

Open partnerships
Open possibilities

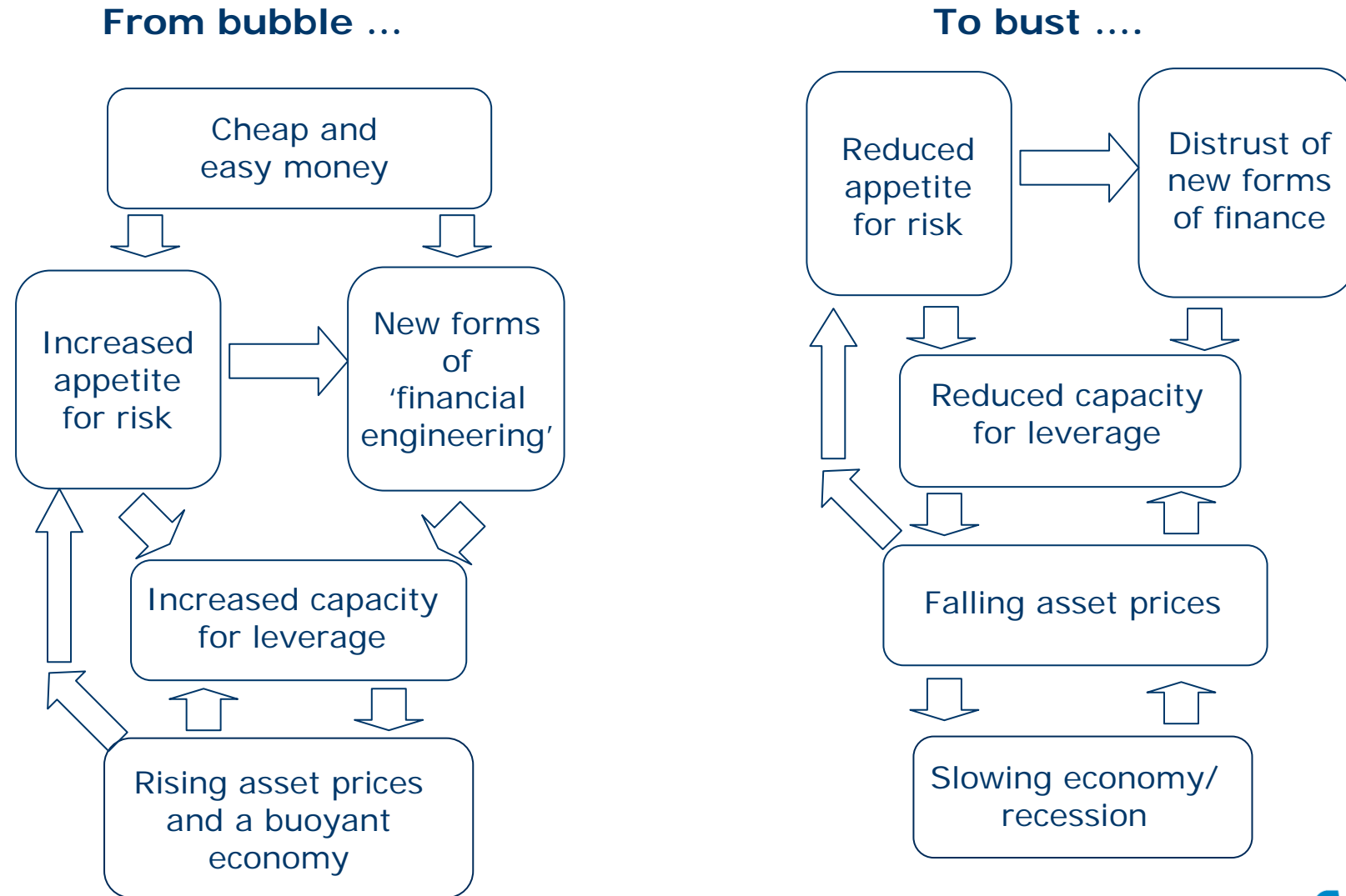
The global financial crisis and its effects on the world, Australian and Tasmanian economies

Presentation to Tasmanian Economic Forum

Hobart Function & Convention Centre
1st December 2008

Saul Eslake
Chief Economist, ANZ

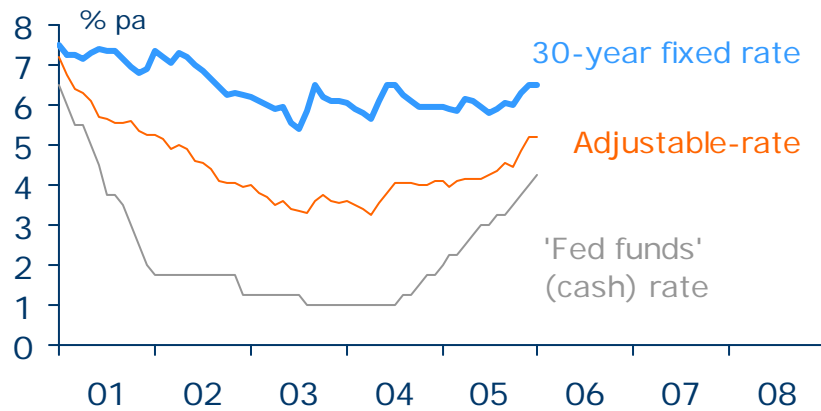
The current global financial crisis stems from the bursting of a 'credit market bubble'



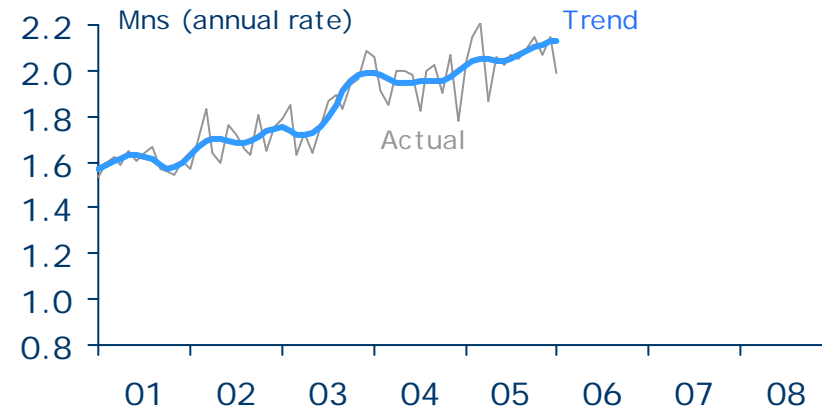
For a time, low interest rates and the explosion in 'sub-prime' lending created boom conditions in the US housing market

US housing market indicators up to 2005

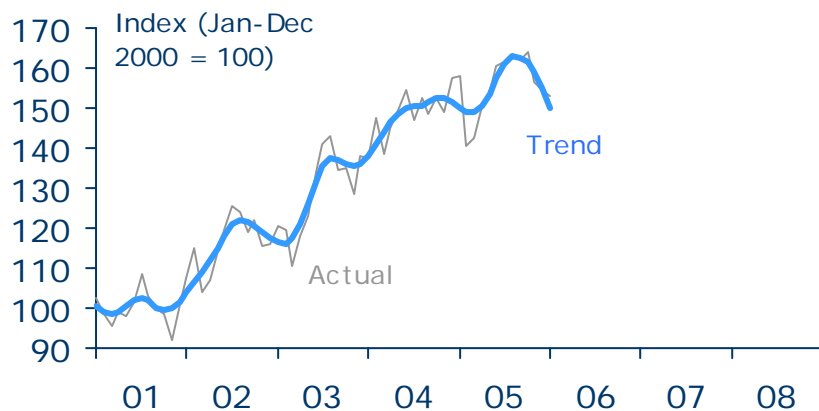
Mortgage interest rates



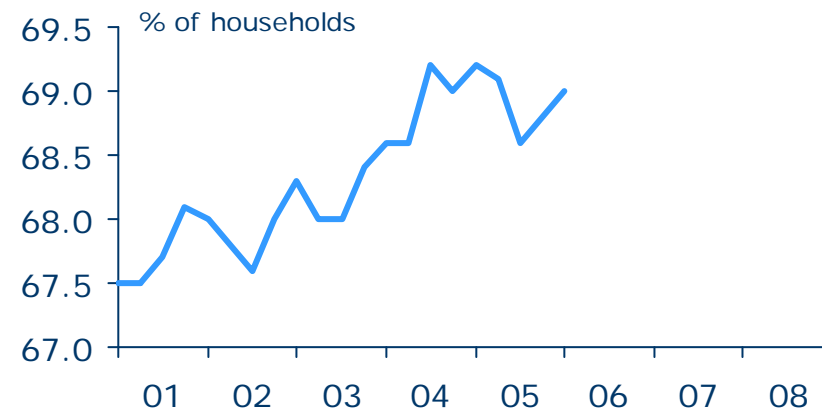
Housing starts



Mortgage applications



Home ownership rate



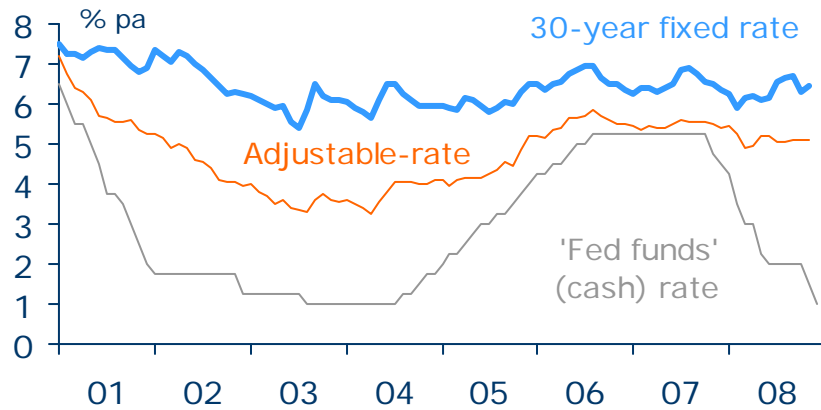
Sources: Mortgage Bankers' Association of America; US Commerce Department.



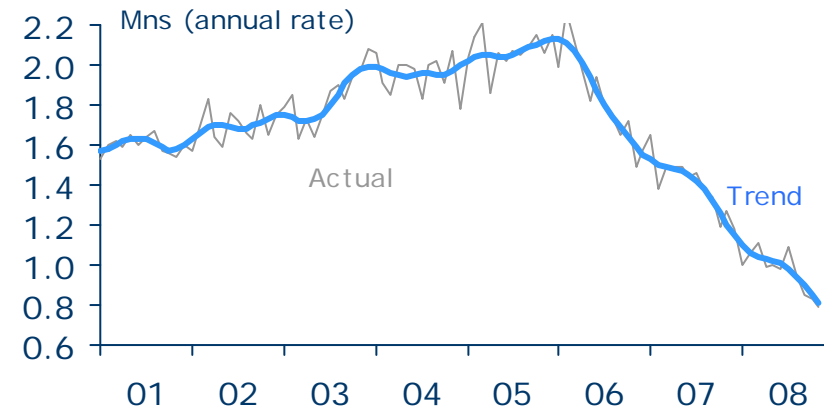
But eventually the bubble burst, as bubbles always do

US housing market indicators up to 2008

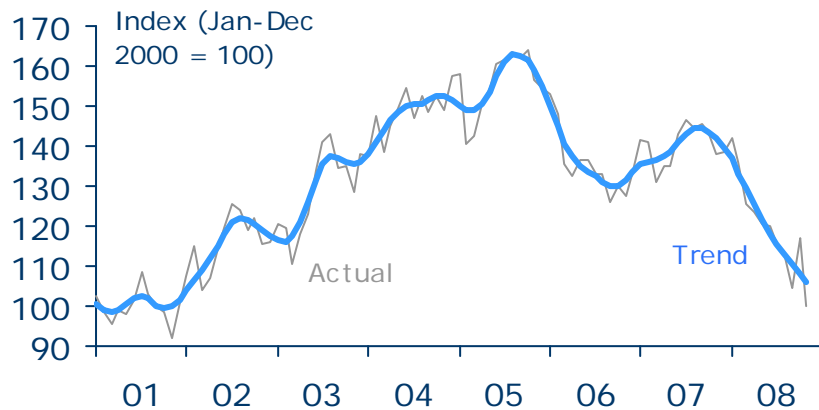
Mortgage interest rates



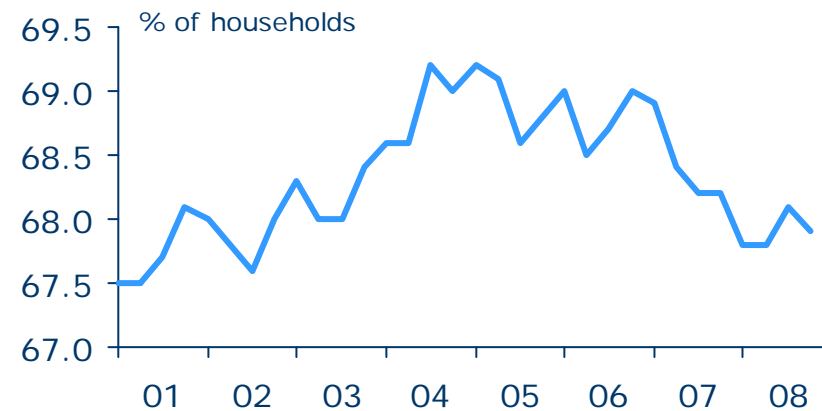
Housing starts



Mortgage applications



Home ownership rate



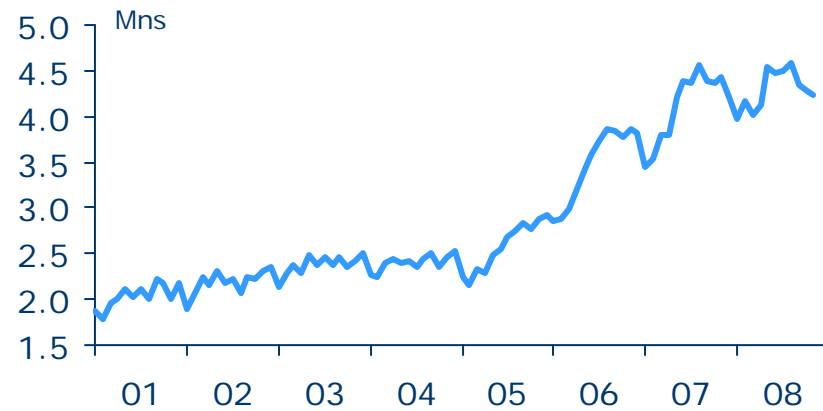
Sources: Mortgage Bankers' Association of America; US Commerce Department.



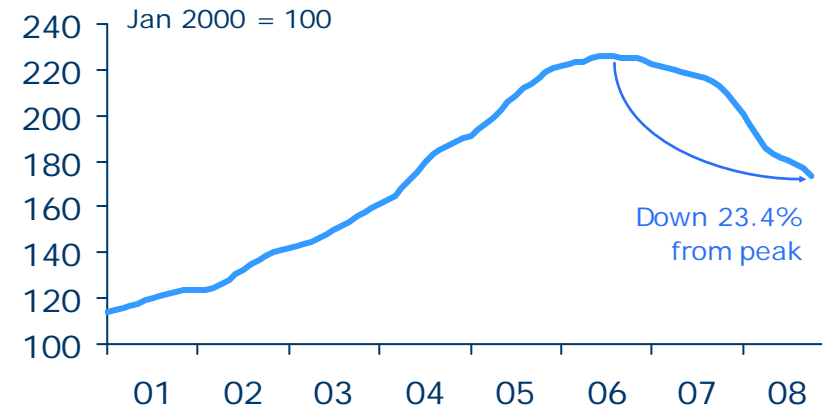
Excess supply of housing as a result of rising defaults and foreclosures is putting sustained downward pressure on prices

US housing market indicators

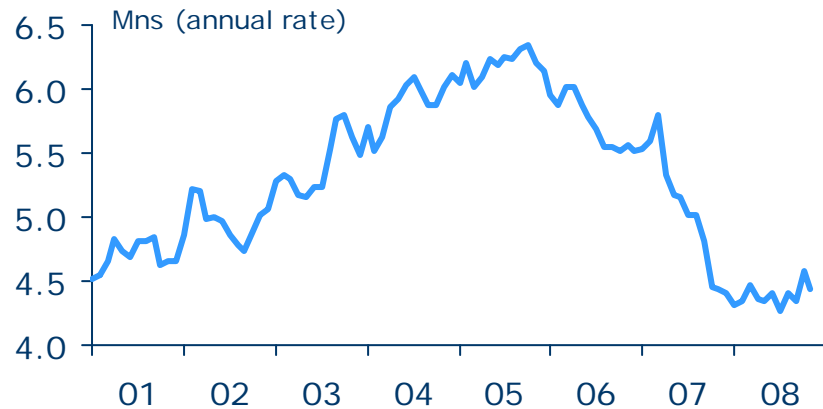
Existing houses for sale



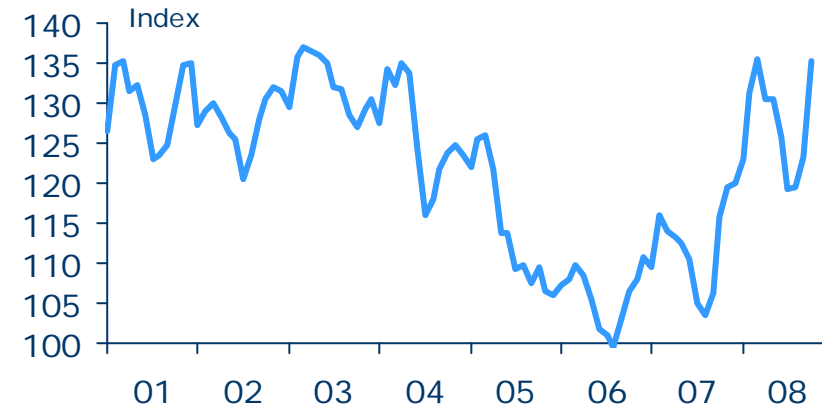
Existing home prices



Existing home sales



Housing affordability

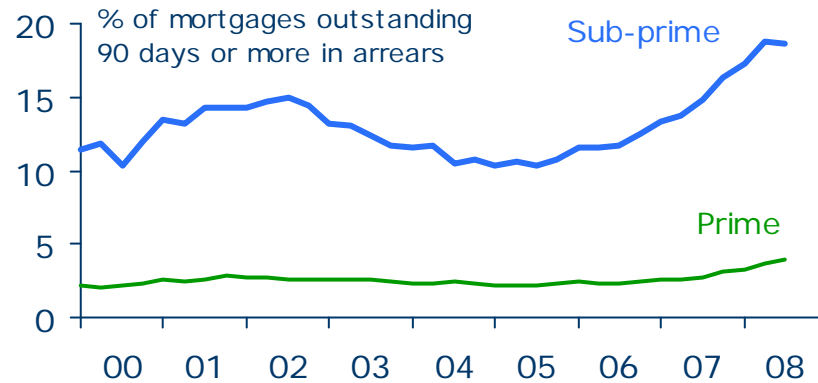


Sources: US National Association of Realtors; Commerce Department; S&P (the Case-Shiller index).

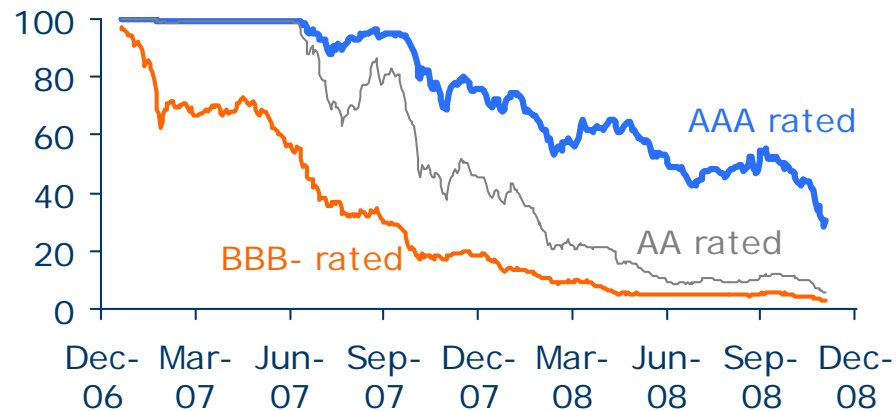


The US mortgage market meltdown has prompted a tidal wave of losses and write-downs by banks around the world

US mortgage delinquencies



ABX index of prices of US mortgage-backed securities



Losses & write-downs announced since mid-2007

Country of origin	Total (US\$ bn)
US banks	418.4
European banks	247.9
Canadian banks	10.0
Asian and other banks	27.5
Total banks	706.6
Other institutions*	243.3

Capital raised by banks since mid-2007

Country of origin	Total (US\$ bn)
US	357.8
European	294.2
Canadian	19.0
Asian and other	34.8
Total	705.8
of which, from governments	305.3

* 'Other institutions' include insurance companies, pension funds and hedge funds. Sources: US Mortgage Bankers' Association; IMF; Bloomberg; ANZ Economics & Markets Research.

Indicators of 'fear' in financial markets reached all-time highs in October and have remained close to those peaks in November ⁷

'TED' spread between 3-month inter-bank US\$ rates and 3-month US Treasury bill yields



'VIX' index of implied volatility of the US S&P 500 share index



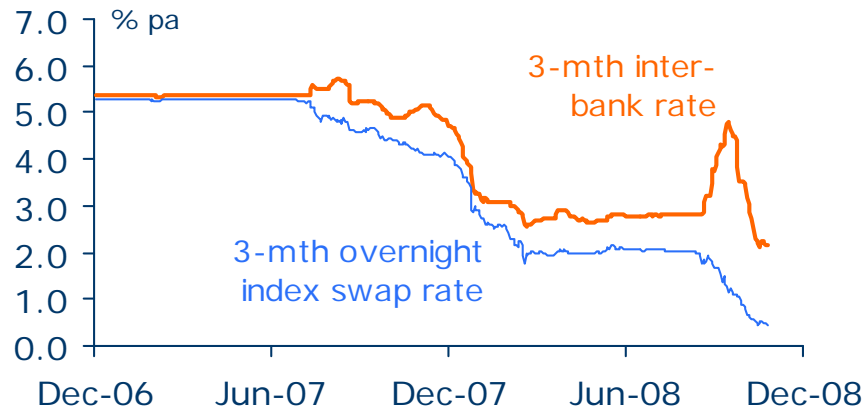
Sources: US Federal Reserve; Datastream; ANZ.



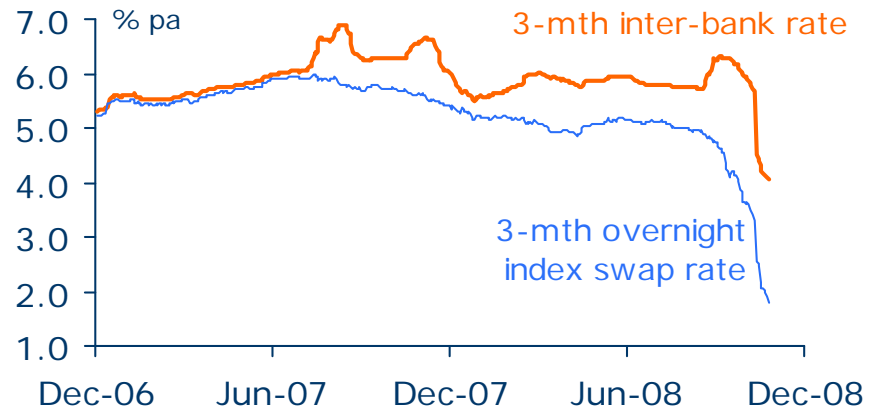
Measures announced by governments since mid-October are slowly working to ease financial market stress

3-month inter-bank borrowing rates and official cash rates

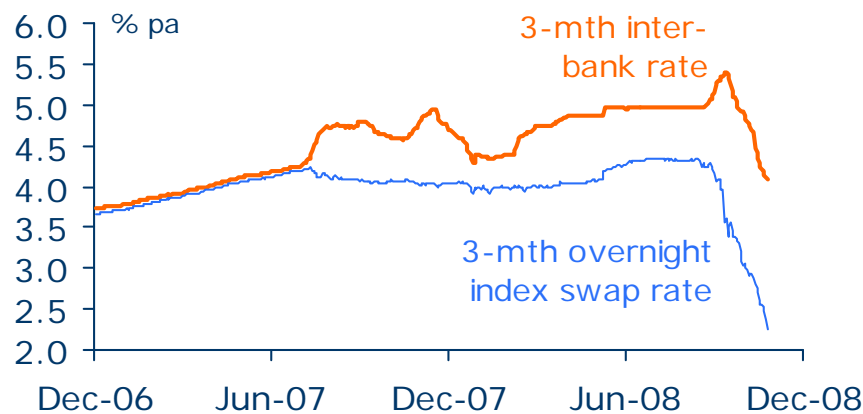
United States



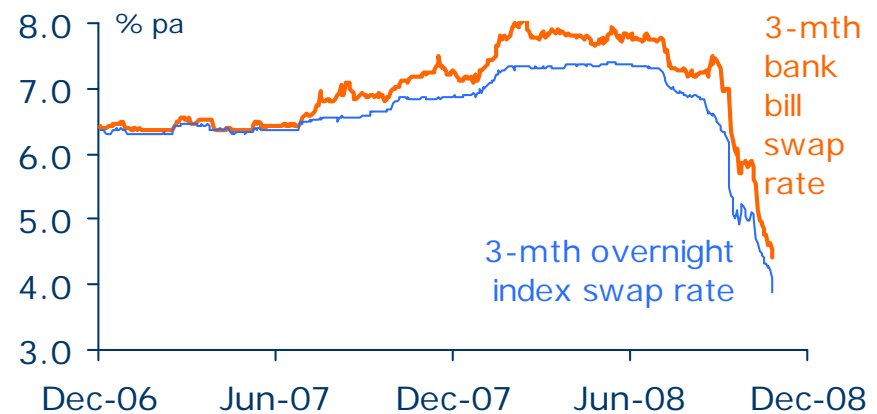
United Kingdom



Euro area



Australia

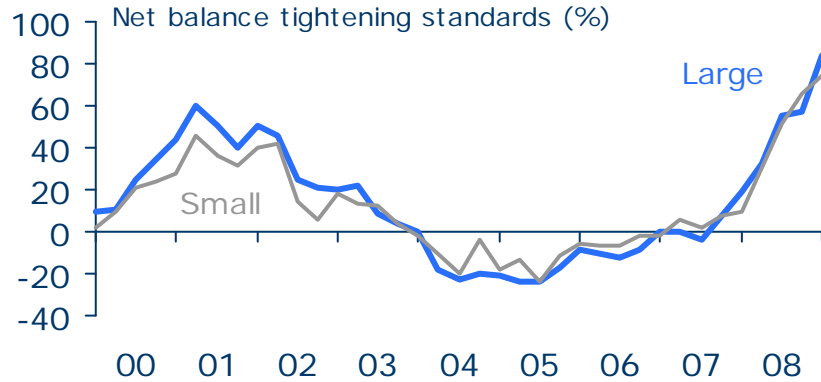


Note: The 3-mth overnight index swap (OIS) rate shows market expectations of the average official cash rate over the following three months. Source: Bloomberg.

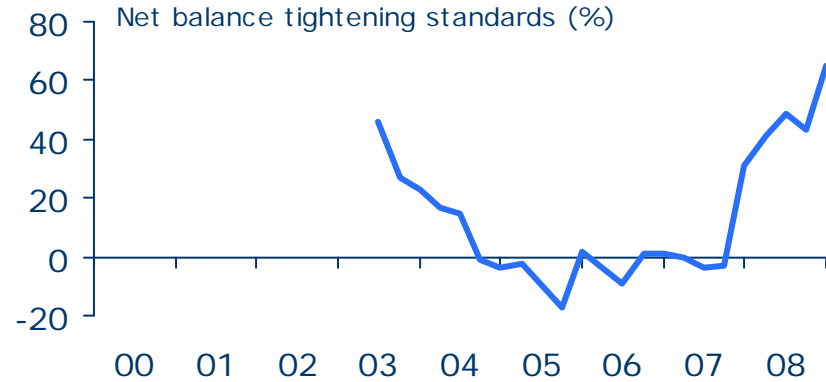


Banks in the US and the euro area are tightening credit standards

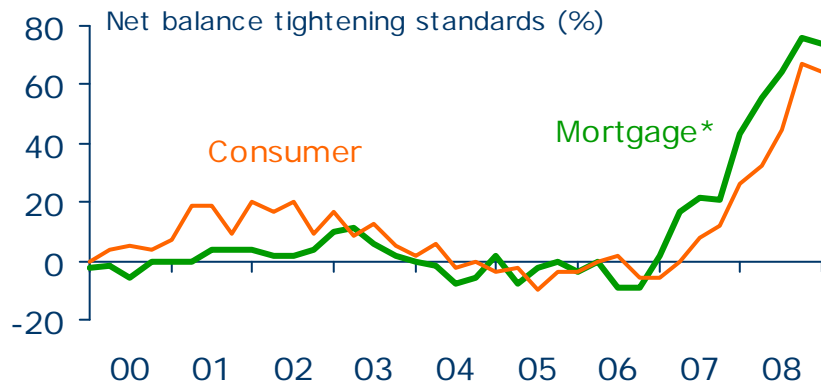
US banks Commercial & industrial loans



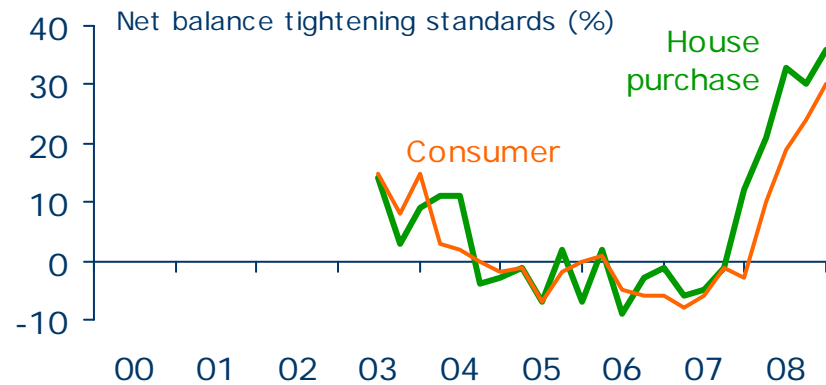
Euro area banks Loans to enterprises



US banks Mortgage and consumer loans



Euro area banks Mortgage and consumer loans



* Weighted average of prime & sub-prime after June 2007

Sources: US Federal Reserve and European Central Bank surveys of loan officers.



Share market investors around the world have lost almost US\$30 trillion since the end of October 2007

Capitalization of world equity markets



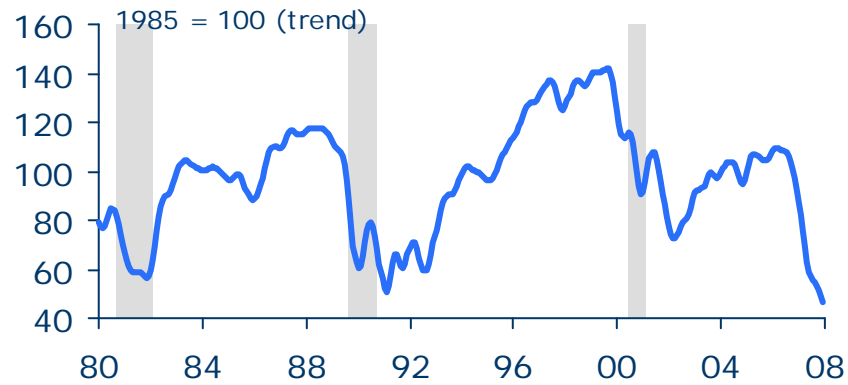
Source: Datastream.



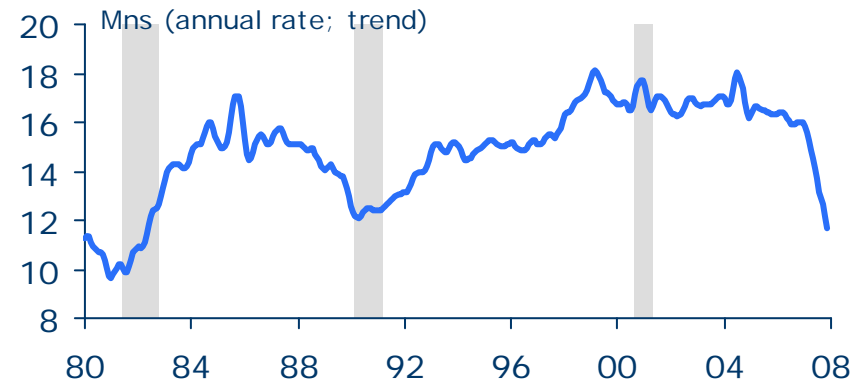
Many indicators suggest that the US economy is heading for, or already in, recession ¹¹

Selected US indicators

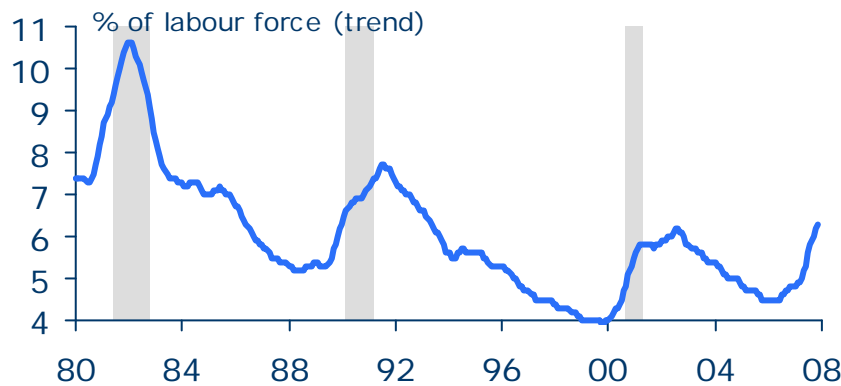
Consumer confidence



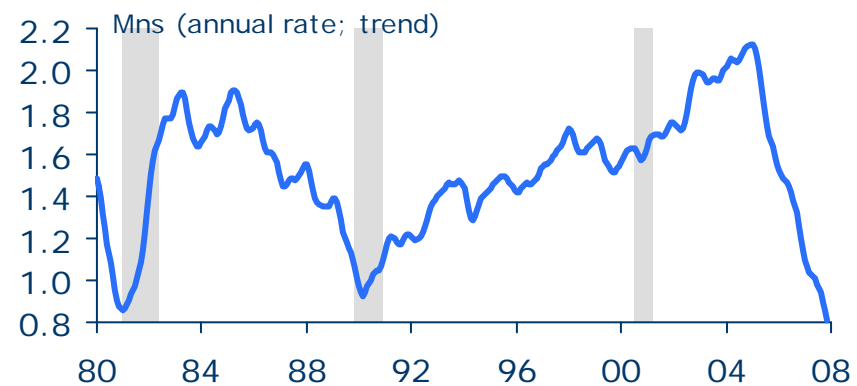
Motor vehicle sales



Unemployment



Housing starts

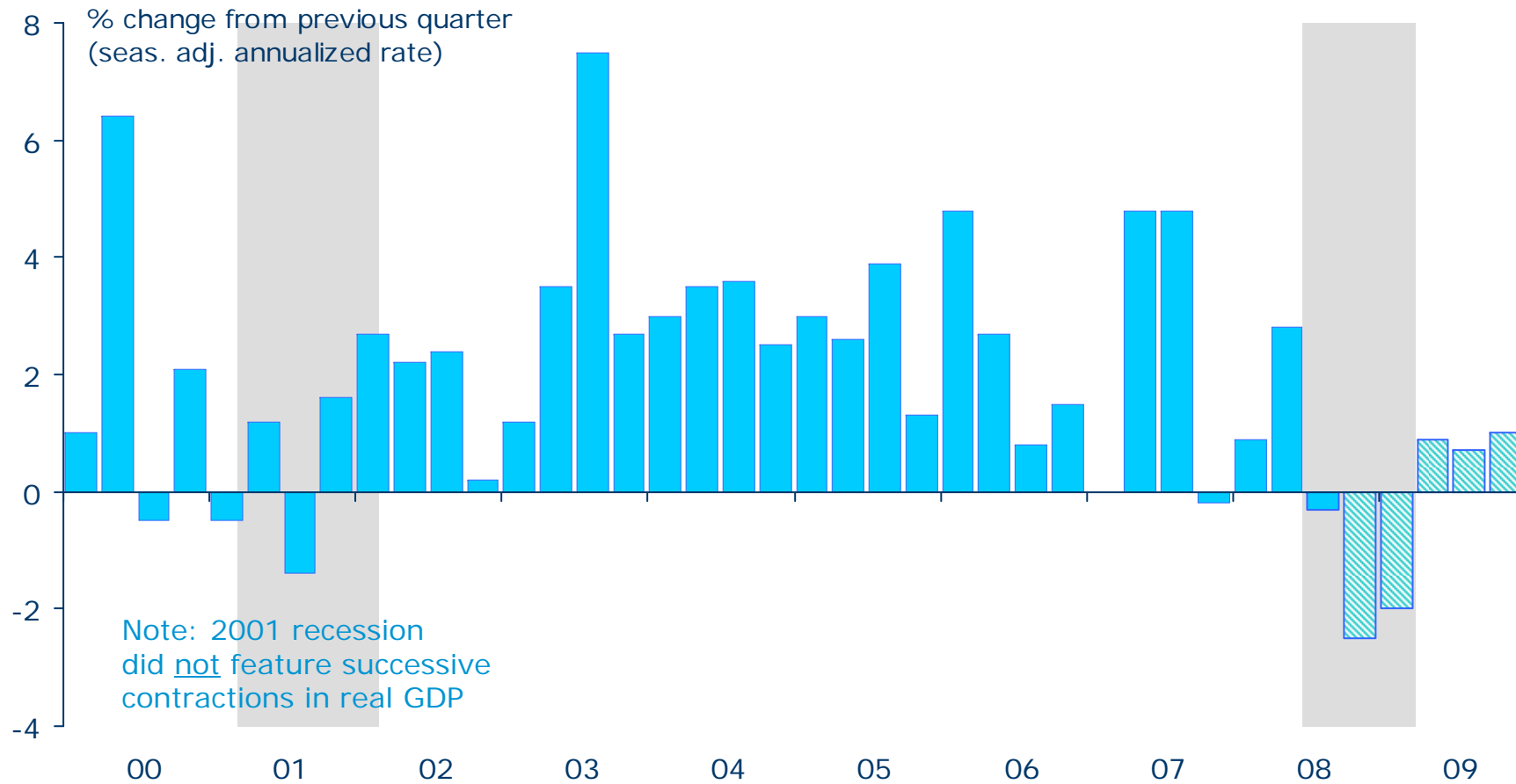


Note: shaded periods denote recessions as designated by National Bureau of Economic Research.
Sources: The Conference Board; Bureau of Labor Statistics; Census Bureau.



The US hasn't experienced consecutive quarters of negative GDP ¹² growth – but is likely to in the current half year

US real GDP growth

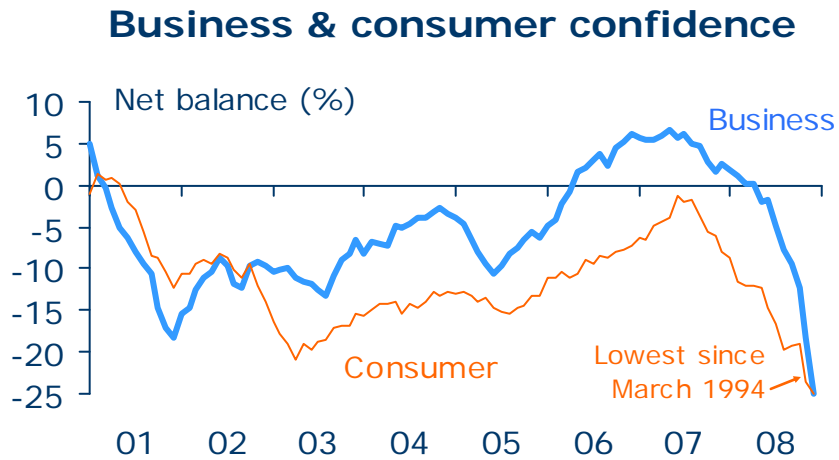
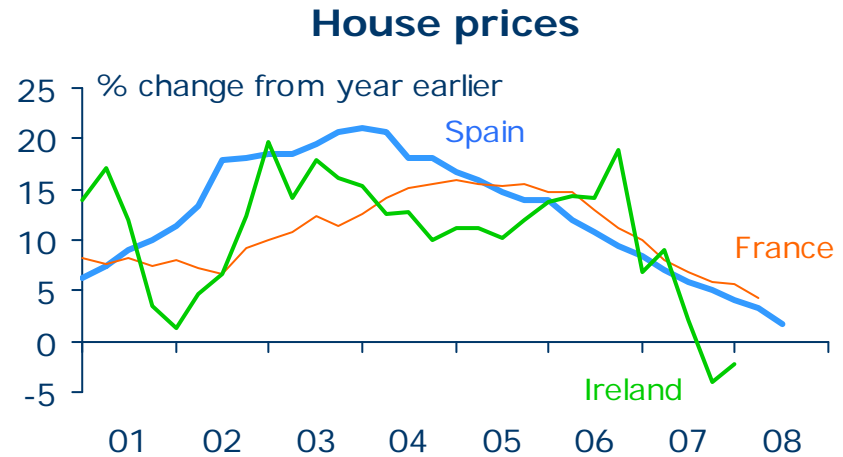
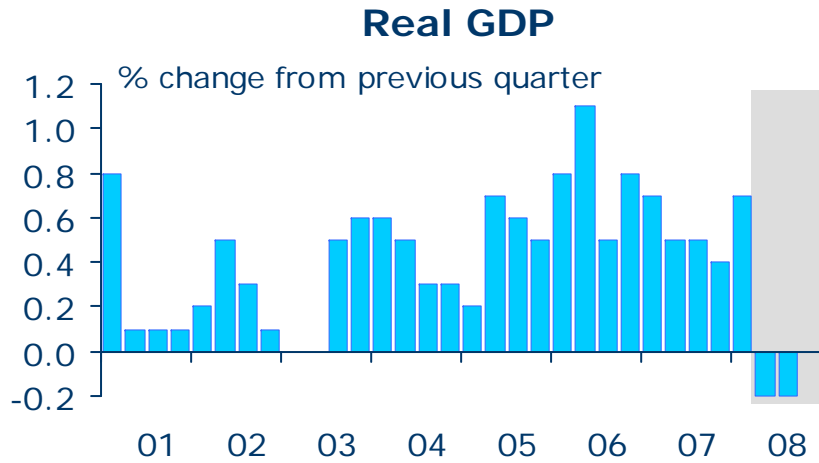


Source: US Bureau of Economic Analysis. Shaded area denotes 2001 recession as designated by National Bureau of Economic Research.



The euro area has also entered recession, although it may not be as severe as in the UK

Euro area economic indicators

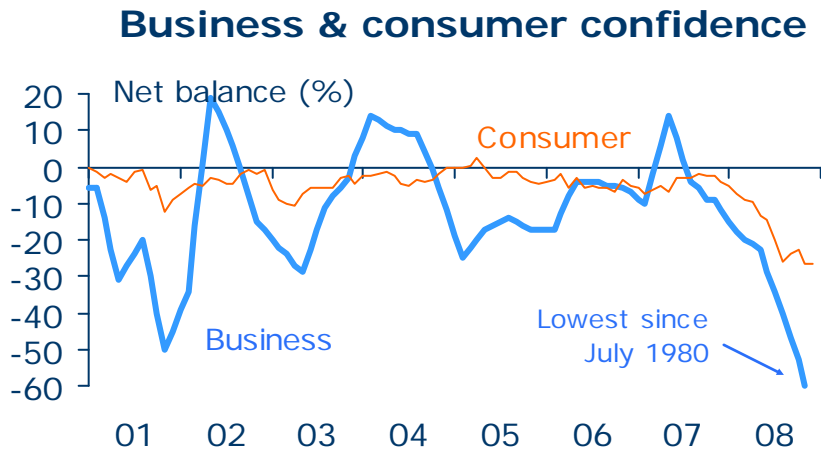
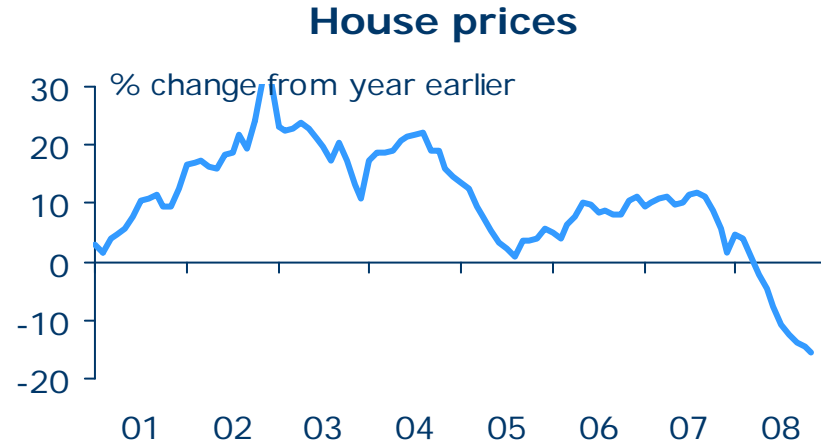
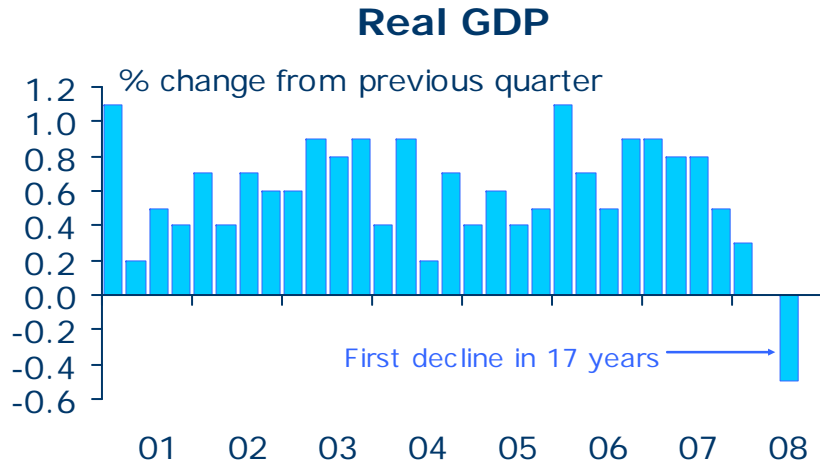


Sources: European Commission; Eurostat; Datastream.



With a relatively large financial sector and house prices falling almost as much as the US, the UK will have a sharp recession

UK economic indicators



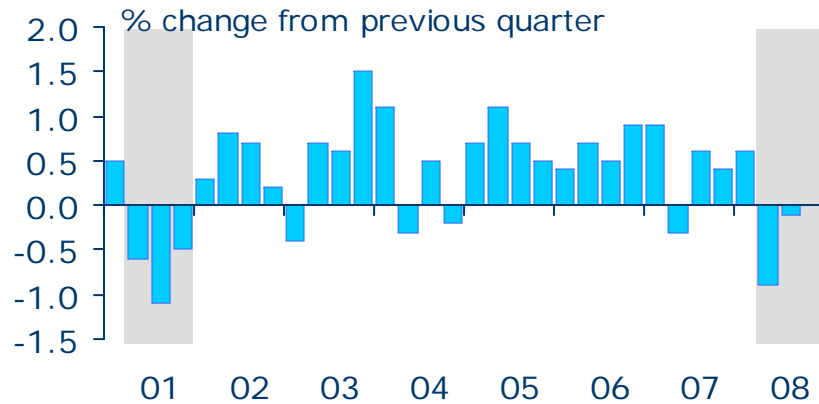
Sources: UK Office of National Statistics; Confederation of British Industry; Eurostat; HBoS.



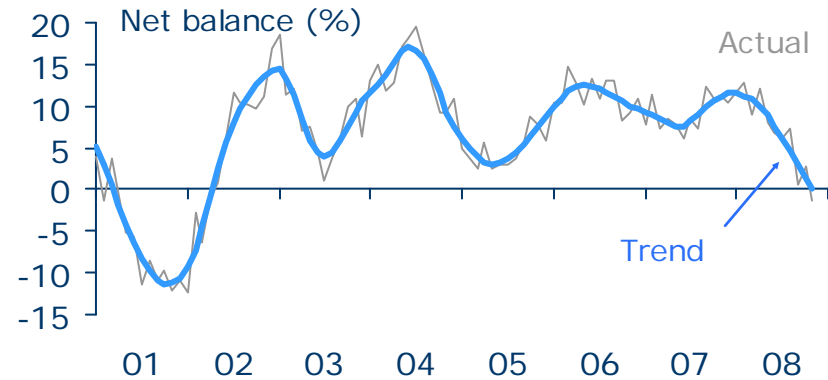
Japan's economy has entered recession even though its banks have very little exposure to the global credit crisis 15

Japan

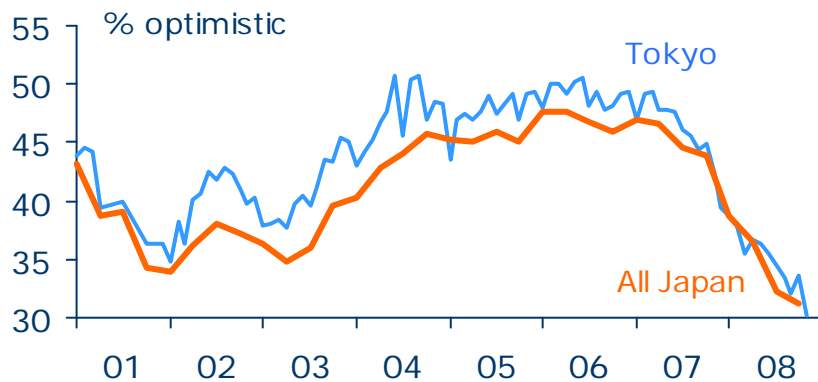
Real GDP



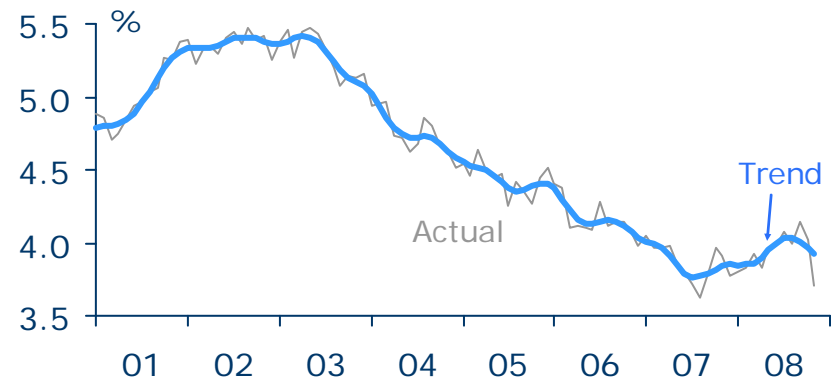
Export volumes



Consumer confidence



Unemployment



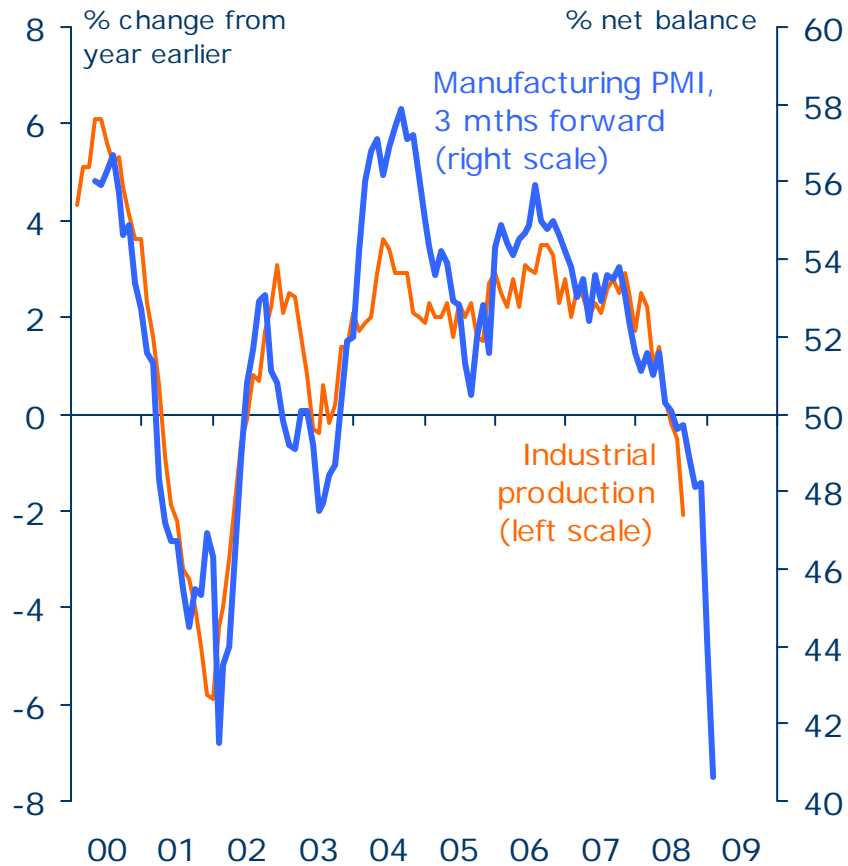
Sources: Japan Economic & Social Research Institute; Ministry of Economy, Trade and Industry; Japan Home Ministry.



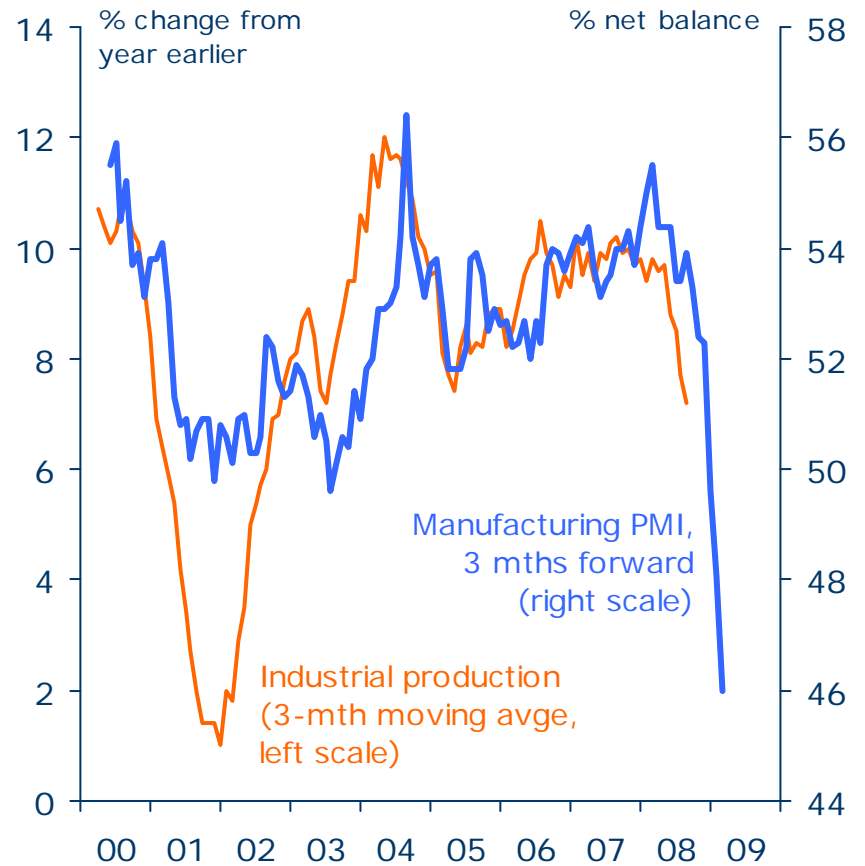
Industrial production is declining in Western countries and also set to slow sharply in developing and emerging economies

Manufacturing purchasing indices (PMIs) and industrial production

Advanced economies



Developing economies



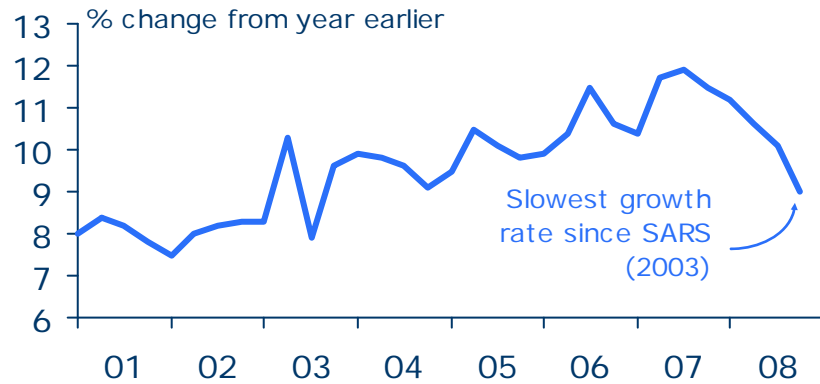
Sources: IMF World Economic Outlook October 2008 database; ANZ.



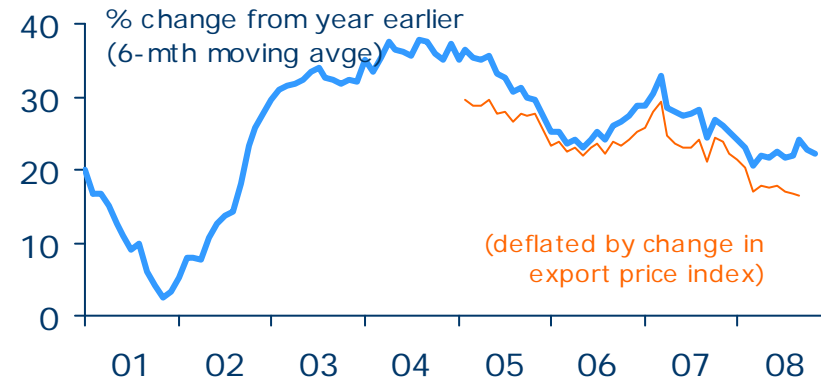
China's economy is slowing, reflecting slower export growth and an internal property slump ¹⁷

Chinese economic indicators

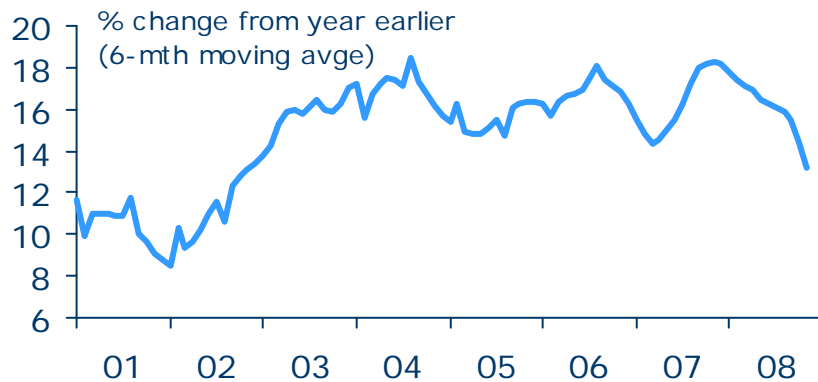
Real GDP growth



Exports



Industrial production



Real estate prices

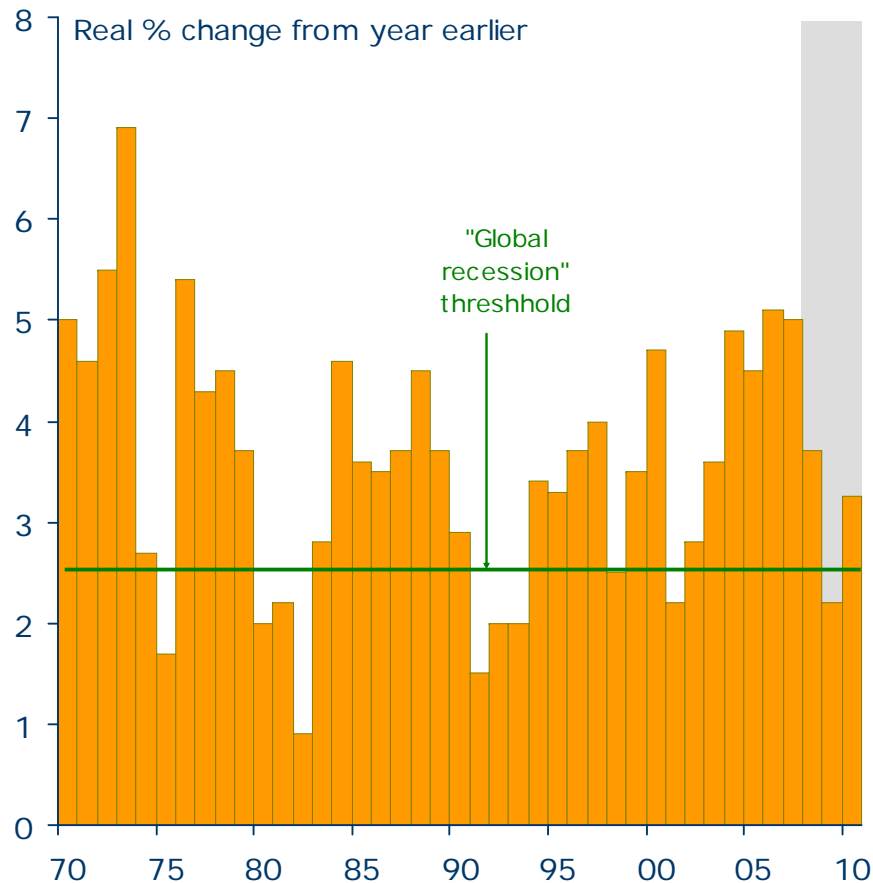


Source: China National Statistics Bureau; ANZ.



Global growth will weaken sharply with 2009 looking like the worst year for 'advanced' economies since the 1930s

Global economic growth



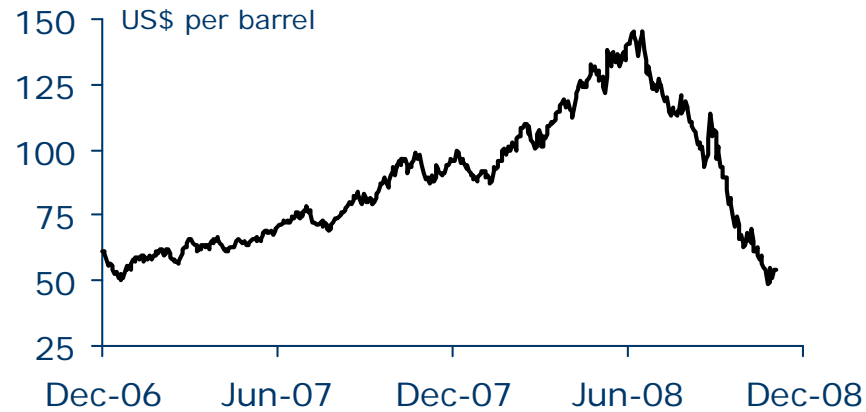
Note: GDP is measured in US\$ at purchasing power parities.

Source: IMF World Economic Outlook October 2008; ANZ Economics & Markets Research.



Commodity prices have fallen reflecting declining demand, the unwinding of speculative trades and a stronger US dollar ¹⁹

Oil



Gold



Base metals



Wheat

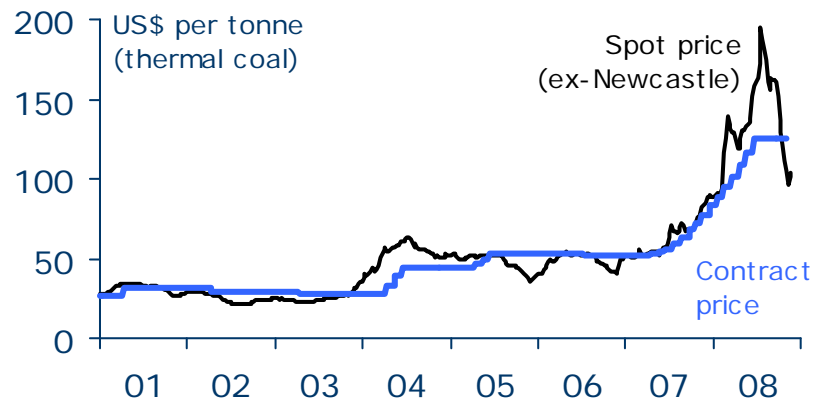


Sources: Bloomberg; Datastream.

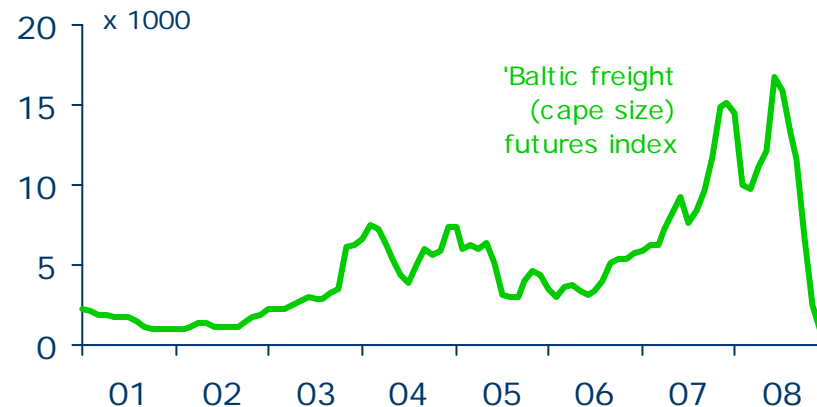


Spot prices for Australia's two largest commodity exports have fallen sharply in recent weeks and are likely to decline further

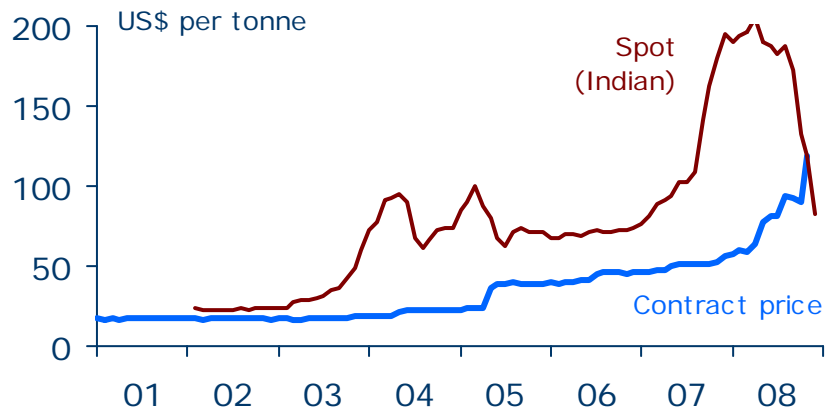
Coal prices



Bulk commodity shipping costs



Iron ore prices

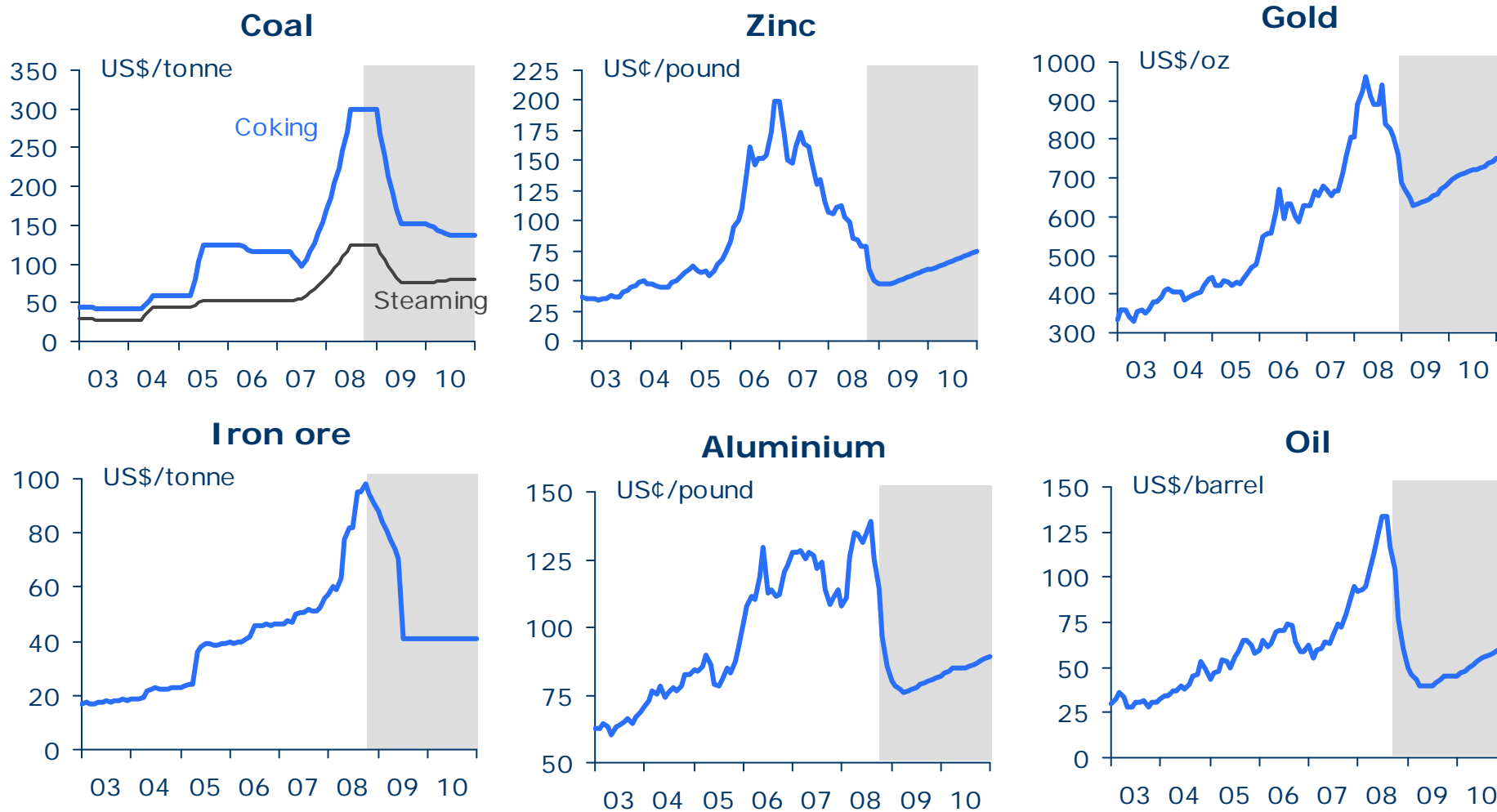


Sources: Datastream; Bloomberg; ANZ Economics & Markets Research.



Commodity prices will fall further over the next 6-12 months though should remain strong by historical standards

Resource commodity prices

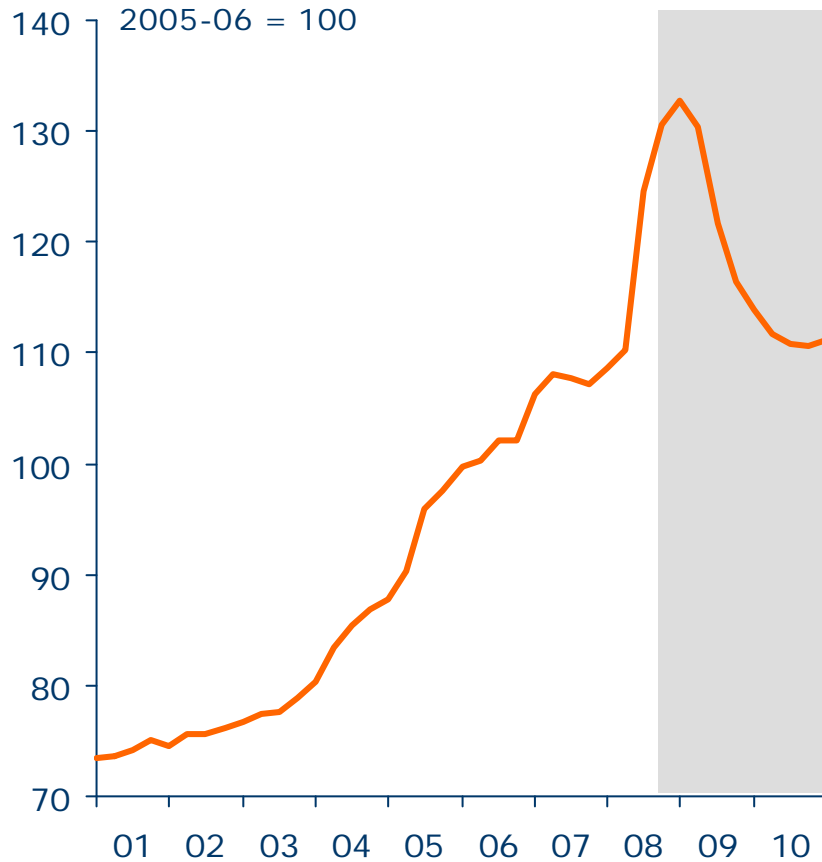


Sources: Thomson Financial; ANZ.

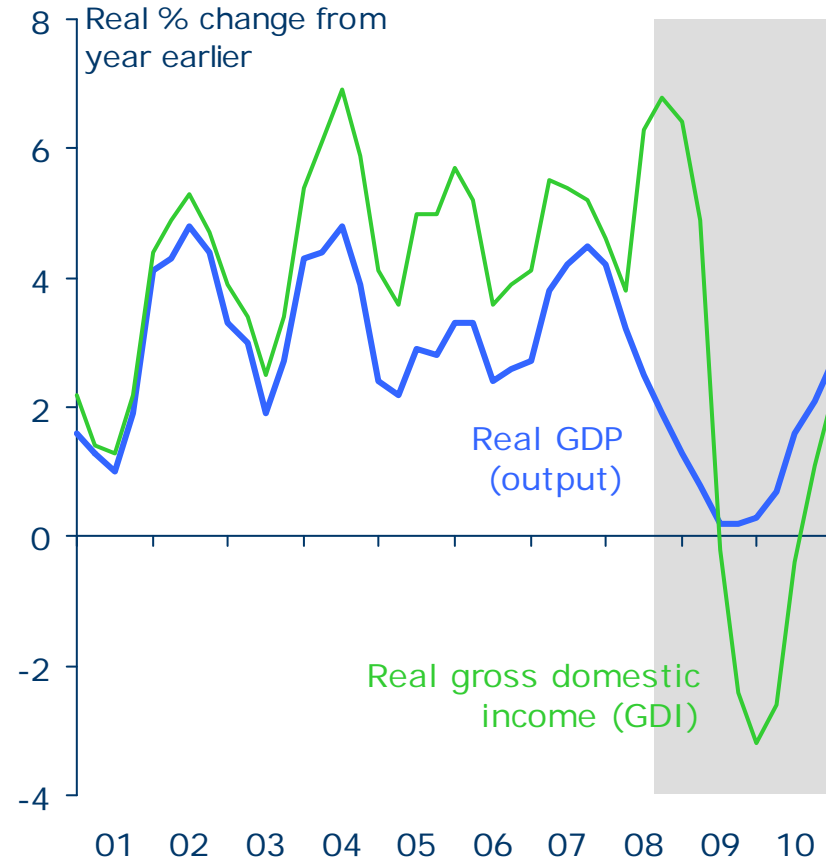


A sharp fall in commodity prices will reverse the contribution which rising terms of trade have made to Australia's income

**Australia's terms of trade
(ratio of export to import prices)**



**Real gross domestic income
(GDI) and product (GDP)**

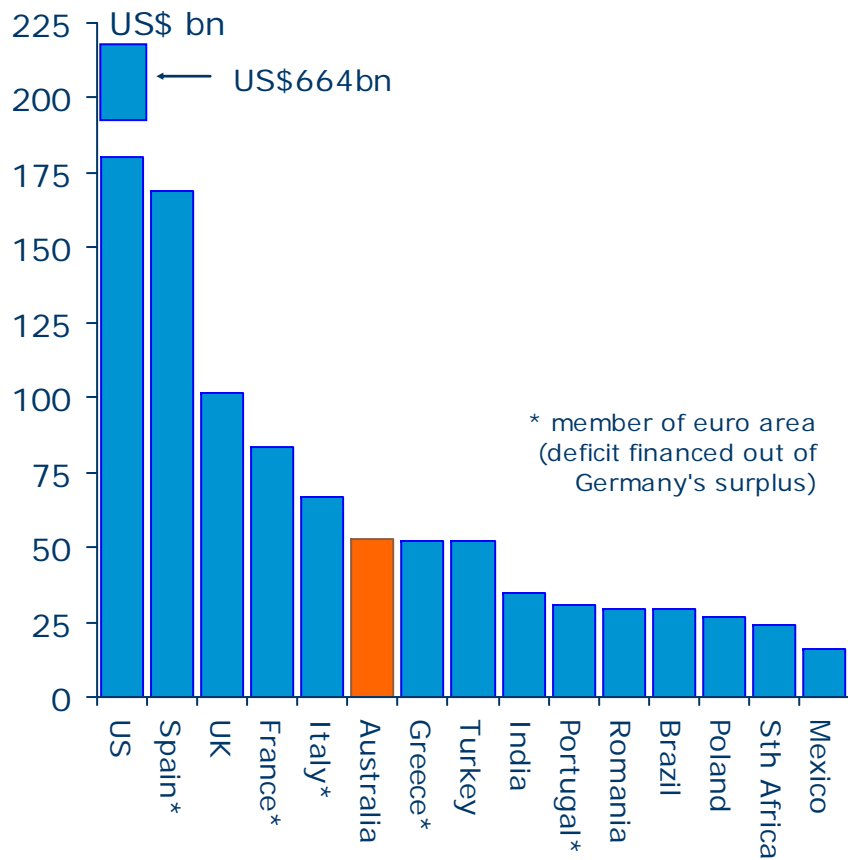


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

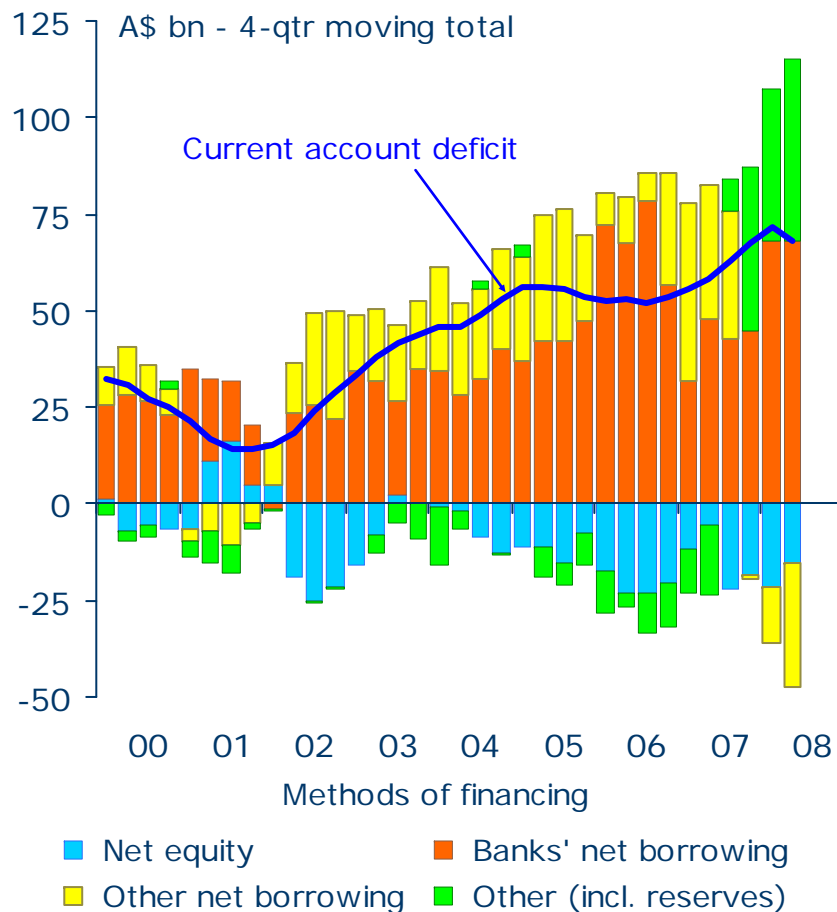


But Australia is exposed to the global credit crunch because of our large external deficit and the way we finance it

Current account deficits 2008



Financing Australia's current account deficit



Sources: IMF *World Economic Outlook* (October 2008); ABS; ANZ. Note that apparently large movements in 'other (incl. reserves) in 2007-08 largely reflect the withdrawal of cash deposits at the RBA by the Future Fund; the RBA had invested these largely in US Treasuries, and they were reported as part of the RBA's official reserve assets.



Australian financial markets have come under similar pressures to their overseas counterparts, though these are now easing ²⁴

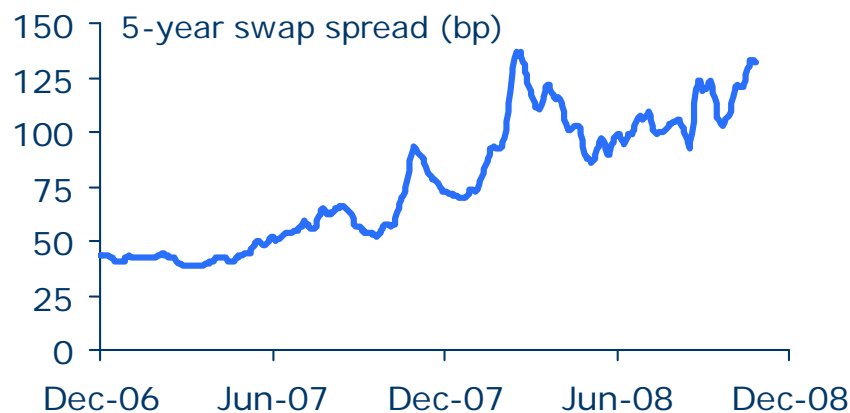
Banks' short-term funding costs



Corporate bond yield spreads



Banks' long-term funding costs



Bank share prices



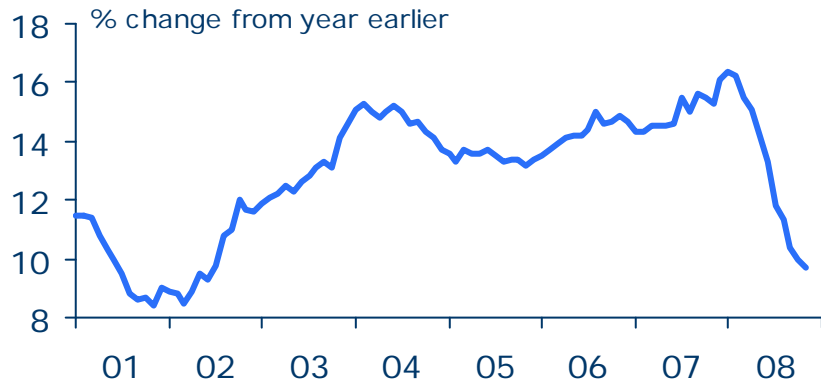
Note: all data shown as 5-day moving averages. Sources: Bloomberg; Datastream.



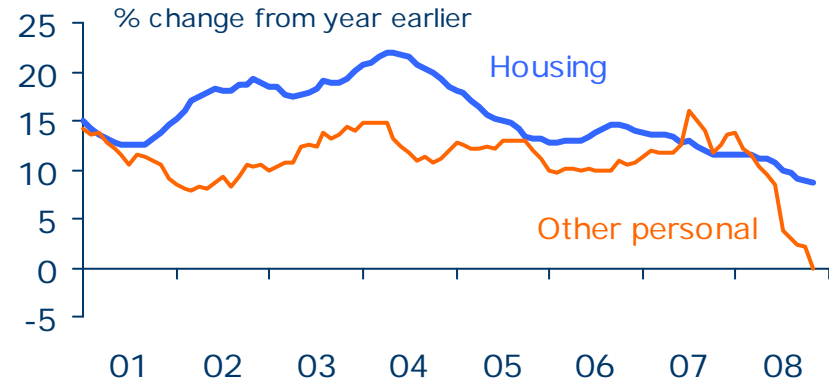
The 'credit crunch' plus the effect of higher interest rates on credit demand has led to a sharp slowdown in credit growth

Credit provided to the Australian private sector

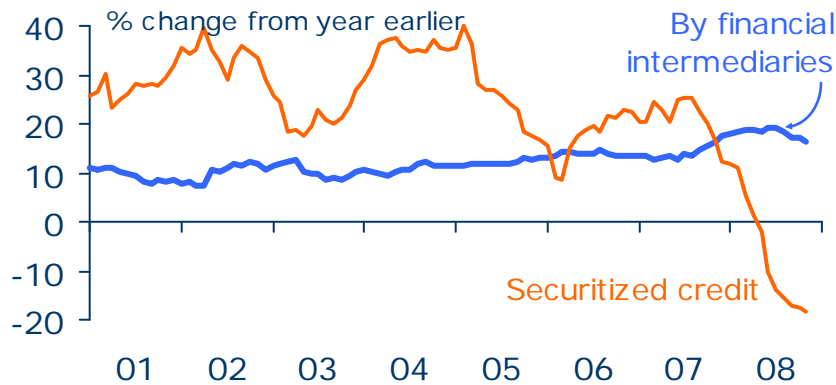
Total credit



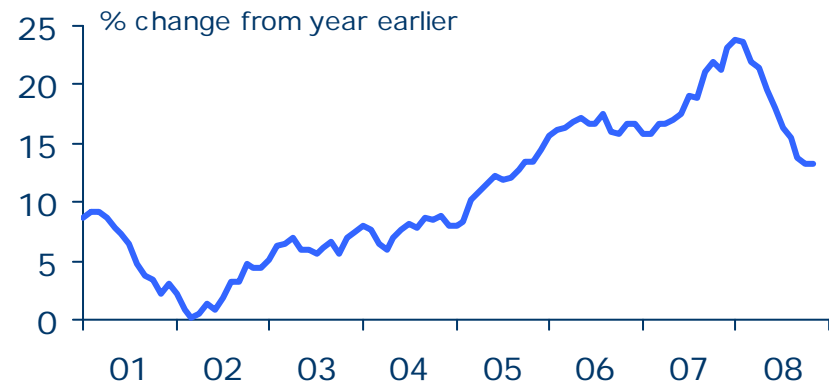
Credit to households



Credit by source



Credit to business

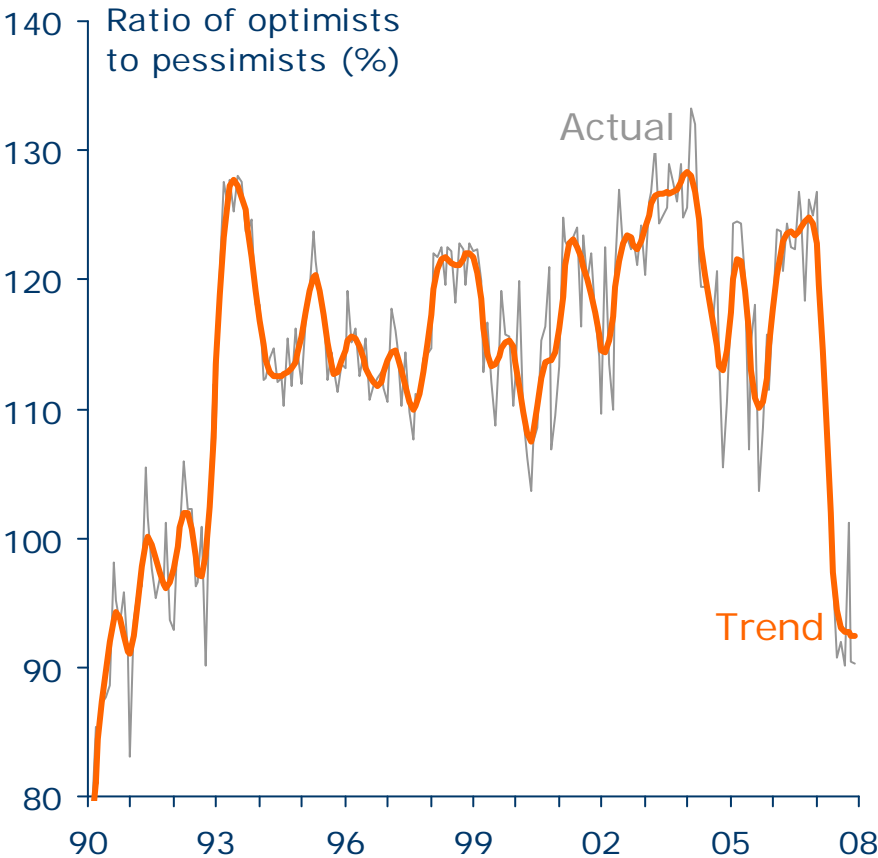


Source: Reserve Bank of Australia.

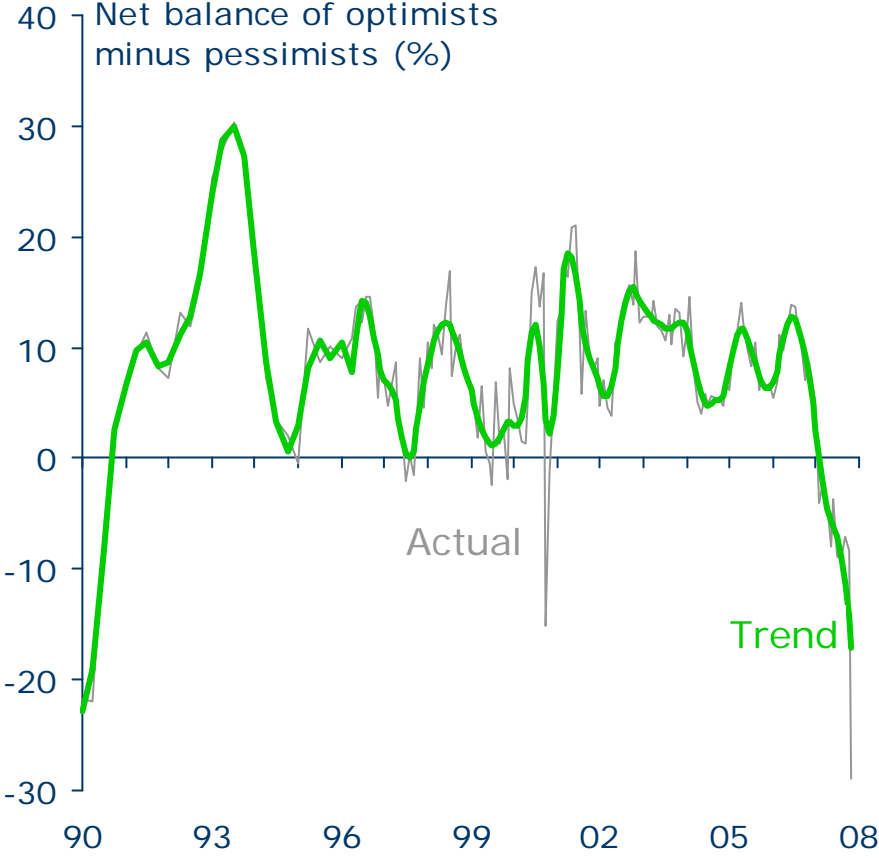


Consumer and business confidence have fallen sharply this year although both now seem to be stabilizing (for now, anyway) ²⁶

Consumer confidence



Business confidence

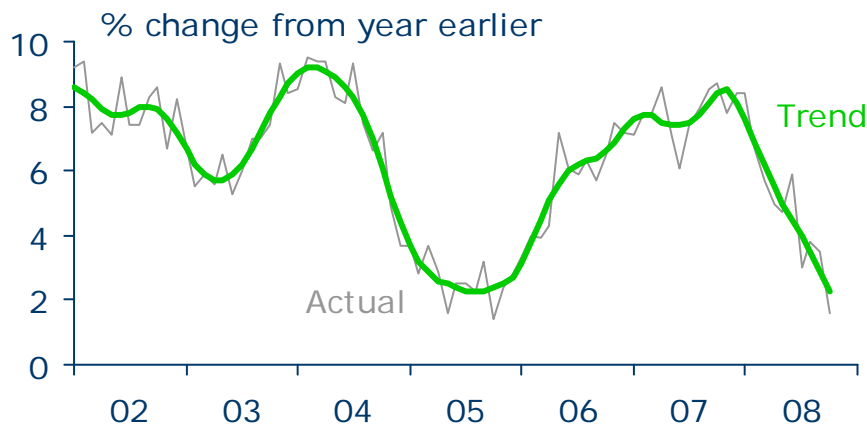


Sources: Roy Morgan Research; National Australia Bank; ANZ

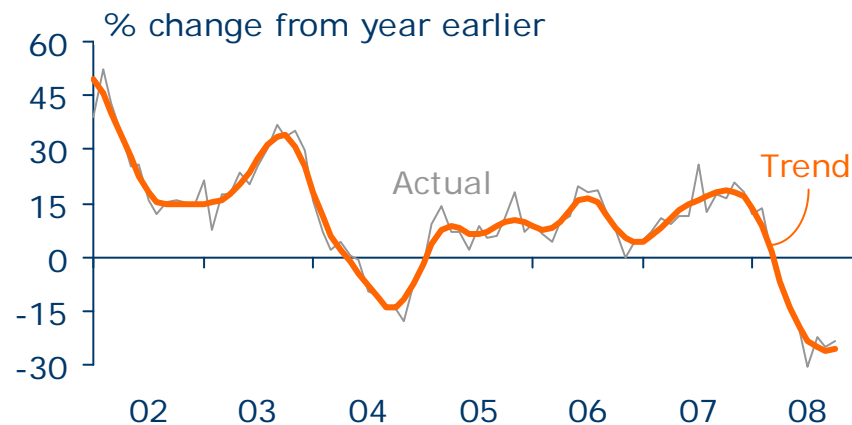


Household spending and borrowing, and housing activity, have both slowed sharply over the past six months

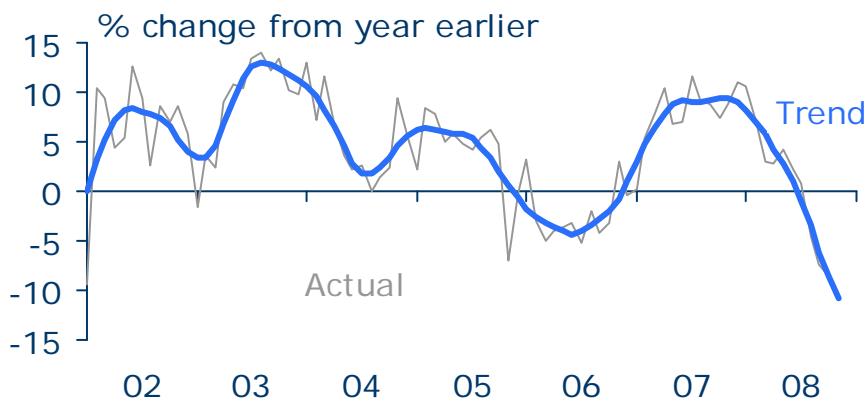
Retail sales



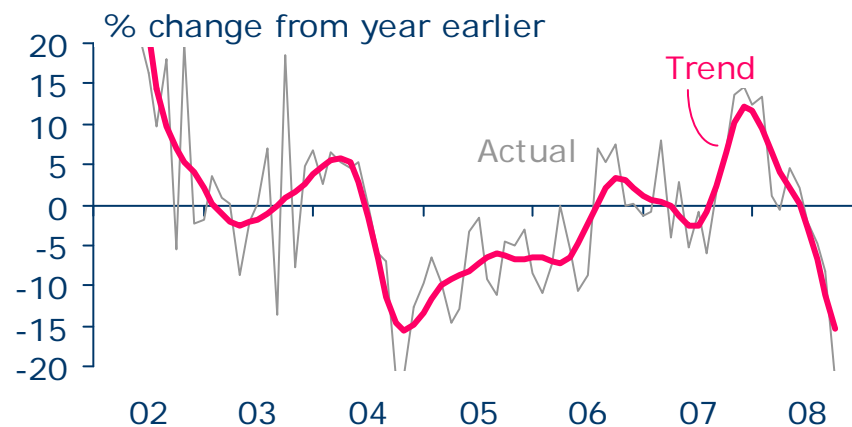
Housing finance commitments



Motor vehicle sales



Residential building approvals



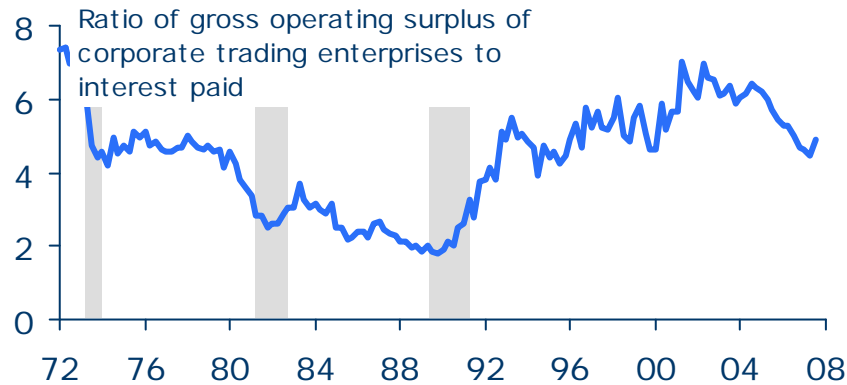
Sources: ABS; ANZ Economics & Markets Research.



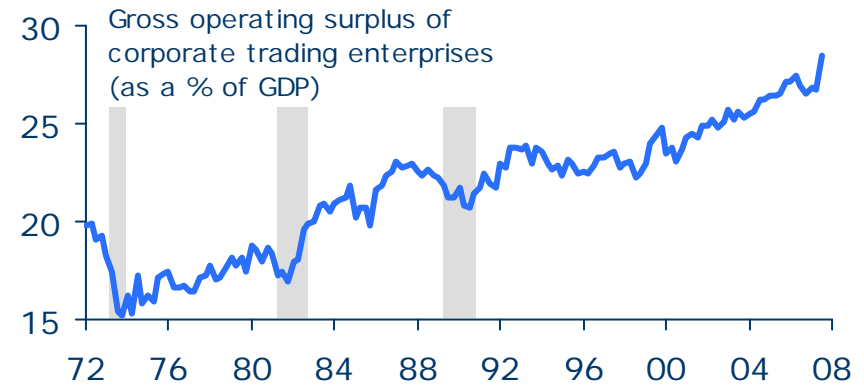
The corporate sector is (in general) in a strong financial position and doesn't need to cut labour costs aggressively ²⁸

Australian non-financial corporate sector finances

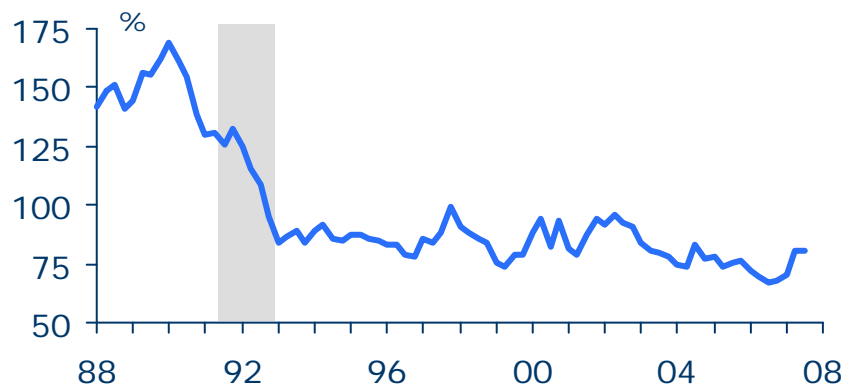
Interest cover ratio



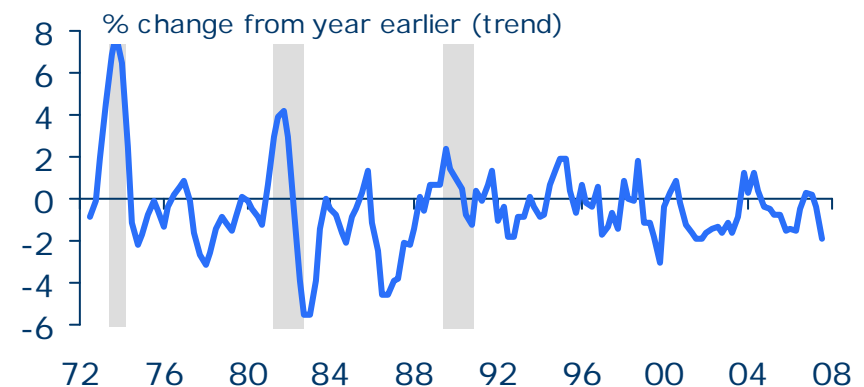
'Profit share' of national income



Debt-equity ratio



Real unit labour costs



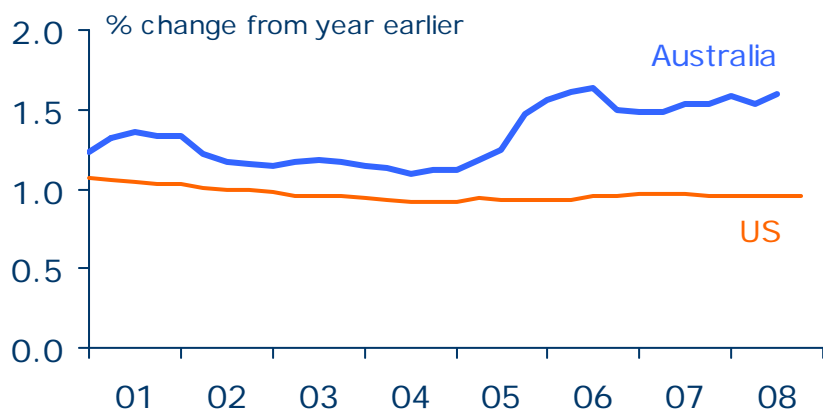
Note: Shaded areas denoted recessions.

Sources: Australian Bureau of Statistics; Reserve Bank of Australia; ANZ.

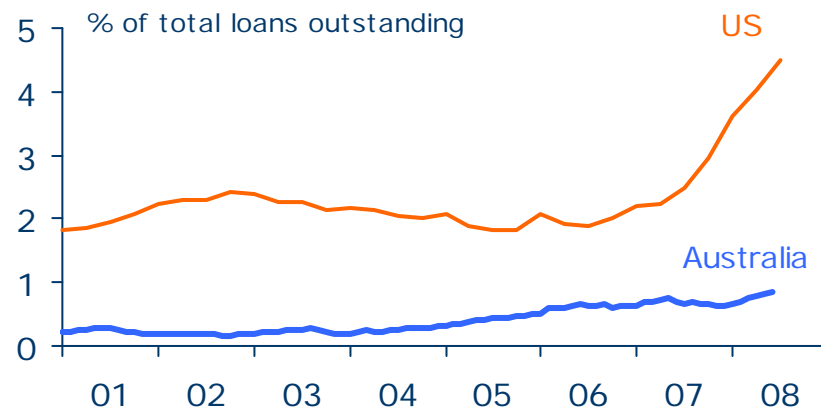


Australia's housing market has clearly softened but it won't become as dire as America's unless unemployment rises sharply

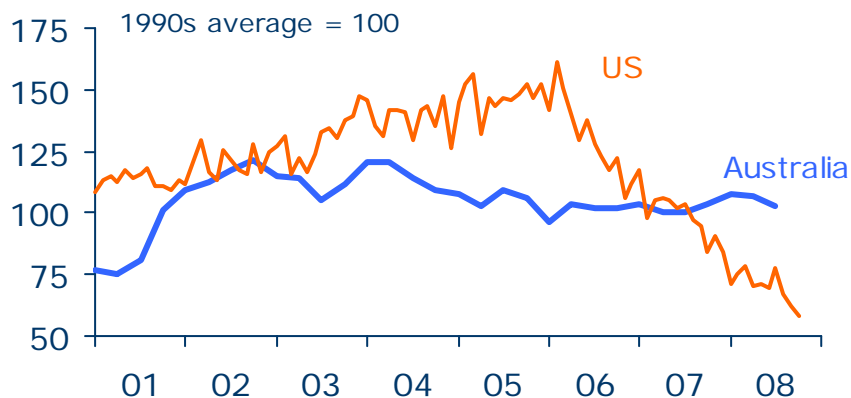
Population growth



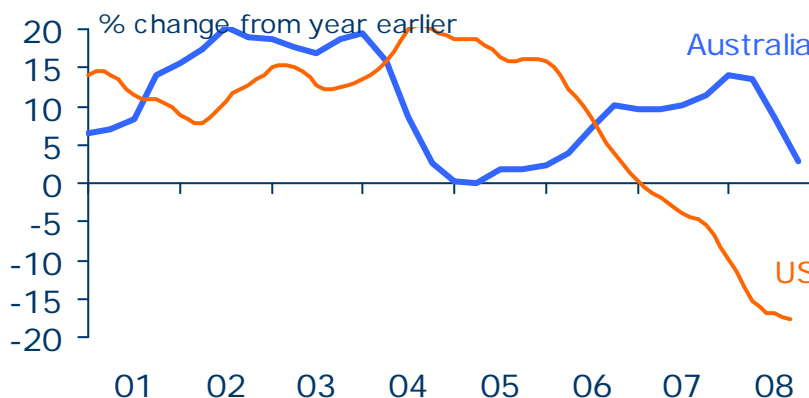
Mortgage delinquency rates*



Housing commencements



House prices

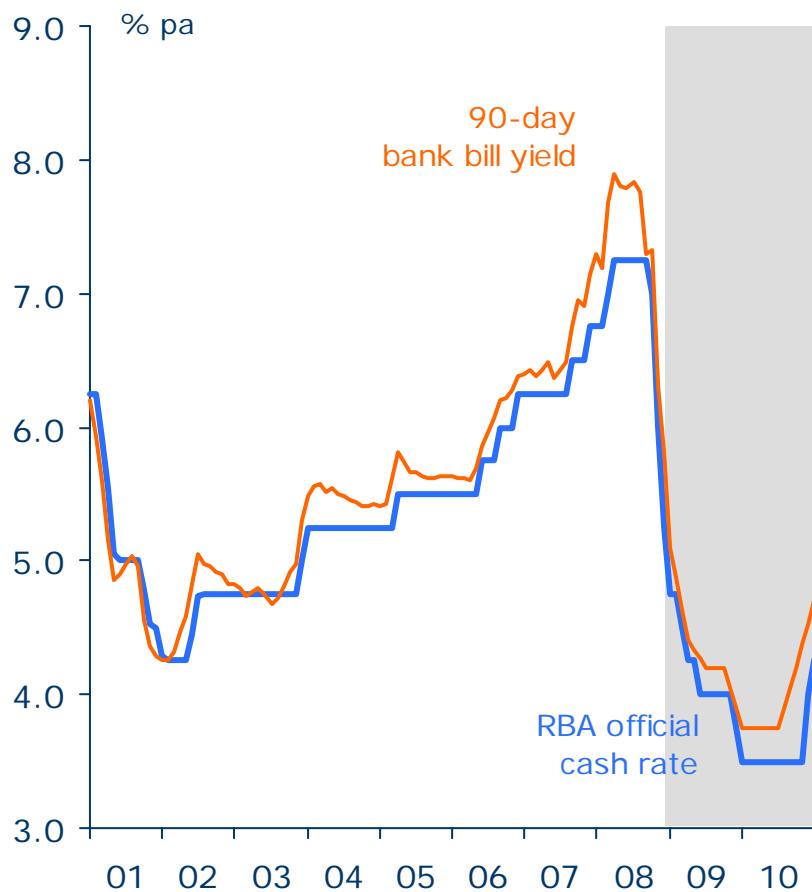


* 90 days or more past due. For Australia, securitized mortgages only (including on-balance sheet mortgages would result in a lower figure). Sources: ABS; US Commerce Department; S&P; Mortgage Bankers' Association of America.



The official cash rate will probably fall to a new low as the RBA seeks to counter the risk of recession

Short-term interest rates



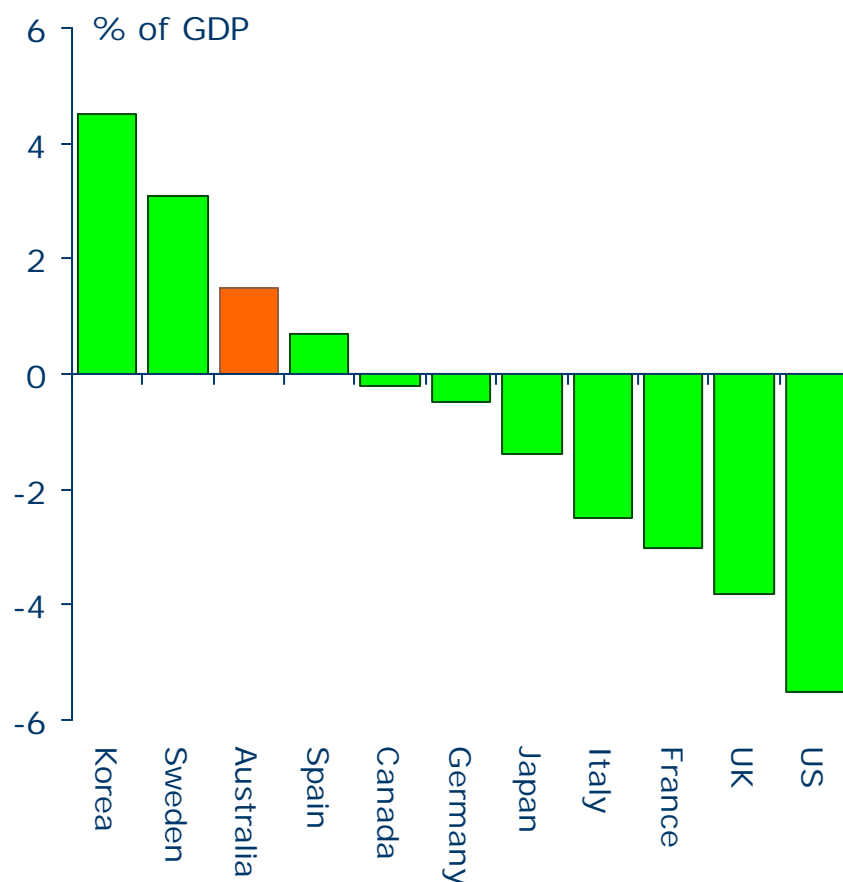
Sources: Thomson Financial; ANZ.

- The Reserve Bank has now cut its official cash rate by 2% in just two months (it took almost three years for them to raise it by as much)
- The larger-than-expected movements in October and November underscore the RBA's capacity to respond decisively to deteriorating economic conditions and its willingness to do so
- Minutes of the November RBA Board meeting suggest that the RBA is aiming to get monetary policy settings at least to 'neutral' quickly
- The widening spread between the cash rate and the rates which borrowers are actually paying means 'neutral' probably implies a cash rate of $\sim 4\frac{3}{4}\%$ rather than $\sim 5\frac{1}{2}\%$ before the current crisis began
- The RBA is likely to want to get monetary policy settings on the 'easy' side of 'neutral', implying the cash rate will fall below 4%

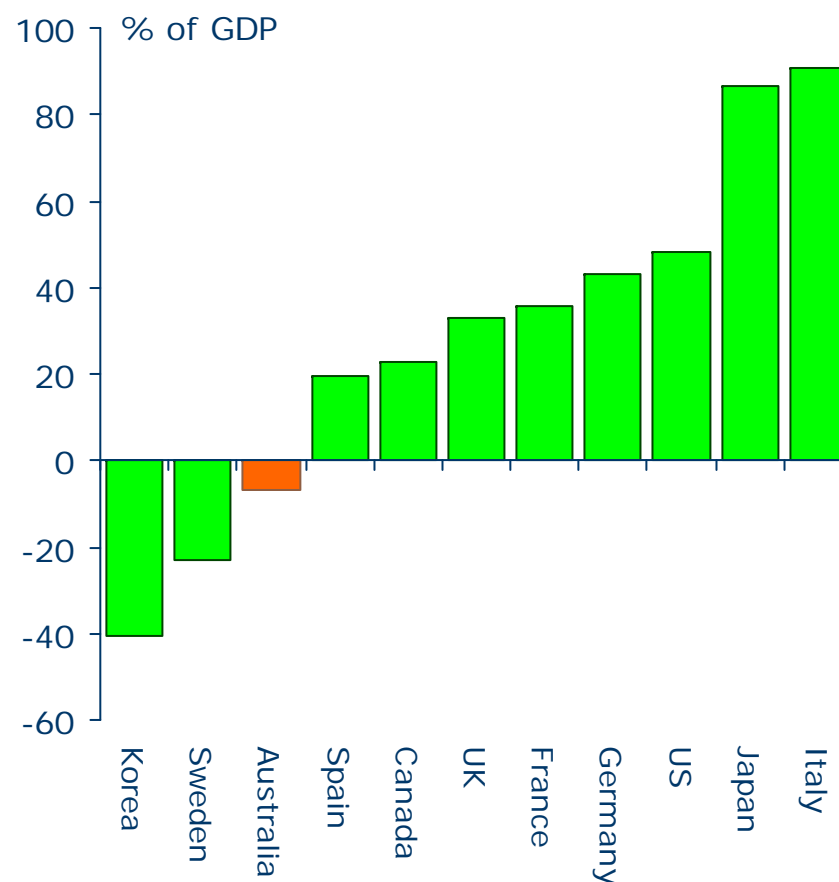


Australia is also very well-placed to use fiscal policy (tax cuts and government spending) to support economic activity

Budget surplus/deficit, 2008



Government net debt, 2008

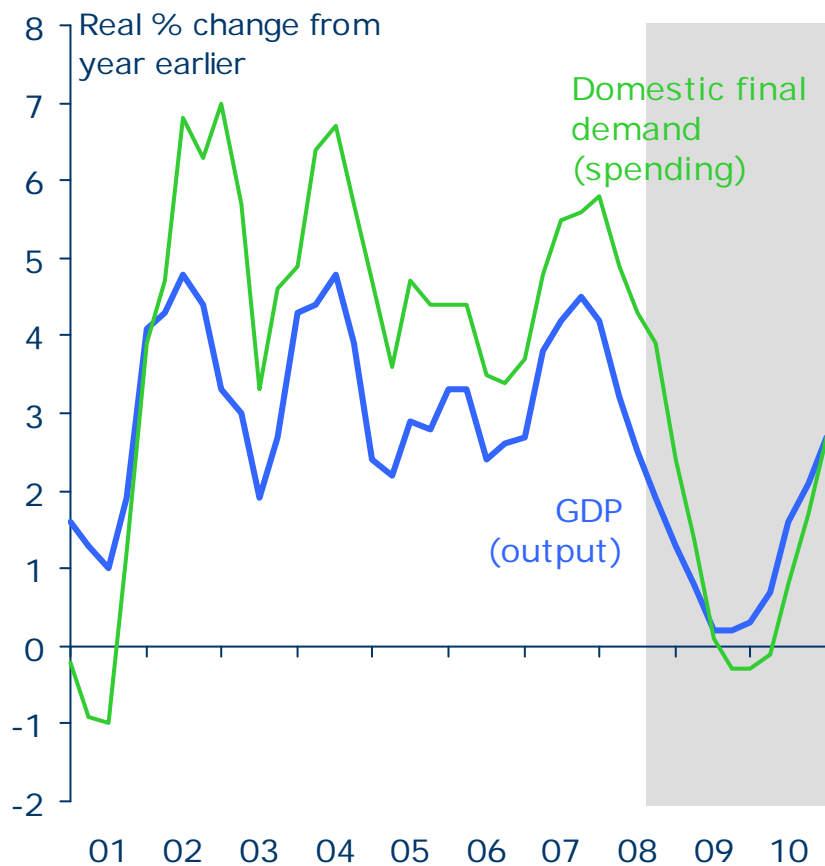


Note: data shown are for the 'general government' sector, ie including State and local governments but excluding government business enterprises. *Source:* OECD, *Economic Outlook* 83, June 2008 (note, forecasts released with *Economic Outlook* 84 in November will not be made available until mid-December).

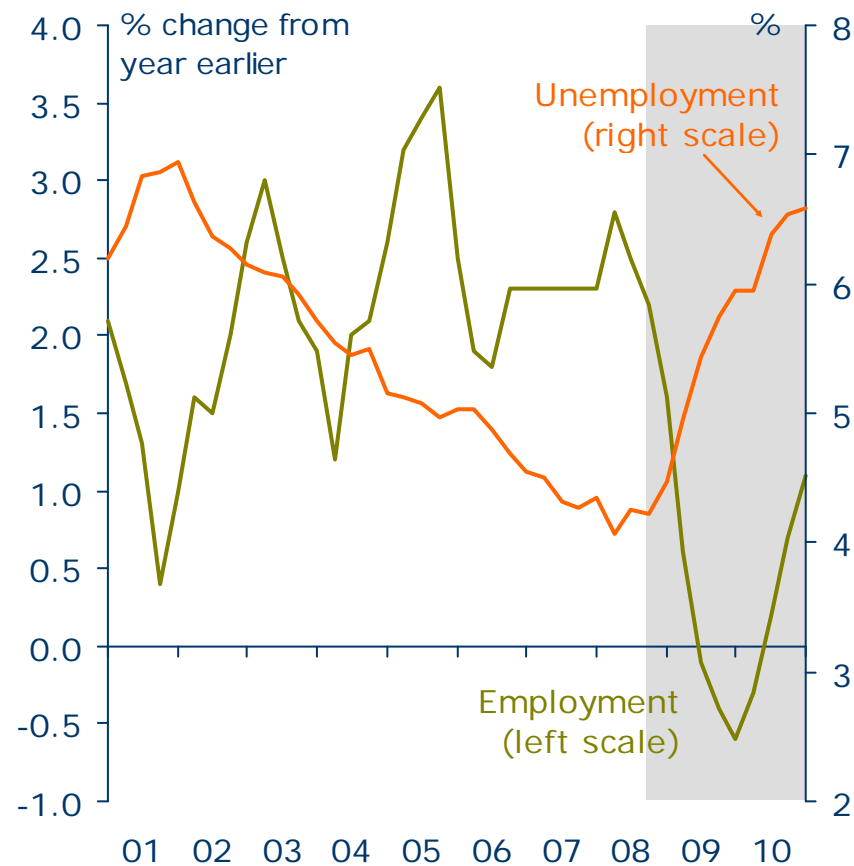


The economy will slow sharply (although it may not contract outright) and unemployment will rise by around 2½ pc points

Spending and output



Employment and unemployment

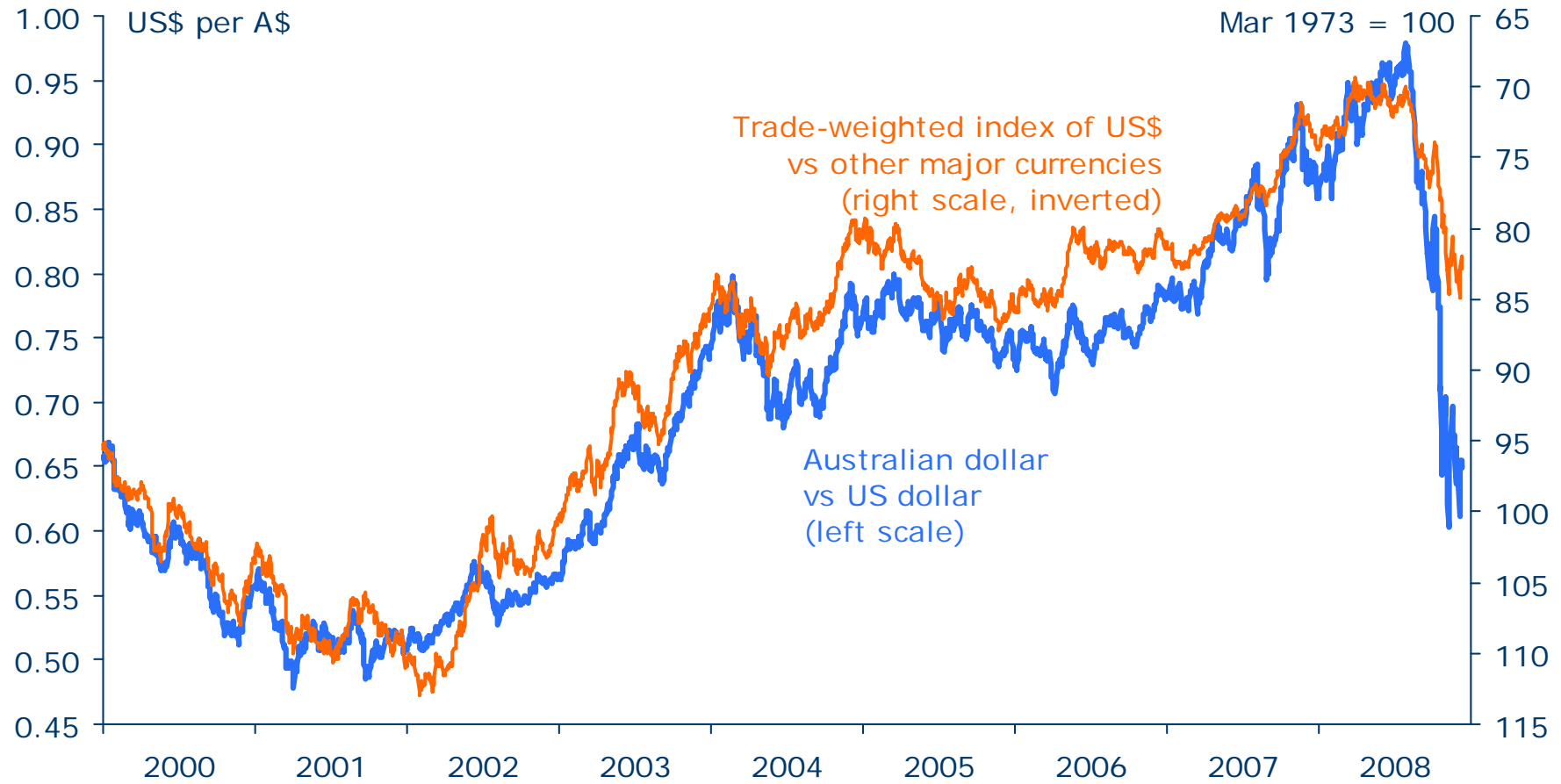


Sources: Australian Bureau of Statistics; ANZ.



The recent sharp drop in the A\$ is partly a reflection of the rebound in the US\$...

A\$ vs US\$ and US\$ vs other major currencies

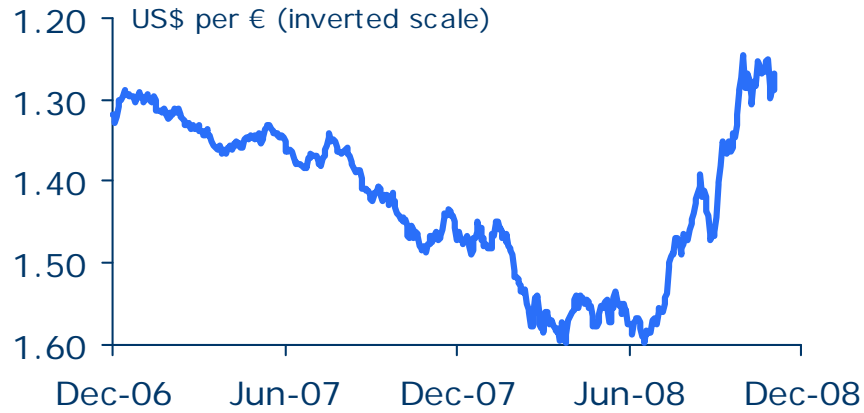


Source: US Federal Reserve Board; Datastream.

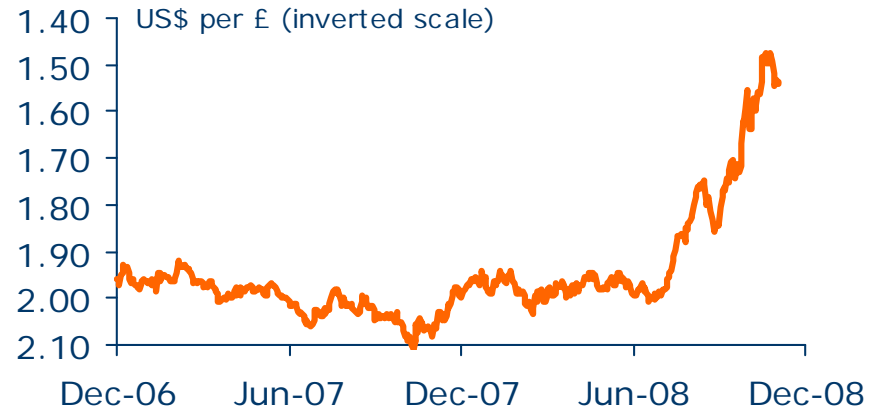


The US\$ has risen against most currencies (other than the yen) since July

US dollar vs euro



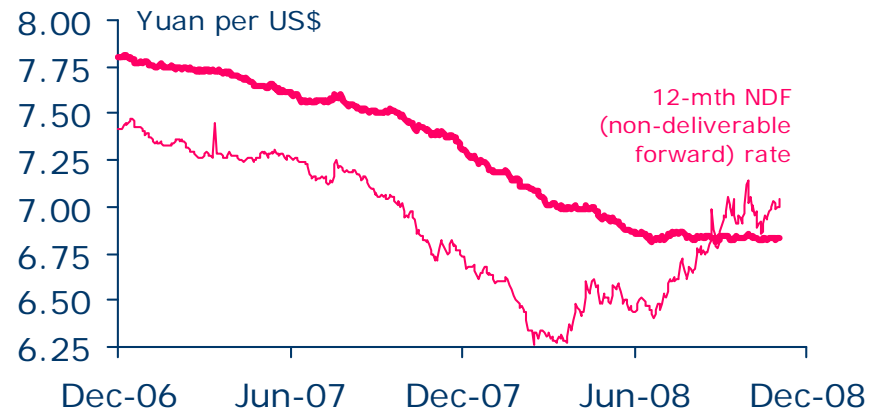
US dollar vs British pound



US dollar vs yen



US dollar vs yuan

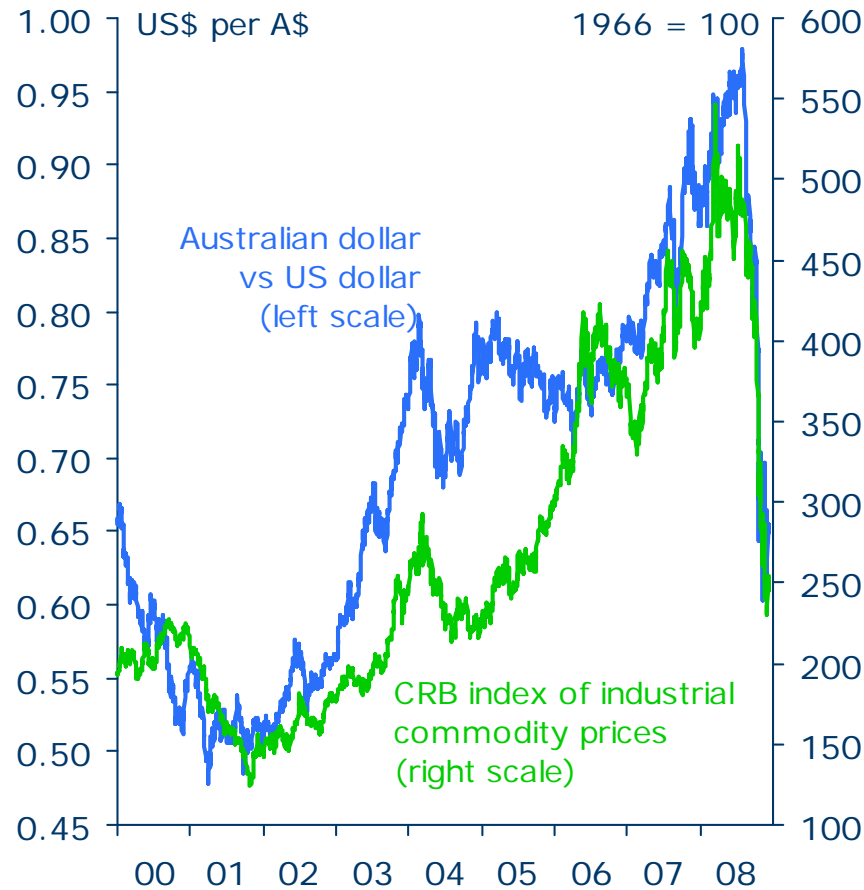


Source: Datastream.

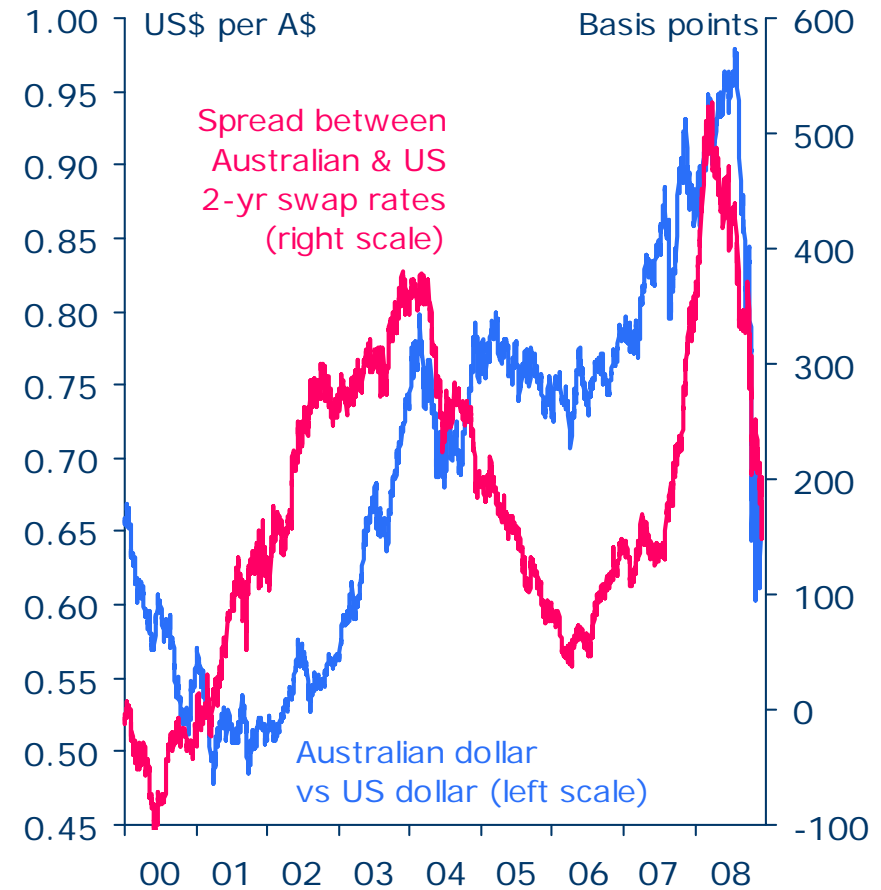


The A\$'s decline also reflects plummeting commodity prices and the narrowing Australian-US interest rate spread

A\$ vs US\$ and commodity prices



A\$ vs US\$ and Australia-US interest rate spreads

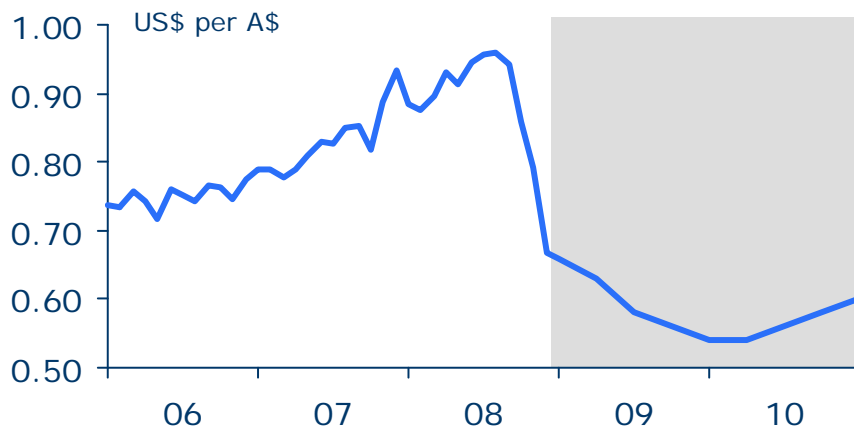


Source: US Federal Reserve Board; Datastream.

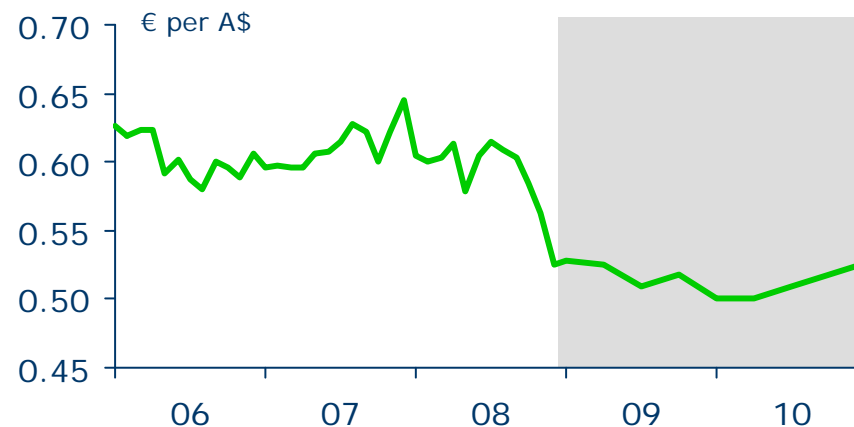


The Australian dollar is likely to remain weak against the US\$ and yen over the next two years

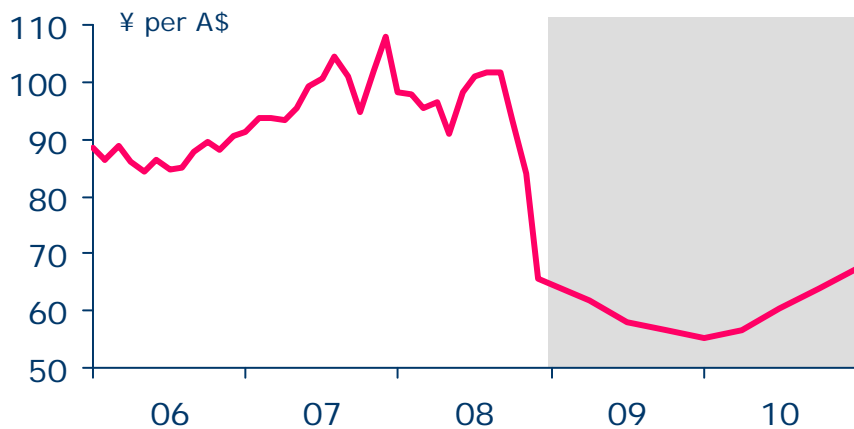
Australian dollar vs US dollar



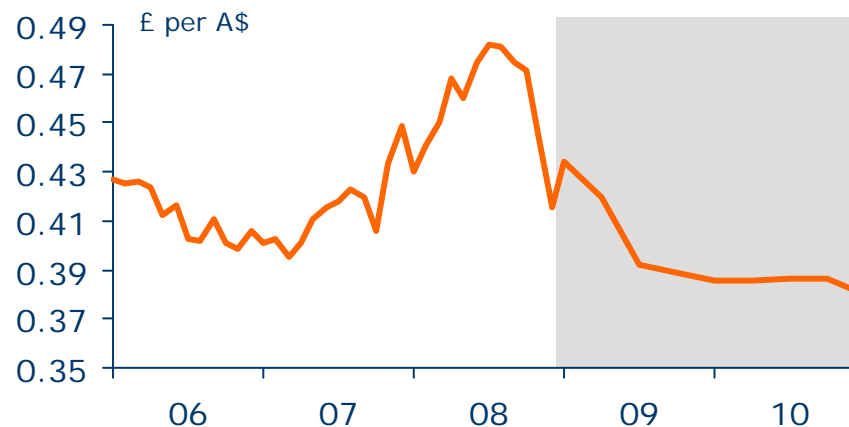
Australian dollar vs Euro



Australian dollar vs Japanese yen



Australian dollar vs British pound



Sources: ABS; ANZ Economics & Markets Research.



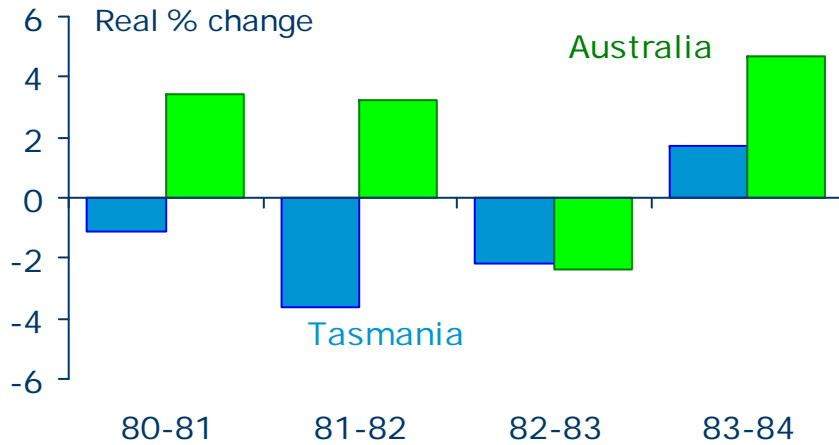
Will Tasmania again fare worse than Australia as a whole during the coming downturn, as it has in previous recessions?

- Recessions have typically hit Tasmania more severely than the national economy, with real output contracting by a larger proportion and unemployment reaching higher peaks in Tasmania than for Australia as a whole
- Some of the reasons why Tasmania has fared worse in previous recessions remain relevant today
 - an above-average proportion of Tasmanians are employed in low-skill occupations (and are thus more likely to lose their jobs in a downturn)
 - with few 'head offices' located in Tasmania, Tasmanians are more likely to be casualties of retrenchments ordered by mainland or overseas head offices
- However there are also some reasons to believe Tasmania may be less vulnerable to some of the recession-inducing factors shaping the outlook for 2009
- Traditionally 'cyclical' industries (manufacturing, mining and construction) now represent a below-average share of Tasmania's economy, compared with a well-above-average share at the time of previous recessions
- Sectors which are likely to be particularly hard-hit by the specific recession-inducing factors shaping the outlook for 2009 are 'under-represented' in the Tasmanian economy
- Tasmanian households are less exposed to the collapse in asset values
- For the first time since at least the 1970s, Tasmania is entering a national downturn with a below-average unemployment rate

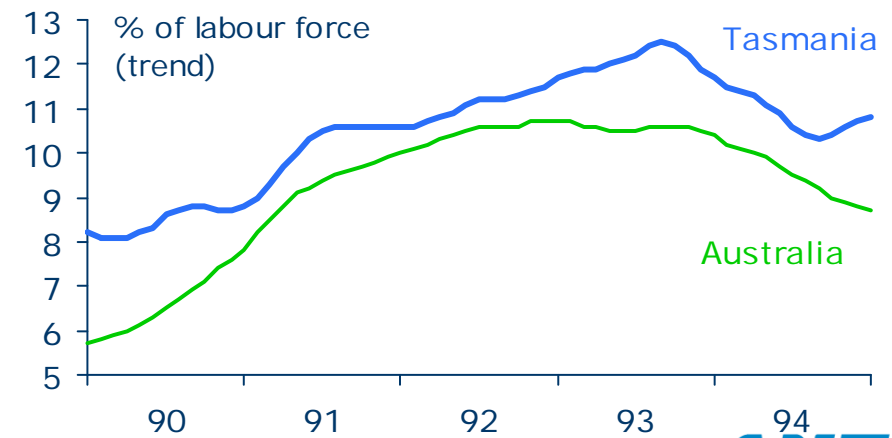
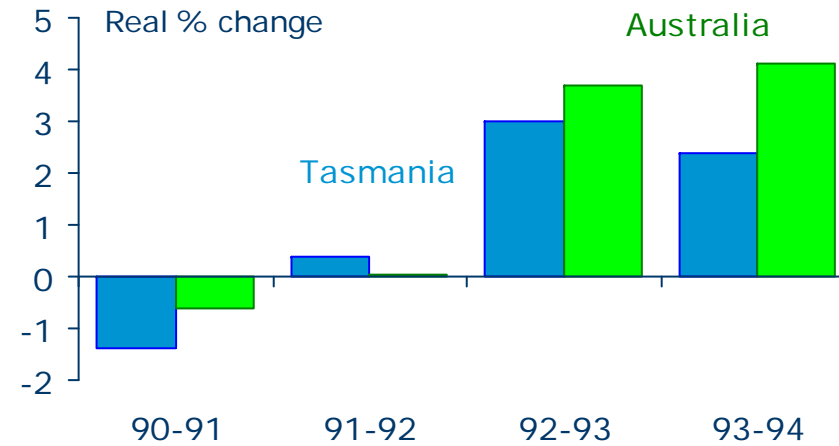
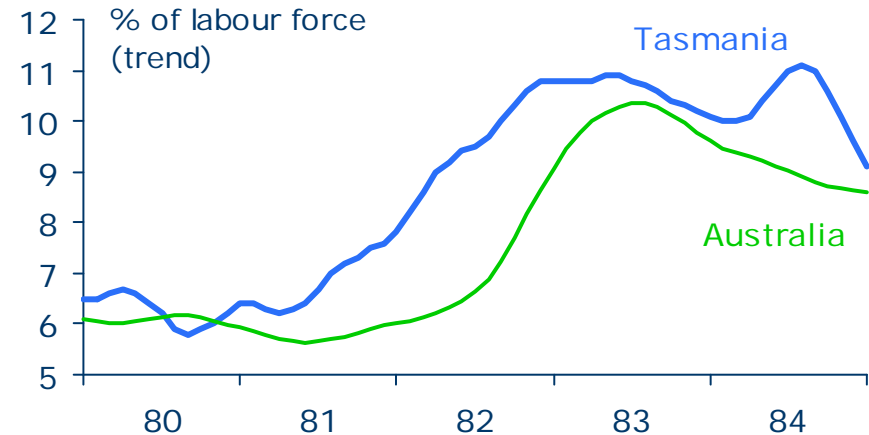
Tasmania has traditionally fared worse than the national economy during recessions

Tasmania and Australia during recessions

Real gross product



Unemployment



Sources: ABS, ANZ Economics & Markets Research.



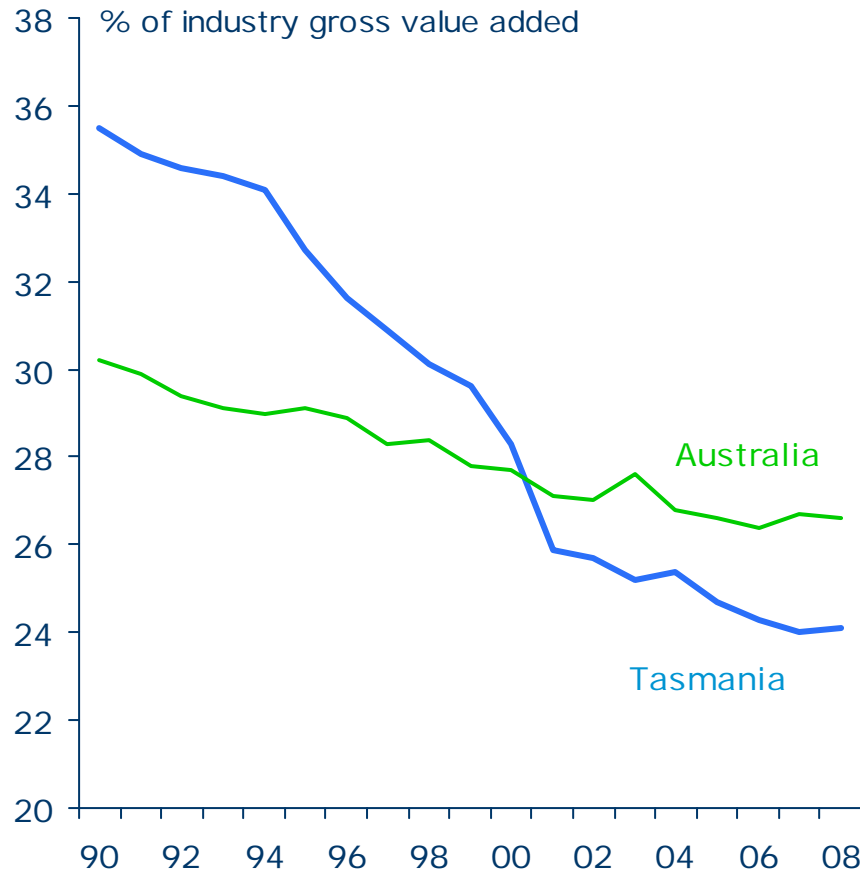
However it is possible that Tasmania may fare relatively better than the national economy during the coming downturn

- Tasmania has a below-average proportion of the sectors which are likely to be hardest hit by the coming national downturn (including mining, construction, finance & insurance, and property & business services)
- Conversely, some of the sectors which will benefit most from the depreciation of the A\$ (including agriculture and manufacturing) or from expansionary fiscal policy (including health and education) are 'over-represented' (by comparison with the national economy) in Tasmania
- Although the global recession will adversely affect international visitor arrivals to Australia, Tasmania's tourism sector may benefit from any increased preference on the part of Australians to 'holiday at home'
- Tasmanian households are arguably less exposed to the 'credit crunch'
 - interest payments absorbed 9.9% of Tasmanian household disposable income in 2007-08, compared with 13.1% of national household disposable income
 - 53.7% of Tasmanian home-owners own their homes outright, compared with 49.5% of all Australians
 - the average Tasmanian mortgage outstanding (in 2005-06) was \$30,000, compared with a national average of \$50,000
 - although conversely reductions in interest rates will be of less benefit to Tasmania
- Tasmanian households are less exposed to the collapse in asset values
 - Tasmanian households directly owned only \$9,500 (on average) of shares in 2005-06, compared with the national average of \$22,700
 - Tasmanian households had superannuation balances averaging \$65,100 in 2005-06, compared with the national average of \$84,500

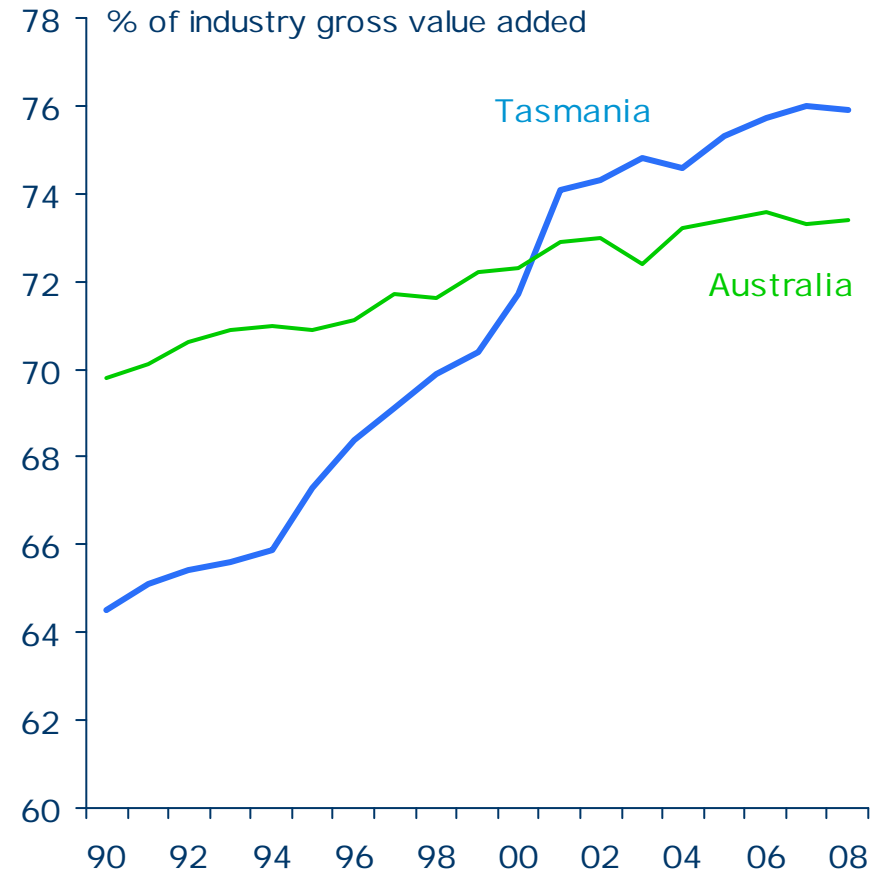
Tasmania's economy is no longer characterized by an above-average share of cyclically-sensitive industries

Cyclical sensitivity of the Tasmanian and national economies

'Cyclical' sectors



'Non-cyclical' sectors

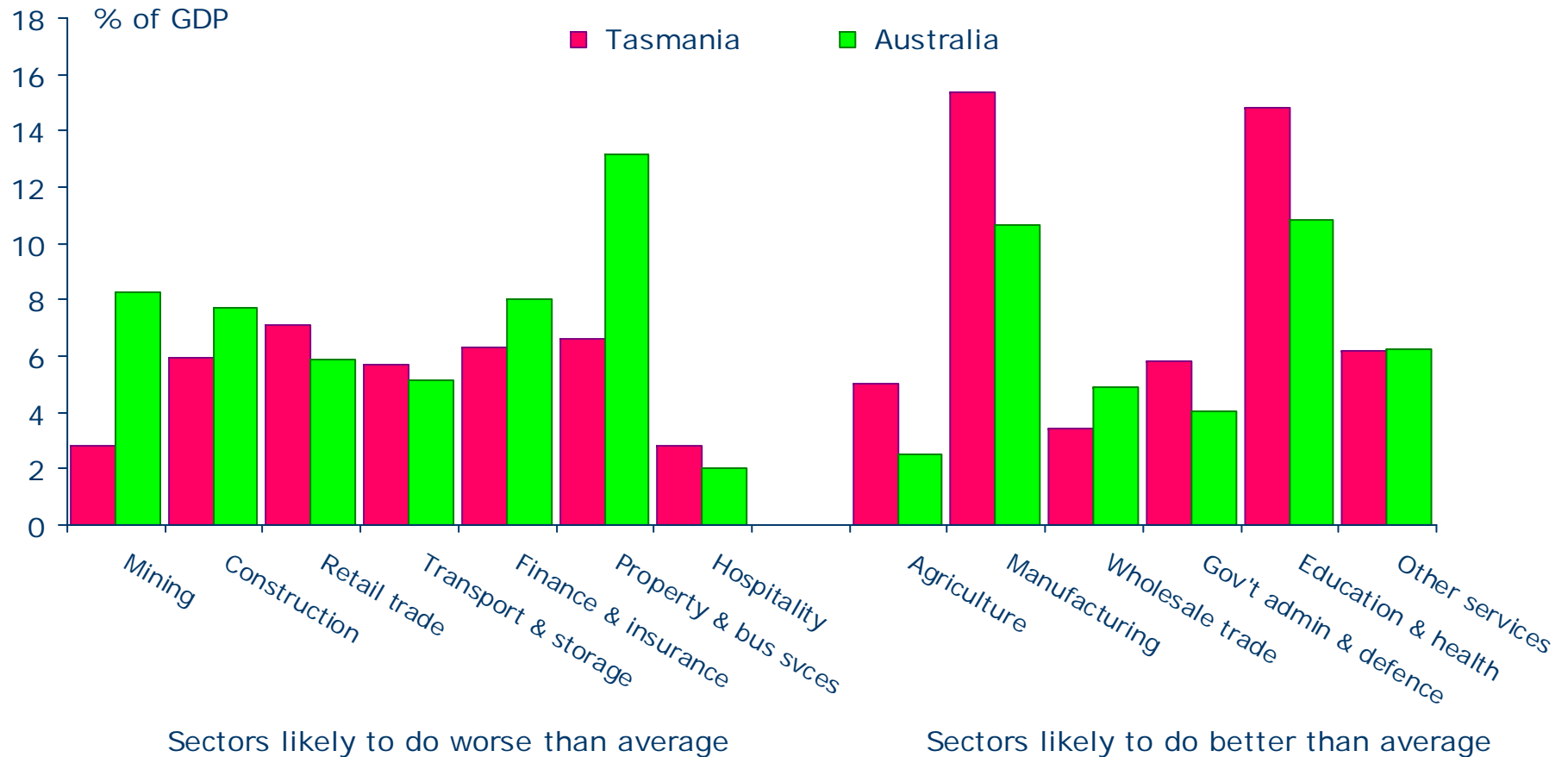


Note: 'Cyclical' sectors are manufacturing, mining and construction. Industry gross value added excludes that attributed to 'ownership of dwellings'. Sources: ABS, ANZ Economics & Markets Research.



Sectors likely to fare worse than average next year account for 37% of Tasmania's economy, cf. 50% of the national economy

Industry shares of gross value added, 2007-08

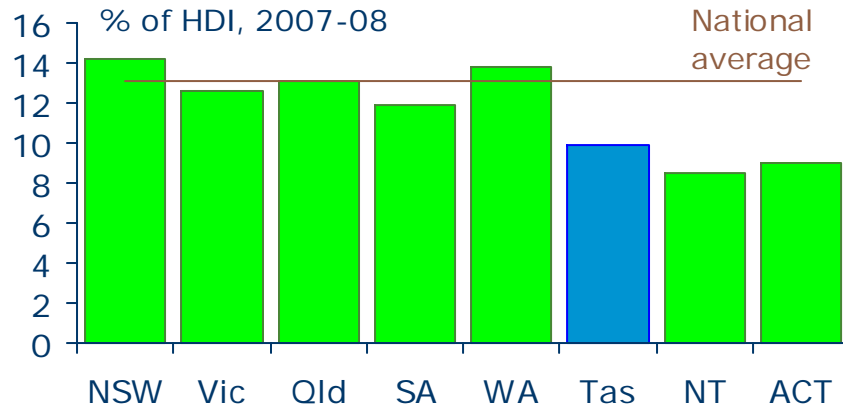


Note: 'Hospitality' comprises accommodation, cafes and restaurants; 'Other services' includes communications, cultural & recreational services, and personal & other services.
 Sources: ABS, ANZ Economics & Markets Research.

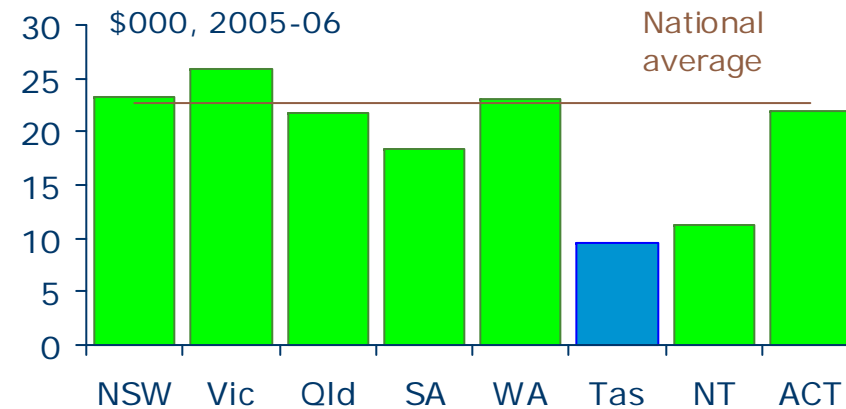


Tasmanian households are less exposed to the credit crunch and collapse in asset values than their mainland counterparts ⁴²

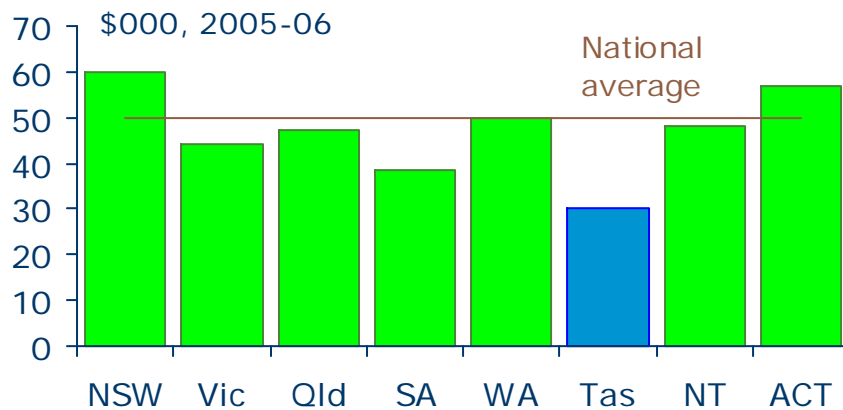
Interest payments



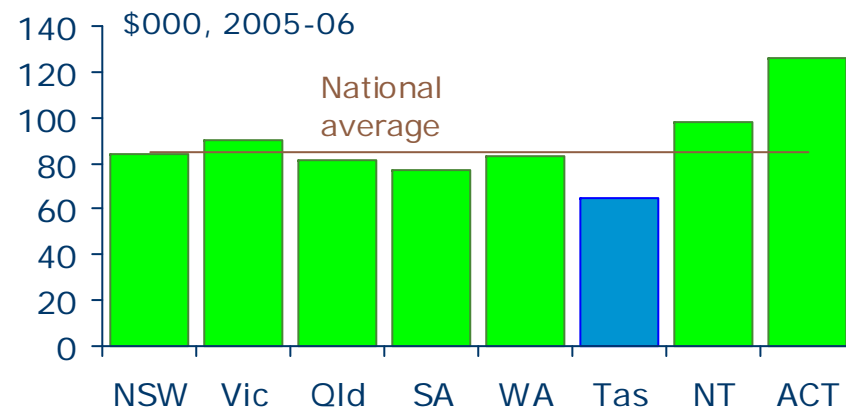
Mean direct share holdings



Mean mortgage outstanding



Mean superannuation balance



Sources: ABS, State Accounts 2007-08; Household Wealth and Wealth Distribution 2005-06.



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