The Australian Economic Story

The Society of Actuaries in Ireland
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Presenter:
Gerard Sheehan
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/km\(^2\) (233/243), world average 53/km\(^2\)
- 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 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 8 • 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)

USD (billions)

0 2,000 4,000 6,000 8,000 10,000 12,000 14,000 16,000

United States (1) China (2) Japan (3) Germany (4) France (5) Brazil (6) United Kingdom (7) Italy (8) Russia (9) India (10) Canada (11) Australia (12) Spain (13) Mexico (14) Korea (15) Indonesia (16) Netherlands (17) Switzerland (18) Saudi Arabia (19) Sweden (20)

Source: IMF
GDP Growth – Australia

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
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%
  - 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.

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

<table>
<thead>
<tr>
<th>Full Speed Ahead</th>
<th>Laggards</th>
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<tbody>
<tr>
<td>Commodity exports and mining services</td>
<td>Traditional Industry and manufacturing</td>
</tr>
<tr>
<td>Construction and Engineering</td>
<td>Retail</td>
</tr>
<tr>
<td>Energy</td>
<td>Tourism</td>
</tr>
<tr>
<td>WA, QLD and NT</td>
<td>NSW, VIC &amp; SA</td>
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</table>
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 world's output
Commodities – Mining and Iron Ore

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

![Resource exports contribution to GDP growth chart](chart.png)

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

<table>
<thead>
<tr>
<th>Capital city</th>
<th>Houses</th>
<th>Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sydney</td>
<td>$775,000</td>
<td>$557,000</td>
</tr>
<tr>
<td>Melbourne</td>
<td>$625,000</td>
<td>$481,000</td>
</tr>
<tr>
<td>Brisbane</td>
<td>$470,000</td>
<td>$383,000</td>
</tr>
<tr>
<td>Adelaide</td>
<td>$405,000</td>
<td>$325,000</td>
</tr>
<tr>
<td>Perth</td>
<td>$537,250</td>
<td>$439,000</td>
</tr>
<tr>
<td>Hobart</td>
<td>$350,000</td>
<td>$255,000</td>
</tr>
<tr>
<td>Darwin</td>
<td>$595,000</td>
<td>$449,500</td>
</tr>
<tr>
<td>Canberra</td>
<td>$570,000</td>
<td>$432,000</td>
</tr>
<tr>
<td>Australian Capitals</td>
<td>$575,000</td>
<td>$480,000</td>
</tr>
</tbody>
</table>

Source: S&P / RP Data
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
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%

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?
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
Labour Market and Unemployment

Composition of employment changing rapidly however:

**Employment by Industry**

- **Mining** (2.4%)
- **Financial and insurance services** (3.6%)
- **Construction** (8.8%)
- **Retail and wholesale trade** (14.3%)
- **Other business services** (14.3%)

*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?