

## Chinese property prices will continue to ease

**“The People’s Bank of China recently took a more hawkish stance...”**

The latest data for April on fixed asset investment, industrial production, retail sales and inflation is released on Wednesday 11<sup>th</sup> by the National Bureau of Statistics (NBS). The inflation figure is likely to attract the most attention, as the People’s Bank of China (PBoC) recently took a more hawkish stance by stating that managing inflation was its top priority;

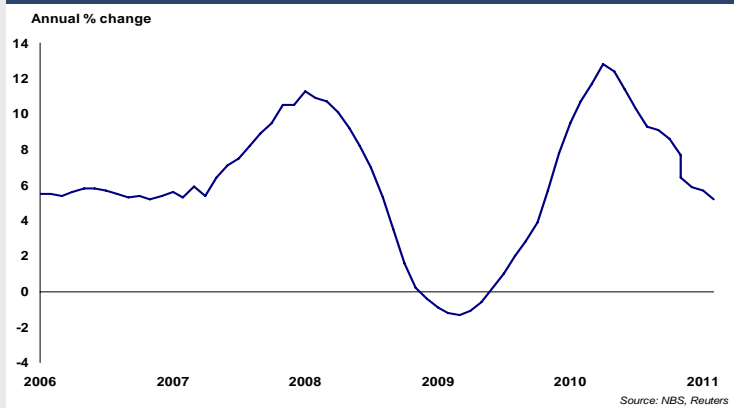
it’s possible that the announcement is a precursor for future tightening. CPI grew by 5.4% in the year to March on the back of rising food and energy costs and now stands at the highest level since July 2008. Even if the CPI figure eases, it is unlikely to halt the tightening cycle of the PBoC.

Also expected in the coming week are the latest figures on property prices. Of late, the NBS property price index has suggested growth is trending down from the peak seen in April 2010 (where annual growth in prices hit 12.8%) to 5.2% in March. This is no surprise as the huge stimulus package has been withdrawn and the speed of monetary tightening is now being ramped up; indeed, the base rate was held at 5.31% for 18 months before 4 hikes in the past 6 months. Moreover, the PBoC have reported that lending for house purchase from Chinese banks was down 40% in Q1 on a year ago, as Beijing tightens its control over the exuberant housing market. Consequently, we believe that price growth will continue to slow as future rate hikes deter potential speculative buyers and officials consider more property taxes such as those employed in Shanghai and Chongqing.

Meanwhile, fixed asset investment into real estate moderated a touch in March; the annual growth slipped to 34.1 from 35.2 in February. The softer tone to the recent economic survey of the manufacturing sector (down to 52.9 from 53.4) suggests that tightening measures to reign in excess liquidity and cool the economy are starting to show their effects. This may mean property becomes a less desirable investment vehicle in the coming months.

**“...stating that managing inflation was its top priority”**

### House prices have trended down over the past 12 months



## US commercial real estate shows further signs of recovery

**“Demand for commercial real estate loans climbed to best level since the mid-1990s”**

Last week’s Senior Loan Officer Opinion Survey on Bank Lending Practices compiled by the Federal Reserve points to an increasingly pronounced divergence between the lending climate in the commercial and residential property markets. While the net balance of respondents reporting stronger demand for commercial real estate loans climbed in the three months to

April to its best level since the mid-1990s, the reading on residential demand remained well into negative territory; significantly, this was the case both for prime and non-traditional loans. Meanwhile, although the

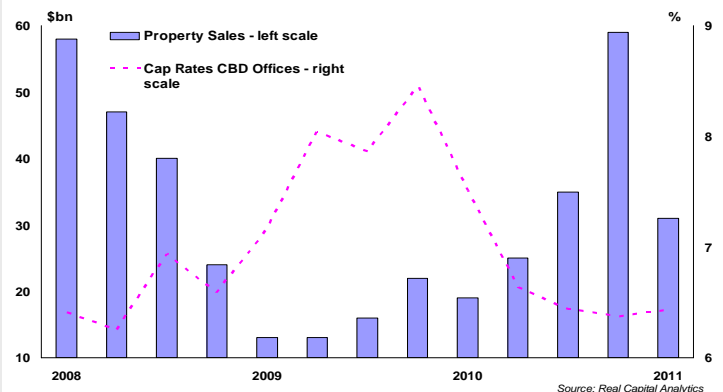
majority of banks indicated that there had been no change in standards for approving loans in the commercial property field, a few large lenders confirmed that they had made it a little easier to obtain finance. In the residential sector, banks still appear more cautious.

The results of this survey broadly tie in with other news flow from the property sector. While home prices remain under pressure and activity levels are still weak, notwithstanding recent volatility in the sales data, the commercial environment has a more encouraging narrative. Figures published by Real Capital Analytics for the first quarter of the year show that transactions covering significant commercial properties exceeded \$31bn over this period which represents an increase of close to 70% compared with a year earlier; interestingly, at a sector level offices and hotels appear to be leading the way in terms of sales growth. The data also shows that cap rates were pretty much unchanged with recent gains in values largely maintained despite the fluctuations in Treasury yields.

Macro releases over the coming week will shed further light on the performance of the US economy after the below par Q1 GDP release. Firm oil prices may continue to inhibit the growth outlook near term. Particularly worth watching will be the April retail sales numbers on Thursday 12<sup>th</sup> followed by CPI inflation (for the same month) and the May University of Michigan consumer sentiment survey on Friday 13<sup>th</sup>.

**“Transactions of commercial properties in Q1 rose by 70% compared with a year earlier”**

### US commercial property transactions and office cap rates



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## Korean interest rates to rise further against strong credit growth

**“Banks continued to lend during the financial crisis”**

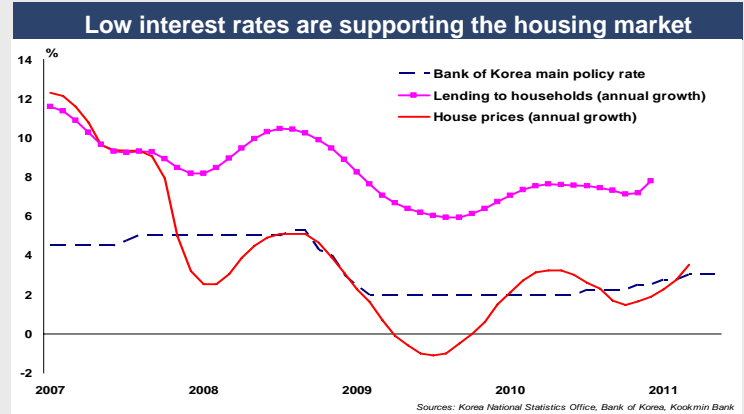
The Bank of Korea (BOK) is due to decide on interest rates on Friday 13<sup>th</sup>. Currently, rates stand at 3% and have been raised four times already since their low of 2% back in June 2010. The BoK has been keen to normalise monetary policy on the back of rapid growth in the money supply and more recently, above target inflation.

Unlike many developed economies, the banking system in Korea remained largely intact following the global financial crisis; annual growth in broad money (M2) barely fell below double digits. Although inflation in goods prices was under control, inflation in asset prices was already showing worrying signs. Indeed, by the time policy had begun to be tightened, consumer price inflation was only 2.6% (well within the BOK target range of 3% ± 1%). However, lending to households was running at 7.5% and house prices were already above their pre-crisis peak (with the growth rate was accelerating). This had prompted the BOK to openly worry about excessive liquidity feeding through to the housing market. Since the tightening cycle began, annual growth in the money supply has decelerated (currently 4.7%), but mortgage lending is still growing at roughly the same rate and house price growth - having slowed during Q3 2010 - is now accelerating again. Moreover, the Q4 2010 results of the RICS Global Commercial Property Survey showed that capital value expectations in South Korea had turned positive, reaching their highest level since Q3 2009.

Against this backdrop, consumer price inflation has moved above the

BOK's target range in recent months (currently 4.2%). Part of this is due to external factors such as energy and commodity prices. However, part of this is also likely because of domestic factors such as strong lending to the household sector. Given the elevated consumer price inflation, strong growth in mortgage lending and rising house price inflation, the BOK is likely to continue normalising monetary policy; another 25 basis points should be delivered next week and 3.75% by the end of the year is a real possibility.

**“House prices are already above their pre-crisis peak”**



## Estimated drop in UK construction output in Q1 to be scaled back

**“Provisional numbers suggest construction output fell close to 5% in Q1”**

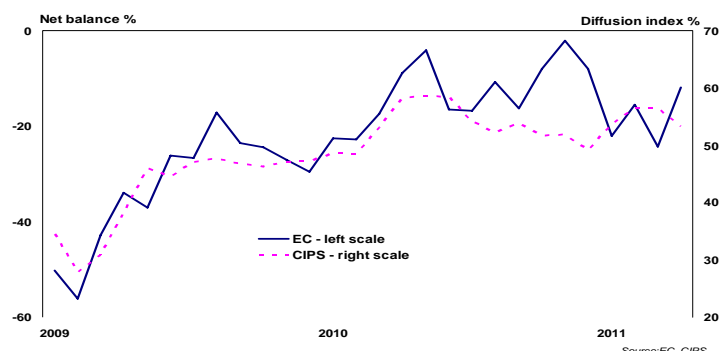
Detailed construction output data for the first quarter of the year is due for release on Friday 13<sup>th</sup>. Provisional numbers for the period contained in the Q1 GDP publication suggests that output fell by a further 5% following the 2% drop in the final three months of last year. The cumulative contraction in construction output over this period of around 7% follows a recorded increase of some

11% in the preceding two quarters. The extent of the suggested fall in output in the early part of this year is hard to square with much anecdotal evidence as well as the weather pattern. Unseasonably

poor conditions in December undoubtedly hit the sector but it is hard to believe that the numbers were so much weaker in the subsequent three months. Hence, our suspicion that the estimated drop in Q1 output may be scaled back.

Significantly, sentiment surveys of the sector continue to paint a slightly better picture of the construction climate than the hard data. The closely watched CIPS report shows the headline index a little down in April but still comfortably in positive territory and consistent with rising output. Meanwhile, the EC survey tells a similar story in terms of its assessment of the current situation although it continues to send warning signals through its forward looking indicators; it also suggests that insufficient demand remains the major drag on activity.

### Sentiment in UK construction is holding up despite weak data



Although announcements made in the budget could deliver some support for the sector, our suspicion is that the trend in output will be broadly flat this year. Further cuts in the government's capital budget will depress activity in key sectors while the stuttering recovery in the economy will limit the extent to which private sector demand for new buildings compensates. Predictably, there is a regional dimension to this with developers in London seeing more opportunity to initiate new projects compared with the rest of the country. For the time being, the jobs outlook in the sector also appears fairly flat.

**“Insufficient demand remains the major drag on activity”**

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