

# Financial Planning e-Newsletter

November 2006

## In This Issue

**Interest Rates & It's  
Effect On Residential  
Property**

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Hi,

In this issue we examine the topical subject of interest rates and house prices.

With inflation now at 3.9% and sitting above the Reserve Bank's 2-3% preferred bandwidth, there is certainly additional pressure to further increase interest rates in the short term.

## Interest Rates & It's Effect On Residential Property

In 2005, Abelson, Joyeux, Milunovich and Chung from Macquarie University undertook a study of residential house prices in Australia from 1970-2003.

The resulting facts about the housing market are quite illuminating given the current volatility in housing prices.

A key point they discovered was the strong negative relationship between 'real' house prices (ie. prices after inflation is excluded), and real mortgage rates. While a negative correlation between housing prices and higher mortgage costs seems fairly obvious, the pronounced effect is somewhat surprising.

They stated that a 1% rise/fall in the real mortgage interest rate will lead to a fall/rise in house prices of 5.4% on average.

Other interesting aspects of the research was that the time lag for the property market was quite lengthy.

In a rising market of 2% or more, it typically takes 4 quarters for the market to adjust to it's equilibrium. When markets are flat or falling, the adjustment process may take 6 quarters.

Given that the 2006 year has been a rising interest

rate environment, then the correlated effect of rising rates and falling house prices appear to playing out as expected.

Importantly, this study provides us with the factual historical research to ensure that we understand why, and when, housing prices move up and down so markedly with interest rates.

It's definitely food for thought when considering your next real estate investment decision.

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If you have any queries about this month's newsletter, please feel free to email or call our office on (02) 9525-0777. If you would like to forward this email to a friend, click on the forward email link below.

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Email: [david@reedfinancial.com.au](mailto:david@reedfinancial.com.au)  
Phone: (02) 9525-0777  
Fax: (02) 9531-7406  
Web: <http://www.reedfinancial.com.au>

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