



# **Aftermath of a financial crisis**

**Annual finisia and MCFS Banking and  
Finance Conference**

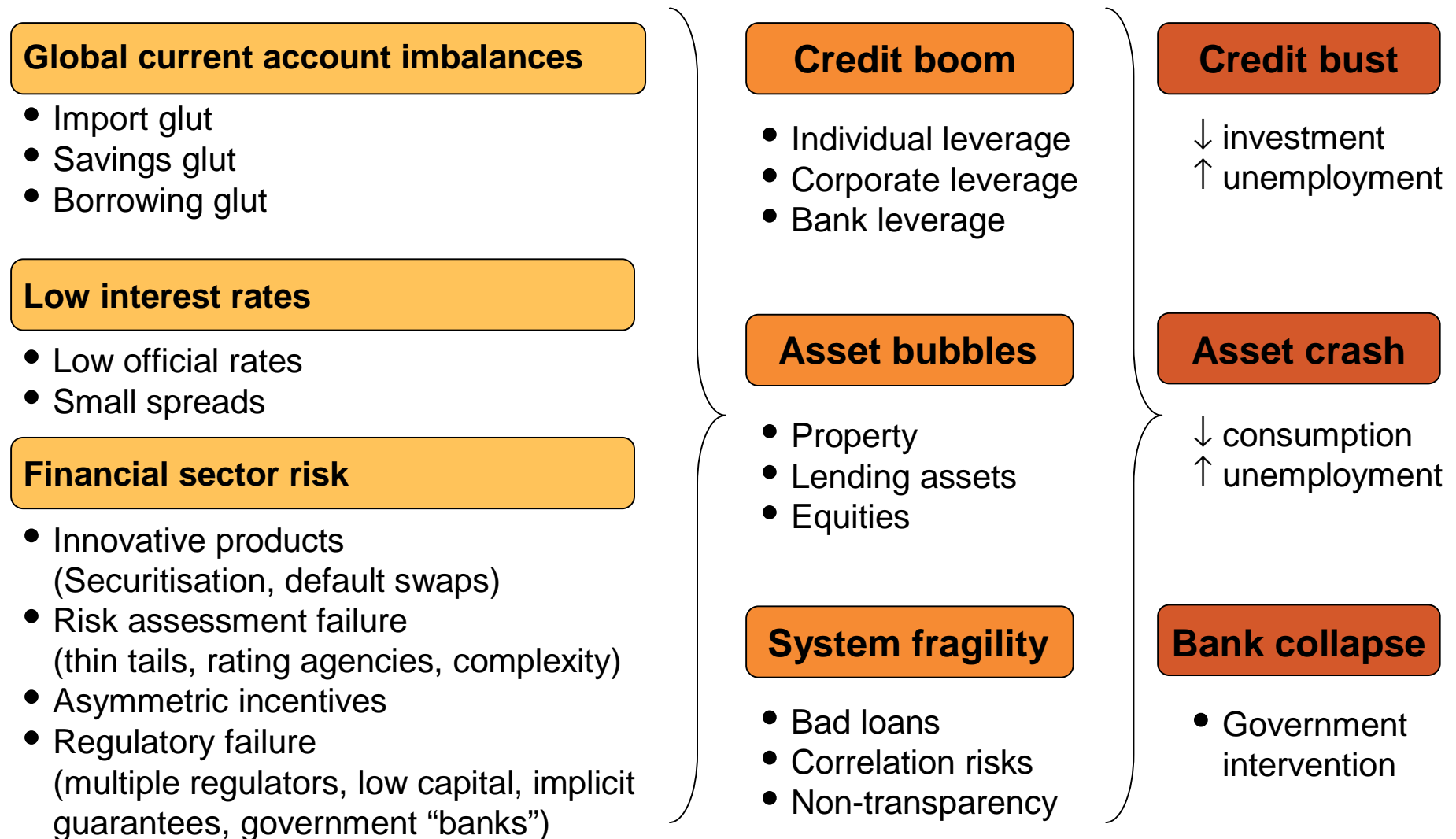
John Daley  
CEO, Grattan Institute  
29 September 2009

**Why did it happen?**

**How did governments respond?**

**What might happen next?**

## What caused the crisis?



Source: Financial Services Authority, *the Turner Review: A regulatory response to the global banking crisis*, March 2009  
David Gruen, “Reflections on the Global Financial Crisis”, *Economic Roundup*, Australian Treasury July 2009

Bank for International Settlements, *79<sup>th</sup> Annual Report*, June 2009; V Acharya & M Richardson, *Restoring Financial Stability*, Wiley 2009

## Do we blame the evil bankers? ...

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“We agreed to make sure our regulatory system for banks and other financial firms reins in the excesses that led to the crisis. Where reckless behaviour and a lack of responsibility led to crisis, we will not allow a return to banking as usual”

G20 Pittsburgh meeting,  
Leaders' Statement, 25 Sept 2009

## ... or was their road paved with good intentions?

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### Helping the disadvantaged

- US Community Reinvestment Act (CRA)
- US Dept of Housing and Urban Development:  
*National Homeownership Strategy* 1994
- Fanny and Freddie:  
explicit and implicit Congressional threats to limit their mortgage portfolio
- Banks to show adequate number of loans to low income borrowers
- Need “financing strategies fuelled by the creativity and resources of the private and public sectors, to help homeowners who lack ... the cash to buy a home or to make the payments”
- F&F to use same criteria as “other” lenders (including the most aggressive)
- F&F given targets for loans to disadvantaged – so F&F bought securitised paper
- Private lenders followed F&F mortgage standards
- More people qualified as sub-prime margins reduced

### Protecting the unfortunate

- Legislated option to “send back the keys”

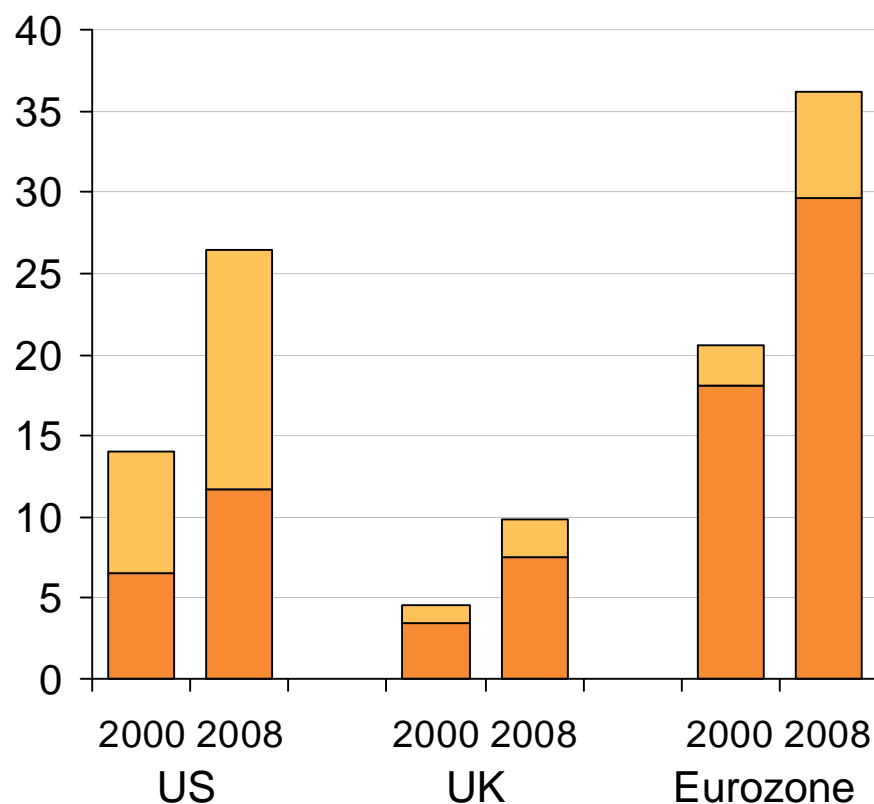
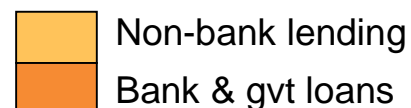
### Tax incentives

- Home equity loan repayments tax deductible

## ... and how do we account for Europe?

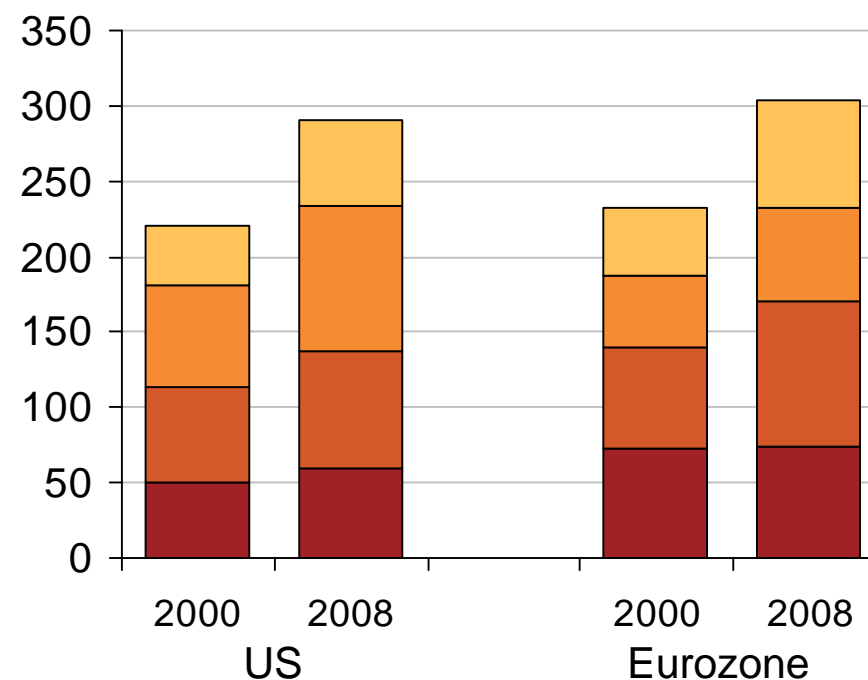
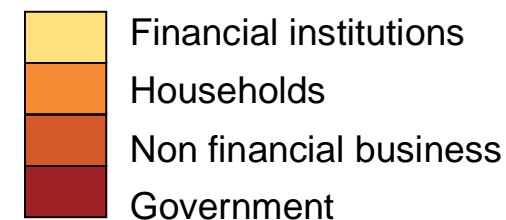
### Not a securitisation problem

Credit outstanding, US\$tr, 2008 PPP



### Not a household story

Borrowing as % GDP



Why did it happen?

**How did governments respond?**

What might happen next?

## **What have governments done?**

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**Financial sector – short-term rescue**

**Financial sector – long-term reform**

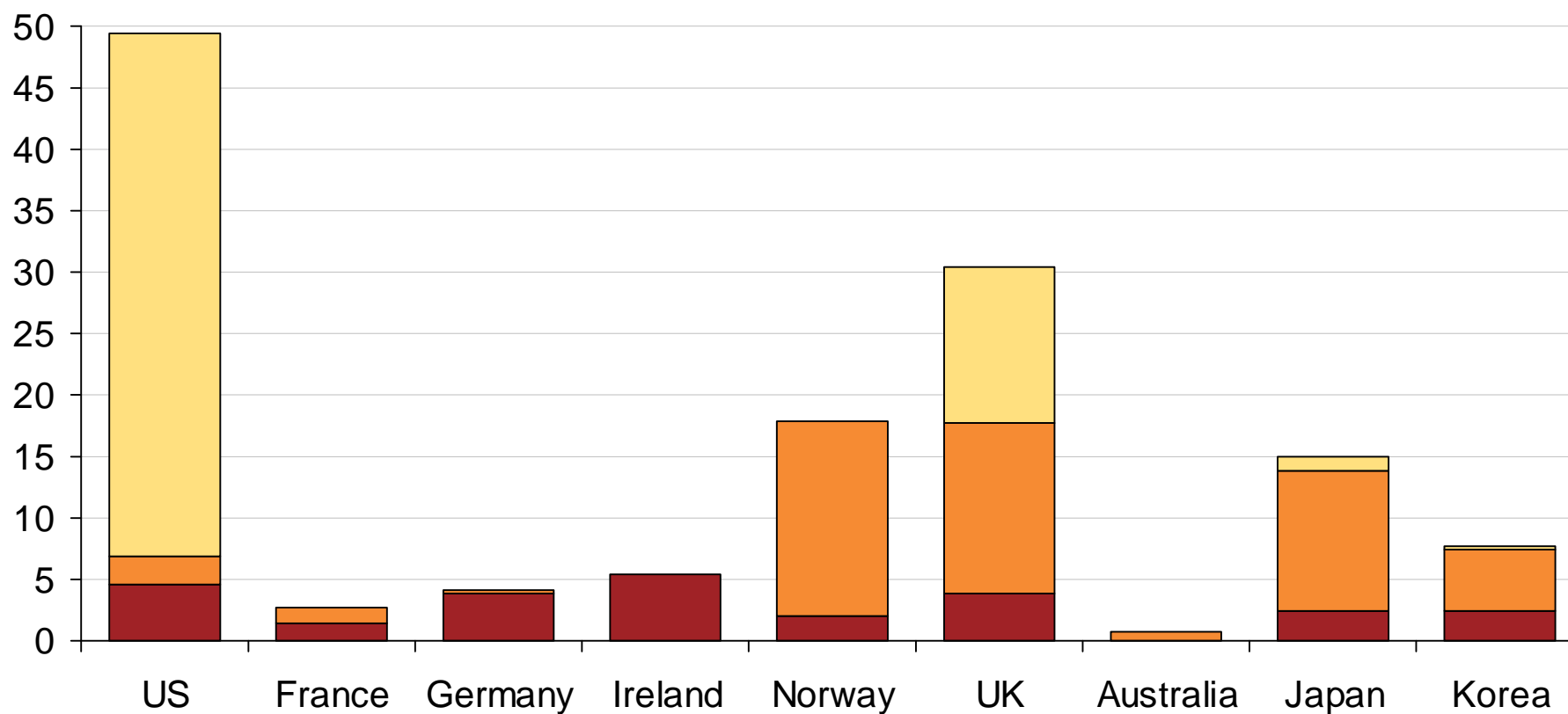
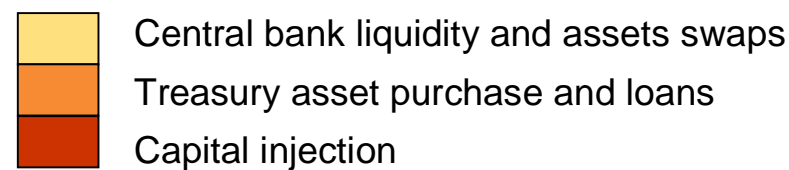
**Fiscal stimulus**

**Shift towards intervention**

## Short-term rescue

### Government support for banking sector

Support as % of 2008 GDP



## What have governments done?

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### Financial sector – short-term rescue

#### Financial sector – long-term reform

- Increased capital requirements
- Supervision
  - Systemic risk supervision
  - Increased intervention
  - Rating agencies
  - Cross-border regulation
- Remuneration
- Central counter-parties
- Separation of “utility” banks

### Fiscal stimulus

### Shift towards intervention

## **What have governments done?**

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**Financial sector – short-term rescue**

**Financial sector – long-term reform**

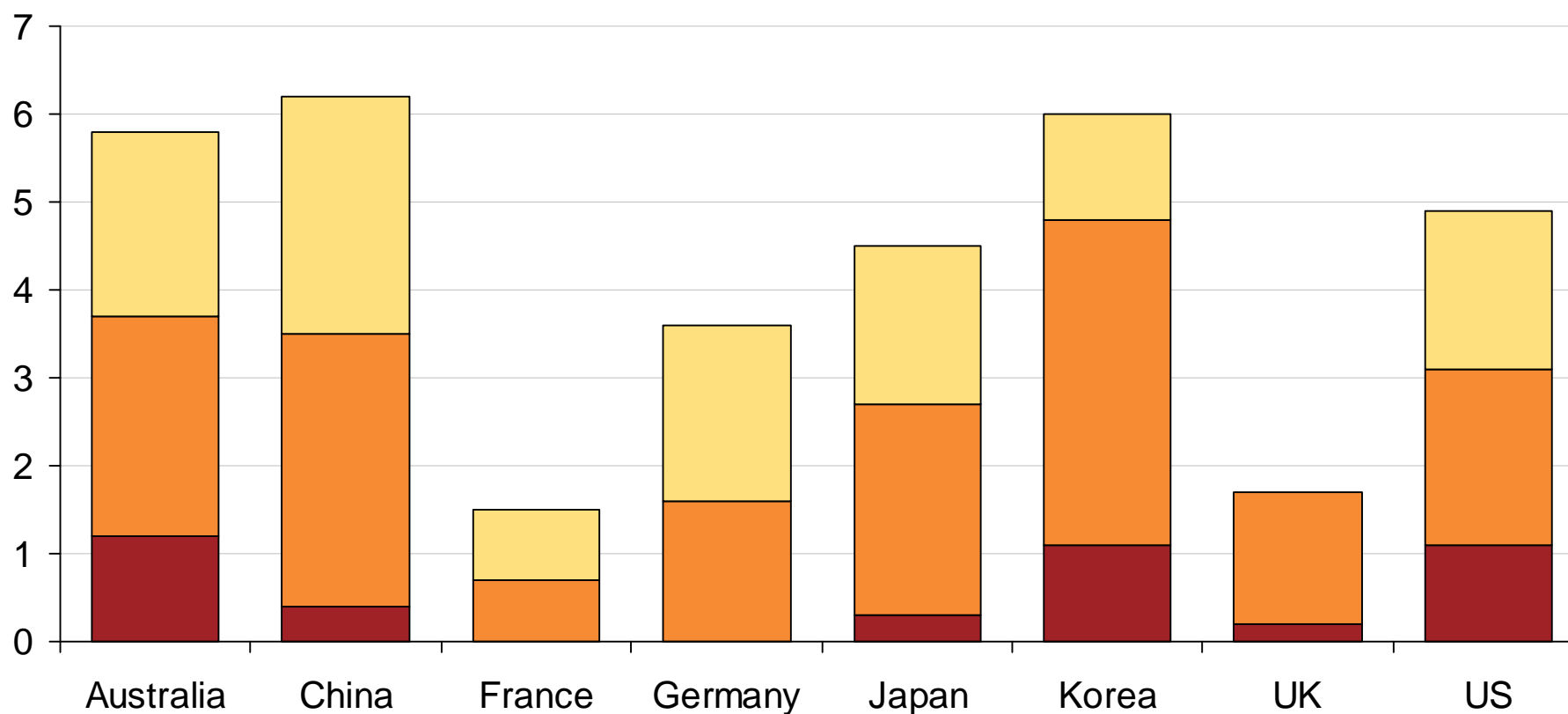
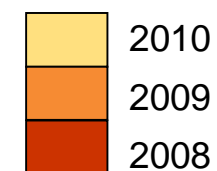
**Fiscal stimulus**

**Shift towards intervention**

## Fiscal stimulus

### Government fiscal stimulus

Additional measures relative to 2007 budget, as % of 2008 GDP



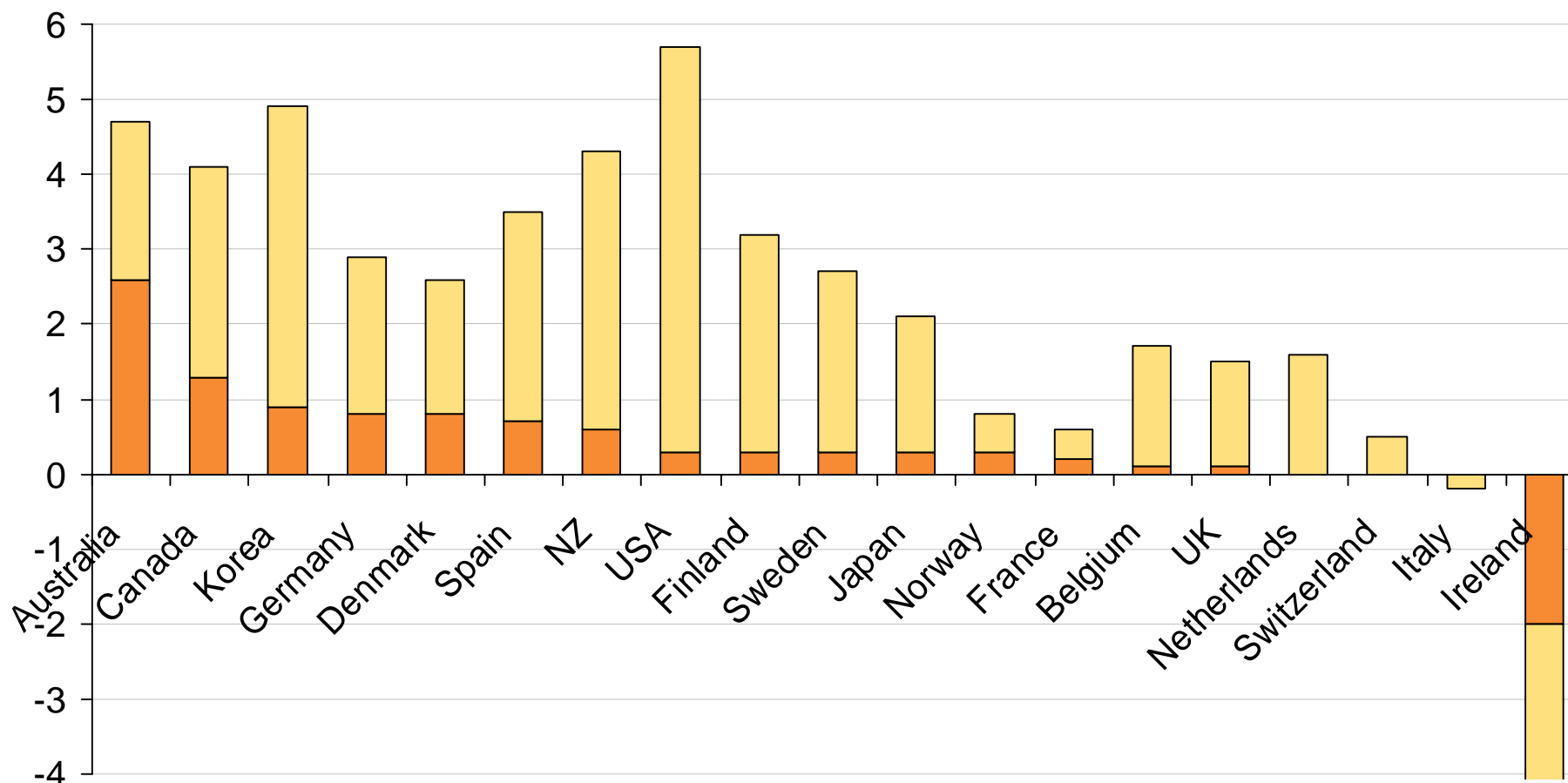
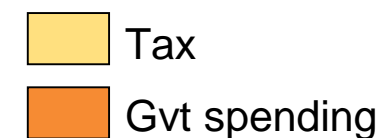
Source: IMF Staff Position Note, "Fiscal Implications of the Global Economic and Financial Crisis", June 2009.

Note: Measures announced as of mid May 2009

## Fiscal stimulus – mostly about taxes, except in Australia

### Government stimulus packages

2008-2010 additional budget as % of 2008 GDP



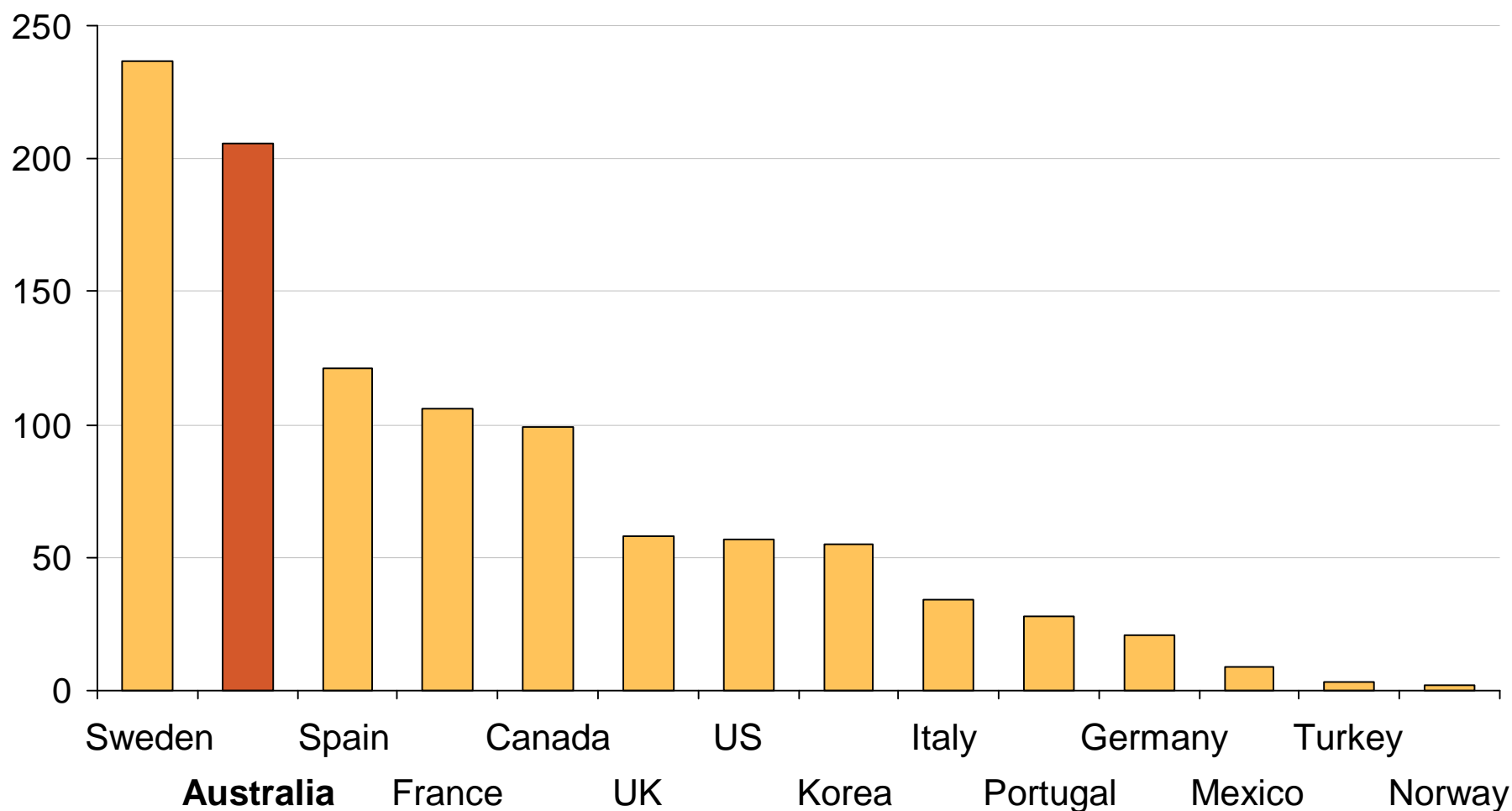
Source: OECD, *Policy Responses to the Economic Crisis: Investing in Innovation for Long-Term Growth*, June 2009

Note: Measures announced as of mid May 2009. Totals do not reconcile to IMF estimates due to variations in methodology

## Fiscal stimulus also about cars, especially in Australia

### Government stimulus for the car industry 2008-2010

USD / capita, 2007 PPP



## What have governments done?

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**Financial sector – short-term rescue**

**Financial sector – long-term reform**

**Fiscal stimulus**

### **Shift towards intervention – regulatory mindset**

- |                               |   |
|-------------------------------|---|
| • “Anti-neo-liberalism”       | Changed burden of proof                                 |
| • Environmental externalities | Greenhouse gas and energy regulation/support            |
| • Behavioural policy          | Non-choice values                                       |
| • Non-economic values         | Personal fulfilment, social interaction, sustainability |
| • Planning externalities      | City transport and design                               |

Why did it happen?

How did governments respond?

**What might happen next?**

## 2<sup>nd</sup> order consequences of intervention

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**Financial sector regulation**

**Industry support**

**Regulatory mindset**



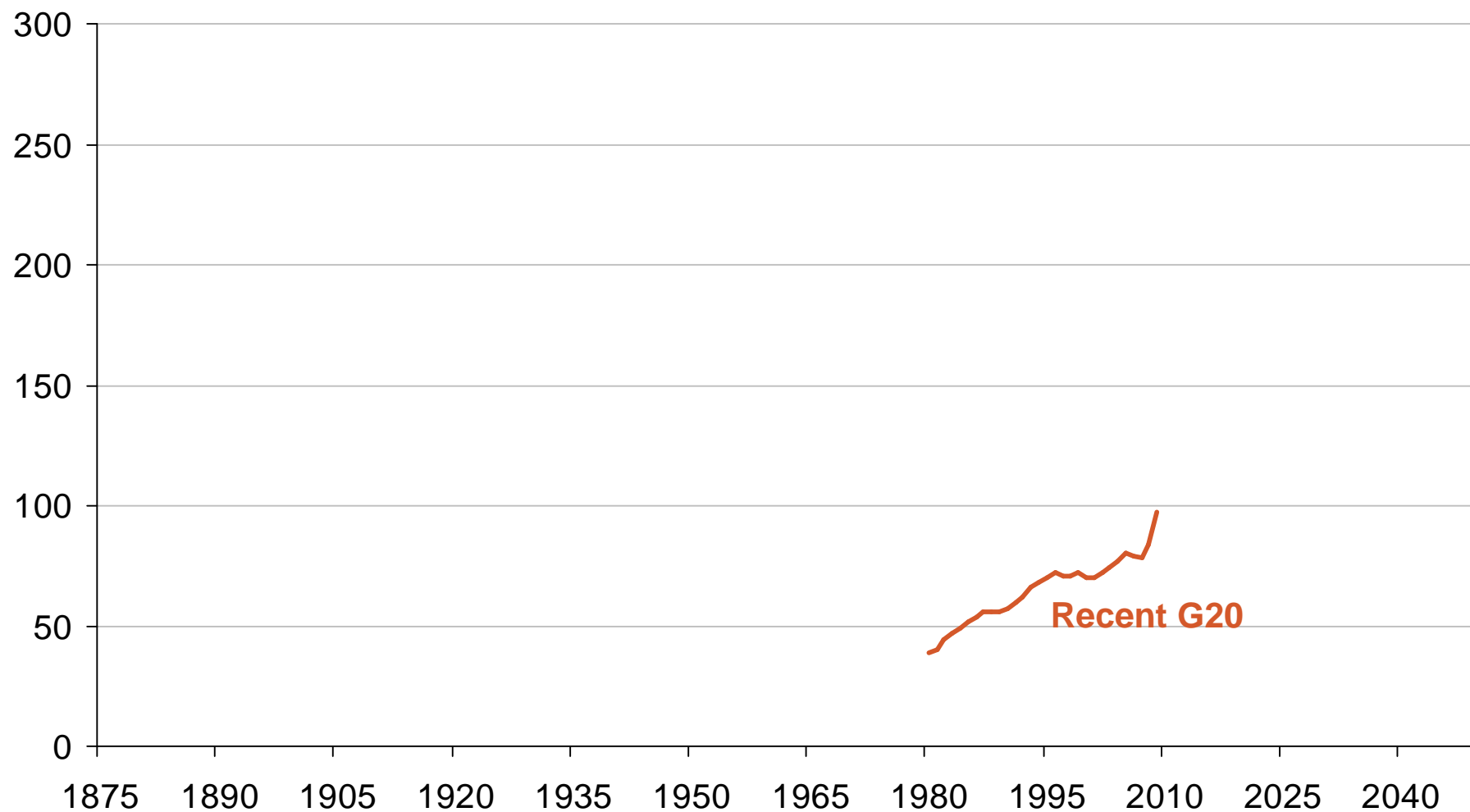
- Higher cost of capital
- Lower economic growth  
(not necessarily less personal fulfilment)
- Higher profit margins  
(more barriers to entry)

**Fiscal expansion**

- Lower economic growth when governments forced to reverse  
(less of an issue in Australia)

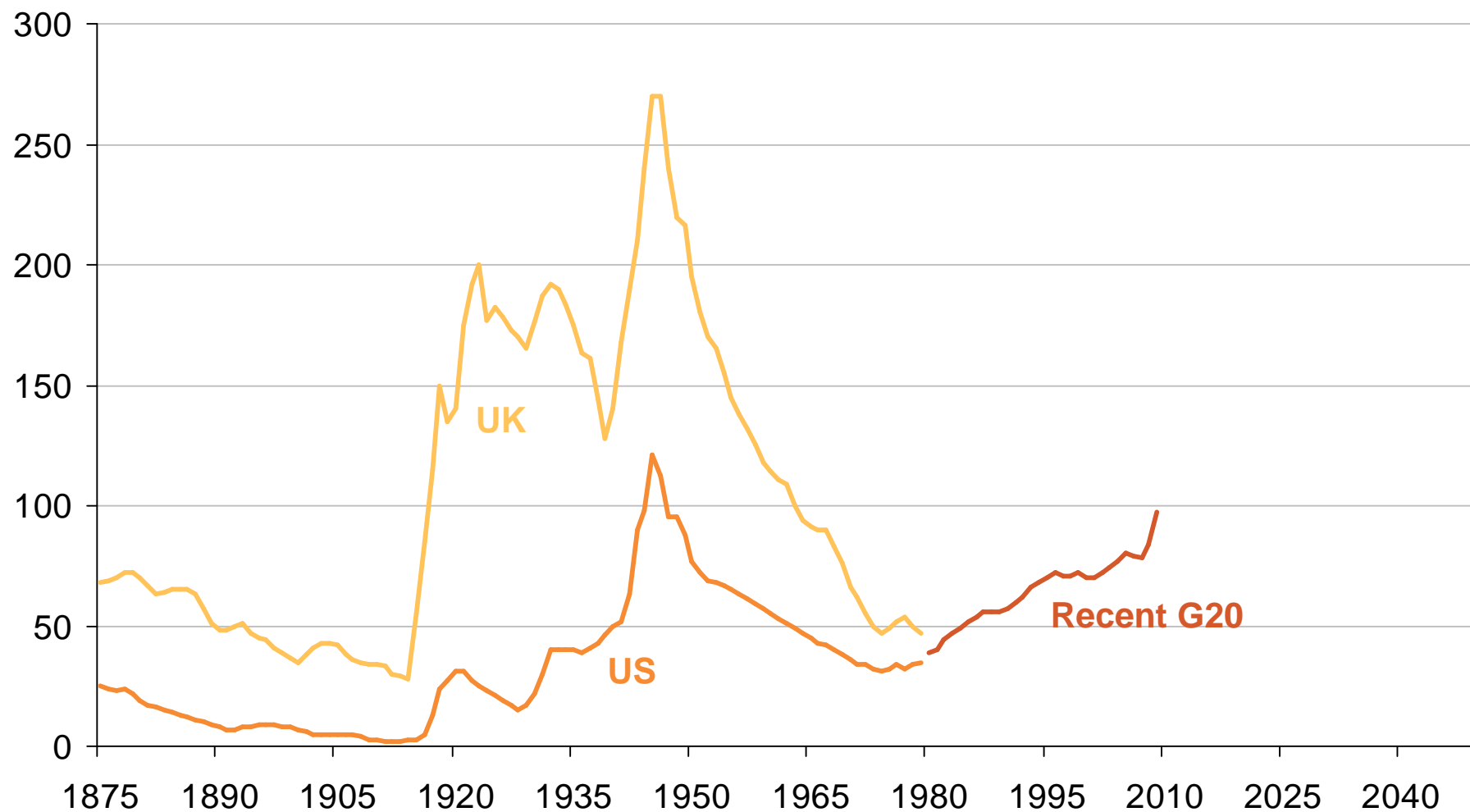
## Government debt – recent changes are a new trend

### Debt / GDP



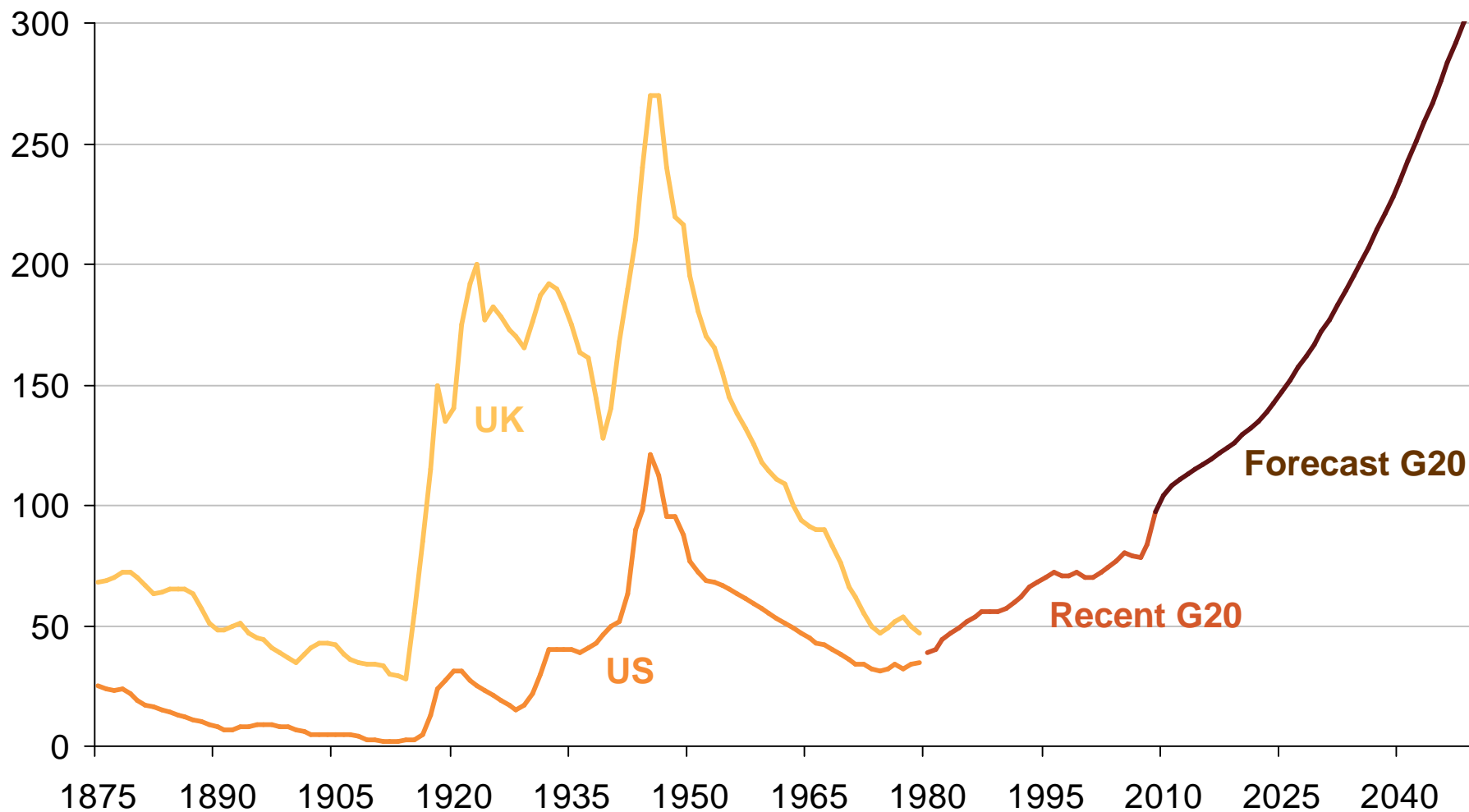
## Government debt: not high by historic standards

### Debt / GDP



# Government debt: forecast to go MUCH higher with ageing population

## Debt / GDP



## So what?

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### Increased regulation

- Slower growth

### Fiscal expansion

- Lower economic growth when governments forced to reverse

### Ageing populations

- Lower economic growth and increased deficits

### Human capital agenda

- Education
- Chronic health – prevention and costs
- Participation

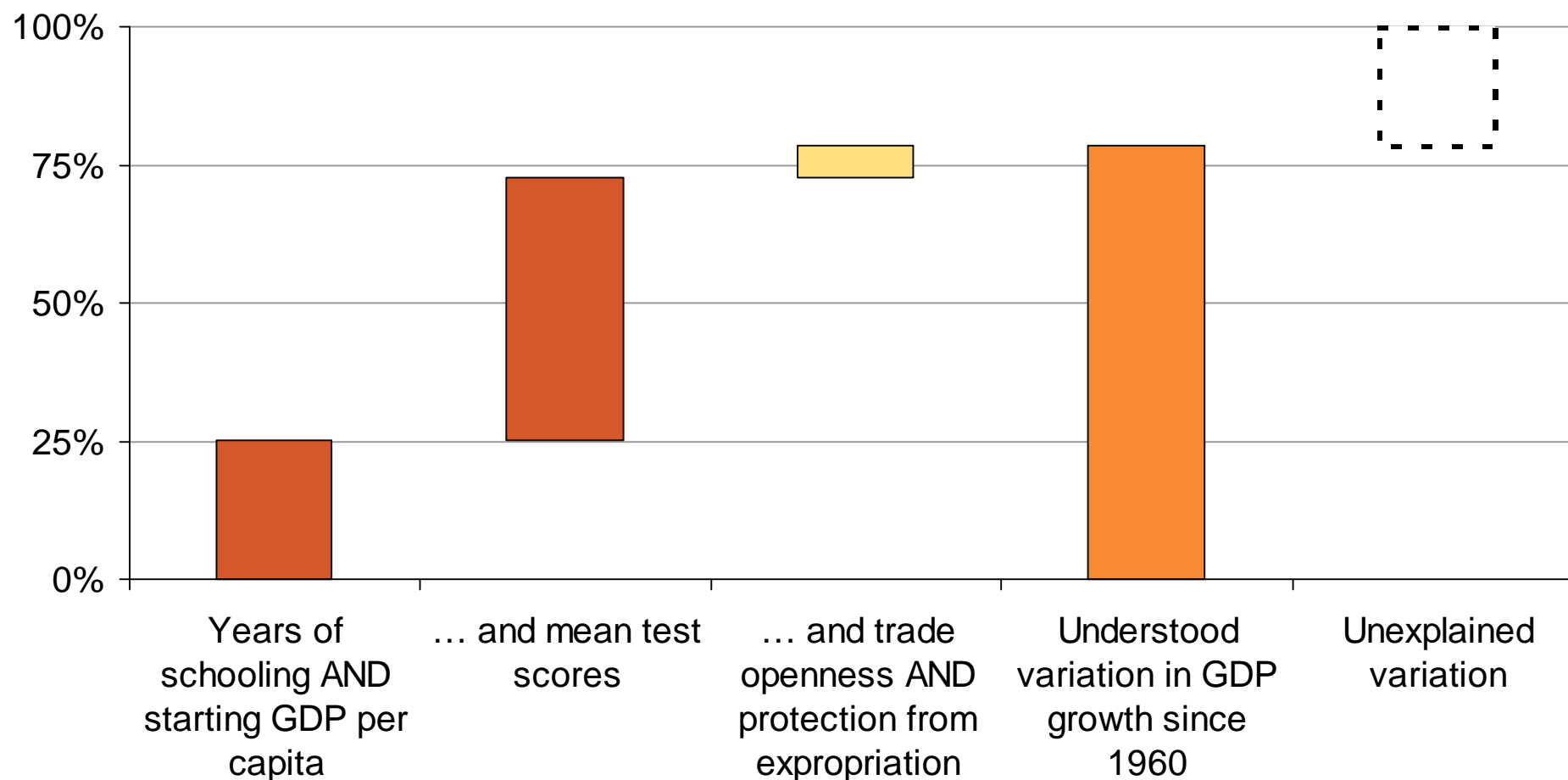
### City infrastructure

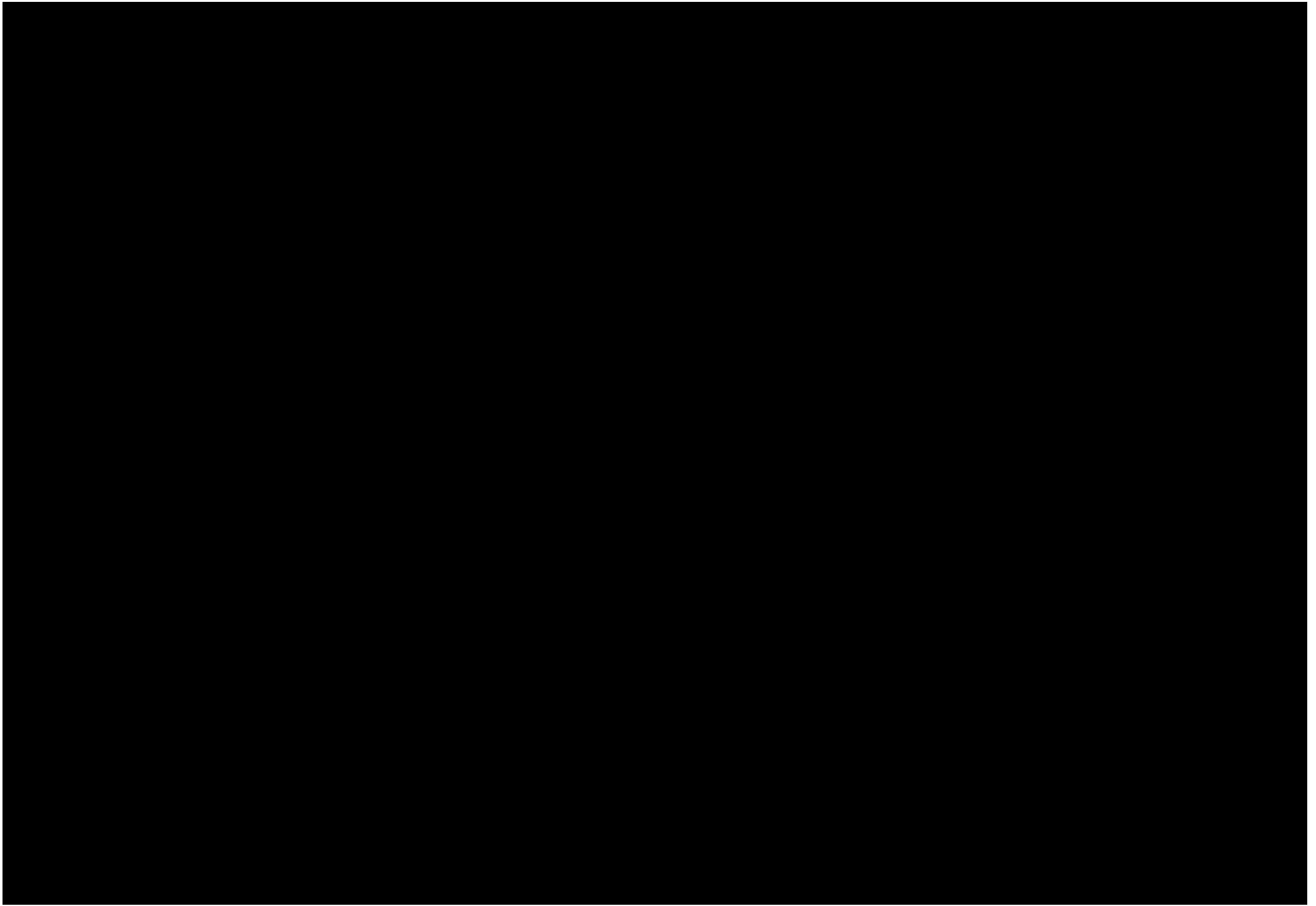
- Transport
- Planning
- Design

### Regulatory rethink

## Impact of drivers of GDP growth

### Explanation of variation between countries in national GDP growth since 1960

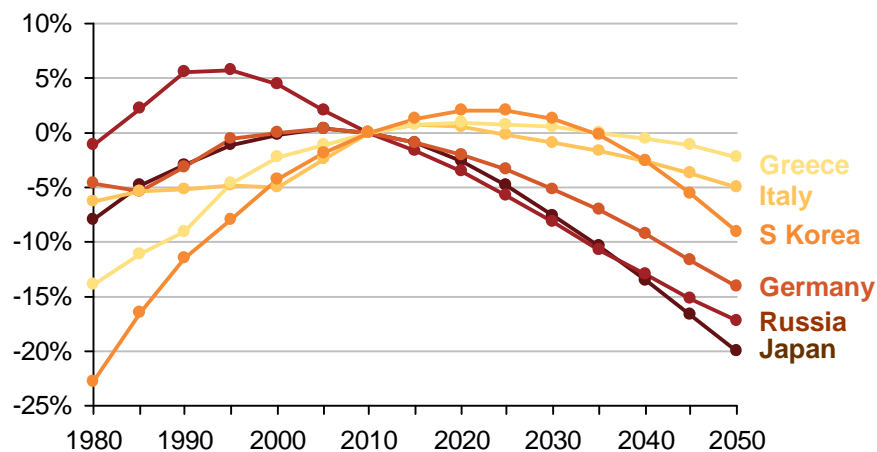




# Population growth – in context

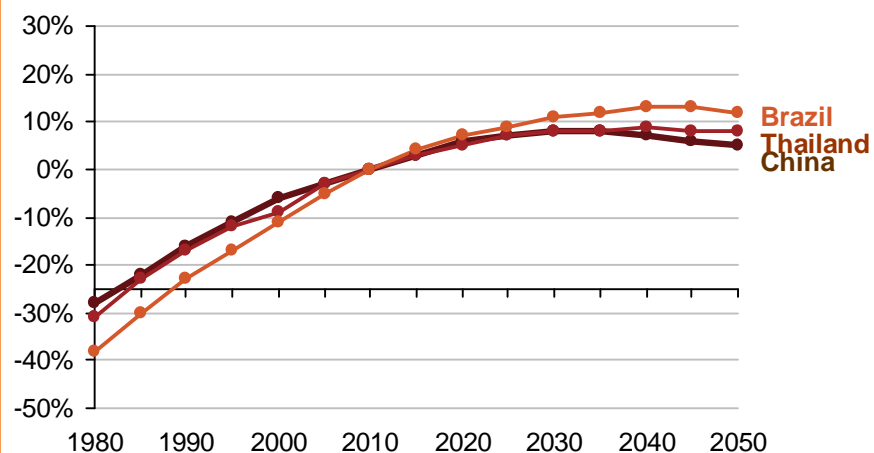
## Developed countries - shrinking

Population growth relative to 2010



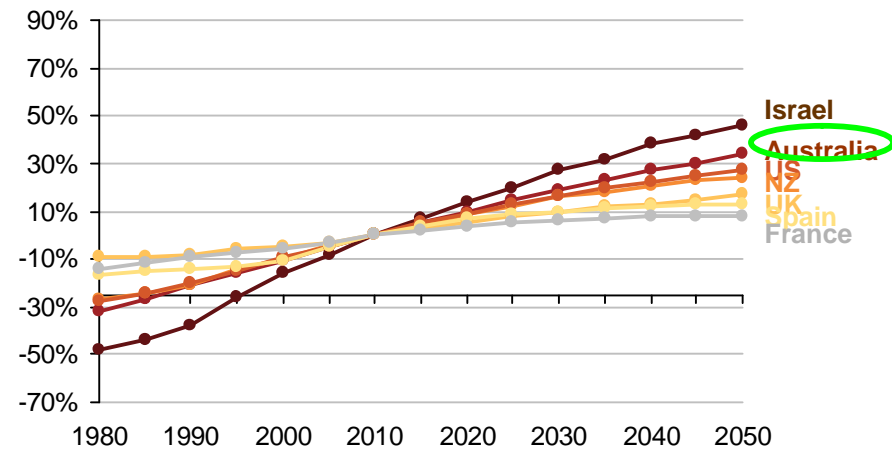
## Developing countries – going to shrink

Population growth relative to 2010



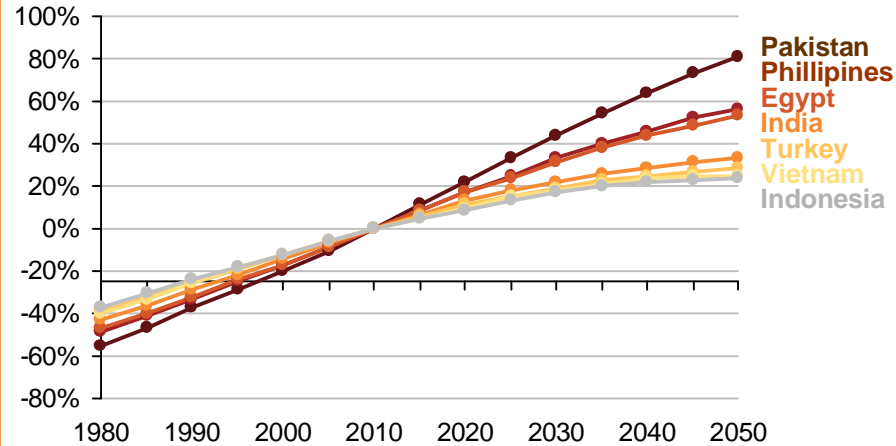
## Developed countries - growing

Population growth relative to 2010



## Developing countries – growing

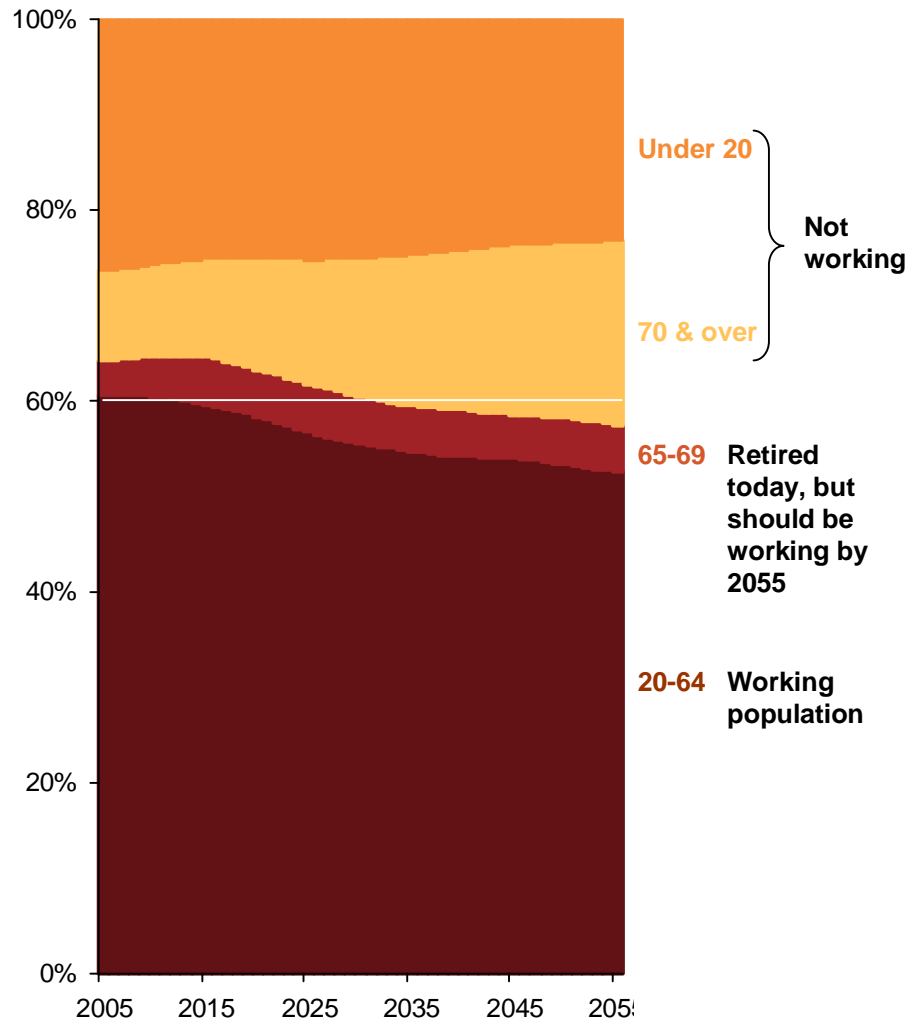
Population growth relative to 2010



# Population distribution – the proportion of employed people will not change much

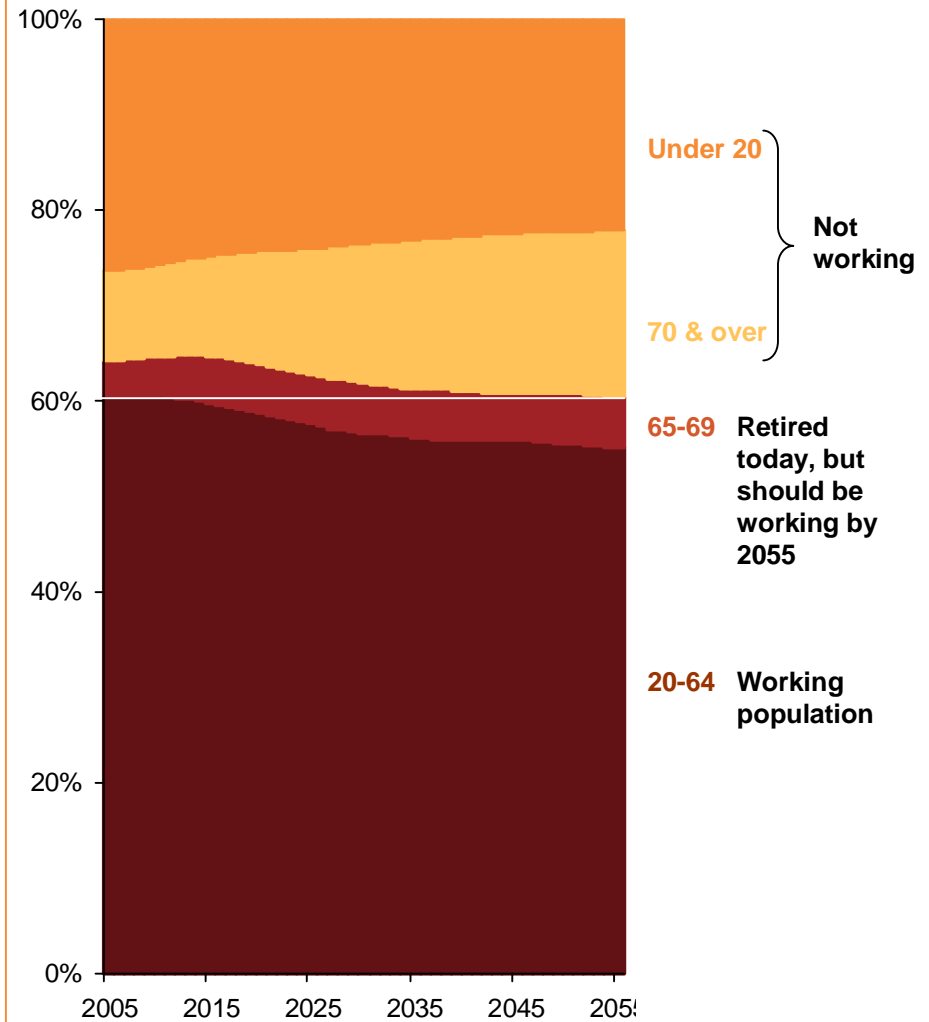
## Australian population

Percentage of population – high growth scenario A



## Australian population

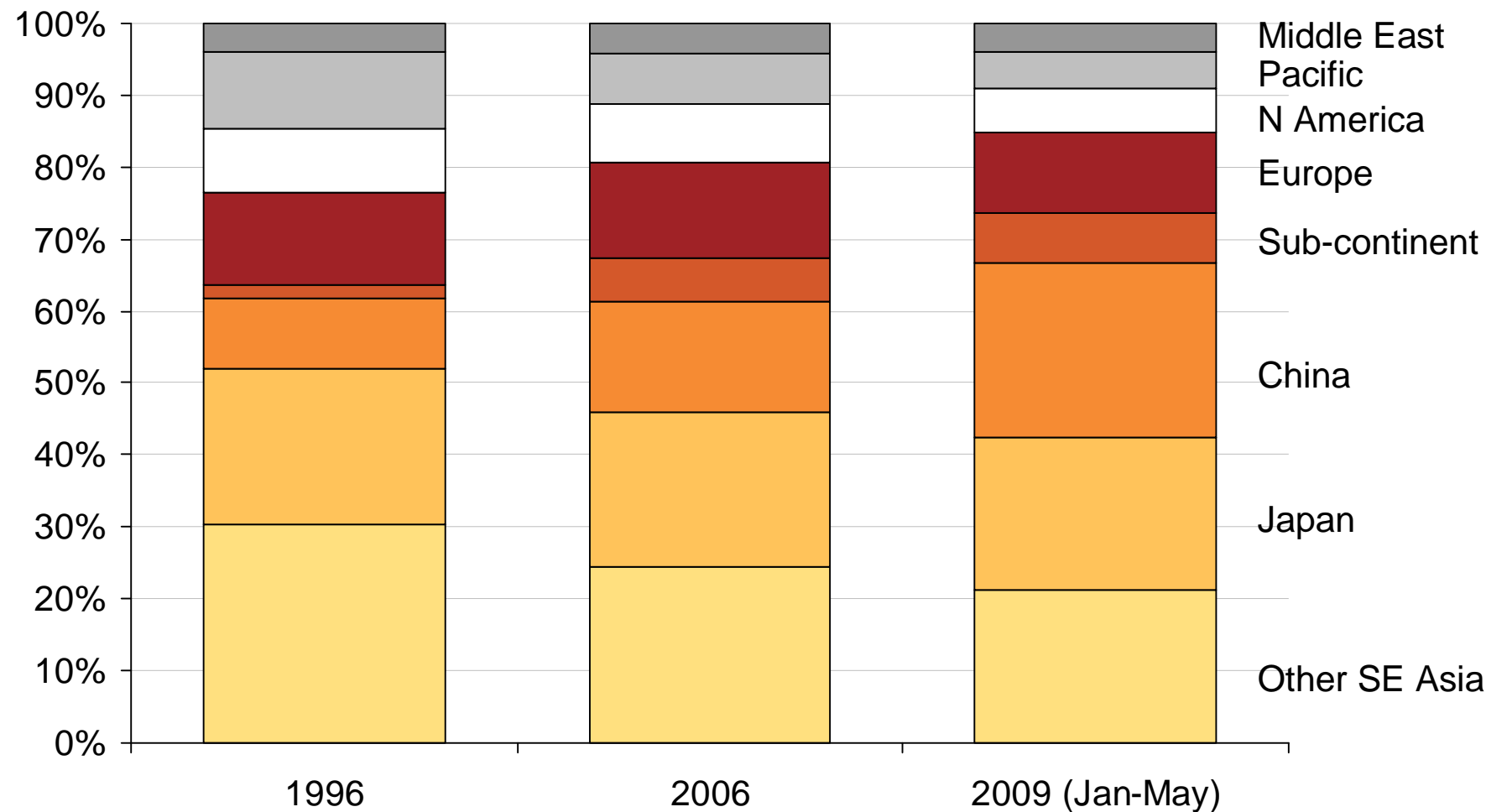
Percentage of population – medium growth scenario B



## China's importance

### Merchandise exports by destination

%



Source: ABS, 5368.0 International Trade in Goods and Services, Australia, Table 14a. Merchandise Exports, Country and Country Groups, FOB Value

Note: Omits countries receiving <0.2% Australia's exports

## Mining boom

### Exports by product

%

