# HAS AUSTRALIA PASSED THE POINT OF NO RETURN?

THE SHORT CUT

**ANDREW MACKEN**

OVER recent weeks, we have observed a wave of activity in the major Australian property markets that suggest the recent downturn may well be over.

At the heart of the apparent resurgence, as is usually the case, is policy, policy and more policy. First on the monetary side of things, policy from the Reserve Bank has resulted in the lowest cash rate on record, at just 1 per cent.

All else being equal, lower interest rates will push up asset prices. There are a number of ways to think about this. Financial analysts will think about the effect a lower discount rate has on the future cash flows generated by any asset.

Simply reducing the discount rate by, say, 1 per cent (forever) on the set of rental cash flows that a property will generate in the future could increase its value by more than 50 per cent. The other way to think about the effect looser monetary policy has on asset prices is to conceptualise a greater supply of money (which is a corollary of lower interest rates) chasing the same quantity of assets in an economy. Naturally, asset prices are bid up.

Second, we have macroprudential policy which is effected by the Australian Prudential Regulation Authority. Among other financial institutions, APRA oversees the banks and recently moved to loosen rules around serviceability tests for mortgage applications.

This is another impediment removed by policymakers to enable the creation of more mortgage credit in the Australian property market.

And third, we have fiscal policy. Or in this case, after Labor's defeat at the federal election, the elimination of the prospect of certain tax policies (around negative gearing, in particular) designed to reduce the incentive to invest in property.

Putting this all together, it's hard to argue with the Aussie property bulls who contend that our policymakers have returned to being aligned and supportive of renewed housing price appreciation.

Do our policymakers even have a choice? This is an interesting question asked far less frequently.

On monetary policy, how can the RBA do anything other can keep interest rates low? Inflation is nowhere to be seen. And with stagnating domestic wages and an ageing population, wouldn't you expect disinflation to persist?

On the fiscal side, the election result effectively locked in favourable tax incentives for property investors. Any move now to reduce these tax incentives for negative gearing would be political suicide.

And what if property prices in Australia's major cities were to fall for some other reason?

The extent of the financial leverage on the balance sheets of Australian households today means there would be very negative knock-on effects to the real economy. Lower property prices could well translate into reduced consumption and higher unemployment rather quickly.

This, in turn, would force the RBA and the federal government to step in with even more supportive policy stimulus. Indeed, it would almost appear we have passed the point of no return — that the only choice is to keep going. This is great news for Aussie property bulls.

Longer term, however, this may not be great news for Australia. Splitting society between those who own property and those who don't will create a very different Australia to the one in which most property owners grew up.

**ANDREW MACKEN IS CHIEF INVESTMENT OFFICER AT MONTAKA GLOBAL INVESTMENTS**

# THE ROAD TO GROUND ZERO

Just a few years ago, we were the rockstars of the global economy. Now Australia and New Zealand have joined a global race to the bottom, writes **Michael Heath**

OUR economies are separated by the Tasman Sea and little else: both have been geared to China's commodity story and both have managed to resist the descent into negative interest rates. But how the mighty have fallen.

New Zealand, like Australia, now finds itself with just 1 percentage point of conventional monetary policy remaining.

That's around the same level interest rates were at when the US and British central banks turned to quantitative easing — buying up bonds as a way of flooding the economy with cash — to support demand during and after the global financial crisis.

New Zealand's rate cut of 0.5 percentage points this week and Australia's back-to-back cuts in June and July suggest both have joined the global race to the bottom.

There seems little doubt Australia and New Zealand's ascendancy is over and both are now right back in the global policy pack.

It's a far cry from five years ago, when HSBC's chief economist for Australia, Paul Bloxham, described New Zealand as a "rockstar economy" and the Australian dollar was still near parity with the US dollar.

In hindsight, it was obvious the two economies would eventually fall back to Earth.

China couldn't keep building skyscrapers and railroads to drive its fortunes, meaning demand for iron ore and other minerals was destined to wane. Similarly, while growth in dairy consumption by Chinese households was massive, it was going to have its limits.

As these drivers eased, both economies then switched to riding the housing tiger, leading to property bubbles that eventually needed to be deflated, leaving households creaking under heavy debts with spending constrained.

Reserve Bank of New Zealand governor Adrian Orr was upfront at his press conference on Wednesday about the potential need for so-called unconventional policy.

"We would be negligent not to be doing the work," Mr Orr said, acknowledging the central bank was looking into how it could operate negative interest rates, buy up assets, and other forms of economic "intervention".

Dr Lowe has maintained that here, negative rates are unlikely. "I am very hopeful that we will not need to go, certainly into negative territory, or to these very low interest rates," he said in June.

But traders and economists are leaning toward the RBNZ's assessment over the RBA's.

While Australia's policymakers have been reticent about negative rates, their assessment from international experience is that they are viable.

The concern had been that citizens would pull their money out of the bank and stuff it into their mattresses. But that hasn't come to pass in nations such as Switzerland, Sweden and Japan.

Critically, the floating exchange rates in both Australia and New Zealand remain shock absorbers. They may be doing that job for some time yet.

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