

Japan to spend at least Yen 16tn on reconstruction after earthquake disaster

“Japanese GDP growth may be 0.5% less than otherwise would have been the case in 2011”

The coming week sees the latest monetary policy meeting of the Bank of Japan with the governor scheduled to give a press conference at its conclusion on Thursday 7th. This may well shed a little more light on official thinking as to the impact of the devastating earthquake off the coast of the Tohoku region and the appropriate policy response from the authorities.

Following on from this on Friday 8th, the March Economy Watchers Survey could also reflect sentiment in the wake of the tragedy. Balance of payments numbers covering the month of February are due out on the same day.

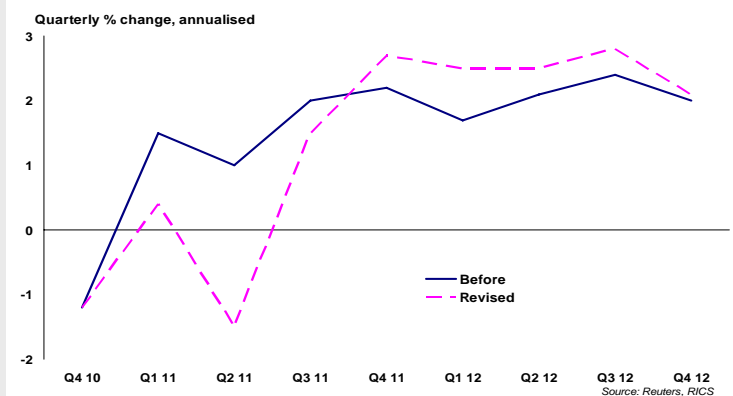
Inevitably, the earthquake will depress the measured level of economic output during the first quarter of the year. Some recovery is likely to be visible as the year wears on but damage to energy supplies leading to further power outages could continue to keep activity lower than would otherwise have been the case. While it is a little early to assess the full impact on Japanese GDP, our initial judgement is that it could turn out to be around 0.5% less than the previous forecast (the revised RICS estimate is 0.7% for 2011). That said, it would not be unreasonable to assume that most if not all of this is made good in 2012 as the reconstruction programme continues to be implemented.

The Cabinet Office estimates the total damage from the disaster to be in the region of Yen 16 to 25tn; the first projection assumes the devastation to the area affected by the tsunami to be twice the level of the Hanshin earthquake (which took place in 1995) while the latter

assumes even greater damage. The rebuilding process is likely to take place, roughly speaking, over a three year period. At least some Yen 7tn will be required from the government's purse to put the badly damaged public infrastructure back in place. Meanwhile, private housing construction will gradually play a bigger role in underpinning the recovery in the economy as the loss of shelter from the earthquake is addressed.

“At least Yen 7tn will be required from the public purse to rebuild infrastructure.”

Growth near term will be weaker than previously expected



Canadian home building likely to decline in the coming months

“Building permits declined by 5.1% in February”

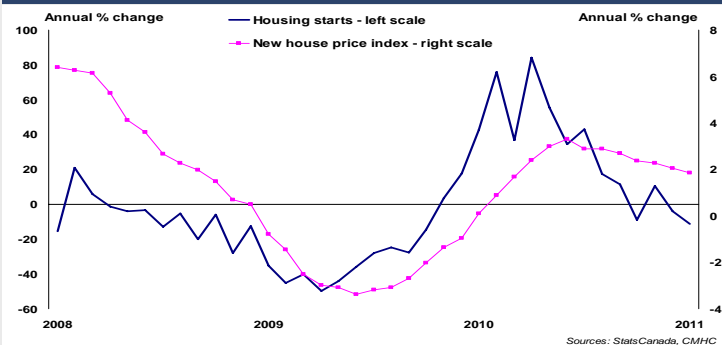
The coming week sees the release of data pertaining to house building activity. Building permits (February) are published on Thursday 7th followed by housing starts (January) the next day. The overall value of Canadian building permits unexpectedly dropped by 5.1% in January from December on a decline in both the residential and non-residential sectors. Residential permits

slipped 1% on the month, with six out the ten provinces recording a fall in permits, the largest declines taking place in Ontario and Alberta. Housing starts rebounded in January, rising 7% on the month. However, they still remain 10% below year ago levels and we do not

expect this strength in housing starts to continue in the coming months due to three main factors.

First, housing starts track new house prices quite closely, and with the annual growth rate of new house prices continuing to fall - in January it fell to a 10 month low - we expect housing starts to weaken accordingly in the coming months. Second, new tougher mortgage rules introduced by the government will make borrowing harder for potential homeowners and hence lower overall demand in the housing sector. Finally, the anticipated interest rate hike by the Bank of Canada (BoC) in late May will lead to higher financing costs for potential homebuyers. Indeed, house building activity is expected to be a slight drag on overall economic growth in 2011, with the Canadian recovery less dependent now on rising house prices and consumption, and more on business investment and exports.

Housing sector continues to moderate



Looking ahead, the Ivey PMI, a good cross-sector gauge that measures the purchasing intentions of 175 government and company managers, surged in February from 40.4 to 69.3. This is in stark contrast to general dataflow in 2011 which has been weak compared to the strong ending to last year, where GDP growth came in at 3.3% annualised. Also, the softer than expected CPI in February (down 0.1% to 2.2%) will ease the pressure on the BoC for an immediate interest rate hike, and allow them to wait till after the general election in early May.

“Bank of Canada likely to hike interest rates by end of May”



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Higher cost of mortgage finance in Europe will hit some markets more than others

“Mortgage rates have begun to go up ahead of the expected tightening in ECB policy next week”

The ECB meets on Thursday 7th with financial markets now believing a quarter point interest rate increase is highly likely, a view that we share. Inflation has pushed through the central bank’s target in recent months while growth indicators remain generally firm and bank lending has picked up. Money markets are now pricing in one more hike in interest rates

this year following an April move. RICS suspects that the ECB may ultimately prove to be a little more aggressive than this although continuing problems around the periphery of the euro area (Portugal, Ireland) could justify a more circumspect approach.

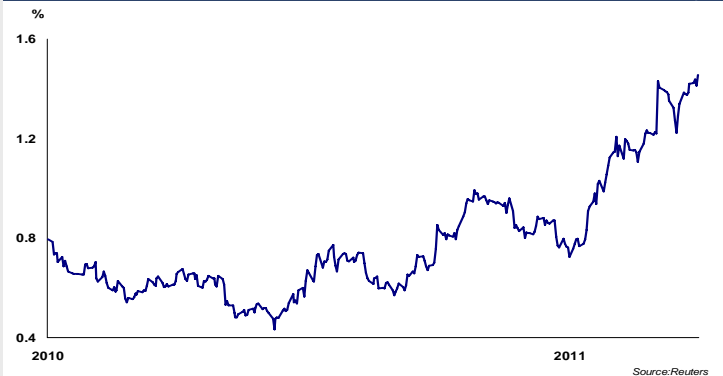
Significantly, the cost of fixed rate mortgages in Europe has already begun to rise as bond markets respond to the prospect of a tightening in monetary policy. Yields on 5 year German government debt have climbed to their highest level since August 2009. This has translated into an even bigger rise in the price of mortgages which in some European countries have increased by as much as one per cent since the start of the year. Predictably enough, while fixed rate deals in Germany and France can still be found around the 4% mark, in Spain and Portugal they are materially higher.

The higher cost of mortgage finance (with the prospect of further increases to come) is not at this stage encouraging RICS to change its expectations for house prices in the euro area. Critically, the European economy is still on course to grow by just a little short of 2% both this year and next and there are signs that the labour market is on the

mend. The jobless rate has slipped from 10.1% to 9.9% in recent months while the level of employment is actually beginning to rise. France could prove to have one of the more buoyant housing markets this year with prices expected to rise by a further 5%. By way of contrast, it is hard to conclude with any confidence that house prices have now bottomed in Spain. Meanwhile the latest readings from the RICS/CI Portuguese Housing Survey suggest that sentiment towards residential property in that country remains downbeat.

“France is likely to prove one of the more buoyant markets”

Interest rate expectations for end 2011 have risen sharply



Australian housing market still feeling effects of flooding

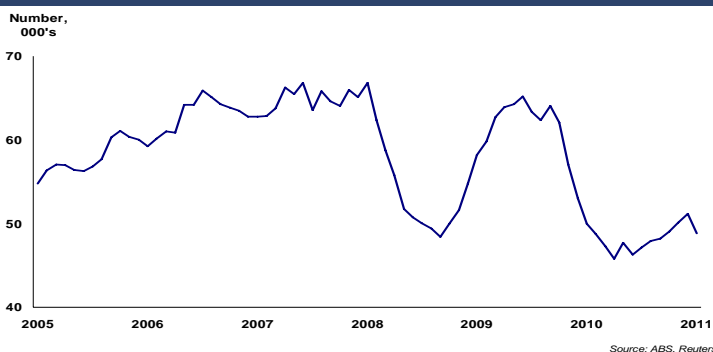
“Mortgage approvals fell from December to January”

The Australian Bureau of Statistics (ABS) release mortgage approvals data for February on Wednesday 6th, and follow it with the latest update on the labour market the next day. The January reading for home loans showed the number fell modestly, from 51,180 in December to 48,871 and we expect the February number to ease further as a result of the extensive flooding in

Queensland.

Predictably, building approvals data for February, released this past

Loans for home purchase have fallen in 2011



week by the ABS, showed that activity in the housing market has been hit by the disaster. Approvals were down 7.4% from January, falling from 12,975 to 12,011. Both readings are below the long run average (approximately 13,000) and bring the number of permits back to levels last seen in the midst of the global financial crisis. While approvals should pick up over the coming months as the reconstruction effort starts, home loans may remain depressed with interest rates at 4.75%. Housing market activity was brought forward in 2009 and early 2010 as a result of very low interest rates and first home buyer grants. But since October 2009, the RBA have tightened policy by 175 basis points and credit is not as cheap to come by. Indeed, standard variable rates offered by banks are now approaching 8% compared to 5.5% in 2009.

Meanwhile, underpinning the strength in the housing market throughout the last year has been the resilience of the labour market. At the peak of the crisis, the unemployment rate rose to 5.8%, low by historical standards, and had retreated to 4.9% by December. However, employment momentum has softened recently; 10,000 jobs were lost in February. The fundamentals are that a weaker labour market will lead to depressed mortgage demand, especially in a monetary tightening cycle; however, we expect the RBA to sit on the policy sidelines for the mean time and the economy to create jobs in the medium term as reconstruction takes place in flood affected states.

“The RBA have tightened policy by 175 basis points since October 2009”

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