Australia’s “rock solid” banks: the financial crisis one year on

Alex Messenger
11 November 2009

That Australia’s banks have not only survived but made enormous profits in the first year of the global recession might, on the surface, indicate that they are exceptionally robust. That view certainly dominates in the Australian corporate press and the Reserve Bank.

According to Michael Stutchbury, economics editor for Rupert Murdoch’s *Australian* newspaper, “the banks have been the first line of defence against the global financial crisis” and Australia “has one of the world’s most resilient and effectively supervised financial sectors.” In a similar vein, Ross Gittins, writing for the *Sydney Morning Herald*, claims that “one of our greatest strengths compared with the Americans, British and other Europeans is that although some of our lesser financial institutions have failed, our banks have been rock solid.” Gittins alleges that strong regulation stopped Australian banks from getting too involved in the so-called toxic asset trade in the lead up to the 2008 crash. He praises the country’s financial overseer, the Australian Prudential Regulation Authority, for making sure that local banks, in contrast to their overseas counterparts, keep their capital reserves relatively high in relation to their debts.

Commentary like this is not just superficial. It represents a conscious re-writing of recent history and a falsification of the banks’ real position. One year on from the crash, the financial elite is keen to hide the distinctive weaknesses of the Australian financial sector and of the Australian economy more broadly. It is desperate to promote the idea that national regulation is an effective prophylactic against global financial shocks. Most importantly, the various financial commentators try to obscure the role that the Rudd Labor government’s ‘wholesale lending guarantee’ has played in saving Australia’s four major retail banks and extending the reach of their oligopoly.

The role of the wholesale lending guarantee

The Labor government passed its so-called ‘wholesale lending guarantee’ into law in November 2008, assisted by an apparent pact of silence on the part of the finance sector and the media. The lack of reporting belied the enormity of what was happening. For a small fee, government would now guarantee all of the banks’ overseas borrowings, including the rollover of hundreds of billions in existing debt. This was not just a case of government lending the banks a helping hand in hard times. Rather, Australia’s four big domestic banks had told the government in October, as the world went into financial meltdown, that without its backing, they would collapse.

How did the Australian banks come to be effectively insolvent (i.e., bankrupt) by October 2008? After all, it is certainly true that they had been far less involved in the global securitisation trade than most other major banks in OECD countries. They were far less exposed to the world of toxic debt.

In truth, Australian banks were no less vulnerable to the events of 2008. They were not reliant on the trading of worthless assets to make their profits, but they did depend—and this has always been the case for Australian banks—on the constant inflow of overseas capital. Nearly 50 percent of their capital is made up of offshore borrowings. When the taps were suddenly turned off after the collapse of Lehman Brothers in October 2008, the banks were in as much trouble as if their assets had been valued at zero.

The nature of the insolvency risk is discussed by Ross Garnaut and David Llewllyn in their book, *The Great Crash of 2008*. Garnaut, a senior economist and government advisor, and Llewellyn point out that some of the banks’ overseas debt was already due in October 2008 and they had no means of refinancing it. Bankruptcy was therefore instantaneous. “There are no degrees of insolvency,” the authors point out. “A firm is just as insolvent if it is not able to meet its financial obligations as they fall due because it cannot roll over debt, as it is if the value of the assets in its balance sheet is deeply impaired. The difference is that the problem on the liability side is much more easily (and in most cases cheaply) repaired by a guarantee than the problem on the asset side [which requires actual bailout money]. The sudden risk of insolvency in Australian banking was simply a more tractable problem than those experienced by other Anglosphere nations.”

One year on, there is no real prospect of the banks coming off life support. The wholesale lending guarantee remains in place, not only because of the insolvency risk, but because the guarantee is a cheap money bonanza. Australian banks are relatively small institutions in global terms, but their guaranteed borrowings make up 10 percent of the total publicly-guaranteed debt that has been issued globally in the past 12 months.

The two largest government-guaranteed bank bond sales so far (a combined $7 billion raised in New York by the Commonwealth and Westpac Banks) occurred in the last six weeks. In these circumstances, the public has a right to be skeptical of the banks' assurances that they will be giving up the guarantee any day now. "There's certainly a growing acceptance of non-guaranteed product offshore," said Commonwealth Bank's treasurer, Lyn Cobley, last month. "All of [the banks] are very focused on moving away from the guarantee, *in due course*."

The banks, via their PR vehicle, the Australian Bankers Association, claim to be outraged by Garnaut and Llewllyn's observation that they were insolvent by October 2008. Their denials, however, do not involve opening their balance sheets for scrutiny. Rather, the banks say that the insolvency allegation "is contradicted by a lot of evidence", including that they "were able to maintain credit growth [throughout the crisis] including lending to small business". That claim is a demonstrable lie. Reserve Bank statistics are unequivocal in showing that business lending declined by $17 billion in the first half of 2009.

"Moderate" capitalism and regulation

According to the financial sector and its media cheersquad, not only are Australian banks unusually healthy, but that health is the product of distinctively strong capital reserve rules that prevented wild investment in securitised assets and other toxic debt packages.

Behind these claims is the proposition that strong and sensible rule-making will protect ordinary people from the forms of financialisation that brought the world banking system to its knees. On this view, and consistent with prime minister Kevin Rudd's attack on US-style '*extreme*' capitalism, Australia is a beacon of *moderate* capitalism. The Australian example has a global significance in this respect, supposedly demonstrating what can be achieved through sound regulation and restraint.

These claims are just ideological gloss. Firstly, and as Garnaut and Llewllyn point out, the fact that Australian banks were not greatly or directly exposed to exotic financial instruments at the moment the system crashed, was no more than an accident of timing: "the major difference between Australia and the US is that we were four years behind". Moreover, there were no specific rules that would have prevented, or now prevent, the growth of securitisation and other fancy debt instruments—developments that Garnaut and Llewllyn call 'shadow banking'.

Secondly, there is nothing moderate or restrained about the mode of accumulation employed by Australian banks, that is, the unrestricted and unregulated import of hundreds of billions of dollars from overseas for the purposes of ploughing that money into the domestic property market, especially into housing, creating a huge housing bubble and even bigger profits. As the banks' sudden 2008 insolvency demonstrates, that business model is as dangerous, both for the banks and the economy more broadly, as any on the globe.

The Australian banks' recent experience underscores the fact that no national economy can be "protected" from the ravages of the global capitalist financial system. Those who agitate for a national 'delinking' are hopeless utopians under conditions of an integrated world system of production and distribution.

In the case of Australia, the country's attractiveness to capital markets is dependent on perceptions about the prices it will fetch for its commodities. This depends, in turn, on the uncertain future of Chinese growth, not the alleged sobriety of Australian bank regulation. When global commodity markets turn and the money dries up, as it did in the depressions of the 1890s and 1930s, Australian banks collapse practically without pause. The difference in 2008 was that Rudd Labor intervened to save—at least temporarily—these lions of private enterprise.