

Hong Kong and Latin America leading rental recovery

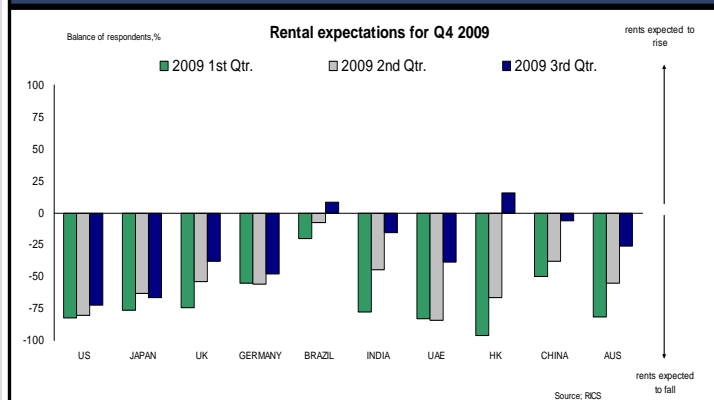
“Lettings and investment activity on the rise in a number of markets”

“...as rental pessimism starts slowly lifting”

- The latest RICS Global Commercial Property Survey for Q3 2009 is noticeably more upbeat than the second quarter report both in terms of the lettings environment and investment activity. Confidence in the outlook for tenant demand over the next three months is either less negative or more positive than was previously the case in every region of the world. Significantly, this better tone is starting to filter through into rental expectations. Surveyors in Latin American and Asian countries are the most optimistic when it comes to the outlook for rents with Hong Kong enjoying a particularly big uplift in sentiment.
- Peru, Columbia and Brazil also reported positive net balances on rental expectations while South Korea, China, Thailand and India were only mildly negative. Australia, UAE and the UK saw less pessimism regarding rental expectations over the quarter. In the US and Japan rental expectations showed little improvement from the lows touched in Q2. Interestingly, a number of European countries including Ireland, France and Spain have the worst readings on the rental outlook.
- The mood amongst real estate investors also appears to have perked up according to the survey with capital values expected to increase in a number of countries including Brazil, Hong Kong, South Korea, China and India. This more positive mood has also been reflected in activity indicators with the number of

investment bidders per property picking up sharply not just in Asia and Latin America but also in a number of European countries. Sentiment towards capital values in the US is, however, still very negative with 53% more surveyors expecting further declines (rather than increases) in the run-up to Christmas. In the UK, the net balance on capital values expectations is still in negative territory although only marginally so and there has been a noticeable increase in transaction activity.

Rental expectations are less negative or even mildly positive



Australian house prices to rise further

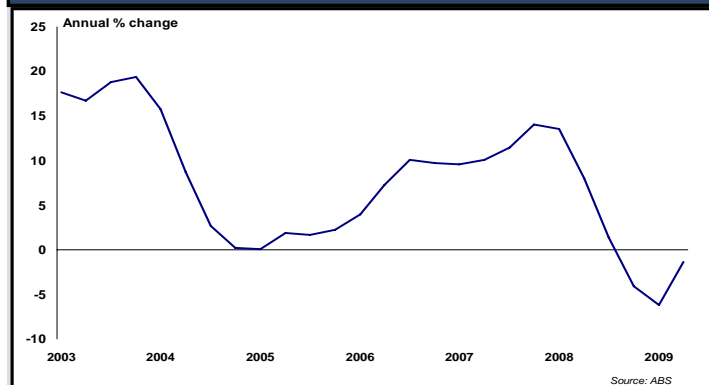
“Recent data suggest that house prices will have increased in Q3...”

“...but the outlook is less certain over the next 12 months”

- Next week sees another update on the Australian housing market with Q3 house prices released on Monday 2nd, followed by building approvals for September on Wednesday 4th. The Australian market defied expectations by posting a 4% increase in house prices in Q2 2009 after prices had fallen just 6% from their peak in December 2007. Recently, more timely data from Australian Property Monitors showed that median prices jumped by almost 4% in Q3 this year which would roughly equate to house price growth of almost 5% over the last 12 months.
- The strength of the Australian housing market is less surprising when considered in a wider context. Indeed, Australia has fared relatively well during the global financial crisis – GDP only contracted in one quarter (as opposed to six consecutive quarters in the UK) and the labour market has also been fairly resilient with unemployment rising from 4% to 5.8% compared to a move from 4.4% to 9.8% in the US. In addition, the Federal government’s First Home Buyer Boost scheme (which offered, on top of an existing AUS\$7,000 subsidy for all first home buyers, an additional AUS\$7,000 for an existing home and an additional AUS\$14,000 for new homes) has markedly increased the number of first homebuyers in the market. But the subsidy has also generated concerns that the boost, combined with a relatively low interest rate environment, has created greater affordability pressures by fuelling a bigger bubble in the housing market.

• However, there are signs that the housing market may be nearing tipping point again. Housing finance approvals and residential building approvals have actually edged down in the past few months (even before the Boost was wound back) and will probably unwind further in September. So the outlook for the next 12 months may be negatively affected by further rises in interest rates as well as any downward adjustments after the distortionary effects of the Boost

Rising house prices may not be sustained through 2010



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Rising interest rates in Norway will dampen the house price outlook

“The Norges Bank expect the main policy rate to reach 2.6% by December 2010 and 4.5% by December 2012...”

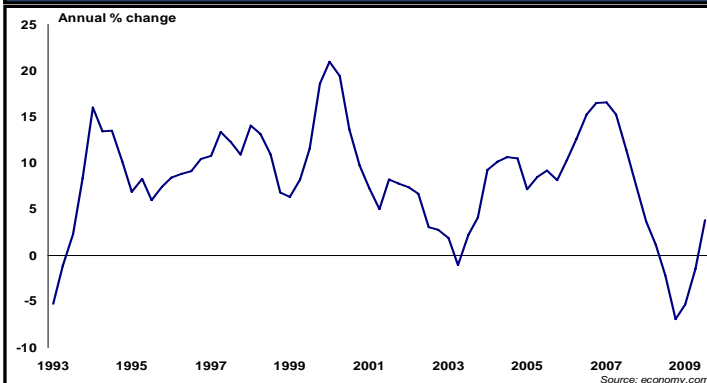
“...this will dampen the outlook for house prices”

- In a widely expected move, the Norges Bank raised its key policy rate by 25 basis points to 1.5% on Wednesday. Although headline inflation continues to fall (1.2%), core inflation is rising (2.4%) and medium term inflation pressures appear to be building. Indeed, to quote a key passage from the Monetary Policy Report (which accompanied Wednesday’s announcement): “with low productivity, higher corporate costs, growth in household demand and higher capacity utilisation, inflation may gradually become too high. This would indicate that the interest rate should be raised”.

- In terms of household demand, some of the recent data flow has indeed been encouraging. Unemployment began to edge down in June and currently stands at 3%, down from its March peak of 3.2%. Meanwhile, annual growth in household credit appears to have stabilised in recent months. At 6.4% in August, it is running at close to its lowest rate since January 2002 but it is still positive. Such factors appear to be contributing to the turn around in house prices. Indeed, the headline index increased by 1.8% in Q3 taking the annual growth rate to 3.8% (the first positive reading since Q2 2008). Interestingly, most of the strength in house prices has been driven by the lower end of the market; apartments are up by 6.6% on the year, small houses are up by 3.9%, while detached houses are up by 2.8%.

- Looking forward, the outlook for house prices is positive in the near term but we are unlikely to see a return to double digit growth, at least in the headline index, over the next twelve months. After all, the Norges Bank has already signalled its intention to raise rates further, possibly as soon as the next meeting. Significantly, the Norges Bank provides explicit policy rate forecasts up to three years ahead; it is projecting that rates will be 2.6% in December 2010 and 4.5% in December 2012. This is likely at some stage to dampen momentum of house price growth.

House price growth has rebounded in Norway



UK construction orders should rebound in the September data

“Weak August orders were driven by a decline in infrastructure and public non-housing”

“A further extension of the QE programme is likely to be announced”.

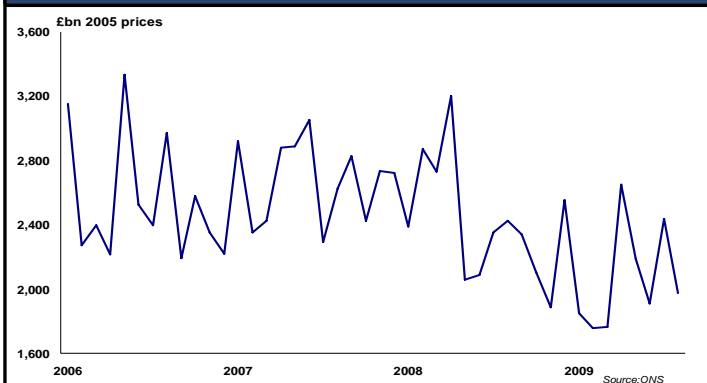
- A further update on the beleaguered state of the UK construction industry will be provided by the release of the monthly CIPS sentiment survey of the sector on Tuesday 3rd and the latest new construction orders data on Thursday 5th. Although the headline index compiled by CIPS has rebounded smartly from the depths plumbed earlier in the year, it still remains below 50 which is the level consistent with stability in output. Interestingly, the last report suggested that the housing component had found something of a floor in September but that commercial activity and civil engineering were still contracting sharply. More generally, jobs are continuing to be lost across the industry according to respondents to the survey.

- Official data on new orders in the construction sector could show some improvement when the September numbers are published. The August figures were a major disappointment casting a cloud over the tentative signs of improvement in order flow in the spring and early summer. Significantly, the biggest drop in demand came in the previously relatively buoyant areas of infrastructure and public non-residential construction. Given that money is still being funnelled into these two parts of the industry, the likelihood is that the next set of data will at least in part reverse the August decline. Even so, the near term outlook for the construction industry is still fairly challenging

while the prospect of significant cuts in public spending in the coming years suggests that the recovery will be hard fought.

- Also on Thursday 5th, the Bank of England will conclude its latest policy meeting. Following the weak Q3 GDP report and the drop in inflation to close to the level requiring Mervyn King to write another letter to the Chancellor, an extension of the quantitative easing programme is likely. Our judgement is that this could be a further £50bn.

New construction orders are not far off recent lows



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