Dark clouds gather over Australian economy

Mike Head
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Until last week, the prevailing view in the Australian business and political establishment, at least in public, was that the national economy had become "de-coupled" from the US, and was therefore sheltered from the worst impacts of the recession taking hold in the world's largest economy. Booming exports to China and the rest of Asia would, the argument went, insulate Australian capitalism from a global slump.

Last week, speaking after attending meetings of the International Monetary Fund (IMF) in Washington, Treasurer Wayne Swan said he was now certain that Australia would not escape the deepening international financial crisis. In an interview with Fairfax newspapers, he said no one at the IMF meetings believed that Asia was de-coupled from the turmoil that began last year with the sub-prime mortgage collapse in the US.

The IMF's "World Economic Outlook" report, presented to the Washington meetings, described the financial crisis as the biggest since the Great Depression, forecast a US recession this year and warned of a 25 percent chance of a worldwide downturn "equivalent to a global recession".

Swan stated: "Australia has never been immune from these sorts of financial crises. The fallout will have substantial knock-on effects to developing and emerging economies, and from our point of view that means flow on effects to Australia." He also warned of an end to the 15 years in which cheap imports from countries such as China had a deflationary impact. A new period had commenced of high inflation and interest rates, combined with slowing growth.

Australia has had 17 consecutive years of economic growth, with an annualised average of 3.5 percent, largely as a result of two factors. One was rising minerals exports and high commodity prices, substantially fuelled by the rapid expansion of Chinese capitalism. The other was unprecedented rises in the levels of corporate and household debt, which generated soaring share prices and real estate values. Now, it is precisely Australian capitalism's reliance on debt and mining exports that has made it extremely exposed, both to the global credit squeeze and to signs of slower growth and inflationary problems in China.

Last week, an economics expert drew attention to this vulnerability. Associate professor Peter Kriesler from the University of New South Wales told ABC radio: "The huge foreign debt and the huge private sector debt means that we're much more susceptible to recession, interest rates etc., coming from abroad.

"If you look at the Australian economy, the manufacturing sector, the industrial base, has been shrinking quite rapidly; we're becoming more and more reliant on a number of key resource exports.... Right now we're so reliant on what's happening abroad, particularly China and India ... there's a possibility that the growth rate there [in China] will slow down, which means that the resource boom that's been carrying us forward will collapse."

In Australia, the international credit crunch triggered by the US sub-prime crisis since last August has already produced a trail of high-profile collapses by heavily-leveraged companies, including ABC Learning Centres, Centro Properties, finance companies RAMS, Allco and MFS, and stockbrokers Opes and Lift. Share prices have fallen by 30 percent since last November's peak, wiping hundreds of millions of dollars off corporate values, particularly among the banks and finance houses.

At the same time, high levels of stress and hardship have been caused by soaring mortgage and credit card interest rates and rising prices for food, fuel and other essential items. Official interest rates have been raised eight times in three years, to 7.25 percent, and this year the private banks have hiked their rates higher than that. Inflation has climbed to 4 percent, well above the 3 percent limit maintained since the mid-1990s. Recent surveys warned that 300,000 households are at risk of losing their homes, and that many young people and workers earning less than $A30,000 ($US28,260; €17,760) a year are already missing credit card payments. Ordinary working people also face the loss of their retirement incomes—superannuation funds are likely to report losses of anywhere between 5 percent and 20 percent this financial year because of the US crisis and share market losses.

These developments have begun to seriously affect consumer and business confidence. New car sales dropped 2.3 percent in February, while housing finance for owner-occupied dwellings plunged 6 percent and retail sales declined by 0.1 percent, led by a 2.3 percent fall in spending at household goods stores. The ANZ bank job ads index—regarded as a forward indicator—showed newspaper advertisements fell to the lowest level in more than 14 years.

The consumer sentiment index, compiled by Westpac bank and the Melbourne Institute, fell to its lowest level since June 1993, at the end of the last recession. "The three months to March showed the sharpest three-month decline in the index (21.2 percent) since its introduction in January 1975," Westpac chief economist Bill Evans said. "This further fall emphasises just how concerned households must be with the current economic environment." CommSec chief equity economist Craig James warned of a "dramatic plunge in consumer spirits".

Business confidence, sales, profits, employment and forward orders are also falling, according to the February National Australia Bank (NAB) survey. Business confidence was the lowest since the September 2001 attacks in the US, and the business conditions index suffered one of the biggest falls in the survey's history. NAB chief economist Alan Oster admitted that the size and breadth of the slowing in domestic demand and business conditions "has caught both business and us by surprise".

There are signs that the fallout from the financial meltdown is far from over. In its current "World Economic Outlook", released this month, the IMF named Australia as having one of the four most overvalued housing markets in the Western world, and one of four

highest levels of housing debt. Borrowings by households had grown from 75 percent of disposable incomes a decade ago to 175 percent, and this included credit card debt of $42 billion, or $2,000 for every man, woman and child. The IMF estimated that Australian housing prices last year were 25 percent higher than could be explained by "economic fundamentals", producing the risk of a sharp "correction".

This warning came after another indication that the banking problems in the US and Europe could spread to Australia. One of the four major banks, the ANZ, shocked financial markets by announcing much higher bad debt provisions for the first half of fiscal 2008-09, sending its share price down nearly 7 percent. The ANZ said its provisions would be about $975 million, a 72 percent increase from a year ago.

The problems are not confined to ANZ. JP Morgan estimates that Australia's top five lenders have about $7.7 billion in secured and unsecured loans made to companies with high gearing. Goldman Sachs forecasts bad debt charges at Australia's other top five banks, excluding ANZ, to rise by 43 percent in the current fiscal year to $2.7 billion. Dun & Bradstreet estimates that one in 12 Australian-based companies is now considered higher risk, which it says implies distressed debt of $3.5 billion.

These developments underscore the fragility produced by the extraordinary growth of financial parasitism in the Australian economy, as in the US. Over the past 30 years, as corporations have constantly shifted production in search of cheaper labour, lower costs and reduced taxes, manufacturing's share of output has fallen from around 16 percent to 10 percent, while financial services have become increasingly dominant. Boosted by the previous Labor government's introduction of compulsory superannuation in the 1990s, the value of funds under management has grown from 50 percent of gross domestic product in 1990 to 160 percent, or $1.7 trillion.

Deep problems lie ahead also because of the reliance on Chinese and other Asian export markets, which are in turn heavily dependent on the US, Japan and Europe for their sales. Under the impact of the US recession and slowing growth in Japan and Europe, China's annual growth rate has begun to slow, from 11.9 percent last year to 10.6 percent in the first three months of 2008. China, like every other country, is now also being affected by rising inflation. Food prices rose at an annual rate of 21 percent in the first quarter of 2008, and the official inflation rate was 8 percent.

Until recently, the Chinese authorities and companies were content to accept higher prices for Australian raw materials in order to secure supplies. However, there are signs that the Chinese regime, haunted by the threat of soaring prices and social unrest, is now demanding greater access to ownership and control over Australian resources. In February, state-owned Chinalco made a $15 billion share raid on Anglo-Australian mining giant Rio Tinto. Last month, Sinosteel launched a hostile takeover bid for West Australian iron ore company Midwest. China is reportedly considering a $22 billion share raid on Australian-South African BHP Billiton, the world's biggest mining company.

On his recent trip to Beijing, Rudd called for the opening of China's financial markets to Australian and other foreign banks and finance houses. Beijing may insist on the quid pro quo that state-owned Chinese conglomerates be permitted to buy up Australian resources, undercutting the ability of Australian-based companies to continuously ratchet up prices, the main source of a 15-year mining export bonanza.

Australian capitalism's vulnerability was underscored when the trade deficit for February widened to a record $3.29 billion, seasonally adjusted, from $2.54 billion in January. Metal and mineral exports fell 18 percent, while coal exports dropped 16 percent. According to the Australian Bureau of Statistics, the principal cause was severe weather conditions at key ports. Nevertheless, deeper processes are at work. The trade balance has been in the red for more than five years, despite the more than doubling of base metals and other resources prices since 2003.

Because of this chronic deficit and dependence on foreign investment, the level of foreign debt has increased from 15 percent of GDP to more than 50 percent over the past two decades, reaching $610 billion by the end of 2007. This level could become unsustainable in the event of a global recession. In addition, there are indications of a significant withdrawal of equity (shares) investment since the US crisis began last August, with two quarterly outflows of up to nearly 8 percent of GDP.

With high levels of foreign and domestic debt, the Australian economy is seriously exposed to the US crisis. The US has been the largest source of foreign investment since World War II, accounting for $45.3 billion last year, or 29 percent of the total, and more than a quarter of the overall stock of investment. It is also the most important destination of Australian foreign direct investment, about 40 percent of which flows to the US, revealing the dependence of large Australian-based corporations on expansion into North American markets.

How badly the economy will fare in the immediate period ahead is not yet clear. According to the official minutes, at their April 1 meeting, Reserve Bank of Australia board members concluded that domestic growth would slow somewhat from last year's 3.9 percent. They noted that the terms of trade—the ratio of export to import prices—would rise another 15 percent this year because of higher prices that China has previously agreed to pay for iron ore and coal. Nevertheless, they expressed nervousness about the economic prospects. "Members recognised that a considerable degree of uncertainty continued to surround the outlook for both demand and inflation."

One thing is certain. The Rudd Labor government is committed to making ordinary working people pay for the failures of the financial markets. Ever since Labor took office, Treasurer Swan and Prime Minister Kevin Rudd have been seeking to soften up public opinion for harsh cuts of $10 billion or more to government spending in next month's budget, citing the need to combat inflation. As his remarks following the IMF meeting indicate, Swan is now using the worsening economic outlook as an added justification for slashing social spending.