

## Chinese tightening shows some effects in PMI surveys

**“PMI surveys are suggesting a modest slowdown”**

The National Bureau of Statistics will publish February data for both CPI and PPI inflation, fixed asset investment, retail sales and industrial production, on Friday 11<sup>th</sup>. Interest is likely to be directed at the CPI number, as the global community looks to see if the monetary brakes being applied by the People’s Bank of China (PBoC) have

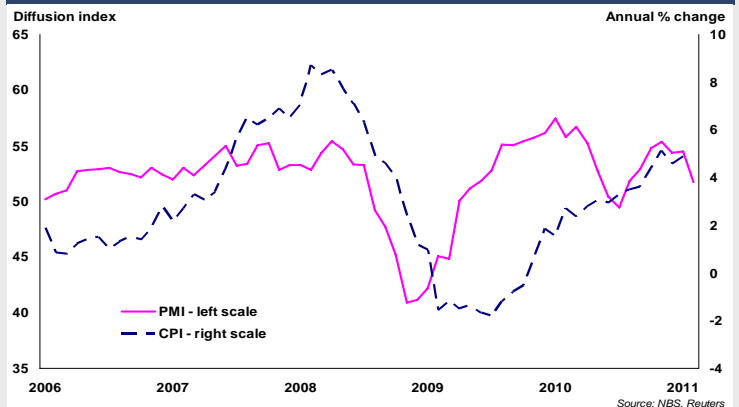
had any effect on rising inflation. Interestingly, next week’s release comes in the wake of recent PMI surveys suggesting a modest slowdown in the Chinese economy; the HSBC/Markit manufacturing survey eased from 54.5 in January to 51.7 in February, representing a 7 month low (where any reading above 50 marks expansion). This reading suggests that growth may have peaked, and we now expect a continuing slowing trend in the sector from Q2 onwards.

Inflation in January, while surprising on the downside of market expectations, showed an increase on December’s figure; annual growth in the CPI bloated from 4.6% in December to 4.9% in January. Moreover, stripping out the effects of rising global food prices, non-food CPI picked up 2.6%, the highest reading in over 10 years. The upward trend in PPI also continued in January, as it rose to 6.6% year on year. Significantly, the upward forces acting on prices appear to be feeding through to wage growth; 11 major cities have indicated they will raise the minimum wage again this year, after doing so in 2010. Secondary effects in the form of rising wages complicate matters for the PBoC; they are keen to control accelerating inflation but weary of attracting further speculative inflows.

Looking forward, it is unclear how much additional tightening the state will deliver and what the impact will be on the real estate sector. Past tightening measures have yet to fully feed through, but there is already some evidence that growth in the wider economy is beginning to moderate. If this slowdown persists, medium term inflation risks are likely to subside and therefore, additional tightening measures maybe shelved for the time being.

**“Inflationary pressures in Asia, China in particular, remain acute”**

### PMI slowdown suggests inflation may ease



## UK construction industry not yet out of trouble

**“The monthly CIPS survey shows sentiment to be improving”**

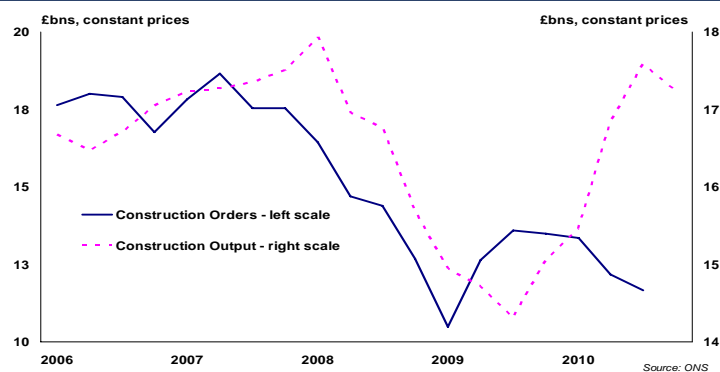
Data on construction output for January is due to be released on Friday 11<sup>th</sup>. The fourth quarter number, in aggregate, showed a drop in output of 2.5% compared with the previous three month period; the December figure was particularly depressed by the unusually poor weather experienced during the final few weeks of last year. The new work component was, predictably

enough, most badly affected with output (in volume terms) dropping by almost one fifth between November and December. By way of contrast, the headline number for repair and maintenance work declined by 12%. For weather related reasons alone, it would not be

unreasonable to expect the January data to show something of a rebound. But how far the underlying recovery in the construction sector that was visible through much of 2010 extends into the current year is more open to question.

On the positive side, the latest CIPS survey of the sector (covering up to February) suggests activity has picked-up in the early months of 2011, that this improvement is fairly broadly based and that businesses operating in this part of the economy retain a degree of optimism about the prospects. Meanwhile, the responses to the most recent (quarterly) RICS Construction Market Survey were altogether more downbeat with the net balances for total workloads, employment and profit margins over the next twelve months all remaining in negative territory. Significantly, the monthly European Commission survey shows that improved weather conditions has led to a modest increase in building activity but that confidence remains unusually weak.

### Construction orders points to weaker trend in output



The trend in order books (according to official data) also provides some grounds for viewing the prospects for the sector with some level of caution. The latest reading shows that total orders in the third quarter of last year dropped to their lowest point since the first few months of 2009. Moreover, with the big cuts in government capital spending programmes about to kick-in, this challenging picture could soon become even more problematic.

**“But order books have slipped back and the big cuts in public spending are about to kick-in”**



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## Canadian economic recovery faster than anticipated

**“Housing starts edged up 0.8% in January”**

The coming week sees a raft of economic data relating to the Canadian real estate sector. Starting with building permits (January) on Monday 7<sup>th</sup>, followed by housing starts (February) on the 8<sup>th</sup> and finally new home prices (January) on Wednesday 9<sup>th</sup>. Housing starts edged up in January by 0.8% to an annualised rate of 170,400, although

they are 11% down on the year. This suggests that building activity has considerably slowed from the heights of late 2009 and early 2010 when it recorded double digit growth. New home prices paint a similar picture, rising 2.1% on the year in December but considerably slower than the high of 3.3% growth reached in mid 2010.

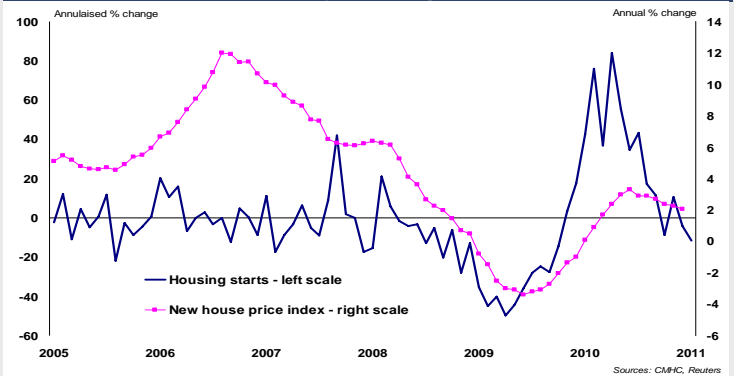
Looking forward, the recent moderation in the growth of house building and prices will likely continue for the following three reasons. Firstly, new mortgage rules introduced by the government in January will make lending more stringent. These include shorter repayment periods for borrowers and reducing the amount homeowners can borrow when refinancing their mortgages. Secondly, we anticipate the Bank of Canada (BoC) to re-start tightening monetary policy in Q2 2011, especially given the strong Q4 GDP data, which recorded annualised growth of 3.2% in addition to Q3 growth being revised up by 0.8% to 1.8%. Indeed, in the statement released following the BoC's monetary policy meeting in February, BoC officials noted that the Canadian recovery is proceeding faster than anticipated. The final factor, one not to be underestimated, is the continued rhetoric from authorities warning households not to take on too much debt. Indeed,

the latest such warning came from the finance minister, in which he stated that the government understands the importance of not taking on more than you can afford and the dangers of rising debt levels.

However, in spite of this slowdown in growth we expect in the home building sector, a complete reversal in trend is unlikely. With employment back up to pre-recession levels, a robust labour market will support the housing market in the coming year.

**“New housing price index up 2.1% on the year”**

### Canadian property sector growth moderates



## European housing recovery to continue, but risks remain

**“RICS expect a gradual though uneven recovery in European housing markets...”**

The 2011 RICS European Housing Review was published this week. The main highlights of the review year, 2010, are: 1) Although the bulk of European housing markets are now recovering in terms of prices, there is marked geographic variation, with some still experiencing bust conditions such as Ireland, Hungary and Cyprus, while others are booming such as the Nordics.

2) Unlike in previous recoveries, prices are generally leading other housing indicators such as transactions and building. This is partly due to low interest rates, which are on the one hand stimulating demand

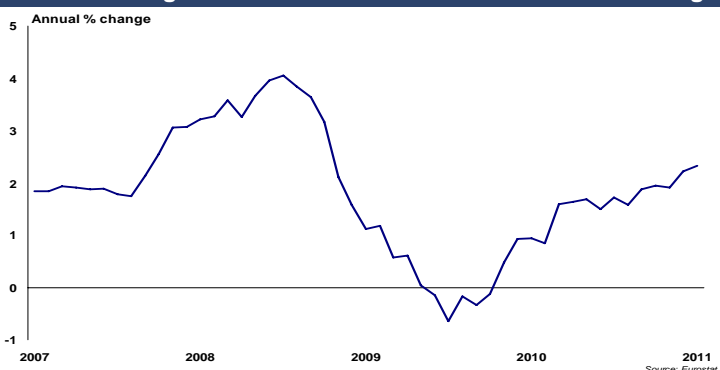
and on the other hand holding down default rates and a wave of repossessions. 3) Contrary to expectations, mortgage debt deleveraging has only taken place in Ireland; across all other countries in the Euro Area, mortgage debt has continued to grow, topping 20% in Slovenia. 4) Residential investment fell across the majority of European markets and where it picked up, it did so only marginally with growth under 5% in the best performer, Sweden.

Looking forward, RICS's central forecast is for the recovery in prices to continue across the bulk of European housing markets, albeit unevenly. On the demand side, we expect that sustained economic growth across the region, set against a robust global backdrop, will feed through to the labour market (a process which appears to be in the very early stages). Meanwhile, development finance is likely to remain restrictive, which should limit any potential supply response.

However, the risks to our central forecast are increasingly skewed towards the downside. Inflation is accelerating in the Euro area (2.4% in January), which is pushing the ECB into hawkish territory. Should it respond with tighter monetary policy (a real near term possibility), mortgage demand could moderate. However, even if the ECB does not tighten policy in the near term, mortgage demand may suffer indirectly through the squeeze exerted by inflation on real incomes.

**“...however, rising inflation skews the risks to our outlook to the downside”**

### Accelerating inflation increases downside risks to housing



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