INSTITUTE OF ACTUARIES

THIRD FINANCIAL SERVICES FORUM

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WHEN LOOKING AHEAD….

- Take a view on the likely **TREND**
- Take a view on the likely **CYCLE** around that trend

People are always claiming that the cycle is obsolete: that it's a new era!!! **WRONG**

THE AUSTRALIAN ECONOMY

- Used to have a wide economic cycle
  - 50s, 60s narrow base to the economy
  - 70s, 80s bad economic management
- Now a mild cycle in the economy (and a stronger trend)
- No recession since 1991

WHY IS THE ECONOMY MORE STABLE?

- Economic reforms
- Better economic management
- Falls in A$ in 1998, 2001
- Close links with China
- Strong banking system
- Management of inventories

THE ECONOMY OVER 15 YEARS

- Real GDP: +71% (to calendar 2005)
- Jobs: + 30% (to early 2006)
- Real wealth per person: = +178% (to 2003/04)

SO, WHY DON'T THINGS FEEL BETTER?

- There's no longer job security
- Most industries are very competitive
- Need to cut costs each year
- We need another round of reforms
- Governments are more overloaded

Welcome to the future

THE ECONOMY: LOOKING AHEAD

- More reforms are needed
- Allow the mild cycle will continue
- Allow for future recessions
- Allow average growth of 3.25/3.5%
- And don't forget that inflation imposes many costs

THE COSTS OF INFLATION

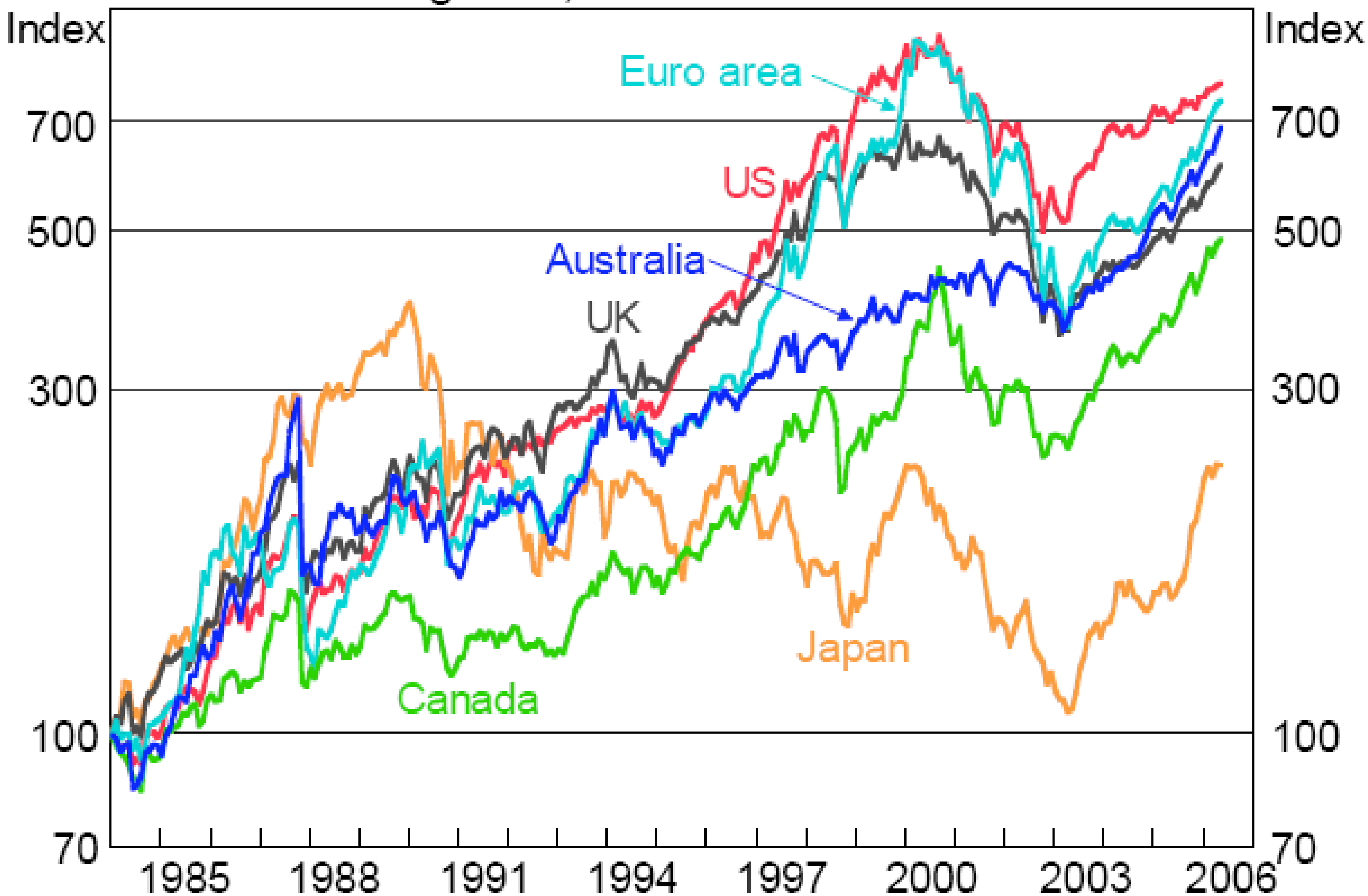
- Greater uncertainty for everyone
- Discourages-term planning
- Distortions to tax, accounting, profits
- Management more casual on costs
- Feeling of unfairness
- Hurts self-funded retirees
- Confuses price signals

THE CYCLE IN THE SHARE MARKET

- Until the 1990s, our share market was the high beta one among the top 20
- Now, it's the low beta one:
  - economy is better managed
  - change in composition of index
  - float of A$
  - franked dividends

Major Countries' Share Price Indices

Log scale, December 1983 =100

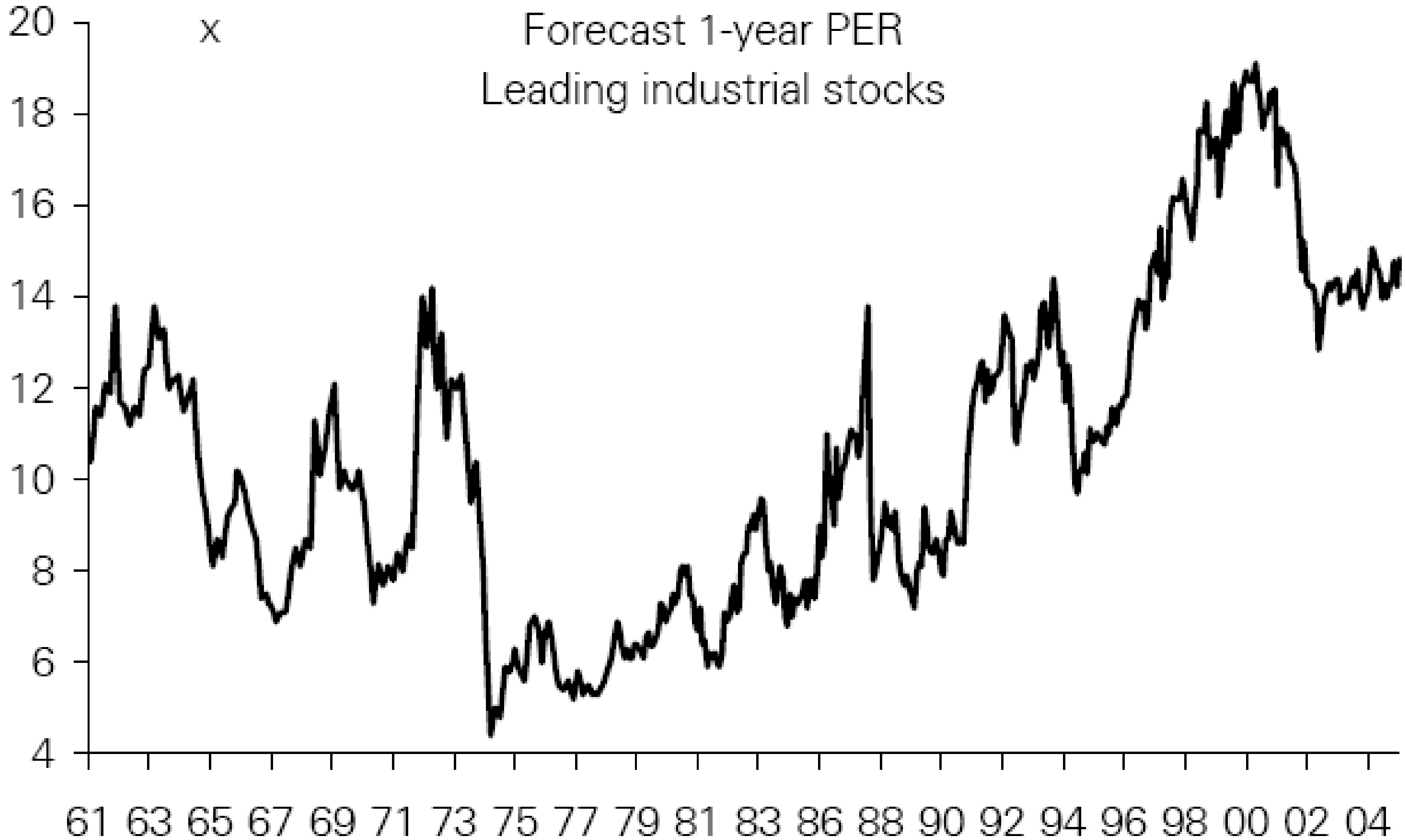


Source: Bloomberg

VALUING SHARE MARKET

- Dividend yield (4% + franking) v. cash rate (5.75%)
- P/e ratio (16x) v. normal for low inflation (17x)
- Earnings yield (6.6%) v. bond yield (5.7%)

Forecast 1-year PER



10-year bond vs earnings yield

KEY INTEREST RATES

- **Cash rate**: set by RBA
- **3,5 year rates**: vary with market views on future of cash rate
- **10 year rates**: vary with market views on growth, inflation, US rates

THE CYCLE IN INTEREST RATES

- Used to be a wide cycle
- Now, a mild cycle
  - low inflation
  - huge build up in variable rate debt

EXPANDING HORIZON FOR ACTUARIES

- Less role in life assurance, DBs
- Increasing role in general insurance
- Ageing of the population – and advice on **prospective** mortality rates
- New types of risk: climate, terrorism etc
- Role in options, derivatives & lumpy investments with long term cash flows

DISCLAIMER

Comments in this presentation are of a general nature only. Individual investors and businesses need to take advice specific to their particular situation and requirements.