

## New UK government to set out the extent of the forthcoming fiscal squeeze

**“Lower gilt yields suggest financial markets have confidence in the government’s ability to address the budget deficit”**

The highlight of the coming week in the UK will be the presentation of the first budget by the new coalition government. The statement by George Osborne comes in the wake of the publication by the recently created Office of Budget Responsibility (OBR) of an updated set of economic forecasts around which the spending and tax decisions will be taken. For the record, HM Treasury is now

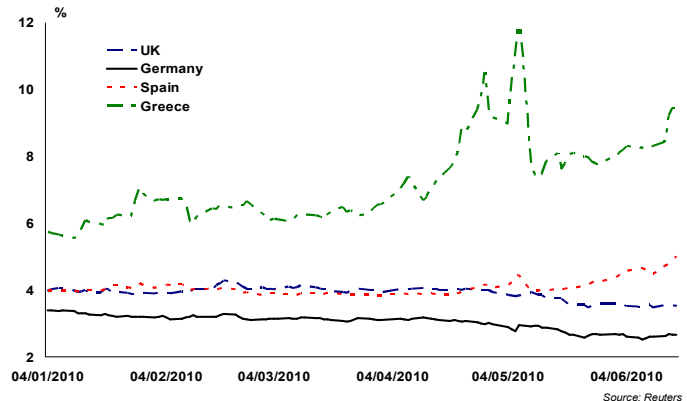
working on the assumption that GDP growth will be somewhat lower than previously envisaged. Despite this, conservative fiscal assumptions by the previous Chancellor resulted in the OBR pencilling in lower estimates for the budget deficit for this and forthcoming years. Significantly, the spending and revenue numbers will be changed next week as the government seeks to take a more aggressive stance to scaling back the shortfall in the budget. Critically, as the chart shows, financial markets appear reasonably content with the rhetoric and early actions of the new government; this has been reflected in gilt yields actually edging lower, in contrast to the picture in Spain and Greece.

One key area of potential savings for the government is the public sector estate. The scope to make progress in this area is highlighted in the RICS submission for the Emergency Budget. More work is urgently needed mapping the extent of the estate in order to identify and eradicate surplus properties and inefficient space usage, especially where collaboration between agencies could result in greater efficiency. Aside from this, RICS can see considerable potential benefits from a simplification of the current system of business rate reliefs and exemptions. RICS is also advancing the case for measures that will encourage more private monies into funding infrastructure projects such as Tax Increment Financing.

Aside from the budget, the Rightmove House Price Index is released on Monday 21<sup>st</sup>, with mortgage lending data from the British Bankers Association (BBA) and the CBI Distributive Trades survey to follow on Wednesday 23<sup>rd</sup>. The number of new mortgage loans for house purchase approved by BBA members is likely to have increased for the third consecutive month in May but will still remain some way below the levels seen at the tail end of last year.

**“Scaling back the public sector estate will provide significant opportunities for savings”**

### Bond yields in the UK have edged lower in recent weeks



## Cautious outlook for French construction sector

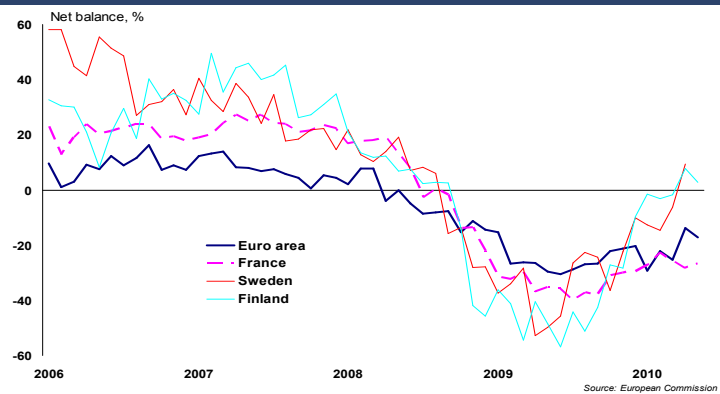
**“Economic recovery will lift confidence in the French construction sector”**

The June edition of INSEE’s building industry survey is due on Wednesday 23<sup>rd</sup>. In May, the headline business climate indicator crept up to 93, the highest reading since April 2009, but it remains at depressed levels (the long run average since 1975 is 100). Beneath the headline indicator, the survey is still showing that activity and employment continue to contract (albeit at a slower rate than 12

months ago) whilst capacity utilisation rates within the sector remain relatively depressed (85.7% compared to the long run average of 88.5%).

A broadly similar picture is evident across the Euro area; the European Commission’s (EC) monthly builders’ survey shows that confidence has improved slightly, but it remains negative and, crucially activity continues to fall while employment expectations remain very downbeat. However, some countries within the Euro area have experienced a much sharper turnaround in recent months that others. This is particularly the case for the Scandinavian countries covered in the EC survey, Sweden and Finland. In both countries, building activity is now increasing while employment expectations have turned positive. That said, the turnaround has been relatively more pronounced in Sweden but this is not altogether surprising considering the vigorous recovery in the economy that has taken place since Q2 2009 (the economy grew by 1.4% during Q1 2010 alone).

### Trends in building activity differ in the Euro area



Shifting the focus back to the French construction sector, RICS expects that confidence will continue to recover on the back of stronger economic activity. However, the low level of capacity utilisation is likely to hinder the jobs outlook within the sector during the course of the year. Forward looking indicators of economic activity suggest a robust pace of growth during Q2 and that the base of the recovery appears to be broadening beyond manufacturing to the service sector. Indeed, the May PMI readings were 61.4 in the service sector (the highest since April 2006) and 55.8 in the manufacturing sector (a three month low). However, it is still early days and this stronger economic activity, as indicated by the business surveys, has yet to feed through to the official labour market data; unemployment continued to increase in April, reaching 2.941m (or 10.1%). In this environment, it will still take time for demand, particularly for housing, to recover.

**“But the low level of capacity utilisation is likely to hinder the jobs outlook over the course of the year”**



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## Hong Kong housing market beginning to cool down

**“Previous survey results showed that the number of loans approved declined in the month by 2.3%”**

The latest update on the Hong Kong residential mortgage market is due towards the end of next week as the Hong Kong Monetary Authority (HKMA) releases its Residential Mortgage Survey results for May. The previous survey results for April showed that the number of loans approved declined in the month by 2.3% to 15,907, but this was coming on the back of a particularly strong reading in March when

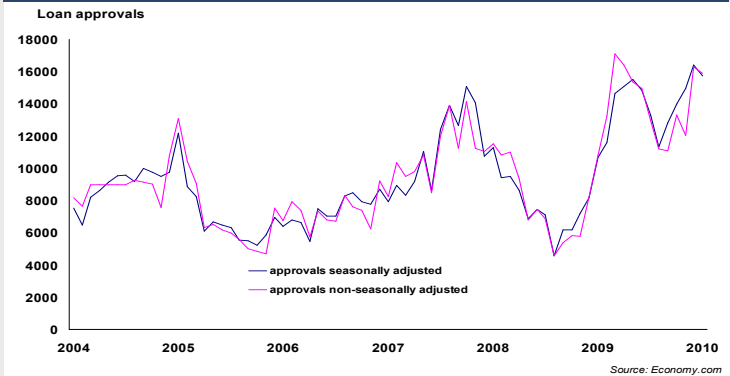
approvals reached their highest for eight months (16,407). In addition to home loans, the latest inflation data for May is released on Tuesday 22nd.

The March number of approvals is running above the long run average (10,000 since 2004), and does so still once the data is seasonally adjusted. However, the seasonally adjusted series shows that this is the first reversal in the upward trend for five months. It would appear that investors are becoming wary of potential government action as they try to forestall rapid inflation in house prices (anecdotal evidence suggests that property prices increased by around 25% last year). Potential measures to slow the economy and prevent a property bubble forming appear to be having the desired affect as the housing market now seems to be easing back. Indeed, the year on year growth in approvals has been retreating since January. Other signs of a tightening have been the continued decline in loan to value ratios on new mortgages. The non-seasonally adjusted number has fallen from a recent peak of 66% in June 2009 to 60% in April. Increasing worries over the sustainability of the current house price boom could be making banks more cautious with regard to lending criteria.

This seems to be consistent with the latest business surveys such as the PMI index which whilst still signalling expansion, fell to its lowest reading in eight months. This suggests the pace of economic activity in Hong Kong is starting to slow. RICS expects the slowing trend in the economy will continue to weigh down on housing market activity in the near term.

**“Annual growth in approvals has been retreating since the turn of the year”**

### Mortgage approvals picked up sharply in 2009 H2



## US housing market losing momentum after tax credits end

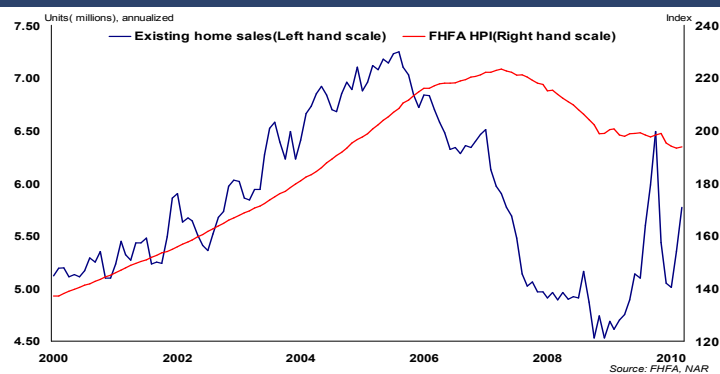
**“New and existing home sales surge in April”**

The Census Bureau releases their May figures for new home sales on Thursday 22<sup>nd</sup> while National Association of Realtors releases existing home sales on Friday 23<sup>rd</sup>. As expected, new home sales in the US jumped 15% in April to 504,000 on the back of the rush by buyers to take advantage of the home buyer tax credit. This takes it to the highest level seen since May 2008. Existing home sales also

showed strong gains, increasing by 7.5%, taking it to 5.7m annualized.

This recent surge of home sales due to the tax credits shows their effectiveness which was similarly the case at the end of 2009 when the tax credits were initially meant to expire. Due to their success, there is now a fear of how the market will cope without these government subsidies. Indeed, May data for housing starts already shows the hangover from these policy inducements, with housing starts down 10% m/m. This drastic decline in housing starts does suggest that the recovery in the housing market has lost some momentum, but RICS believes a renewed downturn is unlikely. The demand for home loans, which saw a rise of 7.5% in mortgage purchase applications last week after five straight weekly declines does offer hope the post-tax credit fall off would be temporary.

### Government tax credits induce buyers



The median price for a new home decreased sharply by 16% m/m, to \$188,804 in April. This reflects the increasing downward pressures facing house prices from distressed properties coming into the market and the existing inventory already on the market. Real estate website trulic.com reported that prices were cut on 25% of all US homes in May, unchanged from April. Sellers slashed a total of \$26.7 billion in May from asking prices, more than the \$25 billion in April and \$22.8 billion in March. The average discount on the reduced homes held at 10% from the original listing. Nevertheless, although there may be more downward pressure on prices in the near term, the news flow on the real economy is improving (industrial output increased by 1.2% in May alone) and this, through stronger hiring, should eventually support the housing market.

**“Downward pressures on house prices continue”**

**RICS UK**  
T +44 (0) 20 7695 1682  
pressoffice@rics.org

**RICS Europe**  
T +32 2 733 1019  
rics europe@rics.org

**RICS Americas**  
T +1 212 847 7400  
ricsamericas@rics.org

**RICS Oceania**  
T +61 2 92162333  
ricsoceania@rics.org

**RICS Middle East & Africa**  
T +971 4 375 3074  
ricsmiddleeast@rics.org

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