

## South Korean rate hikes to continue as commercial property investment eases back

**“Tenant demand in the retail property sector rose for the first time in 2 years in Q2 2010”**

A raft of economic data is released in South Korea next week important to the outlook for the local real estate market. On Tuesday 31<sup>st</sup> industrial production data for July is due, along with the latest service sector activity data. The following day sees the release of August consumer price inflation figures with a final update on second quarter GDP released on Friday 3<sup>rd</sup> September.

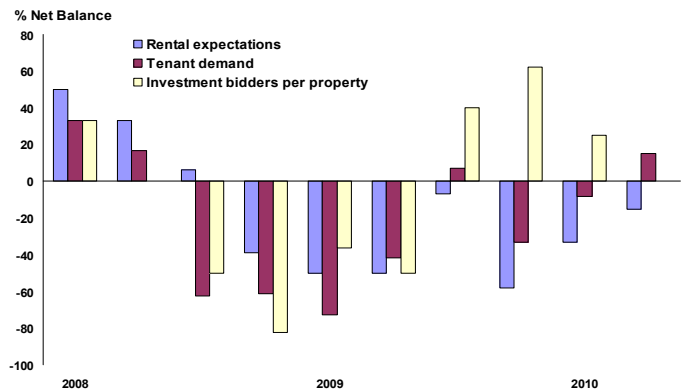
The latest economic data from Korea suggests that growth in the economy has started to gain greater support from domestic demand. Indeed, despite the ongoing removal of government stimulus, the initial Q2 data release showed that a strong investment outturn has helped to support growth of 1.5% in the second quarter. Whilst this is slower than the 2.1% recorded in Q1, the Q2 figure was above consensus and helped support the Won. This should encourage hopes that the economy can continue to recover despite concerns over a slowdown in global economic activity. Indeed RICS believe that the Korean central bank will continue to tighten interest rate policy by 25 basis points when it meets next month taking rates to 2.5%. A recent rise in consumer price expectations is likely to further reinforce this view, particularly as real interest rates remain in negative territory.

In the commercial property market, the latest results of the RICS Global Commercial Property Survey indicated that tenant demand for commercial real estate moved higher in the office and retail sectors during Q2. Rental expectations are no longer negative for industrial

space and moved higher in the retail sector for the first time in 2 years. However, ongoing rises in availability in the office sector continues to dampen rental expectations for offices. In the investment market, capital values rose for the second consecutive quarter in the office market, whilst rising for the first time in 2 years in the retail sector. That said, rising interest rates may be tempering investment transaction activity which fell back for the first time in a year.

**“...however commercial property investment activity appears to be slowing”**

### Investment bidders per property has stabilised in Q2



Source: RICS Global Commercial Property Survey Q2 2010

## Australian commercial property rental recovery kept in check

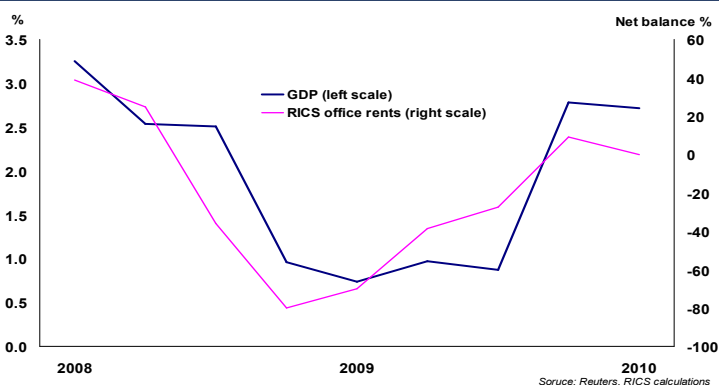
**“Economic growth in Australia moderated slightly in the first three months of the year”**

Australian retail sales for July are released by the Australian Bureau of Statistics on Tuesday 31<sup>st</sup>, followed by second quarter GDP on Wednesday 1<sup>st</sup>. Economic growth moderated slightly in the first three months of the year given tighter monetary policy and the unwinding of fiscal packages. Indeed, quarterly growth in Q1 was 0.5% compared to 1.1% in Q4 of 2009.

Meanwhile retail sales have slowed markedly; annual growth is now running at 2% compared to 8% this time last year.

This moderation in activity can be seen further afield in other sectors of the economy also. Indeed, the results of the Q2 RICS Global Commercial Property Survey shows that surveyors in Australia are finding the pace of growth in the occupier market beginning to temper, as many indicators show increases in activity are subsiding. The all property net balance for occupier demand eased from +62 to +19, while enquiries broadly moved the same way; the net balance softened from +66 to +21. Rents for office property remained roughly the same, as the net balance shifted from +9 in Q1 to 0 suggesting little change in rents as yet despite the ongoing economic recovery. The forward looking rental expectations indicator also confirmed that optimism has been tempered. The net balance for office property showed a movement from +18 in Q1 to 0 in Q2.

### RICS office rents broadly mirror GDP



Source: Reuters, RICS calculations

Looking ahead, the second quarter GDP release is likely to show that the economy will continue to grow. However, downside risks remain; inflation is at the top of its target range and further rate hikes from the Reserve Bank of Australia seem inevitable before the year end. Furthermore, it will take time for past hikes to feed through to the real economy. Meanwhile, recent labour market data has been mixed; the unemployment rate picked up from 5.1% to 5.3% in June, the highest since January but below the crisis peak of 5.8%. Should this trend continue it is likely to weigh on domestic demand in the second half of the year.

**“The Q2 RICS Global Commercial Property Survey signals the market is beginning to cool”**



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## Brazilian central bank to signal end of tightening cycle

**“Inflation expectations continue to fall”**

Banco Central Do Brazil (BCB) hold their next interest rate meeting on Wednesday, 1<sup>st</sup> to set the main policy rate (Selic). The GDP results for the second quarter are due on Friday, 3<sup>rd</sup>. RICS expects the BCB to increase the Selic rate by 25bp to 10.75% and announce the end of the current tightening cycle. Indeed, inflation, measured by the IPCA-15, has been

falling (4.44% in August) and is now below the 4.5% target.

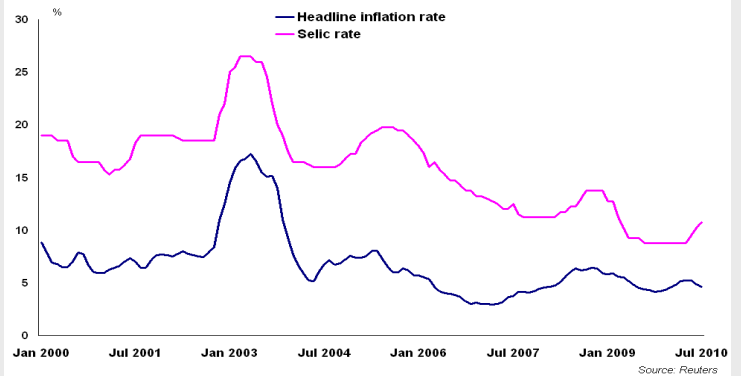
With the tightening that began at the start of the year now feeding into economic activity and prices, the BCB is likely to be concerned by cheap credit fuelling inflationary pressures. Indeed, in the latest BCB market expectations survey, inflation expectations for the coming 12 months have been falling for the IPCA and the broader IGP-M inflation indices. However, even though bank lending rose by 1.2% in July - its slowest rate in three months in July—the annual growth rate is still running at 18.4%. Within this figure, credit to housing rose almost 4% in July, and now stands 50% higher than July 2009. Mortgage credit is likely to increase even further given the structural shortfall in existing dwellings combined with recent legislation requiring banks to earmark 65% of savings deposits to mortgage lending. This shortfall is estimated at 1.6 million homes every year to meet new demand (notwithstanding the existing 5 million shortfall).

The commercial property market is also strong, with the latest RICS Global Commercial Property Survey showing that investment demand

for commercial property is at a 3 year high. Added to this that investment bidders per property continues to rise strongly, one can see why capital values are now booming. Looking ahead, the government-sponsored candidate Dilma Rousseff is leading the polls in the upcoming presidential election. This is good news for real estate as she is most likely to continue the government's existing home building program as well as subsidizing home loans for low income families.

**“Credit to the housing sector increases 4% m/m”**

### Inflation continues to decline



## Swedish rates to rise, euro area rates on hold

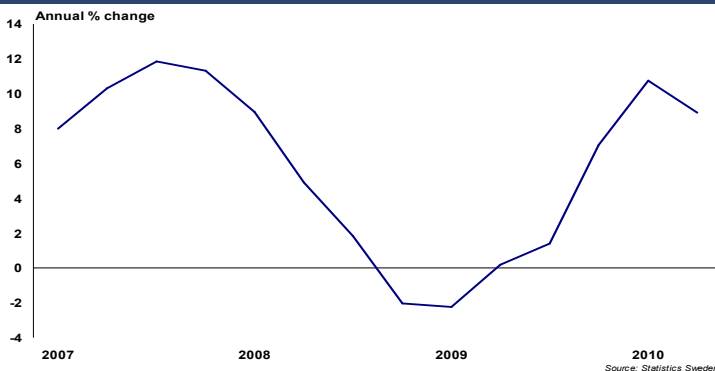
**“Pipeline inflationary pressures are building in Sweden...”**

Both the ECB and Sweden's Riksbank announce their respective interest rate decisions on Monday 2<sup>nd</sup>. The ECB's key policy rate has been on hold at 1% since May 2009 and is expected to remain at this level following Monday's announcement. However, the Riksbank has already begun to tighten policy; it hiked its key policy rate (the repo rate) by 25 basis points to 0.5% in July and is

widely expected to do so by another 25 basis points next Monday.

Headline inflation in both regions is very low at present – 1.7% in the Euro area and 1.4% in Sweden – but unlike the ECB, the Riksbank is increasingly worried about the build-up of pipeline inflationary pressures. Indeed, the Swedish labour market has already started to strengthen, with the unemployment rate falling from its peak of 9.1% to 8.8% on the last reading. Comparable figures show unemployment in the Euro area at 10%, the highest since 1998. Likewise, industrial capacity utilisation in Sweden is only 5.6 percentage points below its long run average and rising quickly, while in the Euro area, this figure is 9 percentage points. The resource utilisation picture reflects the much stronger pace of economic growth that has taken place in Sweden relative to the Euro area; in two out of the last five quarters, the quarterly pace of expansion in Sweden was above 1%.

### House price growth in Sweden is likely to slow further



Coupled with the deteriorating inflation outlook, the Riksbank is openly concerned about asset prices; specifically, households' 'unrealistic expectations of interest rates' and the effect this is having on house prices and debt levels. Indeed, last months monetary policy report dedicated a whole section to house price crash simulations and Riksbank deputy governor Oberg reiterated the point again in a speech only last week. The Riksbank is forecasting that it will raise rates to 0.9% by the end of 2010, to 2.4% by the end of 2011 and to 3.3% by the end of 2012. Under this scenario, house price growth – currently 8.9% above year ago levels – is likely to slow.

**“...and the Riksbank is openly concerned about house prices”**

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