

## Indian real estate remains resilient in the face of interest rate increases

**“The desire to provide an anchor for inflation expectations may swing the balance in favour of one more rate hike”**

The Reserve Bank of India (RBI) meets on Tuesday 25<sup>th</sup> to review its monetary stance. At the September meeting, the key repo rate was raised by a quarter percentage point taking it to 8.25%. Since then, there has been increasing speculation that the RBI may be about to signal a pause in the monetary tightening cycle. This has been fuelled by the decision of a

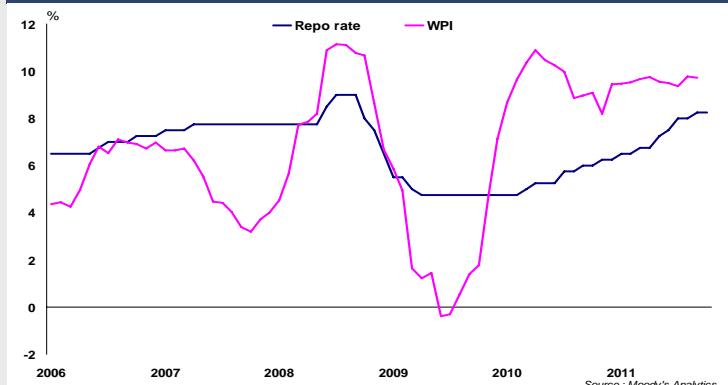
number of other emerging market central banks to do likewise and, in some cases, actually cut rates. However, policymakers in India will, next week, still need to grapple with what is a challenging inflation backdrop; the headline WPI rate is currently running at 9.72% (little changed from the previous reading) against the target of 5 to 5.5%. Indeed, the central bank has been particularly focused on the desire to provide an anchor for inflation expectations and this, more than anything else, may swing the balance in favour of one more rate hike before the RBI takes a breather.

Significantly, the latest data shows that the residential real estate sector remains relatively resilient in the face of the more moderate pace of economic growth and the higher cost of borrowing. The JLL REIS third quarter numbers for the top seven metros indicates prices are broadly stable at recent highs and activity levels also essentially flat. In addition, credit growth for housing continues to post strong year on year gains. The one sign that confidence, particularly amongst developers, may be slipping a little is the drop in the number of new launches (30.3k units against a four quarter average of 44.4k).

Meanwhile in the office market, demand for space generally remains firm; economic growth may have slowed but it is still likely to come in somewhere between 7 and 7.5% this year. This is helping to underpin rental growth. According to the most recent JLL figures, most big cities have seen rent increases of around 2% during the third quarter although Delhi was rather flatter. However, with monetary policy on course to be tightened a notch further in the quest to rein in fermenting inflation pressures, the risk is that this trend moderates over the coming months.

**“Residential prices are broadly stable at recent highs”**

**Inflation remains elevated**



## Uncertainty in the US hampering growth

**“Housing starts increased by 15% in September”**

Uncertainty in the US economy due to policy inaction has led to consumer confidence plummeting to decade lows. Interestingly, it seems the fall in consumer confidence has not adversely affected consumer spending. Indeed, retail sales increasing by 1.1% on the month in September, the largest increase in six months. That said,

without a clear-cut fiscal plan by the government, this policy inaction will continue to be a drag on growth.

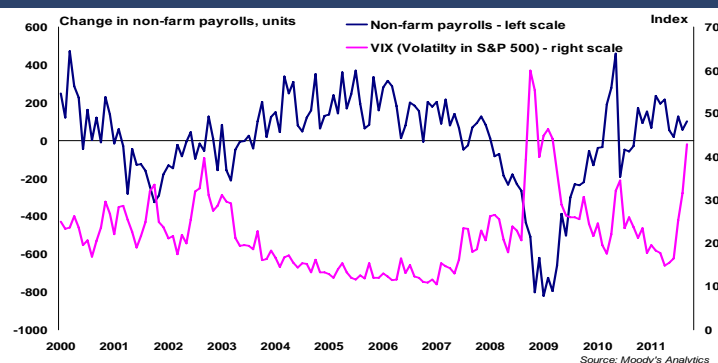
Turning to the housing market, the Case-Shiller house price index (hpi) for August will be published on Tuesday 25<sup>th</sup>. July's reading was

encouraging, with house prices remaining unchanged on the month and a slowdown in the annual pace of decline from 4.5% to 4.1%. It is too early to suggest a broad recovery in the housing market but demand and supply are becoming much more aligned. Indeed, the flow of distressed properties coming into the market has fallen by 33% over the year to August. Even though housing starts recorded a 15% jump in September, the majority of that rise was due to multi-family units, a possible reaction to the increase in rental demand.

GDP growth for Q3 will be released on Thursday 20<sup>th</sup>. The Federal Reserve's latest monetary easing policy action, 'Operation Twist' has sought to bring down long term interest rates, including mortgage rates, to make borrowing more affordable and aid anaemic demand in the housing market. With mortgage rates already at historic lows, we are sceptical about how much lower rates will aid the housing market. Indeed, mortgage applications fell 8% from Q2 to Q3, and with millions of Americans being in negative equity, this effectively chains them to their current property and also prevents them refinancing at lower mortgage rates. The labour market will be key to any self-sustaining housing market recovery. Non-farm payrolls surprised on the upside in September, rising by 103k. That said, anything below 150k will not lower the overall unemployment rate; consistent above-150k readings needed to conclude a self-sustaining recovery is underway.

**“Mortgage applications down 8% in Q3 2011”**

**Uncertainty holds back job growth**



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## House prices in Singapore are still rising

**“The flash estimate suggested price growth moderated”**

Following on from the flash estimate of Q3 home prices earlier this month, the Urban Redevelopment Authority (URA) will publish the second estimate on Friday 28<sup>th</sup>. The initial release, which captures transactions in only the first 10 weeks of the quarter, suggested growth in private residential property prices continued to moderate for the eighth consecutive quarter since the end of

2009.

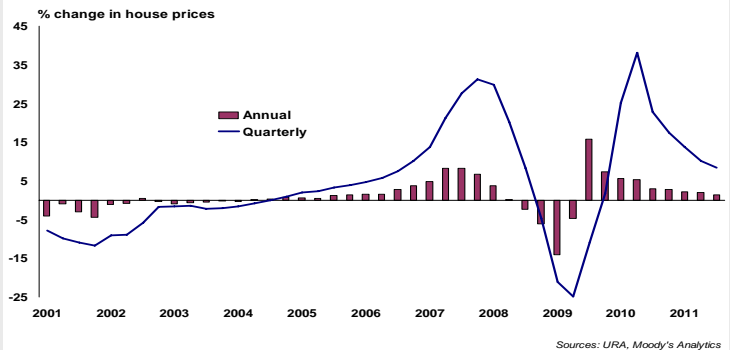
Home prices rose at a more subdued rate in the three months to October, with the quarter on quarter change slowing a touch to 1.3% from the 2% seen in Q2. This will come as some relief to the Monetary Authority of Singapore (MAS), who installed a raft of property cooling measures in January this year to stymie the rise in prices. Meanwhile, in a further attempt to prevent price gains, the URA has released more land for housing development. In a statement made earlier this week, officials said they would release residential sites for sale which would yield 1,900 housing units, adding to some 13,800 units already launched under the government land sales programme. Furthermore, a recent report from Colliers says that although prices are still rising albeit modestly, home buyers have become more cautious because of the grim global economic outlook.

Notwithstanding this, there had been some speculation that the measures would be eased after 2 years of declining price rises, but there are still signs that the market is ‘hot’. Indeed, the annual rise in

prices still stands at 8.5% - down from 10% in Q2 – and resale prices for government-built apartments rose at a faster pace, indicating strong underlying demand for property in the region. The preliminary estimate from the Housing and Development Board (HDB) suggests resale prices rose on the quarter, up from 3.1% in Q2 to 3.8% in Q3. This is not insignificant, as roughly 80% of the population live in HDB apartments. With supply fixed in the short run and new units likely to take time to come to market, further price gains seem likely.

**“Although prices are rising, home buyers have become more cautious because of the grim global economic outlook”**

### House price growth has eased over the last 2 years



## Further weakness in French homebuilding is likely in the near term

**“The near term trend in homebuilding is likely to be negative”**

French housing starts for September are due to be released by INSEE on Tuesday 25<sup>th</sup>. The starts data is quite volatile on a monthly basis, but taking a 6 month moving average to get a clearer view of the underlying trend, starts in August were running at around 29K per month. Although this is still slightly above the long run average of about 27.5K, the rolling six

month trend has been broadly negative during 2011. We expect further weakness in the near term, consistent with recent deterioration in sentiment in the construction sector and wider economy. Over the next 12-18 months, favourable fundamentals could drive a rebound in home

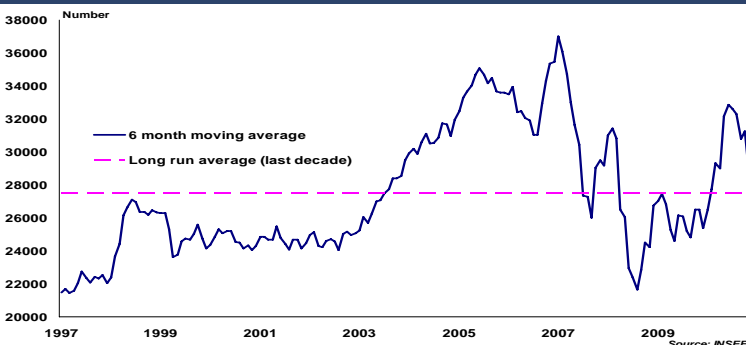
building activity but such factors may in the end take a back seat to general economic weakness if the current uncertainty persists.

A timely measure of business confidence in the construction sector is provided by the European Commission's pan-European monthly sentiment survey. In September, the headline measure fell to its lowest level since April. The survey detail reveals this was driven by declines in both order book levels and employment expectations. However, the recent fall in confidence is more likely related to the generally negative news flow and financial market turmoil seen over the summer rather than sector specific considerations.

Indeed, such considerations i.e. relative under supply are more conducive to a lift in building activity over the medium term. One crude way of measuring the relative undersupply of housing is by comparing the ratio of housing investment to GDP with its long run average. Taking the last decade as a rough approximation of the 'long run', this ratio has been below its average since Q3 2009 and currently stands at 5.1% against the average of 5.4%. To be sure, this does not represent a significant margin of under building and by no means guarantees a lift if the wider economic backdrop further deteriorates. However, it does nonetheless increase the likelihood of a pick up over the course of 2012 provided the current economic uncertainty subsides.

**“Over the medium term, fundamentals should support a rebound in activity”**

### Housing starts could fall further



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