

Australian banks sound alarm over euro-zone fallout

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Over the past two weeks, Australian bankers and others in the corporate elite have issued increasingly troubled warnings about the impact of the European debt crisis on the Australian economy, as well as on the country's key markets in China and across Asia.

CEOs from the four major Australian banks have voiced fears that a credit crunch has developed in Europe that could have a greater knock-on effect than the Lehman Brothers collapse that triggered the 2008 global financial meltdown.

Their remarks have further exposed the claims, still promoted by the mainstream media and the federal Labor government, that the Australian banking system is one of the strongest in the world and that the Australian economy will be shielded from any renewed worldwide breakdown by mineral exports to China and other Asian destinations.

ANZ bank chief executive Mike Smith declared last week: "There is a credit crunch in Europe now, it is spreading to Asia and it will spread here too." He said the consequences were potentially more serious than in 2008-09 because European sovereign states no longer had the reserves to bail out their banks and finance houses as they did then.

Smith said his biggest concern was that one of the European countries might offer sovereign guarantees to banks again "because then we have another potential domino effect" if the guarantees could not be honoured, as appeared likely in the current crisis. "This time, there is no confidence that a sovereign guarantee would make any difference and that would only exacerbate the problem."

The Australian banks remain dependent on borrowing from overseas money markets, primarily in Europe, for an estimated 40 percent of their capital needs. The *Australian Financial Review* reported last Friday that

the big four banks and Macquarie Group will need to raise \$140 billion in funding over the next 12 months. In an ominous sign, the Commonwealth Bank of Australia (CBA) was forced to abort a European fundraising issue last week.

These anxieties have been exacerbated by last week's spreading of the European contagion to Germany, previously regarded as the bulwark of the euro-zone. *Business Spectator* commentator Stephen Bartholomeusz described the "unprecedented semi-failure of an auction of German government bonds" as a "very disturbing signal of distress." The attempted sale of €6 billion of 10-year bonds raised only €3.6 billion, the worst outcome for a German bond sale in the history of the euro.

There have been similar statements of foreboding from Westpac bank chief Gail Kelly, outgoing CBA chief Ralph Norris and former ANZ chief John McFarlane. Norris told Fairfax Media that money markets around the world had effectively frozen in the wake of Germany's failure to complete its bond sale. "This has potential to be significantly worse than the Lehman Brothers collapse and the subprime crisis because now we are talking about nation states," he said.

ANZ chief Smith drew attention to another dimension of the problem. Trade finance was also drying up, he said, threatening the provision of the letters of credit (LOCs) that were an essential tool of Australia's trade with China. The last time that China's steel industry struggled to obtain LOCs was in the final quarter of 2008 and it resulted in a collapse in shipments of coal and iron ore.

Far from being a pillar of strength, the major mining companies could be severely affected, as they were in 2008-09. BHP Billiton chief executive Marius Kloppers

told this month's company annual meeting that the uncertain outlook was bringing production cutbacks. "For some of the people we do business with, there has been a tightening in both the availability of trade finance and terms on which it can be accessed," he said.

The big miners also rely on the global credit markets to finance their massive projects. Yesterday, Kloppers told the *Australian* that European bank lending was "dead." His Rio Tinto counterpart, Tom Albanese, warned that some new mining projects would need to be postponed.

Any move to cut expansion plans would seriously impact on the Australian economy, with its growth projections hinging on previous forecasts of a record \$140 billion in capital expenditure across the resources industry within the next period. Mining infrastructure spending has boomed over the past year, but much of the rest of the economy has already slid back into recession, costing tens of thousands of jobs, especially in manufacturing and tourism.

In his *Business Spectator* column, Bartholomeusz pointed to a third point of financial stress—"less obvious and less-discussed" than the bank liquidity and trade finance squeezes. He said there were already signs that Australian companies generally could face difficulty accessing credit next year. "Over the next two years they could have to refinance more than \$80 billion of maturing facilities, about 60 percent of it next year."

Nervousness has intensified with signs of a serious contraction in Chinese manufacturing output. The earliest measure of China's industrial activity, the HSBC flash purchasing managers index (PMI) dropped to 48 in November from 51 in October. A PMI reading of less than 50 indicates contraction. Financial analysts commented that the survey showed that the industrial sector was in a concerted slowdown phase, not merely a "soft patch."

The mounting concerns in corporate circles were last week publicly acknowledged by the Australian central bank. Answering questions following a speech, Reserve Bank of Australia governor Glenn Stevens said the probability of a "severe storm" from Europe was "higher than we would like." Without an urgent European solution, "the damage to us and everyone else will be unacceptable."

Rather than being shielded from the European "storm" by a mining boom, Australian capitalism is peculiarly vulnerable because of its heavy reliance on exports of raw materials to China and other Asian countries that, in turn, depend on selling manufactured products to Europe and the United States. This exposure is now being magnified by the freezing up of the European financial markets and the withdrawal of funding for local projects by the European banks.

Prime Minister Julia Gillard's government is also less able to prop up the banks and construction companies than in 2008-09. The slump affecting much of the non-mining economy, combined with a 15 percent drop in Australian share markets values since the government's May annual budget, has already hit government revenues.

Treasurer Wayne Swan today announced a new round of spending cuts and deferrals to fill a more than \$20 billion budget black hole over the next four years. These cuts will only deepen the domestic slump, as well as destroying the jobs, social services and living standards of working people. Under conditions of global financial turmoil, however, the government is firmly committed to meeting its pledge to the financial markets to produce a budget surplus by next year, thus making the working class pay fully for the 2008-09 bailout.



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