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AM - Economists expect interest rate hike

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Reporter: Andrew Geoghegan

ELIZABETH JACKSON: The Reserve Bank board is widely expected to decide to lift interest rates when it meets this morning. It'll announce its intentions tomorrow, but most economists believe the bank will move to tame inflation by pushing the key lending rate up a quarter of a per cent to 6 per cent, with the possibility of another rate hike later in the year.

And the latest credit figures are likely to reinforce that plan. Australians are continuing to take on more debt despite the most recent rate rise.

Steve Keen is the Associate Professor of Economics and Finance at the University of Western Sydney. He says that if the nation remains addicted to debt at its current levels, we'll be heading for a depression.

Steve Keen spoke to our Finance Correspondent Andrew Geoghegan.

STEVE KEEN: Mortgages are now higher than they've ever been in Australia's history and they've grown from trivial levels of about five to ten per cent of GDP to 75 per cent now.

You would think though, that after the collapse of the housing bubble in Sydney and Melbourne in the last couple of years, the ratio of mortgage debt to GDP would have started to fall by now, but it's still rising.

ANDREW GEOGHEGAN: Now, this comes despite the rate rise we had in May and the threat of further rate rises. Why then is it continuing to increase?

STEVE KEEN: Well, part of it's because there is still a housing bubble going on particularly in the Perth market, and also to some extent

Brisbane. But I think it's also probably because people have come so used to debt, that you now have all sorts of products being developed by banks to give people so-called access to their equity before they die, and I've got a feeling this is part of what's going on.

People aren't anymore, in the Sydney market at least, borrowing to speculate on a rising market, but they might be borrowing to so-called "access" the equity they've currently got inside their houses.

ANDREW GEOGHEGAN: Is there any sign that people are now borrowing to service their debt?

STEVE KEEN: It appears to be a lot of the borrowing may be simply borrowing from the

bank of Peter to pay the bank of Paul. That, of course, works for a short while, but then that just accelerates your crisis at some stage down the track.

ANDREW GEOGHEGAN: In the past you've been saying that you've been worried as interest rates rise, but now what's your opinion, given that we're looking, this week, at another rate rise.

STEVE KEEN: I think in some ways it may take a bit of extra pain to bring this to an end, because banks seem to have a limitless willingness to lend money to people who may individually be in stressed personal circumstances and regardless of the systemic worries that the entire financial system has.

So maybe it takes a bit more pain to mean that borrowers no longer want to approach banks for the loans, and banks get their fingers burnt to some extent. It may take something like that to bring this bubble to an end.

ANDREW GEOGHEGAN: And if it doesn't, if we continue on these current levels, where will it end?

STEVE KEEN: Well, it'll end in another depression because you simply can't sustain debt levels like this. We're now looking at aggregate debt in Australia exceeding 140 per cent of GDP, when back in the 1950s it was 20 per cent of GDP.

Now, you can work for a while by borrowing money and continuing to service your debt, but if you get to the levels of debt that we're looking at now, I think most people would know on their own personal finances, they can't sustain that pattern.

And yet there seems to be no end to this exponential increase in the rate level of debt compared to the level of income. Either we strike a crisis or we do something now to try to turn it around and stabilise our debt levels and hopefully bring them back down about 40 to 50 per cent below where they are now.

That's a long term process and it will involve a much lower rate of economic growth than we've been used to.

ANDREW GEOGHEGAN: Do you have any magic figure where you think interest rates need to be at before we actually start to see this turn?

STEVE KEEN: No, but a one-quarter-of-one per cent increase in rates now has more whammy than a one per cent increase had back in 89/90. So perhaps another one quarter of a per cent will be all that it takes to burn people's fingers, both banks and borrowers, to stop this lending bubble continuing.

ELIZABETH JACKSON: Associate Professor Steve Keen from the University of Western Sydney speaking to Andrew Geoghegan.

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