



**Australian Government**

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**The Treasury**

# **The Global Financial Crisis and Implications for Australia**

**David Gruen**

**Wednesday 22 April 2009**

# Causes of the Global Financial Crisis

## Proximate Causes in the US:

- Long-term public sponsorship of home ownership for groups that could not afford it
- Incoherent financial regulation in the mortgage market
- 'Originate to distribute' model for mortgages
  - Mortgages bundled up and 'securitised'
  - Given inappropriate AAA credit ratings and sold to final investors
- Risk was supposed to be spread to those most able to bear it
- In fact, it was spread to those least able to understand it

# Causes of the Global Financial Crisis

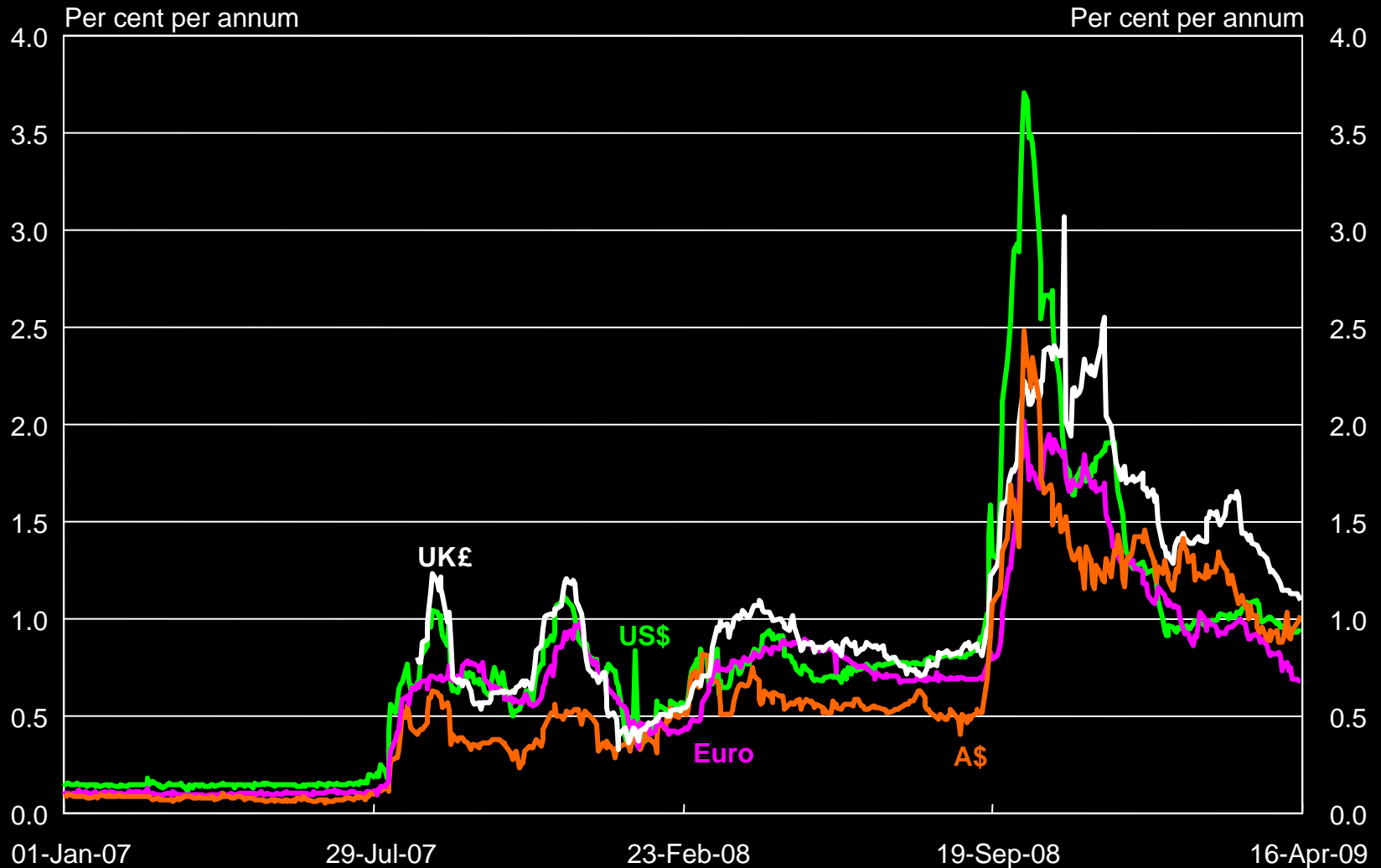
## Wider Causes:

- Large banks, mainly in US, UK, and Europe, gradually became more highly leveraged (more loans for each dollar of bank assets).
- They did this because
  - repeal of the US Glass-Steagall Act in 1999 allowed commercial banks to run large investment banking businesses
  - regulatory frameworks encouraged banks to shift loans ‘off balance sheet’
  - times were good
  - it was very profitable: “while the music is playing, you have to get up and dance”

# Causes of the Global Financial Crisis

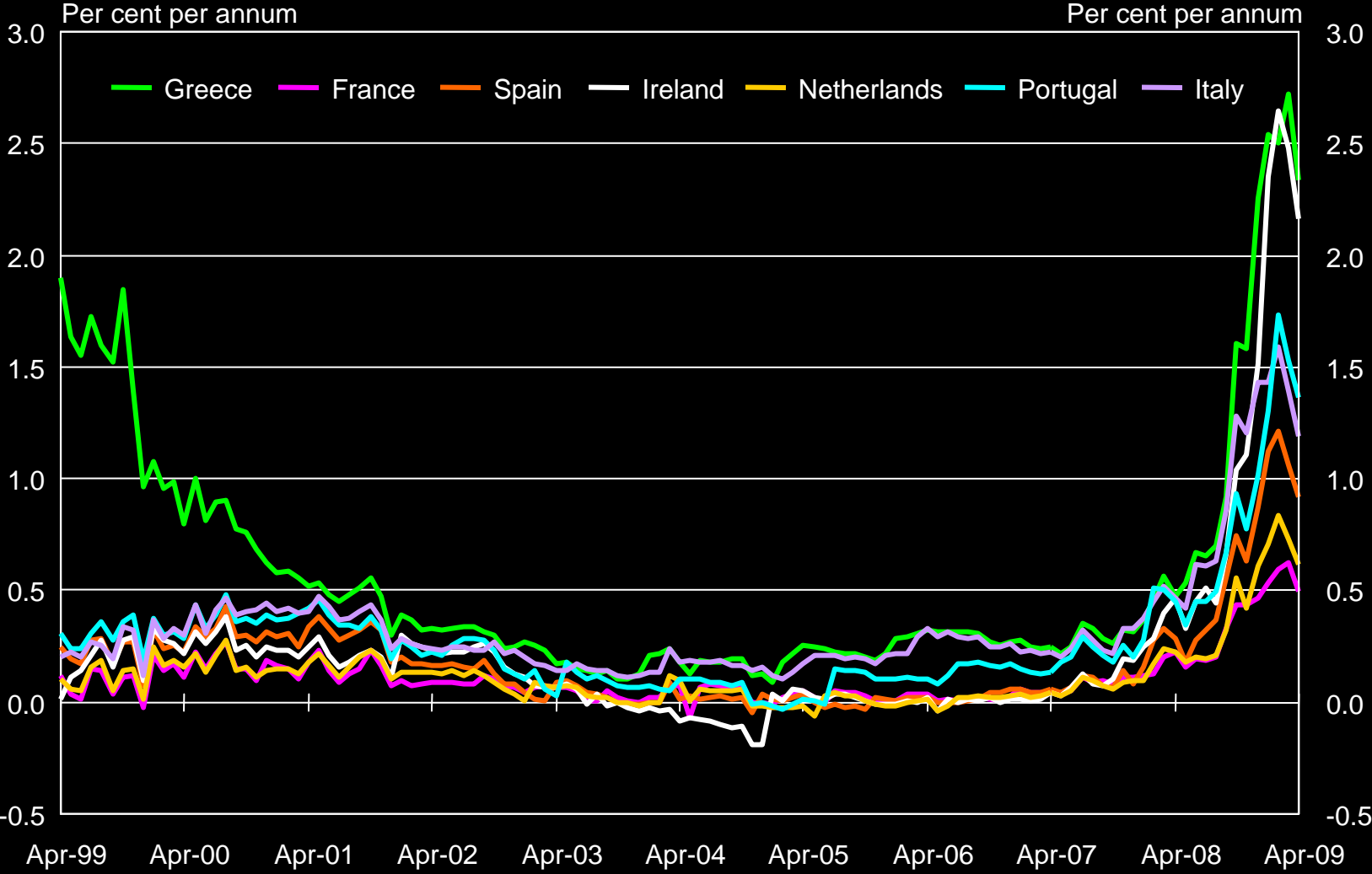
- low global interest rates combined with investors' continuing expectation of high returns encouraged a 'search for yield'
- banks thought they had a better understanding of financial risks than ever before, based on sophisticated models of risk and return
  - : the models were sophisticated, but as it turned out, also spectacularly wrong
- Inappropriate incentives in financial markets – too much pay for short-term returns, not enough downside for losses
  - incentive to take risks which generated good returns most of the time, but with a small probability of disaster

# 3-month LIBOR to Swap Spreads



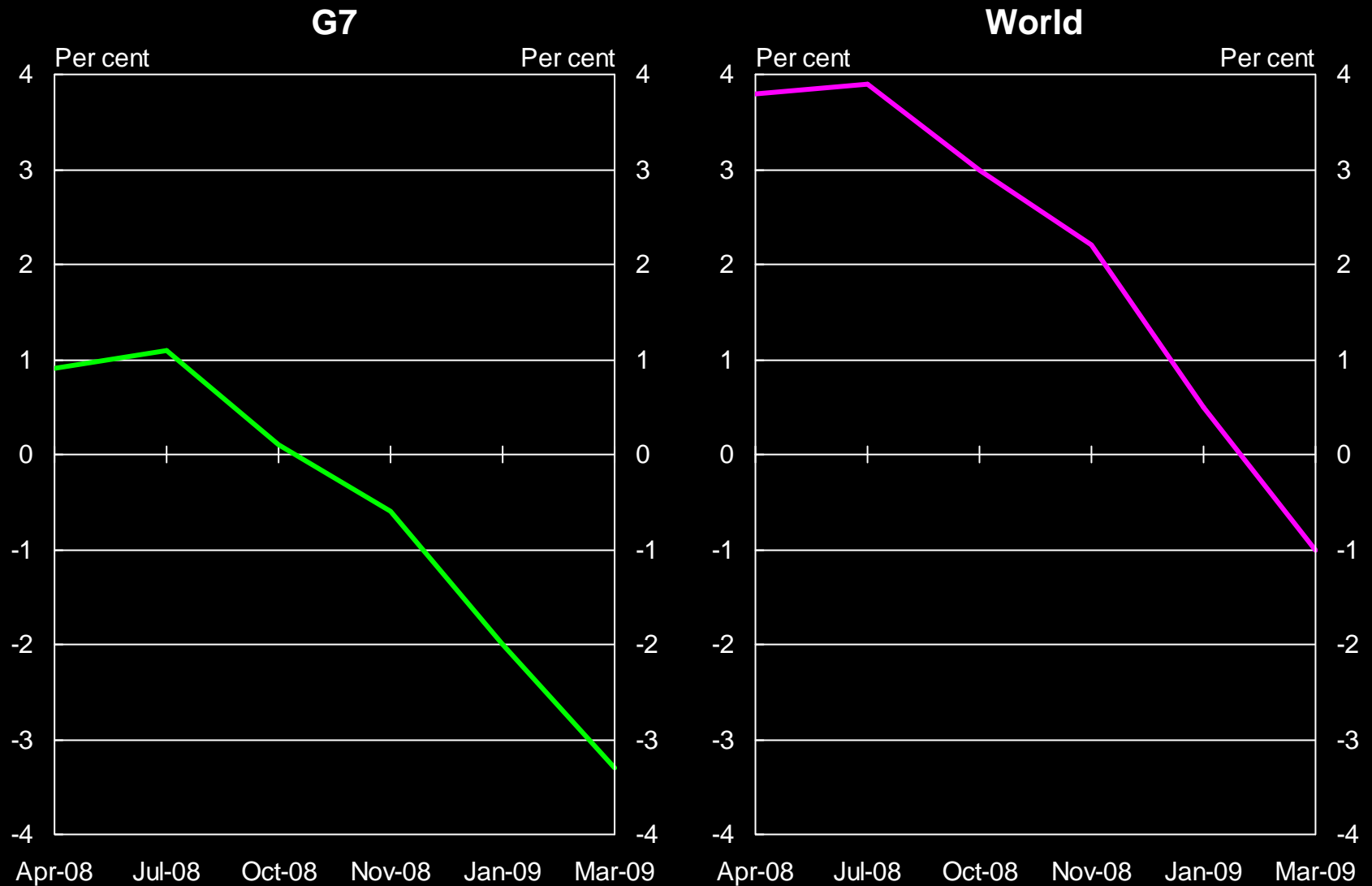
# European Government Bond Spreads

(To 10-year German bunds)



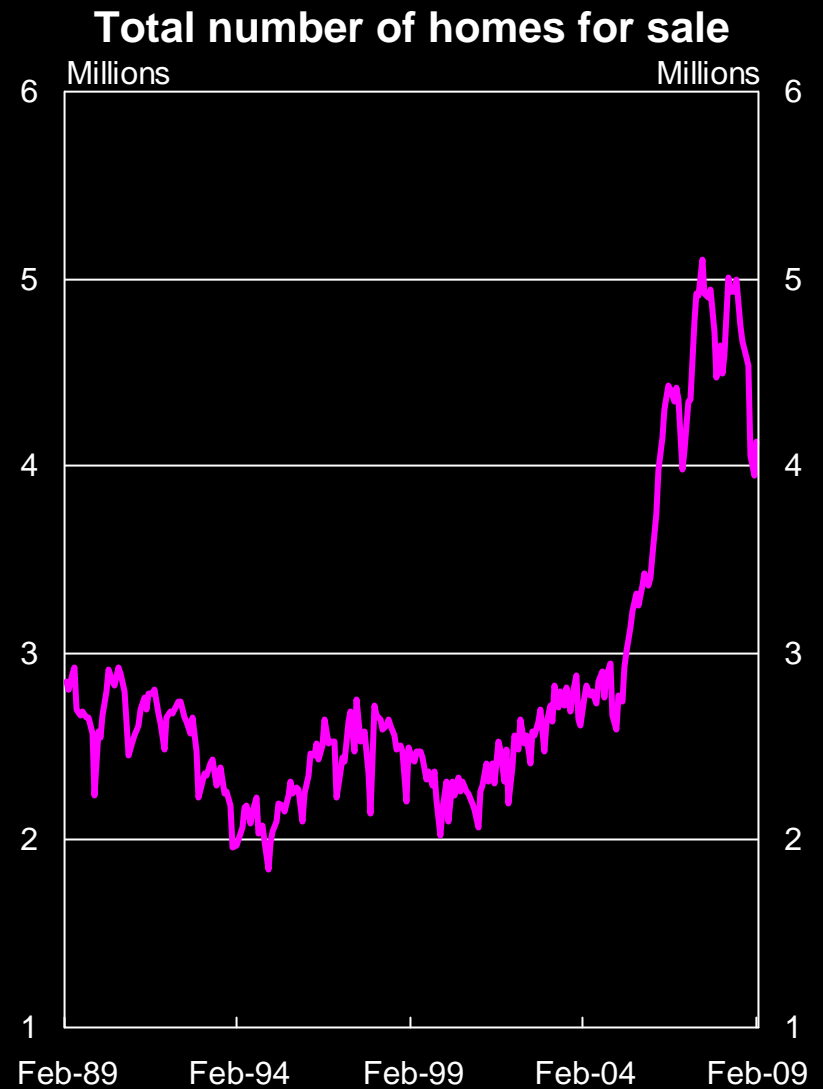
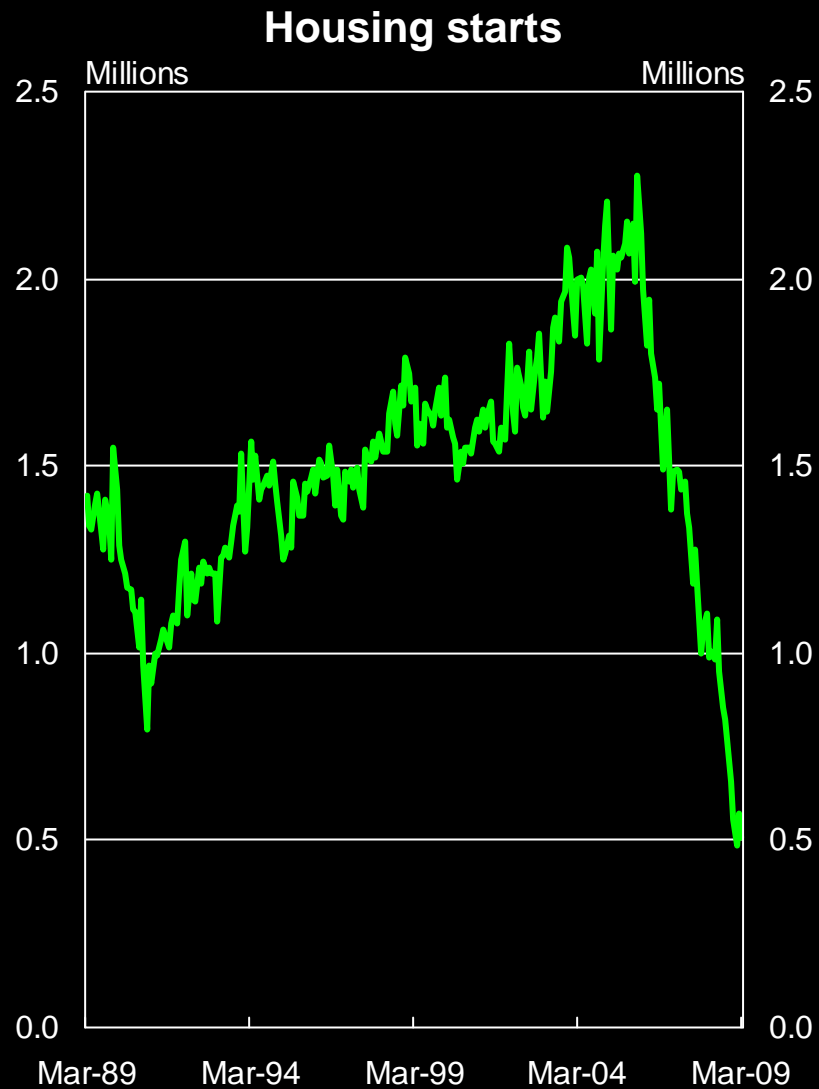
Source: Thomson Reuters.

# IMF Forecasts for 2009 GDP

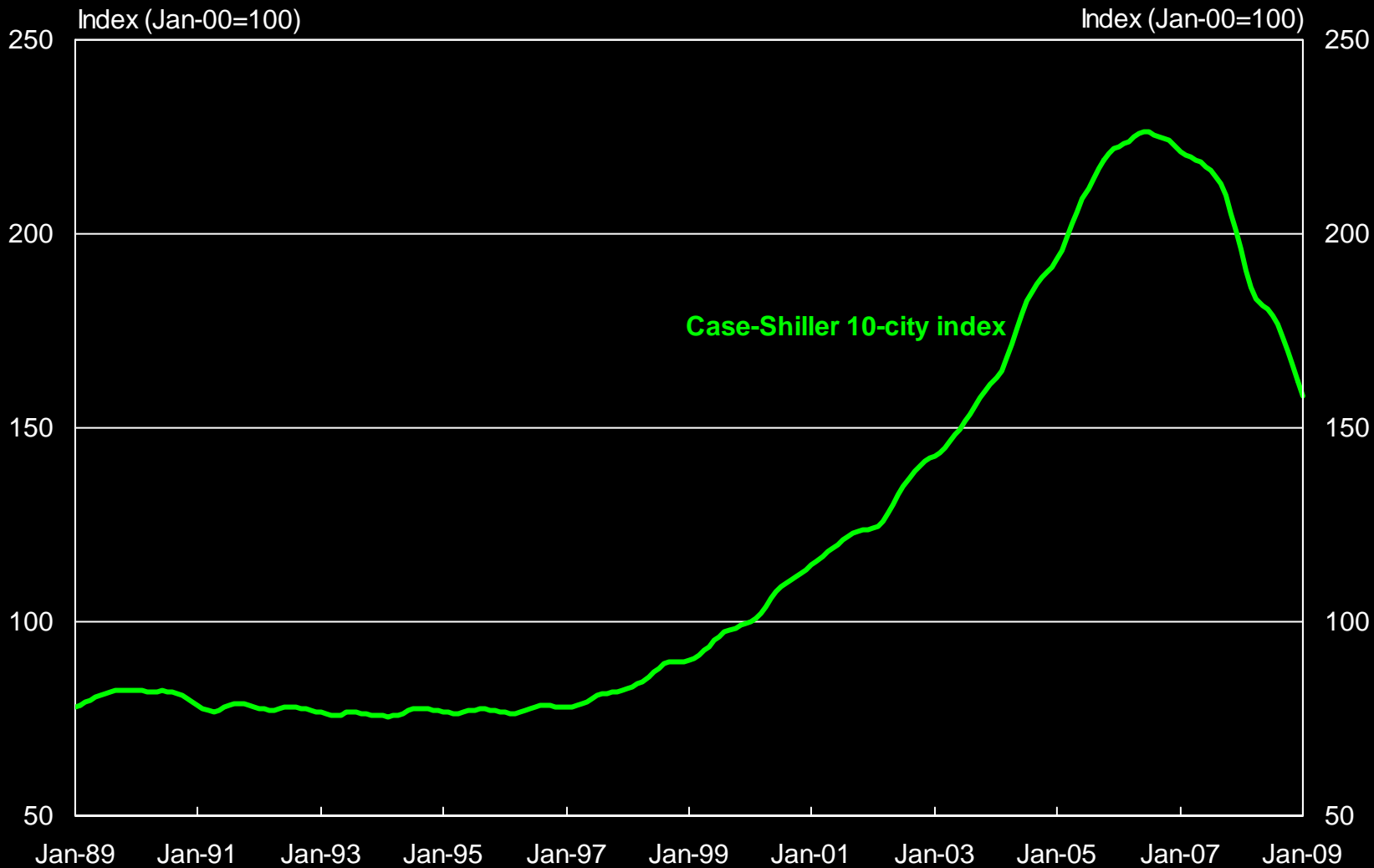


Note: March 2009 forecast is lower bound of IMF estimates. No G7 forecast was provided in the March update, so G3 forecast is used.  
Source: IMF.

# US – Housing Indicators

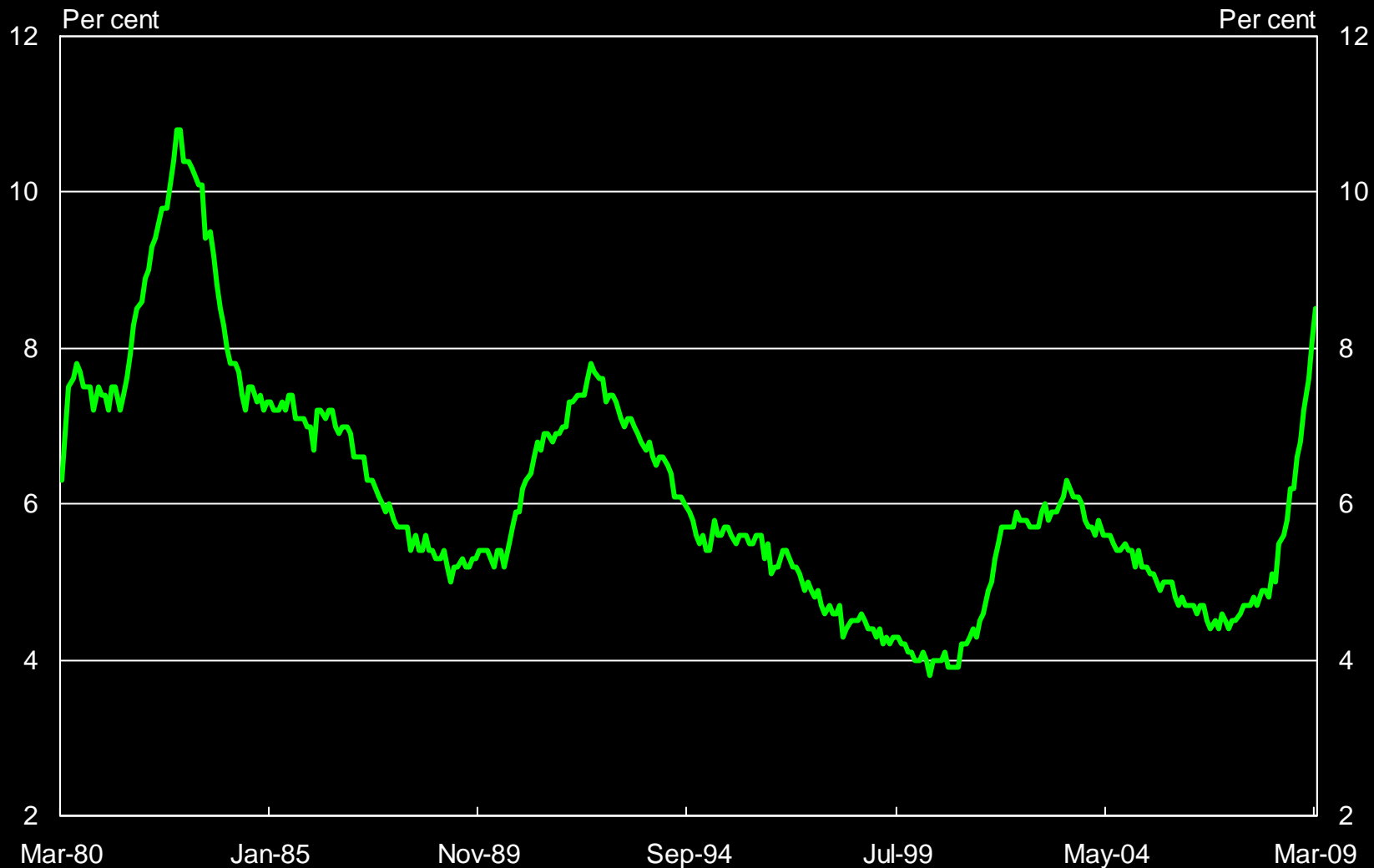


# US House Prices



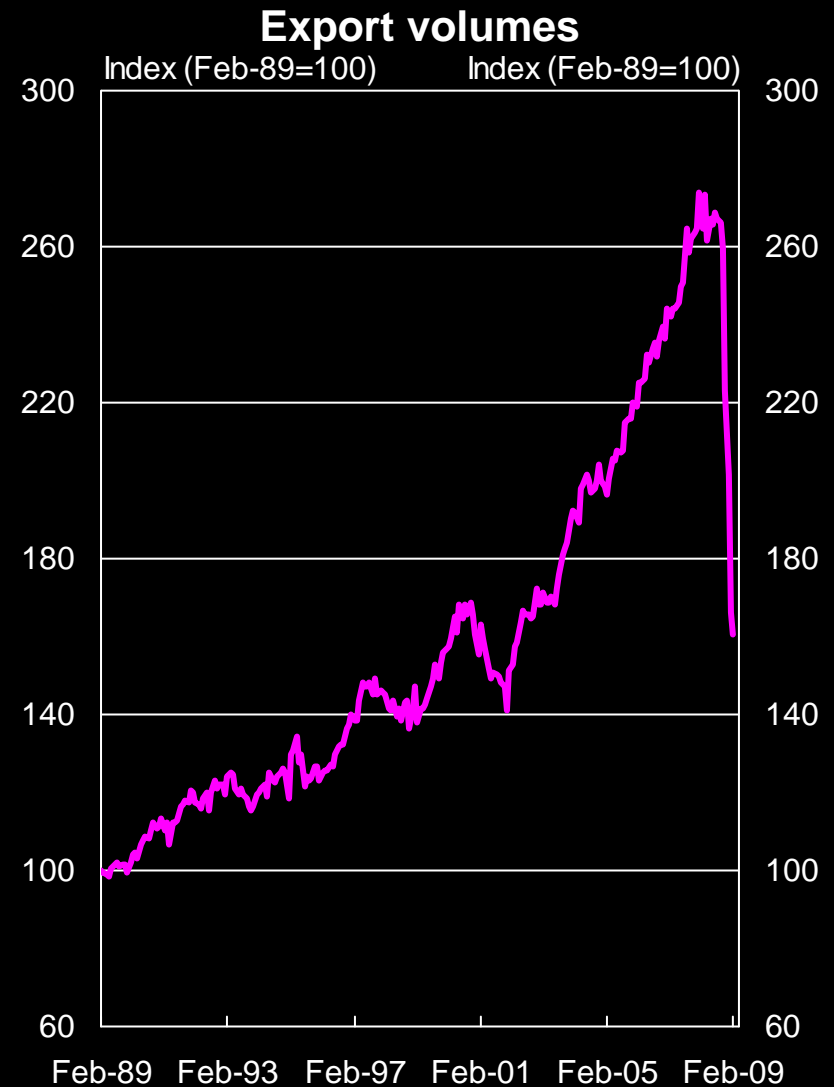
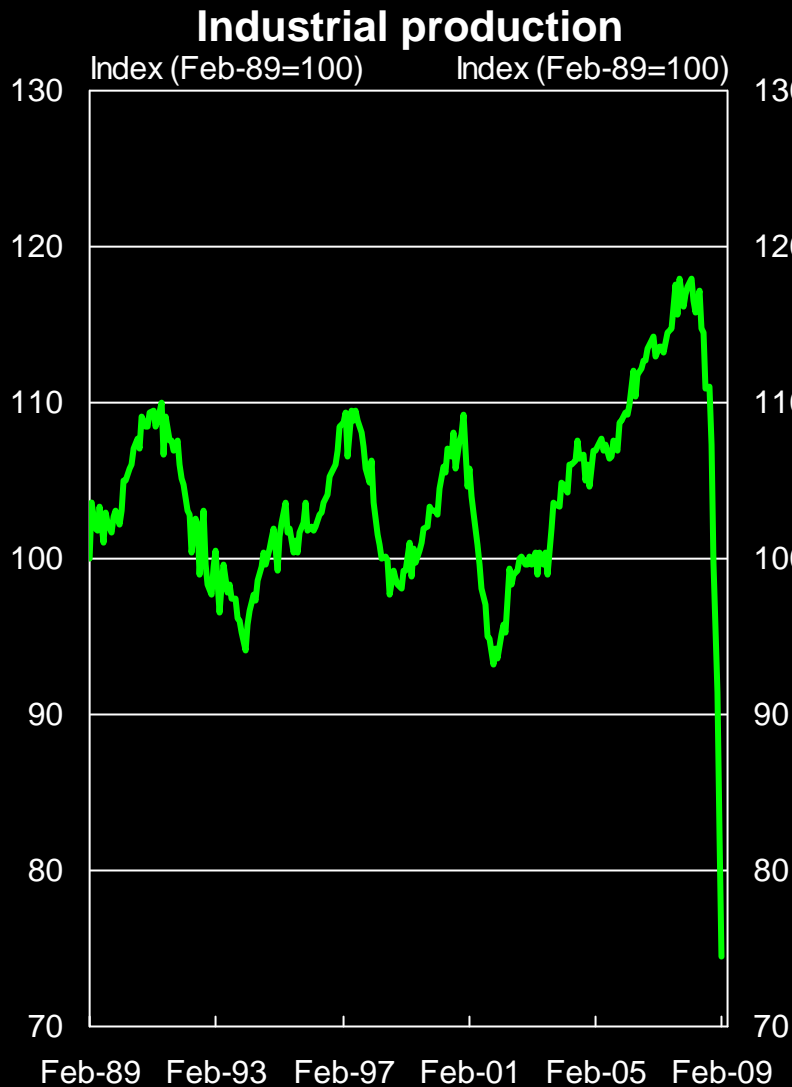
Source: S&P/Case-Shiller.

# United States – Unemployment Rate



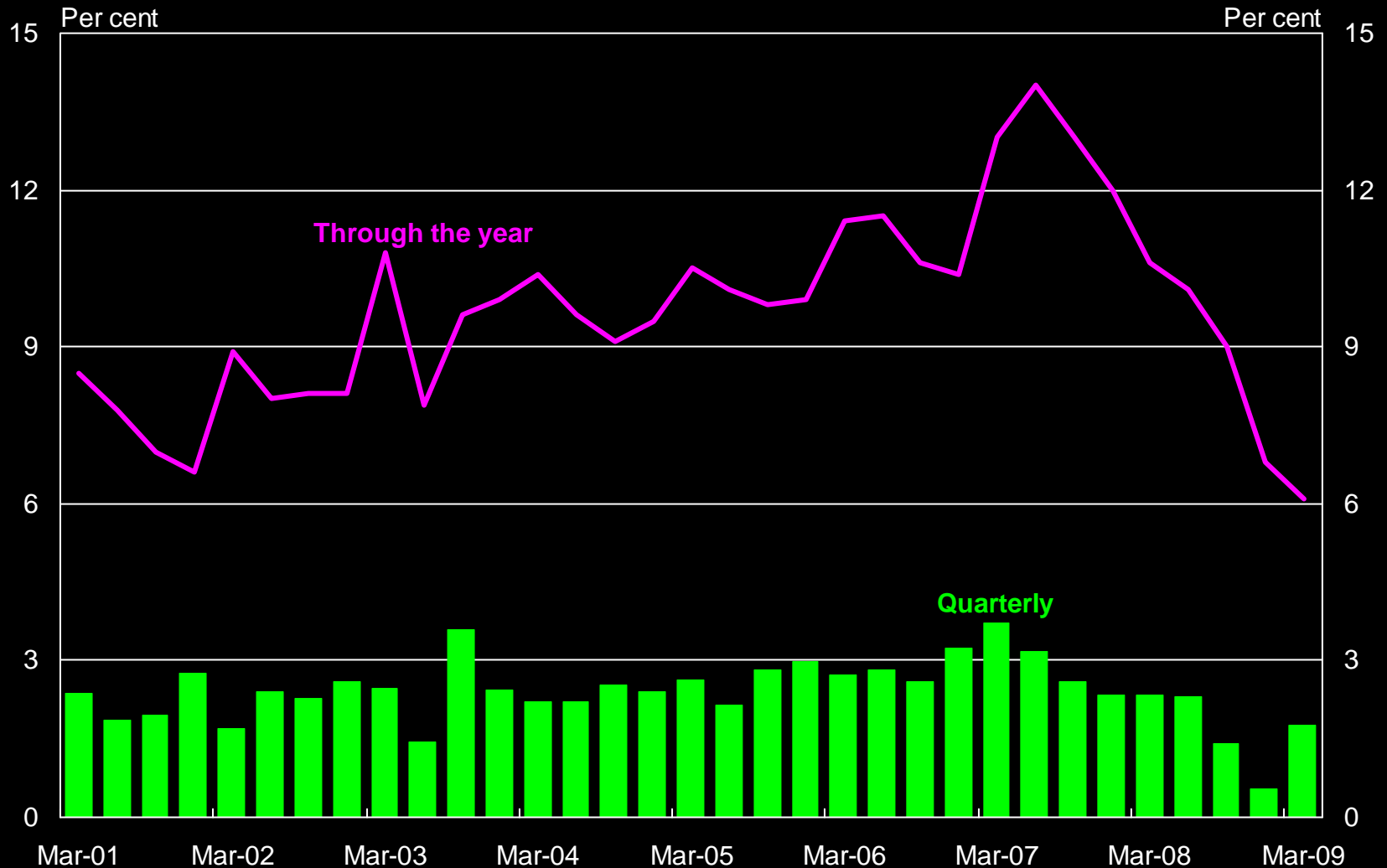
Source: Bureau of Labor Statistics.

# Japan – Industrial Production and Exports



Note: Industrial production is seasonally adjusted.  
Source: Ecwin and Treasury.

# China – GDP



Note: Quarterly figures are Treasury estimates. GDP is on a production basis. Through-the-year data are in original terms.  
Source: CEIC China database and Treasury.

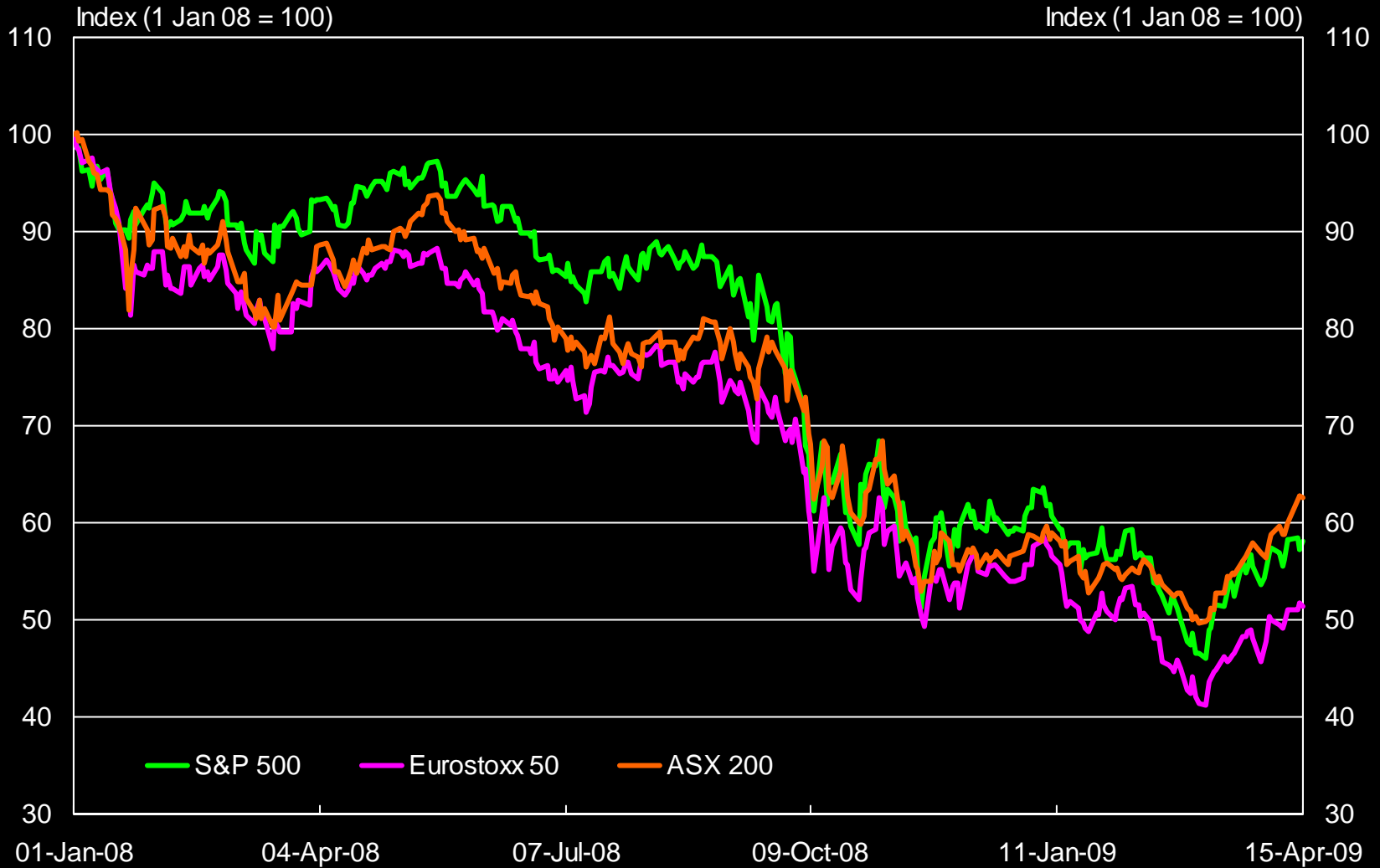
# OECD Output Gap



Note: Estimates of potential output have not been revised and therefore do not incorporate the reduction in supply implied by the downturn. Not all countries had reported their December quarter 2008 GDP at the time of calculation.

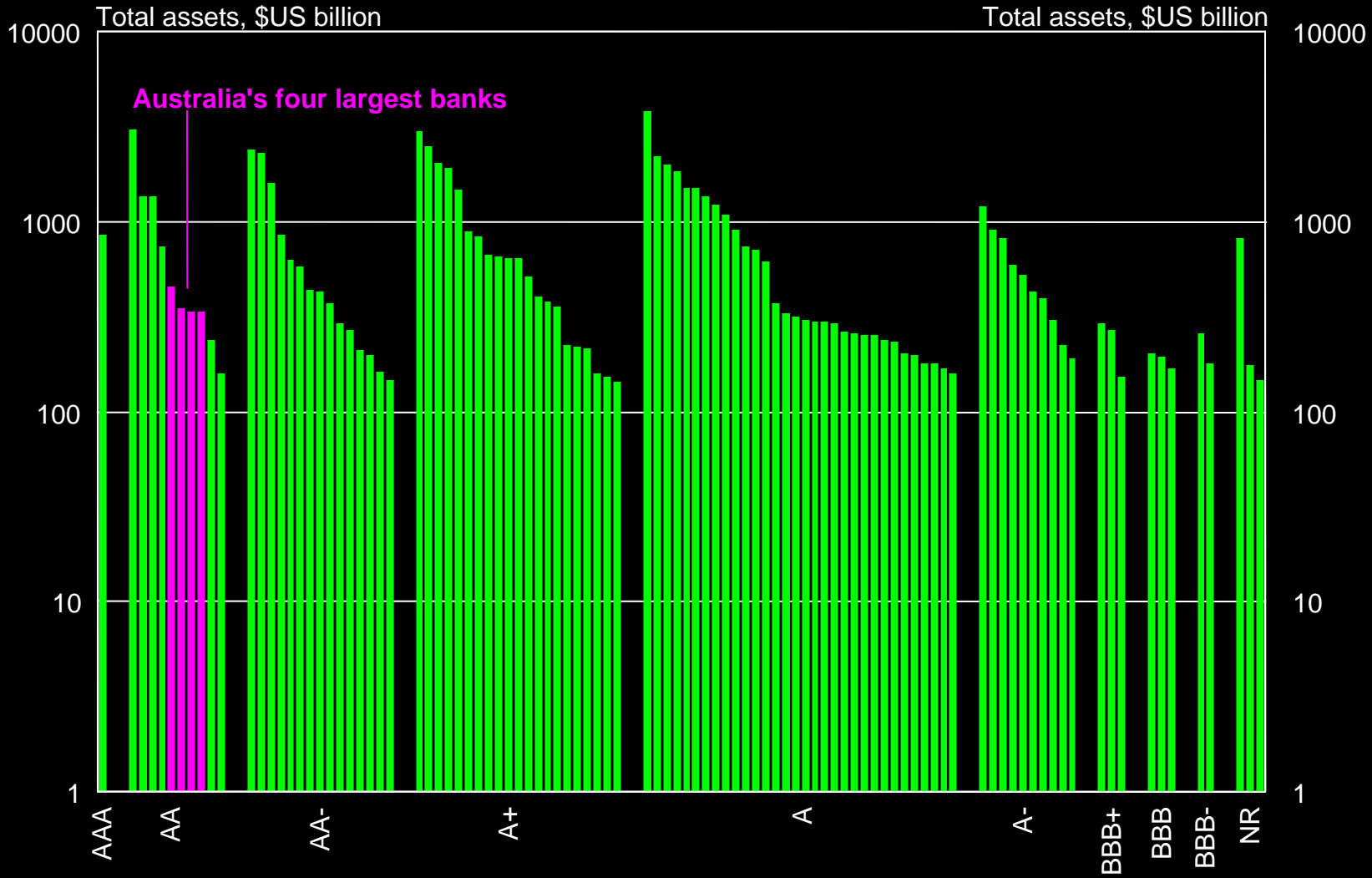
Source: OECD.

# Global Equity Markets



# Credit Ratings of the Largest 100 Banking Groups

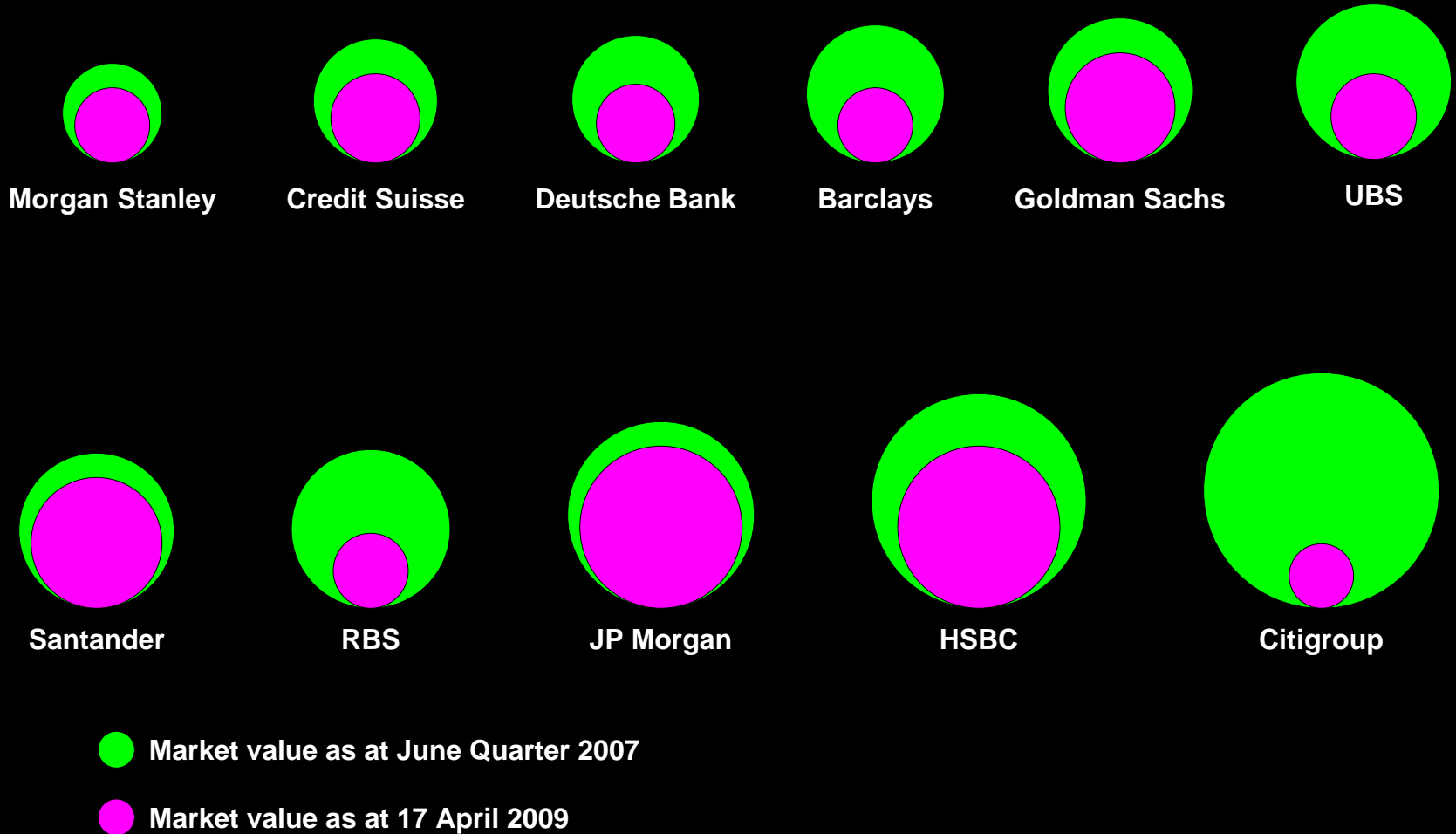
(Log scale)



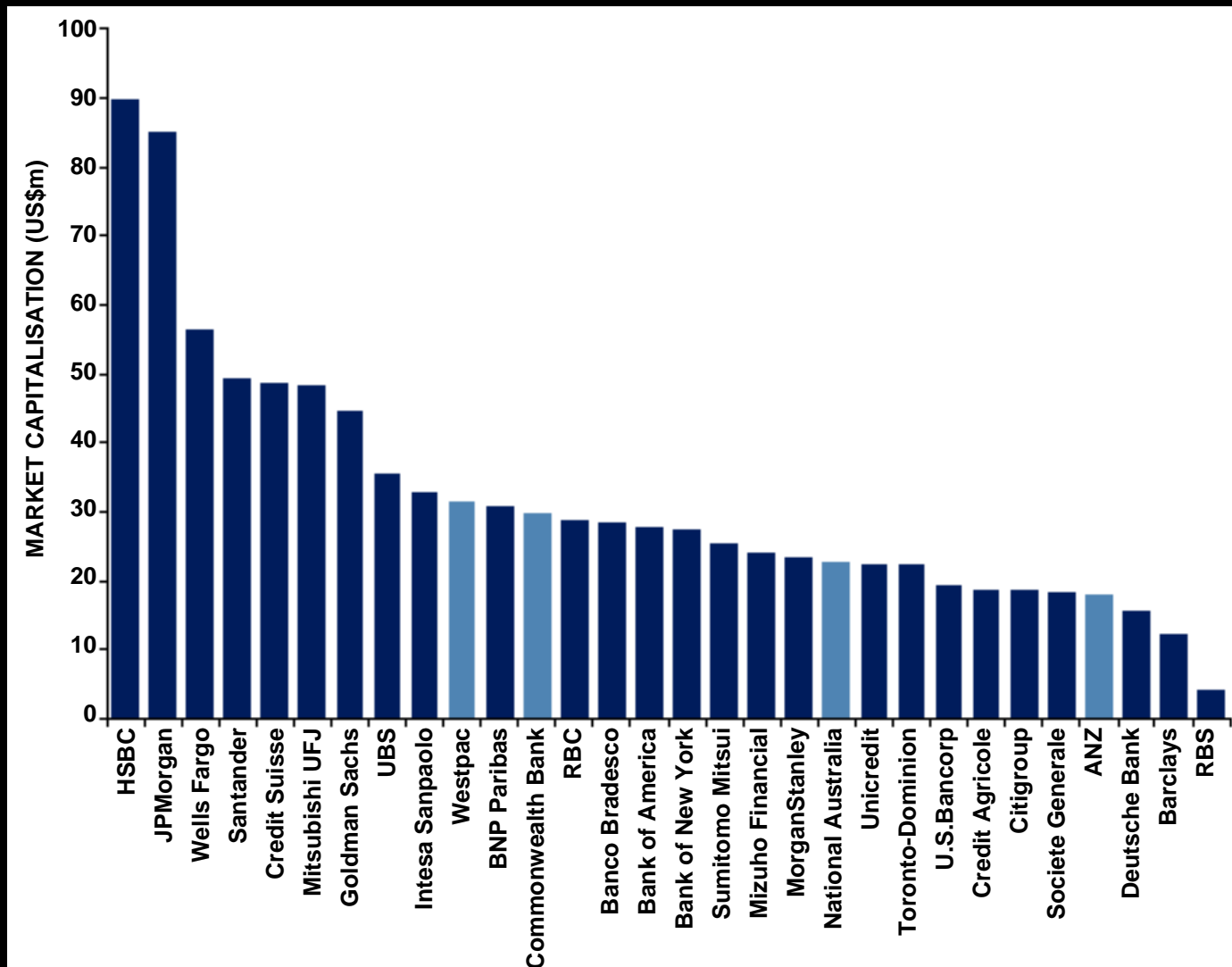
Note: Assets as of late 2007. Ratings as of 20 April 2009. Holding company ratings, predominantly Standard and Poor's.  
 Source: Bloomberg, *The Banker*.

# Banks: Market Cap

(\$US Billions)



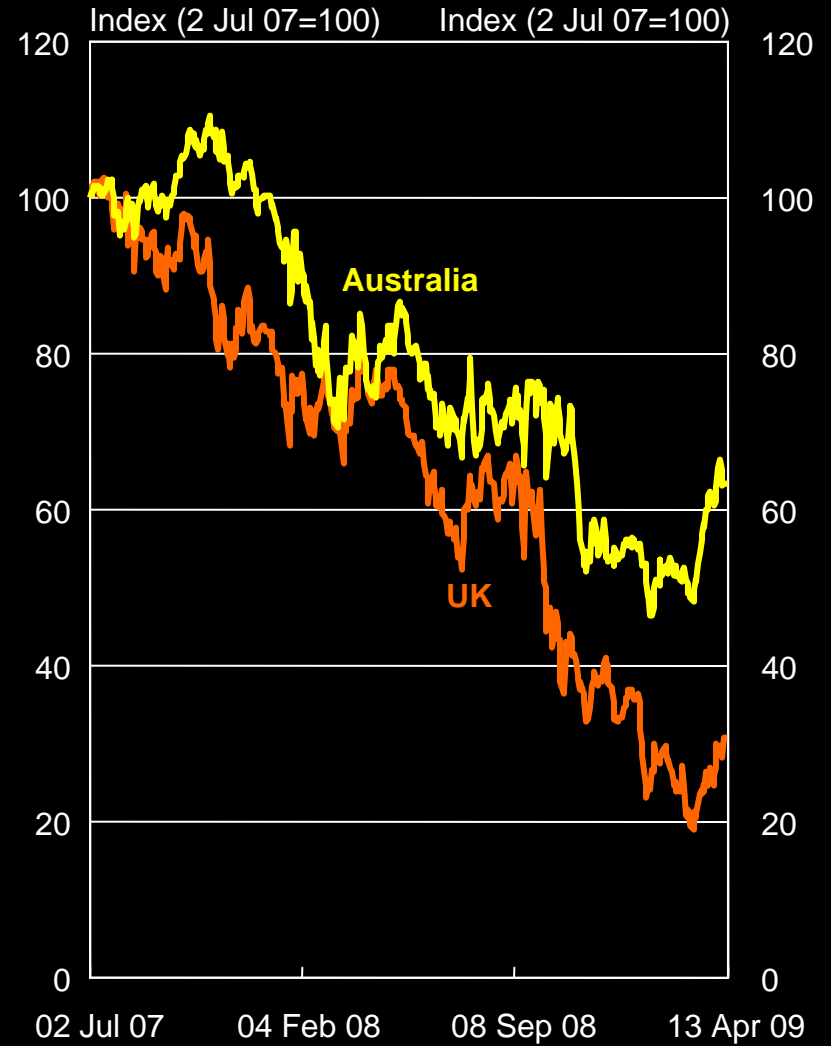
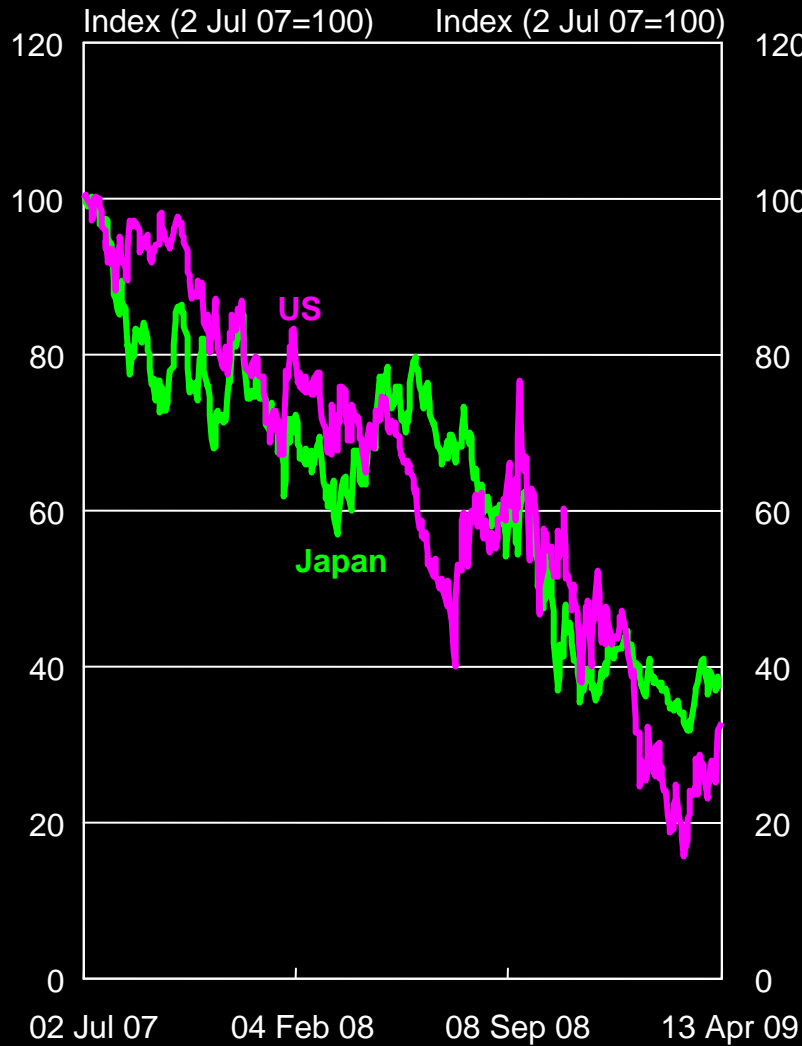
# Thirty Largest Banks in the World



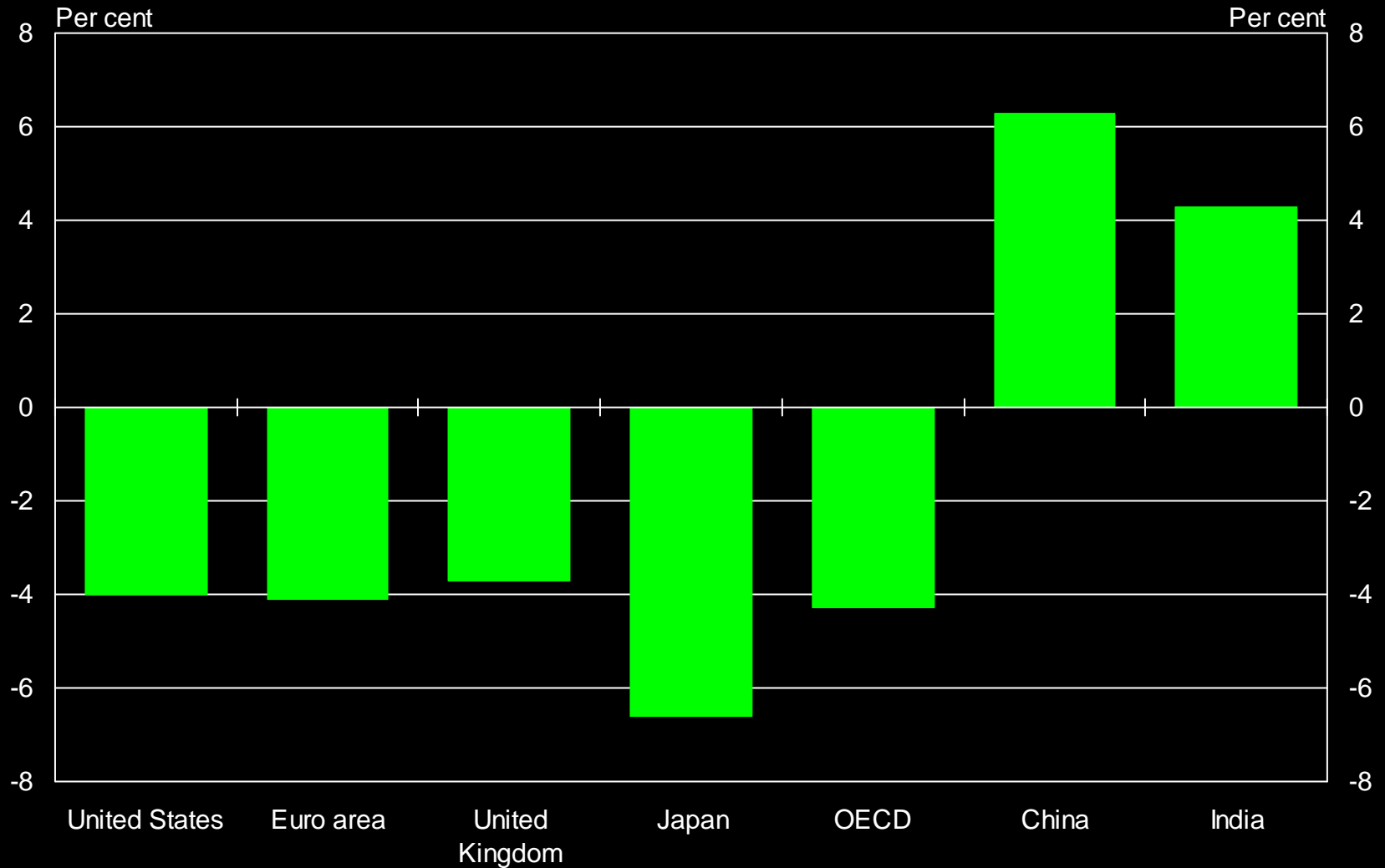
Note: Thirty largest banks by market capitalisation (excluding Chinese State Owned Entities e.g. ICBC). RBS is included for illustrative purposes, despite no longer being one of the top 30 largest banks globally. Market capitalisation is translated into U.S. dollars using relevant exchange rate as at 13-Feb-09.

Source: Reuters (as at 13-Feb-09).

# Banks' Share Prices

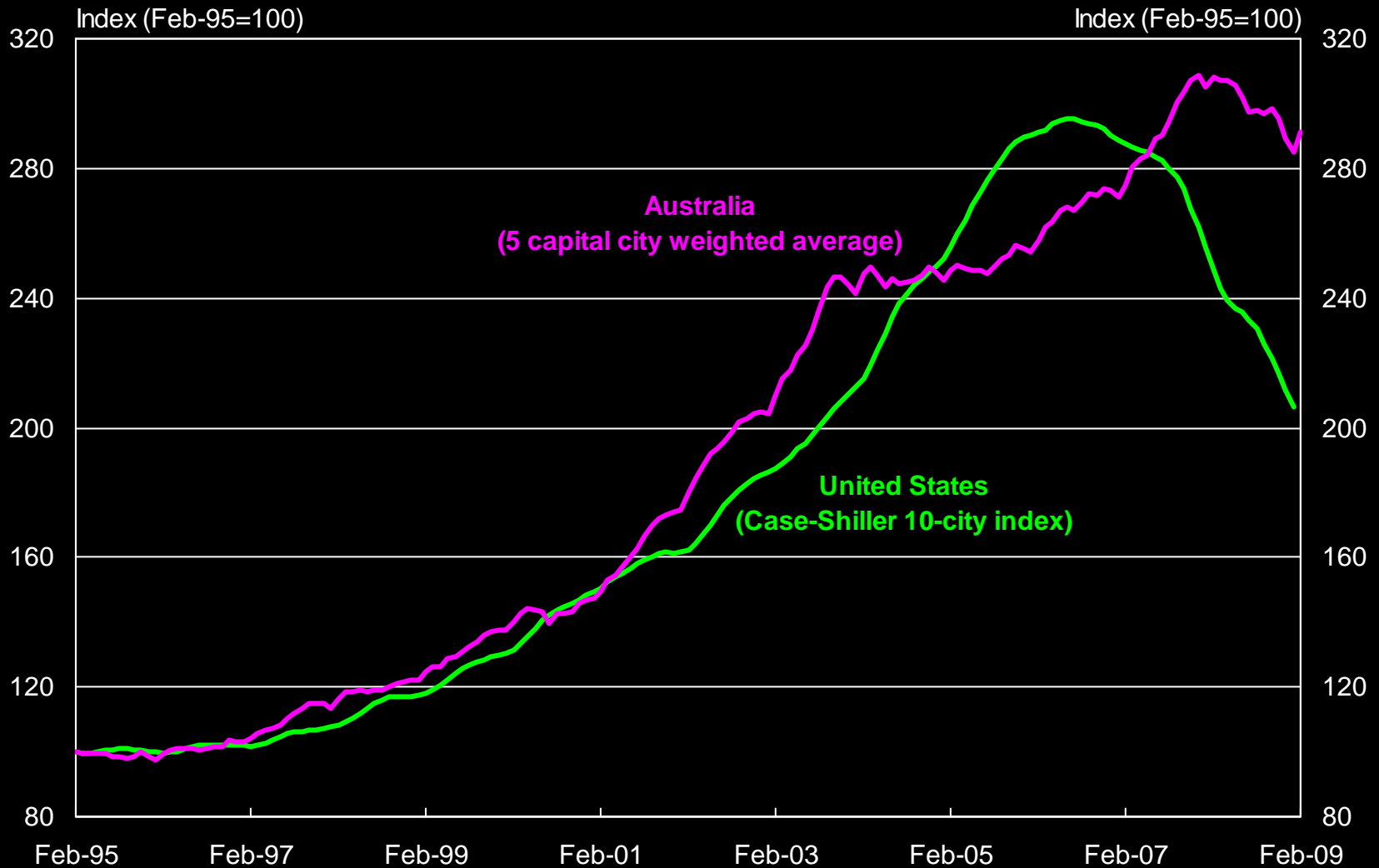


# OECD Forecasts for 2009 GDP



Source: OECD.

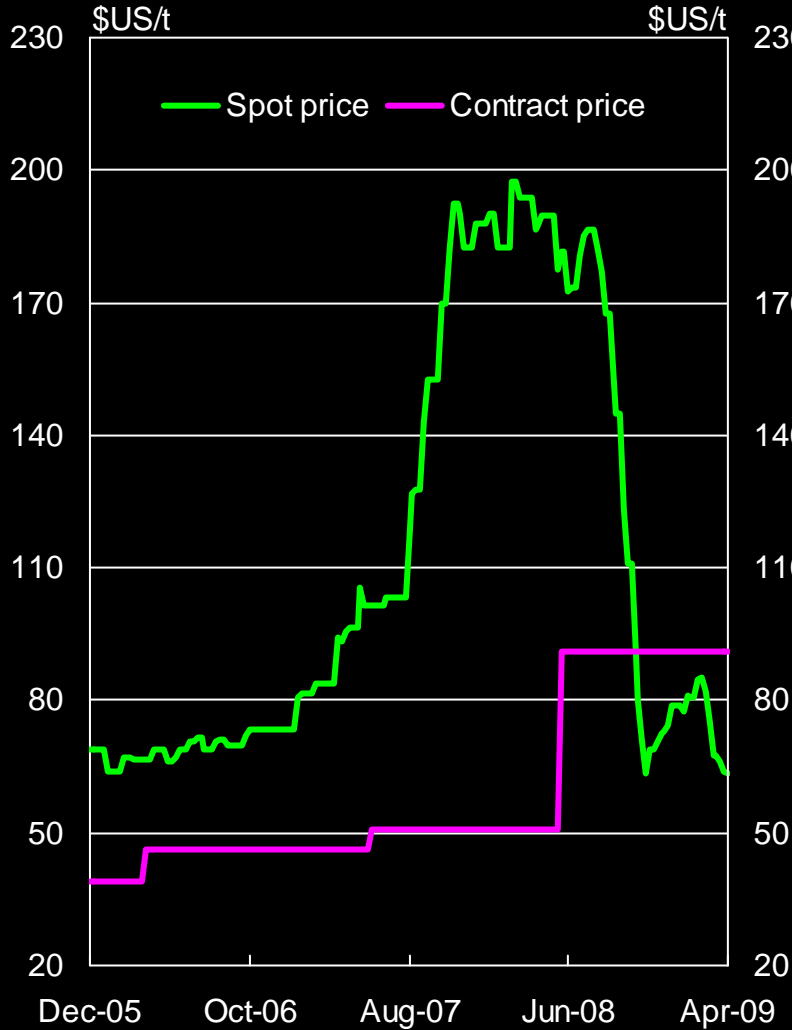
# House Prices



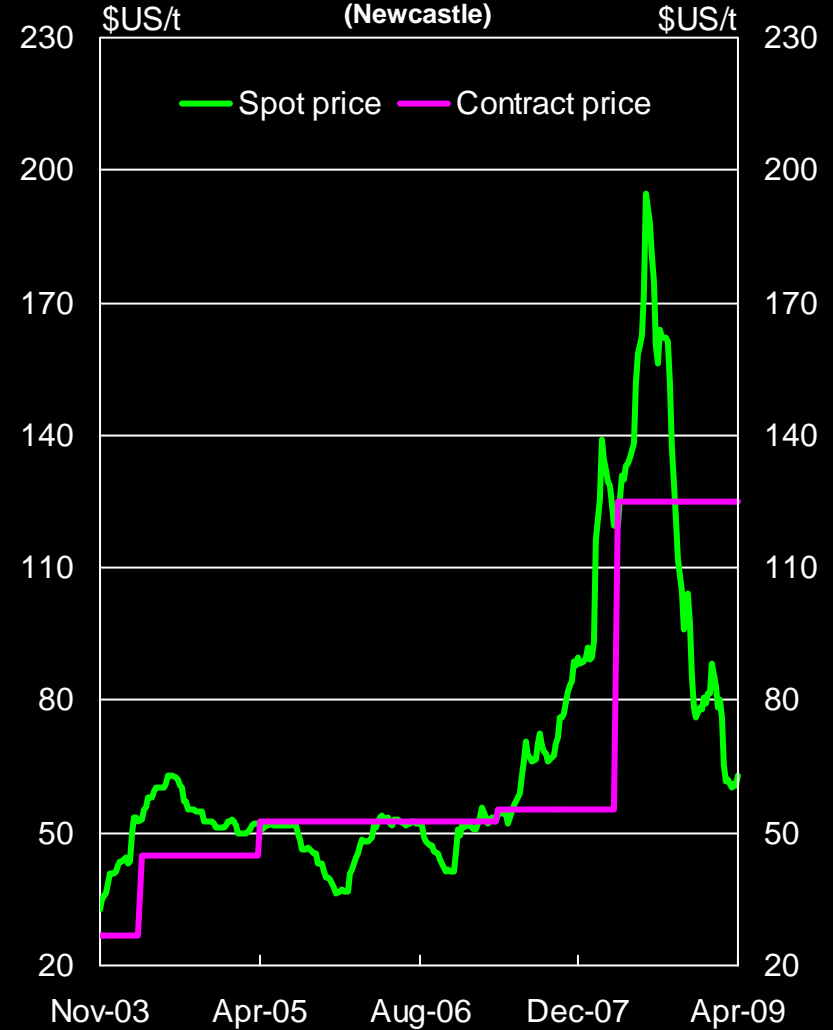
Source: S&P/Case-Shiller, Australian Property Monitors and Treasury.

# Bulk Commodity Prices

## Iron ore



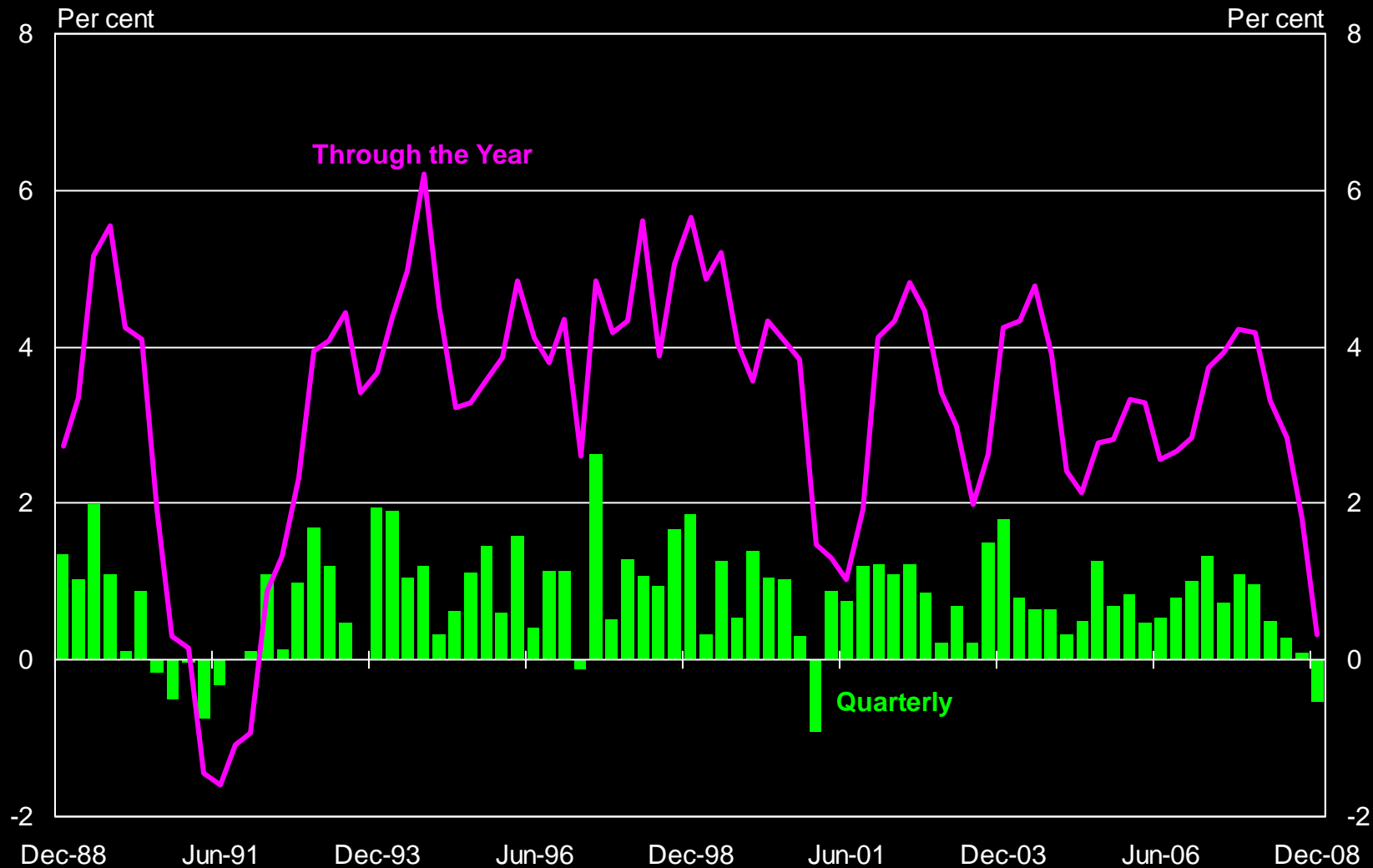
## Thermal coal



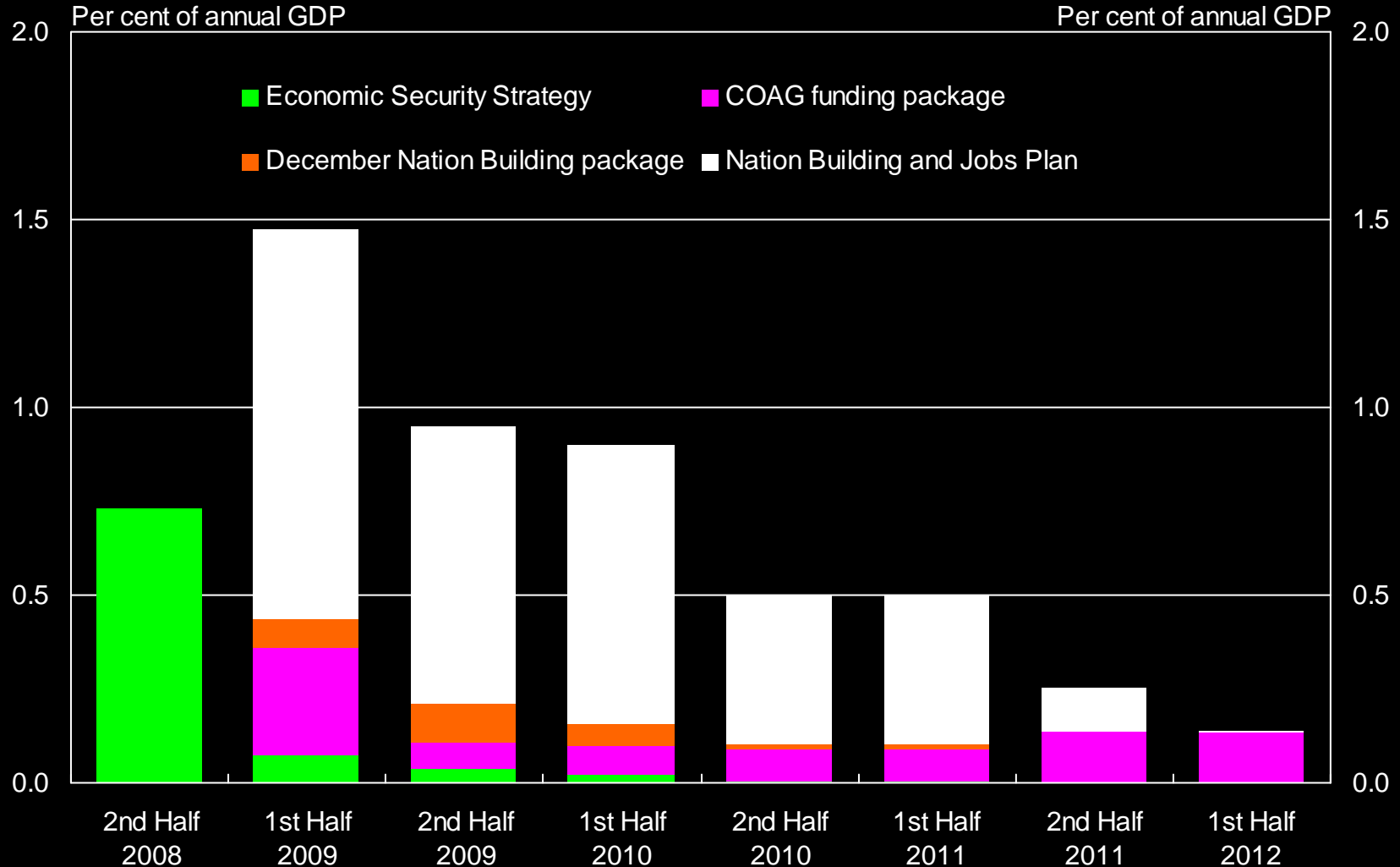
Note: Iron ore spot price is CFR for India/China imports.  
Source: Bloomberg, Global Coal and ABARE.

# Australian Real GDP

(Seasonally adjusted)



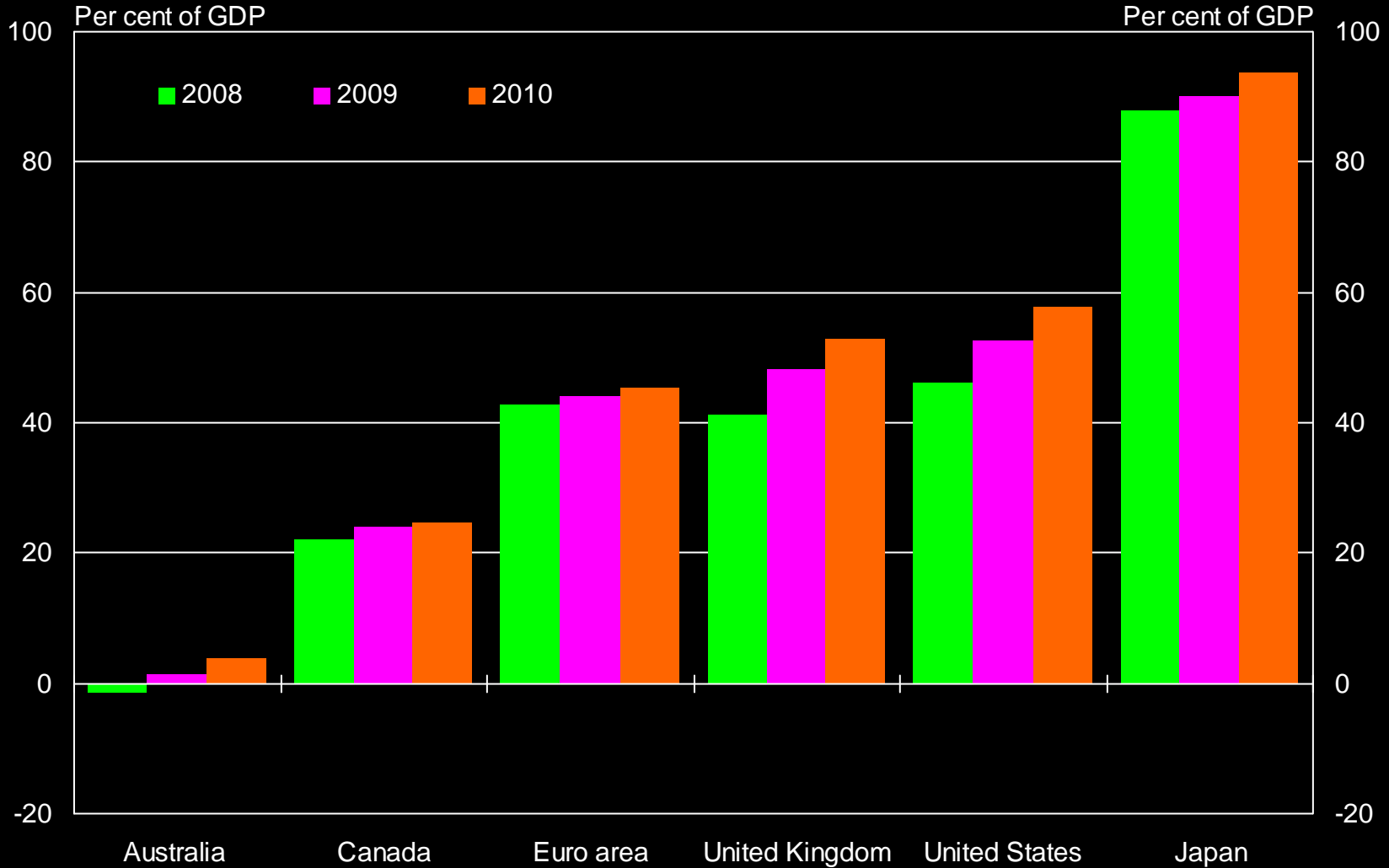
# Fiscal Stimulus Packages Delivered by the Australian Government



Note: Impact on underlying cash balance as a per cent of annual GDP.

Source: Treasury.

# Net Debt Selected Countries 2008-2010



Note: Data refer to calendar years except Australian data are for the Australian Government general government sector and refer to financial years from 2008-09, and UK data refer to financial years from 2008-09.

Source: Treasury, HM Treasury and OECD Economic Outlook 84.



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