

Extract of a Speech given on 27th September 2007

by
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I am not an expert in macro-economic research but on 26th September 2007, I gave a speech to a group of business men and women at the Melbourne Cricket Ground and among other things I made the following observations.

“We have been through a golden period of rising share market values and everyone has made money but the mood of markets is changing. Low inflation has led to low interest rates and this has increased the capacity of people to borrow. Consequently people have borrowed to invest in shares and property. Low unemployment, a resources boom and we have the ingredients for rising markets and prosperity in our communities. I am not just talking about Australia, this has been happening in the US and Europe as well.

Lenders were awash with money and were lending it to people who did not have the capacity to repay if conditions changed. These are the so-called sub prime loans in the US and what we call low doc loans in Australia. Everyone was banking on continually rising asset values.

However, inflation became a concern and central banks increased interest rates. Our Reserve Bank gave explicit repeated warnings that if the mis-allocation to property continues, then they will increase rates.

Institutions have been lending money to people who can't afford the repayments. It is happening here as well as in the US where the sub prime loan crisis triggered a share market fall in July and August. The Victorian Supreme Court issued 2,734 possession orders in the year to June 30. People are defaulting at over 50 loans per week. Mortgage insurance companies have had claims of over \$200 million and this will rise faster as higher rates kick in.

Over the last year, Australia has seen the collapse of several mortgage backed lenders. The United States is working through the sub-prime lending crisis, the German state banks are in crisis (Deutsche is facing billion dollar losses) and now the UK has seen its fifth biggest mortgage lender, Northern Rock PLC, needing to be rescued by the Bank of England. The Federal Reserve in the US has come out and explicitly warned that further credit problems will emerge and this will cause more market volatility. How many signposts do we need?

There is a global liquidity contraction occurring and the potential for this to be the biggest financial event of the current generation is very real but most people are unaware of the potential consequences to what is taking place.”

The Global Financial Crisis followed. The reason that I published these observations is to demonstrate that at that time, any reasonably competent financial adviser could have formed the same, or a similar, view.

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