AUSTRALIA'S AAA CREDIT RATING AFFIRMED. HOW'S YOURS?

By David Collyer (reprinted from prosper.org.au Sept 7, 2010)

The credit rating agency Standard & Poor's overnight reaffirmed Australia's AAA rating.

Donald Horne's 1964 label 'The Lucky Country' was ironic, yet fits our unique position as the western world endures its worst financial crisis since the Great Depression of the 1930's.

S&P says the risks to Australia include its dependence on commodity exports and the prospect of a housing market correction.

And there lies the challenge to our happy stupor.

"Existing house prices have climbed about 50 per cent in five years," S&P's credit analyst Kyran Curry said. "The risk of a collapse is more elevated than in previous years. Australia's banks are heavily exposed to the residential property market. If one of the banks blew up we would be taking a look at the sovereign rating."

"This is not what we think is likely. Australia's banks are sound, liquid, well capitalised and we have given them some of the highest ratings in the world."

"What is most likely is a gradual drag on house prices rather than a collapse. We certainly don't see the growth of recent years as sustainable."

S&P cannot predict the bursting of our bubble – who can? But this sober assessment – that our government has little debt and our banks are well placed – makes clear who the hammer blows will strike in a housing downturn: first homebuyers and negatively geared investors.

First homebuyers typically have limited equity, low early-career earnings and inadequate property knowledge.

Most of the 1.3 million Australians with negatively geared investment properties are middle income earners. They are vulnerable to higher interest rates or bank demands for additional equity.

Both groups have gone all in, gambling on continually rising house prices.

If S&P's modest forecast of steady prices is correct, the next five years will be absolute agony. Interest costs will swallow all their cash flow, year after grinding year. Meanwhile, inflation of even 2 to 3 per cent will wear away their purchasing power.

And after that very long five years, they will be not one penny better off than today. Ouch!

And this is the good news version – S&P are optimists!

The element overlooked in this crazy equation is that both first home buyers and investors are driven to their extreme positions by our badly distorted tax system – twisted to benefit established landowners over the landless.

Land has a special status. We all need an area to call our own. Without it we are not free and cannot participate fully in society. The supply of land is limited – not just by geography, but by government zoning and restriction and most importantly, by existing landowners preferring to hold land, even where it produces a poor return.

Prosper has called loud and long for the introduction of a Land Tax and simultaneous reductions in the taxes on wages and business to prevent damaging financial traps like these.

Perhaps now citizens will hear and understand our message.