

From: [Fenella Bovett](#)
To: [Steven Mitchell](#);
CC:
Subject: FW: Australia and New Zealand - Movements in housing median multiples and household debt - "The Great Wealth Illusion"
Date: Monday, July 23, 2007 8:38:02 AM
Attachments: [AUST-HHLD DEBT.ppt](#)

-----Original Message-----

From: Hugh Pavletich [mailto:hugh.pavletich@xtra.co.nz]

Sent: Sunday, 22 July 2007 16:26

To: demographia@gmail.com

Subject: Australia and New Zealand - Movements in housing median multiples and household debt - "The Great Wealth Illusion"

Importance: High

Very good indeed Wendell. Thank you for the graph above within the email below.

As I will be heading overseas tomorrow for two months (emails checked daily) – I will bcc this email to others in New Zealand – so that hopefully someone generates a graph with respect to the New Zealand situation.

The reality of course is that property inflation is wealth destruction – something regrettably that is poorly understood / appreciated. The “illusion” that inflation is growth / wealth creation still persists – even in some surprising quarters – such as with some economists and property commentators, who should know better. One would think these people should be trained to fully understand the consequences of inflation.

It is a great pity in that it appears there is no household debt / household income information / data available at States / urban markets level in the United States – so that we can clearly see the situation of household debt / household income levels within the “affordable” (at or below a median multiple of 3) United States markets. Regrettably – the best we can go on at this stage is historical data – to get some idea of what household debt levels were in Australia and New Zealand – when our urban markets were at or near affordable levels. In New Zealand during the 70’s (according to Westpac NZ information) household debt levels were running at around 50 – 60% of household incomes.

It would be unreasonable to expect household debt levels to be running at 50 – 60% today – due to the greater availability of credit and the willingness of people generally to take on board greater debt. I understand the overall US household debt figure is currently in the order of 135% of household incomes – and “suspect” (the best one can do without the information) that within the affordable North American markets – household debt could be running at around the 110% - and within the unaffordable markets something in the order of 160 plus %.

In the case of New Zealand my “gut feel” is that if our urban markets had remained affordable – we could have some \$40 - \$60 billion less household debt today.

Is there data on household debt / household income available out of Canada – where the overall Median Multiple is 3.2 (the US 3.7)? It would be most helpful to know the Canadian situation.

The “wealth illusion” is poorly understood – and could be illustrated as follows in comparing a 3 Multiple with 6 and 9 Multiple markets -

Market	3 Multiple Market	6 Multiple Market	9 Multiple
Household Income Base pa	\$50,000	\$50,000	\$50,000
Starter Home price say	\$150,000	\$300,000	\$450,000
Exec Standard House	\$300,000	\$600,000	\$900,000
Difference	\$150,000	\$300,000	\$450,000

Let’s consider just a few points with respect how market behavior changes as urban markets ramp their way up through the Multiples –

(1) Generally – people think they are “better off” as the Multiples ramp up – particularly through the early stages, which I refer to as the “inflation party” stage – but as the Multiples increase, people begin to realize that “something is wrong” in what I refer to as the “inflation hangover” stage. It is likely they will be somewhat confused about this – not quite understanding why they are in reality getting poorer as their own properties are inflating.

(2) It all becomes a little clearer (not necessarily much!) when it comes time to “trade up” (it is very rare to trade down – people naturally aspire to something “better”). In reality (refer to the above examples) – those living in the 3 Multiple Market are considerably “richer” (in real terms) – because they have a much smaller “difference” to deal with – some \$150,000 whereas their poorer counterparts on the 6 Multiple market have a “difference” of \$300,000 to deal with – in the 9 Multiple market a

\$450,000 “difference”. Provided the 6 and 9 Multiple Markets keep inflating – the lending institutions are effectively incentivised to engage in low doc / liar lending. Who cares if they “default” – the artificial inflation pretty much takes the risk out of these lending practices. It’s a different story in a non inflationary 3 Multiple Market (just look at the latest Houston Assn of Realtors www.har.com numbers for a graphic illustration) or when an artificially inflated market stalls – as we are seeing being played out currently with the sub prime situation in the US. The same thing will play itself out in other inflated markets before long too. Inflation and poor quality business / lending go hand in hand (turning a production market in to a punters market).

(3) Those living in the non inflationary 3 Multiple Market are able to get in to the starter home much easier – with significantly lower debt, which they can clear quicker to trade up. Their counterparts in the 6 and 9 Multiple Markets will likely experience much higher debt loads through their lifetimes (the latest Australian Census information confirms this). Playing the “property game” in the inflated markets is in reality a very expensive (and futile) pastime indeed. Many think they are “making money” or getting wealthier (the inflation wealth illusion) but in reality, they are getting poorer. They forget they will likely own their own homes (and will likely trade up) throughout their lives. The only ones getting wealthy with this game are the Banks and other lending institutions – not the home owners. And the “stackers” too – those purchasing multiple properties and loading them up with debt. They are a small proportion of the population though.

(4) The problem is further compounded – when the children of those living in high Multiple Markets wish to purchase their own homes (something rarely considered by the parents at the time they trade up after the children leave home – it all comes as a bit of a shock!). In a 3 Median Multiple Market it is of course much easier for young people to access their own housing – without needing to secure “parental support”. It is near impossible for most of them to do so in high Median Markets – so one way or the other they “tap” their parents (Australian Prime Minister John Howard - as a recent high profile example!). The poor parents are likely to be “up to the gunwales” in debt – having bought something better, when the children “flew the coop”. They (the parents) will likely need to part with portions of their retirement savings (isn’t it surprising how economists are “confused” about poor savings rates!), load up more debt on their own homes or at the very least use their own homes as security, so that the children can access their first homes. No wonder in time – the parents are looking forward to the next part of this debt ponzi game, to get their hands on “reverse mortgage” money as soon as they are 60. In reality – it is all about building an intergenerational “debt mountain”. In fact in the UK – they have started

in to Mortgages that are never repaid. These are “gifted” to the children in the parents wills!

(5) To date there has been no helpful research that I am aware of, been done on what is termed the “spec effect” – in other words how artificially inflating markets trigger amplified existing housing transaction volumes (and dollar volumes) and suppress affordable new housing construction (should be about 50 / 50 I think). Sound GDP to total housing stock values (housing total stock values to GDP should not exceed 1.4 / 1.0 I think). Average housing stock age (should not be more the 50 years in a static market – and less in growing ones). What housing costs should be on the fringes (reasonable quality starter housing should not be outside the \$700 - \$900 per square meter i.e. for a 200 square meter land and house package unit between \$140,000 - \$180,000).these are just a few areas where urban micro research should be focused.

(6) My view is that much of the so called “boom “ we have had in Australia and New Zealand over this last lot of years – has in fact been a hugely damaging “urban property market bubble” (guess where by far the greatest proportion of our GDP comes from?) – caused in the main by the artificial inflation within our urban markets (something well outside the influence – or significant influence – of monetary policy). It is to be hoped that economists and property researchers will start focusing more on the “micro” aspects of our urban markets – so that they gain a better appreciation of the situation and consequences. In fact – it is pleasing to see that this process is well underway.

In conclusion – we look forward to the announcement on housing affordability by the Deputy Premier of Queensland, Hon Anna Bligh, 25 July – this Wednesday. I do hope this important announcement gets a solid airing within the Australian and New Zealand media.

All the best
Hugh

-----Original Message-----

From: wendell cox [mailto:demographia@gmail.com]

Sent: Sunday, 22 July 2007 1:15 p.m.

To: HPaveletich

Subject: Going out soon

Will be sent to all our friends.

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Wendell Cox

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THE WAL-MART REVOLUTION: How Big-Box Stores Benefit Consumers, Workers, and the Economy

By Richard Vedder & Wendell Cox