

RBI may be forced to move if inflationary pressures persist

“In December the WPI jumped by 1.3% pushing the annual measure of inflation back up to 8.4%...”

The coming week sees the release of a key piece of macro data, the January Wholesale Price Index (WPI). This is the most closely watched measure of inflation in India and, like in many other fast growing economies around the world, it has been rising rapidly over the past year. In December alone, the WPI jumped by 1.3% pushing the annual measure of inflation back up to 8.4% from the 7.5% number recorded in November. The key drivers of this worrying trend have been, predictably enough, firmer food and oil prices. Finance Minister, Pranab Mukherjee, acknowledged earlier this week that there is considerable uncertainty surrounding the near term path of inflation but suggested that the overall trend is for prices to moderate.

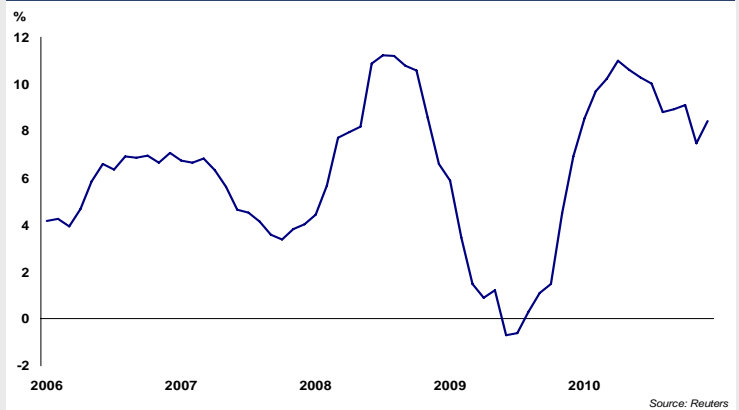
The Reserve Bank of India (RBI) remains rather more cautious about the prospects. Having raised interest rates at the back end of January for the seventh time since March last year, it warned that balance of risks appear, if anything, to be tilting towards stronger inflation and hinted that it was ready to take further action if this did indeed prove to be the case. The next RBI meeting is scheduled for March 17th and unless there is a meaningful shift in sentiment, it would not be unreasonable to expect the authorities to hike the repo rate again, taking it to 6.75%.

Despite the increasingly restrictive monetary stance, the outlook for economic activity remains positive. Notwithstanding some disappointment over the weak manufacturing numbers for November,

GDP still looks to be on course for growth of more than 8.5% in the fiscal year (2011) ending March. Moreover, the likelihood is that the economy will perform similarly strongly during the coming fiscal year with growth projected to come in somewhere between 8 and 8.5%. Even so, recent news flow from the real estate sector has been a little more subdued with residential numbers from JLL REIS pointing to some stability in sales and a rising inventory level.

“...it would not be unreasonable to expect the authorities to hike the repo rate, taking it to 6.75%”

Indian inflation remains above the 5% target



Swedish house price outlook is finely balanced

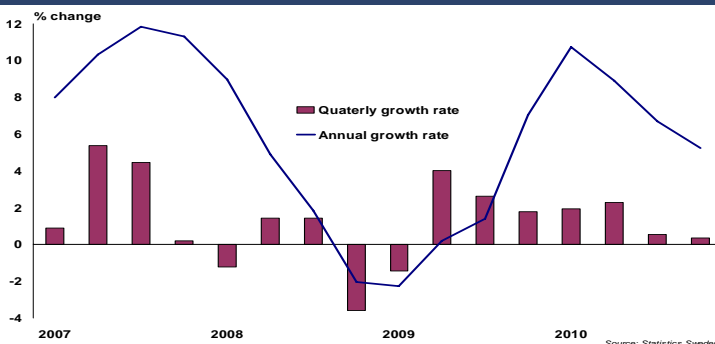
“The strength of the economy will support housing demand...”

The Swedish central bank, the Riksbank, decides on interest rates on Tuesday 15th, while February house price data is due from Statistics Sweden on Friday 18th. Interest rates have been hiked four times since the middle of 2010 from 0.25% to 1.25%, with the last move at December's meeting. The Riksbank has been keen to normalise monetary policy on the back of very strong economic growth (during 2010 GDP growth averaged 2% per quarter), which it believes has increased medium term inflation risks. Meanwhile, house prices are 8.3% above their pre-crisis peak level, but the pace of increase has slowed markedly since H2 2010, rising by

0.4% in Q4 and 0.6% in Q3.

Three factors help explain the slowdown in house price growth during H2 2010. First, the recent tightening in monetary policy has had a knock-on impact on mortgage rates, which have increased from 2.6% to 3.5% over the last six months. Second, the Swedish Financial Supervisory Authority (SFSA) introduced an 85% blanket maximum mortgage LTV limit last October. Finally, a third factor which should not be underestimated, is the Riksbank's year long campaign to sway public opinion over the sustainability of house price growth and rising debt levels. Indeed, the Riksbank has gone out of its way to draw attention to this point and dramatise the consequences of an unsustainable boom in prices.

Swedish house price growth has calmed recently



Looking forward, the outlook for house prices during 2011 is finely balanced. The recent strong performance of the economy should feed through to the labour market and in turn demand for housing. However, the Riksbank is signalling that another 75 basis point of tightening will be delivered by year end. This is likely to restrain demand, as is the SFSA's LTV cap, which has probably yet to fully feed through given that it was only recently introduced. Finally, while interest rates still remain accommodative, there is unlikely to be any let-up in the Riksbank's house price and debt rhetoric, which it hopes will concentrate the minds of opportunistic households.

“...but the authorities have taken several steps to cool the market”



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US residential construction looking for a way out

“Housing starts declined 4.5% during December”

The coming week sees a raft of house building data being published, starting with the NAHB housing market index on Tuesday 15th (February) followed by housing starts (January) the next day. Ground breaking activity has been subdued of late, with housing starts falling 9% for single housing units in December (417,000 annualised rate).

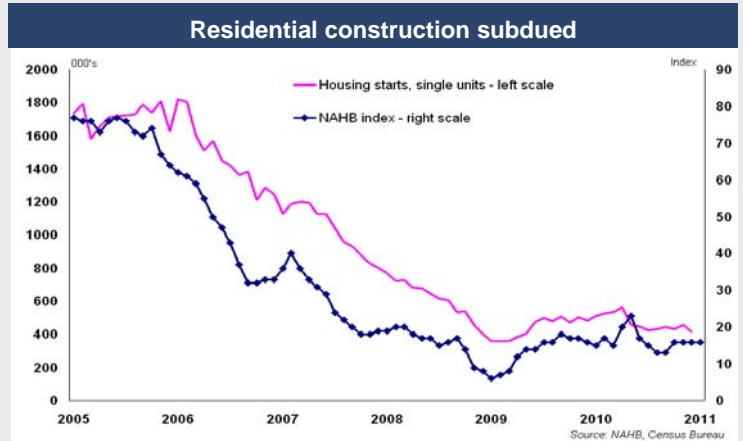
Part of this fall is due to the severe weather in parts of the US, but it is largely attributable to builders' continued concern about the large supply overhang currently in the housing market. Indeed, with demand still anaemic – new home sales are still 57% below their 20-year average – and large amounts of distressed properties still coming onto the market (260,000 in January alone), house prices are still falling and therefore, builders are finding it increasingly difficult to make house building profitable.

The latest NAHB housing market index, which measures builders' confidence levels, is still bouncing along the bottom, with January's figure unchanged at 16 from the previous month (50 and below signifies that conditions are worsening). Respondents to the survey report a lack of building finance being one the major obstacles to increased house building activity. The January Senior Loan Officers' (SLO) survey (a good indicator of lending conditions) suggests that after plummeting in late 2008 and 2009, the amount of commercial and industrial (C&I) loans on bank balance sheets have been roughly flat over the past year. That said, the SLO survey did show a substantial easing in lending standards, for large firms

beginning in early 2010 and for small firms starting around the middle of the year.

Looking forward, the recent remarks by the Fed Governor Ben Bernanke to Congress suggest the central bank is still not convinced about the economic recovery in light of the weak job creation. Given this situation, the demand for housing and in turn the residential construction outlook is likely to remain depressed for some time.

“NAHB index shows builders' confidence still low”



Japanese growth set to slip, albeit only for now

“The Q4 GDP estimate is expected to show a contraction”

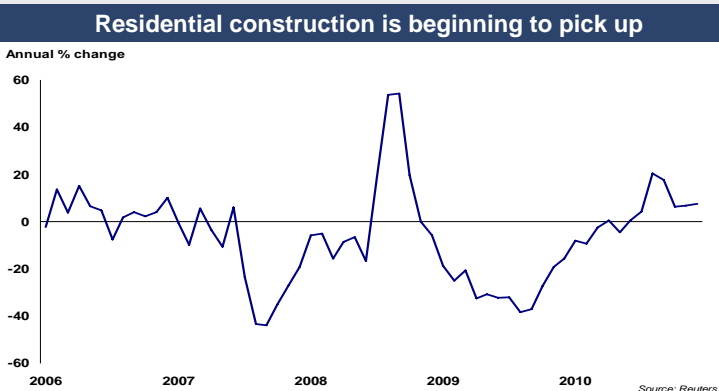
A busy week in Japan approaches as the Statistics Bureau release the Q4 GDP 1st estimate on Monday 14th, followed by the Monetary Policy statement from the Bank of Japan (BoJ) on Tuesday 15th. Released on the same day is industrial production for December, before construction spending for the same period is released on Thursday 17th. At present, the BoJ is

likely to continue sitting on the policy sidelines as it waits to see how the economy reacts to improving global conditions.

The Japanese economy has grown modestly over the last year and the Q4 GDP estimate is expected to show a fall from Q3 (where quarter on quarter growth was 1.1%). The fall is likely to be down to softer exports and the expiry of government stimulus programmes; the strong yen has meant exports decreased in the final 3 months of the year, while consumer demand will have slowed after spending was brought forward in Q3 in order to avoid tax hikes and incentive programmes expiring. The market consensus is for a contraction of 0.5% in Q4, although we expect growth to resume modestly in Q1 as both the manufacturing and services PMI surveys for January have moved into positive territory.

Meanwhile, industrial production is likely to show a strong pick up in December after the preliminary reading shows it rose 3.1% on the month, the highest monthly gain since January 2010. Construction spending may not show as positive a reading, given that orders were weak in the final few months of last year; they dropped by 5.6% and 5.3% in October and November respectively. Notwithstanding this, residential construction has started to pick up. Annualised housing starts have continued to improve and grew at 7.5% in December, the fastest pace in 3 months. Also, orders actually picked up in December by 13.1%, further supporting our expectation for a rebound in Q1 GDP.

“Housing starts have continued to improve”



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