

DEEPER IN DEBT: AUSTRALIA'S ADDICTION TO BORROWED MONEY

Main Points

This report explains the dynamics of debt accumulation and the statistical evidence that our current borrowing trends cannot go on forever. The author outlines the probable economic consequences of the end of the debt binge, offers advice on how to cope with the debt hangover, and proposes reforms to prevent it happening again.

- » Despite the booms and busts in business and the housing market, since 1964 the ratio of Australia's private debt to GDP has grown by 4.2% every year, and is currently 156% of GDP. This exponential growth can't be sustained indefinitely.
- » The increase in national private debt accounted for more than 16% of GDP last year. This means that our economy currently relies on increased borrowing, rather than on actual income, for a sixth of its total activity. This is a big proportion – and it continues to grow. We can't afford to reduce our borrowing without economic pain – yet we have no choice but to do so if we want to bring debt growth under control.
- » After interest payments, households are poorer now than they were in 2002. Interest on mortgage and personal loan payments is more than negating the income increases in the last five years, leaving households worse off in real terms. (No wonder they don't feel that they've 'never had it so good'!)
- » The so-called 'housing boom' didn't build many houses – or create more homeowners. House prices have more than doubled in the last twenty years, far out-stripping increases in real wages and rental returns. And because debt has risen even faster than house prices, our net equity in our houses has fallen.
- » Rising house prices do not in themselves create wealth. While lucky or well-informed individuals can turn a profit from speculating on the housing market, society as a whole cannot. And we've blown a large chunk of our record borrowings on speculation.
- » A return to the crushing interest payment burden of 1990 (when interest payments were at 17%) is just 18 months away if current trends continue. Cutting interest rates is unlikely to work as well as it did the last time Australia's debt bubble burst.
- » Australia's level of irresponsible lending isn't as high as that which brought on the US subprime crisis, but because our rate of increase in debt is so much higher, the impact of any slowdown will be more severe here – and the pain will be much more widely spread.

Several reforms are suggested to deal with this serious long-term threat to household finances and Australia's economic stability. They include:

- » Better information gathering and a full public inquiry on Australia's household debt, taking in the impact of lending standards, housing affordability, negative gearing and capital gains tax;
- » Regulating lenders, not just deposit-takers. Regulators must uphold the principle that loans should be made based on the capacity to repay, not asset-price speculation;
- » Addressing the lack of public housing and the tenuous position of renters, to reduce the incentives for people to take on loans they can't afford; and
- » In the event of a debt-induced downturn, rethinking current policy approaches to inflation and government deficits.