Australian banking system vulnerable to global economic shocks

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Remarks made this week by Australian Treasurer Joe Hockey to a press conference raised eyebrows among financial analysts and commentators. Amid turbulence in global stock and currency markets, evidence of slowing growth across Asia and plummeting commodity prices, Hockey asserted: "Whilst the world will have its challenges and it will be ever thus, the Australian economy continues to strengthen…. We have momentum building in the Australian economy, it is not affected by what is happening in either Greece or China."

Hockey's reassertion of the claim of "Australian exceptionalism" is contradicted by statistics, reports and commentary published over recent months. The international and national factors that shored up economic growth in Australia after the 2008 meltdown in global financial markets have been transformed into the very factors that now threaten to plunge the country into severe recession and, potentially, an unprecedented crisis in the banking system.

Chief among these was the development of an investment boom in mining and resource projects and soaring prices for Australian exports of iron ore and coal. These were fuelled, above all, by the impact of the massive state-financed stimulus undertaken in China.

The so-called "mining boom" ended well over a year ago. The furious competitive war for market share by the major resources transnationals, under conditions of slowing economic growth in China, has savaged commodity prices.

The price of iron ore, Australia's largest export, has plummeted from $135 a tonne in January 2014 to as low as $44, and is expected to remain well below $60 in the long-term. The price of coal, the second largest export, has fallen to a 10-year low. The price for LNG (liquid natural gas) has slumped to $64 a barrel from $99 just three months ago.

Resource-related business investment is down 14 percent compared with 12 months ago and is continuing to fall away. Investment plunged 20 percent in 2014–15 in the state of Queensland and is predicted to fall another 13.25 percent in 2015–16.

A number of resource companies face ruin. Hockey's federal government will lose billions more in tax revenue while the state of Western Australia—the centre of iron ore production—has a ballooning budget deficit and sharply rising unemployment.

The investment collapse, however, is not confined to the resource sector. Surveys conducted by the Australian Bureau of Statistics (ABS) predict falls in business investment across the board in the 2015–2016 financial year: mining down as much as 35 percent; manufacturing down 24 percent and services, the largest area of employment, down at least five percent.

Public infrastructure investment, as a result of budget cutting by every tier of government, fell 8 percent in 2014-15 and will continue to decline over the coming years.

The slump in commodity prices, combined with rate interest cuts by the Reserve Bank of Australia (RBA), has caused a slide in the currency. From a high of 110 cents to the US dollar at the peak of the mining boom in 2011, the Australian dollar is gyrating at six-year lows of between 73 cents and 75 cents. It has fallen against the currencies of all its other major trading partners as well.

Despite the currency falling, Australia's monthly trade deficits have blown out to over $2 billion, with the highest ever monthly deficit being recorded in April 2015—over $4.1 billion. The current account deficit increased by 5 percent in the March quarter to $10.741 billion. Australian net foreign debt is approaching $1 trillion.

The currency could go even lower. An assessment this month by Deutsche Bank's chief economist Adam Boynton forecast a fall in the Australian dollar to 65 cents in 2016 and 60 cents in 2017. If the US Federal Reserve begins raising interest rates from their historic lows this year, the fall could take place sooner and more rapidly. This could drastically worsen the international debt position of Australian capitalism and reduce the flow of international capital into the economy.

While there are not precise parallels with Australia, the collapse in the commodity-dependent Brazilian currency to its lowest level in 12 years has forced its central bank to drive interest rates up by 275 basis points since the start of 2015, reaching 13.75 percent in June. At a certain point, the RBA could face similar pressures.

A perfect storm is developing, leading toward a meltdown in the utterly speculative forms of wealth accumulation of the Australian ruling class in shares and real estate and placing a question mark over the banking system.

Australian household debt has reached 130 percent of GDP, which is the highest level on record and the highest in the world. The pressure on the working class to accept minimal wage rises or outright cutbacks has seen wages growth fall to its lowest level since the ABS began keeping records in 1997. Large numbers of people are only able to maintain their mortgages because of low interest rates. Even small upward movements of interest rates, especially under conditions of rising unemployment, could lead to widespread mortgage default and major ramifications.

A controversial June report by two housing economists, Lindsay David and Philip Soos, predicted that the soaring housing prices in Australia's major cities, especially Sydney and Melbourne, had created the conditions for a "bloodbath" once interest rates rose. The report warned that after years of double digit increases in real estate values, Melbourne "is primed to become the epicentre of a legendary housing market crash." David and Soos condemned the banks for lending "colossal sums of private debt to speculators."

Concerns about the housing bubble led the Australian Prudential and Regulation Authority to demand last December the banks limit lending growth to 10 percent and increase their provisions for bad debt. In March, lending soared by 21 percent compared with 12 months earlier as the speculative frenzy continued.

Australia's four major banks and other financial institutions are among the most profitable in the world, overwhelmingly due to the vast amounts they extract in interest from some $1.4 trillion in outstanding home loans. Their "business model" has been to borrow cheaply on global markets and lend at higher rates domestically.

Hockey's bluster about the "Australian economy continues to strengthen" is a reference to the ongoing expansion of a housing bubble which Australian Broadcasting Corporation financial analyst Ian Verrender labelled last month as the "Ponzi scheme that could ruin us."

Verrender noted: "The laughable myth in the aftermath of the financial crisis was that Australian banks sailed through the storm in tip top shape. Nothing could be further from the truth. When the crunch came they couldn't refinance their huge offshore debts. And it was the Rudd government that rode to the rescue, extending the nation's AAA credit rating that allowed them to limb through. In all they borrowed $120 billion… Without that cash, it would not have just been RAMS [a small mortgage lender] that collapsed."

He warned: "Our major banks face serious challenges within the next 12 to 18 months. Having bumped up their reported earnings in the past three years by cutting their provision for bad and doubtful debt to the minimum, any hit to the broader economy will immediately flow through to their bottom lines."

Far from conditions in Australia being "exceptional," the working class faces the same devastating economic future as its counterparts in Greece, across Europe and the United States.