



PMI residential property overview

Australia MARCH 2007

Summary

Housing

Median house price data for December quarter 2006 showed modest growth in house prices across the board. However, the effect of rising interest rates through calendar 2006 appears to have had a dampening effect in some markets, with some of the effects, particularly of the latter rises in August and November 2006, likely to become evident in the data for early 2007.



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The main story over the second half of calendar 2006 has been the pull back of first home buyers from the Western Australian and Northern Territory markets, as the combination of booming price growth and rising interest rates resulted in a significant deterioration of affordability. This has been reflected in a slowing of price growth in Perth and Darwin in December quarter 2006, which is likely to continue into 2007.

Momentum appears to be picking up in the Brisbane market with consistent price growth coming through over 2006, reflecting improving activity by both owner occupiers and investors. Solid

economic conditions appear to be offsetting interest rate rises, while high levels of overseas and interstate migration will continue to support price growth in 2007.

Little growth is expected in prices in Sydney, Melbourne, Adelaide, Canberra, and Hobart. Varying levels of price growth from quarter to quarter points to prices having reached a limit from an affordability perspective. Price growth over 2007 is likely to be dampened by a rising interest rate environment, although it will be somewhat supported by solid wage rises through the year.

Economic Outlook, inflation and interest rates

GDP growth was 2.7% in 2005/06, which at first glance appears to be a modest outcome for an Australian economy more used to growing at around 3.5- 4% a year in recent years. However, this figure is concealing solid domestic demand. The increase in total spending in the economy (Gross National Expenditure) ran at a substantial 4.0% in the same period, with the remainder of domestic demand being picked up by rising imports, which increased by 6.9%.

Growth in private investment, particularly non-residential construction and spending on equipment, is sustaining the expansion in domestic demand, offsetting softer growth in household spending and a downturn in residential construction. Australia's trade position remains firmly in deficit however, which is limiting the rate of growth in GDP.

In recent months, domestic demand growth has recovered somewhat. Spending by the household sector has improved, with some improvement in the value of retail sales and household credit growth. With expansion in business investment remaining strong, employment growth has remained solid at 2.8% over the year to January 2007, and the unemployment rate has dropped back to 4.6%.

The tightness of the labour market has yet to be clearly reflected in wages growth, with the latest readings for the wage cost

index remaining well below 4.5%, which is the level that we expect to trigger upward pressure on inflation. Nevertheless, the December quarter 2006 reading for inflation did show a rise in underlying inflation to the top of the Reserve Bank of Australia target range of 2-3%. This increase in inflation probably reflects the effect of higher petrol prices on business costs, which have led to a pick-up in consumer prices for some sectors.

The improved momentum in the household sector, combined with the rise in underlying inflation, encouraged the RBA to undertake further pre-emptive strikes against a more substantial and extended rise in inflation and interest rates were raised by 0.25% in both August and November 2006.

Furthermore, there is strong momentum in the business sector, with construction and investment in plant and equipment expected to show slower but still solid growth in 2006/07. Further growth in investment is expected to come from a major round of public infrastructure projects and the upturn underway in non-residential building.

This environment should sustain further expansion in employment, which in turn will underpin wage cost inflationary pressures. Unemployment is already running near historic lows. As growth picks up again, rising employment has pushed the unemployment rate below 5% in 2006/07, which represents a 30-year low. Consequently, the Reserve Bank has a tightening bias on interest rate policy, which we expect will result in an expected additional 0.25% point rise in interest rates in the first six months of calendar 2007, taking the cash rate to 6.5%, and bringing the housing variable rate to 8.3%, by June 2007.



Home Loan Activity

Purchaser activity, as indicated by the growth in the total number of loans to owner occupiers (excluding refinancing), increased nationally by 11% in 2005/06, after bottoming out in 2004/05. The upward momentum continued in the six months to December 2006, with further growth of 7% in a year on year basis. The rate of increase in total loans for owner occupation at the national level has been generally similar across both new dwellings and established dwellings.

However, while the growth in activity was evident across all states in 2005/06, we are now seeing the first signs of a slowdown in the boom resources states of Western Australia (-5%), and Northern Territory (-22%) in the six months to December 2006. These states were the only locations to show consistent strong growth over the 2003/04 to 2005/06 period.

The states to have shown the strongest rate of growth in total loans for owner occupation in the six months to December 2006 are Australian Capital Territory (+23% in year on year terms), Queensland (+15%), Tasmania (+14%), and South Australia (+10%).

In contrast, Queensland (+22%) and South Australia (+18%) showed the greatest rate of growth in the six months to December 2006 for new dwellings, while Australian Capital Territory (+27%), Tasmania (+17%) and Queensland (+13%) had the strongest increases in loans for established dwellings.

Table 2 highlights the recovery in first home buyer activity after showing a significant decline in the years subsequent to the expiry of the Federal Government's additional First Home Owner's Grant in June 2002. After declining to a low of 88,400

in 2003/04—some 39% below the 2001/02 peak of 143,900—the number of loans to first home buyers recovered to 126,400 in 2005/06. This is above the long term average of just under 110,000 loans per annum.

The momentum in first home buyer activity has continued into 2006/07, with the number of loans to first home buyers showing further growth of 5% in the six months to December 2006 compared to the same period the previous year. However, significant declines were apparent in Northern Territory (-43%) and Western Australia (-20%) suggesting that the strong price growth in these markets in recent years (totalling 70% in Darwin and 93% in Perth over the three years to June 2006) is increasingly driving first home buyers out of the market due to lack of affordability.

Apart from the declining trend in Northern Territory and Western Australia, as well as a modest fall in Victoria, the other states are reporting loans to first home buyers at higher levels than their long term average. This is likely to reflect the return of first home buyers to the market as the rapid price growth of previous years tapered off, as well as the introduction of state government incentives to first home

Table 1: Number of home loans approved for owner occupation excluding refinancing, % change on previous year

State	Year ended June											
	New dwellings				Established dwellings				Total dwellings			
	2004	2005	2006	Dec 06	2004	2005	2006	Dec 06	2004	2005	2006	Dec 06
NSW	5	-11	9	3	-6	-10	13	10	-5	-10	13	9
VIC	6	0	6	7	-6	6	7	3	-3	5	7	4
QLD	9	-11	10	22	0	-6	13	13	1	-7	13	15
SA	5	-5	8	18	4	6	5	9	4	4	6	10
WA	23	7	14	-3	1	13	16	-6	6	12	16	-5
TAS	9	13	-5	-3	-8	-11	9	17	-6	-7	7	14
NT	28	46	15	-27	21	38	24	-21	22	39	23	-22
ACT	-9	-14	8	5	-18	-19	13	27	-17	-18	12	23
Australia	9	-4	9	7	-3	-1	12	7	-1	-2	11	7

Source: Australian Bureau of Statistics
Dec 06 – six months to December 2006 and change on same period previous year

buyer purchasers from 2004/05. This points to further growth in first home buyer activity, although the rate of growth in these states is likely to slow.

Investor activity continued to remain weak nationally in the six months to December 2006. After falling by 15% in 2004/05, the value of loans to residential investors increased by a minimal 4% in 2005/06. However, this was purely supported by the massive growth in Western Australia (+55%), Northern Territory (+27%) and Queensland (+5%), as the decline in investment activity continued across the other states.

Despite the slowdown in loan activity for owner occupation in Western Australia and Northern Territory, these states continued to support national growth in investment activity in the six months to December 2006. At the same time, the momentum in investor activity in Queensland continued with year on year growth of 17% in the six months to December 2006. Modest growth occurred across the other states, while investor activity continued to weaken in New South Wales (-11%) and Victoria (-1%).

The decline in investor activity reflects the continued impact of low residential yields and strained affordability on capital growth prospects and subsequently investor demand in the eastern states. Without significant capital growth occurring and with rental yields remaining low in the face of rising interest rates, it is unlikely that any significant growth will re-emerge in the short term in investor activity in the eastern states, while it appears that growth in Western Australia and Northern Territory is likely to slow.

Table 2: Number of home loans approved to first homebuyers, % change on previous year

State	Number of loans to first home buyers							
	Average 1996/97-2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	6 mths to Dec 06	
							No.	%ch
NSW	31,623	43,869	28,791	24,785	27,337	36,040	19,336	11
VIC	29,547	34,307	23,984	21,303	28,178	32,905	16,549	-1
QLD	20,223	33,259	24,389	20,193	19,894	26,700	15,334	23
SA	7,172	9,285	6,822	6,150	6,419	7,701	4,198	9
WA	15,908	17,704	12,775	12,393	16,060	17,485	7,071	-20
TAS	1,872	2,899	2,273	1,611	1,635	2,159	1,061	11
NT	1,074	886	763	964	1,481	1,904	581	-43
ACT	2,079	1,676	1,509	1,001	1,140	1,485	972	36
Australia	109,497	143,885	101,306	88,400	102,144	126,379	65,102	5

Source: Australian Bureau of Statistics
* percentage change on same period previous year

Table 3: Value of loans approved to investors – % change on previous year

State	Investor Finance									
	2002/03		2003/04		2004/05		2005/06		6 mths to Dec 06	
	(\$'000m)	% var	(\$'000m)	% var	(\$'000m)	% var	(\$'000m)	% var	(\$'000m)	% var*
NSW	27,252	32	33,018	21	25,497	-23	24,438	-4	10,974	-11
VIC	11,660	18	13,788	18	12,346	-10	12,059	-2	6,080	-1
QLD	10,211	50	13,624	33	11,439	-16	12,007	5	6,650	17
SA	2,627	64	3,394	29	3,428	1	3,287	-4	1,683	5
WA	4,284	38	5,242	22	5,824	11	9,028	55	4,990	34
TAS	361	67	547	52	522	-5	506	-3	253	4
NT	204	23	298	46	299	1	380	27	230	33
ACT	966	36	1,005	4	827	-18	828	0	400	2
Australia	57,653	34	71,010	23	60,274	-15	62,611	4	31,285	3

Source: Australian Bureau of Statistics
* percentage change on same period previous year

Table 4: Median house prices by capital city

Quarter ended June	Sydney		Melbourne		Brisbane		Adelaide		Perth		Hobart		Darwin		Canberra	
	\$'000	% Var	\$'000	% Var	\$'000	% Var	\$'000	% Var	\$'000	% Var	\$'000	% Var	\$'000	% Var	\$'000	% Var
1996	220.0	3.3	155.0	3.3	130.0	0.0	111.5	-1.1	127.0	-0.8	112.0	6.7	168.0	-6.7	158.0	3.9
1997	241.0	9.5	179.0	15.5	134.0	3.1	114.9	3.0	135.0	6.3	105.0	-6.3	178.0	6.0	155.0	-1.9
1998	272.0	12.9	208.0	16.2	139.0	3.7	120.3	4.7	143.3	6.1	107.0	1.9	180.0	1.1	160.0	3.2
1999	296.0	8.8	232.0	11.5	145.0	4.3	125.0	3.9	148.5	3.6	115.0	7.5	176.0	-2.2	158.0	-1.3
2000	337.0	13.9	264.0	13.8	155.0	6.9	135.0	8.0	157.8	6.3	130.0	13.0	190.4	8.2	184.0	16.5
2001	364.0	8.0	302.0	14.4	160.0	3.2	148.4	9.9	165.7	5.0	120.3	-7.5	187.0	-1.8	203.0	10.3
2002	452.0	24.2	330.5	9.4	185.0	15.6	170.0	14.6	185.7	12.1	130.0	8.1	200.0	7.0	227.6	12.1
2003	519.0	14.8	355.0	7.4	235.0	27.0	220.0	29.4	210.2	13.2	180.0	38.5	206.0	3.0	320.0	40.6
2004	552.0	6.4	365.0	2.8	307.3	30.7	250.0	13.6	255.0	21.3	252.0	40.0	255.0	23.8	372.4	16.4
2005	528.0	-4.3	360.0	-1.4	315.0	2.5	275.0	10.0	295.0	15.7	260.0	3.2	279.8	9.7	352.5	-5.3
2006	525.0	-0.6	371.5	3.2	328.0	4.1	287.0	4.4	405.0	37.3	277.0	6.5	350.0	25.1	380.0	7.8
Quarterly																
Mar-06	517.0	-1.1	357.0	-3.8	325.0	0.9	279.0	0.4	365.0	8.6	282.5	2.2	335.0	2.1	375.0	1.9
Jun-06	525.0	1.5	371.5	4.1	328.0	0.9	287.0	2.9	405.0	11.0	277.0	-1.9	350.0	4.5	380.0	1.3
Sep-06	523.7	-0.2	377.0	1.5	330.0	0.6	285.0	-0.7	440.0	8.6	290.0	4.7	385.0	10.0	375.0	-1.3
Dec-06	524.0	0.1	391.0	3.7	339.9*	3.0	292.4*	2.6	450.0	2.3	290.6*	0.2	396.6*	3.0	381.4*	1.7

Note: variance in quarterly data represents a quarterly increase. Source: R.E.I.A, BIS Shrapnel, ABS

* estimated median price based on quarterly increase in price index supplied by ABS as not all December quarter medians have been released.

Prices

The increase in Sydney's median house price from \$517,000 in March quarter 2006, to \$525,000 at June quarter 2006 would indicate that the Sydney residential market had bottomed out. However, at \$524,000 at December quarter 2006 the median house price remained roughly steady. This would suggest that the rises in interest rates in May, August, and November 2006 had a dampening effect, which is likely to continue at least into the first half of 2007, as the rises continue to impact.

Melbourne reported a 4% increase its median house price to \$391,000 in December quarter 2006, which reflects a 5% increase over the 12 month period. This reflects the modest increase in owner occupier activity in this period, as well as the generally stronger first home buyer activity. Positive price growth is expected to continue, although it is likely to slow due to the rising interest rate environment.

The estimated median house price for Brisbane at December quarter 2006 was \$340,000, representing a 3% increase for the quarter and a 6% increase for the year. After slowing to 2.5% in 2004/05, median house price growth in Brisbane has picked up, as underlying demand, due to high levels of overseas and interstate migration, remains strong. Strong wages growth due to an outperforming economy appear to have offset the interest rate rises through 2006, pointing to continued moderate growth through 2007.

Adelaide's median house price has been relatively static over calendar 2006, although the estimated December quarter 2006 median of \$292,000 represents a



rise of 2.6% for the quarter. Price growth through 2007 is expected to continue to remain modest, as rising interest rates have a dampening effect on demand.

Quarterly growth in Perth's median house price slowed to 2.3% in December quarter 2006, after averaging in excess of 9% per quarter in the nine months to September 2006. The December quarter median of \$450,000 makes Perth house prices the second most expensive nationally, indicating that affordability has deteriorated significantly. Consequently, this slowing trend in house price growth is likely to continue through 2007, particularly as lending activity appears to be waning.

Hobart's estimated median house price showed minimal growth of 0.2% in December quarter 2006. This has culminated a year of varying growth, suggesting that the potential for solid price growth is limited. This is also reflected by limited growth in lending activity.

Similar to Perth, price growth in Darwin also slowed in December quarter 2006. After growth of 10% in September quarter 2006, the rise in the median house price slowed to 3% in the December quarter. Together with the decline in first home buyer activity in the six months to December 2006, this suggests that affordability pressures are beginning to

bite, and points to more moderate price growth through 2007.

The estimated median house price of \$381,000 in Canberra for December quarter 2006 reflected a rise of 1.7% for the quarter and 3.6% for the year. The decline in median house prices in 2004/05 appears to have helped to make housing more affordable. This has been reflected by solid growth in first home buyer activity, as well as total lending in general. Further modest growth is expected in 2007, dampened by a rising interest rate environment.

www.pmigroup.com.au

AUSTRALIA

SYDNEY

Level 21, AMP Centre
50 Bridge Street
Sydney NSW 2000
PO Box R1547
Royal Exchange NSW 1225
PH 61 (02) 9231 7777
FAX 61 (02) 9251 5550

BRISBANE

Level 1, 12 Creek Street
Brisbane QLD 4000
GPO Box 1278
Brisbane QLD 4001
PH 61 (07) 3292 1700
FAX 61 (07) 3221 0200

MELBOURNE

Level 34, 385 Bourke Street
Melbourne VIC 3000
GPO Box 2966
Melbourne VIC 3001
PH 61 (03) 9607 9777
FAX 61 (03) 9670 5179

ADELAIDE

Level 1, 70 Pirie Street
Adelaide SA 5000
GPO Box 2404
Adelaide SA 5001
PH 61 (08) 8359 3270
FAX 61 (08) 8359 3290

PERTH

Level 3,
89 St Georges Terrace
Perth WA 6000
PH 61 (08) 9211 5900
FAX 61 (08) 9481 6045

1300 FOR PMI (367 764)
WWW.PMIGROUP.COM.AU

INTERNATIONAL

USA

PMI Plaza
3003 Oak Road
Walnut Creek, CA 94597
California USA
PH 925 658 7878
FAX 800 288 1970

WWW.PMIGROUP.COM

NEW ZEALAND

Level 7
National Bank Tower
205 Queen Street
PO Box 519, Auckland
New Zealand
PH 64 (09) 302 0044
FAX 64 (09) 302 0066

FREEPHONE 0800 653 857
WWW.PMIGROUP.CO.NZ

ASIA

HONG KONG

Suite 3316, 33rd Floor
One International
Finance Centre
1 Harbour View Street
Hong Kong
PH 852 2295 0040
FAX 852 2295 0046

WWW.PMI-ASIA.COM

EUROPE

IRELAND

3rd Floor, Fleming Court
Flemings Place
Dublin 4
Ireland
PH 353 1 448 2900
FAX 353 1 448 2999

WWW.PMIEUROPE.COM



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