Australian central bank warns of worsening economic outlook

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At its monthly board meeting yesterday, the Reserve Bank of Australia (RBA) left interest rates unchanged at a record low 2.25 percent, but foreshadowed further rate cuts because of deteriorating economic conditions.

Since a 25-basis-point rate cut in February, the RBA has now left rates on hold for two months in a row, after a series of reductions from 4.75 percent in late 2011 in an unsuccessful bid to reverse the deepening economic slump.

In his statement, RBA governor Glenn Stevens said more cuts "may be appropriate over the period ahead" to foster "sustainable growth" in demand. Despite its extremely cautious language, the bank admitted that conditions looked bleak.

"[T]he available information suggests that growth is continuing at a below-trend pace, with overall domestic demand growth quite weak as business capital expenditure falls," the RBA said. "As a result, the unemployment rate has gradually moved higher over the past year."

Despite the lowest interest rates in Australia's post-World War II history, business investment has dried up, on top of a collapse in mining investment. On the official understated figures, unemployment has risen to a 12-year high, with nearly 800,000 people out of work.

Sky-rocketing housing prices, however, fuelled in part by low mortgage interest rates, forced the bank to hold off reducing rates again. The RBA fears exacerbating a huge property bubble, especially in Sydney, the country's main financial centre. "The bank is working with other regulators to assess and contain risks that may arise from the property market," the bank said.

According to RP Data, capital city home prices have soared by 22 percent since January 2013. This has priced an entire generation out of home ownership and sent rents soaring, while also creating the conditions for a housing-driven financial crash.

Mortgage debts have reached previously unheard-of levels in working class areas, so job losses and pay cuts can quickly throw families into severe difficulties. The household debt-to-disposable income ratio hit a new unsustainable peak of 153.8 percent in March, above the pre-2008 crash high of 152.7 percent.

In yesterday's statement, the RBA pointed to a key driver of its lowering of rates. Amid an escalating international currency war, the central bank is trying to push down the value of the Australian dollar to make Australian exports more competitive on global markets. It noted that the Australian dollar had "declined noticeably" against a rising US dollar over the past year, but less so against a basket of currencies.

Hours before the RBA announcement, the shock waves running through the economy as a result of collapsing iron ore prices intensified when Western Australian miner Atlas Iron suspended trading in its shares. Atlas, which employs about 1,000 people, said it would review the company's operations, an indication of mine closures that will eliminate hundreds more jobs.

Atlas is a relatively small iron ore producer but at its peak, in 2011, enjoyed a market capitalisation of almost $4 billion. Its share price has plunged from $4.26 to just 12c, leaving it with a market valuation of just $110 million.

Since late February alone, the global iron ore price has dropped 24 percent to around $US47 a tonne—a quarter of its 2011 peak of nearly $US200 a tonne. Atlas is now losing $11–$14 on each tonne it produces.

Atlas's announcement turned the spotlight back on other prominent miners, including BC Iron, Arrium, Grange Resources and Fortescue Metals Group, Australia's third-largest producer, which is carrying $US9 billion in debt.

The ore price implosion is being driven by two factors—falling Chinese steel production and a ruthless operation by the world's two biggest and lowest-cost producers, BHP Billiton and Rio Tinto, to eliminate their competitors by nearly doubling their output.

Fortescue is among the big two's targets, as is Brazil's giant, Vale. Significantly, so are high-cost Chinese producers. According to estimates by GaveKal Research, Chinese mine output fell 12–16 percent in 2014, but most Chinese firms are hanging on by slashing costs, so the price war will continue.

More fundamentally, Chinese steel production is predicted to decline by 25 percent over the next 15 years. China's economic growth has slowed sharply from around 10 percent to 7 percent, its steel-intensive housing construction is declining and its exports are falling because of ongoing stagnation in its main markets, Europe and America.

Via its two biggest exports—iron ore and coal—Australian capitalism is acutely exposed to the end of China's largely debt- and property-driven boom. Between 2007 and 2014, Chinese annual steel production rose from 489 million tonnes to 823 million, while the rest of the world's output fell from 855 million to 839 million.

Likewise in coal, from 2007 to 2012, Chinese consumption increased from 2.9 billion tonnes to 3.9 billion, whereas the rest of the world's dropped from 4.3 billion to 4.2 billion.

Hopes of corporate Australia's two-decade resources bonanza continuing with the commencement of large-scale liquefied natural gas (LNG) exports have been dashed by the precipitous fall in global oil prices, to which LNG prices are linked.

This has dire implications for the Australian government's developing budget crisis. According to Deloitte Access Economics, every $1 drop in the iron ore price cuts annual tax revenues by $300 million. The price plunge has already added an estimated $4 billion to last December's government forecast of a $40 billion deficit for 2015–16.

Business groups are ramping up their demands for deep cuts to social spending, as well as wage rates and workers' basic conditions, particularly weekend, evening and holiday penalty rates.

The *Australian Financial Review's* editorial yesterday again lashed Prime Minister Tony Abbott's government for abandoning its promises to the financial markets. "Even though the country remains vulnerable to any hiccup in the Chinese economy, the projected return to budget deficit [sic] has been allowed to slip into the never-never," it objected.

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