Home loan stress threatening millions of households in Australia

By Mike Head
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An immense financial and social crisis is developing in Australia because of extraordinary levels of mortgage debt, falling property prices, rising interest rates and the driving down of real wages.

Nearly one million households—one in four—are already being labelled "mortgage prisoners." That is, they are trapped in debt while house values are falling. That number will soar as interest rates rise from their current record lows, according to detailed research published in the past two weeks.

This financial trauma is concentrated in working class suburban and regional areas, where some postcodes have at least 90 percent of mortgaged households "in stress," meaning they do not have enough income to cover mortgage repayments and other living expenses.

These statistics provide a glimpse of the intolerable conditions that confront millions of working class people, while corporate profits soar on the back of record low wage growth and the increasingly casualised, insecure and under-employed workforce.

A speculative property bubble fuelled by cheap credit has underpinned economic growth in Australia since the 2008 global financial crash and the 2012 slump in the China-driven mining boom. Over the past 12 months, however, that bubble has begun to burst, while interest rates are beginning to rise at the same time.

New figures this week show Sydney property prices dropped 5.6 percent over the past year, while the national market fell 2.2 percent. It signals the end of a five-year boom, during which prices in Australia's biggest city rose 70 percent and household debt rising to 200 percent compared to disposable income—one of the highest levels in the developed world.

Numbers of financial economists and business leaders are warning of a possible crash. On Wednesday, Michael Chaney, chairman of Wesfarmers, one of the country's biggest retailing and industrial conglomerates, said house prices could fall 20 percent and drag Australia into recession. Large numbers of people would be left with property worth less than their debts.

Another warning sign came last week. Westpac, one of the four large banks, raised its mortgage rates by 0.14 points, due to increased global borrowing costs, even though the Reserve Bank of Australia had kept official interest rates on hold at a record low of 1.5 percent for 25 months. Three other banks have since joined Westpac's hike and others are likely to follow.

In a report broadcast on the Australian Broadcasting Corporation's "Four Corners" on August 20, Martin North of Digital Finance Analytics, which conducts household financial surveys, estimated that 820,000 households were already "in stress."

This figure would soar if interest rates rose. A 0.5 percentage point rate increase would throw another 330,000 households into stress. Nearly half these households would be in major cities, especially in outer suburban working class areas. In the Sydney outer western suburb of Kemps Creek, for example, 86 percent of mortgaged households would be in stress.

A 2 percentage point rise would see such crisis levels develop in a wider sweep of suburbs, reaching 100 percent of mortgaged households in the Melbourne northern suburb of Fawkner and Sydney's Silverwater and Kurnell.

A 5 point rise, taking rates back to the pre-2008 "normal" level, would throw more than two million households into stress, affecting at least 90 percent of mortgaged households in more than 170 postcodes. Only the wealthiest enclaves would have less than 10 percent in stress.

In another report, North said a full-blown credit crunch was already emerging, illustrated by the growing number of people being rejected by banks for new mortgages. Due to "lax" bank lending practices a year ago, banks rejected only 5 percent of people applying to refinance their mortgage. "Now it is 40 percent, which is a huge difference."

North said people mainly tried to refinance in order to reduce their monthly outgoings, which showed that many households are under mortgage stress. "At the same time the cost of living is rising because wages are falling, so it's a perfect storm for householders. On top of all that, the price of their house is falling."

Paul Dales, economist at Capital Economics, warned: "With the full effects of tighter credit conditions and rising mortgage rates yet to be felt, the current housing downturn will probably end up being the longest and deepest in Australia's modern history."

This prospect is now followed closely on global financial markets. The London-based *Financial Times* noted yesterday that it "follows a similar pattern overseas, where property markets from London to Toronto are seeing price declines as central banks begin to unwind record-low interest rates, consumers balk at paying record high prices and regulators or banks impose tougher lending criteria on consumers.

"Australia is becoming a test case of whether regulators can manage a soft landing, rather than a disorderly crash."

This concern was magnified because at the height of Australia's housing boom in 2015, investors took out more than 40 percent of mortgages. They relied on record low interest rates, generous tax breaks on capital gains and "negative gearing" tax concessions—when rental income undershoots interest costs.

This government-subsidised investment rush, combined with decades of deep cuts to social housing, pushed up prices, placing home ownership out of reach for many young working class people. Sydney became the second least affordable city in the world, with house prices almost 13 times median income.

The investment rush has started to go into reverse. Loans to housing investors totalled $10.4 billion in June, down 18 percent on the same month last year, the lowest approval level in almost five years.

One reason is that a royal commission inquiry into the banks and finance houses has belatedly begun exposing predatory lending practices. This week, Westpac agreed to pay a $35 million fine for lending money to borrowers who lacked the capacity to repay the loans.

The federal government and its corporate regulators, long complicit in these abuses, have felt compelled to start to clamp down, forcing banks to restrict investor lending, interest-only loans and tighten lending criteria.

At the peak of the boom, four in 10 mortgages were interest-only, with investors betting on ever-rising property prices. North told the *Financial Times* a big risk is the $360 billion in interest-only mortgages, which will convert to principal-and-interest loans over the next three years. Up to a quarter of these borrowers may struggle to meet higher repayments and be forced to sell their properties, he said.

Prime Minister Scott Morrison's Liberal National government, the opposition Labor Party and the corporate media are largely burying this worsening social crisis, indifferent and contemptuous toward the human impact.

This is being accompanied by misleading headlines about "booming" national economic growth. According to official statistics released yesterday, annualised growth gained up to 3.4 percent in the June quarter.

Yet, this result was largely driven by further debt-fuelled consumer spending. Wages remained flat and the household savings ratio fell to a decade low of 1 percent. These results only underscore the danger of a terrible slump, plunging more working class households into financial stress.