**The End of Two Housing Booms**
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As goes the U.S. consumer, so goes the world economy. This, in any case, is the way it has been now for nearly a decade. The growth of U.S. consumer demand has been extraordinary, with household saving rates as conventionally measured actually falling below zero. Low interest rates have allowed families to refinance their residential mortgages and increase their spending on other items. Soaring house prices have made them feel richer and further spurred private spending, not least on home improvements and new houses.

All this is changing now that interest rates are rising. Many households had refinanced their homes using variable-rate mortgages or instruments involving balloon payments. Now the bill is coming due. This has had a predictably negative effect on consumer confidence, which fell by nearly 7 per cent in May according to the New York-based Conference Board. Residential construction and sales are notoriously sensitive to interest rates. Not surprisingly, there are growing signs that the overheated U.S. housing market is cooling off.

How worried should we be? For the last few years, the U.S. economy and by implication the world economy have been carried on the back of the American housing market. If house prices now tank in the United States, won't they drag down U.S. and global growth?

One way of gauging the consequences is by looking to Australia. That country experienced a housing boom even more dramatic than America's but on an earlier cycle. In Australia, house prices have risen by some 70 per cent since early 2001. There were all the signs of an overheated market, with families desperately piling into the market for fear of having to pay even higher prices in the future and small investors betting on further increases buying multiple homes and apartments.

Since 2004, the market has cooled off. Housing construction is down sharply. In 2005 house prices in Sydney fell by nearly 5 per cent – and in certain parts of the city by considerably more. Only the continued buoyancy of prices in Perth, in the far west of the country, has prevented prices nationwide from falling more dramatically. All this offers a hint of what the U.S. has in store.

Happily, however, the Australian economy has skated smoothly through these obstacles. (They don't call it the happy country for nothing!) GDP grow ran at 2.7 per cent in 2005, not exceptionally fast but more than respectable. Maybe this shows that consumers are not really so sensitive to the end of a housing boom. Maybe it means that we shouldn't worry so much about the U.S. housing market after all.

But this reading of the record would be wrong. In fact, Australian consumers have not been immune to the end of rising housing prices and to mounting levels of debt.

After having risen for several years, consumer sentiment fell sharply at the outset of 2005. Household consumption rose less than household income. The growth of retail sales –sales of big ticket items like motor vehicles in particular – declined.

So why is the Australian economy holding up so well? The answer comes in two parts. First, strong commodity prices are a boon for Australia. The country is a big producer of aluminum, copper, nickel, coal and iron ore, all of which are in strong demand globally and especially in neighboring China. To Australians it seems as if there is no end to China's demand for these commodities. As a gold producer, Australia benefits from the run-up in the price of the yellow metal. As a sugar producer, it even benefits from the fact that sugar is used in the production of ethanol, a substitute for gasoline.

Thus, just as consumer demand has slowed, business investment, in the commodity-producing sector in particular, has accelerated. Talk about fortuitous timing. Even the strength of house prices in Perth can be explained on these grounds, given the importance of commodity production in Western Australia.

The other part of the answer is stimulus from fiscal policy. Seeing the slowdown in the growth of consumer demand, the government has moved to cut income taxes. Just last month it announced the intention of lowering the top two personal marginal income tax rates and of increasing the income thresholds at which personal tax rates apply. Thus the component of domestic demand, consumer spending, most in need of strengthening will be supported directly.

In addition, the government trimmed taxes on pension funds and increased corporate depreciation allowances. It announced big increases in spending on infrastructure, health, defense, border security, skill development and child care. In the face of this, it is no surprise that demand has continued to grow.

Notice, however, that neither response is available to the United States. The U.S. depends more on exports of manufactures and services and less on commodities. If anything, its growth prospects are dimmed by high commodity prices. And, because of the fiscal profligacy of earlier years, it has no scope for further tax cuts now. Australia was smart enough to run budget surpluses in good times. One can only wish that the United States had been so forward looking.

All this suggests that the United States will not be cushioned from the effects of the end of its housing boom. Australia's experience suggests that the growth of U.S. consumer spending will slow. And, unlike Australia, there will be little that the U.S. government can do to offset this. For the global economy, this suggests that the best advice is "fasten your seat belts."

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