

Brazilian growth to end 2011 on a stronger note

“Inflation declined in December to 6.5%”

Following a sluggish third quarter in which Brazilian growth remained broadly flat, November saw a pick up in activity. Industrial production, after three consecutive months of decline recorded a 0.3% month on month rise. Additionally, the unemployment rate fell from 5.8% to 5.2% (the drop was partly due to seasonal factors), and consumer confidence also rebounded

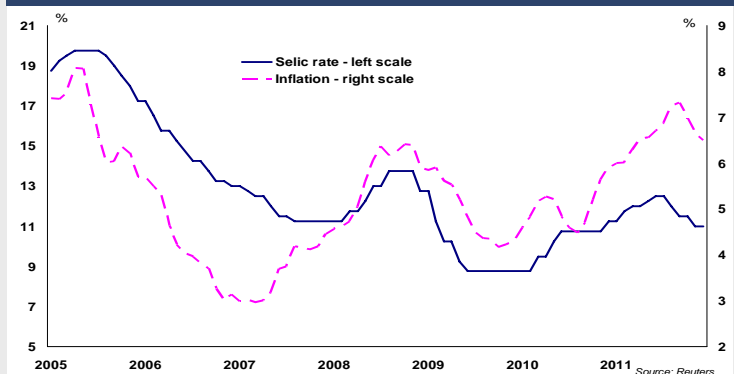
in November. Other positive data flow included the December inflation rate, which came in at 6.5% (the upper range of the central bank’s target), from 6.6% in November. The decline in inflation has enabled the Banco Central do Brazil (BCB) to avoid being in the uncomfortable position of exceeding the inflation target in the midst of an easing cycle.

Indeed, with the European debt crises hurting Brazilian growth in 2011 (likely to be 3%, down from 7.5% in 2010), the central bank has cut the Selic rate by 150bp in recent months to support the economy. The authorities also removed credit curbs and slashed taxes on some goods and investments in order to revive flagging credit growth. Total lending did rebound in November, rising 2% over the month from 0.6% in October. Mortgage finance also increased in November, bringing the annual rate of growth to an impressive 46%, with the government’s ‘My house, My life’ social housing programme aiming to construct two million social housing units between 2010-2013, with a budget of R\$72 billion. This includes providing subsidised mortgages to low income families.

Looking ahead, we expect further monetary easing from the BCB in 2012, with the Selic rate likely to be cut to 10.5% at the upcoming meeting on Thursday, 19th. Although inflation is now within the central bank’s target range, there are still upside risks. Primarily, the minimum wage rising 14% in 2012 could put upward pressure on prices, and with a tight labour market (unemployment is at half the rate it was 5 years ago), we expect unions to bargain harder for pay rises. On the other hand, rising wages will fuel domestic demand, possibly counteracting the headwinds from a global slowdown.

“The Selic rate will likely be cut in the upcoming meeting to 10.5%”

Inflation falls to a 9 month low



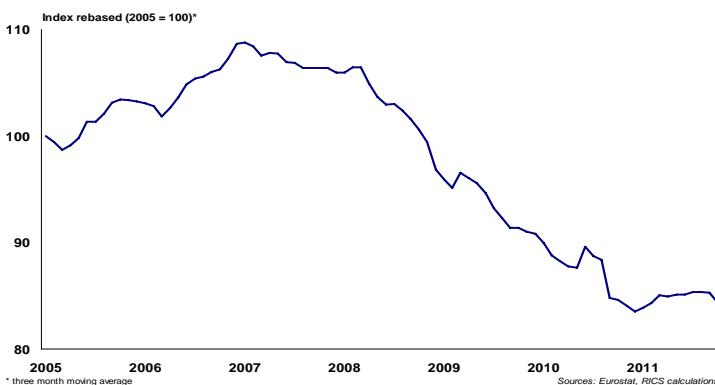
Negative outlook for Euro area construction sector

“Sharp drop in sentiment and tighter credit conditions will likely weigh on the construction sector”

Euro area construction output data for November is due on Wednesday 18th from Eurostat. Taking a three month moving average of the data to smooth through the monthly volatility – something inherent in construction data – output, is broadly flat on year ago levels and 22% below its January 2007 peak.

Nevertheless, we expect output to start trending downwards over the next six months. There are two main reasons for this. First, uncertainty

Construction output is still 22% below its January 2007 peak



related to the sovereign debt crisis continues to weigh on confidence in the region, particularly in the construction sector. Indeed, in December the European Commission’s headline economic sentiment index for the euro area fell to the lowest level since November 2009, while its builders’ confidence reading fell to the lowest level since August 2009.

Second, alongside the low confidence levels, due to the impact of elevated uncertainty, bank sector funding stress has intensified markedly. This is likely to translate into tighter credit conditions, further exacerbating the negative trend in construction sector activity. One measure of bank sector stress in the region is the spread between Euribor, the unsecured interbank lending rate, and Eurepo, the secured interbank lending rate. A wider spread indicates that banks face increasing difficulty accessing funding. The spread between the benchmark 3 month rates has widened dramatically since the beginning of July from about 26 basis points (the normal margin) to 115 basis points presently (though it has come down from a recent high of 124 basis points). To put that into perspective, at the height of the Lehman crisis, the spread widened to 184 basis points. In our view, the sharp drop in sentiment and the intensification in money market tensions are only now starting to be felt in the construction sector; as such we are anticipating a 10% fall in construction output by year end (2012) and see the risks to this forecast skewed to the downside.

“Construction output in the euro area could end 2012 10% lower”



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UK commercial property sector faces renewed challenges

“Both capital and rental values are flat-lining for now”

The December data from IPD on the UK commercial property market is due for release on Monday 16th. This is likely to show a continuation of the trend that was in place for much of last year with both the capital growth and rental value indices flat-lining. After bottoming out in the middle of 2009, the former series did see a 15% recovery over the subsequent twelve months however it has since been trading

water. Meanwhile, the latter was on a downward trajectory until the end of 2009 and from then on has been bouncing along the floor.

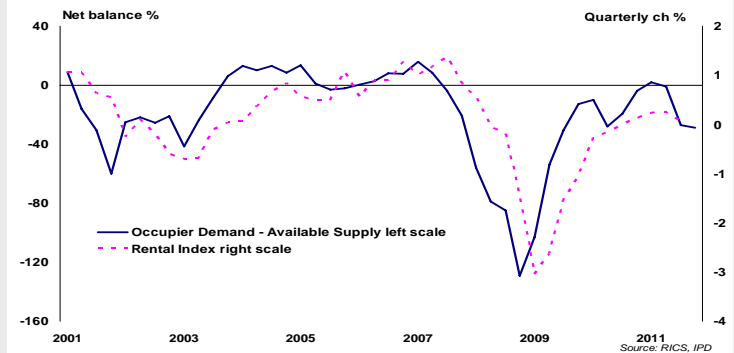
The recently released RICS Commercial Market Survey for the fourth quarter of 2011 suggests that sentiment in both the occupier and investment markets has turned more negative which is not altogether surprising given the run of adverse macro news. The net balance measure for occupier demand to take up space recorded a second consecutive negative reading while the availability net balance remained in positive territory suggesting more respondents are seeing an increase rather than decrease in supply. Significantly, the adjacent chart indicates that subtracting the RICS availability indicator from occupier demand measure provides a good lead indicator of the quarterly change in the IPD rental index. On the basis of the latest numbers, this suggests that the flat trend in rents is likely to persist for at least the first three months of 2012.

Beyond that, the emerging trend in the jobs market will be critical in determining whether the RICS occupier demand series moves further into

negative territory. As it happens, the next set of labour market statistics is due on Wednesday 18th. Our suspicion is that there is more bad news in the pipeline which could see the unemployment rate climb from its current level of 8.3% to nearer 9%. In these circumstances, it would not be improbable to envisage the headline IPD rent index beginning to weaken once again. This concern over the rent outlook allied to the on-going shortage of mortgage finance for the real estate sector helps to explain the more cautious results in the RICS report on the outlook for both capital values and investment transactions.

‘The jobs market will be critical in determining whether occupier demand continues to weaken’

Demand supply balance points to a flat trend in rents at best



Australian mortgage approvals subdued but rising

“Mortgage approvals were subdued throughout 2011”

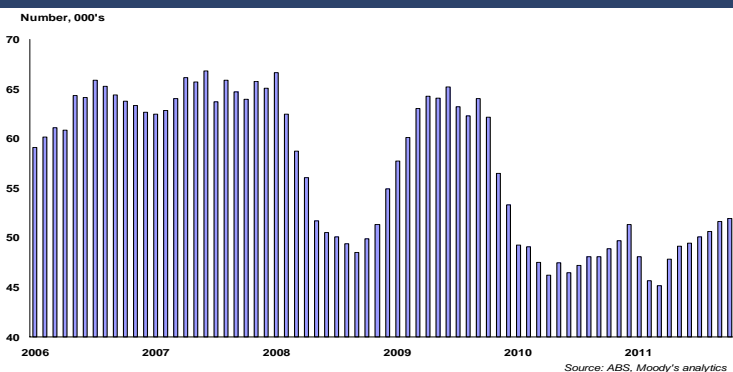
The negative impact of the continuing eurozone crisis resulted in a softer second half to 2011 than we previously anticipated. Alongside this, the Reserve Bank of Australia (RBA) decided the inflation outlook afforded scope for a reduction in the cash rate, and duly trimmed 25 basis points in both the November and December meetings. While no end-game is

in sight for Europe, and Australia’s major export markets in Asia begin to slow, we continue to see an easing bias for the RBA, and expect at least one further cut in the cash rate during Q1. The housing market, which broadly saw activity fall during 2011, should benefit from the change in

policy stance.

Indeed, the supply side of the market remains weak (dwelling unit approvals fell to an 18 month low in October), but the demand side has seen some very limited improvement. Mortgage approvals data, of which the November figure is released on Monday 16th, were subdued throughout 2011, rising steadily albeit modestly from March onwards when they reached a post-recession nadir of 45,196 (against the decade average of 55,863). The tightening in policy between October 2009 and 2010, alongside the completion of the government’s first home buyer scheme clearly stymied demand for housing finance, despite a slight pick up at the end of 2010. The October number (51,981) was the strongest reading in just under two years, and the medium term outlook for policy should further support housing finance commitments into Q1. A potential downside risk to this view is the employment picture.

Mortgage approvals remain subdued



Developments in the labour market will weigh heavily on the outlook for housing in 2012, especially the demand for mortgage finance. The latest labour statistics for December are published on Thursday 19th by the Australian Bureau of Statistics, and are likely to show the unemployment rate maintain its position around 5.2%. It ticked up in November as the total number of employed fell by 39,900.

“The medium term outlook for policy should support lending for house purchase in Q1”

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