Fears of China's "imbalances" add to concerns in Australian corporate elite

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Nervousness and uncertainty about the economy and its future are increasingly taking hold in Australia's financial, media and political establishment, driven by the deepening sovereign debt crises in Europe and the US. Over the past week, fears of global financial contagion have been compounded by warnings of mounting contradictions in the Chinese economy.

Until recently, the almost universal view conveyed by business, media and government representatives was that despite the turmoil engulfing most of the world economy, Australia remained insulated because of the resumption of China's growth after the global financial crisis erupted in 2008. All predictions were based on the prospect of an unprecedented mining boom, anchored by massive coal, iron ore and energy exports to China.

Just two weeks ago, Treasurer Wayne Swan was compelled to make an initial adjustment to the official line, warning parliament that the situations in Europe and the US had created a significant risk of global financial meltdown, from which Australia would not be immune. There remained a glaring incongruity in Swan's speech, however. Despite the depressed conditions in Europe and America—China's largest markets—the treasurer insisted that "the outlook for our own region remains bright."

Even in an economic note posted on the treasurer's web site last Sunday, Swan castigated all those warning of "doom and gloom," pointing to a "strong pipeline" of $365 billion worth of planned mining projects.

Over the past week, nevertheless, there has been a further sharp turn in the corporate and official commentary on the economy, with particular reference to Australia's ever greater exposure to the risks of a financial crisis in China.

Swan's own Treasury department last week acknowledged that the "imbalances" in the Chinese and global economy posed real dangers for Australian capitalism. Treasury released a Working Paper, first published in an academic journal in June, which warned that China's growth had only resumed after the 2008-09 crash on the basis of "one of the world's largest" stimulus packages.

While the Chinese government's vast expansion of spending and credit—estimated at 4 trillion yuan ($US620 billion)—may have rescued China in the short-term from the sharp downturn in its export markets, there were now "challenges in unwinding the effects of the stimulus and addressing structural imbalances." Unless resolved, these processes could "derail growth."

The working paper reviewed the deep tensions between US and Chinese economic policy, noting that the build-up in China's huge foreign reserves was adding to its domestic liquidity. It drew attention to the rise of Chinese inflation to near 6 percent and the growth of local government liabilities and other public debt in China to 60-70 percent of gross domestic product (GDP), as well as the fact that the global financial crisis "is yet to reach its conclusion."

A July 23 column by Michael Stutchbury, economics editor of the *Australian* underlined the message to both Prime Minister Julia Gillard's minority government and the Tony Abbott-led Liberal-National Party opposition: that they had to prepare, via austerity and restructuring measures, for the next "China surprise."

Quoting the Treasury paper, Stutchbury declared that, although Beijing's stimulus measures "saved Australia from the 2009 global recession," there were signs that this outcome was unsustainable. In China itself, "Chinese households are encouraged to speculate in property and, mimicking the tulip-mania of 17th-century Holland, in assets such as tea and garlic."

Globally, the key US-China "imbalances" were "worsening again" as the US Federal Reserve used "quantitative easing" to flood its stalled economy with dollar liquidity, thereby stoking commodity prices and

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threatening to set off a "global inflation shock".

Stutchbury concluded: "The danger for Australia is that … we are becoming more highly geared to an increasingly unstable China boom… we need to prepare for the risk that our next China surprise isn't as fortunate as the one that saved us from the GFC."

These warnings were issued amid further signs that conditions are already worsening for significant sections of Australian business, particularly those being damaged by the mining boom and its flow-on effects, especially the higher price of the Australian dollar.

In its monthly business survey for June, released last week, National Australia Bank—the country's biggest business lender—reported a sharp deterioration in business confidence, with the exception of mining. Confidence levels dropped most significantly in construction (down 21 points to -14).

Conditions in retail fell to "worrying low levels," around those of November 2008, just before the Labor government's initial multi-billion dollar cash handouts to stimulate spending. NAB attributed the erosion in sentiment to the high Australian dollar, "continued cautiousness of households" and concerns about the global outlook.

Underscoring the "two-track" divergence currently dominating the economy as a result of the mining boom, the bank said the gap between the "strong industries" (mining, transport, recreation and finance) and the "weak industries" (retail, manufacturing, construction and wholesale) was "reaching historical highs."

Worse was expected to come. New orders dropped 2 index points to -4, which was 5 points below the long-term average, and the stock index also fell, "implying an expectation of softer demand." NAB predicted gross domestic product growth of just 1.7 percent in 2011.

Although the bank did not say so, such a result would cause a severe blowout in the federal government's budget—which was predicated on GDP growth of 3.25 percent in 2010-11 and 4.0 percent in 2011-12—adding to the pressure from the financial elite for far deeper cuts to social spending than the $22 billion unveiled in the budget.

This week, another major retail chain, the Premier group, announced the axing of 50 stores, adding to the job losses caused by the recent closures of Borders and Angus and Robertson bookstores, curtailed working hours at David Jones and other large stores and a string of further shop closures.

In another indication of nervousness, the *Australian Financial Review* revealed last week that the official banking regulator, the Australian Prudential Regulation Authority (APRA) had called in the chiefs of the major banks to draw up contingency plans to help prevent a financial panic in the event of another global breakdown.

APRA has refused to comment on the closed-door meeting, but industry analysts said the agency was asking the banks to be prepared to liquidate assets in the event of a further major crisis. Despite the official claims that Australian banks are among the soundest in the world, they remain heavily dependent on borrowing from global financial markets.

During the 2008-09 crash, when global credit immediately dried up, the banks were bailed out by a federal government guarantee of their borrowings and deposits, as well as various liquidity injections by the Reserve Bank. Implicit in the APRA intervention is that such a bailout might not be possible again, both because of the larger scale of the sovereign debt crisis and the chance that the commodities boom could end.

CLSA banking analyst Brian Johnson told the Australian Broadcasting Corporation that APRA was "very aware" that the European sovereign debt crisis had demonstrated that financial problems that began in a few countries "end up basically impacting everywhere." Johnson warned that the banks still had structural flaws, "in that they basically borrow money very short-term, they lend it long [term] and they're very reliant on offshore funding."

With increasing intensity, the banks, the Treasury and the media are expressing concern about the precariousness of the Australian economy. Directly and indirectly, they are demanding a shift by the Labor and Liberal leadership to prepare to impose spending cuts and austerity measures just as savage as those already being imposed on the working class across most of Europe and the United States.

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