Australian shares plunge along with Asian, world markets

Patrick O'Connor 9 August 2011

Australian share markets have plunged to two-year lows, down 20 percent from the level reached in April. The massive sell-off—which has triggered fears that the economy will soon go into recession—underscores the acute sensitivity of the Australian markets to shifts in the world economy.

An estimated \$100 billion was wiped off the value of Australian-listed shares last week, and another \$35 billion was lost yesterday. The S&P/ASX200 share index declined by more than 4 percent last Friday and another 2.9 percent yesterday, marking the sharpest two-day fall since Lehman Brothers collapsed in the US in 2008. Today, the plunge was continuing, with more than 3 percent lost by early afternoon.

Among the companies suffering the largest declines were the mining companies and the banks. In five days of trading, BHP Billiton lost 15.6 percent of its listed value, Rio Tinto 18.8 percent, Woodside 15.1 percent, the National Australia Bank 17.2 percent, ANZ 15 percent and Westpac 10.5 percent.

Taken as a whole, the losses wiped out the average gains registered last financial year by the superannuation funds on which millions of working people depend for their retirement.

As on share markets throughout Asia and internationally, trading in Australia has been dominated by fears over the American and European debt crises. Markets in Sydney opened yesterday morning after US government debt had suffered an unprecedented credit downgrade by ratings agency Standard and Poor's. Shares immediately plunged, before regaining ground, only to go down again as soon as the markets in Asia opened and it became clear that the global sell-off was continuing. The decline in the Asian markets also raised fears of declining economic activity in many of Australia's major trading and investment partners—above all China.

The Australian economy narrowly avoided a recession after the 2008 financial crash only because continued Chinese industrial output boosted mineral export earnings. The mining boom, accompanied by record investment in the sector, has been used by the media and Julia Gillard's Labor government to promote the notion of "Australian exceptionalism"—that the national economy is somehow immune or isolated from the capitalist breakdown evident in the US and Europe.

One of most glaring examples of this wishful thinking was a comment entitled "So are we talking ourselves into a recession?" featured on the front page of the *Sydney Morning Herald* on Saturday. Written by Ross Gittins, the article argued that while the Americans and Europeans were rightly worried about their debt crisis, the only danger to the Australian economy was harmful negative talk. "It's a question of whether our increasingly negative perceptions can overwhelm the reality that our economy has a mighty lot going for it," he declared.

International developments, however, are again demonstrating just how deluded is this outlook. World growth forecasts are being rapidly revised downward, and commodity prices, on which the Australian economy is so reliant, are falling in step. The Australian dollar, which is strongly linked to commodity prices, has fallen by around 10 percent since July 27.

Unlike in 2008-2009, there is virtually no prospect of a massive Chinese stimulus spending program to boost demand for Australian exports. "Were China's exports to the West to drop off as sharply as they did then, there would be no way that the government could substitute a commensurate amount of domestic spending," the University of California's Professor Barry Eichengreen told the *Australian Financial Review*. "Chinese growth would fall. The implications [for] other economies that sell parts, components, and, above all, raw materials to China, would not be pretty."

Australia's banks remain extremely vulnerable to another global credit crunch. They are among the most dependent in the world upon continued capital inflows to maintain solvency. Last month the official banking regulator, the Australian Prudential Regulation Authority (APRA), reportedly demanded that the major banks develop contingency plans for liquidating their assets in the event of another 2008-style financial crisis.

This instruction signalled that the emergency measures taken by the government in 2008—guaranteeing borrowings and deposits with public funds—might not be possible again.

The global turmoil has only fuelled fears for the non-mining components in the Australian "two-speed" economy. The retail sector is already in crisis, with consumer spending contracting at the greatest rate for five decades. Manufacturers are continuing to slash output, and industrial workers are suffering further attacks on their wages and jobs. Other non-mining exporters have been hit by the previously rising value of the Australian dollar. Unemployment is expected to significantly increase in the next period, with job ads falling another 0.7 percent last month—the fourth consecutive decline.

Treasurer Wayne Swan has repeatedly attempted to downplay the situation. Asked yesterday about the likelihood of slower growth in China, he replied: "Well, it's a possibility. You can't rule anything out. We are in uncharted waters here." He asserted: "China has the policy flexibility, as it's demonstrated before, to continue to stimulate its domestic growth and of course the region."

The treasurer did not explain the consequences for the Australian economy if Chinese growth were unable to be further stimulated through government spending.

Even without a Chinese slowdown, it is clear that the economic forecasts issued by the Australian Treasury and Reserve Bank will have to be revised substantially downward. Last Friday, the Reserve Bank slashed its 2011 growth forecast from 3.25 percent to 2 percent. The Labor government's predictions of a return to budget surplus by 2012-13—on the basis of \$22 billion in cuts and savings that were detailed in the budget last May—have already been blown out of the water.

Gillard and Swan, however, have stressed that they will not renege on their pledge to the financial markets to deliver the surplus, making clear they will deliver whatever additional cuts to social programs and infrastructure are needed to make up the shortfall. Swan yesterday admitted that the global turmoil "certainly makes it harder" to return the budget to surplus. Asked if that meant "you have to cut harder," he replied, "Well, we'll cross that bridge if we come to it."

The Australian's economics editor Michael Stutchbury noted today that the government's anticipated 2012-13 surplus depended on a near-25 percent increase in tax revenues this year and next. If these revenues grew even slightly slower, at 20 percent, it "would carve \$14 billion off next year's bottom line and leave the budget wallowing in the red"—with equivalent spending cuts required.

If tax revenues were to stagnate in the event of a sharp recession, the deficit would immediately blow out and only a brutal European-style austerity program would balance the budget.

The International Monetary Fund, despite issuing a generally optimistic assessment of the Australian economy in a report on Monday, has urged the government to "stress-test" its budget forecasts for a 30 percent slump in commodity export prices.

Global instability has fuelled the demands of big business and the media for the government to spearhead a major restructuring program, with various "free market" measures aimed at boosting the international competitiveness of Australian capitalism. The *Australian*'s editorial on Saturday—"As world economy teeters, Australia needs to reform"—demanded a "serious productivity agenda," including the promotion of "labour flexibility," i.e., the tearing up of even limited existing workplace conditions and protections.

The ruling elite is continuing its efforts to forge a government capable of delivering a regressive agenda that is opposed by the vast majority of the population. Just as much pressure is being exerted on the opposition Liberal-National coalition to advocate the acceleration of pro-market restructuring, as it is on the minority Labor government to implement it.

The media and corporate Australia has urged the opposition to outline a clear pro-business policy agenda instead of maintaining a near-exclusive focus on its populist campaign against the proposed carbon tax. The *Australian* yesterday declared: "The US's predicament should be a stern warning to the Gillard government and the opposition. Big-spending, waste and irresponsible populism have no place in an increasingly unpredictable world order."



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