

Reserve Bank of India to leave interest rates on hold for now

“WPI inflation dropped from 9% in November to 7.5% in December”

The Reserve Bank of India (RBI) is due to meet on Tuesday 24th in the wake of increasing evidence that inflation is now past its peak. The headline, and most closely watched, WPI measure of inflation decelerated in December to just short of 7.5% (annual rate) from more than 9% in November. On a month on month comparison, the inflation index actually rose (by 0.5%) so the decline in

the annual rate was a direct result of helpful base effects; last December vegetable prices rose particularly sharply. Nevertheless, the underlying picture is clearly moderating which will be welcome news for the authorities. That said, we are inclined to believe that the RBI will choose to leave interest rates on hold for the time being. Expectations for economic growth have been revised downwards in recent months with the FY2012 outturn now likely to come in around 7.3%. However, the tone of recently released sentiment surveys has been a little more upbeat with the manufacturing PMI index, most notably, climbing to a six month high.

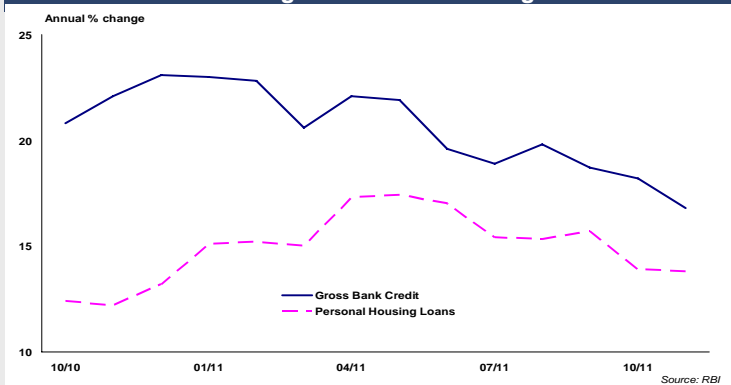
The RBI has already conducted another open market operation in the early weeks of the New Year, purchasing INR 120bn of government securities. This is the seventh round of such activity over the past couple of months. Critically, this action should not be interpreted as an easing in policy. Rather, it is very clearly an attempt to prevent an unintended tightening in liquidity which has been visible in the interbank rate hugging, and at times breaching, the upper end of the existing policy band. Further measures to address this issue are probable during the first quarter as the stress in the market persists in the face of slowing

capital inflows and a current account deficit.

The impact of previous rounds of monetary tightening does appear increasingly apparent in the take-up of credit. Growth in loan demand has slowed to an annual rate of 17% from an average of 22% in the first half of 2011. More specifically, the equivalent numbers for housing related loans are 13.8% and 16%. This more moderate trend in mortgage finance is consistent with some anecdotal reports of lower levels of residential sales activity.

“The open market operations are designed to prevent an unintended tightening in liquidity”

Loan growth is decelerating



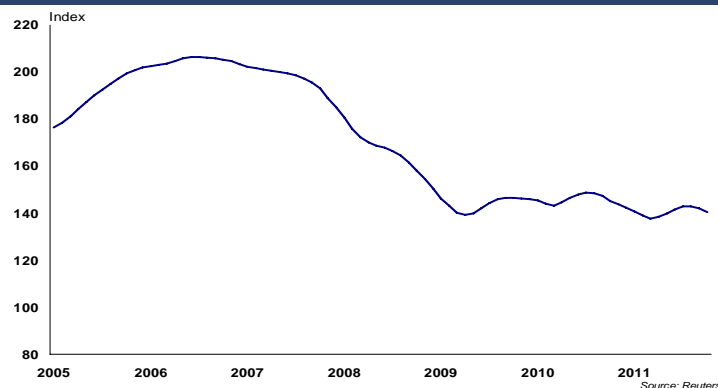
US housing market recovery looks to gather momentum in 2012

“Builders confidence increased to its highest level since 2007”

The New Year has brought with it a marked improvement in the housing market dataflow. Sentiment has become less pessimistic, with the January NAHB Housing Market Index (a measure of builders' confidence in market conditions) reaching a four and a half year high. This was preceded by November's housing starts recording a 9% month on month rise to reach its highest level in 18 months.

The rise in sentiment and ground breaking activity is a sign that home builders are encouraged by the improving domestic macro picture

Case-Shiller index has been broadly stable for most of 2011



including the latest non-farm payrolls, which increased by 200k. Indeed, new home sales reached a seven month high in November, with unsold inventory also at their lowest level since 2007, aiding the fragile housing sector to gather momentum going into 2012. Additionally, the last minute extension of the payroll tax cuts by Congress has slightly alleviated worries that gridlock in Washington will hamper the recovery.

Turning to house prices, 2011 has seen them bounce along the bottom of the barrel, with the Case-Shiller 20 city index staying around the 140 mark for the first 10 months of 2011. Home prices seem to be caught in a cross current: valuations (price to rent ratio) have returned to long run average levels but the housing market remains plagued by excess supply and high delinquency rates. Although there have been small signs of an upward trend in housing activity and a stabilisation in prices, we cannot underestimate the downside risks to a still fragile housing market. Foremost among these is the amount of distressed properties on the market, and there could be up to a further million coming onto the market in the next two years. These distressed sales not only sell for less, but also bring down the value of other homes in the area. This in turn will cause more homeowners to go into negative equity, leading to further mortgage defaults and more distressed sales. Breaking out of this vicious cycle should be a central aim of policy makers going forward.

“House prices still being depressed by the distressed sales in the market”



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Measures to cool Singapore housing market affecting sentiment

“House price inflation eased for the ninth consecutive quarter”

Residential property prices eased for the ninth consecutive quarter in Q4 according to the latest figures from the Urban Redevelopment Authority (URA). The URA published the flash estimate of the index in early January, but will follow this up with a more comprehensive release in the coming week. Price growth moderated to 0.2% from 1.3% in Q3 and 2% in Q2. On an annual basis, prices were up by 5.9%, but this was

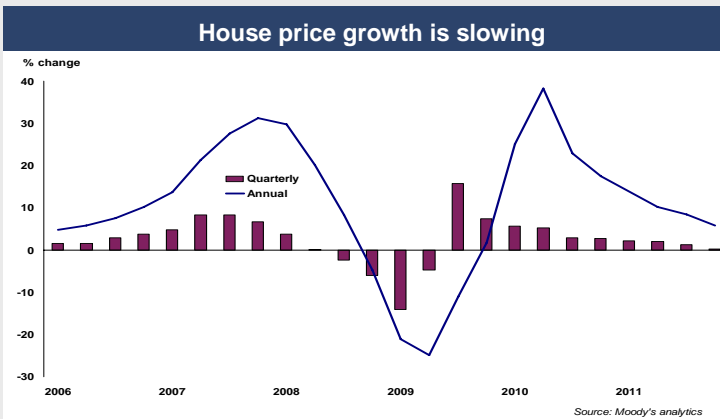
the slowest rate of growth in 2 years, signalling that rising values are slowing. This will come as a welcome development for officials, who introduced a raft of newer measures aimed at cooling the city-state’s housing market. The new steps specifically target foreign buyers.

Singapore residential prices have held up well despite a slowing economy, helped by low interest rates and rising demand from overseas investors, in particular those from China. Indeed, foreign buyers accounted for 19% of all private residential purchases in the second half of 2011, so the newest moves are likely to have a significant impact. Introduced in December, the measures impose an additional 10% stamp duty on non Singapore citizens, effectively raising the price by 10%. For national residents who already own a home, they will have to pay an additional 3% when they buy any subsequent properties. While these actions are unlikely to be reflected in the flash or full Q4 data, we expect them to further dampen price growth in the coming year.

Alongside this, the supply of new homes is set to continue rising after the government released more land for development. 29 sites have been

earmarked for residential development in the first half of this year, which official estimates hope will create 14,000 new homes. The new supply is lower than in the second half of 2011, as the development pipeline remains strong. Consequently, recent land auctions have fetched lower than expected prices, and the share price of developers has also taken a knock. Increasingly, the signs are that the cooling steps have affected sentiment in the residential sector, and we now expect prices to begin falling in the first half of 2012.

“Prices could begin falling in the first half of 2012”



Japanese loan officers survey to show demand for finance continuing to stabilise

“The last survey of Senior Loan Officers suggested that banks had begun to ease credit standards”

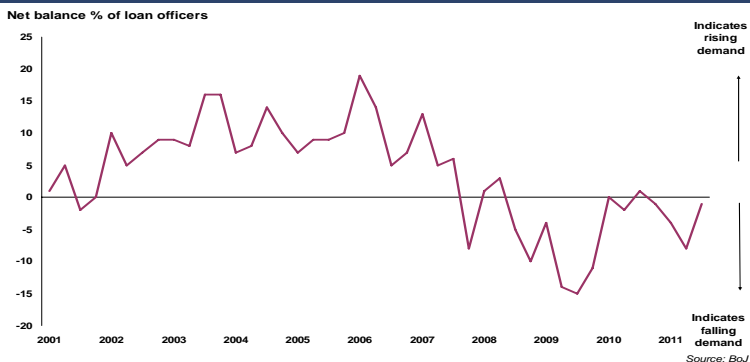
The fourth quarter Senior Loan Officers Survey on Bank Practices from the Bank of Japan is due to be released on Monday 23rd. This is likely to show a continuation of the broadly stable picture in the demand for loans that was visible in the previous three month period. Most notably, the net balance measuring the demand for finance from the real estate and construction sector

was close to zero in the final three months of 2011 suggesting a similar number of respondents had indicated an increase as a decrease (the net balance was -4 in the third quarter). The demand from households for housing related loans was also near zero in the latest report following a

reading of -9 previously. Indeed, the last time this latter series recorded a positive reading was back in the middle of 2008 so even a flatter trend is encouraging in that it may signal a more stable picture emerging in terms of household confidence.

Significantly, the last survey suggested that banks had begun to ease credit standards for approving loan applications albeit only modestly. Whether this pattern persisted into the fourth quarter is more open to question. As elsewhere around the world, increased stress in financial and money markets was visible in the latter part of 2011 as concerns over the European sovereign debt crisis triggered a renewed scramble for safety. This was not quite as pronounced in Japan but there, nevertheless, was a widening in the spread between interbank and official rates. We suspect that this is likely to have led to a little more caution on the part of banks which may well still be evident in the lending data for the early part of 2012. For what it is worth, even the third quarter survey suggested any increased lending was more a function of competitive pressures than a greater appetite for risk.

Demand for housing loans is broadly stable



The good news is that the economic data emerging from Japan particularly from the domestic side is displaying an encouraging level of resilience. However, it will need to continue to do so in the face of the more chequered trend in trade statistics; for the first 20 days of December, exports were 8.3% lower than in the equivalent period of 2010.

“Emerging data particularly from the domestic economy is showing an encouraging level of resilience”

- RICS UK**
 T +44 (0) 20 7695 1682
 pressoffice@rics.org
- RICS Europe**
 T +32 2 733 1019
 ricseurope@rics.org
- RICS Americas**
 T +1 212 847 7400
 ricsamericas@rics.org
- RICS Oceania**
 T +61 2 92162333
 ricsoceania@rics.org
- RICS India**
 T +91 124 459 5400
 ricsindia@rics.org
- RICS Middle East**
 T +971 4 375 3074
 ricsmiddleeast@rics.org
- RICS Asia**
 T +852 2537 7117
 ricsasia@rics.org

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