Citizens Electoral Council of Australia

Postal Address: PO Box 376, Coburg Vic 3058
Phone: 1800 636 432 Fax: 03 9354 0166
Home Page: www.cecaust.com.au **Email:** cec@cecaust.com.au

Authorised by R. Barwick, 595 Sydney Road, Coburg, Victoria 3058. Printed by Citizens Media Group Pty Ltd., 595 Sydney Road, Coburg, Victoria 3058.

Independent Political Party

Australia sleepwalking to 'economic Armageddon'

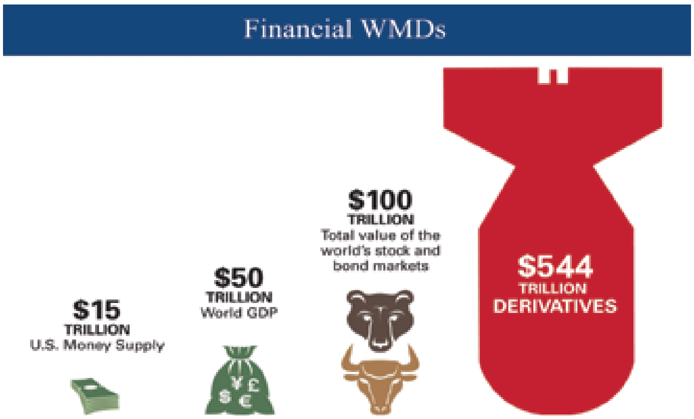
5 April 2017—"Economic Armageddon" blared the headline of news.com.au on 18 February. John Adams, a former economic adviser to the Abbott-Turnbull governments, listed a series of warning signs that Australia is headed for a catastrophe.

The Citizens Electoral Council has for many years sounded the same warning. The difference is, the CEC has put forward the solution.

Here are the signs that Australia is heading into economic Armageddon; the solution is spelled out on page 3.

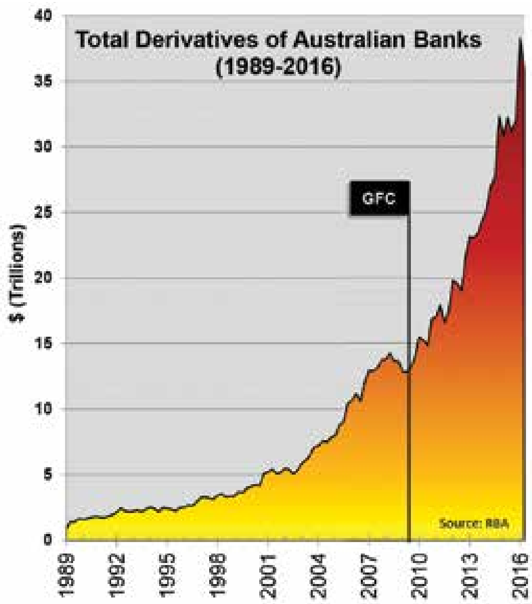
The big one ... Australian derivatives bubble

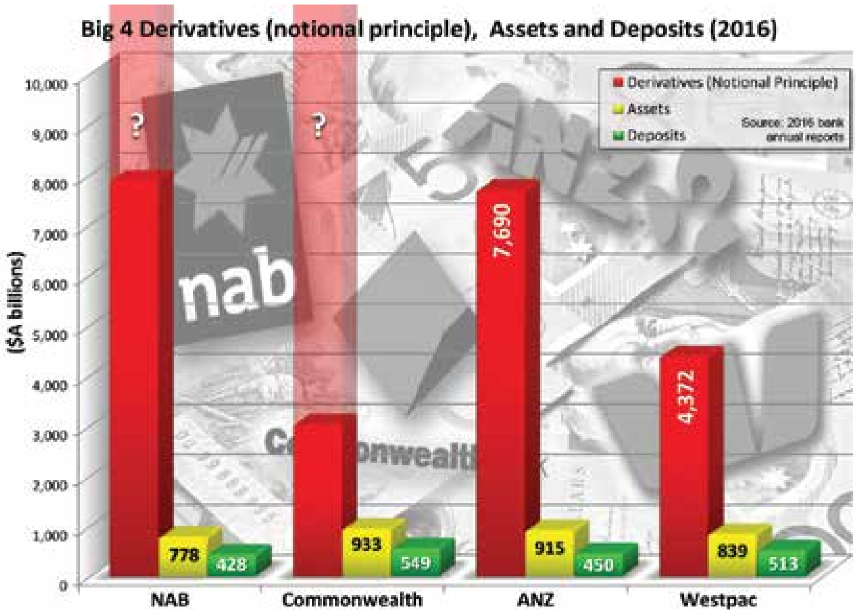
Would you be happy if your bank allowed its traders to take your deposit to the race track and bet on the horses? That's effectively what the banks are doing, but using dangerously complex financial bets called derivatives. Derivatives are bets on interest rates, currency exchange rates, and financial market indexes, and complex combinations thereof. They can generate huge profits, but even bigger losses. Soon after the famous investor Warren Buffett called them "financial weapons of mass destruction", derivatives caused the 2008 meltdown in the global financial system. They remain the greatest threat to the world economy: the Bank for International Settlements measures the value of over-the-counter derivatives worldwide at US$544 trillion—more than seven times world GDP! But financial experts regard this figure as a gross underestimate, and insist the real figure is *US$1.2 quadrillion* ($1,200 trillion)!



Australia's banks are addicted to derivatives. In the eight years since the 2008 crisis, the combined derivatives exposure of Australia's banks has risen 156 per cent. The Reserve Bank measure of "Banks' consolidated group off-balance sheet business" is now *$35 trillion*.

The Big Four banks account for the majority of this derivatives gambling. Their derivatives contracts dwarf their assets and deposits, of which the Big Four hold around 80 per cent of the Australian total. They use deposits to fund their derivatives addiction. Coinciding with the rapid increase in Australian bank derivatives gambling following the 2008 GFC, Australia's two biggest banks suddenly started hiding their full derivatives exposure, CBA in 2012 and NAB in 2016.





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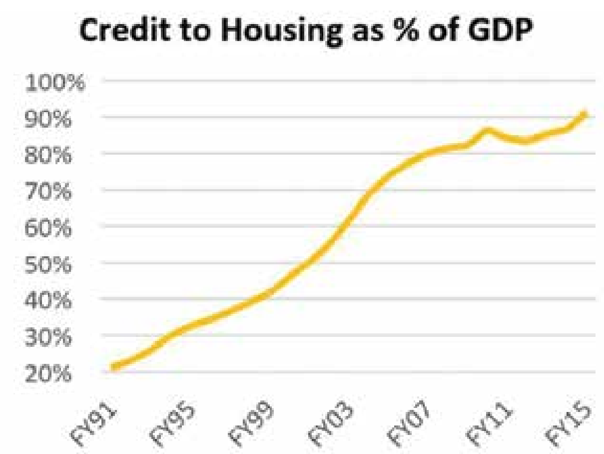
Australian housing bubble

Australian house prices are dangerously unaffordable. They are disconnected from the economy that provides the jobs and pays the wages of the people who buy houses. The housing market is a bubble, and *all bubbles burst*.

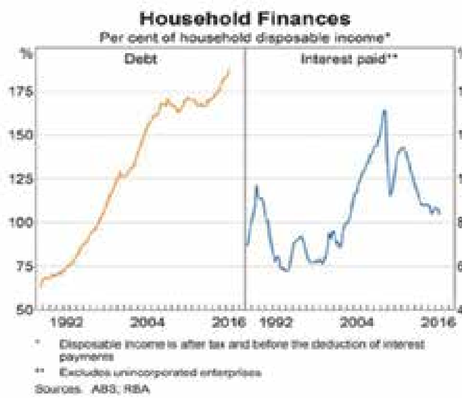
A 22 March 2017 Macro Business report showed that the ratio of the combined value of all Australian housing to the total income of all Australians, is at a record seven and a half times (750%) nationwide; in Melbourne and Sydney it is *much higher*. The current ratio is out of step with the historical average, which until the year 2000 was around three to four times. When other countries have experienced a housing bubble collapse, prices have fallen down to this historical three to four times income range. For Australia, this would mean house prices falling *by half*.

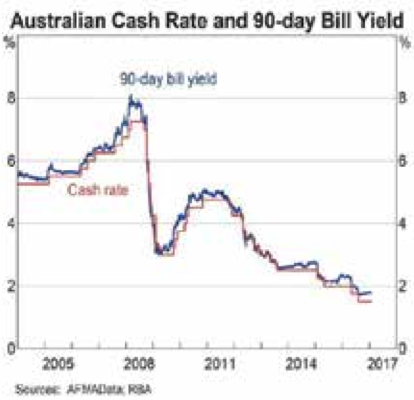
"House prices have decoupled from rents" illustrates how unaffordable housing has become. (Because property investors use negative gearing to partially make up the difference between what they pay on their loans and what they earn in rent, taxpayers are subsidising this bubble with money that should be spent on hospitals, schools and infrastructure.)



"Credit to Housing as % of GDP" shows that bank lending, not supply and demand, is driving up house prices. In June 1991 total bank lending for housing was equivalent to 21.07 per cent of Australia's annual economic output, GDP. By June 2016 banks were lending the equivalent of 95.06 per cent of GDP. Of these loans, 40 per cent were interest only, meaning the borrowers can barely afford them. The CEC has long warned that the bursting of the housing bubble will bankrupt the Big Four banks.

Record Australian debt bubble





Australia's housing bubble has driven up household debt as a proportion of disposable annual income, to a record high of 187 per cent. The only comparable levels of household debt occurred prior to the 1890s and 1930s depressions.

The scariest thing about the record levels of household debt, related to unaffordable house prices, is that *Australia's official interest rates are the lowest on record*. The Reserve Bank cash rate is only 1.5 per cent, and central bank interest rates overseas have been at zero per cent and even negative. These low rates are intended to keep the banking system from crashing and prop up the housing bubble—but this won't last! In fact, interest rates are starting to rise, and as they do they will wipe out Australians who've borrowed large amounts of money.

Australia's net foreign debt has passed *$1 trillion*, equivalent to 63.3 per cent of GDP as of June 2016. Gross foreign debt is double that—$2.13 trillion as of September 2016. This continuously rising foreign debt means our deindustrialised economy is unable to pay its way.

Solution—What Australia must do!

1. Glass-Steagall banking separation

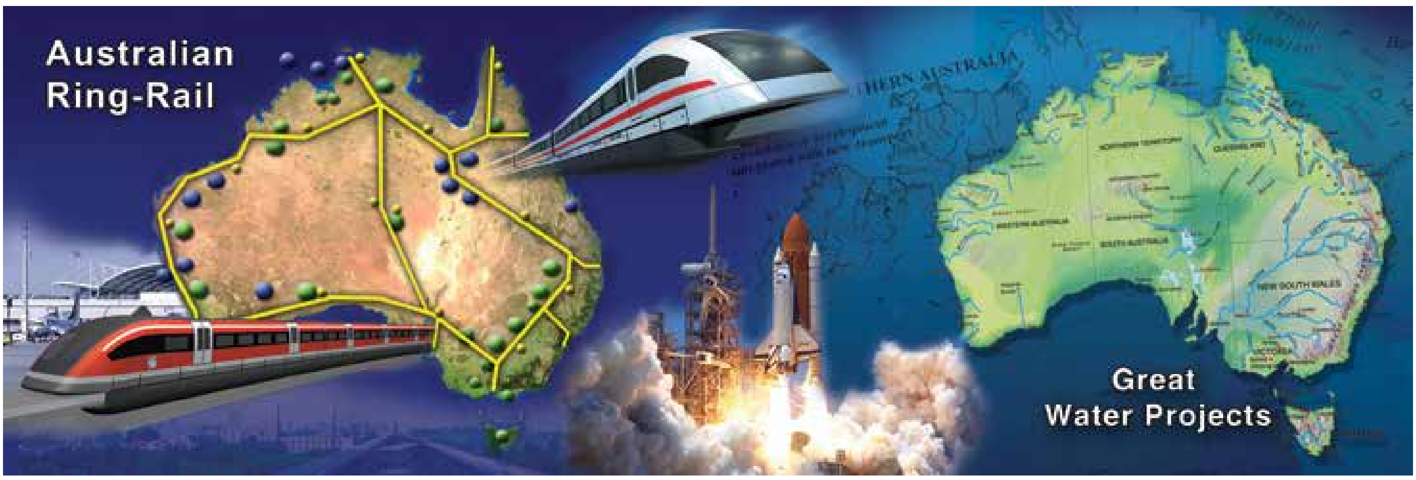
The first step is an emergency measure to protect the real economy from the looming crash caused by wild financial speculation. Glass-Steagall is the name of the American law that separated commercial banks that serve everyday people and ordinary businesses by taking deposits and making loans, from investment banks that speculate in securities. For the 66 years Glass-Steagall was in force, from 1933 to 1999, there were no systemic banking crises in the USA; its repeal enabled banks to become Too Big To Fail (TBTF), and use deposits to massively expand their speculation in dangerous financial bets called derivatives, which in just nine years caused the 2008 crash. Glass-Steagall in Australia will break up the Big Four TBTF banks, which are all addicted to derivatives gambling, so that the banks that Australians use for their everyday business are protected from the crash of the derivatives bubble. As deposits won't be used for speculation, more credit will be available for lending to productive small businesses, farmers etc. in the real economy.

2. A government-owned national bank

Glass-Steagall will stop banks from siphoning credit from the real economy for speculation, but to generate the credit Australia needs to rebuild our economy and productive industries, Australia must establish a national bank. Private banks extend credit for their profit; a government-owned national bank, like the original Commonwealth Bank, issues credit for the nation's profit, especially into long-term investments in infrastructure that shouldn't be based on financial profit. The national bank would also make low-interest loans to productive manufacturing, agriculture and engineering industries which create wealth by value-adding to our resources.

3. Nation-building infrastructure

For the last three decades successive Australian governments have privatised more infrastructure than they have built; consequently the nation has an infrastructure deficit of more than $700 billion. A national bank should fund a program of infrastructure development, to increase Australia's economic productivity and create hundreds of thousands of high-wage jobs. Projects should include: water systems to mitigate droughts and floods; modern railways employing high-speed rail technology, such as magnetic-levitation and vacuum tube (e.g. Hyperloop), both for public transport systems within cities and passenger/freight transport between cities; reliable baseload electricity generators (publicly-owned and operated), utilising Australia's abundant reserves of hydroelectricity, coal and gas, and uranium and thorium.



What *you* can do

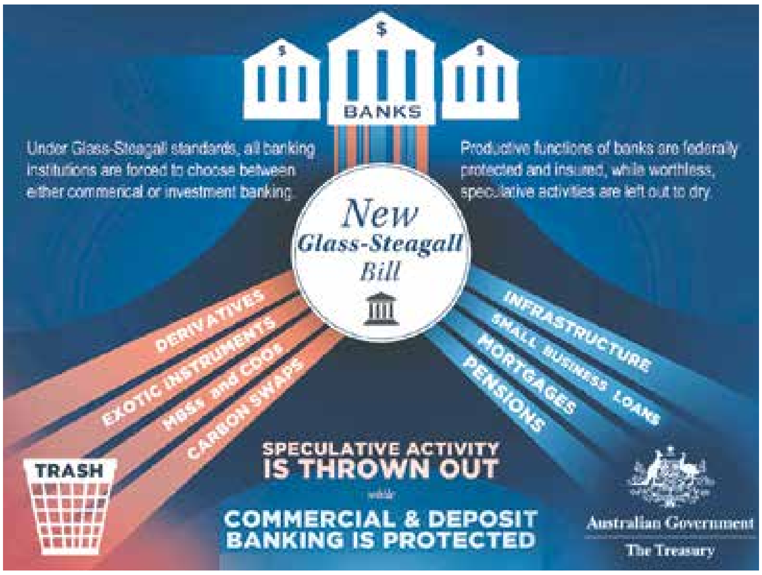
1. Call the CEC on 1800 636 432 and order more of these flyers to circulate

2. Take this flyer to your State and Federal Members of Parliament

3. Sign the online petition for Glass-Steagall at *Change.org*

www.change.org/p/break-up-the-big-banks-now-pass-glass-steagall

How would Australia implement Glass-Steagall?



Implementing Glass-Steagall in Australia would break up the Big Four banks, Macquarie Bank, and any other banks that mix commercial banking with other financial services. To ensure that this is a smooth process, the government would give the banks one or two years to untangle their different banking functions. During this period, the banks would operate under government protection, which would continue for the commercial banks after the separation.

To guard against speculation, and the risk of capital flight, the government would impose capital controls. Unscrupulous bank officials would then be unable to squirrel funds, which rightly belong to the commercial banking side of their operations, outside of the country.

Breaking up Australia's Big Four banks would not be an overly complicated process—except for their derivatives trading. Each bank has commercial, investment, wealth management, insurance and stock broking divisions that are already accounted for separately, which can be spun off into stand-alone businesses that are either sold or floated on the stock market. Untangling the derivatives is another matter. The proportion of derivatives contracts that are underwritten by the deposit base of the commercial side of the bank will have to be "netted out" and cancelled. The investment banking side will only be permitted to retain derivatives contracts that are not associated with the commercial banking side, or do not have other commercial banks as counterparties. There will also be restrictions on derivatives sales to insurance funds and wealth management companies. Blocked from doing derivatives deals with commercial banks, much of the investment banking derivatives speculation bubble will wither and die.

When the separation is complete, commercial banks will be stand-alone businesses that have no contact with investment banks whatsoever—no cross-ownership, no cross-directorships. Commercial banks will only take deposits and make loans: to home buyers, to small and medium businesses, and to farmers. They will not be allowed to engage in securitisation, by which they bundle up their home loans and on-sell them to investment banks. This will stop commercial banks from speculating in the property market, and make more credit available for lending to small businesses and farmers etc. that are the productive base of the economy and provide the majority of the jobs. Presently, without Glass-Steagall, these sectors are being starved of credit while most bank lending is going into the housing bubble.

Investment banks will be left to succeed or fail on their own. People who do business with investment banks will know there will be no possibility of government bailouts, and only invest money they can afford to lose. In turn, this will encourage investment banks away from reckless speculation, as they will need to demonstrate their deals are sound if they are to attract investors.