## Australia: Business lending dries up

Alex Messenger 1 August 2009

Despite the many media claims of imminent economic recovery, business lending plunged in Australia during the first half of 2009. There is no doubt that this crash, the product of sharply declining commercial property values and mounting bad debts, will increasingly translate into higher unemployment. A report released this week by the business forecasting firm, Access Economics, indicates that up to 80,000 construction industry jobs will be lost in the next 3 years.

The report directly attributes these losses to a decline in business investment, which is, in turn, dependent on the willingness of the banks to lend. The report says that 35,000 construction industry jobs have been lost in the last year and that the value of non-residential construction industry output will decline by 27 percent in 2009-2010.

The business lending figures released by the Reserve Bank indicate an unambiguous collapse. The expansion in such lending in the year to May 2009 was less than 10 percent of what it was in the year to May 2008. During the first five months of 2009, total business credit (including established loans) fell by \$17 billion or 2.1 percent, with the amount declining every month since February. In other words, the economy is suffering a sustained commercial lending contraction.

According to business consulting firm, Dunn & Bradstreet, that fall has placed more than 150,000 small businesses at risk of failure in the next 12 months. A record 27,000 small businesses have been declared at risk since April alone. The contraction has also resulted in an increase to 57 days as the average time taken for businesses to receive payment from trade creditors (almost double the normal 30-day term). If the availability of stop-gap "invoice credit" supplied by banks deteriorates, the result will be a spiralling decline in business activity. The ANZ, one of four major

Australian banks, last week announced it was closing its invoice credit service.

The drying up of business credit not only suggests sharply rising unemployment in the near term, but points to the underlying fragility of the banking system. While politicians and bankers constantly declare that Australia's banks are rock-solid, if the Rudd Labor government had not in November 2008 guaranteed their borrowings—effectively allowing them to cheaply rent the government's AAA credit rating—the banking system would have collapsed.

That is because a quarter of the funds held by the banks are borrowed from overseas. So effective has the guarantee been that despite the bedlam in international credit markets, Australia's banks have increased their overseas borrowings, accounting for 10 percent of the government guaranteed debt issued globally over the past nine months.

The banks' continuing profits are also a direct product of the guarantee. It has allowed them to borrow cheap internationally and lend dear domestically, in particular to those borrowers, including state governments, which are operating without the federal guarantee and therefore have difficulty accessing funds overseas.

Even with the public prop of the wholesale lending guarantee, the banks are refusing to extend more credit. Having backed their previous lendings with commercial property and other assets that were hugely overvalued, the banks have an over-leveraging problem—namely billions of dollars in commercial loans that are not backed by valuable security.

The banks' efforts to de-leverage their balance sheets—reduce the ratio of debt to assets—necessarily involve a refusal to create more credit. The big four banks, which together hold 86 percent of Australian business debt, are stockpiling reserves because of well-

justified concerns about asset quality.

A strong indicator of the overvaluation of Australian property, and therefore the exposure of the banks, is the 42 percent fall over the past 12 months in shares for listed property trusts. The scale of the revaluation of the \$68 billion held in unlisted property trusts, up until now hidden by the lack of effective disclosure rules, could be even greater.

A JP Morgan survey of institutional superannuation fund investors found that the average respondent expected capital values on prime grade property in unlisted property trusts to fall 25 percent from their December 2007 peak. The expected fall for industrial property was 31 percent. This potentially means a \$17 billion write-down in assets, to which all major institutional investors, including the banks, are exposed.

Leading property group, Centro, last week posted a \$2.6 billion devaluation of its managed property portfolios. Another infrastructure and property company, the Goodman Group, is on the verge of writing down a \$1.3 billion "goodwill" figure linked to its property assets.

Away from the major listed and unlisted funds, the asset-backed lending of the banks will be directly affected by property value declines. According to the *Australian*, publicly available databases indicate that a total of \$200 billion in commercial loans need to be refinanced in the next three years.

Many companies will have difficulty refinancing their borrowings, but regardless of whether or not those companies fold, the banks will "take a bath" on these loans. The \$200 billion figure does not include the banks' private deals. No one, except perhaps the banks themselves, knows what their real exposure is.

How do these critical developments find their way economic mainstream commentary? into daily Practically, not at all. The suggestion that there will be a quick recovery serves a critical function for the financial and political elite. If the economy can be "recovering," then the unemployment labelled rate—which all economists agree will rise well above the current official figure of 5.8 percent—can be explained as a "lagging" factor in an otherwise improving economic situation.



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