Gloomy outlook on Australian economy from central banker

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A lunchtime address to the Economic Society of Australia by Reserve Bank of Australia governor Glenn Stevens on Wednesday drew considerable media attention because of his remarks during question time that house prices in Sydney, Australia's largest city, were "crazy." That characterisation was underscored by his outline of the state of the economy, delivered during his prepared remarks.

While he named no names, Stevens' question-time comments on the house price escalation were a refutation of claims by federal Treasurer Joe Hockey that houses were affordable because people were still buying them. Median prices in Sydney are around $750,000, with relatively modest homes frequently fetching more than $1 million.

In a "let them eat cake" comment, redolent of a bankrupt ruling class in an earlier epoch, Hockey said people could purchase a house by getting a better-paying job. Calculations show that a single home buyer has to earn more than $150,000 just to enter the Sydney market, more than double the average wage.

Stevens' comments on the state of the Australian economy also blew apart claims by Hockey that growth figures for the March quarter, showing an expansion of gross domestic product (GDP) of 0.9 percent, were "a great set of numbers." Hockey said the Australian economy had a strong and broad-based momentum and the data refuted "clowns" who warned of a recession.

The picture painted by the Reserve Bank (RBA) governor was of an economy increasingly impacted by the ongoing stagnation in the world economy. He was rather dismissive of the first quarter result, embraced by Hockey, saying that some of it was due to an unusually large volume of exports because shipments were less disrupted by the "cyclone season" than was usually the case.

Stevens noted that not much had changed since he last addressed the gathering two years ago. That was "disappointing" because "the economy has not picked up speed as we had hoped."

The GDP results over the past four quarters were "below trend." When all results for the year to June 2015 were in, "it would appear that the outcome will be either right at the bottom of the range predicted two years ago, or, more likely, a bit below it."

In his remarks on the world economy, Stevens recalled that two years ago he had noted that the euro area economy was smaller than it was before the financial crisis. "Regrettably, that remains true today."

Turning to China, Stevens said growth had slowed appreciably over the past four years. While the decline in 2014 may have been what Chinese authorities wanted, the decline over the past six months "may have been a little more than intended." China could no longer rely on the rest of the world simply absorbing its growth in output; it had to expand the domestic market. There also had to be a change in its prevailing financial structure, which "has too many risk aspects." How both these transitions played out was "unavoidably a source of uncertainty."

What was clear was that the pace of growth for Australian exports to China, in particular iron ore, would be lower than over the past five years.

For four years, the RBA has steadily cut its base interest rate to a record low of just 2 percent. This has done nothing to boost economic activity. In the main, it has been directed to try to lower the value of the Australian dollar, to shore up export markets. However, with all the other major exporters seeking to do the same, this means further interest rate cuts are needed to bring down the dollar's value.

Further rate reductions, to which Stevens said the

RBA remained open, will simply again boost house prices, putting the purchase of a house even further out of reach and creating the conditions for a property crash.

Summing up the overall outlook for the Australian economy, Stevens pointed to a problem that is afflicting all major economies, saying it "could do with some more demand growth over the next couple of years."

It was clear from the bank governor's remarks that further interest rate cuts will do nothing to bring that about. Monetary policy could not deliver everything that was needed, he said, and "expecting too much from it can lead, in time, to much bigger problems."

Of the three major sources of increased demand—households, government and corporations—households had probably "the least scope to expand their balance sheets to drive spending. That's because they already did that a decade ago."

Earlier this year, Barclays Bank reported that household debt in Australia, comprising mortgages, credit cards and personal loans, was equivalent to 130 percent of GDP. This is an all-time record, and the highest figure in the world, prompting warnings of vulnerability in the event of another financial crisis.

Nor would further interest rate cuts boost business investment. In fact, the outlook is worsening, according to Stevens. Resource sector investment was down and "has a good deal further to fall over the next two years. Other areas of investment seem very low and while I would have expected that by now these would have been showing signs of strengthening, the most recent indications are for, if anything, a weakening over the year ahead."

Public spending was not growing and public investment spending fell by 8 percent last year. This result contrasts markedly with statements from both the previous Labor government and the current Abbott Liberal-National government about their commitment to infrastructure spending.

Stevens ended his remarks by calling for agreement on infrastructure spending, financed by government borrowing, through which the real economy would benefit from steady construction work.

Of course, the question immediately arises as to why that has not been carried out, either in Australia, Europe, the United States and elsewhere? Stevens pointed to a lack of cooperation by state and federal governments.

However the real reason lies in the hostility of the financial markets to such measures. Any significant increase in public spending would see immediate pressure, starting with downward revisions of credit ratings.

Finance capital delivered its verdict on any Keynesian and quasi-Keynesian measures more than three decades ago. Today its demands are for cheap money to finance speculation, coupled with cuts in social services and working conditions.

During question time, Stevens alluded to this agenda when he repeated a call he has made since 2012 that governments must act on a "to-do list" from the Productivity Commission to end industry subsidies, eliminate red tape and cut back workplace restrictions—code phrases for attacks on jobs, and social and working conditions.