Implications of the global financial crisis for the Australian economy

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There's now no argument that the current global financial crisis is the most serious the world has experienced since the 1930s. The IMF this week upped its estimates of the eventual tally of losses sustained by banks and financial institutions to over US$1,400 billion (that's over A$2 trillion). Already, investors in stockmarkets around the world have lost more than US$23 trillion (that's almost A$36 trillion) since they peaked in late October last year, including almost US$6 trillion (over A$8 trillion) in the past week alone.

A global recession looks increasingly probable, even if by what would now be regarded as a miracle, the world's major governments and leading central banks were able to engineer an end to the financial crisis at their meeting in Washington this weekend. Although developing countries (which these days make up nearly half the world economy) are likely to grow, according to the IMF's new forecasts released this week, by a still-respectable 6% next year, the so-called 'advanced' economies are expected to grow by just 0.5% - their worst performance since 1982.

There's no way that Australia can avoid being adversely affected by these developments. The prices of the commodities that make up more than half our exports are falling. Investors in the Australian sharemarket have lost over A$900bn since our market peaked some 50 weeks ago. Business finance is harder to obtain than it was a year ago, and both businesses and households are understandably more apprehensive about taking on additional debt. Jobs growth is slowing, will slow some more, and unemployment will inevitably rise from its current near 33-year low of just over 4%.

Yet Australia is better placed than most other countries to contend with the deteriorating global economic environment, and although our economy will probably slow by more than forecast in this year's Budget, the chances are that we will not have a recession here.

Australian financial institutions have not engaged in imprudent lending to anything like the extent that their counterparts in America and parts of Europe have done. Nor have they loaded up on securities based on dodgy American mortgages to compensate for a lack of profitable business opportunities at home.

Australian home-buyers have kept up their mortgage repayments to a much greater extent than their counterparts in America or Britain, despite facing much interest rates. As a result Australian banks' loan losses have remained very low by both international and Australian historical standards, and confidence in them has not been shaken in the way that it has been in banks abroad. Nor has the Australian government needed to inject taxpayers' money into them, or put money at risk in order to guarantee their deposits. And Australian house prices are not under pressure from a large volume of distressed sellers, as has been the case in America and more recently European countries like Britain and Spain.

A much larger share of Australia's trade is with countries which will be relatively unaffected by the financial crisis (such as China), than is the case for other Western countries or was the case at the time of the last recession in the early 1990s. Hence, our exports will continue to grow, albeit more slowly and at lower prices than previously expected (although the weaker Australian dollar will help to cushion that).

Australian businesses are, with a handful of exceptions, in much better financial shape going into this downturn than they were ahead of our last recession. They are thus less likely to need to engage in the widespread job-shedding that contributed to our last recession being so painful.

Finally, as the Reserve Bank's bold and decisive move this week demonstrates, Australia has far more capacity than most other countries to use economic policy if needed to sustain economic activity and jobs. If it needs to, the Reserve Bank can cut rates by 1 percentage point six more times. The US Federal Reserve can only do it once. The Europeans were only willing to cut theirs by one-quarter of a percentage point this week, despite being in recession already. And, entering this downturn with a budget surplus and no net public debt, we also have far more scope than most countries to cut taxes or increase government spending if monetary policy proves to be less effective in this environment.

So Australians are right to be concerned about the outlook for the economy and for their investments. I am personally very glad that I am not contemplating retirement in the next couple of years, and I understand the very real worries of those who are. But Australians should also be aware – and our political leaders need to keep reminding us (as they have been) – that Australia is better placed to ride out these challenges than almost any other country in the developed world.