Westpac GROUP

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"Driving Growth: We're all in this together"
Trans-Tasman Business Circle – 30 July 2019
****CHECK AGAINST DELIVERY****

Thank you, Noel and good afternoon, everyone. Johnny, thanks to you too and to the Trans-Tasman team for the invitation to speak today. It's nice to be back.

I would also like to acknowledge the traditional owners of the land on which we meet, the Gadigal people, and pay my respects to Elders past and present.

I thought today I'd share our reflections on what's going on in our economy, and what it will take to get growth going again.

As part of that I'll also reflect on what banks like Westpac are doing to support that growth.

My summary is that overall the economy is ok, and will continue to be ok. But it could be a lot better, and there are a few significant risks out there to watch.

Australia's economy has had a great run. The last time Australia had a recession, Terminator 2 was the top grossing movie, Bryan Adams had the top charting single, and Australia's most popular TV personality was Steve Vizard.

We navigated the GFC without a recession, and average household wealth passed the $1 million-mark last year – a 37 per cent rise from just over a decade ago.

More recently, however, economic growth has slowed. Consumer spending is flat, wage growth is low, and productivity is stagnating.

At the same time, the global economy has also slowed. The IMF confirmed last month that growth in global trade is at its lowest rate since the financial crisis, and investment has weakened.

Slower trade is expected to continue for some time, with the potential impact of an escalating trade war between the US and China, and wildcards like Brexit.

The risk for Australia is concerning. China is by far our biggest trading partner, at around 25 per cent. And our dependence on resource exports means that Australia's economic complexity is quite low compared to the rest of the world – in fact, according to a measure developed by researchers from MIT, we rank lower than Kazakhstan and New Zealand.

Relying on a few big customers buying a few basic products is risky – although I expect demand from China for resources, tourism and education will remain strong for years to come.

Looking through these risks, the underlying drivers of demand in the Australian economy are sound.

Our population growth is well above most developed markets. State and Federal infrastructure spending commitments are large.

Our relatively low dollar should continue to support export earnings and historically low interest rates should stimulate consumer spending. The Morrison Government's recent tax cuts should also provide significant stimulus to the economy.

In aggregate, overall GDP should continue to grow in the 2-3 per cent range.

That's good.

But it could be a lot better.

Post the election, we've seen an increase in business confidence and investment intentions among our customers, but this hasn't yet turned into a significant increase in real investment.

It's a similar story in housing, where the outlook for the Sydney and Melbourne markets is turning up, but hasn't yet translated into growth. Other markets such as Brisbane and Perth remain weak.

And while government spending on infrastructure is helpful, in the long run it's business investment that creates jobs and generates the salaries and earnings that deliver tax revenue to governments.

So, how do we rebuild a more vibrant business sector to drive Australia's growth rate back towards its potential?

There is no *simple* answer – other than the observation that all of us – governments, regulators, the financial sector, and businesses themselves – need to work together to rekindle confidence and fire up the ambition of business leaders to invest in the growth opportunities of the next decade.

Recently this collaboration has not been as strong as it needs to be.

The political dynamics within and between the major parties has made genuine policy reform difficult. The findings of the Royal Commission have damaged trust in banks. And businesses themselves lack confidence, due to an uncertain tax, regulatory, and competitive outlook.

I recognise that governments at both a state and federal level are working hard to boost confidence and provide policy stimulus in the form of tax cuts and infrastructure spending.

And I also recognise that the Royal Commission highlighted cases of inexcusable behaviour by banks and other financial services entities, and that we face years of hard work to earn back trust.

The consequences of these events for the sector have – understandably – been wide-ranging and are ongoing. We accept that, and we *are* changing.

But what concerns me is that these developments may be hampering the ability of banks, governments and regulators to work effectively together to stimulate growth – a role that Westpac, the nation's first bank, has played for more than two centuries.

To address this, there are three areas where I believe we need to work more effectively together: Credit growth, business investment, and economic diversity.

First, we need to get credit flowing again.

It's clear from Reserve Bank data that demand for credit has slowed – the rate of mortgage growth is at an unprecedented low, and lending to businesses has grown only marginally compared to this time last year.

There are a number of factors driving this trend, and it's not all bad: people are paying down debt, and house prices have come down, which makes them a bit more affordable for first home buyers.

But tighter bank credit is often cited as a cause, and I'd like to clarify a few things here.

The first is that banks want to lend. It's a big part of why we exist, and how we make money.

And we want to do it responsibly. It's simply not in our interest to give a loan to someone who can't pay it back.

The responsible lending laws introduced by Parliament in 2009 are well intended, based on sound principles, and generally speaking, have worked well.

But in recent years, we've seen regulators become more prescriptive in their interpretation of what they believe banks need to do, both to comply with the law and to demonstrate that a borrower is creditworthy.

And given the severe consequences of getting it wrong, it's not surprising that bankers are building extra 'buffers' into their policies and processes to make sure they stay well clear of the line.

Banks need to comply with the law. And I acknowledge that the regulators are working hard to meet *their* obligations to *enforce* the law and *maintain* a sound financial system.

In addition, the Royal Commission highlighted that financial institutions were not paying enough attention to the protection of vulnerable customers. This is a matter of deep regret for us and we have changed our policies, processes, and training to better identify and support customers experiencing vulnerability or hardship.

But I do believe the *unintended* consequences of the current legal and regulatory approach pose a danger for our economy.

Why? Because highly prescriptive, micro-prudential regulation reduces lenders' ability to exercise *judgement* in helping customers reach their aspirations.

Here's how banking has worked for centuries: A customer asks to borrow money from a lender. The lender *wants* to give the customer the loan, but needs to make sure the customer can repay. So, they seek enough information to get a high degree of confidence, and only then, will they give their approval.

Over the years, consumer protections have improved – "should I lend", versus "could I lend" – and computer models have improved predictions of customers' ability to repay.

As a consequence, more people have been able to borrow to build their business, buy their home, or fund their education, and at a lower cost. Open banking will improve this further. But even with sophisticated models, we still rely on an experienced credit officer to exercise judgment when things are in the grey area.

Overall this approach has worked well. Our annual losses on mortgages are currently less than two basis points of loans, and are at record lows across all lending – both business and personal.

But the environment, and banks' responses to today's highly prescriptive rules creates a real issue for the future.

Let me bring this to life through four real-life examples: Justin Hemmes, who is here today and owns the Ivy and dozens of other great restaurants and bars around Sydney. Susan Lloyd-Hurwitz, the CEO of Mirvac. Carla Zampatti, the fashion icon and entrepreneur. And Kerry Stokes, one of Australia's most successful businessmen ever.

Each of these great business leaders has three things in common.

First, they've each been a loyal customer of ours for decades.

Second, they've each told me personally the story of how a credit decision made by one of our bankers made all the difference at a key moment in their career – often at the very start.

And third, the chances are that each of them would be turned down if they applied for that loan <u>today</u>.

Kerry Stokes summed it up beautifully recently. He said to me, "If we end up with only prescriptive regulation on credit policies, and no human touch, no entrepreneurial spirit, nor a continuing human support system provided by the lender, we will lose the next generation of budding business men and women."

That’s not the bank we want to be for our customers. And that’s not the banking system that Australia needs if we aspire to improve our standard of living and maintain our position as one of the world’s most successful economies.

To address this, lawmakers, regulators, and the banks themselves need to work constructively together to find a better balance of risk taking, consumer protection, and financial stability.

Since this is a Trans-Tasman event, it’s worth mentioning another proposal over the ditch which could have the unintended effect of slowing credit there too.

The Reserve Bank of New Zealand has proposed to significantly increase the amount of capital banks need to hold, to safeguard the financial system.

While we agree with the objective, we think this proposal goes much further than what is required. Ironically, by leaning so heavily on the banks, it may actually lead to higher credit costs and a much larger and riskier unregulated lending sector, as the banks retreat.

We’re in consultation with the RBNZ on this so hopefully we’ll end up in a sensible place, but it’s another example of where it’s important for banks and the regulators to work closely together to avoid unintended consequences.

So far I’ve focused on the supply side of credit growth – what about the demand side?

Much of the fall in house prices over the last year has been due to a fall in demand – especially among housing investors. With more clarity on negative gearing and capital gains tax, and with new construction slowing, we expect this to start to turn around.

But from a long-term perspective it’s not the price of existing houses that matters – nobody wants a debt-fuelled price bubble.

Rather, it's the growth in demand for new housing among first homebuyers, upgraders, and downsizers that drives consumer spending and employment.

And here it's worth mentioning ways we could help more Australians achieve the great dream of homeownership.

The Federal Government's First Home Loan Deposit Scheme is a great step: It will provide a helping hand onto the housing ladder for people who would otherwise struggle to buy a home.

However, to address long-term affordability we need to consider other changes.

The big upfront cost of buying a home – particularly stamp duty – is both a barrier for buyers and a disincentive for people to sell a home that's bigger than they need (since they would then incur their own stamp duty when they move).

Replacing stamp duty on purchases with a broad-based land tax would fix this and provide governments with stable revenue. As radical as that sounds, the ACT has been rolling out a package of reforms since 2012 in which it's phasing out a bunch of duties over 20 years in favour of a single land value levy.

This means first-home buyers in the ACT no longer pay any stamp duty, and it's being progressively lowered for all homebuyers – all without radical disruption to the property market.

At the same time, we need to work on ways to expand the stock of available housing, by opening up new land and building the right infrastructure to support it.

I recognise that proposals like these can be politically difficult, but they *are* worth considering if we're going to help more Australians into their own homes.

Let me turn now to business investment.

A sustainable economy depends on business investment to drive employment growth, productivity, and innovation, which in turn drives consumer spending and government tax receipts.

Yet despite our current positive GDP growth, business investment as a share of GDP has declined substantially from the mining boom highs and is around its lowest level in 15 years.

Why is this, and more importantly, what can we do about it?

Business confidence is obviously critical, and this in turn depends on policy certainty and expectations about revenue growth versus the cost of investment.

When we speak to our business customers about what's holding back investment, the most common response is "bottlenecks in the system".

According to the World Economic Forum, Australia ranks 77 out of 140 countries for "the burden of government regulation". That's not surprising, when you consider that Australia has over half a million pages of business regulation, and different definitions of "small business" across the states.

And the cost of complying with all that regulation has been estimated by Deloitte at around $94 billion per year – that's money that *isn't* being invested in technology, research, expanding overseas, reducing costs, and improving productivity.

In fact, total R&D spending is down dramatically over recent years, and this reduction is primarily among large businesses – which is an issue because large business spending is an important source of revenue for small businesses. We've also seen a drop in the number of local patent applications over the last few years – which is not a great sign for future commercialisation opportunities.

The good news is that tackling bottlenecks is high on the Federal Government's 'to do' list. And states such as New South Wales have made great strides in modernising systems and simplifying the process of interacting with local government.

Of course, good regulation is *important*: It encourages competition and protects consumers, workers, and communities.

But I don't doubt you'd see an uptick in investment if there were fewer regulatory differences across jurisdictions, if state utilities and local councils moved faster on development decisions, if planning approvals for major projects were quicker, and if tax structures further rewarded investment in R&D and training.

The goal should be to make it easier for local businesses to grow and boost productivity so that they can compete successfully on the global stage.

The Federal Government's focus on ensuring large global companies pay their fair share of tax in Australia is a good start. But there's more to be done.

I'd also like to reinforce that if we can get the demand for investment going again, banks like Westpac will be there to provide the funding.

We are ready to lend.

At the top end, our institutional bank has supported more than $13 billion in transport infrastructure projects, including the Melbourne Metro, Western Roads upgrade, High Capacity Metro Trains and the Westgate Tunnel, which in turn are creating over 25,000 jobs.

We expect this to grow substantially, given the Federal Government's commitment to $100 billion in infrastructure projects over the next 10 years, and similarly large plans in NSW, Victoria, and other states.

At the smaller end, Westpac has loans out to around a third of our 750,000 small business customers. On top of that, we have earmarked another $68 billion that's ready to lend to small businesses for the right investments.

And today I'm pleased to announce that we will soon launch a new digital, unsecured lending service which uses real-time transaction data and advanced analytics to make fast, online credit decisions for small businesses.

We estimate we'll make an extra $10 billion available in unsecured, conditionally approved limits for small businesses, without needing to put up other assets as security.

We are also doing our part to improve efficiency and reduce cost for our business customers. This includes Biz Invoice – a free digital invoicing service; Presto, a multi-channel point of sale solution we've developed with one of our fintech partners, Assembly Payments; and a major investment in the real-time, New Payments Platform.

Beyond banking, we're working with the South Australian government to spur innovation through our "Invested in SA" program. The most recent example has been the "Living Lab" partnership with MIT we announced earlier this month, which will focus on developing new technologies to support the state's goals around population, jobs, and tourism.

The third and final challenge I wanted to discuss today is how we create a more diverse and resilient economy.

Australia as we know is blessed with tremendous mining and agricultural resources. And we should absolutely keep investing in these areas to take advantage of the ongoing economic development in Asia.

But today I wanted to focus on how we can diversify our economy so that we're not so dependent on a small number of industries.

To do this we need to stare into a number of structural challenges – many of which will require fresh thinking and coordination between policy makers, regulators, and business leaders.

Challenges like our ageing population, the shift to a lower-carbon economy, the mass adoption of new technology, rapid urbanisation, and our growing connections with Asia.

Take healthcare for example. The healthcare industry is already today's biggest employer, and its contribution to GDP has risen the fastest of any industry in Australia over the past two decades. And this is only going to accelerate – by some estimates, we will need almost 130,000 more nurses and doctors by 2030. That has big implications for healthcare policy, immigration policy, and education.

This industry has the potential to become an engine room of growth, creating jobs and generating markets for new technologies, new research, new infrastructure – much of which we could potentially export.

Similar opportunities exist in renewable power generation, green buildings, low-carbon transport technologies, defence, financial services, and fresh food manufacture.

Thanks to new technologies such as high-speed broadband and the increasing digitisation of products and services, geographic distance is less and less a barrier for Australian firms to connect with regional and global markets.

That's why at Westpac we're thinking hard about how we can help support the network of connections and new ideas among our customers, backing their entrepreneurial spirit to drive economic growth.

That's why, for example, we invested in fintech venture capital firm Reinventure; set up a new Emerging Industries team to lend to early stage businesses; and created our Businesses of Tomorrow mentoring program.

It’s also why we set ambitious targets around financing climate change solutions; have become Australia’s leading financier of greenfield renewable energy projects; and launched new products including green tailored deposits and sustainability-linked loans.

And it’s why we created the Westpac Scholars Trust to invest in scholarships for 100 future leaders – every year, forever.

The bottom line is, we are as excited about Australia’s economic potential as our founder Governor Macquarie was when he chartered the bank 202 years ago.

Working together, lets reignite the country’s self-belief and aspiration to become an economic leader.

The latent potential is there, the physical and human capital is there, but it will take a focused and *constructive* dialogue between all of us – policy makers, regulators, business leaders, community groups, and banks – to realise that potential.

For Westpac, our immediate task is to get on with resolving past issues, driving efficiency, and making sure we continue to improve service quality and deliver a state-of-the-art, convenient, and supportive banking offering for our 12 million customers.

We accept, and are clear-eyed about, the significant work needed to lift our standards.

But we are not letting our internal challenges distract us from the role we must play building a stronger and more sustainable Australian economy – because we’re all in this together.