AFR Thursday 4 January 2018
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The missing pieces in a big picture of global recovery

Economics

The global rebound will not be certain until stagnant productivity rises again. But are we doing the right things to make that happen?

Michael Spence

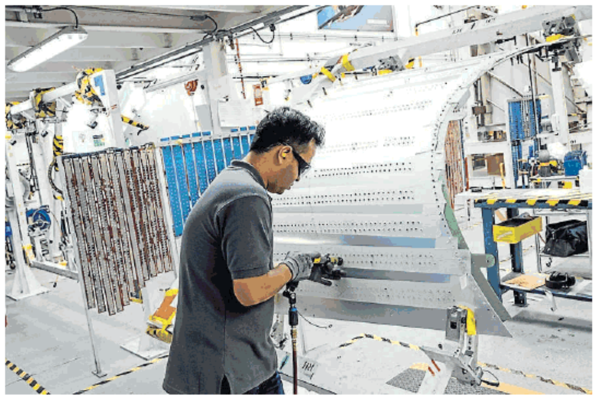
Karen Karniol-Tambour

Most of the global economy is now subject to positive economic trends: unemployment is falling, output gaps are closing, growth is picking up and inflation remains below the major central banks' targets. On the other hand, productivity growth remains weak, income inequality is increasing and less educated workers are struggling to find attractive employment opportunities.

After eight years of aggressive stimulus, developed economies are emerging from an extended deleveraging phase that naturally suppressed growth from the demand side. As the level and composition of debt has been shifted, deleveraging pressures have been reduced, allowing for a synchronised global expansion. Still, in time, the primary determinant of GDP growth – and the inclusivity of growth patterns – will be gains in productivity. Yet there is ample reason to doubt that productivity will pick up on its own. There are several important items missing from the policy mix that cast a shadow over the realisation of full-scale productivity growth and a shift to more inclusive growth patterns.

First, growth potential can't be realised without sufficient human capital. This lesson is apparent in the experience of developing countries, but it applies to developed economies, too. Unfortunately, across most economies, skills and capabilities do not seem to be keeping pace with rapid structural shifts in labour markets. Governments have proved either unwilling or unable to act aggressively in terms of education and skills retraining or in redistributing income. And in countries such as the United States, the distribution of income and wealth is so skewed that lower-income households cannot afford to invest in measures to adapt to rapidly changing employment conditions.

Second, most job markets have a large information gap that will need to be closed.



Workers need more guidance on how to update their skills. PHOTO: BLOOMBERG

Workers know change is coming, but don't know how skills requirements are evolving, and thus cannot base their choices on concrete data. Governments, educational institutions and businesses have not provided adequate guidance on this front.

Third, firms and individuals tend to go where opportunities are expanding, the costs of doing business are low, prospects for recruiting workers are good and the quality of life is high. Environmental factors and infrastructure are critical for creating such dynamic, competitive conditions. Infrastructure, for example, lowers the cost and improves the quality of connectivity. Most arguments in favour of infrastructure investment focus on the negative: collapsing bridges, congested highways, second-rate air travel and so forth. But policymakers should look beyond the need to catch up on deferred maintenance. The aspiration

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should be to invest in infrastructure that will create entirely new opportunities for private-sector investment and innovation.

Fourth, publicly funded research in science, technology, and biomedicine is vital for driving innovation over the long-term. By contributing to public knowledge, basic research opens up new areas for private-sector innovation. And wherever research is conducted, it produces spillover effects within the surrounding local economy.

Almost none of these four considerations is a significant feature of the policy framework that prevails in most developed countries. In the US, for example, Congress has passed a tax-reform package that may produce an additional increment in private investment, but will do little to reduce inequality, restore and redeploy human capital, improve infrastructure, or expand scientific and technological knowledge. The package ignores the very ingredients needed to lay the groundwork for balanced and sustainable future growth patterns, characterised by high economic and social productivity trajectories supported by the supply side and the demand side (including investment).

Bridgewater founder Ray Dalio describes a path featuring investment in human capital, infrastructure and the scientific base of the economy as path A. The alternative is path B, characterised by a lack of investment in areas that will directly boost productivity, such as infrastructure and education. Though economies are favouring path B, it is path A that would produce higher, more inclusive and more sustainable growth, while also ameliorating the lingering debt overhangs associated with large sovereign debt and non-debt liabilities in areas such as pensions, social security and publicly funded healthcare.

It may be wishful thinking, but our hope for the new year is that governments will make a more concerted effort to chart a new course from Dalio's path B to path A.

PROJECT SYNDICATE

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We should know how this property movie ends

Housing

Bubble or no bubble, people borrow too much – and the banks have let them do it.

Richard Holden

For all the discussion of housing prices in Australia, it is very hard to tell if there is a bubble. Sydney price-to-income ratios are the second-highest in the world – above London and New York – but hey, Sydney is a great place to live. Supply is constrained by zoning laws, two national parks, a mountain range and an ocean. Yet demand continues to grow, so prices tend to rise.

I don't know if there's a bubble in the Australian housing market, but there are some very troubling markers that suggest impudent borrowing and lending. Just the sort of things that preceded the US housing implosion nearly a decade ago. And I worry that bankers, borrowers and regulators seem not to have learned the lessons of that very painful piece of economic history.

First, the markers. Australia lenders will let you borrow a lot compared to your income. If one adjusts for tax and exchange rates and uses an online mortgage calculator, it is easy to see that a major Australian bank will lend about 25 per cent more for the same income level compared with what a major US bank will now lend.

Not only can one borrow a lot, the structure of the loans is often very risky. A staggering 35.4 per cent of home loans in Australia are interest-only, according to recent APRA figures. That has dropped from above 40 per cent thanks to APRA's recent 30 per cent cap on the amount of new loans that can be interest-only.

provide inaccurate information about their income, assets, or expenses to lenders seem prevalent and on the rise. A UBS survey in late 2017 found that approximately 30 per cent of home loans, or $500 billion worth could be affected. This is exactly what occurred in the US.

We can't even be sure that people have true equity in their new properties. With deposit insurance one can get away with a 5 per cent deposit, although it is typically 20 per cent without. But how careful are banks about where the deposit comes from? There are now troubling suggestions that the leading use of unsecured personal loans is

> *If it was them lending their own money then I might believe it.*

for a mortgage deposit. All of this is aided and abetted by mortgage brokers – or at least some of them. A remarkable 55 per cent of all new mortgages come through a broker. And those brokers get paid based on how many dollars of home loans they write.

Their incentives are thoroughly misaligned with both borrowers and lenders – just as was the case in the US a decade ago. There are also high-powered

respondents tells us a lot. In October last year Westpac CEO Brian Hartzer told the House of Representatives Standing Committee on Economics: "We don't lend to people who can't pay it back. It doesn't make sense for us to do so."

ANZ's Shayne Elliott holds the same view, telling the committee, "It's not in our interest to lend money to people who can't afford to repay". If it was them lending their own money then I might believe it. But people act differently when they are playing with other people's money. That is the essence of the moral hazard problem.

Mr Elliott, told ABC's *Four Corners* that mortgages are all individual risks: "The reality is that housing loans are pretty good because they're quite diverse in terms of lots of relatively small loans across ah across the country."

"Ah", indeed. One of the key lessons from the US experience was how highly correlated the risks on mortgages are. Do Australia's lenders really not get that?

Bubble or no bubble, we seem to be blithely repeating the US housing-market experience in almost every respect. People borrow too much and banks let them; there is moral hazard and fraud in mortgage issuances; regulators finally do something – very little and very late.

The happy scenario is that macro-prudential regulation is finally biting, and that underwriting standards are starting to

Time for a legacy that's sustainable

Martin Rees

Now is the time of year we resolve to use our time better in the time to come.

Our cosmic horizons are far more extensive than those of our forebears. We have entered the anthropocene era when one species, ours, can determine the planet's fate.

The collective "footprint" of humans on the Earth is heavier than ever; today's decisions on environment and energy resonate centuries ahead. They will determine the fate of the entire biosphere and how future generations live.

In contrast, our planning horizons have shrunk because our lives are changing so fast. The political focus is on the urgent and immediate, and the next election.

Medieval cathedrals took a century or more to complete. Now, there are few efforts to plan more than two or three decades ahead – or to build structures that will, as the cathedrals have done, offer inspiration for a millennium.

As an antidote to short-termism, we should welcome the initiative of the California-based Long Now Foundation. In a cavern deep underground in west Texas, it is building a massive clock designed to tick (very slowly) for 10,000 years, programmed to resound with a different chime every hour over that expanse of time.

Don't forget that a key trigger of the US housing meltdown was when five-year adjustable rate mortgages could not be refinanced, and borrowers faced steep upticks every quarter in their interest rates.

Interest-only loans in Australia typically have a five-year horizon and have often been refinanced. If this stops then repayments will soar, adding to mortgage stress, delinquencies, and eventually foreclosures.

So-called "liar loans", where borrowers

incentives for those originating loans with banks, creating more moral hazard.

But perhaps the biggest marker of all is the response from lenders. On liar loans, an ANZ spokesperson said UBS' survey of 907 people was "extremely limited" compared to the total number of home loans.

Opinion polls the day before an election are also small compared to the number of total voters, but they have been pretty accurate in Australian elections overall. A representative sample of around 1000

improve. Even if that is true, we are still left with highly indebted households who have nearly $2 of debt for every $1 of GDP, a raft on interest-only loans that will soon involve principal repayments and stagnant wage growth. Having lived in the US during the mortgage meltdown I'm sorry to say that I've seen this movie before. The question is: why haven't our bankers?

Richard Holden is professor of economics at UNSW Business School.

Those who visit it this century will contemplate an artefact built to outlast the cathedrals – and will hope that it will still be ticking a hundred centuries from now, and that this century's legacy is a world that is sustainable rather than devastated.

THE TELEGRAPH, LONDON

Lord Rees is Britain's Astronomer Royal.

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