

# Australian central bank interest rate cut reveals fears of global recession

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In an extraordinary attempt to shore up the country's banking system and stem the local share market crash, the Reserve Bank of Australia (RBA) yesterday reduced official interest rates by a full percentage point--double the cut expected by the money markets.

Financial commentators were stunned and initially elated by the move, the first time that rates have been slashed by 100-basis points since May 1992, during the last recession. Australian share prices, which had fallen almost 10 percent in a week, bounced back sharply on the news. The ASX 200 closed 1.7 percent higher at 4,619, after diving more than 3 percent in early trade.

The Australian dollar, which had suffered its greatest-ever week-long decline against the US and Japanese currencies, rallied to close at around 72 US cents, still far below its near-parity with the greenback just over two months ago. By this morning, however, the dollar's fall to under 70 cents had resumed.

Overnight plunges of more than 5 percent on Wall Street also reversed the short-term lift in share prices, with the ASX 200 down by more than 3 percent at midday today.

Despite the initial celebrations on the money markets, the RBA statement explaining the rate cut decision gave little reason for confidence. Bank governor Glenn Stevens expressed serious concerns that the global financial turmoil could cut off credit sources for Australian banks and other businesses, and send the world economy into recession with severe implications for Australia.

Stevens said conditions in international financial markets had taken a "significant turn for the worse" in September. "Large-scale financial failures in several major countries were accompanied by serious dislocation in interbank markets and heightened instability in other markets, including sharp falls in share prices."

The RBA governor added: "The recent deterioration in prospects for global growth, together with much more difficult market conditions even for creditworthy borrowers, now present the risk that demand and output could be significantly weaker than earlier expected."

While the RBA lowered the official cash rate from 7 percent to 6 percent, Australia's four major banks--the Commonwealth, Westpac, ANZ and NAB--refused to pass on the full cut to homebuyers and other borrowers. In a sign of their financial fragility, the banks withheld 20 basis points, taking their rates to 75 basis points above the RBA rate, citing their exposure to the

soaring cost of funds on the international markets. Credit card rates, some of which currently exceed 20 percent, will not come down at all, leaving ordinary working people under enormous financial stress.

Almost immediately, however, fears were expressed that the sheer size of the rate cut could indicate panic and fail to avert recession. The *Australian's* economics editor Michael Stutchbury, commented: "Don't just stand there--panic! But it's a controlled panic from the Reserve Bank, justified by the dramatically increased risk of a credit-crunch recession." On the *BusinessSpectator* web site, Robert Gottliebsen warned that the rate cut was "not enough to return us to good times". He outlined a "pessimistic scenario" that "the two-year downturn will extend to three or four years and will be severe".

Other commentators voiced concerns about the prospect of stagflation-recession combined with soaring inflation. In its statement, the RBA acknowledged that the official inflation rate was still likely to rise to around 5 percent for the year to September. Its rate cut marks a complete about-face-earlier this year the bank raised rates twice in a bid to drive down consumer spending and dampen rising prices.

Fears of a prolonged global slump, accompanied by the collapse of the mining boom, have sent Australian share values and the local currency plunging to four-year lows, more than a third below their recent peaks. In less than 12 months, \$A400 billion has been wiped off share prices, with the main indexes falling close to 35 percent since last November, while the Australian dollar has tumbled even faster--down almost 30 percent against the US greenback since July.

With Australia's main energy and mining export markets--the US, Europe and Japan--already sinking into recession, accompanied by a sharp downturn in China's growth, share prices for major mining houses have led the rout. Since July, Rio Tinto has lost nearly 40 percent of its value, BHP Billiton more than 30 percent, Oz Minerals almost 50 percent and Woodside Petroleum close to 30 percent. New iron ore miner, Fortescue, has been hit even harder--more than 60 percent.

Since reaching record levels on July 2, world commodity prices, measured by the US CRB Index, have dropped by almost 35 percent because of concerns about falling demand for raw materials. They remain at historically high levels but last week the CRB index recorded its biggest weekly fall--roughly 10 percent--in more than five decades.

Only weeks ago, BHP Billiton and Rio Tinto were still claiming that the growth of Chinese capitalism would protect their super-profits for many years to come, and media commentators were insisting that the proceeds would insulate the Australian economy from the worst of the global meltdown. Now, financial analysts are warning of a rapid slide from a minerals boom to a bust.

The global credit crisis is also cutting off funds for mining companies to finance new projects and acquisitions. Standard & Poor's last week issued a negative credit outlook for mining and materials companies, including BHP Billiton. Already, Fortescue has been unable to raise \$2 billion to meet its pledge to double output to 80 million tonnes of iron ore. Fortescue executive director of operations Graeme Rowley told the *Australian* last week, "money out there is hard to get at the moment".

Despite months of assurances by the Rudd government and the regulatory agencies that Australia's banks are sound--unlike their US and European counterparts--a prolonged credit freeze-up will have serious implications for the banks, which depend on the international money markets for up to 60 percent of their funding sources.

Since October 2006, the International Monetary Fund has issued several warnings about the fragility of the Australian banks. Just two weeks ago, the IMF said the global turmoil had "highlighted their vulnerability to rollover risk associated with short-term wholesale funding" and "the protracted loss of access to international short-term debt markets".

Last week a Freedom of Information request by the *Australian* revealed that the federal government's \$64 billion Future Fund, set up in 2006 from accumulated budget surpluses and the privatisation of Telstra, secretly lent unknown amounts to three of the big four banks--Westpac, the ANZ and NAB--shortly after the global crisis intensified with the collapse of the US investment bank Bear Sterns on March 16.

While the total amount of these loans is unknown, they potentially expose the Future Fund to further losses. According to calculations by the *Australian*, the fund, which the previous Howard government claimed would "future-proof" the Australian economy, has already lost \$2 billion through investments on stock exchanges and other money markets.

In effect, behind the backs of ordinary people, the Future Fund has been bailing out the banks, together with the Rudd government and the Reserve Bank, which has been pumping billions of dollars into financial markets for months. For his part, Prime Minister Kevin Rudd has repeatedly boosted the four major banks' standing, declaring that they have AA credit ratings. These assurances are highly dubious, given that the same ratings agencies gave AAA status to the US sub-prime loans whose disintegration sparked the financial meltdown last year.

Rudd and Treasurer Wayne Swan have also insisted that the banks are subjected to the most rigorous regulation in the world. Yet, the RBA last month reported that the banks had "off-balance sheet business" of \$13.8 trillion at the end of June, compared to \$5.8 trillion in June 2003. While financial analysts say most of this is not risky, if just 1 percent defaulted, it would wipe out Australia's banking system. According to the *Australian's* Adele Ferguson: "A big concern is the exposure of Australian banks to

collateralised debt obligations, a fancy term for structured products based on bonds backed by mortgages and other consumer debt. Because they are off the balance sheet they lack transparency."

In order to bolster their positions, the big banks are exploiting the credit crunch to swallow up their smaller competitors, which have found it almost impossible to obtain funding on world markets. Between them, the four top banks already control 85 percent of local banking funds but they are now tightening their grip on the market further, and this will inevitably lead to large-scale job losses in the banking sector. Westpac is taking over the fifth-largest bank, St George, and the Commonwealth is moving to buy the next biggest two, Suncorp and BankWest.

Prime Minister Rudd immediately welcomed the RBA's rate cut and declared that his government would also take "tough action, tough decisions" that "may not be popular" in order to ensure the stability of the banking system, which he described as the "cornerstone" of the government's policy.

In part, his comments sought to justify his open support for the banks not passing on the full rate reduction to borrowers. More broadly, they are another warning that the Labor government will implement harsh austerity measures to impose the burden of the economic crisis on the working class in order to protect the banks and other major corporations.

Ordinary people are already bearing the brunt of the collapse of the mountain of debt that has fed the massive profits and executive salaries of the financial and corporate elite. Some 15 percent has been wiped off superannuation and other retirement funds, forcing people to postpone their retirements or try to go back to work. Tens of thousands of working class people have lost their homes, unable to pay their mortgages.

In a speech last week, Rudd blamed "greed" and "extreme capitalism" for the economic crisis. But the unrestrained accumulation of wealth in the hands of a tiny layer at the expense of the working class simply expresses the inexorable logic of the market and the profit system itself, which has compelled competing corporate giants to seek ever-greater rates of return in order to survive. Labor has fully embraced these processes. In fact, the last Labor government in the 1980s and 1990s, in concert with the US and British governments, led the way in implementing the increasing de-regulation demanded by the markets.

Every aspect of economic and social life has been subordinated to the dictates of private profit through the free market doctrines of self-regulation, privatisation, user-pays, "competitiveness", welfare slashing and tax-cutting. Now, amid the wreckage produced by the capitalist system, the Labor government is determined to bail out and prop up those responsible for the breakdown.



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