

## US housing starts may suffer relapse in March

**“February housing starts jumped more than 20%”**

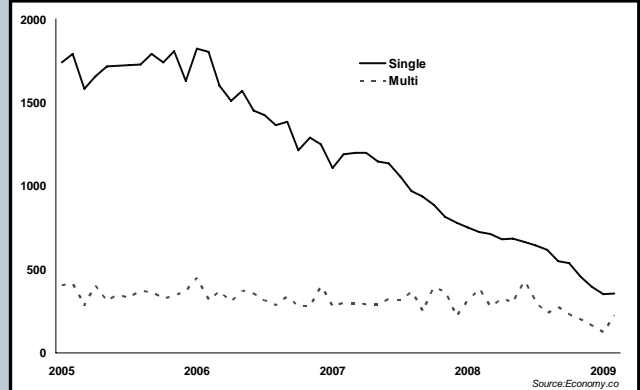
- The closely watched NAHB housing market index is due for release on Wednesday 15<sup>th</sup>. The headline reading in March of just 9 suggests that the sector is still very much bouncing along the bottom; a low of 8 was briefly touched in January. All the component parts of the series are telling a fairly similar story with sales, prospective buyer traffic and sales expectations still significantly below the levels seen in the recession of the early 1990s.
- Following on from this, the latest housing starts data will be published on Thursday 16<sup>th</sup>. The February number caused something of a stir by jumping more than 20%. That does, however, need to be put in some perspective. In January, housing starts fell by close to 15% taking them down to just 477,000. This compares with a high in January 2006 of 2.27m and a reading of more than one million in the first month of 2008. It also needs to be noted that most of the increase in February came in what has recently been the more volatile multifamily sector. Single family starts were barely changed. Meanwhile, the total number of permits authorised rose just 3%.
- It is quite likely that the number of housing starts will slip back in March given the scale of the previous month’s gain. However there are a few tentative signs that the

bottom of the housing activity cycle may be drawing closer. Existing home sales have risen in two out of the last three months with the annual rate of decline now less than 4%. In addition, new home sales posted an unexpected rise in February.

**“this was driven by the more volatile multifamily sector”**

**Bounce in Feb housing starts driven by multifamily homes**

000's (annual rates)



## Chinese real estate investment slows to a trickle

**“Urban Fixed Asset Investment has recently begun to pick up...”**

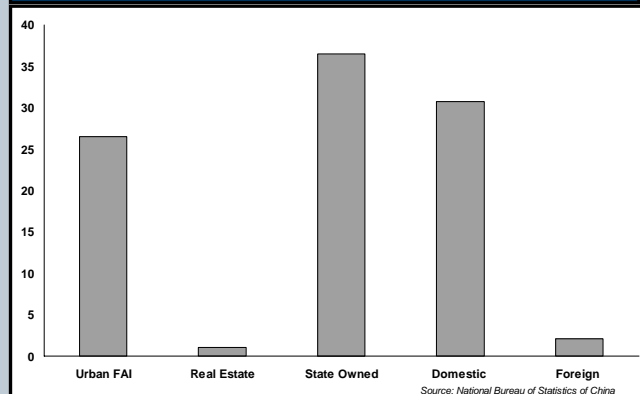
- Data is due for release on Thursday 16<sup>th</sup> on urban investment in China covering the month of March. The latest figures reported annual growth in the first two months of the year at a stronger than expected 26.5%. This compares with 22.5% in December and 26.1% for the whole of 2008. The rebound reflects the stimulus provided by both fiscal and monetary policies in recent months. As an indication of this, central government driven investment projects have been steadily increasing with the latest numbers putting the year-on-year gain in excess of 40%. This compares with an average for last year of less than 30%.
- The big loser has been the real estate sector which accounts for around 20% of total investment expenditure. In the first couple of months of 2009, it grew at a meagre pace of just 1%. To put the downturn in this area in some context, in December it was still showing a 10% plus increase and for whole of last year, the gain was close to 21%. The weakness in real estate is also evident in the official house price data and the RICS Global Commercial Property Survey, both of which turned down substantially in the latter part of 2008.
- It is noteworthy that bank lending for fixed asset investment has accelerated in recent months on the back of the easing in policy by the Chinese central bank. Historically

this has provided a good guide to the subsequent pattern of capital spending. As a result, it would not be unreasonable to assume that the recent improvement in the latter will persist over the coming months. However, investment in the real estate sector may take a little longer to gain traction reflecting in part an overhang of inventory.

**“...but the real estate sector has been the big loser”**

**Real estate investment has virtually ground to a halt**

Annual % change (Jan/Feb)



## Euro area construction output will fall more but not as fast

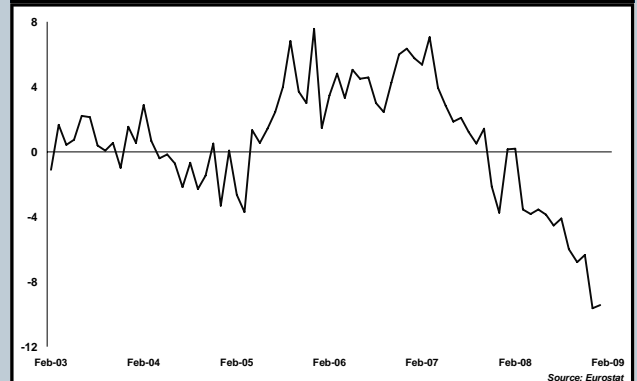
- Euro area construction production data for February is due for release on Friday 17th. In January, construction output rose by 1% on the month (the first increase since May 2008) resulting in a slight moderation of the year on year pace of decline (from -9.6% to -9.4%). The main driver of the drop in construction output to date has been insufficient demand according to the European Commission (EC).
- Of the six factors that could limit output cited in the EC construction survey (demand, weather conditions, shortage of labour, shortage of material and/or equipment, other factors and financial constraints), the deterioration in the demand balance is by far the most material. This has been fuelled by the worsening sentiment surrounding the housing market and the wider economy. Somewhat surprisingly, the EC survey shows that the financial constraints balance has remained more or less stable since the onset of the credit crunch. Significantly, the ECB's latest Bank Lending Survey shows that the housing market and wider economic prospects have been far more important drivers of tighter credit standards amongst lenders than the cost of funds.
- In terms of the outlook, the EC construction survey registered a modest improvement in the demand balance in March. While RICS would not suggest that this will necessarily signal a turning point for the sector given the generally poor macro news flow, the likelihood is that the pace of decline in construction output will continue to moderate over the coming months.

“tentative signs of improvement”

“but output will still fall in the near term”

Construction output has fallen by 9.4% in the year to February

Annual % change

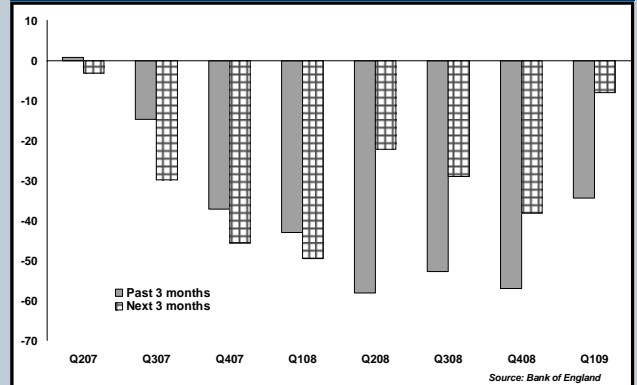


## UK commercial market yet to hit the floor

- Data on both the residential and commercial property markets are due out over the coming week. On Wednesday 15<sup>th</sup>, the March RICS Housing Market survey and the February DCLG housing market index are published. In the case of the former, much attention will be paid to the new buyer enquiries series which began to move into positive territory in November. Subsequently this turnaround has been followed by a modest pick up in transaction activity albeit from historic lows. Meanwhile, the DCLG index currently stands 11.5% down from the peak reached in January last year. This is somewhat less than the high teens drop signalled in both the Nationwide and HBOS series.
- Following on from this, on Thursday 16<sup>th</sup>, IPD will release the monthly numbers for commercial property valuation in March. The peak to trough adjustment in capital values in the 'All Properties' category is now around 40% and the likelihood is that a floor has yet to be reached. Crucially bank finance to support transaction activity remains in short supply (as highlighted in the latest Bank of England Credit Conditions Survey) while the worsening economic environment is continuing to weigh heavily on tenant demand. There has recently been some evidence of an increase in overseas interest in the UK market following the slide in sterling which may now be providing a measure of support for prime properties.
- An initial yield of around of 7% particularly when compared to the current risk free rate of return would suggest that some value is returning to the commercial property market. Typically, the differential is somewhat narrower than the current gap which is approaching four hundred basis points. That said, with rents under increasing pressure the yield on offer may not feel quite so secure discouraging potential investors.

Availability of credit to real estate sector continues to tighten

% net balance of respondents showing further tightening



“worsening economy is continuing to weigh on tenant demand”

“...but overseas interest in the sector is growing”

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