

Housing loan demand rebounds in Poland as economy continues to accelerate

“It now looks likely that the MPC will sanction a further interest rate increase next week”

The Monetary Policy Council (MPC) of the Polish central bank meets on Wednesday 8th against a backdrop of further evidence that the economy is continuing to expand at a rapid pace. Data for the first quarter of the year showed that GDP increased by 4.4% when measured on an annual comparison; the equivalent figure for the final three months of last year was

4.5%. Significantly, the growth was entirely driven by domestic demand with household consumption particularly strong. In the light of this outcome, it now looks likely that the MPC will follow the surprise May hike in interest rates with a further round of monetary tightening next week. Such a move would be consistent with the desire of the authorities to see a stronger zloty to help curb inflationary pressures.

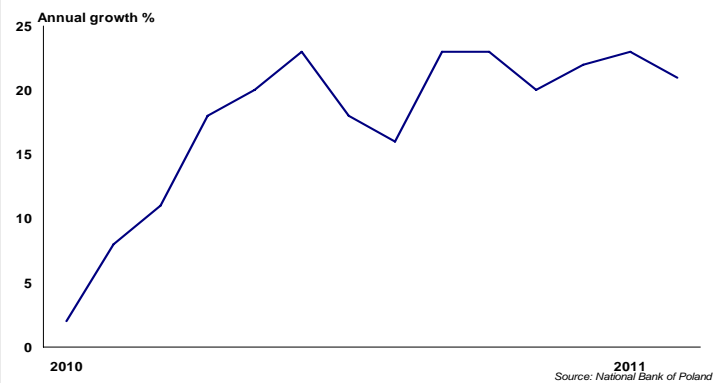
Consistent with the increasingly robust performance of the economy, and notwithstanding the rising trend in interest rates, there are signs that demand for housing loans is rebounding. Although the year on year growth rate remains relatively modest compared with the pre-crisis era, it has climbed from the low single digits in the early part of 2010 to in excess of 20% at the present time. Significantly, the latest Senior Loan Officer Opinion Survey suggests that the demand for home loans is likely to accelerate further over the coming months, which is being driven primarily by a perception of an improving outlook for the residential property market.

Meanwhile, the Q1 RICS Global Property Survey suggests that sentiment towards commercial real estate is increasingly positive in

both the occupier and investment markets. Interestingly, the availability of good quality space appears to be diminishing in the face of rising occupier demand leading to low vacancy rates, a reduced reliance on inducements and rising rental expectations. In addition, healthy investment demand is continuing to underpin the strong reading on capital value expectations. The net balance of respondents to the survey who expected further gains in capital values was actually higher in Poland than anywhere else in either western or eastern Europe.

“Sentiment towards commercial real estate is increasingly positive”

Housing loans are rising at an annual rate of more than 20%



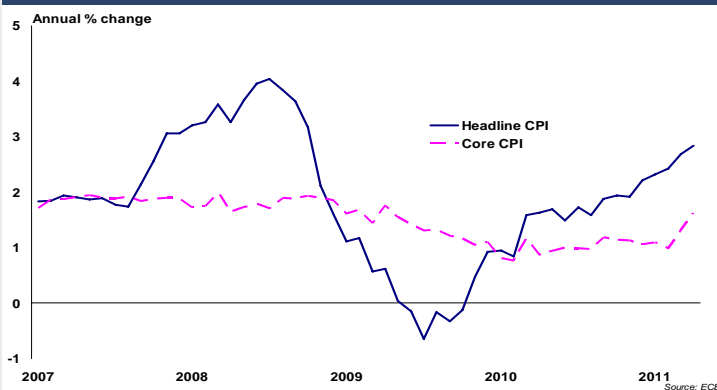
Tighter ECB policy likely to have uneven impact across euro area housing markets

“ECB likely to hike rates by a further 25 basis points in July and rates are likely to reach 1.75% by year end”

The next ECB interest rate decision is due Thursday 9th. In April, policy was tightened by 25 basis points to 1.25%, the first move since May 2009. The policy rate is widely expected to remain on hold following the June meeting, but hiked by another 25 basis points in the July meeting and by year end, is forecast to reach 1.75%. While the ECB acknowledges that headline inflation is

principally being driven by energy and commodity price increases rather than domestic overheating, it sees further upside risks to the current rate (2.7% vs. the ‘close to but below’ 2% target) and is

The ECB is reacting to elevated headline inflation



concerned that ample monetary liquidity is complicating matters.

The likely direct impact of tighter monetary policy on house prices in the euro area will depend crucially on structural differences in national mortgage markets. Here we contrast Germany and France with Italy and Spain (house prices are edging up in Germany, rising in France, broadly flat in Italy and falling in Spain). In the former pair, mortgage lending is predominantly financed via the bond market (long term lending) whereas in the latter two countries, funding predominantly takes place via the money markets (short term lending). Therefore, the feed through from tighter ECB policy to mortgage lending rates is likely to be far greater in Italy and Spain compared to Germany and France.

Direct pass through aside, rising interest rates are likely to indirectly affect the various national housing markets in the euro area via their impact on the pace of economic activity. In this respect, the initial impression that German and French house prices are better able to weather tighter monetary policy than those in Italy and Spain is further reinforced. Indeed, the latest GDP data shows the French and particularly German economies steaming ahead, whereas in Italy and Spain, growth has been relatively lacklustre. As such, the risks of tighter monetary policy stalling activity (alongside negative labour market spill over effects) are far greater. All in all, German and French house prices seem less vulnerable to tighter ECB policy than those in Italy and Spain.

“Italian and Spanish house prices more vulnerable to tighter ECB policy than German and French prices”



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New Zealand house prices likely to ease on weaker sentiment

“Despite headline inflation recently tipping the scales...”

The latest house price data is available in New Zealand next week, as both QV and the Real Estate Institute of New Zealand (REINZ) release dwelling prices for May on Wednesday 8th. This is followed by the Reserve Bank of New Zealand (RBNZ) official cash rate announcement the following day. At present, the cash rate stands at the record low level of 2.5%;

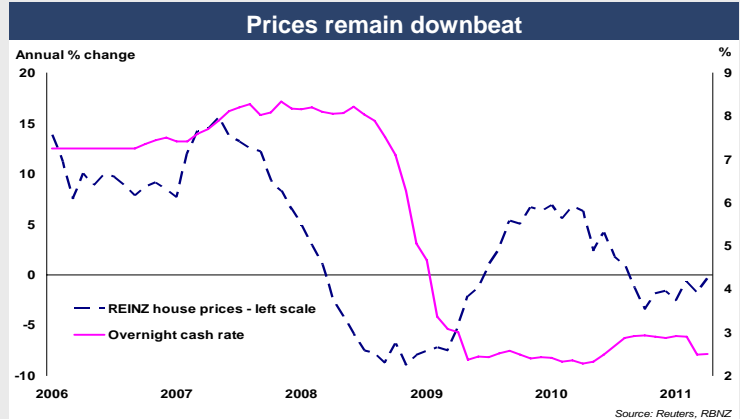
the 2010 tightening cycle stalled as the economic recovery failed to gain traction and was subsequently reversed following the Canterbury earthquakes earlier in the year. Despite headline inflation recently tipping the scales (annual growth of CPI in Q1 rose to 4.5% from 4% in Q4), we expect the RBNZ to continue sitting on the policy sidelines and we don't envisage a rate hike before the year end. The rhetoric from the RBNZ seems less hawkish than previously was the case and it now appears willing to keep policy accommodative until downside risks to the recovery dissipate.

The pause in tightening will bring welcome relief to those in the housing market. Generally, activity has been weak amidst the uncertain economic outlook, but more recently prices have picked up. The REINZ house price index rose 1.1% on the previous month in April, following a 0.5% increase in March and 2.3% in February. While the market looks more promising than 6 months previously, there is cause for caution; the slow pace of home sales means stock levels are rising, which could contain further price rises. Also, the average number of days taken to sell a property was 43 days in April compared

with 41 in March, and 40 days for the same month last year, suggesting a more cautious attitude from buyers.

Looking ahead, we expect the housing market to remain subdued over the near term. The unemployment rate remains high by historical standards (6.6%) and inflation is well above the target range, which is eroding real incomes. Both factors are likely to contribute towards weaker housing demand for the time being.

“..we don't envisage a rate hike before the year end”



UK construction output to begin to show a slightly more positive trend

“Recent official construction output data has been viewed with a degree of scepticism”

Following the publication earlier this week of the Government Construction Strategy by the Cabinet Office, figures showing output from the sector in April are due to be released on Friday 10th. Recent data charting developments in the construction industry have been viewed with a degree of scepticism. Most notably, official numbers indicate that the volume of output was

considerably weaker in the first quarter of this year than in the final three months of 2010. Given the unusually poor weather in December, this assessment is widely disputed; it is generally believed that

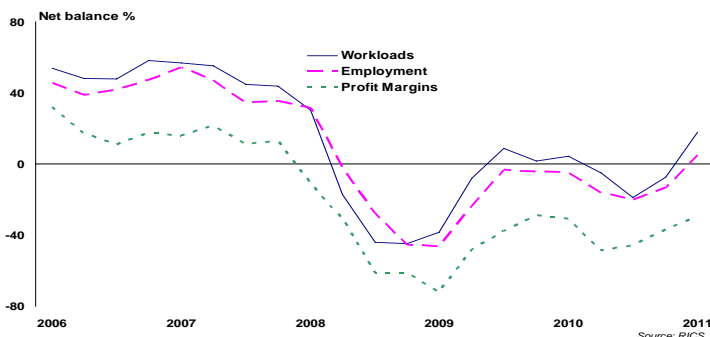
businesses operating in the building sector were particularly badly hit in the run up to the end of the year.

The questioning of the trend in output signalled by official figures has been underpinned by the raft of sentiment surveys charting developments in the sector. Most recently, the RICS Construction Survey suggested that workloads edged up in the early part of this year compared with the previous three month period. Predictably, the improvement was fuelled by a stronger contribution from the private sector particularly on the commercial side. Meanwhile, public sector demand has begun to be scaled back under the weight of the severe spending cuts now being implemented.

The April data will be closely watched for any indications that the official numbers are beginning to follow the slightly less negative picture highlighted in much of the anecdotal evidence. Significantly, the forward looking indicators on workloads and employment contained in the RICS survey and shown in the chart are portraying a more upbeat story (even if projections on profitability are still notably downbeat). Although concerns clearly still exist not just over the impact of the tightening in fiscal policy but also regarding the continuing lack of development finance, the implication of the RICS survey is that the construction sector is slowly beginning to recover from the traumas of the recession.

“RICS forward looking indicators are portraying a slightly more upbeat story”

Signs of a pick-up in activity in the UK construction sector



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