Mortgage distress and default in Australia: drivers, impacts and policy directions — is Australia different[1]?

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Abstract

This paper will report on the outcomes of a research project into mortgage default and distress in Australia, funded by the Australian Housing and Urban Research Institute. In addition to drawing on recent secondary material, including relevant parliamentary inquiries and industry surveys, the paper will present initial findings from a survey of mortgagors facing claims of possession on their homes, accessed through the supreme courts of New South Wales and Victoria. The paper will explore the key triggers of default, the range of social and economic impacts on defaulters and the implications for policy reform. Emphasis will be given to the socio-spatial dimension of mortgage distress in a metropolitan context.

Keywords

Mortgage default; mortgage stress; financial crisis; Australia; recession; spatial impact; housing boom.

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Introduction

In the period 1997 to 2007, Australian housing markets experienced a pronounced boom. House prices rose particularly sharply in the largest metropolitan areas — Sydney and Melbourne — and also grew rapidly in Brisbane and Perth, the latter as a result of a minerals boom in Western Australia, fueled by China's remarkable double-digit economic growth and emergence as a global leader in manufactured exports. Australia consistently figured in the 'top five' countries identified by *The Economist* magazine as having unsustainably over-valued housing markets — along with the United States, United Kingdom, Ireland and Spain (see next section). Critics also pointed to the very high level and growth in both consumer and investor residential mortgage debt in Australia over the boom period.

Surprisingly, then, from when the global financial crisis struck late in 2007, to date Australia has fared relatively well, both with respect to the macroeconomy and in the housing sector. Although there are — as argued later — signs that this benign picture is changing, it is certainly the case that, by the end of 2008, Australia had been but lightly brushed by the global economic turmoil. The year 2009 may tell a different tale.

This paper attempts to outline the broad picture of the Australian situation, to explain why this experience has differed from outcomes in most other OECD countries and, finally, to suggest why the future may embroil Australia too in a downward spiral of economic contraction, rising unemployment, escalating mortgage defaults and corporate and personal de-leveraging.

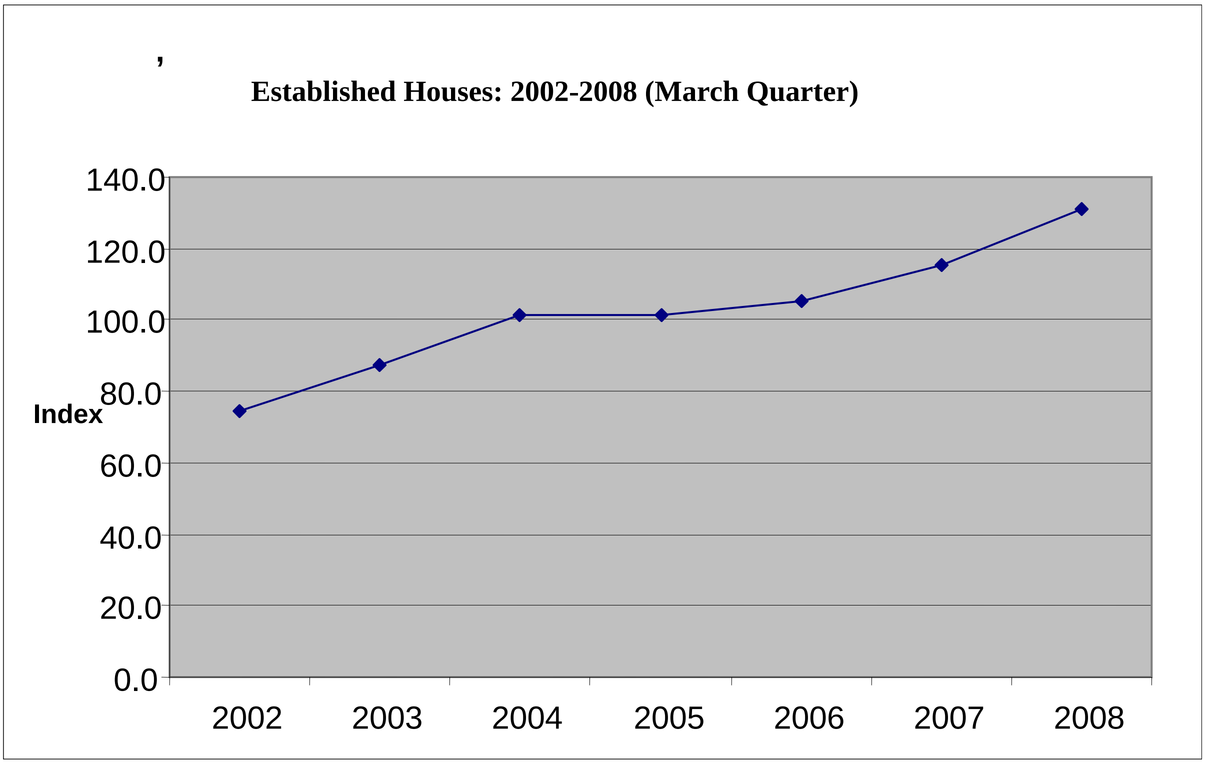
Anatomy of a Crisis

This section first outlines the nature of the housing boom in Australia in recent years, and then discusses the rising trend in mortgage stress and defaults as the boom moderated. The section finishes with a brief presentation of preliminary results from a survey the authors have carried out into residential mortgage repossession in two states; this is intended to give some initial insight into the nature of rising housing stress at the final point of dispossession.

1. The house price boom

Median house prices in Australia's main cities almost doubled between 2002 and 2008 (see Figure 1). The boom in Eastern Australia stalled in 2005–06 but took off again in 2007 (see Table 1). Perth's house price inflation continued through to 2006 but fell off after that as the minerals boom in Western Australia stalled. In 2008 and into 2009 average house prices have moderated but did not fall noticeably, except in parts of Sydney. New house construction and residential sales volumes did, however, fall markedly, suggesting that quantity reactions in the markets for both new and existing housing were absorbing much of the impact of falling demand (for discussions of why this might be so, see Berry and Dalton, 2004; Case and Quigley, 2009).

Figure 1: Australian Eight Capital Cities, House Price Index



Source: Australian Bureau of Statistics (2008)

Australia's housing boom has been driven by a mix of fundamental, institutional and conjunctural factors. The economy experienced almost 17 years of uninterrupted economic growth; rising incomes underpinned rising housing demand, especially in favoured locations in the metropolitan regions. Consistently high immigration, focused on the large cities, and falling average household sizes reinforced urban housing demand, whereas supply-side constraints in urban land markets and the move to 'up-front' user-pays infrastructure charges limited the rate and raised the cost of new house construction on the expanding urban fringe — especially in Sydney. Existing taxation regimes encouraged both owner-occupiers and small landlord-investors to build wealth through housing. Housing accounts for almost 60 per cent of total wealth in Australia; average housing wealth of home owners in 2003–04 varied from $174,000 in Darwin to $506,000 in Sydney (ABS, 2007a). Finally, booming agricultural and minerals exports to emerging Asian countries further focused jobs and housing demand on the main port-cities.

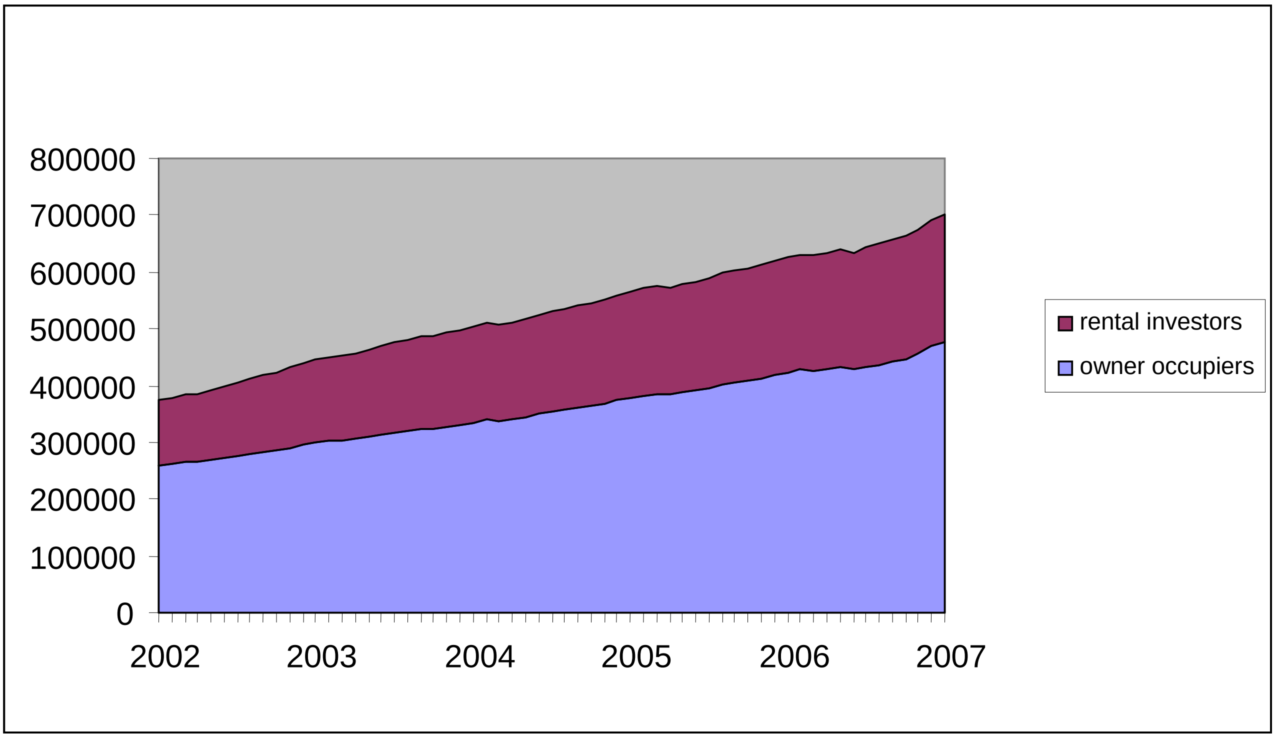
Table 1: Median House Price Changes in the Eight Capital Cities, Australia: 2007

City	Annual Change to December 2007 — Houses (%)	Annual Change to December 2007 — Units/Apartments (%)
Sydney	4.8	1.7
Melbourne	25.2	14.7
Brisbane	20.1	11.3
Adelaide	20.0	24.1
Perth	1.7	0.7
Canberra	14.6	11.4
Hobart	11.3	18.9
Darwin	5.3	-2.1

Source: Australian Property Monitors (2008)

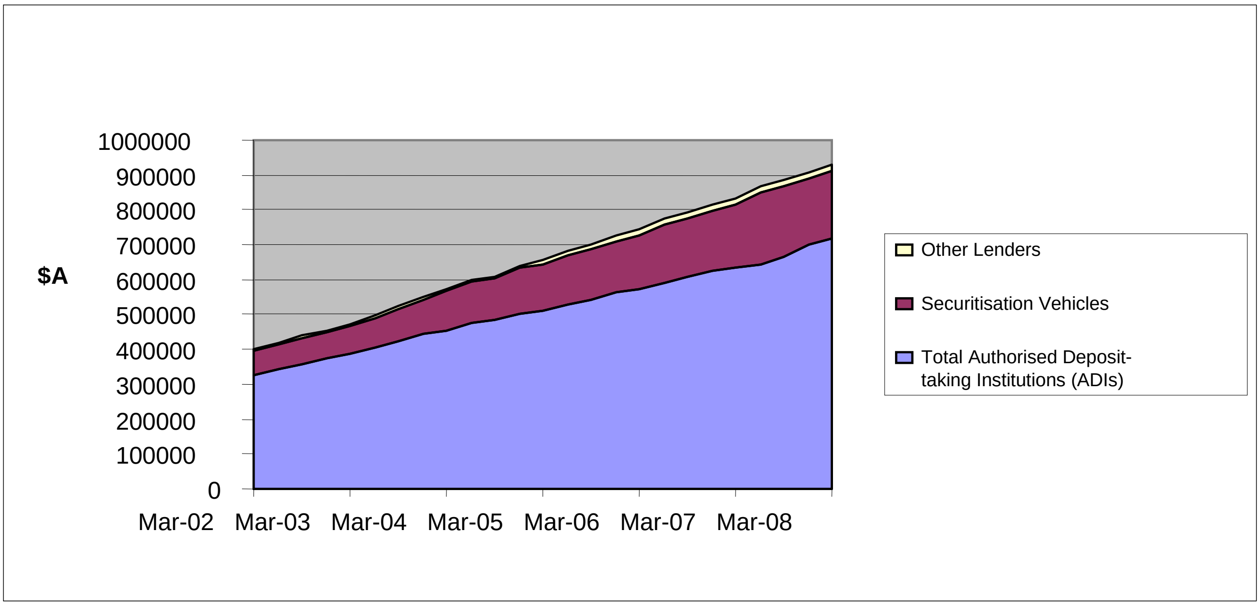
However, as in other countries, it was the pervasive impact of financial deregulation and the explosive growth of new forms of credit, particularly through mortgage markets, that really underpinned the housing boom and caused it to last so long (Berry, 2009). In Australia's case, the four large commercial banks had come to dominate the primary mortgage market by the 1990s and have continued to do so, in part by acquiring smaller rivals. In that decade a secondary mortgage market began to grow quickly and compete with the big banks, putting pressure on margins and encouraging product innovation. Mortgage backed securities attracted superannuation funds looking for liquid property assets. Landlord-investors accounted for an increasing proportion of mortgage borrowing, as Figure 2 demonstrates. Securitisation accounted for a growing proportion of mortgage debt outstanding up until early 2008 (see Figure 3); this market has almost disappeared with the onset of the global financial crisis. New mortgage products allowed, indeed encouraged, owners to re-finance loans and extract equity for both investment and consumption purposes (Ellis et.al, 2003).

Figure 2: Housing Finance Commitments, owner occupiers and rental investors, Australia, 2002–2007 (A$millions)



Source: ABS, 2007b (cat. No. 5609.0, Table 12)

Figure 3: Housing Finance, Total Loans Outstanding by all Lenders, Australia, 2002-2008 ($Amillions)

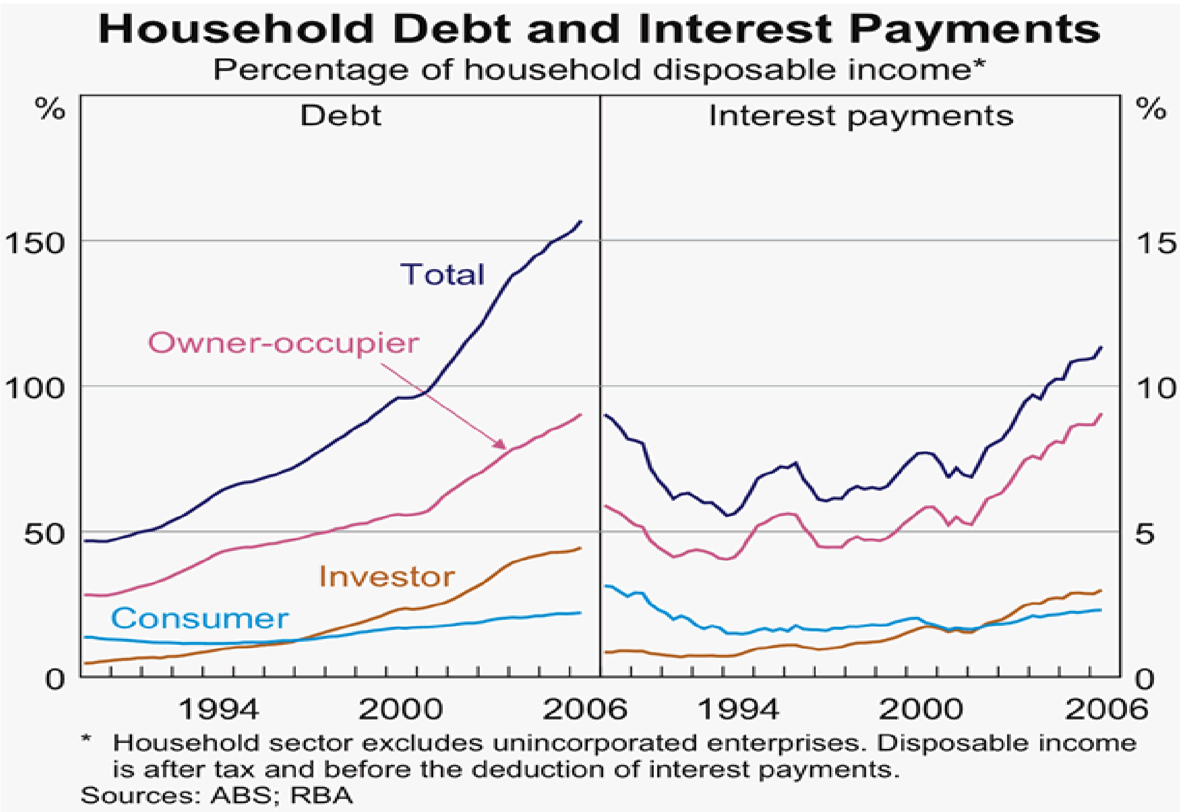


Source: ABS, 2007b (cat. No. 5609.0, Table 12)

2. Mortgage debt and delinquencies

The consequence of a decade of credit-fueled growth in housing prices has been a pronounced rise in indebtedness of owner-occupiers and landlord-investors (see Figure 4). By 2006, the ratio of mortgage debt to household disposable income had risen to over 90 per cent for home owners, and almost 50 per cent for investors. Not surprisingly, mortgage interest payments doubled in relation to household disposable income in the 12 years to 2006. More recent data reinforces this trend. 'Over the last 18 years, the level of household debt grew twice as fast as the value of household assets. As the ratio of household debt to assets doubled from 9 to 19%... Most debt was incurred to buy houses, with owner occupier housing the largest type of debt and investor housing the fastest growing' (Australian Bureau of Statistics, 2009, pp. 30-31). In a 2007 study, Fitch Ratings (2007) found that Australia ranked sixth in overall household risk exposure, behind New Zealand, Denmark, the United Kingdom, Norway and Sweden (in that order). With respect to housing over-valuation, Australia ranked tenth, but third in relation to household debt vulnerability (see Berry, 2009).

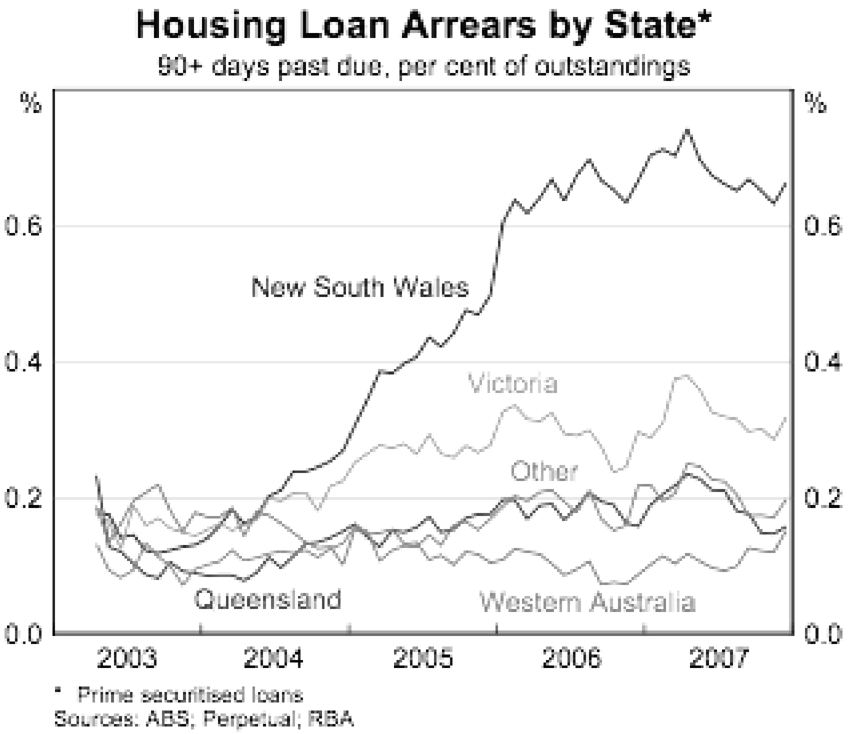
Figure 4: Debt and debt servicing ratios 1990–2006



Source: RBA (2008b; www.rba.gov.au/Statistics/B21hist.xls)

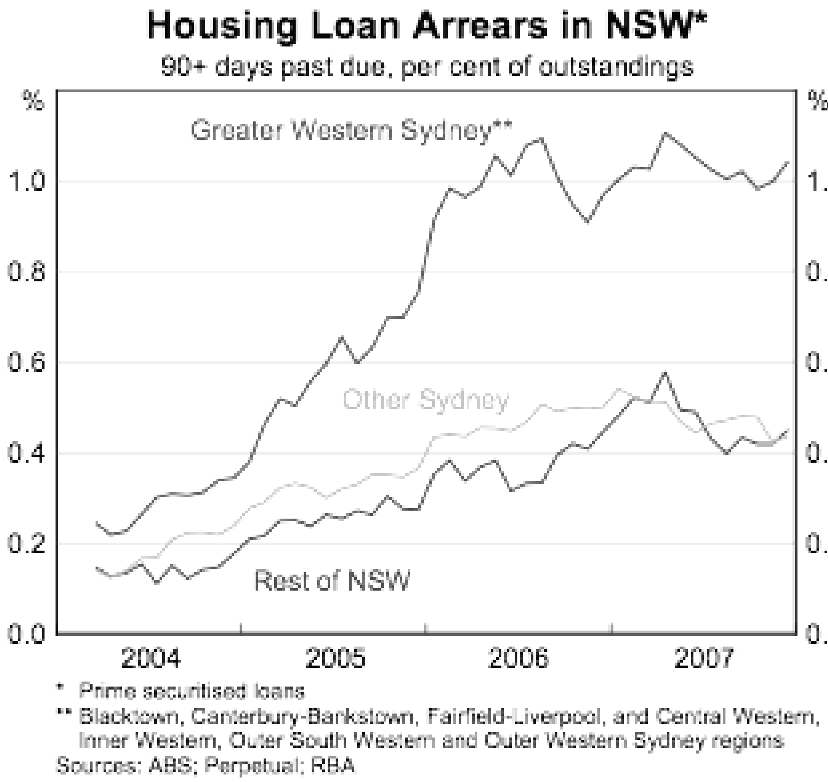
High debt vulnerability began to be evident from around the turn of the 21st century in the form of rising mortgage delinquencies. However, this trend started from a very low base. By 2007, less than one per cent of outstanding securitised residential prime mortgage loans were 90+ days in arrears (RBA, 2008a). There are, however, significant regional variations. Both the small scale and temporal and regional trends are expressed in Figures 5 and 6. NSW and, especially, the western region of Sydney have the highest delinquency rates. Moreover, 'non-conforming loans' are much more likely to be in arrears, around 7 per cent by the end of 2007 (see Figure 7). These loans are generally originated by non-bank institutions and can be seen as the Australian equivalent of US sub-prime loans. 'Low doc loans' have also trended upward in arrears; they are seen to be 'prime' but such borrowers do not undergo the usual strict credit checks used by lenders and insurers to approve standard mortgage loans. Figure 8 shows, that from the beginning of 2006, the 30+ day delinquency rate has climbed for loans originated by non-bank institutions — referred to in Australia as 'non-authorised deposit-taking institutions' or 'non-ADIs'. The arrears rate for the banks, large and small, has remained relatively stable at less than 1 per cent (see also, Richards, 2009, Graph 6 for a similar picture).

Figure 5: Comparison of housing loans in arrears, by state



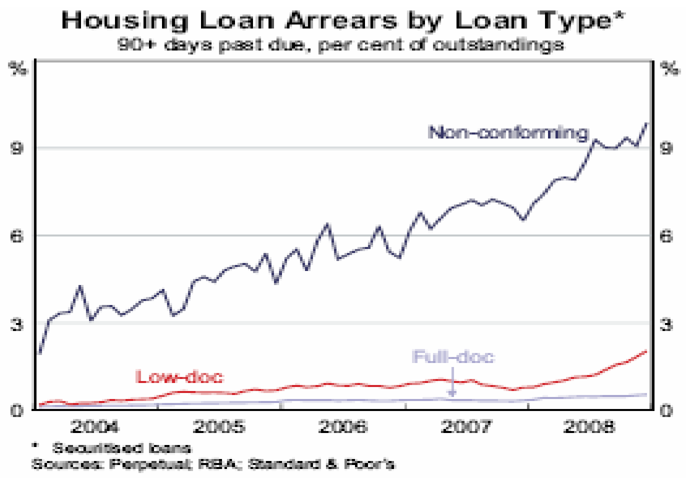
Source: Reproduced from RBA (2008a: Graph 45)

Figure 6: Regional comparison of NSW housing loans in arrears



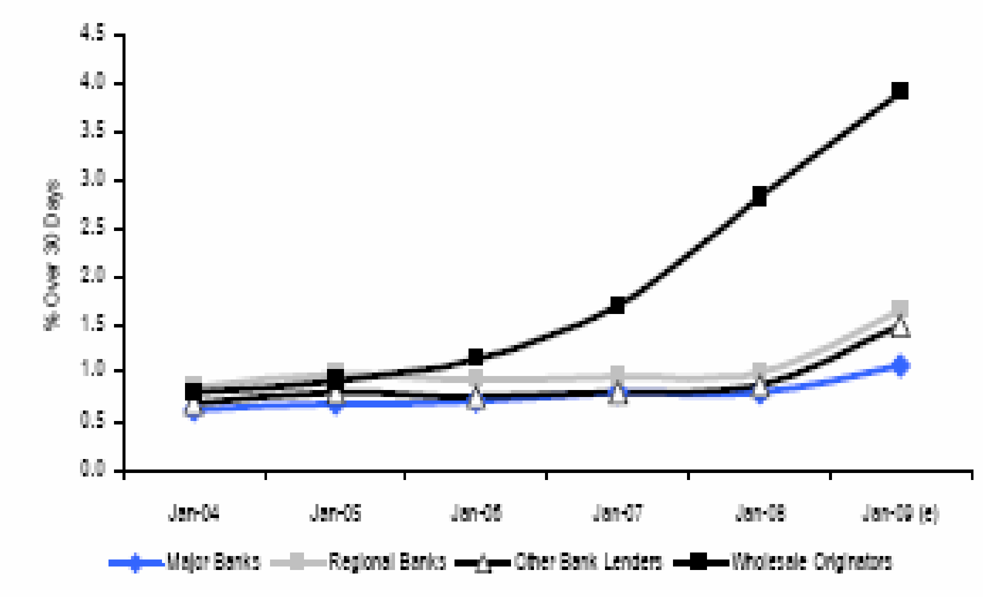
Source: Reproduced from RBA (2008a: Graph 46)

Figure 7: Arrears 90+ days by kind of loan, per cent of outstandings



Source: Reproduced from RBA (2009: Graph 72)

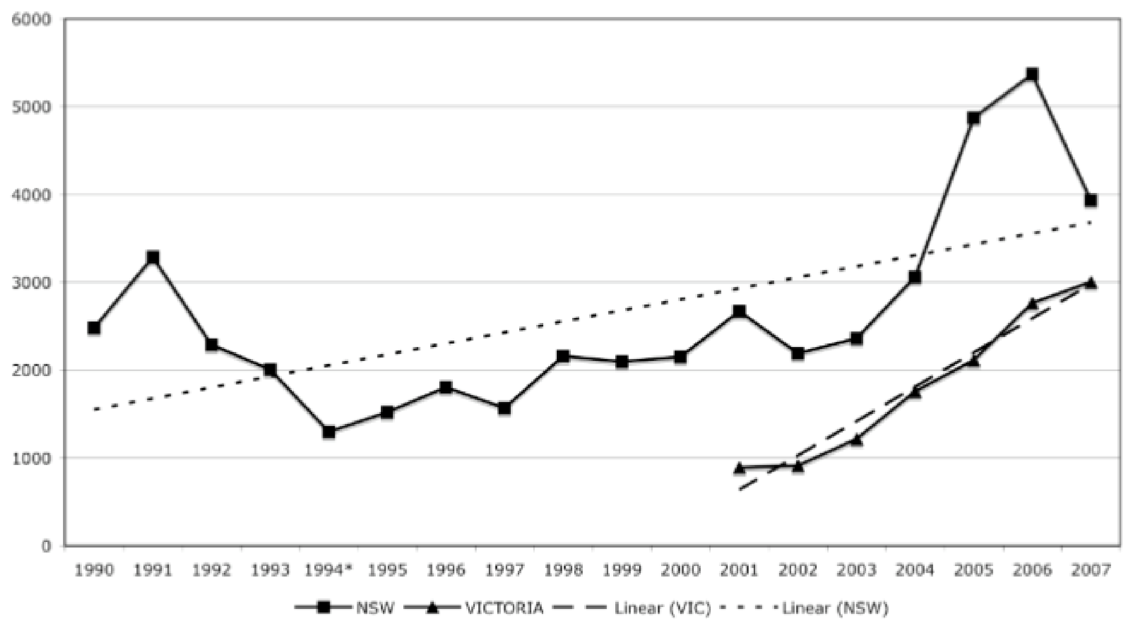
Figure 8: Loans 30+ days in arrears by loan originator



Source: Fujitsu (2009)

Finally, at the sharp end, it is clear that house repossessions have been rising sharply over the past few years. Figure 9 shows that Supreme Court directed possessions doubled in NSW and trebled in Victoria (Australia's two largest states) since year 2000.

Figure 9: Number of applications for claims of possession (1990/2001–2007)



Source: Personal communications with Supreme Court of NSW and Supreme Court of Victoria

Official statistics provide one picture of the current state of affairs. However, they tend to hide variations across both social groups and regions. Continuing and close monitoring of mortgage stress by market intelligence firm Fujitsu is providing an on-going narrative of developments in this space. Fujitsu (2009) maintains a statistically representative rolling national sample of 26,000 mortgagor households, based on monthly surveys administered to 2,000 respondents. Using a series of questions, respondents are identified as being in mortgage stress, as follows:

- *mild stress* — households are maintaining mortgage repayments but by delaying or reprioritising other expenditures, borrowing more on other loans (including credit cards) or refinancing their previous mortgage loan.

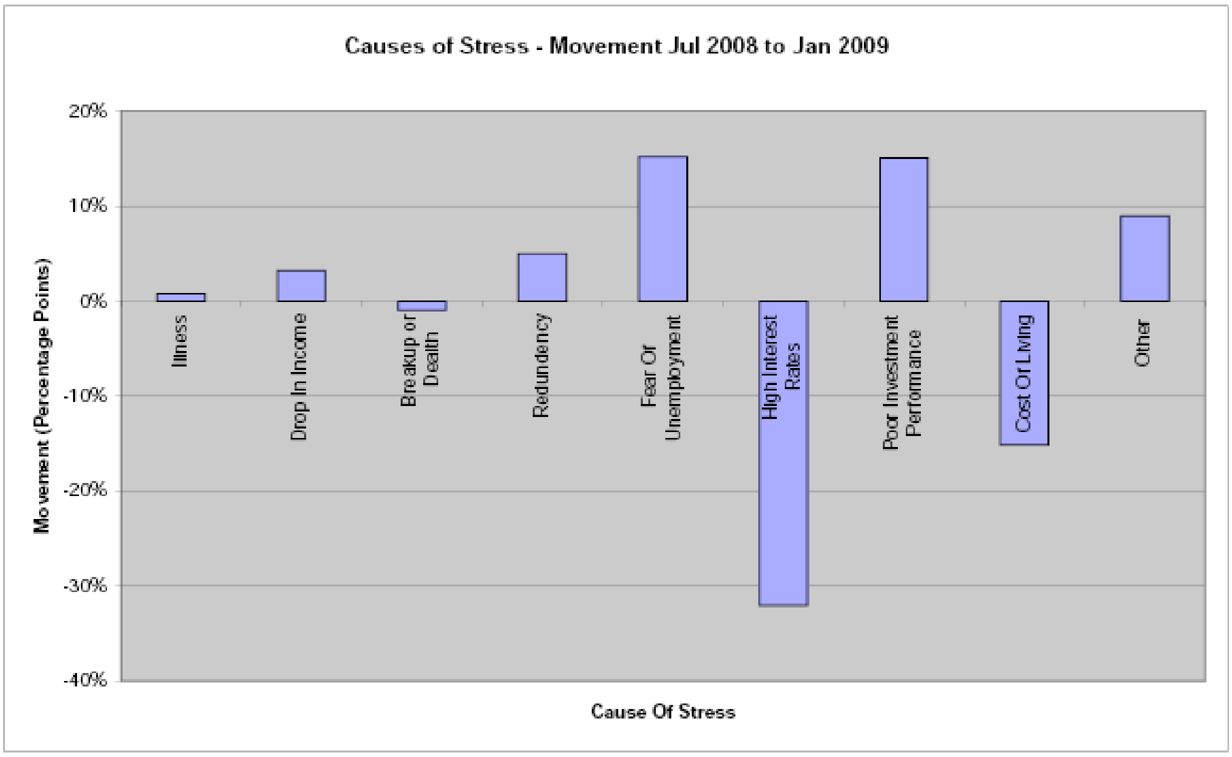
- *severe stress* — households in mortgage arrears, seeking to sell their home or refinance their mortgages or facing foreclosure by lenders.

Figure 10 traces the monthly trend in mortgage stress, as defined, to February 2009 and forecasts a very sharp rise for later in 2009, for reasons noted below. The drop in absolute numbers of stressed home buyers, from a peak of 900,000 in August 2008 to 625,000 in February 2009, follows from a fall of 400 basis points in official interest rates over that period, 375 points passed onto lower home mortgage rates. The forecast rise in stress is based on a rapidly deteriorating national economy in the context of an unfolding synchronized global economic recession — 'the Great Recession' noted by the International Monetary Fund. The prospects of rising unemployment and decline in investment returns to retirees are replacing high mortgage interest rates as the prime drivers of mortgage difficulties, according to the survey respondents — see Figure 11.

Figure 10: Growth in Mortgage Stress

Source: Fujitsu (2009)

Figure 11: Causes of Mortgage Stress



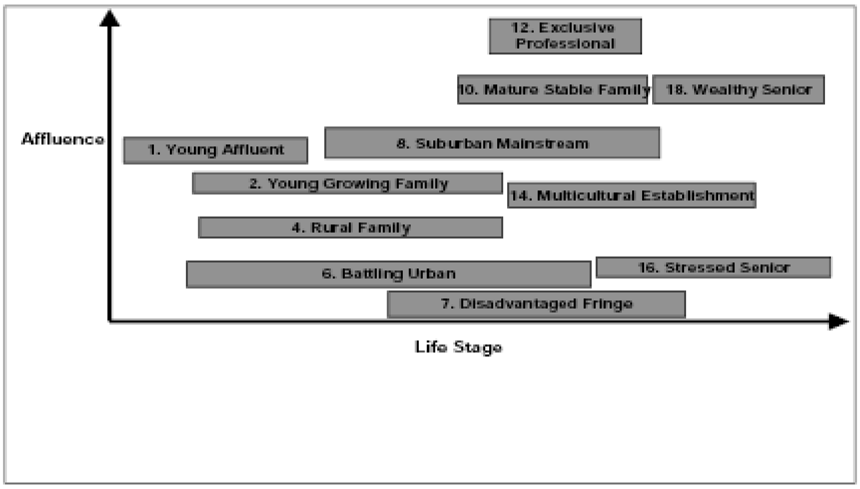
Source: Fujitsu (2009)

The likelihood of rising mortgage stress is increased by the recent sharp rise in purchases by first home owners. As part of the Federal Government's fiscal stimulation package for the construction sector, in the context of dealing with the fallout from the global financial crisis, first home purchasers have been given grants of up to $21,000. This has resulted in a surge of demand at the lower cost end of the new home market, supporting stronger prices in certain locations. However, high loan-to-value ratios in this market provide little buffer if unemployment continues to rise as forecast.

The Fujitsu research suggests that mortgage stress is unevenly articulated across both socio-economic groups and space. Twelve groups or segments are identified. Figure 12 maps them schematically with respect to relative affluence and stage of the life course. The categories are largely self-explanatory (but see the brief descriptions in the Appendix).

Figure 13 summarises the relative impact of mortgage stress across these segments. The largest absolute numbers of stressed households fall into the ‘disadvantaged fringe’ and ‘suburban mainstream’ groups. The former includes households on very low incomes living on or beyond the peripheries of the major cities. The latter group comprises households in routine white and blue collar occupations living within the metropolitan regions of the capital cities.

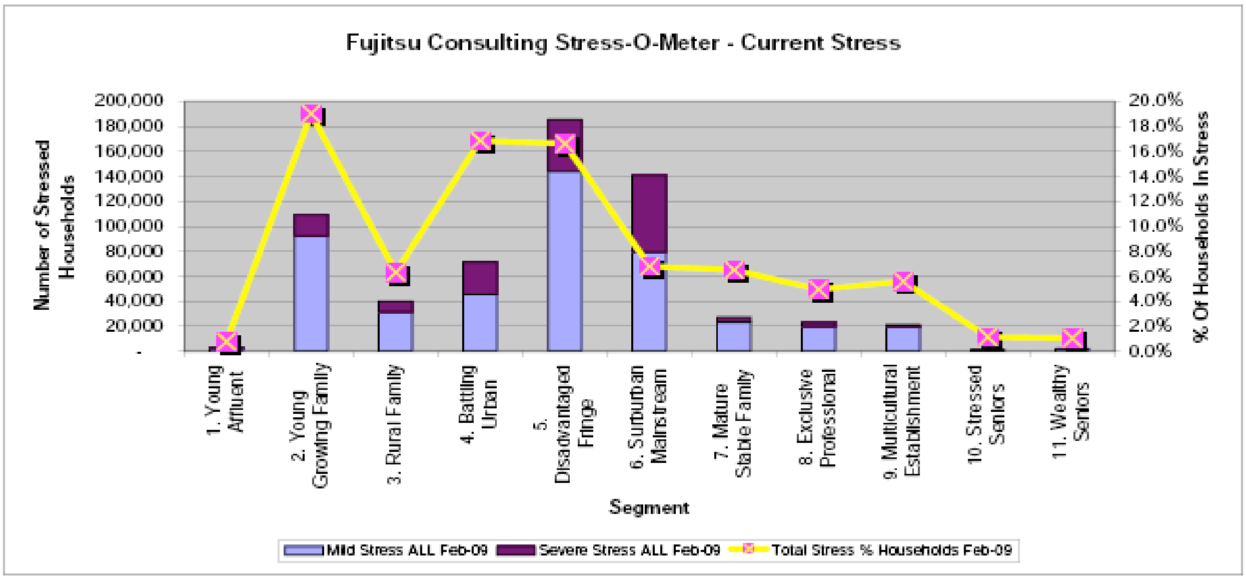
Figure 12: Schematic map of stressed segments



Source: Fujitsu (2009)

This segment also displays the highest ratio of severe to mild mortgage stress. However, Figure 13 also indicates (note the line graph) that the highest concentration of stress is in the 'young growing family' segment: households of middling income early in the life course, typically recent home purchasers with high loan-to-value ratios and vulnerable to adverse changes in both interest rates and employment conditions. High stress rates are also evident in the 'disadvantaged fringe' and 'battling urban' segments. The latter include households on low to moderate incomes living in lower socio-economic, urban areas with significant population mobility and higher than average dwelling densities. If the sharp jump in mortgage stress forecast for late 2009 eventuates (as per Figure 10), the Fujitsu report suggests that the stress level among 'young growing families' could exceed 45 per cent, more than doubling the current rate. The rates for 'battling urban' and 'disadvantaged fringe' would exceed 30 per cent (Fujitsu, 2009, p. 12).

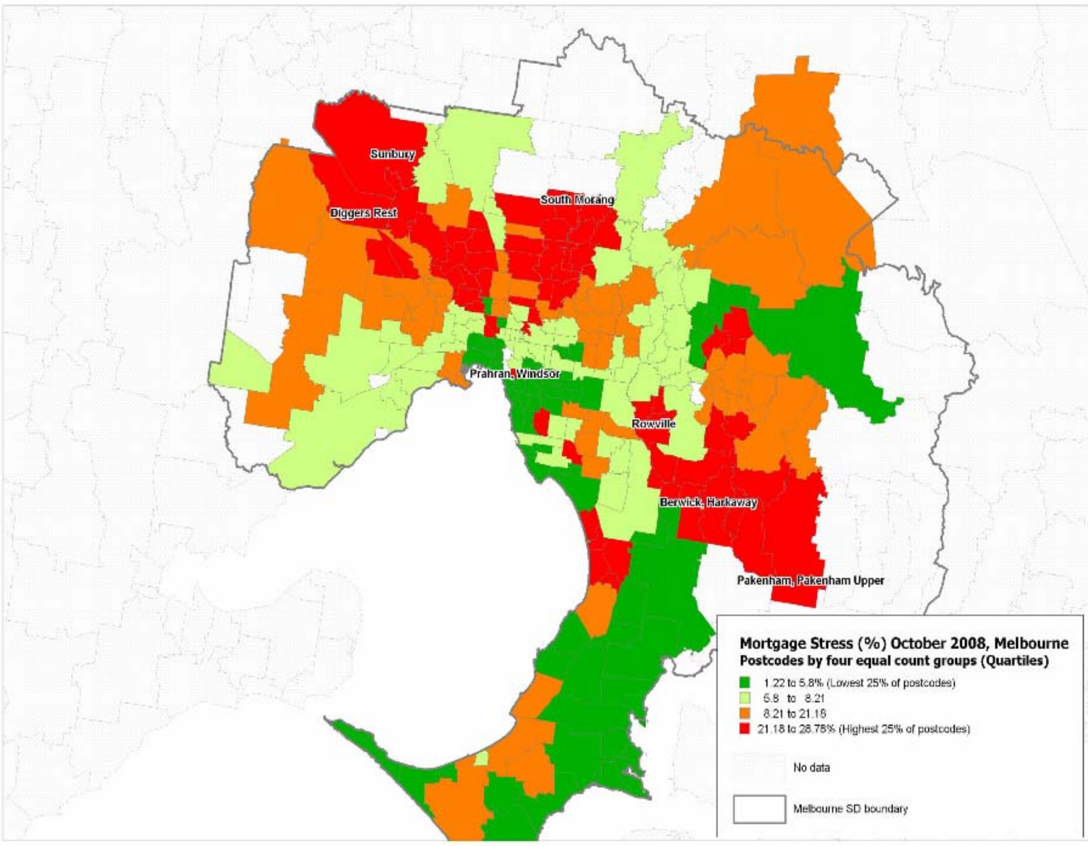
Figure 13: Fujitsu Stress-o-meter



Source: Fujitsu (2009)

Figure 14 maps the relative spatial impact of mortgage stress across metropolitan Melbourne. The areas of highest stress are located in the outer-north, the north-western corridor and the outer-south-east, all traditional working class suburbs that have undergone extensive deindustrialisation over the past 30 years. However, pockets of 'affluent stress' also appear in the immediate south-east, traditionally high socio-economic areas. This may indicate that, if the economic situation continues to worsen, higher socio-economic households living in high housing value areas will face increasing difficulties in meeting their mortgage repayments.

Figure 14: Mortgage stress in Melbourne



Source: Fujitsu (2009), special calculation

3. The Survey

As part of a larger study, the authors conducted a survey of a sample of mortgage repossessions in the two largest states, New South Wales and Victoria. The sample was derived from supreme court records in the two states, focusing on cases recorded in the months of November and December 2008. In total, 90 defaulting mortgagor responses were received (for details on the survey, see Berry et al., 2009, p.4). The full results will be presented in a forthcoming research report to be published by the Australian Housing and Urban Research Institute (www.ahuri.edu.au). Some of the preliminary results are noted below:

- The overwhelming proportion of respondents were home purchasers; only 4 respondents were landlord investors, while another 4 were owner-occupiers borrowing on their houses to invest in non-housing assets or businesses.

- 43 per cent were couples with children, 9 per cent single parent households and 17 per cent single person households.

- Two-thirds of respondents received household incomes of less than $60,000 (around the national average); only 10 per cent received more than $100,000.

- Almost 60 per cent had purchased before 2003, although one in eight did so in 2007, the year the housing boom peaked.

- The mean purchase price of the housing was $244,210; the mean initial mortgage, $202,966.

- The mean value of non-housing debt was $43,154, with average credit card debt at $6,034.

- Two-thirds of respondents had refinanced their mortgage loans at least once, a quarter had done so three or more times.

- Two-thirds of respondents began experiencing mortgage repayment difficulties inside three years from purchase; a third experienced difficulty between 6 months and two years of purchase.

- Overwhelmingly, the major cause or trigger initially for missing repayments was loss of income and/or employment (63 per cent of cases); a third of respondents also nominated high interest rates and other debts as significant causes.

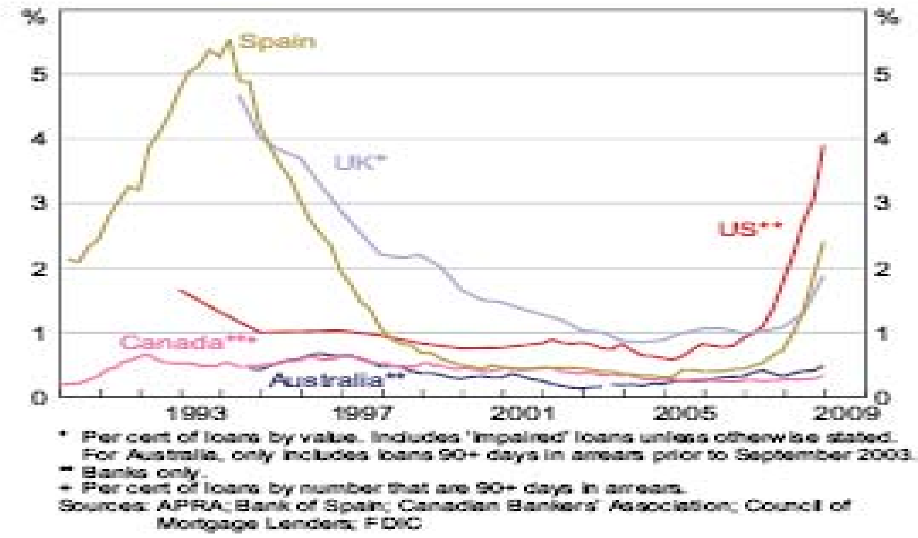
- When respondents fell behind in their repayments, 40 per cent relied more on their credit cards and 38 per cent borrowed from family or friends; 21 per cent refinanced their loans and only a quarter sought financial advice.

It appears, then, that mortgagors who get to the final stage of losing their homes are likely to be relatively lower income households, reliant on multiple forms of debt, likely to go further into debt in an attempt to maintain their mortgage, with limited access to financial advice and vulnerable to job loss and interest rate volatility. All this supports the comments made in preceding sections, above. However, it should be stressed that these results are preliminary only, and intended to inform follow-up intensive interviews the results of which will be duly reported, along with the necessary qualifications concerning the bias inherent in relying on official court records.

Australia is holding up to date — Why?

By early 2009 the Australian economy had finally followed the other OECD countries into economic recession. However, unemployment was only marginally higher (just over 5 per cent) and, as noted above, the housing market had slowed but was not in free-fall. Figure 15 shows the relatively less severe incidence of mortgage stress in Australia.

Figure 15: Non-Performing Loans (per cent of loans)



Source: RBA (2009, graph 71)

There appear to be a number of factors at work here.

First, the fundamental long-term demand drivers in the housing market remain robust. Population growth continues to centre on the large cities. Population ageing is associated with declining household size, further boosting the demand for housing. Moreover, Australia does not have an over-supply of housing stock as a result of the boom to act as a drag on the new construction sector.

Second, it has become clear that the existing financial sector regulatory regime in Australia has been more effective than in many other countries in moderating the lending excesses during the boom. The four biggest commercial banks (as noted) hold more than 80 per cent of outstanding residential mortgage debt and have increased their market shares since the onset of the global financial crisis. The Australian Government moved in late 2008 to guarantee all deposits in the banks and smaller ADIs; a fee is charged for deposits in excess of A$1 million. The government also guarantees (for a fee) the wholesale borrowings of Australian banks in global markets. The big four banks (apparently) have relatively small exposure to sub-prime type loans. Although, collectively they have written down several billion dollars worth of mortgage backed assets, notably credit default swaps, this has reduced their current profits and not impacted on their credit worthiness. Consequently, all four banks retain their AA credit ratings, among about a dozen worldwide. It is also critical that, in Australia, unlike the US, mortgage lenders have access to all the assets of defaulting mortgagors. Hence, Australian borrowers do not have the implicit put option enjoyed by American mortgagors in many US states.

The fact that Australian banks did *not* become heavily involved in the so called 'toxic assets' debacle was, according to a past Reserve Bank Governor, the unforeseen consequence of an earlier regulatory restriction imposed by the federal government in the late 1980s. The so-called 'four pillars policy' prevented any of the big four banks from taking over or merging with each other, in the interests of maintaining competition in the domestic banking sector. That meant that each was virtually free from takeover threat and hence was not forced to aggressively chase growth by moving strongly into non-traditional commercial banking areas.

Third, the government has moved quickly to stimulate the Australian economy through fiscal policy. A major part of the federal government's fiscal stimulus package has been focused on housing and infrastructure provision. Some A$6.7 billion has been committed to boosting the supply of social housing over the next two years. In addition, as noted above, the grant to first-home purchasers has been increased, encouraging a short term jump in demand. It is not clear how long this increase in housing demand can be maintained, especially if the general economy continues to decline. The Reserve Bank of Australia has also sought to ease liquidity constraints by progressively reducing official interest rates by 400 basis points since September 2008; all but 25 basis points of this reduction was passed onto lower mortgage rates by the big banks. Finally, the federal government has committed to establish a fund to underwrite large commercial property developments, the private funding for which has largely dried up. This venture has been termed the 'Rudd Bank' after the Prime Minster Kevin Rudd, by the Opposition and media.

Policy Implications for Australia

Given that, to date, Australia has largely escaped the worst impacts of the global financial crisis and the scale of mortgage defaults experienced in many other advanced countries, it is tempting to see little need for policy reform in this area. The continuing benign pronouncements of the Reserve Bank of Australia (noted above) would appear to support a quiescent if not complacent stance. However, even ignoring the problem of global contagion, noted below in the final section, there are reasons for not adopting such an optimistic position.

First, as demonstrated, although the current levels of mortgage stress and non-traditional mortgage products offered in Australia are relatively low by international standards, the trend is clearly upward. Second, currently there are limited regulatory controls over non-bank (non-ADI) mortgage lending and no national controls over mortgage brokers. Third, a national parliamentary inquiry into home lending found that most borrowers had low levels of financial literacy and regulators, lenders and borrowers had only limited access to relevant, incomplete and timely data on mortgage defaults and re-possessions (House of Representatives, 2007).

This parliamentary inquiry made three key recommendations, namely that:

1. The Australian Bureau of Statistics collect data on mortgage possessions, indicating the kinds of loan products and lenders involved, the location of defaulters and the 'primary cause' of default.
2. The Australian Government move to regulate all housing loan products and advice services, including the activities of mortgage brokers and non-ADI lenders.
3. Existing dispute resolution procedures between parties to mortgage loans be improved, including extension of the jurisdiction of current procedures.

The parliamentary inquiry focused on the increasing role and inadequate regulation of mortgage brokers across the Australian states and territories. Mortgage brokers were found to be involved in the origination of three out of every four loans by 2007. It was argued that mortgage brokers have a vested interest in selling loans and therefore encouraging quantitatively more borrowing and refinancing of existing loans. Brokers were also found to have little or no responsibility for the subsequent repayment performance of borrowers. These last two findings together suggest scope for significant moral hazard in the mortgage broking industry. The Inquiry also identified the wide variability in the qualifications and training of mortgage brokers and the absence of uniform minimum relevant qualifications.

Following the change in federal government in November 2007, the Commonwealth Treasury released a *Green Paper on Financial Services and Credit Reform* (Australian Government, 2008). The Green Paper recommended a national agenda designed to close gaps in the existing regulatory environment, including national licensing requirements and monitoring of brokers and improved design and coverage of dispute resolution procedures. It recommended that brokers and ADI and non-ADI lenders be covered by nationally consistent requirements concerning licensing, conduct and advice provision.

The authors have provided a summary of the various policy proposals that have been advanced in Australia to lessen the adverse impact of mortgage stress (Berry et al., 2009) — see Table 2.

Table 2: Proposals to minimise and ameliorate mortgage default

ACTORS/PROCESSES— TOPICS TO ADDRESS	*PREVENTATIVE MEASURES*	*RELIEF MEASURES (RESTORATIVE)*
Lenders' practices		
Establishing a balance between conservative and irresponsible lending. Models, indicators and/or formulae for defining and assessing hardship and debt-servicing capacity of mortgagors that are commonly accepted by the financial industry, government regulating agencies, in legal forums and by financial advisers. Embedding clear and widely accepted practices of response to hardship (variations) due to both individual circumstance and wider economic impacts. Planned response by government to economic downturn, diminishing credit and increasing vulnerability of specific households to falling house prices, reduced income or higher interest rates.	Regulate mortgage brokers. Stricter criteria for lending based on debt-servicing capacity, not asset value, restricting the size of loans (LVR), and aspects of eligibility relating to income. Make lenders, and their agents/brokers, more responsible for confirming debt-servicing capacity of borrowers — eradicating no-doc and minimising or redefining low-doc loans. Require open, plain English, and detailed information on all loan products and services — perhaps through ASIC and the Understanding Money website. Improve reporting as well as regulation of non-ADIs and provide borrowers with lists of regulated borrowers, all demanded to be members of APRA-approved external dispute resolution organisations	Expand and enhance APRA-approved external dispute resolution (EDR) services as well as their powers to discipline lenders. Ensure repossession cannot occur while independent appeals (EDR) over rejected hardship claims or other matters of serious and legitimate dispute are in process. Enhance government reporting and advisory powers of the Banking and Financial Services Ombudsman and other EDRs or establish a specific home mortgage ombudsman with special powers. Regulatory agencies, such as OFT and APRA, continue reviewing products and services as well as market demand and awareness. Monitor national, state-by-state and regional developments in terms of default and house prices for timely introduction of government relief to householders.
Borrowers' behaviour		
How to best inform borrowers more and more effectively about responsible borrowing and options to minimise the risk of default, repossession of a home and high financial losses due to problems with repayments. Improving borrowers' skills and knowledge about the dangers of certain lending practices and products. Improving borrowers' knowledge of and enhancing the support and relief systems available to those in financial distress.	Improve secondary and tertiary education on financial management of home mortgages. Free, easily accessible and independent financial advice when a home loan is applied for. Publicise responsibilities of a mortgage and default more — e.g. build a narrative around a great Australian nightmare.	Free, easily accessible, and independent financial advice if in arrears. Revise and expand eligibility for mortgage relief assistance — providing uniform national coverage, redefining hardship and taking into account temporary emergency measures during downturns. Identify and publicise through the popular media those lenders taking most court actions, borrower types, and loan kinds most prone to default. Improve public credit

		reporting.
Housing context		
Ensuring households have a range of options for accommodation that are affordable and accessible where they need to work. Private and public tenants' rights to secure long-term housing at a manageable cost. Access to temporary housing for evicted households and tenants of leased properties where the mortgagee is threatening to take, or has taken, possession.	Improve terms, conditions and supply of housing accommodation options that compete with owner-occupation, e.g. enhance public and private tenants' rights, expand social housing, etc.	Implement guidelines and rights to temporary housing assistance for defaulters. Enhance tenants' rights when the house they are leasing is subject to a claim of possession and later when it is repossessed. Appropriate reforms include sufficient notice to vacate, the claim of possession providing sufficient reason to break a lease, and compensation for costs associated with moving.

Future imperfect

In spite of Australia's apparently favourable current situation, some commentators are pointing to a deteriorating domestic environment by the end of 2009 (see right hand side of Figure 10). Such outcomes are based on the national unemployment rate reaching 10 per cent by the end of 2009. Forecasts of Australia's unemployment rate have been adjusted upward to 7.8 per cent in the April IMF World Economic Outlook (IMF, 2009a), while the 2009-10 Federal Budget forecasts unemployment to rise to 8.5 per cent during the next financial year. More pessimistic commentators expect the rate to climb much higher due to the effects of rapid de-leveraging by households (Keen, 2009). Even if the IMF and Treasury forecasts turn out to be more accurate, unemployment would then be running at about twice the rate during the peak of the boom in early 2007, giving credence to the fears expressed by owner-occupiers experiencing mortgage stress (as noted in Figure 11). At the time of writing (May 2009), the official unemployment rate in Australia stood at 5.9 per cent, up a full percentage point on the year before.

Official rates understate the full degree of labour underutilization in economies like Australia. The Centre for Employment and Equity has developed a measure of underurilisation, adding underemployment and hidden unemployment to the official unemployment rate (CofFEE, 2008). In the early-1990s recession in Australia, while unemployment roughly doubled to 10.8 per cent over three years, the total underutilisation rate more than doubled to 19 per cent, affecting almost one in five Australian workers. A similar recurrence in 2009-10 would greatly intensify the reach and intensity of mortgage stress.

Moreover, the impact of future rises in unemployment and underemployment will be felt unevenly across space. Rates will diverge within and between regions, depending on the distributions of skills and existing jobs. Those areas with large numbers of workers employed in firms and industries heavily dependent on global demand are particularly vulnerable to the accelerating, synchronised downturn. Baum and

Mitchell (2009) have developed an ‘employment vulnerability index’ (EVI) to explore the contours of the differential socio-spatial impact of rising unemployment patterns. The index is a weighted average of three key indicators: the proportion of people employed in particular jobs like manufacturing and mining; the proportion of employed people without post-secondary qualifications, and; the proportion of people working full-time (for details, see Baum and Mitchell, 2009, Appendix A). Suburbs across the main cities are then divided into the following categories: ‘red alert’, suggesting high job loss potential; ‘amber alert’, medium-high loss potential; blue coded suburbs represent medium to low loss potential.

Two broad types of vulnerable suburbs are apparent from this analysis. First, ‘traditional battler suburbs’ are those with long established histories of industrial decline, high long term unemployment and intergenerational disadvantage; they correspond, to a large extent, with the areas where ‘battling urban’ and ‘disadvantaged fringe’ households live (cf Figures 12 and 13). Second, ‘new emerging areas of disadvantage’ are those metropolitan areas where aspiring, often younger, highly geared mortgagors have moved to purchase housing (‘suburban mainstream’ and ‘young growing family’ segments in terms of Figures 12 and 13) and provincial cities overly dependent on particular industries like mining and tourism which are vulnerable to global economic downturn.

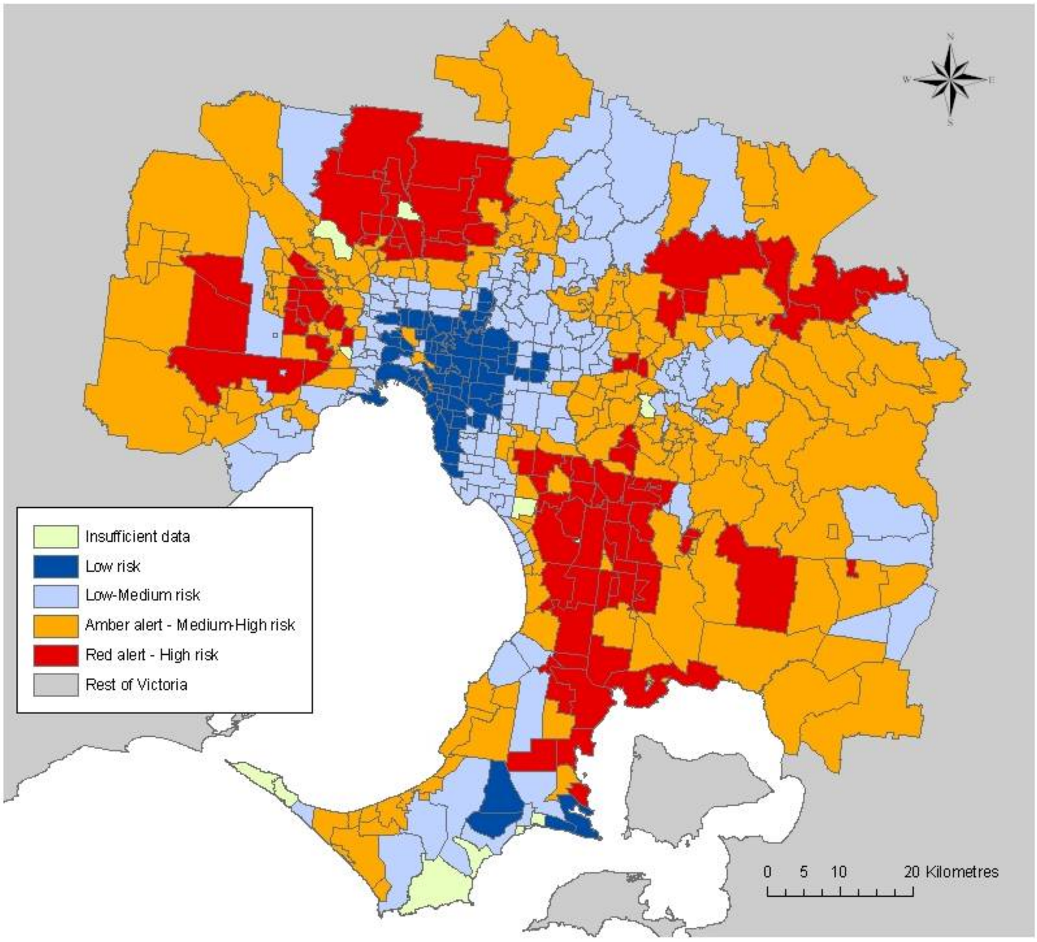
Figure 16 reproduces mapping of these categories across the metropolitan region of Melbourne.

Of significance for the possible future impact of mortgage stress in Melbourne is the close comparison of Figures 14 and 15. The suburbs where mortgage stress is already highest are, in general, those most vulnerable to future ‘joblessness’, suggesting that if the Australian economy does, in fact, decline over the next year or two, then mortgage stress and associated defaults may be expected to rise substantially, at least in Melbourne.

Melbourne may not be alone here. Based on these suburb-level measures, Baum and Mitchell (2009, pp. 14-14) calculate a regional concentration ratio for the capital cities and smaller metropolitan regions. Among capital cities, those with a higher than average likelihood of facing high job losses are Adelaide, Melbourne and Brisbane (in that order). Sydney and Perth display moderate vulnerability, while Darwin and Canberra are the least vulnerable of the capital cities, on this measure. The latter result is unsurprising given the importance and stability of government (including defence forces) employment in those two cities.

In non-metropolitan regions, examples of high vulnerability are Noosa and Maroochy on the Sunshine Coast (tourism), Whyalla and Gladstone (mining) and Maryborough and Bunbury (declining rural service centres).

Figure 16: Employment vulnerability in Melbourne



Source: Baum and Mitchell (2009, p. 21)

Concluding comment

In April 2009, the IMF (2009a) finally revised downward its forecast of economic activity for Australia. From earlier forecasts of moderate growth, Australia is now expected to shrink by 1.4 per cent in 2009. Nevertheless, Australia's situation still differs from most of the other developed economies. In the first place, Australia's recession is expected to be milder, since, as a group, the developed economies are forecast to shrink by 3.8 per cent (ibid.). Second, Australia's recession is unlikely to occur in the same way as in the United States. In the latter country, sharply rising mortgage defaults in housing markets triggered a systemic crisis in the banking and shadow banking sectors that resulted in a credit crunch that caused a domestic recession. Sharply rising unemployment in the US fed back into declining consumption and private investment (further weakening housing markets) and reinforced the rate of mortgage defaults as more households fell behind in their repayments and experienced negative equity in their homes. This vicious cycle was exported to other countries, directly in the case of Europe due to the heavy involvement of European banks and financial institutions in US mortgage-backed derivates, indirectly in the case of large emerging economies like China by way of declining US imports.

It is this latter development that bodes ill for Australia. As China and Japan are Australia's major export markets, falling growth in the former, on top of continuing stagnation in the latter, threaten to intensify Australia's recession boosting unemployment which, in turn, will increase the likelihood of mortgage defaults as heavily indebted borrowers and lenders both seek to de-leverage in an increasingly pessimistic environment. In short, the causal chain of events is precisely the reverse of that in the United States. Rising mortgage defaults in Australia would be triggered by (and reinforce) a domestic recession, rather than cause it. The vulnerability of the newly unemployed and highly indebted recipients of the federal government's first home owners grant increase this risk. The large mortgage lenders appear to be increasingly cognizant of this risk. Interestingly, Australia's largest bank (Commonwealth Bank of Australia) has preemptively committed to granting unemployed mortgagors a six to twelve month 'repayment vacation', effectively shifting the (compounding) repayment burden to the future. The other large banks have followed this lead. Similarly, the banks appear to be tightening lending standards to require mortgage applicants to demonstrate a genuine savings history towards a minimum deposit of 5 per cent of the house value; this, however, still leaves borrowers with very high LTVs.

To some extent, and in the immediate term, counter-cyclical policy by the Australian government may stem the downward domestic spiral. However, Australia is a small open economy and is heavily dependent on the larger countries effectively re-inflating their economies. In particular, it is difficult to see any long term improvements globally before the US banking crisis is resolved. The IMF's April 2009 Global Financial Stability Report (IMF, 2009b) underlines the very serious and lingering nature of the credit crunch, increasing to US$4 trillion the global losses accumulated in financial assets weighing down the balance sheets and paralysing the lending activities of banks throughout the developed world.

So, Australia is different — but it won't make any difference in terms of final outcomes if the continuing G20 deliberations fail to achieve effective, coordinated action to solve the global credit crunch and reestablish a general climate favourable to lending for private consumption and investment. Not surprisingly, then, Australia's Prime Minister Kevin Rudd adopted an activist international stance in favour of concerted cooperative fiscal stimulation by developed and large emerging economies in the lead up to the April 2009 G20 Leaders' Conference in London. It just underlines again that in a highly interdependent global economy, 'contagion' — positive and negative — is an increasingly prevalent condition of existence.

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Appendix: Fujitsu Household Segments (source: Fujitsu, 2009)

1. Young Affluent: These are predominantly young and affluent individuals, commonly renting apartments in fashionable high density inner-city suburbs near public transport hubs. Many are transient tenants who regularly change their residence. They have high incomes, most have no children and a high proportion of de facto households. 40% have recently moved and home sharing is common. Building activity is high with considerable invested in building and alterations, and property values and rental costs are also high. Most are white collar workers with professional or executive careers across a variety of industries, especially finance and property, and a significant proportion have or are undertaking tertiary education. Technologically savvy they are early adopters of technology and are the segment most likely to purchase goods or services online or by phone. They opt for premium credit cards but are attracted by interest free offers. Car ownership is below average with public transport preferred.

2. Young Growing Family: These are young families who are new home buyers purchasing separate homes in affordable new estates on urban fringes with low density housing and average to below average property values. Building activity is high but average building spend is below average. These neighbourhoods are young and have the highest building approval and population growth. The segment is typically made up of blue collar workers and tradespeople, people in clerical, sales and service occupations, and a significant proportion of transient workers in remote mining locations who are suitably compensated for adverse working conditions. Despite being relatively affluent, mortgage commitments lead to tight family budgets. Most have no post-school qualifications but an above average number of technical diplomas and certification. Due to work commitments from both partners they have a preference for non branch based banking. Computer and internet use is above average.

3. Rural Family: These are individuals in rural areas. There has been a marked population decline in this segment. Most housing is separate with low property values. Significant numbers of homes are owned or being purchased, but rental properties are also common catering to the transient section of the population. Predominant industries are agriculture; forestry and fishing with blue-collar employees, but local enterprises require a significant proportion on white-collar administrative and managerial staff. Employees cater to local needs in townships in a variety of manual labour, trade and service oriented professions. Early school leavers with few post-school qualifications are common. Computer ownership and internet use is low. Vehicle ownership is average. Affluence and incomes are generally low but sometimes supplemented by rental income. Most individuals are Australian born with a significant proportion indigenous.

4. Battling Urban: These are individuals with strong financial constraints and limited incomes, living in urban and suburban areas. High density apartment blocks are common in these areas, and State and privately rented housing availability leads to a highly transient and mobile population. Suburban semidetached and separate houses also make up a significant proportion of these neighbourhoods catering to mobile couples and families. Building activity and property values are average to low and housing density is high. With average incomes and education levels, the jobs in this segment are across a variety of industries and are mainly mid to lower white-collar and clerical roles. They have above average ownership of computers and internet use. Vehicle ownership is below average. Unemployment levels are high in many areas and qualifications are low. There are significant areas with post 1980s migrant populations, and tertiary education is valued in these areas.

5. Disadvantaged Fringe: These are disadvantaged peripheral urban and country areas with low income levels. State rental accommodation is common, but there is also a significant proportion of young families purchasing homes in newer peripheral suburbs with low-mid density housing and low property values. The majority of homes are owned or being purchased. Most of the population have a European or Oceanic ancestry. Education levels are low but tertiary institution attendance is average, suggesting academic and professional aspirations. They are not technologically savvy; hence computer and internet use is low. Credit card usage is uncommon and multiple car ownership (older models) common. Individuals mainly have manual blue-collar or clerical white-collar jobs in a variety of industries, especially retail, wholesale trade, health, community services and hospitality. Unemployment is high.

6. Suburban Mainstream: These are a mix of white and blue collar workers in a variety of industries predominantly not as decision makers. Significant numbers of households have children. Many individuals are Australian born, but there are significant numbers of Europeans and Asians. Incomes and affluence are above average, and are supplemented by some rental income. Neighbourhoods are stable and well established with a high rate of home ownership and a combination of housing types in mid-high density areas within metropolitan districts and fringes, with relatively high property values. There is little population growth and average building approvals but many properties have or are being renovated. They are frequent users of the internet, direct debit and remote banking. Credit card and mobile phone usage is high, and multiple car ownership per household is the norm. There are significant numbers of mid size separate homes either being purchased or fully owned.

7. Mature Stable Family: These are affluent and established individuals in mid-outer suburbs with above average household size and mortgages. They have separate homes on large blocks of land in established communities, with multiple vehicles and significant personal possessions with requisite insurance cover. Housing density is low but building rates are high with above average expenditure on new residences and extensions. Tertiary education is valued and parents are still supporting their dependent children. The segment is technology savvy with 60% home computer ownership, and uses the internet for banking and invests in financial planning. Corporate managers and business owners across a variety of industries are common in this segment. There is not a large investment in property or shares despite the segment having above average incomes.

8. Exclusive Professional: These are some of the wealthiest individuals living in the most exclusive suburbs. These professionals and business owners are financially astute and obtain advice from their personal planners or on-line. They enjoy fast access internet services, and are high-end technology savvy. Although they are heavy users of premium credit cards, they prefer to pay off the balance each month. They are generally the type to feel financially stable, and have the highest household incomes, highest rate of home ownership, and also have the highest commitment to mortgage/rent payments. They are predominantly upper white-collar professionals, primarily employed in the property, business, finance and insurance sectors, and usually married couples with older dependent children aged 18 to 24. They earn substantial incomes, investing through numerous methods including property and share portfolios that in turn provide considerable additional income.

9. Multicultural Establishment: This segment contains individuals from a variety of different cultures (predominantly Southern and Eastern Europe and Southeast Asia) living in established multi-cultural communities with individuals born in Australia. Affluence levels are moderate and incomes are below average but some additional income is gained from rent. There are significant numbers of early school leavers in blue-collar roles, many in the manufacturing, utilities and construction industries.

There are also individuals in lower white-collar roles, but unemployment in this segment is high. Many own their medium-value homes but others take advantage of State (above average proportion) and private rental accommodation. Separate housing is prevalent and located in high density areas. Building activity is low and the population is non-transient with moderate growth. They are not technology savvy; hence computer and internet use is low. Car ownership levels are also low.

10. Stressed Seniors: These are senior individuals across provincial and metropolitan areas, generally living in lower value homes in low-density suburbs. The segment also includes residents in nursing homes and retirement villages. Most are home owners and many are no longer working and are retired, living on pensions and other incomes. Most are early school leavers and those still working are in a variety of occupations and industries in predominantly white-collar roles. Affluence is relatively low with limited income from government pension and supplementary assistance. They are not technologically savvy, have low computer and internet use and prefer to use branch banking. Car ownership is low, and unemployment is above average. The oldest citizens are in this segment and are predominantly in retirement villages and nursing homes.

11. Wealthy Seniors: These are senior individuals across provincial and metropolitan areas, generally living in lower value homes in low-density suburbs. The segment also includes residents in nursing homes and retirement villages. Most are home owners or purchasing new homes, and many are no longer working and are retired, living on personal pensions supplemented by other incomes. Many are early school leavers and those still working are in a variety of occupations and industries in predominantly white-collar roles. Affluence is relatively high and many individuals gain significant income from rent and investments. There are significant numbers of recent retirees. They are quite technologically savvy, have relatively high computer and internet use but still prefer to use branch banking. Car ownership is average, and unemployment is above average.