Australian bank fiasco—a warning of “tougher times” ahead

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A capital-raising debacle involving one of the country's "big four" banks, the former government-owned Commonwealth Bank of Australia (CBA), has underscored the fragility of the entire banking and financial system amid rising bad debts and warnings of worse to come.

CBA faces an investigation by the Australian Securities & Investments Commission (ASIC), the federal corporate regulator, after refusing to disclose to the financial markets a 30 percent rise in its debt write-offs while raising $2 billion from institutional investors to boost its capital reserves.

When the rise in CBA's bad debt impairment expense for 2009 from $1.7 billion to $2.5 billion became known, finance houses forced the bank to scuttle the capital raising at $27 a share, and hastily re-do the operation at $26 a share, at a cost of hundreds of millions of dollars. The move prompted analysts to slash an average of $400 million from CBA profit forecasts and helped drive down the bank's share price to a near six-year low.

Only weeks ago, the financial markets and the media were lauding CBA for taking advantage of the international banking crisis by buying BankWest, an Australian subsidiary of the troubled UK giant HBOS, for a fire sale price of $2.1 billion. Now, CBA has become the latest bank to shock the markets by revealing previously undisclosed liabilities.

CBA's subsequent attempt to blame its underwriter Merrill Lynch for failing to inform the markets drew savage criticism from financiers. John Sevior, head of equities at one of CBA's largest shareholders, Perpetual Investments, told the *Australian Financial Review*: "It was absolutely, 100 percent CBA's responsibility to have disclosed this information to the market. It shakes your confidence in the honesty or competence of the bank—or both."

At their core, the CBA's troubles reflect its exposure to debt-laden companies like Babcock & Brown and Centro, as well as collapsed companies such as ABC Learning and Allco Financial Group. The bank compounded the damage to its reputation, however, by defending its refusal to announce its revised bad debt estimate. "The company did not consider that the information contained in the announcement with respect to the impairment expense was material to the company," CBA said in response to a query from the Australian Securities Exchange (ASX).

The bank's lack of transparency threw a further question mark over what else lies hidden in the books of the banks. According to the *Australian Financial Review* of December 20, the CBA fiasco "has undermined confidence in a sector already battling rising bad debts and slowing credit growth as the effects of the global credit crunch continue to reverberate".

Despite Australian-based banks and lending institutions being propped up by billions of dollars in loan guarantees and other assistance by the Rudd government, the affair further exposes the claims of the government and media commentators that the local banking system is fundamentally sound. Even heavier losses are likely in 2009, compounded by rising unemployment and the spread of business collapses from highly-leveraged companies to retail, industrial and mining firms.

Wilson HTM analyst Brett le Mesurier this week downgraded his share-buying recommendations on the other three big local banks—Westpac, National Australia Bank (NAB) and ANZ, warning that likely higher bad debt charges from a "second wave" of bankruptcies had not yet been factored into the banks' share prices.

Already, in recent weeks, major mining and industrial companies have been forced into negotiations with banks, including base metals miner OZ Minerals. Iron ore miner Fortescue Metals revealed it had issued new shares just to pay outstanding bills. PaperlinX admitted it might breach debt covenants because of delayed proceeds from asset sales, while publishing conglomerate PBL was forced to secure a $445 million lifeline from its private equity owners to lower its $4.2 billion debt.

At its annual shareholders' meeting last week, ANZ warned that the prospects of Australia avoiding recession were slight, undercutting the claims made by the Rudd government and the media just weeks ago that a recession could be prevented through economic stimulus packages. ANZ, which nearly quadrupled its credit impairment charge to $1.95 billion in 2007-08, said Australia was feeling the early stages of a global slowdown. "There will be implications for the banking industry, through bad debts, which will continue to arise from these economic conditions," ANZ chairman Charles Goode said.

ANZ was not alone. At NAB's annual general meeting, CEO John Stewart predicted "tougher times for banks across the board". Stewart, who is about to retire, added: "In over thirty years in this business I have not known such a time of economic and market uncertainty."

After seeing their share prices halve in the past 12 months, the banks have tried to bolster their balance sheets by raising more than $13 billion in capital through issuing shares—usually at 10 percent discounts to the prevailing market price—or underwriting their dividend investment plans. In recent weeks, they have also raised $33 billion by issuing bonds, all guaranteed by the Rudd government.

Among the concerns voiced in financial circles is that CBA's public brawling with Merrill Lynch could raise deeper questions in the minds of ordinary people. Peter Morgan, founder of 452 Capital, told the *Australian*: "You've got two banks at loggerheads, which is not doing anything for the man in the street and any efforts to get capitalism back on an even keel. This is absolutely playing into the hands of people who believe that capitalism is only played at the big end of town."

Indicators of a deep slump

As the CBA affair unfolded, more dire news emerged about the economy and the prospects for next year.

A KPMG business survey showed that 40 percent of small and medium businesses, across the board and in all states, are planning to shed jobs, with 78 percent forecasting that the economy would contract in the next 6 to 12 months. KPMG's Graeme Matthews commented: "So that means that I think in the next short period of time there'll be some additional business failures. Unemployment will increase and there'll be tough times ahead."

The ACCI-Westpac Industrial Trends survey found business sentiment had plummeted during the previous three months to its lowest level since 1990, because of weak domestic and international demand and continuing turmoil on international markets. Businesses were also highly pessimistic about the first half of next year.

New homes construction experienced the sharpest quarterly fall in eight years, as the credit crunch and falling demand hit the market. Work began on about 35,400 homes in the September quarter, a drop of 10.7 percent compared to the previous quarter, in seasonally-adjusted terms.

Australian Bureau of Statistics data showed that households saw more than half a billion dollars a day wiped off their total financial assets in the September quarter, extending the losses from falling house values, share prices and retirement funds since the start of the year to $215 billion. Net equity in pension fund reserves alone fell $47.4 billion in the quarter.

According to results compiled by SuperRatings and industry regulator, the Australian Prudential Regulation Authority, superannuation funds lost 20 percent, or $90 billion, over the 12 months to November, with the losses accelerating in the November quarter, during which 13 percent, or $25 billion, was wiped off. As a result, a growing number of workers are being forced to delay retirement, or go back to work.

The transformation of the mining boom into a bust was highlighted by the axing of nearly 700 mining jobs in a week, followed by Rio Tinto's announcement it would shut its 11 iron ore mines in Australia for two weeks because of declining demand from steel mills, on top of its previous decision to slash 14,000 jobs worldwide.

At the same time, the federal, state and territory governments are plunging into deficits, because of falling mining royalties and other tax revenues. These deficits mean that, far from being able to issue economic stimulus packages, governments will unveil drastic cuts to social spending, further aggravating the downturn, as well as the hardship facing working people.

The Labor government in South Australia, whose coffers have been boosted by record mining royalties in recent years, last week announced that its liabilities would force the budget into territory seen as dangerous by credit ratings agencies. Figures released by Treasurer Kevin Foley showed the state's net debt more than doubling from $637 million this financial year to $1.5 billion next year, $2.5 billion in 2010-11 and $3.3 billion in 2011-12.

Saying state revenues had "literally evaporated overnight," Foley unveiled plans to cut 1,600 public sector jobs and sell off government buildings. Even so, the budget will go into a deficit of $112 million this financial year, with an $81 million deficit expected next year.

South Australia became the fourth state and territory—following New South Wales, Tasmania and the Northern Territory—to confirm it would be in deficit this year. The *Australian Financial Review* estimated that state and territory governments had collectively suffered a $3 billion budget reversal for 2008-09, led by a $980 million revenue decline in the most populous state, NSW.

The newspaper further warned that the federal government's surplus, forecast in the May budget to be $21.7 billion, had already almost disappeared. Last month, Treasurer Wayne Swan said the global financial crisis had poked a "$40 billion hole" in expected tax receipts over the next four years.

In addition, according to the *Sydney Morning Herald*, the Rudd government has announced more than $37 billion in spending in the past two months in efforts to revive consumer and business confidence. This amount, which includes $6.2 billion for the car companies and billions more in assorted business tax breaks and incentives, does not cover the far larger underwriting of the banks and financial institutions.

Prime Minister Kevin Rudd has now demanded that his ministers produce proposals for significant spending cuts, and resurrected the budget razor gang, which cut $4 billion from the May budget. Finance Minister Lindsay Tanner told the *Australian*: "With the intensified pressure, that inevitably means that we'll be looking even harder because the choices we're facing are tougher than we expected."

From the outset, Labor's response to the economic crisis has been to make the working class pay the cost, while bailing out the banks and other corporate giants responsible for the meltdown of the market system.