

# Signs of economic reversal in Australia

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Signs are mounting that the Australian economy is at a turning point, as the minerals export boom that has sustained overall growth rates wanes. International commodity prices are falling precipitously under the impact of the sharp slowdown in China, the financial crisis in Europe and the renewed stagnation in major world markets, including the US and Japan.

Australia has officially avoided a recession for the past 21 years, even in the immediate aftermath of the 2008–09 financial crisis. Australian capitalism's historic reliance on revenues from raw materials intensified over these two decades. Minerals and energy resources make up more than half its exports. Iron ore and coal alone account for nearly one-third, valued at some \$100 billion a year.

This performance largely rested on the rapid growth of the Chinese economy since the early 1990s. China has become Australia's single largest export market, accounting for 23 percent of exports, followed by Japan with 16 percent and South Korea with 8 percent. China and the other Asian markets, in turn, depend heavily on manufactured exports to the US and Europe.

Over the past six months it has become increasingly apparent that China has entered a slowdown that could exceed the contraction it suffered in 2008–09. The massive stimulus measures that the Beijing regime used then to rescue the economy have left an unsustainable mountain of debt, making it impossible to resort to such measures on that scale again.

At the same time, new low-cost mines, built since the 2008 crash, are coming on stream in countries like Mongolia, Pakistan, Afghanistan and Mozambique, as the global mining companies and their customers scour the planet for cheaper resources. In coking coal, for example, Mongolia now supplies 45 percent of China's imports, compared with Australia's 23 percent. Only three years ago, Australian mines supplied 65 percent and Mongolia 11 percent.

The combination of falling demand and rising lower-cost supplies has sent commodity prices, especially for iron ore and coal, plummeting from previous record highs. Coking coal, which 12 months ago traded for as much as \$US320 a tonne, now sells for less than \$180. Iron ore spot prices have more than halved over the past year and fell by almost a quarter over the past month alone, taking them below \$US90 a tonne, their lowest level since late 2009.

*Business Spectator* columnist Stephen Bartholomeusz commented this week: "With China's steel mills sitting on (and now depleting) significant inventories and starting to make production cutbacks of their own... the market has shifted from the balance that under-pinned the resource sector's 'super-cycle,' where supply was lagging demand, to one where the market is oversupplied."

The most visible symptom of the collapse of the Australian mining boom has been BHP Billiton's decision last month to defer mine and port expansion plans worth \$40 billion in South Australia and Western Australia (see: "BHP mine delay signals end of Australian mining boom"). That announcement took the total value of Australian mining projects postponed in recent months to more than \$100 billion.

This week, the deferrals intensified when Fortescue Metals, Australia's third largest iron ore producer, became the first company to halt a mine expansion already under construction. It stopped work on part of its Solomon mine project and delayed a total of \$US1.6 billion in construction plans, eliminating about 1,000 jobs. Fortescue cut its near-term expansion target from 155 million tonnes of iron ore per year to 115 million tonnes, citing the slump in prices.

Fortescue's decision, reportedly made under pressure from its lenders, highlighted another feature of the reversal taking place—the acute vulnerability of the mining companies to the continuing turmoil on global

financial markets. As a highly capital-intensive business, mining depends heavily on borrowed funds.

Fortescue, which already had \$10 billion of debt, would have needed to raise another \$1 billion to fund its construction projects even if the iron ore price collapse had not reduced cash flows from its existing operations. The company also faced a \$US2 billion principal repayment in 2015. Just before the announcement, ratings agency Fitch shifted its outlook for Fortescue to “negative,” foreshadowing a possible further downgrade to its BB+ rating, which is already below investment grade.

Australian banks are also vulnerable. US-based consultancy Variant Perception last week warned that falling export prices could generate a funding crisis that would spread to the banking sector. Its report stated that “Australia’s net external debt levels resemble those seen on the European periphery... Australian banks and corporations rely heavily on foreign funding, and structural global deleveraging and stop-go flows add volatility for Australian banks.”

The report noted that the banks relied on external sources for an “extraordinarily high” 40 percent of their funding, with about half in short-term borrowings, increasing the risk of a “funding shock.” Such a crisis was averted in 2008 when the Labor government guaranteed the banks’ overseas borrowings, but the European and global debt crisis has since worsened, raising the possibility of a greater global credit freeze than in 2008.

For the past two decades, Australian governments, state and federal, have also become increasingly reliant on mining-generated revenues, including from royalties and taxes. The drying up of these revenues will have a devastating impact on their budgets and drive demands by the financial markets and corporate elite for savage cuts to social spending.

All the federal Labor government’s budget calculations, including its pledge to the financial markets to return to a surplus this financial year, have been based on continuing high commodity prices and record export volumes. The unravelling of these optimistic forecasts will mean severe cuts to health, education and housing and other essential programs, and hence working class living standards.

The *Australian Financial Review* has pointed to a \$120 billion shortfall in the federal budget over the rest

of the decade, and demanded far deeper reductions in spending. A government expenditure review committee is reportedly preparing a new round of cuts. Ministers will report back with proposals by October, ahead of a mid-year budget review due before December.

State governments, especially in Western Australia and Queensland, which are most dependent on mining revenues, will be no less affected. By one financial analyst’s estimate, the fall in the iron ore price alone will slash West Australian state revenues by nearly \$1 billion this financial year. Over the past year, state governments have already destroyed tens of thousands of public-sector jobs, and axed services in areas such as health care, public transport, schools and technical colleges.

The end of the mining boom will only accelerate the recessionary trends already evident in the rest of the economy. Basic industries such as manufacturing, construction, printing and retail have been severely affected by the global financial crisis and the high value of the Australian dollar, driven up by the mining boom. The result has been an accelerating avalanche of job cuts throughout these sectors.

Federal Treasurer Wayne Swan sought to downplay the about-turn in mining, claiming that \$250 billion of mining investments were still “largely locked in.” But as the BHP and Fortescue announcements demonstrate, these investment plans were made in anticipation of continuing high prices and can be scrapped with little warning on the demands of the financial markets.

Even as he tried to dismiss the implications of the project cancellations, Swan conceded that mining prices had fallen faster than anticipated, and pledged to make whatever further cuts were necessary to deliver a budget surplus. Like governments around the world, the Labor government is intent on imposing the burdens of the economic breakdown on the working class.



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