

Chinese investment into real estate remains high; rate hikes should see it ease

“Growth is expected to slow from the double digit pace seen in 2010..”

The National Bureau of Statistics (NBS) release Q1 GDP on Friday 15th, alongside the monthly array of economic data; CPI and PPI inflation, industrial production, retail sales and fixed asset investment (FAI), all for March. Also expected in the coming week are urban property prices and the M2 measure of the money supply, for the same period. Growth is widely

expected to slow from the double digit pace seen in 2010, with authorities indicating they are willing to forgo some of the speed while putting a greater emphasis on sustainability. That said, output for 2011 as a whole is still likely to exceed 9%. Recent PMI surveys of the services and manufacturing industries do suggest a slowdown in Q1, with the March services number easing to a 27 month low. Crucially, the 51.7 reading still signalled expansion.

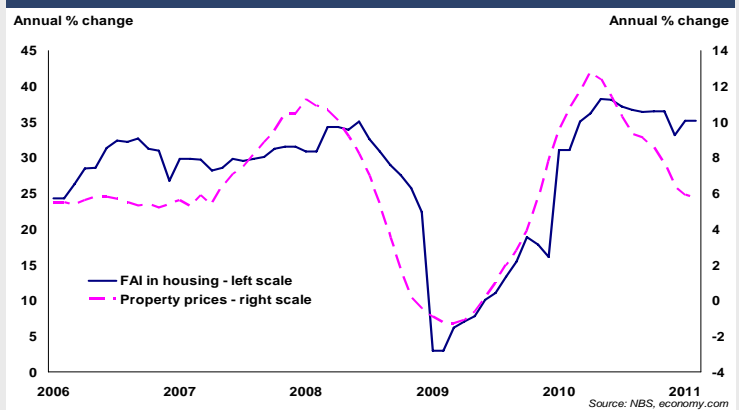
The NBS indicated that total FAI rose 24.9% in the first two months of this year, with a large proportion of this coming from investment into property. Indeed, investment in the country's property sector in January and February rose 35.2% to reach CNY425bn, of which CNY301.4bn went into residential housing construction; an increase of 34.9% on a year ago. Investment in real estate collapsed in 2008, with annual growth falling from 35% in June to 3% by January 2009. However, action by the People's Bank of China (PBoC) to loosen monetary policy meant M2 exploded and investment back into the sector expanded sharply, even surpassing the pre-crisis high.

This has fuelled the unprecedented rise in property prices; annual

growth has slowed from the zenith of 12.8% in April last year, but remains elevated at 5.8%. To remedy this, the PBoC have started tightening monetary policy, with the latest hike in 1 year working capital coming this past week; the fourth increase since October has seen the rate move to 6.31%. We expect a further 50 to 75 basis points to be added throughout the year as inflation rises on the back of growing food and commodity prices. It is hoped and expected that the tighter policy environment will also dampen the excessively high rates of investment.

“It is hoped that the tighter policy environment will dampen the high rates of investment”

FAI into real estate has held up despite rate hikes



Swedish inquiry on house prices plays down bubble talk

“Current level of house prices can be explained by ‘fundamental factors’..”

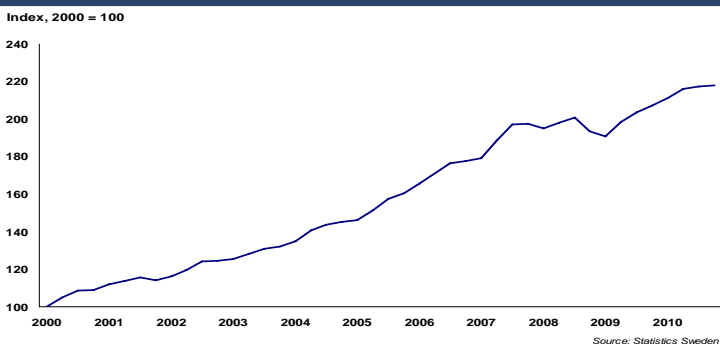
This week saw the publication of the eagerly awaited inquiry by the Riksbank into the risks in the Swedish housing market. In truth, none of the conclusions are likely to come as surprise. Predictably, the report steered clear of suggesting that Swedish house prices are in bubble territory despite climbing to new record highs. Indeed, it went as far as to suggest that the current level of

prices ‘can largely be explained by what are usually called fundamental factors’. However the report went on to add that there may be reasons to question whether the so-called ‘fundamental factors....themselves are on reasonable levels’. This is a pretty explicit

reference to the prevailing (low) level of interest rates.

A key element of the Riksbank's thinking is that interest rates are not necessarily the best weapon in the armoury to address imbalances in the housing market. Instead, it emphasises the virtues of ‘macroprudential policies’. One such measure, which was introduced by the Swedish Financial Supervisory Authority last October, is an 85% loan to value ceiling on mortgages. Alongside this, as RICS noted in a recent note, ‘Soft-signalling; a new approach to house price bubbles’, the Riksbank is also trying to manage market sentiment by making well judged commentary. The indications are that it is having some success in trying to cool the market (see chart) but as the inquiry concludes, ‘should house prices....continue to increase, the Riksbank and other authorities must be ready to act’.

House price increases have slowed



The central bank next meets on Wednesday 20th and the likelihood is that interest rates will be raised by a further quarter point taking the repo rate to 1.75% (from a recent low of just 0.25%). Further increases are likely over the balance of this year; indeed, the Riksbank has pretty much signalled that it anticipates the repo rate climbing back above 3% over the next few years. Meanwhile first quarter house price data, due for publication on Wednesday 27th, could provide some clues as to the timing of subsequent moves on rates and the urgency to implement other related measures.

“Riksbank to raise the repo rate again later this month”



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Stronger Indian economy continues to support real estate

“Inflation remains a key area of concern”

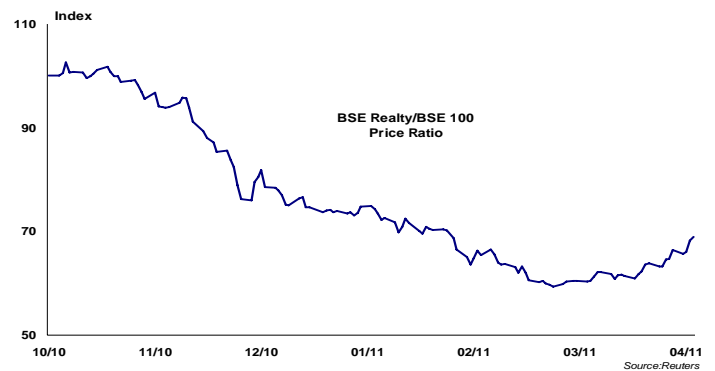
Recent data suggests that the Indian economy is continuing to surge ahead. A good example of this is provided by the release of numbers for exports in February; on a year on year comparison they leapt by just short of 50% which is the fastest annual gain in 11 months. Meanwhile, the PMI surveys for March were both fairly upbeat with the manufacturing index remaining little changed at 58 and the service index dipping a little but still coming in just short of 59 (any reading above 50 signals expansion compared with the preceding month). The next key figure to watch will be industrial production for February on Monday 11th. This is likely to be strong reflecting the healthy contribution being made by the external sector.

Arguably of greater importance, however, will be the March WPI inflation figure which will be released on Friday 15th. The previous reading showed inflation at 8.3%. Although this is down from the 11% high touched in April last year, it still remains a key area of concern for the authorities. Given the recent behaviour of commodity prices, it is hard to envisage this picture improving very much over the coming months. Indeed, it would not be a surprise if this measure of inflation was still around the 8% area at the end of the year. Reflecting this, it looks probable that the Reserve Bank of India will raise interest rates once again when they meet on Tuesday 3rd May. This would represent the ninth increase since March last year.

So far, the adjustment in monetary policy is having a relatively limited impact on much of the property sector. Infrastructure output is still growing at a healthy clip and activity in commercial real estate remains firm although the picture is a little more mixed in the residential sector where some developers are being adversely affected by the more cautious approach of banks. Significantly, while the wider Indian stock market has rebounded by around 10% since the middle of last month, the real estate sub-sector has climbed by 20%.

“real estate equities outperform the wider stock market since the middle of March”

Real estate equities begin to outperform



Canadian house prices continue to rise albeit at a slower pace

“The average house price in Canada rose 9% on the year to \$365,192”

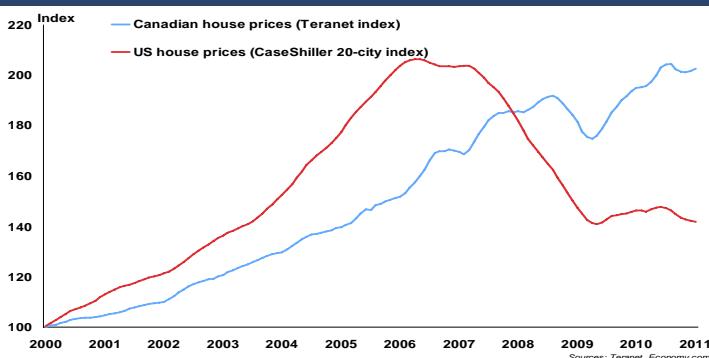
The coming week sees the release of key housing market data; the new house price index on Tuesday 12th (February) followed by existing home sales (March) on Friday 15th.

Existing home sales in February declined by 6% year on year. That said, February's sales figure ran close to the 5 year average for that month, with the

year on year decline due to base effects (Q1 2010 reported record sales). Sales activity eased in almost two-thirds of all local markets from the previous month, offsetting the gains in Vancouver and

Calgary. The average sales price for an existing home recorded 9% annual growth in February (currently stands at \$365,192), however this was highly skewed upwards by a number of high value homes being sold in the Greater Vancouver area, and once Vancouver is taken out, the growth figure is a more modest 3.4%. Indeed, this highlights the regional divide between western and eastern Canada. Resource rich western Canada is currently enjoying one of its strongest economic booms in recent history on the back of high commodity prices, which in turn has resulted in house prices recording up to 20% annual growth rates in some western cities. House prices in eastern Canada however, have already begun to ease up after the double digit growth of early 2010, with house price growth around 3-4% in Toronto and Ottawa. We expect national house price growth to continue to recede in the coming months due to the tighter mortgage regulations that came into place in March.

Canadian Vs US house prices: A correction needed?



Looking ahead, the Bank of Canada (BoC) meet Tuesday 12th to set the primary interest rate. The financial markets have already priced in a rate hike by September 2011, although we expect the BoC to resume normalising monetary policy sooner than this, partly in response to the recent Business Outlook Survey, which recorded rising costs and inflation expectations on the back of high commodity prices.

“Western Canada records much higher price gains than the rest of the country”

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