

Australian economy at risk as Asian bubble reaches bursting point

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11 March 2011

In a deliberate rebuff to the Gillard Labor government's claims of long-term "robust growth", a leading economist and Reserve Bank board member has warned that the inevitable bursting of Asia's "hot dollar" bubble will drag the Australian economy into a crisis far worse than anything it has experienced since the onset of the global financial crisis in 2008.

Warwick McKibbin, the Reserve Bank board's only academic economist, told reporters that when Asia's property bubble collapses, Australia's terms of trade (an index currently reflecting the high price of Australian mineral exports) will go into reverse, threatening recession and the dramatic fall of asset prices, including housing. His comments coincided with a report showing that Australian house prices are the most overvalued in the world, with a price/rental ratio 56 percent above the long term average.

Despite these warnings, the Labor government continues to argue that Australia remains an exceptional global case, showing strong headline rates for GDP growth, and thus the growing social crisis, and the economy's deep inherent contradictions, can be comfortably ignored. The day after McKibbin's comments, Treasurer Wayne Swan, announced that according to the just-released GDP figures, the economy grew at 0.9 percent in the three months to the end of December, its fastest pace since the 2007 March quarter and 2.7 percent in the year to December. "These national accounts represent a very solid outcome for the economy, for an economy which is the envy of the developed world," Mr Swan declared. It has been widely reported that Labor will not be reappointing McKibbin, whose term on the Reserve Bank board is due to expire.

Near-zero official interest rates in the US and Europe

and the US Federal Reserve's policy of "quantitative easing" are flooding the globe with cheap US dollars, pushing up global inflation in the mining, energy and food sectors and creating a stock market, property and construction bubble, especially in China. These developments have provided a steroid-like boost to world resource prices, particularly iron ore, a commodity for which Australia is the highest exporter. About 70 percent of China's steel consumption (for which iron ore is the main component) is in the construction industry. Iron ore prices have risen 85 percent in the last year, while the price of wheat is up 81 percent and cotton 165 percent.

Australia's terms of trade are the highest in more than a century. According to McKibbin, however, as much as 40 percent of their surge can be traced to US and European monetary policies. "This is why inflation is taking off all over the world," McKibbin told the *Australian* newspaper. McKibbin also said the current increase in global liquidity dwarfed the expansion of liquidity and credit that preceded the onset of the GFC in 2007. "This cycle is even bigger," he said. "We are seeing 2004 to 2007 or 2001 to 2007 all over again, but mixed with what we observed after the financing of the Vietnam War in the late '60s and early '70s when very loose monetary policy in the US through the dollar standard translated into global inflation which took more than a decade to get under control." The 'stagflation' crisis of the early 1970s, to which McKibbin refers, created the conditions for a social crisis that led to mass political upheavals across the globe, including in Australia and Europe.

McKibbin also pointed out earlier this month that when Australia's terms of trade fell, the dollar would fall sharply and interest rates would sharply rise. "As interest rates go up, a whole bunch of assets and balance sheets will get crunched, so I am not optimistic."

Foremost among the assets at risk is housing. With a population of 22 million, the value of Australia's housing stock is \$3 trillion, making it a central component of the economy. The cost of servicing debt on overpriced houses is crippling for families, with the proportion of income required to meet loan repayments increasing by 5.8 percent to 34.8 percent in the past year. A study published this week and commissioned by the second-tier mortgage lender, Bankwest, concluded that more than 80 percent of Australian municipalities had average house prices that were well outside the affordability of police, teachers, nurses, fire fighters and ambulance officers, most of whom earn more than the median wage. About 75 percent of municipalities in Australia's capital cities, where most Australians live, were too expensive for this group.

Sharply rising unemployment or inflation—precisely the effects that McKibbin predicts from the bursting of the Asian bubble—would make mortgage repayments impossible for large numbers of households, making default inevitable and sending house prices down. According to a Morgan Stanley global strategist, Gerald Minack, “the fact that [Australia has] very expensive property makes [it] very vulnerable to any sort of economic shock.”

Neither the latest GDP figures nor the other indices and assessments that will be released over the coming weeks, will alter the Labor government's dominant policy goal, which is to make massive cuts to federal spending in the May budget. That policy not only reflects the core political demand of big business—after all, budget cuts are a preparation for further reductions in the corporate tax rate—but also a growing disquiet about the likely speed and ferocity of inflation growth in the coming period. McKibbin himself has warned that the only way to fight the roaring inflation that will flow from a turn in the terms of trade, is to generate large budget surpluses as quickly as possible. McKibbin also calls for the further deregulation of the Australian labour market.

Labor is already on the case. It has seized on the cost of Queensland's flood relief to justify cuts to roads, clean energy investment and education programs. In February, responding unquestioningly to big business demands, Prime Minister Julia Gillard announced that welfare “reform” would be the May budget's centrepiece. This will involve punitive attacks on recipients of

unemployment benefits and disability support pensions, as well as on the 800,000 or so working age people who do not receive any benefits because they have simply given up looking for work. Gillard said last month that she wanted to ensure that the incentives of working outweighed the “attractions” of receiving welfare—code for taking steps that would make it impossible to live on welfare at all. The so-called attractions of welfare amount to \$230 per week for a single person. The average weekly rent for a house in Sydney, Australia's largest capital city, is \$450 per week. The average cost of an apartment is \$410 per week.

On the health front, the states and the federal Labor government signed a package of so-called ‘reforms’ in February, which will effectively end block funding for state hospitals and make funding dependent on meeting efficiency (cost-cutting) benchmarks. These changes mirror market-based counter-reforms in the school system, in every instance pushed through with the close assistance of the trade unions.

At every level, the Labor government, conscious of the risk of a massive economic downturn, is preparing for an assault on the social standing of the working class. Swan and Gillard may be unhappy that McKibbin has so publicly ‘let the cat out of the bag’ regarding the real contradictions in the Australian economy, but on the question of how the government should deal with the impending crisis, big business, Labor and its various advisers are of one voice: fiscal and labour market “adjustment” must be implemented through ever-deeper cuts to wages, jobs and living standards.



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