Colonial First State Global Asset Management

The Global Policy Response –
The unprecedented becomes commonplace

Presentation to ASFA SA

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Agenda

1. The economic environment

2. Policy response globally

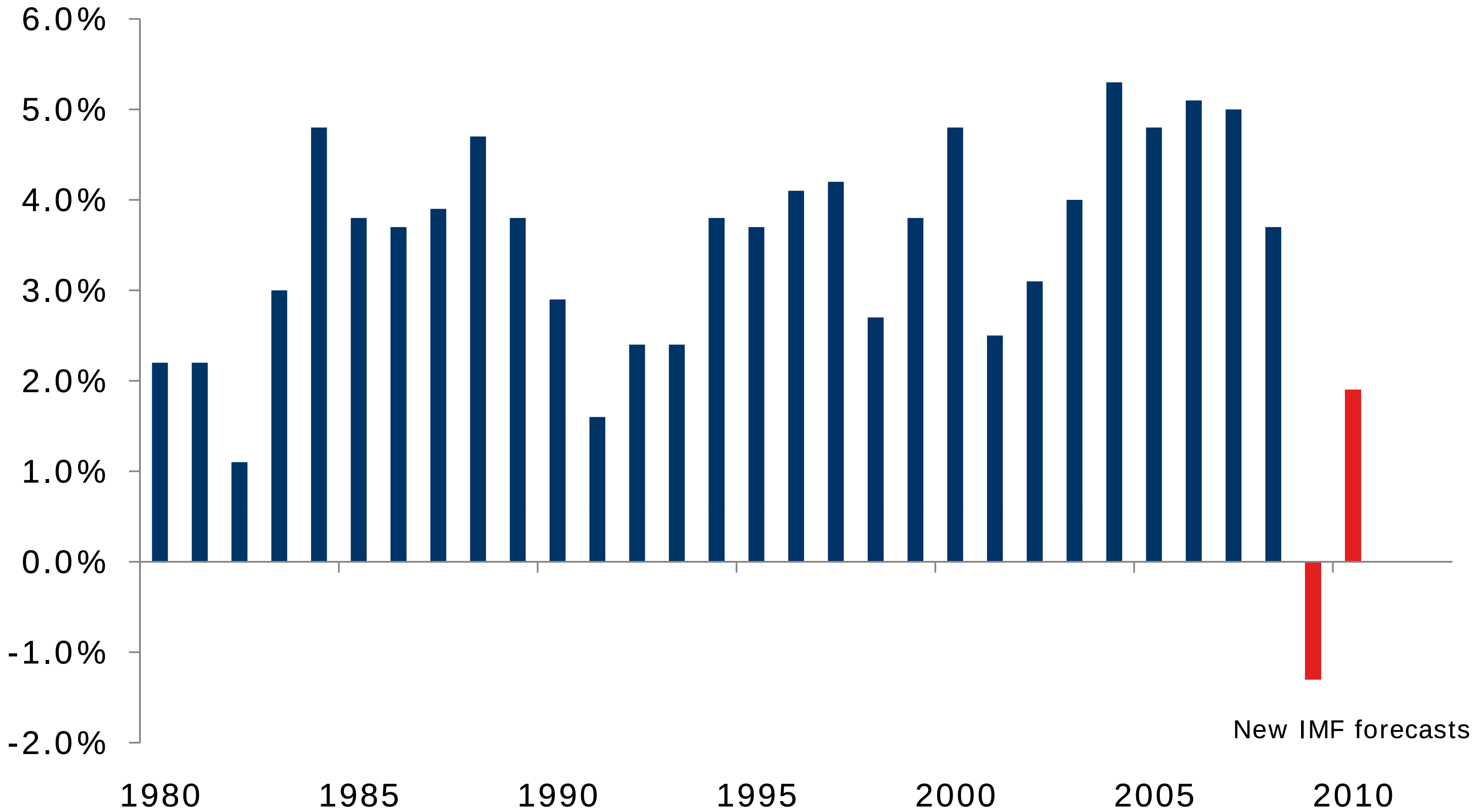
3. Policy response in Australia

The global economy – the bad news

- Stage 1: The Global Financial Crisis (GFC) – still a concern, but some signs of stability on government policies
- Stage 2: The great recession – in full swing
- Stage 3: Political and social implications – yet to really unfold
- IMF now expects 'growth' -1.3% in 2009 (the lowest since WWII) and just 1.9% in 2010. Advanced economies to 'grow' by -3.8% 2009 and 0% 2010. Emerging markets to grow by 1.6% 2009 and 4.0% 2010.
- Global slowdown is highly synchronized – all down together!
- Global trade has collapsed – this is a great concern

Source: IMF and Colonial First State Global Asset Management

Global economic recession



Source: IMF. World Economic Outlook April 2009

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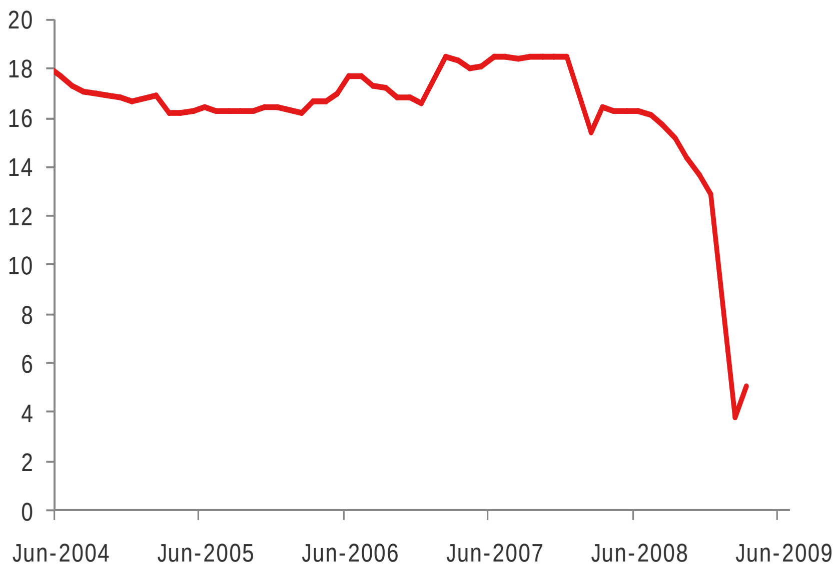
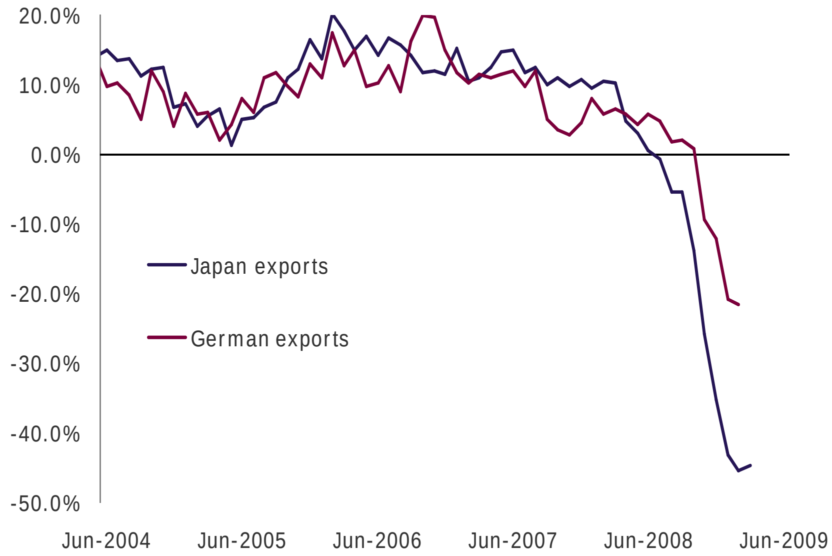
Impact is everywhere

Chinese industrial production, yoy%



Source: China value-added of industry YoY cumulative. Bloomberg. Data to 31 March 2009

German and Japan exports



Source: Bloomberg. Data to 28 February 2009 for Germany, 31 March 2009 for Japan

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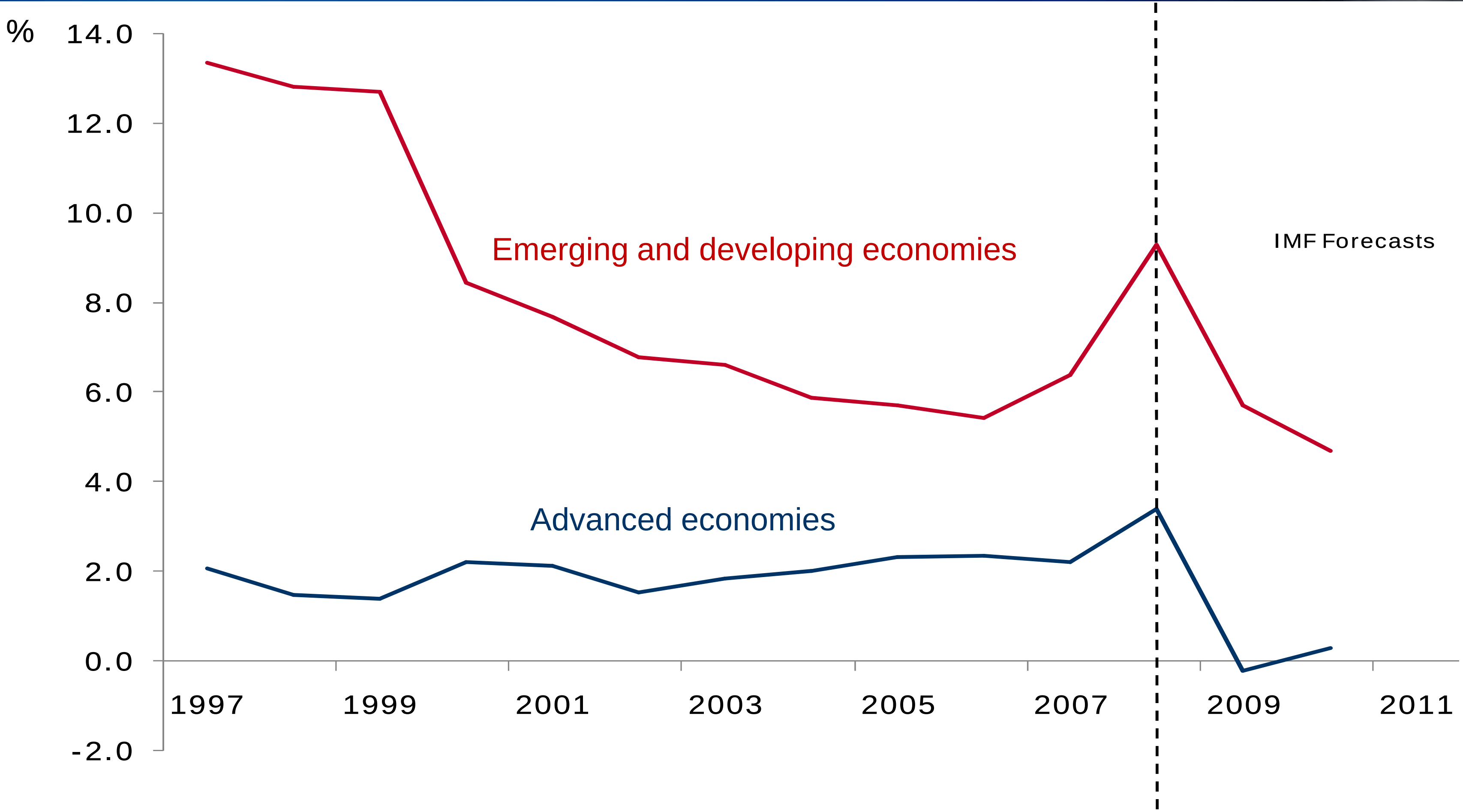
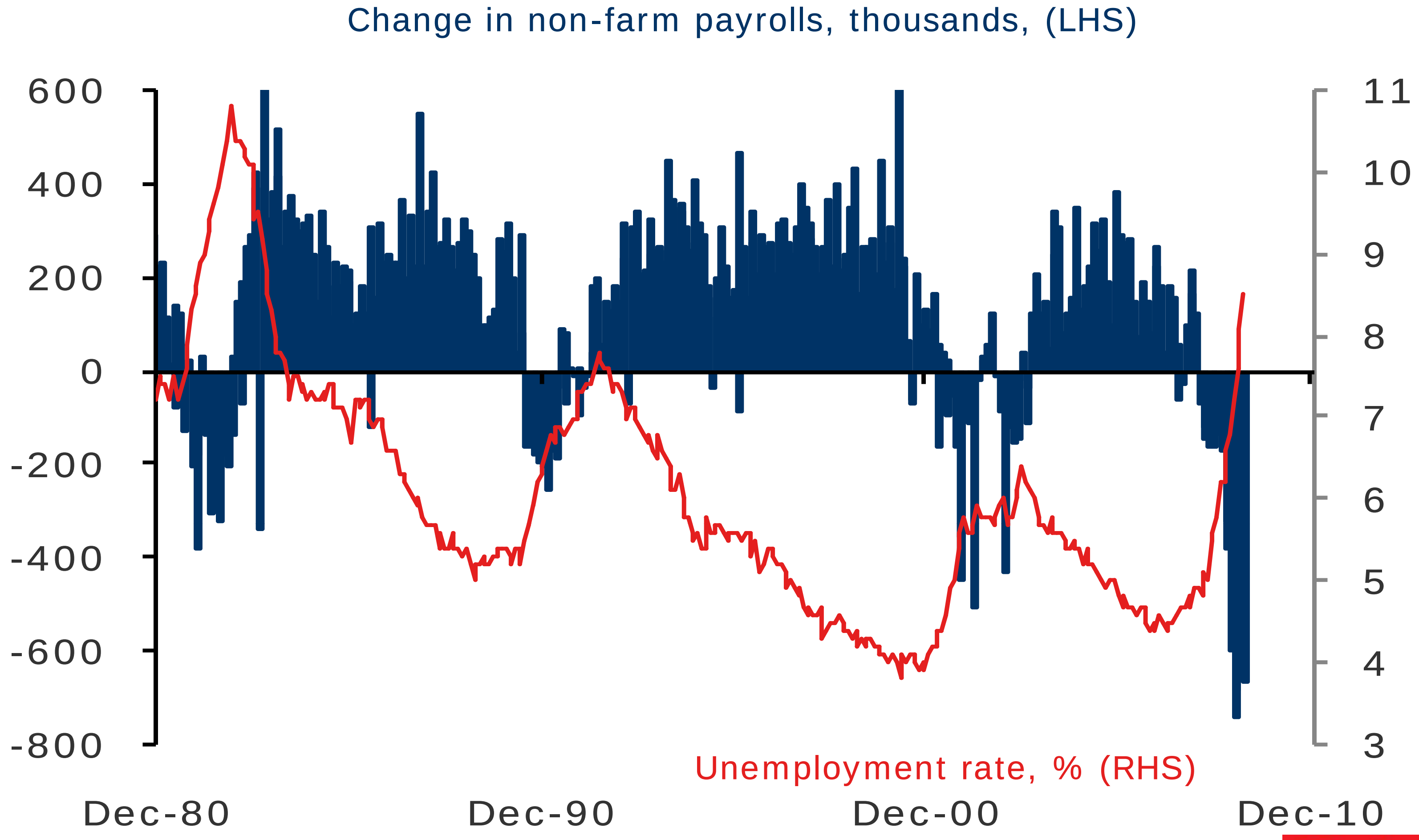
Global inflation falling



Source: IMF. World Economic Outlook April 2009

US labour market is weakening sharply



Source: US Bureau of Labor Statistics. 3 month moving average. Data to 31 March 2009

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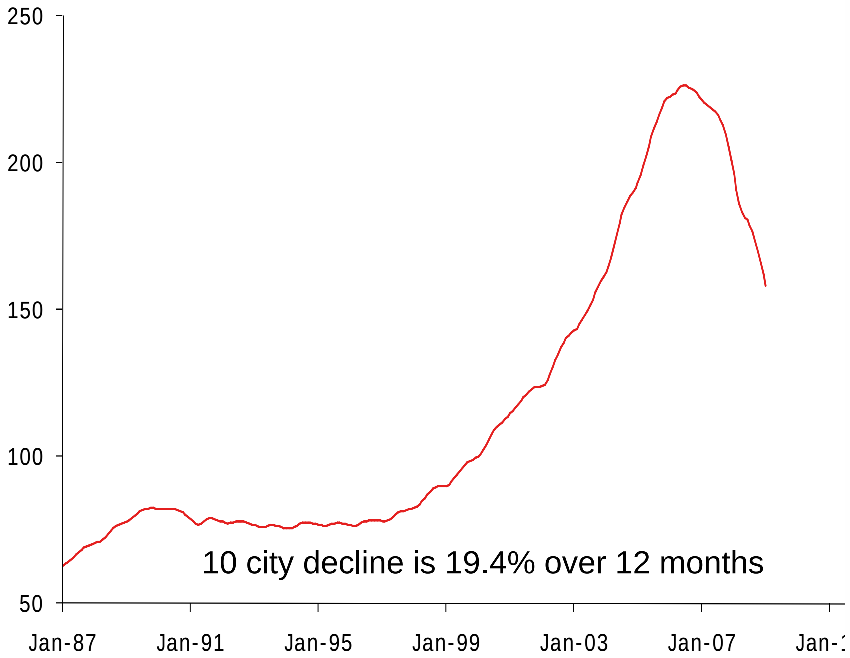
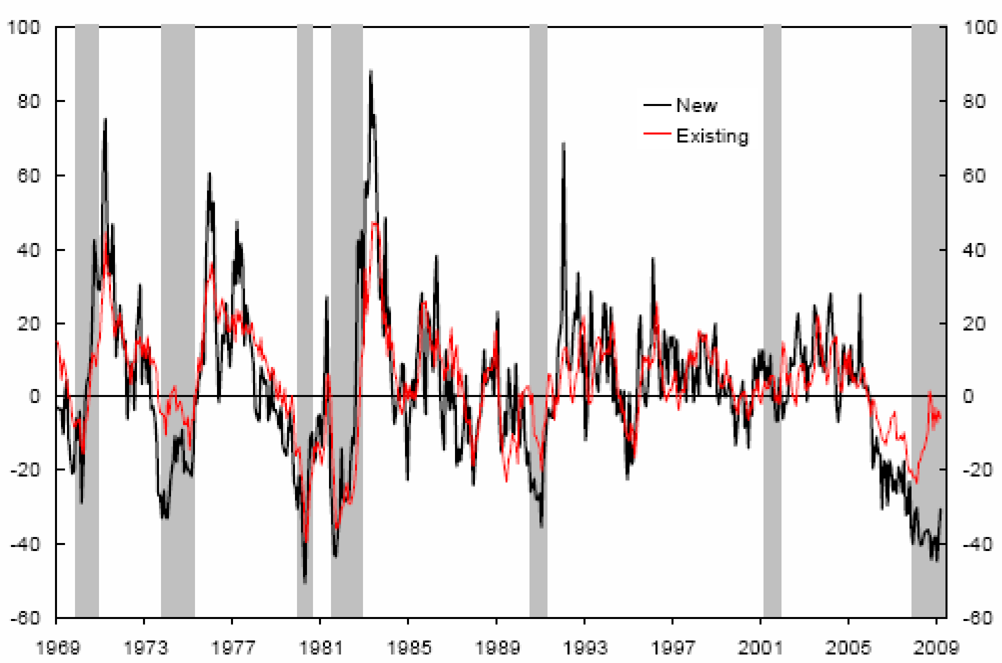
US housing market remains troubled

US house prices still falling



Source: S&P / Case-Shiller 10 City index, Bloomberg. Data to 31 January 2009

US new and existing home sales



Source: Census, NAR, NBER. Note, shaded areas show recessions

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The global policy response

- Policy response has been unprecedented
- Interest rates have been slashed
- Where interest rates have hit zero central banks have moved to Quantitative Easing (QE) - the US, UK and Japan...more to come
- Likely no more important institutions will be allowed to fail
- Intervention into the banking/financial system has been dramatic
- Public sector spending and debt is replacing private sector

Source: Colonial First State Global Asset Management

The global policy response – G20

- Market expectations for the G20 meeting in early April were relatively low – so markets were surprised with the strength and breadth of the outcome.
- G20 accounts for 90% of global GDP, 80% of world trade and 75% of the worlds population.
- Looks like G20 will become a key global body, not just in dealing with this crisis, but for the future.
- The obvious advantage over the G7 is that it includes China and other major economies and strategically important countries such as India, Brazil, Saudi Arabia, Korea, Indonesia (and Australia).

Source: Colonial First State Global Asset Management

The global policy response – G20

The financial commitment:

- Total spending increase of $US1.1tr
- IMF funding increased by $US500bn, to $US750bn
- IMF also allowed to sell some of its gold reserves to provide funds to the poorest nations
- Multilateral development banks funding increased by $US100bn
- $US250bn made available to help international trade finance
- Financial commitment designed to “help restore credit, growth and jobs in the world economy.”

Source: G20 communiqué

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The global policy response – G20

Focus on jobs and growth:

- Support for aggressive fiscal policy easing to “save or create millions of jobs which would otherwise have been destroyed”.
- To date this has included $US5tr than will raise global output by 4% (over a number of years).
- Support for continued aggressive easing of monetary policy.
- Where interest rates have hit zero, support for “unconventional” instruments”, ie. quantitative easing.
- Commitment to “take all necessary actions to restore the normal flow of credit through the financial system and ensure the soundness of systematically important institutions.”

Source: G20 communiqué

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Fiscal policy easing has been very large

	2009	2010
Argentina	1.3	
Australia	**2.1**	**1.7**
Brazil	0.4	0.2
Canada	1.5	1.3
China	**3.2**	**2.7**
France	0.7	0.7
Germany	1.5	2.0
India	0.6	-
Indonesia	1.3	0.6
Italy	0.2	0.1
Japan	1.4	0.4
Korea	2.3	1.3
Mexico	1.5	-
Russia	2.3	1.6
Saudi Arabia	3.3	3.5
South Africa	1.8	-0.6
UK	**1.4**	**-0.1**
US	**2.0**	**1.8**

Discretionary fiscal measures
- % GDP, relative to 2007

Source: IMF

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The global policy response – G20

- For those worried about longer-term impact of policy stimulus, the G20 stated that “we are resolved to ensure long-term fiscal sustainability and price stability and will put in place credible exit strategies.”
- G20 also agreed to “conduct policies cooperatively and responsible with regard to the impact on other countries and will refrain from competitive devaluations of our currencies.”

Source: G20 communiqué

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The global policy response – G20

Strengthening financial systems:

- Agreed to "much greater consistency and systematic cooperation … that a global financial system requires."
- "Regulators and supervisors must protect consumers and investors, support market discipline, avoid adverse impacts on other countries, reduce scope of regulatory arbitrage, support competition and dynamism, and keep pace with innovation."
- Agreed to establish the Financial Stability Board (FSB), to work with the IMF to reshape the regulatory system and take account of macro-prudential risks and to "extend oversight to all systematically important financial institutions, instruments and markets."

Source: G20 communiqué

The global policy response – G20

- The FSB will also "endorse and implement ... tough new principles on pay and compensation."
- In a nod to the future, "once recovery is assured (the FSB will) take action to improve the quality, quantity and international consistency of capital in the banking system ... to prevent excessive leverage and require buffers of resources to be built up in the good times."
- The FSB will also "take action against non-cooperative jurisdictions, including tax havens."
- Global Finance Ministers (including Swan) to meet again to drive FSB agenda.

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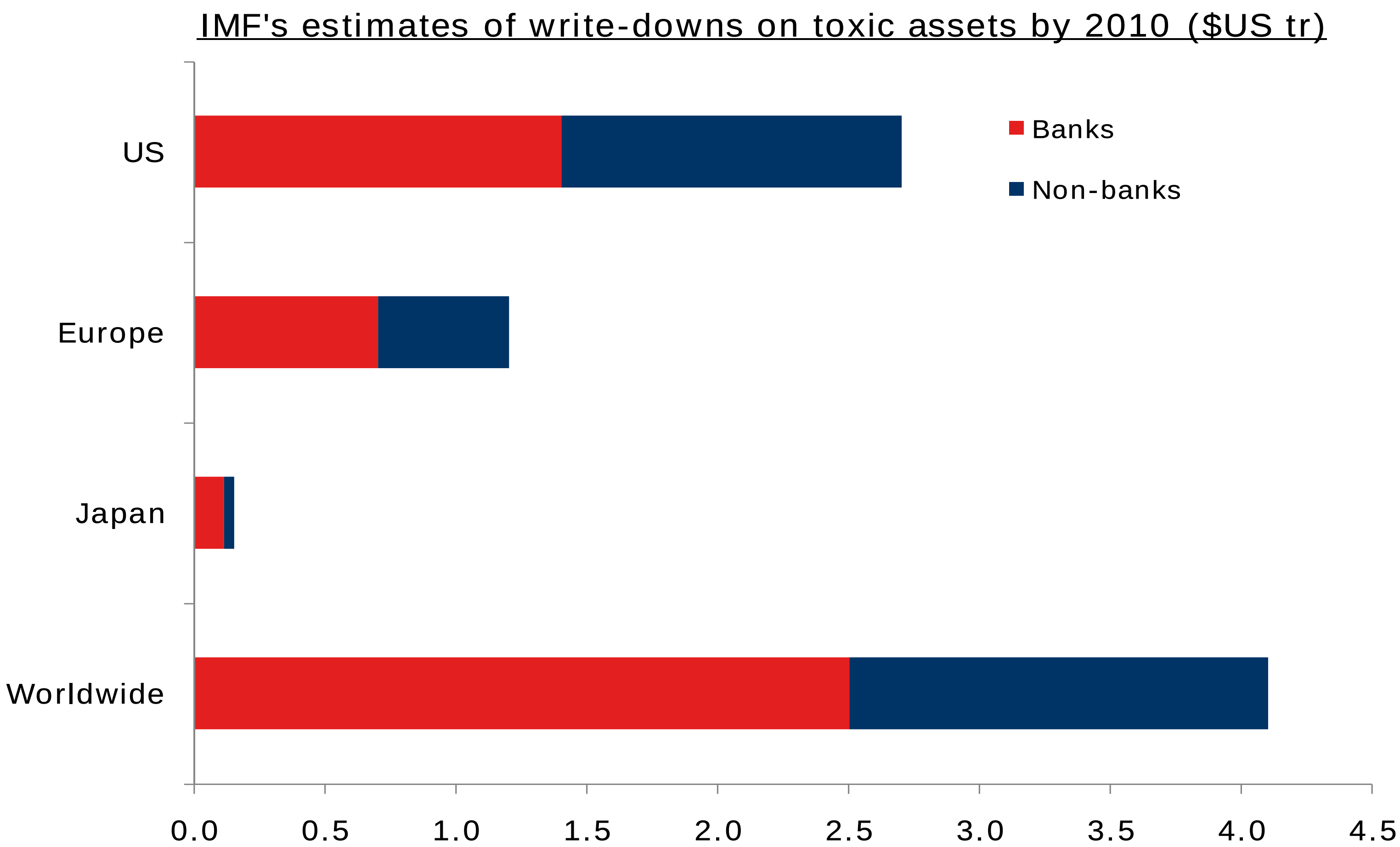
Source: G20 communiqué

Mounting losses in financial system



Source: IMF World Economic Outlook April 2009

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The global policy response – G20

Strengthening our global financial institutions:

- Agreement to increase funding to MDBs to ensure the GFC does not lead to a significant loss of capital flow to the developing and emerging economies.
- More significantly, G20 will reform the IMF and associated bodies, so that they reflect the current and prospective state of the global economy – not that which prevailed 50 years ago.

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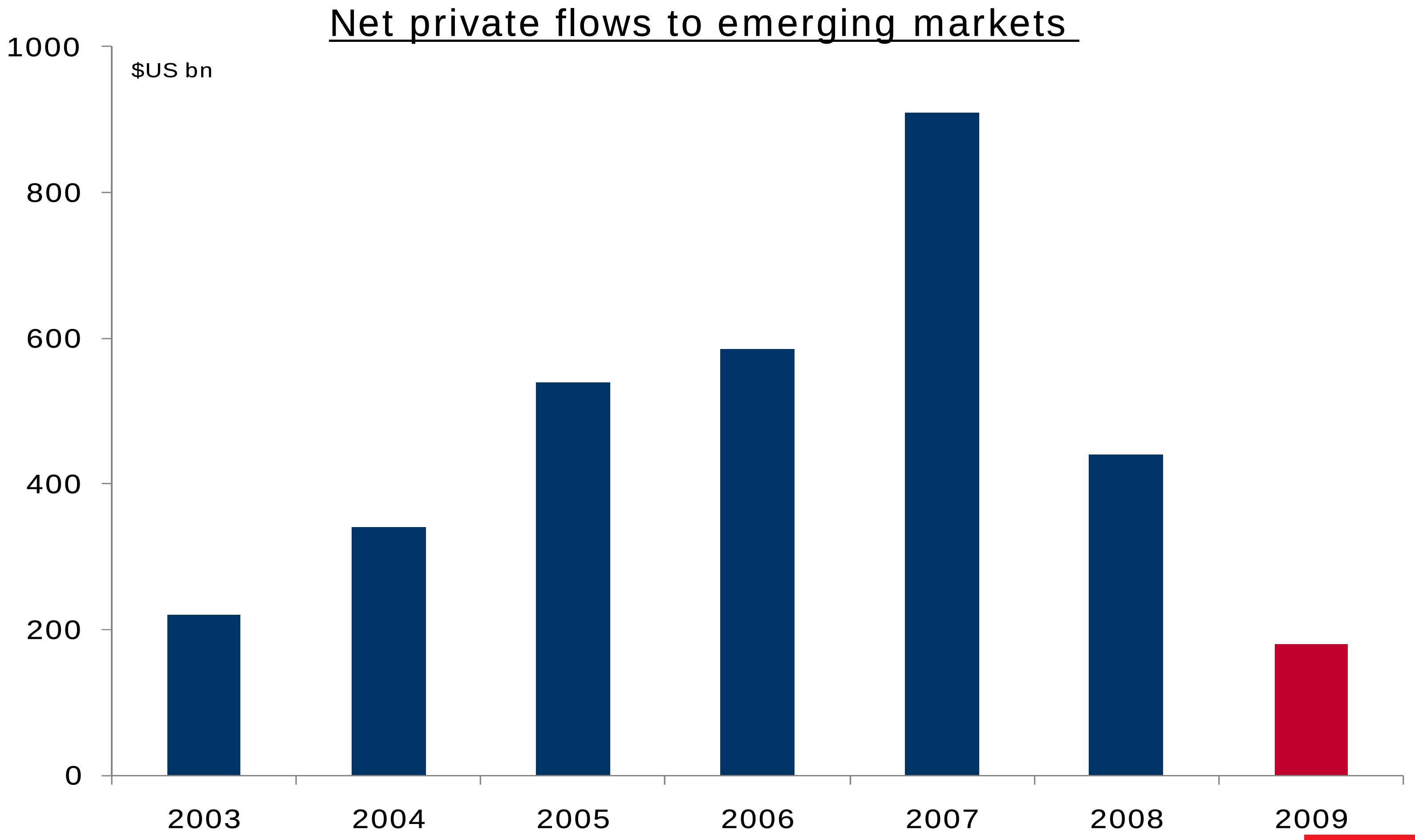
Source: G20 communiqué

Need to support emerging economies



Source: Institute for International Finance, AFR

The global policy response – G20

Resisting protectionism and promoting global trade:

- $US250bn committed to provide funding for global trade if the traditional sources of trade finance are not available.
- Leaders agreed that “reinvigorating world trade and investment is essential for restoring global growth.”
- Leaders agreed not to implement domestic policies that could harm the trading activities of other nations.
- WTO to play a role in this regard.

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Source: G20 communiqué

The global policy response – G20

Ensuring a fair recovery for all:

- A commitment to not leave the poorest of nations behind in the recovery process.
- Also commitment to using the policy response as an "opportunity" to promote a cleaner-greener world.

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Source: G20 communiqué

The global policy response – US

Interest rates slashed:

- The Federal Reserve cut the Fed Funds target rate from 5.0% in September 2007 to a 0%-0.25% range as at December 2008.
- Fed also stated that low interest rate environment will be maintained for “an extended period.”
- From March 2009 the Fed started “Quantitative Easing” – agreeing to buy an initial $US300bn in Treasury bonds.
- This is designed to lower interest rates across the yield curve and provide funds to the banking system.

Source: Colonial First State Global Asset Management

The global policy response – US

Fiscal policy eased:

- In February, President Obama signed the "American Recovery and Reinvestment Act". Total package is worth $US787bn and 5.5% of GDP, weighted to FY09 1.3% and FY10 2.7%.
- Some of the main features include roughly $US285bn in tax cuts for individuals and businesses, as well as additional spending for food stamps, aid to States, unemployment benefits, and health care subsidies for laid off workers.
- The Obama Administration expects the package should generate 3-4 million jobs by the end of 2010.

Source: UBS

The global policy response – US

Financial / banking system support … choose your acronym!

- TAF – Term Auction Facility. December 2007. Fixed amounts of term funding auctioned to banks against a wide range of collateral.
- TSLF – Term Securities Lending Facility. March 2008. Lends up to $US200bn Treasury securities for 28-day term against federal agency debt, federal agency MBS and non-agency AAA/Aaa MBS.
- PDCF – Primary Dealer Credit Facility. March 2008. Extends credit to primary dealers at primary dealer rate for a range of investment grade securities.

Source: US Federal Reserve

The global policy response – US (cont'd)

Financial / banking system support … choose your acronym!

- AMLF – Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility. September 2008. Fed extends loans to banks to finance purchase of high-quality asset-backed commercial paper from money market mutual funds.
- TARP – Troubled Asset Rescue Plan. October 2008. $US700bn made available to Treasury to purchase "troubled assets" from banking system.
- CPFF – Commercial Paper Funding Facility. October 2008. Fed provides a liquidity backstop to US issuers of commercial paper.

Source: US Federal Reserve

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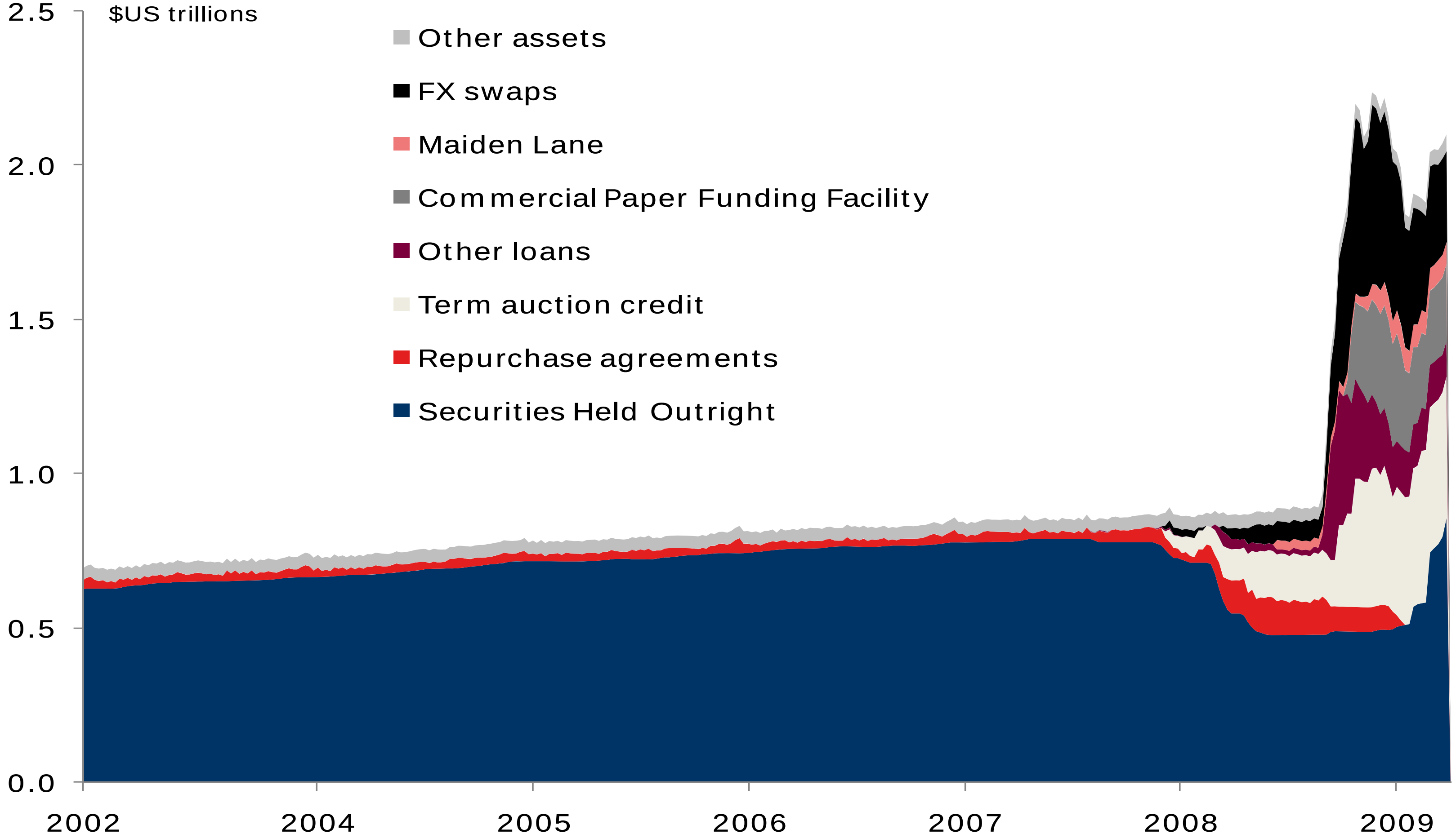
The global policy response – US (cont'd)

Financial / banking system support … chose your acronym!

- TALF – Term Asset-Backed Securities Lending Facility. November 2008. Fed to lend $US200bn to holders of AAA-rated asset-backed securities and recently originated consumer and small business loans.
- PPIP – Public-Private Investment Plan. March 2009. Designed to use public money to encourage private sector to purchase "legacy" assets and loans from the banks and low prices – to then allow banks to recapitalise.

Source: US Federal Reserve

Fed expanding balance sheet



Source: US Federal Reserve. Data to 15 April 2009

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The global policy response – US

Support to global systems (FX Swaps)

- US Fed extends USD swap lines to ECB and SNB (December 2007).
- Lines to ECB and SNB expanded (March 2008).
- Line to ECB expanded again (July 2008).
- USD swap lines extended to BoJ, BoE and BoC (18 Sept 2008).
- USD swap lines extended to RBA, Riskbank, DNB and Norges Bank (24 Sept 2008).
- Increase in swap lines to all of the above banks (29 Sept 2008).
- Further increase in swap lines to BoE, ECB, BoJ and SNB (April 2009).

Source: US Federal Reserve

The global policy response – US

Support to US banks and systemically important institutions

- Fed approves financing arrangement for JPM Chase to purchase Bear Sterns – March 2008.
- Fannie Mae and Freddie Mac put into "conservatorship" – 7 Sept 2008.
- Lehman Bros files for Chapter 11 bankruptcy – 15 Sept 2008.
- BoA announces intent to purchase Merrill Lynch – 15 Sept 2008.
- NY Fed lends $US85bn to AIG – 16 Sept 2008.
- SEC announces temporary ban on short-selling of financial stocks.
- Fed uses $US125bn of TARP money to purchase preferred stock in nine major US banks – 28 October 2008.

Source: US Federal Reserve

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The global policy response – US

Support to US banks and systemically important institutions

- Ford, Chrysler and GM request TARP money – 18 Nov 2008
- Treasury, Fed and FDIC announce deal to support Citigroup with package of guarantees, capital and liquidity access – 23 Nov 2008
- Treasury authorises TARP money to GM and Chrysler – 19 Dec 2008
- Treasury and Fed announces a package of guarantees, liquidity access and capital for BoA – 16 January 2009
- Treasury Secretary announces Financial Stability Plan, involving purchase of convertible preferred stock in banks – 10 Feb 2009
- Fed and Treasury announce they will “stress test” US banks to determine extend of possible losses and capital needs - Feb 2009

Source: US Federal Reserve

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Australia – the bad news

- Global recession means recession here
- Rising unemployment
- Softer house prices
- Deleveraging
- Negative wealth effects
- Weaker commodity prices
- Corporate cost cutting
- Slowdown in business investment
- Profit downgrades
- Tight access to credit
- Project cancellation

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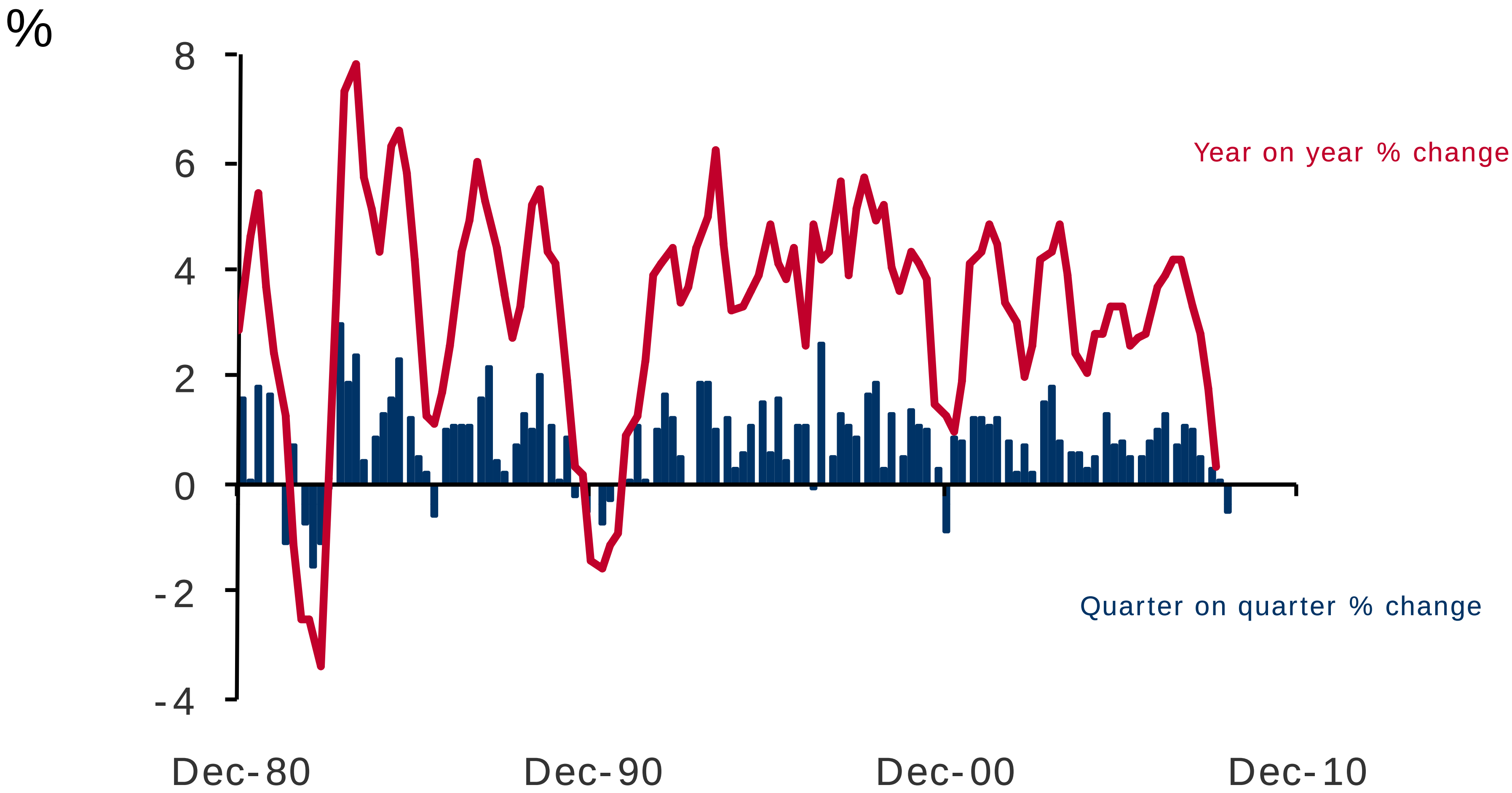
Source: Colonial First State Global Asset Management

Australian economic growth



Source: ABS. Data to 31 December 2008

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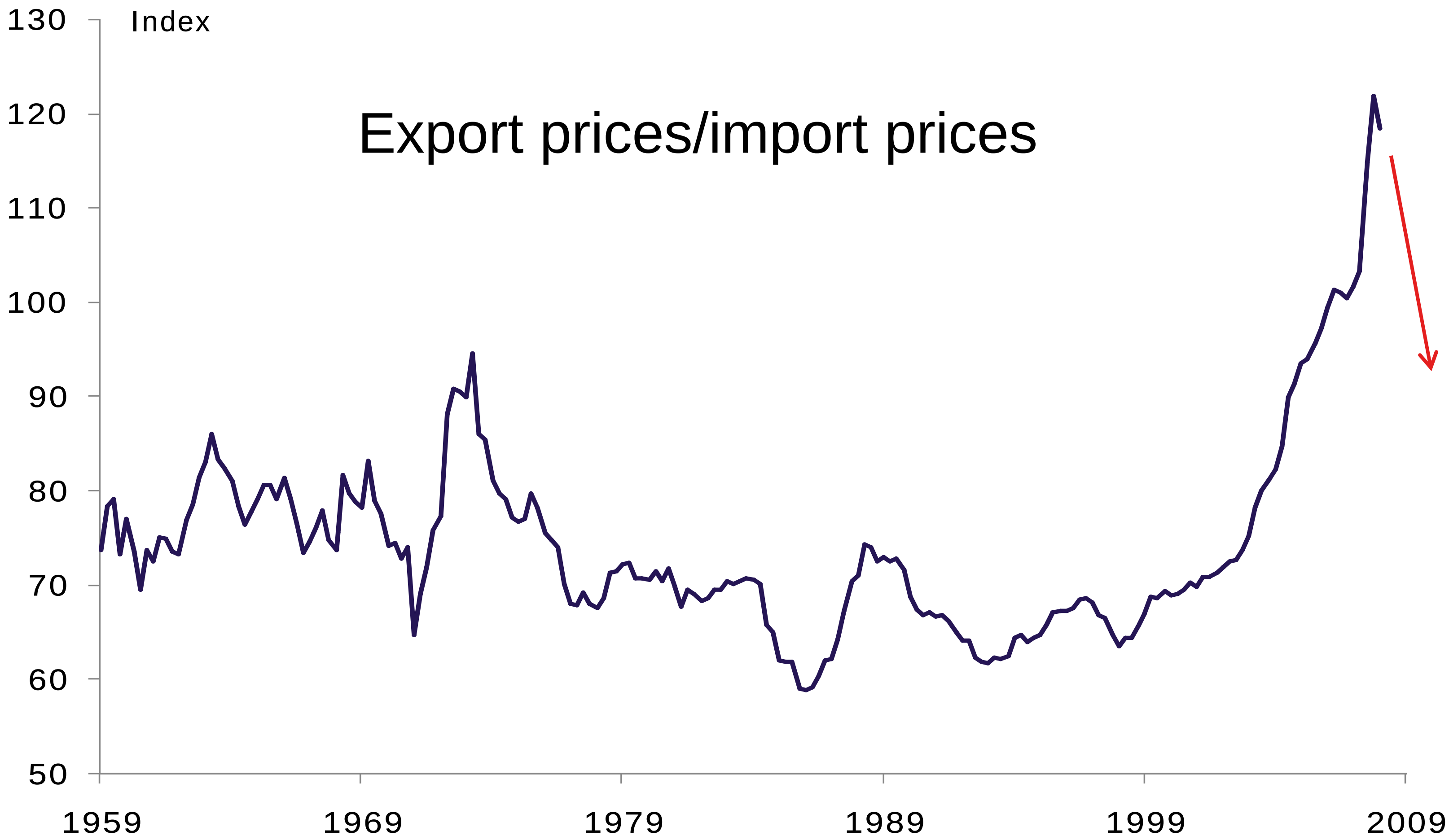
Australia: Terms of trade boom in reverse



Source: ABS. Data to 31 December 2008

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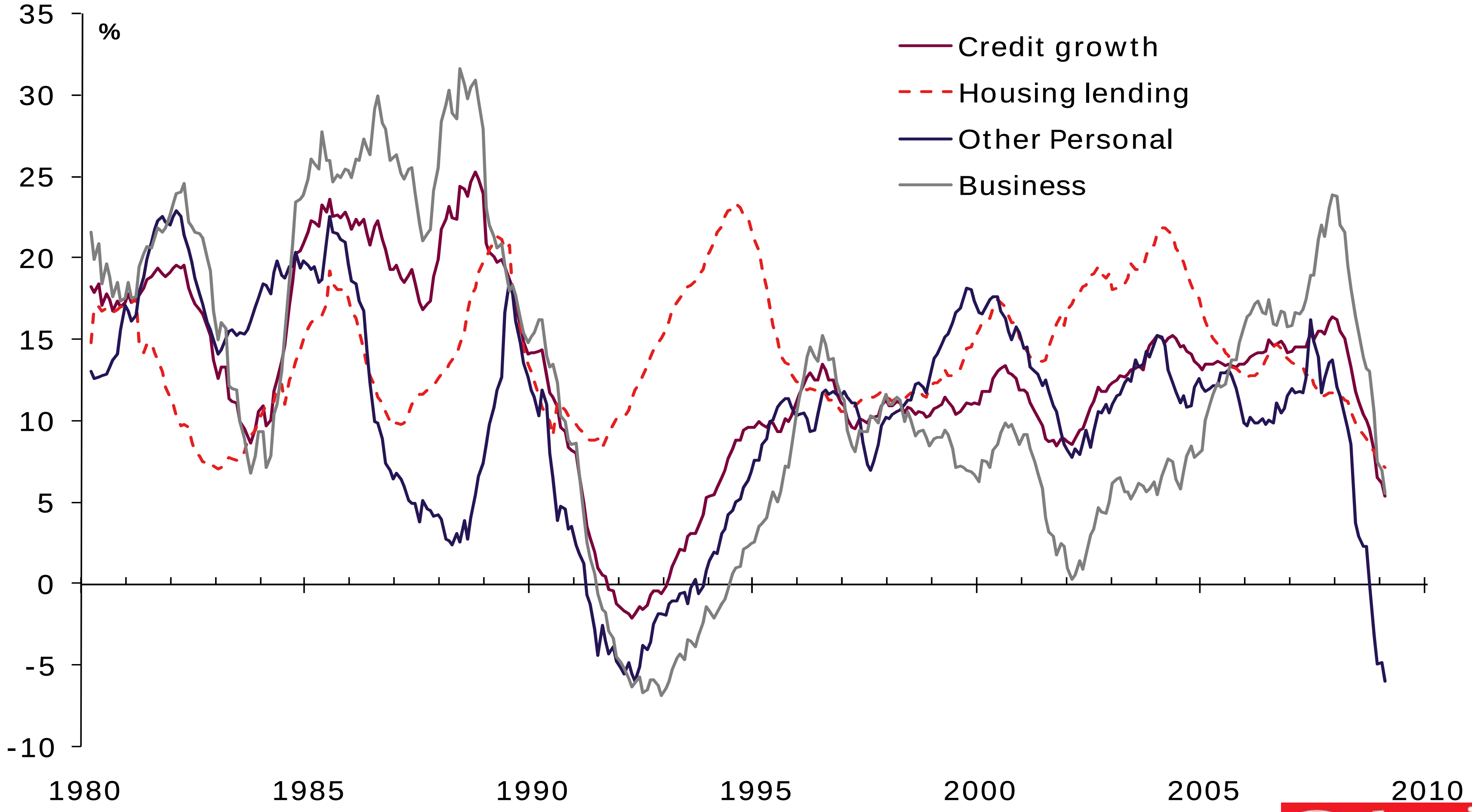
Australia: Credit growth slows sharply



Source: RBA. Data to 28 February 2009

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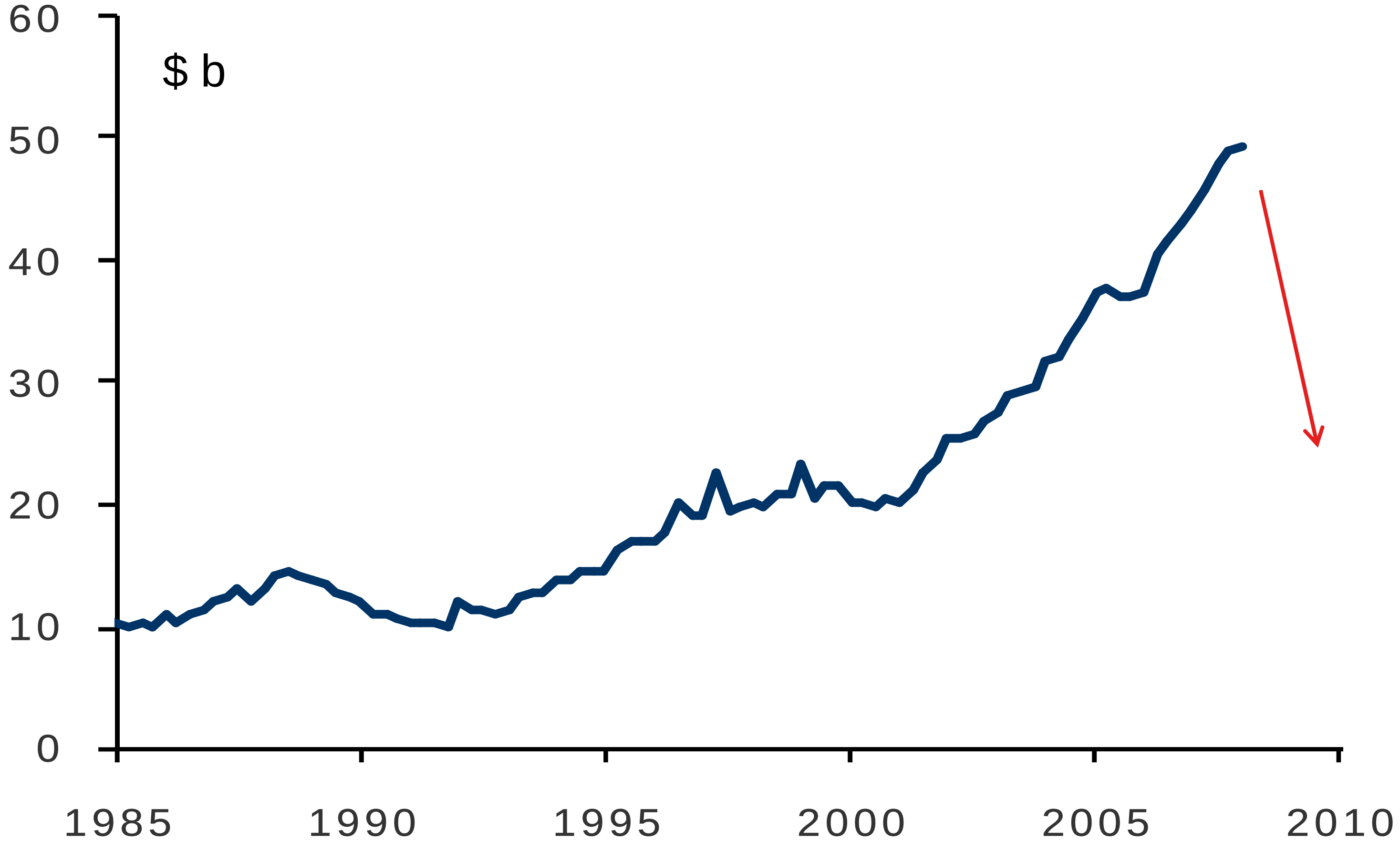
Business investment…has been a driver of growth, set to slow



Source: ABS. Data to 31 December 2008

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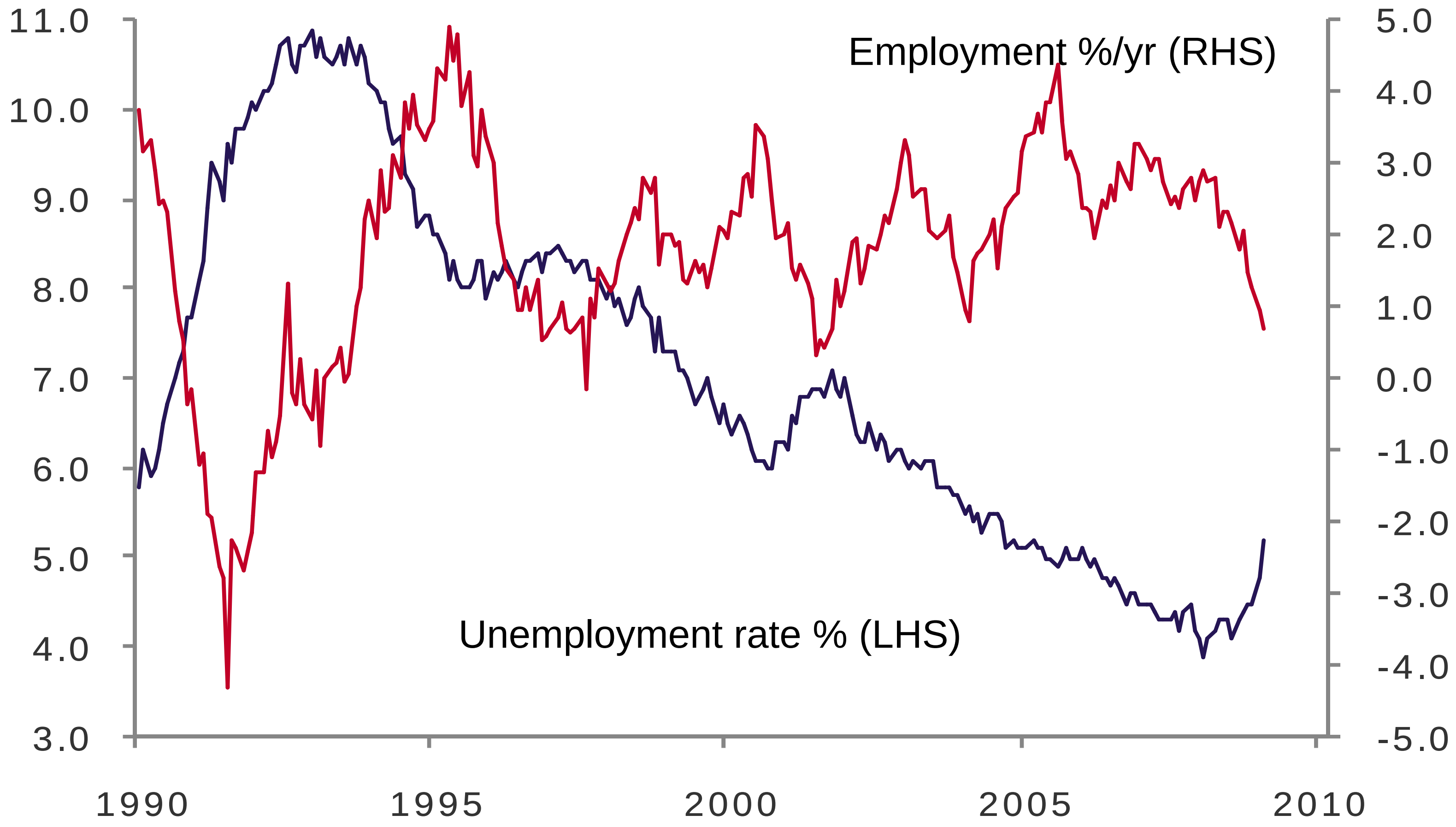
Australian job market is softening



Source: Annual % employment growth and unemployment rate. Data to 28 February 2009

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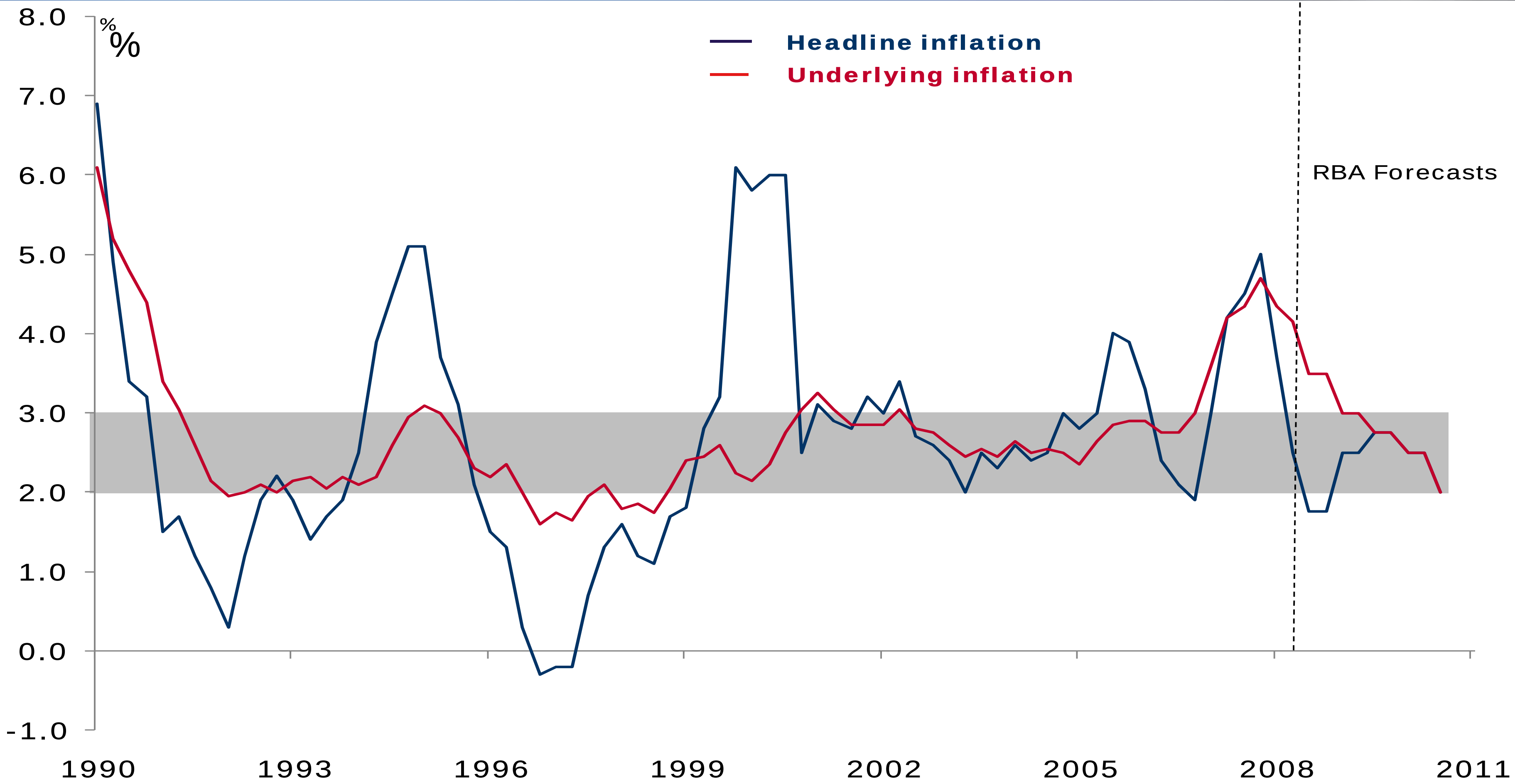
Australia: Inflation to fall fast



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Source: ABS, RBA. Data to 31 March 2009. Underlying inflation is an average of Trimmed mean and Weighted Median. RBA forecasts as at March 2009

The global policy response – Australia

Monetary policy response

- Most aggressive policy easing in the history of the RBA.
- 2 Sept 2008 -25bp to 7.0%
- 7 Oct 2008 -100bp to 6.0%
- 4 Nov 2008 -75bp to 5.25%
- 2 Dec 2008 -100bp to 4.25%
- 3 Feb 2009 -100bp to 3.25%
- 7 April 2009 -25bp to 3.0%
- More to come?

Source: RBA

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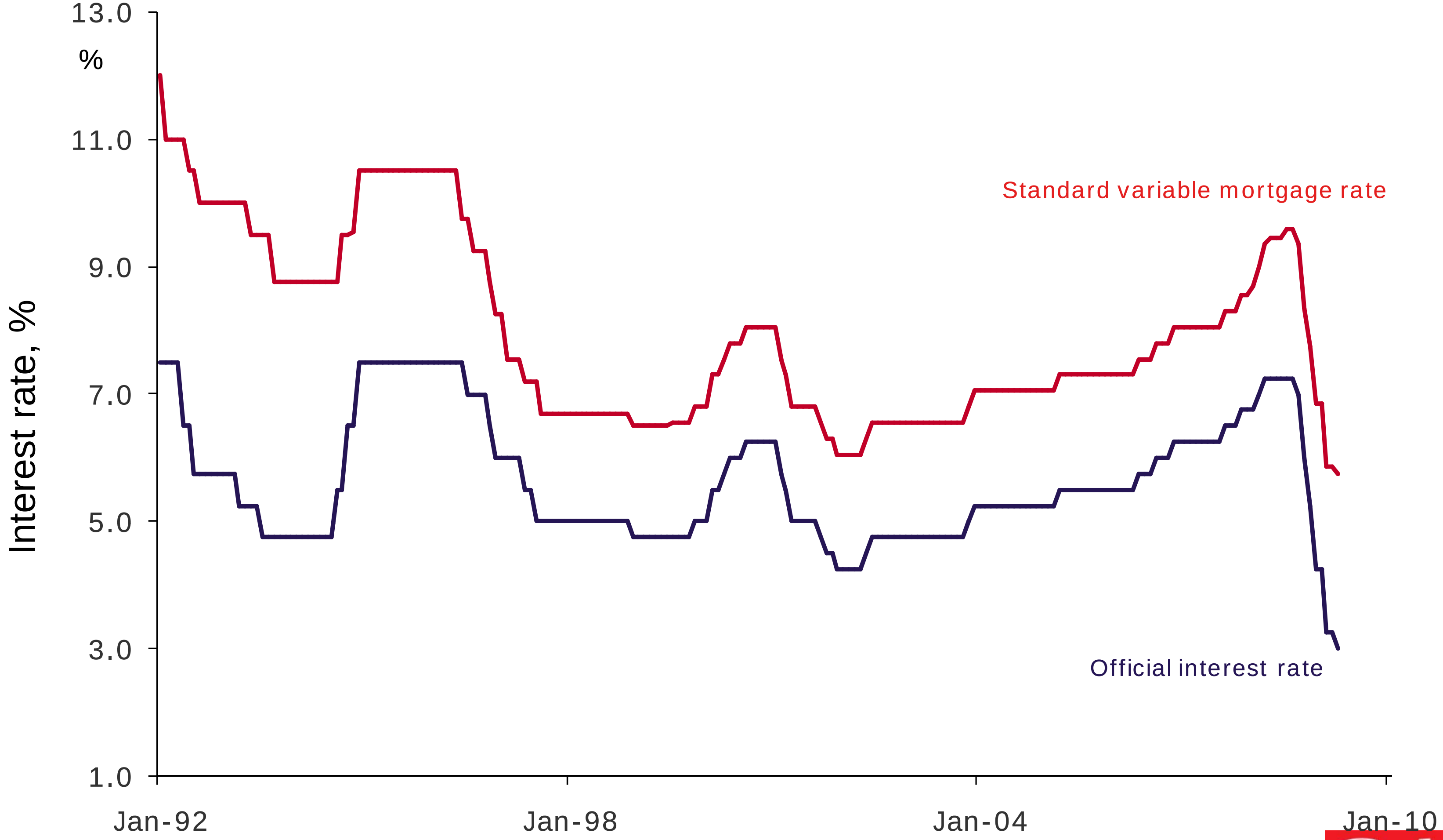
Monetary policy transmission mechanism is working



Source: RBA. Rates as at 7 April 2009

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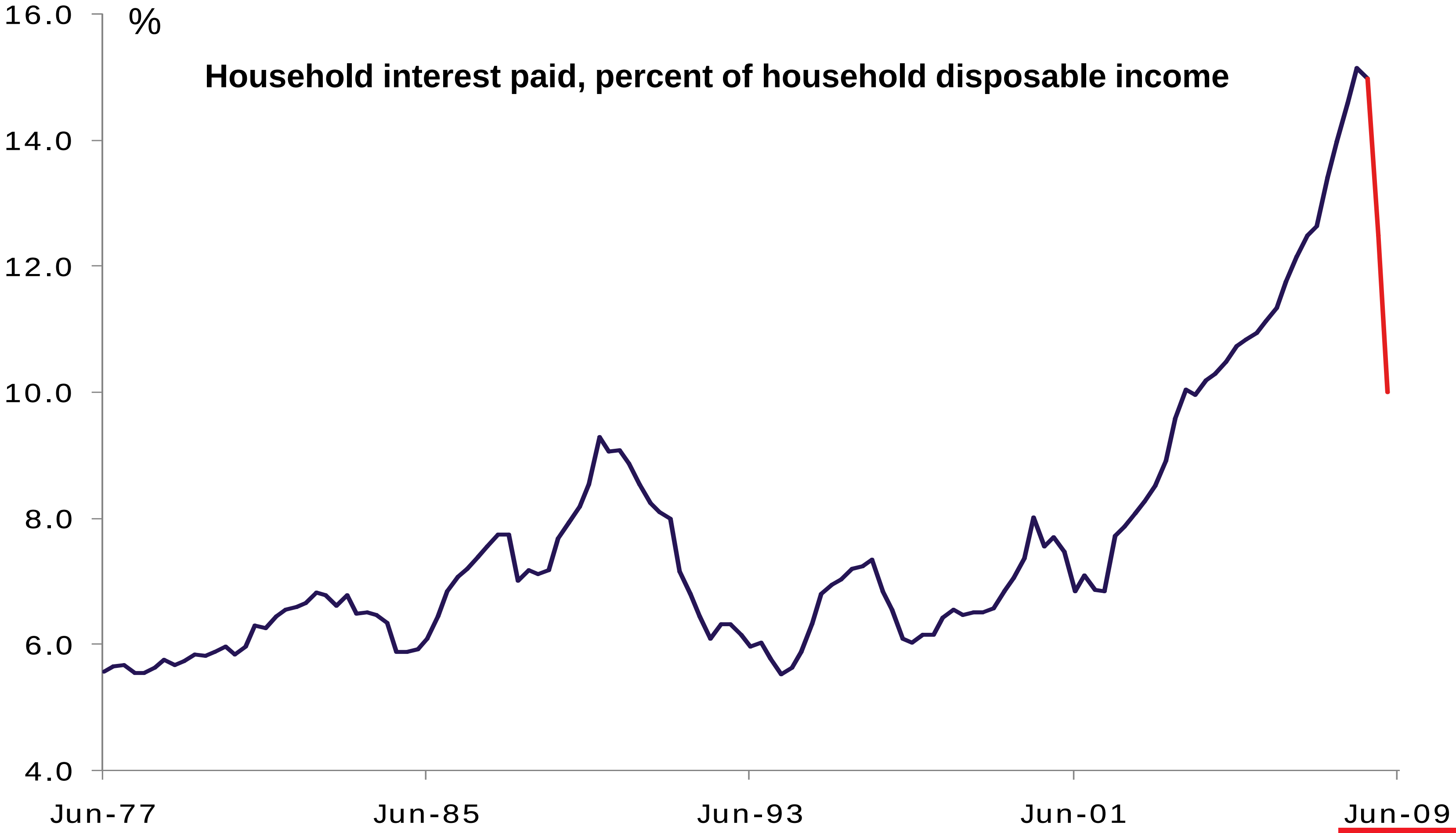
Household interest payments are falling



Source: RBA. RBA forecasts used to include interest rate cuts since September 2008.
Actual Data to 30 September 2008. Forecasts used for December 2008 and March 2009.

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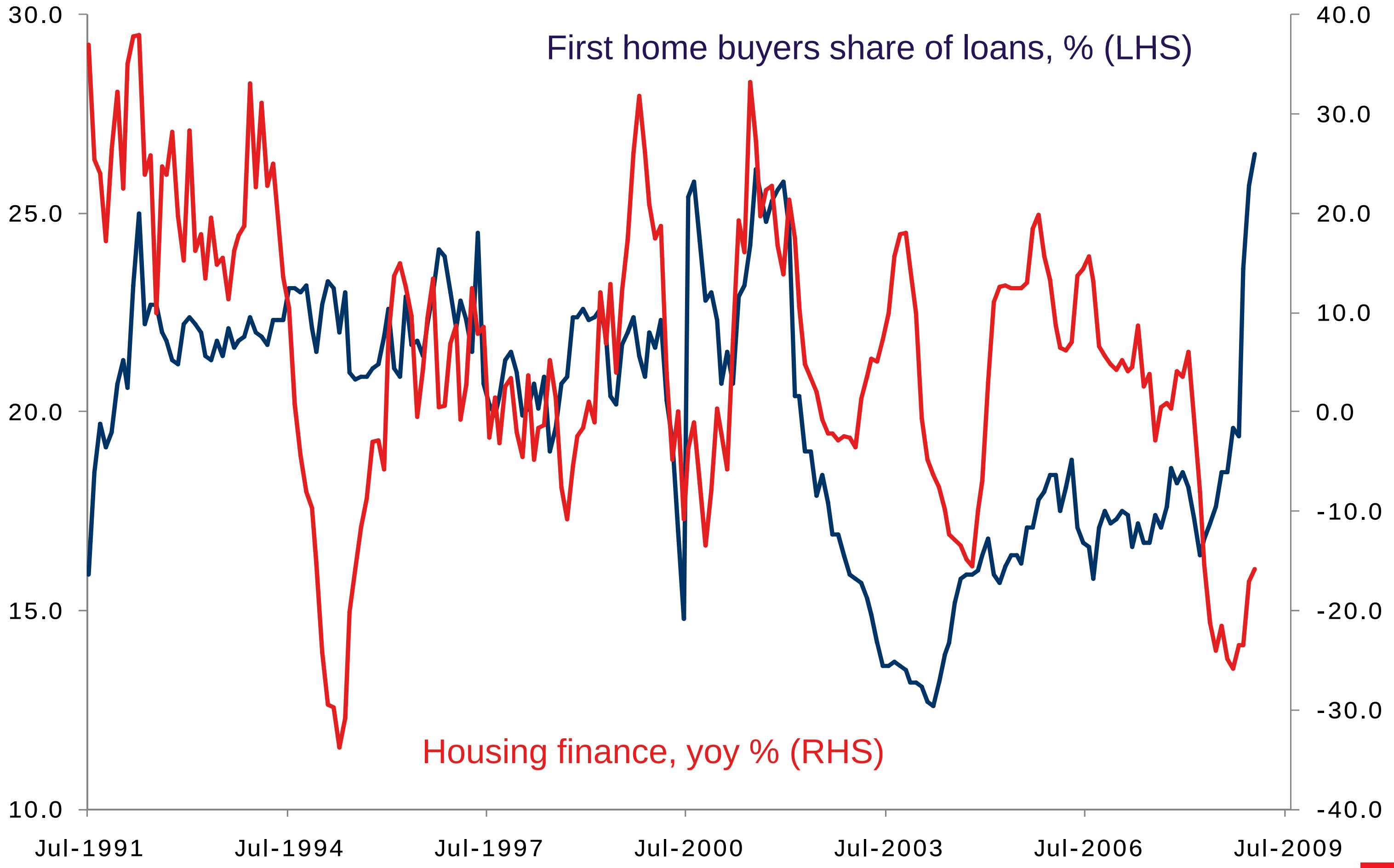
Housing market responding to positives



Source: ABS. Data to 31 January 2009

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The global policy response – Australia

Fiscal policy response

- **$A10.4 billion emergency fiscal plan (Oct 08)**
  - Lump sum payments – family and pension
  - First Home Buyers Grant addition
  - Training places
- **$A4.7 billion Infrastructure spending (Dec 08)**
  - Mostly payments to the States and local councils
- **Australian Business Investment Partnership** (RuddBank – support to commercial property market)
- **Nation Building and Jobs Plan** (Feb 09)
  - $A42.0 billion over 4 years, including;
  - $A12.7 billion cash payments
  - $A28.8 billion in infrastructure
  - Budget into deficit

Source: Colonial First State Global Asset Management, Commonwealth Treasury

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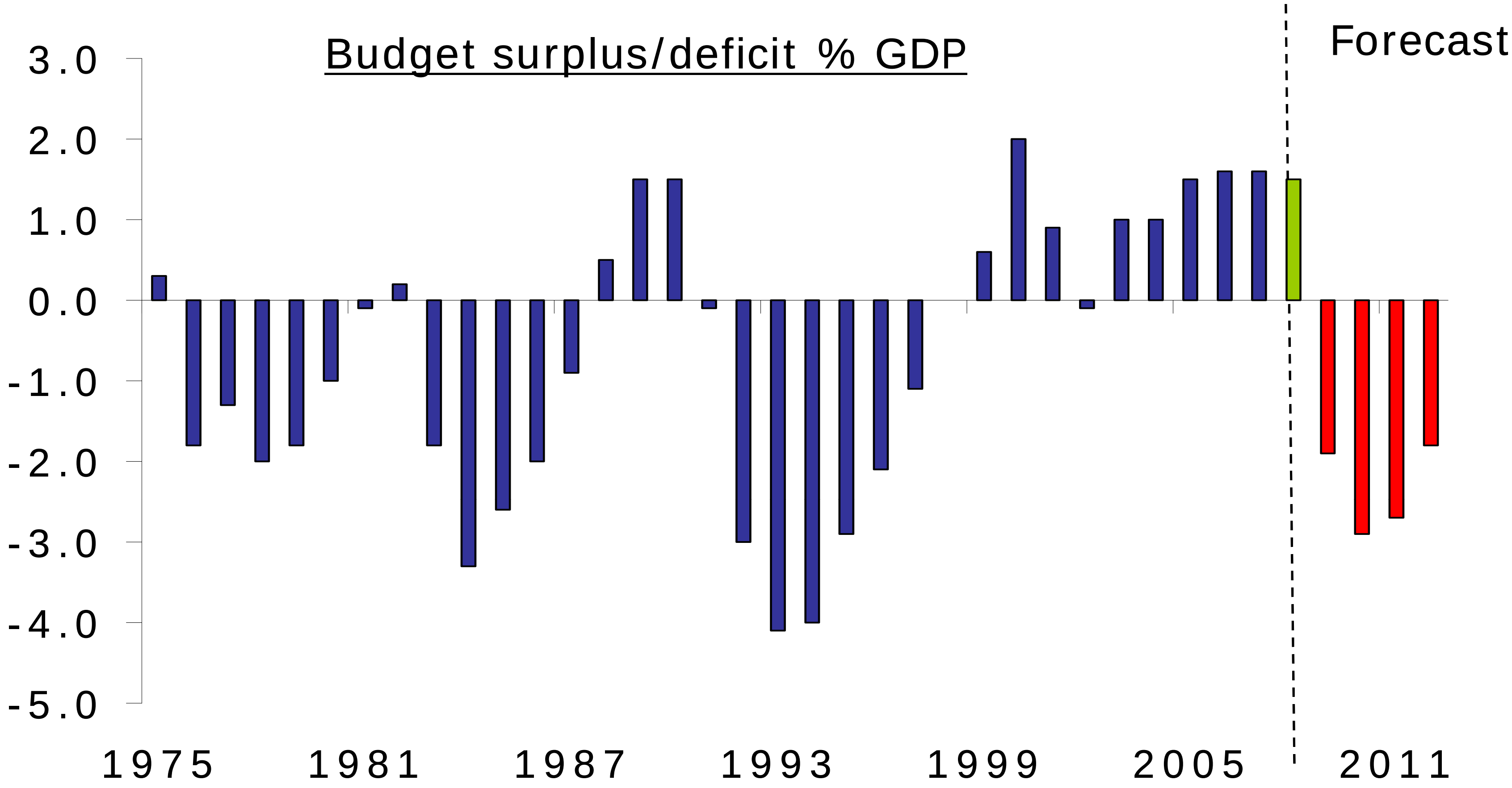
The Federal Budget…deficits will be larger



Source: Treasury. Data as at 3 February 2009

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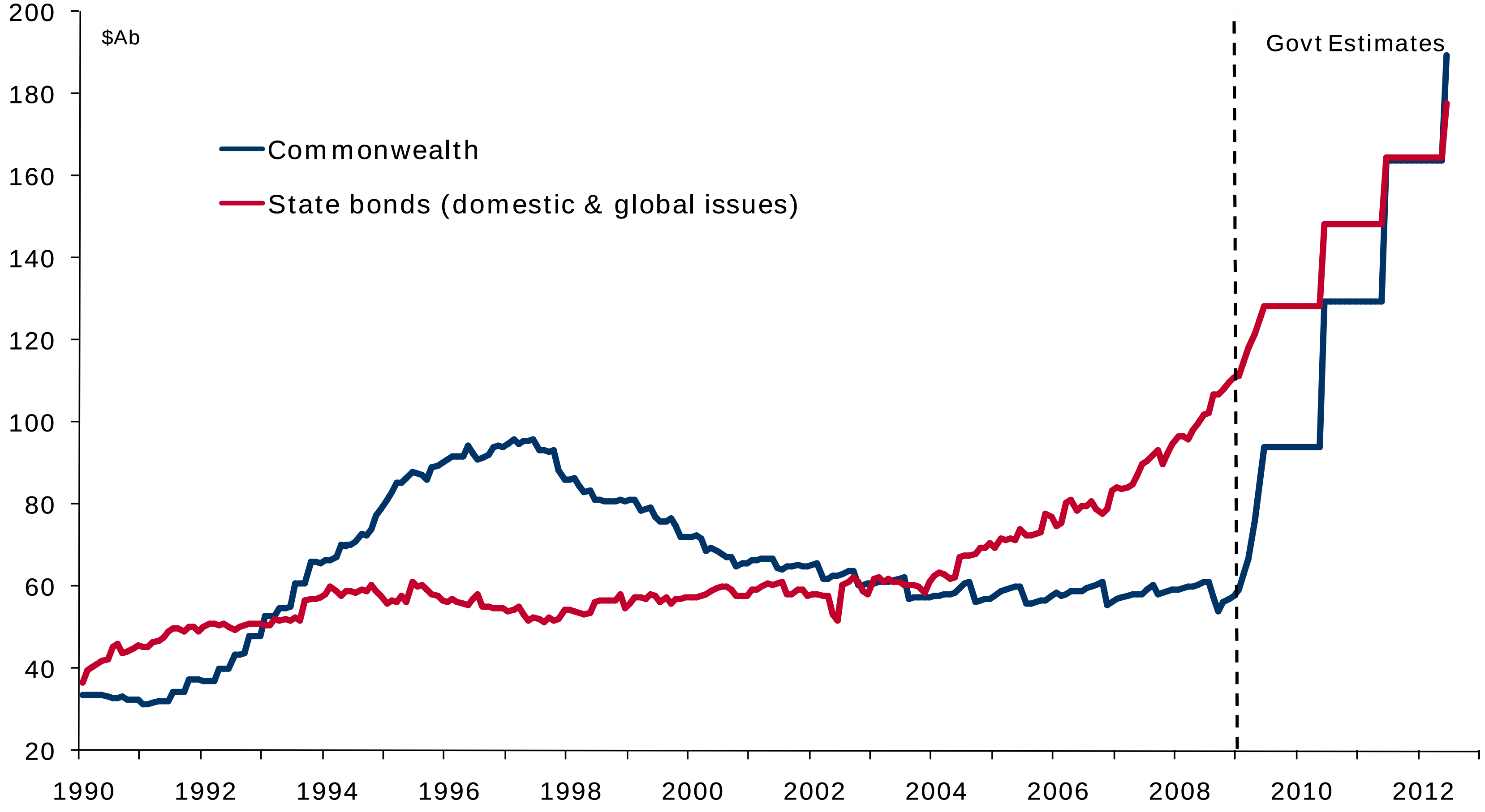
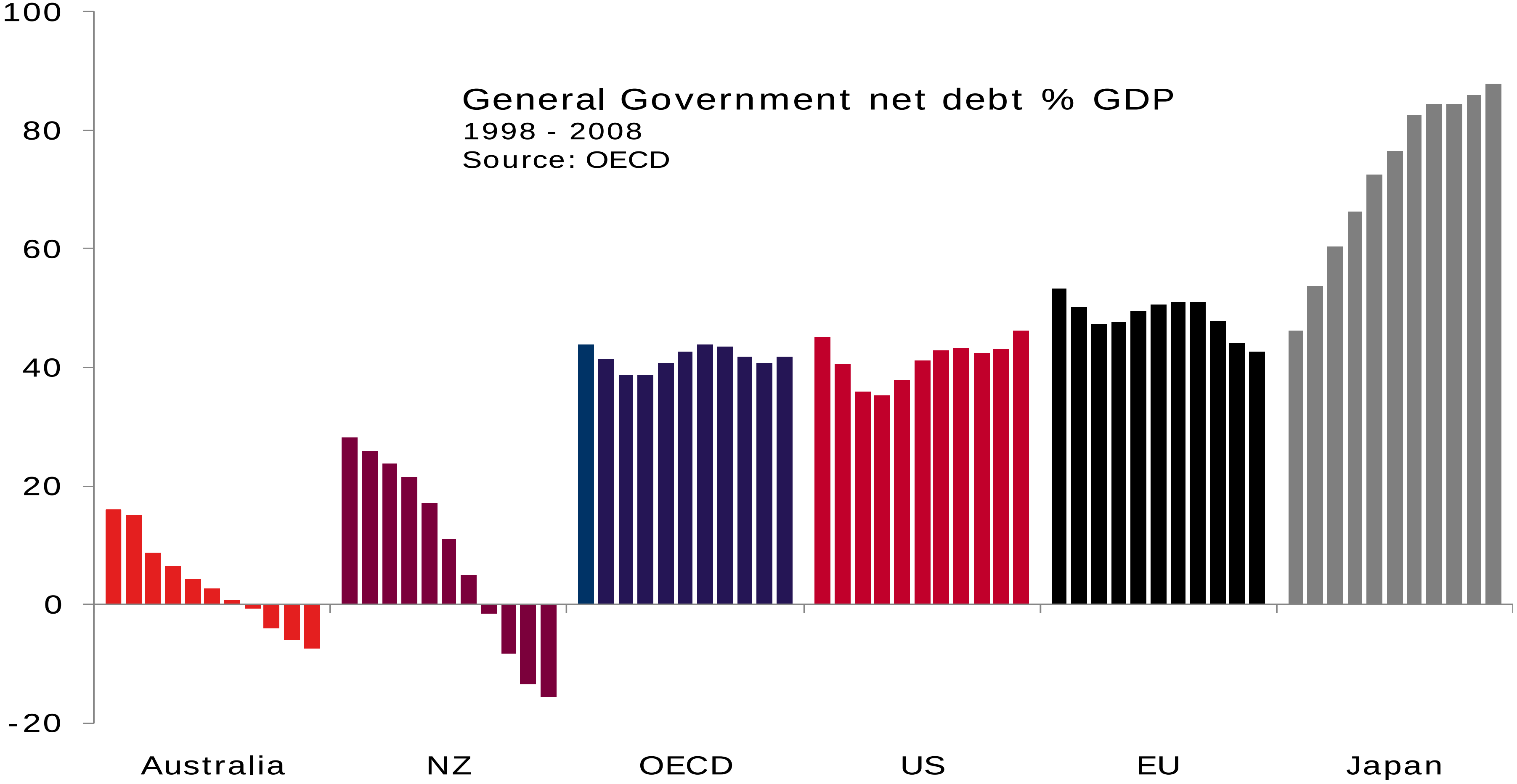
Commonwealth bond supply to rocket higher



Source: RBA, Commonwealth and State Treasury, Colonial First State Global Asset Management.
Data as at March 2009

But Australian government debt position still looks good



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Source: OECD. Data as at 3 February 2009

The global policy response – Australia

Banking system support

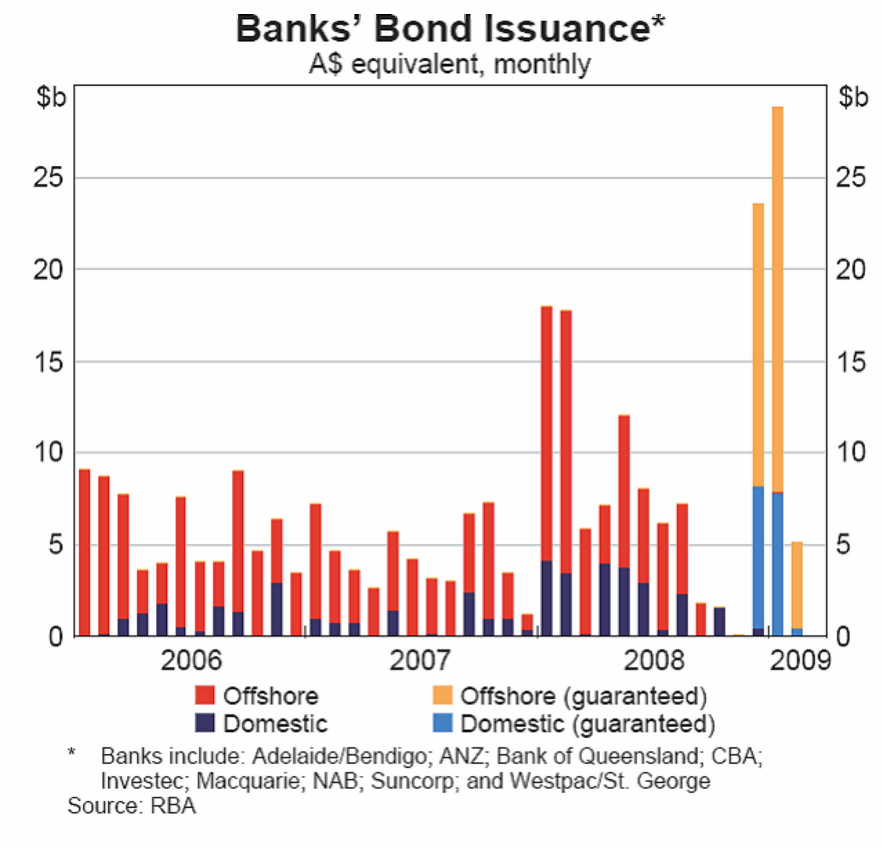
- In October 2008 the Commonwealth government announced a guarantee of bank deposits and wholesale funding.
- For a fee eligible banks can use the Commonwealth's AAA rating to borrow in global markets – has been very successful.
- No need for any capital injection for Australian banks.
- Commonwealth also supporting RMBS market by acting as "corner stone" investor for new issues.

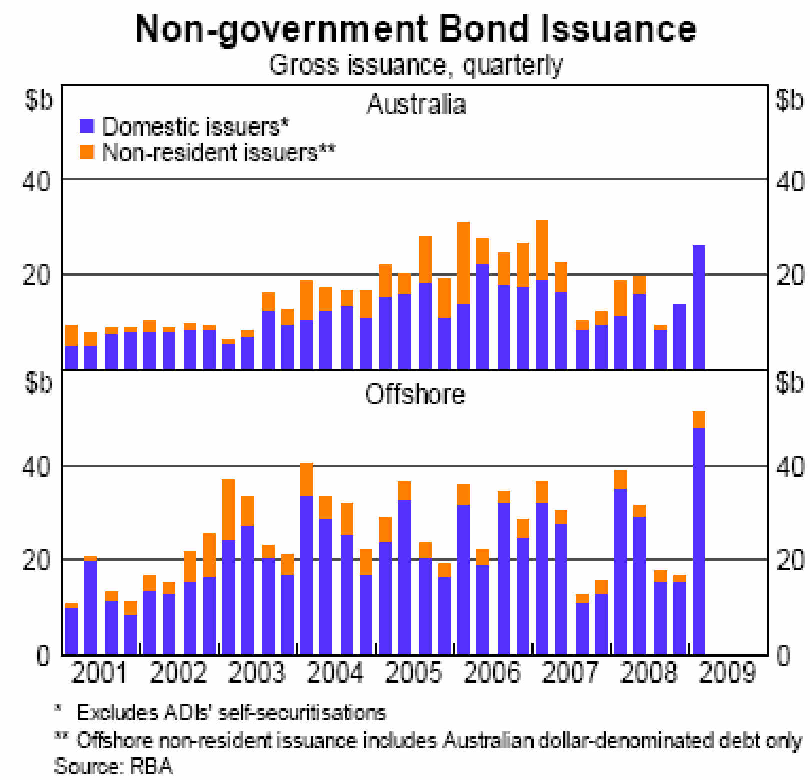
Support to States

- March 2009 Commonwealth offers, for a fee, a time-limited voluntary guarantee for State bond issues, both new and existing.

Source: Colonial First State Global Asset Management, Commonwealth Treasury

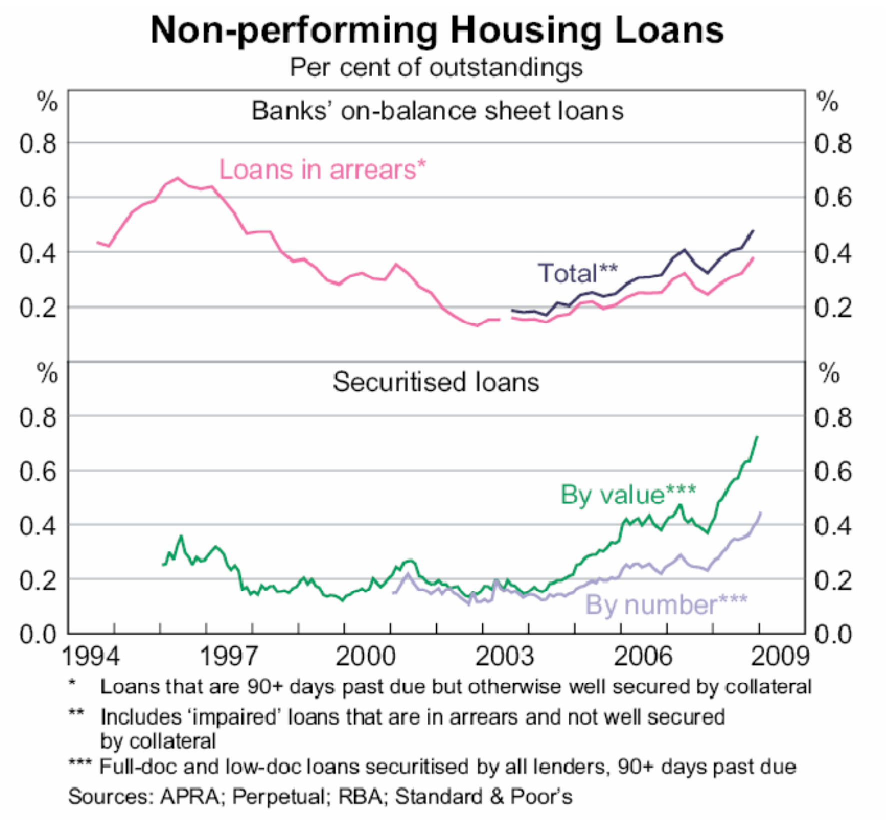
Australian banks using guarantee

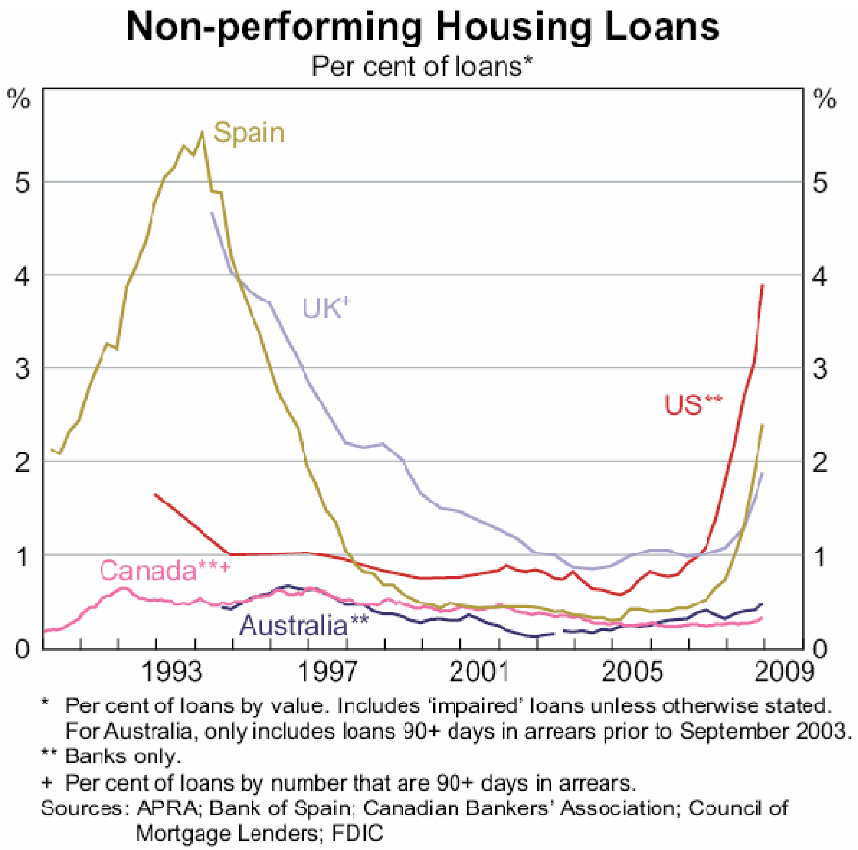




Source: RBA Financial Stability Review March 2009

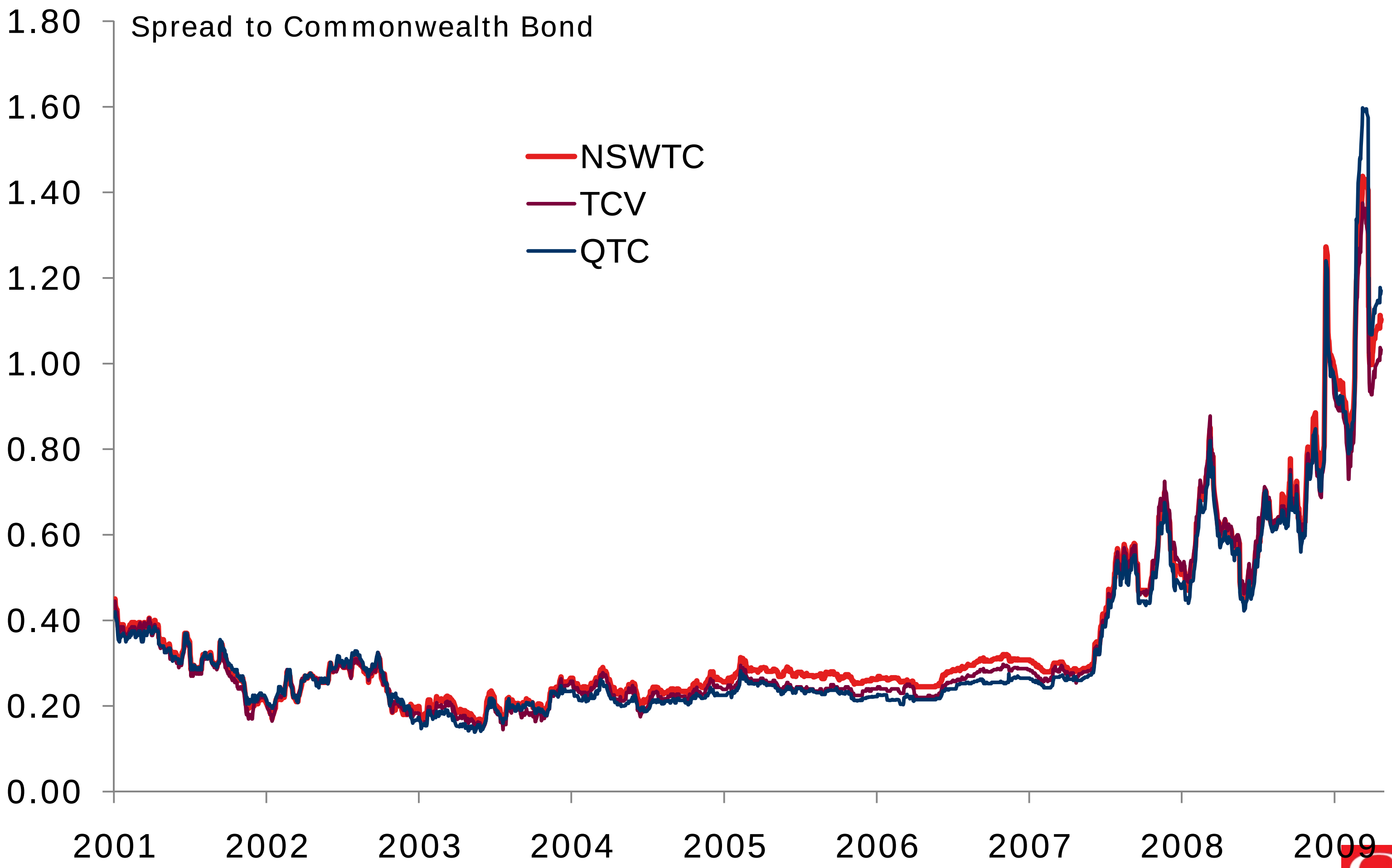
Australian banking system in much better shape





Source: RBA Financial Stability Review March 2009

Commonwealth will now guarantee State debt



Source: Citi, Bloomberg. Data to 31 March 2009

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Summary

- The global economy is in the deepest recession since WWII
- But global policy response to the GFC and the "great recession" has been unprecedented
- G20 policy initiatives showed a better-than-expected level of cooperation and coordination – implementation will be key
- US policy response also unprecedented.
- Australia went into the recession in better shape than most and with more ammunition in the policy response
- So Australia is well placed to lead the eventual global recovery
- 2009 will be volatile as views develop – but recessions do end

Source: Colonial First State Global Asset Management

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