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Mr Peter Hallahan
Committee Secretary
Senate Economics References Committee
Suite SG.64
Parliament House
Canberra ACT 2600

Dear Mr Hallahan

Possible links between household debt, demand for imported goods and Australia's current account deficit

Some comments follow:

(a) current levels of household debt and whether these are historically high (as a proportion of income or otherwise)

I refer the committee to an article on the Treasury website by Comley, Anthony and Ferguson, "The effectiveness of fiscal policy in Australia – selected issues" where they suggest at page 2 that "the household savings ratio in Australia is not the best proxy for overall private savings behaviour" suggesting that private savings comparisons ought to include reference to corporate savings. They also model the various links that might be made and make a distinction in their analysis between short-term and longer-term analysis and I generally agree with those factors.

(b) the factors, including the lending policies of banks and other financial institutions, that contribute to household debt levels

Bank and other financial institution lending policies are a private concern of the way that they choose to run their business and in terms of their targets will be inextricably linked to the state of the economy rather than to the level of specific activity that occurs in one part or for one sector of the economy.

(c) the extent to which demand for imported goods contributes to household debt levels

Unable to comment except to suggest that low interest rates have an impact upon the level of debt that can be serviced by a household and this therefore may influence some households to increase expenditure on private goods. This is a personal choice made by the individual.

(d) the extent to which demand for imported goods by Australian households contributes to the current account deficit

The position of the current account deficit and how it is perceived is a matter for government. From an economic point of view one has to be careful to distinguish the short-term special interests promoted by concentration on the balance of the current account against the more general interests of the economy in the longer run. I think that it is very difficult to make a generalization about demand for imported goods or any other factor that is immediately visible without looking at the wider picture and all of the consequences of factors impacting the current account balance.

(e) risks for households and the economy of high household debt levels

Where households choose to take on greater personal debt then there may be consequences, depending upon how households manage their position. This is no different, in principle, from other decisions made by households. The economy will be buoyed by a general increase in expenditure, this can occur in a number of ways including household borrowing to fund expenditure. In the longer term economies will grow and recede and I see nothing unhealthy about this activity.

(f) whether there is a case for addressing the lending policies of banks and other credit providers and if so, what practical options are available

There is no case for interfering with bank lending policy on the basis of a governmental redistribution since it would be partial and selective and not address the concern, if in fact there is one, that the current account deficit is too high. Financial institutions have an excellent track record as private lenders in managing their lending positions.

(g) whether there are other measures that might be taken in place of possible restrictions on lending practices which would be as effective

The usual measure of raising interest rates will probably produce more careful personal expenditure, however note my comments at (a) above as to whether that is the best measure if one takes into account the whole picture for savings.

(h) whether any Commonwealth social and economic policy settings should be changed as a result of matters identified above

Not that I can see.

(i) whether there is a need for any other form of regulatory intervention in relation to this issue

It has not been established that there is a need to further interfere in the private mechanism. Before regulatory intervention is deemed necessary, it is suggested that empirical evidence be examined to determine the precise nature of the "issue" and to properly understand the distinction between specific and general economic concerns. Reactions to special interest short-run concerns will produce more secondary consequences without necessarily addressing more general concerns within the wider economic framework. Therefore I see no need for regulatory intervention.

(j) any related matters

None, other than those noted above.

Yours sincerely

David Morrison
10 February 2005