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A century of swings in index of misery

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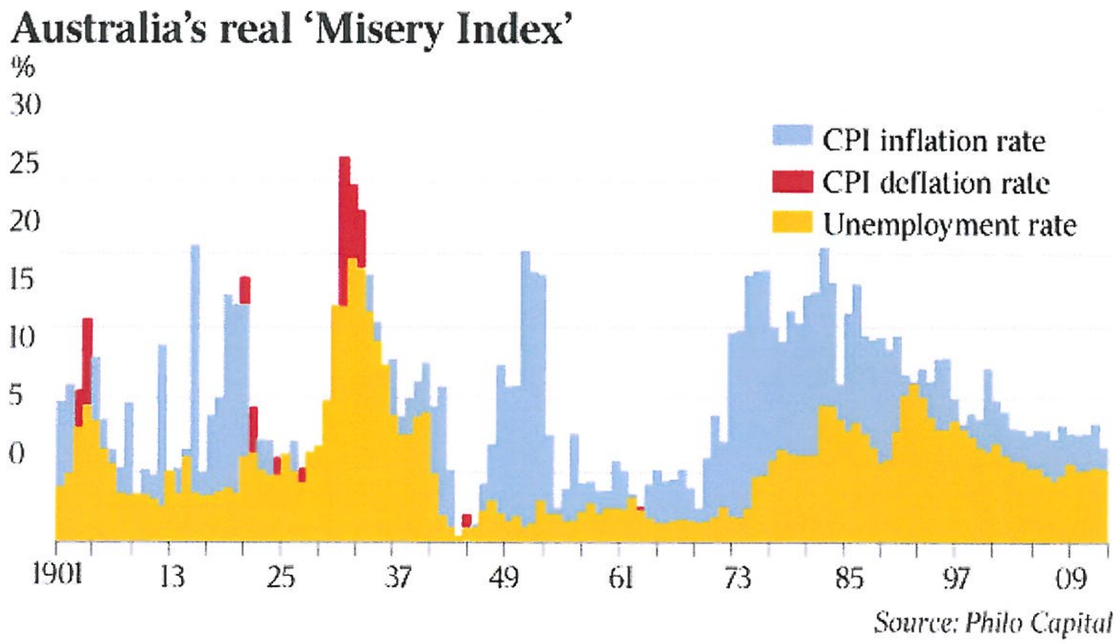

Source: The Australian

MANY people believe the times we're living are unusually difficult ones -- that things are a lot worse than in earlier decades.

Their worries usually include one or more of these issues: the flow-on effects of the global financial crisis and Europe's sovereign debt problems, job insecurity, living costs, work-life balance, excessive indebtedness, a sustained drop in the sharemarket and flat to falling house prices.

Economic unhappiness and economic well-being are hard to measure, but an index of economic misery created by an American academic, Arthur Okun, throws some light on how a nation's pendulum swings between good and bad times.

This index combines the rate of unemployment and the rate of inflation. The grey and black bars in the graph show the ups and downs in the Okun misery index for Australia.

On this measure, our nation has experienced three periods of intense economic misery since the beginning of the last century. The first was the Depression of the 1930s, when unemployment was extremely high for much of the decade. It's a matter for conjecture how much longer those tough times would have lasted had it not been for the outbreak of World War II.

Inflation wasn't a worry in the 1930s. Instead, Australia experienced four years of deflation - a decline in the general level of prices, shown in the chart by the red bars. Deflation inflicts a different form of economic misery than inflation: people and businesses with borrowings are likely to find it more debilitating than inflation.

When looking at the Okun index over the long term, it's useful to incorporate deflation by using the absolute value of price inflation/deflation.

We then get what Ashley Owen, who created the chart I've included today, calls the "real misery index".

The second phase of intense economic unhappiness was in the aftermath of WWII through to the Korean war. Unemployment was low and inflation was in the high teens.

In the 1970s and 1980s, economic misery took the form of stagflation: unemployment was high and inflation rapid. This was a worldwide experience, and followed the jump in oil prices and the massive boost to American money growth as the US printed money to finance the Vietnam War and implement a social program called the "Great Society".

Here, stagflation lasted longer because of the poor economic management of the Whitlam and Fraser governments.

As measured by unemployment and inflation/deflation, the level of economic misery in Australia is well below the levels of discomfort and stress of these three earlier episodes. Debt and work-life balance are bigger worries these days - but they largely result from the choices that individuals make.

The chart is also a reminder that we haven't seen much inflation since the recession of 1990 broke the spiral. Subsequently, the Reserve Bank was given its independence, and China's emergence as a manufacturing powerhouse also helped keep a lid on inflation.

Australians under 40 have no experience of working or investing in conditions of high inflation.

With the global slowdown, inflation is unlikely to be an immediate concern, here or overseas. But in their attempts to moderate the effects of the global financial crisis and Europe's financial woes, the central banks of the big economies are back to printing lots of money.

In the medium term, global inflation could well take off again, and Australia would find it hard to stay on the low-inflation path.

Then the index of economic misery will soar again.

When higher inflation catches people by surprise the market value of bonds slumps, borrowers with variable rate loans pay more, investors favour more speculative assets and shares trade at lower price/earnings multiples.

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