

## UK commercial property values set to edge up in August data

“Capital values slipped just 0.1% in July ”

“Any recovery in the market will be hampered by the lack of mortgage finance”

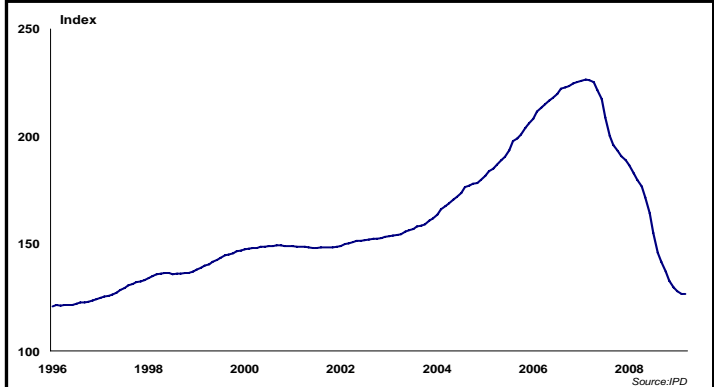
- Further evidence that the UK commercial property market is close to finding a floor is likely to be provided by the latest figures from the IPD due for release on Monday 14<sup>th</sup>. The July data suggested that capital values for ‘All Properties’ slipped just 0.1% compared with June; this was the most modest month on month drop since the market turned down back in mid 2007. As a result, the peak to trough fall now stands at 44%. In terms of sector performance, retail values rose in July for the first time in two years albeit by just 0.05% while both the office and industrial sectors continued to be marked down.

- The other encouraging aspect of the July report was the less aggressive reduction in the rent indices. All three main sectors posted further declines but the ‘All Properties’ measures slipped just 0.58% (compared with June) which represent the smallest monthly drop since November 2008. Relative to a year ago, rents in the office sector have fallen by close to 14%. In stark contrast, retail rents are less than 6% down. Even so, the initial yield in the office sector still stands above 8% while in retail, it is now below 7.6%. Over the past 20 years, the average yield gap between these two sectors has typically been

rather larger at close to 1%.

- The August data could post the first monthly increase in capital values since June 2007. Even if this proves to be case, the general lack of mortgage finance is likely to provide a material headwind to a meaningful recovery in commercial property prices.

### Capital values appear to be bottoming after a 44% drop



## US housebuilding recovery threatened by foreclosures

“House-builders sentiment is recovering but only gradually”

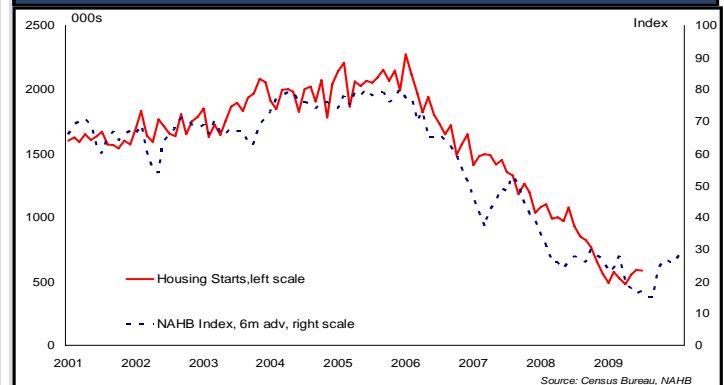
“Housing starts should continue to edge up”

- The closely watched NAHB housing market index is next due for release on Wednesday 16<sup>th</sup>. Although the survey has shown that builders’ sentiment has improved from the lows at the start of 2009, it remains deeply depressed and is only recovering very gradually. The headline index ticked up to 18 in August (from 17 in July) while the ‘traffic of prospective buyers’ indicator increased from 13 to 16. The most optimistic news in the last release was that the forward looking component jumped from 26 to 30. That was probably fuelled by more favourable news-flow, such as a jump in new home sales and an easing in the pace of rising unemployment. Next week’s data is expected to reveal that the NAHB survey edged up again.

- Following on, the latest housing starts data will be published on Thursday 17<sup>th</sup>. As building permits were unchanged between June and July, it seems most likely that housing starts will post a number similar to the 581,000 (seasonally adjusted and annualised) reported in July. The NAHB forward looking index has been a good lead indicator of housing starts over the next six months. That relationship suggests that housing starts will hover between 500,000 and 700,000 per month over the rest of this year.

- One of the risks to the housebuilding sector is that foreclosures are still expected to rise sharply with recent reports that the Treasury expect there could be millions more to come. The sharp rise in foreclosures (and hence forced sales of existing homes) earlier in the year contributed to the collapse in new home sales. The threat of a repeat scenario means housebuilders are likely to be cautious for the rest of this year.

### NAHB index suggests further rises in housing starts



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## Euro area construction output still on the floor

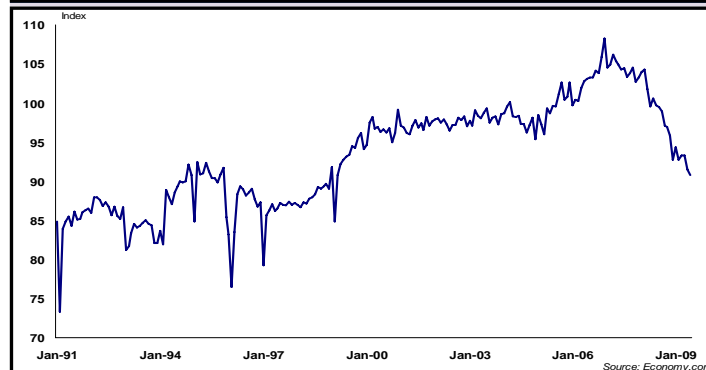
“Construction output is now 16.2% below its December 2006 peak...”

“...more upbeat news on the wider economy offers some encouragement for the sector”

- Against the backdrop of improving economic news flow across much of the euro area, it will be interesting to see whether there are any signs of a bottoming out of the recession in the construction sector; the latest data is due for release on Thursday 17<sup>th</sup>. In June, construction output fell by 0.8% compared with the previous month taking the index to its lowest level since March 1999. Total construction output is now 16.2% below its December 2006 peak.
- A particular drag on the sector has been the sharp drop in activity in the residential area which accounts for around half of total construction output. Declining house prices, albeit more modest falls than in either the US or the UK, have hit sentiment towards new developments. Meanwhile, the oversupply of property in a number of markets has also taken its toll on building plans; this problem has been exacerbated by the withdrawal of foreign buyers from the market place. Although the credit crunch in the euro area has been less marked than in much of the Anglo Saxon world, finance is less freely available than was previously the case which has contributed to the slacker trend in mortgage activity.

- Sentiment in the construction sector still remains understandably quite cautious with EC survey suggesting that the trend in new orders remains weak. However the more upbeat news on the wider economy, with Germany and France both posting positive growth in the second quarter, provides some grounds for believing that this picture could gradually begin to turn around.

### Construction output in the euro area is still falling



## Korea property fears set to drive interest rates higher

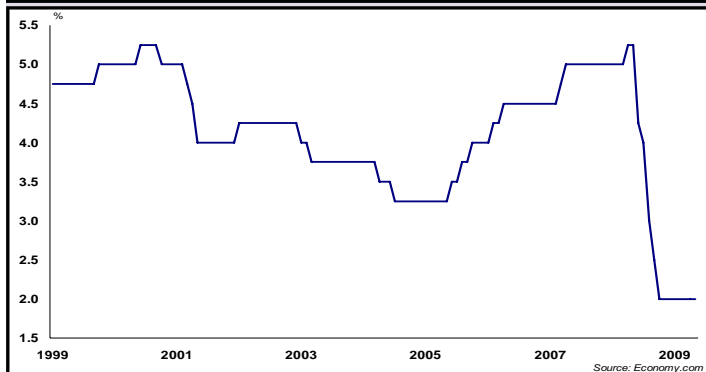
“The BoK drew attention to rising house prices and rapid mortgage lending”

“a hike in interest rates now looks likely before the year end”

- The Monetary Policy Committee of the Bank of Korea (BoK) decided to maintain its base rate at 2% at its latest meeting. In the statement accompanying the decision it acknowledged the improvement in the economy, driven by a combination of strengthening external conditions and domestic demand. However, the MPC also drew attention to rising house prices and rapid mortgage lending, underlining concerns that the loose monetary stance is spilling over into asset prices and possibly stoking a bubble.
- The turnaround in some of the indicators has indeed been marked. To give a flavour of this, the economy grew by 2.3% in Q2 (taking the annualised growth rate to 9.7%) after growing 0.1% in Q1. Annual growth in exports reached 4.5% in June, the first positive reading since October 2008 (having contracted by 25% in January). Consumer confidence is now at its highest level since the series began in July 2003. And annual growth in retail sales volumes have now stabilised, having contracted by 6.8% in February.

- However, the monetary stimulus provided by the BoK may now be spilling over into asset prices and the housing market in particular. Indeed, annual growth in mortgage loans outstanding increased by 10.7% in Q2. Reflecting the concerns of the authorities a hike in interest rates now looks increasingly likely before the year end.

### Korean interest rates set to rise before the year end



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