

Uncertain outlook for the French construction sector

“Confidence has improved, but order books are shrinking”

The INSEE June monthly business survey of the French building industry is due Wednesday 22nd. Although the May survey revealed a modest deterioration over the month in some indicators, the results suggest overall that conditions are still much improved compared to the beginning of the year; building activity is rising now and confidence has recovered to normal

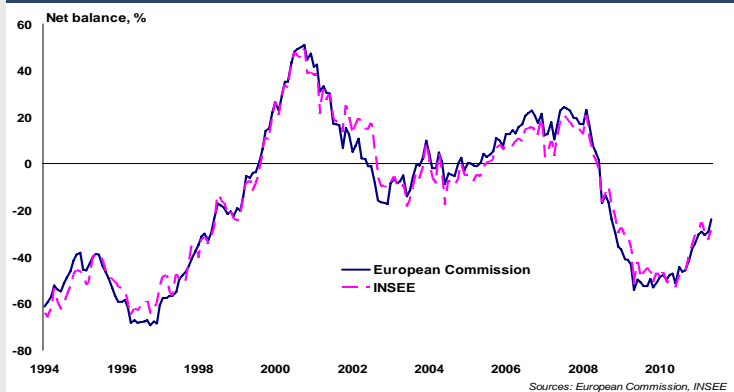
levels. This overall impression is also mirrored by the European Commission (EC) builders' survey (relating to France), which also extends to the May period.

The fly in the ointment to all of this is that overall order books, whether measured by the EC or INSEE survey's, continue to shrink. This is all the more disappointing because new orders are actually rising, but evidently not fast enough to offset completed deals. And this is one of the key factors likely to put a lid on confidence levels going forward; builders are encouraged by the incoming order flow but nervous that it's still not enough to sustain activity levels. Additionally, there are other factors the industry has to contend with, though not directly covered by the INSEE or EC surveys. Prominent among them is shrinking profit margins; the implied construction output deflators taken from the national accounts indicate that output prices rose by about 3% during the year to Q1, although the Eurostat construction cost index (covering wages and materials) increased by just under 5% over the same period.

Looking forward, construction output is likely to remain broadly stable over the next 12 months and the risks to the scenario are very finely balanced. If input costs stabilise, this should provide some relief to margins and if the economy continues to grow, this should generate new orders for the sector. But, with the ECB intent on raising interest rates, the growth outlook is arguably softening, and this is likely to be further compounded by the elevated levels of uncertainty related to the European sovereign debt crisis.

“Economic growth should support the sector but tighter ECB policy will dent the growth outlook”

Order books continue to fall in the French construction sector



HKMA further tightens lending criteria to cool 'red hot' market

“The release trails recent attempts to cool the 'red hot' property market..”

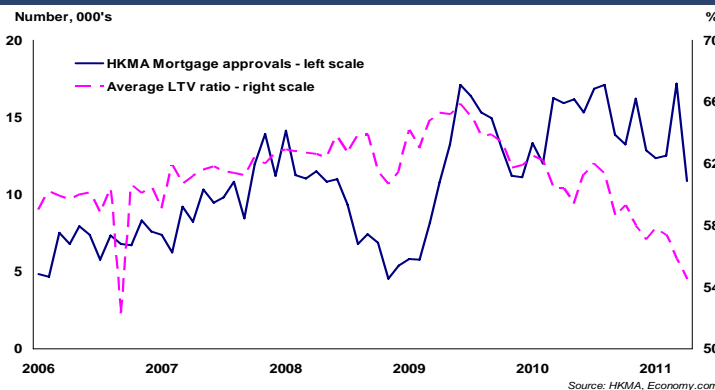
Expected in the coming week are the latest results from the Hong Kong Monetary Authority (HKMA) residential mortgage survey, providing an update on the mortgage market in the territory. The previous release, highlighting results of the April survey, showed that mortgage applications fell 35% year on year; the biggest fall since February 2009. Indeed, the demand side of the

market has dwindled over the past 6 months, as tighter restrictions on mortgages from the authorities have increased the cost of borrowing (via a staggered decrease in maximum LTV ratios). Loan approvals

were also down by a similar amount, 32% on year ago levels, also registering the greatest fall since February 2009. Significantly, the average LTV ratio for new loans has fallen, partly the result of the prudential measures and renewed mortgage restrictions.

Interestingly, next week's release comes after the latest attempt from the HKMA to cool the 'red hot' property market. Officials last tightened mortgage restrictions in November last year, when it also imposed a stamp duty of 15% on housing transactions conducted within six months of the owner buying the property to prevent speculation in the market. But they now feel the time is appropriate to act following, what the Chief Executive of the HKMA called "signs of renewed exuberance" in the market.

Loan approvals have fallen sharply in April



On Friday 10th June it was announced that the maximum LTV ratio for properties valued at between HK\$10-12m would be reduced to 50%, for properties valued HK\$7-10m the LTV is reduced to 60% and properties valued under HK\$7m the LTV is capped at 70%. Further to this, if the principal income of the applicant is not domestically based from Hong Kong, the maximum LTV ratio will be lowered by at least 10 percentage points regardless of property types or values. This last measure comes in an increased effort to limit purchases of local properties by buyers from China, whom many blame for pushing up property prices and follows similar, but less vigilant, restrictions.

“..following signs of renewed exuberance in the market”



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Bank of Canada appeals for moderation in the housing market

“Housing-related debt has tripled in the last decade”

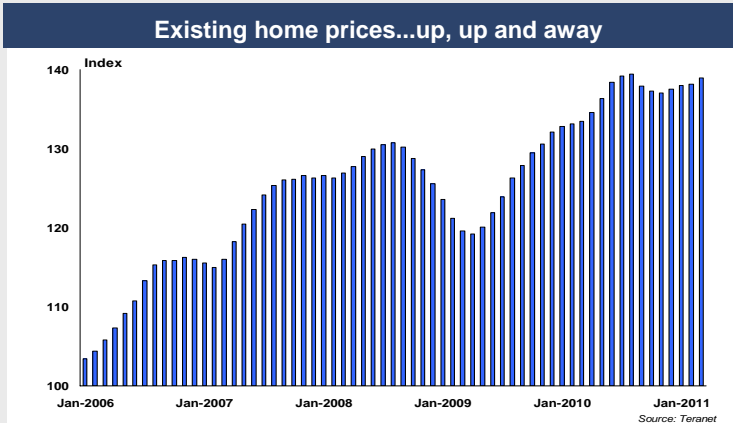
Mark Carney, the Governor of the Bank of Canada warned, in the most explicit terms to date, the risks involved with rising house prices. In a warning to households and banks, he appealed for ‘moderation’ in the housing market although stopping short of mentioning raising interest rates. Indeed, with housing-related debt in Canada almost tripling over the last decade to \$1.3 trillion and real estate debt being the single largest exposure for Canadian financial institutions (40%), the Bank of Canada sees volatility in house prices as a significant threat to the overall Canadian economy.

The speech was given in Canada’s hottest real estate market Vancouver, which has seen house prices rise 55% from their recession trough (nationally, house prices have risen 31%). Without using the word ‘bubble’ the Governor stated that hot spots like the Vancouver housing market were taking on ‘financial asset market’ characteristics, where expectations can dominate underlying forces of supply and demand. Governor Carney indicated that excesses may already exist in certain areas and segments of the market such as multi-family housing units, where supply remains elevated.

The Governor stated that the two main factors which cause him to have growing concerns about the sustainability of the recent gains in house prices are: i) the average level of house prices relative to average household disposable income now stands at 4.5, compared to the long run average of 3.5 and ii) residential investment, when

measured as a share of GDP, has exceeded its long run average for the past 7 years, and is now at levels that have previously proved to be peaks in Canada. The Governor also highlighted the risks posed by cheap credit which has been used to bid up the price of Canadian homes and also recently, the influx of money from emerging markets such as China into the Canadian housing sector. The speech highlights the recent trend of central banks to face head-on the challenge provided by perceived asset bubbles and the attempt to manage expectations through rhetoric.

“40% of all debt on Canadian banks’ books is real estate related”



Lending to the UK real estate sector to remain flat

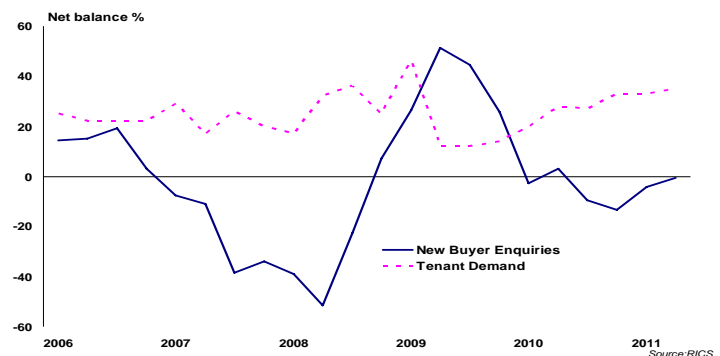
“Loans approved for house purchases have been broadly flat since the middle of 2010”

Recent data suggests that British banks are broadly on course to meeting the lending targets agreed with the government under Project Merlin. Despite this, some sectors continue to struggle with funding and real estate, in its various forms, is pretty much at the top of the list. The latest figures from the British Bankers’ Association (BBA), due on Thursday 23rd, are likely to highlight the on-going pressures facing both the mortgage market and the wider property industry. In terms of the former, the number of loans approved for house purchases by BBA members have been broadly

unchanged since the middle of last year, and interestingly, the April figure for remortgaging was the lowest since January 2010.

Over the last few months, the number of mortgage products on the market has increased and some are now based on higher loan to value ratios than previously was the case. Even so, the need to find relatively large deposits coupled with uncertainty over the prospects for the economy and in particular, the likelihood of large scale job losses in the public sector, is clearly dissuading first-time buyers from entering the sales market. The adjacent chart demonstrates that while tenant demand for rental property is continuing to grow strongly, buyer enquiries to purchase property remains pretty flat. Moreover, the forward looking indicators from the RICS surveys provide little reason to believe that this picture will change anytime soon.

Demand to rent is growing while enquiries to purchase are flat



Shortage of finance is regularly cited as a factor inhibiting development according to the RICS Construction Survey and this is to some extent borne out by lending figures which show that, on an underlying basis, the volume of outstanding debt to companies working in this area is being scaled back. Interestingly, however, the European Commission’s monthly survey of the building industry continues to identify a lack of demand as being the principal factor depressing activity in the sector. The most recent RICS survey suggests that workloads will pick-up over the next twelve months but only modestly.

“Lack of demand is the principal factor depressing activity in the construction sector”

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