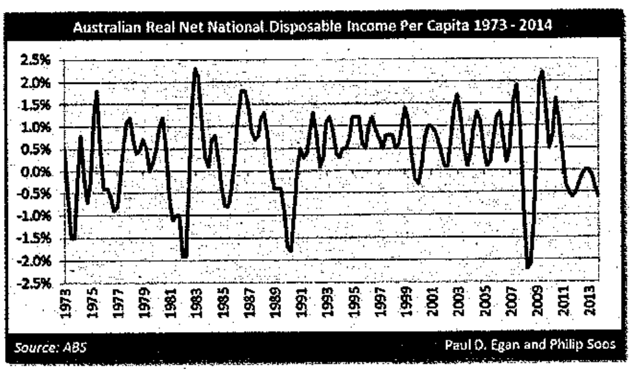
Real Incomes, Real Debt *by Philip Soos*

Real GDP is typically used as the proxy for economic growth, but real net national disposable income per capita (RNNDIPC) is a better measure as the Australian Bureau of Statistics notes:

Real net national disposable income is a key measure of Australia's economic wellbeing. It adjusts gross domestic product (GDP) for income flows between Australia and overseas, for changes in the relative prices of our exports and imports (the terms of trade) and for depreciation of fixed capital used in the production process, as these influences can increase or decrease the capacity of Australia and Australians to buy goods and services.

According to the quarterly data, Australia had experienced either zero or negative growth since Q1 2012. As commodity prices continue to plunge due to the worldwide surge in production, the terms of trade has fallen significantly, indicating RNNDIPC should remain negative in the future.

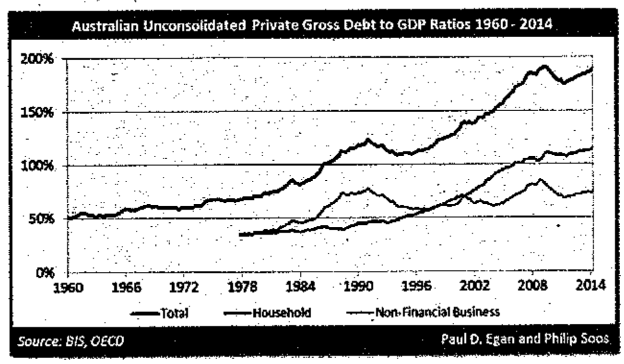


A major driver of economic growth is the acceleration of private debt. The exponential increase of household debt over the last two decades has boosted the economy, resulting in an extreme private debt burden. The Bank of International Settlements records unconsolidated household and non-financial business debts.

We know from the RBA the vast majority of household debt is mortgage debt, with a small remainder of personal debt. The latter is steadily decreasing in absolute terms and hence relative to the size of the economy since the Global Financial Crisis, but this unfortunately only makes more room for an increase in mortgage debt.

While Australia's non-financial business debt is quite low relative compared to other wealthy and rapidly developing nations (the OECD and BRIC), household debt is the real killer. As of Q2 2014, Australia is ranked fourth-highest, 0.3% behind third placed Netherlands, and we should pass them in the next quarter (Q3 2014).

Both Demark and the Netherlands have been deleveraging since their housing bubbles burst during the GFC, but the fall in their nominal GDP actually keeps their ratios high (akin to Irving Fisher's debt deflation paradox). Switzerland, in second place, is continuing to leverage given their negative nominal cash rate of -0.75 per cent and housing bubble.



The Australian government has hoped the mining boom and FIRE (finance, insurance and real estate) sector would help grow the economy for the next couple of decades, while neglecting almost everything else. But the capital expansion phase of the mining boom has now passed, with falling commodity prices threatening the insolvency of the mining companies.

There is almost nothing left that is productive and large enough to fill the gap left by the end of the debt-financed housing bubble and mining investment boom. The economy is in a technical income recession, with negative real wage growth, increasing unemployment and underemployment and falling national income. A housing oversupply has damped rents to the point where they are falling in real terms.

Australia had the opportunity to invest in productive enterprise and engage in authentic tax reform, but the lack of genuine political and economic democracy has resulted in an economy that is steadily more inefficient and inequitable. The wealthiest 1% has feasted on a banquet of unearned economic rents, ensuring we will follow the path of the Eurozone and United States.