

Australian financial inquiry warns of insolvency danger

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9 December 2014

Contrary to the carefully cultivated popular myth that Australia's banks constitute a pillar of strength that withstood the post-2008 worldwide breakdown, an official report released last Sunday warns that the country's financial system is acutely vulnerable to another crash.

The Financial System Inquiry report offers a glimpse of the fragility of global capitalism. Even the most supposedly stable economies are increasingly exposed to financial meltdowns that will have devastating consequences. According to the report, a severe bank crisis could cost the Australian economy up to \$2.4 trillion and throw another 900,000 people out of work. This would double the current official jobless rate of 6.2 percent.

The inquiry said the risks confronting the Australian economy are much greater than during the 2008–09 meltdown—during which the banks were propped up by federal government guarantees—due to falling export commodity prices, slowing growth in China, and deepening government budget deficits.

Commissioned by the Abbott government a year ago, the report declares that “the Australian financial system has characteristics that give rise to particular risks, including its high interconnectivity domestically and with the rest of the world, and its dependence on importing capital.”

The inquiry warns that Australia's four major banks, which between them control more than 80 percent of the domestic home lending market, are not in the highest quartile of capital ratios held by banks around the world. Unless required to lift their ratios to “unquestionably strong” standards, they could rapidly lose the confidence of foreign investors, setting off a downward spiral toward insolvency.

According to the report, these dangers are

compounded by the “big four's” dominance of the banking sector. “This concentration, combined with the predominance of similar business models focused on housing lending, exacerbates the risk that a problem at one institution could cause issues for the sector and the financial system as a whole.”

The report is all the more revealing because the inquiry panel consisted of five highly-placed financial and business representatives, led by one of the country's most senior ex-bankers, David Murray. He headed the country's largest bank, the Commonwealth Bank of Australia, for 13 years and then chaired the federal government's Future Fund for six years.

Their report paints a very different picture from the constant claims by successive Australian governments, Labor and Liberal-National alike, and the mass media that the banks saved Australia from the economic and social suffering experienced elsewhere around the world following the global financial crisis (GFC).

As the panel notes, the international funding on which the Australian banks rely dried up abruptly in 2008, creating a liquidity crisis until the then Labor government stepped in to underwrite all their overseas borrowings. The Labor government also went deep into deficit to finance two stimulus packages that particularly propped up the construction sector, on which the banks depend.

“The GFC and the associated economic downturn left the Australian federal and state governments with notable higher net debt, which has yet to peak, despite Australia's less acute experience of the GFC,” the report states. As a result, Australia's AAA credit rating was threatened by rising government debt levels, and any downgrading would, in turn, undercut the banks' own credit ratings.

“Another financial crisis like the GFC could put

Australia's AAA credit rating in jeopardy, with likely knock-on effects for the credit ratings of Australian ADIs [authorised deposit-taking institutions]. This would make it more difficult for banks to access offshore funding markets, and would raise their funding costs."

Given that the major banks only hold raw equity capital of 4-4.5 percent, if asset prices fell by that amount—as they did overseas during the GFC—they would be rendered insolvent, the report warns.

Inquiry chairman Murray amplified these warnings in a speech to a business lunch yesterday, hitting back at complaints by the banks to the very suggestion of lifting their capital ratios. If the global ratings agencies simultaneously downgraded their assessments of the government and bank debts, "the government could be put in quite some spiral to the extent where foreign bondholders become extremely nervous," he said.

"We don't want such a spiral," Murray stated, adding that Australia's debt to gross domestic product ratio of 22 percent could creep toward the 30 percent level that ratings agencies use as a cut-off for AAA ratings.

Murray emphasised that the circumstances that shielded Australia from the GFC "will not recur." He said: "We had very high terms of trade, negligible net government debt, a budget surplus, a triple A credit rating, a record mining investment boom and a major trading partner [China] growing at an annual rate of around 10 percent and able to throw immense resources at a stimulus program that favoured our exports."

Australia's "big four" are currently making record profits, totaling nearly \$30 billion in 2013-14, but this is largely driven by speculative real estate lending, which currently makes up a staggering 95 percent of their loans, fuelling an unsustainable housing market bubble.

The banks are protesting loudly at the inquiry's calls for higher capital ratios, along with bigger internal "mortgage risk" contingencies and a "leverage ratio" to limit the use of borrowers' funds undertake risky investments. However, banking stocks rose yesterday, amid expectations that the government will shy away from the inquiry's recommendations and predictions by some banking analysts that any changes will cost the big banks comparatively little.

This indicates that, despite Murray's dire warnings, the major banks are intent on continuing to pump up

their profits as quickly as possible, come what may. As for the Abbott government, Treasurer Joe Hockey called for further submissions, and delayed any government decisions until mid-2015. In any case, he said, bank capital ratios are a matter for the existing official regulator, the Australian Prudential Regulation Authority.

The mass media quickly buried the report's findings on the fragility of the financial system, focusing instead on several of the inquiry's other recommendations, which include cutting trade union representation on superannuation fund boards, and trimming some bank charges for credit and debit card transactions.

However, the report's alarm about rising government debt levels was seized upon to ramp up the pressure on Prime Minister Tony Abbott's government and the rest of the political establishment to end the impasse over key measures in last May's budget to slash social spending. These measures, such as imposing a \$7 impost to see a doctor, lifting limits on tertiary education fees and denying welfare to young jobless workers, remain stalled in the Senate in the face of widespread popular hostility to them, and to the government.

"Maintaining Australia's AAA sovereign rating requires the now-chronic federal budget deficit to be tamed," yesterday's *Australian Financial Review* editorial reiterated. In other words, the working class must continue to be made to pay for the deepening global economic crisis, not the banks and financial speculators who are responsible for the worsening breakdown.



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