

February 2006 No. 291

Market outlook

Too much of nothing

"What do you think will happen this year?" Nearly every conversation we have had since returning to work has started this way. And in general we have answered with a somewhat rhetorical response of, "That depends on what interest rates do." Now, assuming that interest rates do not rise, then 2006 looks quite good. But if interest rates do rise, and most expect they will lift by at least 0.25% during calendar 2006, what does such a rise really mean to the residential property market?

Matusik website survey results

Before we get into interest rates, let's cover the results of our latest website survey. We asked eight questions, one of which covered interest rates and their possible direction over the next twelve months. To this question, one-third of our respondents thought that rates would rise by 0.25%, whilst another third thought rates would rise twice, totalling 50 basis points during 2006. A quarter of respondents thought interest rates would remain steady during 2006.

Linked to this interest rate outlook were our respondents' views of inflation, with half thinking the CPI will remain around 3% during 2006, but 40% thinking it will climb up to 4% during the year. Whilst still on matters economic, just over half of our respondents believe employment will remain strong, with just one-third thinking unemployment will rise during 2006. Most think the Australian stock market will also remain strong, and whilst not a bull market, most thought that the All Ord's would finish 2006 between 5,000 and 5,500 index points. (The All Ordinaries Index was 4,576 in mid-December when the survey was posted on www.matusik.com.au)

During 2004/05 Queensland's population grew by 75,900 new permanent residents. One third of those surveyed believe that this result is repeatable during 2006, whilst another third think a result between 60,000 and 70,000 is more likely. Interestingly, another third think that migration

Congratulations to our 2006 Forecast survey respondent, **Yvonne Austin** – you're off to the spa! New survey coming soon to www.matusik.com.au

north will increase, resulting in an annual intake of 80,000-plus new residents over the next twelve months.

When it comes to residential prices across the south-east corner of the state, 52% think prices will rise by up to 5% during 2006; with another 22% thinking the rise will exceed 5%. One in ten think nominal prices will remain steady, with the remaining 16% thinking prices will fall by up to 5% by December this year.

When asked about the issues facing the Queensland residential market over the next twelve months – by far the most frequent response was "infrastructure", or more specifically, the lack of it, across the south-east area of the state. Whilst a few mentioned interest rates, hyped-up negative press and affordability, these responses were usually mixed in amongst concerns regarding the lack of infrastructure and the limited attempts (to date) to do anything about it. Most (65%) of our respondents believe that Mr Beattie will remain the Premier after the next election, but most wrote "unfortunately" or "by default" after their response to this question. Despite the lack of a credible opposition (our respondents' words, not ours!) 25% wanted Labor out regardless, whilst 10% thought Anna Bligh would do a better job.

So in summary, and based on this survey, 2006 looks OK. Exciting? Perhaps not. Solid? We'd say, yes!

Table 1 What impact does rising interest rates have?

Time period	interest rate % increase	% change in housing starts*	% change in house prices**	% change in house sales***	% change in confidence****
Early 1970	1.4%	-8%			
Late 1973 - mid 1974	3.4%	-34%			
Early 1980	4.4%	-33%		-39%	-18%
1985 - 1986	4.0%	-17%		-24%	-17%
Late 1988 - 1989	2.5%	-23%	-32%	-31%	-30%
Late 1994	1.8%	-27%	-5%	-21%	-18%
1999 - 2000	1.6%	-34%	-3%	5%	-27%
Mid 2002 to date	1.3%	-10%	-19%	-39%	-17%
Average	2.50%	-24%	-15%	-22%	-23%
0.25% increase in interest rates =		-2.5%	-1.5%	-2.0%	-2.5%

Matusik Property Insights - ABS, RBA, Westpac-Melbourne Institute and Matusik Database.

Percentage change for starts, prices, sales and confidence covers the year either side of the start if interest rate tightening

* Total Australian housing commencements. ** Weighted average annual change of established houses across the eight Australian capitals. *** Detached house sales on land under 1,000sqm across South East Queensland. **** Westpac-Melbourne Institute's Good time to buy a dwelling index.

Interest rates

Now if interest rates do rise, what really does happen to the residential market? We wrote, in response to the 0.25% rate rise last March, that it is rare that “so much has been written about so little,” or words to that effect. And the same applies to 2006. In general, 2006 is shaping up to be somewhat lacklustre in the absence of rocketing prices and demand. We are already witnessing a return to the “normal” market, which makes up four or sometimes five years of the typical seven year cycle. During this phase, improvements in sales, prices and starts are mild (anything over 5% per annum is good), and usually there is a nice balance amongst buyer types – being 60% owner-occupiers and 40% investors (of which few are speculators). Unfortunately, with a change in (say) rates, will come heaps of negative press, with many claiming the ‘end of the world’ as we know it. Another way to describe 2006, as our heading suggests, is “too much of nothing,” to quote Bob Dylan. Unfortunately, in the press especially, much will be made of little this year.

Charts 1 to 4 illustrate some regression analysis we undertook during the first week back in the office. All four graphs chart home loan rates against one of four residential market variables. Chart 1 shows dwelling starts (commencements) across Australia; chart 2 shows weighted average established house prices across the eight capital cities; chart 3 shows house sales across

south-east Queensland (we looked for Australia-wide figures in this regard, but could not get reliable data going back far enough – c’est la vie); and chart 4 looks at confidence, and in this case as measured by the Westpac-Melbourne Institute’s “good time to buy a dwelling” index.

The results of this analysis are summarised in **table 1** on the front page. Table 1 shows - when looking at rate rises since the early 1970’s and measuring the four residential variables for twelve months either side of the rate rise - that a **0.25% rise in interest rates** causes:

- housing starts to fall by 2.5% over a twelve month period after the rate rise,
- house prices to drop 1.5% (often quickly – within six months - after the rate rise),
- sales volumes (across south-east Queensland at least) to drop 2%, again over a twelve month period after the lift in rates, and
- confidence to fall by 2.5%, and again this usually happens quickly after the rate rise.

Let’s hope that rates remain on hold during 2006. But if they do rise, hopefully this analysis illustrates that the “sky will not fall,” and much that will be written about the rise and its impact on the residential market will be “too much of nothing.” **matusik**

Chart 1

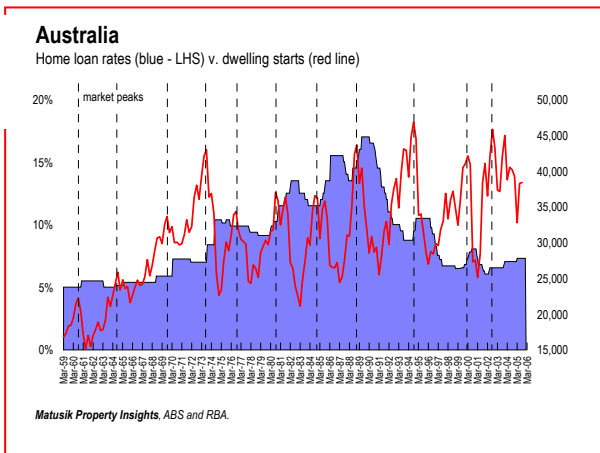


Chart 3

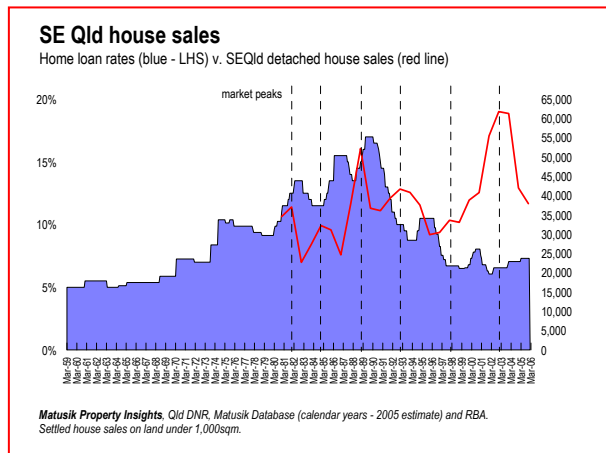


Chart 2

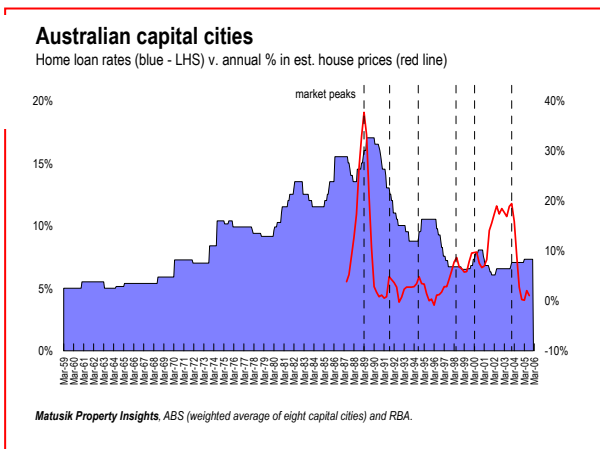


Chart 4

