

Korean central bank may be first to target emerging housing bubbles

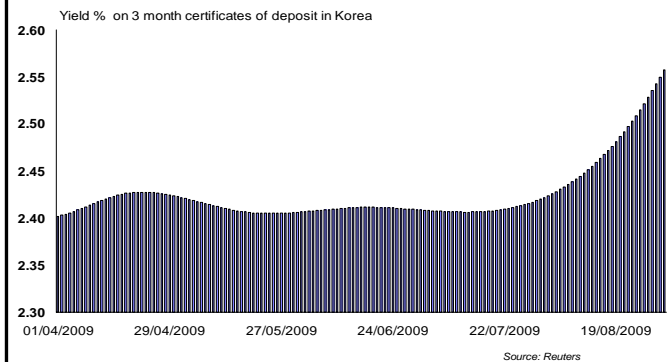
“Concerns that loose monetary policy may be stoking a renewed asset price bubble...”

“with financial markets now factoring in a rate hike before year end”

- The Bank of Korea meets on Friday 9th to set interest rates amid mounting evidence that the economy is responding well to previous policy measures and a firming in the global growth environment. Having slashed interest rates to 2% in response to the largest global economic slump in decades, concerns are now growing that the sharp recovery in the external environment coupled with loose monetary policy at home may be stoking the fire of another house price bubble.
- A tightening in mortgage lending criteria has occurred in recent weeks with banks told to focus on incomes rather than asset prices when advancing loans for house purchase. The changes in lending criteria follow a rebound in the property market which has seen apartment prices rise consecutively over the last four months to a level which is now approaching pre-crisis highs. Business and consumer confidence on the home front continue to gain strength as exports have retraced some of their losses and should be further helped in the coming months by the strength of the Japanese Yen relative to the Korean Won.
- Money market rates have been climbing in recent weeks in anticipation of the first rise in interest rates which many believe may occur before the year end. Short term lending rates which had held relatively steady for months have gained over 25 basis points since early August to 2.75% indicating that at least one

quarter point interest rate hike may be on the cards before year end. Indeed, the Korean authorities may be one of the first to test the theory of “leaning against the wind” to target an asset bubble in the post-financial crisis world.

A rise in interest rates is expected before year end



Australian first home buyers will act before the Boost expires

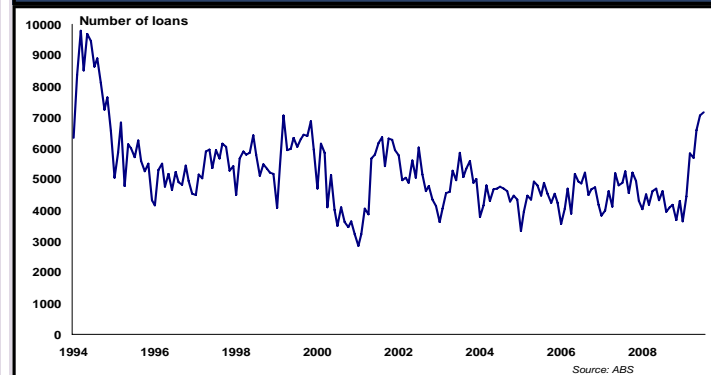
“Demand for housing finance may spike up before the Boost expires”

“Chronic undersupply will continue to push up prices in the future”

- Next week sees another update on the Australian housing market with data on housing finance approvals for August, an indicator of short-term demand, to be released on Wednesday 7th. The Australian housing market has held up well compared to other countries during the global financial crisis and part of that resilience has been attributed to subsidies from the Federal Government for first home buyers.
- The introduction of the ‘Boost’ in October 2008 (which offered, on top of an existing AUS\$7,000 subsidy for all first home buyers, an additional AUS\$7,000 for purchasing an existing home or an additional AUS\$14,000 for new homes) has markedly increased the number of first home buyers in the market. The proportion of new finance for house purchase that is attributed to first home buyers hit a series high (since 1991) of 28.5% in May, but has since moved back to around 25% - but both proportion and number of borrowers (17,000 in July) were above the long run averages of 20% and 9,500 respectively. It is possible that stretched affordability means that first homebuyers activity in the market has now peaked. But the Boost scheme is due to be rolled back to AUS\$10,500 and AUS\$14,000 for existing and new homes respectively from 1st October. The data may spike upward as people take advantage of the scheme at the last minute. But that will be offset by more subdued housing finance data in the coming months, especially once the Boost is withdrawn entirely from the end of 2009.

- By providing an incentive to buy newly constructed homes, the Boost scheme was also attempting to address the problem of low housing stock. Since the end of 2008, the proportion of new loans that are for construction of dwellings has increased from 7% to 11%, while the level of loans is at its highest since 1994. Nevertheless, the Reserve Bank has still suggested that a chronic undersupply of housing will continue to place upward pressure on house prices in the near term.

Loans for housing construction at their highest since '94



Stabilisation in euro area economy begins to spread to property

“Recent data flow in the euro area has improved...”

“...but strong recovery in the euro area or its property sector is still some way off”

- The ECB will announce its interest rate decision on Thursday 8th and is widely expected to keep rates on hold at 1%. This is because the September ECB staff projections show medium term inflation to be below the bank’s 2% target (it is forecast to fall between 0.8% - 1.6% in 2010). The main factor contributing to the ECB’s subdued inflation outlook is the high level of slack in the euro area: unemployment is currently running at 9.6%, the highest in a decade.
- Nevertheless, the ECB staff projections were still revised upwards from the June release (inflation was previously forecast between 0.6% – 1.4% in 2010). These revisions come on the back of generally improved data flow during the third quarter. This improvement has been exemplified by the PMI survey and the final September release of the services component is due on Monday 5th. The service sector PMI has recovered from a low of 39.2 in February to 50.6 (according to the flash release) in September. This suggests that more stable economic activity is extending beyond the manufacturing sector.
- Naturally, this improvement is beginning to be felt in the property market. On the residential side, mortgage lending is beginning to stabilise as are house prices in some key markets. Indeed, euro area mortgage lending increased at a 1.8% annualised rate in August. Meanwhile, in Spain, house prices fell at a

1.8% annualised pace in Q2 (compared to -10.3% in Q1), and in Germany, they increased at a 0.2% pace in August (compared to -2.8% in July). On the commercial side, the latest RICS Global Commercial Property Survey indicates that in Western Europe, occupier demand is still falling, but at a slower pace, and capital value declines are expected to moderate. Looking forward, a stabilising euro area economy will continue to be felt in the property market, but a strong recovery in both cases is still some way off.

Euro area service sector activity has stabilised



Outlook improving for Canadian housing market

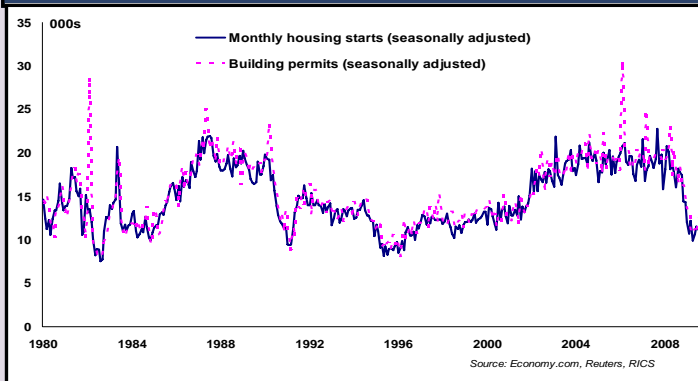
“Recent data has suggested that the outlook for the housing market is improving”

“Canadian housing starts may have moved past the weakest point in this cycle”

- Next week, data on building permits for August will be released on Tuesday 6th, followed by housing starts for September on Thursday 8th. Data related to housing construction are good forward looking indicators of sentiment towards the housing market in 6-12 months time. Recent data has suggested that the outlook for the housing market is improving, even though a generally weak economic backdrop remains in place. GDP has fallen for the past three quarters while the unemployment rate has risen from 5.8% (at the start of 2008) to 8.7%, although it has seemed more stable in the past couple of months. A sign of a brighter outlook in the housing market is that house prices rose in July for the first time since September 2008.
- Canadian housing starts in August jumped by 12% to 150,400 (seasonally adjusted and annualised). But as an indication of their historical weakness, housing starts are still 31% lower than 12 months earlier and 15% below their long run average. The apparent downturn in housing starts is, in part, a natural correction following an extended (six year) boom during which housing starts data averaged over 220,000. That was also exacerbated by a general weakness in the wider economy. But on the back of August’s numbers, the 3m/3m growth rate in housing starts (an indication of the recent trend) moved up to 7.5%, suggesting that the weakest point in this cycle is past.

- One sign that housing starts may falter in the next couple of months is that building permits, once adjusted for seasonal factors, have been stuck at a relatively low level (of around 12,000 per month) for the past three months. However, the data released for July were partly affected by a strike in Toronto so it is likely that building permits will have posted a reasonable gain in August. The relationship between building permits and housing starts suggests that housing starts will edge slightly higher over the next couple of months.

Building permits point to small rise in housing starts



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