Australia: Labor government forced to revise economic forecasts as global crisis deepens

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Reacting to a raft of damning surveys showing the impact of the global economic and financial crisis on the broader Australian economy, the Reserve Bank of Australia (RBA) last week cut the cash rate by a larger than expected 75 basis points, from 6 percent to 5.25 percent—the second major cut in as many months. In October, the RBA slashed the cash rate by a huge 100 basis points.

While claiming these measures, combined with a $10 billion fiscal stimulus package announced last month by the Rudd Labor government "would help growth", RBA governor Glenn Stevens admitted that "slowing global economic growth and falling commodity prices would have a countervailing negative effect". Stevens continued: "On balance it appears likely that spending and activity will be weaker than earlier expected."

In fact, the government and RBA interventions are being overtaken by the deepening global economic crisis. Late last week, the International Monetary Fund (IMF) in its updated World Economic Outlook forecast that the Australian economy would grow by just 1.8 percent for the next year.

For its part, the Rudd government has been forced to revise down earlier economic growth predictions. Releasing the Mid-Year Economic and Fiscal Outlook last week, federal Treasurer Wayne Swan reported that a $40 billion hole had been "smashed" in budget revenue declaring: "There's no point in trying to sugar coat these figures. The Budget has felt the full force of the global financial crisis." He announced the government had revised down its budget surplus estimate for the current fiscal year from $21.7 billion to just $5.4 billion.

The government also cut its gross domestic growth estimate for 2009-10 from 3 percent to just 2 percent and now forecasts a rise in unemployment to 5 percent in June 2009 and 5.75 percent in June 2010. AMP Capital Investors' Shane Oliver nevertheless accused the government of "erring on the side of optimism". Citing "the impact of the downturn in global growth, the blow to confidence, the loss of wealth, the slump in commodity prices" Oliver predicted growth this financial year would go down to one and a half percent or "maybe even a little bit lower".

Oliver's remarks were borne out by a series of reports released last week pointing to the growing threat of recession.

A survey by the Australian Chamber of Commerce and Industry (ACCI) and Commonwealth Bank of Australia revealed that business confidence (as measured by the Expected Performance Indicator) fell to just 29.9 in the third quarter, from 33.8 in the second, the lowest level since the survey began in 1994. Just one year earlier the index stood at 51.3 in the third quarter.

The survey also found that the index of general business conditions fell to 41.1, its lowest level since 1994, from 60.9 a year earlier. At the same time, growth indicators such as sales, profits, wage growth, employment and investment all declined from the previous quarter. The profits index plunged to 37.2 in the third quarter from 41.1 in the second quarter and 52.6 in the same quarter a year earlier—indicating that business conditions are rapidly deteriorating.

Another survey of 300 companies in manufacturing, services and construction by the Australian Industry Group (Ai Group) found 60 percent of those surveyed confirmed the global crisis had already had a "negative impact" on sales and new orders, while one in five companies reported that the impact had been "strongly negative". The survey also found that 53 percent of firms had reduced their capital investment plans and 38 percent had acted to reduce employment. Employment in the services sector, for example, declined for a fifth consecutive month in October.

Ai Group chief executive Heather Ridout admitted that "order books were poor right across the services sector" with the index for new orders down 5.8 points to 38.7 in October, and were "particularly weak" in the retail trade sector. Retail sales sank 1.1 percent in September, the biggest drop since April 2005.

Ridout warned that the survey results, combined with "anecdotal evidence" from "a wide cross-section of sources", confirmed "we are in for a rough ride" and suggested "very strongly that the malaise has spread to the real economy". She added, "[W]e are yet to feel the full impacts".

Other figures revealed a sharp decline in activity in October across most sectors, including manufacturing, services and construction—all major Australian employers. The latest Performance of Manufacturing Index (PMI) revealed that activity for last month was the lowest since the index began in 1992, with a downturn in transport equipment, basic metal products, construction materials, chemicals, petroleum, coal and wood products and furniture. Falls in activity in the printing and publishing sector were described as "significant".

A report just released by the Australian Bureau of Statistics (ABS) indicated a downturn in the construction sector was already underway, with building approvals falling 7.2 percent to 11,167 units in September (seasonally adjusted), the lowest level since April 2001 and the third consecutive monthly fall. Reed Construction Data had previously reported a 500 percent increase nationally in the number of construction deferrals over the last four months, compared to the same period last year.

Slowing economic growth in China and Japan is beginning to impact on Australia's mining industry, with cuts to steel production in both countries reducing the demand for iron ore and coal and undermining commodity prices. The Central Iron and Steel Institute reported that China was expected to post a 20 percent decline in steel output in the fourth quarter, while the trade ministry announced Japanese mills would undertake the largest cut in production for five years.

Citing the falling demand for commodities, mining company Mount Gibson Iron announced last week it had cut its sales target for the 2008-09 business year to 5 million tons from 7.2 million tons, after defaults on iron-ore purchases from Chinese buyers. The company plans to shed nearly 200 jobs, or one third of its workforce.

Also last week, WorleyParsons, Australia's largest engineering group, said it had been forced to withdraw 250 workers from two mining sites where it was hired as a contractor because of production cuts. While 180 workers will be retained, 70 are slated to lose their jobs. As well, manganese and nickel miner Consolidated Minerals will lay off staff at its Kambalda nickel operations in Western Australia.

More job losses loom in the auto industry, which has already seen hundreds of positions axed at Ford Australia, GM Holden and across auto component companies. This week, the Federal Chamber of Automotive Industries (FCAI) reported that new vehicle sales in Australia plunged in October, with only 79,105 new cars and trucks sold, down 11.4 percent or 10,184 units compared to the same time last year.

The FCAI also raised concerns about "the impact of liquidity constraints on the availability of wholesale finance to dealers" in light of the recent withdrawal from the Australian domestic market of major credit providers GMAC and GE and reports that Ford Motor Credit Company had cut local lending. GMAC, the finance arm of troubled US auto giant General Motors, provided around one third of all vehicle credit in Australia. A lack of ready credit will impact on car dealerships' ability to maintain and replenish stocks, leading to the widespread closure of car yards at the cost of thousands of jobs.

Further job cuts loom in the financial and banking sector, with financial adviser KPMG warning this week that 10,000 positions could be lost in the next 12 months. "Given the current economic environment, cost management will be of increasing importance," a group spokesman warned.

Last week, asset manager Allco Finance Group went into receivership after banks refused to roll over its more than $1billion debt. The finance group had earlier revealed it planned to slash more than 200 jobs from its 500-strong global workforce. Insurance and banking group Suncorp-Metway also announced job cuts as part of cost-savings "due to deteriorating market conditions, resulting from the global credit crisis". Media reports speculated that as many as 1,500 jobs could be axed.

In the media industry, News Corporation announced last week it would step up cost cutting and "manage down" staff numbers in its Australian and British newspaper operations, after reporting a 30 percent fall in its first quarter (financial year) profit. In manufacturing, OneSteel will slash 150 jobs at its Whyalla smelter in South Australia.

Another company placed in receivership last week was Australia's largest childcare provider, ABC Learning, which operates 1,200 centres and employs 16,000 staff. The company's major creditors, Australia's "big four", the Commonwealth Bank of Australia, National Australia Bank, Westpac and ANZ, will get first call on the proceeds, leaving little, if anything, for small investors. While the Rudd government has granted a $22 million subsidy to keep the child care centres open until December 31, staff will be given only "limited access" to an estimated $20 million in outstanding leave entitlements.

On Thursday the Australian Bureau of Statistics released labour market figures for October showing the official unemployment rate remained at 4.3 percent, unchanged from last month. However, while employment rose by 34,300, this was solely due to an increase in part-time jobs of 43,500. Full-time jobs fell by 9,200, the first consecutive monthly decline in full-time employment since late 2005. Overall, the number of people looking for full-time work rose by 10,200 to 338,200.

Remarking on the ABS figures investment bank JP Morgan's chief economist Stephen Walters warned: "Officials probably will not take too seriously a job report that indicates that firms rushed to employ tens of thousands of new workers as equity markets collapsed, the world's major economies plunged into recession, and governments in many countries were forced to bail out their respective banking systems".

Walters, who days earlier had predicted that economic growth in Australia would slump to just 1.4 percent by 2010, pushing unemployment up to 9 percent and leaving around one million jobless, declared "our view is that as private investment is postponed or cancelled amid an increasingly gloomy outlook, jobs prospects will dim". He dismissed the government's latest growth and employment estimates saying he believed Australia "has dropped into what is likely to be a shallow recession."

"We've got GDP growth contracting both in the current quarter and in the first quarter next year. Now that in itself is going to drive unemployment much higher than the government forecasts, and therefore there's a much bigger drain on the government's budget position," Walters declared.

Pointing to the RBA's two recent interest rate cuts, Walters said that these matched those made during the 1991 recession. He warned: "Now, I think there's a message there—what's particularly worrying is that the offshore economic and financial conditions remain awful, and I think even if domestically Australia has some pretty sound fundamentals, I think the tidal wave of bad economic and financial news from offshore is going to swamp these official forecasts."