INTRODUCTION

I tried very hard to find a suitable speaker for this subject today. Lord knows I am pretty well connected within the financial community. I tried no less than three past Governors of the RBA as well as two past Deputy Governors. Some would not be in Sydney. Others are still writing but say their speaking days are over. One came out of hospital just days ago and frankly did not feel up to the task. I cast further afield without success. So you are left with yours truly.

The GFC and its aftermath is not an easy subject. Views differ widely – perhaps even wildly.

I tried to make this address entertaining, even amusing but it is a subject that I feel very strongly about and so I am going to subject you to some straight shooting – EXPECTED IT MAY NOT BE AS ENTERTAINING AS YOU BUT HOPEFULLY IT WILL BE INFORMATIVE. Hopefully you will leave here with an understanding of the issues and likely outcomes that you won’t find in any books or hear from any recognised commentators. Like the preachers say – “I will take my text today from”......Winston Churchill who once said that those who do not read history are doomed to relive it.

When contemplating the GFC a truer word was never said.

Therefore I want to start out by demonstrating that financial crises are caused by nothing more than a habit forming drug. I want to rename this talk:

HEROIN, COCAINE AND LEVERAGE the three most habit forming drugs known to mankind.

We will look at three, one minute case studies to highlight Heroin, Cocaine and Leverage. Then I want to delve into two financial debacles that happened right here in Australia in our lifetimes – HOOKERS and INDUSTRIAL ACCEPTANCE CORPORATION (IAC). Next we will take a few moments glancing back 3 to 400 years and see that the carnage of leverage is not something that first raised its head in our times.

Having done that we will be in a position to understand an examination of the GFC in a new light.

Government officials, financial executives, investors and ordinary folk the world over just limp from one disaster to the next without really understanding its causes – merely reliving history. The tragedy is that it will all happen again sometime in the next 25 years and there is not a lot we can do about it. But if we and our kids and grandkids build a better understanding we, and they, will recognise the approach and be better prepared. That alone is worthwhile. So sit back and relax – but pay attention. You will need to. I do promise however that what I will say will be easier to follow than any remarks that might have come from better speakers that were not available.

Let me begin by outlining three brief case studies.

CASE # 1 is a young man we will call Alan who smoked pot in the school toilets on occasion. Found it quite fun and there were no apparent harmful after effects. At a party decided to experiment with cocaine. Great buzz and he felt more confident in himself, smarter, more entertaining just....better. Several months later he tried it again. Then carried a little with him - without using it. One night when he felt a little off colour and things had gone badly for him during the day he remembered his little cache. Now it had become a prop. Pretty soon it was a daily dose and even more frequent.

His body now craved the substance. He had joined the ranks of the legion of young Australian men and women who are dying a frightful death or fighting through the extended hell of withdrawal.
CASE # 2 concerns Barry who is a very upright, God fearing, teetotalling Australian citizen. He is unfortunate enough to suffer a bad car accident. Emergency operations bind his wounds but recovery will be excruciatingly painful. The speed of recovery depends in no small way on his mental attitude and the blur of blinding pain is an obstacle. Morphine is administered and the recovery process moves forward. Each time the drug is stopped the very real pain of the trauma returns and recovery is set back.

Eventually, through no fault of his own Barry has become addicted to the Morphine. As the pain of the trauma passes, his body manufactures a synthetic pain to justify another dose. He faces the agony of recovering from the recovery. Withdrawal.

CASE # 3 involves 22 year old Colin, a trainee financial executive who has amassed $5,000 in cash savings and has a block of land worth $50,000 left to him by his grandfather. He decides to enter the stock market. He buys $5,000 worth of a penny arcade mineral explorer at 6 cents a share. Within weeks the stock rises to 8 cents and he sells. He now has $6,600 for a $1,600 gain - 32% inside a month. Not bad. He looks wider afield and investing this princely sum he has an even bigger win leaving him with $10,000, and his eye is caught by Silver Valley, a nickel explorer selling at 50 cents a share.

The feeling of omnipotence is creeping up on him, so he decides to borrow a little, to cash in on even greater wealth creation. He obtains a second $10,000 to invest with his own and sinks $20,000 into Silver Valley. His plan is to sell at $1, a level his analysis has assured him the stock will easily reach within a short period. He is right again. The stock hits $1 quite quickly. To his credit he is true to his strategy and unloads at that level. A $20,000 gain on his $10,000 and he repays the borrowed funds. 32% on the first sortie and now 200% - all based on his very own analysis. At 22 he is fast becoming a very well off young man. $5,000 has been turned into $30,000 with very little perceived risk given his powers of observation and deduction. But Silver Valley continues its rapid rise. $1.50 - $2.30 - $2.90. His heart is breaking. At $3.00 he could have now been holding $110,000 in his hot little hand.

How could he have been so blind. Or was it that he was too timid. The spoils always go to the brave.

Some quick analysis leads him to the conclusion that the stock is good for $4.00 and as he has some ground to recover not to mention some lost pride, he decides to re-enter the market on a brief but high rolling basis. He borrows $20,000 against the land giving him $50,000 cash which he uses as equity to borrow another $200,000 to buy $250,000 of Silver Valley at $3.20. He waits with pounding heart as the market moves steadily up. $3.50 - $3.70 - $3.90. The adrenalin is becoming too much. He stands in the Stock Exchange viewers gallery with his mobile phone in his hand. He even has his broker's number punched in so all he has to do is hit the call button to be connected. The fateful $4.00 is reached. He hits the call button. The broker is busy - will you wait or can he call you back? He tells the secretary he prefers to wait.

$4.10 - $4.15 - $4.20. Into the viewer's gallery walks a well-known financial journalist. "Alan", he says "Do you have any Silver Valley - Yes? - great, they are making an announcement in a few minutes - nickel by the bucket load". Alan finds himself stabbing the end button on his mobile breaking the connection, even before he realises what he is doing. The adrenalin is almost squirting out his ears. The announcement comes - 22 holes drilled in all - all absolutely dry - not a skerrick. $3.00 - $2.20 -$1.70 - $1.15. He finally gets through to his broker when the market is under a dollar. His proceeds are a mere $70,000 out of which he owes $200,000 to the broker and $20,000 on his mortgage.

These three cases highlight in over simplified terms, what I consider the three MOST DEADLY HABIT FORMING DRUGS known to mankind. The parallels are disconcerting. Heroin and Cocaine are well documented even if not successfully dealt with.

Case three - the Doyen of the trading floor - would be less of a tragedy if a clinical case studies lead to a greater understanding of this deadly habit forming drug - leverage. But I despair when I examine history and find that
huge sections of the community suffer from it at regular intervals. It is rare for any generation to get away unscathed.

Oh yes, there is always the rationale that what happened this time is something new and different from what went before. Baring’s, Orange County, Proctor and Gamble, Metallgesellschaft, AWA, et al, represent the ravages of those heinous tools of the devil himself - DERIVATIVES.

WRONG! Every one of those disasters was nothing more or less than plain and simple leverage. Certainly derivatives were a tool - just as an axe is a tool for cutting wood, but becomes a murder weapon in the hands of a deranged mind.

Perhaps it might be instructive to take a few minutes to examine a couple of episodes in leverage. They will seem quite thinly disguised as we view them in retrospect, but evidently at the time and in the heat of the moment the nature of this evil drug was not recognised.

HOOKERS 1960

In the late 1950’s the real estate agent chain, L J Hooker, started to accelerate its fledgling "own account" activities in land subdivision and home building and acquired

- Cattle spreads in the NT bigger than Belgium
- A string of sheep stations across NSW
- A chain of hotels in NSW and ACT
- Landtrusts, a finance company

If all this smacks of being a bit of a stretch, try this for size. The race to acquire broad acres for home allotment subdivision became so feverish that the modus operandi changed. The level of pre-acquisition analysis was minimised to the extent that executives would charter a plane and fly at two thousand feet over the then outer suburbs of Sydney and other capitals and select what looked like attractive open country, making the acquisition decision before coming down to earth - in every respect of the word.

Where was the money coming from? Hookers, from a humble beginning in Maroubra, had been nothing more than a real estate agent until the late 50’s. Albeit the largest in Australia. This kind of business is not capital intensive. Borrowings are modest unless and until you decide to become a principal as well as an agent. When you cross that threshold the entire nature of your business changes dramatically. The team at Hookers knew real estate like no other. The banks and finance companies, and vendors, were acquiescent. The debt mounted, but Hookers equity of redemption kept rising with the steadily and sometimes rapidly rising prices of land. All holdings, at current prices, so significantly exceeded outstanding debt that ratios were seen to be sound. What could go wrong?

Two things.

In 1961 the Menzies Government introduced a sudden and savage credit squeeze. From midnight on that fateful November day, interest rates were virtually doubled and as if that was not enough, interest payments on monies borrowed after that moment were not to be tax deductible. Can you imagine what that would do to the feasibility sums on land held for subdivision perhaps two to five years down the track. Not only would holding charges sky rocket, but demand for the finished product would fall leading inevitably to longer holding periods.

Within weeks of that bombshell, the Sydney Water Board changed its rules. Up until then their practice was to provide, from its own financial resources, the amplification mains to bring its services to the perimeter of a
new subdivision, leaving only the reticulation from lot to lot to be financed by the subdivider. **Overnight** that was changed, leaving all the amplification mains and necessary pumping stations an added financial burden on the developer. Suddenly broad acres that were previously selling for **high and spiralling prices** were dramatically depressed - **where a market still existed**. Suddenly debt exceeded asset backing and a group of companies that had been **high on the hog one day was destitute the next**. In came **Keith Campbell** and a new team of executives at the corporate level. **Thousands of jobs were lost immediately** as we attempted to save the jobs of the remainder. Five years of knuckle grinding, back bending, iron disciplined, 18 hour days and the monkey was finally off the company's back. Thousands had suffered - not only those, often innocent people who had lost their jobs **but the investors** whose shares had fallen through the floor.

Anyone who had held their jobs or struggled through without selling their shares, participated in what was finally a **remarkable recovery**. That number of people would have been much, much greater had the asset grabbing that preceded the disaster been internally funded. The fact that a **high level of borrowings** was involved meant that the fall in the value of assets, which might have been say **30% represented more than 100% of the funds invested by the company.**

**The final days in the aeroplanes** were probably what sealed the fate of the company. In retrospect it seems bizarre. Just about as **crazy as young Alan discarding his total modus operandi as he stood in the viewer’s gallery** of the stock exchange when he got “the word” from the trusted journalist.

**IAC 1974**

Here, as in the **other latter day episodes**, I had the **inestimable advantage** of arriving on the scene after the event and so always had the benefit of hind sight. I always, however, went to great lengths to try to **put myself into the position of those who were caught up** in the heat of the chase or were **slowly seduced** by creeping leverage. **IAC in 1974 was no different to the other cases we have looked at today except it gives a view into the lenders part** in the drama. **IAC in 1973 had besieged the debenture market** raising more money in two months than even the Commonwealth Govt had ever managed in any similar period. The cash was **burning a hole in their pocket**. The rush was on to get the money to work - there was, after all, the **debenture interest bill** to pay. I spent days examining the credit approval process of IAC and the **minutes** of the boards of IAC and one major borrower in particular - a borrower that was **atypical** of the developers of the day - I'll call him George. George was a tried and trusted customer of IAC over a decade or more. There had developed a good **working partnership** between borrower and lender. They understood each other well and a healthy respect existed. George was seeing **more opportunities than he could properly evaluate** and probably without realising it started putting up **cursory evaluations to IAC** in the belief that the reality experts there would **separate out the weeds from the chaff** and refuse the unsound deals.

**Back at IAC**, with **pressure to get big bucks out the door**, there was evidence to suggest that **greater reliance was placed on George** than ever before and less than usual analysis was done on the deals submitted. In the **thrill of the chase**, as bizarre as it might seem, **both sides were relying on the other** and in fact neither undertook any real or professional analysis on deals that almost **exclusively turned out as dogs**.

**George went to the wall. IAC ended up with "The biggest loss ever recorded in Australia by a surviving corporation"**

The comparison between Heroin and Cocaine and Leverage becomes even more interesting when you consider the role of "pushers" in all three.

In the case just reviewed, IAC may not have been a pusher in the full sense of the word, because it did not introduce the deals to George but it certainly **aided and abetted**.

However you only have to **read the ads** in the media to find on any day, numerous enticements to borrow - **interest holidays** by retailers, **low start** home loans, participation in the stock market via **margin investment** etc. etc.
Well we have looked around in the 1960's and 1970's. They are not isolated incidents. On each occasion we have examined a single company event, but each case is truly representative of thousands occurring simultaneously, inflicting grievous harm to the very fabric of society. Why then do they continue to occur? Is this a phenomenon of the modern, post war era? Let's take a few moments to see if anything similar happened earlier.

360 years ago the stable and conservative, some would say even sombre, Dutch economy, went ape. Holland became a nation of leverage junkies. Not in the financial markets. Not in real estate. Not even in the paintings of the Dutch masters. A cargo of tulips bulbs arrived from Constantinople in 1562. Over the ensuing decades, possession and cultivation of these flowers carried enormous prestige. Attention focussed on cultivation and display of ever more exotic blooms. To quote from Galbraith's "Short History of Financial Euphoria"

"Appreciation of the more exceptional of the flowers rapidly gave way to a yet deeper appreciation of the increase in the price that their beauty and rarity were commanding. For this the bulbs were now bought, and by the mid 1630's the increase seemed to be without limit. The rush to invest seemed to engulf the whole of Holland. No person of minimal sensitivity of mind felt that he could be left behind."

Then again, from Blainville's "Travels"

"A young sailor, for bringing word of a shipment of goods from the Levant, was rewarded by a merchant with a fine red herring for his breakfast. Presently the merchant, who was much involved in tulip speculation, found missing a bulb worth, in today's terms, some $50,000. When he sought out the sailor to question him, the latter was discovered contentedly finishing the onion, as he supposed it to be, along with the fish"

But I digress. All the evidence of events at that time show that vast sums of borrowed funds were involved in the continued bidding up of the value of tulips. The bubble burst in 1637 when some of the deeper thinkers became nervous and began to exit the market. Others observed this and in a flash the trickle of departures became a torrent. Panic followed.

"Those who had purchased, many by pledging everything they owned for credit, were suddenly bankrupt. Substantial merchants were reduced virtually to beggary and many representatives of a noble line saw the fortunes of their house ruined beyond redemption." "The collapse of tulip prices and the resulting impoverishment had a chilling effect on Dutch economic life in the years that followed. There ensued, in modern terminology, an appreciable depression" Mackay's "Extraordinary Popular Delusions"

Between the mid 1600's and today there have been well over a hundred such occurrences of outbreaks of leverage. I don't have to re acquaint you with the famous South Sea Bubble, and you probably have heard of many other fabled and ill fated episodes. Perhaps the most outrageous of all was "The carrying on of an undertaking of great advantage, but nobody to know what it is" The prospectus was oversubscribed and prices bid up subsequently, doubtless with borrowed funds.

Worse even than that, you could cite Penn Square Bank where the head of the Oil and Gas Division usually took his prospective borrowers into a broom closet to approve deals. His alternative to that was to pull on Mickey Mouse ears and squat on the top of his desk during the approval process. The highly conservative and respected Continental Bank of Illinois bought vast amounts of such loans either not knowing or caring about the idiosyncrasies of the approval process. Continental went into virtual bankruptcy, with the US Government stepping for the benefit of depositors.

Now with all that under our belts let's take a quick look at the current situation with the benefit of an historical perspective. We should hold in mind that every 20 years or so the charlatans and pushers have their
day and hook a new generation that should know better. You can legislate against crime but it is not possible to legislate against foolishness and greed.

GFC

The recent GFC is no different. This time it was home lending – which used to be the safest activity known to banking. The CLINTON White House sent instructions to Fanny Mae and Freddy Mac to bring the poorer classes into decent homes.

- No need for buyers to have any equity in the purchase.
- No need for the buyers to have any other assets.
- No need for the buyers to have a job or an income to service the mortgage.
- No need to change the law that let borrowers walk away from a mortgage without any continuing responsibility by merely dropping the keys in the lap of the lender.

None of these safeguards were necessary because home prices never fall and it was a laudable exercise to look after the underprivileged. Indeed the instructions were to lend up to 115% of the purchase price so the buyers could afford to furnish. Now this is an irresistible opening for hopeless cases to borrow up to the gills and buy houses. Little surprise home prices were soaring into the stratosphere and quickly reached unsustainable levels.

The lending banks were required, by global standards, to keep regulatory amounts of capital against risk assets. The banks were reluctant to raise the new capital needed to support their ballooning mortgage portfolios. They did not want to dilute existing shareholders and were certainly aware of the difficulty of servicing additional capital with profits and dividends demanded by the market. So, with no new capital the banks faced a restraint which may have lessened the looming crisis.

However, this last vestige of restraint disappeared when the Investment Bankers entered the picture with a bevy of derivatives invented on the trot. Derivatives in and of themselves are not dangerous if used sensibly. An axe is a useful, even essential, tool on the hands of a woodman. In the hands of a homicidal maniac it is a very dangerous weapon. The investment banks did not even consider the woodsmen and the maniac. They were simply focussed on how much money they could make this year, and with that in their pockets, never gave a thought to what might happen next.

First an investment bank would buy a couple of thousand home mortgages of about $200,000 each, from the originating banks and bundle them into a conglomerate package totalling say $4 billion. All of the individual mortgages were toxic as the borrowers may well have no job, no money and no other assets. However not all will fail and even if some do fail not all will lose money after sale of the mortgaged property. Therefore the investment bank breaks the $4 billion into several tranches of say $ billion each. Let’s call them A,B,C and D, all of which own a homogenous 25% of the total. Then they sell participating certificates in each category.

Tranche D will bear the first billion of any losses and therefore being risky will have a high rate of interest to reward the investors who buy these securities. These are the equivalent of Junk Bonds.

Tranche C will only suffer if losses exceed one billion. This will represent a less risky investment and therefore attract a lower rate of interest. Still risky, still subprime but certainly safer than Junk.

Tranche B can’t lose anything unless losses exceed $ billion or 50% of the whole ball of wax. Pretty safe and therefore gets rated as Investment Grade and the interest return is appropriately lower than the preceding two categories.

Tranche A is perfectly safe as long as losses do not exceed 3 billion dollars or three quarters of the whole exercise. Therefore it gets rated by the rating agencies as AAA and the interest coupon on these certificates is quite low.

These A, B, C and D are sold globally to pension funds, local government bodies, individual investors et al, who rely on the Rating Agencies readings of the risks.

They all even take on board some category D in the chase for higher returns. Their investment parameters, after all, allow them to invest in home mortgages and even category D falls into that definition. Worse still, they could, and did, borrow at rates well below the rate on category D and so went on a spree adding another level of leverage. They bought more and more of the riskier stuff on borrowed funds and intended to simply bank the interest differential, doing it all on borrowed funds and without outlaying a cent of their own money.

Commercial banks, particularly but not exclusively in America, took a lot of the riskier stuff in the chase for return and were lending to Local Govt bodies, Pension Funds and other clients taking as security the mortgage certificates those clients were buying with the borrowed funds. Leverage on an Olympian scale pushing home
prices to multiples of reality. It was a plain as the nose on your face that this bubble had to burst – and burst it did.

When a market falls by 10% it is not a catastrophic event so long as all the investors in that market are substantially using their own funds. They can continue to hold their home and meet their mortgage obligations. But if they have borrowed 90% to fund the home then a mere 15% fall in value wipes them out and leaves them owing more than the value of the property. Try a fall of 30 or 40% in value. They lose all incentive to pay instalments or interest. When the borrowers can’t or won’t meet their obligations the lender takes possession and tries to sell the property to recover their loan.

Remember, in America the borrower can just walk away without any continuing responsibility. Why would you stay when you owe $250,000 on a house that has fallen in value to $150,000? When all this happens it does not happen in ones or twos. It happens rapidly and accelerates with the rush by lenders to beat the price fall of the security. It grows like an avalanche. The core argument that home prices never fell was shot to pieces. It was clear to any thinking individual that this was false in the face of such leverage and the ridiculous levels to which it was pushing home prices.

The result – Pension Funds, Municipal Authorities, Banks, Lending Insurers and Individuals all suffered huge losses and brought the global financial system to its knees.

WHAT WAS THE RESPONSE?

To me it was always clear that the Americans would choose the easy way out of the room and try to debase the currency (enhance exports and make imports expensive) and bring about a period of moderate inflation. This has been the time honoured way out for millennia even back to Roman days and earlier. The US would never face the music but rather would kick the can down the road until inflation took care of everything.

True to form they did just that, printing money and then came Quantitative Easing on a massive and continuing scale. Interest rates close to zero would allow the banks to make millions to rebuild capital and inflation would make the problems, fixed in 2008 dollars, easily manageable. A great plan but it has not worked. The numbers of jobless refuse to fall. Economic activity is stagnant. Inflation refuses to raise its head – in fact deflation seems to be the worry. The growth in the Money Supply (the number of dollars out in the economy) is staggering and cheap. What has gone wrong?

Before I tell you what I think let me say that I have not jet found anyone to agree with me. On the other hand I have an unbroken record of getting the big issues right.

There is a caveat however I MIGHT HAVE BEEN CONSISTENTLY RIGHT BUT SOMETIMES FOR THE WRONG REASONS. This however has happened so consistently throughout my banking career it has to have been more than sheer luck. So, even if I am alone I just might be worth listening to. Economists often fail to give due weight to the human factor. When a graph goes up, it is human nature to believe, in the absence of compelling arguments to the contrary, that the trajectory will continue forever. The same on a graph going down. The American populace, in fact the global populace, sees that interest rates have fallen dramatically and their background belief is that they will continue to fall and stay low for ever. So why borrow and spend when memories of 2008 are still fairly fresh – even if not understood. So why borrow and spend when there is, after all, no hurry.

All the money released by the Fed has merely gone into the reserve accounts the commercial banks keep at the Fed. The money supply only increases when the banks draw out of those accounts and lent to customers who spend it and it accelerates from there.

Let’s run over that again.

The Fed buys bonds from the banks. The banks place the funds in their reserve deposit accounts at the Fed. o far nothing has reached the community. So far no impact on the economy. Next, as the theory goes, customers seek loans from the banks. The banks withdraw from their Fed accounts to fund the loans. Now there is one dollar out in circulation. The borrower spends the cash to buy a car – it has turned over once. The car sales yard pays for replacement stock and pays wages to his staff. Now that original dollar has turned over three or four times. The process accelerates and multiplies the effect of the original monetary easing.

What we are facing now is that the initial demand for loans is seriously more limp than what might normally be expected.

The Fed, the Bank of England, the European Central Bank, the Bank of Japan etc just keep making more and more cash available with nothing like the expected economic response. So we have the largest pool of money provided by central banks in the history of the world. Not by a small margin but perhaps 50 or 100 times larger
than ever before. They have just kept throwing more and more of the same at the problem. The definition of insanity is to keep doing the same thing over and over but expecting a different outcome. At some point public economic opinion will change and spending will lift, based on cheap loan availability. The questions that I am constantly asking are

**WHAT WILL TRIGGER THAT CHANGE?**

**WHEN WILL IT HAPPEN?**

**WHAT WILL BE THE IMPACT?**

The first question is difficult. I believe it will come slowly as people start to forget the leverage crisis that kicked off the GFC. History tells us that memories are short. People will become bored with waiting to take advantage of low cost money. That will trigger a small kick up in inflation initially. Central Banks will respond with a small lift in interest rates. This is the time-honoured response to keep the economy from overheating. So far it looks like a soft landing. Wackedo!! But this time things are very different to anything we have seen before. When the interest rate uptick occurs populations will be jolted out of their belief that rates are going down further and going to stay down forever and a race will commence to get in before the opportunity passes. There is a massive amount of money that has been sitting there and just growing exponentially but passively.

It won’t take much at all for that to start accelerating throughout the economy and then what was planned to be a period of moderate inflation will run like a wildfire.

**GERMANY 1930’S**

The currency collapse in Germany in the 1920s was driven by massive money printing by the central bank. Result....

- Food prices doubled in price every 48 hours
- Thieves seeing a wheelbarrow of cash would take the barrow and leave the cash
- The climax in 1923 saw a loaf of bread that had cost one mark, going for 726 Billion marks
- Hitler screamed conspiracy and millions listened

**ARGENTINA**

I once held a one million Argentine Peso bank note. In 1970 it would have bought a three bedroom, three bathroom apartment with a huge balcony enjoying an uninterrupted view across the river Plate.

A few short years later you needed two more to buy a pack of chewing gum.

**RUSSIA**

100 roubles to the US dollar in 1994 and 30,000 roubles in 1999.

**UKRAINE**

2 million of their currency in 1992, last week would not even by a candy bar.

**BELARUS, YUGOSLAVIS, ROMANIA, TURKEY, THAILAND, MALAYSIA, THE PHILIPINES, INDONESIA, ZIMBABWE**

My first round of drinks.

I don’t think we will face anything that bad but it will not be a soft landing. Inflation flaring upwards will take interest rates up with it. Remember the Whitlam pyramid – that is not so long ago. In fact it should still be clear in all our memories. It was great to have a big mortgage THEN because our incomes soared, the value of our homes galloped higher, our equity in the property grew exponentially and our debt suddenly became inconsequential. Not so this time. In 1974 banks were regulated and home loans were capped at 8% whereas market rates were twice that and more. This time there is no such regulation and kids will get creamed if they do not have fixed rate arrangements.

**In short, it might be a good time to have no debt at all.**

For the risk takers it might be a good time to invest in assets that rise in value as currencies fall

We have lived through the GFC and now we have to live through the solution. The cure may prove to be more dangerous than the illness.