

Australia and the Capital Market Evolution

Distinguished Speaker Seminar Series

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26 April 2007



Overview of the paper

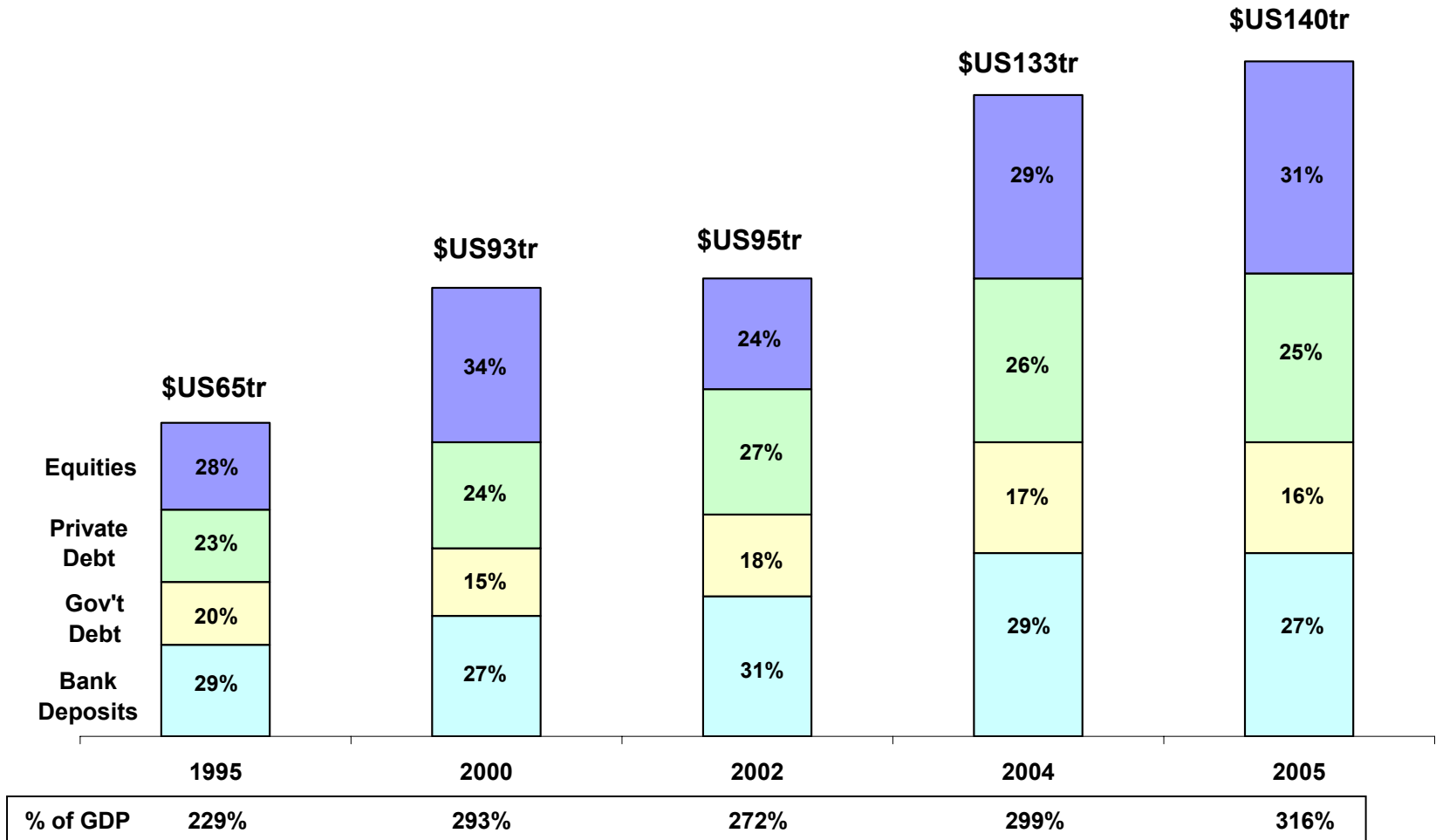
Global Capital Markets	<ul style="list-style-type: none">• Last decade has seen rapid growth of global capital markets. Cross-border flows of equity (direct & portfolio), debt, and bank finance have grown strongly and Australia attracts significant international investor interest.• Global trading (exchange & OTC) in derivatives have experienced rapid growth.• Australia has also experienced a rapid growth in capital markets.	Slides 4-11
Issuance of Equity Capital	<ul style="list-style-type: none">• Equity capital has been an important element underpinning business investment and GDP growth in Australia.• Capital raisings in Australia compare well with the rest of the world, particularly in areas such as infrastructure assets and property trusts.	Slides 13-17
Investment in Equity Capital	<ul style="list-style-type: none">• Australia has a strong, and increasingly sophisticated, retail equity culture.• Flows into superannuation continue to drive domestic institutional investment in equities and Australia remains an attractive investment destination for foreign institutional investors.	Slides 19-33
Debt & Derivative Markets	<ul style="list-style-type: none">• Rapid expansion of asset securitisation has driven a deepening of Australian fixed interest markets for asset backed securities as Gov't debt has declined.• Derivatives volumes have grown strongly as the stock of debt and equity securities has increased, bank balance sheets have expanded strongly and Australia has become proficient in mortgage securitisation.	Slides 35-40
Conclusions	<ul style="list-style-type: none">• The growth and structure of global capital markets suggest they may now exert a much larger influence on economic growth than they have in the past.• Australia has proven it can be a leader in global capital markets, fostering innovation and punching above its weight in a number of areas. In others, we haven't kept pace and need to improve to maintain our standing.	Slide 42-43

Global Capital Markets

Global markets have grown strongly

- Between 1995 and 2005 the total size of global capital markets rose by 115% to \$US140tr.
- McKinsey Global Institute forecasts markets will grow to around \$US214tr by 2010.

Growth in Global Capital Markets*

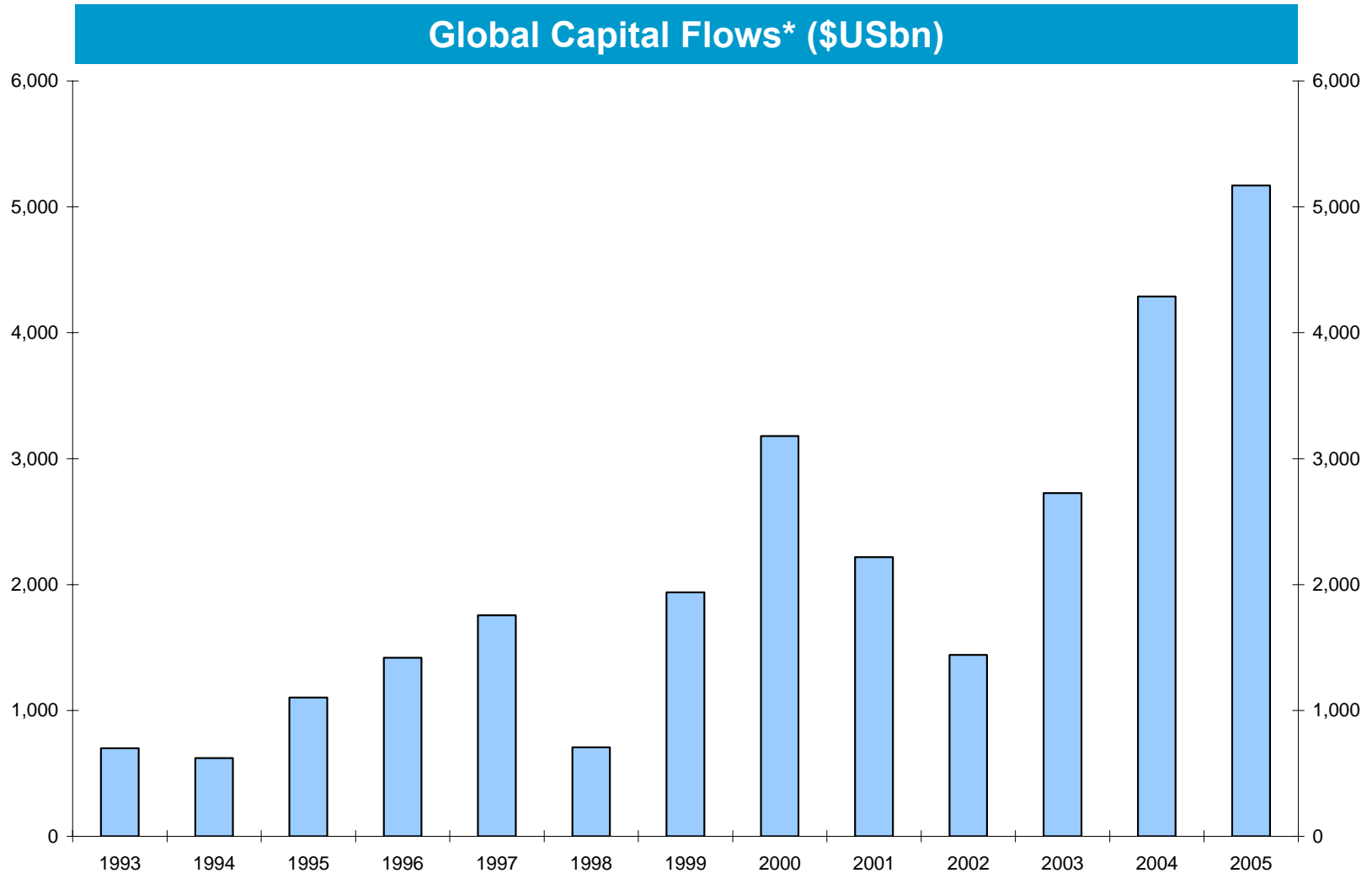


* Excludes derivative markets

Source: McKinsey Global Institute

Cross-border capital flows growing

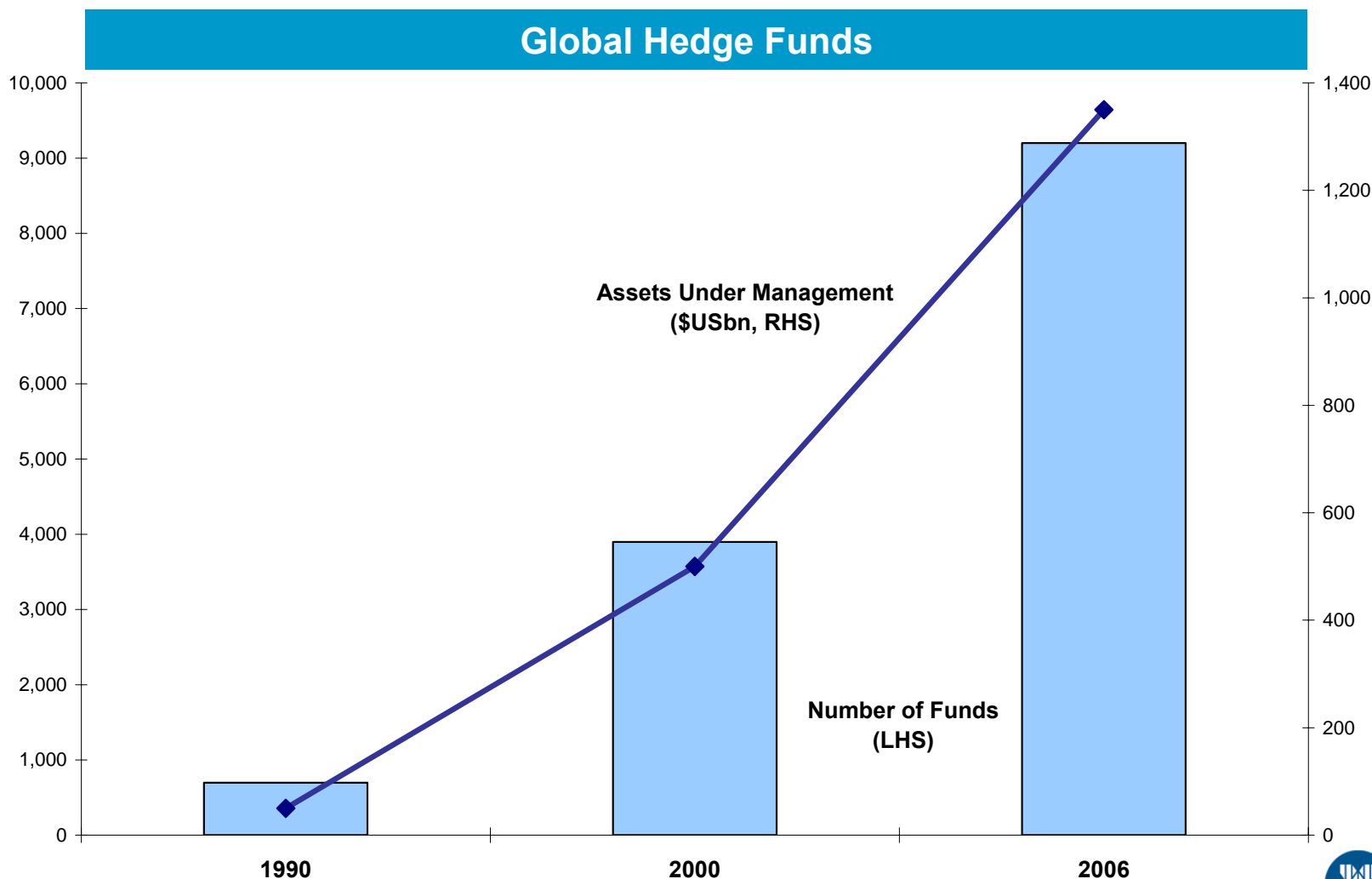
- Japan, China, Germany, and oil rich countries make up a large portion of the global savings pool. The US accounts for almost two-thirds of global capital imports and Australia continues to be in the top 5 capital importer countries (#4 in 2006).



* Direct and portfolio flows of debt, equity and bank finance
Source: IMF Global Financial Stability Report (April 2007)

Global hedge funds a growing force

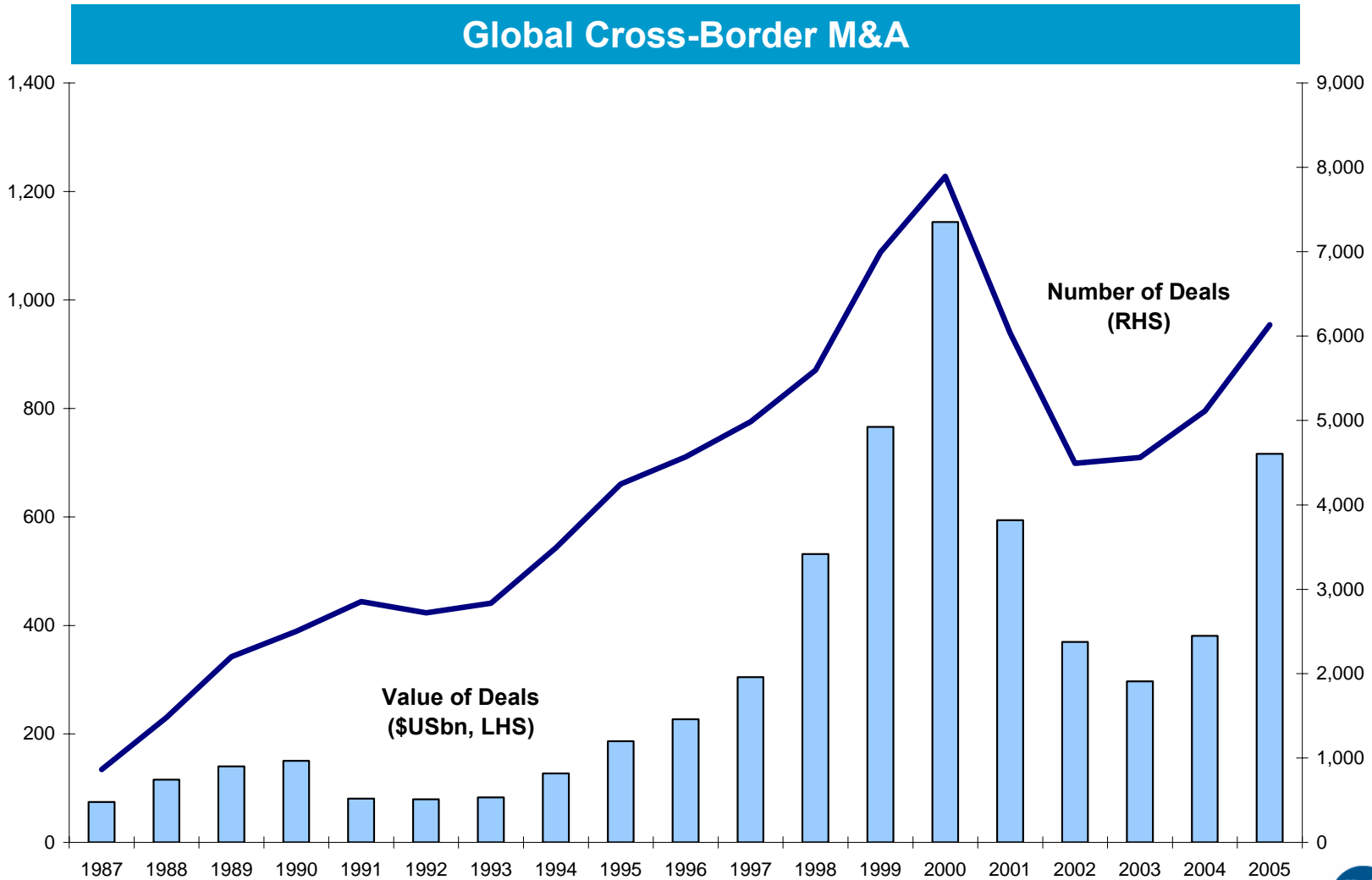
- Assets under management of hedge funds have grown rapidly but are still a relatively small proportion (estimated 10%) of the overall asset management sector – although substantial leverage can magnify their impact on financial markets.



Source: Hedge Fund Research Inc

Capital flows partly driven by M&A

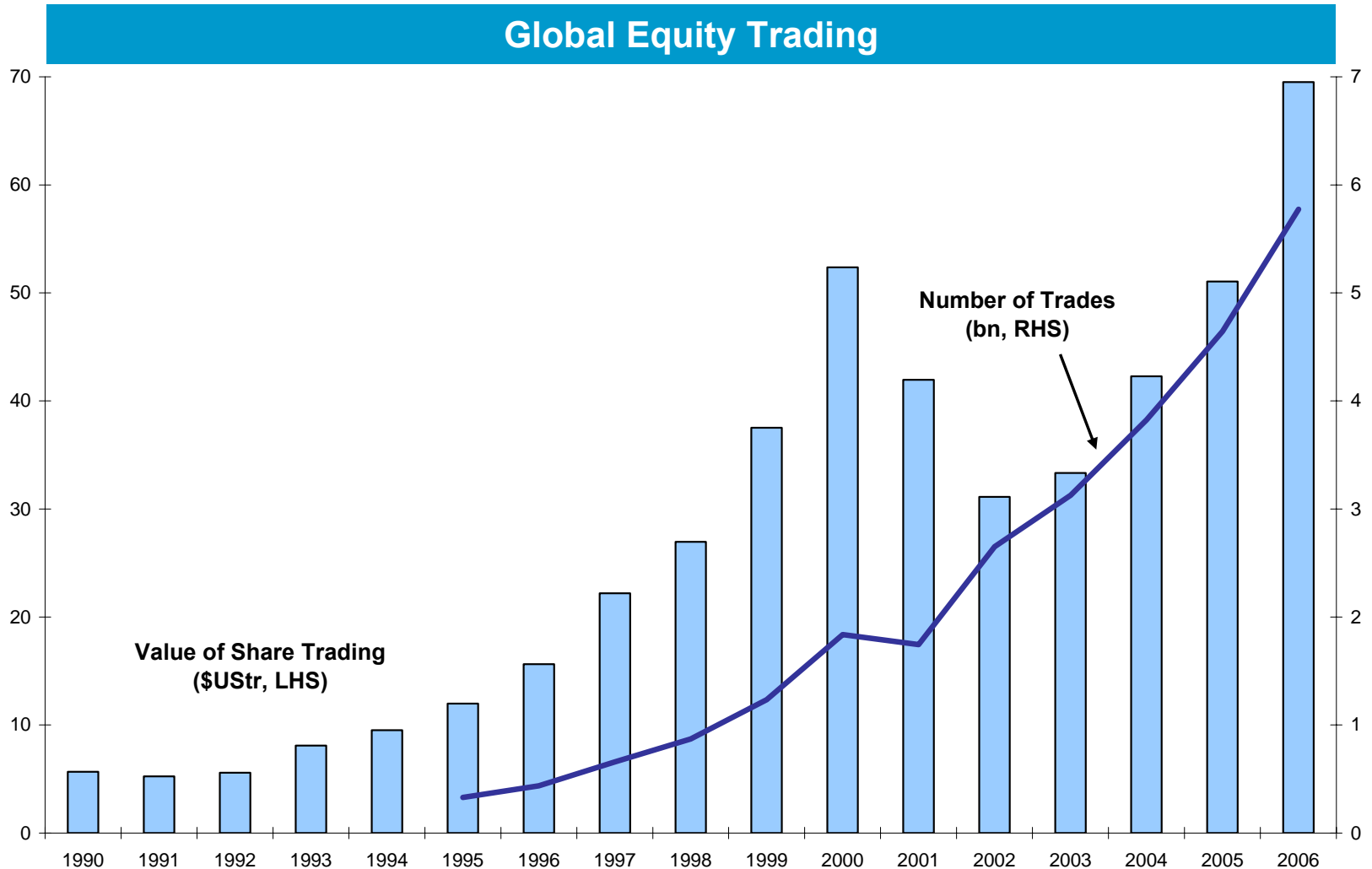
- Data for 2006 should show global growth continuing.
- Australian cross-border M&A has also grown, particularly sales of Australian assets.



Source: United Nations World Investment Report

Global equity trading has grown rapidly

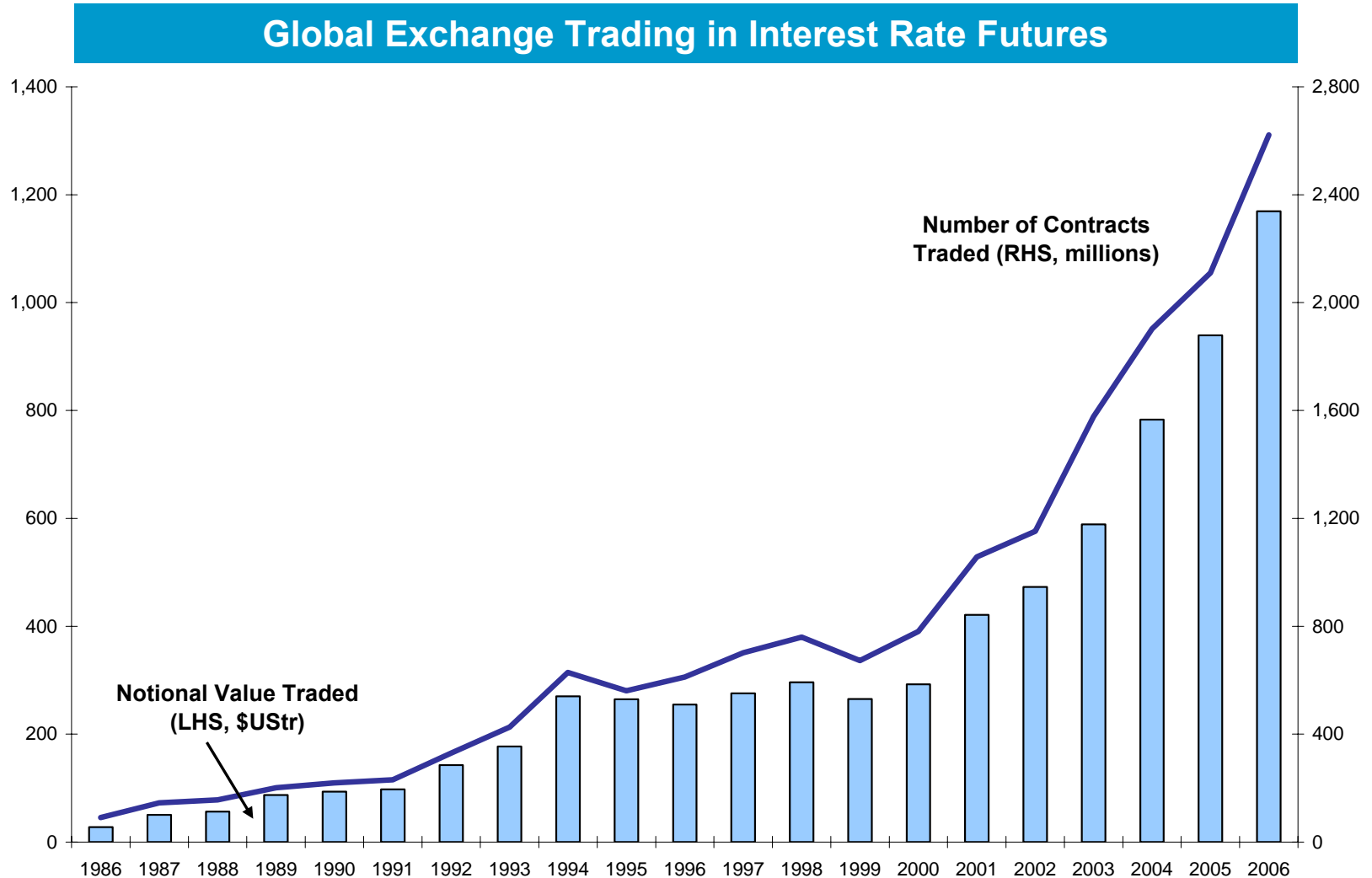
- The number of trades has been rising steadily, with new computer based trading techniques driving growth in the past few years. The value traded has surged on the back of strong equity prices in the last three years.



Source: World Federation of Exchanges

Surge in interest rate futures trading

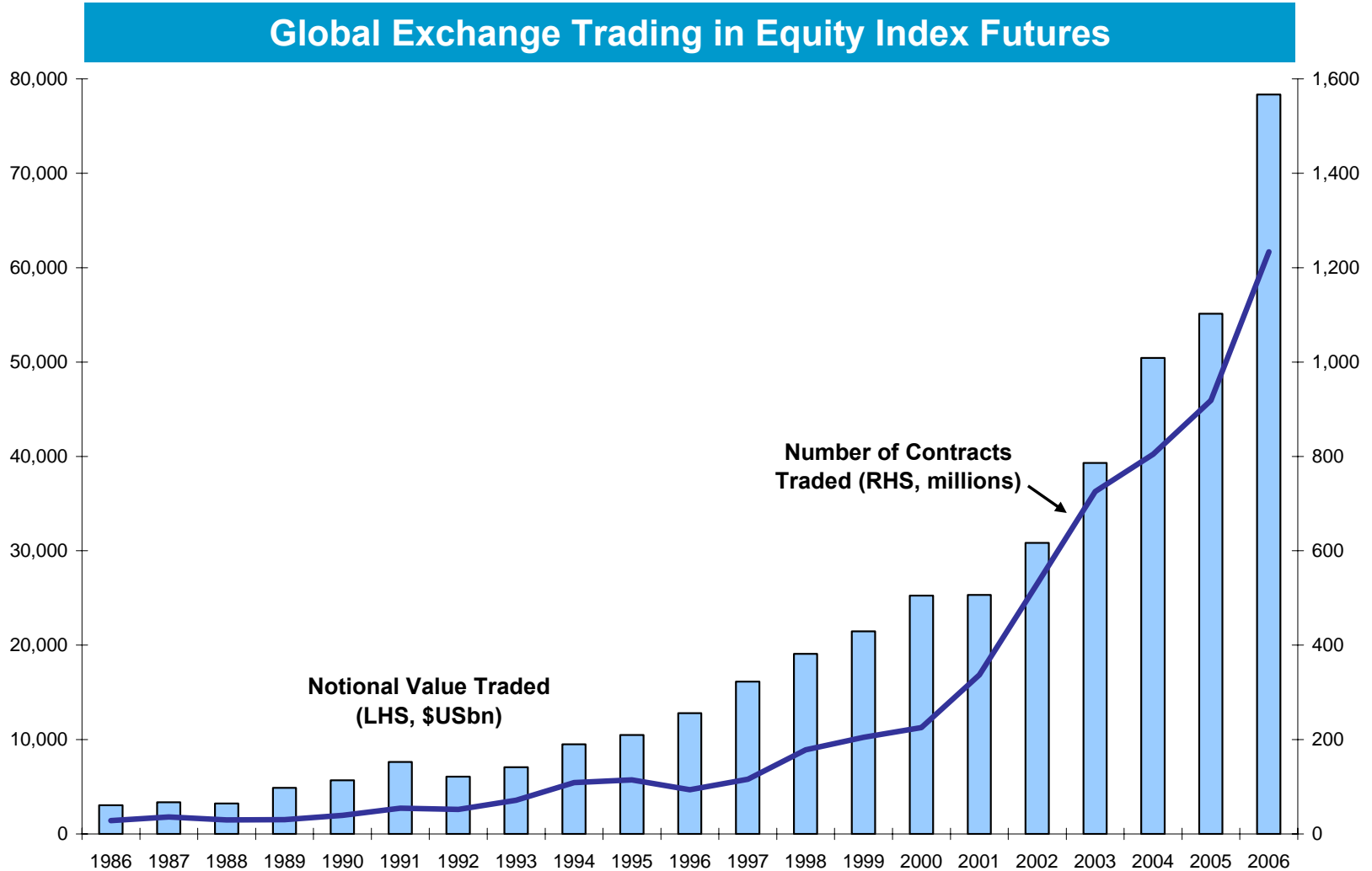
- On-exchange trading in fixed interest futures has grown strongly over recent years and rapid growth has also been seen in OTC derivatives (largely swaps).



Source: Bank For International Settlements

Strong growth in equity index futures

- On-exchange trading in equity index futures has also grown strongly but the overall size is still dwarfed by interest rate futures. OTC equity derivatives (options) have also seen rapid growth.

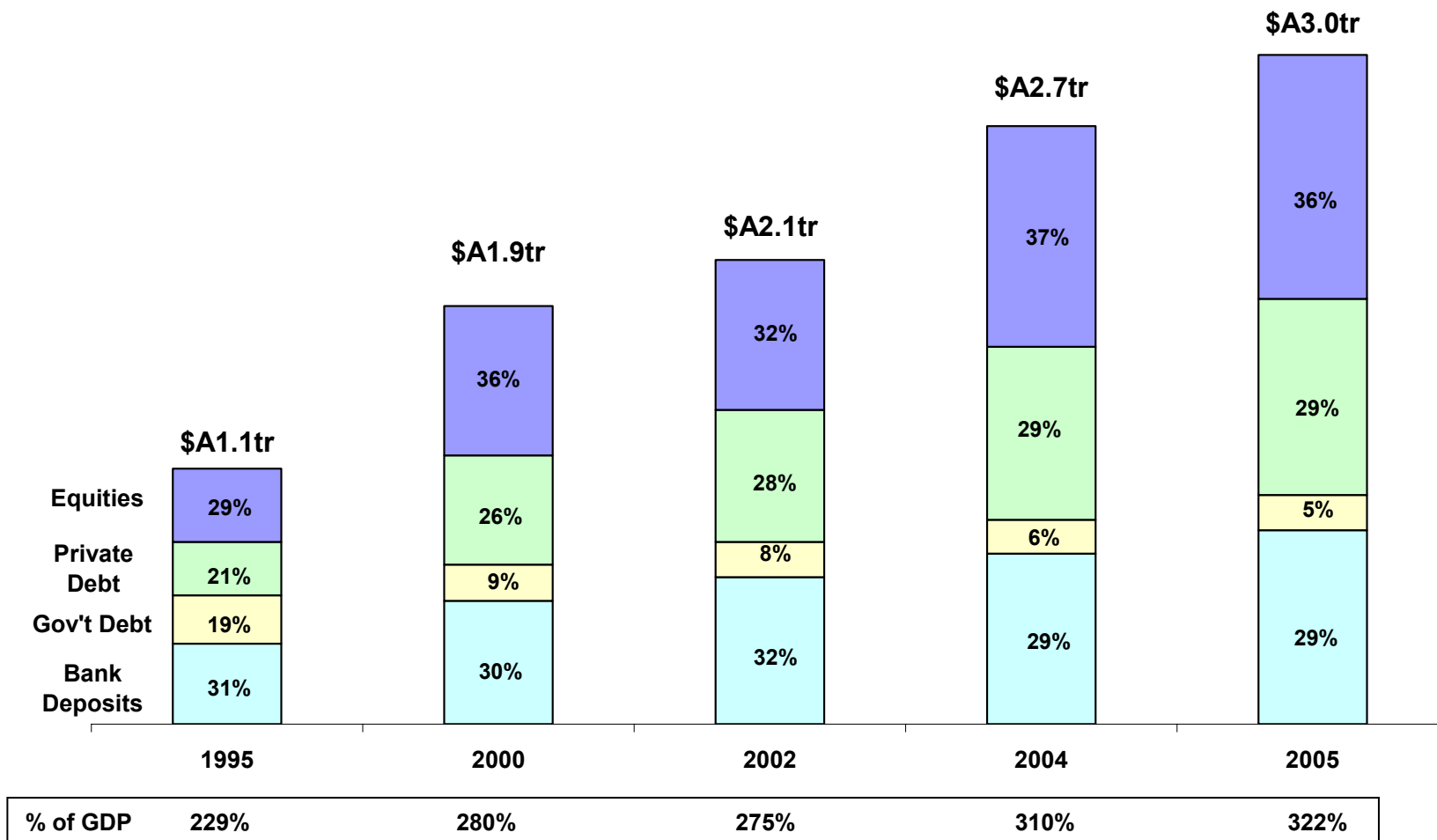


Source: Bank For International Settlements

Australian market growth even stronger

- Capital markets reached \$A3tr in 2005, up 173% on a decade earlier (cf global growth of 115%).
- Australian capital markets are slightly deeper than the global average, at 322% of GDP in 2005.

Growth in Australian Capital Markets*



* Excludes derivative markets

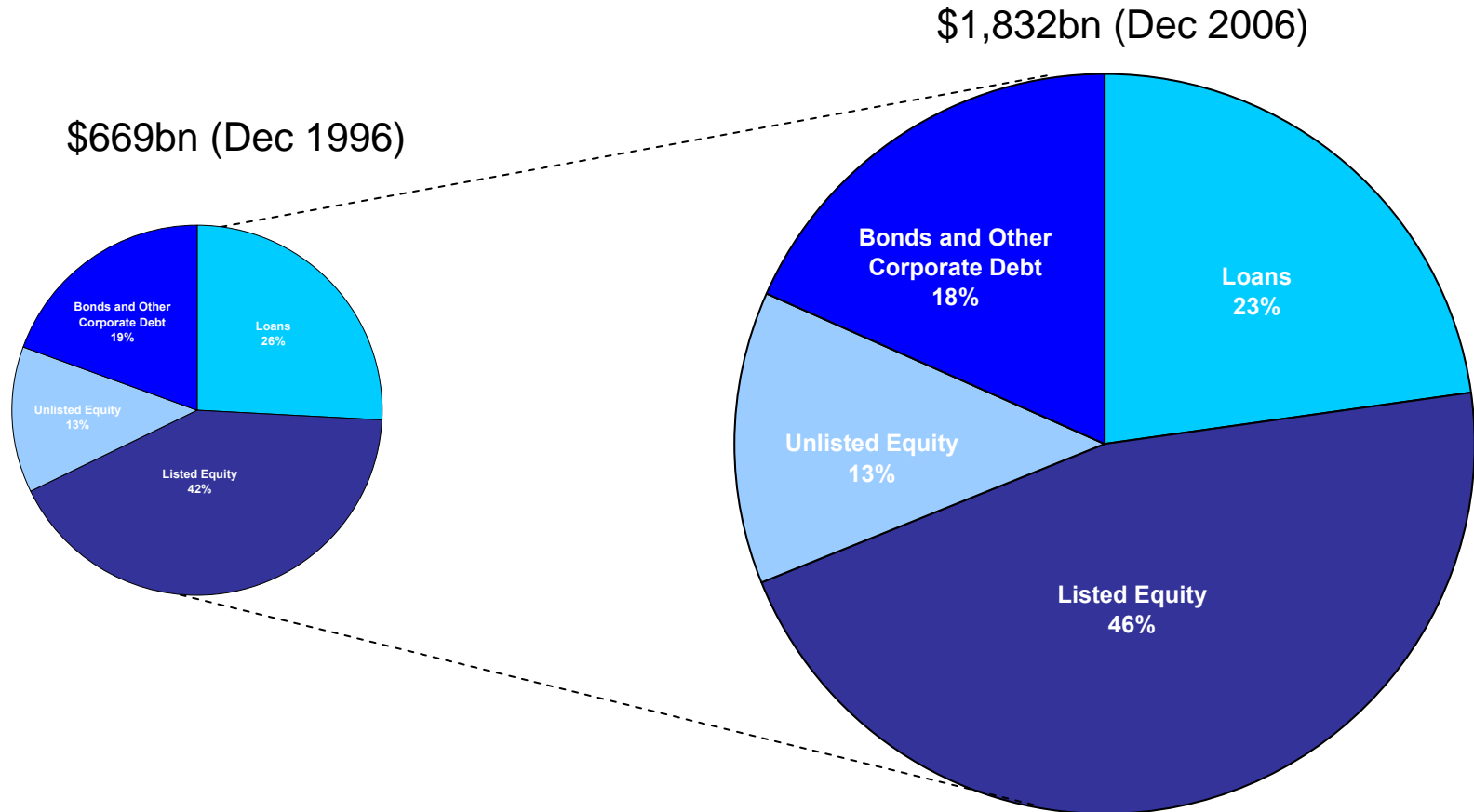
Source: ABS, ASX

Issuance of Equity Capital

Financial liabilities underpin business activity

- Real GDP growth averaged 3.3% p.a. over the past decade on the back of strong (7.1%) business investment growth.
- Financial liabilities of non-financial corporations grew 10% p.a helping to finance investment.

Financial Liabilities of Non-Financial Corporations (\$bn)



Raising Equity Capital on the ASX

ASX Capital Raising

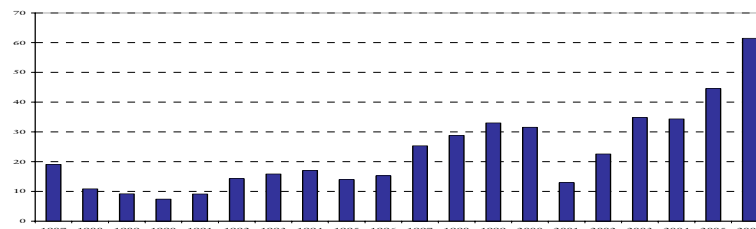
	2006 (\$Bn)	2005 (\$Bn)
Primary Raisings		
- IPOs	17.0	22.5
Secondary Raisings*		
- Rights Issues	5.0	2.6
- Placements & SPPs	25.6	8.4
- DRPs	7.6	7.4
- Calls**	2.1	0.0
- Options	0.7	0.4
- Staff share plans	3.3	3.3
TOTAL RAISINGS	61.5	44.6
Other Capital Changes		
- Share Repurchases	-7.5	-8.6
- Dividends Paid (Gross)	-41.9	-29.0

* Excludes equity issued as part of a share financed M&A, or to retire debt

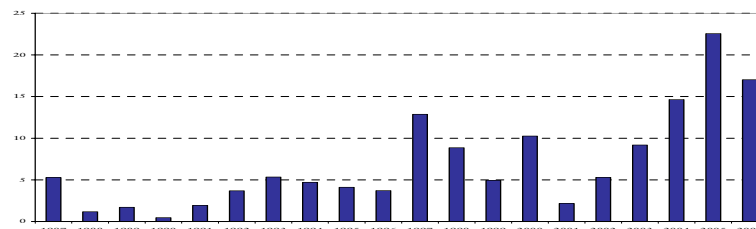
** Issue of fully paid or part paid quoted securities due to the payment of a final call or call on contributing/part paid securities.

Source: ASX

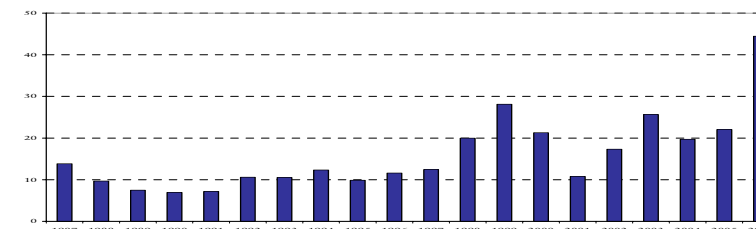
Total Capital Raising (\$bn)



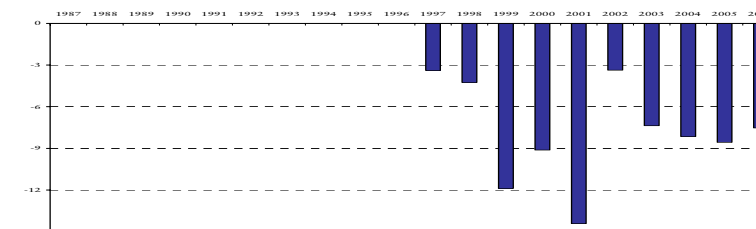
Primary Capital Raising (\$bn)



Secondary Capital Raising (\$bn)



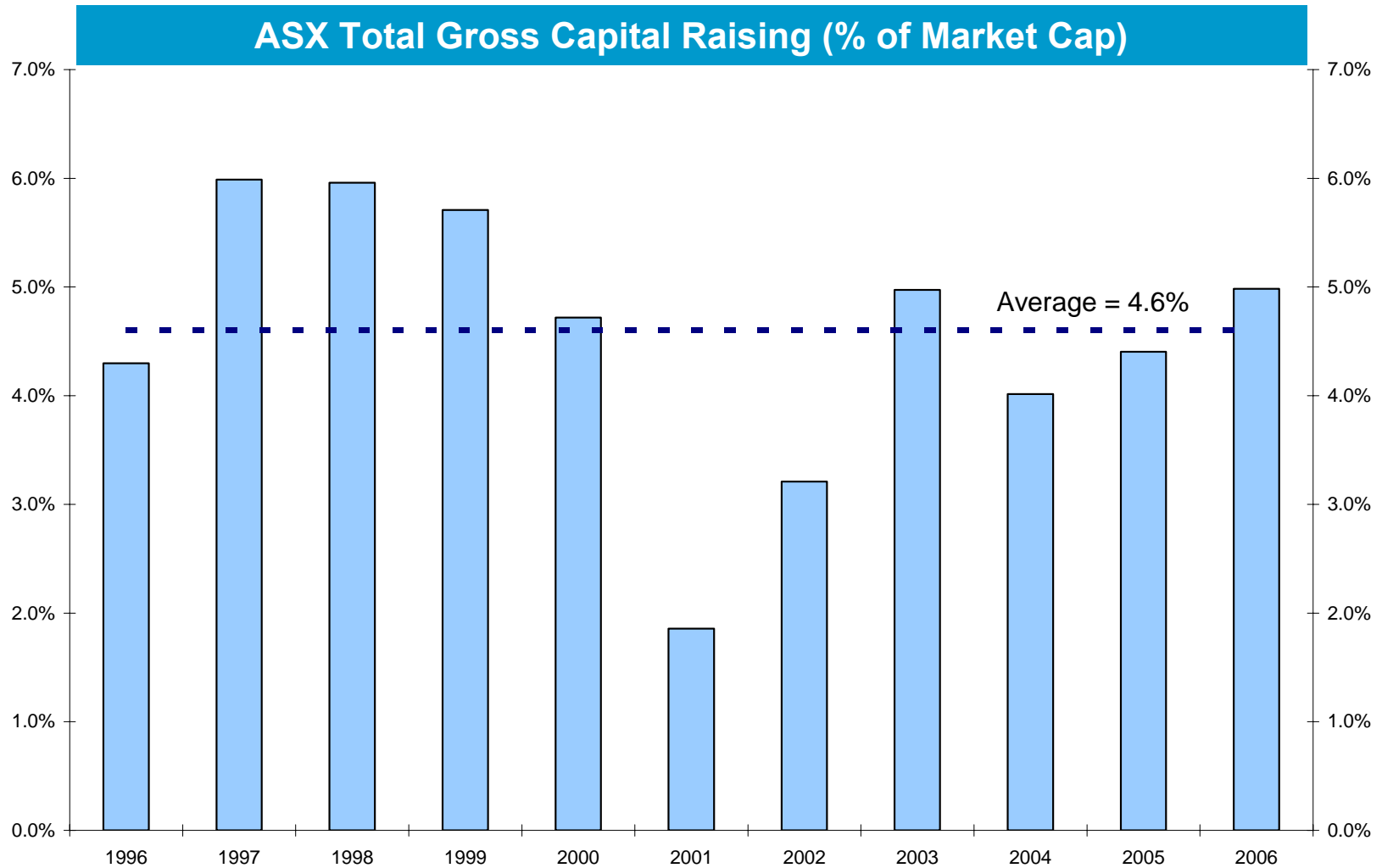
Share Buybacks (\$bn)



Source: ASX

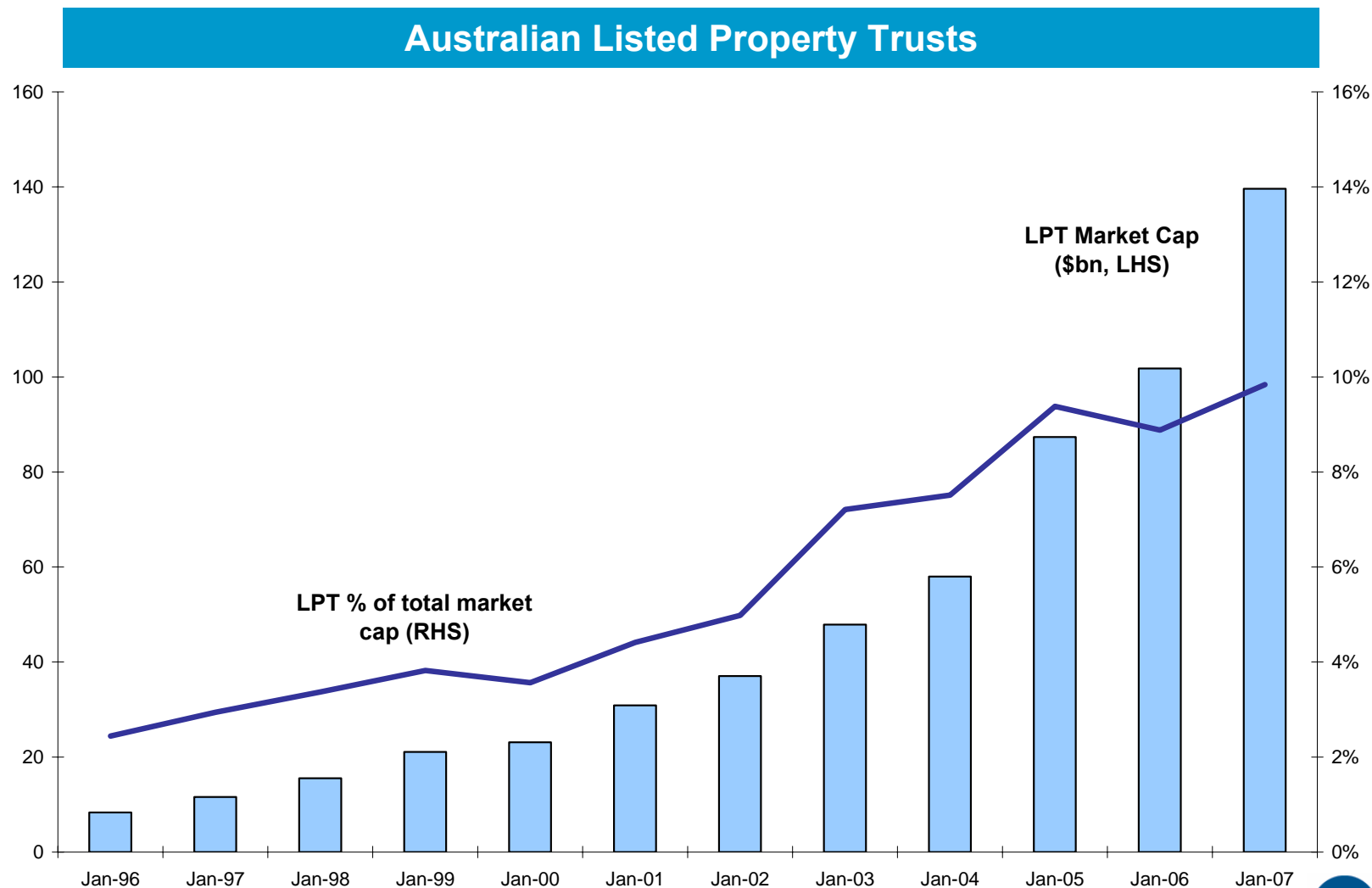
Capital raisings regenerate ASX markets

- Over 10 years, gross capital raisings have averaged 4.6 % of market cap.
- In 2006, ASX (5.0%) outperformed other exchanges: Hong Kong (4.9%), LSE (2.7%), TSX (2.6%); SGX (1.8%), Euronext (0.8%) and NYSE (0.7%).



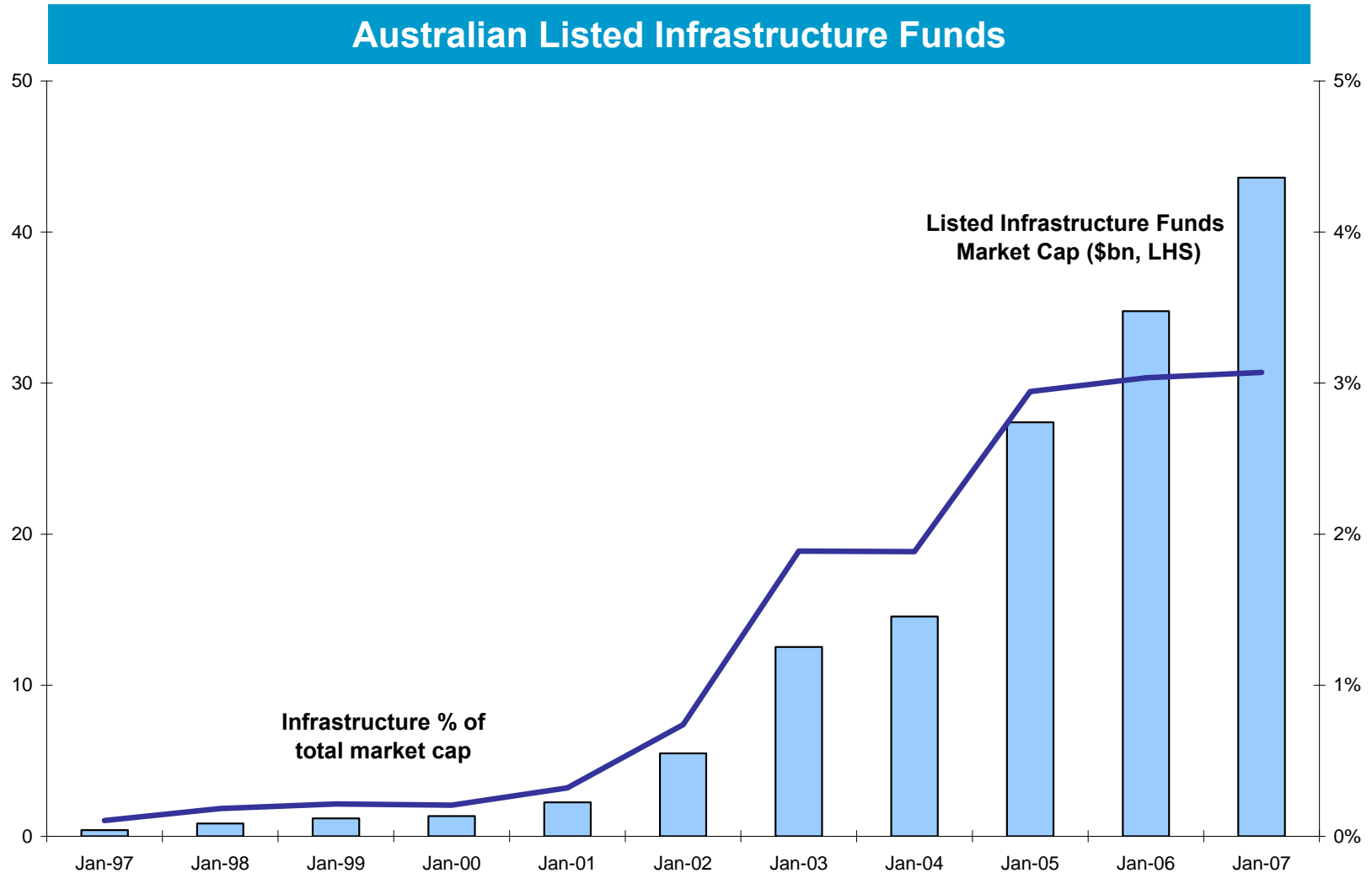
LPTs – An Australian success story

- The Australian LPT market is one of the most successful property products in the world. It has grown to be worth over \$140bn – and comprises 10% of total ASX market capitalisation.
- ASX has 12% of global listed real estate assets – compared to 2-3% of total global equity assets.



Infrastructure – Australia a global leader

- The Government has been calling increasingly on the private sector to provide infrastructure. While infrastructure projects are often largely debt financed, there has been a sharp increase in ASX listed infrastructure funds. Their market cap exceeds \$40bn – 3% of the total equity market.

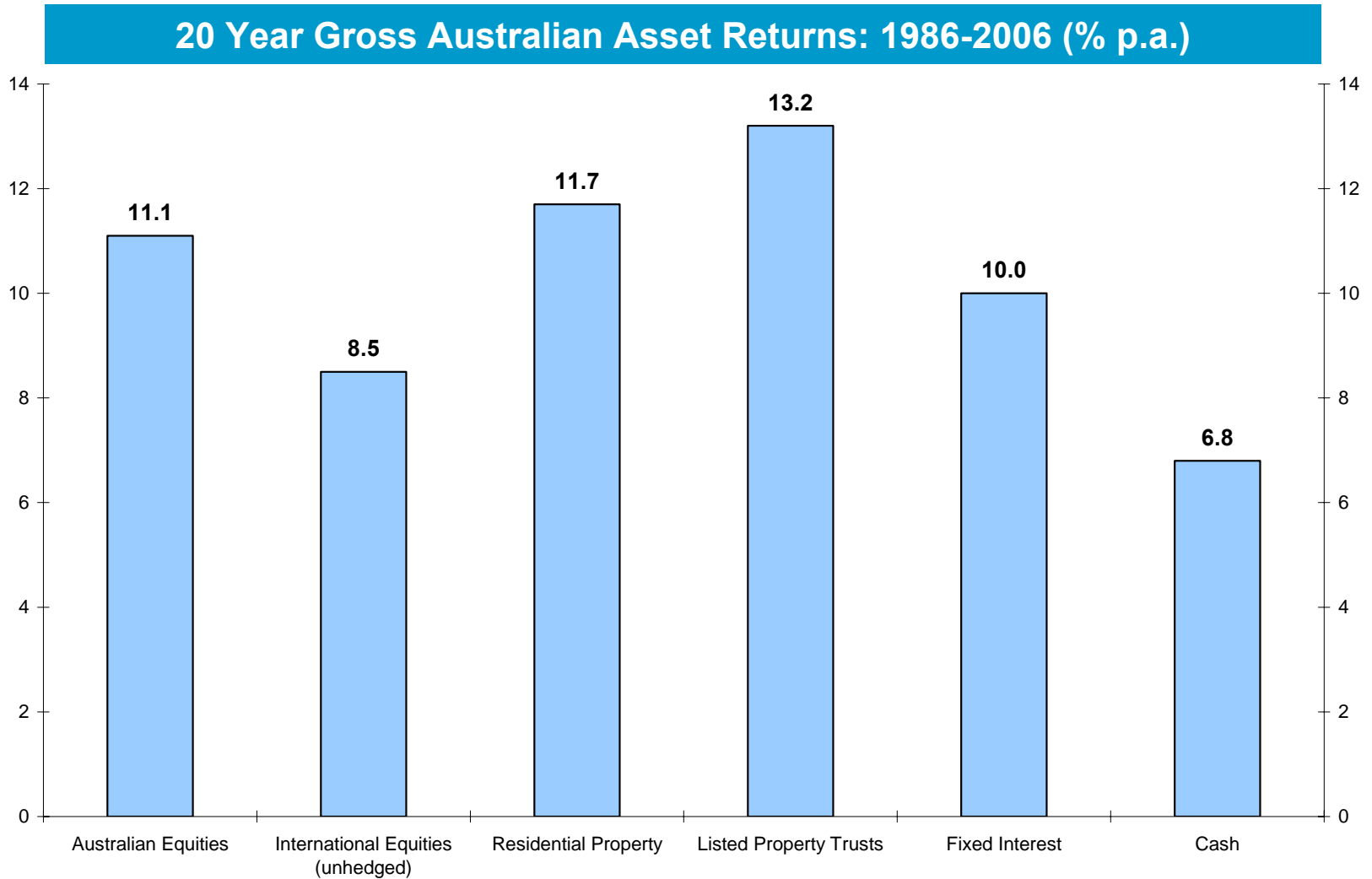


* Includes only listed funds – not ASX listed companies which have a large infrastructure element (eg Telstra, AGL, etc)
Source: ABS, ASX

Investment in Equity Capital

Listed assets deliver strong returns

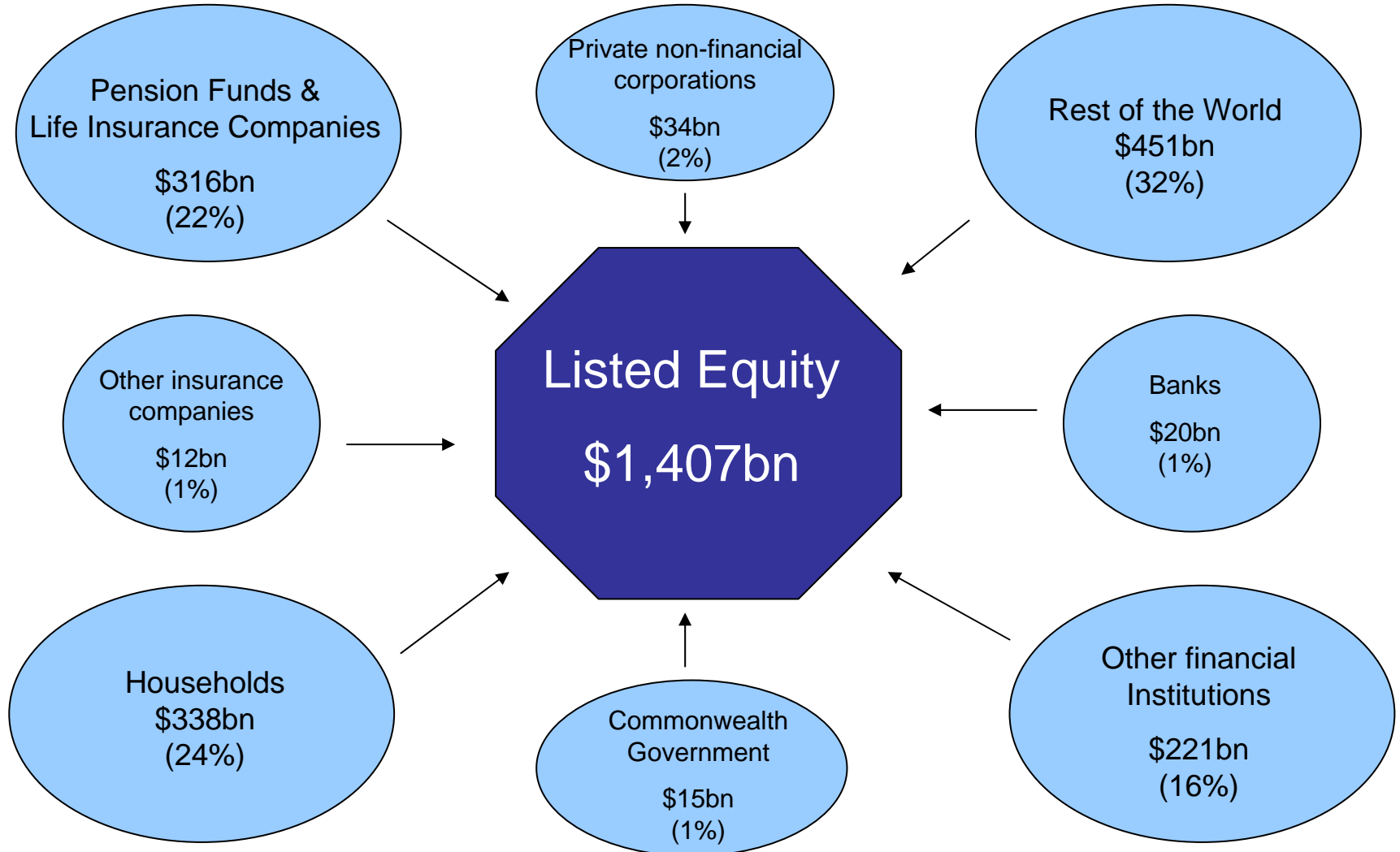
- Listed assets (LPTs and equities) have performed strongly relative to other asset classes over 20yrs.



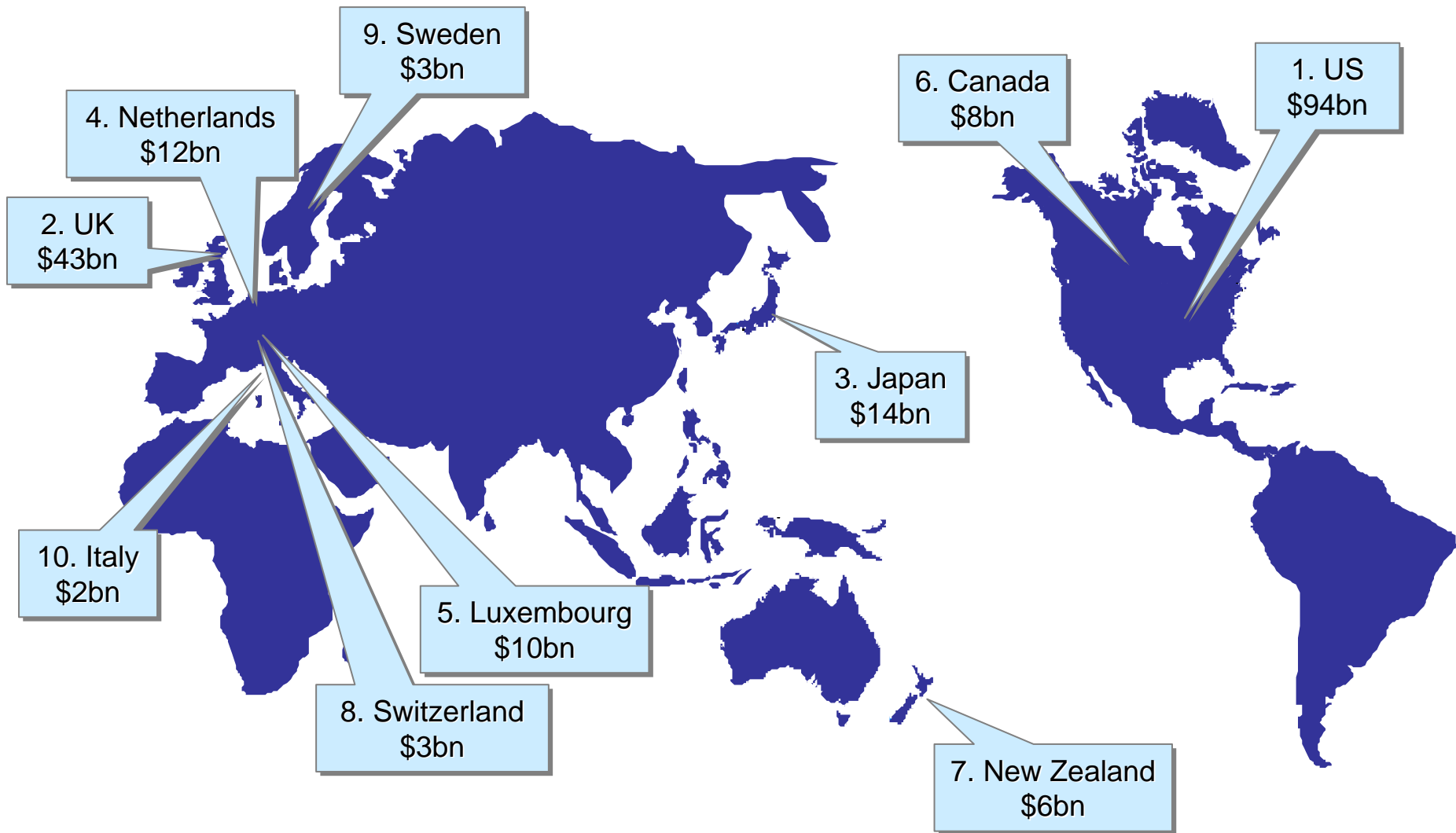
Source: Russell Investment Group

Mapping ownership of ASX listed equity

- Domestic institutions, in total, own around 40%, foreign investors 32% & households 24%.

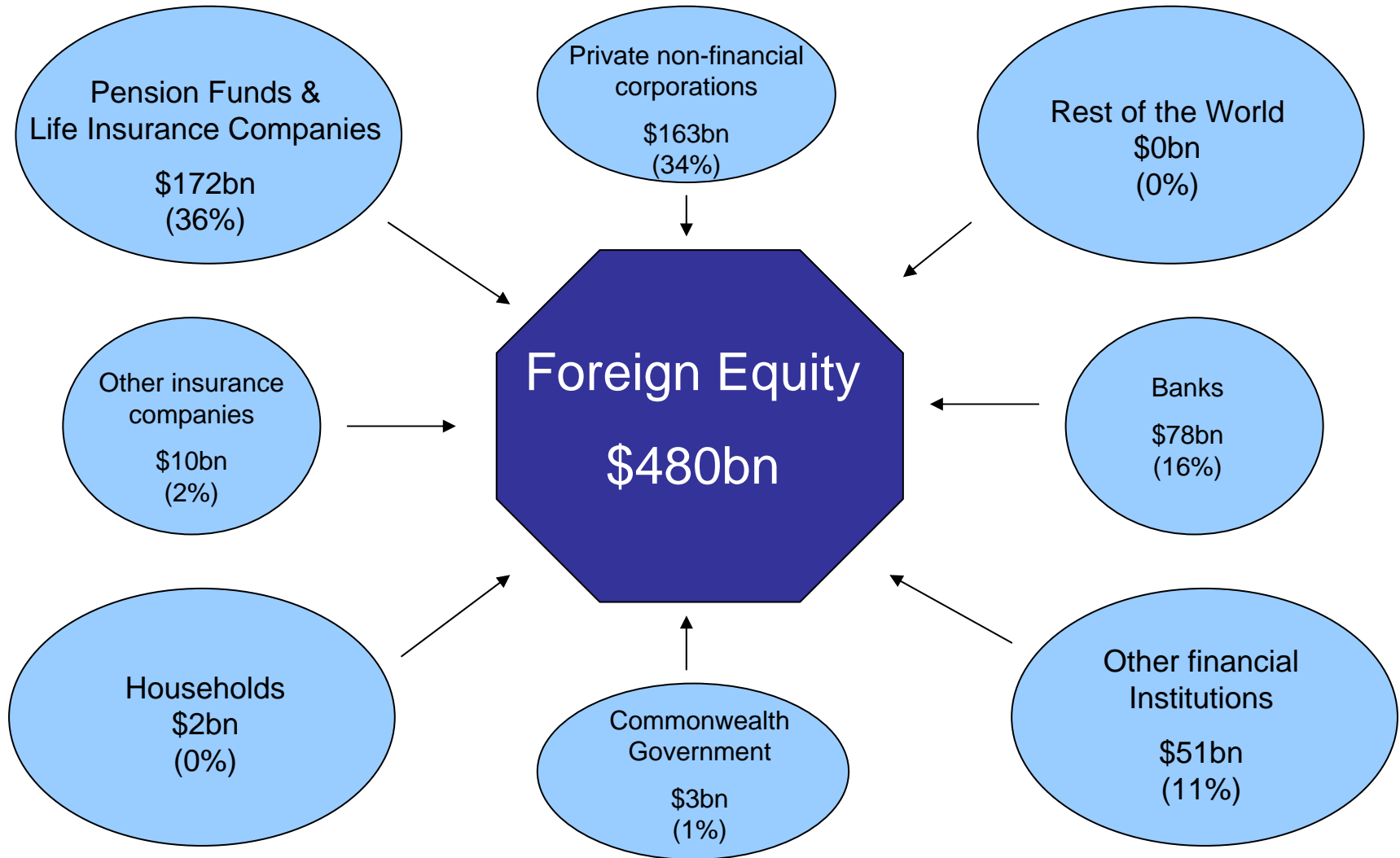


Portfolio investment in Australian equity*



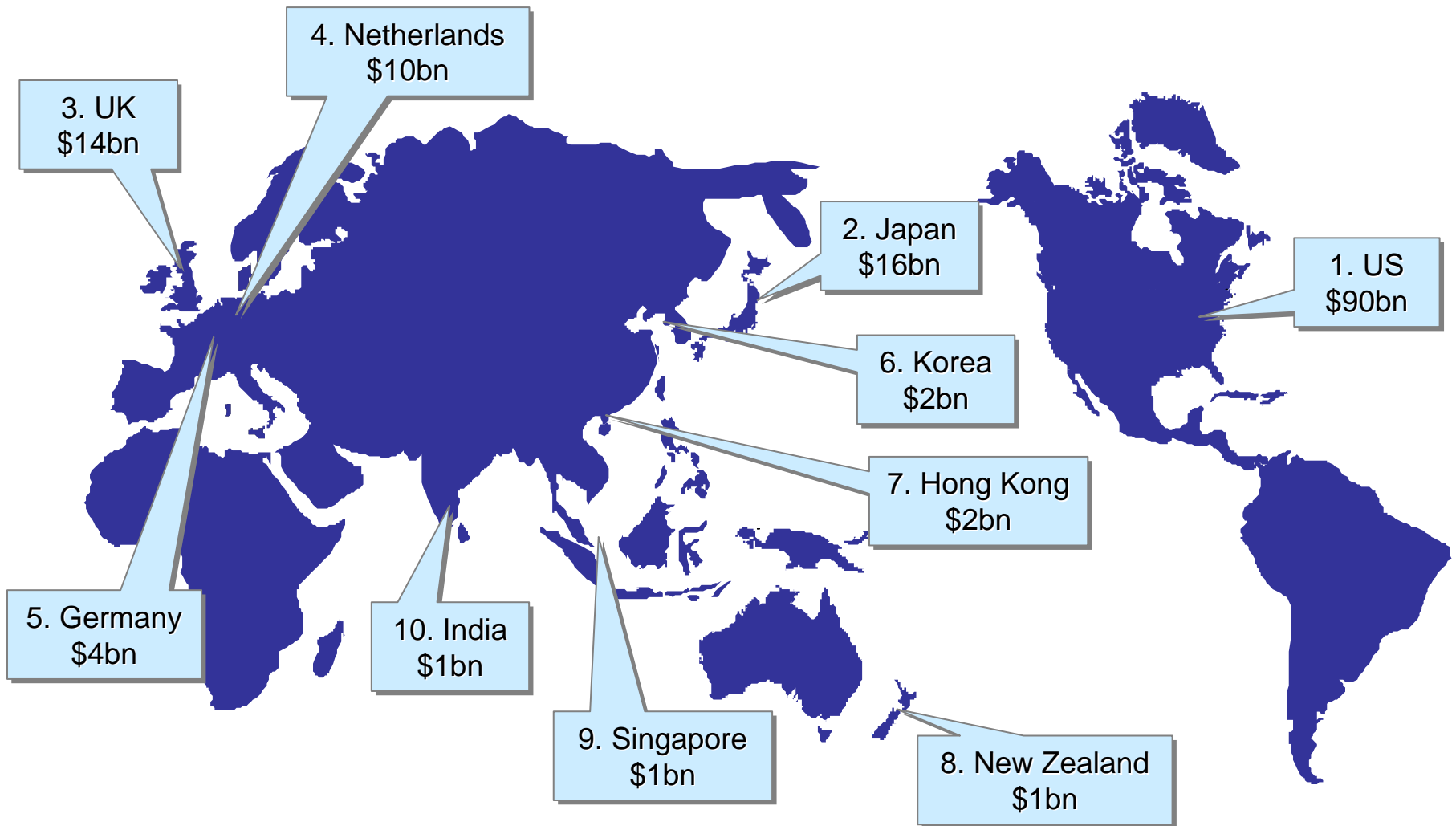
* Data is at end 2005. \$US amounts converted to \$A at an average 2005 exchange rate of \$A1=\$US0.76
Source: IMF Coordinated Portfolio Investment Survey, RBA, ASX

Mapping Australian holdings of foreign equity



Source: ABS Financial Accounts (December Qtr 2006)

Australian foreign equity portfolio holdings

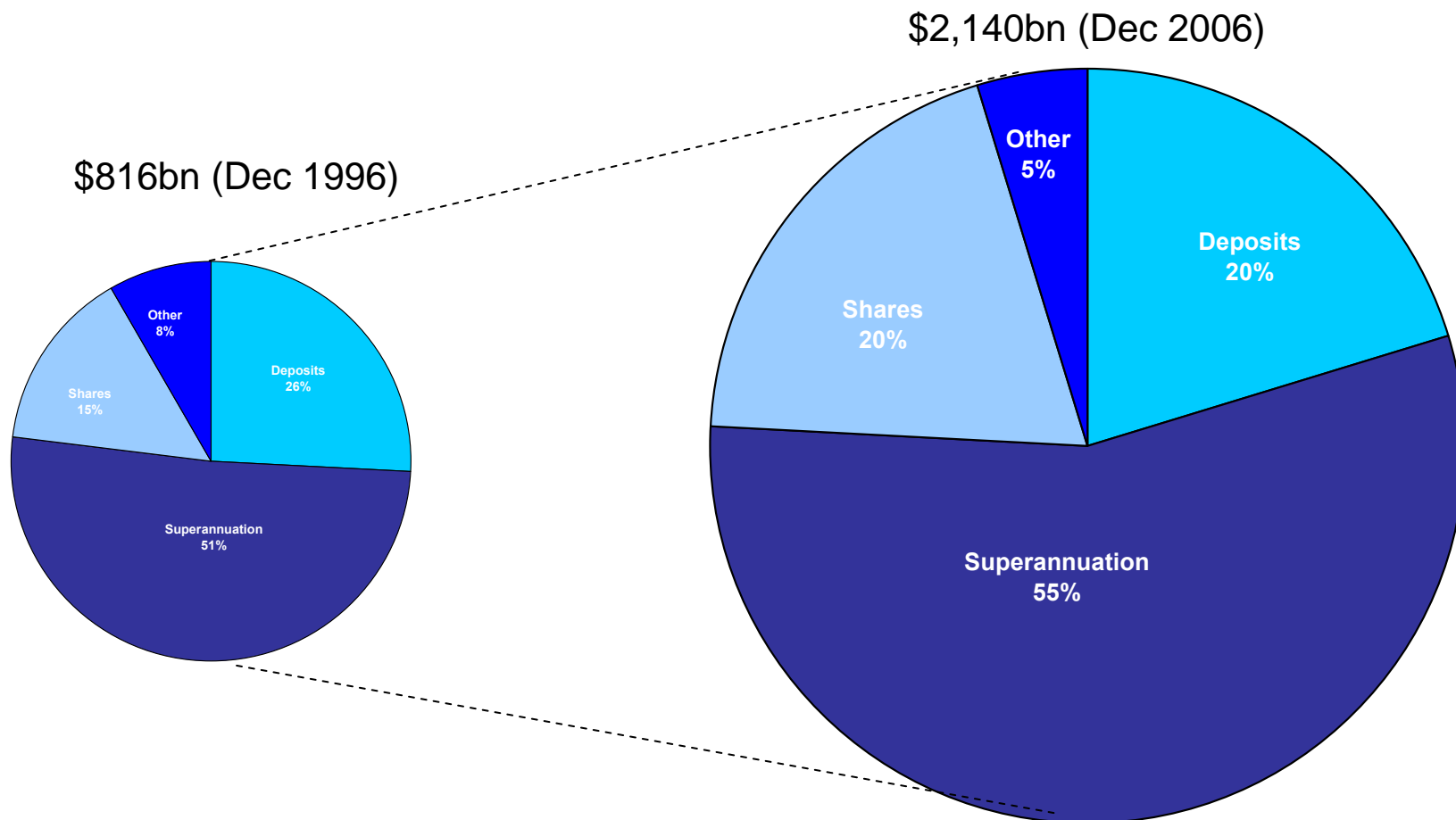


* Data is at end 2005. \$US amounts converted to \$A at an average 2005 exchange rate of \$A1=\$US0.76
Source: IMF Coordinated Portfolio Investment Survey, RBA, ASX

Households: strong financial asset growth

- Annual growth of financial assets averaged 10% for the past decade.

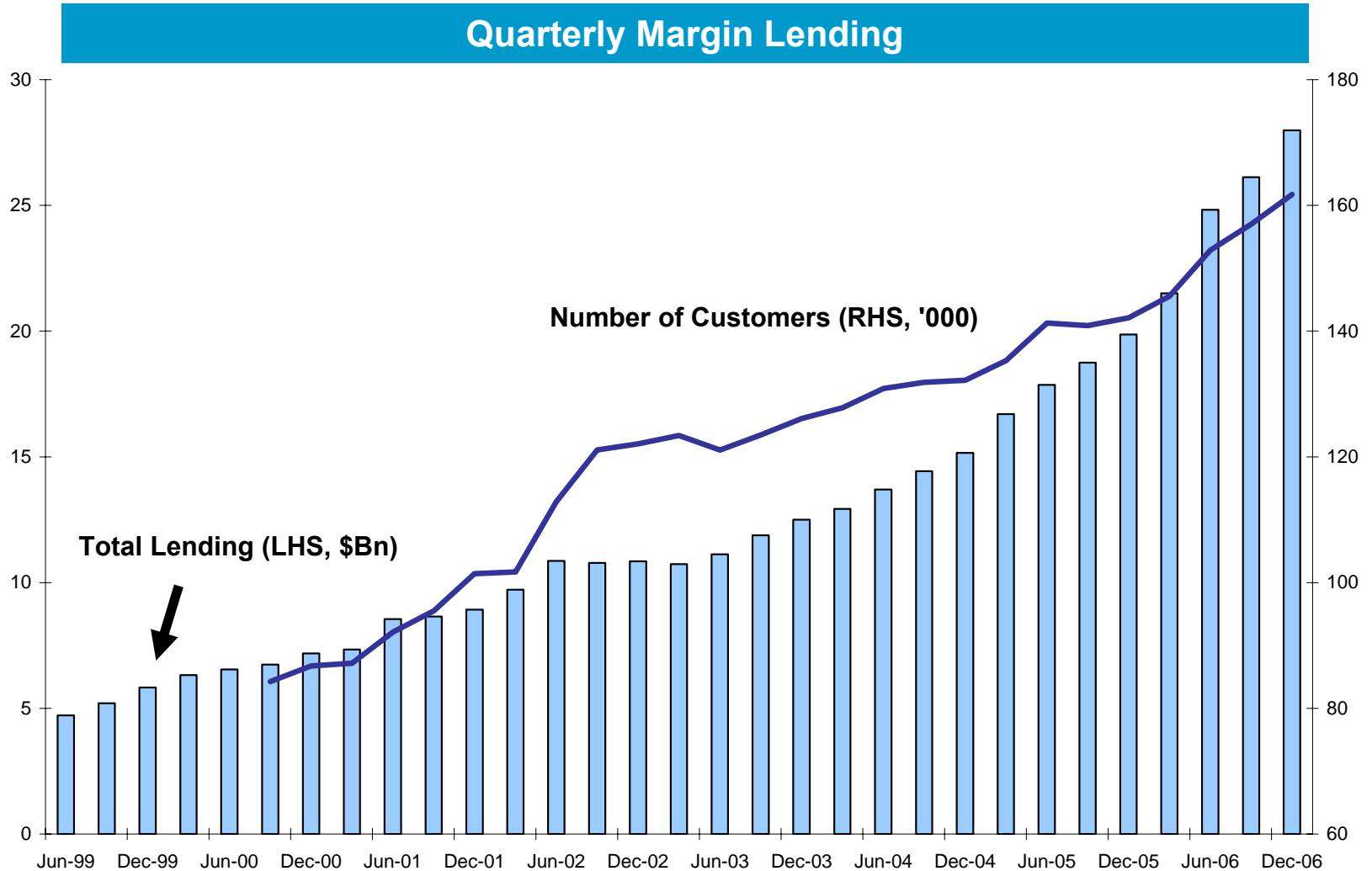
Size and Share of Household Financial Assets



Source: ABS Financial Accounts (December Qtr 2006)

Margin lending helps drive retail investment

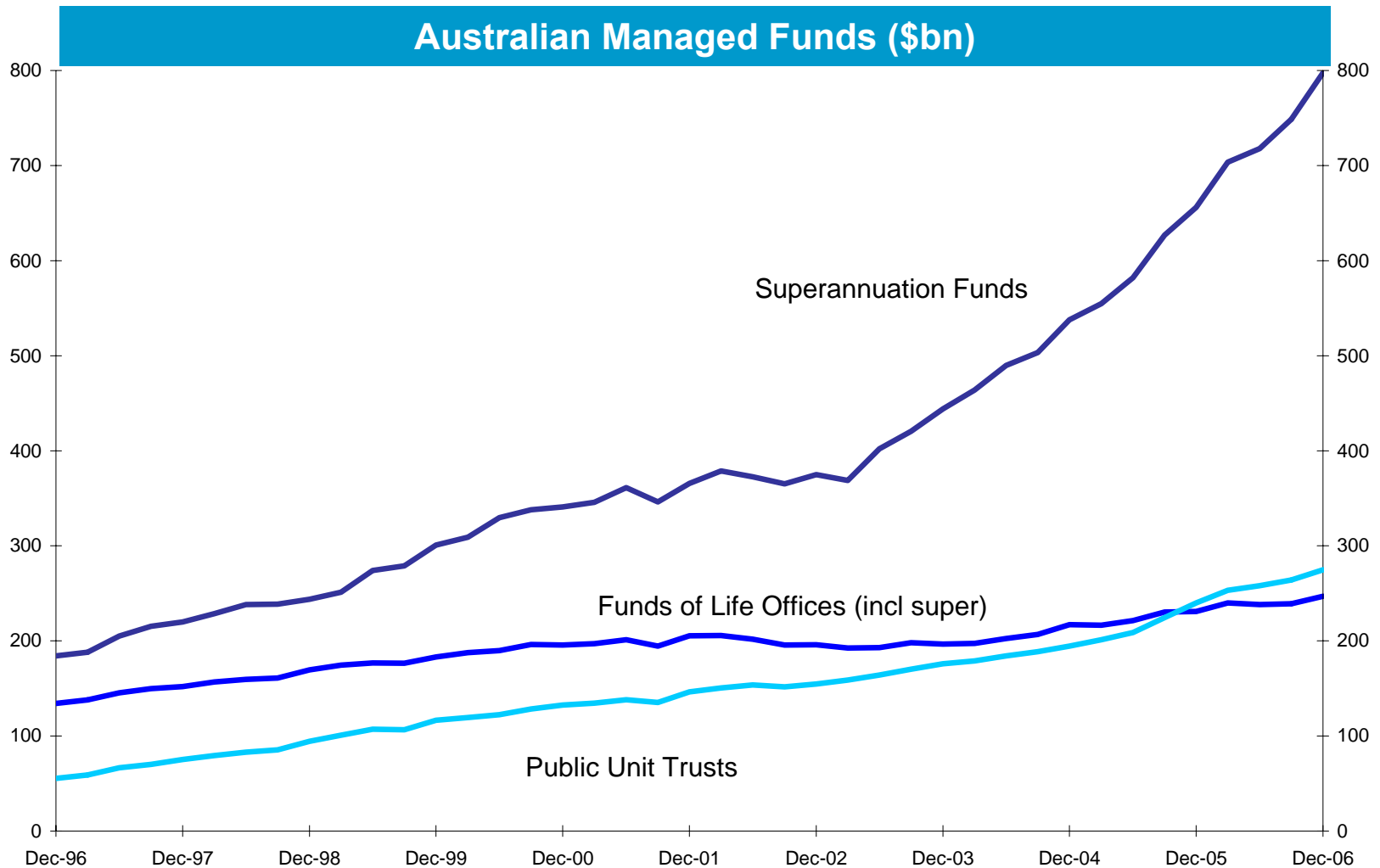
- Gearing levels of around 40% mean that the \$26bn in outstanding loan balances is covered by securities holdings valued at \$61bn.



Source: RBA

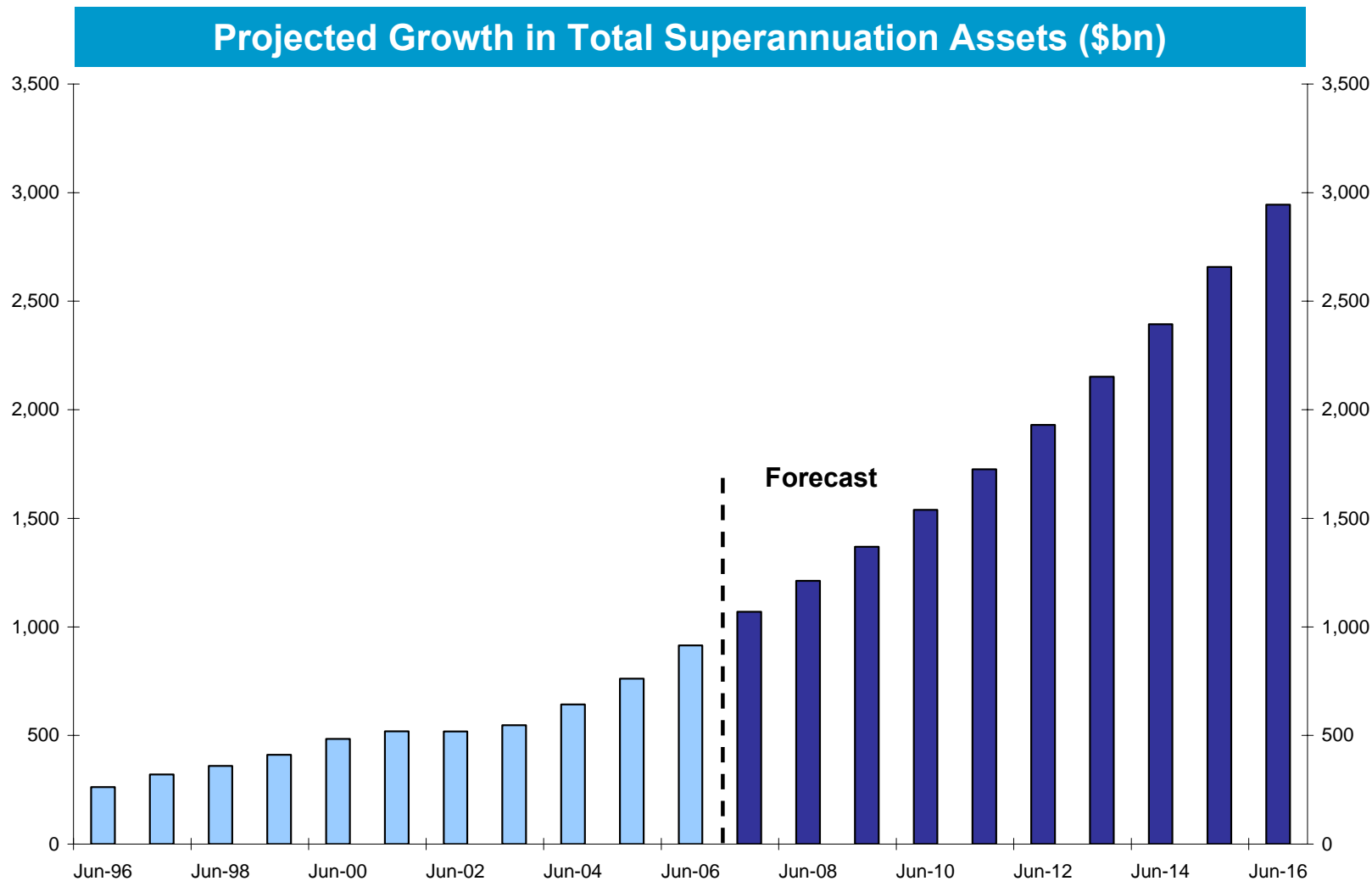
Rapid growth in institutional managed funds

- While superannuation has shown the most rapid growth, public unit trusts (listed and unlisted) have also grown strongly.
- The largest unit trust segments are unlisted equity trusts and listed property trusts.



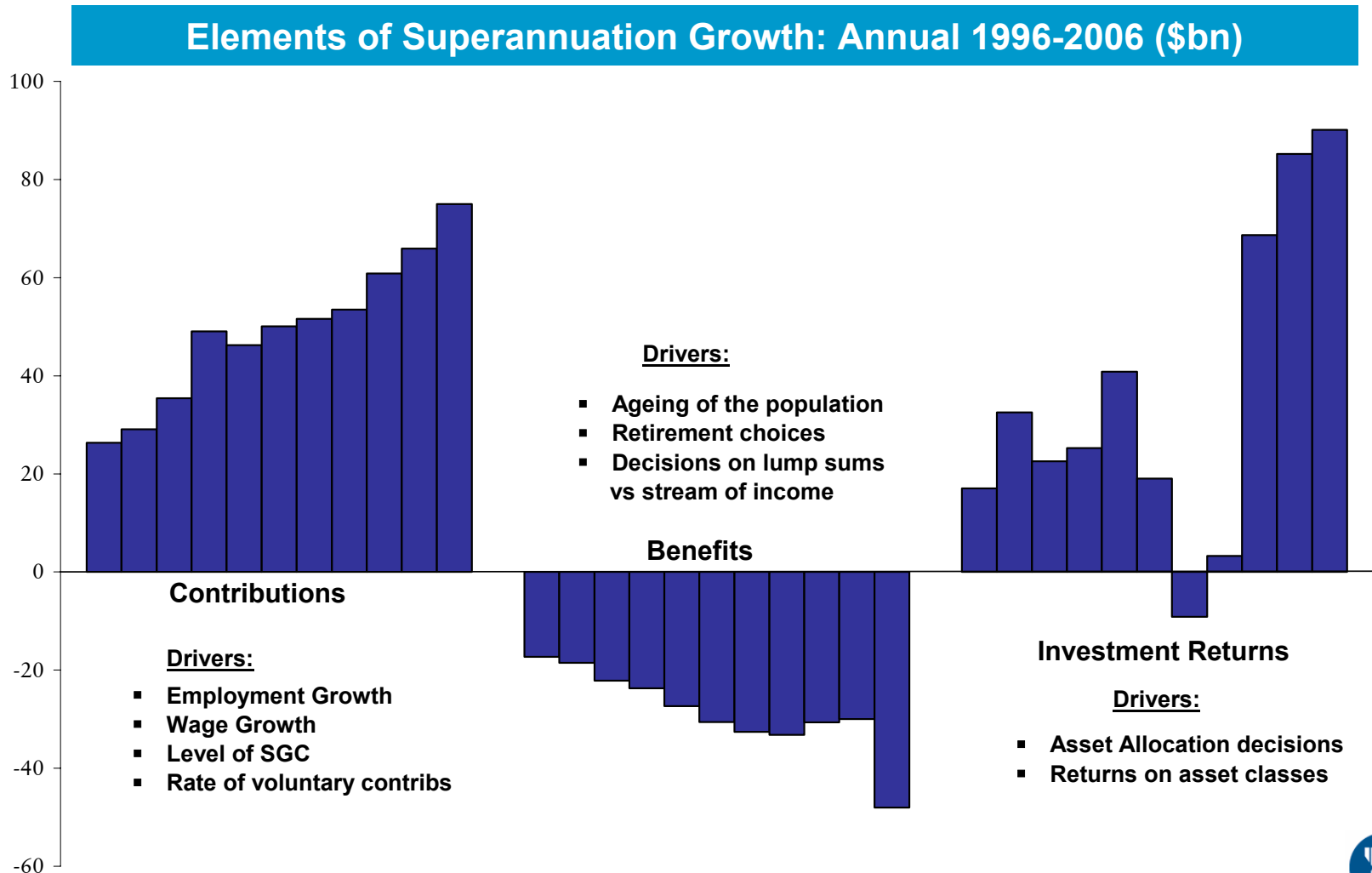
Superannuation continues strong growth

- Super assets grew at a cumulative annual growth rate of 16%pa over the past decade. Rainmaker project (prior to the last budget changes) this to reach \$3tr (2016). Future Fund to grow to \$140bn by 2020 (ie 5% of total super assets).



Drivers of superannuation growth

- Contributions of \$75bn in 2005-06, growing by an average 11% a year.
- Benefits paid out of \$50bn in 2005-06, growing by an average 11% a year.
- Investment returns, more volatile than the other factors, but strong in recent years.



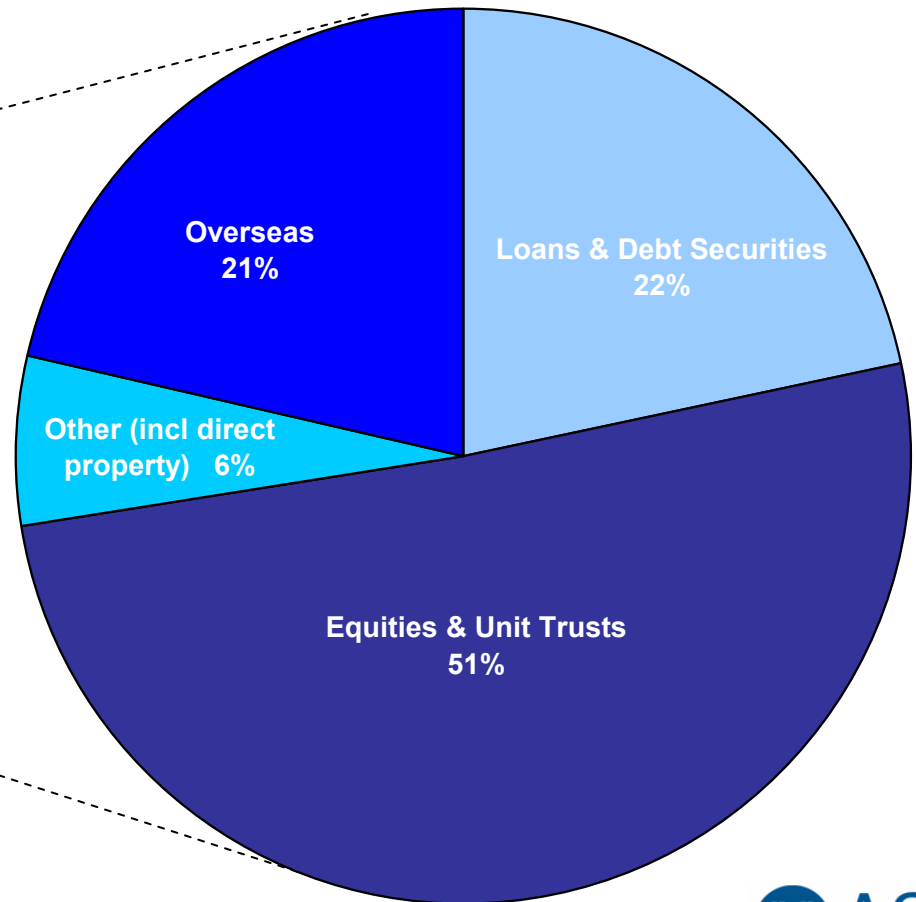
Source: APRA

Superannuation: Changing asset mix

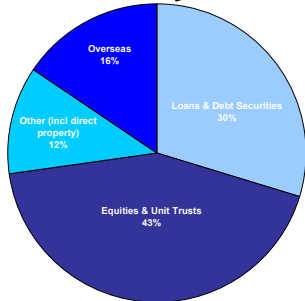
- Allocation to equity and foreign assets rising while interest rate exposure has been falling.
- Around 30% all equity holdings are in foreign stocks.

Size and Share of Superannuation Assets*

\$798bn (Dec 2006)



\$184bn (Dec 1996)

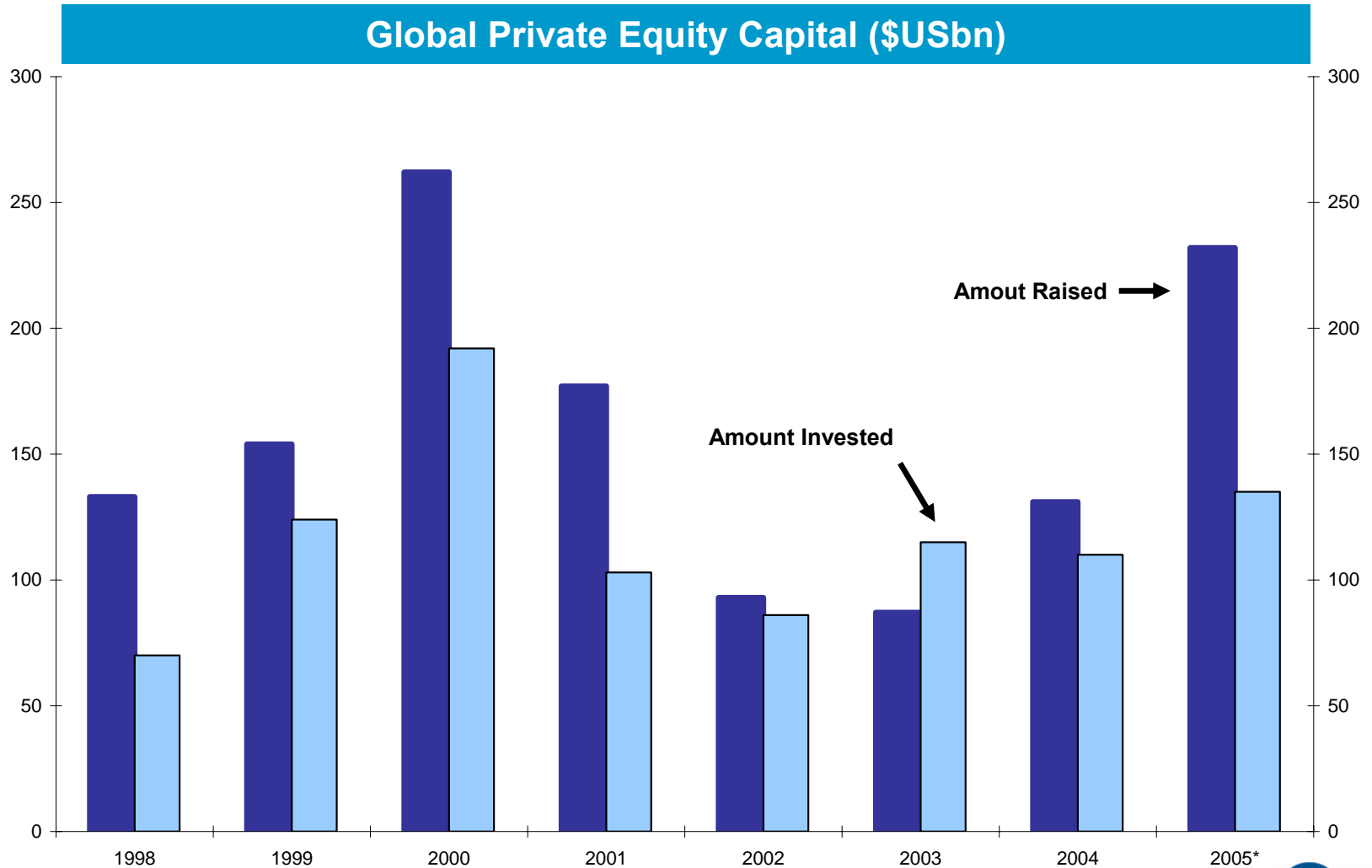


* Excludes statutory super funds of life offices

Source: ABS Managed Funds (December Qtr 2006)

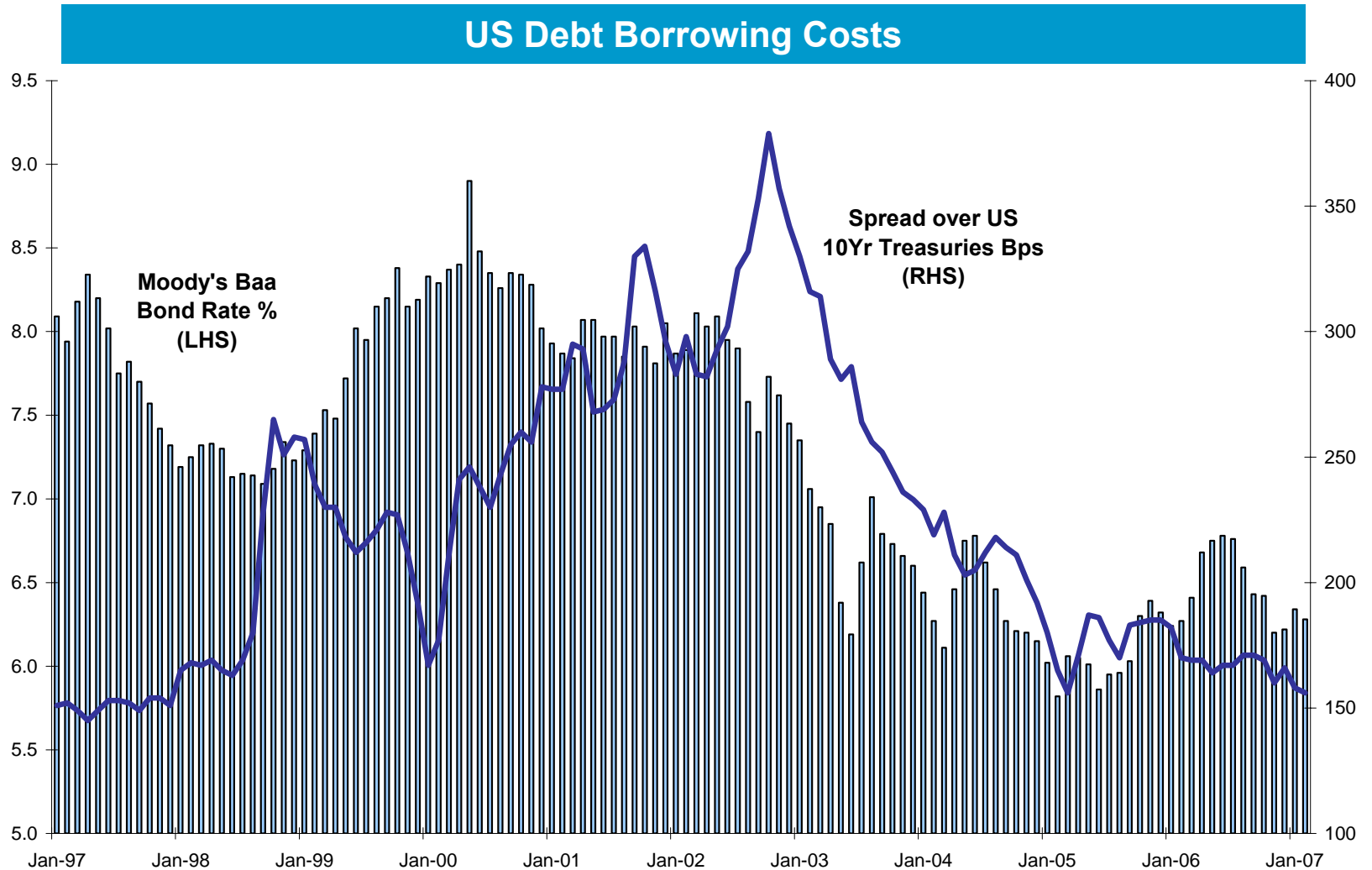
Global private equity: small but fast growing

- In 2005, around \$US240bn was estimated to have been raised by private equity funds.
- Anecdotal reports vary widely on how much was raised in 2006 with estimates as high as \$US430bn (Private Equity Intelligence).



Private equity: Easy credit market conditions

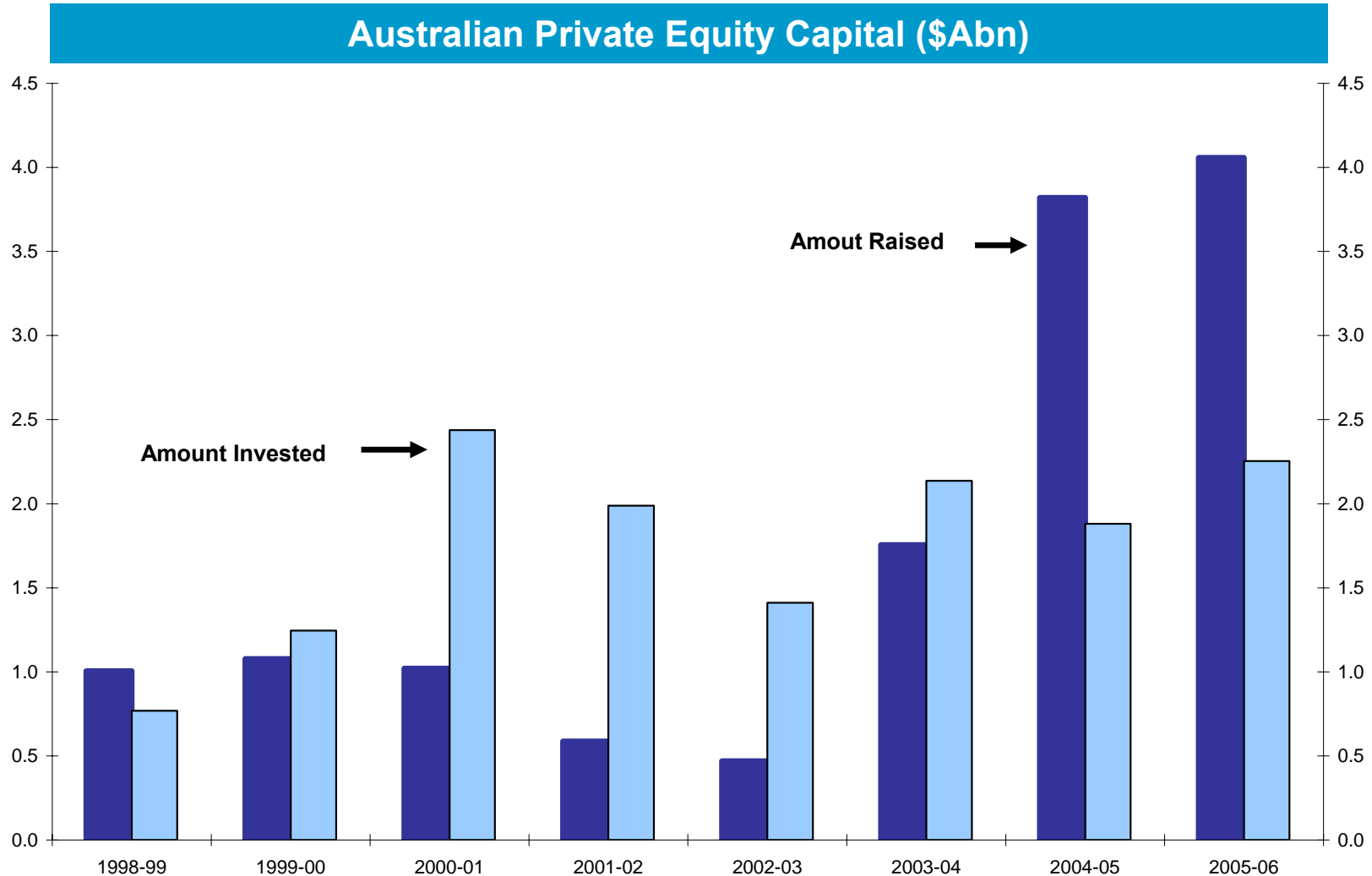
- Private equity funds use significant leverage to structure takeovers. Credit conditions in recent times have created an environment conducive to securing finance at reasonable rates.



Source: US Federal Reserve

Australian private equity: a similar story

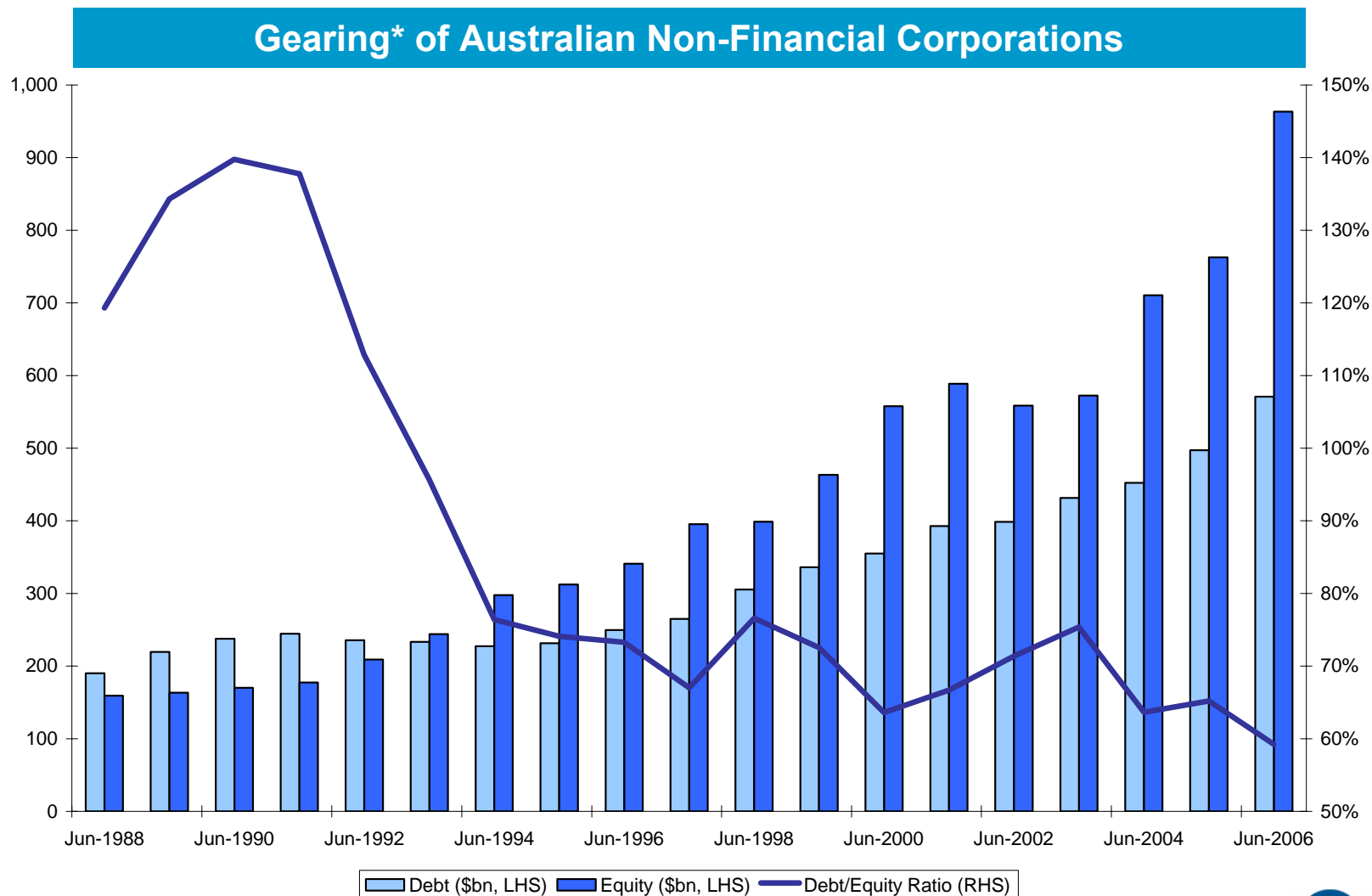
- In Australia capital raised by private equity firms has risen sharply. The average deal size of investments has risen. In 2005-06 over half of investments were in consumer related industries.



Source: AVCAL

Declining leverage of Australian corporates

- Non-financial corporations have expanded both their debt and equity liabilities, but since the last recession gearing of the sector has declined significantly and private equity transactions are looking to re-leverage balance sheets of target companies

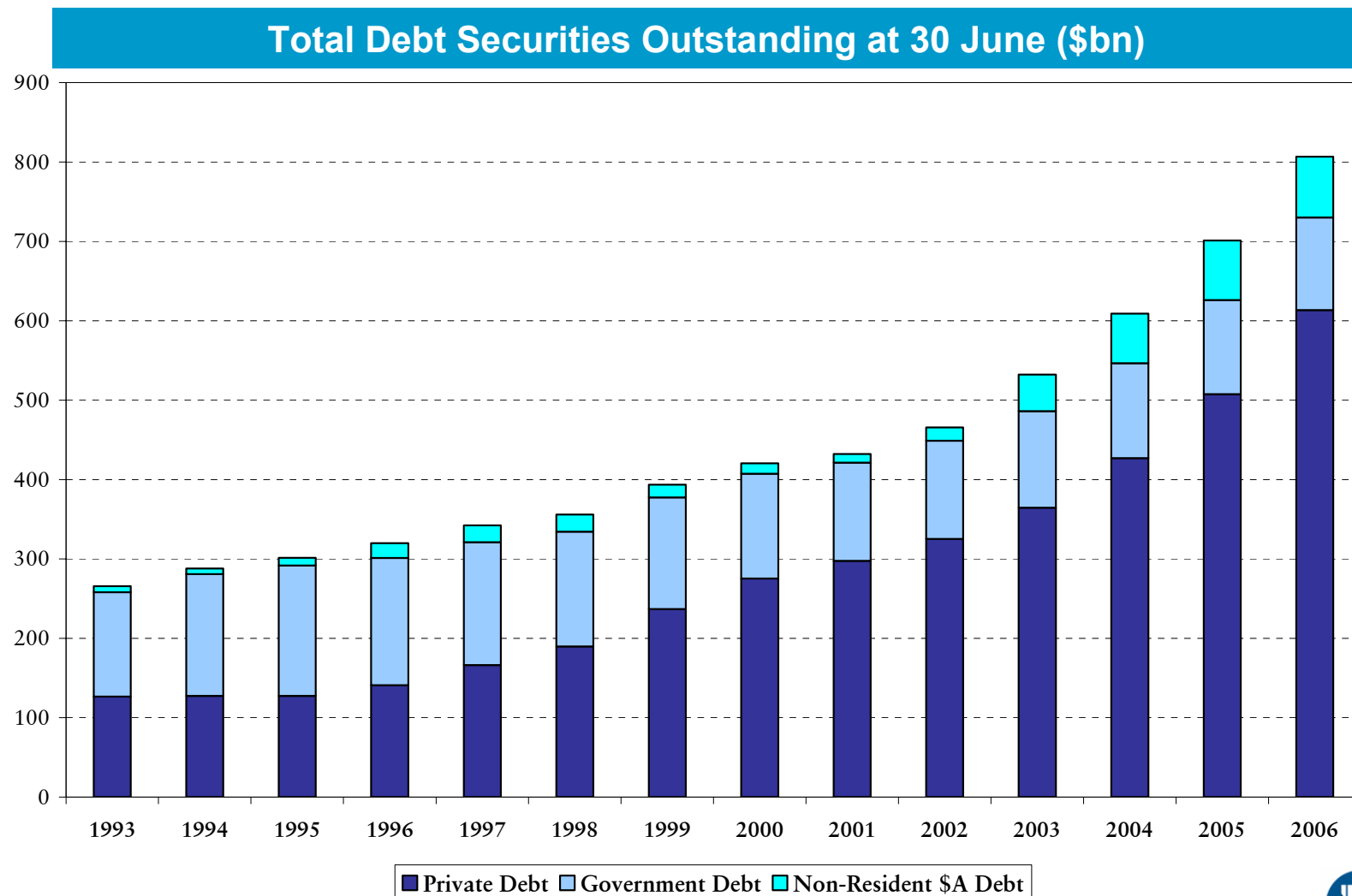


* Measured as outstanding debt (incl banks loans) divided by equity issued (listed and unlisted)
Source: ABS, ASX

Fixed Income and Derivatives

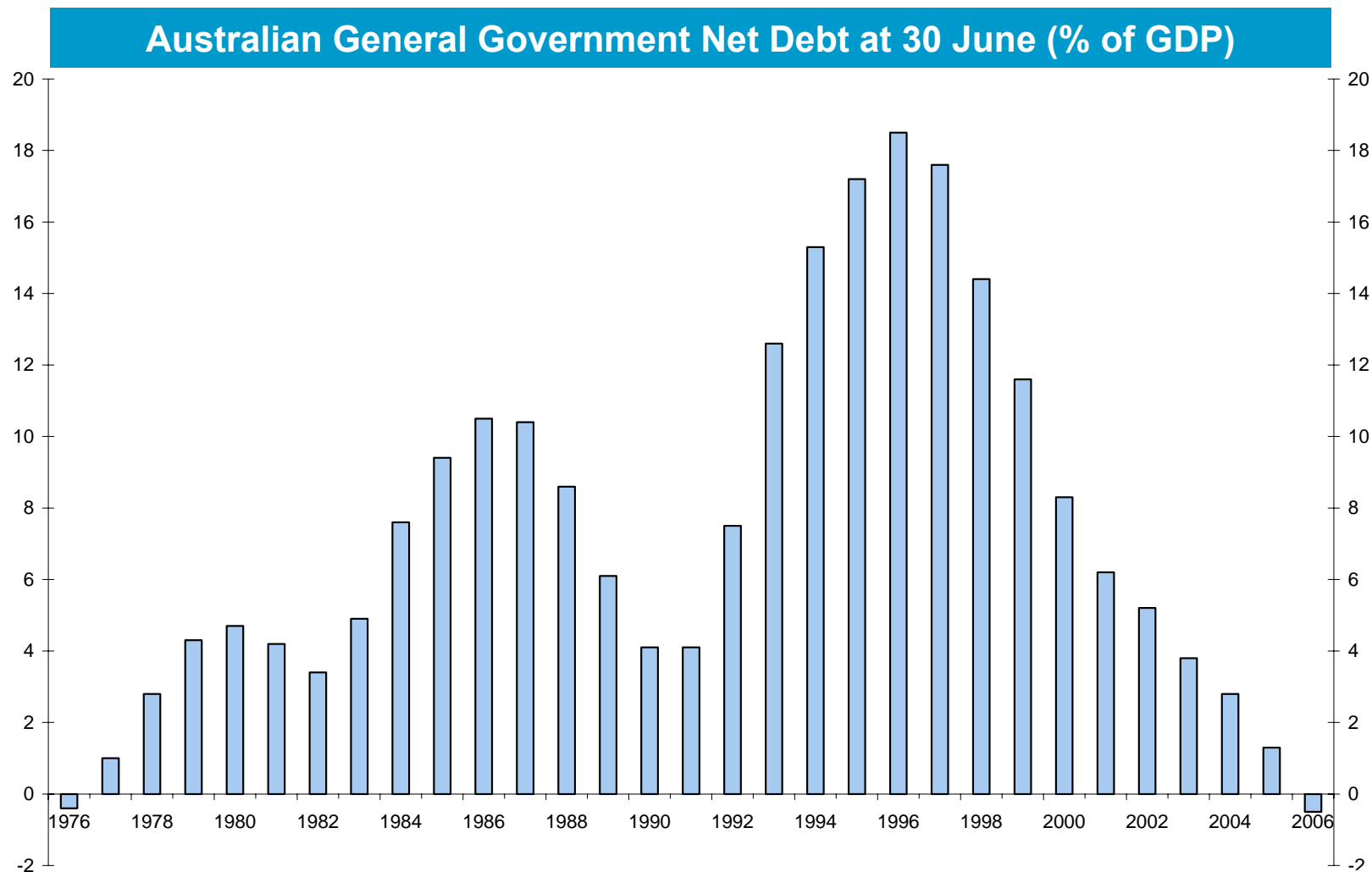
Australian debt securities outstanding

- Private sector debt (ie corporate bonds and asset securitisation) accounts for around $\frac{3}{4}$ of total debt outstanding. It has been growing strongly (as has \$A issuance by non-residents) while public sector debt (C'wlth & State) has declined.



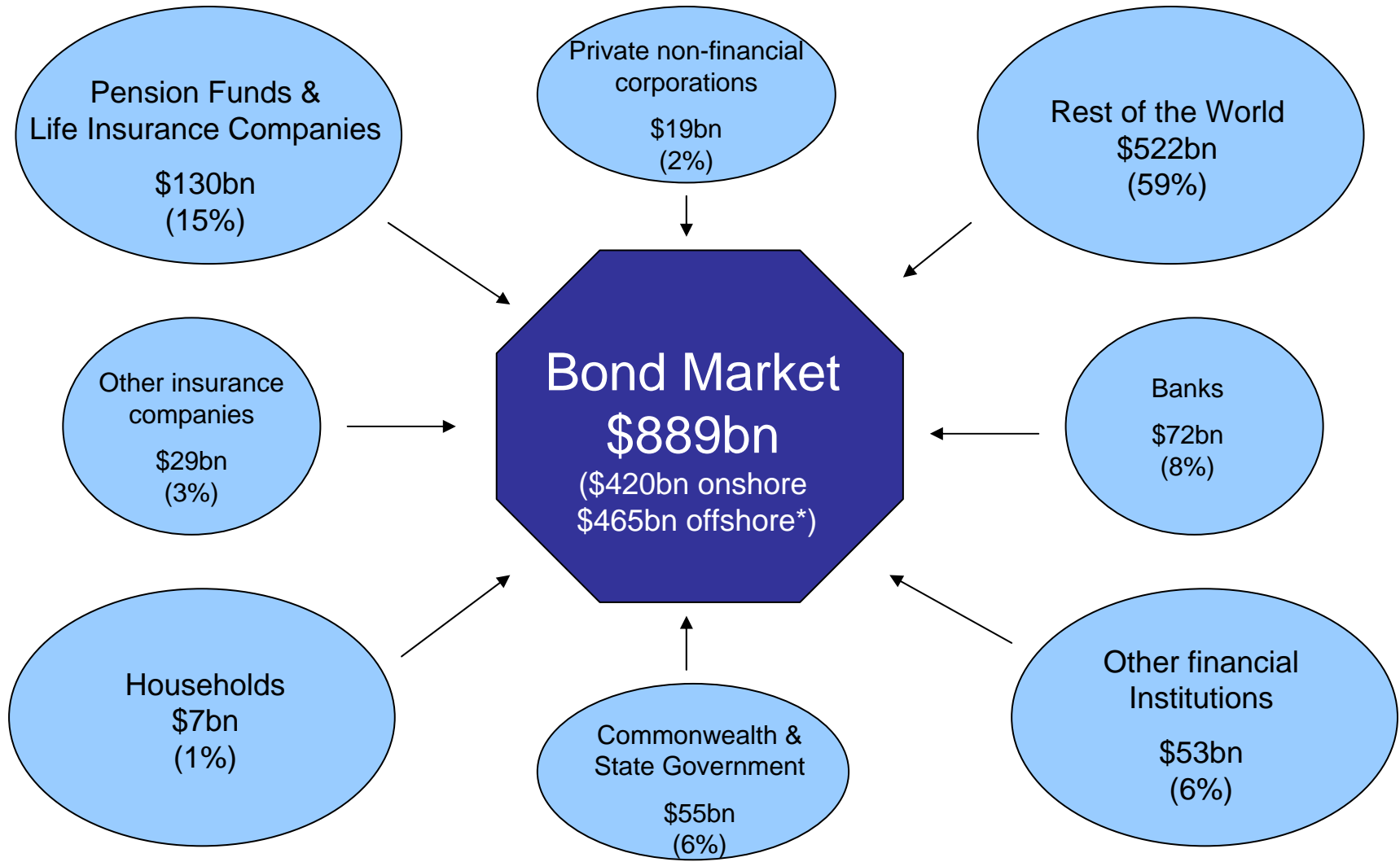
Australian Government debt declining

- Government debt peaked in 1996 at 18.5 per cent of GDP.
- There has been a steady decline to -0.6 per cent of GDP in June 2006, the first negative proportion since 1976.



Source: Commonwealth Budget Papers

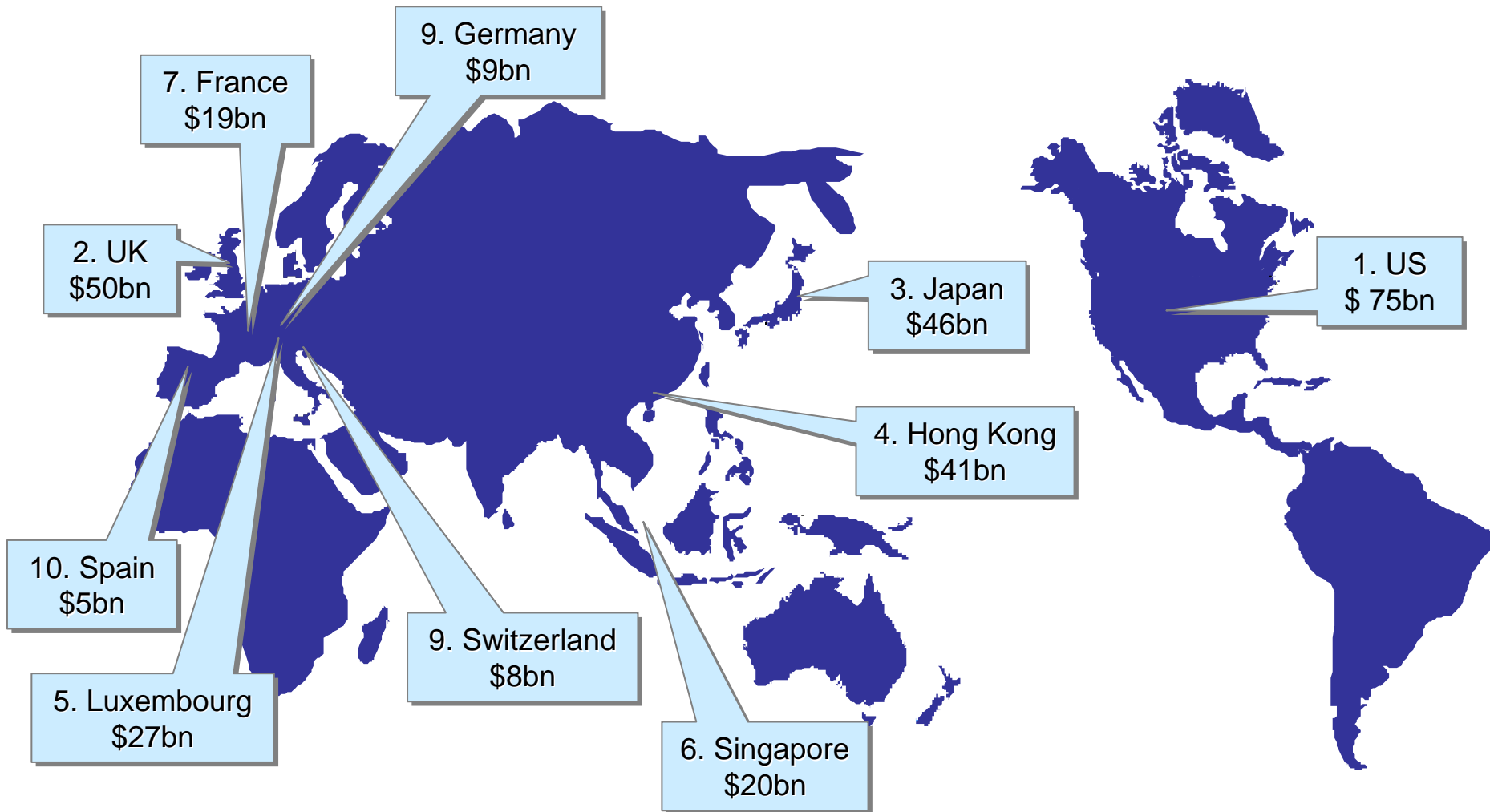
Mapping ownership of Australian bonds



* Includes bonds issued offshore in both \$A and foreign currency.

Source: ABS Financial Accounts (December Qtr 2006)

Portfolio holdings* of Australian debt

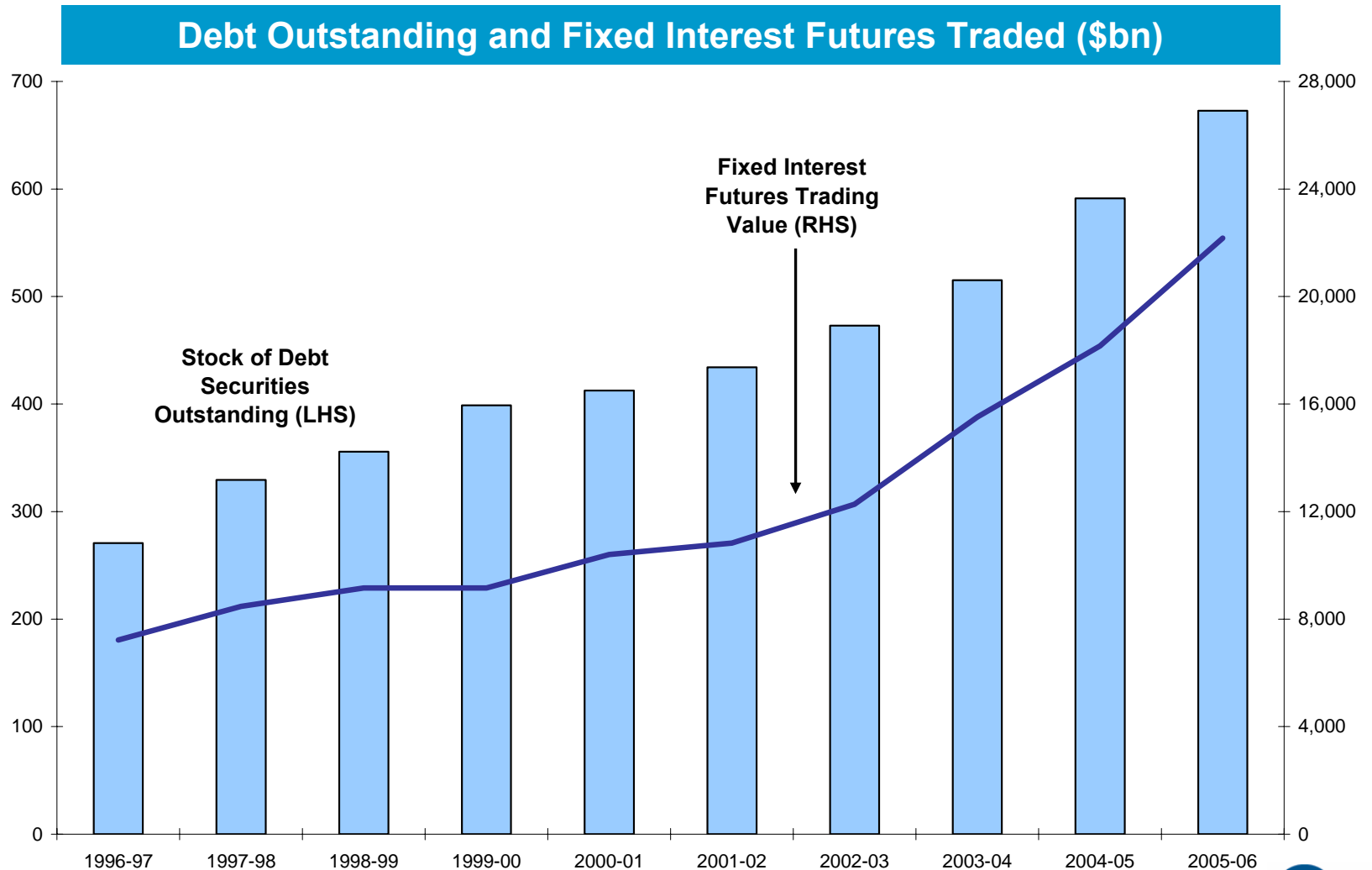


* Data is at end 2005. Excludes holdings as foreign reserves or by international organisations. \$US amounts converted at an average 2005 exchange rate of \$A1=\$US0.76

Source: IMF Coordinated Portfolio Investment Survey, RBA, ASX

Australian interest futures track issued debt

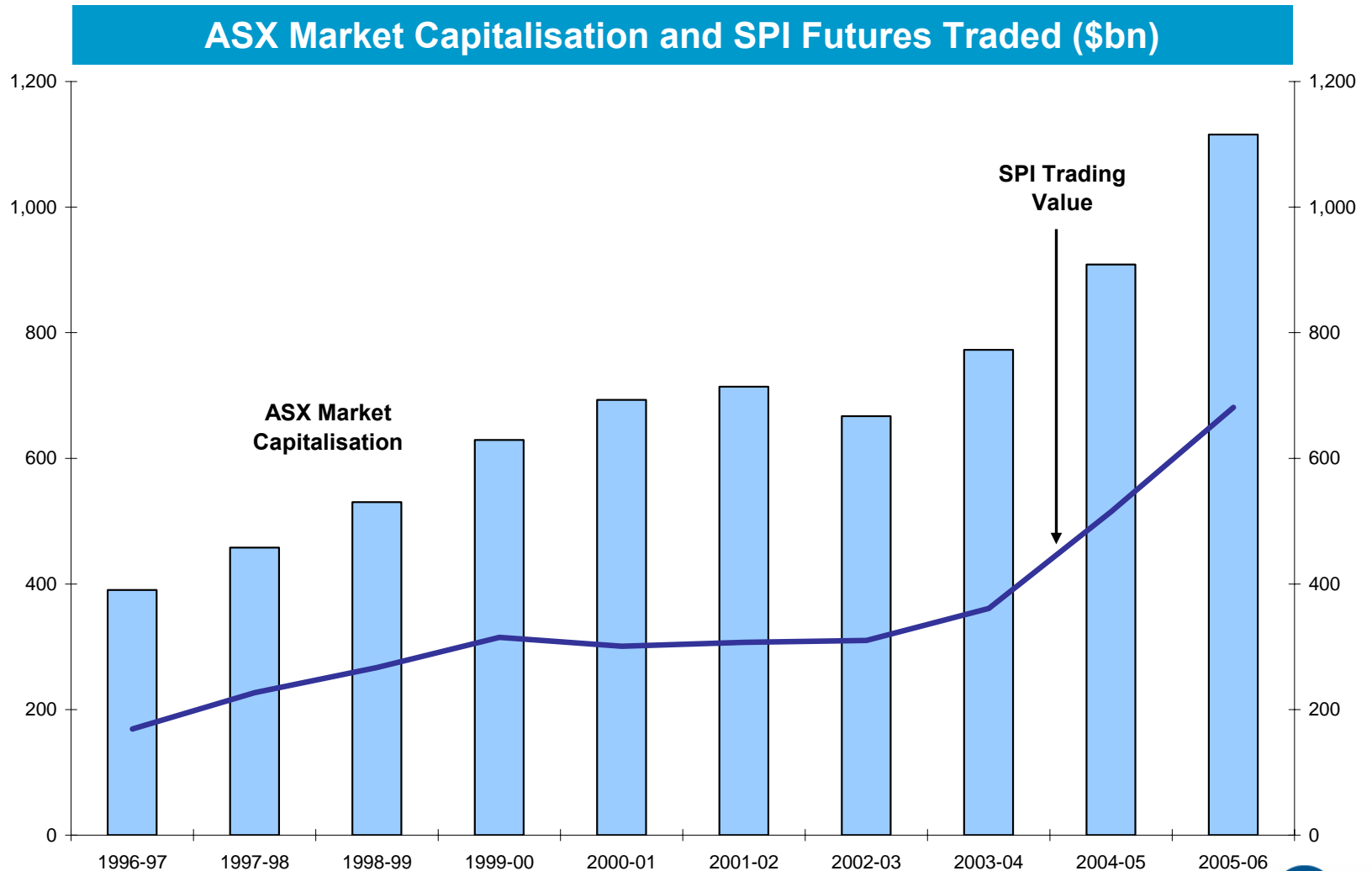
- Growth in exchange traded fixed interest futures trading tracks growth in debt outstanding.
- Also strong growth in OTC interest rate derivatives. In 2005-06, total turnover reached \$A22tr, with repurchase agreements accounting for almost two-thirds of the total.



Source: ASX, RBA

Australian equity futures track market cap

- Trading in SPI futures has traced growth in overall market cap.
- However, SPI trading has not kept pace with cash trading of equities with the derivatives liquidity ratio declining to under 70% over the past decade.

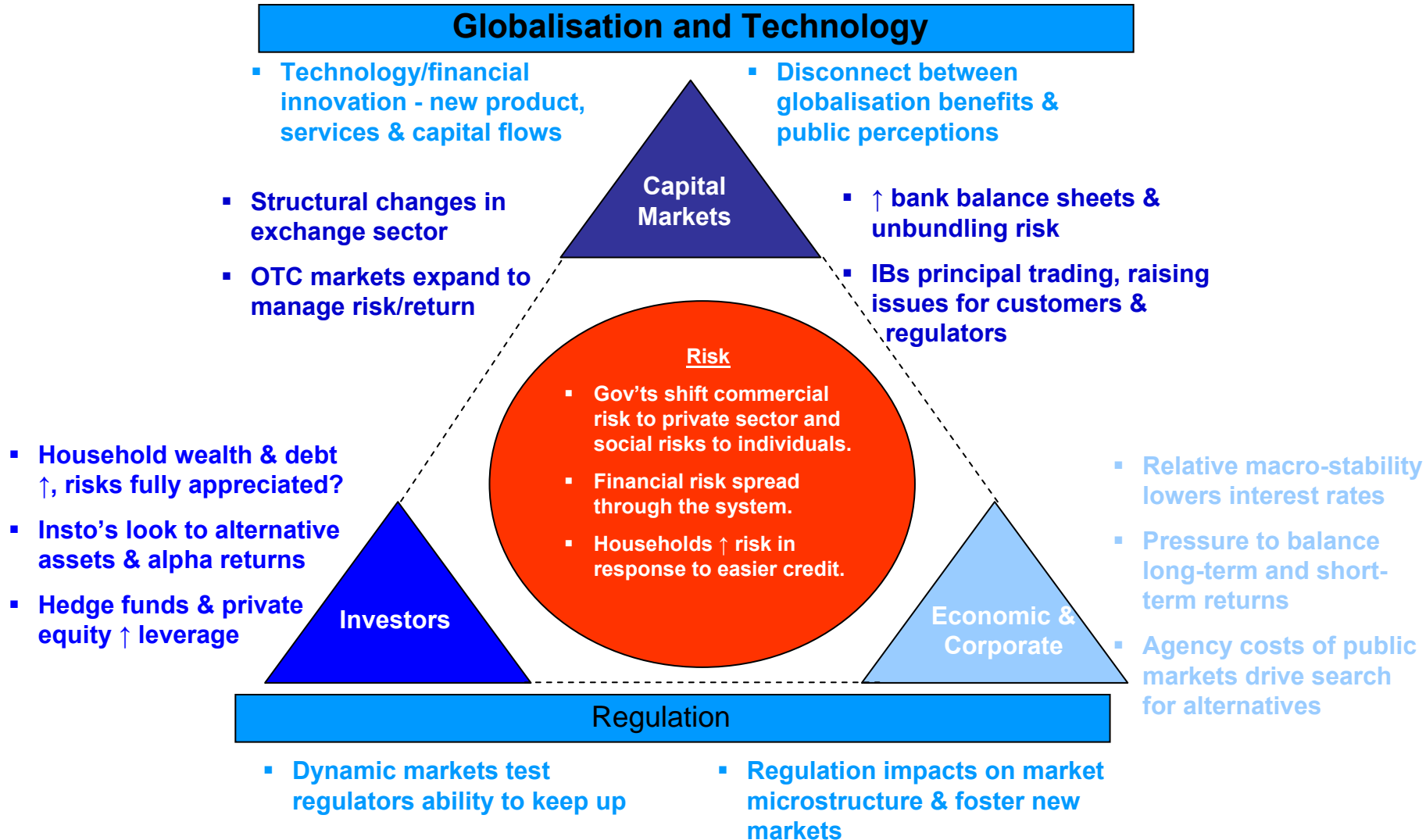


Source: ASX, RBA

Conclusions

Global economy & markets – key pressures

Perceptions financial sector driving the real economy with the major macro challenge controlling asset price bubbles not price inflation - tipping point in the relationship between real economy and capital markets?



Performance of Australia's capital markets

What we have done well

- Leading in: regulatory reform; product development (eg. infrastructure and LPTs); early adopters of products (eg. financial derivatives, asset securitisation).
- Relatively deep (market cap/GDP) & liquid equity market, and good access to new capital.
- Institutional investment market is one of the largest in the world, driven by compulsory super, adding significant liquidity to asset markets, narrowing bid-offer spreads and lowering the cost of capital.
- Institutional investors, and Australian domiciled MNEs, are the major conduits for the export of domestic capital into foreign assets.
- Retail engagement in our equity market (incl options) is healthy and sophisticated.
- Our capital markets are open and we have significant global engagement in our equity & fixed income markets.

Where we can still develop

- Venture capital markets have not been as successful as in other countries, where they are a vital source of start-up capital for SMEs.
- Equity index derivatives use biased to cash equitisation and index arbitrage activity.
- Long end of the yield curve has not developed, restricting price discovery and potentially crowding out micro reform opportunities in those sectors with long dated asset lives.
- Certain offshore products (eg ETFs and credit derivatives) have not taken a strong hold yet.
- Use of markets to deal with environmental issues (eg water, carbon emissions) has been growing overseas but we don't have deep and liquid markets in this area. Participants and Gov'ts need to work together.
- Need to continue to attract new public listings (private companies, privatisations, etc).

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