# Australian bank warns of fallout from global turmoil as consumer confidence crashes

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A near-record collapse in consumer confidence and the increasing risk of a European sovereign debt default have prompted Australia's second-biggest bank to predict a deepening downturn in the local economy.

Westpac warned last Friday that 2011 and 2012 would be dominated by "falling consumer confidence and global financial turmoil spilling over to business confidence," leading to higher unemployment.

Westpac's grim warning, coming on top of sharp falls in retail sales, further dented the claims that had been made for months by the Gillard government and the media that Australia was shielded from the worldwide financial contagion.

In the minutes of its July 5 policy meeting, released yesterday, the Reserve Bank admitted that its forecast for economic growth of 4.25 percent in 2011 was unlikely to be achieved. "The downside risks associated with a possible adverse European financial shock looked more significant than had been the case a few months ago," the central bank conceded, adding that growth had slowed in China, while domestic consumers remained "cautious".

These official comments downplay the actual situation, both globally and within Australia. Domestically, department store chain David Jones reported an "unprecedented" drop in sales in June and July, triggering an 18 percent plunge in its share price, and sparking a wider rout in retail and media shares. Fears of widespread job losses and reductions in working hours followed. David Jones set the pace by revealing a 10 percent cut in hours for its 9,000 workers, of whom 95 percent are casual or part-time.

The Westpac-Melbourne Institute index of consumer sentiment fell dramatically in July to 92.8, from 101.2 in June, meaning that pessimism outweighed optimism for the first time since 2008-09.

This sharp shift reflects the severe financial stress that many households are already suffering—because of rising living costs, cuts to working hours and higher interest rates, as well as falling home prices. These concerns have been heightened by the Labor government's proposed carbon tax, which will further fuel steep price rises for electricity and other basic necessities.

Confidence among people with mortgages plunged by 16 points, almost double the average for all consumers. Mortgage arrears rates are rising, especially in areas of high unemployment; and house prices dropped 2.7 percent in the first five months of 2011.

Despite Prime Minister Julia Gillard's continuing claims that Australia's economic "fundamentals" remain "sound", there is also a growing public awareness of the depth of the international economic crisis and the savagery of the austerity measures being implemented in Europe and the US.

In a commentary posted on *Business Spectator*, Westpac's chief economist Bill Evans noted that "consumer views on the outlook for their own financial position" had been "sustained at extremely weak levels only recorded on three previous occasions—during the recessions of the early 1980s and early 1990s and in mid 2008."

Westpac's forecast received front-page headlines last weekend, with reports featuring the bank's prediction that the Reserve Bank would be compelled to slash official interest rates by a full percentage point within 12 months. Little coverage was given, however, to the full contents of the Westpac commentary, including its prediction that the official unemployment rate would head from 4.9 percent toward 5.75 percent through 2012, implying the destruction of about 80,000 jobs.

Evans said the initial catalyst for the 1 percent interest rate cut would be "further adverse events in Europe and their knock on effects on global financial markets." He noted: "Sovereign defaults/major restructuring are likely to be the only credible 'solution' for the weakest countries with these events triggering major losses for the European banks… those banks expected to be most exposed are likely to find credit more and more scarce, imposing credit crunches across Europe.”

Westpac’s economist warned that the resulting crisis would feed into a spiral of falling employment and business and consumer confidence in Australia. He made it plain that the local economy would not be sheltered from the storm, even if the predicted multi-billion dollar mining investment boom still eventuated.

Evans pointed out that mining investment represented only about 4 percent of Australian economic activity, just 2 percent of direct employment and perhaps 5 percent of indirect employment, via the construction and services sectors.

While other economists expressed doubts about Evans’ forecast of a 1 percent interest rate cut, he was certainly not alone in sounding an alarm about the potential flow-on impact of the European debt crisis. Morgan Stanley economist Gerard Minack said that if the default danger spread from Greece to Italy and Spain, the Australian financial sector would be “hugely exposed”.

During the 2008-09 meltdown, the Labor government was forced to prop up the local banks with multi-billion dollar borrowing guarantees, because of the drying up of the global credit markets, on which the Australian banks depend heavily for funding. Major European defaults could drag Australian institutions even more directly into the vortex. Latest figures show that while Australian lenders’ exposure to Greece is minimal, they have about $US3.3 billion at stake in Italy and $4.2 billion in Spain.

Chris Richardson from Deloitte Access Economics said weak consumer spending could give way to a more dangerous scenario, if major investors became jittery and delayed some of the $A76 billion that the government is forecasting in business investment this financial year, nearly all of which is in mining.

None of these statements directly referred to the underlying danger: that the Chinese economy, on which the mining investment increasingly relies, could fall victim to the crises affecting its two largest markets as the European woes combine with the US government debt ceiling crisis and the ongoing recession across America.

If China’s growth were to seriously falter, let alone implode, Australia’s so-called “two-track” economy—an investment boom and soaring dollar, which are having devastating side-effects on local manufacturing, tourism and education providers—would rapidly become mired in slump.

Confidence among senior company executives has nosedived, according to the latest Deloitte survey of more than 100 chief financial officers across Australia’s biggest companies. It found that business confidence levels had hit their lowest levels since the series began in the second half of 2009. The net balance of optimists versus pessimists had dropped from 54 percent to 4 percent in three months, with two-thirds warning of above-average levels of economic uncertainty.

A 7 percent fall in sales of business vehicles in the June quarter has added to a string of statistics already pointing to a substantial downturn. The *Australian Financial Review* drew the following picture: “And it’s not just vehicles sales, it’s retail spending, housing job vacancies, employment, consumer confidence, business confidence--just about every indicator is tracking below a pace that is consistent with the ‘strong rebound’ consensus that dominated only a month or so ago.”

Attempts have been made, by the Reserve Bank and others, to attribute the contraction simply to consumer “caution” and a trend toward greater household saving. A survey released by ING Direct bank this week, however, pointed to the serious difficulties already facing many working class families. It found that 20 percent of households had no savings at all.

This hardship is set to worsen, as the Labor government moves further to impose on working people the burden of bailing out the banks and business during the 2008-09 crash—a breakdown for which ordinary people bore no responsibility. Amid the mounting evidence of downturn, which will undercut its tax revenues, the Gillard government is under intensifying pressure from the corporate and media elite to slash social spending in order to meet its pledge to the financial markets to eliminate the budget deficit by next financial year.