RICS Global Real Estate Weekly

10th June 2011

Deafening silence from the Riksbank as house prices begin falling in Sweden

> **"House prices begin to fall in Q1"**

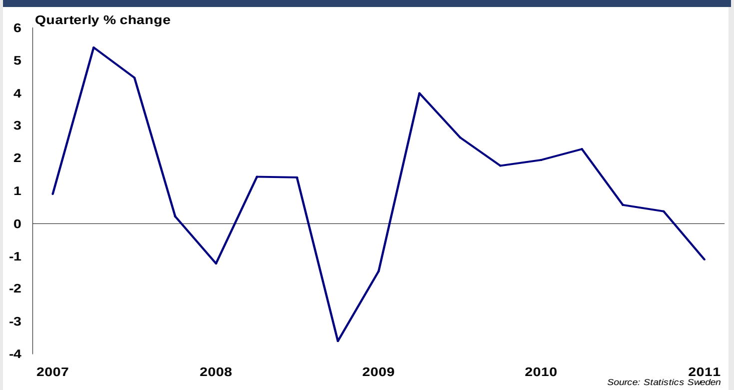
Swedish house price data for May is due Thursday 16th. The monthly data (quoted in money terms and subject to revision) has been showing a negative trend since February, while the quarterly data (an index) showed, in Q1, the first decline in over two years. Indeed, prices fell by 1.1% but they are still 13% above their Q1 2009 trough.

At least two factors account for the change in trend; tighter monetary policy and stricter mortgage lending regulations. Indeed, the Riksbank has hiked rates by 150 basis points since July to 1.75% presently (mortgage lending rates have risen by 130 basis points over the same period, to 4.2%). Coupled with higher borrowing rates has been the blanket 85% cap on mortgage loan-to-value ratios imposed by the Swedish Financial Supervisory Authority (SFSA) in October 2010, after some initial prompting by the Riksbank.

Another factor likely to have played a role is the Riksbanks' adoption of a novel approach, which we term 'soft-signalling' (see extended article at www.rics.org). By this we mean a *concerted* strategy to condition public opinion by drawing attention to the risks of a bubble, without actually saying there is one (something a central bank cannot credibly do). Indeed, between October 2009 and April 2011, the Riksbank had in effect been conducting an intensive public relations campaign, whereby it has sought to dramatize through a variety of means (workshops, speeches, monetary policy committee minutes), the possible risks associated with a house price bubble. This culminated in the publication of the results of the Riksbanks' 'inquiry into risks on the Swedish housing market' on April 5th (the conclusion was predictably nuanced, but the 420 pages of ink spilt over the issue was rather more telling). However, since this date, which coincided with the release of the Q1 house price index, the Riksbank has been conspicuous by its silence on the issue. It seems with the advent of falling prices, the housing-risk bogeyman, handed such a star role in virtually all of the Riksbank's publications till recently, has been dropped. Until the next time.

> **"Riksbank halts its housing-risk rhetoric"**

Swedish house prices fell in Q1 for the first time since Q1 2009

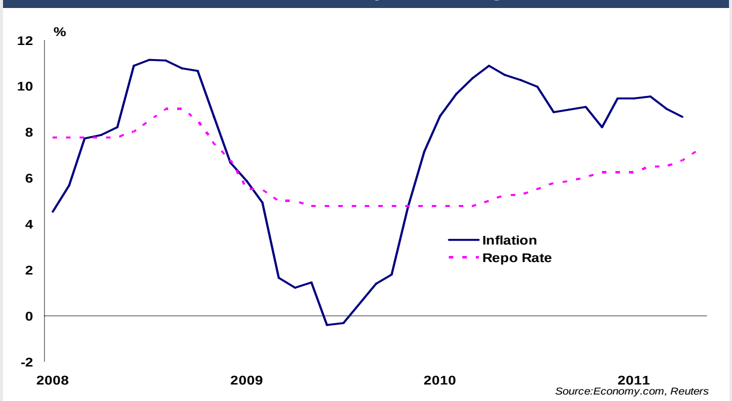


Further interest rate increases in the pipeline in India

> **"Most credit indicators are pointing in an upward direction"**

Just over a month ago, the Reserve Bank of India (RBI) boldly decided to lift interest rates by a further half a percent in an effort to signal it's determination to combat the excessively high inflation. On Thursday 16th, it will have the first opportunity to review the initial impact of this move as well as considering in some detail the need to add to it. WPI inflation numbers for May published two days earlier could have a significant bearing on the outcome of the meeting. Our suspicion is that the data will show Indian inflation still hovering above 8.5%; in these circumstances, it is hard to see the RBI sanctioning a pause in the tightening process even though the measures now being adopted are gradually likely to be visible in a less robust growth trend.

Indian inflation continues to point to higher interest rates



For the time being, most credit indicators are still pointing in an upward direction and remain consistent with a generally resilient economy. For example, annual lending growth to large companies accelerated to 26.9% in April from 24.1% in March. A broadly similar trend can be seen specifically in the real estate sector where credit to borrowers in the commercial property industry continues to increase at an annual rate in excess of 20%. Meanwhile, the story is not that different in terms of personal credit; mortgage lending has risen by more than 17% in the twelve months to April; up from the March figure of 15%. Interestingly, the latest RICS Global Commercial Property Survey shows sentiments towards real estate to still be positive despite the more restrictive monetary stance.

A guide to what might encourage the RBI to sanction a pause in the tightening cycle has been provided by Dr Rangarajan who is chairman of the Economic Advisory Council; he recently noted that it's key for inflation to slip back to the 7.5% area. This, however looks implausible in the near term although the decision to defer yet again a decision on raising prices of diesel, kerosene and cooking gas (needed to rein in the fiscal gap) could provide some relief. More likely, it will take a drop in commodity prices to push inflation down to this level.

> **"Postponing the increase in the price of diesel, kerosene and cooking oil could provide some relief"**

China hopes to avoid a hard landing

"Residential price growth edged down in April for the twelfth month in succession"

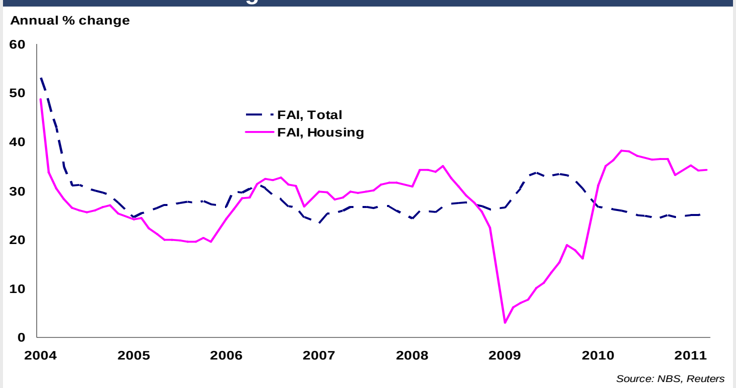
A veritable parade of macro data is released next week as inflation, industrial production, fixed asset investment (FAI) and retail sales are all published by the National Bureau of Statistics on Tuesday 14th. The release is likely to be of particular interest to markets, as concerns grow about the viability of the world's second largest economy to continue growing at its current rate. Indeed, softer than expected April data has caused many to question whether China is heading for a 'hard landing' in the second half of the year. Industrial production slowed considerably in April and is expected to ease further in May after power shortages in some parts of the country; this is consistent with the latest PMI surveys for May. Moreover, FAI could also edge down as investors continue to feel the effects of tightening measures in the property market. Also worth noting, closely watched house price data is due for release the following week.

Looking at the property sector, the headline residential price inflation edged down once more in April for the twelfth month in succession. Despite this apparent slowdown, the 70 city index showed that prices only fell in a handful of locations. Interestingly, the two cities pioneering the maiden property tax, Shanghai and Chongqing, continue to show annual growth in prices; 1.3% and 5.3% respectively.

The combined tightening measures (made up of the property tax, interest rate rises and hikes in the reserve requirement of banks) being employed by the Peoples Bank of China are seemingly having the desired effect on property prices, but it remains to be seen whether further tightening will be employed to control inflation. CPI moderated to 5.3% in April, but remains above target. Controlling inflation has been highlighted as the main target of authorities throughout 2011, and if it sustains its elevated position then it's quite conceivable the PBoC may tighten policy further in the coming months; we expect another 25 basis points to be added by during the second half of the year.

"Suggesting tightening measures are seemingly having the desired effect"

Housing investment remains elevated



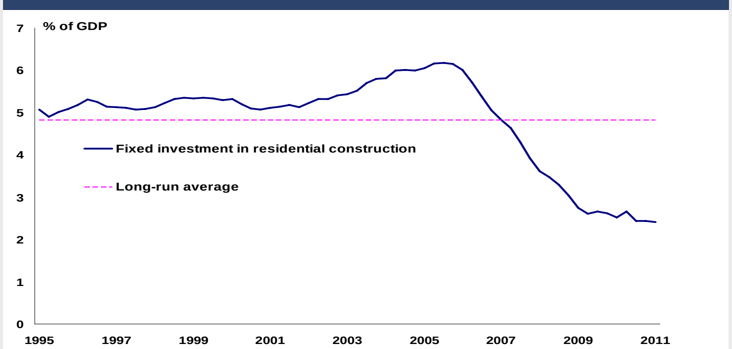
Source: NBS, Reuters

US residential construction in the doldrums

"NAHB housing market survey remained at 16 in May"

The coming week sees the release of residential construction data, starting with the NAHB housing market index (June) on Wednesday 15th and followed by housing starts (May) the next day. The NAHB HMI (a measure of homebuilder's confidence) has been broadly stagnant for the past six months, with May's value remaining at 16 (a reading below 50 indicates builders' view sales conditions as deteriorating). May's survey asked builders for factors restricting potential homebuyer activity, 90% of builders surveyed said clients are concerned about being able to sell their existing home at a favourable price, while 73% said consumers think it will be difficult for them to get financing. Hence, financing is still a major issue for builders and homebuyers.

US residential construction well below average



Source: BEA

The lack of builders' confidence in the market is reflected in the low level of housing starts, which dropped 10.6% in April to an annualised rate of 523,000 (in contrast to the long run average of 1.4 million). The massive supply overhang of existing homes already on the market coupled with falling house prices has led to the current state of under-build in the economy (see chart). Additionally, distressed sales account for 30% of all home sales in the US, with a foreclosed property typically selling for 20% below its value. Hence, the spread between the median price of a new home and an existing home (which includes distressed properties) has been widening of late, and currently stands at $54,000.

Looking ahead, the recent speech by the chairman of the Federal Reserve seemed to suggest that another round of quantitative easing is highly unlikely. That said, he re-emphasised that monetary policy shall need to remain highly accommodative for an extended period. This should ensure that mortgage rates remain at their current lows, keeping affordability at historically high levels in the coming months. Despite the increased affordability, we forecast house prices dropping 6% in 2011, bringing them back to 2002 levels.

"US housing starts declined 10.6% during April"

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