

“One of the
most articulate
economists
in Australia”
—ALAN KOHLER

STEPHEN KOUKOULAS
MYTH
BUSTING
ECONOMICS

A NO-NONSENSE GUIDE TO
YOUR MONEY, YOUR BUSINESS
AND THE AUSTRALIAN ECONOMY

WILEY

MYTH BUSTING ECONOMICS

**A NO-NONSENSE GUIDE TO YOUR
MONEY, YOUR BUSINESS AND THE
AUSTRALIAN ECONOMY**

STEPHEN KOUKOULAS

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ABOUT THE AUTHOR

Stephen Koukoulas is one of Australia's leading economic visionaries. With his rare and specialised professional experience from almost 30 years as an economist, he looks at economics with refreshing honesty and openness, especially when the answer to many of the economic issues of the day are neither black nor white.

His first job was in the Commonwealth Treasury in Canberra, arriving in an office where most of the staff were smoking, ashtrays were overflowing, the floor was a Soviet-grey lino and there was a huge computer printout of data on his desk that had to be checked with a sharp pencil and a calculator. After 8 years, Stephen moved to Citibank in Sydney and, at age 33, was appointed Chief Economist. It was in this role where he started to gain a profile in the business sector, funds management industry and the media. But in 1999, when Citibank merged with Salomon Smith Barney, Stephen was left to 'look for other opportunities in the market'; in other words made redundant as the new Citibank strove for new 'synergies' and 'efficiencies'. The 'other opportunities' for Stephen came in the form of a writing role at *The Australian Financial Review*. It was here that he started to stir the pot with frank and fearless analysis, opinion articles and bold calls in the financial markets.

The years that follow see Stephen returning to the financial markets, working for TD Securities which led to a promotion that would take him to London just before the global financial crisis. It might have been this experience that formed Stephen's views about the virtues of using all levers of policy to promote economic growth and preserve jobs in times of economic and market upheaval.

On returning to Australia in 2010, he rejoined Treasury part-time as the macroeconomic adviser on financial markets. With the GFC still bubbling along in one form or another, he worked with then Treasurer Wayne Swan's office up on Capital Hill, talking through and analysing what the high Aussie dollar, the Greek debt disaster and the still fractured markets might mean for policy settings in Australia. A few months later, the 2010 election saw the return of the Gillard government and Stephen's mate, Jim Chalmers, who was Chief of Staff to Treasurer Wayne Swan and is now the Federal Member for Rankin, asked him if he would like to be economic policy adviser to Prime Minister Julia Gillard.

Stephen was in Prime Minister Gillard's office for 10 months before leaving for personal reasons. In 2011, Stephen established his own advisory business, Market Economics, which prepares independent and tailored macroeconomic analysis for business clients needing to convert economic data into financial market and policy risks. His work provides clients with interesting and often unique insights into the macroeconomic policy debate.

With his unique background and knowledge, Stephen offers more than many economists. He has briefed Australian Prime Minister Tony Abbott on crucial economic policy issues; presented to over 35 central banks around the world; and delivered keynote addresses to the corporate world, the small business sector, retail investors and even Year 12 HSC economics students. He is a popular talking head for the ABC, Sky TV, radio and Network Ten's *The Project*, and has a reputation for breaking down complex issues on the economy into easily understood commentary and analysis of the matter at hand.

For more on Stephen, or to follow his blog, visit www.thekouk.com.

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For Meredith, oh how I miss you.

To Phoebe and Oskar — the shining lights of my life.

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And of course, to those over the years who have nurtured and fine-tuned my career and ideas on economics and financial markets and on how to sell a story. The likes of Grant Bailey, Chris Pashley, Mark Aldridge, Colleen Ryan, Roger Kilham, Martine Irman and from the distant past, it now seems, Chris Higgins, are just a few of the special people that probably don’t realise how much they influenced my career. What good people they are. To Arthur

Sinodinos, thanks for hiring me as a graduate in Treasury all those years ago.

Finally, to my family. The last few years have taught me more about life than I will ever know about economics. More than I wanted to know. Who cares where the economy is or where interest rates are going when your world falls apart. Loved ones matter, not the ASX200. There is the personal exhilaration so often experienced in life and shared with your family during the good times, usually when luck also goes your way. These feelings are best shared and should be savoured like there is no tomorrow. Alas, we have also had to share the horrid grief and absolute despondency when ill-health and death end the most special relationships.

PREFACE

I adore economics and financial markets. They incorporate so much that is good for people, and for social fairness and decency, when implemented well. Yet there is a dark side that can be, and often is, exploited so these economic gains are eroded, unrealised or unequally distributed in society.

I am lucky to have spent all of my professional career tied up in real-world economics. That means I have applied the economic theory I first learned 30 years ago when studying for my honours degree in economics at the Australian National University.

While the learning process in economics and markets never really ends as long as your mind remains open to new ideas, many of the fundamental underpinnings of economics and finance will always hold true. Whether I am talking to a fund manager in Boston, Dubai or Beijing with many billions of dollar to invest, a Year 12 Higher School Certificate student in Canberra or Sydney, or people in the mortgage industry, or advising the prime minister or treasurer or the head of Treasury, the key issues of growth, sustainability, fairness, risk management and scenario planning are much the same.

Economics is not that hard, so long as you are aware of the linkages and consequences of acting in one area or another. Being alert to why government economic policy is changing or should change is enriching, even if it is simply to crystallise your thoughts on why some changes are inadvisable. I have long been shocked by how few people carefully audit their personal finances, especially at a time when the government is focused on cutting spending and raising taxes. As we get older we need to be sure we will

have enough money to live comfortably in retirement, with decent health care and the financial freedom to do nice things, for ourselves and our children.

The importance of economic policy matters is matched by their frequent coverage in the media. Whether I'm giving a quick interview for a news grab on Radio 2GB, having a longer chat on the ABC's Radio National or doing a spot on *The Project* or Sky Business TV, I have found that the thirst for information in the media is constant.

At a personal level, and this is really the pitch of this book, economics covers your job, business and superannuation. It spans interest rates, buying a racehorse, reverse mortgages and gap years for young adults, and so much more. It's about being aware of the economic policy our political leaders deliver and making sure we know what is at stake economically when we elect this or that government. And don't forget about the rest of the world and its pivotal influence on the Australian economy, which of course means you.

If you gain nothing else from reading this book, I hope you will be alerted to the importance of monitoring your own personal finances, from the fees you pay on your mortgage and superannuation to the costs of owning a dog or going to the theatre. Economics is about making choices. Some of the money you spend on buying that morning coffee might instead contribute to paying off your debt.

By the end of the book, I hope you will be more aware of your financial position and have a better sense of the trade-offs involved in spending today rather than saving or investing for tomorrow. I also hope you are encouraged to participate actively in the national economic debate and thereby help guide Australia towards better policy choices and better economic outcomes. Be informed and aware

about economics and money, and be vocal. After all, at the end of the day it is all about you.

chapter one

MASTERCHEF VS MASTER ECONOMIST

My motivations for writing this book include frustration and disappointment with the direction of national economic policy, the prevailing lack of financial self-awareness and the woeful state of financial planning in Australia. The reality is that many people have little understanding of their own financial status, let alone the high-brow economic policy contemplated and delivered by the government of the day. An equally worrying problem is the unhelpful and often counterproductive financial advice given to business, mortgage holders and those saving for retirement through their superannuation fund. This may sound like a harsh assessment, but as you work your way through the following pages, there should be a realisation that this assessment is correct: people are complacent when it comes to their own money and the big-picture policy settings that influence their financial wellbeing.

The problem of financial complacency

I'll start by noting that many Australians simply don't care about politics and, by default, economic policy. This is demonstrated by Australian Electoral Commission estimates that show some 10 per cent of eligible voters do not bother to register on the electoral roll. A further 10 per cent of people on the electoral roll don't turn up to vote at each election. Add to that a further 5 per cent or more who cast an informal vote. On top of all this, an unknown number register a formal vote only because they are required to and would be fined if they failed to do so. Despite this level of apathy, there are unending complaints

from the community about the government of the day, whether Labor or Liberal/National Party Coalition. 'They are all hopeless!' is the all too common refrain. And often at the core of these complaints are the government's economic policies, whether implemented or merely promised.

This level of disengagement encourages politicians to pitch the economic policy debate at simple, hip pocket issues that voters are most likely to fasten on when they watch the 10- or 20-second grab on the evening news. Major economic policy reforms that set Australia up so well in decades past were debated, analysed and implemented for the medium- to long-run wellbeing of the economy, rather than being advocated and shot down in the interests of political point scoring, as is all too frequently the case now.

As for people being aware of their own finances, an Essential Research poll conducted in 2014 found that 52 per cent of people with superannuation savings paid 'not much attention' or 'none at all', or had 'no idea' about the arrangements for their retirement incomes. The poll found that only 15 per cent of people paid 'a lot of attention' to their superannuation arrangements. This is astounding, even for young people, given how important retirement incomes are for people who are living longer and want a better standard of living in retirement.

Paradoxically, most people show little or no interest in their own finances, yet cost of living pressures dominate their concerns.

An odd thing about this lack of interest in personal finances is the high profile accorded to cost of living pressures in the general community, particularly among older people. Paradoxically, most people show little or no interest in their

own finances, yet cost of living pressures dominate their concerns.

This financial complacency sees people with superannuation savings not bothering to check the details of how their money is being invested or the fees they are being charged, yet they lament loudly when at age 50, 55 or even 60 they realise they will not have enough savings to fund a decent retirement.

The Australian Taxation Office offers the startling statistic that there are 4 million unclaimed superannuation accounts, holding \$18 billion in total assets. This is an extraordinary illustration of the lack of knowledge and interest so many have in their own financial fortunes. It is hard to fathom why people would not bother to keep track of or chase up their own money. Laziness? Too rich to worry? Or is it that they don't understand how superannuation works and how easily they can track their wealth accumulation and retirement income, along with their ability to add to it throughout their working life even when they change jobs.

A simple lack of effort to understand superannuation seems to be the most likely cause of this financial neglect. It could also be that many have built up a reliance on the government to 'fix things' when needed. In the case of retirement income, why should I bother if I spend all my money now and don't save for retirement, when I know there is a decent age pension to fall back on?

Government economic policy and personal finances are about money, wealth, wellbeing and comfort. Without money it is hard, if not impossible, to access a good education, good health care, a comfortable retirement — even, in more extreme although all too common cases, decent food, clothing and shelter.

Included in the broad category of personal wellbeing, of course, are issues relating to our environment and how the planet can sustain the 7.1 billion people currently on it, let alone the 10 billion or so predicted by 2050. Money, finances and wealth matters are the focus of this book. But I hope readers will be persuaded to take greater responsibility for their vote to ensure our politicians do things right, even if it involves each of us paying a bit more tax or paying more out of our own pocket for services. Over the longer run, good economic policy and good economic outcomes mean higher incomes and wealth for the whole economy. These benefits accrue, in large part, to you and me and directly improve our personal financial position. If we elect duds to federal or state government, and if we don't take an interest in what economic policies are implemented, we run the risk of missing out on a decent lifestyle not only now but into our retirement. This takes time, certainly, but a little effort in thinking about your economy can help to deliver high financial returns.

Think of it this way. It is mandatory for our teenage children to spend hour after hour learning how to drive competently, yet there is no requirement — or even much interest, I might say — to teach them about money, saving, debt, income and opportunity cost. Many people under the age of 25 have little or no idea about how to manage their money. Financial ignorance and a general indifference to money matters persist for most people throughout their lives. This helps to explain why, despite almost 25 years of strong economic growth in Australia, too many people still fall on economic hard times. Most people turn out to be good or excellent drivers as a result of the effort that went into teaching them. Most, unfortunately, have little clue about their finances or where all their money goes each week and wonder why they are unable to save enough for a comfortable retirement.

Financial ignorance and a general indifference to money matters persist for most people throughout their lives.

The reasons for this neglect of financial wellbeing are not entirely clear, given that the issues and coping techniques are relatively straightforward. Again, it is a bit like driving a car. Learning how to drive involves learning to pay attention, to watch out for the dangers and risks ahead. You learn the rules about what is safe so you don't speed; you don't drink and drive; and you maintain your car. The good news is you can still drive wherever you want and go 110 kilometres an hour on the freeway. Not bad. Barring the outside chance of an accident, you will be much better off for having learned how to drive, which allows you not only to get from A to B, but to do so in the safest possible way. If you learn the ins and outs of finance and pay attention to the rules that surround savings, investment and spending, then, barring an accident, you are likely to achieve financial security. With financial knowledge, you are less likely to be ripped off or to end your working career without adequate savings. And you are more likely to take actions that save money, such as negotiating a lower interest rate on your mortgage or lower fees on your superannuation, both of which are money saved.

If you learn the ins and outs of finance and pay attention to the rules that surround savings, investment and spending, then, barring an accident, you are likely to achieve financial security.

Planning, preparation and enthusiasm — an analogy

In examining why so few people bother to take more than a cursory look at their finances, it is instructive to consider an illustration that might at first seem at an odd tangent from a discussion of economic policy, finances and financial planning.

In recent years television has produced a boom in wonderfully entertaining cooking shows. One is the Ten Network's *Masterchef*. In this show otherwise ordinary people with a lot of interest, and possibly a bit of talent, use their skills and knowledge to cook what are often weird and wonderful meals. They do this with direction and advice from some of the best chefs in the world.

Often the contestants do a remarkable job. Sometimes they match the finesse of Heston Blumenthal or the flair and creativity of Gary Mehigan. The contestants' sense of euphoria and accomplishment when they cook a great dish that the judges enjoy and rank highly is palpable. But more often than not these incredible highs are not realised; the wannabe chefs fail to cut the mustard and their dishes are judged to be merely so-so.

There is drama when the truffle-infused beetroot risotto is overcooked and gluggy, or when the duck breast turns out to be raw inside despite the crispy skin. Sometimes the contestants are too slow at 'plating up', forget to drizzle the jus or misjudge the seasoning of the quail compote. These mistakes cost them dearly when it comes to qualifying for the next round or gaining that all-important immunity pin. But the judges, the masterchefs themselves, are there to guide the contestants on what went wrong, making sure that the next time they step up to the hot plate, their earlier mistakes are not repeated.

We might apply the *Masterchef* principles regarding effort, teaching and learning, and even entertainment, to our own economics and finances. There are, or at least there should

be, similarities between planning for and preparing a meal and planning and preparing a business plan or investment decision. We know that every day businesses fail despite the best efforts and endeavours of those involved. Business results will often fall well short of the principals' objectives and dreams. This is because the people running the businesses and making the investment decisions are not the equivalent of the TV masterchefs.

There are, or at least there should be, similarities between planning for and preparing a meal and planning and preparing a business plan or investment decision.

Despite the crushing dismay of the contestants who are sent to the elimination challenge, in the real world a dodgy apricot chicken dish really doesn't matter all that much. For those who get through to the next round there is always tomorrow night to attempt to cook that restaurant-quality meal. When contestants do cook the equivalent of a dog's breakfast and must leave the show, tears are shed, there is a convulsion of bitter disappointment, but invariably they go home vowing to learn from their experience. Many go on to start a restaurant, café or catering business, using their newfound experience to embark on a new career. And the families of the *Masterchef* contestants will enjoy many culinary treats in the weeks and months after their loved ones leave the show and try out their new skills in the kitchen at home.

A model worth applying?

Of course, failures among *Masterchef* contestants have never triggered a recession or driven unemployment higher, nor have they increased economic inequality

through a poor decision on tax reform or regulation of financial service advice. None of these culinary deficits have ruined the environment at a great cost to future generations. No one who forgot to plate up the port wine jus has lost their life savings as a result or been financially crippled by one of the few dodgy financial planners around the country. Nor have they implemented policies that trigger mass job losses or an inflationary spiral. Saucepan errors are only about fancy food not turning out to be fancy after all. Nothing more serious than that.

Which begs the question: why is there not a show called 'Master Economist'? Or 'Master Financial Planner'?

Let me make the case.

Contestants on such a show, and a few million viewers who might watch it, would soon become engrossed, I reckon, in seeing how their economy and the financial markets work. Imagine, they could be treated to a heated discussion between Westpac's Chief Economist, Bill Evans, ANZ's Warren Hogan and BT's Chris Caton on the commodity supercycle. Or they could watch and learn from AMP's Shane Oliver, NAB's Alan Oster and Commonwealth Bank's Michael Blythe as they discuss why the global growth cycle and commodity price swings will matter for the Australian economy. Think about it. They could see Mark Bouris, Alan Kohler and Marcus Padley go head to head on superannuation investment strategies and the benefits and pitfalls of investing in property, stocks, bonds or international markets.

How exciting would that be?

Imagine a masterclass with ex-Treasury and Reserve Bank of Australia officials such as Ken Henry, Bernie Fraser, Martin Parkinson or Ian Macfarlane talking about how they pulled the policy levers to reform our economy or how they

reacted during the global financial crisis to make sure Australia did not fall into recession. What about having Gina Rinehart, Gail Kelly, John Symonds, James Packer or Frank Lowy talking about their business successes and how they did it? What a winner!

The prospects for this show are getting better and better.

But there's more. Let's throw in a few academic economists to round it out. Steve Keen could go on about the debt crisis and why we all will eventually be ruined because of debt. Warwick McKibbin could give some insights into the workings of the RBA, Australia's central bank, citing his experience on the board and action on climate change, while John Quiggin could reveal his thoughts on income distribution and wealth, and why inequality is a severe handbrake on economic growth. Let's also see what Bob Gregory has to say about the labour market and why Australia cannot enjoy a 3 per cent unemployment rate with current policy settings. What about ex-Treasurers Paul Keating, Peter Costello, Wayne Swan and John Howard going head to head? The likes of Professor Judith Sloan, Gerard Henderson, Chris Kenny and Terry McCrann could offer their whacky ideas on economic policy in a lighthearted 'bloopers and zingers' section.

The list of possible talent for the show is a mile long.

If this is not potentially as entertaining as the pressure test cook-off on a wagyu beef and pickled pear tartlet, I don't know what is. Participants and viewers could get to see world-class economists, policy leaders and financial experts discussing and debating the things that matter to every viewer's financial wellbeing. And they would all come away from such a show knowing the trade-offs in the policies our politicians need to implement for economic growth, jobs, wealth and financial fairness to be delivered.

Viewers could see the trade-offs involved when government policy is set.

Viewers would no doubt get to understand why economists, or at least some of us, are delighted with a strong retail sales report or are dismayed when the government fails to implement a policy change on taxation — for example, where the long-run benefits to the economy are obvious, but the political risks are considered to be too high.

Viewers could see the trade-offs involved when government policy is set. Instead of wondering whether the lobster is overcooked, the master economists and contestants could work out what it might mean for Australia and our individual finances if the economic policymakers overcook the economy so inflation runs higher for several years, or if the RBA fails to cut interest rates when growth is too weak so the unemployment rate moves higher.

On a more personal level, viewers could see the risks and trade-offs involved when they choose to invest their superannuation in a balanced fund or a hedge fund or property or fixed income or an international growth option. Similarly, they could get a feel for what might lie ahead for their business as, for example, Australia's terms of trade fall away rapidly over the next few years as the world faces a glut of supply in the commodities that Australia produces. The show could have a 'forecasting and market predictions' section, which would be interesting in itself but would also help to sort out who the true master forecasters were.

In much the same way that we marvel at the ability of some *Masterchef* contestants as they reveal a near-perfect croquembouche, watching 'Master Economist' would give viewers insights into why the federal budget matters, why it is important that they think about their own business plan, superannuation, mortgage and personal finances as

they move through life. It might even make some of them want to investigate whether any of that \$18 billion in unclaimed superannuation money is theirs.

We might present a special challenge for our 'Master Economist' contestants: How do you deal with a budget deficit? What has led to the deficit? Which taxes should be hiked and which areas of government spending cut if we are to move back to a budget surplus? What are the consequences of raising the goods and services tax, for example, and how could the extra revenue for the government from such a tax hike alter the nation's finances? What to do about government spending cuts? Defence is an easy option to cut, especially considering those expensive submarines being built in South Australia ... or is it? What are the implications of making such a cut? What would it mean if the 'Master Economist' contestant advocated a cut in spending on education? Sure, it might see the budget move to surplus in the next few years, but what about over the longer term when Australia is left with a poorly educated, low-skilled workforce?

I could go on!

These are the sorts of questions policymakers in government confront every day. Little wonder it is a tough job, or that when a decision is made some sectors of the community will feel hard done by — and will voice their views — while others will delight in the government's largesse.

Answers from contestants could be monitored by the policy experts, who would no doubt impart their own wisdom, including pointing out that most policy changes have consequences elsewhere in the economy and that different sections of the economy win or lose when policies are changed. A simplistic case in point is lifting the GST rate to help move the budget back to surplus.