MIND THE GAP:

PREPARING FOR AUSTRALIA'S THIRD CENTURY OF ECONOMIC GROWTH

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CHECK AGAINST DELIVERY

Introduction

Thank you Steve for that introduction and thank you all for coming today. I heard there was going to be a big turnout but wow!

When I moved to Melbourne 22 years ago the AICC was already the place for business people to discuss important issues, so it's a privilege to be here.

Back in June when I agreed to give this speech my footy team had won five out of the last six games. So I thought, great! September—I can talk about the finals.

Unfortunately, my family barracks for Richmond, so I had to come up with something else.

So instead I thought I would try to address one of the great mysteries of modern Australia—and no, I don't mean Dustin Martin's hair.

The mystery is this: Why is there such a gap between what the economic facts are telling us, and how people feel about the future of the national economy?

Australia's GDP is growing at 3.3%; unemployment is 5.6%. Over the past five years median income has risen by 15%, the average amount spent by households on servicing their debt has fallen by 8%, and the oil price has fallen by 45%. Mortgage interest rates are at 50 year lows, and property prices are rising in major markets.

And yet a recent survey by JWS Research showed that only 14% of Australians believe the national economy is headed in the right direction[1].

This is more than a comment on politics, or regional variations due to mining. It shows up in Westpac's survey of both business and consumer sentiment.

So how do we explain this mystery?

Before proposing an answer, and to give some context, I'd like to address three questions:

First, what's going on in the world economy, and what opportunities and challenges does this create for Australian businesses?

Second, what's the role of banks in supporting this changing economic landscape?

And third, how is Westpac responding, especially given the current reputational issues that the industry faces?

Why the pessimism?

I'll start with the world economy, which still hasn't fully recovered from the GFC. As Glenn Stevens pointed out last month, over the last ten years GDP growth in the G7

[1] JWS Research, "True Issues #10", August 2016.

economies averaged just under 1%. This compares to 2.5% in the 10 years leading up to 2006.

Since 2008 central banks have been operating with "emergency monetary settings". Money has been pumped in, and interest rates have been lowered dramatically—in some countries like Switzerland and Japan, they are actually negative.

At a recent conference I attended, a former central banker said "the problem is it's not working…and we don't really know why."

That creates a feeling of uncertainty and unease.

The "king tide" of technology has clearly played a role as well. In many industries it's upsetting business models, changing cost structures, and creating new competition. This creates uncertainty for business leaders and job anxiety for employees.

Global media also contributes. We're all now just one click away from the latest attack by ISIS, the latest immigration battle in Europe, or the latest 'wisdom' from Donald Trump. That makes the world seem a much smaller place, and it leads us to project issues from one market onto our own.

All of this has created a growing anxiety about the future and political dislocation.

In the recent Federal election a record number of people voted for minor parties. That says that a sizeable minority of Australians are uneasy about the status quo.

They're asking questions like:

- Will I have a job in a year?
- Will I have enough for my retirement?
- How will my children cope in this new world?

So that's the expression of Australians' pessimism. But back to my mystery. *Why* are Australians pessimistic?

I think we are witnessing what I would call an aspirations gap.

In the 2000s things felt easier. The resource boom was in full swing. Up til 2008, median incomes rose 7% per year on average. House prices rose 10% per year on average. Retirement was a long way away, and the kids were still in school.

Now income is rising more slowly. We've renovated the house, but haven't managed to pay off the debt. We're worried about our jobs, and some fear immigration. Retirement looms closer, and stock markets are going sideways. That teenager is now 25 and still slumped on the couch. We're worried about her future, and whether she'll ever be able to buy a house.

Life hasn't quite worked out the way many Australians expected. The dream of a bright future that they aspired to seems farther away.

Challenges and opportunities for Australia

So, what do we do about this?

My first observation is that things *are* improving. The Australian dollar has come down, helping exports. Resource shipments—especially natural gas—are growing. The apartment construction boom is supporting growth in manufacturing, and rainfall points to a bumper crop season—although we've clearly had a bit too much rain here in Victoria. The shift to a service economy is happening, with nearly 750,000 new jobs created in service industries in the last five years.[2]

As a result, we think business conditions are improving as is business confidence.

My second observation is that we can't rely on central banks or governments to keep pumping money into the economy.

Much of that money has accumulated in short-term financial assets or in some cases property rather than more productive commercial loans or infrastructure.

It's not about supply—it's about demand. We have to address the demand gap.

The world economy can only grow when consumers spend and businesses invest.

Government has a role in this: Lower taxes give people more money to spend. Better roads and trains reduce transport costs, improve productivity, and encourage businesses to invest.

Plenty of people are telling politicians that it's solely up to them to fix economic policy and get the country moving. That's not my view. I'm saying that business also needs to do more. Business needs to help fix the demand problem.

The opportunity is to spot the new sources of demand that are coming, and invest to get ahead of them.

To make sure that a disproportionate share of the world's future spending happens here.

Now this plays to our strength: Australia has a long history of adapting to change—especially technological change.

For the past few years there's been a lot of talk about *disruption*: Using technology to compete through lower costs, new channels to market, improved service, or getting around a protected position.

Think of Airbnb, one of the new global disrupters: Lower cost rooms, a digital sales platform, a better service experience; undermining the value of established hotels.

[2] IBISWorld 1/8/16

For the economy, disruption is a good thing because it improves productivity.

But disruption is about the supply side: taking cost and margin out of an existing supply chain.

What this disruption lens misses is that a company like Airbnb also creates demand.

It opens up new opportunities for people to travel who otherwise wouldn't.

It creates new demand for cleaning services, property management, home renovation, local restaurants, and entertainment.

And it creates a potential new source of income for people whose home is a dormant asset.

In fact there is a world of opportunity if we get ahead of the mega-trends driving new sources of demand.

Let me give you **five** examples, starting with the growth of **Asia**.

At current rates the Asian middle class will grow to over 3 billion people by 2030.

They will look to improve their lives through better health, education, travel, and entertainment.

Australia's reputation for safe food gives us a real advantage here. We've all heard about Chinese demand for infant formula. Bega Cheese—a Westpac customer I'm proud to say—has partnered with Blackmores to sell infant formula directly in China.

They're now taking this to the next level by developing dairy products specifically for a health-conscious middle class in Asia.

Another important mega-trend is the aging **baby boomers**.

A child born in 1950 turned 65 last year. Over the next ten years 2.7 million people will pass that milestone in Australia. In general they are much healthier and wealthier than the generations that preceded them.

They are going to have very different spending habits and this will cascade through many industries.

They're not ready for a retirement home. They're active. They'll want to travel. They'll want to eat out. They'll downsize.

I recently drove by a new retirement village in Sydney. It looks like a six star hotel. Read their website and it even sounds like a holiday resort: wine tasting evenings, three restaurants, access to beaches, pools, gyms.

It's not cheap, but it is tapping into a new source of demand.

The third trend is **digital services**: Using technology to deliver new, online services that people will pay for. Three years ago who knew they needed a Netflix account? Or an online FX trading platform? Or a site where they could get freelance home office support?

The opportunities are endless, whether in entertainment, education, finance, social activities, or B2B services. And for once our geographic distance isn't an issue.

Another opportunity is in **data collection and analysis**. Thanks to drones, satellites, and the Internet of Things, we are on the cusp of an explosion in numeric, photographic, audio, and video data. This data will help people manage their lives better, help businesses improve performance, and help governments deliver better services and measure environmental impacts, and even help surf clubs spot sharks.

Data collection devices need to be designed, built, run, and serviced. Data needs to be gathered, stored, analysed, and the insights distributed. There are legal, privacy, and competitive strategy issues to be resolved. Each of these creates a business opportunity.

We're already seeing this in our business, where we've been able to help clients like David Jones understand customer purchasing behaviour to better plan the layout and product mix in their stores.

And finally there's **medical testing and personalised medicine**. Personalised medicine for many diseases appears increasingly likely to become a reality. When it does, millions of people around the world will happily spend money to identify their risk factors and receive drugs or devices that are personalised to their own needs.

The trick is for business people to work with academia, governments, and young innovators to serve this new demand.

I recently visited one of our Westpac Bicentennial scholars, Dr. Antonio Tricoli, at his lab at the ANU. He and his team have developed tiny detectors that measure exposure to bad UV light, to help prevent skin cancer. All going well, they hope to embed these detectors in wearable devices and possibly even clothes. But he'll need help to bring these ideas to market.

Hopefully that help will come from an Australian business.

Banks must adapt to the new economy as well.

Westpac recently became the #1 bank for small business in Australia: across all of our brands, 50% of Australian businesses have some relationship with us.

So we've begun to rethink the products and services we offer our customers.

As part of our 200th Anniversary next year we've launched the Businesses of Tomorrow program.

This followed research which showed that what drives sustainable business success isn't really economic conditions, or access to the latest technology. Rather, what matters is leadership.

So the Businesses of Tomorrow program is not about providing financial support—it's about helping our best businesses get the practical knowledge, mentoring, and networks they need to reach their full potential.

We're on the hunt for 200 great Australian businesses of any size to take part in the program. They don't even have to be Westpac customers—they just need to represent the sort of businesses that will drive our economy.

Some companies take their boards to Silicon Valley—we'll take these businesses. Twenty of the top Businesses of Tomorrow will go on an international study tour to the US, Israel, and China.

They'll also receive $100,000 in professional services as well as personal attention from a highly respected business mentor, like Pip Marlow and Carla Zampatti.

We think giving back through programs like this is a logical extension of our role as a bank.

And let me turn to that now.

The role of banks

One of our core beliefs at Westpac is that banks exist to support economic development. That makes banks different to other businesses, and it brings with it a responsibility.

I say to our people that unless Australia does well, we don't do well. We need to measure our success based on our customers' success.

A bank like Westpac is part of the circulatory system of the economy.

Instead of blood, we pump money around—from depositors to borrowers, who spend and invest, into businesses that employ people and re-deposit the money.

4.1 million Australians have their salaries deposited into Westpac bank accounts.

Every month our debit cards are used to make 83 million purchases and cash withdrawals, worth a total of $6.4 billion.

Every month we help 16,000 Australians to buy a property or build a new home.

Every year we finance the purchase of 200,000 cars and trucks.

And just like the body needs a healthy heart, the economy needs a healthy banking system.

This means our banks need to be resilient.

Australia's banks need to be part of the solution if the economy gets in trouble, not part of the problem—the heart needs to keep pumping.

For that to happen, banks need to be strong enough to absorb losses when parts of the economy are doing it tough.

That's why it's important for banks to have both strong capital and solid returns.

Australia has had a current account deficit for nearly 50 years.

In practice, this means that Australian banks raise money from overseas investors to fund the economy.

And overseas investors have choices.

Equity investors provide capital to support growth. They look at future returns, including dividends.

Debt investors provide funding for loans. They look at a bank's debt rating, capital, and leverage. But *they also* look at returns, because the higher the returns are, the more cushion there is to absorb losses before the debt investor loses money.

Of course profitability is often an area of contention for Australia's banks.

There are many critics of the size of bank profits. And I understand the concern, given the size of the numbers at a time when people feel anxious about their own financial situation.

What I would say to those critics is this:

These are very large businesses that play an important role in the health of the overall economy.

Last year the Finance and Insurance sector was about 9% of the economy – this means it's tied with mining as the largest industry.

It was also the second largest contributor to overall *growth* in GDP.[3]

These profits go back into the economy, through dividends and retained capital to support more loans to customers.

Four of the five largest taxpayers are banks. Last year the banking industry as a whole paid over $14 billion in taxes to the Federal Government.

And $14 billion buys a lot of services.

Every teacher, and all the support staff, in every public primary school in Australia.

[3] IBISWorld, 1/8/16.

2.75 million operations in public hospitals.

Or every police officer in Australia.

In other words, like the heart recycles blood around the body, so too the returns of banks are recycled in a number of ways through the economy.

The trust gap

Having said all that, it is impossible to convince someone of the value you're adding if they don't trust you.

And we need to recognise, that, as an industry, we have a trust gap.

Trust is at the heart of banking. And trust in banking is like trust in any other relationship: It requires that we treat people fairly and honestly.

As a result of things some bankers have done, or the way banks have responded when things have gone wrong, some people have concluded that banks—and bankers—are only out for themselves.

And banks only have themselves to blame for that.

We need to recognise that at times we have not met the expectations of the community.

People are saying things need to change.

They **do** need to change.

The good news is they ***are*** changing.

Across the industry we are changing processes and we are changing behaviours.

At Westpac we are going back to basics and reviewing all of our products, policies, and processes, to make sure they are working in our customers' interests.

I'll give you one small example.

Last week some of you may have read about a mistake we made with one of our products.

We weren't applying a discount properly on some accounts for younger customers.

The fees needed to be manually reversed and in some cases they weren't.

Through our reviews we identified the mistake, reported it to ASIC, refunded the money, and have now put automated systems in place to make sure it won't happen again.

Procedural mistakes like this are not acceptable.

And they do nothing to help banks regain trust from people who are already skeptical.

Yes, we found it and fixed it: Part of the Westpac ethos is that if we get it wrong we put things back on track.

But this small example shows the need for constant vigilance and continuous improvement on the part of the banking industry.

We're also focusing on our culture more broadly, reinforcing our goal of being one of the world's great service companies.

Let me be clear: I am proud of the 40,000 people who work at the Westpac Group. I know that overwhelmingly they come to work each day wanting to deliver great service and help their customers.

Across the company, complaints have fallen by over 70 per cent in the last four years.

Over the past three months we had three times as many compliments as complaints in our branch network.

This gives me confidence we are on the right track—but we know we need to do more.

We are putting our financial advisers through ethics training, and are incorporating the principles of the banking oath into our code of conduct for all employees.

We are also changing practices that might be seen as creating potential conflicts of interest.

Through the Australian Bankers' Association we are working to agree on steps the industry can take to eliminate the perception of conflicts of interest in the way front line staff are paid. An independent expert is reviewing those practices and we will adopt whatever is agreed.

Having said that there are things Westpac can do on our own, and we're moving ahead.

From next month we're planning to remove all product related incentives across our 2,000 tellers in the Westpac branch network. Rather, their incentives will be based entirely on customer feedback about the quality of service they received in the branch.

We have also revisited the way we reward specialised sales roles in our network. We will no longer vary reward values based on different products; but rather our people will be rewarded for meeting the full range of our customers' needs.

This is all part of making sure that when our customers walk into a branch, they don't have cause to question the quality of service that they're getting, or the motivation of our people.

At the same time we're reinforcing standards of behaviour, and enforcing consequences when people fall short.

We're appointing an independent customer advocate who is empowered to resolve issues for our customers. And who can overturn decisions made by our internal dispute resolution process.

And we're investing more in our compliance and oversight capabilities, to make sure we can quickly spot and resolve issues when they occur.

We're also continuing to give back to the community, through our support of the Westpac Rescue helicopters, the Westpac Bicentennial Foundation, which gives a hundred scholarships a year, volunteering leave and matching gifts for staff, and 200 Westpac community grants of $10,000 each this year alone.

It's part of why the Dow Jones Sustainability Index has just recognised Westpac as the world's most sustainable bank, for the third year in a row.

And we'll continue to take action now, Royal Commission or not.

Conclusion

Let me conclude by noting that Westpac was founded almost 200 years ago.

So we've been backing Australia and Australians for a very long time.

It means that over our history Westpac has had to be open to change.

The difference today is that banks—like any other successful business—have to be slightly ahead of how the world and our communities are changing.

I can promise you, all 40,000 of us at Westpac are committed to changing. We are committed to closing the trust gap.

Getting service right can help us close that gap.

We create value for Westpac when we help customers create value for themselves.

That's why I believe that over the long term, there *is* no gap between the interests of Westpac and the interests of our customers.

Right now, those interests are best served by helping the economy adapt to the real challenges and opportunities that we face. By taking advantage of the mega-trends driving the world economy to close the demand gap.

And by supporting Australia's economic growth, to reduce the aspiration gap.

I want the next Airbnb to be an Australian company, or at least to be led by an Australian.

And of course I'd like them to be proud to say they bank with Westpac.

Thank you.