

## Indian real estate begins to reflect the more challenging economic climate

**“The plunging rupee is a key risk to the view that interest rates have peaked”**

Confirmation of the softer trend in the Indian economy is likely to be provided next week with the release of Q2 GDP data on Wednesday 30<sup>th</sup>. These numbers cover the period July to September and will reflect the weaker picture signalled by other higher frequency indicators. Growth in industrial production has, for example, moderated from more than 7% in the

preceding three month period to just over 3% while the pace of infrastructure output has also slowed. Significantly the service sector Business Activity Index which effectively captures sentiment rather than hard data has now recorded two consecutive readings pointing to a contraction in output with the latest release being the lowest in two and a half years.

Against this backdrop, it is not surprising that the Reserve Bank of India (RBI) is shifting away from its tightening bias towards monetary policy. Following the hike in the repo rate to 8.5% in late October, RBI Governor Duvvuri Subbarao went as far as to say that ‘if the inflation trajectory conforms to projections, further rate hikes may not be warranted’. However, the plunging rupee is a key risk to this scenario; since the beginning of August it has fallen by close to 20% against the US dollar, which will add to the challenge of lowering WPI inflation from its current level of 9.7%.

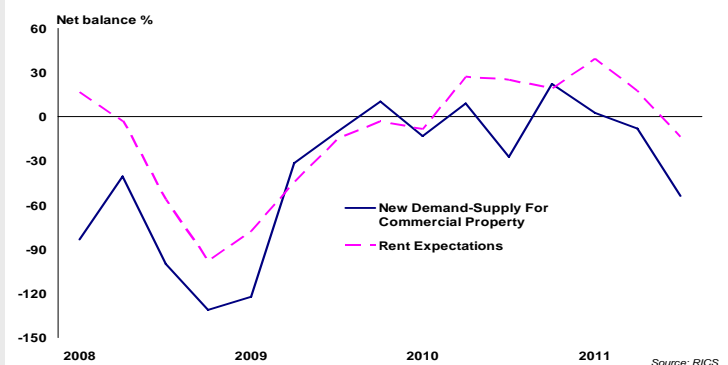
The less robust economic picture does now appear to be filtering through to some parts of the real estate world. The RICS Global Commercial Property Survey showed a slight moderation in both rent

and capital value expectations although to put these results in some context, this follows close to two years of firm gains in both series.

Meanwhile, the National Housing Bank’s Residex measure of house prices in fifteen cities is showing a broadly similar picture. In the latest three month period, prices have declined in close to two thirds of the locations compared with the preceding quarter. However, only two cities are showing a price drop when the comparison is made on a year on year basis. Nevertheless, the combination of rising interest rates and a squeeze in disposable incomes is presenting a significant headwind for the market.

**“Both commercial and residential property indicators have softened a little over the last few months”**

### Sentiment towards commercial rents is moderating



## French home building activity likely to slip further in the near term

**“In the near term, home building is likely to fall further”**

French residential building starts (October) and new home sales (Q3) data are due from INSEE on Tuesday 29<sup>th</sup>. The latest data point to a slowdown already underway on both fronts since their respective post-recession peaks. Indeed, new home sales peaked at 30k in Q3 2010 but have since slipped to 23k, a 24% fall. Meanwhile, starts, which tend to lag sales by about 2

quarters, peaked at 111k in Q1 2011, but have since slipped back to 90k. Assuming that quarterly starts fall by the same magnitude as

sales and given the usual time lags involved, they could quite plausibly decline to around 85k per quarter by year end.

However, the risks to this forecast in building activity are clearly skewed to the downside given the recent deterioration in the wider macroeconomic data. First, the French composite PMI survey - a reliable lead indicator of economic activity - suggests the economy is now contracting. Second, slowing activity now appears to be feeding through to the labour market, with the unemployment rate rising over the last couple of months from 9.7% to 9.9% presently. Finally, credit conditions on mortgages have started to tighten and are likely to continue to do so, given the sharp widening in euro money market spreads.

### The housing market is likely to come under further pressure



In spite of the weaker near term outlook for house building, the medium term picture remains promising given the relative undersupply of housing. One crude way of measuring this shortfall is to compare 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, but does nonetheless increase the likelihood of a pick up over the medium term once the current economic headwinds subside.

**“Medium term prospects for the home building sector are brighter”**



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## Brazilian economy slows

**“Central bank likely to continue to cut rates in the coming months”**

Q3 GDP figure, which will be released on Tuesday 6<sup>th</sup>, is likely to show that the Brazilian economy recorded no growth in the third quarter and is on track for around 3% growth for the whole of 2011. This is a marked slowdown from the 7.5% growth recorded in 2010, which resulted in sharp rises in consumer prices and consequently monetary tightening by the central bank earlier this

year. In what has been a dramatic and unexpected reversal of its stance, the Banco Central Do Brazil (BCB) has started easing policy, cutting 1% off the Selic rate since August (now at 11%). This was widely interpreted as the BCB putting employment and growth above inflation, as the rapidly deteriorating external trade environment was one of the main reasons given for the rate cuts, even though inflation was above the target rate of 4.5% and currently stands at 7%.

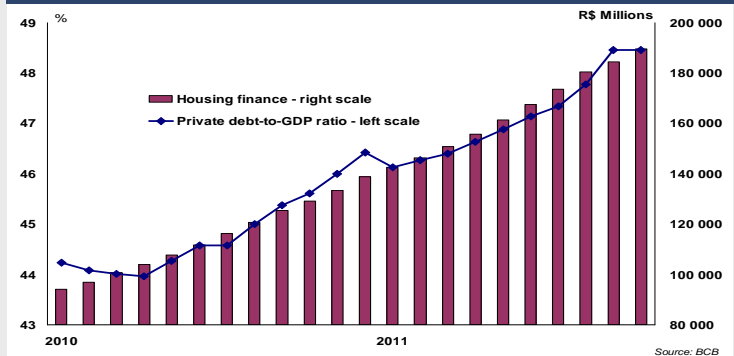
The central bank will likely see some validation for their unorthodox policy cuts in the latest data on the Brazilian economy, which shows industrial production contracting by 1.3% in October compared to year ago levels. Additionally, bank lending, a key driver of the rapid recovery in the economy post-recession, eased in October, to its lowest annual rate in 15 months (18.5%). The slowing credit expansion could partly be due to earlier macro prudential policies put in place, such as higher reserve ratios for banks and higher capital requirements for consumer loans.

That said, housing finance continues to increase exponentially, rising

47% on the year in October, slightly down from the 51% annual growth recorded earlier this year. Ambitious social housing targets by the government are keeping demand for mortgages elevated, and will do so in the medium term. Indeed, although the economy is slowing and forecast to do so in the coming 6 months, the long term fundamentals of the economy remain strong; low debt-to-GDP ratios, massive infrastructure spending in the pipeline - upcoming Olympics and World Cup in addition to the development of recently discovered off-shore oil fields - and a growing middle class to boost consumption.

**“Credit expansion has eased, although still rising at 18.5% year on year”**

### Housing finance continues to surge



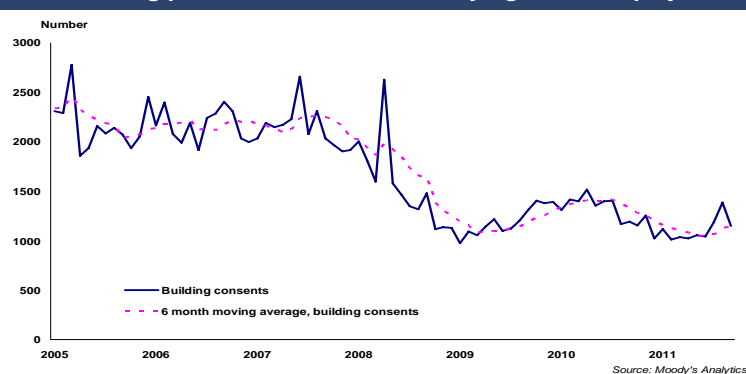
## New Zealand housing activity is muted, but prices are on the up

**“Dwelling consents tumbled in September after strong gains in July and August”**

Building permits data for October is published by Statistics New Zealand on Wednesday 30<sup>th</sup> and should show consents rising modestly after the previous month's reading. The number of new dwellings authorised in September tumbled following strong gains in July and August, when they picked up by 13.6 and 16.7% respectively. The August rise was particularly strong;

indeed it was the biggest month on month increase since April 2008. However, the underlying trend is still upwards, suggesting the 17% fall in September reflects nothing more than the extraordinary strength of the two preceding months. Permits should resume rising in the near term as

### Building permits fall, but the underlying trend is up...just



reconstruction following the earthquake damage in Canterbury continues.

More broadly, levels of building activity are still low. The total volume of building work fell in the second quarter of the year, led by a 12% fall in residential building to the lowest level since 1993. This was consistent with the number of building permits slumping in Q2. The pick up in Q3 consents should boost the volume of residential activity. On the commercial side of things, the latest RICS Global Commercial Property Survey showed that development starts in the third quarter were broadly flat, following a modest uptick in new groundbreaking activity in the Q2 survey. Nevertheless, the risks for this sector are skewed to the downside; occupier demand declined in the third quarter and the unemployment rate remains elevated.

Back to residential sales, activity weakened in October as the Real Estate Institute of New Zealand (REINZ) reported only 5,007 transactions were made, down 4.4% from September. The decline in sales suggests buyers remain cautious and are taking heed of economic conditions and rising home prices. On this point, the latest reading from the REINZ index showed prices rose in October for the fourth month in succession. Indeed the 3.4% rise was the most since June 2010, and prices are now only 3.3% from the peak of the market.

**“Sales activity was weak in October”**

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|--|---|--|---|---|---|---|
| <b>RICS UK</b><br>T +44 (0) 20 7695 1682<br>pressoffice@rics.org | <b>RICS Europe</b><br>T +32 2 733 1019<br>ricseurope@rics.org | <b>RICS Americas</b><br>T +1 212 847 7400<br>ricsamericas@rics.org | <b>RICS Oceania</b><br>T +61 2 92162333<br>ricsoceania@rics.org | <b>RICS India</b><br>T +91 124 459 5400<br>ricsindia@rics.org | <b>RICS Middle East</b><br>T +971 4 375 3074<br>ricsmiddleeast@rics.org | <b>RICS Asia</b><br>T +852 2537 7117<br>ricsasia@rics.org |
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