

German construction sector still under pressure

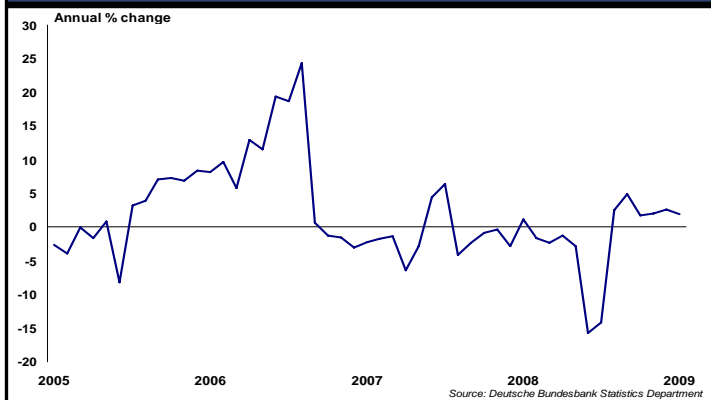
“Weak demand and rising cost pressures are weighing on output...”

“...this scenario is likely to continue”

- The German construction PMI Survey for October was released on Thursday 5th. The headline index came in at 43.4. This is the lowest reading in four months and indicates that overall output in the sector contracted (50 is neutral from a growth perspective). The decline in output took place across the survey’s three subsectors (commercial, residential and civil engineering). The main reasons for this highlighted in the survey are a combination of falling new orders and rising cost pressures.
- The PMI data is a useful guide to the likely behaviour of the official data which, to date, has portrayed a slightly rosier view of the sector. Construction output still grew by 1.9% y/y according to the official data (August). Meanwhile, there remains positive momentum in new orders, although such momentum has begun to fade recently. Indeed, on a three month on three month annualised basis, growth in total construction orders slowed from 22% to 12% in August. Signs of rising cost pressures - the other factor highlighted by the PMI Survey - have yet to be reflected in the official construction cost index (annual growth was 0.4% in Q3). However, the construction cost index includes a number of variables (with land overwhelmingly the most important), while the PMI Survey is probably homing in on the surge in energy prices. The oil price has more than doubled from its trough of \$39pb in February to \$75pb in October. This is indicative of the cost pressures the sector currently faces.

- Looking forward, the German construction sector is likely to come under pressure over the next 12 months. Even as the domestic economy emerges from recession (GDP grew by 0.3% in Q2), the simultaneous pick up in the global economy is likely to keep oil prices (and energy costs more broadly) well supported. This in turn will put downward pressure on profit margins in the sector and it comes at a time where underlying demand conditions, as reflected in order books, are becoming a little less favourable.

German construction output is likely to contract again



Canadian housing market recovery continues

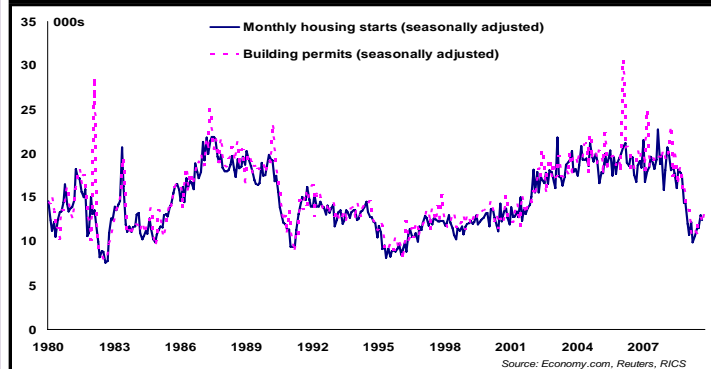
“Housing starts and house prices should edge up further...”

“...but tighter monetary policy in the medium term is still a threat”

- A comprehensive update on the Canadian property market is due next week with the release of data on housing starts for October on Monday 9th followed by the latest house price index on Thursday 12th. Data related to housing construction are good forward looking indicators of sentiment towards the housing market in 6-12 months time. Recent figures have suggested that the outlook for the housing market is improving, along with recent improvements in the wider economic backdrop. Indeed, economic output is stabilising, after contracting for 10 months, and unemployment fell back in September, from 8.7% to 8.4%.
- Canadian housing starts fell by 4% in September, following a 13% jump in August. But over the last three months, housing starts were 16% higher than the three months before that. However, the sector still looks historically weak – the 150,000 (seasonally adjusted and annualised) housing starts in September were still 16% below their long run average. Building permits, which act as a lead indicator for housing starts, jumped by 9% (on a seasonally adjusted basis) in August. Although that may have partly been boosted by a backlog in permits, after a strike in Toronto in July, it does suggest that housing starts will continue edging up, approaching the 160,000 (seasonally adjusted and annualised) mark by the end of the year.
- Insofar as improvements in housing starts reflect general demand for housing, the recent developments discussed above also

bode well for Canadian house prices. On a national average, house prices have nudged up in the past two months, although only by 0.3% in total. This series, released by Statistics Canada, only measures new house prices and appears to be lagging the existing house price series which, as in Australia and the UK, have shown a surprisingly strong rebound since early 2009. But if some of the recovery is being supported by low interest rates then tighter monetary policy may lead to another downturn in house prices in the medium term.

Building permits and housing starts are edging up



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Chinese money boost to support ongoing investment

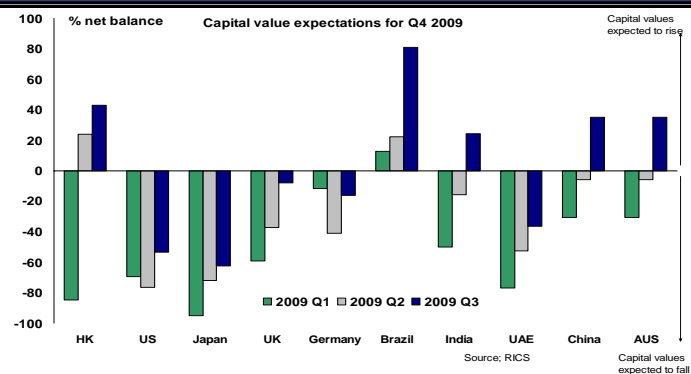
“Money supply growth is starting to feed into commercial property pricing ...”

“..and should underpin ongoing rises in investment activity”

- Several pieces of key economic data pertinent to the Chinese property market are released next week. Chinese retail sales, industrial production and producer price inflation data are all released on Wednesday 11th. Also on the same day, the latest update on fixed asset investment is due which provides a year to date figure on growth in urban investment spending.
- The latest economic numbers in China have continued to exceed consensus expectations. Money supply and lending growth was strong in September with M2 up an annual 29.3% and Yuan lending also rising 34.2%. The lending splurge should continue to underpin improvements in fixed asset investment with no signs as yet that an exit strategy to policy stimulus measures is imminent. Indeed, this week, Chinese officials reaffirmed the country's pro-growth policy stance as Guo Qingping, an assistant governor of the People's Bank of China, told a financial forum that the central bank would stick to its appropriately relaxed monetary policy stance and ensure an adequate amount of liquidity in the banking system.
- Urban fixed asset investment has grown by 33% in the year to September. This compares to 25% growth in the whole of 2008. Underpinning the acceleration in growth has been an investment in real estate and projects under way. Investment into real estate is up by 17.7% compared to 20% for the whole

of 2008 whilst projects underway have grown by 37% in the 9 months to September. Worries over a renewed real estate bubble however have resurfaced in some quarters. The latest Global Commercial Property Survey from RICS for Q3 shows that property prices and rents are yet to take off although are no longer falling. Expectations towards future price gains into Q4 have picked up sharply however. Other measures to control bank lending may yet be re-enacted such as changes to bank reserve requirements should rising asset prices present a new threat to economic stability.

Commercial property prices are expected to rise into Q4



Korean rates to remain on hold for a little longer

“House prices have now risen for seven consecutive months”

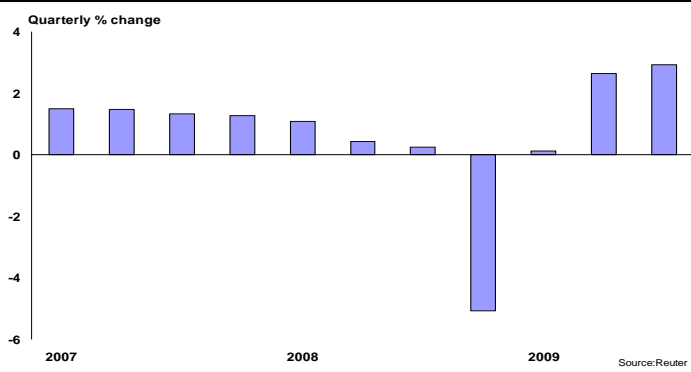
“Mortgage lending controls have been imposed recently”

- The Bank of Korea meets again on Thursday 12th against a backdrop of continued speculation about the possibility that it will soon begin to unwind the monetary stimulus that has helped support the economy over the past year. Recently released Q3 GDP data posted an increase of more than 12% when measured on a quarter on quarter annualised basis. However, some other activity indicators are painting a more mixed picture. The HSBC/Markit manufacturing purchasing managers' index slipped in October to 52.5 from 52.7, which is consistent with a more modest acceleration in business activity. In addition, exports also dropped during the month.
- On the real estate front, data published by the country's largest lender Kookmin Bank show that house prices have now risen for seven consecutive months with a 0.4% gain being recorded in October. However, the rebound in the residential market masks significantly divergent trends between the capital and the rest of the country. While Seoul is clearly benefiting from an upsurge in investor interest, elsewhere there is considerable evidence of the market being dragged down by a glut of unsold properties. It is also noteworthy that the Bank of Korea has softened its stance regarding the residential market of late; in both August and September, it explicitly warned about raising rates if property prices continued to rise

but in October, it acknowledged the picture had begun to stabilise.

- One factor justifying this shift in stance from the monetary authority is the decision of the Financial Supervisory Service to impose controls on mortgage lending. There will now be a limit on the percentage of a borrower's annual income that can be spent on servicing debt amounting to 50 per cent in the capital and 60 per cent in Incheon City and Gyeonggi Province.

GDP data shows Korea has rebounded smartly



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