

## Hungarian interest rates to be cut as risk aversion eases

- The Hungarian central bank meets again on Monday 27<sup>th</sup> having held policy steady since the half point interest rate cut in January. Political pressure has been building for it to take further measures but as recently as the June meeting, the Monetary Council was still more concerned with issues surrounding financial stability. Significantly, there are signs that the best indicators of risk appetite in Hungary are improving. Credit default swap spreads in the shorter maturities have slipped back to their lowest levels since the back end of last year while the HUF has appreciated to the 270 area against the euro; as recently as March, it was trading up above 300.
- Economic news flow generally remains fairly gloomy justifying the case for further action from the authorities. Both consumer and business confidence have edged up in a small way over the past few months but still hover close to their lowest levels in more than a decade. Meanwhile, output in the construction sector remains near the lows for the cycle. On an annual comparison, it has dropped by a little more than 10% but, tellingly, it is around one third down on the high water mark briefly touched in 2005.
- Given the improving risk backdrop, it is likely that interest rates will be lowered from 9.5 to 9% next week. But the

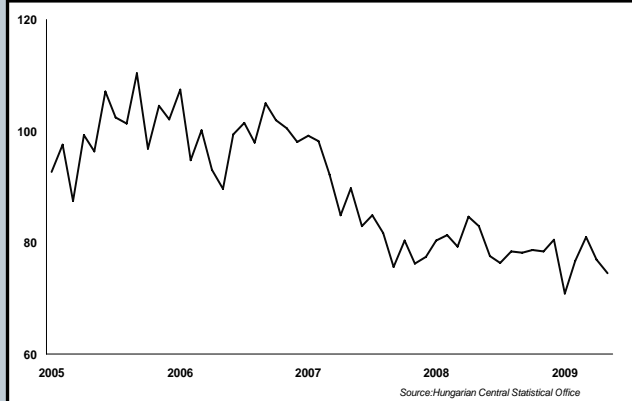
central bank is likely to continue acting in a prudent manner mindful of dangers of a renewed bout of risk aversion. It is also likely to be keeping a watchful eye on inflation which in June came in at 3.7% compared with the target of 3%. Tax changes are likely to push the headline inflation rate higher over the coming months.

**“Economic news flow generally remains fairly gloomy”**

**“Best indicators of risk appetite in Hungary are improving”**

### Hungarian construction output is still on the floor

Index level



## Australian building approvals to continue to improve

- The relative resilience of Australia to the global economic downturn is clearly reflected in the housing market. Although the US and UK have seen prolonged periods of house price declines, the Australian market has only seen a modest adjustment. Prices were down by 6.7% y/y in March and more recent data suggests that this has improved to a 1.2% annual decline in May. The next update on the Australian property market will come from building approvals data for June, to be released on Thursday 30<sup>th</sup>.
- Residential building approvals data, a pre-cursor to any housing development, act as a good indicator of confidence in the sector. The US housing market experienced an extended boom in residential development with building permits for housing trending upwards for several years. The subsequent crash has seen the number of permits fall for almost 3 years. Building approvals in May 2009 were 77% lower than their September 2005 peak. By contrast, residential development in Australia has shown relatively modest cyclical tendencies and the downturn that may have stemmed from the global financial crisis has been less severe. Monthly building approvals for residential dwellings hit a high peak in late 2007 but, at 9,594, they were only marginally above the long run average of 9,168. And the downturn has been relatively short - by May 2009 approvals had risen to 8,010, up 10% from their

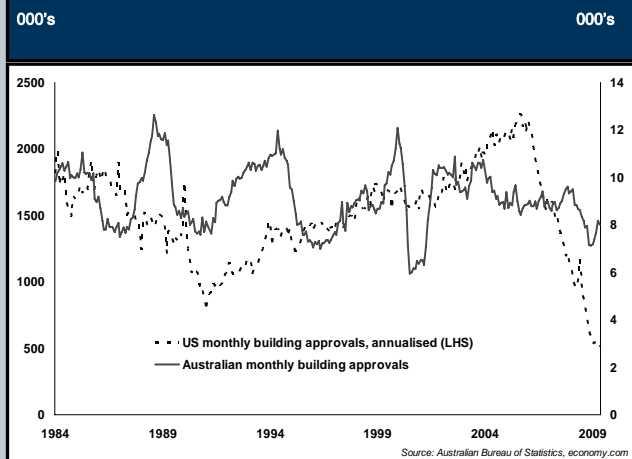
trough in December 2008.

- Although developer uncertainty and consumer caution will put a cap on activity levels, the strength of housing demand, particularly from first home buyers, means that building approvals data will continue to edge up over the next few months.

**“The resilience of the Australian economy is reflected in the housing market”**

**“Building approvals will continue to edge up”**

### Australian cyclical movements less extreme than in the US



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## Euro area lending data to show further deterioration

- Euro area M3 lending data for June is due from the ECB on Monday 27<sup>th</sup> and the ECB's quarterly Bank Lending Survey for July is due on Wednesday 29<sup>th</sup>. Annual growth in M3 lending is currently running at 3.7% (down from its November 2007 peak of 12.7%). The ECB Bank Lending Survey shows that credit standards (for households and businesses) have tightened significantly since Q3 2007.
- Looking forward, bank lending standards are likely to tighten further. However, the forward looking component of the survey indicates that the pace of tightening will continue to slow (as it has done since Q1 2009). Meanwhile, given rising unemployment in the euro area (9.4% in May up from its low of 7.2% in April 2008), lending for home purchase is also likely to contract further.

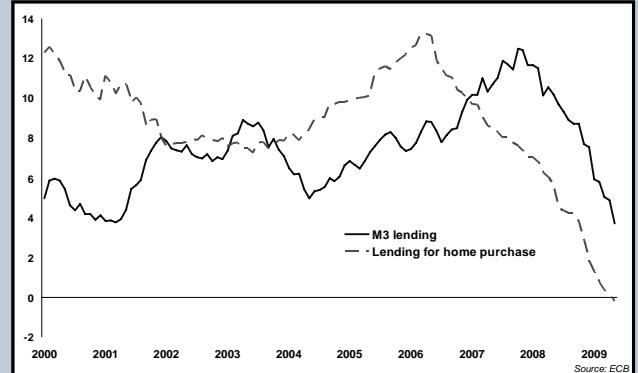
**“Mortgage lending is likely to fall further...”**

**“...and mortgage loan standards are likely to tighten further”**

- One of the key components of the M3 data is lending for home purchase; annual growth in this area has fallen from 13.2% in March 2006 to -0.2% in May. The ECB Bank Lending Survey shows that this is attributable mainly to falling loan demand and tightening credit standards. On this latter point, however, credit standards have been tightened largely because of a lower level of confidence in the region's economic and housing market prospects rather than difficulty in obtaining finance. Interestingly, the country breakdown in the M3 data shows that annual growth in mortgage lending is currently -10.7% in Ireland, while in Spain, it is 1.2%. Some have questioned the accuracy of official Spanish house price index (8.6% below its peak), suggesting it should be showing falls closer to the Irish experience (prices are 21% below their peak). However, the M3 data lends support to the view that Spanish house prices have indeed fallen less than in Ireland.

### M3 lending and mortgage lending have slowed sharply

Annual % change



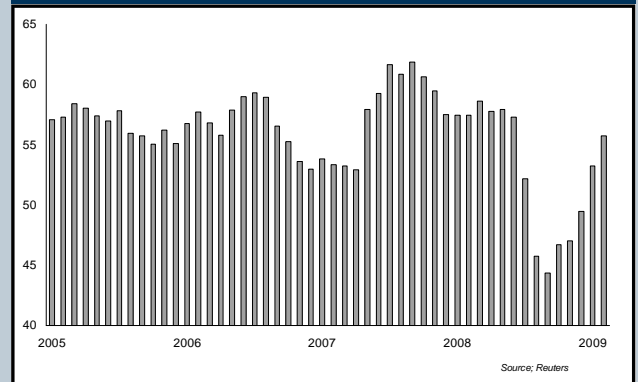
## Indian rates on hold as economy improves

- The Reserve Bank of India (RBI) meets on Tuesday 28<sup>th</sup> to review interest rates amid signs that the worst of the downturn may be over for the Indian economy. Recent economic news-flow has offered some hope that the economy is responding well to a cocktail of medicine including sharply lower interest rates, cuts in duties and an increase in spending on infrastructure projects. Interest rates have fallen by 425 basis points to 4.75% since October last year as the government and central bank have taken aggressive action to combat a sharp slowdown in economic momentum. Indeed, RICS expect the central bank to leave interest rates unchanged when they meet next week, with the full effects of previous policy moves yet to work their way through the economy.
- The outlook for the commercial property market has certainly improved in recent months. Any signs that the economy is stabilising should help boost the labour market which in turn will support a slower rate of decline in the rental sector. The latest Global Commercial Property Survey from RICS is due for release on Monday 27<sup>th</sup> and it will be interesting to see whether agents have become any more positive on the outlook for lettings activity.
- Both hard and soft economic data already confirms that a turnaround in business conditions is underway. Industrial

and infrastructure output have risen more than expected in recent months with the latest survey from ABN Amro continuing to show an expansion in manufacturing activity. With the full extent of economic stimulus yet to kick in, improved growth should help the property market stabilise in 2010.

### Manufacturing activity continues to recover

Diffusion index, % points ABN Amro



**“Indian economy is responding to economic medicine..”**

**“...the forthcoming RICS Survey will provide clues as to whether property market conditions are improving”**

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