Retired Officers' Club

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Speech Notes

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I'm delighted to be here talking to fellow bankers and fellow ex-Westpac-ians about what is an unprecedented time not only in the financial services industry, but in the global economy.

I am proud of my 30 + years with Westpac (M106656) spending that long with the one company I can't help but closely follow its progress. And this isn't just from a "keeping an eye on my competitors" view either – after all, I still bank in the Private Bank, and I have a keen interest in the share price too!

I owe my career and my current role to the development and opportunities I was given at Bank NSW/Westpac and I have many fond - and many funny – memories, ranging from being a young expat in London, to learning how to chase bad debts in China, to doing all-nighters working on presentations for David Morgan.

But perhaps they're stories we can chat about afterwards – it's much more topical to talk about what's going on in the financial world.

I know that you all truly understand when I say that the past twelve months have been unlike any in my career. We have seen major international banks collapse, government bail-out packages, and economy after economy slide towards recession.

Two weeks ago we saw the US announce a package to offload toxic debt to the private sector and get the banks, and the entire financial system, off life support.

And while the idea behind the package and the whole ‘bad bank’ idea is worth discussing, what’s even more interesting is how we got to this situation in the first place.

Like many others, I don’t believe the Global Financial Crisis was the result of one specific incident, or issue. It was a combination of factors that created a snowball effect in terms of the American economy, and then like a particularly nasty virus, its impact spread quickly to all of the economies America has dealt with. Which is to say, almost every economy in the world.

As economic commentator Ian Verrender said recently, “globalisation - the very thing that boosted our wealth - and the rapid development in transport and communications technologies that brought us closer together and connected us in ways few of us still do not completely comprehend, has had some unintended consequences. It has resulted in the very first co-ordinated global recession. We are all now marching in sync. For the first time, geographic spread has not decreased risk.”

So what were the initial snow drifts that started the financial crisis that so quickly spread globally?

One of the underlying factors was people leveraging themselves to the hilt as they tried to amass wealth at the height of the stock market boom. Some refer to this as greed!

Another factor was the watering down of risk procedures and lending standards as companies became complacent in the wake of an extended boom period.

And on the issue of risk, innovation in the financial sector grew at such a rate that financial institutions and regulators were unable to understand, let alone manage, the level of risk being taken on.

As US Treasury Secretary Tim Geithner said, when announcing his plan for bad bank assets:
"As a nation we borrowed too much and let our financial system take on irresponsible levels of risk. Those decisions have caused enormous suffering, and much of the damage has fallen on ordinary Americans and small-business owners who were careful and responsible."

As I'm sure he realizes it's not just the ordinary Americans who were careful and responsible who have been disadvantaged. It is also ordinary Brits, Italians, Japanese, Chinese, and Australians, among others!

As I mentioned earlier, it's the globalisation that created the global economy that helped us in the boom times, which has now helped spread the side effects of this crisis throughout the world faster than anyone expected.

And the results have certainly been far-reaching and widespread. Massive financial powerhouses including Merrill Lynch, RBS, AIG, HBOS, Bear Sterns, and Lehmans, among many others, have either failed or required bailing out. And economies around the world are slipping further and further towards recession, if they're not already there.

We now have a whole new range of issues to consider on a global scale.

With governments around the world introducing stimulus packages to help drive growth in their economies, will we see an increase in protectionism?

I'm sure we all saw the jokes about how the Australian government's stimulus package should be spent on VB and Bonds t-shirts – though actually that won't help us anymore - but protectionism is no laughing matter.

In the same way we are seeing a tension between a government encouraging Australians to spend and financial advisers encouraging them to save, the same tension exists in the global marketplace.

While it may seem a great idea to buy local, if every citizen of every country did so, it would actually be disastrous for the global economy and for our collective ability to drag ourselves out of this economic crisis. The paradox of protectionism, to coin a new phrase.

I don't believe that it a burning issue, but I mentioned it because it is a subject no economists or business pundits were even thinking about twelve months ago, yet I have already seen more than a few columns about this exact issue - yet another indication that truly we are living in unprecedented times.

Globalisation helped get us in to this mess, and we need globalisation to help get us out.

But how will Australia get through this crisis and what is the impact on our banking system, and our broader economy?

The good news is that, as you well know, the Australian banking system is far more stable than our overseas counterparts. And this comes down to a number of factors.

Firstly our regulatory framework has proven to be one of the most effective in the world. We are far more conservative in our approach to risk than many of our US counterparts.

We also tie the re-payment of mortgages to the borrower, not just the house, which meant we didn't see the 'jingle mail' that happened in the US where home-owners simply mailed their house keys to the bank when they couldn't keep up with the mortgage – or burnt their houses down rather than hand them over to the banks.

And we didn’t undertake the kind of sub prime housing lending that was one of the initial landslides in the earthquake that became the GFC.

The conversion of mortgage securities from huge, illiquid assets owned by local banks into liquid financial instruments that could be sold across the world combined sophisticated U.S. financial services dangerously with relatively unsophisticated financial services elsewhere.

The sub prime lending and the ‘jingle mail’ phenomenon, combined with an excess supply of housing, were a toxic combination that set the credit crunch in motion.

And I’m delighted to say we don’t have these three factors here.

Essentially, we are in a much better place than the banking systems off-shore.

But it’s obvious that the Australian banking industry has been impacted by the GFC.

I believe we have seen three key issues for banks as a result from the crisis: the higher cost of debt, a slow-down in lending and the potential for credit rationing.

The higher cost of debt has been one of the most significant issues for the banking sector, and has had far-reaching impacts for both customers and shareholders.

This time last year banks were increasing interest rates outside of the RBA movements; one year on, and banks are passing on most, but not all, of RBA rate cuts. The direction has changed but the need to pass on some of the additional funding costs to customers has not.

We have also definitely seen a slow-down in lending, and the potential for credit rationing, while not yet realised, certainly remains as a threat.

However I would like to point out that the slowdown in lending is not all because the banks have stopped lending, as some parts of the popular media and some politicians would have us believe. Yes, banks are charging more for risk, because as we all know – for good reason – risk has been repriced forever.

Banks are also ensuring that their lending criteria adequately reflects risk – but we have not stopped lending.

Another major impact of the crisis is consolidation across the banking sector.

A quick scan will show that, where a couple of years ago we had a relatively healthy second tier banking structure who helped maintain competition across the banking system and offered a variety of alternatives to consumers not wanting to bank with the big four, we now have a regional bank structure of just three.

And we have almost constant speculation that all three are about to be bought out or taken over.

Our former employer bought St George to take out NAB's position as Australia's largest bank. And CBA bought BankWest, making it second in line.

So we now have two big elephants in Sydney, and two smaller but still huge elephants in Melbourne.

But more important than what has been created is what has been lost, and that is two regional banks (or rather one super-regional and one regional), and some of the competition in Australian banking services.

For my money I don't believe the current Federal Government is all that worried about that prospect.

I've had a dig at the Government for this particular issue a few times lately, and I'm going to do it again today.

Because in a marketplace where the funding costs are higher for regional banks than for the four majors, I can't see how it makes sense for the government to charge regional banks more for their wholesale funding guarantee. And that is exactly what they're doing.

I can't see how it can be anything other than anti-competitive to sting the regional banks more for the funding guarantee when they are already paying more for their funding. It has created a very uneven playing field, making it difficult for regional banks like BOQ to build shareholder value and at the same time remain a competitive alternative in the marketplace.

In a recent speech about the future of Australian banking, David Morgan indicated that any stand alone financial institution with a credit rating much below AA will, at best, struggle to obtain funding on a cost competitive basis with the Australian majors.

And he's right.

What he also mentions is that the second tier of financial institutions in Australia is fast-disappearing, rapidly becoming an extinct species.

What he doesn’t mention is that this doesn’t seem to bother the Federal Government.

To my way of thinking the last issue on the Government’s agenda is competition in the Australian banking system. They want stability for the ‘big four’ and in my view don’t really care if the rest of the banking players disappear.

From my perspective the Federal Government’s interventions on that Sunday in October last year were both timely and necessary and potentially avoided a major financial crisis here in Australia. However the initiatives also had the effect of distorting our competitive banking system, particularly in the area of wholesale funding. I think now is the time to reassess some of these initiatives in order to remove the distortions created.

Anyway, let me get back to the Big Four.

A number of economists and business commentators have suggested that the Big Four will actually prosper from the banking crisis, as a result of reduced competition, increased market share and enhanced pricing power.

I agree with these suggestions.

Look at the foreign players in our marketplace. Most have either packed their bags and gone home or significantly downsized their scope of activities in Australia. Non bank lenders such as Wizard and Rams have either disappeared or been taken over. Even “we’ll save you John” has taken refuge in the bosom of one of the Big Four.

In fact, I don’t see how the Big Four can anything but benefit from the situation we are currently in. And I’m confident they believe it is only a matter of time before the name Bank of Queensland ceases to exist in Australian banking.

So let me assure you that it is my very clear intention to ensure that doesn't happen.

It is my intention to ensure that BOQ continues to be a real alternative to the 'big 4' in Australia.

We still want to be a 'big small bank', and not a 'small big bank'. We still want to offer Australian consumers, and shareholders, an alternative in banking.

But I'm sure you're not here to listen to me wax lyrical about BOQ.

However allow me to stay in sunny Queensland for a few minutes to talk about our recent election.

Anna Bligh's comfortable election win here just a few short weeks ago has dealt a blow to the theory that governments that lose their AAA credit rating are unlikely to get re-elected.

It seems Queenslanders believe that Anna and her team are doing an OK job with our economy and have got what it takes to turn things around.

It's no secret that I have been a supporter of Anna Bligh's, even adding my two cents worth as part of her job squad, but even so I will be interested to see whether her cabinet of fresh faces delivers on the pre-election day promises of job creation and a boost to the tourism industry, among other things.

The Queensland business community will be watching closely to see whether Anna and her team follow through on their pre-election day record of continuing to invest in vital infrastructure and other projects to keep the Queensland economy from sinking as low as the other states.

In a state which was, up to 18 months ago, growing at a blistering rate, with 70,000 new bodies crossing the border each week, we are now seeing headlines similar to those seen in NSW a few years ago.

I am not, of course, saying that is the fault of State Government; what I am saying is that how they handle this situation will be closely watched by all Queenslanders, and may even be what they are remembered for in years to come.

I sincerely hope they do the job well, because despite my southern origins I have a great affection for Queensland and would love to see us take the lead among Australian states once again in terms of economic growth.

But rather than ending on a note of doom and gloom, I would like to take a minute to look at the lighter side of the crisis.

I recently was sent a list of new phrases that have been coined as a result of the GFC, and would like to share with you a few that took my fancy.

Brickor mortis

Or the stiffening of the housing corpse after death. We have the British to thank for this one. Brickor mortis aptly describes the current state of the housing market in the United States and Britain, and to some extent in Australia, where home owners are too scared to sell and buyers too scared to buy, leading to a property market frozen stiff.

Ninja loan

A Ninja has "No Income, No Job or Assets". These alarmingly lax lending criteria were applied by some unscrupulous lenders as America's debt-fuelled housing frenzy reached fever pitch.

Zombie bank

A half-dead creature that lives off taxpayer handouts. A zombie bank is one whose liabilities exceed its assets. The term was first coined in the late 1980s and 1990s to describe the situation in Japan when the bursting of dual real estate and sharemarket bubbles wreaked havoc with its banking system. The Japanese government continued to pump money into its banks to try to bring them back to life, but these attempts are often cited as being partly responsible for producing Japan's "lost decade" in the 1990s. Instead of being left to suck the lifeblood out of the financial system, some argue that zombie banks should just be shot in the head.

Well let me assure you we have no zombie banks here in Australia; in fact, we are in pretty good shape and are positioning ourselves to come out of this downturn swinging.

As I mentioned earlier, I think the big four will come out of this downturn stronger than ever, and there is a huge opportunity for regionals like BOQ to take a strong lead in the regional banking space.

We will definitely see more interesting times ahead as the fall-out continues from the GFC. I will be interested to see if people start to question the idea that a big, double or triple A rated bank is a safer bet than a small regional bank, which is conservative in nature and not exposed to high risk corporate lending.

Particularly given that it was all big, A rated American banks that so spectacularly collapsed last year and are now a part of history.

I will be interested to see if the government re-considers its position regarding the pricing of the guarantee, in order to shore up competition in the banking sector rather than helping diminish it.

And of course, I’ll be interested to see how Westpac fares under the hand of Gail Kelly throughout these unprecedented times.

As always, it has been a pleasure to come here today to talk to you.

Thank you.