



# What lies ahead

Money asked three experts for their take on what to expect in 2012

## Beating the fear factor

**Mark Bouris**

**COMPANY** Yellow Brick Road  
**TITLE** Executive Director

The Melbourne Cup Day cut in interest rates should lessen customer fear, which will benefit many areas of the economy including retail, housing and small business. Back in June my company, Yellow Brick Road, launched "The RBA Appeal" to give people the opportunity to voice their concerns about rising interest rates directly to the RBA. After six long months the people's voice made it to the central bank's ear. Turning to 2012, this is my take:

**SHARES:** The Aussie equity market, a global underperformer since the GFC, has been hit hard by the RBA's overly tight monetary policy. This has been exacerbated by an unprecedented rise in our currency, making exporters and import-competing industries less competitive.

Subject to the RBA maintaining its commitment to the end of this monetary policy cycle, with the possibility of further rate cuts in 2012, we would be more bullish on equities from a market timing perspective. The sharemarket remains nearly 40% below its late 2007 peak, and is due for a run, especially if the RBA takes its foot off the rate brake.

**RESIDENTIAL HOUSING:** The housing market had one of its toughest years ever in 2011. National house prices have not risen since March 2010. So while house prices have been falling modestly by 3-4%, both disposable household incomes and rents have been rising rapidly. In dollar terms, rents have increased by 4.6% over the past year according to the ABS, which

also estimates disposable household incomes have risen by around 8% over the past 12 months. This means the ratio of house prices to both incomes and rents has been falling. Affordability has been improving, which is why more first-time buyers have been entering the market.

As the RBA has cut interest rates, and fixed-rate loans have been declining for months due to the reduced cost of long-term money, we expect the housing market to experience a modest rebound commencing in early 2012. So this is a very good time to get set in the market. Affordability is solid and rental vacancy rates tight – just what you want to see. But don't expect double digit capital gains in 2012, just steady total returns.

**INTEREST RATES:** Not even the RBA knows exactly where rates are heading in 2012. For months we had been arguing it needed to cut rates. I felt the non-resources economy was much softer than the RBA's strategists believed. I still think the economy needs more support, and that the currency is unnecessarily high. However, the RBA is an independent organisation with a specific mandate to look after the stability of the currency, maintain full employment and look after the economic prosperity and welfare of the people.

Interest rates will be governed by the inflation data, for better or worse. This is very hard to predict. The RBA believes the so-called "neutral" interest rate is around its current 4.5%, or perhaps one notch lower at 4.25%. If we assume the economy can grind out trend growth in 2012, this would imply rates will remain around their current levels. The risks to the downside are a marked deterioration in the global economy. On the upside would be an outbreak of inflation. Either is possible and only time will tell.

