

Reserve Bank of India voices concern over pockets of the real estate sector

“RICS expects a further hike in interest rates next week...”

The Reserve Bank of India (RBI) hold their monetary policy meeting on Tuesday 2nd amid concerns that a bubble may be emerging in some parts of the real estate sector. On the same day, RICS release its third quarter results of the Global Commercial Property Survey. This will include the latest forward looking indicators for

both rents and capital values across office, retail and industrial property in India.

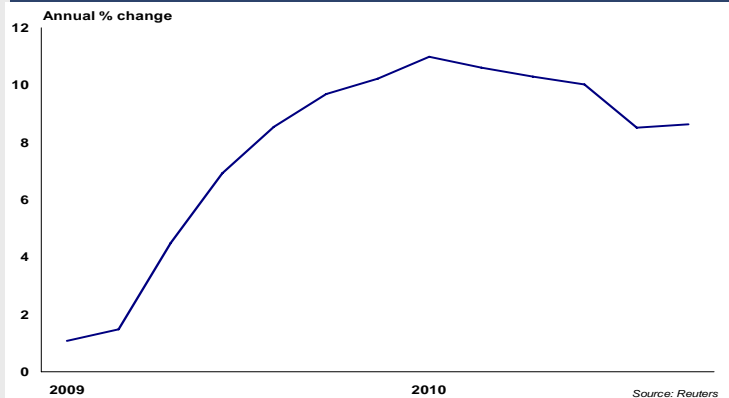
Having raised interest rates quite aggressively in recent months, RICS expects a further 25 basis point increase in the repo rate to 6.25% at next week's meeting as inflation pressures remain a key concern for policymakers. Indeed, annual growth in inflation actually moved higher for the first time in 5 months in September. Voicing its concern over a potential real estate bubble, the RBI advised the Indian government this week to set up a monitoring mechanism to look at foreign direct investment (FDI) into some pockets of the real estate sector. Specifically, the RBI is concerned that the rules limiting FDI are being circumvented by foreign investors who are speculating on real estate, potentially inflating prices in some areas.

The RBI has suggested various measures to clamp down on property speculation by foreign investors. These measures include a lock in period for the original investment and tighter monitoring of revenues generated by investments through setting up a quarterly report on the receipt and usage of foreign inward remittance. Other measures

proposed include introducing clauses where the investor or investee company is not allowed to sell undeveloped plots of land. All in all it appears that the RBI view the property sector as a key risk to the medium term macroeconomic outlook if left unchecked.

“...on the same day RICS release the Q3 results of the Indian commercial property survey”

Inflation in India remains stubbornly high



QE2 announcement imminent in the US; impact on property is uncertain

“Excess home units exert downward pressure on house prices...”

The US Census Bureau publishes its Q3 2010 figures for housing vacancies and homeownership on Tuesday 2nd. In Q2, the homeownership rate fell by 0.2% pts to 66.9% (the high watermark of 69.1% was reached in Q2 2004) and is the lowest since 1999. The rental vacancy rate held steady in Q2 at 10.6% (against the long run average of 8%). There are close to 41 million rental units in the US

and if the rental vacancy rate were to revert to its long run average, over 1 million excess units would have to be absorbed. These excess

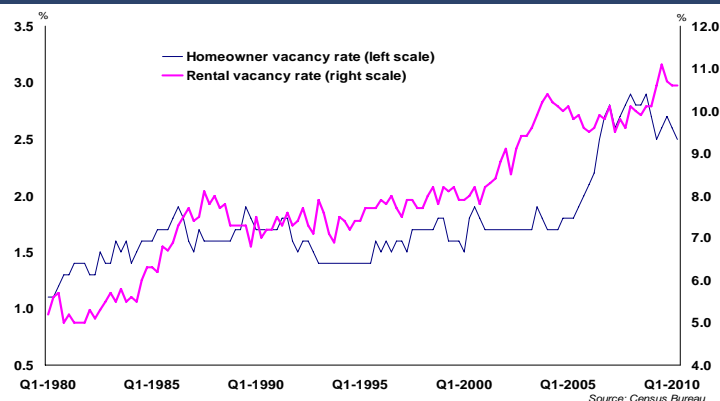
units continue to exert downward pressure on housing starts, rents and house prices.

With this in mind, the Federal Reserve is set to embark on a second round of quantitative easing in a bid to reflate asset prices and the economy. However, much uncertainty surrounds the scope and pace of bond purchases. With the Fed currently failing on both counts of its dual mandate (low inflation and maximum sustainable employment), the current goal of macroeconomic policy was summed up recently by the Chicago Fed President: “we need lower short-term real interest rates”. In its communications, the Federal Reserve has hinted that large scale asset purchases (LSAPs) are the preferred way to lower interest rates. The base scenario for financial markets is \$500 billion over the next five months. However, any disappointment at the headline figure would likely be more than offset by a nod to the possibility of further purchases if conditions warrant. That would be interpreted as an open-ended promise to do whatever it takes to meet the conditions of its dual mandate.

While the further quantitative easing is good news for the economy, it is less clear cut how it will support housing. Previous attempts did bring down mortgage rates, but this hardly fed through to mortgage purchase applications. With this in mind, and given continued labour market weakness, the homeownership rate is likely to continue its downward trend in the near term.

“...Fed likely to embark on second round of quantitative easing to reflate economy”

Rental vacancy rate holds steady



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Spain—mixed signals on economy and housing

“The PMIs signal stalling growth momentum, but other surveys have remained stable”

The Spanish manufacturing and service PMI surveys for October are due respectively on Tuesday 2nd and Thursday 4th. Both PMIs peaked during the second quarter and by September, they were both sub-50, signalling modestly contracting activity (the manufacturing PMI fell from 51.2 to 49.6 and the services PMI fell from 49.2 to

47.8). The following week on Thursday 11th, the INE is due to publish its flash estimate of Q3 GDP. The data show growth resumed in 2010, albeit modestly (0.2% in Q2 and 0.1% in Q1).

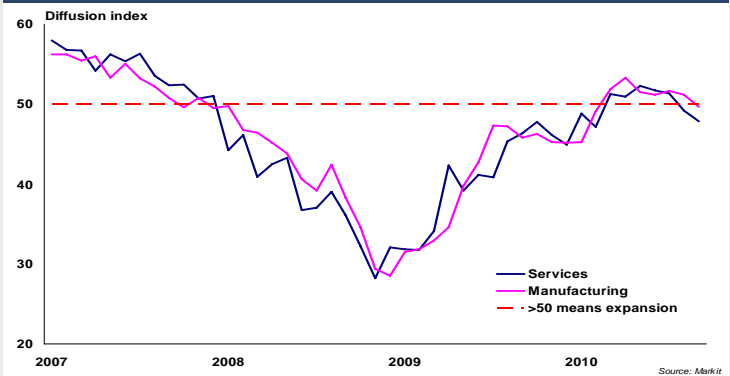
Recent PMI readings have been at variance with other high frequency survey indicators, which paint a slightly more stable picture. Indeed, the ministry of commerce's headline business climate index was broadly unchanged during Q3 at -15, the highest level since May 2008. Likewise, the European Commission's economic sentiment index remained broadly unchanged from Q2 at around the 90 level (notwithstanding a slight dip in July). Taken at face value, these two business surveys suggest the PMIs may be slightly exaggerating the downside risks to GDP in the third quarter. It's certainly not inconceivable that the official data will show that growth has stalled, but the body of evidence to date suggests the case is not clear cut.

Likewise, the state of the housing market is equally debatable. During Q3, the Bank of Spain's Asking price index fell by 1.3%, while the ministry of housing's valuation based index declined a further 0.9%. However, the less timely but more accurate transactions based index

produced by the INE indicates the prices actually increased by 1.6% in Q2 (the Q3 data is not available yet). Looking at the potential drivers, it's still difficult to reach any firm conclusions; residential investment as a share of GDP continues to fall, but so does demand (unemployment rose to 20.5% in August). On balance, given that the housing supply overhang has yet to be fully worked off, prices are still probably drifting lower.

“More timely indicators suggests house prices continue to fall, but more reliable ones suggest otherwise”

The PMIs signal staling growth in the economy



RBA set to resume tightening of monetary policy

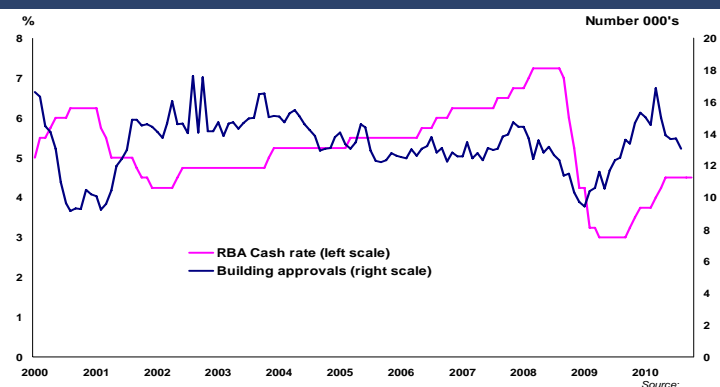
“The minutes from the October meeting stated that the decision to raise rates was ‘finely balanced’”

The Reserve Bank of Australia (RBA) interest rate decision is due to be announced Tuesday 2nd. This is sandwiched between two housing data releases from the Australian Bureau of Statistics (ABS). The Q3 house price index is due Monday 1st and September building approvals data are due Wednesday 3rd. The minutes from the RBA meeting in October stated that the

decision to raise rates was “finely balanced”, but in the event, they did not hike given uncertainty over weakness in the global economy.

Meanwhile, monthly building approvals have been falling steadily since March, suggesting the aggressive nature of RBA tightening at the back end of last year has fed through to residential construction sector. The August number fell 4.7% from July to 13,049, the lowest figure since August 2009. However the tightening cycle, which has been on pause since May, is widely expected to resume next week. This is likely to follow in the wake of solid domestic dataflow and an increasingly strong growth profile driven by commodity prices and a strong Australian dollar. Indeed, quarter on quarter inflation picked up by 0.7% in Q3 (up from 0.6% growth in Q2) to take the annual rate of core CPI to 2.8% (the RBA targets core prices). This posts near the top end of the RBA's target range (2-3%) and RICS now believe it is more likely than not that a hike of 25 basis points will be delivered in November.

Approvals have fallen since round of tightening



Finally, the house price index released next Monday will be watched with interest to see how the aforementioned rate hikes have affected prices. Domestic demand for mortgage finance has been subdued building and approvals have fallen. However, house prices have continued to rise strongly and are up 20% on year ago levels. Looking ahead, house price growth is likely to cool as past interest rate rises feed through to the housing market, but not that dramatically given the strength of the economy.

“Meanwhile, monthly building approvals fell 4.7% from July to 13,049”

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