

Rate rises set to moderate pace of Australian house price recovery

“Higher base rates reflect an economy that has needed less emergency support..”

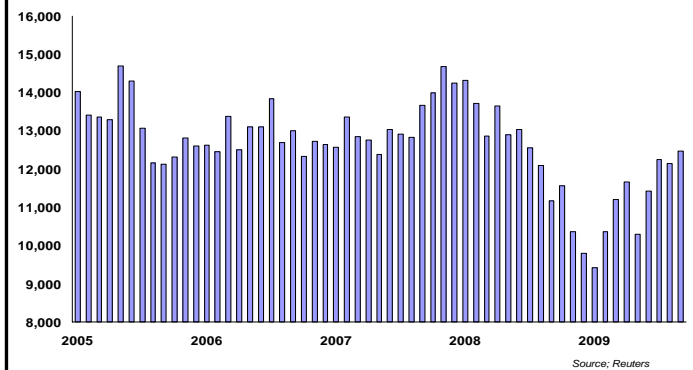
- The Reserve Bank of Australia (RBA) meets on Tuesday 1st to decide on interest rates amid growing signs that the economy is returning to health. Australian base rates sit at 3.5% at present, which compares to a mere 0.5% in the UK and a target of 0 to 0.25% in the US. Higher base rates reflect an economy which has needed far less emergency support in the wake of the global credit crisis. Indeed, the loss of economic output in Australia has been far less pronounced with all of the lost ground since the collapse of Lehman Brothers already retraced.

- Having been the first of the G20 countries to have raised interest rates in the wake of the global economic crisis, RICS expects that next week’s meeting will see a further increase in rates to 3.75%. Indeed, market indicators are now pricing in several more moves higher into next year with the expectation that interest rates could hit 4.5% by June. Rising interest rates could weigh on the strength of the property price rebound by the middle of 2010 and will also add to worries over affordability issues. Based on several, albeit, crude measures of housing affordability, house prices looked stretched, particularly in an environment in which mortgage costs are set to rise. The ratio of average house prices to earnings currently sits at 6.5, significantly above the long run average of 4.5 since 1984.

“..although housing affordability remains stretched particularly as rates move higher ”

- Next week also sees the release of other economic data pertinent to the property sector. Private sector credit figures are due on Monday 30th whilst building approvals data are released on Tuesday 1st. RICS expects that the buildings approvals numbers will remain strong as the recovery in the construction sector continues apace. With all sub-sectors of construction work having risen during the third quarter, private sector construction activity looks set to add renewed support to total workloads.

Building approvals to gain further strength into 2010



Signs of a pick-up in activity in India as RBI sends warning shot

“Q3 GDP likely to come in close to previous reading of just over 6%”

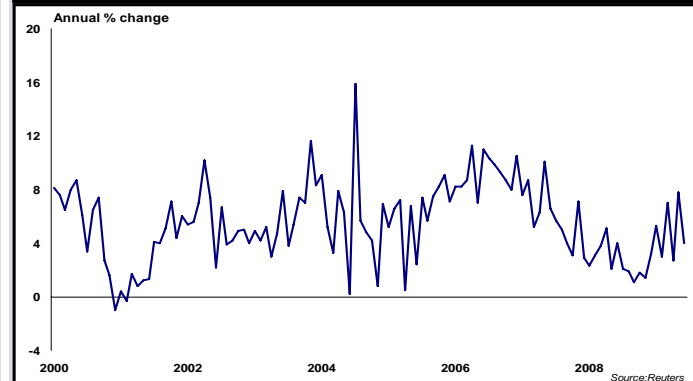
- Third quarter Indian GDP data is due for release on Monday 30th. Recent high frequency activity indicators suggest that growth is likely to have remained close to the previous reading of just over 6%. This compares with the low of 5.8% touched in the first quarter of the year. The manufacturing PMI has pretty much moved sideways since rebounding from 44.4 in December to 55.7 in May (a figure above 50 indicates expansion); the October reading was 54.5. Industrial production numbers tell a slightly more positive story despite slipping back in September but bank credit has yet to pick-up in a material way.

- Meanwhile, the construction sector is demonstrating some evidence of returning to a firmer growth path. The latest figures on infrastructure output for the month of September show growth of 4% compared with a year earlier. Adding this to the already published numbers suggest that infrastructure output has risen by 5% in the first half of the financial year. This compares with an increase of 3.4% in the equivalent period of 2008/09. Significantly, recently released forecasts from Global Construction Perspectives and Oxford Economics indicate that over the next decade the Indian construction market will jump from being the ninth largest in the world to the third with annual growth in construction output averaging around 9%.

- Returning to the current situation, the Reserve Bank of India (RBI) in its latest quarterly review of monetary policy noted

that ‘after showing some correction in the latter part of 2008...real estate prices have risen significantly in major cities’. Although this does appear to be the case in pockets, doubts have been raised about just how widespread the rebound in prices really is. More than anything, the statement from the RBI appears a warning shot that the current accommodative monetary stance can’t continue indefinitely. The likelihood is that interest rates will begin to move upwards in the early part of 2010.

Infrastructure output is beginning to recover



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Spanish housing market activity to improve but headwinds remain

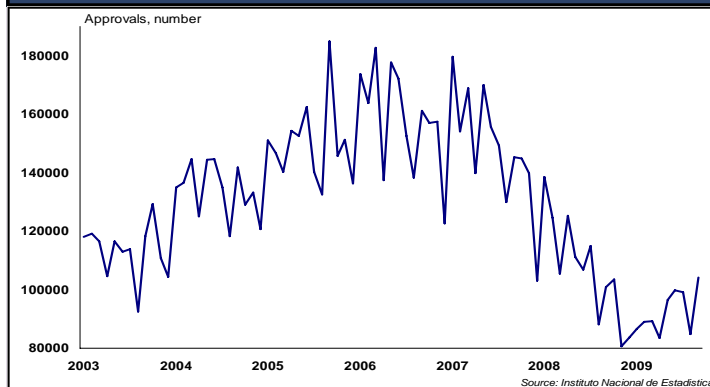
“Housing market activity has improved...”

“...but there are risks to the outlook”

- Spanish mortgage approval data for September was released earlier in the week. The latest figure showed approvals reaching 104,245, which is the highest level since July 2008. Approvals are now 29% above their November 2008 trough (80,684). However, they are still 20% below their long run average (130,355 since January 2003) and 44% below their September 2005 peak (184,936).
- The rebound in Spanish housing market activity can be attributed, at least in part, to low and still falling interest rates as well as improving macroeconomic news flow. According to the Bank of Spain, the weighted average lending rate for home purchase has come off its peak of 6.1% in October 2008 to 2.7% in September, the lowest since this series was introduced in January 2003. In terms of the news flow, the rate of contraction in the economy has slowed, as has the underlying pace of job shedding. GDP still fell in Q3, but at 0.3%, was the slowest pace since the economy began contracting in Q2 2008. Meanwhile, unemployment continues to increase but the (three month on three month) pace of increase has tumbled from 18.4% in January to 5.7% in September.
- Looking forward into 2010, the trend in approvals is likely to remain positive, but future increases may not be as large as has been the case recently. The rate of decline in the overall econ-

omy will probably continue to ease - in line with lead indicators of the economy such as the PMI surveys – and this in turn will further support the labour market. However, economic headwinds remain. Although the PMI surveys have broadly improved, both the manufacturing and services indices still remain in negative territory. Moreover, consumer confidence, whilst much improved from its February low of -48, has been hovering around the -20 mark since June. These factors would caution into extrapolating forward too far the recent trend in approvals.

Spanish housing market activity is 29% above its trough



Upward revision to Q3 UK construction estimate likely

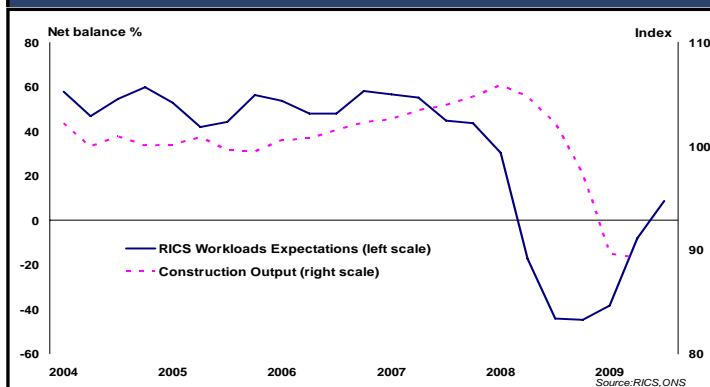
“Provisional estimates point to a fall of 1.1% in construction output ...”

“...but the RICS survey suggests that workloads only fell modestly over the period”

- The coming week will provide a further update on the state of the construction sector in the UK. The latest indicator of sentiment in the sector will be provided by the CIPS index which is due for release on Wednesday 2nd. The October report showed the construction industry to still be firmly in recession with a stabilisation in new orders being insufficient to prevent a further fall in activity. The survey also suggested that the housing sector appears to be closer to finding a floor than either commercial business or civil engineering.
- Harder data on construction will follow with the publication of the formal Q3 output numbers on Friday 4th. Provisional estimates for use in the preliminary GDP number assume that output fell a further 1.1% in the third quarter. This estimate is, however, often subject to hefty revisions so the update due at the end of next week will be worth watching. If the drop of 1.1% were to be confirmed, it would point to a worsening picture in the sector after a very modest decline in the second quarter. Significantly, the latest RICS Construction Survey points to only a very small drop in workloads during the period with some tentative signs of optimism about the prospects for the next twelve months.
- Turning to housing, at the very beginning of the week (Monday

30th), the Bank of England will release its October lending figures. Mortgage approvals have risen smartly in recent months taking their cue from the firm trend in the RICS new buyer enquiries series but there are just a few signs that it may prove harder to maintain this positive momentum going into 2010. The latest net balance reading for buyer interest, while still encouraging, is somewhat down from the highs seen in the early part of the summer.

Construction workload expectations have turned positive



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