# Australian companies write down $47 billion

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Australia's publicly listed companies have been forced to slice $47 billion from their balance sheets for the 12 months to 30 June, a devaluation that has helped drive down profits for listed companies by 21.5 percent over the same period. The $47 billion figure does not include devaluations in the unlisted property trust sector. These are expected to top $17 billion.

The astonishing $47 billion list of write-downs, which is dominated by mining companies and by property and infrastructure trusts, indicates an economy swamped by unsecured debt. (Companies had already effected write-offs of $16 billion for the previous financial year). More significantly, it indicates the end of what has been, for the past quarter century, a key driver of Australian economic growth—the parcelling-out to the financial and corporate elite of overseas borrowings backed by ballooning asset prices. All that sustains the flow of money at present is a government guarantee on overseas bank borrowings, put in place in November 2008, when the threat of global financial collapse was at its sharpest.

The largest write-down in the 2008-2009 list was by miner BHP-Billiton, which posted $5.8 billion in devaluations, $2.5 billion of which is attributable to the closure of its nickel mine in Ravensthorpe, Western Australia. Property company GPT made write-downs of $3.25 billion, financial services company Babcock and Brown posted a $1.43 billion devaluation, while Westfield, the world's largest shopping mall owner, wrote down nearly $3 billion in assets. The end of debt-fuelled household consumption in the US makes Westfield's position precarious, more so because its boom-time building program was underpinned by huge borrowings. There are expectations of similar retail write-downs during the balance of 2009.

However, this historic collapse in asset values, unprecedented for its size and speed, has not yet shaken the confidence of share market investors. In fact, the flood of red ink over the past six months (companies have been progressively leaking their write-downs since February in order to soften investors up) has coincided with a 30 percent increase in the price of Australian stocks. Over the course of August, the traditional corporate reporting month, the share market climbed 5 percent. By 31 August, most of the major banks, as well as Macquarie Group, had hit 52-week highs. Macquarie has declared annual write-downs of $2.7 billion.

These developments, based on earnings projections best described as optimistic, are of concern to some analysts. According to Atul Lele, an equities strategist with Credit Suisse, "the market has run quite fast and priced in a lot of forward earnings quite quickly. That's fine in an environment with a high degree of certainty, but we don't have a high degree of certainty at this point."

So what are the reasons for this 'disconnect' between share prices and the decline in corporate wealth and profit?

Firstly, not only was the expectation of asset devaluations and a collapse in profits already built in to share prices by the crash of 2008, but the market's worst short-term fears have not been realised, at least not in Australia.

A key reason for this is the federal Labor government's $42 billion stimulus package. That package, proclaimed and passed into law in March, has worked, at least for a short period, as a modest safety net for economic activity, especially in the construction and retail sectors. This is not merely because of the stimulus spending itself, but also because of further expected expenditure during the remainder of 2009, especially in school construction. But the stimulus will begin to wind down within 6 months. In fact, the longer-term prognosis for the construction industry, a sector directly affected by the collapse in commercial property and infrastructure values, is bleak. A report released by business forecasting firm Access Economics last month estimates that 80,000 construction industry jobs will disappear in the next 3 years.

Secondly, the market has reacted positively to the efforts of companies to stem the profit collapse through a remorseless reduction in labour costs. According to Glen Hart, an analyst from Aviva Investors, investors were pleased with the reporting season because "earnings had come in ahead of expectations… A lot of that was the result of severe cost cutting, which was more than the market thought was likely or even possible."

The cost-cutting is not only taking the form of sackings but, just as critically, cuts to pay and hours. In July alone, a loss of 16,000 full-time positions was "offset" by an increase in 48,000 part-time jobs. These new jobs can and do include full-time positions reduced to part-time hours. In other words, under the disguise of part-time job creation, business has been able to stem a short-term collapse in profits, keep a lid on the nominal unemployment rate and keep favour with banks and investors by maintaining, superficially, the appearance of long-term profitability. The ability of corporations to rapidly slash labour costs has rested directly on the collaboration of Labor governments and the trade unions which have, to date, largely suppressed the opposition of workers.

Thirdly, share market investors are influenced by the incantations of the country's leading economic commentators, many of whom now declare, in the face of staggering write-downs and rising underemployment, that Australia's recession is over. These statements have behind them a desire to keep investment flowing and confidence high. The form they take is a distinctive Australian nationalism: the notion of an island state insulated from global economic turmoil.

Writing on the last day of the reporting season, high profile commentator Alan Kohler told investors "the Japanese election result is a distant blast reminding us that there are big things going on elsewhere. But down under, its business as usual… In Australia interest rates will rise again soon: if not tomorrow then certainly before Christmas, signalling an official end to the crisis… if it can even be called a crisis…. [E]ven in a world that is recovering, Australia is an island. This is almost entirely due to two significant shortages: of houses in Australia and commodities in China, as its economy roars out of a brief downturn turbo-charged by bank lending."

"What's more," Kohler goes on, "there seems to be almost no lasting damage to the Australian economy, apart from the federal budget. And despite warnings from an increasingly desperate [opposition Liberal Party] even that is not particularly serious."

David Uren, economics correspondent for the Murdoch-owned *Australian* newspaper, wrote on the same day that "it increasingly looks as though the downturn in Australia and Asia was mainly a crisis of confidence. The banks are intact, unemployment has not risen markedly and housing markets are firm. Confidence has recovered."

Statements like these, also mouthed by Labor politicians and bureaucrats and recycled back through the media, might well have a short-term calming effect on investors. But each statement is either manifestly false or reveals only a sliver of the real picture. Contrary to Kohler, a housing shortage cannot, without investment, create employment or growth. On the question of China's "turbo-charged" state-sponsored lending, like the huge stimulus packages of other countries including Australia, it is not sustainable in the long term. Finally, and contrary to Uren, the banks are only "intact" because of the government lending guarantee. Without it they would be scrambling for the overseas borrowings that make up about 25 percent of their funding.

Growth in the Australian economy depends on two factors: the sustainability of exports to North East Asia and the importation of vast amounts of foreign capital. Under conditions where credit markets remain dysfunctional and where an estimated $US2.5 trillion in toxic assets remains at large across the globe, the ability to borrow is already compromised. The $47 billion annual asset write-down provides a sharp indication that the strategy of funding corporate wealth by betting on property asset growth is no longer viable.