# Moody’s warns Australian government of credit downgrade

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In the days leading up to this week’s recall of parliament, which could result in a rare “double dissolution” election of both houses on July 2, the Australian government was handed two warnings—from the international credit rating agency Moody’s and from Australia’s Reserve Bank—about deteriorating state of the economy.

The alarms underscore the political crisis of the Liberal-National Coalition government, which is under mounting pressure from the corporate elite to implement deeply unpopular austerity measures. It is threatening to call a double dissolution election as a means of breaking the legislative deadlock between the two houses of parliament.

The warnings underscore the reversal hitting Australian capitalism because of the implosion of the two-decade mining boom, which is now being compounded by signs that the other pillar of the economy—a speculative housing bubble—is also collapsing.

Last Thursday, Moody’s warned it could strip Australia of its AAA credit ranking unless stronger action was taken to reduce the growing federal budget deficit and debt levels. Then, last Friday, the Reserve Bank of Australia, the country’s central bank, said a glut of inner-city apartments could end in a property market collapse that would endanger Australia’s financial stability.

Moody’s credit outlook report bluntly voiced the concerns of the financial elite. It criticised the failure of the political establishment to sufficiently cut spending on welfare, education and health, due to electoral calculations. It said this left Treasurer Scott Morrison with almost no choice but to increase taxes in the scheduled May 3 budget if he wanted to preserve the AAA rating.

Moody’s analyst Marie Diron warned: “Limited spending cuts are unlikely to meaningfully advance the government’s aim of balanced finances by 2021, and government debt will likely continue to climb, a credit negative for Australia.”

Although Australia still had a favourable budget position relative to other countries with AAA credit ratings, Moody’s noted Australia’s government debt had trebled to 35.1 percent of gross domestic product (GDP) in 2015 from 11.6 percent of GDP 10 years earlier. “We expect government debt to increase further to around 38 percent of GDP in 2018,” it said.

The agency’s advice cut directly across repeated promises by Morrison not to raise taxes. In response to Moody’s report, he was forced to backtrack, saying there would be “revenue measures” in the May 3 budget.

Prime Minister Malcolm Turnbull attempted to exploit the Moody’s warning to reiterate his recent declaration that the population had to learn to “live within our means”—that is, accept even deeper cuts to public health, education, social services and living standards than those already inflicted by successive Labor and Coalition governments over the past decade.

Labor leader Bill Shorten and shadow treasurer Chris Bowen swiftly pledged to heed the Moody’s message. Bowen said “tough decisions” were needed on both revenue and spending. He said losing the AAA credit rating “would be a blow to confidence, and it would have flow-on effects to the ratings of major corporate entities as well.” Labor has announced a number of tax measures, including a regressive tobacco tax, but provided no detail of its proposed “tough” spending cuts.

Falling tax revenues from mining industries and mining-related construction are quickly deepening the budget deficit. According to the *Australian Financial Review*, the Parliamentary Budget Office has predicted that, even since the Turnbull government's mid-year budget update last December, the deficit over the next four years would blow out by a further $27 billion to $96 billion.

In its latest Financial Stability Review, issued last Friday, the Reserve Bank of Australia (RBA) pointed to increased global risks. It cited problems overtaking "emerging economies," slowing growth in China, weak growth and high levels of "non-performing loans" in Japan and Europe, and an "uncertain" pace of "normalisation" in the United States. As a result, there was "a risk of a disruptive fall in asset prices."

Australian banks and finance houses are acutely vulnerable to a global crash, as they were in 2008, when they were propped up by a guarantee of their borrowings by the then Labor government. That is because they again depend heavily on borrowing funds on the international markets to finance domestic lending, particularly in the housing market—the biggest source of their profits. The RBA noted that "a large global shock could be difficult for overseas policymakers to address, which could have spillover effects on the Australian economy."

However, the RBA's sharpest warning related to the danger of a housing bubble crash. It said an over-supply of new apartments, especially in Sydney, Melbourne and Brisbane, could "weigh on prices and rents," exposing investors and banks to losses.

The RBA devoted a special section of its report to the danger of a withdrawal of Chinese investors from the market. It said the Australian banking system's direct exposure to Chinese property investors and developers "appears to be small"—with Chinese investment estimated at 2–3 percent of the total residential sector. "However, if Chinese demand were to decline significantly, that could weigh on domestic property prices and so lead to losses on the banks' broader property-related exposures."

The housing bubble is far larger than any Chinese contribution, even though Chinese purchases of residential and commercial property more than quadrupled from $5 billion to $24 billion per year between 2013 and 2015, according to official Foreign Investment Review Board (FIRB) statistics.

Since 2011, there has been a fivefold rise in dwelling approvals, as investors sought speculative profits via rising property prices. Many bought apartments "off-the-plan" before completion and may now seek to avoid making settlements on the properties because of falling prices.

Recent data has shown that some apartments in central Melbourne are being resold at less than 30 percent of their off-the-plan price. Nearly 45,000 apartments are due for completion and settlement during 2016 in Sydney, Melbourne and Brisbane, with more than another 50,000 apartments under construction, approved or awaiting approval.

Last Friday saw a telling indication of the financial stress gripping the industry. One of Australia's highest-profile real estate chains, McGrath, called for a trading halt on its shares. It said it was reviewing its "prospectus forecast," having already lost half its value on the stock exchange.

These developments are intensifying the big business demands for Turnbull to deliver what he promised them when he deposed his predecessor Tony Abbott seven months ago—an offensive on social spending and workers' conditions. Last weekend's *Australian Financial Review* highlighted the RBA's warning on its front page and published an editorial declaring: "As Australians prepare for a probable July 2 election, the national debate is failing to come to grips with how much we are living beyond our means."

The editorial demanded that the government break through the "budget gridlock" to achieve "serious spending cuts" and push "hard" on "tax and workplace reform"—that is, more corporate tax cuts and a sharper attack on workers' jobs, wages and working conditions.