

## German house prices to remain relatively flat over next 12 months

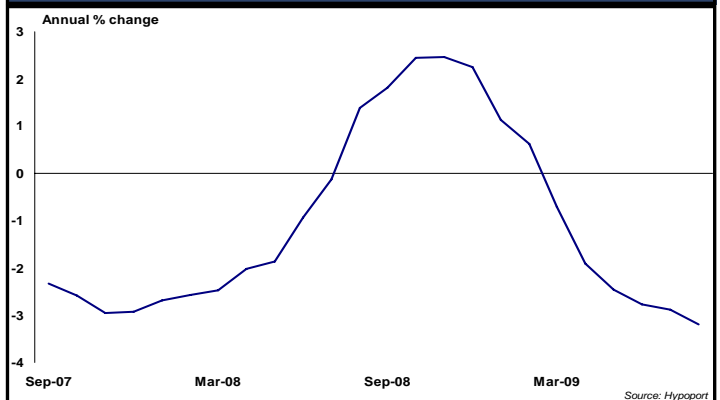
“German house prices are likely to remain relatively flat...”

“...but the risks are skewed slightly to the downside due to further weakness in the labour market”

- German house price data for September is due from Hypoport next week. The headline index is down by 3.2% y/y but prices are currently flat on an annualised basis (three month on three month). The performance of the headline index has been driven by the existing homes and apartments sub-indices, down by 5.8% y/y and by 3.9% y/y respectively (the new homes sub-index has remained unchanged over the year).
- The relative stability of German house prices over the last year can be attributed, in part, to the following factors. First, mortgage lending has been relatively stable, both ahead of and following the global financial crisis. Even at its March 2006 peak, mortgage lending only grew by 2.6% y/y and is now only down by 0.4% y/y. Second, there was no building boom. Residential investment as a share of GDP currently stands at 5.5% and has been below its long run average (6.5% since 1991) since Q1 2001. Finally, government policy i.e. the short time workers scheme, is limiting the rise in unemployment (up from 7.1% in December 2008 to 7.7% presently). At the margin this is limiting some potential forced selling that might otherwise take place (although admittedly, the low degree of homeownership, at c.40%, is also a major factor). The short time workers scheme involves full time workers agreeing to work part time in return for not being made redundant with the government compensating the shortfall in their earnings.

- Looking forward, German house prices are likely to remain relatively flat over the next 12 months, but the risks are slightly skewed to the downside. The short time workers scheme has proved successful (the OECD estimated in July that the take up of this scheme has totalled more than 1.4million workers). But unemployment expectations remain elevated according to the European Commission and this suggests the labour market and consequently the housing market is likely to deteriorate further.

### German house prices have remained relatively flat



## Canadian housing market improving but will it last?

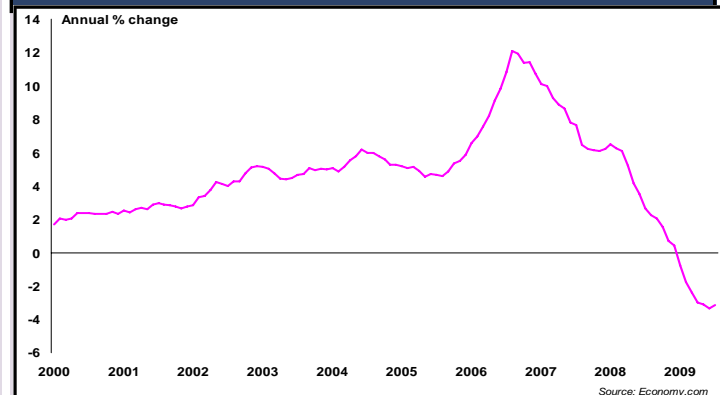
“House prices rose by 3% in July”

“Non-residential construction will remain subdued”

- The next updates on the Canadian property markets come with the release of the new house price index for August on Tuesday 13<sup>th</sup> followed by data on non-residential construction spending for Q3 on Friday 16<sup>th</sup>. Recent data have suggested that the Canadian economy may already be pulling out of recession. After a 4.5% fall from its peak, GDP was roughly stable in June and July and September’s PMI, a more timely indicator of recent activity, was at its highest level since July 2008.
- Indeed, house prices in Canada may be nearing their trough earlier than expected. Prices rose by 0.3% in July. That was the biggest monthly change since February 2008, and left prices 3% off their peak – an incredibly mild correction when compared to the 30% falls reported by the Case-Shiller index for the United States. Recent improvements in the housing market have probably been driven by the low cost of borrowing and returning consumer confidence (which, in September, reached its highest level in two years). Already, housing sales have rebounded to their 2007 levels. More cautious commentators note that there are still some risks to the housing market – the economic recovery is only in its early stages and a weaker labour market could also undo recent gains.
- At a headline level, construction investment in the non-residential sector has held up well through the recession. Although spending in 2009Q2 fell by 1.5% compared to Q1, it had

increased by 1.5% compared to 2008 Q2. However, sharp annual falls (of 14.5%) in industrial construction spending have been offset by a 16.6% increase in institutional construction. Meanwhile, commercial construction has been relatively steady (falling by 1.3% between 2008 Q2 and 2009 Q2). Looking forward, construction activity may wane further as high unemployment will increase vacancy rates in office and industrial property and government support (via institutional investment) is unlikely to compensate for that weakness altogether. Subdued numbers are expected over the rest of 2009.

### Canadian house price falls may be reaching their trough



## More evidence likely of improvement in UK commercial property

“The last (IPD) report showed the first rise in capital values since June 2007”

“Foreign investors accounted for more than half of all purchases in the third quarter”

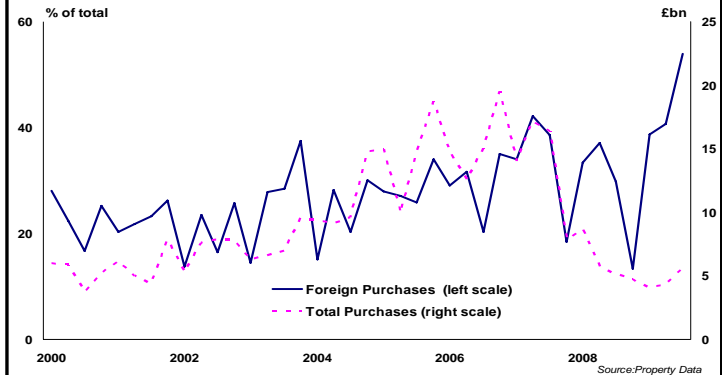
• The coming week sees the release of important data for both the residential and commercial property markets in the UK. On Tuesday 13<sup>th</sup>, the September RICS Housing Market survey is published. The last report suggested that new instructions to estate agents were beginning to edge up although insufficiently so to keep pace with demand. The result was a further rise in the closely watched sales to stock ratio, which effectively captures market slack, and the highest reading in the price expectations net balance since January 2007. On the same day, Communities and Local Government releases its August housing market report. Like other indices, this measure of house prices has also climbed off the floor in recent months. The headline UK house price index has risen by 5% from its March low. Significantly, this series like most others indicates that London is fairing rather better than other parts of the country.

• Following on from this on Wednesday 14<sup>th</sup>, IPD publishes the monthly update of valuation trends in the commercial real estate market. Significantly, the last report showed the first monthly rise in capital values, albeit of just 0.2%, since June 2007. From peak to trough, this index suggests that capital values declined by 44% with initial yields rising from around 4.5% to close to 8% over the same period. The August report also provided some tentative evidence that the pace of decline in rents is beginning to soften. The monthly drop of 0.5%, was

the most modest decline since October last year and tallies with improved rental expectations in the Q2 RICS UK Commercial survey.

• The better tone to the commercial market has also been reflected in an increase in transaction activity. Provisional figures from Property Data shows that the value of purchases jumped by almost one-third between the second and third quarters of the year. The increased interest in the market was led by foreign investors who, benefiting from the weak sterling, accounted for more than half of all purchases.

### Foreign buyers underpin commercial property market



## Japanese construction sector still lagging the economy

“Forward looking economic data has shown some improved signs..”

“..although deflationary threat reduces chances of an early retreat from emergency support”

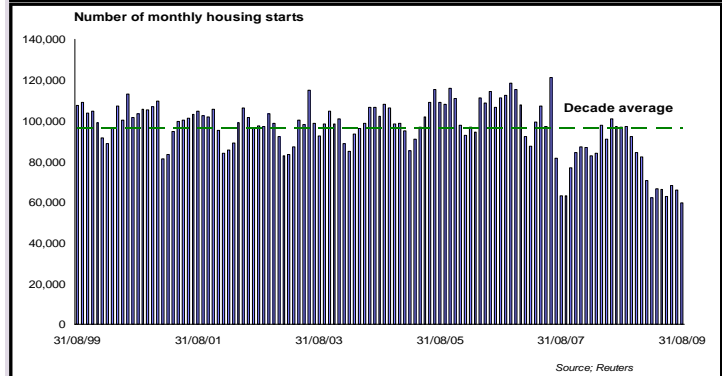
• Next week sees a raft of economic data released in Japan important to the near term outlook for the Japanese property market. The Bank of Japan begins its two day meeting on Tuesday 13<sup>th</sup>, to decide on monetary policy amid some signs that gradual improvements in the Japanese economy are slowly emerging. Other crucial indicators to look out for next week include M2 monetary figures on Tuesday 13<sup>th</sup>, industrial production numbers on Thursday 15<sup>th</sup> and the construction spending figures on Friday 16<sup>th</sup>.

• The forward looking economic data has offered some encouragement in recent weeks. Business surveys point to an ongoing improvement in the trading climate among big manufacturers in the quarter to September. The Cabinet Office’s survey of consumers also edged higher in August for the eighth consecutive month. Even some of the lagging economic numbers have improved. The unemployment rate receded in August to 5.5% from 5.7% a month earlier, which was the first monthly decline since January. In addition, household spending exceeded expectations in August rising 0.9% mom with retail sales also up 1% on the month.

• Counterbalancing these improvements somewhat has been an acceleration in the deflationary trend in August and continuing

weakness in both machinery orders and construction activity. Deflation accelerated to a record 2.4% in August whilst housing starts hit a thirty year low with less than 60,000 projects underway. RICS expect that next week’s construction spending figures, whilst weak, could mark a series trough as the lagged impacts of a strengthening economy feed through. With the deflationary threat overhanging, however, any talk of an early exit from emergency credit measures when the BoJ meet may be premature.

### Housing starts hit a thirty year low in August



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