

## Manufacturing strength in Germany is lifting consumer confidence

**“The manufacturing sector has recovered strongly, feeding through to other areas of the economy”**

German manufacturing orders data for July is due on Wednesday 8<sup>th</sup>. To date, the manufacturing sector has staged a huge rebound since the depths of the financial crisis; orders are 24% above year ago levels and 39% above their February 2009 lows (though they are still 13% below November 2007 peak).

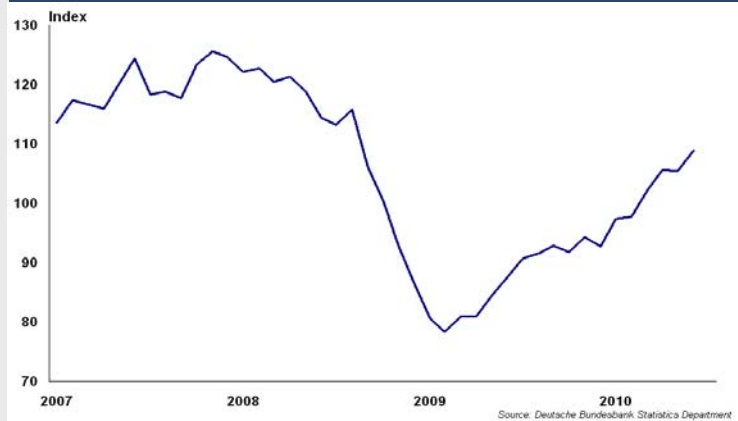
So strong has been the rebound in manufacturing, it is feeding through to the labour market, lifting consumer confidence and in turn stimulating consumer spending. Indeed, the unemployment rate peaked at 7.7% shortly after manufacturing orders had collapsed, but following their rebound, the unemployment rate has fallen more or less continuously (currently 6.9%). Meanwhile, consumer confidence has recovered sharply and reached the highest level in August since October 2007. The knock-on effect on the consumer spending has been marked; household goods sales volumes have been increasing on an annual basis in every month since January (which marked the first increase since September 2008).

Apart from the knock on effect that confidence has had on spending, there have also been some interesting developments in the housing market recently. The Association of German Pfandbrief Banks' (VDP) house price index shows single family home prices increasing by 1.7% in Q2, taking the annual growth rate to 1.1%, the first positive reading since Q1 2009. This chimes with the Hypoport data, whose composite house price index increased by 0.7% in Q2, taking the annual growth rate to 1.6%, also the first positive reading since Q1 2009. Whether

this heralds a sustained recovery in the housing market remains to be seen. After all, global growth momentum is fading, which increases downside risks to German manufacturing activity. Therefore, we are likely to see one or two more quarters of relatively strong growth in house prices, in lagged response to current manufacturing strength. Beyond this, through 2011, the housing market picture is likely to be more subdued.

**“Recent house price gains are unlikely to be sustained beyond 2010”**

**German Manufacturing orders have recovered strongly**



## Canadian housing market beginning to cool

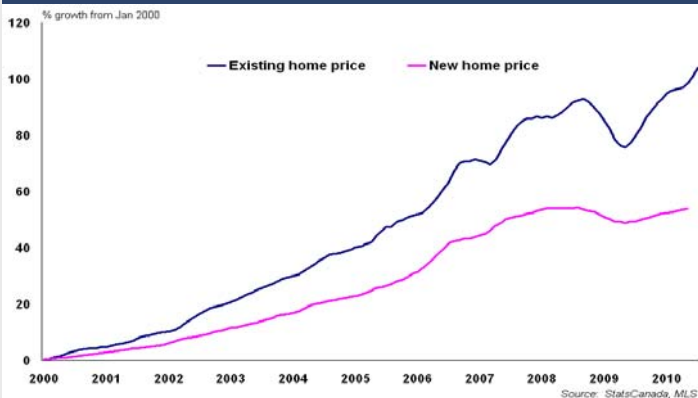
**“Residential building permits record a 4.5% m/m drop in June”**

A range of economic data pertaining to the Canadian real estate market will be released in the coming week. The Canadian Housing and Mortgage Council (CHMC) publish its building permits for July on Wednesday 8<sup>th</sup>. The following day CMHC release their housing starts data for August and Statistics Canada publish their new house price index for July.

building activity has been falling lately. Indeed, single unit dwellings dropped sharply, by 9% alone last month and has fallen in five of the last seven months. The reason for this, as cited by the Bank of Canada (BoC), is a phasing out of various government stimulus measures, which had the effect of pulling forward demand for homes in late 2009/ early 2010. Indeed, sales have fallen 30% from year ago levels and by 6.8% in July alone. It is also likely that house price momentum is now easing, in line with the weakening sales picture. However, it is still too early to tell given the lags in the published data and the time it normally takes for changes in demand to feed through to prices.

The starts and permits data tell a broadly similar story; residential

**Existing home prices doubled over the last decade**



Looking forward, the BoC will meet next week to set the overnight rate. In its latest monetary policy report, the BoC stated its projection includes a gradual reduction in monetary stimulus, following last month's 25bp hike. Although inflation remains well under control (it was 1.8% in August), the BoC is still keen to normalise monetary policy and is surprised about the recent strength in house prices. Indeed existing home prices have increased by almost 40% from the trough during the recession, and are now well above the pre-crisis peak. In spite of recent soft macro numbers, we expect the BoC to hike the rate by 25bp in the next meeting, bringing the overnight rate to 1%. This, alongside new regulations for mortgage lending is likely to further temper home building activity and transaction levels.

**“Housing starts continue to decline”**



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## Australian housing market outlook deteriorates

**“Mortgage approvals at the lowest level since February 2001”**

Australian housing finance data for July is due Wednesday 8<sup>th</sup>. In June, the total number of housing finance commitments (mortgage approvals) fell to 46,420. This is the lowest number since February 2001 and is 29% below its post-crisis-peak of 65,053 reached only 12 months earlier.

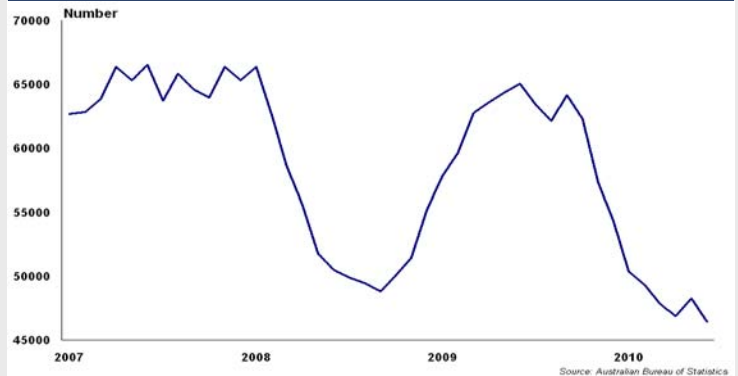
The principal factors weighing down on approvals have been the phasing out of various homebuyer subsidies since Q4 2009 coupled with the increase in interest rates. Indeed, the additional \$7,000 first time buyers had been eligible for to purchase existing homes was withdrawn at the end of September 2009 as was the additional \$14,000 they had been eligible for to purchase newly built homes. Meanwhile, the Reserve Bank of Australia (RBA) has raised the target cash rate from 3% last September to 4.5% currently. As a result mortgage rates have also risen, with the average variable rate up from 5.4% to 6.9% over the same period. So far there has been limited spill over from the fall in mortgage lending and rising interest rates to house prices; they still increased by 3.1% in Q2 (compared to a slightly stronger 4.2% in Q1) and are 18.4% above year ago levels.

However, the risk going forward is that moderating price growth turns into outright falls. Certainly downside risks are building; economic activity is slowing at home and globally, the RBA retains a tightening bias given that inflation remains above target (3.1% against the target range of 2-3%) and housing affordability is highly stretched. Indeed, the capital city affordability index fell to the lowest level since records

began (Q4 1984). In terms of growth momentum, the Australian PMI surveys for manufacturing and services have deteriorated further. In Australia's main trading partner China, economic activity has also cooled. But encouragingly, the latest Chinese PMI data showed some resilience, with the composite PMI reading edging up slightly (but still well below levels seen at the beginning of the year). Given these risks, house prices are unlikely to find much support in the near term.

**“Downside risks to house prices are building”**

### Mortgage approvals have fallen sharply this year



## Ditto New Zealand

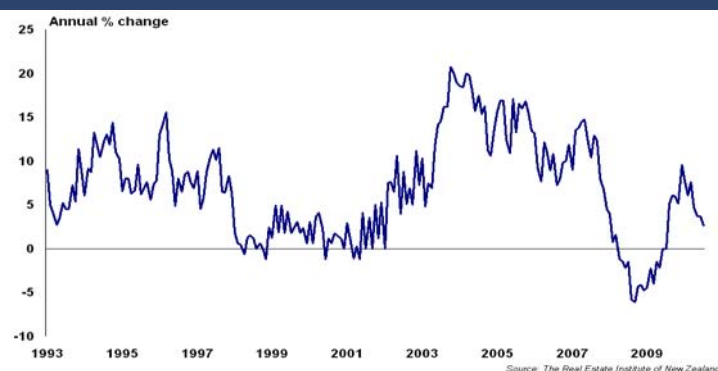
**“Rising supply and weakening demand has weighed down on house price growth”**

New Zealand house price data for August is due from Quotable Value (QV) on Monday 6<sup>th</sup>. In July, the average sales price increased from \$404,715 to \$407,191. This contrasts with the Real Estate Institute of New Zealand (REINZ) data, which shows the median sales price falling from \$352,500 to \$349,000.

Since the beginning of this year price momentum has been fading given rising supply and weakening

demand; according to the more detailed REINZ data, annual growth has moderated from 9.6% last December to 2.6% presently. Indeed, the unemployment rate has nearly doubled to 6.8%, albeit from a relatively low base (3.5% in Q4 2007 compared to the long run average of 6.1%). Meanwhile, the total number of dwelling permits issued in July reached 1,451 units, which is 22% above year ago levels. However, there still remains a significant undersupply of housing; residential investment as a share of GDP was 3.8% in Q1 against a long run average of 5.3%. This undersupply, coupled with interest rates still close to historic lows, is likely to have prevented sharper falls in prices given the deteriorating labour market.

### House price growth has moderated



Looking forward, house prices are likely to fall throughout the rest of this year. Leading indicators of economic activity point to a marked slowdown, both in manufacturing and services and therefore, ultimately a further deterioration in demand for houses. Fortunately however, the housing supply situation is likely to remain tight and this should limit the size of future price falls. Nevertheless, the risks to the outlook are skewed to the downside; the Reserve Bank of New Zealand (RBNZ) still has a bias towards more tightening (it hiked rates in July from 2.75% to 3%) given elevated inflation expectations, which would exacerbate any deterioration in demand. However, the RBNZ may well reconsider further hikes in the near term given the weakening global macro backdrop.

**“Tight supply should limit the size of any correction in prices”**

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