

## **Steve Keen's DebtWatch No 16 November 15 2007**

### **Election Housing Promises Special**

### ***Both Are Plagues on Our Houses***

Both Liberal and Labor housing policies will make Australia's debt and housing affordability crises worse. The only difference between the two is how much damage they will do.

Both parties have promised tax-advantaged savings systems that will enable First Home Buyers to accumulate larger deposits. This will undoubtedly help them compete with other buyers in the housing market, but a lack of competition amongst buyers isn't the problem. The real problem is that we've driven house prices far too high, by devoting far too much borrowed money to buying houses. By increasing deposits while doing nothing about loans, both parties will only add fuel to the house price fire.

The ALP gives the example of a two income family, earning average wages, who could increase their deposit by \$18,000 as a result of their scheme (and the Liberals scheme is much the same). That looks good on paper. But without any change to lending policies, that larger deposit will simply be used to secure a larger loan--up to \$360,000 larger, if Mr & Ms First Home Buyer attempted to buy a house with a 5% deposit.

Of course, no lender would offer such a loan--because even with an 8% home loan rate, interest payments would consume 140 percent of their gross income. But in the current housing market, they could easily be offered an interest-only loan equivalent to 85 percent of the purchase price, with repayments of 47 percent of their income.

And what would that do to home affordability? Make it worse, of course. A fair slab of their increased purchasing power would be eaten up by yet higher prices, driven by ever higher household debt.

The Liberals scheme is even worse, because it adds three more logs to the house price fire:

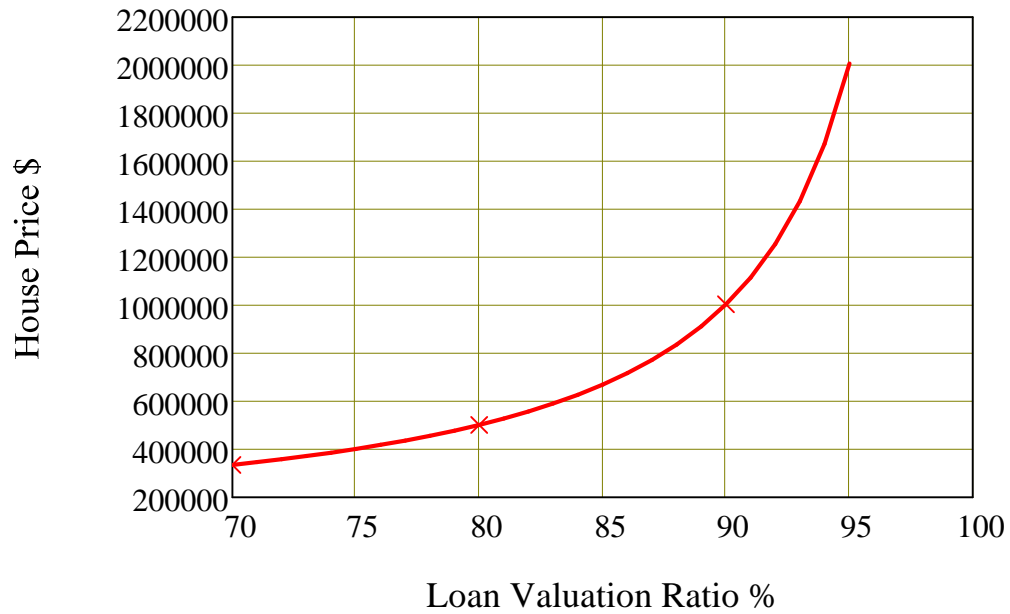
- It allows relatives to contribute up to \$1,000 a year to the savings account;
- It lets relatives take an equity stake in the First Home Buyers house, without being liable for capital gains tax on its sale; and
- It promises to use future government surpluses to top up these savings accounts.

We have already achieved the world's most unaffordable housing with loans that are based solely on the incomes of the borrowers. This proposal would throw parents income and government savings into the mix, and therefore push mortgage debt beyond its already astronomical level. It's a silly step towards the madness that marked the peak of Japan's ill-fated Bubble Economy in 1990, when lenders briefly offered 99-year mortgages.

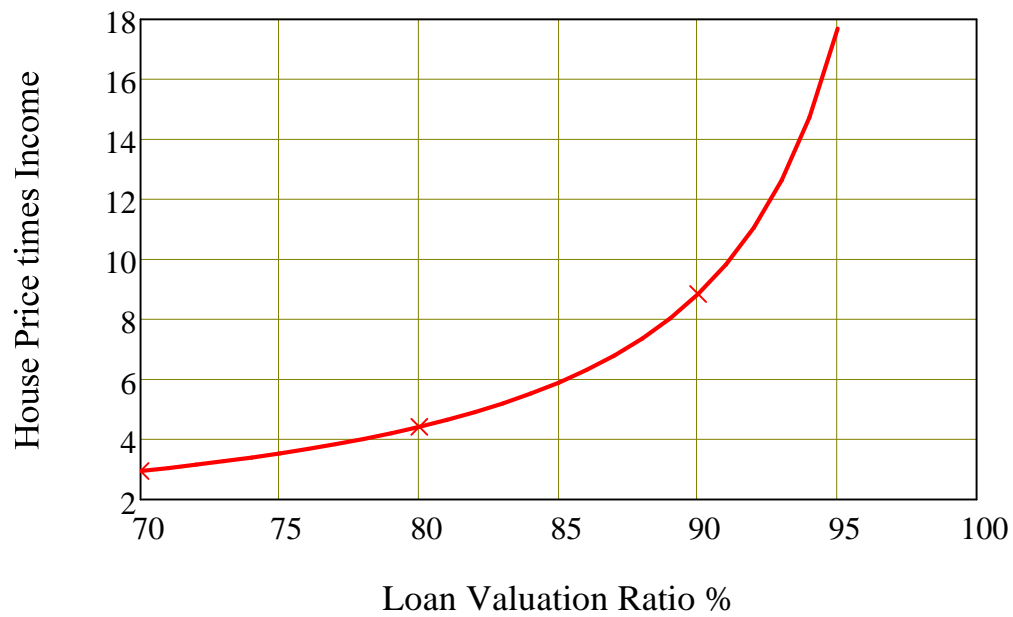
We thus face a choice between a bad housing policy, and an almost insane one. I hope that neither represents what either party really thinks is needed, but is instead a product of this "me too" election campaign, where each side is afraid of suggesting a policy that can be "wedged" by its opponent.

With both parties offering us a Hobson's Choice on housing in this election, the best we can hope for is that whoever wins ditches their campaign promise, and instead develops a policy that restores some parity between mortgage debt and income--perhaps by limiting loans to some sensible multiple of the rental income that a house can be expected to generate.

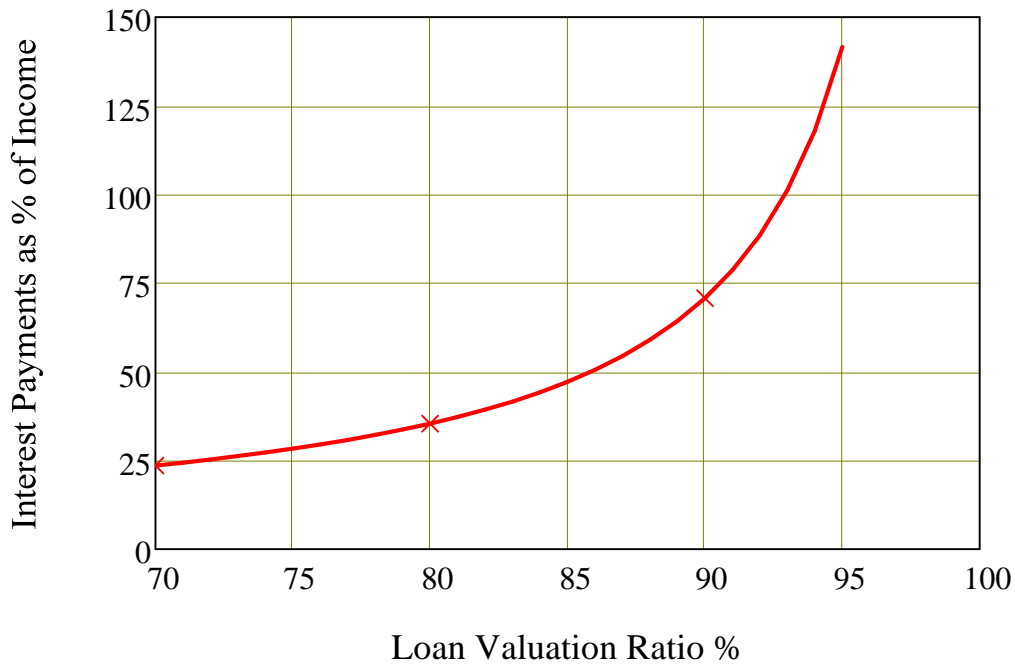
### House Price as Function of LVR



### Price/Income Ratio as Function of LVR

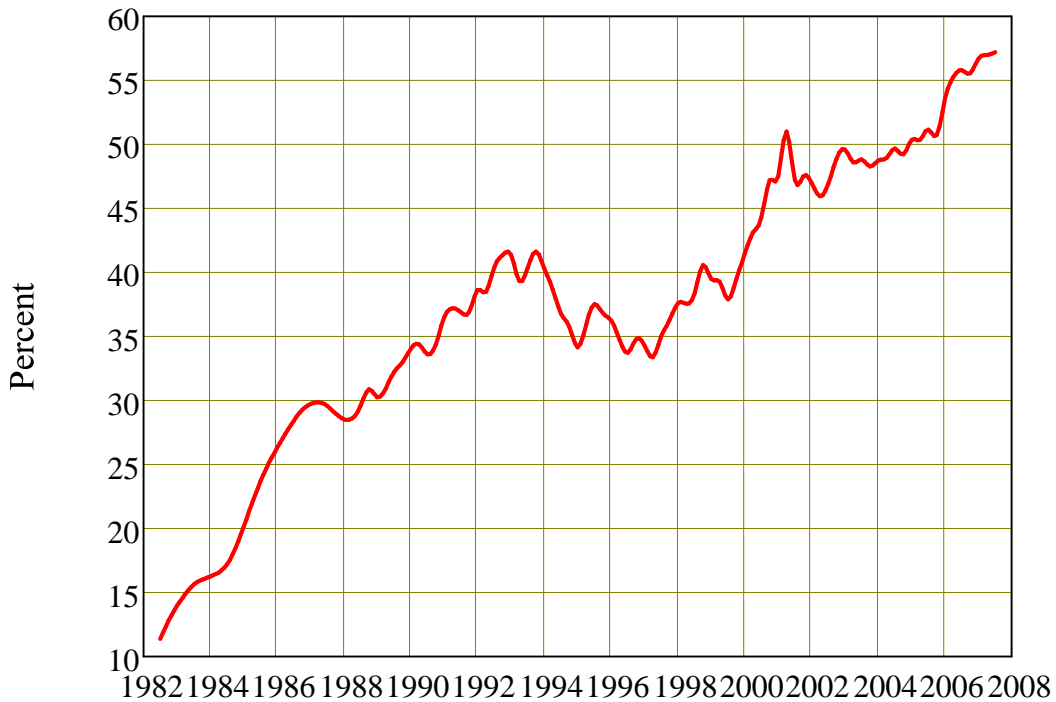


### Interest Payments/Income as Function of LVR



### Chart Of the Month

#### Foreign Debt to GDP



One of my subscribers raised the topic of the "Foreign Debt Truck" that the Liberals used to effect in the 1996 campaign. Had the foreign debt story changed once the Liberals took over?  
 Not according to the figures. Though foreign debt hasn't followed the same obviously

exponential trajectory as aggregate debt, the foreign debt to GDP ratio has nonetheless risen faster than the aggregate ratio, and it is now over five times what it was in 1982--and two thirds higher than it was when the Liberals won office.

Table One: Aggregated Debt Summary

**Table One**

	0	1	2	
0	"Summary"	"Total Private Debt"	"Nominal GDP"	
1	"Date (levels)"	2007.75	2007.5	
2	"Levels (\$m)"	1703964	1045708	
3	"Change Month \$m"	18714	6952.02	
4	"Change Month %"	1.11	0.67	
5	"Change Year \$m"	236448	79033	
6	"Change Year %"	16.11	8.18	
$D_1 =$	7	"Since 1990"	8.6	5.4
	8	"Since 1980"	11.98	7.93
	9	"Since 1964"	13.48	9.42
	10	"Date (% GDP)"	2007.75	"N/A"
	11	"As % of GDP"	159.8	100
	12	"Change Month"	0.46	"N/A"
	13	"Change Year"	7.23	"N/A"
	14	"Since 1990"	2.92	"N/A"
	15	"Since 1980"	4.11	"N/A"
	16	"Since 1964"	4.16	"N/A"

Table Two: Disaggregated Debt Summary

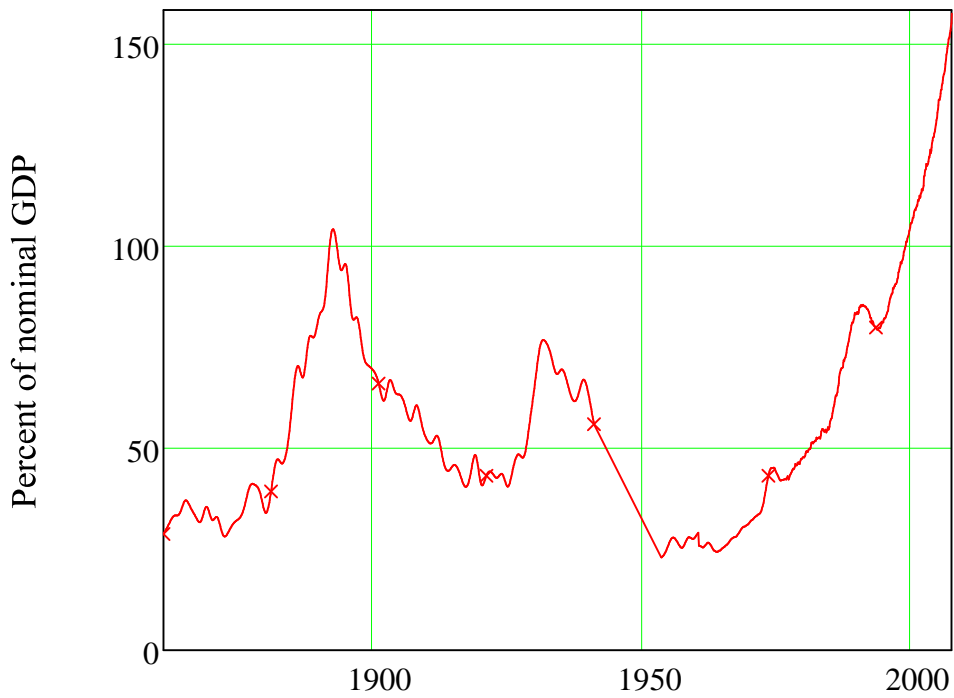
**Table Two**

	0	1	2	3	
0	"Detail"	"Business"	"Mortgage"	"Personal"	
1	"Levels (\$m)"	661600	894459	147902	
2	"Change Mth \$m"	12667	6476	-430	
3	"Change Mth %"	1.95	0.73	-0.29	
4	"Change Yr \$m"	126581	93104	16760	
5	"Change Yr %"	23.66	11.62	12.78	
$D_2 =$	6	"Since 1990"	4.96	14.7	5.48
	7	"Since 1980"	10.62	14.03	10.45
	8	"Since 1976"	11.16	14.3	11.23
	9	"As % of GDP"	62.07	83.91	13.88
	10	"Change month"	1.31	0.1	-0.92
	11	"Change year"	14.24	3.12	4.19
	12	"Since 1990"	-0.78	9.22	-0.38
	13	"Since 1980"	3.01	6.03	2.62
	14	"Since 1976"	3.07	5.78	2.99

### Debt to Income Ratios

Long Term Debt

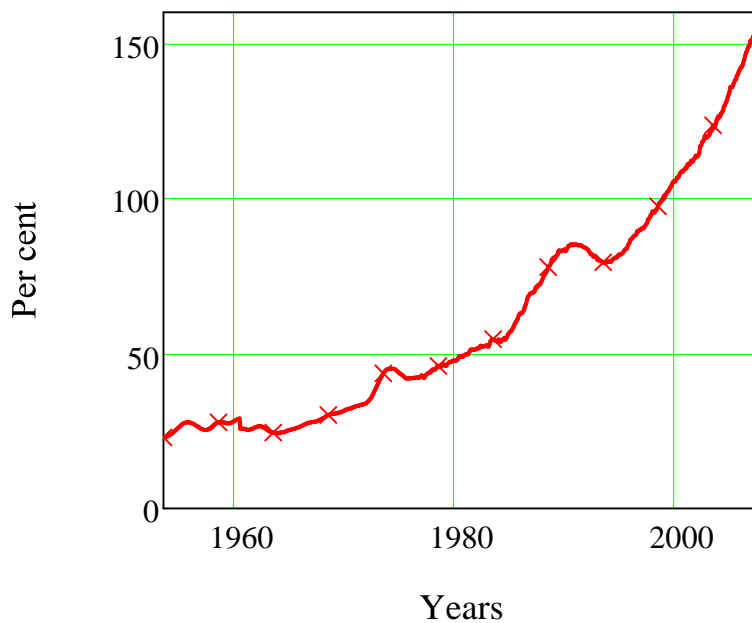
#### Australian Private Debt to GDP



▢ Debt to GDP (D02 & G12)

Figure 1

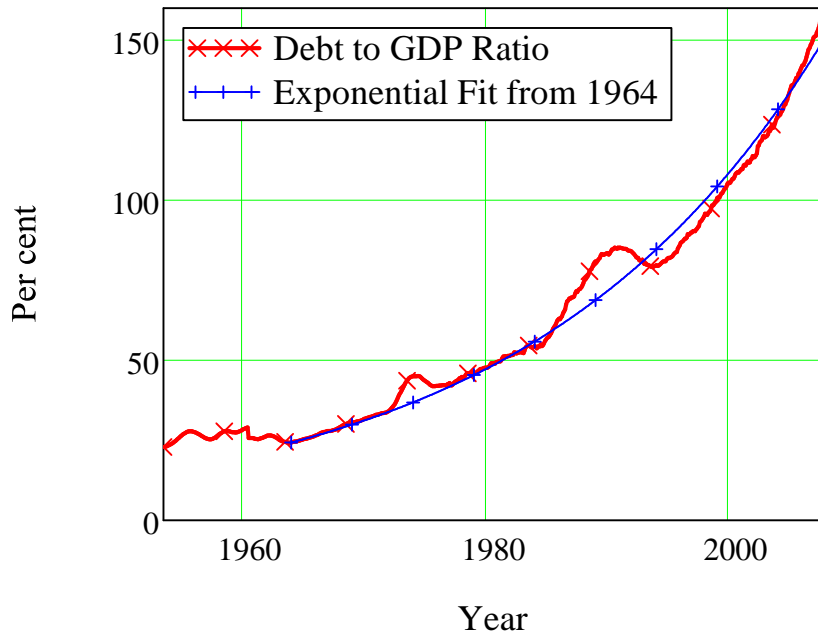
#### Australian Private Debt to GDP



▢ Debt to GDP Regression

Figure 2

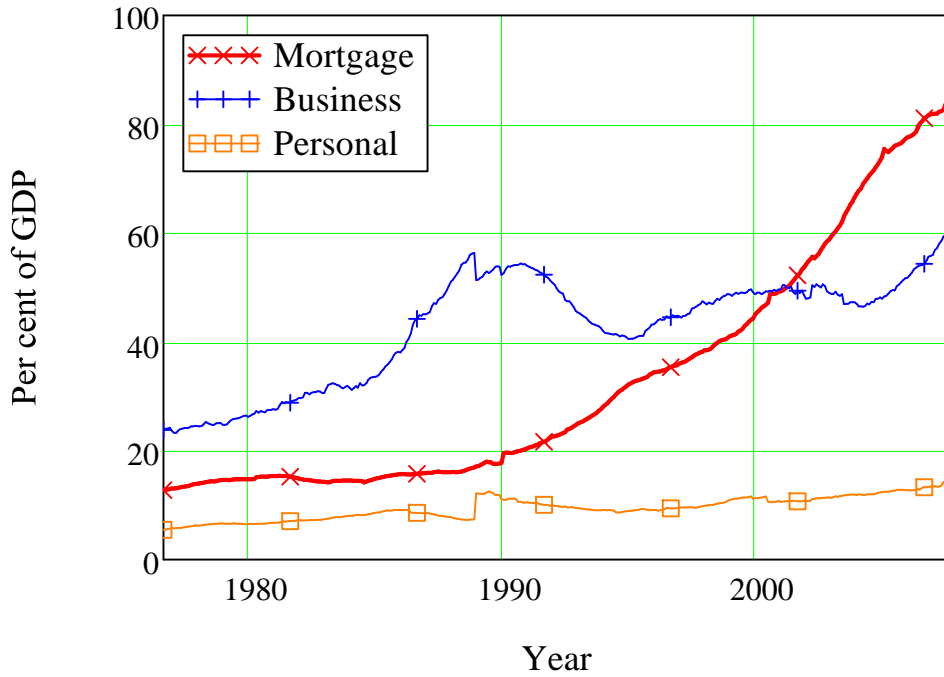
### Australian Private Debt to GDP



▾ Debt Components to GDP

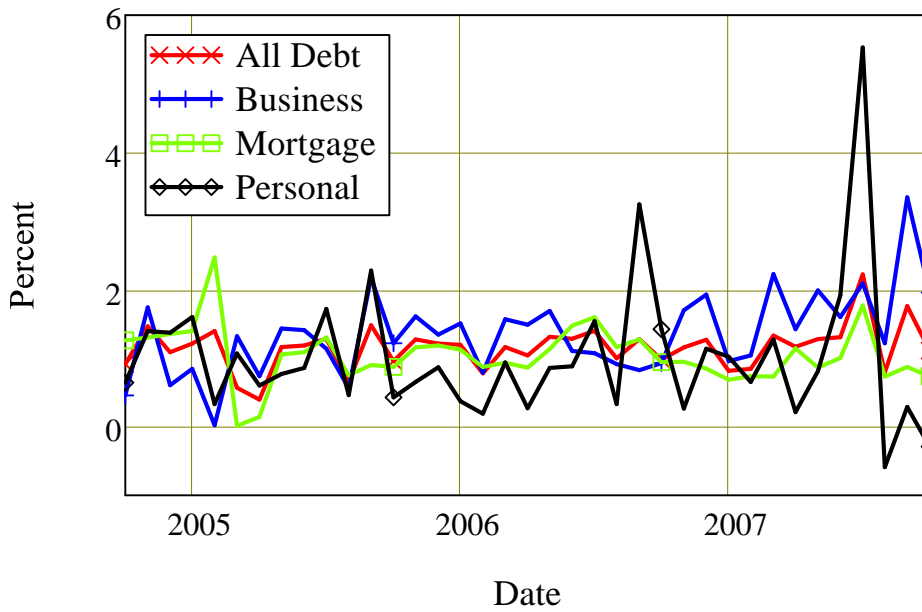
**Figure 3**

### Components of Australian Debt



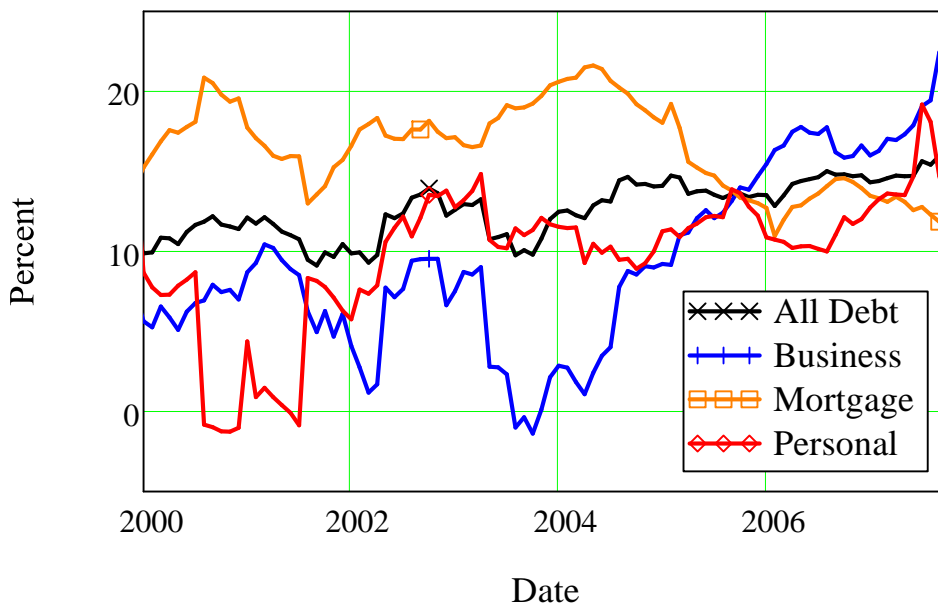
▶ Monthly Growth Rates

### Debt Monthly Growth Rates



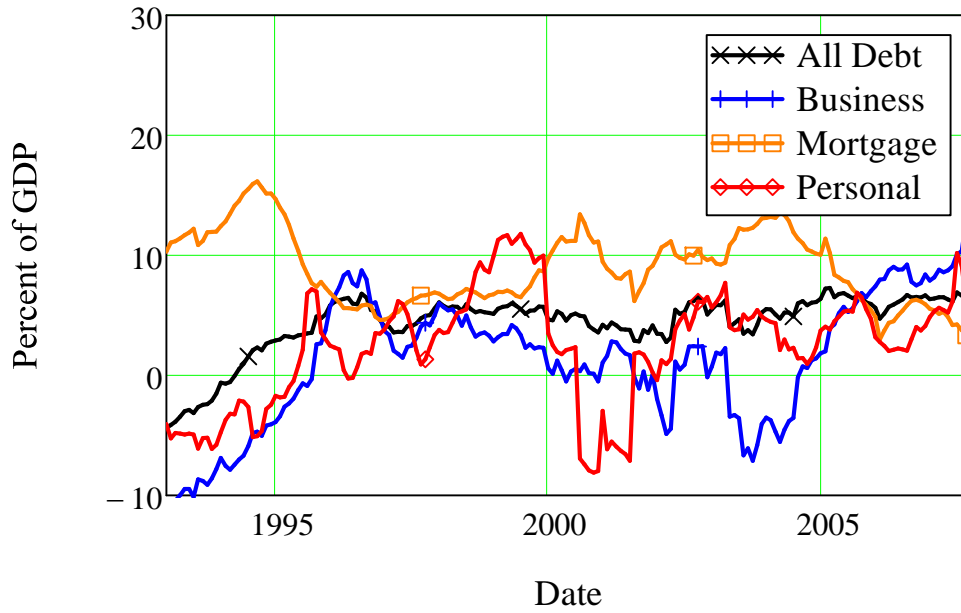
▶ Yearly Growth Rates

### Debt Yearly Growth Rates



▶ Ratios Yearly Growth Rates

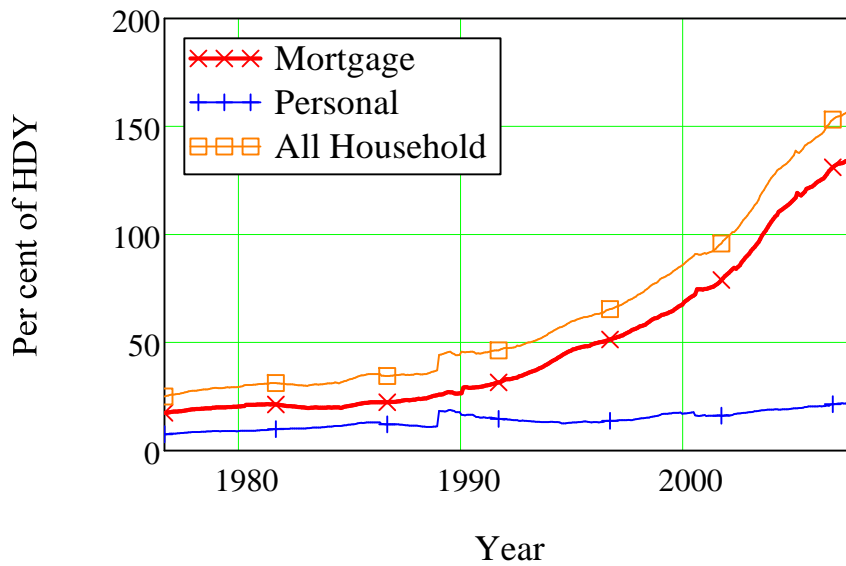
### Debt Ratios Yearly Growth Rates



▢ Debt to Household Disposable Income

**Figure 4**

### Household Debt to Disposable Income

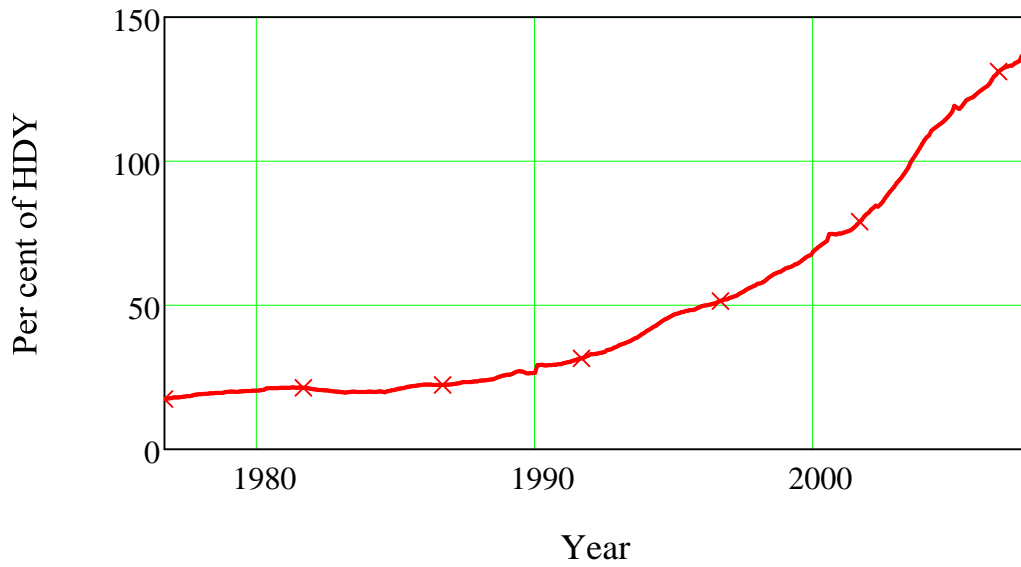


▢ Mortgage Debt to Household Disposable Income

**Figure 5**



### Mortgage Debt to Household Disposable Income

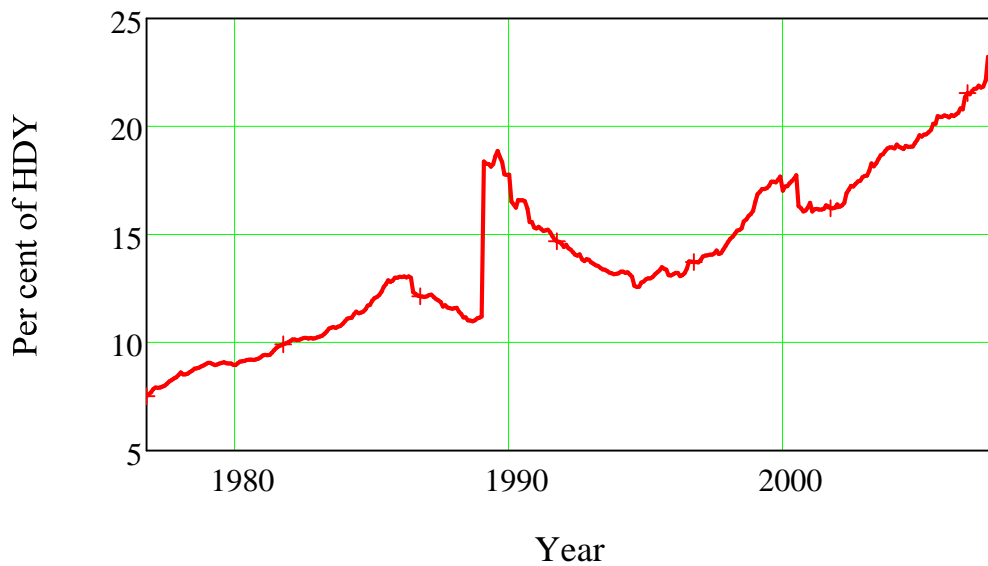


▢ Debt to Household Disposable Income

(the big jump in personal and fall in business debt in 1989 was due to a change in bank classifications of debt types that caused a proportion of business debt to be reclassified as personal).

**Figure 6**

### Personal Debt to Household Disposable Income



▢ Business Debt to GOS

**Figure 7**

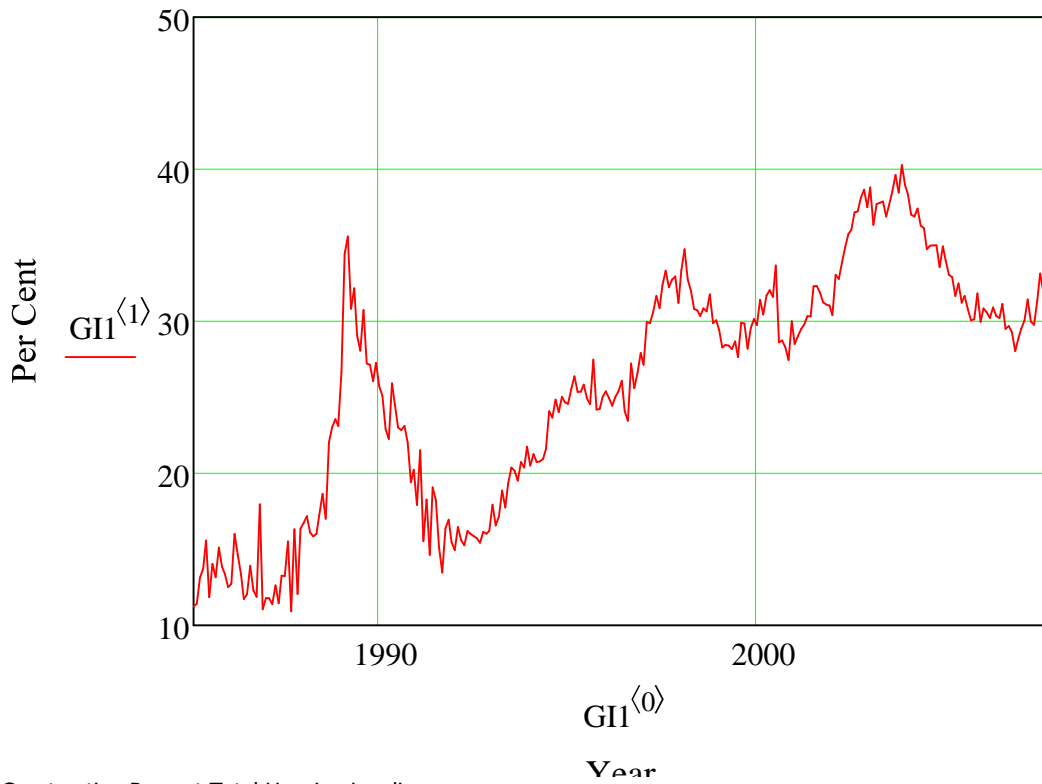


### ***Housing Finance Analysis***

▣ Investment Percent Total Housing Lending

***Figure 8***

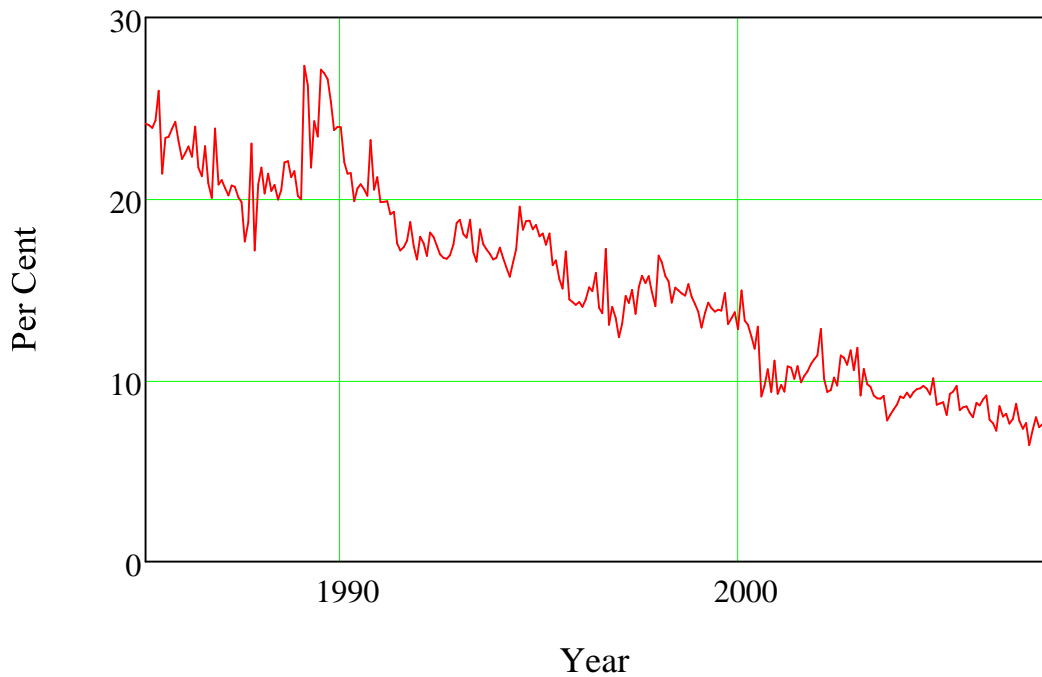
### "Investor" Percentage of Total Housing Lending



▣ Construction Percent Total Housing Lending

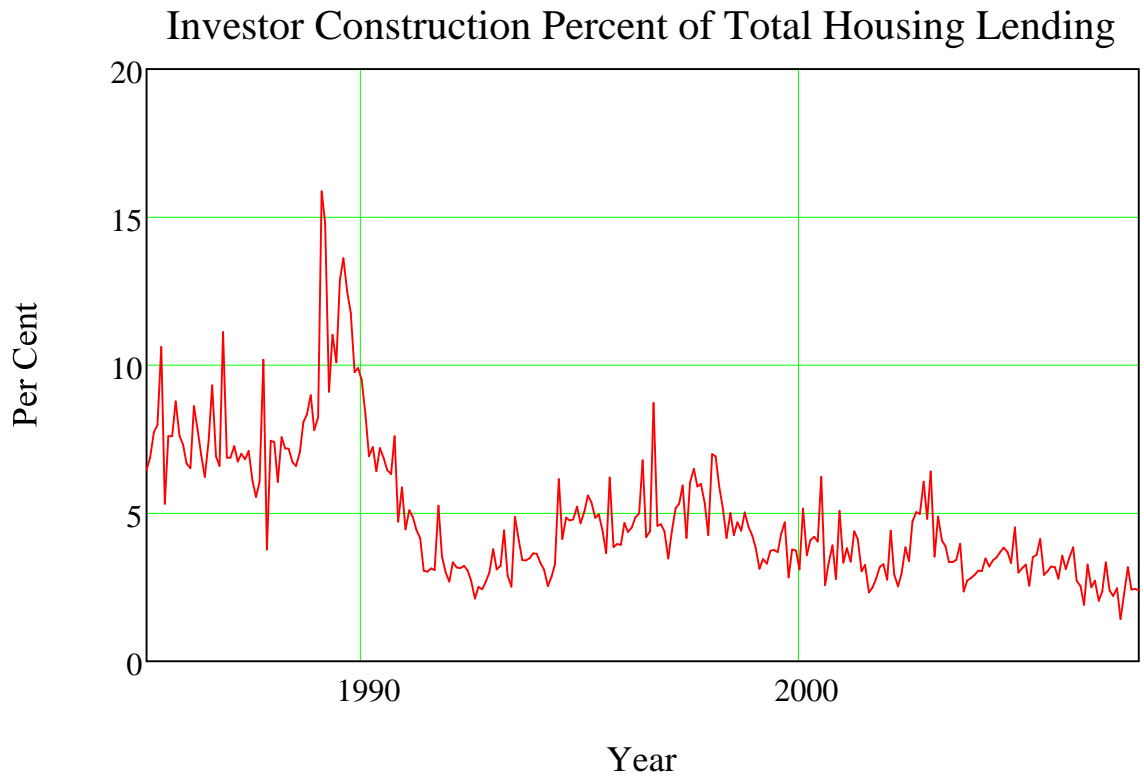
**Figure 9**

### Construction Percentage of Total Housing Lending



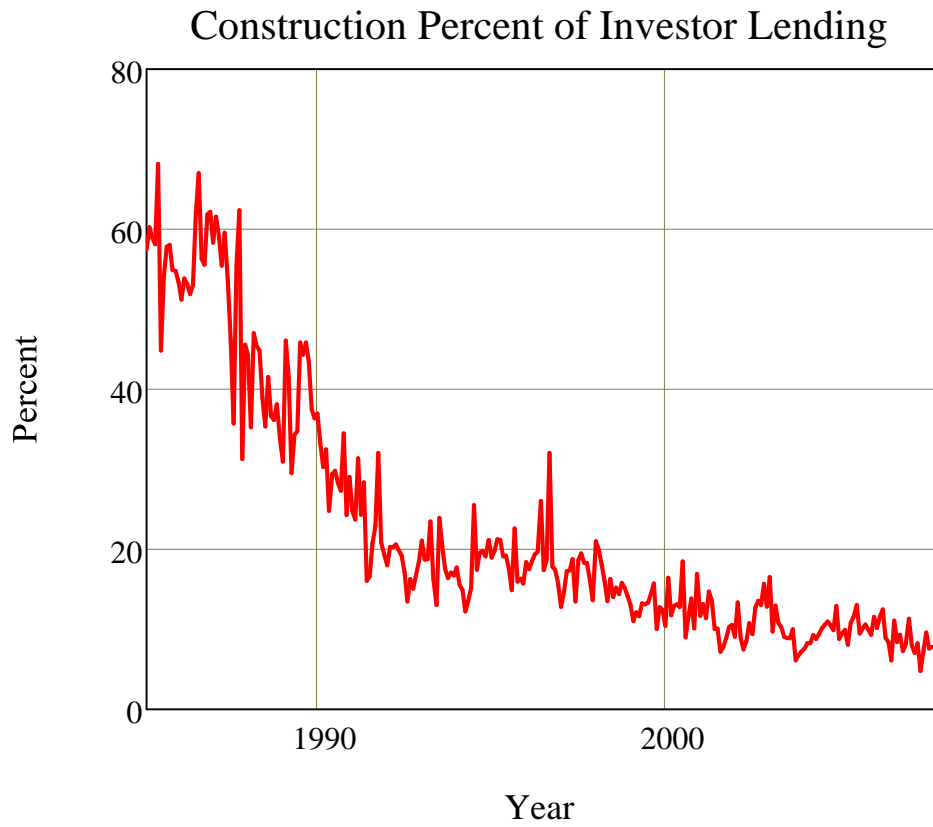
▣ Investment Construction Percent Total Housing Lending

**Figure 10**



Construction Percent of Investor Lending

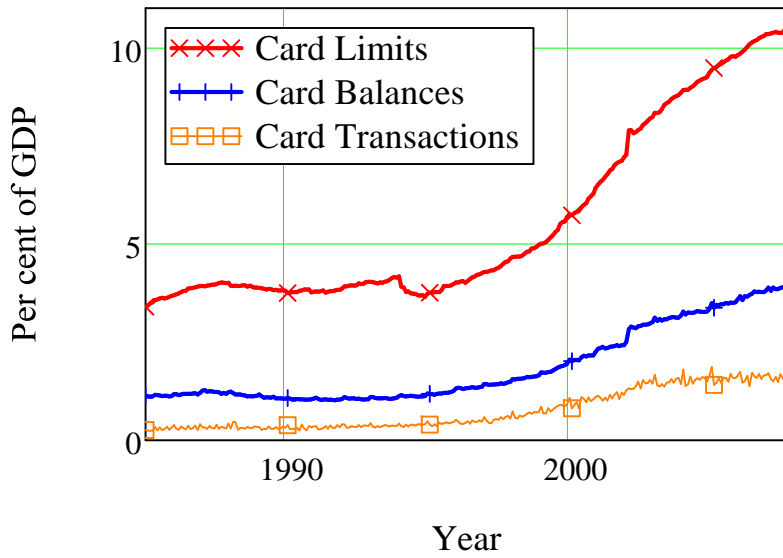
**Figure 11**



**Personal Finance Analysis**  
**Figure 12**

Credit Card Data

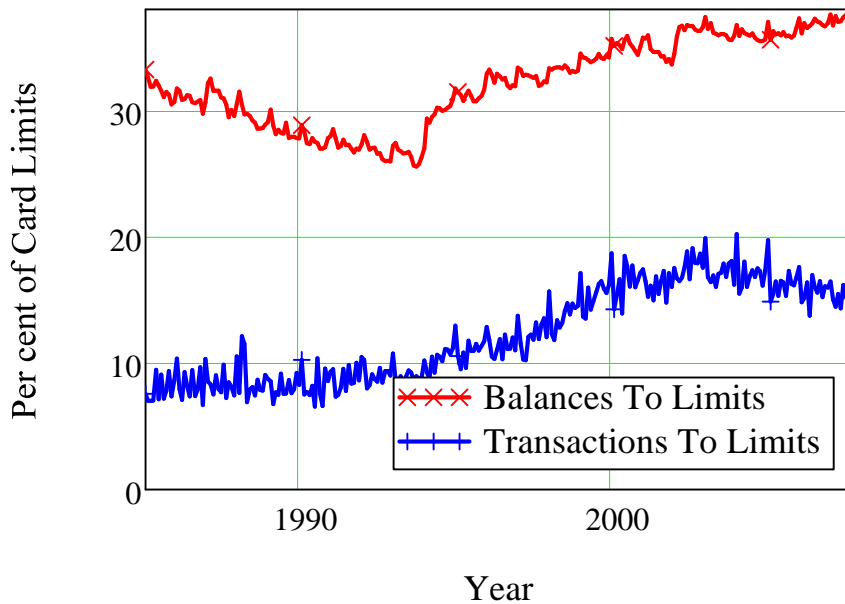
### Credit Cards To GDP



**Figure 13**

▢ Credit Card Data

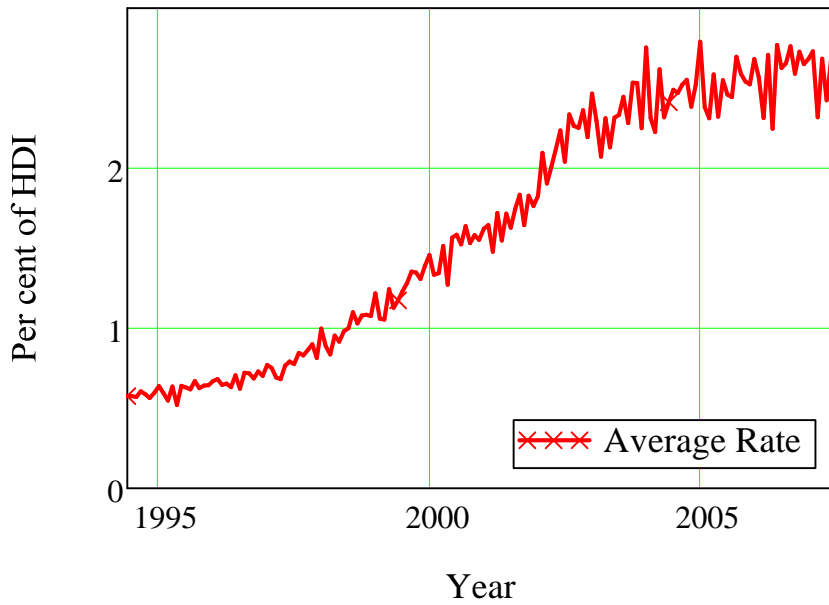
### Credit Cards Usage



**Figure 14**

▢ Credit Card Repayments

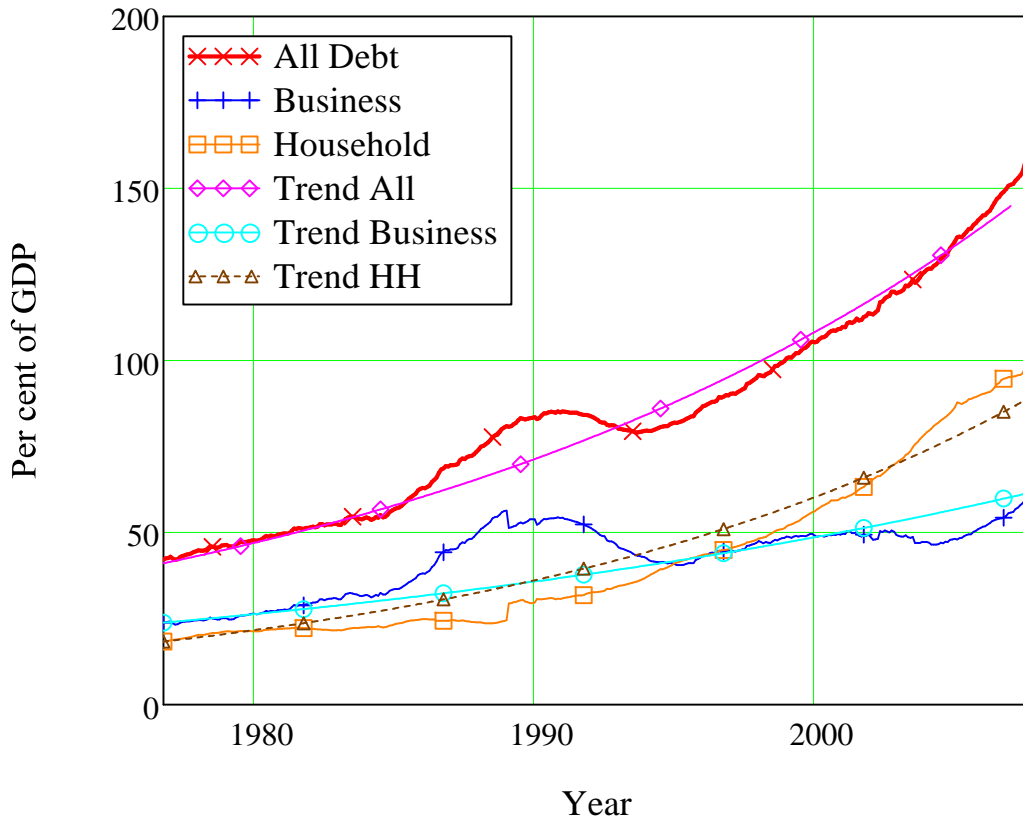
### Credit Card Repayments



▢ Debt components to Income

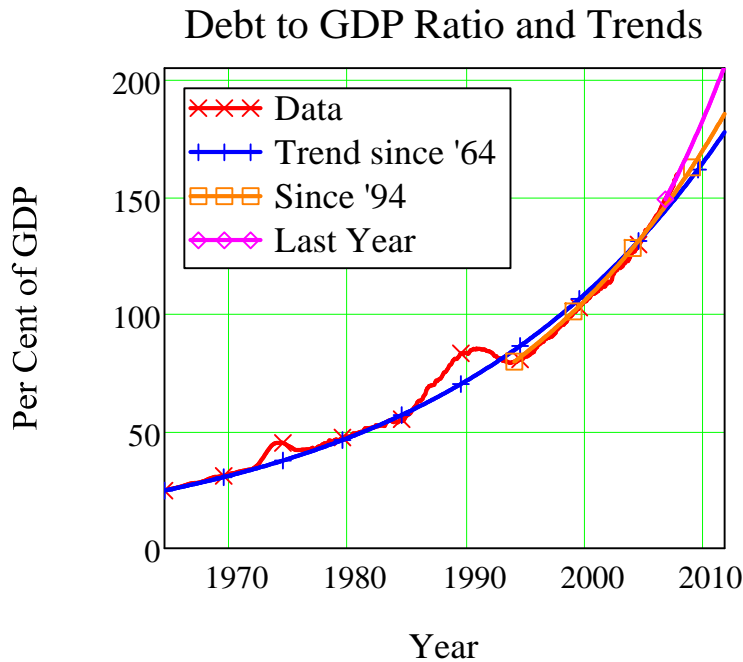
Figure 14

### Trends in Private Debt



▶ Debt to GDP Trends

**Figure 15**



▶ Debt to GDP Exponential Growth Correlation Ratios

These tables show the approximate exponential rate of growth of debt from various starting dates, and the correlation coefficient between this exponential approximation and the data. The correlation is staggeringly high, especially for a data series which, from an equilibrium point of view, should have no trend, or at worst should move in the opposite direction to changes in the official rate of interest--thus keeping the debt repayment burden constant.

**Table Three: Exponential Growth Rates & Correlations since 1964 & 1977**

	0	1	2	3	4	5
Corr77 =	0 "Debt ratios"	"All"	"All"	"Business"	"Household"	"Mortgage"
	1 "Start Date"	"mid-1964"	1977	1977	1977	1977
	2 Growth rate"	4.17	4.05	3.09	5.07	5.78
	3 "Correlation"	99.11	98.43	73.45	98.11	98.16
	4					

**Table Four: Exponential Growth Rates & Correlations since 1990**

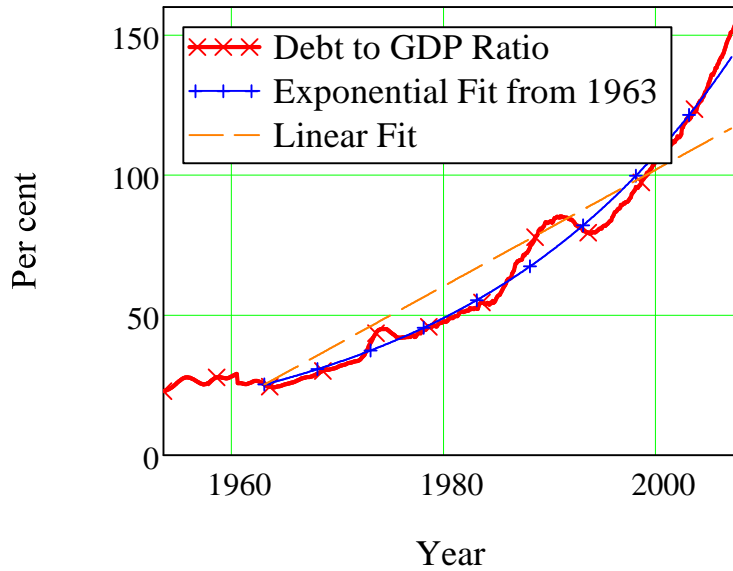
	0	1	2	3	4
Corr90 =	0 "Debt ratios"	"All"	"Business"	"Household"	"Mortgage"
	1 "Start Date"	1990	1990	1990	1990
	2 "Growth rate"	2.8	-0.97	6.81	9.32
	3 "Correlation"	96.45	-17.26	99.67	99.77



▢ Debt to GDP Linear vs Exponential Regressions

**Figure 16**

**Australian Private Debt to GDP**

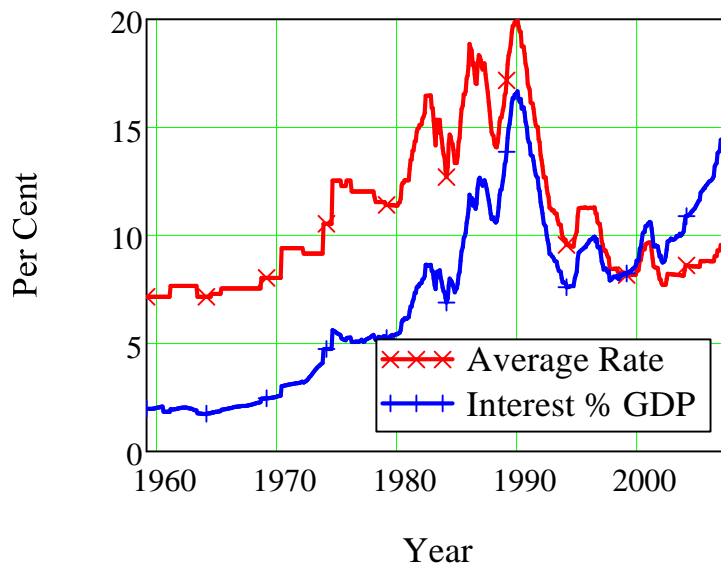


**Debt Servicing Burden**

▢ Interest Rates & Payments

**Figure 17**

**Interest Rates & Interest Burden**

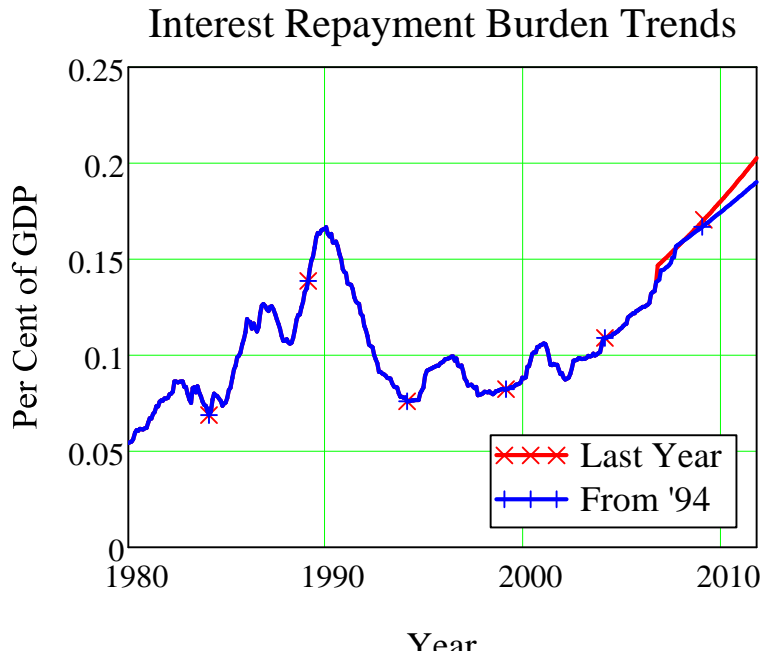


▢ Interest Payment Trends

If trends in debt growth continue, then even without any increases in official interest rates, the interest repayment burden on the economy will exceed that of 1990 sometime between September 2008

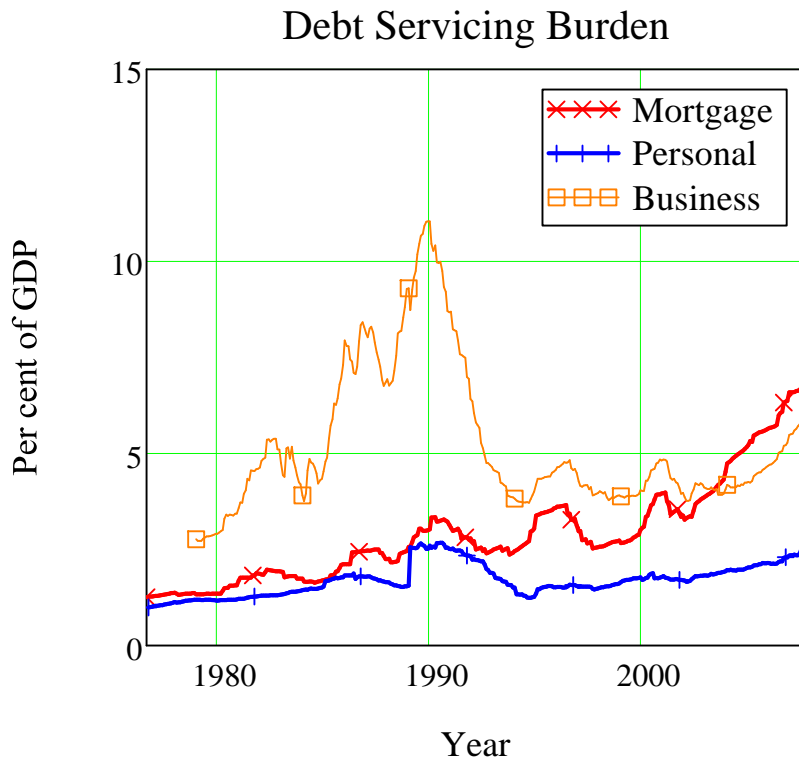
and September 2009.

**Figure 18**



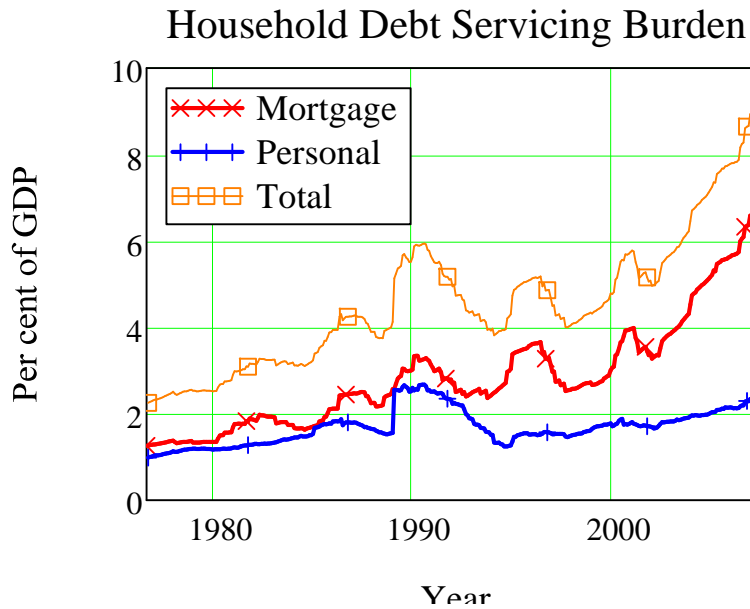
▶ Debt Servicing by Loan Type

**Figure 19**



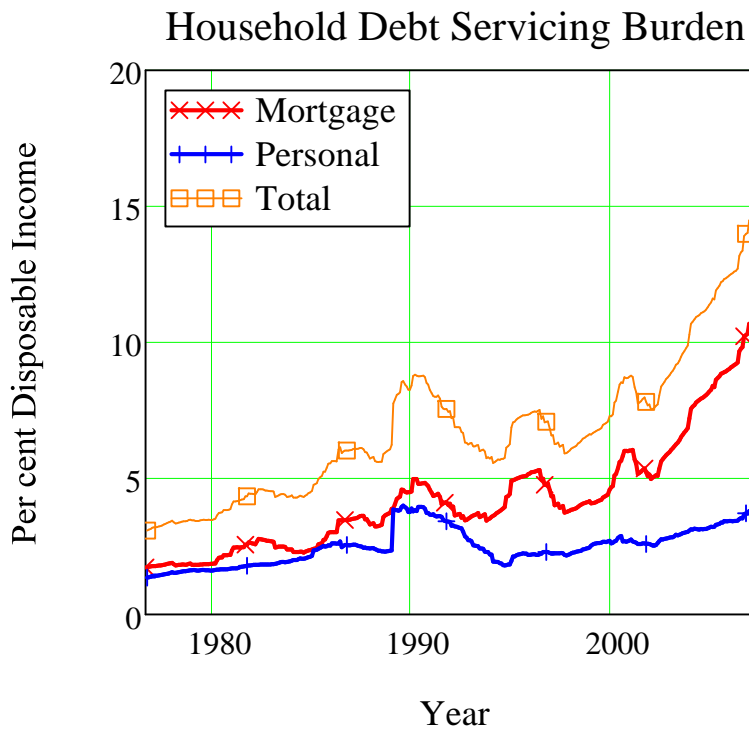
▾ Household Debt Servicing

**Figure 20**



▾

**Figure 21**



It's obvious why high interest rates prior to 1990 brought the economy to a standstill when one sees the following graph: the interest servicing charge on business loans peaked at almost 30 per cent of Gross Operating Surplus. Even though business debt has recently started to rise as a proportion of GDP, the debt servicing burden remains in the range that applied in the early 1980s.

**Figure 22**



The debt repayment burden is affected by both the rate of interest, and the level of debt. This chart shows the percentage of GDP that is required to pay the interest on outstanding debt, as a function of average interest rates (the vertical axis) and the debt to GDP ratio (horizontal axis). We are approaching the pain threshold that applied back in 1990, when debt servicing consumed 16.7% of GDP. The dramatic rise in household debt in the last thirteen years has almost negated the impact of falling average interest rates.



**Figure 23**