Australia’s Resilience During the GFC

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**Outline**

- Nature of the shock facing Australia
- Factors moderating the shock
  - Resilience of export markets
  - The banking system and regulatory structure
  - Bank deposit guarantee
  - Response of the Reserve Bank of Australia
  - Stimulus package
- Longer term issues
- Conclusion
Real GDP growth

Real GDP Growth Rate (annualized)

99-Q1  00-Q1  00-Q3  01-Q1  01-Q3  02-Q1  02-Q3  03-Q1  03-Q3  04-Q1  04-Q3  05-Q1  05-Q3  06-Q1  06-Q3  07-Q1  07-Q3  08-Q1  08-Q3  09-Q1  09-Q3

Australia  Canada  Germany  New Zealand  UK  US
Unemployment rate

- 5.7 percent at the moment (down from 5.8% in the previous quarter)
- IMF forecast published in June of 2009 of 7.9%
- Treasury forecast published in June of 2009 of 8.25% by mid 2010
The shock

- The shock facing Australia was very different to that facing the rest of the world
- The shock was not sourced in our own financial sector
- The shock was an external shock from the US and elsewhere
  - affecting our confidence
  - affecting our financial sector
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The nature of the shock
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Regulation and banking
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Confidence

Confidence

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Confidence
Equity markets

S&P ASX200, 2007-2009
Resilience of export markets

- As the crisis hit, Australia was in the midst of an extended commodities boom
Resilience of export markets

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Resilience of export markets
Resilience of export markets

Current account balance as a percent of GDP

-8.00% -7.00% -6.00% -5.00% -4.00% -3.00% -2.00% -1.00% 0.00%
The regulatory structure

Council of Regulators

- The Reserve Bank of Australia
- The Australian Prudential Regulatory Authority
- The Treasury
- The Australian Securities and Investment Commission
The regulatory structure

Council of Regulators

- An informal council with no power as a group
- Very clearly defined role of each of the parties
- No room for regulatory arbitrage
- APRA particularly conservative
The four pillars policy

- 4 largest banks in Australia are prohibited from taking each other over
  - 1990 policy initial version 6 pillars under Paul Keating
  - 1997 Wallis inquiry recommended dismantling the policy
  - The treasurer changed the policy to a 4 pillar policy

- Aim to avoid reduction in competition by merger or take over of each other
  - banks argue international competitiveness is limited
  - doesn’t mean the big four can’t take over small banks
The four pillars policy

- Structure of four pillars made space for banks to be profitable from lending to the domestic household sector
- Small number of entities to benefit from a lack of competition
- Large enough entities to still compete with each other
The Banks

- All 4 major banks AA rated by Standard & Poors
- Banks 13.5% after tax return on equity from January - June 2009
  - although this is down by 14% from the previous years
  - reduction in profits due to increased provisioning
- Higher interest rates than most economies meant less need to search for yield
- Only 5% of the income from banks from trading
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The Banks

- Little exposure to CDOs and MBS
- Lending standards are generally high and prudential supervision conservative
- Credit assessments of third party originators stringent
- APRA introduced higher risk weights on loans with low documentation
- Borrowers cannot walk away from their debt providing incentives to repay early
- No tax deductibility of mortgage interest payments provides incentive to repay early
- (see Bloxham and Kent 2009)
The Banks

- Lending is generally funded by offshore borrowing by the banks
- Access to this funding at the height of the global crisis created problems for Australia
- September-October, 2008
  - deterioration in global money markets
  - difficult for authorized deposit taking institutions (ADIs) to manage their liquidity
  - RBA expanded domestic market facilities to alleviate
  - included increasing swap facilities in US dollar short term funding markets
The bank deposit guarantee

- October 12, 2008 the government announced
  - a guarantee all deposits and wholesale funding ADIs
  - aim to facilitate access to funding
  - guarantee was unlimited
The bank deposit guarantee

- Created substantial distortions in financial markets
  - institutions not subject to the guarantee were hit hard hit
  - created instability in other sectors of the financial markets
  - some non-guaranteed institutions even stopped allowing withdrawals
  - those affected still do not have access to their money
  - Australia almost had its own financial market crisis
The bank deposit guarantee
The bank deposit guarantee

- Amendments to the guarantee to avert a financial crisis in Australia
- On 24 October 2008,
  - a threshold of $1 million
  - over this amount, a fee is charged to receive the benefits of the deposit guarantee
  - foreign bank branches in Australia also covered
Interest rates (nominal)
Interest rates

- Prior to the crisis cash rate 7.25%
- Reached the emergency rate of a low of 3% in 4 dramatic and 2 conventional moves
- High enough interest rates prior to crisis to not approach the zero bound when cutting rates
- The first developed economy to raise interest rates following the crisis by 0.25 basis points in October 2009
The stimulus package

- Australia has a long history of surpluses so was in a good position prior to the crisis
- Stimulus package 3.9% of GDP (42.4 billion dollars)
- Compared to an OECD average of 2% of GDP
  - of OECD countries only the US (5.6%) and Korea (4.9%) are greater
- Treasury estimated that the economy would contract 1.3% without the package
  - there is discussion that this figure will be revised
  - actual growth 0.6%
The stimulus package

**Measures**

- **Short term**
  - immediate transfer payments of $900 to taxpayers earning less than $100,000

- **Long term**
  - Infrastructure and investment
  - Investment incentives
  - Education

- **Weight more on increasing government expenditure than reducing taxes**
Longer term issues

- Much criticism that the stimulus package is too big and should be below the average of the global stimulus given initial conditions.

- Problem is that the size of the package is much larger than the average of the rest of the world (3.9% of GDP v’s average of 2% of GDP))
  - crowding out of export markets
  - appreciation of the Australian dollar
  - export markets and jobs in export markets likely to be affected in the longer term
Longer term issues
Longer term issues

- Much criticism that the Government directed stimulus expenditure not necessarily focussed in the right areas for long term growth
  - Business Council of Australia calling for ‘better expenditure’ on infrastructure and fear that capacity constraints are to be met again

- Housing market extremely strong still
Conclusion

- The shock facing Australian was very different to the one facing the rest of the world

- Main factors in Australia averting a crisis were
  - export resilience
  - strong regulatory structure
  - strong initial conditions

- Possibly too early to comment on the true success of Australia through this period
  - some longer term issues emerging
References


- OECD (2009), “Strategies for aligning stimulus measures with long term growth”, manuscript, OECD