

Sent: 30 March 2004 8:50 AM  
To: housing@pc.gov.au  
Subject: Submission to the First Home Affordability Inquiry

Dear Sirs and Mesdames

Australian housing prices are underpinned by an increase in the availability of debt. Government policy needs to address the risks associated with the resulting rise in both housing prices and household debt.

The introduction of a Financial Stability Review by the Reserve Bank of Australia is a welcome development. However, the first Review (March 2004) was inadequate and merely repeated some well known risks and oft touted mitigants. The Review was backward looking; failed to adequately analyse the gravity of risks; failed to adequately assess the likelihood of risks eventuating either alone or in combination with other risks; and provided little on the role of policy in mitigating risks.

The Review points out the risk to the economy of the household sector deciding to consolidate its balance sheet. But is this a risk or an ultimate certainty? At the very least, the household sector will surely become a net saver again. Will that affect economic and financial stability?

The Review shows that locally incorporated banks have reduced their general loan provisions relative to the value of their loan portfolios. The capital requirement for bank mortgages was halved in the early 1990s (and there are currently proposals to further reduce such capital requirements). How will these developments affect financial stability going forward, particularly when taken in the context of a likely rise in risks (such as a rise in global interest rates, a fall in asset prices, a consolidation of household balance sheets and a rise in mortgage defaults)? Does this warrant a policy response?

Banks have increasingly relied on offshore borrowings to fund their loan portfolios, and almost half of these offshore borrowings are repayable within 3 months. The Review has little of substance to say about the risks associated with this development. How would global lenders respond to any significant fall in housing prices in Australia and a rise in default rates? How would the economy be affected by a large reduction in offshore borrowings?

The Financial Stability Review reflects a lack of insight and diligence by the very institution charged under legislation to ensure that monetary and banking policy contributes to financial stability.

Yours sincerely

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