

Australia's place in Asia's economic revolution

Speech to the Australia Israel Chamber of Commerce

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John McFarlane, Chief Executive Officer, ANZ

Thank you for the invitation to speak to you. The Australia-Israel Chamber of Commerce always provides an important platform for discussing significant national and business issues and I'm very pleased to have been invited to speak to you again.

I'm scheduled to speak to you about Australia's place in Asia's economic revolution.

You know, that's a fairly heavy topic for a Friday lunchtime. I suspect someone on my staff was trying to make me sound like an intellectual. As you know, I'm actually a Scot who likes a good lunch, can play a guitar and, I guess, I'm learning a thing or two about banking.

Why don't we start there, with banking, and hopefully we can make our way to Asia by the end of my talk. If I don't, there are always questions are the end.

Important developments this week

It's been a busy week in business. The world's fifth largest media company held an AGM in Adelaide. Woolworth's decided to try their hand at being publicans. Some Swiss miners decided to strike it big in Australia. You might also have noticed that a Melbourne bank announced another record profit.

The really significant aspect of our 2004 result was that it showed just how far ANZ has come in 2004 and over the past seven years.

In 2004 we produced a record operating profit after tax of \$2.8 billion, up 20% and total return to shareholders was 17%.

We completed the \$4.9 billion acquisition of The National Bank of New Zealand and have made good progress with the integration of our New Zealand business. It was accretive in the first year, which is unusual in acquisitions these days.

There was a \$3.6 billion Rights Issue to fund the acquisition – the biggest share issue since the float of Telstra. The Rights Issue was triple subscribed and a good outcome for shareholders.

We have now largely completed a seven-year program of structural de-risking of the Group. As a result ANZ's risk profile has been substantially reduced and is now comparable with other major Australian banks.

We have continued to develop our culture, which we now consider a competitive advantage. We have created a new structure for our specialist businesses, led by an experienced team with a strong track record, to help accelerate growth and build market share.

We have also developed innovative programs to strengthen our connection with the community. This includes responses to some of the major social issues that involve the financial services industry such as financial literacy and savings, and programs that help our people engage with the community.

We've come a long way

What's exciting for me though is to look back at how far we have come since 1998 and what our people collectively have achieved.

In 1998, our market capitalisation was \$14 billion. Today, it's \$37 billion.

Our average stock price was \$9 in 1998, today it's over \$20 and around \$21 taking into account our rights issue last year.

We were the highest cost Australian bank in 1998 with a cost-income ratio in the mid-60s. Today we are the most efficient with a cost-income ratio in the mid 40s.

In 1998, our profit was flat at around \$1.1 billion. We announced a \$2.8 billion profit on Tuesday.

We have radically transformed our business portfolio. We were primarily a corporate bank with some personal banking businesses. Today, we are still a leading corporate bank, but personal now accounts for the greatest portion of our earnings and we have leading personal business in all segments in New Zealand and the Pacific, and in Australia in credit cards, mortgages and auto-finance.

The most talked about aspect has been our emergence as a major force in Personal Banking, which is a non-traditional business for ANZ, and which will be the major engine of our future growth. Our approach to this has been distinctive:

- Different brands in cards
- Third party mortgage distribution
- \$5 all you can eat banking
- Local CEO branch model

I believe ANZ now has the best suite of personal banking products in the market and this was confirmed at the recent Personal Investor Magazine awards ceremony we were Bank of the Year for the 5th year running, and out of the 30 banking awards available, ANZ won 12.

We have radically reduced risk. We used to be a player in emerging market bond trading, international lending in South America, the Middle East and South Asia, and our businesses in those countries were a constant source of surprises to us and to our investors. Today, we are primarily a domestic bank, focused on our core businesses and overall risk is in line with our peer banks.

And of course in 1998, by and large banks were hated in the community. Today, although I don't think we are loved, we are in a much more neutral space and at ANZ we are making real progress in rebuilding community trust with innovative programs addressing financial literacy and savings.

Another 3 years

In part, that's why I'm really quite excited to have signed another contract to be at ANZ for another 3 years.

The other reason for that excitement is we have now established the foundation to lift our sights and be clear that ANZ's aspiration is to become Australasia's leading, most respected and fastest growing major bank.

This aspiration reflects my strong belief that delivering value to shareholders is not just about building the capacity of the organisation to perform and grow consistently in the short term but ensuring ANZ can stand the test of time and can deliver sustainable performance and value over the long term.

It also reflects my views about what makes successful companies and translates into a clear set of priorities for ANZ.

Companies with **superior revenue growth** generally produce the highest earnings growth and share price multiples. Our approach in recent years has involved moderate revenue growth and significant efficiency gains. ANZ is now very efficient, among the most efficient banks globally, and so our priority has to be to generate superior revenue growth.

Companies with **market leadership** generally produce the highest long-term shareholder returns. We are now the leading bank in New Zealand and have a number of other leading positions in Australia and the Pacific.

We now need to increase market share in each of our core businesses, particularly in those lower risk, more sustainable businesses where we are underweight such as our Australian personal banking and small business banking businesses.

Companies with **distinctive customer relationships and service** generally increase market share and produce the highest sustainable revenue growth. Specialisation has helped us make real progress in this area. It's provided our businesses with focus and vitality and we have great products for our customers.

This year, we reorganised to **harness synergies** between the specialist businesses and to broaden and deepen their offering to customers. It is good progress but we need to do more. We need to give customers a tangible reason to choose ANZ over our competitors.

Companies that **manage cost effectively** are able to improve earnings, offer lower prices and free up resources for investment in future revenue growth. We are going to support this with increased investment funded by reallocating costs to growth businesses, re-investing funds generated by growth and continuing to run our business in lean, agile way.

Companies that engage in **non-core or risky activities** generally produce substandard and volatile shareholder returns and divert management attention from what is important. We have had a consistent strategy of ceasing high-risk activities and narrowing our focus to core businesses where we have realistic leadership prospects.

Priorities for the coming years

Integrating our acquisition in New Zealand

Growing our traditional Corporate banking business, and bolstering our Institutional business in the face of global competition

Seizing the opportunity to grow radically in small business and in our very successful personal banking division. We've already announced we will open up to 80 new branches in the most rapidly growing growth corridors, and plan more ATM facilities generally.

Taking account of the reality that the boundaries of Australia and New Zealand will ultimately be constraining for a group of our size and given the interdependence of Australia and Asia, we will need to look outwards to Asia and the Pacific as longer-term growth options.

Asia - Australia's geographic neighbourhood

This brings me back to the point I wanted to make today about Asia and why it's so important to Australia and Australian businesses, and why ANZ has a long-term interest in Asia.

Last year, East Asia accounted for \$56 billion of Australia's exports of goods and services. This compares with sales worth \$15 billion to the European Union and \$11 billion to the United States.

While commodities dominate Australia's trade to the region, services are also becoming increasingly important. Tourism and the tens of thousands of Asian students who are being educated in Australia are increasingly important. As well as generating export earnings, they are helping Australian's deepen their understanding of the region and develop closer cultural ties.

There are signs of an increasing appetite for investments by Australian companies in Asia. Bluescope Steel is building a \$280 million coated steel plant in China and Qantas is about to launch a new Asian discount airline based in Singapore.

The reality here is that the boundaries of Australia and New Zealand are increasingly constraining for many of our best companies and we need to look to Asia for at least some of our future growth.

ANZ is now one of the largest direct investors in Asia.

China

Whether or not you do business in Asia, you can't ignore it. And no country in Asia more so than China.

China has accounted for one-third of the recent increase in global growth.

When you visit Shanghai, Shenzhen or Beijing, and talk to the young optimistic, ambitious entrepreneurs in business and government, it is amazing to think that the re-emergence of a market-oriented economy in China is only 10 years old.

Everyone knows the statistics that leave you in awe of China. How it consumes a huge percentage of global resources – much of them from Australia – 25% of the world's steel and 50% of the world's cement. And how it is home to some of the largest corporations on earth, four of which were included in the most recent Fortune 500 list.

While there are many contingencies in predicting China's future, our models are suggesting China's economy will overtake Japan's in 2015 and America's in around 2040.

In fact in aggregate, China's rapid expansion is stimulating trade and growth in other regional economies. For most of its trading partners, the notable exception being the US, China buys more than it sells, and overall is driving rapid trade and investment flows.

While some Australian businesses face new challenges because of this Chinese economic revolution, Australia is already benefiting and these benefits will only increase in coming years.

As a major raw material supplier and smaller, but still significant exporter of advanced manufactures and services to China, Australia should be cheering on the continued rise of China and its further integration into the world economy.

There are many balancing factors however, which suggest caution. As a banker, and a cautious one at that, they are not lost on me.

The economy has been growing at more than 10% over recent years. Signs of over heating – infrastructure bottlenecks, supply shortages and pressure on prices – have led the government to target some slowdown. Nevertheless, just last Friday China's national statistical bureau announced that the economy was still growing at 9.1%, down from 9.8% in the first quarter on the year.

The country has about 650 cities, 31 provinces, 80 different local dialects and under-developed logistics in transport and communications infrastructure.

Consequently foreign investors have learnt to enter the market with a "regional" rather than national focus.

As a senior executive at Unilever said recently reflecting on some bad experiences, "foreigners still think they can tackle China in one go, when they would never start in 17 countries in Europe at once." And that's exactly ANZ's view of China, and examining opportunities there.

So China is critical to our future but we are entitled to be optimistic about other parts of the region and I want to briefly look at several other countries in Asia to illustrate this.

Indonesia

In the next most populous country of the region Indonesia, where despite separatism and religious violence and the near economic collapse 2 to 3 years ago, there is cause for optimism.

The economy has been growing at 5-6% a year, government finances have been getting back under control, and the local stock market has shown great promise providing a more stable and attractive environment for both foreign and Indonesian investment.

Malaysia

Recent leadership changes in Malaysia have also been encouraging. After a period of fiscal stimulus, government spending and monetary policy is under control. Tight controls continue on foreign investment, but the overall outlook for investment in Malaysia is also encouraging.

As a result, we are seeing growth rates in Malaysia of more than 7%, which are amongst the best in Asia.

Vietnam

In 1993, just over 10 years ago, ANZ was one of the very first foreign banks to open a branch in Vietnam. Progressive opening of the economy since the time of our establishment has led to dramatic effect.

After China, Vietnam also boasts Asia's best performing economy, growing by an average of 7.4% a year over the past decade.

Exports grew by 20% in 2003 and Vietnam is aspiring to join the WTO, further integrating itself into the world economy, in the next year or two.

Cambodia

During the last decade, even countries facing such immense difficulties as Cambodia have achieved national reconciliation and peace after many years of conflict.

While it remains one of the world's least developed economies, following United Nations and International Monetary Fund support during the 1990s, the economy has performed relatively well with annual growth rates averaging approximately 6% over the past five years.

Cambodia's banking system is at a very early stage of development. At present the banking system has approximately 120,000 customers out of a population of over 14 million offering a major opportunity for the development of banking services as the economy grows.

Opportunities and risk

So in Vietnam and Cambodia, as in other parts of Asia there are challenges and roadblocks, but also great opportunities. Australian companies need to look at these opportunities closely but with attention to risk assessment and mitigation strategies.

The key for business strategies is to be modest in aspiration, clever in finding niches appropriate to scale and competencies, and effective in execution. Getting it wrong can be costly; getting it right can deliver significant, if medium to longer term, returns.

ANZ in Asia

For me, the practical outcome from this is that while Asia is never going to be the biggest part of ANZ's future, it is going to be an important part of our future.

As far back as 1969 we opened a representative office in Tokyo and over the next four years we had established a presence in Hong Kong, Jakarta, Singapore and Malaysia, and Kuala Lumpur.

In 1986 we established a representative office in China, 1990 in the Philippines, and in 1993 we became one of the first foreign banks to establish banking operations in Vietnam.

As with other foreign companies we have had negative as well as positive experiences, but we have learned from them, and they provide a platform of experience on which to move forward.

Really we have two agendas in Asia. The first is the area I have just spoken about – our ANZ network in Asia.

As China continues to become the manufacturing centre of the world, intra-regional trade will continue to grow rapidly. It has already reached US\$715 billion, which equals to 10% of global trade.

Increased investment in infrastructure will be needed. We estimate that US\$135 billion of privately funded infrastructure will be made between 2004 and 2009.

Our positions in 11 Asian countries, and our traditional strength in corporate banking really gives us something to build on based on the growth in trade and investment flows in the region. We're now adding more expertise and people in trade finance, capital markets and foreign exchange to support our customers who are working and expanding in the region.

The second area is our consumer business in Asia, where economic growth is fuelling tremendous growth in consumer banking.

Increasing wealth is leading to higher levels of savings - we estimate US\$3.5 trillion of new savings will be generated in Asia in the next five years. Around half this growth will be in consumer deposits.

Growth in savings is going to be followed rapidly by higher spending and increased borrowing. The nascent market for credit cards illustrates the potential: today only 0.5% of China's consumers hold them, compared with 63% of Taiwan's.

The growth rates in financial services in Asia which will result are likely to dwarf what we will see in well developed markets.

But like the rest of Asia, the Chinese market is not without risks. One big uncertainty concerns the level of non-performing corporate loans. However we are seeing quite significant moves by the Chinese authorities to deal with this issue and today banks have improved their operating systems and skills and have an increasingly developed approach to risk management.

ANZ's approach to Asia

Primarily we should follow our Australian and New Zealand clients into Asia, and bring Asian clients into our domestic markets.

I believe there is an intelligent, low risk way for ANZ to participate in Asia's growth. That is by developing partnerships with local banks focussed on consumer banking.

In most markets, local banks tend to dominate in retail banking and Asia will be no different, and so joining forces with a local bank that can benefit from ANZ's expertise in credit cards, mortgages, small business banking, technology and risk management makes a lot of sense.

The idea isn't new for us and we already have experience in making it work. For example, with Panin Bank in Indonesia and with Metrobank in the Philippines where we've entered into a credit card joint venture.

In each case, we have a minority shareholding and we add value through our experience in credit cards, mortgages, car finance and retail distribution. Both those businesses are doing well.

Over the next five years we'll build more of these partnerships with a focus on retail banking. We've recently signed a memorandum of understanding with a Shanghai-based credit cooperative and are now working with them to improve their risk management processes ahead of them becoming a commercial bank.

There are other areas of China such as Beijing, Shandong and Guangdong that may be of interest over time.

This strategy isn't risk-free and so we're careful in selecting our partners. We're focussing on consumer banking, which is fundamentally lower risk than corporate banking, we're making modest investments and we're contributing ANZ's expertise in risk management and personal banking. This approach gives us a really good chance of success.

Over the very long term, we are likely to see a truly regional market emerge, which lays open the prospect of a truly regional bank, headquartered in Australia.

The upside of this strategy could be material over the longer term. Asia has been on the recovery path from the economic issues of the late 1990s. Wealth is growing very rapidly and financial institutions are moving to take advantage of this.

Our strategy is to give ANZ a new growth platform by participating in this.

Notwithstanding these opportunities, those of you who know me know I'm not one for large risks and ANZ will take a measured approach to Asia, to enhance our growth options and to deliver even better support for our own entrepreneurial Australian and New Zealand customers who are venturing north.

Conclusion

Given our leading positions in New Zealand and in the Pacific, our main priority is to build on our underweight position in Australia.

In conclusion, academics and journalists will endlessly discuss issues in the Australian relationship with Asia and no doubt dwell on nuances.

However, Australia is also blessed by being close to the most dynamic region in the world. In economic, geopolitical, cultural and numerous other aspects we have more cause for optimism about the region and our relationship than at any other time.

At ANZ we acknowledge difficulties, will proceed with caution, but believe our own future and Australia's future is intimately tied to the dramatic economic revolution taking place in our own region, not just Australasia, but in the broader region.

Thank you.