

Debt rings alarm bells

When investment writers talk about “realistic expectations” it is normally about alerting investors to the fact that high market returns should not be expected to continue.

That sort of article would not be out of place when talking about residential property based on the figures for the last year released this week by Australian Property Monitors showing annual growth rates of 15 % aually.

But this is an entirely different perspective.

The Australian Investors Association – a not-for-profit organisation dedicated to educating investors – had its annual conference on the Gold Coast this week. Among the speakers was Sydney academic Steve Keen, Associate Professor of Economics & Finance, University of Western Sydney.

Keen is a serious academic – anyone that studies American economist Hyman Minsky’s financial instability hypothesis is passionate about their work – but his reputation as an economics commentator developed after he began warning of a serious financial crisis from around 2005 based on his economic modelling work and a book titled Debunking Economics.

He also claims the inaugural Revere award for economics – an award voted on by an international economics website for the economist who did the most to warn of the impending global financial crisis. (named after Paul Revere’s famous ride to warn Americans of the approaching British army).

It would be something of an understatement to say that Keen is worried about personal debt levels – specifically the ratio of our personal debt to the country’s gross domestic product. On Keen’s analysis that is sitting around 160%. ncerns him is that rather than our economy recovering from the GFC it could still be heading towards a 1930s-style deleveraging.

However, he was also arguing back in 2007 that we were heading for a “recession we can’t avoid”. That the Australian economy – with the help of a strong stimulus package - got through the global financial crisis without falling into recession countered that argument.

Keen clearly is focussed heavily on one aspect of the economy – personal debt. And he makes a passionate, if extreme, argument based on intricate mathematical models that if the recovery is fuelled by increasing personal debt we will again be heading into a boom-bust cycle. Mainstream economists – such as our Reserve Bank – argue that looking at personal debt levels without the counterbalancing figure of asset values is misleading.

Keen is critical of central bankers for allowing personal debt to build up to historically high levels – although acknowledges that the decisive action by the chairman of the US Federal Reserve, Ben Bernanke, probably averted a 1930s style depression.

Whether Keen is right to be as fearful as he is about the Australian – and global – economic outlook only time will tell. Forecasting the future is always a fraught affair no matter how sophisticated the maths.

The debate at the macro-economic level about the importance of debt levels will probably rage among academics and practising economists for years to come. However, bringing Keen's work down to a personal household level – and assessing whether your personal debt is rising or falling – might be a powerful piece of personal economic management.

* Written by Robin Bowerman, Head of Retail at Vanguard Investments Australia