

## China's five year economic plan awaited as residential property slows

**"The residential land transaction market slowed further in Q3..."**

The Communist Party of China is set to meet on October 15-18<sup>th</sup> to set out the 12<sup>th</sup> five year plan. This annual meeting focuses on China's economic and social development strategy and is set to lay the foundations for the shape of China's economic policy in the five years beginning 2011. It is anticipated that any tweaks to economic policy will

continue to focus on the overriding theme of rebalancing the economy more towards domestic demand via both raising household incomes and improving the equality of income distribution. Specifically with regard to the property sector, the five year plan should reconfirm the need to build more than 12 million affordable homes.

Other areas that are likely to be addressed which have a key bearing on the property sector include plans to improve infrastructure, respond to ongoing urbanization trends and near term forecasts for local government spending. Construction firms and real estate investors will be keenly eyeing the detail of the plan amid some reports that ongoing measures to clamp down on property speculation are starting to impact on land transactions and pricing for real estate in several key metropolitan areas.

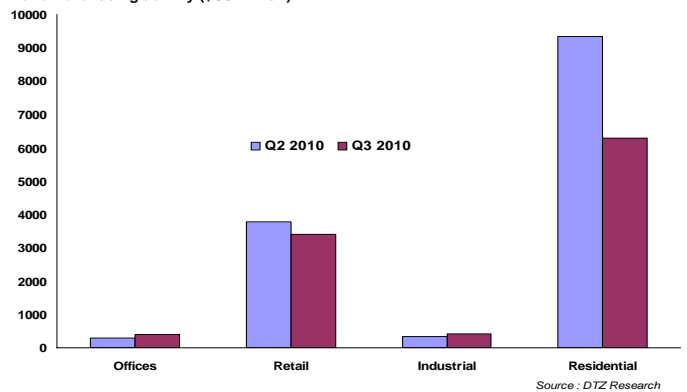
A report this week by the international property firm DTZ, concluded that previous tightening measures have slowed transaction volumes across some sectors of the Chinese property market during Q3. Land transactions in value terms fell 22% in Q3 compared to Q2 however this was almost entirely driven by a softer trend in the residential

sector. Deal activity, in value terms in the commercial space continued to rise in both the office and industrial sectors. With domestic insurance funds now free to enter the Chinese real estate market and incomes set to double over the next five years, any correction in real estate values may prove short-lived.

**"...although commercial land activity remained buoyant"**

### Land transaction activity is slowing in residential

Land Purchasing activity (\$US million)



## Russian property to continue to recover as interest rates remain on hold

**"Headline inflation has climbed to a seven month high but interest rates will remain on hold for now"**

A number of key economic indicators are due for release in Russia on Wednesday 20<sup>th</sup>. These include September numbers for unemployment, fixed investment and retail sales. Recent hard data has been positive although the PMI sentiment surveys have been less so. The unemployment rate slipped to 6.9% in August, investment rose at the fastest pace in two years, retail

sales recorded its second best annual growth rate in 21 months and construction output surged 22% after a summer lull. As a result, our

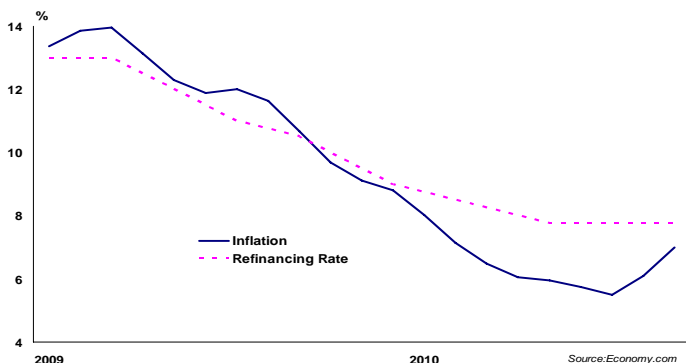
best guess is that Russian economy will post a gain in GDP for the whole of 2010 of around 5%. A more immediate concern is the worsening inflation picture; the headline rate climbed to a seven month high in August fuelled by higher food costs in the wake of the drought.

For the time being, the central bank appears committed to holding interest rates steady. At the policy meeting held at the end of September, it noted that the refinancing rate would remain unchanged for some months to come because inflation risks are still at 'acceptable levels' but stated that the situation was being carefully monitored. We suspect that the central bank will begin to tighten policy in 2011 albeit only in a modest way. Significantly, it did this week widen the trading band for the rouble in a move seen as a step on the road to a free floating currency and, quite possibly, a change in the policy regime to inflation targeting.

The gradualist approach to interest rate increases from the central bank is likely to help support the property market in Russia with deal volumes already in recovery mode after the disappointment of last year. Residential real estate may continue to be favoured over commercial property helped by an undersupply particularly in Moscow. It should also benefit from the government's decision to incentivise mortgage lending by setting aside a significant amount of funding for loans on newly-built residential accommodation.

**"Residential real estate should benefit from undersupply and the incentivising of mortgage lending"**

### Inflation is being boosted by higher food prices



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## Brazilian central bank to decide key interest rate

**“Inflation remains relatively low”**

The Banco de Brazil (BCB) meet on Wednesday 20<sup>th</sup> to set the key monetary policy rate (Selic). COPOM (the monetary policy committee) held the benchmark interest rate at 10.75% in September, pausing a tightening cycle that began in April when rates stood at 8.75%. The BCB have since said the economy is moving to a sustainable

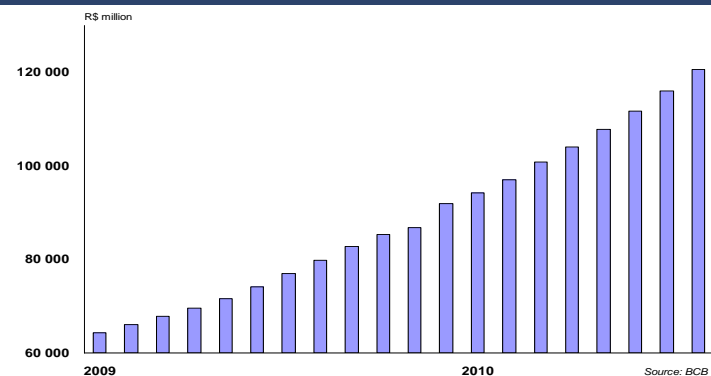
growth rate with low inflationary risks. Indeed, inflation has been low during the second half of the year, with the CPI rising only slightly in September to 4.7% (on the back of rising food prices). This is still below levels seen earlier in the year; CPI reached a high of 5.6% in May. Moreover, with industrial output unexpectedly falling in August (-0.1% on the month), RICS believes the BCB will continue to leave interest rates on hold.

The recent fall in industrial production can be mostly attributed to a drop in exports, which slipped from \$19.2 billion in August to \$18.8 billion in September. The fall in exports has been due partly to the sluggish recovery in the developed world but is also a result of the appreciation of the Brazilian real, which has climbed 7.5% against the dollar since June. Also, the high interest rate prevailing in Brazil relative to developed countries is causing large inflows of capital, exacerbating the problem. Indeed, Brazil's Finance Minister recently spoke about a global currency war, with nations competing to devalue their currency. He has hinted at direct intervention in the FX market to counter the appreciating real.

Meanwhile, in the housing sector, credit to housing (mortgage lending) continues its astronomical rise, increasing 3.9% during August, and now stands 51% higher than year ago levels. The federal government housing programme which subsidises mortgages for low income families has aided the rise in lending. Just under 410,000 contracts to buy apartments under the programme had been completed by April, and the goal is 1 million by the end of the year.

**“House lending continues to surge”**

### Exponential rise in house lending



## All aboard the ‘QE2’

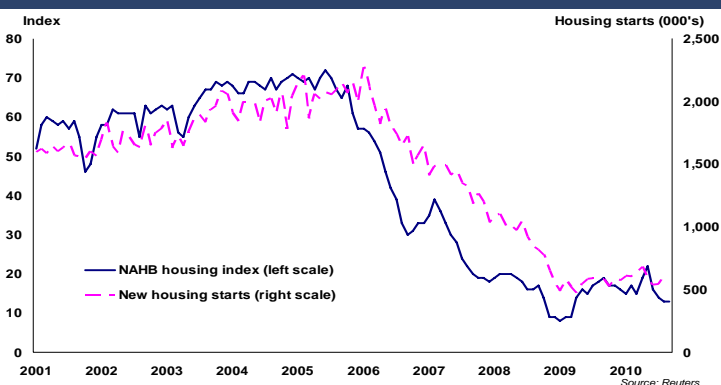
**“Residential construction remains depressed”**

The National Association of Home Builders (NAHB) release the latest results of their housing market index on Monday 18<sup>th</sup>, while the Census Bureau provides new housing starts data for September the following day. Housing starts have been subdued in recent months as transaction activity has slowed in the wake of the ending homebuyer tax credit; indeed starts in

August were still 60 percent below the 10 year average of 1.5 million.

The NAHB survey result for September held at 13 for the second straight month, which is the lowest reading since March 2009. A reading above 50 indicates that more builders view sales conditions as good than poor, and the index has not read above the watermark of 50 since April 2006. Evidence of the weakening in housing activity has been visible in both muted data for pending home sales and the number of building permits issued. Notwithstanding this, there are some signs that more positive data may emerge. Mortgage applications have risen recently on the back of historically low interest rates and lower house prices and this combination could finally be enticing buyers back into the market.

### Housing market activity remains depressed



Looking ahead, the FOMC meeting in early November will take a centre stage as the discussions are likely to cause reverberations the world over. It is widely expected that the Fed will undertake a second stage of quantitative easing in an attempt to stimulate the flagging economy. Worse than expected jobs data in September underlined the US economy's weakness and pressure is now firmly on the Fed to restart a large scale asset purchase programme as it grapples with lowering the long term interest rate. Indeed, the minutes from the September meeting provided the strongest indication to date that ‘QE2’ is imminent.

**“Mortgage applications have risen on the back of low interest rates and lower house prices..”**

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