THE ENDING OF AUSTRALIA'S FINANCIAL CYCLE

Paul Osborne

Australia is in the throes of the unravelling of a domestic financial cycle which spans 30 years (1992–closing). The current financial cycle is a credit boom that has mostly formed in the residential real estate sphere. The definition of a financial cycle is only loosely agreed upon; this is their challenge, but it is also their strength. However, some of the agreed-upon defining characteristics of a financial cycle are that: it involves an internal domestic credit boom, mainly focused on real estate; it is long in duration; and it is commonly more than double the usual business cycle of 8–10 years. During this time, memories of past busts recede from view and market participants and policymakers presume the cycle is now tamed. The financial cycle is set off by a real economic boom and features strong interplay between rising property values and collateral, rapid credit expansion, and the banking system. Credit constraints are dismantled during the early stages of the cycle, and risk taking grows alongside that of the cycle, which adds to the length of the cycle. Financial cycles transform the economy, including the nature of employment, and go hand-in-hand with construction and infrastructure booms, which in turn skew government revenues, thereby creating contingent liabilities in the process. The financial cycles of different countries operate at different frequencies — however, major trading partner countries can have cycles which are linked.

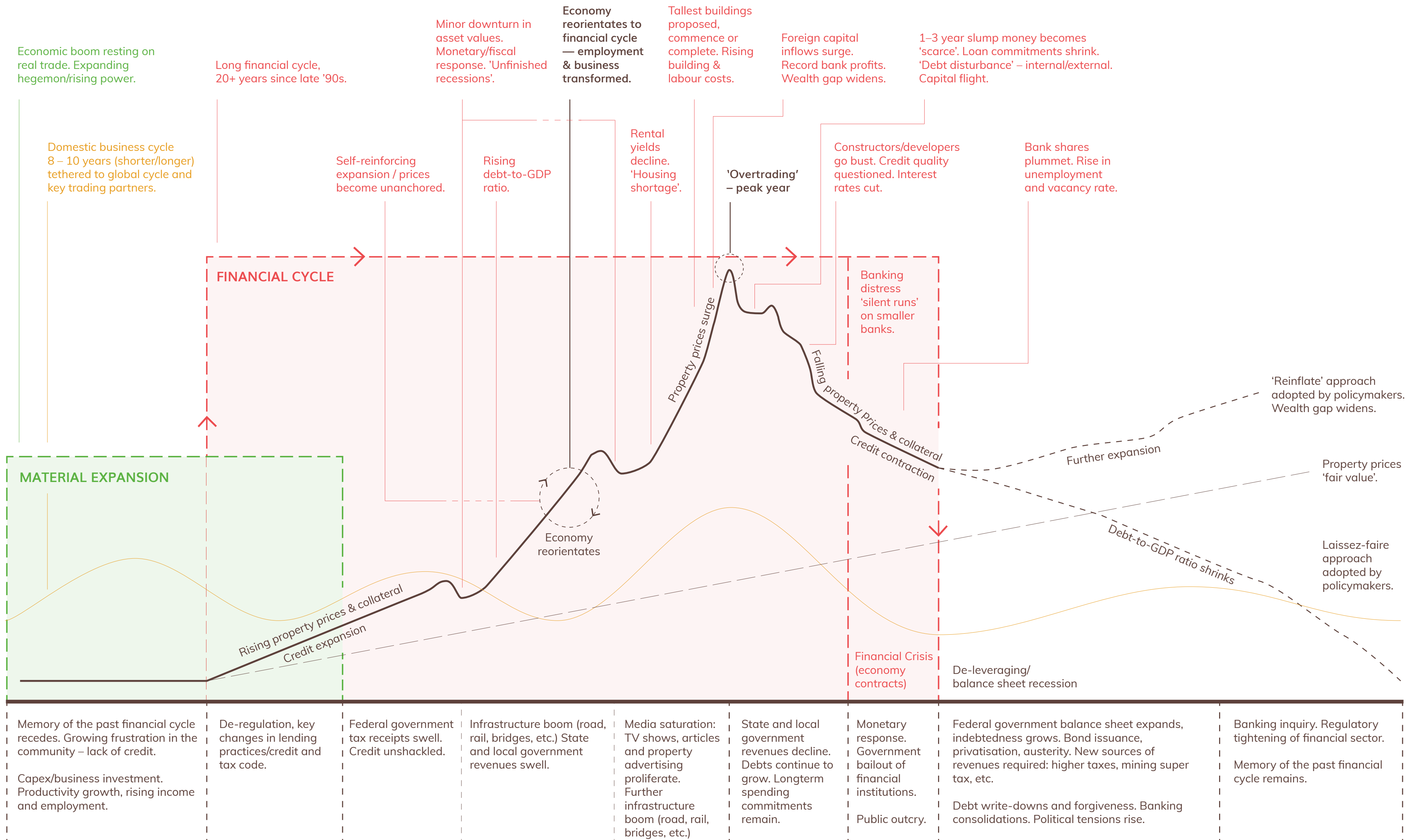
The starting point for understanding the financial cycle is to accept that the boom must make way for the bust. The future bust is encoded into the genome of the financial expansion before the upswing gets underway. Think endogenous qualities over exogenous ones. The ending of the usual domestic or global business cycle, or even the global financial cycle — which can often be in sync — or the economic decline of a major trading partner are factors that commonly help bring about the end of the domestic financial cycle. It is here that the worst effects are experienced. Most commonly, the banking system comes under great stress, marking the end of the cycle, and a domestic financial crisis, either mild or severe, can ensue. The cause and result are heavy falls in property values and a long de-leveraging process, including debt write-downs and insolvencies, resulting in a slow recovery. Financial cycles can span multiple economic contractions, making them hard to detect.

As the economy becomes wedded to financial expansion during the period of ascent, the unwinding of credit expansion can cause structural problems for the real economy. In recent times, equities

prices have been a mere distraction compared with property markets in understanding the cycle's full force, due to the credit creation process and nature of debt accumulation.

The concept of the financial cycle is still mostly misunderstood in our time. Yet it is the closest approximation to comprehending today's decades-long asset price expansion. Australia has had five consequential financial cycles in its history, including the current cycle — they are a recurring theme. Spain, Ireland, and the United States have all faced the end of their own cycles this century. Ishmael, in the novel *Moby Dick,* forewarns readers that the calm conditions are but the wrapper and envelope of the storm to come. To understand the financial cycle view of the economy is to see things in a similar light. The long-term 'benign' and tranquil conditions that seem to be creating rising prosperity end up subverting themselves. As the late economist Hyman Minsky put it: stability is destabilising.

SECRET AGENT ◈ **The Financial Cycle** by Paul Osborne



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Material expansion | Financial cycle | Property prices | Business cycle

THE END OF THE FINANCIAL CYCLE

It is my view that the nation has reached a 'critical break' in the housing market and that this current financial cycle (1992–closing) is coming to a close. The slump stage has now been reached. Recent interest rate increases, rising inflation and higher government bond yields, as well as declining mortgage commitments are the appropriate signifiers. The logic for this declared end of cycle is an over-indebted household sector which will experience growing difficulties in financing itself, an exhausted monetary system, limited fiscal space, and revised hurdle rates required for future investment. Irving Fisher's *Debt Deflation Theory of Great Depressions*, from 1933, cites a 'debt disturbance event' as the primary cause for a financial boom end to end. This 'debt disturbance' is now likely in motion for Australia.

The signifiers are not the cause for the current financial cycle to end, they are merely just bringing into being what was always inevitable after a long period of credit expansion. Due to many mortgage obligations remaining fixed, properties being withdrawn from sale, as well as additional financial buffers retained at the household level from pandemic stimulus — the worst of the effects may still be a few years away. Initial interest rate increases can act as impetus for home buyers to 'buy in' and fix in home loans before perceived interest rates get too high. Borrowing limits can be more restricted by higher interest rates in the short-term, than any offsetting fall in property values, therefore some will rush in to secure a mortgage and reserve their borrowing power. Speculators, who having witnessed minor downturns before, elect to wait for the recovery period to begin, which is 'just over the horizon' — and therefore refuse to trade during the period of the slump.[1] And of course, new speculators are created, who sense opportunity, and buy into the slump period.

The direct itemised events that bring about the end of the cycle are the 'black box' which, if the financial cycle is at its end — as I claim here — will be dissected by historians well into the future. Capital flight, a stampede to the exits, a credit crunch, China's property crisis, etc., are just some of numerous blows that may tip the long credit expansion into reverse. But regardless of events, contraction was always going to follow expansion.

This downturn is not one that the 'property veteran' has seen before — it's likely a different beast altogether. Therefore, the smaller downturns of the past few decades are of limited relevance; this

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[1] *'Manias, Panics, and Crashes - A History of Financial Crises'*, Charles P. Kindleberger 2005 Chapter 6, Euphoria and Economic Booms. New Jersey: John Wiley & Sons, Inc.

includes the 2008 financial crisis, which had limited effects on Australia. The true ending date of this financial cycle can only be appended in retrospect, but the runway left is short. The culmination of a domestic financial cycle, combined with the peak in the usual business cycle, is when the great real estate booms end, often in the form of bust.

Numerous commentators, including officials at the RBA (Reserve Bank of Australia), have pointed out that as long as employment remains strong, mortgages will continue to be repaid, and, while house prices will 'correct' a significant downturn will be avoided.[2] Here, I make the opposite claim. Falls in house prices will lead to unemployment, and then unemployment and falling house prices will feed back into each other, creating a downward self-reinforcing spiral. This is how financial cycles commonly manifest towards their end. The economy reorients over a long time period and becomes dependent on the financial expansion. The unwinding is a painful structural adjustment.

This paper is one of three essays on the financial cycle. The first essay will provide an overview of financial cycles and what they are, and Australia's position within the current cycle. Moreover, the five financial cycles in Australia's history will be tabled. The relationship with the construction boom and skyscrapers will also be discussed. (To clarify, when the financial cycle is discussed, this will refer to the domestic financial cycle, not the global financial cycle, unless the global financial cycle is expressly stated.) Essay two will go further into the long credit expansion, and the role of central banks, and commercial banks. Essay three will explore the potential aftermath, as this financial cycle draws to its close, as well as the expected consequences. The future is unknowable, of course. Possibilities are discussed but attempts at clairvoyance are avoided. Property always provokes charged discussion in this country, and it's easy to fall into overly bearish or bullish sentiment. The hope is that the picture painted here is one that is realistic. These essays are written for market participants who, in their dealings with high prices and large debt loads, can bear in mind the forthcoming information, and either use it or discard it, in their decision-making processes.

THE LITERATURE OF CYCLES AND PHASES

The reader may ask by what justification are the twin cycles — the domestic financial cycle and the standard business cycle — to be accepted as separate yet interconnected identities that warrant partitioning. The financial literature comprises numerous examples of economic cycles, especially

[2] How Are Households Placed for Interest Rate Increases? RBA, Michele Bullock 2022.

prior to World War II, when the Great Depression, the Melbourne Land Boom, and the Florida Land Boom were still fresh in people's minds. There are also works by economists and sociologists which provide frameworks that deal with the change of power structure in world economic affairs, as well as the effects. For Australia, a commodity exporting nation, this is important. I shall provide a few examples of economists who are outside of the present standard mainstream as well as a few who are not.

Economist Irving Fisher's *The Debt Deflation Theory of Great Depressions* was written in 1933, while the stock market crash of 1929 was still fresh.[3] Fisher, who lost his wealth in the crash, sought to understand the crisis, which continued to persist. On cycles, he observed: 'instead of one cycle, there are many co-existing cycles, constantly aggravating or neutralising each other'. He declared the single business cycle a myth. Fisher named two bad actors, 'debt disturbances' and 'price level disturbances', which were catalysts to the downturn, while over-indebtedness was the leading reason for the large downturn in the first place. Debt deflation is one potential result of a bust, especially under the conditions of high debt loads, unless a 're-inflate' strategy is implemented, which would require monetary or fiscal response. Since the Great Depression, Fisher's recommendation to re-inflate has been the adopted stance by most central banks, as they learnt from the severity of the depression, which was thought to have been exacerbated by the laissez-faire approach of policymakers. However, Fisher's identification of multiple cycles has been less adopted into current economic thought.

By far the best take on the domestic financial cycle in modern times is from Claudio Borio, Head of the Monetary and Economic Department at the BIS (Bank of International Settlements). Borio separates the business cycle and the domestic financial cycle that operate across a nation's economy at a given point in time.[4] The domestic business cycle usually lasts for 8–10 years (but may be shorter/longer) and is often in sync with the global business cycle. Unemployment rises and falls during these cycles, but financial assets domestically are not heavily impacted. The domestic financial cycle acts under its own volition but interacts with the business cycle. Commonly, domestic financial cycles are double the length of the business cycle (or longer) and tend to feature strong credit expansion within the private sector, which usually finds its way into domestic property

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[3] *The Debt-Deflation Theory of Great Depressions*, Irving Fisher 1933. This is a very important paper for understanding the financial cycle early on in the 20th century.

[4] BIS Working Papers No 395, *'The financial cycle and macroeconomics: What have we learnt?'* Claudio Borio 2012. The importance of Borio's paper cannot be overestimated. It provides key insights into the cycle, with over a decade and a half of research on financial cycles behind him (Borio). The paper uses little mathematics and is simple in its approach. Further papers have undertaken a more rigorous approach, yet don't distil the ideas as clearly as this paper.

markets. Market participants are drawn into the self-reinforcing asset upswing, which continually distorts perceptions of value and attitudes to risk, and financial liberalisation weakens financing constraints. During the long upswing, a nation's fiscal position often appears to be in excellent health. Revenues accruing to governments appear strong, as the economy roars along and windfall taxes, levies and duties are collected from higher and higher property values, which are then often directed to infrastructure expansion projects. Monetary policy can be too loose. In the short run, this stimulates both the domestic economy via a credit boom, and the exporting of goods, as lower interest rates assist in devaluing the national currency. Long periods of inflation and 'benign' conditions lull policymakers into complacency.

These periods of perceived stability can produce large financial imbalances, as well as a huge dislocation of resources within the domestic economy. What's more, these financial cycles are getting longer. Borio found that, since 1998, the average length of the financial cycle has expanded to 20 years. Once the boom tilts to bust, the ramifications soon become apparent and can be catastrophic. Just like a rubber band that is stretched and released, the credit expansion turns to a credit contraction, and the return position of the band snaps back. However, the band overcorrects upon its return, rather than returning to any presumed steady state. An economy may go back to growth as the crisis abates; however, the true financial position of that economy is always behind, and the growth trajectory is forever altered.

Giovanni Arrighi, the late Italian economist and sociologist, provides a concept which carries over larger timescales, as well as providing an understanding of the role of the hegemonic power and rising powers. Arrighi suggests that nations toggle between two distinct stages.[5] First, there is a material expansion phase, which comprises trade and the production of commodities. A rising hegemony creates growing positive-sum trade relationships, in both the incumbent and rising power, as well as the countries which supply the materials and services to these rivals. Second, as competition moves to zero-sum between business interests, profits are squeezed, and a transition to a financial phase occurs, abetted by the state, which delays the impending crisis. This financial phase is one that deals with financial instruments and speculation, and can last for long stretches of time, before the eventual crisis is reached.

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[5] *The Long Twentieth Century; Money, Power, and the Origins of Our Times*. Giovanni Arrighi, London: 1994. Chapter 2, 'The Rise of Capital'. The use of 'material expansion' and 'financial expansion' by Arrighi has far greater ambition than my use of the terms throughout the essay.

The often-misinterpreted Adam Smith proposed a somewhat similar pattern, in which capital was first invested in agriculture (including mining), then manufacturing, and then foreign commerce (which is the financial stage).[6] Each new stage would see a rise in profits for the expanding nation, but the profits would not be as durable as they had been in the previous stage. Smith foresaw that a falling rate of profit would accompany a nation's maturity, and that a nation may have a few centuries of strong economic conditions before its eventual decline — something which Arrighi has shown to be speeding up. In relation to financial crises, there would be a preceding propensity for overtrading, and afterwards money would become 'scarce'. Smith and Arrighi both had the vision to be able to view patterns occurring over many centuries — something which is mostly lacking from economics today, which is more focused on short-term calendar time, such as days, months, and years.

Hyman Minsky shunned equilibrium theories. His financial instability hypothesis provides important insight into the quality of the credit structure.[7] He was sure that you could tell a lot about an economy by the way households and firms financed themselves. He demonstrated three sequences of financing that usually take place within an economy. Starting with 'hedge financing', a household or firm borrows money, and with the revenues from the asset purchased, both the interest and principal amounts are repaid, with future financing costs and cash flows fixed in advance. Hedge financing conditions eventually tilt to 'speculative financing' ones, in which revenues from assets only cover interest costs on debt. Here, it is presumed by the borrower and lender that cash flows will grow, tilting the investment into a unit of hedge financing. The final stage, 'Ponzi finance', often emerges under the conditions of variable rates of interest and floating debt. As cash flows from assets do not cover the interest component, Ponzi finance is simply a matter of finding the greater fool; the borrower may even borrow to pay interest, like a person who uses one credit card to pay off another, and the self-reinforcing nature of rising asset values distorts views on risk.

This process of transition from one financial state to another can go on for decades. Once financing costs rise, households or firms under variable interest rate financing are transformed. Speculative financing units are transformed into Ponzi finance units, while borrowers in states of Ponzi financing become insolvent. The same situation could occur should a sudden change in cash flows take place, rather than financing costs merely changing — cash flows and financing costs could even occur at the same time. Together, higher financing costs and falling cash flows are the ultimate problem for

[6] *The Wealth of Nations*, Adam Smith 1776. Book 3, Chapters 3 & 4.
[7] *Stabilizing an Unstable Economy*, Hyman Minsky 1986. Chapter 9.

borrowers. As balance sheets across the economy are interconnected, the economic system in these circumstances may be prone to come under great stress, and a financial crisis could result. Minsky refers to the 'fragile financial structures' which can be viewed synonymously with the maturity end of the financial cycle.

However, it is Borio's description of a financial cycle that is so well suited to today's global central banking regimes, especially in the era of inflation targeting, atomised credit relations, and surging property prices. The role of the hegemonic and rising powers that Arrighi and Smith understood so well, are helpful to understand Australia's own financial cycles, as Australia is a commodity exporting nation to the various global powers. Fisher provides a compelling case for the reasons that financial cycles end, while Minsky's three phases do well to explain the long length of the financial cycle — by directly understanding how households and firms finance themselves. This helps our understanding of the current financial cycle with Australian characteristics.

THE FINANCIAL CYCLE

- The financial cycle is often set off by a material expansion within the economy; for a commodity exporter, expansion of the hegemonic or rising power/s sets off the boom.
- The financial cycle stems directly from the architecture of the financial system itself. The boom and bust are inseparable bedfellows.
- There is co-movement between rising property prices and the expansion of bank credit.
- Financial cycles can span numerous generations of RBA governors, politicians, and market participants, as well as span multiple economic contractions, before they end.
- They have a long duration period, at least twice as long as the usual business cycle, and they are domestic in nature.
- Dismantling of credit constraints and emphasis on rising collateral are present.
- Self-enforcing 'lock in' upswing rewards those early in the cycle, and risks accumulate and distort.
- The economy reorientates during the financial expansion. Construction and jobs tied to the credit expansion predominate, and contingent liabilities are created.
- The cycle ends in sync with the economic decline of major trading partner/s, or the end of the traditional business cycle or global financial cycle. Financial cycles themselves can cause the business cycle to end.
- Economic potential output is often overestimated during the credit expansion.
- Crises are large, and often a domestic financial crisis follows. Distress occurs within the banking system. Property prices fall heavily.
- Severe expressions at the cycle's end include banking failures and debt-deflation/balance sheet recessions.
- The bust period spans multiple years compared with just one year on average for a standard business cycle recession.

A NATION OBSESSED

The sheer scale of Australia's domestic property market is hard to comprehend. It is unparalleled in size and power and according to the ABS (Australian Bureau of Statistics); the residential housing market's value alone recently surpassed $10 trillion dollars — and this excludes farm land, commercial and industrial property.[8] To put this in perspective, this value sits at almost fivefold the combined value of all companies listed on the ASX (Australian Stock Exchange), or put another way, the total Australian Government Bond market is valued at less than one-tenth of the value of the national residential housing market. Over the decades, the housing market has created enormous wealth for many Australians across the class divide.

Property has become a crucial system-wide necessity for institutions, governments, individuals, and families, who earn their livelihoods through either direct or indirect association. Councils depend on rising values to secure more in rates to maintain local areas, state governments are funded significantly by stamp duties and land taxes from property, which fund infrastructure projects and provide services. The federal government draws revenues from the collection of GST from property transactions and from capital gains taxes and income tax from the industries related to property.

Australia had the strongest house price growth on record in 2021 at 23.7 per cent according to the ABS, whilst wage growth was a mere 2.3 per cent in comparison.[9][10] The laws of physics suggest that the nation cannot have house price growth increasing at a pace that is so vastly different from wage growth indefinitely — it is always an unsustainable path. Fiscal response by the Government during the pandemic helped build households' balance sheets, and credit creation was further unleashed. The counterintuitive frenzied conditions of the past few years have been the prevailing result. The pandemic years will likely be looked back upon as the golden days for house prices in Australia: properties being acquired sight unseen over Zoom in one's pyjamas, places being acquired in far-flung locations to escape the cities at huge premiums, beach homes doubling in value in just a few years. The lessons from 2008 and the more affected markets of the United States, Ireland and Spain have not been learnt locally — and this has been a mistake.

Dogma-like beliefs have proliferated throughout the Australian community for decades and have been hard to dislodge: 'the property market only goes up'; 'the market doubles every ten years'; 'you

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[8] Value of residential dwellings passes $10 trillion, ABS, Released 14/06/2022.
[9] Strongest annual growth in property prices on record, ABS, Released 15/03/2022.
[10] Annual wage growth increases to 2.3%, ABS, Released 23/02/2022.

simply cannot lose in housing'. Australian households have expanded their balance sheets to become some of the most indebted in the world. But change is underfoot. Properties are being withdrawn from the market, and auctions are failing. Owners are battening down the hatches to weather the storm. Previous property market declines have been offset by stimulus measures, such as the Rudd Government's stimulus package to households in 2009, and the Morrison Government's $291 billion package during the height of the pandemic.[11] Or, in other cases, interest rates have dropped, or quantitative easing has been initiated. Such policies that seek to stimulate are more difficult now, as the risks are that inflation will only be exacerbated by any such stimulatory policies. Federal and state governments have also accumulated substantial combined debts, on track to reach $2 trillion over the next couple of years, and the RBA is fighting inflation the only way it knows how — by driving the cash rate up.[12] The mythological beliefs that many Australians have about housing are slowly being eroded and reshaped, one interest rate rise at a time.

MEMORIES FADE AND MARKET TIME IS LONG

In the marine sciences, the term 'shifting baseline' is commonly used to describe the loss of experience when comparing past and present conditions, often in order to understand the health of ecosystems. An individual fisherman may make an observation of local fishing stocks by comparing his most recent catch with those of recent years. The fisherman cannot compare today's catches to those of 30, 50 or 100 years ago. The comparison, the baseline, is just too short. A measure from pre-industrial times, or from a period when the ecosystem had enjoyed sufficient rest, such as at the end of the World Wars, would be more accurate for establishing a baseline. In contrast to the fisherman, the scientist uses technical methods to reach those hard to establish baselines. In asset markets such as property, long waves of activity build up over large time scales, which create a 'shifting baseline' for market participants.

Australia's long-term property prices have been influenced by numerous historical events: the baby boom post World War II; financing costs; first home buyer and negative gearing schemes; depreciation and capital gains tax exemptions; power–law distributions in wealth capture; high-skilled immigration; no/low deposit home loans; high loan-to-value ratios; shared equity schemes; mining booms; foreign investment; productivity growth and rising incomes; dual-income households

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[11] Economic Response to COVID-19, Treasury, May 2021.
[12] Total Australian state and federal government debt to double to $2trn, AFR, Ronald Mizen Finbar O'Mallon 23/06/21.

(especially as more women entered the workforce); building and material costs; and a belief in property from the populace, to name just some factors amongst innumerable others.

There is great interdependence across time that links policymakers and market participants, that cannot be untangled. Yet policymakers and market participants have often assumed the inverse of this since World War II. This likely has had much to do with the efficient-market hypothesis as well as rational expectations theory. *The Theory of Speculation*, which was written by French mathematician Louis Bachelier at the turn of the 20th century and translated into English in 1964, was pivotal to the development of the efficient market hypothesis. Another important paper was *Rational Expectations and the Theory of Price Movements*, which was published in 1961 by John Muth. This provided modellers with the assumptions required for how people should behave in aggregate. Both economic papers, along with their offspring, have been hugely influential on economists and policymakers, particularly from the 1970s onward.

According to the models that rely upon the efficient market hypothesis, the 2008 financial crisis was a one in a one-in-a-billion event.[13] Self-equilibrating theories discourage people from taking into account a historical view, presume rational decision making by buyers and sellers, and also presume that asset prices will always reflect their fundamental level. Nonetheless, the financial crisis did happen, and there has been plenty of self-reflection within the economic profession since. Yet the theory still holds sway today. Many of the most influential policymakers still come from decades of training grounded in equilibrium-based modelling, underpinned by elegant mathematics and 'rational expectations' as the tools for understanding complex systems. These old habits are hard to part with. Many of these models treat financial shocks as exogenous, imposed from the outside, rather than inherent to the inside, as key properties of the financial system itself. The old theories from prior to World War II — many of the authors of which had direct experience of large busts — were forgotten or rejected. The modelling was only made larger to capture every variable. The physicist Carlo Rovelli, in his book The Order of Time, writes: 'In the end, every attempt to impose order leaves something outside the frame'.[14] Over-reliance on complicated modelling, as opposed to some general common sense using simple rules, has let down central banks, policymakers and the community.

[13] *The (mis)Behaviour of Markets - A Fractal View of Risk Ruin and Reward.* Benoit B. Mandelbrot and Richard L. Hudson 2008. London: Profile Books, Ltd.
[14] *The Order of Time, Carlo Rovelli* 2019. Milano: Penguin Books. Page 181.

Decisions made in the past cascade forward in time and impact events today — 'market time' is long and subject to historical events. Yet the tendency for buyers and sellers is to transact on their own time. People buy a home as social practice, such as prior to getting married or when their family expands, or they purchase an investment property — once they have the deposit to do so — and will stretch to eye-watering prices to achieve their means. Decisions that last 30 years or longer via mortgages are quickly entered, often without regard for the point in the cycle that one may be in. And it is leverage that is deployed to allow a borrower to stretch into the future and bring consumption forwards to today. The financial historian Roger Ward Babson wrote extensively about the Florida land boom and crash of the late 1920s. He observed: 'There has never been more than one Florida boom within one generation. It has been impossible to catch the same people twice, but it has always been possible to catch each generation.'[15] Memories quickly fade of past downturns, and risks accumulate within the financial system over time, which catch market participants unawares when the eventual downturn arrives. Financial cycles can go on for decades, be untied to the business cycle; they reward those who commence their financial activities at the start of a financial cycle, and crush those who arrive late. In modern times, these financial cycles have stemmed directly from the household level of the economy.

THE FIVE FINANCIAL CYCLES

There are five identifiable financial cycles of note that have occurred throughout Australia's history since 1788. The four prior to the current financial cycle all had severe consequences for the nation. Rather than being simply siloed to any one state or city, these financial cycles rippled across the nation, and each disrupted the banking system. All featured a strong credit expansion within the property market that flowed into high property values. All had a bust, after the cycles had reached their limits. The cycles were brought to a head by external events, such as drought, global recession, or the economic decline of Australia's major trading partner. Yet their creation was from the inside, the financial system itself. The cycles are listed here chronologically by number, and will be referred to in this essay, as well as the essays that follow as: Financial Cycle 1 (1830–1843), Financial Cycle 2 (1873–1893), Financial Cycle 3 (1966–1974), Financial Cycle 4 (1978–1990), and Financial Cycle 5 (1992—2022), which is closing.

[15] *The Florida Land Boom of the 1920s*, Gregg M. Turner 2015. Unites States: McFarland & Company, Inc. Page 164

Financial Cycle 1 (1830–1843) Peak year of overtrading 1841. Severity: high

The King of England in 1804 modified usury laws which prevented any funds being loaned for more than 8 per cent interest.[16] This was to play an important role in the cycle three decades later. Tasmanian legislators in 1830 passed an act that declared English usury laws not applicable to Tasmania, paving the way for English capital, which had restricted investment opportunities at home, to invest in Tasmania. The rate of interest in Tasmania for loaned funds was anywhere from 10 to 15 per cent. English capital thus flowed freely into Tasmania. NSW followed Tasmania's lead in 1834. In 1831, interest on deposits was offered by a 'General Savings Bank' and other banks followed, creating competition for deposits. The Tasmanian banker Charles Swanston understood the full force of the financial cycle early in Australia's European settlement. The Derwent Bank, under Swanston's stewardship, could not lend out English capital for any purpose other than mortgages. Loans quadrupled in four years until the slump began in late 1841 (the NSW slump began slightly earlier). When the property market started to decline, English investors became skittish and sought to reclaim loaned capital. The Bank of Australia failed on the 2nd of March 1843. A banking crisis swept over the colonies as Sydney Banking Co, Archers Gilles & Co, Colonial Bank, Derwent Bank, and the Port Philip Bank in the new colony of Victoria, all failed. NSW, Tasmania (Van Diemen's Land), Victoria and South Australia were badly affected. The rest of the 1840s was heavily impacted by this early bust.

Financial Cycle 2 (1873–1893) Peak year of overtrading 1888. Severity: major and long-lasting

The future premier of Victoria, Thomas Bent, carried out a forty-acre subdivision in Church Street, Brighton in Melbourne in 1873. It was a profitable success, and a springboard to further development. The emergence of Brighton as a prestige suburb of Melbourne, Thomas Bent's upward rise, and the long boom all grew together in parallel. The Victorian Parliament replicated English building society statues in 1876, which allowed building societies to trade in property. This led to an explosion in building societies competing for deposits and using them to speculate on real estate.

Twenty major financial institutions and 100 public companies failed between July 1891 and March 1892, as the land boom came crashing down.[17] The land boomers were cut off from English and

[16] *Foundations of the Australian Monetary System* 1788-1851, S.J. Butlin, 1953.
[17] *The Land Boomers, Michael Cannon*, 1966. This is a very important book in understanding Melbourne's land boom and bust from the late 19th century.

Scottish bank capital, and funds on deposit with the banks were recalled. The official end date of the boom was Sunday 30th April 1893, when a Government Gazette was issued, declaring the entire following week a bank holiday, to halt a run on the banks for deposits.[18] However, this had the opposite effect, and many of the Victorian banks failed. Victoria was plunged into a financial crisis. NSW also had a banking crisis, and Queensland was also heavily impacted. The property-led depression that followed was Australia's largest in history. This is under-appreciated across the globe as an example of one of the great property busts. A high number of Victorian properties still standing today were built between 1880 and 1893, as very few buildings were constructed after the banking crisis crippled economic activity, particularly in Victoria. Property booms in South Africa and California were also taking place at the same time. The English Panic of 1890 is also important to note here, as well as the economic depression in the USA in 1893. A global financial cycle had ended.

Financial Cycle 3 (1966–1974) Peak year of overtrading 1973. Severity: high, particularly for NSW and QLD. The downturn was comparatively short.

Sydney's real estate market surged substantially from 1966, as the population hit 2.5 million. 'Australia Square Tower', the office tower completed in 1967, was Australia's first skyscraper. In January 1972, the median price of a block of land in Sydney passed $10,000 and increased to $14,300 by December 1972.[19] The peak of this short financial cycle was May 1973, when the median price reached $15,900 per block of land. The Sydney CBD office market went into a frenzy as commercial property boomed. Queensland was also going through a period of property speculation, with 40 per cent of all sales going to overseas buyers.

Max Beck Constructions Pty Ltd, one of Victoria's largest building contractors, went into liquidation in late 1973. This was a direct warning of what was to come, even as land markets still had substantial demand. More funds started to flow out of Australia than came in, and after 11 years of dominant inflows, money became 'tight'. The credit squeeze imposed by the Whitlam Government in 1974 brought about the end of the boom. This is now known as the '74 credit crunch'. Numerous financial companies went bust. Spillover events continued to happen. In 1977, Sydney's largest land holder, Parkes Development, fell into provisional liquidation. The Bank of Adelaide failed and was taken over by ANZ in 1979. Numerous building societies fell into distress shortly after the credit squeeze across various states.

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[18] *The Pleasant Career of a Spendthrift*, George Meudell 1929. London: George Routledge & Sons, Ltd. Page 14
[19] *The 1974 Collapse of the Property Market in Sydney*, John Vander Have 1989.

Financial Cycle 4 (1978–1990) Peak year of overtrading 1988. Severity: high.

Financial Cycles 3 and 4 are closely related and therefore Cycle 3 can be seen as a precursor to Cycle 4. Recovery from the '74 credit crunch started to occur around 1978. Residential property grew strongly before the early '80s recession choked off growth. Yet, debt-to-GDP only dropped marginally during the 1982/1983 recession. The rebound in property markets from the recession was swift. This financial cycle was most prevalent within the commercial property markets, mainly office buildings, especially in Melbourne and Sydney. Commercial property values rose 10 per cent in 1986, and then accelerated. Sydney office prices more than doubled between 1986 and 1989. Foreign capital from Japan surged in the late '80s; almost one out of every three dollars invested into Australia was coming from Japan. Most of the high-rise office towers we have today were built during this period. Deregulation of the financial sector was largely complete at the end of this cycle. And this is partly responsible for the size of the asset boom, as well as for Financial Cycle 5 (below). Australia, and its main trading partner Japan, had matched fortunes.

The 1990 recession marked the end of this financial cycle. Banking distress followed in subsequent years nationwide. Victoria's Pyramid Building Society collapsed in 1990, with total debts in excess of $2 billion, and $900 million of taxpayers' funds were promised to recompense depositors. The State Bank of South Australia and the State Bank of Victoria effectively failed, requiring huge state government assistance. ANZ and Westpac experienced large losses. Unemployment across the nation exceeded 10 per cent in the cycle's aftermath.[20]

Current Financial Cycle 5 (1992–closing) Peak year of overtrading 2021. Severity: to be determined

The starting point for this current cycle can be traced to 1992. Commercial banks, which were hit hard by bad debts incurred in the commercial property market bust during the 1990/1991 recession, found a new 'safe' borrower of funds: the residential home buyer and property investor. Private household debt surged in 1992 and 1993, growing 10 per cent per annum, and 17 per cent per annum in 1994.[21] Business investment across Australia lifted strongly at the start of this financial cycle, the material expansion had begun. The introduction of home equity loans in the mid '90s allowed households to borrow against existing equity in their own homes and most of this equity was used to fund additional real estate. The 'cashing out' of house equity has greatly altered the housing market

[20] 'This time it really was different', AFR, 23/06/2010.
[21] The Australian Financial System in the 1990s, RBA, Marianne Gizycki and Philip Lowe.

and prices have accelerated along with it. Household debt to disposable income reached 100 per cent by the end of 1999, which was up from 54 per cent at the start of the decade. The deregulatory reforms of the financial system over the '70s and '80s had allowed the household sector to take on much riskier activities. The 1988 Basel Accord (Basel I), which imposed capital requirements on commercial banks, was adopted into the Australian banking system in 1998. This gave preferential risk-weighting to residential mortgages, over those of commercial ones, and was a cornerstone moment to future distributions of credit. Commercial banks presumed this was good practice in safe lending. Households, which faced reduced competition from corporate borrowers, who were de-leveraging well up to the mid '90s, as well as free falling interest rates from the 1990 peak (17.5 per cent), have since gone on a 30-year mortgage odyssey.

OVERTRADING AND PEAK YEARS

The current financial cycle (1992–closing) has been interrupted by the 1997 Asian financial crisis, the 2000 dotcom bubble, the 2008 financial crisis, the Royal Commission into Banking and Financial Services, the 2020 pandemic, and the numerous wars that have occurred over the past few decades. However, these events have not stopped Australia's internal financial cycle from expanding. The domestic responses to global events, such as stimulus measures, interest rate cuts, or unconventional monetary policy, have only extended the Australian financial cycle, as have the numerous policies that simply added to demand, such as stamp duty relief and first home buyer grants.

The term 'unfinished recession' refers to a recession that has been protected by swift monetary policy and fiscal responses to re-stimulate the economy. The economy recovers and policymakers are applauded; yet firepower is greatly reduced to defend even the most garden-variety type of recessions in the future, leaving the economy exposed to 'the big one'. The most serious financial crisis, the 2008 financial crisis, was not a crisis for many of the world's commodity exporting countries, including Australia. It could be argued that the 2008 financial crisis was a mostly transatlantic crisis, rather than a transpacific, or commodity-exporting nation one.[22] Commodity prices surged, as the Chinese economy undertook unprecedented stimulus programs. The 2008/2009 Chinese stimulus plan alone injected US$586 billion into their economy. Canada is another example of a commodity-exporting nation that managed to skip the worst effects of the 2008 financial crisis and extend its own financial cycle.

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[22] *The 2008 crisis: transpacific or transatlantic?* BIS, Robert N McCauley 2018.

The peak years of overtrading in Australian history have been 1841, 1888, 1973, 1988, and likely 2021, for each financial cycle. Overtrading is demonstrated by surging property prices, and a high volume of transactions, and can be seen generally when things are at their most 'euphoric'. The slump that follows usually lasts 1–3 years, before the bust phase. All financial cycles have had a peak year at the crest of the booms. Other years of overtrading include 1854, during Victoria's gold-rush; however, the use of credit was not greatly extended. The downturn was not as severe, and therefore this was not a financial cycle endpoint, or not an important one. It is likely that this early period of wealth creation flowed into the Melbourne land boom to come. There was also an early boom in the late 1820s in Sydney that ended up in banking distress in 1828, but property owners generally owed the government the funds, and were able to secure deferment payment options. The Great Depression, which occurred after the 1929 American stock market collapse, caused much misery in Australia. But the property sector was not heavily leveraged, and therefore this was likely not the end of the domestic financial cycle.[23] For Australia, this was instead a severe business cycle ending, tethered to the end of a global financial cycle. Another strong year of overtrading was 2007, just prior to the 2008 financial crisis, but that sits within the current financial cycle and does not come close to 2021 in size. All the financial cycles have played a part in the reorientation of the economy and caused a sharp downturn when they have ended. The Melbourne Land Boom, which ended in 1893, remains Australia's most significant financial cycle. Financial Cycle 3 (1966–1974) was the most minor, as the recovery period was quick; however, there was plenty of crossover between Cycles 3 and 4, particularly in the debt build-up within the commercial property market sector.

The core building blocks to Financial Cycles 3 (1966—1974), 4 (1978—1990) and 5 (1992–closing) have been the deregulation of the entire financial system. The banking system was rather a sedate and boring place after World War II. Between 1945 and 1971 there were no banking crises in any of the advanced global economies.[24] In 1971, the REIT (Real Estate Investment Trust) was born, which allowed capital to pool more easily, minimised risk for participants, allowed for a public listing, and provided a taxation advantage. Australia's deregulation process commenced in 1973, with the all-important step of the removal of interest rate controls placed over banks, which freed up the banking system to compete for deposits and mortgages. From this genesis, deregulation created its own momentum, and within 13 years, virtually all controls on banks had been removed, foreign

[23] *Two Depressions, One Banking Collapse*, RBA, Chay Fisher and Christopher Kent 1999.
[24] *Crises Now and Then: What Lessons from the Last Era of Financial Globalization*, Eichengreen and Bordo 2003.

banks had been allowed to enter the market, and the exchange rate had been floated.[25] These developments largely paved the way for the great credit expansion to come.

MATERIAL AND FINANCIAL EXPANSIONS

Financial cycles are nourished by the material expansions that occur prior to them, or in tandem with them, that rely on real trade and commerce. Financial cycles can be punctuated by multiple material expansions, which can greatly contribute to their length. Foreign capital inflows commence once the material expansion is underway and stay within the productive economy, before moving on into deeper financial activities. The material expansion is tightly bound with the business cycle but becomes less so as the financial expansion gathers pace. The financial cycle transforms the economy, thereby influencing the traditional business cycle. The material expansions comprise of strong business investment and provide the economy with the most solid of foundations. Financial expansion is the upward rise of the financial cycle. There are a few things to note in relation to the Australian situation. Australia has been, and is, a leading nation when it comes to supplying raw materials to the hegemonic power, as well as to the rising powers, since colonisation. The five financial cycles have all seen strong material expansions either prior to them or at their starting points. Wool was the first dominant export, followed by gold, then mineral resources and energy — which have so far dominated the course of this century. During the listed financial cycles, as the material expansion slowed, a boom in construction commonly took its place.

Financial Cycles 1 (1830–1843) and 2 (1873–1893)

In Charles Swanston's time, 1830–1840 was a time of great pastoral expansion in Tasmania (Van Diemen's Land) as well as NSW. Strong immigration, capital import and the opening of new frontiers for European occupation, including the founding of modern Melbourne, allowed for a solid material expansion. Britain was the hegemon, to which Australia was a key supplier. The material expansion turned to bust, yet property continued its ascent for a while before stopping. The Derwent Bank's collapse in September 1849 was the long drawn-out result of this. The Melbourne Land Boom during Financial Cycle 2 (1873—1893) had seen a significant prior material expansion phase in the form of the Gold Rush, which commenced in 1851, as well as booms in wool, wheat, mining, and other staples, particularly from the early 1870s. In 1873, the prices of wool and wheat were almost double

[25] Australia's Experience with Financial Deregulation, RBA, Ric Battellino 2007.

those of two decades later, when the collapse of the Melbourne Land Boom was in full force. The annual production of gold was decreasing each year from its peak in 1856 of £12 million, to just £250k in 1890. BHP was valued at £14.4 million in 1890 before cratering to £4.3 million by the end of 1892. After the banking crisis in Victoria, BHP market capitalisation fell to £1.835 million.[26] During the height of the Victorian property boom between 1886 and 1890, not much was taking place in the economy except for property speculation. As Land Boomer participant George Meudell noted, 'There was no solid foundation for all this paper wealth. Production did not increase pari passu [side-by-side], nor overseas trade, nor exports, nor shipping'. The bust resulted in decades of miserable economic conditions for Victorians before the eventual recovery. Two strong material expansion periods thus helped underwrite Financial Cycle 1 (1830–1843) and Financial Cycle 2 (1873–1893) as they commenced their financial expansions.

Financial Cycles 3 (1966–1974) and 4 (1978–1990)

Throughout the 20th century, Australia experienced strong material expansion by supplying key resources to the fading powers of the UK and the United States, and to the rising power of Japan, which helped underwrite Australia's Financial Cycle 3 (1966–1974) and Financial Cycle 4 (1978–1990) via mining booms. The long drought broke in Australia from 1966 and widespread rains helped smooth the path for the next expansion. The strongest GDP[27] growth for Australia in the 20th century occurred in the 1960s, with an average growth rate of 5.3 per cent.[28] No public company illustrated the dramatic nature of the mining boom of the '60s and early '70s more than Poseidon Nickel, which had a share price trading between 4 and 6 cents in 1966 and reached a peak of $280 in February 1970. By 1974, the publicly listed company had entered receivership, as the financial cycle ended. A second mineral and energy boom commenced in the late '70s and lasted until the global recession of the early '80s. The resource booms were rocky across these two cycles. Japan had its own substantial material expansion which largely rested on manufacturing, before it too, converted to a financial expansion. It ended with one of the great busts of the 20th century. The Australian commercial property boom fell bust in 1990, roughly at the same time as Japan's property and share market sank so spectacularly. Today in Japan, examples of land and condo prices can still be found below their 1990 peak. Commercial real estate values in Japan fell 87 per cent from their peak.

[26] *The Bull the Bear and the Kangaroo: The Story of the Sydney Stock Exchange*, Stephen Salsbury 1988. Sydney: Allen & Unwin.
[27] GDP measures the monetary value of final goods and services — that is, those that are bought by the final user — produced in a country in a given period, usually a year. It is a single crude figure, but a helpful indicator to draw comparisons.
[28] Australia's Century Since Federation at a Glance, Treasury.

Financial Cycle 5 (1992–closing)

Taking the mantle as Australia's largest trading partner, passing Japan in late 2007, has been China, which has largely helped underwrite Australia's current financial cycle (1992–closing) and which is challenging American hegemony. The Open Door Policy of 1978 which allowed foreign businesses to come to China, was the starting gun for China's rise. The other critical date was the 11th of December 2001, when China was admitted into the WTO (World Trade Organisation). Its economy has since grown twenty-fold. Australia has played a crucial role in supplying the vast materials required for the largest urbanisation project that the world has ever seen, as well as the raw materials required for the world's biggest manufacturing nation. China has helped to provide two periods of material expansion for Australia within the current cycle — one prior to 2008, and one following, in the huge stimulus programs undertaken by the Chinese Government since the 2008 financial crisis. The second strongest GDP growth rate occurred in the second half of 1990 with an average growth rate of 4.5 per cent, just as the current financial cycle got going. China expanded quickly, particularly from 1996 onwards.

The rapid expansion of the economy of the United States from the early '90s was capitalising on globalisation, deregulation, and a technological expansion. The European Union was founded in 1993. Australia's economy benefited along with these global economic events which expanded trade. Productivity growth surged. Business investment started to expand in the early '90s in Australia and continued to grow strongly until the mid 2010s. However, in recent years, business investment has slowed sharply.

BHP, Australia's largest resource company, had a closing share price of $10.30 on the day of China's WTO admission. The recent share price is just under four times this amount. Arguably, no Australian company has benefited as much from China's expansion. Yet, many residential houses purchased back at the same time in 2001 have exceeded this multiple of return on investment when stripping out dividends and rents. Financial expansions can produce assets that achieve larger financial returns than productive investments, subject to their timing.

Trade relationships are often crucial to these material expansions. The 1957 trade agreement between Australia and Japan aided the supplanting of the United Kingdom as Australia's major trading partner by Japan in just one decade.[29] China's 2001 WTO admission resulted in an even

[29] Australia and Japan: A Trading Tradition, APH 1999–2022.

swifter change in Australia's major trading partner, from Japan to China. Foreign investment and tourism are also augmented by strong trading partners. At the peak of the Japanese economy in 1990, the leading place of departure for flights into Australia was Japan, overtaking New Zealand. In the current cycle, China overtook New Zealand by 2018 as the leading place of arrivals into Australia.[30]

Both Japan and China have had a marked impact on Australian property investment and have contributed to the architectural fabric that the construction booms have brought with them, for good or ill. While the old hegemon, the UK, and the existing one, the United States, retain the highest amount of direct foreign investment into Australia, it is the rate of change that matters. Japan quickly expanded its pace of direct foreign investment into Australian real estate in the late '80s. China too had made swift investment into Australian property up until quite recently. Both countries in their peak years were the source of most real estate acquisitions. It's this rate of change that contributes greatly to the booms, as the feedback loops involved create further momentum to property markets, as the foreign investments flow into construction and add to general economic activity. The new rising power invests foreign capital into Australia, which competes with capital coming from the usual foreign locations, such as the UK, Canada, Singapore and the United States. While property investments from the United States have tended to be commercial, foreign investment from China went strongly into residential property, especially during the height of activity in financial year 2015–2016.

CONSTRUCTION AND RELATIONSHIP WITH FINANCIAL CYCLES

In the middle of 2007, Spain was full of vibrancy. New buildings were taking to the skylines of Madrid and Barcelona, and construction sites were on each corner. In my early twenties, I was in Barcelona, for a property conference. This was just prior to the 2008 financial crisis. Another young Australian and I were chauffeured round the city to bear witness to the 'Spanish miracle' that was taking place. We were taken to new building after new building, including the Torre Glòries, the famed new skyscraper on the Barcelona skyline. The noise of construction pulsated throughout the city, new gleaming towers were rising, and optimism was high. Everything looked good from afar. What followed was one of the most spectacular real estate busts so far this century. Financial expansions go together with construction booms.

[30] Overseas Arrivals and Departures, Australia, ABS, June 2019.

There is a strong interplay between construction and the financial cycle. There is a tendency to overbuild in good times as the ‘under-supply’ story is often exaggerated in periods of expansion. The longer the boom period goes on, the more prone the sector is to consist of only the most optimistic developers and constructors. The cautious developer is initially outcompeted as they are unable to buy development sites, due to feasibility models not meeting financial benchmarks. Those with a neutral level of risk survive, and those that roll the dice again and again outperform during the expansion — yet require constant growth to maintain their higher cost structures. The more that developers invest collectively, the more prices go up. Investment begets further investment, until the unravelling begins.

Each financial cycle produces things that were not possible in the past that furnish a paradigm shift in thought and help entrench ambitious plans. Melbourne during the land boom and bust of the 1880s saw the technology of the hydraulic lift change the fundamentals of CBD land prices, which doubled, as buildings could be greatly increased in height, and economic realities were consequently reassessed. The key property technology of the modern era, as well as the most intense form of capital investment per square metre of land, is the skyscraper. Skyscraper completions in Financial Cycles 3 (1966–1974) and 4 (1978–1990), were buildings constructed purely for commercial purposes. Most completions took place across Australia between 1972 and 1991. Sydney commenced its boom a little earlier, with the completion of Harry Seidler’s ‘Australia Square Tower’. This building was a landmark building for the office tower boom to come and showed they could be profitable. It is most likely the most important skyscraper Australia has ever produced.

The surge in office towers across Australia in the ’70s and ’80s was by no means only an Australian phenomenon. It followed a broader shift globally to more financialised activities and urbanisation. Luis Buñuel's final film in 1977, *That Obscure Object of Desire*, shows a scene of a Parisian landscape saturated with fresh glittering commercial towers amid derelict residential quarters, as the lead protagonist, Mathieu, goes off in pursuit of Conchita. The ’70s were a time when businesses began to shift away from forms of productive investment to those dealing with financial instruments. The earlier planning reforms of the ’60s had allowed for greater building heights, especially in Melbourne and Sydney.

Office space demand was growing as the ongoing deregulation of the finance sector created high demand for CBD located office space. The credit expansion boomed and building activity surged. The 1974 credit crunch and early ’80s recession provided for the rockiest of conditions for the

commercial real estate market. Melbourne's peak building heights straddled boom and bust occurring between 1986 (Rialto Tower) and 1992 (Telstra Corporate Centre), as developers and planners became more bullish about filling office space late in the boom, as well as the potential revenues to be had. Completions of the tallest buildings often cluster each side of a peak of the financial cycle, as the grandest plans win approval and financing before the eventual slump. The world's first iconic skyscraper, the Empire State Building in New York, was completed as the Great Depression took hold in 1930 and was a financial failure for the many groups involved.

In Melbourne, three kilometres of office towers were built in the form of skyscrapers between 1972 and 1993. This added a further 742 office floors to the city. Australia at that time was awash with foreign capital, the growth of competitive non-bank finance companies contributed to easier credit conditions, and credit standards were lax. The bust was substantial for the commercial property market and the banking system was impacted by large write-downs and credit losses.[31] There exists a broad period between 1967 and 1991 which can be deemed the first skyscraper phase in Australia's history. Many of today's office skyscrapers, both in Melbourne's and Sydney's CBDs, can be attributed to this period. This first phase of skyscraper completions lasted just over twenty years, with completions spilling over past the 1990 recession, and spanning Financial Cycles 3 (1966–1974) and 4 (1978–1990).

Emerging from the ashes at the end of the 1990/1991 commercial bust (Financial Cycle 4, 1978–1990) comes the current residential boom (Financial Cycle 5 1992–closing). Small apartment buildings started to take shape in the CBD from the mid '90s onwards, as land values — which had plummeted as a result of the commercial property downturn — allowed residential property developers to experiment with the novel idea of city living. 'Postcode 3000', which was a Melbourne planning initiative introduced in the early '90s, greatly aided this transfer from commercial to residential usage. The skyscraper was slow to take off during Phase 2 (1992–closing) as developers, planners and lenders were largely cautious with the form in the aftermath of the 1990/1991 recession. The 'Melbourne Terrace Apartments' opposite the Queen Victoria Market (1994) and the 'Republic Tower' (1999) by architectural firm Fender Katsalidis led the way to successful owner-occupier development. Meanwhile, the firm Central Equity built numerous residential apartment buildings in the early '90s, which catered to the more basic end of the spectrum adored by property investors. 'Freshwater Place', the Southbank tower, became one of the first residential skyscrapers

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[31] *Credit Losses at Australian Banks: 1980–2013*, David Rodgers 2015.

in Melbourne to complete, in 2005. Since this time, over 80 per cent of skyscrapers have been built for residential usage in Melbourne's CBD, with over 10kms, or 2,730 floors, being added to the city in the skyscraper form alone. The business model of off-the-plan pre-sales has proved a tremendous boon for developers. It was common enough in the early days that an apartment bought off-the-plan was worth more than its contract price upon completion, which only encouraged buyers to commit to these 'ideas of the sky'. This, combined with foreign purchasers, particularly from Asia, has been instrumental to the financing of the modern residential skyscraper.

The construction cycle of skyscrapers shows the boom in domestic property to be over 50 years long and delivered over three financial cycles. Melbourne's office tower completions commenced in 1972 and finished with the 1990 recession (the spillover buildings complete just after this time). In Sydney, the introduction of skyscrapers started a little earlier, in 1967, as the leading commercial city. The current financial cycle (1992–closing) is predominately a residential skyscraper boom. Smaller towers commenced in the early '90s, yet it took until the mid 2000s for residential skyscrapers to emerge. In the last five years, the completion of skyscrapers in Melbourne has been substantial.

Melbourne is more singular in its skyscraper focus across the various financial cycles. The current cycle has mostly been a residential tower boom for Melbourne, while the '70s and '80s produced commercial towers for the city. Sydney is more even-handed in its commercial building activity, as the leading commercial centre. The initial infrastructure of office buildings in the CBD, as well as the institutions that inhabit them, are of increasing importance to share of GDP for Australia. Higher incomes have been, and are, accruing to knowledge-based industries. The associated benefits of agglomeration have seen firms cluster in cities and the workforce eager to live close by has only grown. Cities have also taken steps to grow their cultural amenities, such as art precincts, restaurants, and entertainments. Yet the tilt to excess is always a symptom of financial expansion. The tallest and biggest towers occur at the peak. These towers provide insight into where the money is flowing. In Financial Cycles 3 and 4, the towers were built for commercial activity. The current financial cycle has been based around residential skyscrapers. This flows directly back into the credit aggregates as well. One of the leading economic historians on booms and busts, Charles Kindleberger, observed that the relationship between skyscrapers and asset price bubbles is forever strong.

CONSTRUCTION DRAWING TO ITS CLOSE

Towers have increasingly employed gimmicks in both name and structure, such as 'Beyoncé Tower' to attract customers. Many buildings, especially across Melbourne and Sydney, reveal plenty about their financing capital as well as the origins of the buyers. The ornamentation, colours, and use of lucky numbers, such as 8, are indicators of the financing capital. Due to the building boom, as well as supply and labour issues, many buyers have faced significant time delays to their move-in dates. Market prices for apartments that have been secured off-the-plan are now commonly worth less than the prices paid for them. It is not uncommon for resale unit values of apartment buildings to be less than their original sale price of a decade ago. Potential purchasers are starting to lose faith and will likely continue to withdraw. A new crop of buildings, known as the 'supertalls' and 'megatalls' are the next phase of property technology, which will attempt to reach lofty heights. Australia's proposed tallest building, 'STH BNK', has recently commenced marketing for its Southbank site, as it seeks to join the global 'supertall' club. If history serves as a guide, a project like this will either never be built, or will complete at the depths of the downturn.

The current construction phase is now winding down. Cranes are vanishing from skylines, and the noise of construction machines is quieting. The building group Probuild, a former large construction player in Melbourne, surprised many by declaring itself insolvent. Numerous others are still set to follow. The surge in both material costs and labour costs has put a large proportion of fixed contracts in untenable positions for constructors. New contracts have been hard to form, as both constructors and their clients are worried about future costs. New applications for planning permits are continually decreasing. As with the end of Financial Cycle 4 (1978–1990), many companies are likely to press ahead with plans to develop, and therefore several skyscrapers will complete past this financial cycle's end. However, foreign capital, particularly capital from China, is shrinking its footprint in Australian real estate. Few realise that China's own property woes have impacted Chinese developers that had, or still have, exposure to Australian property.

There is a new crop of developers who arrived after the 2008 financial crisis who have only ever experienced boom conditions. Often seeded with private money, many of these developers are growth focused and have continued to purchase development sites deep into the current financial cycle, often with substantial development plans in the works. The slowdown in buyer commitments and delayed construction timelines are problematic. Prior to and during the construction period, developers have no cashflow to service short-term debts. The lengthening of this time is what

creates pressure for developers. It is inevitable that many of these individuals and groups will simply go bust. The conditions are simply too wicked for many to survive. The established developers are likely to have their problems as well. At a recent property conference, Mr Tarun Gupta, the CEO of Stockland commented that a 5 per cent wage rise each year over the next two years for the average Australian, combined with a 5 to 10 per cent correction in housing, would bring the housing market back to equilibrium by 2024 if the RBA cash rate is 3.25 per cent. Mr Gupta is likely naive to the financial cycle and will probably be disappointed in his expectations.[32] Ireland, Spain and the United States had huge building booms prior to the 2008 financial crisis. Spain's construction sector was roughly 10 per cent of GDP prior to 2008 and is now only half this share. Australia's construction industry for some time has been close to 10 per cent of GDP. Construction booms often don't fade away gradually; they end abruptly.

THE CURRENT FINANCIAL CYCLE (1992–CLOSING) AND THOSE BEFORE IT

Financial Cycles 3 (1966–1974) and 4 (1978–1990) and the current financial cycle (1992–closing) are interconnected. The completion of office skyscrapers in the '70s and '80s can mostly be viewed as a connected phase of development across Australia's major cities which was severed by the 1990 recession. The deregulation that took place in Australia from 1973, and had largely been completed by 1986, has been instrumental in ushering in today's large financial cycle. The high indebtedness of the corporate balance sheet at the end of Financial Cycle 4 (1978–1990) is now a feature of the household's own balance sheet. Yet the present debt levels are much larger now than those of the previous cycles. And all financial cycles, when they end, cause distress in the banking sector, including bank failure, and a construction downturn.

In a speech given in Brisbane in May 2017, Philip Lowe, the Governor of the RBA commented on the early period of credit liberalisation.[33] He said that the nation had had a choice of what to do with this abundance of credit and lower nominal interest rates and had chosen housing over other possibilities. Deregulation was following an international pattern that was largely based on market-based principles and globalisation. As with most things, benefits existed, and costs have become apparent over time. The periods of material expansion, falling interest rates, and strong foreign investment have acted as a stimulus to what has been one of the great long financial cycles in Australia's history. But financial cycles always end, and rarely are they smooth. In 2021, the total

[32] Housing market will return to balance in 2024: Stockland CEO, AFR, Nila Sweeney and Michael Bleby 19/09/2022.
[33] Household Debt, Housing Prices and Resilience, RBA, Philip Lowe 2017.

value of property traded in Australia was $687 billion, equal to one-third of the country's GDP. This was one of the great years of 'overtrading' and peak years.[34] Adam Smith could have diagnosed the Australian situation quickly. This is the standard historical pattern at the end of the financial expansion phase of the cycle and into the slump, followed by bust.

Australia's financial cycle should be viewed as one continuous such cycle. The cycle has not been broken over the past 30 years, having been protected and extended by monetary and fiscal responses, as well as demand measures, such as home buyer grants, and numerous material expansions. There has also been strong commercial property investment recently, as well as a boom in hotel and student accommodation. The current expansion has therefore been broad.

Financial cycles change the nature of work and employment for those within them. As the economy converts into its financial cycle, from the past productive material expansion phase, there is a reorientation of the economy that takes place. The employment and business activities that are altered are often those that serve the speculative financial industries. Once the eventual downturn arrives, it can be very hard to handle for a more financialised economy to adapt. Business and job growth, which have centred on activities that are related to the financial cycle, cannot easily be replenished. The growth of construction employment, traditionally a drag on productivity, is also directly related to financial expansion. Construction currently accounts for a high share of Australia's GDP. Almost 1.3 million Australians are employed in the construction sector. For every home built in Australia, three jobs are supported. The growth of household services per share of industry since 2013, which includes services such as dog walking and beauty services, is likely further testament to an indirect association with rising property markets.[35] What's more, it can be difficult ex ante to identify the true extent of the links between the financial cycle and employment; it is only in their aftermath that this becomes clear.

In an earlier speech given during the depths of the financial crisis in August 2008, the RBA Governor Philip Lowe directly addressed the financial cycle.[36] Yet searchable memos don't appear to show any mention of the financial cycle by Philip Lowe since that 2008 speech. Lowe was one of the early contributors to the modern interpretation of the financial cycle. With Claudio Borio, he contributed early research on the financial cycle back in 2001, in BIS (Bank of International Settlements) paper

[34] Home settlements surge to $687b – or one-third of Australia's GDP, AFR, Michael Bleby 09/02/2022.
[35] Household services boom puts a rocket under employment, AFR, Yolanda Redrup 24/06/2014.
[36] The Financial Cycle and Recent Developments in the Australian Financial System, RBA, Philip Lowe 2008.

No 1, as well as in other papers that followed. Lowe and Christopher Kent (RBA Assistant Governor, Financial Markets) produced a paper on credit cycles in 1997.[37] Here, they were talking about financial cycles before the terminology started to shift. Financial cycles do not hold much weight in the RBA's present intellectual canon — at least publicly. The RBA produced a single research paper on financial cycles in 2017 that concluded there is little evidence that the financial cycle and business cycle operate at different frequencies.[38] The authors remain more convinced on economic variables, rather than financial ones. Luci Ellis, Head of the Financial Stability Department at the RBA, said at a conference in 2016, 'I'm open to further evidence on this [the financial cycle], but from what I've seen, a literal cycle does not fit the data'.[39] Ellis remains more convinced of a single cycle. In contrast with the views of numerous RBA personnel are the findings from the BIS (Bank of International Settlements). The financial cycle is very much entrenched in their thought and research papers and is increasingly so within the work of the ECB (European Central Bank) and the IMF (International Monetary Fund). The BoE (Bank of England) has also started to produce papers about the financial cycle. There is strong evidence of its existence.

Financial cycles are hard to detect. Quality datasets reaching far back into history can be challenging to obtain. A reliance on overly mathematical modelling techniques by policymakers over those more based on historical perspectives, is likely also a problem. The shifting baseline effect sees policymakers focused on recent decades, rather than recent centuries, of financial history. Financial cycles are infrequent, and Australia has only had five observable financial cycles over its history. Charles Swanston, the first banker to experience the force of the financial cycle, wrote on the edge of his collapse, 'I begin seriously to be afraid of a general bankruptcy. All kinds of property, whether stock, land or shares in companies are unsaleable except at ruinous prices. Land and Stock are not worth half the value they were three years ago'.[40] Swanston had pushed the boundaries in a number of ways; he extended too many loans, had used undisclosed bank funds for his own speculations, and simply acquired too many assets. The financial cycle is always a race against its eventual expiry. Like the lit wick of a firecracker, the flame runs along the wick and gets closer and closer to the powder. The wick requires constant tinkering to lengthen it (new credit growth/material expansion/immigration growth, etc.) and delay the inevitable outcome. Once the flame finally hits the powder, there is not much that can be done to stop the ignition. All that can be done is to limit

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[37] *Property-price cycles and monetary policy*, BIS, Christopher Kent and Philip Lowe 1998 Both Lowe and Kent refer to separate credit cycles that are independent of equity prices.
[38] *Exploring the Link between the Macroeconomic and Financial Cycles*, RBA, Adam Cagliarini and Fiona Price 2017.
[39] Booms, Busts, Cycles and Risk Appetite, RBA, Luci Ellis 2016.
[40] *Captain Charles Swanston 'Man of the World' and Van Diemen's Land Merchant Statesman*, Eleanor Robin 2017. Page 196.

its worst effects. Yet, any path taken will have side effects; this is unavoidable. They are part of the financial cycle, to be remembered for a long time to come; and then simply forgotten.

SUMMARY

- Australia's financial cycle is ending. The boom must give way to the bust.
- The financial expansion has closed, and the slump period has arrived.
- Financial cycle 5 (1992–closing) should be seen as one continuous cycle lasting 30 years.
- The 'debt disturbance' event has likely occurred: rising interest rates, inflation and rising government bond yields, and new hurdle rates for business/property investment; the household sector is simply too indebted.
- Australia has had five consequential financial cycles: Financial Cycle 1 (1830–1843), Financial Cycle 2 (1873–1893), Financial Cycle 3 (1966–1974), Financial Cycle 4 (1978–1990), and Financial Cycle 5 (1992–closing). They are a recurring theme.
- A financial cycle's ending will impact the entire financial system, rather than simply having a state-by-state impact, but the effects of the end will be expressed differently across the system.
- Banking distress or a banking crisis is the standard historical response to the end of the cycle.
- Peak years of great overtrading have been 1841, 1888, 1973, 1988, and likely 2021. The slump afterwards usually persists for 1–3 years before the bust phase of the financial cycle.
- Financial cycles are much longer than the business cycle, typically twice the duration, and the downturns tend to be of greater significance.
- Memories fade of the past downturn resulting in a 'shifting baseline' for market participants and policymakers. Risks rise over time but are less evident for those in the marketplace. Rising financing costs tip borrowers from 'speculative finance' to 'Ponzi finance', and from 'Ponzi finance' to insolvency.
- Credit expansion sooner or later turns into the credit contraction phase.
- The equity market is a mere distraction compared with the property boom; this is due to total size of property markets, the credit creation process and leverage.
- The financial expansions are seeded by the material expansion, resting on real trade, that underpins the early stages of the financial cycle.

SUMMARY

- Australia's global 'comparative advantage' as a commodity exporter tethers its domestic financial cycle to the hegemon or rising expanding power/s. One should therefore watch other nations and their own financial cycles, including New Zealand, Canada, and China.
- The economy reorientates itself during the financial cycle. This makes the downturn's ending difficult, as business and employment cannot adapt quickly enough to industries outside the financial cycle's orbit.
- Infrastructure projects, government revenues and employment, are all tied to the financial cycle.
- Malinvestment, a diversion of resources away from productive parts of the economy, builds up.
- Construction is tied heavily to the financial cycle, particularly the most intensive capital works such as skyscrapers. The booms of the '70s and '80s had a strong commercial property related credit expansion; this was the hardest hit area of the bust.
- The surge in residential towers across the major cities over the past decade is a good indicator of the financial cycle. The current boom has been mostly residential, and it is here that the biggest impact will likely be felt.

About the author

Paul Osborne is the director of Secret Agent HQ Pty Ltd, Melbourne, Australia. Secret Agent was founded in 2008. This essay is an opinion based on 20 years of direct property experience. This is not financial advice. For any further information please contact info@secretagent.com.au