



Aftermath of a financial crisis

Annual finsia and MCFS Banking and Finance
Conference

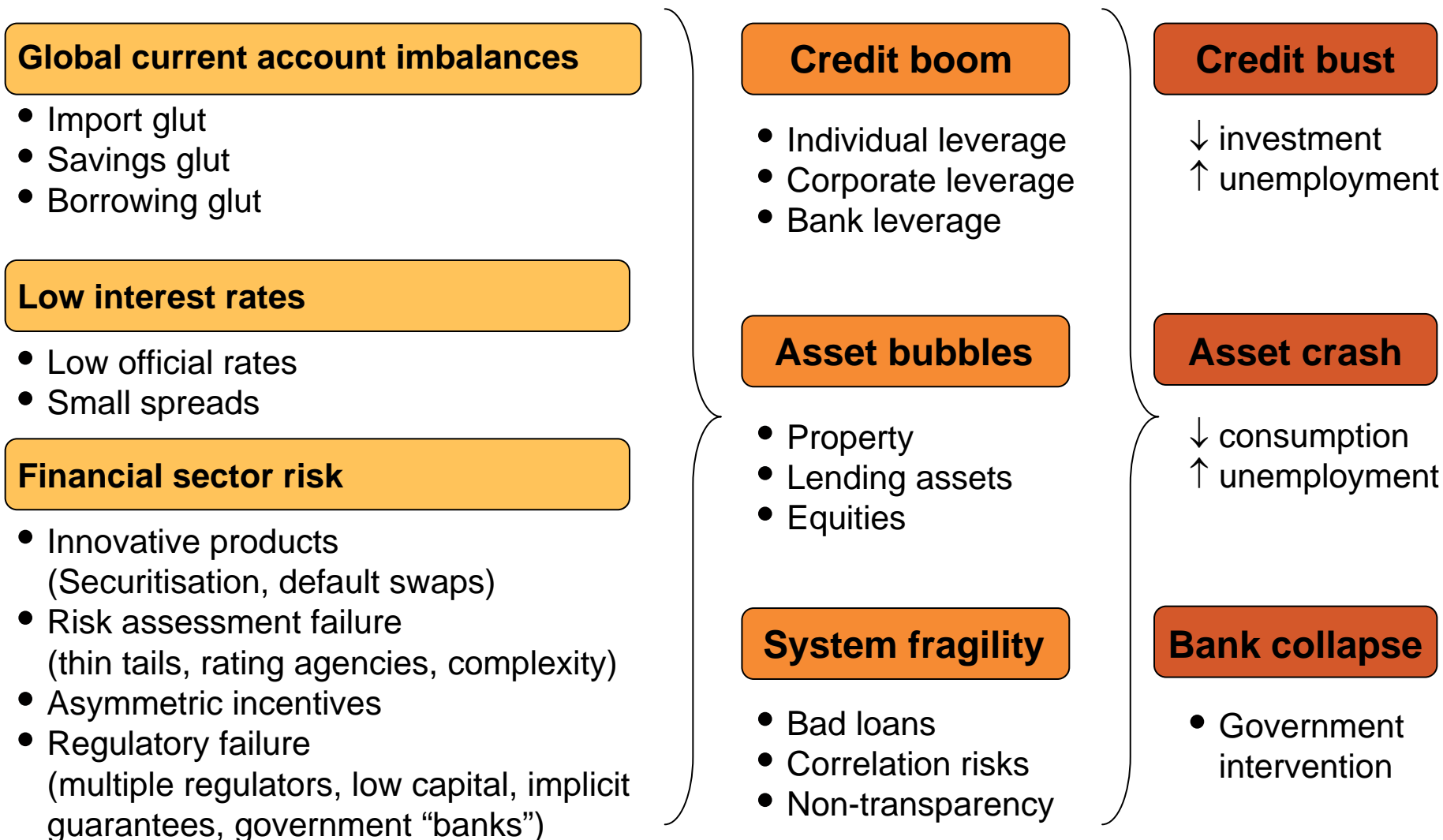
John Daley
CEO, Grattan Institute
29 September 2009

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, *79th Annual Report*, June 2009; V Acharya & M Richardson, *Restoring Financial Stability*, Wiley 2009

Do we blame the evil bankers? ...

“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?

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”

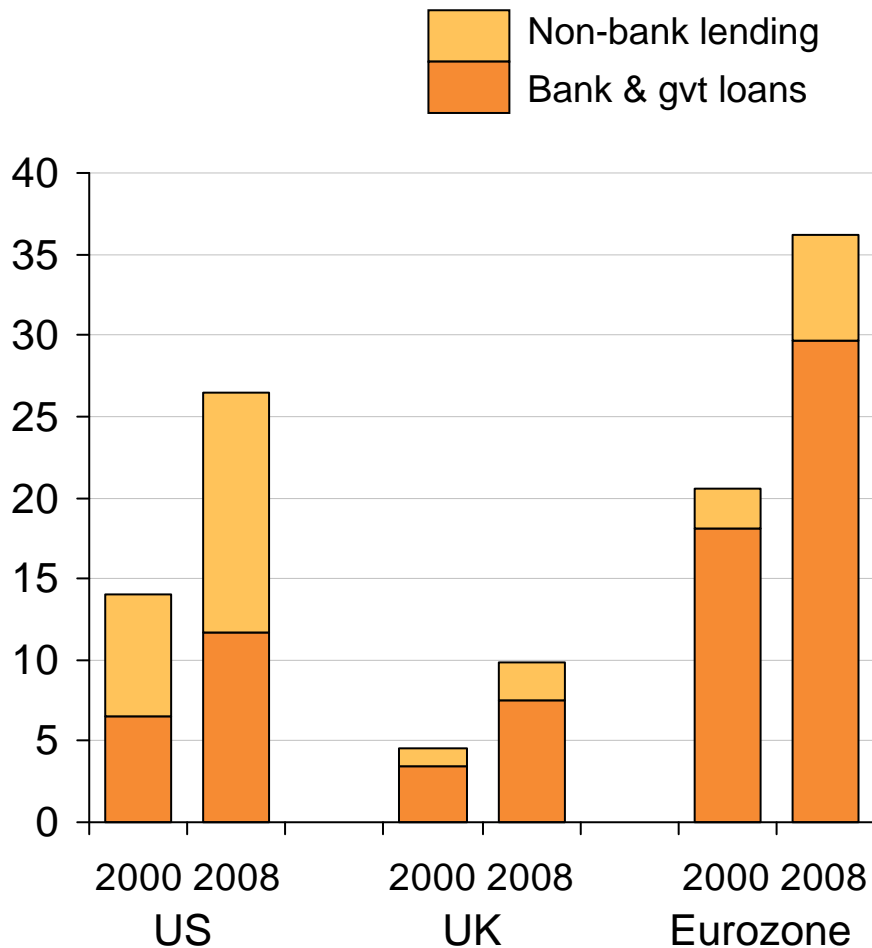
Tax incentives

- Home equity loan repayments tax deductible

... and how do we account for Europe?

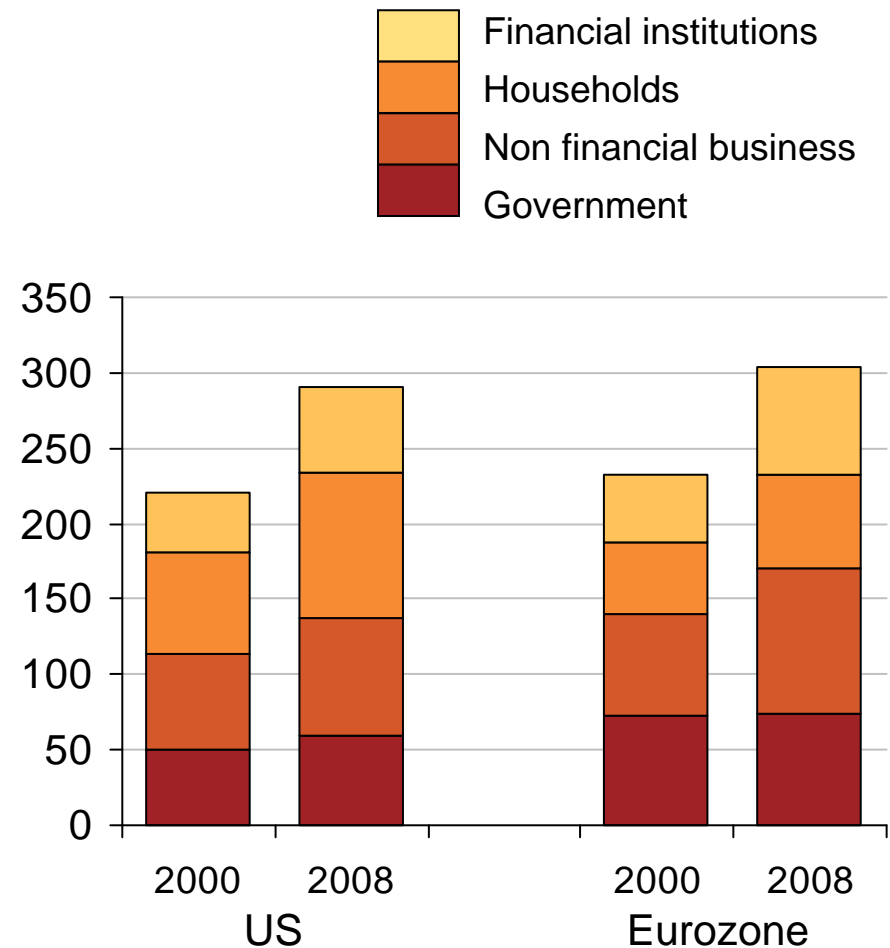
Not a securitisation problem

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?

Financial sector – short-term rescue

Financial sector – long-term reform

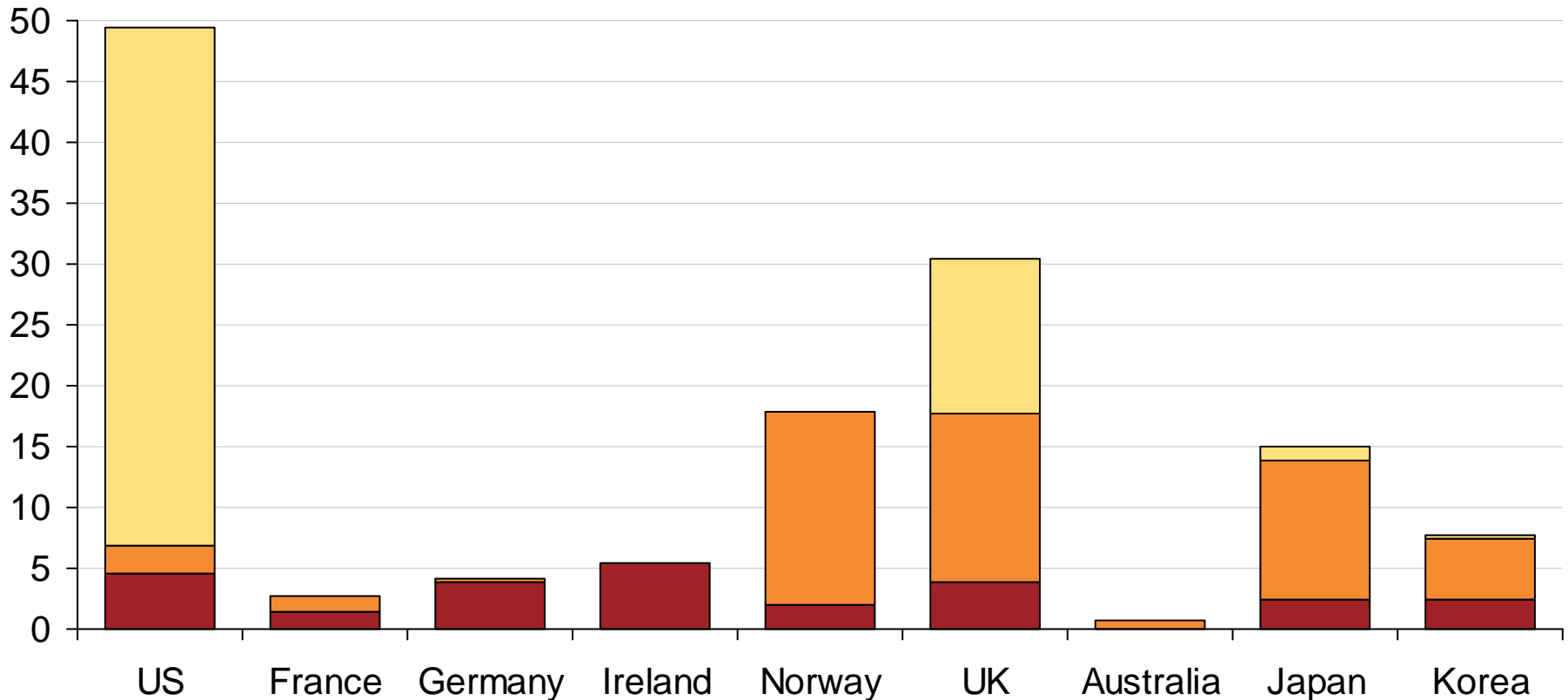
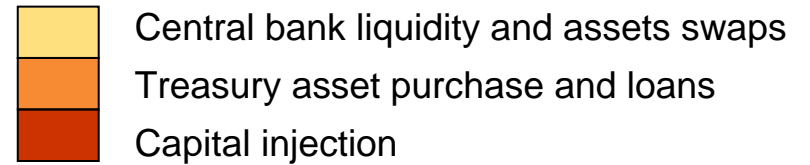
Fiscal stimulus

Shift towards intervention

Short-term rescue

Government support for banking sector

Support as % of 2008 GDP



What have governments done?

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?

Financial sector – short-term rescue

Financial sector – long-term reform

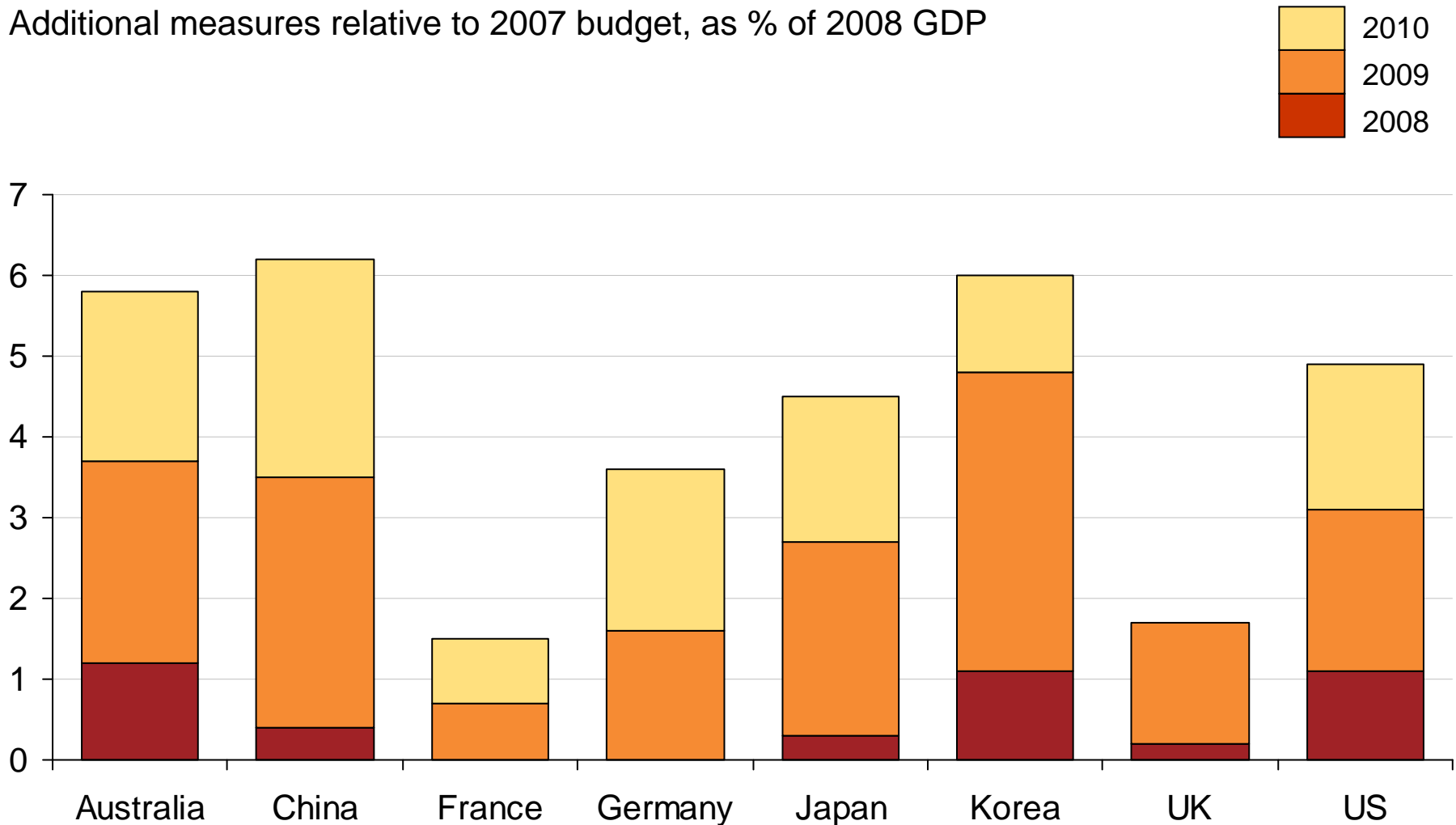
Fiscal stimulus

Shift towards intervention

Fiscal stimulus

Government fiscal stimulus

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

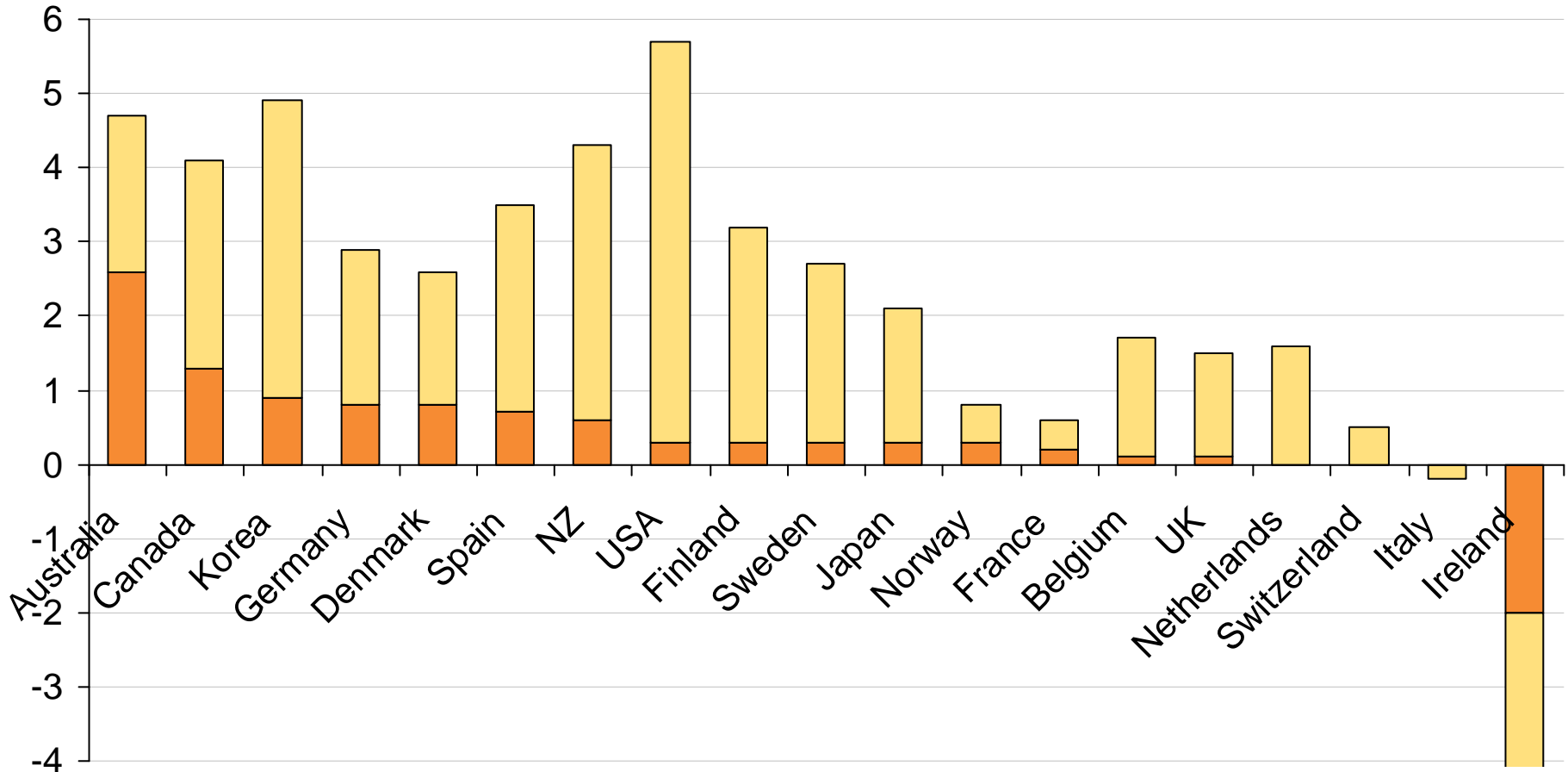
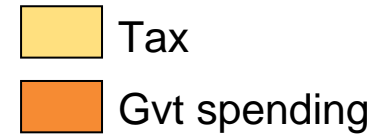


Source: IMF Staff Position Note, "Fiscal Implications of the Global Economic and Financial Crisis", June 2009.
Note: Measures announced as of mid May 2009

Fiscal stimulus – mostly about taxes, except in Australia

Government stimulus packages

2008-2010 additional budget as % of 2008 GDP



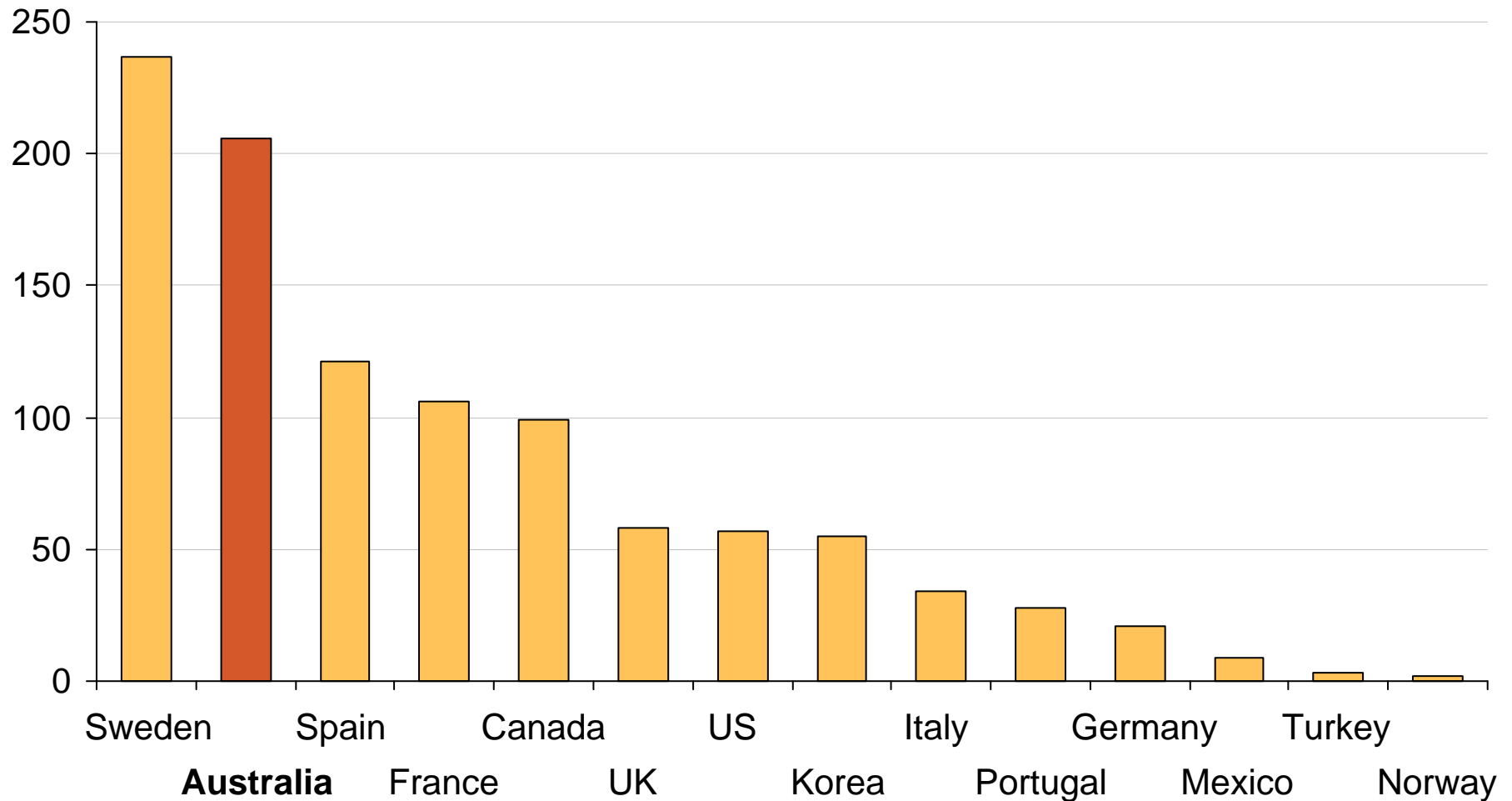
Source: OECD, *Policy Responses to the Economic Crisis: Investing in Innovation for Long-Term Growth*, June 2009

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?

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?

2nd order consequences of intervention

Financial sector regulation

Industry support

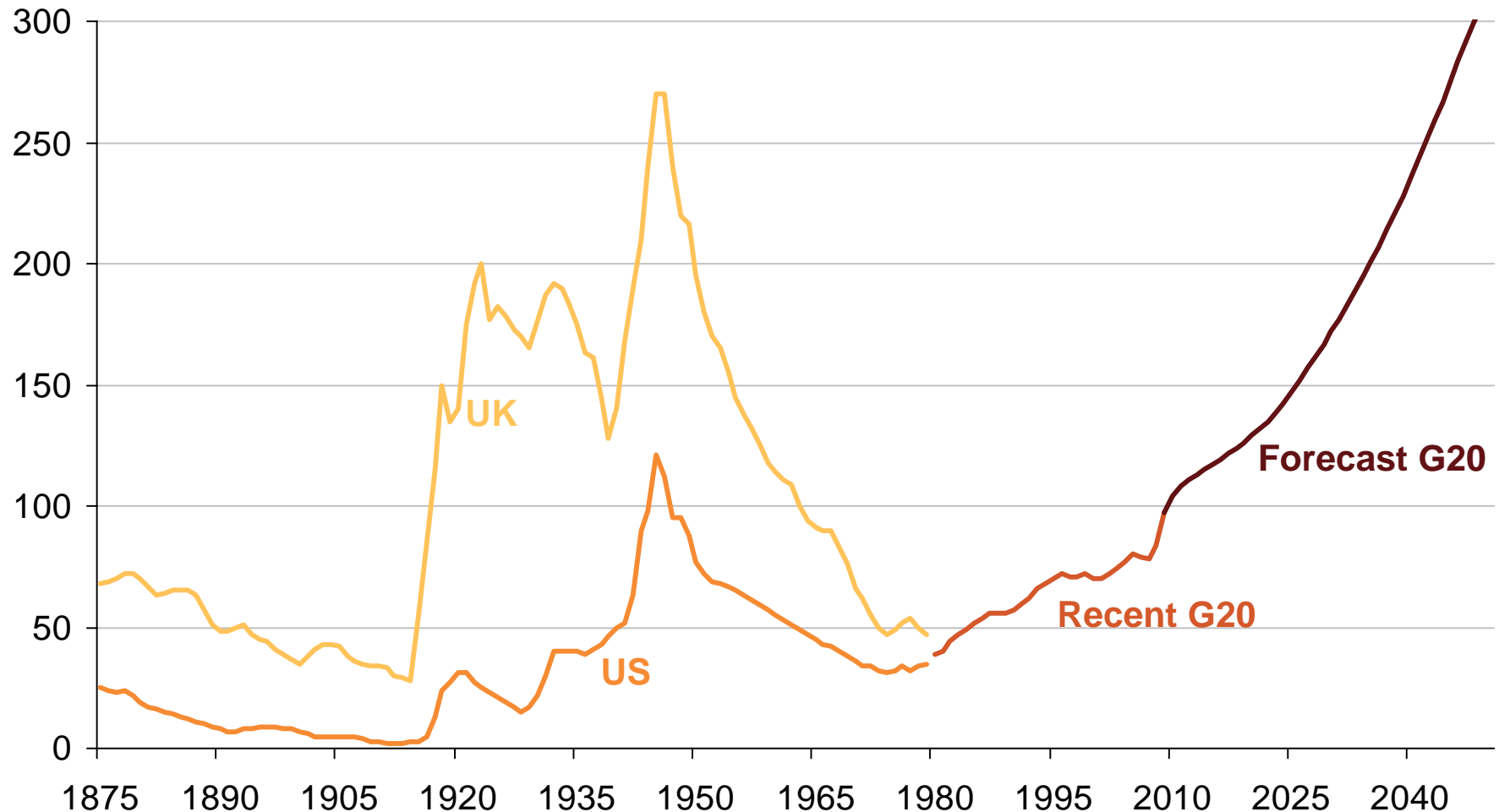
Regulatory mindset

Fiscal expansion

- Higher cost of capital
 - Lower economic growth
(not necessarily less personal fulfilment)
 - Higher profit margins
(more barriers to entry)
-
- Lower economic growth when governments forced to reverse
(less of an issue in Australia)

Government debt: forecast to go MUCH higher with ageing population

Debt / GDP



So what?

Human capital agenda

- Education
- Chronic health – prevention and costs
- Participation

City infrastructure

- Transport
- Planning
- Design

Regulatory rethink

Increased regulation

- Slower growth

Fiscal expansion

- Lower economic growth when governments forced to reverse

Ageing populations

- Lower economic growth and increased debt/GDP

Impact of drivers of GDP growth

Explanation of variation between countries in national GDP growth since 1960

