Continuing turbulence on Australian share markets

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Turbulence on Australia's share market continued throughout last week, largely echoing the turmoil on US and international markets. At the same time statistics were released confirming that inflation was rising, producing fears of stagflation—that is, of a recession combined with inflation.

At the end of the week, the convulsive roller coaster in share values—with hundreds of billions of dollars wiped out and then regained—the benchmark S&P/ASX 200 index closed 5 percent higher at 5,860.3 points, despite experiencing major falls on Monday and Tuesday. On January 22, dubbed "Black Tuesday", the market experienced its fourth-biggest one-day fall in history, losing 7.3 percent and more than $100 billion. This was nowhere near the largest single day fall—25 percent in October 1987—but it represented the culmination of the longest losing streak and poorest opening to a calendar year for a quarter century.

The US Federal Reserve Board's decision on Tuesday night local time to cut official interest rates by 0.75 percentage points triggered a rally, buoyed by speculative investors pouring in to buy stocks to cap previous losses. The market saw its biggest three-day gain in 20 years. Nevertheless, at the close of trading on January 25, the index was still 14.5 percent below last November's record peak.

Last week's turmoil was accentuated by thousands of "margin calls". Once the market began to plunge, share traders who had borrowed to buy stock received calls from their lenders requiring them to immediately raise more money to cover their losses or sell their holdings. The resulting panic highlighted the growing use of debt on the share market itself. One on-line trading site, Comsec, was deluged by 40,000 transactions in the first 90 minutes, causing a 30-minute crash of the site.

Highly-indebted finance and property companies—until recently the darlings of the market—have suffered the heaviest price losses. Those falling more than 50 percent in the past year include the Allco financial engineering group, the financial and property group MFS and the retail mall owner Centro. Others on the list are Prime Financial Mariner Financial, Flexigroup and some funds operated by Babcock & Brown, Australia's second largest merchant bank.

The global credit crunch triggered by the US subprime crisis and indicators of US recession have led to warnings that much worse may be yet to come. Hugh Giddy, a portfolio manager at Cannae Capital Partners said: "What perhaps we are seeing a foretaste of is that most financial companies can go bust because they have so much leverage."

Already, some of Australia's highest-profile business people have been caught up in the crashes of these groups. Among them are Sir Rod Eddington, Australian chairman of JP Morgan, former chief executive of British Airways and chair of the Rudd government's business advisory panel; Bob Mansfield, former Telstra chairman and Optus chief executive; David Clarke, former Westpac executive, head of BT Financial Group and chief executive of MLC; and Andrew Peacock, former Liberal Party leader and ambassador to the US.

Writing of Allco founder and executive director David Coe, the *Australian* noted that his group almost helped take over Qantas, the country's largest airline, last year, in an $11 billion private equity bid, backed by $7 billion of debt. "Less than a year ago, Coe was lauded as a financial genius, set to turn his Allco Financial Group into another Macquarie Bank. Indeed, he played a key role in a bid for Qantas and, if he had pulled it off, would have been one of the biggest shareholders in the national airline."

These reverses reflect the Australian economy's increasing dependence on financial parasitism, augmented by the growth of superannuation funds and privatisation of public assets and services. In a speech last December, Reserve Bank deputy governor Ric Battellino said: "The funds management industry in Australia has expanded at a remarkable pace over the past couple of decades. Since 1990, the value of funds under management has grown at an annualised rate of 12.5 percent, and now stands at around $1.7 trillion. This is equivalent to about 160 percent of GDP, up from about 50 percent in 1990."

Meanwhile, manufacturing declined. Between 1977 and 2007, manufacturing's share of output fell from around 16 percent to 10 percent, while property and business services rose from 7.5 percent to 12.5 percent. Mining rose, but only from 4 percent to 7 percent.

Battellino reported that superannuation fund assets had risen by an average of 14.5 percent per annum since 1990, and comprised about half the funds under management in Australia. Following the Hawke-Keating Labor government's introduction of compulsory superannuation payments, funds managed by super funds rose tenfold between June 1992 and June 2007, from about $80 billion to $800 billion. According to the *Australian Financial Review*, this figure has since risen to $1.2 trillion. Individual investors poured $22.4 billion into superannuation funds in the June 2007 quarter—three times the previous record—to take advantage of tax concessions granted by the Howard government. As with share-trading, many people borrowed money to benefit from this tax handout.

A substantial slice of the superannuation market is controlled by union-employer industry funds, giving the unions multi-billion dollar stakes in the share market and large investment projects. For ordinary workers and middle class people, however, their retirement incomes are threatened by any share market collapse. Jeff Bresnahan, managing director of SuperRatings, a super fund tracker, said in a statement: "This correction has already wiped out the financial year-to-year gains for nearly all funds—and for a number of funds has more than wiped out members' entire 2007 and part of their 2006 earnings."

According to the *Australian Financial Review*, super funds were "inundated" with calls from worried members. Seafarers Retirement Fund secretary Glenn Davis said: "Most members want someone to talk them through what's going on and how to counter this volatility." A recent study by the government's financial literacy foundation found that 73 percent of respondents thought their super would be insufficient to meet their retirement needs.

The domestic economy's dependence upon retail sales and consumer

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debt is unsustainable. Retail sales doubled from about $10 billion in 1995 to about $20 billion in 2007. The sharpest rise was in household goods, which grew from 100 on the Australian Bureau of Statistics (ABS) index in 1997 to about 275, dwarfing all other types of retail spending. Much of this was financed by mortgage and credit card debt. Household debt has soared to about 160 percent of household disposable income, and established house prices more than trebled in Australia's capital cities from 1990 to 2007, plunging home loan affordability to record lows.

Last week saw more evidence emerge of the resulting financial stress: a steep increase in evictions. The New South Wales Sheriff's Office reported that lenders gained 3,935 writs of possession over houses and apartments last year, 67 percent more than the 2357 writs issued in 2005. Real estate agents said most repossessions occurred in parts of western Sydney, where house prices have fallen by as much as 26 percent since 2004 in working class suburbs.

Household budgets are also being severely affected by the rising cost of living. The ABS reported last week that the underlying annual rate of inflation had reached 3.7 percent, well above the Reserve Bank of Australia's (RBA) target range of 2-3 percent. The steepest rises occurred in petrol, rent and financial services, all of which affect working people the most.

The financial crunch will only worsen if the Reserve Bank raises official interest rates at its next meeting on February 5, for the fourth time in just over a year. Banking industry economists have begun calling on the RBA to lift rates "aggressively" by 50 basis points. The ANZ bank's head of market economics, Warren Hogan said rising inflation expectations represented the "greatest threat to the RBA's policy mandate since the inception of the inflation target in the early 1990s".

Some corporate chiefs warned that the 15-year period of deflationary pressure produced by the super-exploitation of vast new sources of cheap labour in China and India is coming to an end, particularly as workers in those countries demand higher wages. Queensland Investment Corp chief executive Doug McTaggart told the *Sydney Morning Herald*: "[The former US Federal Reserve chairman] Alan Greenspan, in particular, and Western central bankers, pumped up global liquidity for a long time. Normally you would expect that to be inflationary, but over the last 15 years those inflationary pressures have been tempered by the export of deflation from China, India and other emerging countries."

For all the short-term relief on the stock exchange, the US Federal Reserve's interest rate cut has fuelled anxieties in business circles that it could generate another credit bubble, fuelling worsening inflation. A member of Macquarie Bank's equity strategy team, Tanya Branwhite, warned of stagflation. "It's the worst of all worlds—low growth and high inflation."

Prime Minister Kevin Rudd's Labor government has responded by declaring its determination to satisfy big business demands that the working class pay the price for the economic crisis, through severe cuts to social spending and the suppression of wage demands.

Last week, days after meeting RBA officials, Rudd declared a "war" on inflation. He issued a "five-point plan" for fighting inflation, starting with "hard-line" cuts to government spending. Rudd reiterated pledges made the previous week to make cuts deeper than the $10 billion mentioned during last year's election campaign, and announced a new target of delivering a budget surplus of at least 1.5 percent of GDP in 2008-09, up from the Howard government's 1 percent target. That would mean a surplus of around $18 billion. No details have been provided of where the extra billions will be found, but social spending is certain to be cut, with welfare "fraud" already mentioned.

Other unspecified measures include "speeding up policies to train more skilled workers and get more people into the workforce," which is likely to produce renewed drives to force people off unemployment and disability pensions into low-paid work on poor conditions. Also on Rudd's list is "encouraging savings," which is likely to mean more tax concessions to boost superannuation contributions and other forms of diverting funds into banks and other investment vehicles.

Another key item is the establishment of Infrastructure Australia, a body to coordinate public and private investment in areas such as ports, roads and railways. In the name of combatting "infrastructure bottlenecks," this agency is designed to deliver major investment funds, such as Macquarie Bank, new bonanzas in toll roads and other "public-private partnerships".

The common feature of these various plans is to further boost corporate profit-making at the expense of working people and public services. One area of spending that will not be touched is the $31 billion in tax cuts promised over the next four years, the vast bulk of which will go to higher income earners. Treasury statistics released last week revealed that the tax handouts and concessions introduced by the Howard government already totalled more than $50 billion for the 2006-07 financial year—more than the combined spending on education, community services, culture, defence, infrastructure and transport. Tax breaks soared by 67 percent over two years, with the superannuation concessions alone accounting for $25 billion last year.

By the end of last week, the corporate media had declared that Rudd's plan was seriously deficient because it failed to commit the government to preventing wage rises. The message was spelt out in no uncertain terms by Rupert Murdoch's *Australian* editorial on January 25. It said the Labor government was facing its "biggest test to date"—to head off "inflationary wage demands". The editorial explained why the newspaper had backed Labor's election last November. "Throughout last year, we encouraged Kevin Rudd to attack the Howard government from the Right. The Prime Minister took the advice, declaring himself to be economically conservative." Now Rudd "must deliver" by stopping any attempt by workers to offset rising prices. "Belt-tightening is needed, not higher wages," the editorial insisted.

Rudd and Deputy Prime Minister Julia Gillard quickly stepped up to the mark, emphasising that the aim of Labor's new industrial relations system was to ensure that no wage rises occurred without productivity trade-offs. "We obviously want to see an environment of wage restraint. We've made sure, in designing our new industrial relations system that it is focused on building productivity," Gillard said in a media interview.

After only two months in office, the Labor government is already on a collision course with the working class. Inevitably, as inflation worsens, workers will demand wage rises to overcome increasing financial stress. But as the global economic crisis deepens, Labor will do everything demanded of it by big business to drive up profits and impose on ordinary people the full brunt of the deteriorating situation.

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