Centre of Full Employment and Equity

Opinion and Commentary

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The Great Australian Dream – heading south!

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The Great Australian Dream – full-time secure employment; steady real wages growth; owning a house; and leaving your kids better off than you were.

We hear continually hear that the economy is booming and that we have never had it so good. Well recall what Marcellus said in Hamlet: "Something is rotten in the state of Denmark".

Yesterday's RBA decision to hike the interest rate to 6.75% will add more pain to households already hurting from a combination of poor Federal policy and economic circumstances.

The various measures of housing affordability all show that Australia now ranks among the worst in the World. More than one million Australian households are in housing stress and this figure rises daily. Further, home ownership is now impossible for many young Australians who have to compete in an increasingly expensive rental market.

Workchoices has exacerbated this. In shifting bargaining power excessively towards employers, it has cut real incomes and reduced job security. More Australians are underemployed now than ever before while others are forced to work longer hours, increasingly unpaid, for fear of dismissal.

How does yesterday's RBA decision worsen this stress?

The RBA sets the cash rate upon which all other rates such as mortgage rates are based. Rates are now at an 11-year high and have risen six times since the last election, despite the Prime Minister promising to keep them at record lows.

They are rising because the underlying inflation rate is now above the RBA's upper limit of 3 per cent.

The RBA believes that strong output and credit demand will further add to inflation pressures as the economy reaches full capacity. They also believe the World outlook is strong.

However, significant global uncertainty exists as a result of the US housing and financial market troubles. Some are predicting a US recession leading to a world economic slowdown. That is a big risk in the RBA's decision.

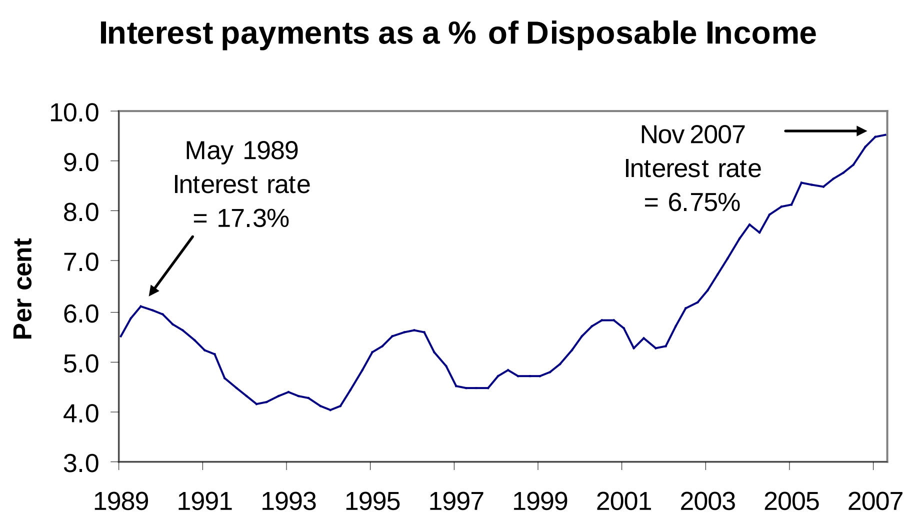
The RBA increases the interest rate to squeeze our spending and keep inflation in check. Add $40 per month for every $250,000 of your mortgage as result of yesterday's rise. Monthly repayments are now around $250 higher for average mortgage holders since March 2005. Income growth is trailing inflation and so there is less to spend overall.

Spending cutbacks damage businesses and business investment contracts as financing costs increase.

If the successive interest rate rises do significantly dampen expenditure then unemployment will increase. World commodity demand is keeping our economy afloat at present but should that also slow then things will look very bad.

The financial stress facing Australian households, who have lumbered themselves with record levels of debt, is now acute. While the interest rate rise will force many households to spend less, many others will go broke. There has been a sharp rise in forced home repossessions by banks recently.

The accompanying figure shows the interest burden on household debt as a percentage of disposable income (what you have to spend after taxes). In 1989, the interest rate was 17 percent. The Federal government uses this figure to persuade us that current interest rate levels are not bad. But when interest rates were 17 per cent, the average mortgage holder was better off than now because the mortgage repayments as a percent of average household's disposable income were much lower. This is because wages growth was stronger then and the debt levels were lower.



Source: ABS National Accounts.

So when deciding which political party provides better economic management don't be fooled by the 17 per cent argument.

The rising rates are also driving the Australian dollar higher which will cause pain for exporters who suffer reduced price competitiveness. This fallout will exacerbate the impact of the drought. The upside is that petrol prices which are based on import parities will be lower as our dollar increases in value and our holidays abroad become cheaper.

The housing pain is not just restricted to the 30 per cent of households that have mortgages. The already tight rental market will get worse as investors abandon housing and first-home buyers are priced out of the purchase market. The irony of this so-called boom is that while baby-boomers enjoy the increased housing wealth their kids are being denied the same opportunities that their parents enjoyed.

The stark, understated reality is that the current adult generation will be the first in history to leave its children worse off than they were. The housing market, Workchoices and general degradation of public service are combining to ensure that.

For the younger generation, the Great Australian Dream has gone south!