

## German house price momentum likely to reverse in H2

**“House prices are likely to continue rising in the near term”**

In September we downgraded our German house price outlook, believing the slower pace of economic growth would feed through to the labour market and eventually prices, thereby reinforcing the weaker price dynamic which already appeared to be in train. Whilst we still retain this view, the latest data indicates the previous softness in prices was more of a blip

than a change in trend. Consequently, we have pushed back our expectation of the eventual inflection point in house price growth to H2 2012; in other words, we give the current upturn another six months or so.

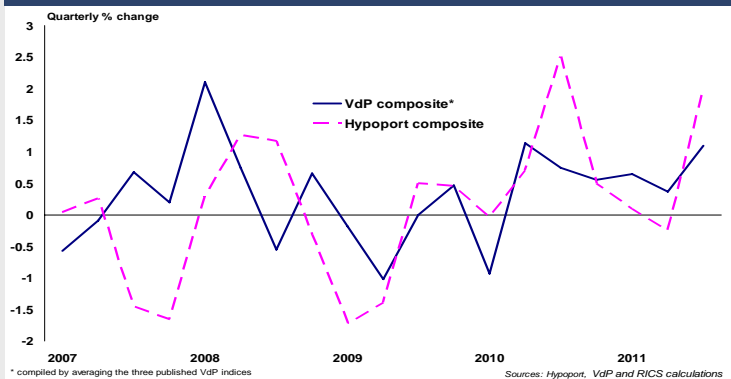
The two main house price indices - Hypoport (monthly) and VdP (quarterly) – accelerated sharply in Q3. The headline Hypoport index increased by 2% over the quarter (or 8.2% annualised), whilst a simple average of the three published VdP indices (VdP don't publish a headline index as such) increased by 0.9% over the quarter (or 3.8% annualised). Although it's not clear exactly why price growth slowed in Q2 and rebounded in Q3, a large part of the explanation behind the general upturn in German house prices is the strengthening labour market. Indeed, having peaked at 10.8% in March 2005, the unemployment rate has since fallen more or less continuously, reaching 5.5% in October, the lowest at any point in the last 20 years.

Whether this improvement in the labour market continues is another matter. The labour market typically lags economic growth and leading survey indicators (the PMI, the IFO and the EC index) have fallen

sharply over the last 12 months or so, signalling a likely slowdown and possible contraction in growth during 2012. Although further falls in unemployment may well take place in the near term, given the lead/lag relationship between growth and the labour market, the balance of risks surrounding the latter over the medium term is skewed to the upside. This in turn is likely to slow momentum in house prices, which we expect will begin in about 6 months time.

**“Weakening economic growth is likely to weigh on prices over the medium term”**

### House prices have risen on the back of a strong labour market



## Canadian housing sector activity likely to moderate in 2012

**“GDP growth was flat in October”**

Canadian GDP growth looks likely to slow in the final quarter of 2011, with October's GDP reading coming in flat. Activity levels since spring last year have been largely driven by one-off factors. Q2 activity slowed due to supply disruptions caused by the Japanese earthquake and maintenance shutdowns in the oil sector. Supply chains mended and energy producers

reopened in Q3 so the economy was given a boost. But these boosts were mostly absent in Q4, likely resulting in a moderation in growth.

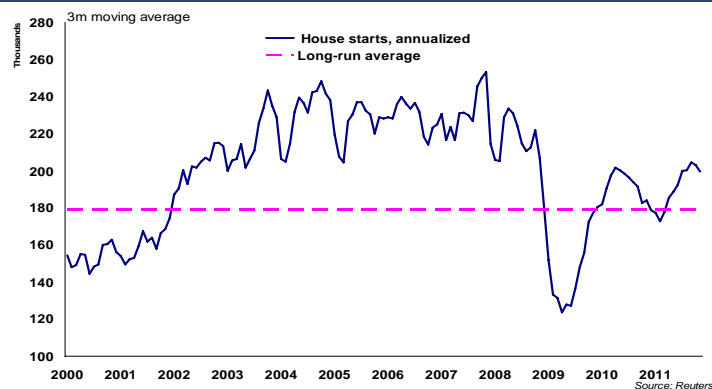
That said, GDP is on track to finish 2011 up 1.7% q/q annualised (down from 3.5% in Q3).

The housing sector's performance broadly mirrored the economy's. Housing starts slumped in November (December's data comes out on Tuesday 10<sup>th</sup>), after showing robust growth in the autumn. November's figures came in at 181k, down from 208k in October (housing starts have averaged 200k in the second half of 2011). The big swings in housing starts can be attributed to the volatile multi-unit housing sector (condominiums). It recorded double digit growth earlier in the year, and now looks to be slowing on the back of the excess build in Q2 and Q3. Indeed, with Canada's housing market hardly being affected by the sub-prime crises, the subsequent low interest environment led to a real estate boom, with sales and prices increasing by double digits in major cities like Toronto and Vancouver. This fuelled fears of a housing bubble, and subsequently, the Bank of Canada (BoC) identified the high level of household debt as a risk to the financial system. Additionally, the BoC introduced macro-prudential measures to stem the rise in housing finance.

Turning to house prices, data from StatsCanada showed the new house price index rising 2.5% year on year in October, up slightly from September. We expect house price growth to be flat in 2012, in line with the slowdown in housing starts. Indeed, recent strong employment gains in the labour market have also slowed, putting an additional dampener on the housing sector.

**“Housing starts slumped in November”**

### Housing starts slow after a strong Q3



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## UK construction sector faces another difficult year

**“The base rate will remain at 0.5% for the whole of 2012”**

A number of important economic releases are due over the coming week. On Tuesday 10<sup>th</sup>, the December RICS Housing Market Survey is due for publication alongside the retail sales monitor from the British Retail Consortium and the Q4 survey from the British Chambers of Commerce. Following on from this on Thursday 12<sup>th</sup>, apart from November industrial production data, the Bank of England will deliver the conclusions

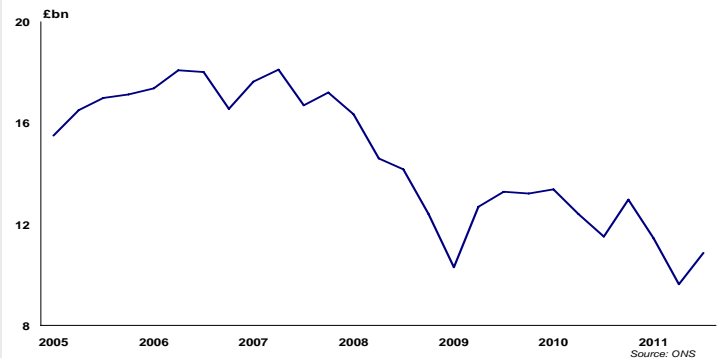
of its latest round of deliberations. No change in the policy stance is likely on this occasion but we are still of the view that the February or March meetings could see a further round of quantitative easing announced, possibly in the region of £75bn. In terms of the base rate, our judgement is that it will remain at 0.5% for the whole of 2012.

Finally on Friday 13<sup>th</sup>, construction output figures for the penultimate month of last year are published. Monthly data on construction is inevitably fairly volatile so needs to be treated with a degree of caution. That said, the October numbers suggest that the volume of output fell by 2.5% compared with September and by 2.7% when measured against construction activity a year earlier. More significantly, the underlying trend tells a not dissimilar story with output in the three months to October just over 1% down on the same period of 2010. Construction orders data, a forward looking indicator, actually picked up sharply in the third quarter of last year to £10.9bn but any positive interpretation of this figure needs to be seen in the context of it being the second lowest reading since the early part of 2009.

Indeed, our suspicion is that the level of construction output over the course of 2012 will be lower than it was in 2011. This will, however, mask huge divergences in activity at a sector level. While both public housing and non-housing workloads could record significant declines, private housing development may show a small increase on the back of the government's mortgage indemnity scheme for new build properties. There could also be modest rises in activity in the infrastructure and commercial space although it would be premature to assume a wall of institutional funding for the former.

**“Construction output could fall by 3% in 2012 as a result of a significant drop in public sector workloads”**

### New construction orders remain weak despite bouncing in Q3



## Softer Chinese data to continue into the first quarter of 2012

**“The softer picture seen in November continued into the final month of the year”**

December data on inflation, asset investment and house prices are released over the coming fortnight, as is the Q4 GDP reading. It is likely to confirm the softer macro picture seen in November continued into the final month of the year with the Q4 GDP figure set to undershoot the 9.1% seen in Q3. The December PMI survey showed a marginal pick up in

manufacturing and services output, after signalling a contraction in November; it rose from 49 to 50.3, but remains some way below the year average (51.4). This weakness is broadly attributed to two sources, the external slowing in demand (caused by the ongoing euro area crisis), and

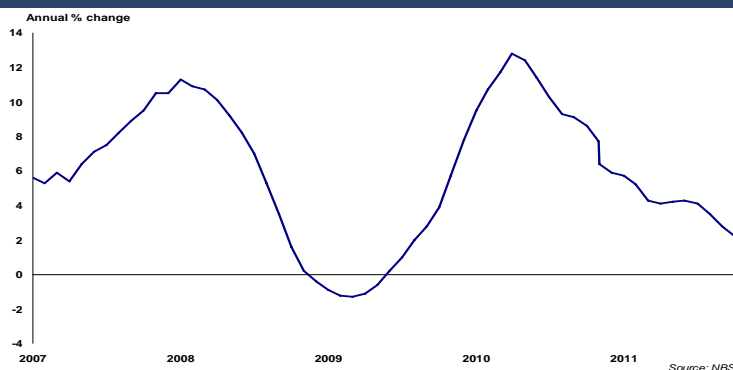
the policy induced correction in the domestic housing market.

Indeed, policy makers set about cooling the red hot housing market after prices shot up in 2010. The series of monetary and fiscal tightening measures employed over the last year have achieved relative success, as price growth dropped from the peak of 12.8% in April 2010 to 2.2% in November. While we now expect a looser stance in policy to support growth, the likelihood is that prices will continue to moderate into the first quarter of 2012. Our view is supported by recent data from Hong Kong based developer Greentown China, which showed transactions fell by 44% on year ago levels in December.

Alongside this, consumer prices have started to slow. The November figure eased to 4% after reaching a three year high of 6.4% in August. It is now at the top of the 2-4% target range. Cooling inflation, along with weakening economic activity, should be a signal for the authorities to ease policy. Having hiked the reserve requirement of banks significantly over 2011, we expect these measures to be relaxed first. The downside to the house price correction is the knock-on effect on asset investment. While the weakness on the demand side is not yet mirrored on the supply side, there has been a drop off in the rate of rising investment into housing projects; the annual rate of investment stood at 29% in November, but is the lowest reading since September 2009.

**“Going forward, we expect a looser stance in policy to support growth”**

### House prices are trending down



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