Australian treasurer warns of global economic “contagion”

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For more than two years, the Australian Labor government has claimed that the national economy had escaped relatively unscathed from the global financial crisis. Australia, it insisted, had proved to be an exception to the worst economic meltdown since the 1930s.

Just two months ago, in handing down the 2011-12 budget, Treasurer Wayne Swan asserted that a China-driven mining investment boom could be converted into an “opportunity boom” for the entire population—provided that working people accepted multi-billion public spending cuts and other austerity measures in the meantime.

Last Wednesday, delivering a ministerial statement on the global economy, Swan was forced to make something of a shift. He warned parliament that the escalating sovereign debt crisis in Europe, combined with the continuing depressed conditions in the US and the earthquake-related hit to the Japanese economy, had created a significant risk of financial “contagion” and “of course we are not immune from global uncertainty.”

“Most significantly, we have seen debt problems confronting a number of European economies—especially Greece,” Swan said. “[W]e should not underestimate the challenges ahead,” he added, noting that Moody’s had just cut Portugal’s credit rating by four notches to below investment grade.

“The potential for contagion is significant, particularly in the event of a disorderly default or an unravelling of assistance,” Swan said. “With banks in Europe and the US holding significant amounts of European government debt, such contagion could generate renewed financial market turmoil globally.”

There was a glaring contradiction in Swan’s speech. Despite “continued sluggish growth and challenges in addressing fiscal sustainability” in Europe, the US and Japan, the treasurer insisted that because of strong growth in China and India, “the outlook for our own region remains bright.”

Swan spoke of an “Asian Century,” of which the mining boom in Australia was merely the first manifestation. The “shift in global gravity” from West to East was driving “an unprecedented pipeline of business investment.”

Swan did not explain how China and India could power ahead, when their primary markets lie in the US, Europe and Japan. The treasurer did not refer to the increasing signs of inflation and slowdown in China, produced by the country’s soaring public debt levels. Nor did he mention the extraordinary vulnerability of Australian capitalism, produced by its economic dependence on China.

Swan’s speech followed a grim assessment by outgoing Reserve Bank board member, Professor Warwick McKibbin. He told a business conference late last month that the global economy was facing a “slow motion train wreck” that could make the previous financial crisis of 2008-09 look like a “blip”. The coming crisis could undo the mining boom and bring on inflation of the kind not seen since the 1970s, he said.

McKibbin warned of “unsustainable” government debts in dozens of European countries, as well as the US and Japan. As the US created more dollars to inflate away its debt repayment obligations, countries that were linked to the dollar, including China and India, would suffer severe inflation, leading to far higher interest rates.

Just before Swan’s speech, Reserve Bank governor Glenn Stevens added a further note of warning. Explaining why the central bank had not lifted interest rates this month, despite earlier financial market expectations, Stevens noted that global economic growth had slowed, and that European debt problems had added to uncertainty and volatility in financial markets.

At the same time, Stevens pointed to early signs of a domestic downturn. He said the resumption of coal production in flooded Australian mines after this summer's natural disasters continued to proceed more slowly than initially expected. He foreshadowed a sharp cut in the bank's forecast—issued only two months ago—of 4.25 percent growth in Australian gross domestic product during 2011.

Stevens' about-face came amid a raft of data highlighting the so-called "two-track" character of the Australian economy, with the mining boom flattening sections of business by driving up interest rates and the value of the Australian dollar. Recent statistics and surveys have revealed stagnant retail sales, falling consumer confidence, declining home building and rising corporate insolvencies. According to the Australian Chamber of Commerce and Industry, business confidence has plunged to the lowest level in 13 years.

In his parliamentary address, Swan dismissed these "soft spots" and urged people to remember that "our fundamentals are strong."

One statistic that the government continues to highlight is the relatively low, official unemployment rate that has remained stuck at around 5 percent for months. But *Business Spectator* columnist Robert Gottliebsen drew attention to a far more significant indicator—the number of hours worked, which has fallen over the past six months by as much as it did during the height of the global financial crisis.

There was a near 6 percent drop in hours worked between July-September 2010 and April-May 2011. This equates to millions of workers suffering a cut in their hours and incomes. Gottliebsen noted: "The fall in the number of hours worked has been particularly prevalent in retail and tertiary education—two of the highest labour-employing industries in the country." Far from "strong fundamentals", these are recessionary conditions that will only worsen if and when the Chinese economy begins to slow.

Shortly before Swan delivered his statement, a Chinese envoy delivered Beijing's own warning of the contradictions confronting Australian capitalism. Chinese diplomat Ouyang Cheng told a business forum in Adelaide that Australia had a "dual-speed and patchwork economy" that relied too heavily on China's demand for minerals.

Reading from a prepared speech and making clear his remarks were on behalf of the Chinese embassy, Ouyang demanded a greater opening up of the Australian economy to opportunities for Chinese corporations. He bluntly stated that "long-term cooperation" between the two countries was threatened by policies that discouraged Chinese investment in Australia, especially by Chinese state-owned enterprises.

An *Australian Financial Review* editorial commented that China's unusually frank message came less than a week after the government had trumpeted that two-way trade with China had hit $100 billion—a 23 percent increase in the past year. Beijing's intervention underscored the "uncomfortable consequences of such rapid economic dependence".

Significantly, the editorial concluded by noting that this dependence also tied the Australian economy to the ability of the Beijing regime to prevent the eruption of working class unrest. China had a serious risk of "price instability driving social instability" and "Mr Ouyang has just reminded us that Australia is leveraged to both problems."