

The economic landscape in 2009



Slower growth: where to for
Australian business?

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Australia can't expect to be immune from the global financial crisis or the ensuing economic downturn ...

- Australia has a large current account deficit (on its transactions with the rest of the world) which it has been financing largely through overseas borrowings by local and foreign banks
 - such borrowings have become more difficult and (relatively) more expensive
 - foreign banks (especially those now under the control of governments) are likely to become less willing to lend abroad (including to Australia)
 - Australian banks don't have sufficient capital to replace all the lending previously undertaken by foreign banks or securities markets
- 'Terms of trade' gains (mainly due to rising commodity prices) have boosted Australia's national income by 2% pa (or nearly 15%) since 2001
 - the sharp fall in commodity prices since mid-2008 (which has further to run) will detract significantly from national income in 2009 (as well as adversely affecting employment and investment)
- Deep recessions in many of Australia's major trading partners will inevitably affect the volume of Australia's exports
- Australian share prices have fallen by at least as much as share prices overseas, adversely impacting household and business finances
 - Australian households and businesses are now emphasizing 'balance sheet repair' rather than spending
- Australian business confidence is inevitably affected by the almost relentless tide of 'bad news' from overseas



... but that doesn't mean that Australia's outlook is as bleak as other countries, or will be as bad as 1990-91

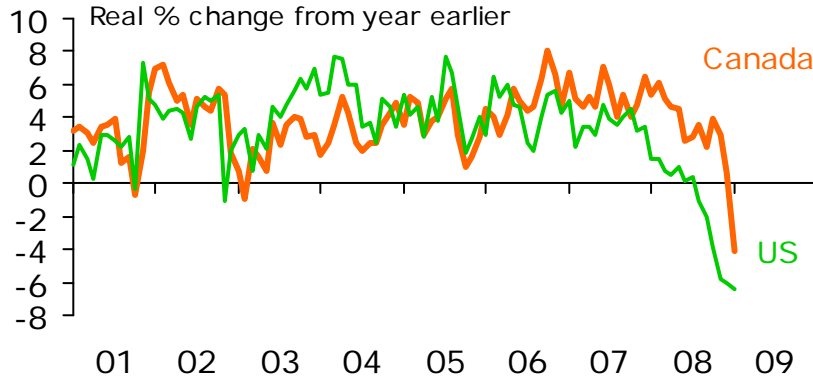
- Most of the factors which have precipitated such severe downturns in the US and Europe are not present to anything like the same degree in Australia
 - Australia's banking system is still in good shape – making profits, not needing capital injections from governments, and continuing to lend (albeit on more demanding terms)
 - despite being 'expensive' relative to incomes, Australian house prices haven't fallen significantly (except at the top end), and there are some good reasons to expect that they won't
- The large fall in the A\$ is of considerable assistance in two ways -
 - in cushioning the impact of sharp falls in commodity prices
 - and in reducing the risk of deflation
- Monetary policy is working more effectively in Australia than in many other countries
 - interest rates paid by most borrowers have actually fallen, in some cases significantly
- Fiscal policy is being activated earlier into the downturn than in previous Australian recessions, and earlier than in the downturns now being experienced in other countries
 - and the measures being taken in Australia have in many respects been better designed than those in other countries



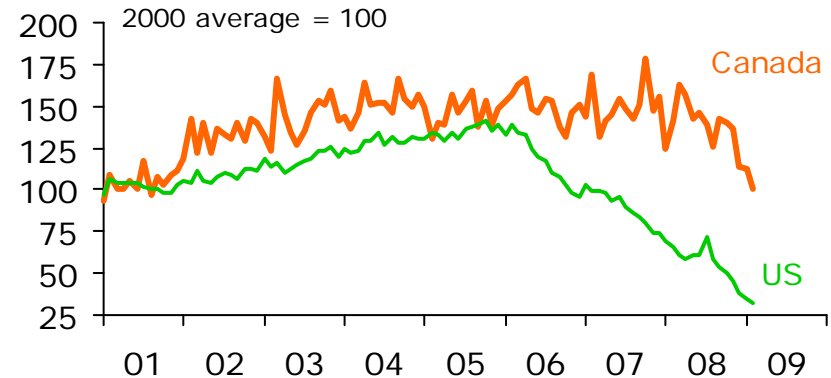
Canada is doing better than might be expected given its proximity to the US – some lessons here for Australia?

Canadian and US economies compared

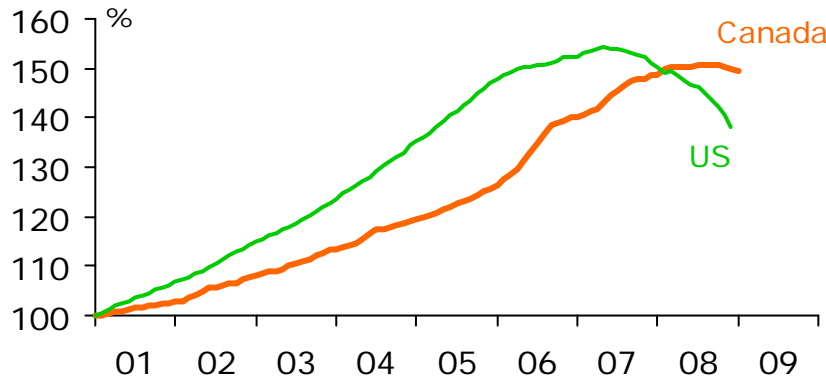
Retail sales volumes



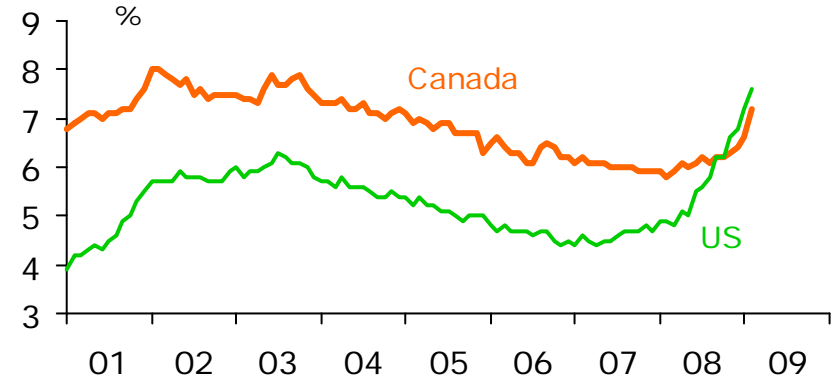
Housing starts



House prices



Unemployment rate



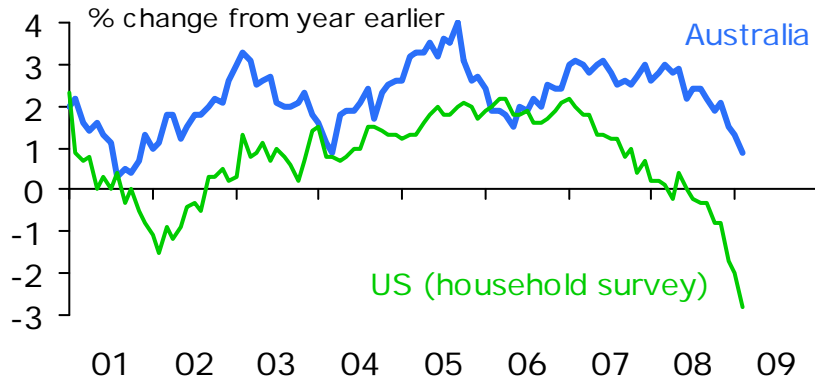
Sources: Statistics Canada; US Commerce Department; US Federal Housing Finance Agency; US Bureau of Labor Statistics; ANZ.



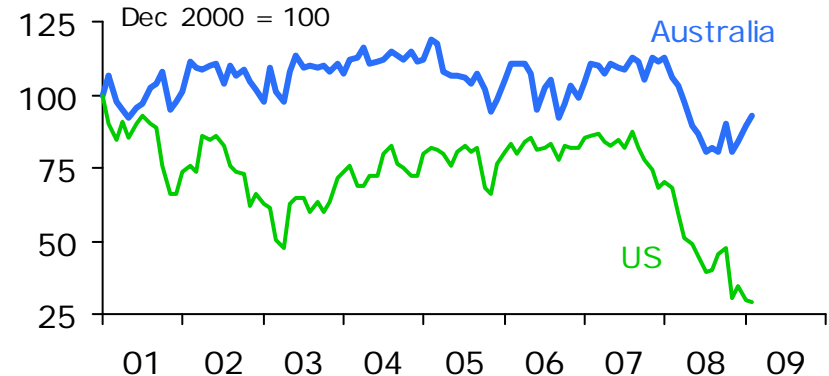
Australia's economy has obviously slowed, but not to anything like the same extent as the US and others

Australian and US labour market and household spending

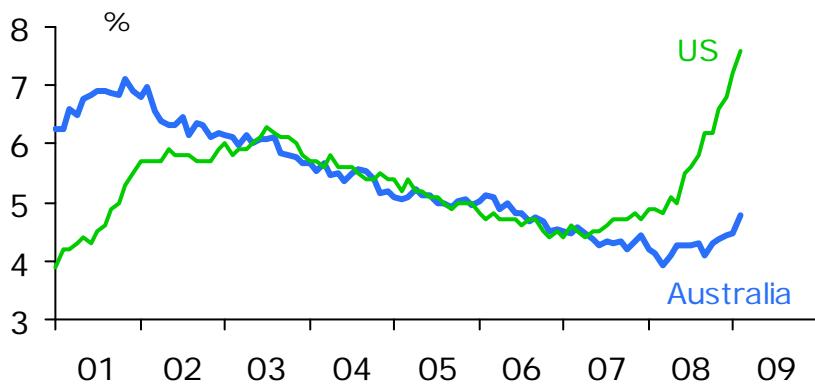
Employment



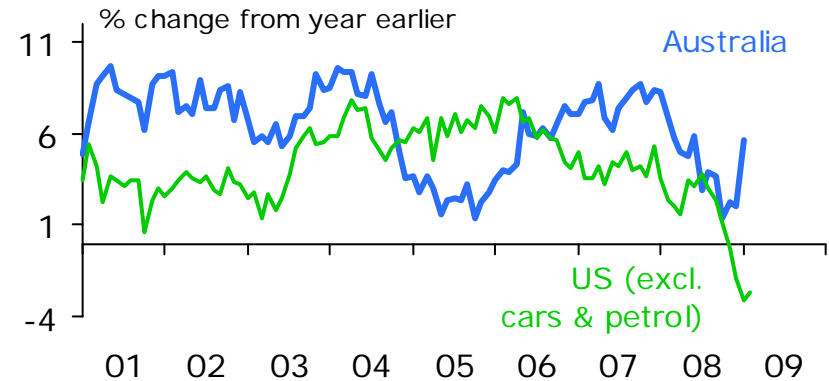
Consumer confidence



Unemployment rate



Retail sales



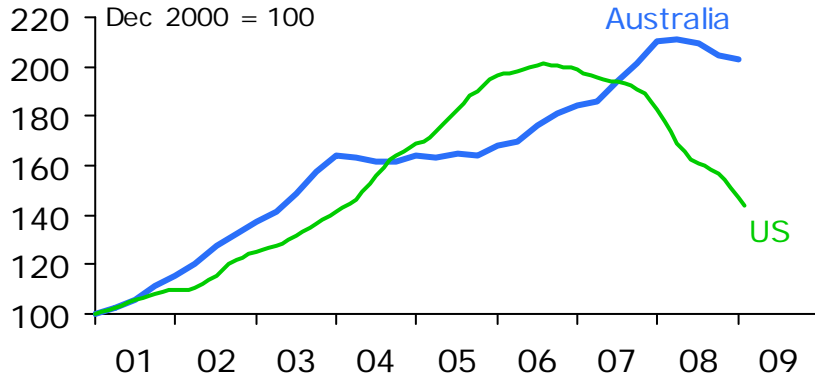
Sources: ABS; US Bureau of Labor Statistics; The Conference Board; Roy Morgan Research; US Commerce Department; ANZ.



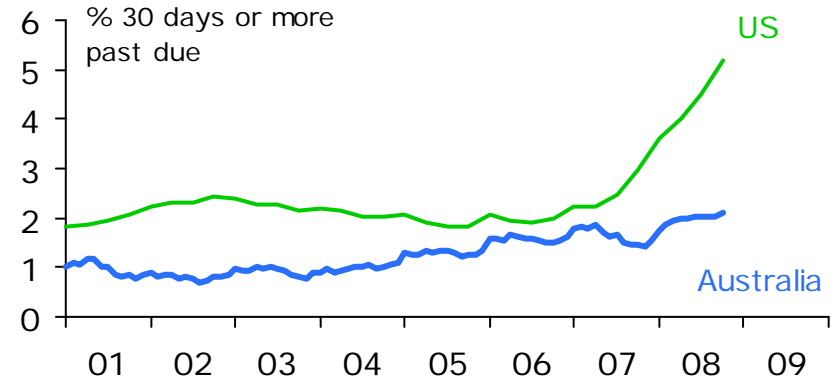
Australia's housing market has not come under anything like the same stress as the US or more recently Europe

Australian and US housing markets and household finances

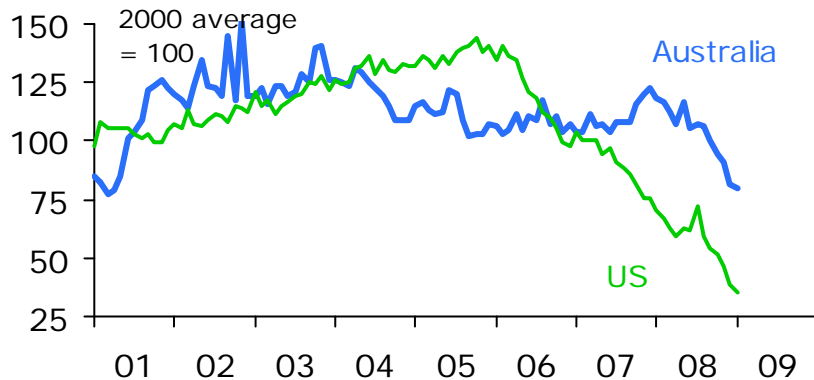
House prices



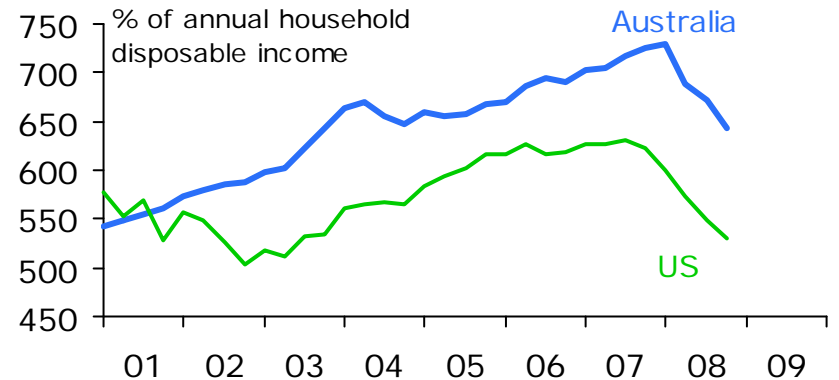
Mortgage delinquency rates



Housing approvals



Household net worth

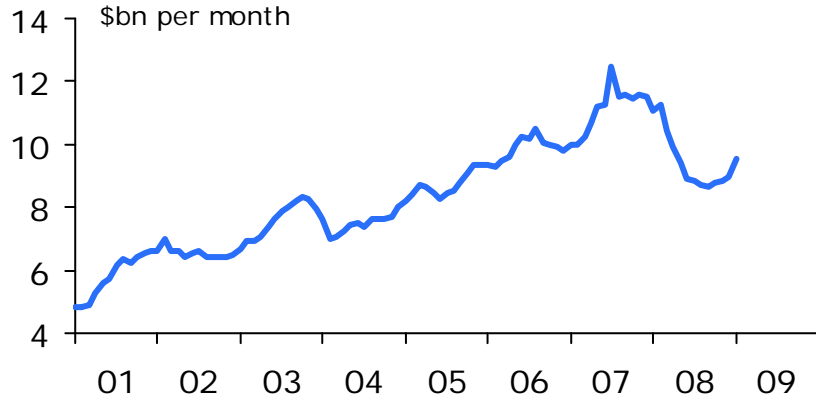


Note: Australian mortgage delinquencies are for securitized mortgages only. Sources: ABS; S&P; US Federal Reserve; Mortgage Bankers' Association of America; US Commerce Department; ANZ.

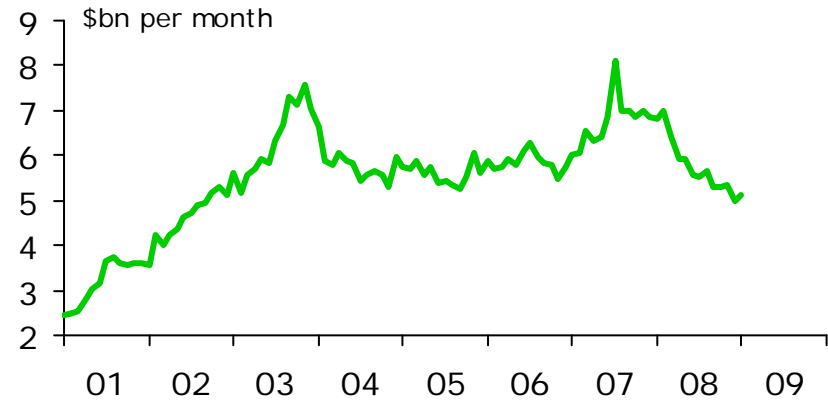


If anything the mis-match between housing demand and supply will widen further

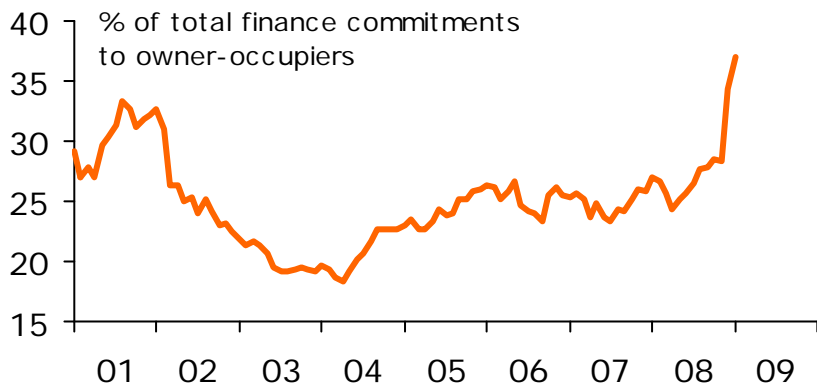
Housing finance commitments to owner-occupiers



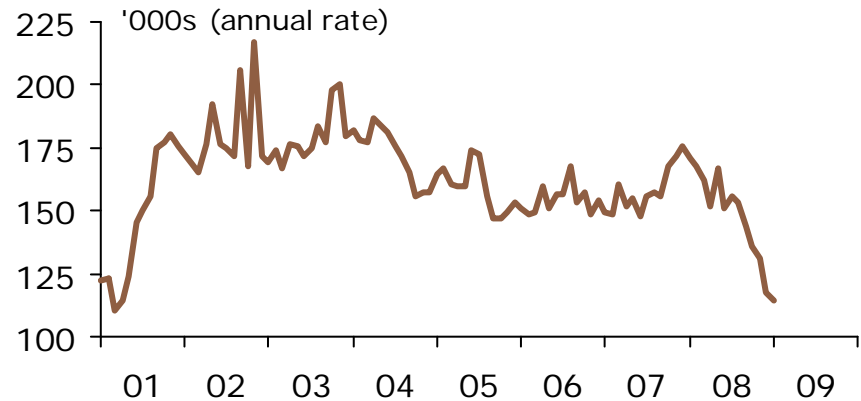
Housing finance commitments to investors



First-time buyers as a pc of total commitments to owner-occupiers



Residential building approvals by local governments

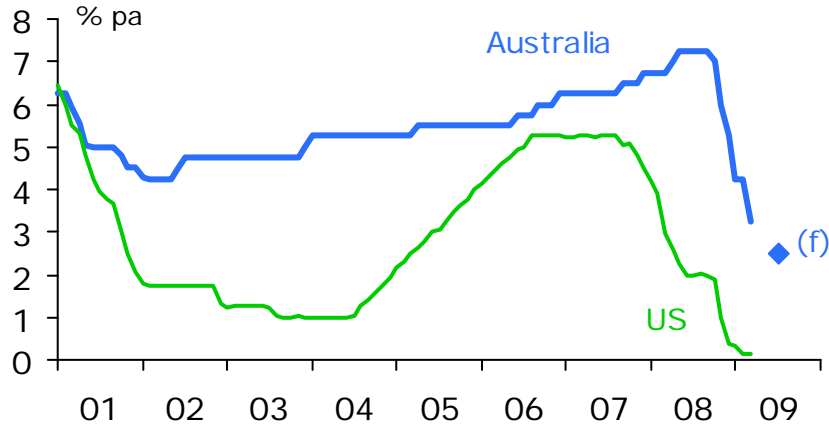


Sources: ABS; ANZ.

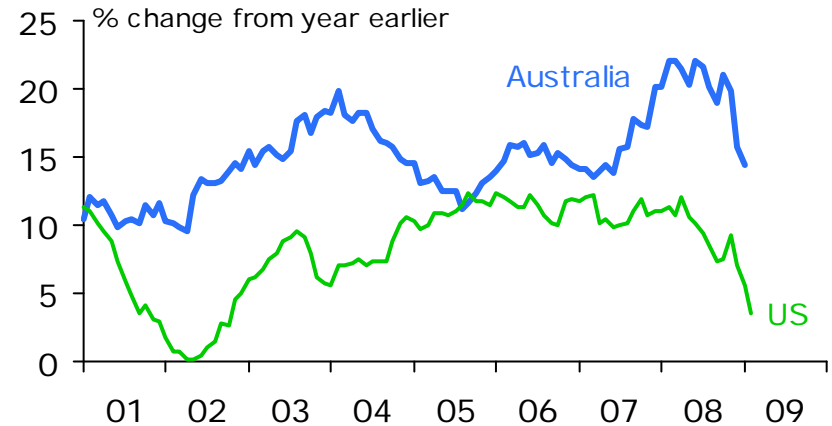


Monetary policy is 'working' more effectively in Australia than in the US

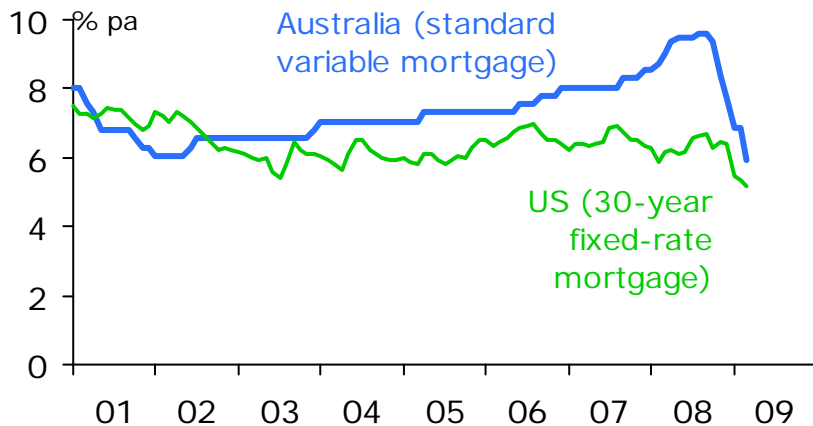
Official interest rates



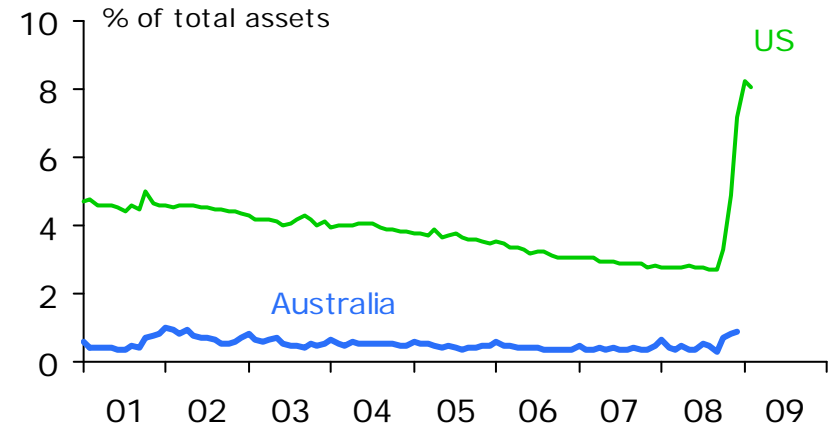
Bank lending



Most common mortgage rates



Bank cash holdings



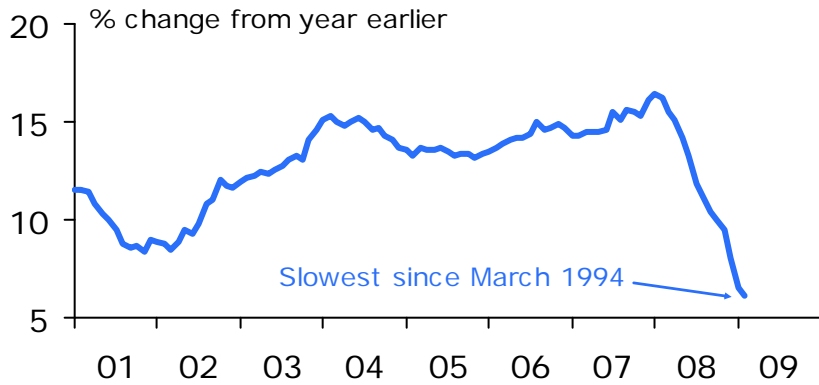
Note: 'Cash' includes deposits with the central bank. US banks are subject to required to hold cash reserves against their transactions account balances and thus typically hold a higher proportion of their assets in cash than Australian banks which are no longer subject to such requirements. Sources: RBA; US Federal Reserve; Datastream.



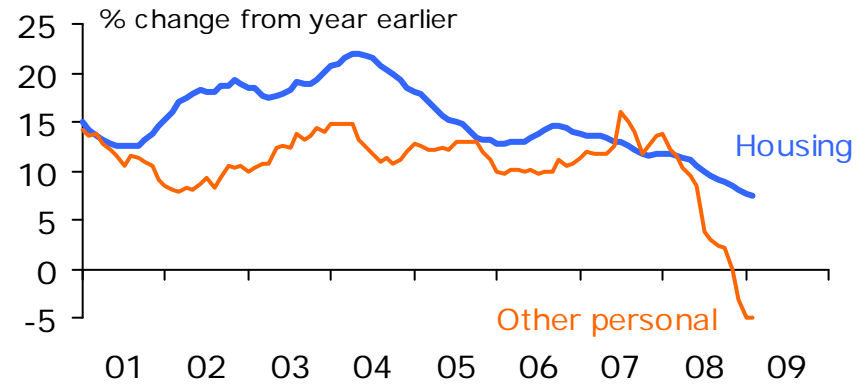
Nonetheless both the demand for and supply of credit to Australian households and businesses is slowing

Credit provided to the Australian private sector

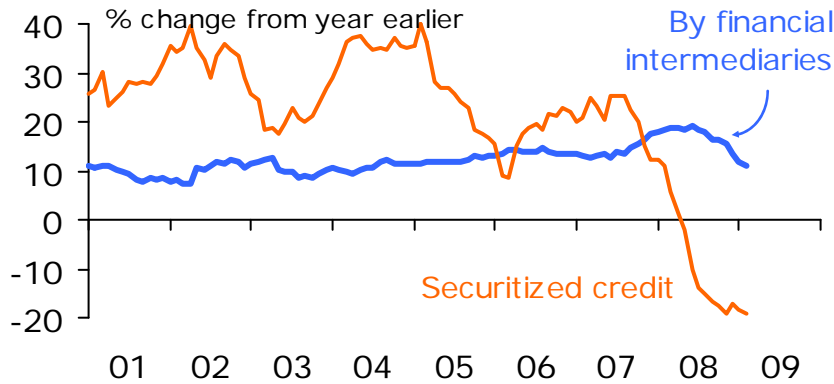
Total credit



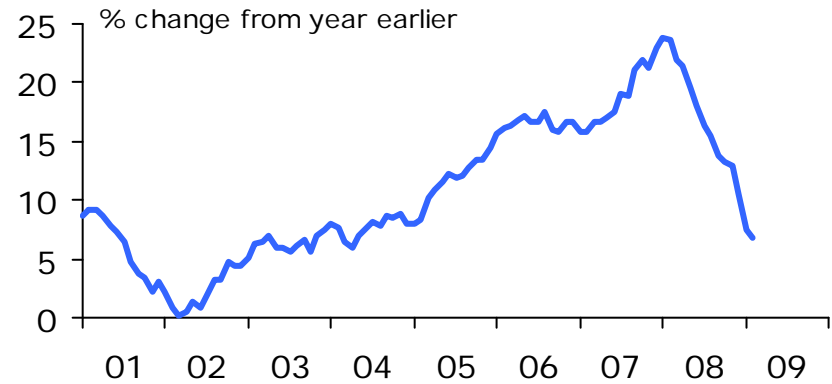
Credit to households



Credit by source



Credit to business

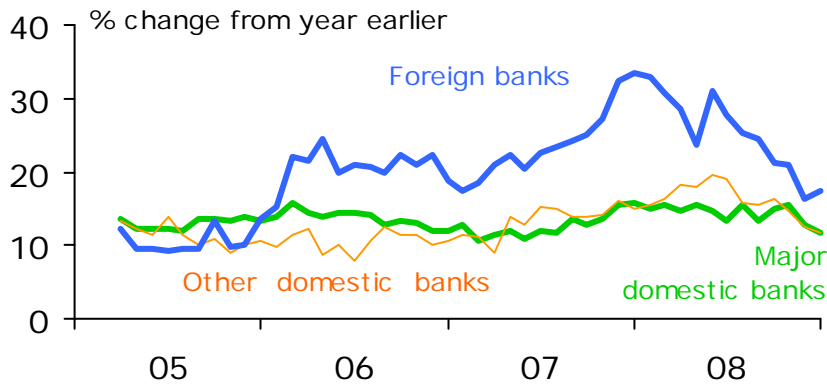


Source: Reserve Bank of Australia.

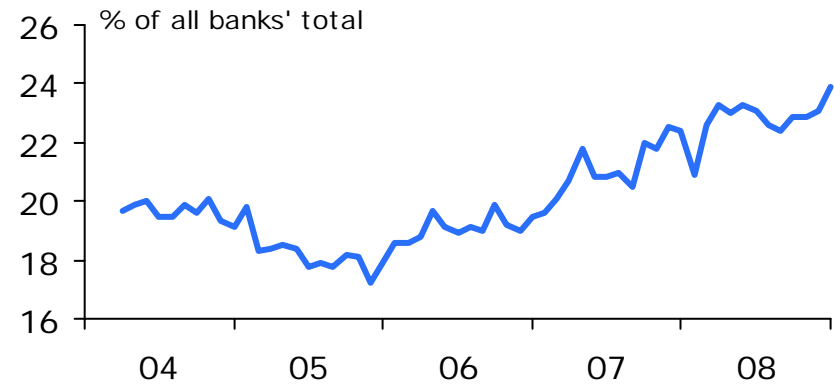


Withdrawal of foreign bank operations in Australia would add to pressures on credit availability

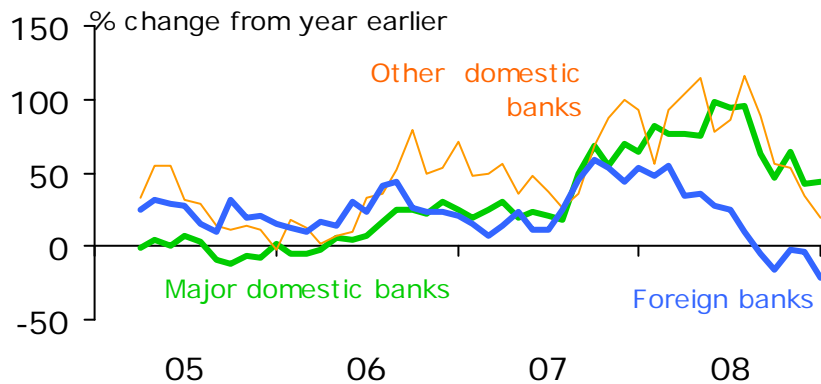
Growth in gross loans and advances



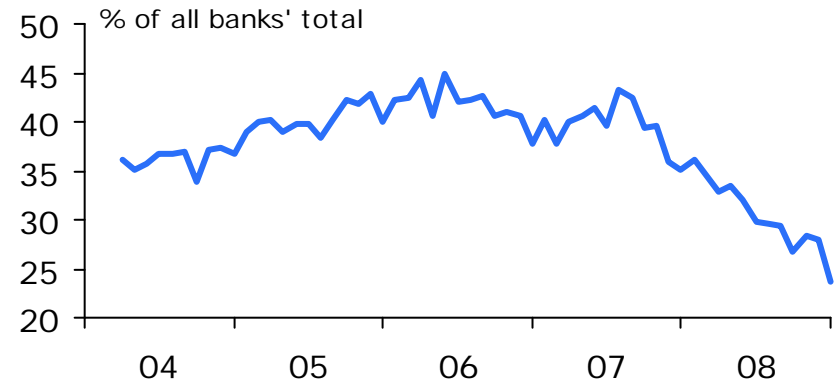
Foreign banks' share of non-housing loans



Growth in securities holdings



Foreign banks' share of securities holdings

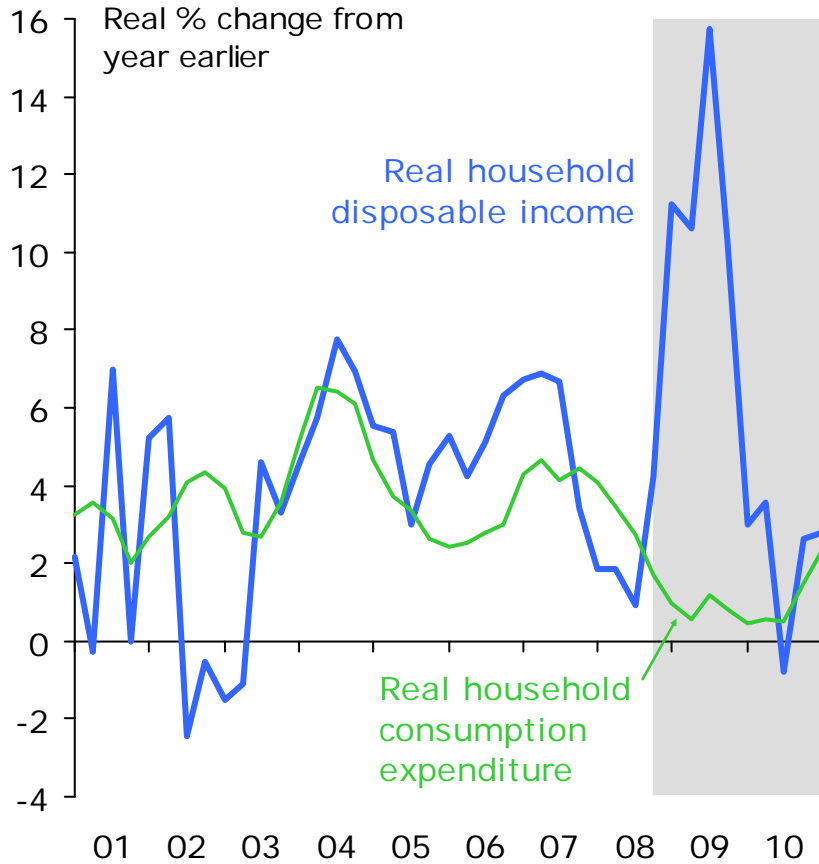


Note: 'foreign banks' comprises branches and subsidiaries of foreign banks operating in Australia.
 Source: APRA monthly data

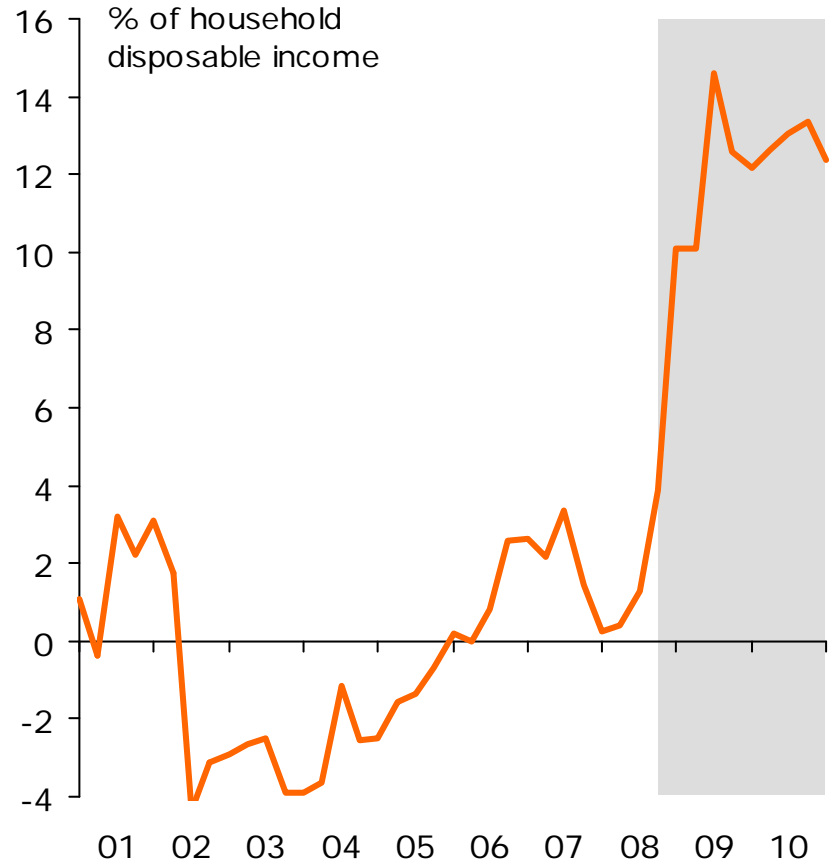


Policy measures will boost household disposable incomes sharply – but most of it will be saved

Household disposable income and spending



Household saving rate



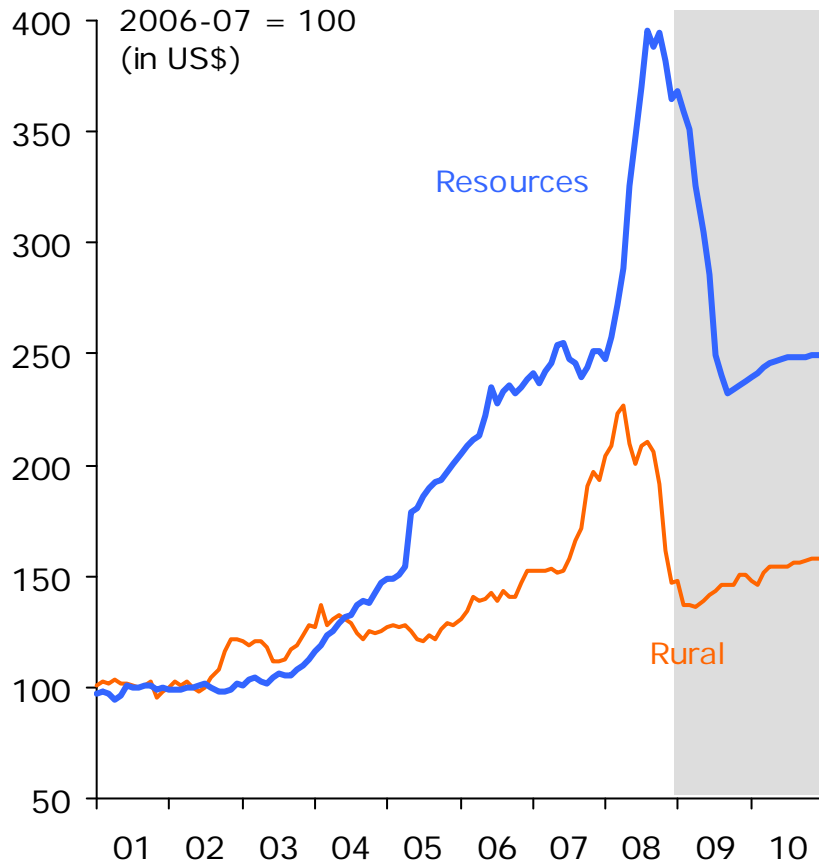
Sources: ABS; ANZ.



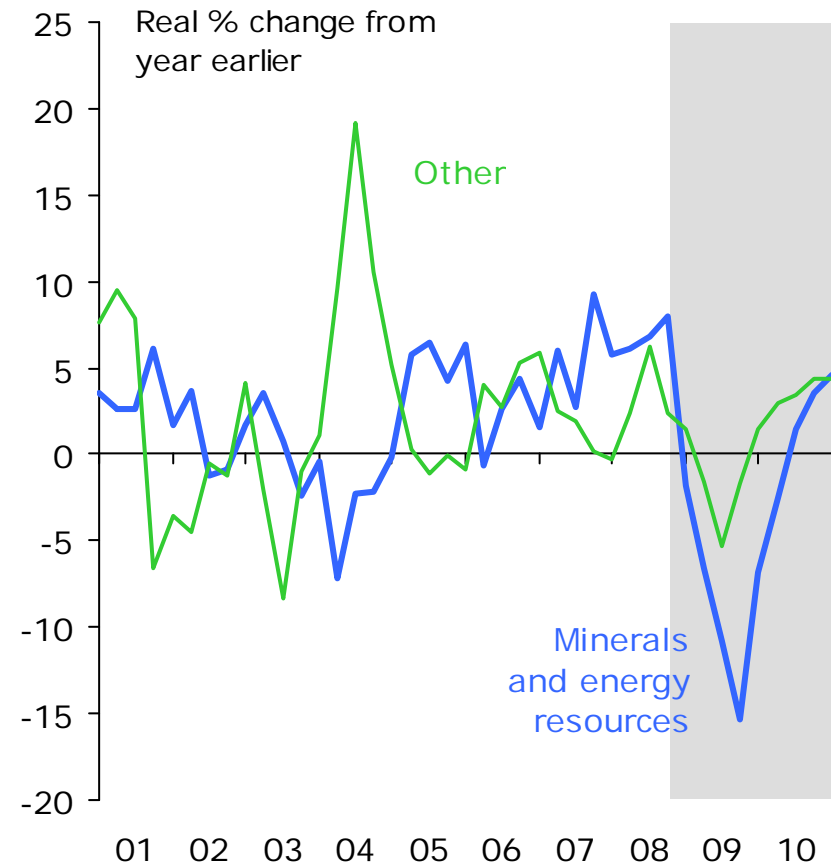


Export commodity prices and export volumes will fall sharply in 2009

Export commodity prices



Export volumes

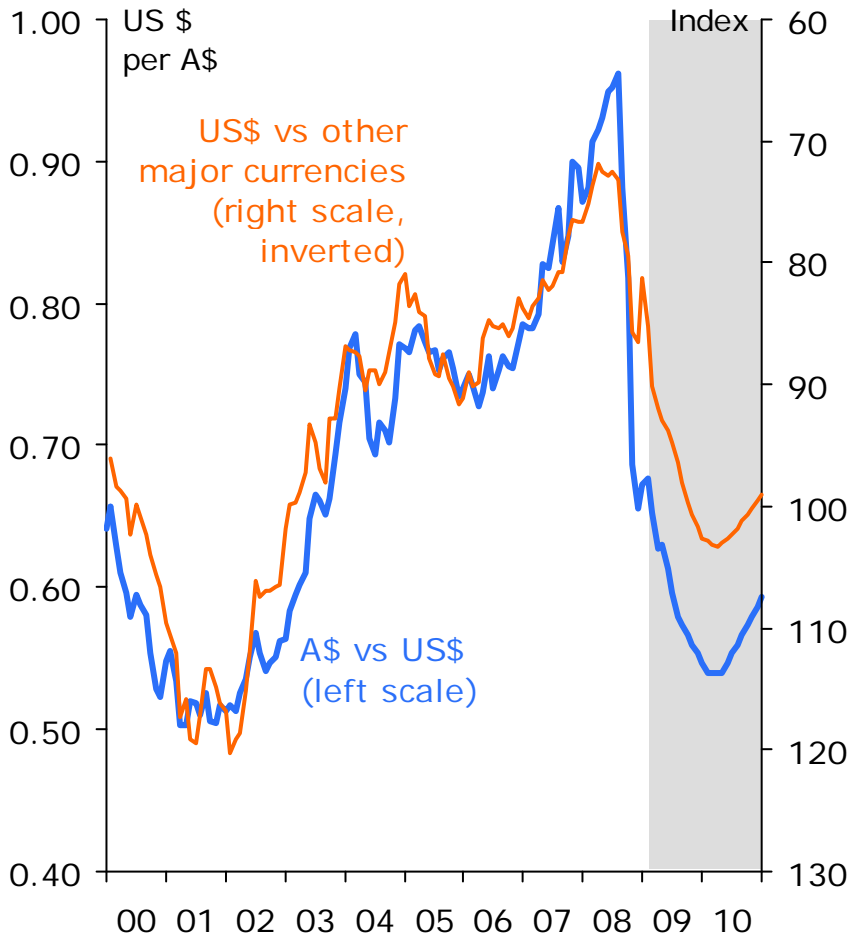


Sources: RBA; ABS; ANZ.

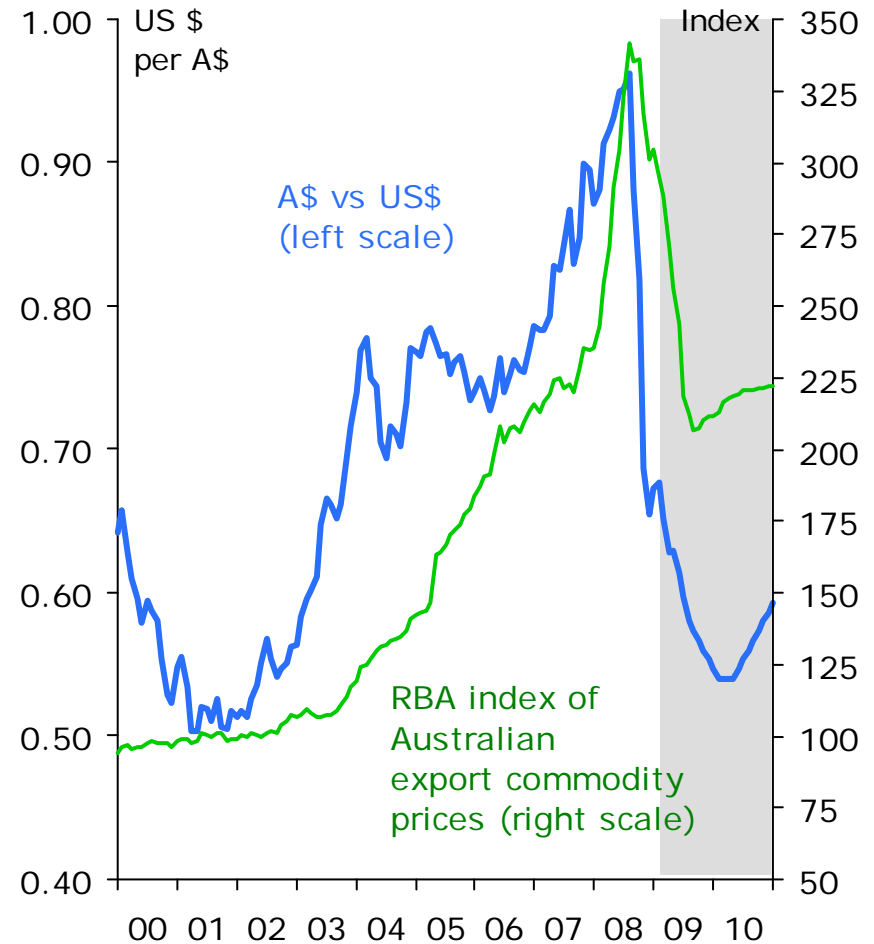


The A\$ will fall further against a resilient US\$ - though this will help cushion the economy and resist deflation

A\$ vs US\$



A\$ & commodity prices

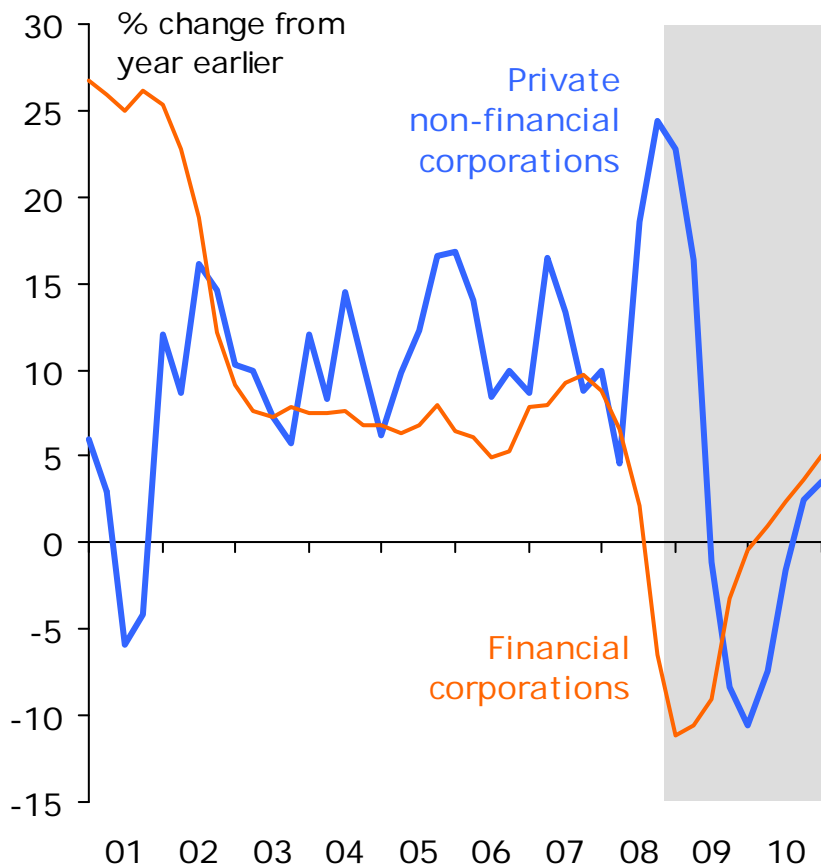


Sources: Datastream; US Federal Reserve; RBA; ANZ.

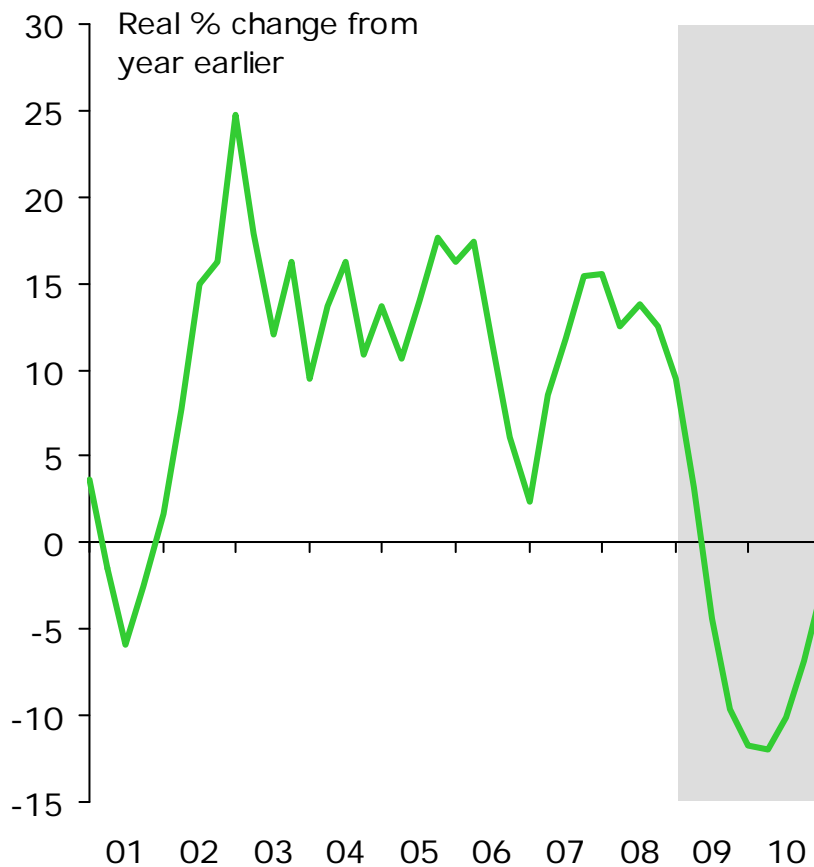


Corporate profits are likely to fall sharply, in turn prompting significant reductions in capital investment

Corporate 'gross operating surplus'



Business investment

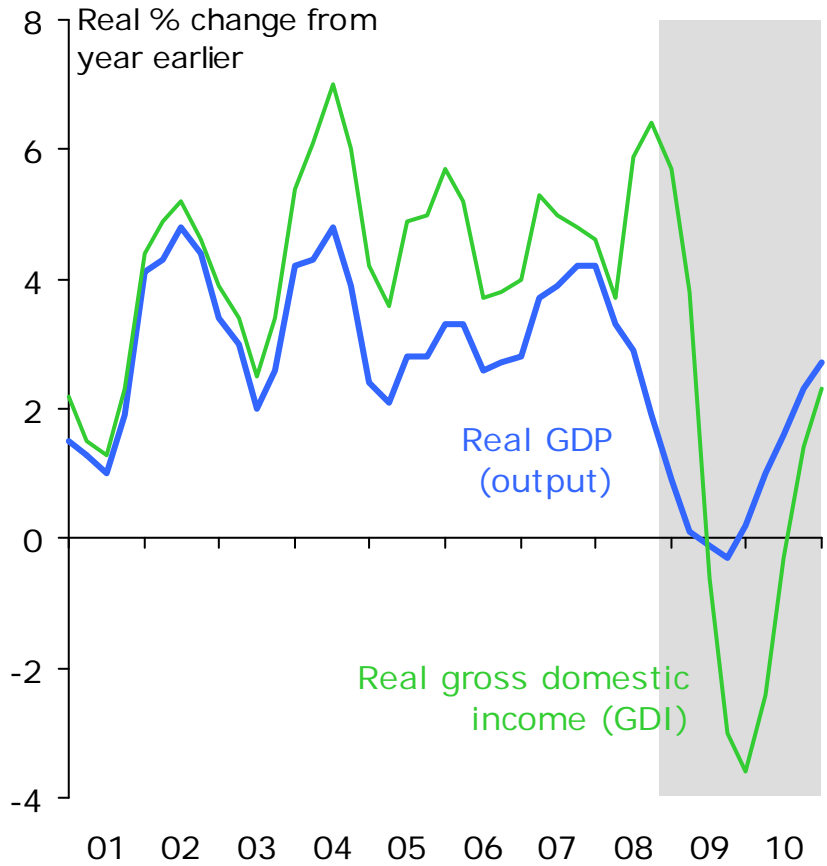


Note: 'gross operating surplus' is the national accounting equivalent of profits before interest, tax, depreciation and amortization (EBITDA) and, for financial corporations, provisions. Sources: ABS; ANZ.

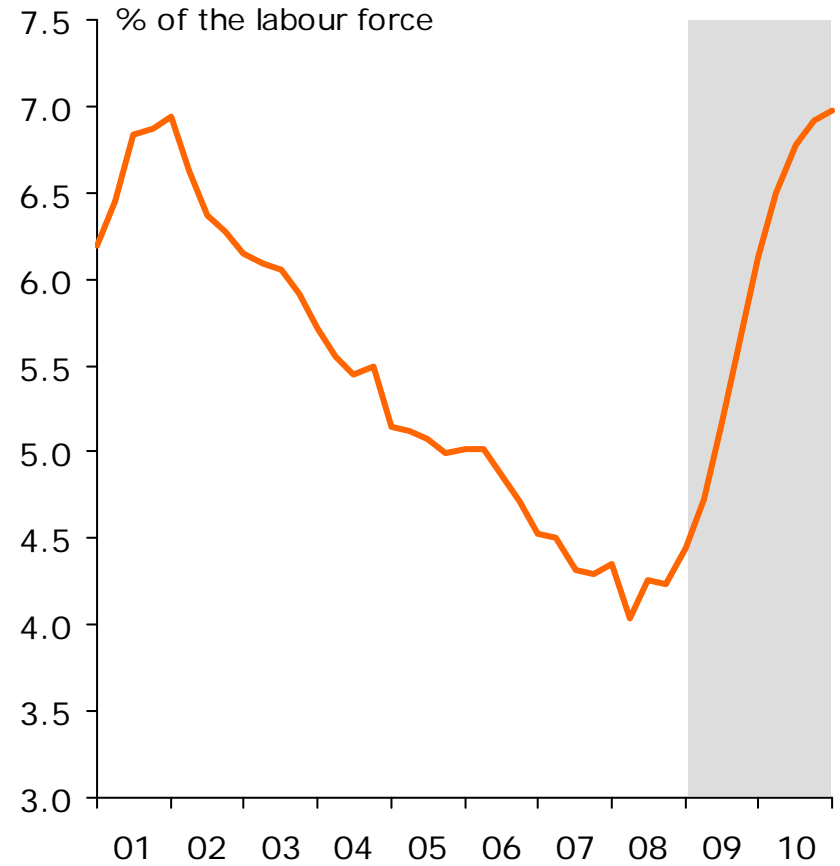


Australia will experience a recession (on most definitions) during 2009, with only a slow recovery in 2010

Gross domestic product and income



Unemployment

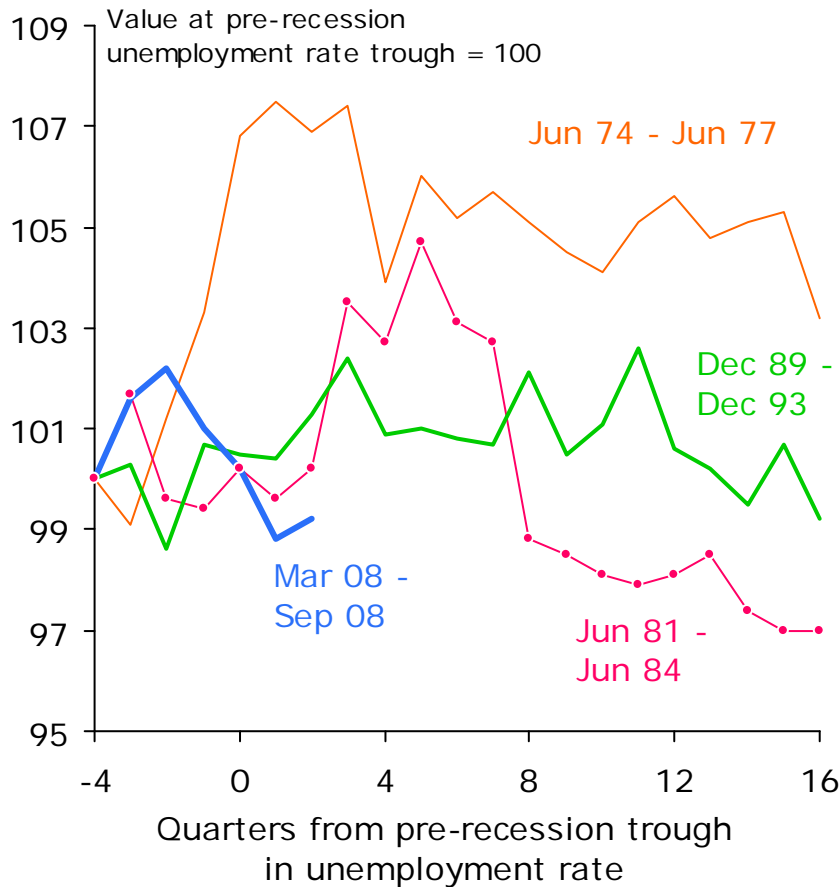


Note: real gross domestic income (GDI) is real GDP adjusted for changes in the terms of trade; it measures the 'purchasing power' of the income associated with producing the GDP. Sources: ABS; ANZ.

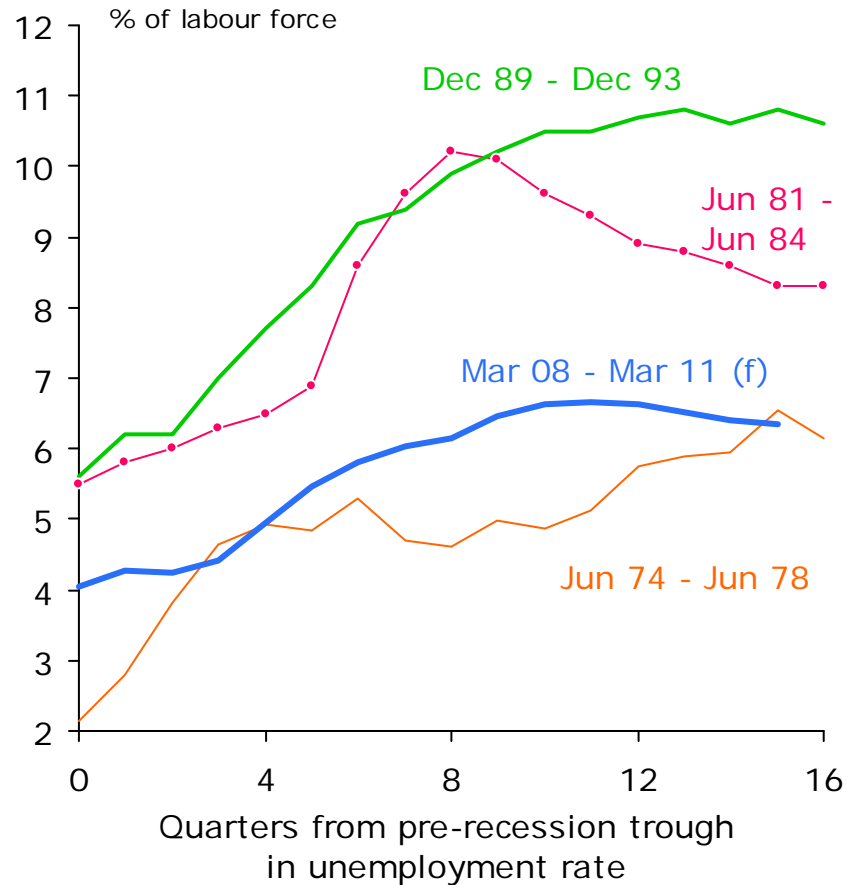


Employees haven't priced themselves out of jobs in the way that they did prior to previous recessions

Real unit labour costs before and during recessions



Unemployment rate during recessions

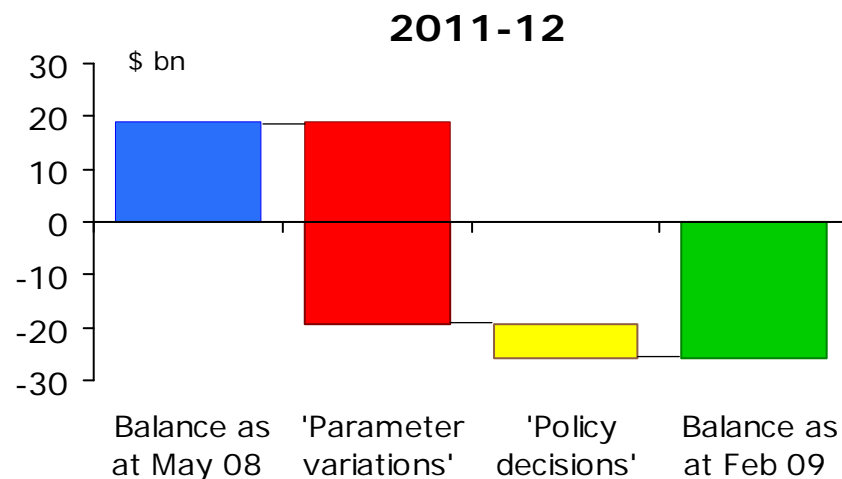
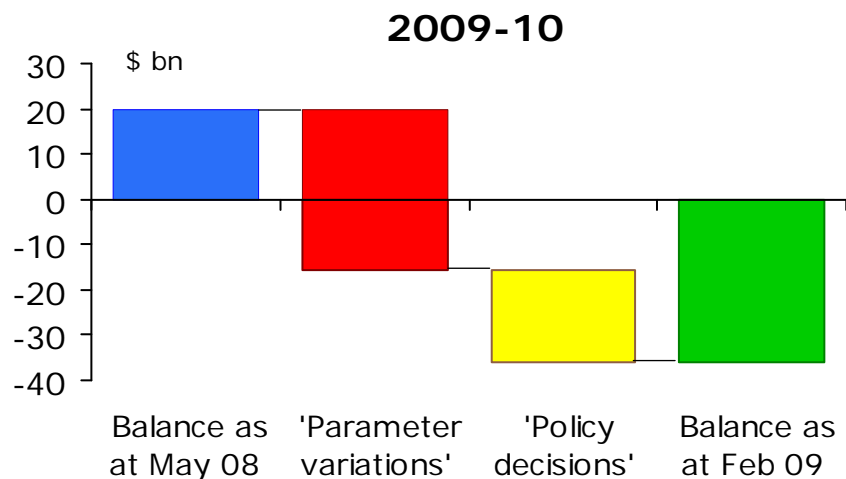
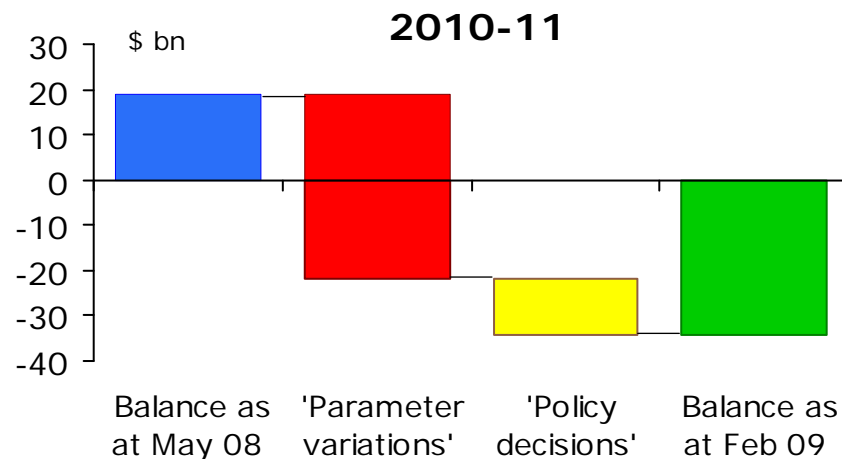
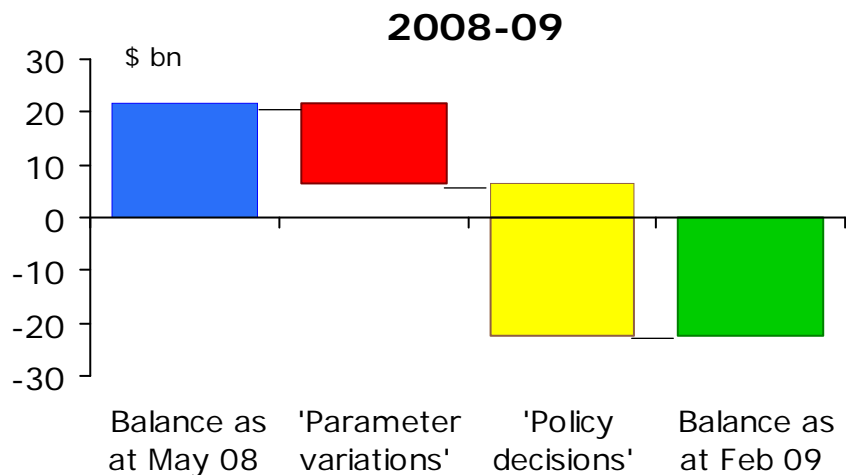


Note: real unit labour costs are employee compensation plus other 'on-costs' per unit of output produced, deflated by an index of output prices.
 Sources: ABS; ANZ.



Sharply lower revenues would have resulted in budget deficits no matter what the Government did

Sources of changes in estimates of the Budget cash balance



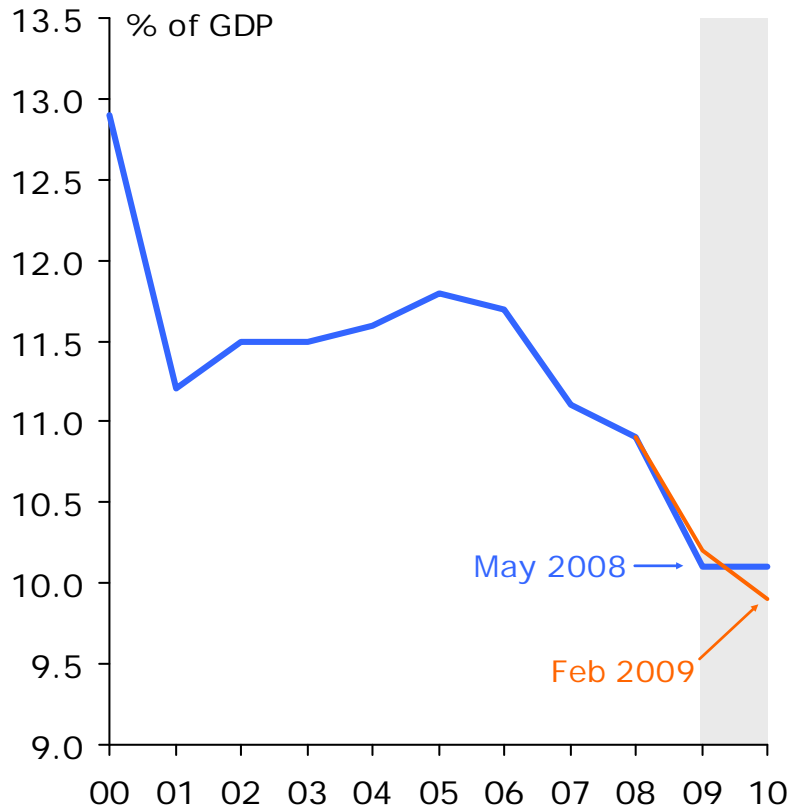
Note: 'Parameter variations' are changes in the cash balance due to changes in economic and other forecasts or assumptions.
 Source: Mid-Year Economic & Fiscal Outlook (November 2008); Updated Economic & Fiscal Outlook (February 2009); ANZ.



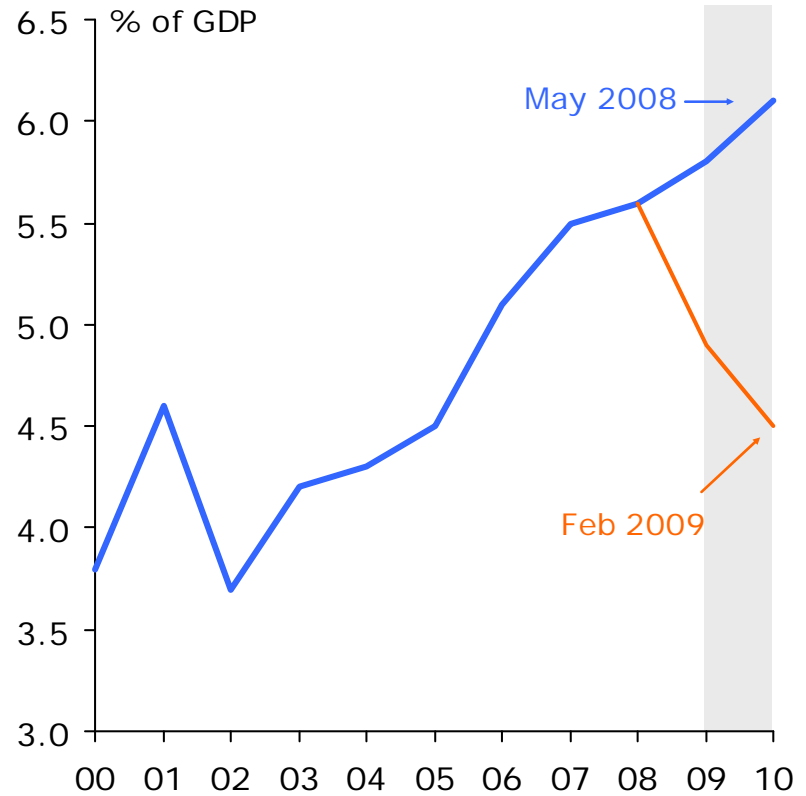
The previous government's redistribution of income from businesses to households was not sustainable

Individual and company income tax as a % of GDP

Individuals



Companies

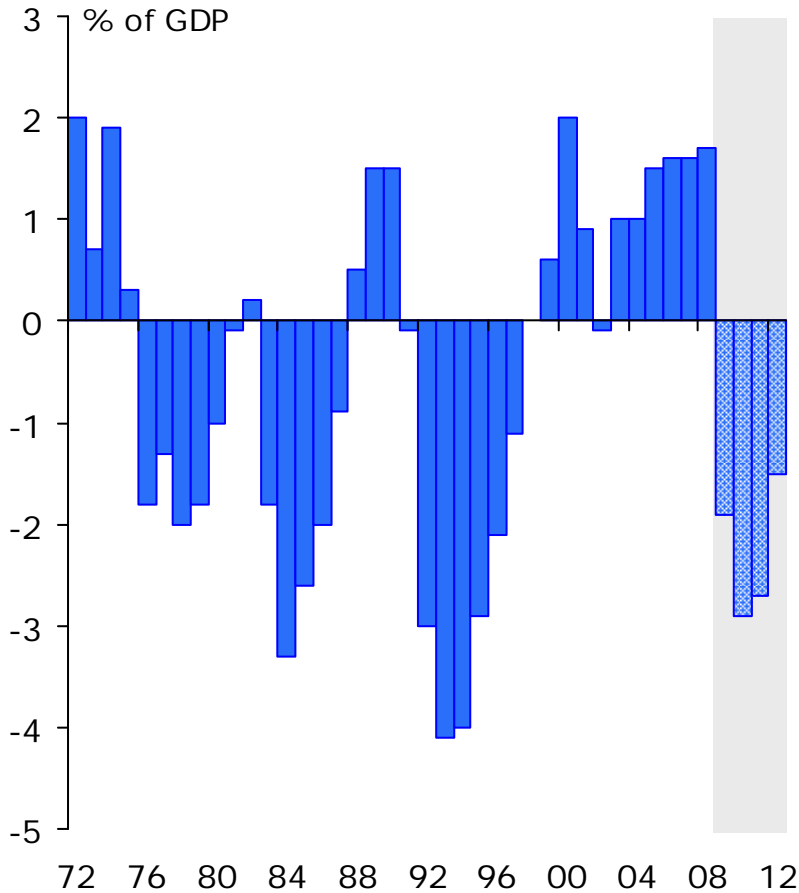


Sources: 2008-09 Budget Paper No. 1 (May 2008); Updated Economic & Fiscal Outlook (February 2009)

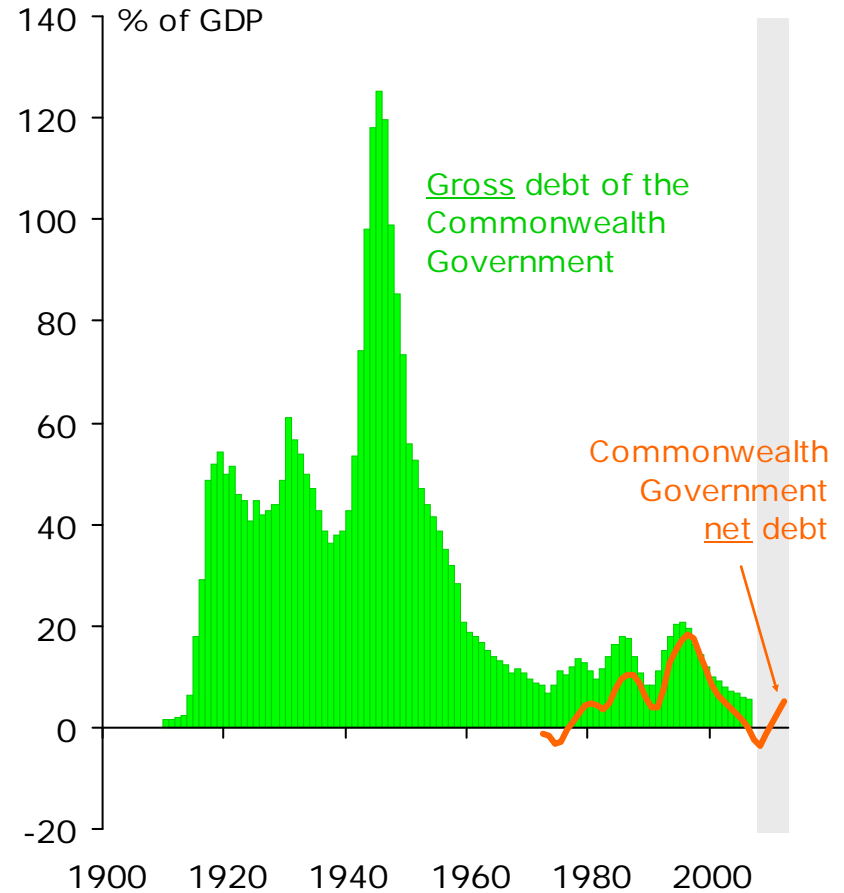


Though the government will again be a borrower, public debt will remain very low by historical standards

Australian government cash balance



Australian government net debt

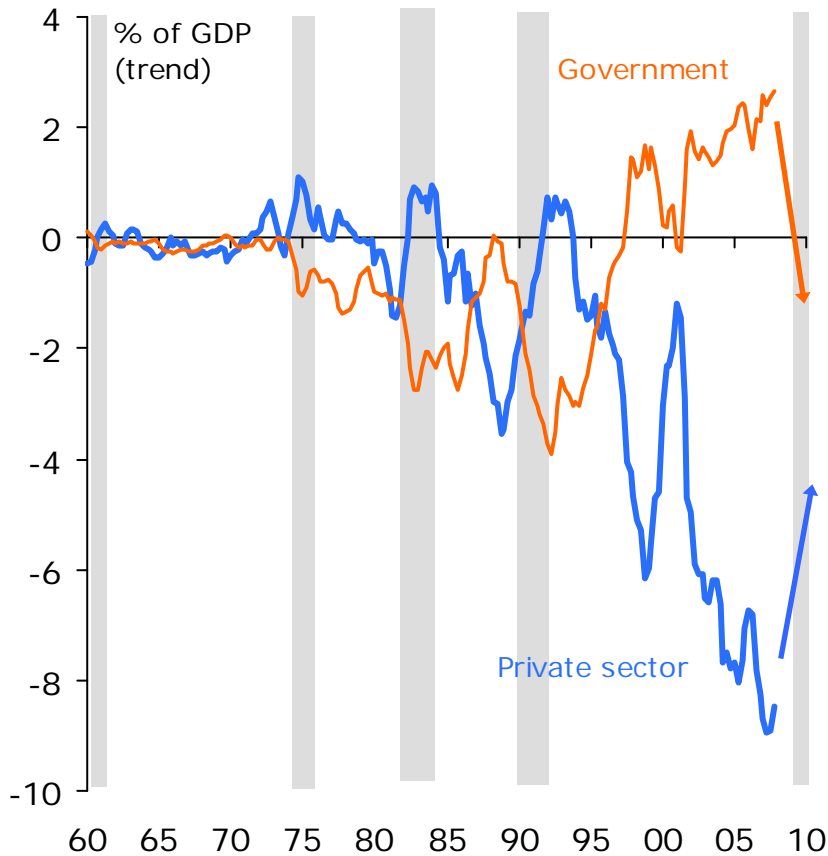


Sources: Mid-Year Economic & Fiscal Outlook (November 2008); Updated Economic & Fiscal Outlook (February 2009); Alan Barnard, 'Government Finance' in Wray Vamplew (ed.), *Australians: Historical Statistics* (1988); RBA, *Statistical Bulletin* (Table E10).

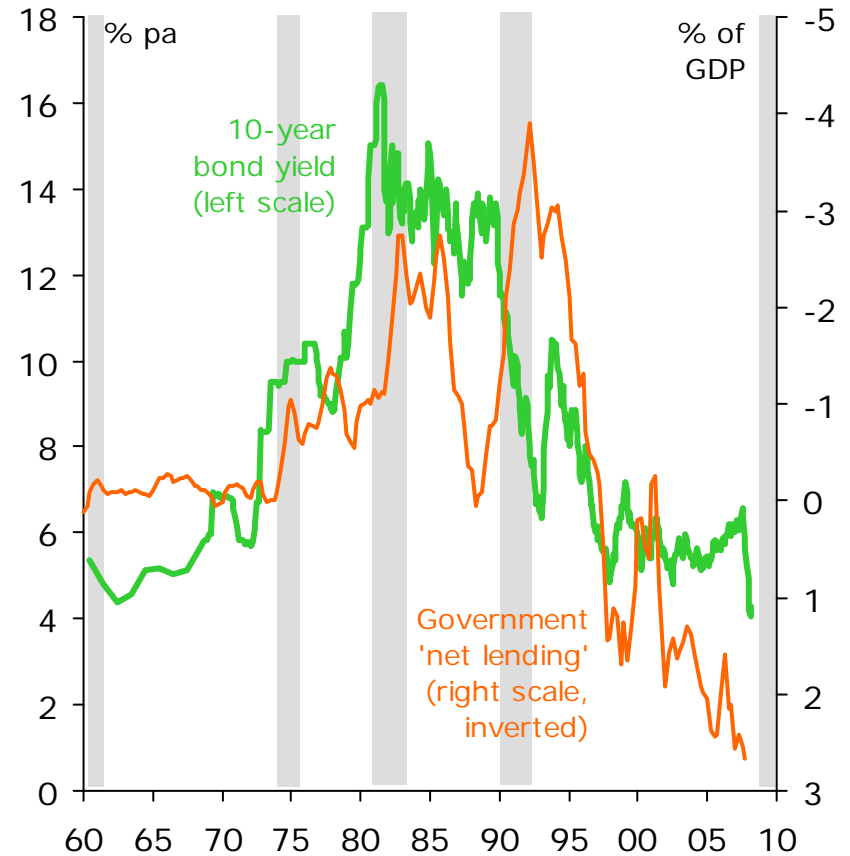


Interest rates invariably fall in recessions despite the Budget being in deficit

Private and government sector net lending



Government budget deficits and long-term bond yields

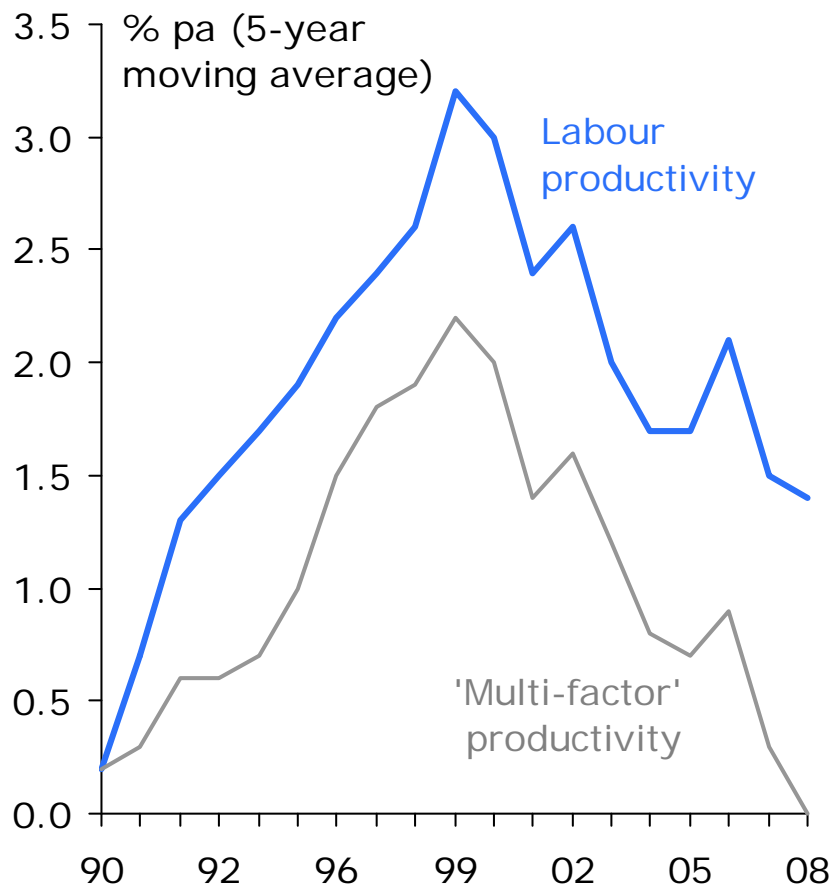


Note: 'Net lending' is gross saving minus gross investment. Shaded areas denote recessions. Sources: ABS; RBA; ANZ

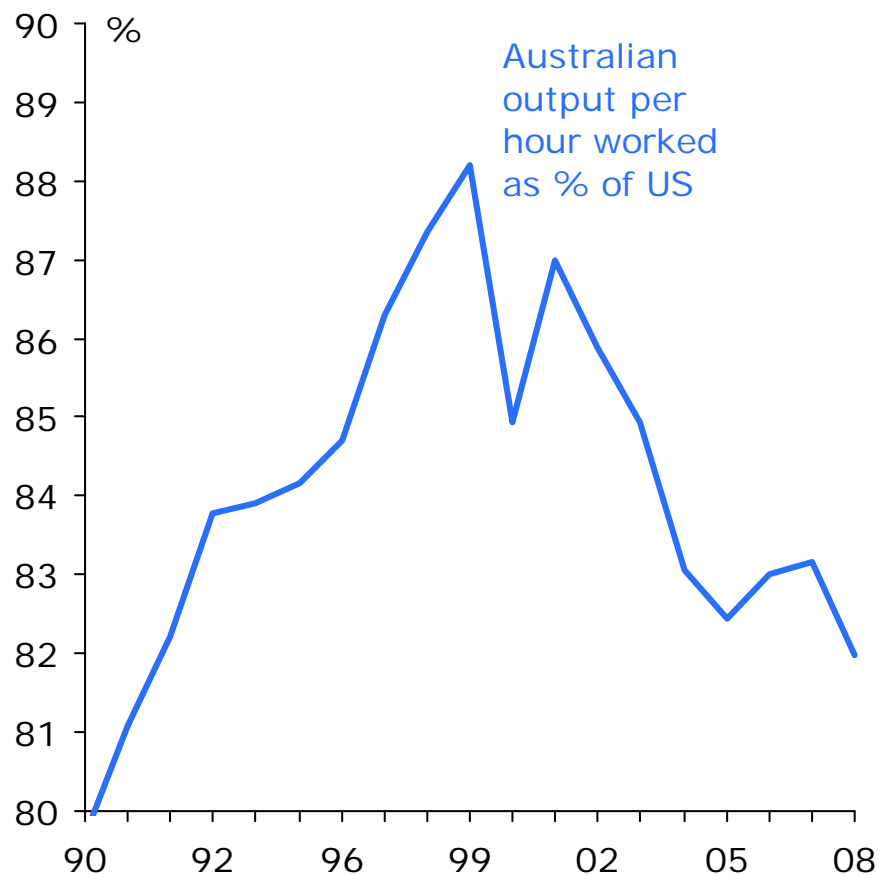


The end of the boom leaves exposed Australia's dismal productivity performance during the past decade

Productivity growth rates



Australian labour productivity relative to US



Note: productivity growth rates are adjusted (by ABS) for changes in labour quality.

Sources: ABS; The Conference Board and Groningen Growth & Development Centre *Total Economy Database* (January 2009); ANZ.



- The world is experiencing its most serious financial crisis since the 1930s, and (possibly) the worst economic downturn since then ...
- There's no way that Australia can avoid being affected by these developments
 - Australia will be affected through its reliance on overseas borrowings, its exposure to lower commodity prices, weaker demand for non-commodity exports, the impact on households and businesses of sharply lower share prices and (more generally) heightened uncertainty and diminished confidence
- Australia does however have some advantages in confronting the global situation
 - a more robust banking system and resilient housing market
 - more effective monetary and fiscal policy
 - beneficial effects (in these circumstances) of the decline in the A\$
- Australia will experience a recession (on most definitions of that term) during 2009
 - although it won't be as severe as those in many other countries, and is unlikely to be as bad as those of the early 1980s or early 1990s
- However there will be no quick return to the pre-crisis boom conditions
 - the global crisis has exposed Australia's reliance on commodity revenues, and our poor productivity performance since the end of the 1990s



- Strengthen the balance sheet
 - if possible, retain earnings within the business or raise new equity to pay down debt
- Manage the profile of debt maturities
 - avoid having a concentration of debt maturing or 'rolling over' at any particular point in time
 - lengthen the maturity of liabilities where prudent and possible
 - consider 'locking in' historically low interest rates in coming months
- Keep a very close eye on cash flow and 'working capital'
 - pay special attention to inventories and debtors, and act promptly to correct any unanticipated 'blow-outs'
 - consider arranging stand-by facilities (although these have a cost)
- Manage exchange rate exposures conservatively
 - don't let a sound business be undermined by large movements in exchange rates
- Try to retain skilled and experienced employees
 - they may be hard to get back when the business cycle eventually turns
- Look out for opportunities to acquire assets or business from 'distressed sellers'
 - other businesses which have ignored some of the above advice will be forced by financial pressures to liquidate useful assets and viable businesses at attractive prices

