

Finance houses warn of loss of Australia's AAA credit rating

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In the lead-up to next week's Australian federal budget, representatives of the global financial markets have warned of a sharp worsening of the country's economic position, and ratcheted up their demands for the Abbott government to slash social spending.

A series of statements, highlighted on front pages of the *Australian Financial Review* last week, declared that the nation's triple A credit rating was at risk because of ongoing budget deficits. Any downgrade could, in turn, threaten the ratings of Australia's four major banks.

The Australian economy avoided recession in the 2008–09 financial crisis largely as a result of China's massive stimulus packages and its continuing high demand for minerals. However, it has been hit hard by slowing growth in China, Australia's largest export market. Prices for iron ore have halved over the past year and for coal over the past five years.

Deutsche Bank issued a report, described by the *Australian Financial Review* as “scathing” and “bleak,” which predicted that the country was headed for 15 years of consecutive budget deficits, through to 2023–24. It warned that debt would rise to levels where the AAA credit rating would be cut.

Adam Boyton, Deutsche Bank Australian chief economist, made a thinly veiled condemnation of hints from Prime Minister Tony Abbott that next week's budget might not contain major spending cuts. Boyton said that despite the precipitous fall in export commodity prices, which has slashed an estimated \$238 billion from government revenues over the past 30 months, Australia had a “spending problem” not a “revenue problem.”

Wall Street-based investment bank Goldman Sachs warned that the government was running out of time to contain another \$50 billion blowout in the federal

budget this year. In a note to clients, Goldman Sachs chief economist Tim Toohey said that, within months, global ratings agency Standard & Poor's could place on a “negative outlook” the AAA rating that Australia has held since 2003, during the mining boom.

“A mix of sharply lower commodity prices, weak growth and political impasse have resulted in an unprecedented degree of fiscal slippage over recent years,” he stated. Toohey said the plunge in iron ore prices in recent months alone would slash another \$55 billion off government revenues over the next four years.

Toohey's “political impasse” is a reference to the government's eventual abandonment, because of intense public opposition, of a number of key provisions in last year's budget—such as charges to see doctors, welfare cutoffs, deregulation of higher education fees and the erosion of pension levels.

Former Commonwealth Bank of Australia CEO David Murray amplified the message. He said the budget deterioration, combined with already record low interest rates, made the AAA rating “increasingly vulnerable, with little room to move.” He said any downgrade would also hit the large banks, whose borrowings are effectively underwritten by the federal government, increasing the urgency for them to set aside extra capital to protect themselves against a funding crisis.

Murray, who headed the Abbott government's financial system inquiry, released a report last December insisting that the banks were under-capitalised, and over-dependent on foreign borrowings. The government has yet to respond to his call for banks to be required to hold higher capital reserves, a recommendation that the banks have trenchantly opposed.

The unraveling of the two-decade mining boom has exposed the underlying susceptibility of the Australian economy to the impact of the ongoing global breakdown that began seven years ago. New private capital expenditure—a measure of business investment in production—has dropped more than 7 percent since 2011 and is predicted by the Australian Bureau of Statistics to fall by another 8.6 percent in 2014–15.

In another note to clients last week, Andy Scaman, a London-based portfolio manager at Stratton Street, said it was time to question if Australia's luck had run out. He placed Australia below his firm's cutoff for a "wealthy nation" because net foreign liabilities, in 2011, stood at 81.5 percent of gross domestic product, above the 50 percent threshold that the International Monetary Fund (IMF) regards as marking vulnerability to external crises.

Over the past 15 months, the Reserve Bank of Australia has cut official interest rates to a record low of 2.25 percent in an unsuccessful bid to boost business and consumer spending. It is also trying to lift flagging exports by driving down the value of the Australian dollar. However, this has instead produced a precarious housing price bubble, particularly in the main financial centres, Sydney and Melbourne, with investors pouring funds into real estate speculation rather than productive activity. Median house prices in Sydney have risen 30 percent during the past three years.

The IMF announced that it is sending a team to Australia next month to examine the risks posed by the property speculation and levels of household debt, which now stand at a record 177 percent of household income, one of the highest ratios in the world.

IMF mission chief James Daniels called for a "sensible strategy" to eliminate the budget deficit, combined with "tax reform" and a new drive, like that unleashed by the Hawke and Keating Labor governments in the 1980s and 1990s, to lift productivity. This means further cutbacks to public spending to reduce corporate and high income taxes and a deeper assault on wages and working conditions.

Over the past several weeks, the Abbott government, aided by the media and the Labor Party opposition, has used the barrage of nationalist propaganda surrounding the centenary "celebrations" of Anzac Day, in part to distract attention from the economic and political crisis surrounding the budget.

In February, the deep public hostility to the government triggered a leadership challenge to Abbott within his Liberal Party, which he narrowly survived. The handing down of the May 12 budget will once again point to the government's fragility. Despite slashing spending in last year's budget, particularly by cutting health and education funding to the states by \$80 billion over the next decade, the deficit is still forecast to remain at near-record levels for the foreseeable future.

Treasurer Joe Hockey last week acknowledged the risk to the triple-A credit ranking, saying that failure to restore a surplus would imperil the rating. But the government is under mounting pressure from the corporate elite to impose the full burden of the economic reversal on the working class, or face punishment by the financial markets.



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