

Commercial real estate market in Hong Kong remains strong

“The Q1 RICS Survey suggests sentiment towards real estate in Hong Kong remains positive”

Following the stronger than expected Q1 GDP figure published last week, inflation data for April is released by the Census and Statistics Department (censtatd) on Monday 23rd. Prices accelerated at an annual rate of 4.6% in March, up from 3.7% in February and are now at the highest level since July 2008. The underlying inflation rate (netting out one-off government

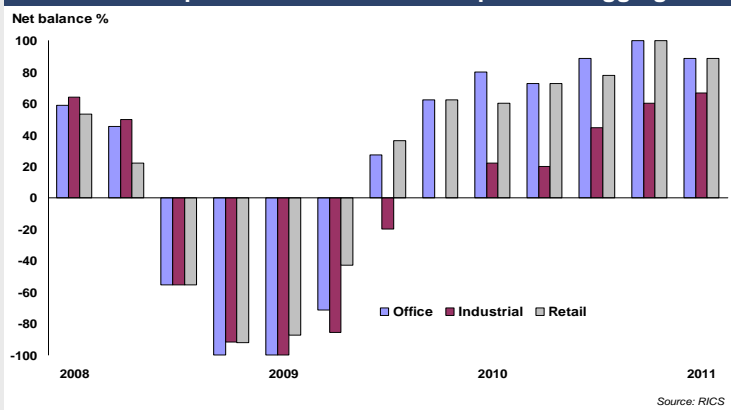
measures) was a little lower, standing at 4.4%. Censtatd officials suggested the biggest contributor to this gain was the enlarged increase in the prices of food and private housing rentals (something that is being seen all across Asia). The sustained low cost of borrowing in the region, while stimulating growth, is fuelling the continued rise in prices of goods and real estate. We expect inflation to ease throughout 2011 as the accommodating policy environment becomes less so.

Meanwhile, the Q1 RICS Global Commercial Property Survey suggests sentiment towards real estate in Hong Kong remains strongly positive. Property professionals in the region indicated that tenant demand is bullish and continuing to underpin the rise in rental expectations; 81% more respondents indicated they expect rents to rise rather than fall next quarter. On the investment side, demand picked up over the quarter to the highest reading for 18 months, while capital value expectations have reached a new survey high. Again, 81% more respondents expect values to rise rather than fall next quarter. This is particularly prevalent for the office and retail sector (where the net balance of respondents swelled to 89%).

Consistent with the RICS data is a Q1 report from Colliers which suggests the trend for commercial property, especially in the office and retail sector, is continuing to rise. Indeed, both the retail price and rental index showed strong quarter on quarter growth in Q1, which was in excess of the growth seen in mainland cities such as Shanghai or Guangzhou. Furthermore, the outlook for Q2 is equally positive, with all indicators expected to improve on the performance of Q1.

“The Q2 outlook is equally strong, with all indicators expected to improve on the performance of Q1”

Rental expectations for Industrial space are lagging



US housing market moving sideways

“New home sales rise 11% in March”

The coming week sees the release of key residential property data; new homes sales (April) are published on Tuesday 24th followed by the FHFA house price index (Q1 2011) the next day. New home sales increased in March by 11% to an annual rate of 300,000, continuing the sideways trend of home sales over the past 6 months (they have averaged 300,000 over the

past half year which is roughly 50% below the long run average). Additionally, the low level of housing starts seen since the start of the year is reflected in the month's supply of new homes, which fell in

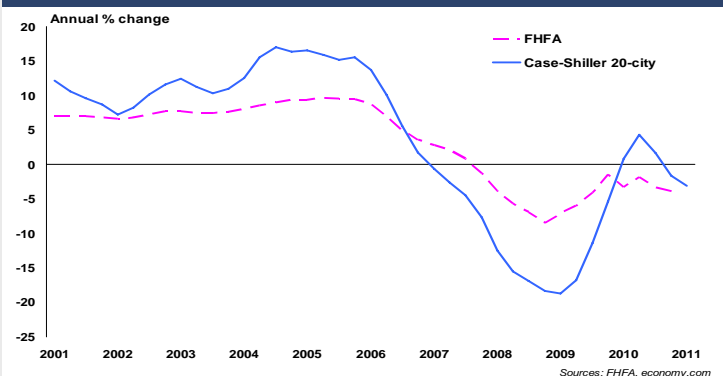
March from 8.2 to 7.3. Existing home sales, which account for about 90% of total home sales in the US, increased by 4% in March to an annualised rate of 5.1 million. Significantly, distressed sales accounted for 40% of all existing home sales in March, and it is estimated that the total number of homes foreclosed, or on the verge of being foreclosed, number between 8 and 9 million.

House prices continue to fall according to the quarterly FHFA house price index (HPI), with prices in Q4 2010 slipping 1% quarter on quarter and 4% on the year. The FHFA HPI is 16% below the pre-recession peak and has fallen much less than the Case-Shiller HPI. This is due to the fact the FHFA only includes homes which have been purchased with prime, conforming loans (up to \$700,000) insured by government sponsored agencies. Hence, the index will exclude high end homes which require a mortgage larger than \$700,000 and will also exclude non-conforming loans such as sub-prime loans. It is not surprising therefore, that between 2000 and the peak of the housing bubble, the Case-Shiller 20-city index which does include aforementioned loans, increased by 105%, while the FHFA HPI showed a more modest increase of 62%.

The Federal Reserve's latest minutes from their April meeting forecast a slow recovery in the housing market, restrained by the massive supply overhang and depressed home values.

“FHFA house price index fell 4% during 2010”

FHFA index less volatile than the Case-Shiller index



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Property sector stronger in faster growing European economies

“Rent expectations are most upbeat in Germany and France”

The coming week sees a raft of business sentiment surveys released in the euro area. Most notably, flash estimates for the purchasing manager indices in Germany, France and Italy on Monday 23rd will be followed by the IFO and INSEE reports on Tuesday 24th. Finally, on Friday 27th, the European Commission will update its monthly sentiment numbers. The likelihood is

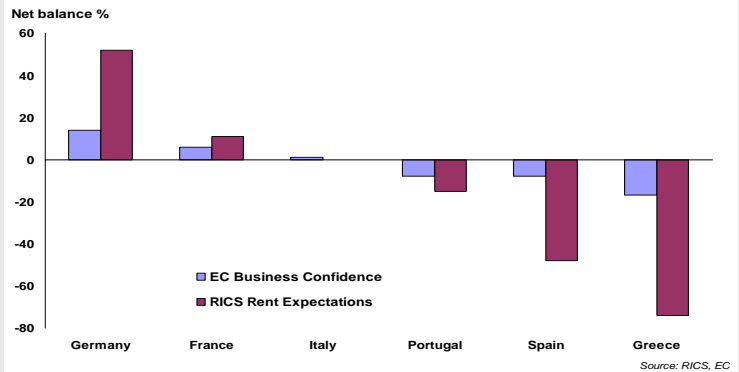
that the overriding picture to emerge will be that Germany is continuing to see particularly strong growth and that France is also enjoying the fruits of recovery. In contrast, business confidence is likely to remain weaker in those countries who are either being bailed out or where speculation of such an eventuality is very much to the fore.

Interestingly, the results of the Q1 RICS Global Commercial Property Survey broadly chime with the picture painted by the business confidence indicators; this is clearly demonstrated in the accompanying chart, which shows rent expectations to be most upbeat in Germany followed by France and most negative in Portugal, Spain and Greece (Ireland is also very much in this latter camp). It is noteworthy that the picture on the outlook for rents is reflective not just of stronger demand to occupy premises in the group of countries led by Germany but also a lack of stock. Specifically, in the case of Germany the net balance reading for available space was -20, that is 20% more respondents saw availability drop rather than rise in Q1. This was most marked in the office sector.

Meanwhile, the debate continues to rage as to how best to deal with continuing problems in Greece. The ECB remains steadfast in its opposition to any form of restructuring which may in part be a function of the fact that it has bought something in the region of €45bn of Greek bonds over the past year. Highlighting the approach it clearly prefers, Lorenzo Bini Smaghi suggested that Athens needed to “convince its citizens to pay taxes” and “retire at 65 as everyone else does in the western world”.

“The ECB remains steadfastly opposed to any form of Greek restructuring”

Business confidence and rent expectations move in tandem



UK property lending remains subdued as construction workloads edge up

“The RICS measure of construction workloads rose in Q1 contrary to ONS data”

The second release for Q1 UK GDP is due to be published on Wednesday 25th. The first estimate suggested that the economy had grown by 0.5%, just about making good the contraction in the final three months of the last year. Significantly, a suggested 4.7% drop in construction output in the early part of 2011 played an important role in limiting the extent of the rebound in the headline

growth number. Subsequent data showing a detailed breakdown of the construction numbers point to a slightly more modest decline in output from the building sector. However it is not of a sufficient magnitude to,

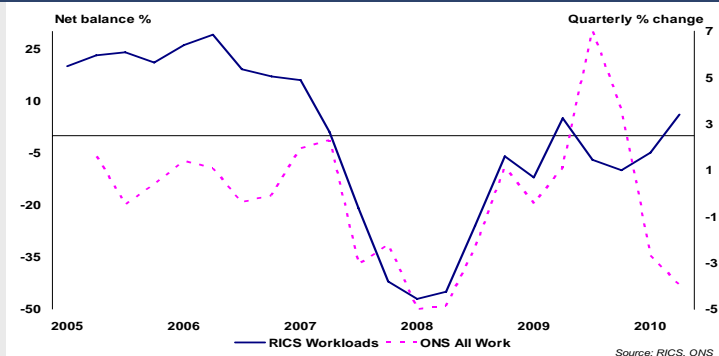
on its own, lead to a revision of the headline GDP figure. That said, the latest RICS Construction Market Survey suggests that even this slightly less negative assessment of developments in the industry is too downbeat and that workloads actually rose in the early part of this year.

The latest lending figures from the British Bankers’ Association (BBA) are due for release on the same day. The most closely watched element of this release typically relates to the mortgage numbers; approvals have been edging up in recent months with the March reading for purchases of property climbing to its best level since July last year. Even so, at 31,660 it still stands way down on the long run average of almost 58,000 per month. Further modest increases in the number of mortgages being granted are likely in the coming months but this will still fail to address the challenges being faced by first-time buyers attempting to take their first steps on the property ladder.

The other element of the BBA numbers worth following relates to corporate lending. Despite the coalition government’s attempt to commit banks to providing more finance to businesses the evidence that this is delivering results is pretty sketchy at best. Indeed, the data relating to the real estate and construction industries is particularly disappointing but consistent with much anecdotal evidence received by RICS that development finance still remains in short supply.

“It is not clear that banks are as yet providing more finance to business”

Q1 construction work edges up casting doubt on ONS data



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