Australian economic slowdown undermines Howard government

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Five months after winning the Australian federal election on the basis of a scare campaign over interest rates, the Howard government's economic strategy is unraveling. Not only have reports this week revealed a huge current account deficit, record levels of debt and a stalling economy, but the Reserve Bank has lifted interest rates by 0.25 percent, with predictions of another rise in the near future.

The first statistics appeared on Tuesday, when trade figures showed that the current account deficit had ballooned to $15.2 billion or a staggering 7.1 percent of GDP for the December quarter—the worst since 1950-51, in the midst of the Korean War. Increased imports, stagnating exports, high levels of international borrowing and the repatriation of profits by foreign corporations, all contributed to the result.

Over the same quarter, Australia's foreign debt jumped by nearly $15 billion to $421.9 billion or 51 percent of GDP, provoking a raft of comments to the effect that the nation was living "well beyond its means". The vast bulk of the borrowing—96 percent—has been on the part of private banks, to feed the housing and consumer spending bubble that has sustained the Australian economy, and the Howard government, for nearly a decade.

The announcement provoked shocked responses from economic analysts. ABC finance correspondent Stephen Long explained that the current account figure was about $1 billion worse than expected. "It's a very, very bad number, in fact it's a record deficit, the second three-month period in which we've had a record deficit..."

Long went on to quote some of the reactions: "Stephen Walters, Chief Economist at JP Morgan is calling it a staggering number, you've got Stephen Kokoulos at TD Securities saying it's shocking, Michael Every, Senior Economist at RBC Capital saying this is not a very positive story."

Commentators were quick to note that the figures were worse than 1986 when Treasurer Paul Keating warned that Australia was in danger of becoming "a banana republic". Federal Treasurer Peter Costello dismissed the comparison, reiterated his mantra that "the fundamentals are sound" and pointed to predictions that Australian commodity exports were set to rise.

The following day, the Reserve Bank announced its interest rate rise. And just two hours after that, the Australian Bureau of Statistics released figures showing that the growth rate had slumped to just 0.1 percent for the December quarter—the lowest quarterly growth rate since 2000. The latest statistic comes on top of a 0.2 percent figure for the September quarter and an overall rate for 2004 of just 1.5 percent.

Facing the media for a second day in a row, Treasurer Costello was forced to concede that the government's budget estimate of a 3 percent growth rate for 2005-06 was unlikely. He attempted to pin the blame on the state governments for failing to invest in infrastructure and to brush aside the slowdown as a temporary "rebalancing" of the economy. The indicators, however, point to a more fundamental crisis.

Just two weeks ago, Reserve Bank governor Ian Macfarlane warned that Australians would have to get used to years of stunted growth and higher interest rates as the economy hit the limits of its productive capacity. He blamed the housing boom for diverting investment from much needed infrastructure and made clear that an interest rate rise was needed to stem pressures for increased wages.

Economists warned that Macfarlane's comments signalled the end of the so-called Goldilocks economy—neither too hot nor too cold. Harvinder Kalirai, research head at fund manager State Street, pointed to the danger of a return to the stagflation of the 1970s. "Higher interest rates and lower growth rates is a stagflationary-type of outcome. It's the opposite of Goldilocks," he said.

The latest economic news has left the Howard government flailing for answers. On Wednesday, Immigration Minister Amanda Vanstone suddenly announced a huge increase in the intake of skilled migrants to address labour shortages in key areas—an abrupt about-turn from the government's notorious and oft-repeated stance on immigration. The following day Prime Minister John Howard issued a plea to the Reserve Bank to hold off any further interest rate rise. Pointing to low inflation and low growth, he declared: "[T]here is a respectable argument that there should not be another rise for a while."

Howard's obvious nervousness is not simply the result of the exposure of his promises on interest rates. Rather, his entire economic and political strategy, which has been premised on fuelling housing and consumer spending, is coming undone.

Higher interest rates, a collapse of the consumer debt bubble and economic slump threaten to alienate his corporate backers as well as his electoral base in the so-called mortgage belt.

The availability of low interest loans, coupled with intense speculation in the property market, has sent housing prices to dizzy heights, particularly in the major capital cities. As a result, working people wanting to buy a home have had to take out huge mortgages. So while interest rates remain comparatively low, in absolute terms—a fact that Costello has repeatedly pointed out—the size of the loans means that even a small rate rise will produce a sizeable increase in repayments.

The latest 0.25 percent increase will force many home buyers to cut back on spending. Another rise will make their financial situation untenable. A survey by Hawker Britton UMR found that 28 percent of home buyers would have trouble making home loan repayments if interest rates increased by 0.5 percent. Among those earning less than $50,000, 36 percent said they could not afford a 0.5 percent increase.

The federal government is left with a series of unpalatable alternatives. Howard and Costello are pinning their hopes on an export-led recovery—above all on the sale of commodities to China. But there are many question marks over the sustainability of China's high economic growth rates, and, indeed, of world growth rates that depend on the US, with its huge budget and current account deficits.

The government now confronts a barrage of criticisms from big business for dragging its feet on economic "reforms". None of these are new. For a number of years corporate leaders and media commentators have been demanding that the Australian economy be made more "competitive"—through lower government spending, reduced taxes, more infrastructure spending and the removal of legal restrictions on business, including sacking workers.

With signs of an economic recession these demands are becoming more strident. Several pundits have pointedly observed that, since coming to office in 1996, the Howard government has largely rested on the reforms carried out by the previous Labor governments from 1983 to 1996.

Yesterday's *Australian* editorial entitled "Time to take a long, hard look" declared: "[T]he challenge of these economic times is not simply for Australian families to tighten their belts: it is for the Australian government to initiate a new wave of reforms. Yesterday's soft growth figures are one more indication we have exhausted the benefits of the reforms of the 1980s and 1990s." After listing a series of "reforms", it concluded by denouncing the state governments for "splurging" and Howard for his "high tax, high spend policies".

The *Australian Financial Review* editorial caustically derided Costello's response to the new statistics, declaring: "He now preaches, as if they were new ideas, industrial relations reform, skilled immigration, clearing the obstacles to investment in ports and rail and laying the foundation for skills training. The problem is that these things should have been done years ago, but the coalition lost its appetite for fundamental reform somewhere after it introduced the GST and was content to bob along on a rising tide."

In laying out its economic prescriptions, the *Review* issued an open threat: "Mr Costello needs to put his nose to the grindstone and lead a concerted attack on production constraints wherever they're found. In two and a half years, his re-election hopes might depend on it."

Significantly, the Labor opposition was quick to join the chorus demanding tough economic measures. Having lost the last election over the interest rate scare, the party has concluded it must concentrate on proving its credentials to big business. Shadow treasurer Wayne Swan immediately weighed in on Tuesday, berating the Howard government for its $66 billion in election promises and its failure to carry out "economic reform".

There is no question but that, over the next weeks and months, the Howard government will begin implementing savage new attacks on the social position of ordinary working people. And Labor will be baying on the sidelines, insisting on ever-harsher policies.

For the majority of working people, the so-called Goldilocks economy of the last decade has proven anything but a boon. While a layer of the population has enriched itself, its wealth has been based on a frenzy of speculation and the ruthless restructuring of both the public and private sectors. The further "reforms" being prepared amount to the gutting of what remains of the welfare state through the privatisation of health and education, the stripping of welfare recipients of benefits and the removal of basic protections for workers.

As the Howard government and the Labor opposition are well aware, this is a socially and politically explosive agenda.