

MACROECONOMICS AT WORK EXERCISE

HOUSEHOLD DEBT AND ITS MACROECONOMIC IMPLICATIONS

REFERENCE: ‘Costello’s debt chook getting smellier’ (by Tony Walker), *Australian Financial Review*, 17 January 2003, p.79.

CHAPTERS RELEVANT TO THIS EXERCISE: Chapters 6, 11.

OVERVIEW

Expenditure by households, in the form of consumption and residential investment, is determined mainly by the current level of incomes but *also* by other factors including what is sometimes referred to as the ‘wealth effect’. The wealth of households is held partly in the form of personal possessions but mainly in the form of housing. Thus if, for example, the price of housing increases (even if there is no increase in current income) this is likely to increase the level of expenditure by households (and hence aggregate demand and hence the level of GDP). So an increase in gross wealth may actually *induce* greater indebtedness (i.e. households may be persuaded to borrow more – whether for housing or consumer durable items such as cars or household items – if their gross wealth increases). However, increased indebtedness brings with it a greater claim on current income, leaving less disposable income in the hands of households to spend on consumption or residential investment. A high level of household debt is thus a concern because of its likely (adverse) macroeconomic effects on expenditure on these elements of aggregate demand. This article notes the sharp increase in the level of household indebtedness that has in fact occurred in Australia in recent years. It analyses the possible consequences of this increasing level, likening it (with a somewhat mystifying metaphorical flourish?) to a ‘putrefying chicken around the neck’ of the Commonwealth Treasurer.

QUESTIONS

1. How is the level of household debt measured? What is the current magnitude of Australia’s household debt?
2. Why do you think debt has reached this level?
3. What is meant when it is said that this level is ‘unsustainable’?
4. What are some possible macroeconomic effects of a high level of household debt?
5. How is the issue related to that of what has been termed ‘middle-class poverty’?