

Swedish house prices likely to fall further

“House prices fell by 1.1% in Q1, the first fall in over two years”

Swedish Q2 house price data is due Friday 15th. In Q1, prices declined for the first time in over two years (by 1.1%), but were 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 175 basis points since last July to 2% presently

(mortgage lending rates have risen by 150 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 central bank.

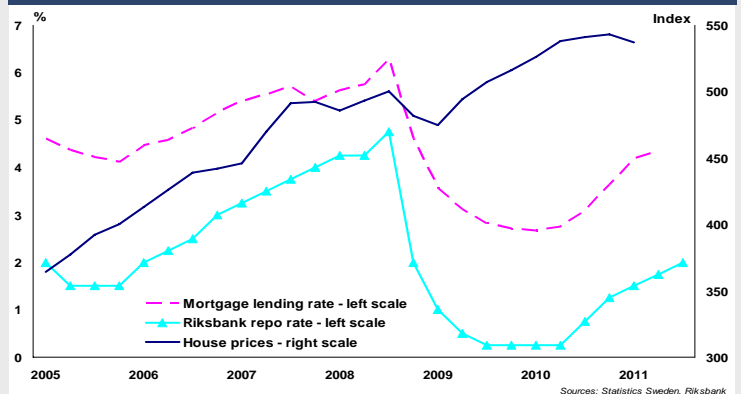
Another factor likely to have played a role is the Riksbank's adoption of a novel approach, which we term 'soft-signalling'; a *concerted* strategy to condition public opinion by drawing attention to the risks of a bubble, without actually saying there is one (something a central bank cannot credibly 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. However, since the release of the Q1 house price data, the Riksbank has been conspicuous by its silence on the issue.

Looking forward, we expect Swedish house prices to continue falling through the remainder of this year and this trend may well extend into

2012/2013. This view is conditioned primarily on the Riksbank's intention to normalise monetary policy; their own published forecast shows the policy rate - the repo rate - reaching 2.3% by the end of this year, 3% by the end of next year and 3.5% by the end of 2013. That said, to the extent that further falls take place, they are likely to be of a gradual nature; anything more ominous will undoubtedly cause the central bank to reevaluate their policy tightening bias.

“Prices are likely to fall further as the Riksbank tightens monetary policy, but any such falls will be gradual”

The Riksbank has hiked 175 basis points since last July



Chinese slowdown expected

“Official Q2 GDP should confirm growth has eased from the rapid pace seen in 2010”

The National Bureau of Statistics release the usual monthly barrage of data on Friday 15th, amongst which will be the closely watched June CPI inflation number; fixed asset investment and industrial production data is also likely to attract interest as markets consider the severity of the slowing in the Chinese economy. Significantly, second quarter GDP is released the

same day, which should confirm growth has eased further from the rapid pace seen in 2010. We expect the year on year rate to slow from 9.7% seen in Q1 to around 9% on the back of slowing industrial

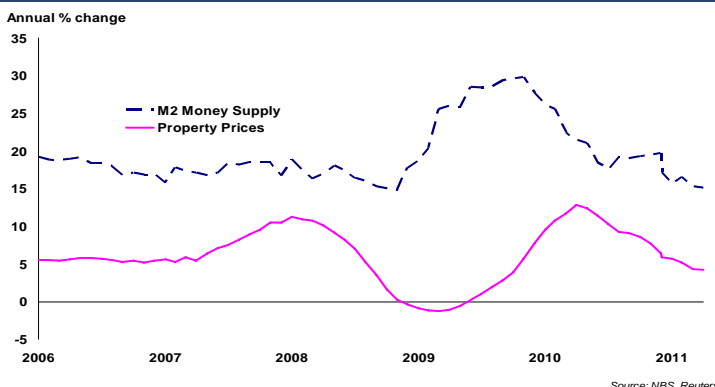
production, a sustained rise in inflation and lower than expected PMI survey results; the latest readings for the manufacturing PMI showed a notable slowdown in June to 50.9 from 52.0 in May.

The recent upward trend in inflation has seen the rise in prices reach uncomfortable levels; in May, the CPI figure jumped to 5.5%, the highest since July 2008. Food inflation, which has contributed 65% of the rise in CPI since January, continues to pick up and is currently running at 11.7%. Authorities in Beijing have always said that controlling inflation is the main priority for this year, and have acted in the past few days, pre-empting next week's release; the People's Bank of China have increased the benchmark lending rate by 25 basis points to 6.51%, the fifth such hike in eight months. The move sits alongside other tightening measures in the way of higher reserve ratios for commercial banks, and a target annual growth rate for M2 (money supply) of 16%.

The less accommodative monetary environment, while not reigning in inflation, is seemingly affecting the housing market. House price increases have moderated over the past year and currently stand at 4.2% (from a peak of 12.8% in April 2010). The full effects of fiscal policies (such as the maiden property tax) are yet to be seen, and we feel the easing in M2 and higher borrowing costs are having a greater effect.

“To ward off inflation, the PBoC has hiked interest rates for the fifth time in eight months”

Targeting the money supply could impact property prices



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Canadian household debt continues to rise as corporate debt declines

“Residential mortgage lending is 12% higher than year ago levels”

The coming week sees the release of the Bank of Canada’s (BoC) Senior Loan Officers survey (Q2 2011) on Monday 11th. The survey measures business lending conditions, with Q1 results showing an overall net easing in lending conditions at the headline level and across all sub-categories of commercial, corporate and small business borrowers. Indeed, for commercial and

small-business borrowers, the balance of opinion regarding price-lending conditions showed the greatest degree of consensus on easing since the survey began in 1999. A key point in the latest survey is that although business finance is easily obtainable, demand for business loans remains modest. This is reflected in companies’ debt to equity ratio, which shows that non-financial firms continue to deleverage following the recession, falling from 184% right after the recession to 164% in Q1 2011.

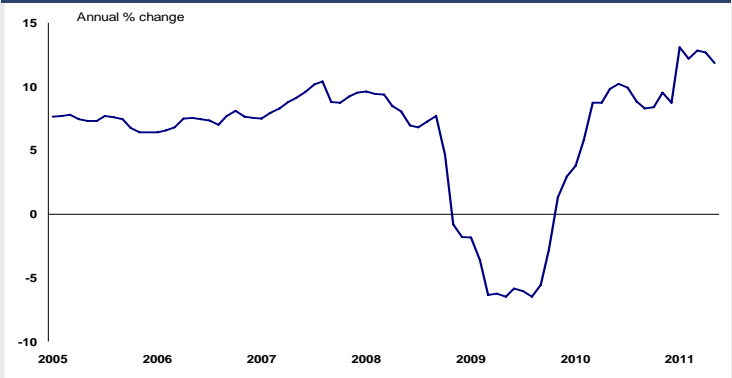
In comparison, household credit (including mortgages) has been growing post-recession, increasing 7% from year ago levels, with housing finance making up the bulk of the increase, recording a 12% rise during the past 12 months. Indeed, with house prices continuing to rise, housing starts picked up in May, boosted by a pickup in multi-unit starts. Following a recent speech by the governor of the BoC in which he appealed for moderation in the housing market, and highlighted possible overbuild in the condo market in particular, the recent pickup in condo starts is a cause for concern (up 4% in May), and the June housing starts figure released in the coming week will be watched closely for further signs of overbuild. That said, as tighter mortgage

regulations and falling affordability continue to limit demand for new homes, this will likely result in a more moderate pace of growth for home prices in the coming months.

Looking ahead, the BoC will likely continue their monetary tightening cycle in September, as inflation is running well above the 2% target rate (3.7% in May). As interest rates rise, the cost of sustaining the high levels of household debt will rise, leading to a possible increase in default rates.

“Tighter mortgage regulations and higher interest rates could weigh on housing demand going forward”

Housing finance continues to rise



Institutional investors can play a vital role in PPP infrastructure projects

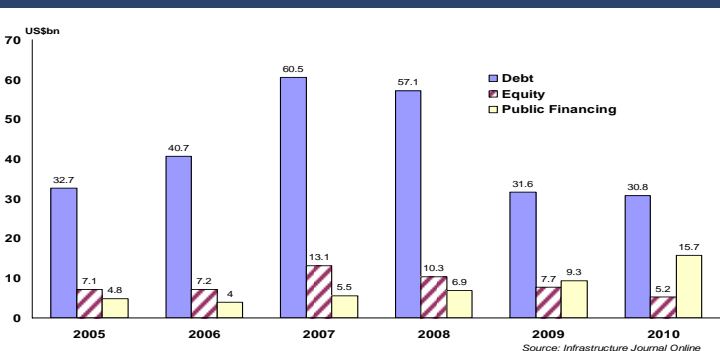
“Infrastructure investment needed over the next 25 years to be \$50 trillion”

RICS has recently published research into the future of Public Private Partnerships (PPPs) examining the impact of the financial crisis on the use of PPPs and how this will affect infrastructure delivery. The report argues that PPPs will be an essential tool in meeting the estimated US\$50 trillion of infrastructure investment needed globally over the next 25 years.

One of the main impacts of the financial crisis was a reduction in the willingness and ability of banks to lend large sums to finance

infrastructure projects. One potential way to fill this gap is through increased levels of institutional investment. The report suggests that although institutions, including pension funds, do invest in infrastructure they are not yet major players in the PPP market. The appetite for institutional investment is growing in Australia and the UK which are both well established markets with substantive and diverse portfolios of projects at various levels of maturity. New players are also predicted to enter the PPP market in Canada as it continues to evolve. Major funds including the Canada Pension Plan Investment Board and the Ontario Municipal Employees Retirement System have made major infrastructure investments around the world and although investment in Canada has been limited, the RICS report predicts that this will grow as PPP project sizes increase and market transparency improves.

Global PPP Project finance



Less mature PPP markets may struggle to attract institutional investment to the same extent. There are general problems with securing long term investment in India where the RICS report suggests that institutions, such as insurance companies are unwilling to invest in companies setting up greenfield infrastructure projects. The need for infrastructure at a time when many governments are reducing levels of public spending means that PPPs will have a vital role over the next decade. As projects grow in size and scope institutional investors will play a greater part in their delivery.

“Institutional investment to play a key part in future infrastructure projects”

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