Australian dollar falls below 50 US cents amid growing signs of recession

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The Australian dollar fell below 50 US cents this week, its lowest level since the currency was floated in 1983, adding to fears of recession following the 0.6 percent economic contraction in the December quarter. On Friday, the dollar slid to 49.02 cents, a 26 percent decline since January 2000, and just over half its 1983 price of 91.20 US cents.

Prime Minister John Howard argued that the fall was simply a reflection of the strength of the US dollar. But the Australian currency has also fallen to record lows against a trade-weighted index of currencies, including the euro, yen and pound. On this index of the country's main trading partners, the dollar has dropped by 19 percent since early last year.

"This is a nervous level and everybody is watching. It is the only currency in the world breaking through its lows," noted Clifford Bennett, a Singapore-based currency strategist at investment bank BNP Paribas. "US48 cents is possible—and there is even a risk of a dip to US45 cents."

Financial analysts speculated that Japanese banks were selling off their Australian assets to avoid collapse, adding to the dollar's weakness. A number of Japanese banks and financial institutions are liquidating assets before the end of Japan's financial year on March 31, after major falls on the Tokyo share market.

With his government facing the prospect of defeat in an important by-election this Saturday, in a formerly safe Liberal seat, Howard has tried to put the most positive spin on the dollar's slide, claiming it will assist exporters.

The *Australian Financial Review*, however, pointed out that prices would rise for imported capital equipment and other imported goods required for production, which together cost $84 billion in 2000. Consumer imports, which totalled $34 billion last year, would also rise in price, dampening demand.

"In a modern integrated economy many exporters need imports of capital equipment or material inputs before they can take advantage of those much-vaunted higher export returns," the newspaper's editorial commented on Friday.

Moreover, Australia's chief export markets are likely to contract this year. Japan, which takes one-fifth of Australian exports, has deep financial problems and other markets throughout East Asia will be affected by the emerging slump in the US.

Factors cited for the dollar's weakness include market perceptions of Australia as an "old economy" dependent on raw material exports and concerns about mounting political instability. Howard is obliged to call a general election before the end of the year, yet his government faces deepening hostility, expressed in anti-government landslides in two recent state elections. As a result he has begun to carry out a series of economic policy reversals, which have been highly unpopular in business circles, in an effort to claw back votes.

Driven by electoral considerations, Howard condemned media reports of a possible recession as "alarmist" and insisted that the fundamentals of the Australian economy were strong. The response of Treasurer Peter Costello, whose relations with the financial markets are more intimate, has been less forceful. Refusing to rule out a recession, he argued that if it occurred, it would be shallower than "Labor's recession" in 1990-91, when unemployment reached 11 percent.

A day later, the Bureau of Statistics reported that the official unemployment rate rose to 6.9 percent in February, its highest level in more than a year. This is considerably higher than in late 1989, just before the last recession, when the jobless rate was below 6 percent.

This week's figures also showed that youth unemployment jumped almost 4 percentage points to 26.9 percent, the worst result for two-and-a-half years. For all workers, the jobless total rose 26,400 to 673,800, even though the number of people employed rose slightly.

Apart from the unemployment figures, a series of other indicators reveal the deepening economic downturn.

* The Australian Securities and Investments Commission reported a jump in the number of businesses facing insolvency. The appointment of receiver-managers was 139 percent higher this January than last. Wind-ups initiated by creditors increased by 65 percent, while new business registrations fell 25 percent.

* Two major companies went into liquidation—HIH Insurance, the parent company of FAI Insurance, one of the country's largest insurance firms and Centaur Mining, whose owner Joseph Gutnick blamed the rising cost of loan repayments in US dollars.

* After surveying retail, wholesale and manufacturing businesses, Dun and Bradstreet, the financial information publisher, predicted that the economy would continue to contract during the March quarter and possibly the June quarter. The firm's economic consultant, Dr Duncan Ironmonger, who first forecast recession last November, said sales, employment and profits were likely to shrink until July.

* Insolvency accountants predicted a flood of bankruptcies among small and medium-sized businesses, pointing to sharp falls in revenue and profits, combined with cash flow problems caused by the government's Goods and Services Tax (GST).

Council of Small Business Organisations chief executive Rod Bastion said the GST scheme required businesses to pay their tax instalments when they sent accounts to customers, not when payments came in. With the average time for paying accounts blowing out to 68 days, many small businesses have been forced to borrow to cover their tax liability.

* An estimated $11.2 billion was wiped off prices on the Australian Stock Exchange on Tuesday, the largest one-day fall in nearly three months, following heavy losses on US share markets the night before.

* The Westpac Bank reported that its Melbourne Institute Index of Consumer sentiment declined 15.4 percent in February, the largest one-month fall in the index's 25-year history. There was also a 33.6 percent fall in perceptions of economic conditions over the next 12 months.

Westpac said the only comparable collapses in consumer sentiment had occurred in April 1990, during the early 1990s recession; in July 1982, during the early 1980s recession; and in November 1987, following the October sharemarket crash. The bank warned that “decidedly nervous” consumers could wind back their spending to “dangerous levels” in the next few months.

* The country's biggest retail business, the Coles Myer group, announced a 33 percent fall in its first half-year net profit to $196.4 million. Another major retailer, the Harvey Norman chain, reported a drop in sales of 40 percent in some stores. Owner Gerry Harvey remarked that customers had simply “disappeared”.

Beneath these retail statistics lie indications that the amassing of credit card and other forms of personal debt has reached its peak. According to the Bureau of Statistics, consumer finance commitments, which include both housing and personal loans, totalled $126.8 billion last June, up 30 percent from $97.5 billion three years ago.

The dollar's decline has also pushed up the foreign debt owed by state and federal governments and Australian business—most of which must be repaid in US currency. In Australian dollar terms, net foreign debt rose from $268 billion to $294 billion from June to September 2000 and has since exceeded $300 billion. This amounts to an increase of more than 60 percent since June 1995 and represents a record 46 percent of Gross Domestic Product.

Fearing recession, corporate chiefs and bankers are demanding that the Reserve Bank cut official interest rates by another one percentage point, on top of the 0.75 percentage point reduction since January. This may serve, however, to trigger further sell-offs of the dollar on international markets.