

# Hooked on debt and living on borrowed time

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**Australians owe the rest of the world about \$600 billion, writes Marc Moncrief.**

A new opposition leader, a controversial war, industrial relations and, of course, interest rates: behold the themes for Australia's previous and next federal elections.

Two years on from an election in which interest rates were the dominant economic issue, Australians are warming up for the next campaign. They are weighing the impact on their budgets of four interest-rate rises since the last polling day and pondering another rise possibly as soon as next month.

Debt – and the ability to manage it – is likely to lead debate again in the election almost certain to be held this year. It encapsulates arguments on interest rates, fiscal policy, public versus private debt and the new WorkChoices legislation.

"It is one of the issues that will almost certainly be deciding the next election," said a political strategist busy constructing the opposition's platform.

To tease out the nuances of the debate, The Age asked economists, debt professionals and politicians: Does Australia have a debt problem? If so, what can the federal government do about it? Should it do anything at all?

"Australia obviously does have a debt problem," said Deborah Southon, a director of Fox Symes, a company that develops programmes for people who have lost control of their debt. "It's not apparent at the moment for the simple reason that the economic circumstances are rather good.

"We've had record low interest rates and very low unemployment, so we've had a very buoyant economy. The problem we have is with the level of credit out there and households where the debt-to-income ratio is problematic."

The ratio of Australian households' debt to disposable income has more than doubled since 1998 and continues to break records. Having crossed a notional boundary of 150 per cent in the December quarter of 2005, the ratio had climbed above 157 per cent when last recorded by the Australian Bureau of Statistics in the last September quarter.

That credit has been paid for by huge borrowing from abroad. Australians owe the rest of the world's lenders about A\$600 billion (NZ\$680 billion). Though this is nearly double the net debt Australia held in 1999, none of it is government debt.

That borrowing has fuelled a strong economy but it has also brought higher prices. The cycle feeds back when inflation tips above 3 per cent a year, the upper limit of the Reserve Bank's tolerance, and interest rates begin to rise.

On the average 2006 mortgage of about A\$220,000, the 0.75 percentage points added to interest rates this year means about A\$140 a month less to spend on shoes, groceries, school fees and plasma-screen TVs.

Ms Southon said a survey conducted for Fox Symes showed 40 per cent more households rated interest rates of concern in the December quarter of last year than in the previous quarter. Fox Symes was receiving about 6000 calls a month asking about debt assistance, part of a "progressive increase" from a more normal 4000 to 5000 calls a month.

"Should there be another movement in interest rates, it will have an even bigger impact on those households where budgets are already stretched," Ms Southon said.

Shadow treasurer Wayne Swan also said Australians' debt increased the risk to households. "While most households appear to be managing their debt- servicing obligations, any significant economic shock could be grave for households that are highly indebted," Mr Swan said.

Labor is well acquainted with the power of debt fear. After the 2004 election, the party sought to quantify the effect of the government's interest- rate campaign, in which Prime Minister John Howard promised interest rates would stay low under the Coalition. THE SURVEY separated swing electorates into five groups based on the percentage of households holding mortgages and found the swing to the Coalition was 700 per cent greater in electorates with the highest concentration of mortgages compared with electorates with the lowest concentration. "While household worth has increased at a faster pace than debt, not all household assets can be used to service debt," Mr Swan said.

A recent paper by the Organisation for Economic Co-operation and Development, the peak public policy forum for the world's richest nations, ranked Australia as the country with the second-highest proportion of income dedicated to servicing debt.

Mr Swan said the best way a government could help Australians manage their debt was to act responsibly on its own finances.

"High levels of debt and households' increased sensitivity to interest-rate rises make it critical that fiscal policy not complicate monetary policy," he said.

Late to the game, scoffs the government. Acting treasurer Peter Dutton said the percentage of disposable income dedicated to mortgage repayment on a new home was about 27.6 per cent below the high of 31 per cent under Labor in 1989. Furthermore, the proportion of export income that went to pay interest on foreign debt was 9.8 per cent, "well below the peak of 20 per cent recorded in the September quarter 1990", he said.

"The Australian Government has eliminated the A\$96 billion debt that Labor left in 1996, which leaves the Australian Government in one of the most envied positions in the world." On April 21, Treasurer Peter Costello declared the Australian Government free of net debt.

The opposition claimed that debt was still high; it had simply been shifted to households. Labor attacked Australia's current account deficit, the gap between what Australia earns and what it spends, which then sat at A\$500 billion.

Only weeks earlier, the Australian Bureau of Statistics had reported that January 2005 had brought the worst monthly trade deficit on record. Australians had bought A\$2.7 billion more from foreign countries than the world had bought from Australia, more than double the A\$1.15 billion deficit the month before.

Australian National University economics professor John Pitchford told *The Age* the two conditions of debt-free government and record debt placed responsibility for the current account on Australian households.

He said people who borrowed too much would be dealt with by "robust legal arrangements", bankruptcy law.

"(Debt) is probably a very useful political debating point, but I think these days both Treasury and the Reserve Bank, on private debt, have very similar views: that it's not an enormous policy problem for Australia," Professor Pitchford said.

But Mr Dutton said: "The level of the current account deficit primarily reflects private-sector investment decisions."

While the pressure mounts, the Reserve Bank's latest credit figures show consumers keep borrowing to buy. Housing credit, personal credit and business credit have all had double-digit growth in the past year.

Three interest-rate rises since May are starting to take their toll but in the shape of debts going bad; not falling demand.

Last week, rating agencies Standard & Poor's and Fitch Ratings issued research referring to the creeping threat that climbing interest rates pose as arrears increase.

Economists and investors were hedging their bets on another rate rise as all looked to yesterday's release of inflation figures to cement their expectations.

Two weeks ago, the yield on the 30-day bank bill for March delivery showed investors had priced in a 28 per cent chance of an interest-rate rise. By last Friday, the bill showed a likelihood of 50 per cent.

But despite those rises, the pressure from debt-driven inflation is still on.

Monthly inflation figures from TD Securities and the Melbourne Institute show prices rose 3.8 per cent in the year to December. Figures show inflation dipping after each of the year's rate increases, but quickly regaining momentum.

As customers' disposable incomes fall, businesses in industries such as retail and tourism watch revenue dry up.

For money lenders, all this means that more and more debt is not repaid. Fitch Ratings' research said last week that banks would struggle this year to replicate the phenomenal growth of the past few years.

But do the numbers add up to a problem for government?

The question, as it applies to policy, may have been put best in an International Monetary Fund paper last October: "Should consenting adults be trusted?"The Age