Falling exports and home sales: recession "baked in Australia's cake"

Mike Head
12 January 2009

The shockwaves from the global financial breakdown have well and truly arrived on Australian shores, with the latest figures showing precipitous falls in home building and mining exports.

Metal ores and minerals exports dropped by 13 percent in November, contributing to a 4 percent decline in total exports, while the number of homes approved for construction dived by nearly 13 percent to their lowest level in around eight years.

Both results were far worse than expected. Even before they were released, global banks were warning that the country was already in recession (two successive quarters of negative growth) and that worse lay ahead in 2009.

Recession "already is baked in Australia's cake," JPMorgan Chase Bank stated in an economic research note issued on January 2. "Australia is in the midst of the first recession since the early 1990s, the ripples of the global economic hurricane belatedly having washed ashore... Households currently are in a rare state of retreat, previously upbeat businesses are slashing investment and hiring, and commodity exports are in free-fall."

The bank said the Australian economy had most likely already contracted in the final quarter of 2008 and would do so again in the first quarter of 2009. JPMorgan estimated that Australia's official jobless rate could double to 9 percent by the end of 2010, or close to a million unemployed, up from 4.4 percent in November.

A sharp December fall in media advertising, including a 50 percent drop in newspaper employment ads, caused Goldman Sachs JBWere's Christian Guerra to comment: "We had previously assumed the 2009 financial year would be a cyclical low for the ad market. However, our economics team now believes Australia will endure a deeper recession and a shallower recovery. As a result, we see the downturn lasting through 2010."

Because both Japan and China, Australia's largest export markets, are now slashing production, hopes have vanished that the local economy would be sheltered from the worst of the global storm.

In fact, the heavy dependence of Australian capitalism on raw material exports, combined with historically unprecedented levels of household and corporate debt, makes it particularly vulnerable to the economic meltdown that began in the United States in mid-2007.

By the end of last year, the local share market had suffered one of the biggest losses in the world—stock prices fell 43 percent, or 47 percent from their peak in November 2007. By comparison, Wall Street's Dow Jones index lost 33.8 percent and the S&P 500 38.5 percent. According to the *Australian Financial Review*, the falls in Australia have already exceeded those of the Great Depression of the 1930s, when prices dropped 46 percent from their 1929 high to their low a year later.

One of the biggest factors is that export mineral prices suffered a major drop in the second half of 2008—the CRB index of a basket of commodities has sunk more than 52 percent since July. For Australian-based mining companies, including the two giants, BHP Billiton and Rio Tinto, the situation will only deteriorate after April, when new price and volume contracts will commence. For hard coking coal, prices are expected to drop at least to $US120 a tonne in April, from $US300 a tonne in present contracts.

The reversal of the mining boom has started to flow through the entire economy. The sharpest fall in the number of homes approved for construction in November occurred in Western Australia, the most mining-dependent state, where approvals plunged 29.5 percent.

Nationally, approvals for both commercial and residential properties, regarded as indicators of future economic activity, plummeted 34.7 percent in the year to November. ICAP senior economist Adam Carr described the results as "completely horrific".

All the indications are that the building slump will intensify. A survey conducted by the Australian Industry Group and the Housing Industry Association showed construction activity at new lows in December, the 10th straight month of decline. As a result, major job losses are expected to hit building workers in coming months and the national economy, which barely grew by 0.1 percent in the September quarter, before the worst of the global credit crunch, will slow further.

November's plunge in construction came despite extraordinary efforts to stimulate investment. The Reserve Bank had slashed interest rates by 2 percentage points in the preceding months, and the Rudd government had tripled the first homebuyers' grant to $21,000. During November, the government also announced a $10.4 billion "economic stimulus" package, mostly consisting of minor one-off handouts to pensioners and parents to boost consumer spending in the lead-up to Christmas.

The failure of the government's efforts was underlined by the latest retail and car sales figures. In November, retail sales rose 0.4 percent in seasonally adjusted terms, but only food sales kept the data in positive territory. Once food was taken out of the statistics, sales fell by 1.1 percent—the worst result on record.

New vehicle sales dropped 11.3 percent in December, on top of a 22 percent plunge in November, producing a full-year decline of 3.6 percent. A much steeper 12.5 percent fall is predicted for 2009. This is despite the Rudd government's $6.2 billion assistance package for the car industry and a $2 billion special fund to prop up showroom finance after GE Money and GMAC announced they would pull out of the market.

These results give an early picture of the severe financial and social impact that the economic crisis will have on ordinary people. Even though mass unemployment has yet to hit, working people are already heavily in debt and being forced to cut back, delay or cancel spending on housing, consumer items and cars.

An Australian Chamber of Commerce and Industry survey showed business confidence fell to record lows in December. Many firms have put capital expenditure, including vehicles, on hold, and expect jobs to be shed over the next six months. Companies reported that business conditions, sales and profits continued to decline over the final months of 2008 and were expected to deteriorate further in early 2009. A Dun and Bradstreet survey found that 20 percent of firms expected to have fewer staff in the March quarter than a year ago, 54 percent predicted sales would decline and 59 percent thought profits would drop.

Beneath the surface of economic life, a new round of asset and profit write-downs has started to emerge, reinforcing fears of a "second wave" of business bankruptcies that will spread from highly-leveraged companies such as Centro, Allco, ABC Learning and Lift Capital to trading companies, miners, manufacturers, retailers and wholesalers.

Last week, three prominent companies—Leighton Construction, investment company GPG and property group Tishman Speyer—joined a growing list of firms alerting shareholders to profit downgrades or asset revaluations that could seriously affect company balance sheets and breach debt covenants with banking syndicates.

Leighton warned that interim net profit would be down 60 percent and full-year net profit down 21 percent after taking into account $240 million of investment write-downs in six listed entities, including BrisConnections, RiverCity, Connect East, Devine and Macmahon Holdings.

Tishman Speyer said the valuations on all 18 properties in its portfolio had been written down by a collective $220 million to $2 billion. *Australian* commentator Adele Ferguson commented: "The reality is that Tishman Speyer and many other LPTs (listed property trusts) are yet to come clean about the real value of the properties in their portfolios. If they did, most would be in breach of their loan covenants, which would result in a liquidation of assets at fire-sale prices or a renegotiation of debt at a higher interest rate, which would savage their already mauled earnings."

Other well-known companies with a reported downside risk to their earnings forecasts include Wesfarmers, Qantas, Virgin Blue, Suncorp, Macquarie Infrastructure Group and Lend Lease. Those at risk of investment write-downs and dividend cuts include Westfield, Washington H Soul Pattinson, Goodman Group, Valad and GPT.

This list has serious implications for the banks. Australia's largest investment bank, Macquarie Group, has warned that the last quarter of 2008 was "exceptionally challenging". It said "unprecedented market conditions" had forced it to report $1.14 billion of write-downs during the second half of 2008, and it expected $400 million of write-downs in the first six months of 2009. The announcement sent Macquarie's share price down to $32.50, about one-third of its level a year ago.

Shares in the second largest investment bank, Babcock and Brown, were suspended after it warned that it would book more than $2.6 billion worth of write-offs, making its assets worth less than its debts. The company had $2.63 billion in assets at June 2008 and is selling off the bulk of them to halve its $3.1 billion in debt.

Babcock's syndicate of 25 banks has until next week to consider whether to keep the company afloat to February. Local banks have an estimated $800 million direct exposure to Babcock, led by Westpac (up to $250 million), CBA ($200 million), ANZ and Suncorp ($125 million each) and NAB ($100 million).

Under the headline, "Real carnage about to start," the *Australian Financial Review* last week reported: "Insolvencies and company administrations have jumped by about a third in the past year, but insolvency experts expect the real carnage will begin for a broad range of businesses early this year."

Australian Securities and Investment Commission figures showed insolvency appointments in October totalled 1,296, up from 1,018 in October 2007, with the number of companies entering external administration jumping from 633 to 847. A liquidator, Colin Nicol of McGrathNicol, told the newspaper that most of the major casualties during 2008 were highly-leveraged, but this year he expected many retailers to start folding after January, together with mining and car component firms, as well as construction companies.