



RESERVE BANK OF AUSTRALIA

TRANSCRIPT OF QUESTION & ANSWER SESSION

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MR SWITZER: Let's start with the most exciting guy in the room because, you know, at the core of our whole financial system is the Reserve Bank. We hang on every word that they utter, particularly now; and Guy, you've got a fantastic name – Guy Debelle – Guy “a beauty”. And we all said “you little beauty” yesterday when the Reserve Bank Minutes came out. Is the economy looking a lot better now than it was, say, 12 months ago?

DR DEBELLE: Well, as you said, we put out the Minutes of the last Board meeting yesterday. I'm not going to say much more than what was in that but - - -

MR SWITZER: No, of course. You repeat and we'll celebrate it

DR DEBELLE: Yeah, I'll regurgitate it for you. The economy is looking better than we thought it might a few months ago; that's certainly true. Certainly, the world is looking a better place than it was looking last October when it wasn't looking a great place. And, here, the China story has really helped, combined with the fact that – we're the only – basically, the only major country which actually recorded export growth around the world, and that's a China story. But the other thing is that the stimulus – we've had a lot of stimulus put in on both the monetary and the fiscal side. As Vernon mentioned earlier, home loan rates are as low as they've been for 30, 40 years and that's actually working here.

So monetary policy and fiscal policy are working here – and that's not necessarily been the case in other countries. So – as was said yesterday, the situation is looking somewhat better than it was looking. The risks are more evenly balanced than they were. The risks are still out there, but they're certainly more evenly balanced than they were looking a few months back.

MR SWITZER: When you were sitting at home not being a Reserve banker and you saw a lot of the bad news about China and about views on the Aussie economy, did you sometimes get really cranky but, no, you had to sort of contain your crankiness because things were – we were a good chance of ending up where we are now?

DR DEBELLE: No. What happened in the last part of last year was pretty much unprecedented in terms of the whole world slowing dramatically all at once. We've never really seen that before. We had always thought we'd do better than the rest of the world but, when the rest of the world is sort of contracting – the US economy is contracting 5 or 6 per cent and unemployment is rising to 10 per cent – doing better than that is not necessarily setting an incredibly high bar. But, nevertheless, we thought we would do better. And there was that synchronised collapse. I think everyone looked at the events which happened in the US in September. Businesses pulled their heads in; households pulled their heads in; financial markets completely pulled their heads in; and things weren't looking great there for a while. And that was true probably through to the end of the year. But I think what's shown through is that parts of the world have been able to get out of this okay because they didn't go into the situation with as many problems as countries like the US. And so countries

like China have been able to impart a lot of stimulus to their economy. We've been able to do the same. It's been effective and we're sort of seeing some of the benefits of that now.

MR SWITZER: I guess everyone in this room, they know you have to be political and careful about what you say, but one area of your expertise where everyone would love to hear what you think might happen is in the area of credit markets and securitisation. So we'd love you to say, "Oh, securitisation will get better next month," but what is the true story?

DR DEBELLE: Well, securitisation actually I think is getting better. I mean, I think I can say it's going to get better next month because it's actually getting better month by month. Now, one thing I think which everyone in this room probably should be aware of, and probably are aware of, is the market is not going to be back to where it was in June 2007. That's not going to happen. One thing – and it relates to something Vernon was talking about earlier about the offshore buying of mortgage-backed securities in this country – a lot of them were bought by SIVs. Now, if I would have said "SIV" two years ago, none of you would have known what the hell I was talking about, but they're now reasonably well known. So a lot of those structured investment vehicles, they just don't exist any more. And they were a decent buyer of Australian RMBS offshore. And they're not around any more to buy them going forward, so some chunk of the demand for the Australian RMBS from that part of the market just ain't there any more. I think, however, from what we can – because there hasn't been many new RMBS written over the last two years – in fact, there really hasn't been any outside what the AOFMs bought – but everyone keeps on paying off their mortgages, the actual stock of outstanding RMBS – of Australian RMBS is down about 40 per cent from where it was two years ago which means, if you think about investors out there looking to buy this stuff, they have 40 per cent less of it than they did two years ago so, at some point, they're going to start to want to buy some more.

And I think every day we're getting closer to that point, but it's not going to be as big a market probably, at least in the short term, as it was a couple of years ago. You know, our general sense is that sort of secondary market – that overhang of the sort of stock which have been out there is getting close to be being run off. The SIVs have basically closed down and sold all their stuff back into the market. That process is basically finished. So I think once that process is finished then we're closer to the point where people are going to be looking for new mortgage-backed securities to buy.

MR SWITZER: Okay. Are we actually short of funds at the moment for the housing market?

DR DEBELLE: No at the moment - we've got reasonable growth in credit for housing. It's not the 20 per cent we had a few years back but it's travelling at about 8

per cent at the moment, which is a decent pace. So there's not a shortage of housing credit out there at the moment.

MR SWITZER: It's just concentrated in the big four banks because they're in the much stronger position to buy and also get the profits.

DR DEBELLE: Yeah. So the share of the mortgages - as everyone in this room I'm sure is well and truly aware - the share of mortgages being written by the four largest banks has gone up considerably; that's certainly the case.

MR SWITZER: Guy, do you have any views on how we could see funding increase in an alternative way rather than waiting for securitisation to improve?

DR DEBELLE: I mean, one - as I said, I think the main realisation a lot of people have - and a lot of participants in the industry, not necessarily on the broking side but more on the aggregation side - is the point I made at the beginning, which is the industry is not going to be the same as it was - and as the point Phil made. The industry is not going to be the same as it was a couple of years ago. So if you want to go back - if you think you can go back to the funding model you had two years ago, you're probably kidding yourself. I mean, that's true for a major bank, just as it is for the smallest non-bank. You know, the world has changed. Funding is not going to be as readily available. It's not going to be as cheap as it was a couple of years ago. So every participant in the industry has got to be aware of the fact that the situation has changed. So you have to look at putting in place a sustainable funding model, and that's going to vary depending on who you are. So, as I said, I think the main realisation everyone has got to come to is the point that it's not going to be the same. But, there is out - we have seen again in the last few months that the credit unions and building societies, for instance, have picked up a bit of market share so, those guys, which are primarily deposit-funded - there were some - some part of that sector did rely on securitisation, not all of it, and they are able to sort of provide an alternative source. The non-banking sector, as I said - it's basically, at this stage, is a question of when that securitisation market comes back for them to be a viable source of competition. But the other point I suppose is that one thing that the experience over the last - well, Vernon would probably say 30 years, but at least since the early to mid-90s is that, as we went on from there, we saw a lot of players come into this market so, ultimately, the ability of people to come in and provide that competition was there. Some of those people who came in towards the end, their ability to compete has probably been fundamentally undermined but, if margins were to start to increase, there is the scope for people to come in and provide that competition, just as they did through the '90s.

MR SWITZER: So for people in this room who want to look to the economic or money market indicators that might say that the potential for securitisation to get better – what are those indicators? Are they a much greater improvement of the US economy with Treasury yields low so people feel secure and then they'll take their money out of government bonds and want to put them into securities products?

DR DEBELLE: Yeah. I think one other point – one point which is worth highlighting: there's never been an issue with the credit quality of mortgage-backed securities in this country. In fact, no one has actually lost any money on a mortgage-backed security in this country, unlike the US. But, unfortunately, the word "mortgage-backed security" has been tarred with the reputation of what happened in the US, even though the quality of Australian mortgage-backed securities is considerably higher. And so I think you have to get past the point where investors or – if you're a fund manager out there and you go and tell your pensioner who's got their funds with you, "Oh, by the way, I've just invested a chunk of your funds in mortgage-backed securities" – whereas a few years ago they were very happy about that because they got a nice fat return out of it – now, they say, "Oh, mortgage-backed securities equals bad." So the investor mentality has got to change back again to recognising the quality of the Australian mortgage-backed security which has continued to perform right throughout this whole episode. So it does – and it partly relates to what you said, Peter, that people have to be – they're getting low yields on their supposedly very safe investments and they need to be looking to move beyond that again, and that's going to take time. I mean, investor confidence was shot in October and we're six, eight, nine months on from that now and it's certainly improved, and one hopes it continues to improve, but it is going to take a little more improvement to get people comfortable with investing in it. But, as I said earlier on, every day we're one day closer to that.

MR SWITZER: From the bank's point of view, on your radar screen is a 40 per cent fall in real estate prices showing up in any of the economic indicators you guys look at?

DR DEBELLE: Well, I mean, I can only say what we've seen about what's happened so far but house prices this year have been rising so – and for a while there we saw the top end of the market come off, but now the whole market is basically rising. And one point on the first home owner's scheme is that the first home owner share has been high over the last few months, and I'm sure all the people in this room have seen a disproportionate number of them walking in the door, but the other thing to remember is a lot of the first home buyers weren't in the market for the previous five, six years almost throughout – for the bulk of this decade actually, because house prices were higher relative to incomes, because interest rates were higher. So, to some extent, those people were shut out of the market, relatively speaking, for a while, and they've come back into the market now, obviously encouraged by the first home owner's grant but also by where interest rates are and the fact that house prices had not done a lot for a few years made it – housing affordability had certainly

improved. So some of those people have probably brought forward their purchase, but some of them are also catching up on a purchase they haven't been able to do for a while.

MR SWITZER: So clearly there were years where first home buyers were very low so, on average, it's probably not all that different.

DR DEBELLE: Yeah.

MR SWITZER: So questions – one here.

MR ANTOS: Paul Antos, Mayfair Finance Group – I'm also an advisor as well as a broker. My question is really towards Guy in relation to the Reserve Bank's view on the establishment, or whether or not it is feasible, of a people's bank, as has been labelled in the media lately. We – I think, from a broker's perspective, we want to see more competition from the banks and from the non-bank sector, so I'd like to see what his thoughts are about that.

DR DEBELLE: Yeah. I thought one interesting response was the credit unions and building societies coming up and saying, "Hang on; what about us?" You know, so there is this sector out there called the credit unions and the building societies which do business with you guys which are somewhat community-oriented and sort of have that local presence. Beyond that one I'm not sure I'm going to stray too far down that track.

MR SWITZER: I guess the RBA line would be: if it's there, you're happy to regulate them.

DR DEBELLE: Well, I mean, APRA regulates the banks; we don't.

MR SWITZER: Yeah. Well, okay - - -

DR DEBELLE: So - - -

MR SWITZER: - - - indirectly affect their life - - -

DR DEBELLE: Yeah. Yeah. So there are a bunch of financial institutions out there, you know, called credit unions and building societies, as well as the banks like Glen's outfit (Dr DeBelle refers here to Glenn Baker, Chief Investment Officer of ING Direct, who was also a panel discussant) and the regional banks, obviously. So there are not just four providers of housing finance in this country.