

India inflation path is key to a stable slowdown in property

“Rising global food prices remain a threat to the inflation outlook.”

Several pieces of key economic data are due in India next week important to the outlook for the real estate market. On Tuesday 12th industrial production data covering August is released whilst on Thursday 14th inflation data for September will be published. The inflation data is likely to be closely watched amid growing concern that

sharp rises in global food prices could prompt more aggressive action from the central bank, as it attempts to bring the annual inflation rate back to 6% by March from the current 8.5% rate.

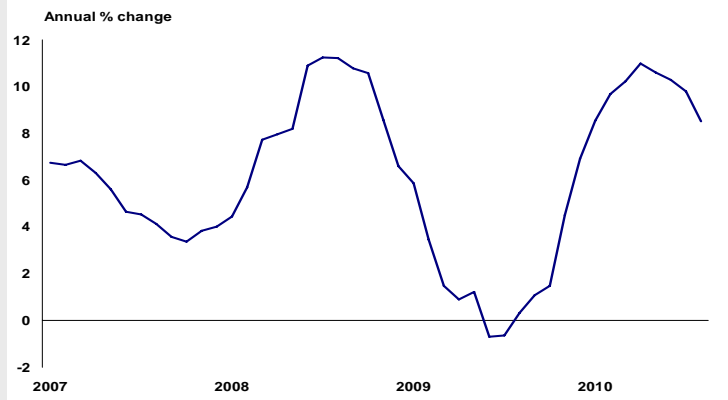
News that many commercial banks are now passing on previous interest rate hikes is likely to weigh on confidence towards the commercial and residential property sectors in the coming months. Last week saw several commercial banks increasing their benchmark prime lending rate by 50 basis points for the first time since July including the State Bank of India, PNB and INBI Bank. These rises are likely to temper demand more acutely in the commercial property sector. Weaker demand combined with an overhang of available properties is likely as a result to limit the possible upside in rents.

Indeed, a report released this week from the international property firm Cushman and Wakefield estimates that despite a strong economic growth outlook, oversupply problems in some sectors of the commercial property market may remain until 2013. This is in spite of an estimate demand for commercial property of 240 million square feet between 2010 to 2014. In the residential sector, forecasted demand

over the same period is 4.25 million units with demand expected to outstrip supply by a ratio of 3 to 1 in the top 7 cities. Interest rate hikes are unlikely to allay concerns that a further correction could occur. Despite some moderation, RICS expects the strength of the economic recovery to support the real estate market into 2011. However, continued rises in global food prices may prompt more aggressive central bank action.

“...which in turn will dictate the pace of the course of central bank action”

Inflation remains a threat to stable property slowdown



Hong Kong Chief Executive to call for sustainable housing market

“According to Centadata average home prices have increased by 17% this year”

On Wednesday 13th the Hong Kong Chief Executive, Donald Tsang, will make his annual policy address for the forthcoming year. Expected to be high on the agenda is the issue of affordable housing. The recent trend in residential prices has been in an upwards direction, driven by favourable borrowing conditions, speculative buying and limited land supply. As in China, the

overheating property market has become a pressing social and economic issue; according to Centadata average home prices have

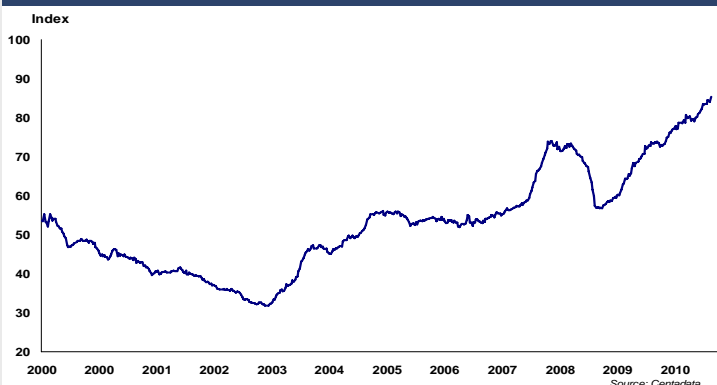
increased by 17% so far this year following a 24% rise over the same period in 2009. One policy expected to be discussed is the issue of subsidising home ownership.

In light of this, RICS Asia has put forward a proposal designed to assist the Hong Kong government as it strives to support a more sustainable housing market. An RICS task force proposes that the government reintroduce the Home Ownership Scheme, which aims at providing sustainable growth of affordable homes. In this, the government should aim to subsidise home ownership for first time buyers within the lower to middle income bracket. Land supply issues in Hong Kong mean property comes at a premium and is out of reach of first time buyers trying to get onto the market, despite the readily available credit. RICS are keen to stress that this subsidisation needs to be planned and implemented carefully, so as to avoid potential speculators from taking advantage of the scheme. Another area where RICS are keen to assist government is with a rent to buy scheme, which would allow tenants to rent a property for a specific period of time while retaining the option to purchase when this period ends. The hope is that this could provide a more appropriate basis for mortgage providers to lend on.

“RICS propose the government should aim to subsidise home ownership for first time buyers”

With close to zero interest rates and ample liquidity, demand for property is high in Hong Kong; as the economy continues to gather pace (GDP in Q2 grew at better than expected 6.5%) the unemployment rate has scaled back to pre crises levels.

Prices have accelerated since the back end of 2008



Medium term German inflation and house price outlook is subdued

“Inflation remains subdued...”

German inflation data for September is due from the Federal Statistical Office on Tuesday 12th. In August the headline rate fell slightly to 1% from 1.2% in the previous month. However, over the last 12 months or so the trend in prices has generally been positive. The upward trend in prices can be largely attributed to energy prices; excluding such effects, inflation has been far more subdued, reaching 0.8% in August, where it has been broadly hovering since the beginning of the year.

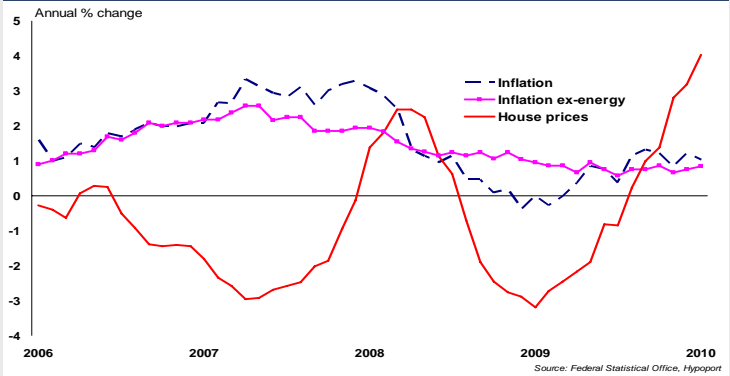
Although core prices remain subdued, the near term risks are tilted to the upside given reduced slack in the economy. Indeed, the unemployment rate continues to fall, currently standing at 7.5% compared to its peak of 8.3% last August. This largely reflects two factors: 1) the government’s short time workers scheme (in place till the end of 2010) and 2) the recovery of the manufacturing sector. So far, however, the strengthening labour market appears to be having a more visible impact on house prices than goods prices. Indeed, the August Hypoport data showed house prices rising by 1% on the month, pushing the annual growth rate up to 4%. Moreover, the data suggests that if the current pace of quarterly growth is sustained, prices will be 10% higher in 12 months time.

However, the current pace of house price momentum is unlikely to be sustained. Aside from the imminent expiry of the short time workers scheme, there is mounting evidence that activity in the manufacturing sector is coming off the boil. The manufacturing PMI survey

deteriorated sharply in September (from 58.2 to 55.1) while the forward looking component of the IFO survey also fell in September (from 105.2 from 103.9). Therefore, the most likely scenario going forward is that house prices will continue to rise over the next six months or so, as a lagged response to recent manufacturing and labour market strength. However, the medium term outlook is less upbeat given increasing downside risks facing the manufacturing sector.

“...house price momentum has been strong”

Improving labour market is supporting house prices



South Korea’s strong recovery moderates

“Downside risks to the economy increase”

The Bank of Korea’s (BoK) monetary policy committee is due to decide the key monetary policy rate on Thursday, 14th. The markets were surprised back in July when the BoK raised the base rate by 25bp (currently at 2.25%), the first hike since February 2009. It signalled it was ready to boost the benchmark 7-day repurchase agreement rate again in September, but in the event, it held off. Since then inflation has continued to increase,

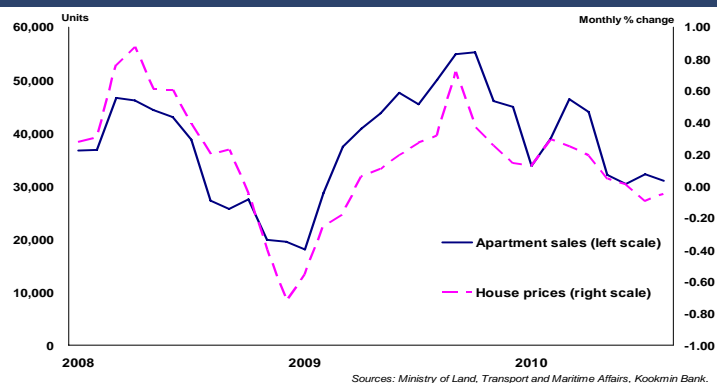
reaching 3.6% in September (due to soaring food prices), above the BoK’s target range of 2.5-3.5%.

The reason the BoK is holding off tightening currently is to insure the economy against downside risks given developments domestically and in the wider global economy. Indeed, although exports remain strong – they increased by 17.2% in the year to September - the HSBC/Markit purchasing managers’ index showed that manufacturing shrank in September for the first time in 19 months, pointing to a slowdown in the country’s strong recovery. Meanwhile, the US Fed is signalling that it is likely to embark on a second round of quantitative easing in November, while the BoJ has already just done so. Both actions follow a deterioration in each country’s respective economic prospects. While Korea’s major trading partners are easing policy, the BoK is unlikely to actually tighten policy for fear of its already strong currency appreciating further.

Meanwhile in the property sector, house prices edged down for the second consecutive month in August by 0.05% (this was preceded by a 0.1% fall in July). This likely reflects the deterioration in consumer confidence during the last few months. Renewed falls in house prices are likely to be welcomed by the BoK, which not so long ago had signalled its concern over excessive lending to households.

“BoK likely to remain on hold for time being”

House prices decline



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