

Riksbank turns nervous about house prices

“Riksbank sounds caution over recent price growth...”

Swedish house price data for Q2 are due for release by Statistics Sweden on Thursday 15th. In Q1, house prices rose by 1.9%, pushing the annual growth rate up to 10.7%, the highest since Q4 2007. To the extent that there was a correction in Swedish house prices in the wake of the global financial crises, it was brief and modest. Indeed, between Q3 2008 and Q1 2009, prices fell by a total of only

5.3%, but they have since recovered and are now 5.2% above their pre-crisis peak.

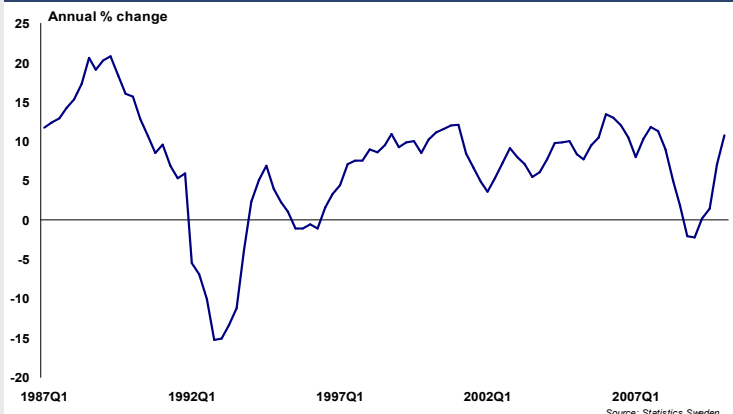
The Swedish central bank, the Riksbank, has become apprehensive about the recent pace of house price growth. Indeed, this month's Monetary Policy Report included a section entitled "Effects of a fall in house prices", which simulates the effects on the economy of a 20% fall in prices. The key messages are: 1) although the recent increase in house prices can largely be explained by fundamentals, it can't be ruled out that unrealistic expectations (with respect to house prices and interest rates) are also playing a role; 2) although the risk of a crash is small at the moment, the current pace of house price growth is not sustainable in the long term; 3) a 20% fall in house prices would over the next 12 months, assuming monetary policy is eased in response, result in a 0.9 percentage point reduction in GDP growth and a 0.6 percentage point increase in unemployment; and 4) if anything, these estimates are too conservative (the model does not take into account psychological factors for example) and the true impact on the economy may be even more detrimental.

The timing of this message from the Riksbank is highly significant and was clearly intended to concentrate the minds of Swedish households. Indeed,

it coincided with the start of the monetary policy normalisation phase (the first change in the repo rate for 12 months from 0.25% to 0.5%). Moreover, given the reference to households' unrealistic interest rate expectations, it suggests the Riksbank is worried that consumers have not yet come to terms with the inevitable. The Riksbank is forecasting they 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.

“...and signals further interest rate rises are likely”

Swedish house prices are growing strongly



Chinese GDP to moderate further as residential property prices slip back

“RICS expects GDP to come in at around 10.5% in Q2”

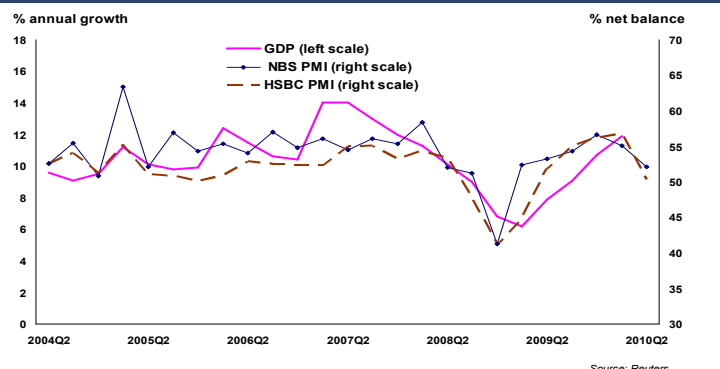
A raft of economic data is due in China next week amid ongoing signs that the economy is cooling following measures to rein in monetary stimulus. Thursday 15th is awash with Chinese macro economic statistics with the highlight being the latest GDP figures for the second quarter. With respect to the real estate sector, Thursday also brings the latest update on urban fixed asset investment. The breakdown of these

figures provides a key indication as to how Chinese developers are responding to measures to curb property speculation. Other indicators due

on Thursday include retail sales, industrial production and the latest inflation numbers.

RICS expects Chinese GDP to come in at around 10.5% compared to 11.9% in the first quarter. The slowdown in GDP is consistent with the latest trends from business surveys. The National Bureau of Statistics (NBS) PMI survey and HSBC PMI both point to a moderation in economic growth in Q2. In the real estate market, the latest data shows that property prices are already starting to slip, as lending restrictions have intensified. Prices fell back by 0.4% during May, which was the first monthly decline since March 2009. Significantly, the national index captures price trends for both residential and non residential properties. RICS survey data suggests a strong commercial property price rebound in China since Q3 2009 which may be adding support to the headline NBS index.

Business surveys point to weaker growth in Q2 2010



On the NBS measure, the biggest price falls during the month were recorded in Hangzhou, Nanjing and Guangzhou, where prices fell by around 0.5% on the previous month. In Beijing and Shanghai prices have also turned down although to a lesser degree with declines of 0.1% recorded in Beijing and no change in Shanghai. The modest NBS price falls stand in stark contrast to anecdotal reports of much larger double digit falls in residential property prices since April. Indeed, RICS would not be surprised if the price falls accelerate in the coming months as measures to temper the residential property sector start to feed through into the national index. That said, commercial property prices could still see some further upside should rental expectations continue to firm as the economic recovery remains on track.

“Property prices fell modestly in May and are set to fall further in the residential market...”



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Australian home loan demand dampened by aggressive monetary policy

“Home loan approvals fell in April for the seventh straight month, declining 1.8 percent...”

Housing finance approvals for May are released by the Australian Bureau of Statistics on Monday 12th, while the National Australia Bank (NAB) business confidence and Westpac consumer confidence surveys are released on Tuesday 13th and Wednesday 14th for June and July respectively. Home loan approvals fell in April for the seventh straight month, declining 1.8% to 47,669 from March. It

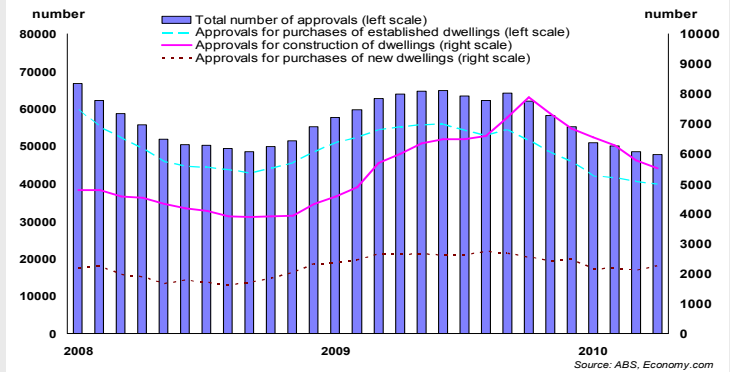
confirms that the property market is cooling amid the Reserve Bank of Australia's (RBA) aggressive tightening of monetary policy, and the removal of stimulus packages for first home buyers at the end of 2009.

In view of the RBA raising the cash rate by 150 basis points since October, housing finance demand has moderated considerably. The total number of finance approvals fell steadily in 2008, from a peak of 66639 to 48525, before recovering all earlier losses by June 2009. Since then the number has declined markedly. Indeed April's number was 26.6 percent below the June high. The removal of stimulus measures, such as the first home buyer grant for new dwellings, also dampened demand for housing finance. The number of approvals for new dwellings has declined each month since the turn of the year and the figure in April was 8% below that of December. The demand for loans to finance construction of dwellings also dropped, as the number turned down in April by 4.8%. Given that the RBA held the cash rate steady at 4.5% this week, and further signs that the labour market is firming (the unemployment rate dropped to 5.15% in May), RICS expects the number of finance approvals for May to stabilise, with the headline figure remaining broadly similar to that in April.

The NAB business survey for May showed that confidence, while remaining positive, eased slightly in the month as the net balance moved to +6 from +13. Confidence in the mining sector fell the most, as the incoming super profits tax on resources weighs on the minds of those in the industry. The Westpac consumer confidence survey also showed a decline, as the index fell by 5.7% from May to June; a combination of RBA rate hikes and deteriorating conditions abroad are cited as reasons for this.

“The number of approvals for new dwellings declined each month since the turn of the year ...”

Loans to purchase new dwellings have remained stable



Brazil's economy cools slightly on back of interest rate hikes

“Sharp fall in retail sales in April”

The latest index of retail sales figures for May are released by the Brazilian Institute of Geography and Statistics on Tuesday 13th July. The Brazilian Central Bank (COPOM) will meet to set the Selic rate on Wednesday 23rd. The volume of retail sales for April was down 3% from March yet was still over 9% higher than April 2009. The sharp fall in April is down to two main factors. Firstly, the expiry of

consumer tax credits at the end of March resulted in consumers flocking to stores that month, artificially inflating the base of comparison for April

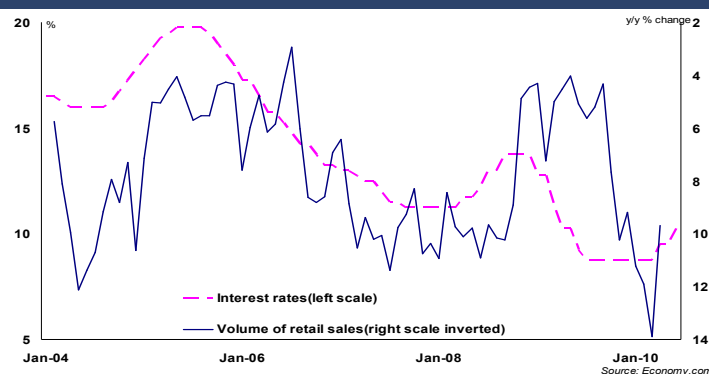
numbers. Secondly, the tightening of monetary policy, with a 150bp increase in the Selic rate during the last 3 months has led to higher borrowing costs in the economy.

COPOM's upcoming meeting will be the first of four scheduled meetings for the rest of 2010. With retail sales falling in April, and also June inflation (IPCA) coming in at 4.84% y/y, a fall from May's figure of 5.21%, there does appear to be a slight cooling in the economy. The official inflation target rate is 4.5%. In the minutes of their last meeting, COPOM members are still quite concerned about inflationary pressures but the recent data could ease demands for a 100bp hike and instead an increase of 75bp is now more likely. The announcement in March for a \$45bn expansion (on top of the existing earmarked amount of \$19bn) of the government subsidised housing program for low income families will likely add to upward pressure on key sectors such as construction costs and housing prices. Indeed, the National Index of construction (Sinapi) which measures the cost of construction per square meter increased 6.52% y/y in June. The aforementioned housing scheme aims to build 3 million housing units according to government bank, Caixa Economica Federal, Brazil's biggest mortgage lender.

Indeed, the lack of fiscal policy tightening combined with government programs including the \$64bn housing subsidies for low income families leads us to believe that interest rates will rise by a further 225bp by year end. This should bring the interest (Selic) rate to 12.5%.

“Government housing policy likely to increase construction and housing costs”

Retail sales volume fall as borrowing costs rise



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