

# The Antipodean



## The fear factor



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How is it that nearly a decade on from the GFC, after more than 660 interest rate cuts globally, an expansion of major central bank balance sheets worth more than \$US12 trillion, and the creation of 14 million jobs in the US alone that global economic growth still remains so sluggish and feeble? The IMF has again downgraded its global growth forecast for this year and next to 3.1 per cent and 3.4 per cent from 3.2 and 3.5 per cent respectively.

Business investment is lethargic and wages and inflation pressure remain stubbornly absent worldwide, as indicated by last weeks' inflation report for Australia. US household net wealth is at record levels, surpassing the pre-crisis level by a massive 26 per cent, helped along by record equity prices, and yet the savings ratio has risen from 4.1 per cent in September 2008 to 5.8 per cent currently. The savings ratio in Australia has averaged 9.8 per cent of income in the eight years since the Global Financial Crisis (GFC). This is more than double the average of just 3.9 per cent in the 20 years prior.

One answer lies in the fear factor. Just as the Great Depression left lasting scars on the household psyche, the GFC has left workers, consumers and business leaders fearful and conservative.

### Switchers versus persisters

Research by the Chicago Federal Reserve shows a very close relationship between the rate of job switching and nominal wage growth. This is not too surprising given the primary objective for most job switchers is to move to a new job with a higher wage scale. Their willingness to switch reflects their confidence in themselves and in the labour market. Conversely, job persisters tend to have a lower rate of wage growth and tend to be less productive with a lower learning curve.

This research goes some way to explaining why wage and productivity growth is still so weak

currently. In the US, where the data is most readily available, the rate of job quitting declined rapidly in the wake of the GFC as employees became more fearful about job security. It has only been making a slow ascent ever since. In most industries, quits have not reached their pre-GFC levels and in some, such as finance and insurance where wage growth has traditionally been among the highest, the quit rate is still very low at just 57 per cent of the pre-crisis peak.

### Feeling less wealthy

The wealth effect, that is, the rise in consumption that comes from an increase in household wealth, has weakened since the GFC. Prior to the crisis, it was estimated that for every \$100 increase in housing wealth, consumption would rise by around \$3.40. Post the financial crisis this increase in consumption is estimated to have fallen to just \$1.70.

In Australia during the 2004–08 housing boom, when house prices were rising on average by 6.9 per cent, households were spending the built-up equity in their home to such an extent that the savings ratio actually turned negative. Since the GFC house prices have averaged 8.1 per cent. Instead of spending this increased wealth, households have been paying down debt. The average household with a mortgage in Australia is 22 months in advance of their payments. Fear means equity has been built up on household balance sheets rather than cashed-out.

### Corporate short-termism

Ironically, low interest rates are turning fixed income assets into long-term investments and making equity assets more short-term in nature. Lower interest rates reduces the cost of debt and so encourages government and corporations to issue longer dated bonds. As a result of this, the average duration for most bond indices has increased significantly since the GFC, making these investments more sensitive to changes in market interest rates.

"The GFC has left workers, consumers and business leaders fearful and conservative,"

In contrast, yield-hungry, growth-fearing, conservative investors are rewarding companies for paying dividends and conducting stock buy-backs instead of undertaking new capital investment that has a longer payoff period.

Based on current yields and assuming no uplift from capital growth it would take an investor in the Australian bond market 22 years to double their investment. The equivalent for an investor in Australian equities is 10 years.

The preference by corporates for dividends is putting downward pressure on new investment spending, thereby undermining potential growth in the future.

**"The only thing we have to fear is fear itself"**

On 4 March, 1933, Franklin Roosevelt began his first inaugural address by saying "the only thing we have to fear is fear itself". He backed this up with the New Deal, an "experimental" package of regulatory reform and public works programs designed to support moral and boost confidence in the real economy.

"Experimental" monetary policy has done much to support the financial sector (and by default, the wealthy) post the GFC but has done little to address confidence in the real economy. For this we need to reflect back on the lessons from the Great Depression, overcome the forces of fiscal conservatism, and eliminate the fear factor.