

Interest rates are a key risk for the French housing outlook

“Mortgage lending remains flat”

French new home sales for Q4 and housing starts for January are due Tuesday 22nd, while French mortgage lending is published in the ECB M3 breakdown on Friday 25th. Overall, the data should indicate a broad recovery in demand and supply back to around their long run averages, although mortgage lending remains flat rather

than growing. Indeed, total new home sales have rebounded sharply since 2008 where they fell to 1,514 in Q4, and were back up to 29,989 in Q3 2010. Monthly housing starts are a far more volatile series, but after taking a 6 month moving average to observe the underlying picture, it appears the trend has stabilised around the long run average of 28,800. Annual growth in mortgage lending is broadly flat, which compares with the long run average rate of about 15%.

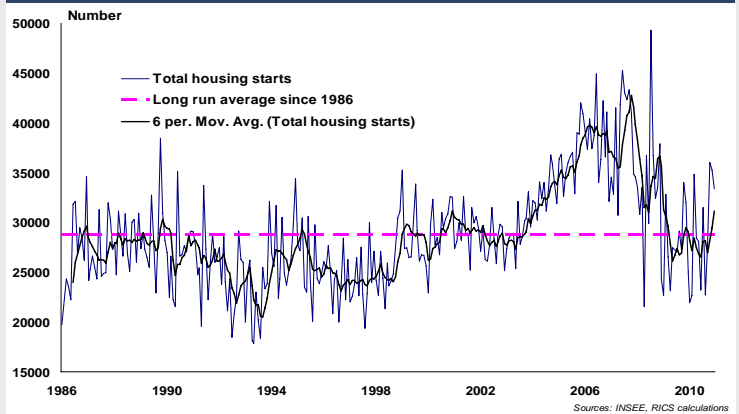
Looking forward, the evolution of these housing indicators will depend heavily on the state of the economy. Here the evidence is broadly supportive; GDP data released this week showed the economy continuing to grow at a slow but steady pace (0.3% q/q). Meanwhile, leading indicators such as the composite PMI index reached a 4-month high of 57.8 in January, which if sustained suggests upside potential to the next GDP print. Six consecutive quarters of economic growth appear to be finally feeding through to the labour market; the unemployment rate has fallen from its post-crisis peak of 10% in November 2009, to 9.7% in the last reading.

Sustained growth and a gradually improving labour market is good

news for the house building sector. It is unsurprising then that builders' confidence, whilst still negative, has improved to its highest level in January since October 2008 according to the European Commission's monthly sentiment data. However, a key risk facing the sector is the future path of interest rates; the ECB has turned increasingly hawkish in recent months on the back of above target inflation readings and is signalling it may soon begin to hike rates .

“Composite PMI hits a 4 month high of 57.8”

Housing starts around long run average



Hong Kong property continues to broach new heights

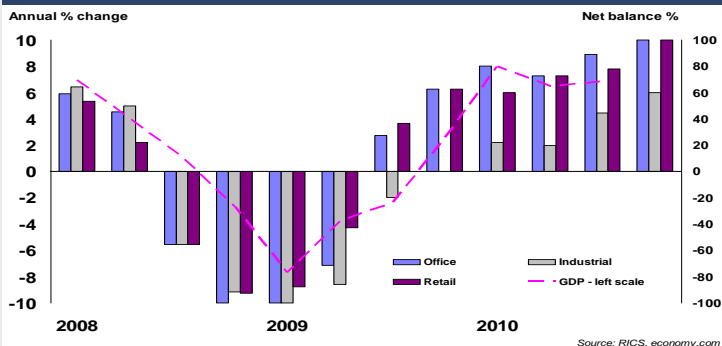
“Growth recovered from the nadir of -7.7% in 2008 to 8% in Q1 2010”

Some key economic data are released in Hong Kong next week, as the Census and Statistics Department (censtatd) release employment data for the three months to January on Monday 21st and CPI inflation for January on Tuesday 22nd. Labour statistics, calculated using a 3 month moving average, have been encouraging of late, with the unemployment rate dropping to 4% in

the three months to December from a post crisis high of 5.5%. Job creation has also been improving, as the economy added 22,000 jobs in the last three months of the year.

Also published next week is GDP for Q4 and for 2010 as a whole, which will be released on Wednesday 23rd as part of the Hong Kong Financial Secretary's Budget Speech. Growth has been strong throughout 2010, recovering well from the sharp loss in output caused by the financial crisis; the nadir of -7.7% has been reversed and the economy grew at 8% in Q1, before easing slightly to 6.5% and 6.8% in Q2 and Q3 respectively. The bullish performance of the economy as a whole is seemingly reflected in the property market. The recently released RICS Global Commercial Property Survey for Q4 2010 shows that the commercial real estate sector is continuing to perform strongly; sentiment from property professionals remains positive as the outlook for both rents and capital values sit near the top of RICS standings. Indeed, rental expectations for office and retail property returned a net balance result of +100, indicating that all respondents anticipate rents to increase over the coming three month period.

Rental expectations have improved in line with GDP



Notwithstanding this, downside risks to both growth and the property market persist. The CPI measure breached the 3% target in December, coming in at 3.1%; the highest annual growth since November 2008. Indeed, in the latest release censtatd said the economy is likely to face higher inflationary pressures in the coming months. This is due in part to the pick-up in import costs amid rising global food and commodity prices, as well as the gradual build up of domestic price pressures in the face off the strong pace of economic expansion.

“RICS results show that commercial real estate is continuing to perform strongly”



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Inflation in danger of ruining Brazil's party

"Inflation at a 6 year high of 5.99%"

Next week sees the government of Brazil announce its budget for 2011 (Thursday 24th). The same day, the unemployment numbers and credit report will be released for January. The recently planned budget cuts of \$30 billion to rein in inflation have not convinced the markets, as inflation expectations have continued to rise for the 10th consecutive week to stand at

5.75%. Indeed, with inflation at a 6 year high (5.99% in January), there is a real danger of inflation expectations becoming unanchored. The tight labour market is a major contributing factor to the inflationary pressures in the economy, with the unemployment rate in December coming in at a record low of 5.3%; Brazil's central bank has a 4.5% inflation target for 2011 and 2012. Indeed, the central bank has been urging the government of late to cut expenditure in the fight against inflation. The alternative route of monetary tightening will almost certainly exacerbate the appreciation in the currency.

Meanwhile, in the commercial property market, the continued rise in the general price level as well the strong economy is supporting the boom in capital values recorded in the latest Q4 2010 RICS Global Commercial Property Survey. The survey projects capital values to continue rising in the coming months, as well as rental expectations. Tenant demand has increased over the last quarter, and the current supply constraints in properties available will exert upward pressures on commercial property prices in the medium term. Investment demand is still growing, but with the government keen to halt or reverse the continued appreciation of its currency, this could be a

downside risk for potential international investors in the coming months.

Looking forward, the size of the fiscal retrenchment will be a major factor in deciding the scale of interest rate hikes by the central bank over the coming months. They will be keen on further fiscal rather than monetary tightening to control inflation.

"Government plans to cut expenditure by \$30 billion in 2011"

Rental expectations rise on back of increasing inflation



Cost of money set to edge upwards in the UK as mortgage finance remains tight

"Inflation back on target if MPC raises base rates in line with market expectations"

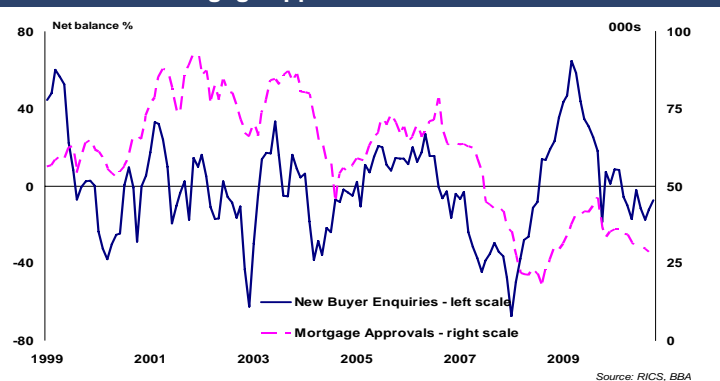
The past few days have been challenging ones for policymakers in the UK. CPI data showed that inflation climbed to 4% in January, while labour market statistics recorded the number of people out of work again edging upwards. This contrasting picture was reflected in the comments of Mervyn King at the publication of the latest Inflation Report. The key chart outlining

the central projection for inflation showed the headline rate to be broadly back at the 2% area in two years time if interest rates move as the market expects (75 basis points of increases over the next twelve

months). However he went out of his way to stress that it was premature to conclude that monetary policy would follow this path.

For much of the property sector, the prospect of earlier increases in the cost of money than previously seemed likely is undoubtedly a concern. But market linked borrowing rates, particularly for mortgages, have already begun to creep upwards. Reflecting this, an official endorsement through a modest hike in the base rate may itself be less significant than it at first appears. Meanwhile, the housing market is unlikely to derive much succour from the outcome of Grant Shapps summit this week designed to deliver more finance towards first time buyers; early indications are that a lot more work is still needed on product development.

Mortgage approvals set to remain flat



Key pieces of news over the coming week include the release of the minutes from the February MPC meeting on Wednesday 22nd which will show how many members voted for a rate hike. On the same day, the latest lending figures from the British Bankers' Association are likely to demonstrate the importance of providing more money for new entrants into the housing market. Following on from this, the CBI Distributive Trades Survey (Thursday 24th) will give a feel for retail sales in February while the second stab at Q4 GDP (Friday 25th) may show the drop in output in the final part of last year was a little less dramatic than initially estimated.

"BBA data will demonstrate the need for more finance in the housing market"

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