Australian banks downgraded as concerns mount over falling property prices

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Australia's four major banks, depicted by the government and the media as among the most secure in the world, are no longer "unquestionably strong," according to a credit rating agency. The reason is their exposure to record levels of household debt and declining real estate values.

In a survey of 100 world banks compiled by S&P Global Ratings, Australian banks last year experienced among the "steepest declines" in their risk adjusted capital, or RAC, pushing them into the bottom half of global rankings. They would need to raise billions of dollars to return to the "unquestionably strong" top quarter of lenders.

This result, reported on the front page of the *Australian Financial Review* on Wednesday, but virtually nowhere else, is another indicator of a potential property and financial crash that would have devastating economic consequences, particularly for millions of ordinary working people who could lose their homes.

Since 2012, soaring house prices, combined with falling real wages, have accelerated the rise in Australia's total household debt to around $2.5 trillion, and around 200 percent of disposable household income—one of the highest ratios in the world. Back in 1991, the ratio was less than 75 percent.

The unsustainable property bubble, while enriching layers of investors, also kept the economy afloat after the collapse of the mining boom six years ago. That collapse itself flowed from the 2008-09 global crash, the impact of which was temporarily delayed by raw material exports to China, boosted by Beijing's massive debt-driven stimulus measures.

Over the past year, however, house prices have begun to fall, threatening to leave many households with mortgage debt greater than the value of their homes. Any rise in interest rates, which the Reserve Bank of Australia has kept at the record low official level of 1.5 percent since August 2016, will have a severe impact on heavily-indebted working class families.

By one estimate, a 5-point rise, taking rates back to the "normal" level before the 2008-09 breakdown, would throw more than two million households into "stress," leaving them without enough income to cover living expenses.

The S&P downgrading could have dire implications during the next global financial meltdown, which is being predicted in ruling class circles. During the last crash, the banks were suddenly endangered because of their dependence on international financial markets, which froze. The Labor government of Kevin Rudd propped up the banks by guaranteeing their loans and deposits.

In late 2014, a financial system inquiry headed by ex-Commonwealth Bank of Australia chief David Murray recommended Australia's banks maintain "unquestionably strong" status. This week, Murray told the *Australian Financial Review* that this was necessary for two reasons: firstly, to ensure that if the government did have to support the banks in a crisis, it would eventually get its money back; and, secondly, to allow the banks to retain the faith of foreign investors in a systemic downturn, given their reliance on international debt capital markets.

The S&P decision reflects its view on the vulnerability of Australian capitalism as a whole, not just the big banks. The agency's RAC ratio is calculated by dividing a bank's total capital by its risk-weighted assets. The risk-weighted assets figure is adjusted based on the prevailing economic risk score of the country in which the bank operates.

Corporate media commentators are warning of a steeper fall in the property market if the current royal commission into the abuses and predatory crimes committed by the banks and other financial companies recommends regulatory changes to curb profiteering lending practices.

Capital Economics chief economist Paul Dales told the media that while house price falls to date have been "small"—2.7 percent nationally over the past year—Australia could be in for a record decline. "At the moment the trajectory is a bit worrying, because the house prices seem to be declining at a faster rate and, in our view at Capital Economics, this will eventually prove to be the largest downturn in Australia's modern history," he warned.

Dales forecast a greater slowdown in the housing market over the next 6 to 12 months.

Some figures in the finance industry have predicted an even more serious implosion. Last month, on the Nine Network's "60 Minutes" program, Martin North from Digital Finance Analytics said that Australia was uniquely vulnerable when it came to an economic crash tied to a property downturn.

North drew attention to the possibility of a crunch, produced by a combination of unmanageable household debt, rising interest rates and renewed global financial turmoil.

"At the worst end of the spectrum, if everything turns against us we could see property prices 40-45 percent down from their peaks, which is a huge deal. There's $1.7 trillion held by the banks in mortgages for owner-occupiers and investors. And that's about 65 percent of their total lending. That's higher than any other country in the Western world by a long way… We've got a debt bomb, we've got a debt crisis and at some point it's going to explode in our face."

That prognosis triggered a flurry of denials throughout the corporate media, insisting it was scare-mongering. But indicators in recent weeks have added to the plausibility of North's warning.

• House prices across the country fell for the 12th straight month in September and this trend is now spreading from the biggest markets, Sydney and Melbourne, which are 6.2 percent and 4.4 percent down from their respective peaks in July and November 2017.

• Sales volumes are declining even faster. Settled sales activity is down 10 percent year-on-year, with Sydney down 18.5 percent and Melbourne down 15.8 percent.

• Financial comparison site Canstar reported that an average homeowner is spending more than one-third of their income on home loan repayments, leaving them in mortgage stress.

• A forward indicator—new dwelling approvals—fell to its lowest level in almost two years in August, led by a 38 percent drop in high-rise apartments from July. This also throws into doubt thousands of construction workers' jobs.

• One unnamed major bank sent to property brokers a blacklist of 6,700 apartment projects, where it would refuse loans to buyers or offer reduced loan to value ratios.

There were also reports in the *Australian Financial Review* of "off the plan" purchasers of apartments having difficulty financing the final settlements on their units, because banks had dropped their valuations of the properties by as much as 25 percent since the sales contracts were signed.

Adding further nervousness is the fact that banks, in their insatiable quest for profits, made approximately $500 billion in interest-only property loans during 2013-16. These loans are due to convert to principal and interest mortgages, with far higher repayments, over the next three years.

Both the Liberal-National government, led by recently-installed Prime Minister Scott Morrison, and the opposition Labor Party, assisted by the media, are trying to bury nearly all mention of this worsening financial and social crisis. They are concerned that it will produce even deeper political disaffection, in addition to multiple evictions and the consequent human misery.