Australia's "two-track" economy: super-profits and falling living standards

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Amid an ongoing share market decline produced by the US and global financial turmoil, economic indicators in Australia have revealed an acute divergence in what media commentators are increasingly describing as a "two-track" or "two-speed" economy.

For many in the corporate elite, despite falling share values, times have never been better. Soaring commodity and energy export prices are producing vast super-profits for mining and construction companies, largely driven by the still continuing growth in demand from China. But for the overall economy and the vast majority of working people the situation is very different. A virtual recession is underway, with living standards declining rapidly due to escalating petrol prices, historic levels of mortgage and household debt, falling house values and huge losses by superannuation funds.

How quickly the slump has taken hold can be gauged from the almost 35 percent fall in consumer confidence over the past year. The Melbourne Institute index fell by another 6.7 percent in June to the lowest level since the 1990-92 recession, when the official unemployment rate rose to 11 percent.

Another indicator was the 7.9 percent fall in new housing loans in May, taking the decline since January to almost 23 percent. Finance for new housing is now running at about half the level of one year earlier: a staggering decline. Because of collapsing sales and expectations, lending for business has also plunged almost 15 percent in the past month, according to Citigroup.

Macquarie Bank senior economist Brian Redican commented that the mining boom would keep Australia's overall economic growth rate positive, but this would not help consumers. "It will feel like a recession for a lot of people and consumer spending will be as weak as during a recession," he said.

Australian Retailers Association executive director Richard Evans said visits to shopping centres had fallen significantly over six months. "Demand has dropped right off—the 10 years of economic sunshine has now turned into an eclipse, and we don't know whether it's going to be a full eclipse or partial eclipse."

The prospects of a recession are being reflected in the share prices of retailing companies. By this week, the market value of a major home appliance chain, Harvey Norman, had more than halved over the past six months.

Personal bankruptcies in the past financial year were at the second highest levels on record. Nearly 26,000 people declared themselves bankrupt, just 400 shy of the all-time high in 1998-99, and another 6,619 people who were insolvent and unable to pay their bills entered a debt agreement.

Analysts have warned that worse conditions lie ahead for both homebuyers and renters, with the plunging demand for home loans leading to further falls in property prices, and a drying up of investment in real estate. Australian Property Monitors predicts that rents will rise by 40 to 50 percent over the next four years, as fewer people try to buy their own homes.

Because of renewed fallout from the year-old global credit crunch, homebuyers also face further interest rate rises. Over the past week, the private banks have again raised their mortgage rates independently of the Reserve Bank, citing higher lending costs on global markets. In the case of the Commonwealth Bank, the largest home lender, the 0.14 percentage point rise means that the bank has added 0.51 percentage points to mortgage rates this year, on top of eight Reserve Bank increases of 0.25 percent in the official cash rate over the past three years.

The Reserve Bank warned this week that worsening inflation was increasing the likelihood of another official rate rise. According to the Australian Bureau of Statistics (ABS), inflation is running at 4.2 percent, way above the bank's 2-3 percent target range; but the next result from the bureau, due on July 23, is expected to be higher again. Petrol prices alone have risen 15 percent in the past three months.

So far, despite a wave of layoffs in the auto industry and other factories, the slump has yet to show up in official jobless figures. The latest ABS survey reported jobs growth of almost 30,000 in June, a bounce back from a decline of 25,600 the previous month. The trend shows monthly growth slowing sharply to 8,500, down from 30,000 over the past few years. This is nowhere near enough to cope with school leavers and newly arrived immigrants entering the job market.

UBS Investment Research economist Scott Haslem predicts that the official jobless rate will rise from just over 4 percent to 5 percent by mid-2009. Once unemployment starts to rise, the impact on many heavily-indebted working class households will be severe, inevitably leading to a new surge of mortgage and debt defaults. Already, according to a previous Fujitsu Consulting survey, about 400,000 households are expected to be in "severe" mortgage stress by September, with half likely to lose their homes over the coming period.

Adding to the stress in working class households are heavy losses of retirement income because superannuation funds have lost billions of dollars on the financial and property markets. With the Australian share indexes now down to their lowest levels in two years, and 30 percent below their highs of last year, the end-of-financial year statements being mailed out by the super funds are reporting falls of more than 5 percent, stripping workers of many thousands of dollars.

Under the compulsory superannuation scheme introduced by the Hawke and Keating Labor governments in the 1980s and early 1990s, workers have little choice or control over these funds, which now have nearly $A1.2 trillion ($US1.18 trillion) under management, mostly in highly speculative markets.

On this front like every other working people are being forced to pay the price for the failure of financial markets following the orgy of debt-fuelled speculation in housing, shares and derivatives over the past period.

Significantly, the plunge in new housing loans has occurred across the continent, including in the main mining boom states of Queensland and Western Australia. Likewise, the latest National Australia Bank business survey shows a sharp deterioration in business conditions in all industries and all states.

These results indicate that the "two-track" character of the economy is not geographic but socio-economic, with the proceeds from the mining bonanza going almost exclusively into the pockets of a small, very wealthy layer of society.

At the top of the pile, mining giants like BHP-Billiton and Rio Tinto have secured a virtual doubling of iron ore and coal prices for contracts with China and Japan. "The mining sector is experiencing massive income inflows from strong commodity prices and this is financing further investment capacity, as well as providing a boost to government coffers," said Adrian Hart, senior manager of BIS Shrapnel's infrastructure and mining unit. In Western Australia alone, home to some of the largest iron ore, coal and natural gas projects, the state's Chamber of Commerce and Industry calculates that there are major construction projects worth $165 billion in the pipeline, including $66 billion under construction or committed.

Such unprecedented revenue boosts have so far prevented the national economy from officially sliding into recession. BIS Shrapnel is predicting that economic growth will average between 2.5 and 4.5 percent over the next five years, although these estimates are based on the calculation that China will be largely immune from the slump already hitting its main export markets in the US and Europe.

The vulnerability of the Australian economy to the global financial turmoil has been highlighted by this week's renewed slide on the local share market, with $25 billion wiped off prices on Tuesday alone. Because of the crisis gripping their US counterparts, the banks have been especially hard hit, despite self-serving claims that they are not heavily exposed to the plunge in US property prices. ANZ, for example, fell 68 cents to almost a five-year low of $17.12—almost a half its market value in October.

Prime Minister Kevin Rudd's Labor government is committed to meeting the requirements of the financial markets, which are demanding that further pain be inflicted on the working class. Last week, the government said it would announce more spending cuts and savings measures when it releases its midyear budget review before the end of the calendar year. Finance Minister Lindsay Tanner said the cuts already unveiled in the May budget would be followed by longer-term measures drawn up by the government's razor gang.

The announcement, hailed on the front page of the *Australian Financial Review* last Friday, came just a day after the International Monetary Fund, while applauding the budget's measures, warned of the likely need for further spending cuts and higher interest rates. With inflation risks "clearly on the upside," the IMF said "more spending cuts would be required and we encourage the authorities to identify areas where additional spending cuts could be implemented". In addition, the Reserve Bank "should be prepared to tighten quickly if leading indicators suggest that domestic demand will not slow as expected".

Treasurer Wayne Swan welcomed the IMF statement as "a strong endorsement of the Rudd government's first budget and long-term reform agenda to build our economy's productive capacity".

In response to the further instability on global markets produced by the bailout of the United States mortgage giants Fannie Mae and Freddie Mac, Swan also issued a statement expressing confidence in the strength of Australian banks and finance houses. He had no words of comfort for homebuyers, however, warning of tougher times ahead and urging them to "look for a bank that can best shield them from the increased cost of borrowing flowing from the US subprime crisis". This was despite the fact that all the major banks have moved, almost in synch, to once again raise their rates.