

Outlook for French homebuilding sector has become more uncertain

“French homebuilding activity has partially recovered...”

French housing starts data for September is due from INSEE on Tuesday 26th. In August, starts (for ordinary residences) fell by 26% on the month to 21,443 units, which is the lowest level since the beginning of this year. However, the monthly data is highly volatile. Partially accounting for this by taking a three month moving

average, starts fell by a less dramatic 5% to 24,482 units, but they are still about 30 % above their March 2009 low.

Given the volatility of the starts data, the trend can be difficult to interpret. It's true that home building activity is well above its lows but recent swings have been so large as to cast doubt over whether this constitutes a genuine recovery or just data noise. However, taken alongside new housing sales, which historically have tended to closely track starts, as well as the house price data, the picture becomes slightly clearer. Indeed, concomitant with the recovery in demand (new home sales are up by 70% from their Q4 2008 lows) and prices (up 6% from their Q2 2009 low), it seems reasonable to conclude there has been a genuine, albeit partial, upturn in house building.

The question remains whether the recovery in both building and sales will be sustained. Here, the outlook is more uncertain and recent data (a slowing economy and deteriorating labour market) indicate mounting downside risks facing the sector. Indeed, the October Flash PMI readings fell for both the manufacturing and service sectors, while the unemployment rate has been rising for the last three months,

reaching 10.1% (the highest since September 1999). These developments in the wider economy at least partly explain why builders remain so downbeat, in spite of recent improvements on the activity front. Indeed, the European Commission's monthly survey of builders shows sentiment broadly unchanged during Q3 and not much above its recession lows. With confidence so negative alongside worsening economic fundamentals, building activity may struggle to recover further.

“...but the outlook has become more uncertain given the deteriorating macroeconomic backdrop”

French homebuilding activity has partially recovered



US housing sector begins long road to recovery

“Existing home sales rebound in August by 8%”

The coming week will see the release of home buying activity data for September with the National Association of Realtors (NAR) publishing existing home sales on Monday 25th and the Census Bureau releasing new home sales on Wednesday 27th. Existing home sales rebounded in August by 7.6% after recording their largest one month drop in July (26%). However, they still remain

at depressed levels (29% below the 10-year average) after the expiration of a popular tax credit for homebuyers. The market for new

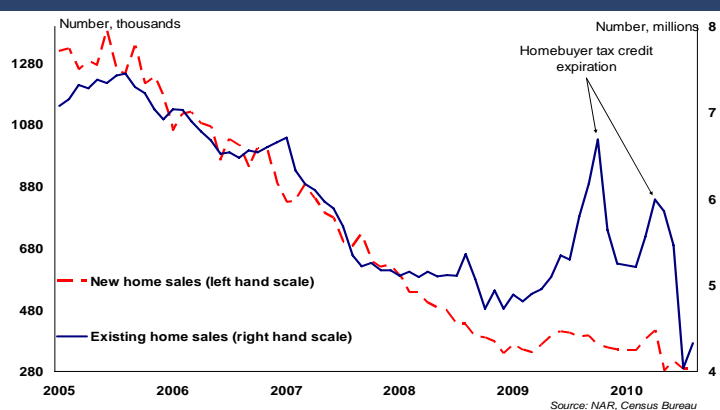
homes is also trying to find its feet after the tax credit expiration, with sales unchanged in August at 288,000 units (annual rate) after an 8% drop in July.

Meanwhile, US mortgage applications (a good lead indicator of future home sales) slumped last week, with the Mortgage Bankers Association's adjusted index of mortgage applications (which includes both purchase and refinance loans) falling 10.5%. With mortgage rates at historic lows, the depressed level of refinancing suggests there are other factors weighing down mortgage activity i.e. low credit scores, high unemployment, negative equity and tight lending standards being the main barriers. The current tight lending conditions will not be helped by the recent legal row over foreclosure procedures in large lending institutions. Attorney Generals in all 50 states said last week that they were looking into accusations that lenders submitted false statements and failed to properly review files before evicting homeowners. Royal Bank of Scotland estimates potential settlement of the case could range between \$1.3 to \$4.3 billion.

Looking ahead, the release of the Q3 GDP data next week will have a large bearing on the size of the quantitative easing the Fed will likely begin in early November. With new US jobless claims rising unexpectedly last week, there will be increased pressure on the Fed to pump more money into the economy in the hope of boosting growth and employment.

“Mortgage applications fall 10.5% in week ending Oct 15th”

Home sales look to recover



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Japanese housing starts show some signs of improvement

“Housing starts picked up above 70,000 for the first time since Jan 2009”

Housing starts and construction orders data are due in Japan on Friday 29th alongside several other key indicators important to the real estate sector. In a data rich week for the Japanese economy, Friday also sees the release of labour market figures, household spending trends and the latest reports on manufacturing, industrial production

and core inflation.

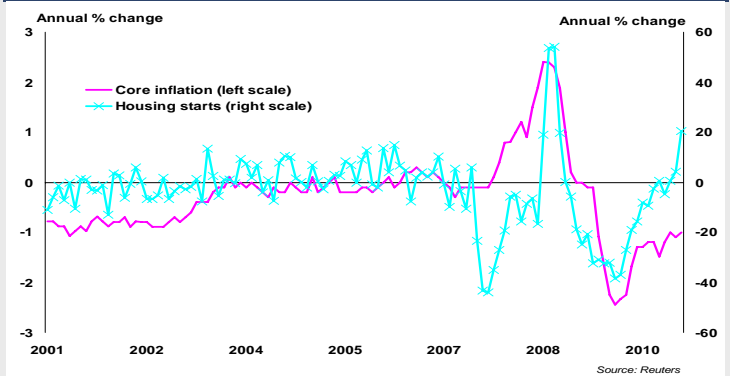
Having plummeted by around a third since Q4 2008, housing starts have been trending on a relatively flat path for much of the last 18 months. That said, the latest reading for August showed a healthy figure with housing starts breaching the 70,000 mark for the first time since January 2009. The uptick in housing starts is consistent with the slight improvement to the deflationary picture which has occurred in recent months. Indeed, housing starts have tended to track the deflationary trend in the wider economy quite closely over the last decade aside from the brief detachment in 2007 when changes to the planning system held up planning consents.

In the construction sector as a whole, annual growth in new orders has stabilised over the last two months, having been in sharp decline for much of 2009 and 2010. This quite volatile indicator appears to have hit a trough in April 2010 and is likely to gain some support from the lagged impacts of better economic growth in Japan over the last few quarters. That said, worries over the growth outlook have re-surfaced in recent months which has prompted renewed currency intervention

by the central bank to weaken the Yen. The Nomura/JMMA PMI of manufacturers showed the first contraction in activity during September since June 2009. As a result, the announcement of a new programme of “comprehensive monetary easing” is likely to add some support to the construction sector with both housing starts and construction orders to trend upwards as easing deflation lowers real interest rates.

“..with lagged impacts from better growth to feed through to construction”

Housing starts have trended closely with core inflation



Hong Kong mortgage market braced for latest update on cooling measures

“Loan approvals increased further in August to 17,114”

Next week the Hong Kong Monetary Authority (HKMA) will announce the results of its residential mortgage survey for September. The release is likely to be closely watched as the HKMA look to see what affect the recent mortgage tightening measures have had on lending activity.

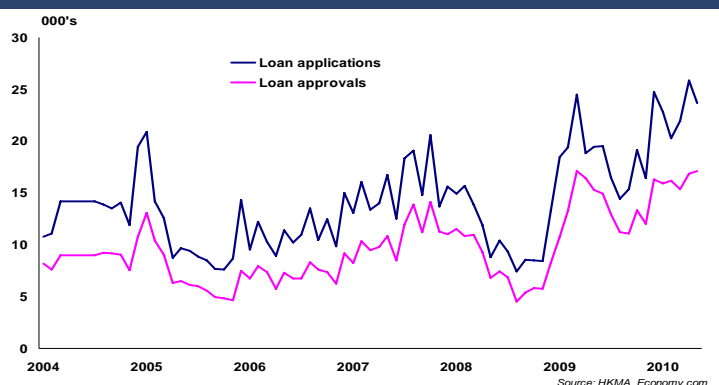
The August results suggest that, so far, the effects of the prudential tightening measures have been mixed; loan approvals increased further in August to 17,114 from 16,837 in

the previous month, but the rate of increase has moderated. Indeed, the previous month had seen the headline number jump from 15,345. Meanwhile, the delinquency ratio has remained at an all time low of 0.02 percent. There has also been evidence of a slowdown in the number of applications. Mortgage petitions in August fell from 25,877 to 23,663, a nine percent fall. However, this should be taken in context; the number of applications in August was the highest in the survey’s six year history and, as high demand for property is met by small supply, property prices are soaring and preventing first time buyers from getting into the property market. The measures imposed by the Hong Kong government aim to cool the market by tightening the mortgage lending criteria (a maximum LTV ratio of 60 percent has been applied) and reducing speculative buying. Another key concern is that people currently taking out mortgages will be unable to afford repayments once interest rates rise to more normal levels.

The outlook for the residential mortgage market in Hong Kong will be dependant on how keenly the new rules are enforced. The September results of the survey will give a better indication of how the measures are affecting activity after two months as opposed to one in August.

“There has been a slowdown in the number of loan applications”

The spread between applications and approvals has widened



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