banking sector

Banking Sector and housing

- ▶ Fortunes of banking sector closely tied to housing market.
 - ▶ Major bank balance sheet assets dominated by housing loans
 - Total housing loan market of A\$1.23trn (2/3rds owner occupier, 1/3rd investment)
 - Two thirds of all housing loans (A\$1.03trn) on balance sheet of 4 major banks
 - ▶ Banks funded through a mix of
 - Deposits c. 55%
 - Short term debt c. 20%
 - Long term debt c. 15%
 - Equity and securitisation 10%
- } Link to offshore wholesale debt markets

Source: APRA, RBA

Banking Sector – In good shape

- ▶ Despite the enormity of the numbers – financial sector has weathered recent volatility and is in good shape
 - Asset quality and arrears holding up well
 - Banks well capitalised and already prepared to meet Basel III Capital requirements – APRA aggressively implementing timelines and conservative in approach
 - Banks holding considerable liquidity, A\$150bn in High Quality Liquid Assets, \$200bn in liquidity available from RBA.
 - Funding mix is improving, increasing use of deposit funding and reduced reliance on short term debt
 - Banks have been holding back dividends to increase capital
 - Profitability – 4 major banks pull in a combined c. \$12bn in after tax profit annually

Source: APRA, RBA

Life in Australia

»» Irish Expat's perspective

The 'Good'

Beach **Sun** Sand Weather Travel Warm BBQ *Perth*
Food *Brisbane* Eskies Gold Coast *Christmas on the Beach*
Friday Lunch *The Rocks* City to Surf Bondi Harbour
Opportunity Fresh Air **Blue Sky** New People *Melbourne*
Fish Music **Outdoor Life** Ute Palm Beach **Sunrise**
Swimming *Manly* Running **Warm Winters** Sydney

The 'Not so good'

It's just not Ireland!

Thank You

Questions ?

Appendix

»» Superannuation

Superannuation Industry

- ▶ A\$1.6trn in assets under management, approx. 100% of GDP.
- ▶ Projected to grow to A\$7.6trn by 2033, or 180% of GDP *
- ▶ 4th largest superannuation market in the world.
- ▶ Moved to DC based model in 1992
- ▶ Compulsory contribution 9% of salary
- ▶ Increasing to 12% on a phased basis

* Source: Deloitte: Dynamics of the Australian Superannuation System. The next 20 years: 2013 - 2033

Self Managed Super Funds (SMSF's)

- ▶ DIY Super funds – allow more flexibility and control over investments.
- ▶ Fastest growing sector, accounting for c. 30% of total market and growing (accounted for only 9% in 1995)
- ▶ Recent legislative changes make it easier for members to operate SMSF's
- ▶ Regulated by the Tax Office –Max 4 members (typically also Trustees)
- ▶ Increasingly being used for investment in real assets such as property, with possibility of using leverage.

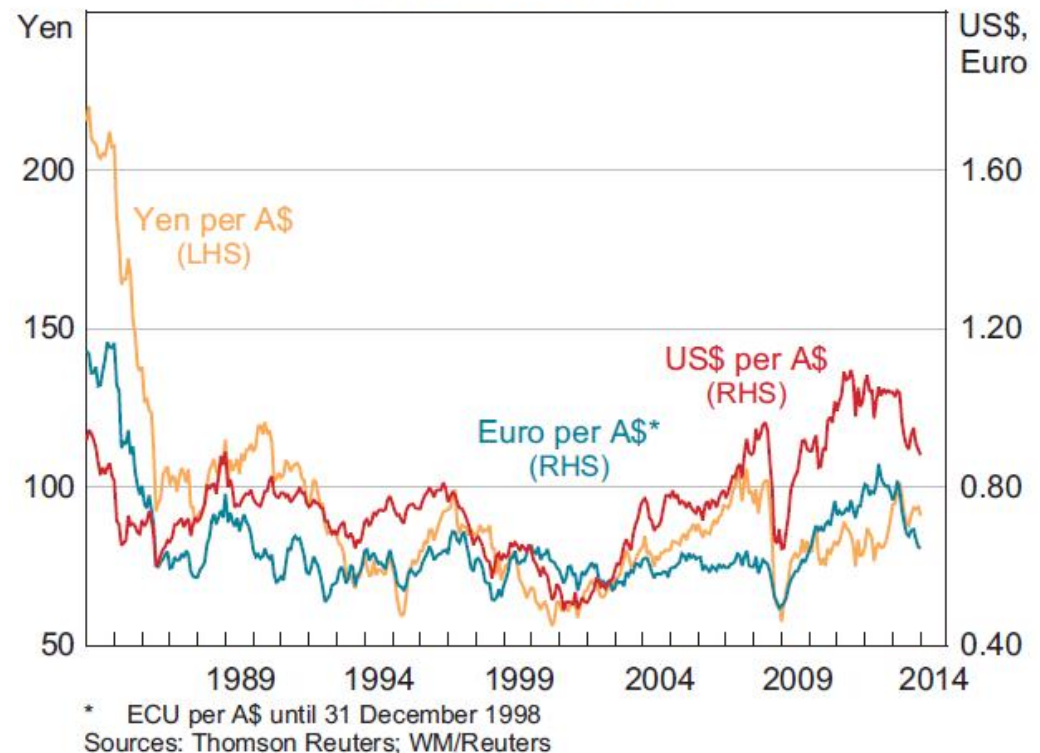
Appendix

»» Additional detail

The Australian Dollar's impact

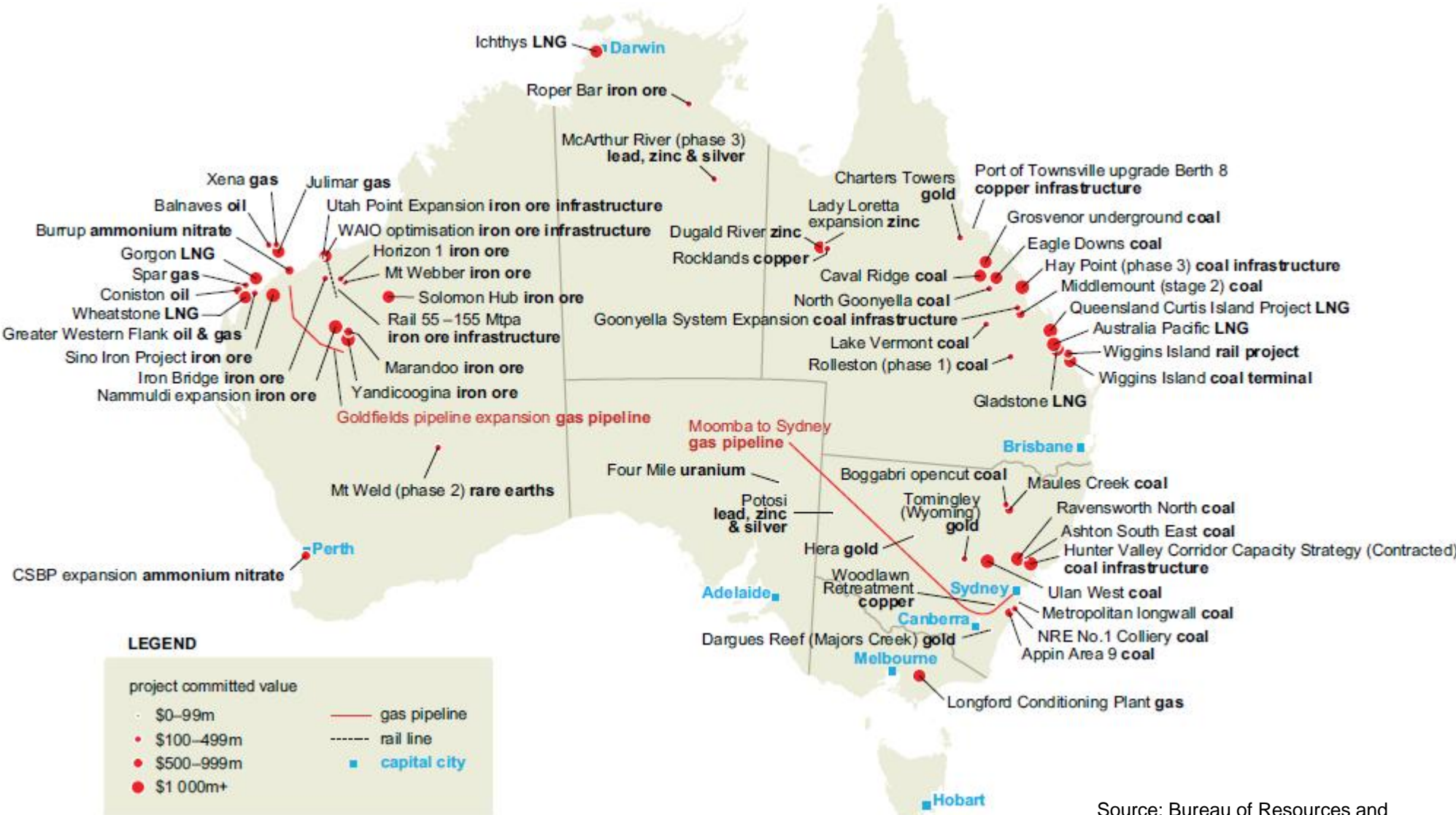
- ▶ The Australian dollar is a free float currency.
- ▶ Has demonstrated a positive correlation to global growth.
- ▶ Vulnerable to external shocks – popular amongst hedge fund community/carry trade.
- ▶ Seen by many as proxy for emerging Asia exposure
- ▶ High AUD has impacted Australian competitiveness

Australian Dollar against US Dollar, Euro and Yen



Source: RBA

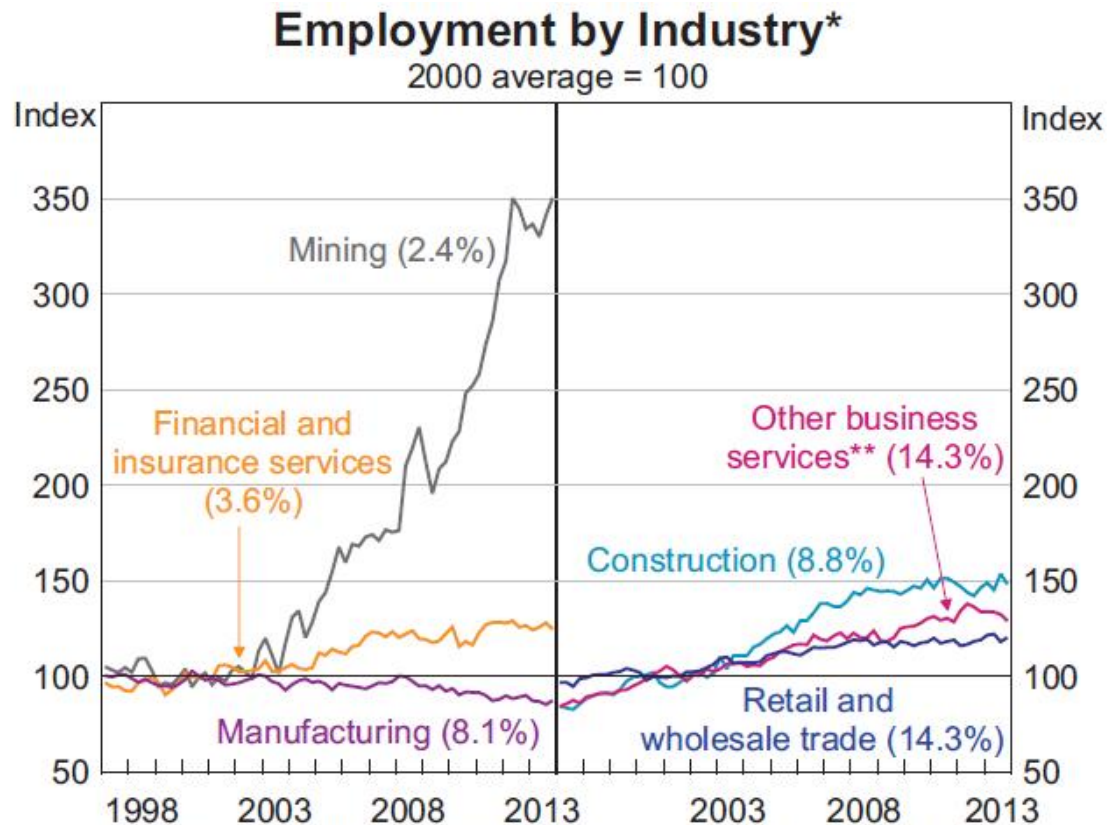
Major Resources and Energy Projects



Source: Bureau of Resources and Energy Economics, Australia

Labour Market and Unemployment

- ▶ Composition of employment changing rapidly however:



* Figures in parentheses represent share of total employment based on latest quarterly data

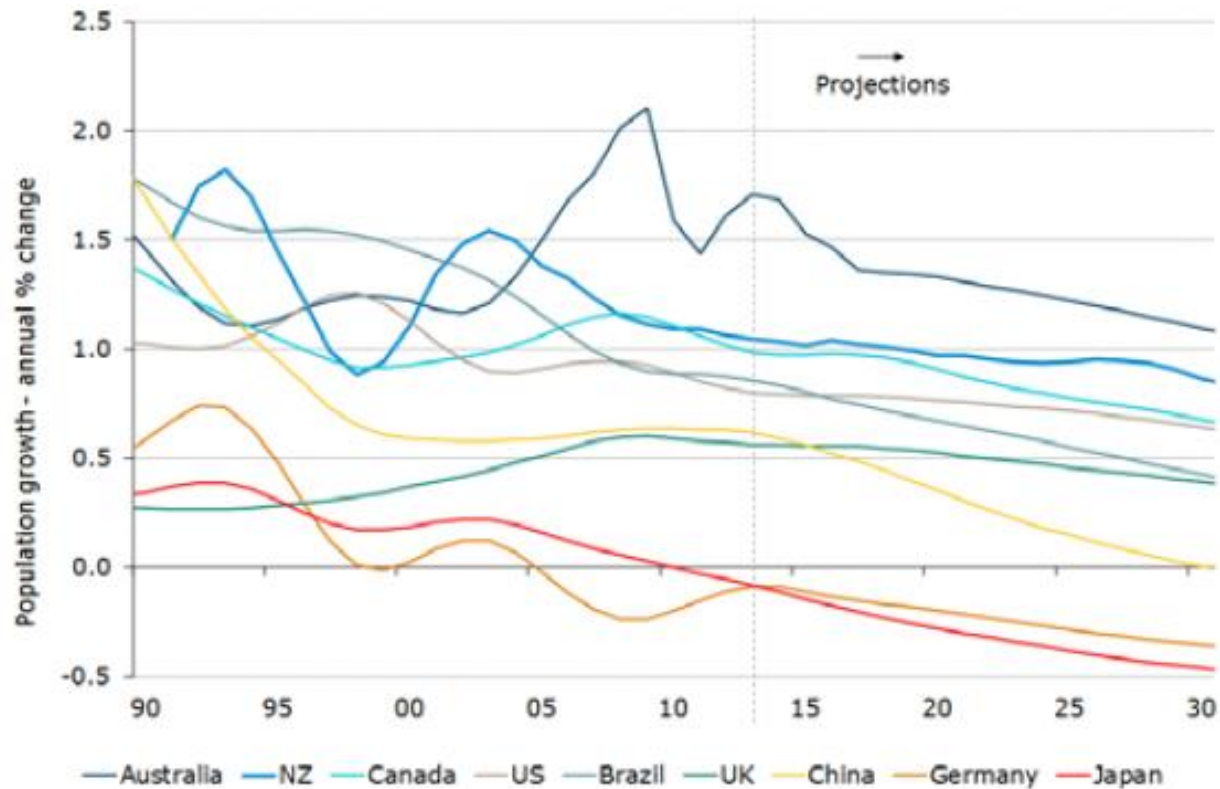
** Includes: information media and telecommunications; rental, hiring and real estate services; professional, scientific and technical services; administrative and support services

Source: ABS

Source: RBA

Population Growth

- ▶ Positive population growth projected to continue



Source: ANZ

Lending Standards

- ▶ Conservative, full recourse lending with limited subprime / low doc loans.
- ▶ Strong consumer credit legislation – responsible lending obligations enacted in Federal and State law
- ▶ APRA well recognised globally as strong regulator
- ▶ Extensive use of Lenders mortgage insurance

Lending standards only as strong as borrowers ability to repay

- ▶ What could affect the ability to repay?