

India faces deflation as real estate outlook worsens

“Inflation is likely to turn negative shortly”

- The pace of growth in bank lending in India has slowed markedly in recent months reflecting the downturn in the economy. As recently as late September, the year on year increase exceeded 30%; it has subsequently slumped to around 18%. In cash terms, bank lending has been broadly flat since the early part of November. March data released on Friday 27th should show that lending activity is continuing to slacken. This worsening picture is now being reflected in the emergence of a deflationary environment. WPI inflation has dropped to just 0.44% and is likely to turn negative before too much longer.

“Commercial property values and rents are both falling”

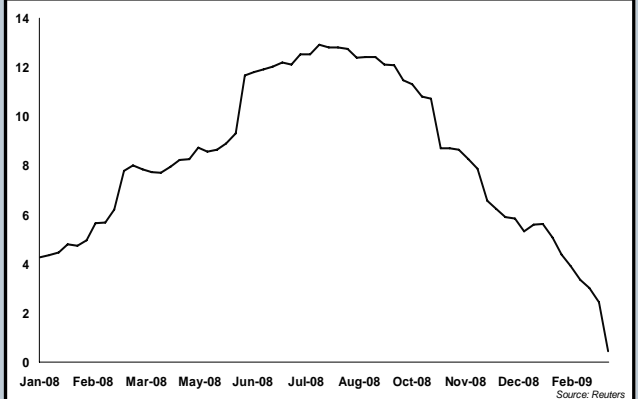
- The latest RICS Global Commercial Property Survey demonstrates how the deterioration in the economic picture has taken its toll on real estate. In the second quarter of last year, a net balance of just 27% of respondents expected rents to fall. By way of contrast, this figure jumped to 100% in the most recent report. A broadly similar response was found in terms of the outlook for capital values. Meanwhile, inducements to take up space have predictably increased, the development pipeline has dramatically eased and investor interest has faded away.

- With deflation almost inevitable and the economic numbers softening, it is likely that the pressure on the Reserve

Bank of India to take further action over the coming months will grow. More in the way of interest rate cuts looks likely (RICS sees a strong possibility that rates could fall as low as 2%) alongside a reduction in the cash reserve ratio (of up to 150 percentage points). On top of this, there is a real possibility of outright quantitative easing.

WPI inflation edges ever closer to zero

Annual % change



No imminent recovery in US housing market

“Fed action should ease financing constraints”

- A sharp rise in housing starts and building permits in February does not herald a rapid recovery in the housing market. The rise in housing starts (up 22% m/m) reflected a large increase in the more volatile multi-family home sector. Single family homes were only up by 1% and that can easily be explained by milder weather.

- More generally, data may be reaching a trough but remains weak in absolute terms. For example, building permits in February were up by 3% from January but were still 45% lower than February 2008. Similarly, it would not be surprising to see a small rise in February's data for existing home sales and new home sales when released on Monday 23rd and Wednesday 25th respectively. New home sales have fallen by around 10% m/m for the last two months and January's sales of 309,000 were a massive 78% below the peak in 2005. Data for existing home sales are bumpier but are expected to continue to hover between 4.5m and 5.1m, as they have done for the last 17 months. As recent pending home sales data showed a 7% monthly fall, a sustained recovery in either series over the next few months is unlikely.

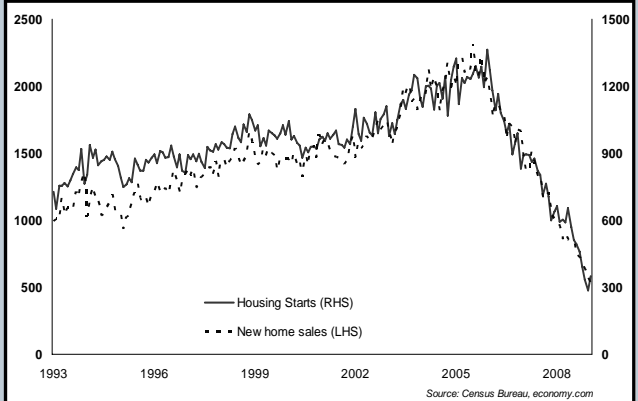
- Of course, these data pre-date the Fed's announcement of a massive asset purchasing scheme. The decision to buy an additional \$750bn in mortgage backed securities, and

more generally to huge a massive boost to the money supply, should improve bank lending and ease refinancing constraints. To some extent, that should help address the high and rising numbers of forced home sales. Nevertheless, in the near term, a grim unemployment outlook and economic uncertainty will depress confidence and weigh on both construction activity and home sales.

Housing starts and home sales must be near trough

Thousands

Thousands



“But a sustained recovery over the next few months is unlikely”

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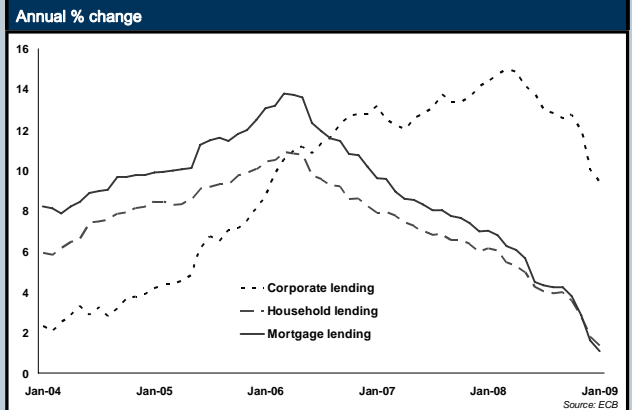
Euro area M3 lending contract further

- Data on M3 money supply in the euro area (covering the month of February) will be published on Thursday 26th. Although the ECB bank lending survey has for some time been signalling the emergence of a credit crunch in the euro area (in terms of rising credit standards), growth in lending had remained positive throughout the entire financial crisis – that is until January’s M3 release. That showed that lending fell by 0.8% on the month, the first contraction since September 2000, taking the annual growth rate down to 5.9%, the lowest since November 2004.
- In terms of the sectoral breakdown, corporate lending growth has proved far more resilient than household lending and in particular, mortgage lending. Indeed, lending to the corporate sector is still currently running at 9.4% y/y, while lending to the household sector is running at 1.4% y/y and mortgage lending is running at 1.1%. The recent trend in lending has been mainly related to demand side factors, with the downturn in real economic activity sapping the household’s and corporate sector’s appetite to take on more debt. However, there is also mounting evidence that the slowdown in lending growth is being driven by supply side factors. The results of the ECB bank lending survey for the three months to January

showed that costs related to banks capital increased at the fastest pace since the financial crisis began.

- Looking forward there is little reason to believe that growth M3 lending will pick up in the short term. Household and business confidence sank to new lows in February, suggesting that demand for lending will remain weak.

Corporate lending has proved more resilient than household lending



“January showed lending fall for the first time since the crisis...”

“...this is likely to continue”

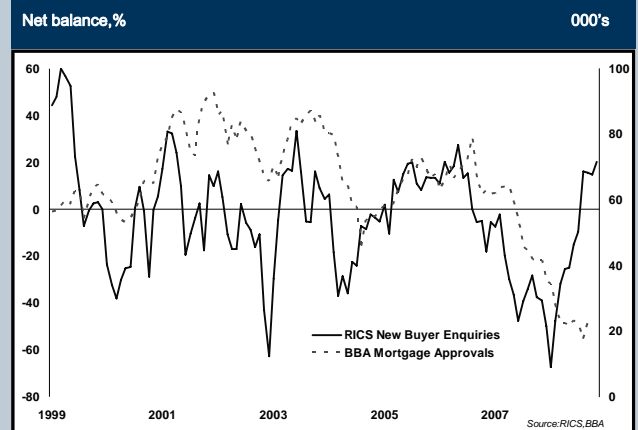
UK mortgage approvals to edge up again

- Data released by the British Bankers Association (BBA) on Tuesday 24th will provide the first estimate of mortgage lending in February. The January figures showed the number of mortgage approvals climbing for the second consecutive month; they rose to 23,376. This compares with a low in November of 17,574. The BBA data provides a good guide to the more complete numbers published by the Bank of England (BoE). The fact that the BoE figures are only showing an increase in mortgage approvals of 4,000 over the same period reflects the fact that banks are taking market share from other lenders.
- It is likely that the February BBA data will show a further increase in the number of mortgages approved. The RICS ‘new buyer enquiries’ series, traditionally a reliable lead indicator of mortgage activity, is continuing to strengthen. The latest positive net balance reading of 20 is the best since August 2006. While it is conceivable that some of the new registrations with estate agents may be ‘window shoppers’, the drop in house prices and the lower cost of borrowing strongly suggests that there is a genuine appetite to buy if the finance is available. Although the commitments from Northern Rock, RBS and Lloyds TSB will together only boost gross mortgage lending by around £20bn (less than 10% of lending in 2008) this should still be sufficient to lift the number of approvals from excep-

tionally low levels.

- The BBA will also release data showing sterling lending to the M4 private sector. This will, in all probability, post a further drop in loans advanced to the construction sector reflecting both the generally cautious stance of lenders as well as a drop in demand as activity has stalled.

Bounce in buyer enquiries points to higher mortgage approvals



“New buyer enquiries point to increased mortgage activity”

“But lending to the construction sector may fall further”