Global financial storm hits Australian economy

Mike Head
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The deepening financial turmoil in the United States and worldwide is sending tremors through the Australian banking system and share market, and shattering what remains of the claims that the local capitalist economy would be protected by booming exports to China and other Asian markets.

Billions of dollars are being wiped off share prices, particularly those of the banks, and the Australian dollar has nose-dived, reflecting the Australian economy's vulnerability to a global downturn, precisely because of its dependence on raw material exports and current high commodity prices.

Perplexed financial commentators have described the events of the past two weeks as "earthquakes", "tectonic shocks" and "unimaginable". As the New York stock exchange staggered from one crisis to another, prices on the Australian markets followed suit, falling to their lowest levels in three years. This week alone, nearly $A80 billion has been wiped off. Over the past year, prices have dropped even further than in the US—the leading indexes have lost more than a third since their peak last November.

Less than two months ago, the Australian dollar was riding high, climbing almost to parity with the US greenback, largely because of soaring coal, natural gas and iron ore prices agreed to by Chinese, Japanese, South Korean and Indian buyers. Since then, the dollar has lost more than 20 percent of its value against the US currency and even more against the Euro and yen, as every major economy has headed toward recession and growth has slowed in China and India.

Australian authorities are anxiously making soothing noises, insisting that the "fundamentals" of the economy remain strong. In a major speech this week, Reserve Bank of Australia (RBA) governor Glenn Stevens claimed that the local banks were weathering the turmoil well. He asserted that the banking system was in sound shape and "light years away from what's happening in other banking systems around the world".

Prime Minister Kevin Rudd and Treasurer Wayne Swan defended Stevens's comments. They told parliament that while the global crisis had a long way to run yet, local banks' exposure to the collapses of Lehman Brothers, Merrill Lynch and the American Insurance Group (AIG) was modest. Behind the scenes, however, Rudd and Swan held crisis meetings with the RBA, Treasury and financial regulators, while the RBA joined other central banks around the world in pumping billions of dollars into the financial markets to try to prevent a disastrous drying up of credit.

None of the reassuring words—dismissed by one commentator as "mood music"—has had the desired impact. According to the *Australian Financial Review* on Thursday: "The deepening financial crisis gripping the northern hemisphere has sent panic through global debt markets, prompting a blow-out in spreads and dashing what slim hope there was of a near-term recovery in credit conditions."

Commenting on the AIG collapse, Joshua Williamson, a senior strategist at TD Securities, said it had "taken the financial crisis from being the worst in a generation to the worst since the Great Depression... Looking one step ahead, the real risk now is that global liquidity dries up further, adversely affecting the real global macro-economy."

Another barometer of the underlying crisis was the rout at Australia's largest merchant bank, the Macquarie Group. Last May, its shares peaked at nearly $100; this week they fell below $30, slashing its market value from $25 billion to less than $10 billion.

For two decades, Macquarie has been a free-market icon, dubbed the "millionaire's factory" because of the multi-million dollar remuneration packages it generated for its top executives. In 2006-07, Macquarie's then chief executive, Allan Moss, took home $33.5 million in salary, bonuses and share options, or the equivalent of $92,000 a day, setting a new Australian record for executive salaries.

Moss and his associates made their money through what became known as the "Macquarie model"—a complex Ponzi-like scheme in which they bought up assets around the world, continually revalued them upward and then borrowed against the inflated asset values to fund payments to investors and themselves. The group also spun the assets off into satellite funds and trusts, and collected fees from them along the way.

All this was conducted with the full approval of the corporate regulators. In fact, Macquarie set the benchmarks for generating profits through the ever-greater leverage of debt. Just three years ago, the *Sydney Morning Herald's* business pages said the bank "has mesmerised the sharemarket with financial origami and investors have rejoiced in the apparently endless stream of money it generates. It is admired by analysts, investors and executives who praise its originality and its agility."

Over the past 12 months, falling global stock and asset prices, combined with soaring credit costs, have seen the Macquarie model unravel. This week, Standard and Poor's put the bank on a negative outlook and cast doubt on its structure after reports that the group would have difficulty with $5 billion of the $45 billion in debt that it must refinance by March 2009. Another outfit that adopted the Macquarie model, Babcock & Brown, has sunk even lower—its share price has collapsed from $31 last November to around 80 cents.

The fallout has not stopped there. Australia's four largest banks are far from immune to the global shockwaves. Despite issuing statements that they had relatively small exposures (totalling about $400 million) to Lehman Brothers' collapse, their shares have led the stockmarket down, with the National Australia Bank tumbling to its lowest level since 2000.

The international credit crunch triggered by the US sub-prime crisis in August last year 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.

Now mining shares are being hit, indicating fears for the very sector that has been held up as the saviour of Australian capitalism. A few months ago, Andrew Forrest was proclaimed by *Business Review Weekly* as Australia's richest man, topping its rich list at just under $10 billion because of soaring prices for the iron ore from his Fortescue Metal Group's mine. Since then, Fortescue's share price has plummeted nearly 40 percent, sending Forrest's wealth ranking tumbling.

Retirement incomes wiped out

As elsewhere around the world, it is ordinary people, not the wealthy elite, who will be forced to bear the economic burden for the failure of the financial system. Working class households, already severely stressed by soaring debt levels, high mortgage and credit card interest rates and rising prices, now face a sharp further decline in living standards.

In his speech this week, RBA governor Stevens spoke bluntly of a "new phase" in which households would have to "consolidate their debt, grow their consumption spending at a pace closer to income and perhaps look to save more of their current income". This is under conditions where household debt has risen to an historic high of about 175 percent of disposable income (up from 75 percent a decade ago), because working people have increasingly had to borrow to cover living costs.

Governments at every level, federal, state and local, are warning of severe cuts to spending on social programs, basic services and infrastructure. In New South Wales, the most populous state, it has been revealed that local councils have lost hundreds of millions of dollars by sinking funds into complicated, high-risk investment products, and are preparing to slash spending on essential projects, including roads. A recent report found that NSW councils had a combined exposure to collateralised debt obligations and capital-guaranteed products of $1 billion. Before Lehman Brothers collapsed, some 24 councils had been considering a class action against the corporation.

At the same time, millions of people are seeing their retirement funds decimated. Over the past two decades, ordinary working people have been compelled by the compulsory superannuation scheme introduced by the previous federal Labor government to take cuts in real wages and divert money into giant superannuation funds, all of which have been caught up in speculating on the financial markets.

So far this calendar year, according to Jeff Bresnahan, managing director of SuperRatings, balanced superannuation funds have lost about 11 percent. Losses on the local and international sharemarkets, where the majority of funds were invested, had worsened since June 30, the end of the last financial year, during which the funds lost an average of 6.4 percent. Bresnahan said "some people are going to have to stay in the workforce for one or two years longer" and "hundreds of thousands of Australians ... really have to clearly rethink their retirement strategies".

Over recent years, ordinary people have been increasingly convinced, and enticed via tax concessions, to pour extra money, including their life savings, into superannuation funds, which mushroomed in size from about $80 billion in 1992 to some $1.2 trillion in January this year. Individual investors poured $22.4 billion into the funds in the June 2007 quarter alone—three times the previous record—to take advantage of extra tax concessions granted by the Howard government. Many people borrowed money to benefit from this tax handout and have lost heavily.

The exponential growth of superannuation funds has been part of the growing financial parasitism of the Australian corporate elite, which has sent the value of funds under financial management to unprecedented levels—from 50 percent of gross domestic product in 1990 to 160 percent, or $1.7 trillion, by the beginning of this year—while large sections of industry have been restructured, downsized or shut down.

The devastation of superannuation funds is an indictment of the Labor and trade union leadership, which forced workers into these funds as a means of making them pay for their own retirement while old age pensions fell below the poverty line. Many of the largest funds are owned and run by union-employer partnerships, giving the unions a vested interest in driving up profit rates at the expense of their own members, and making them complicit in the disaster now unfolding.