

Chinese house prices grow at slowest rate for 2 years to allay concerns of a bubble

“Housing investment picked up by 32% in September”

Data on fixed investment and consumer price inflation is released by the National Bureau of Statistics (NBS) on Wednesday 9th. The September CPI reading remained high at 6.1%. Inflation in China has stood above the 4% target for the past 12 months, though it may begin to ease in the coming months. The less accommodative monetary environment

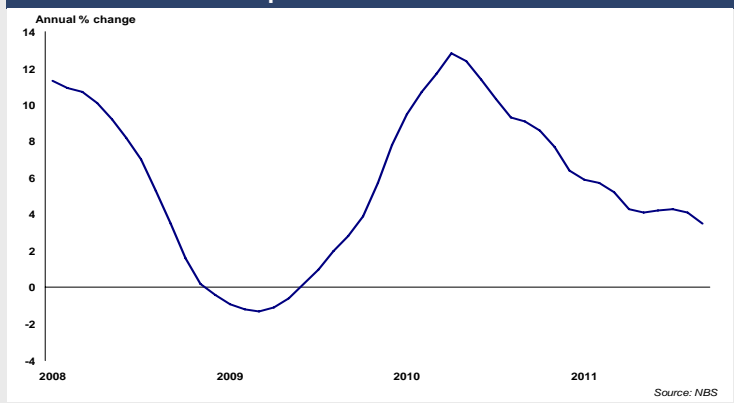
enforced by policymakers, coupled with favourable base effects, should mean price growth starts to fall in the final three months of the year. That said, we don't expect it to fall back to the target until Q1 2012. This should alleviate the pressure on the authorities to hike interest rates further while the global economy faces renewed uncertainty in the face of an intensifying European crisis. Indeed, we believe the People's Bank of China will sit on their hands for the time being, but may ease restrictions on banks lending in the New Year as they try to maintain the stable growth in M2; the target is broadly 16%.

The wider trend in the macro data has improved of late; solid growth in industrial production (the October number is also released on Wednesday 9th) and more positive readings from the PMI surveys further suggest the soft landing we have expected for some time. The GDP reading for Q3 was a robust 9.1% which also lent weight to our forecast. Meanwhile fixed investment into the property sector, which contributes up to 15% of GDP, is still continuing to rise at a significant pace; investment into housing projects rose by 32% on year ago levels in September.

There remain concerns regarding the property sector, where prices have risen sharply post-2009, but could be set for realignment. Indeed, the latest results from the NBS show prices across 70 cities continued to rise, but at the slowest pace seen in 2 years. Annual growth eased from 4.1% in August to 3.5%, further suggesting that the restrictive measures - combined with the maiden property tax - brought in over the past 12 months are now having the desired effect.

“Annual price growth eased from 4.1% in August to 3.5%”

House price inflation has slowed



No change in Polish interest rates for now; real estate rents still heading higher

“NBP to hold rates steady despite inflation running well above target”

The National Bank of Poland (NBP) meets on Wednesday 9th and is likely to leave interest rates on hold for the fifth successive month. In the wake of the October meeting, the authorities left open the possibility that a further round of policy tightening could be sanctioned, drawing attention to both the prospect of inflation remaining at elevated levels over the coming months and the sharp

fall in the zloty over the summer. Significantly, the latter has begun to stabilise more recently albeit with the help of intervention.

Nevertheless, the on-going turmoil in the euro area and the associated

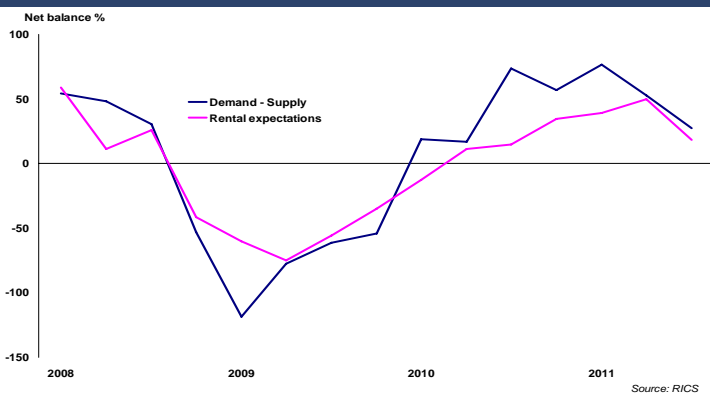
attraction of safe havens inevitably means that the NBP will need to maintain a high degree of flexibility for a while to come.

Some comfort can be taken from the latest PMI survey which recorded a headline reading of 51.7 with the output component jumping to 53.8. Both series exceeded expectations and suggest that any moderation in growth in the fourth quarter will be relatively modest. Inflation may remain close to 4% until the year end but then could begin to retreat quite sharply as last January's VAT hike falls out of the annual calculation. Indeed by the middle of next year, the headline rate could be approaching the NBP target of 2.5%. This could provide the basis for some reversal of the interest rate hikes sanctioned in the first half of this year particularly if the fiscal austerity programme does gradually take its toll on economic growth. Critical to any such move is that the more stable trend in the zloty is maintained.

For the time being, the news flow emanating from the commercial real estate sector remains relatively positive. Occupier demand continues to grow albeit at a lesser pace than earlier in the year but it is still outstripping new stock coming to the market helping to underpin rents. According to Jones Lang LaSalle, prime office space in the centre of Warsaw now goes for between €22 to €25 / m² / month which is not far away from the 2007 high watermark. Indeed, the latest RICS Global Commercial Property Survey suggests that the rent expectations trajectory is still upwards with the office sector leading the way.

“Rents are likely to continue rising with demand outstripping supply”

Rent expectations remain positive but less so than previously



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US housing market in need of a helping hand

“New policy initiatives needed for housing market recovery”

Policymakers in the US have turned their sights on the housing market, which they see as key for the US economy attaining a sustainable recovery. The US government, which last week announced an enhanced refinancing facility for homeowners with negative equity (there are approximately 11 million homeowners whose mortgage is more than the value of their home). Now the

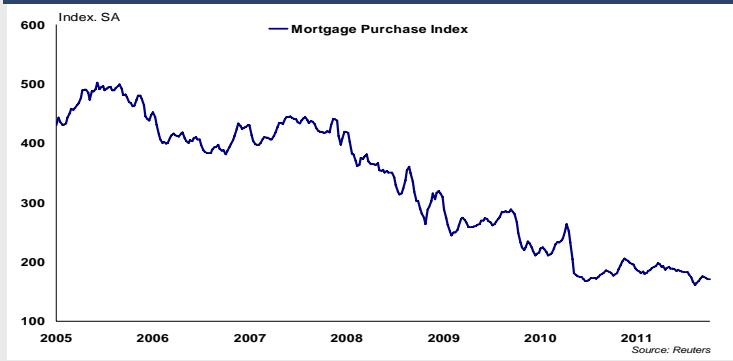
Federal Reserve board members have also got in on the act, with Daniel Tarullo in a recent speech in New York saying additional mortgage backed-securities (MBS) purchases should move back up the top of the list of options available to the Federal Reserve. Vice Chairman Janet Yellen also recently stated that additional asset purchases might become appropriate if the state of the economy warranted additional stimulus. Indeed, Wednesday’s statement by the FOMC after their monetary policy meeting echoed these sentiments, emphasising the depressed nature of the housing market, and that the central bank was “prepared to employ its tools to promote a stronger economic recovery”.

The housing market is ripe for policy intervention, with the massive supply overhang likely to take a couple of years to eliminate. In addition to this is the continued flow of distressed properties compounding the downward pressure on home prices. This in turn has made homebuilders reluctant to increase their activity; residential investment as a share of GDP currently stands at 2.2% compared to 6.3% pre-recession.

Turning to housing finance, the Fed’s Senior Loan Officers Survey will be published on Monday 7th (Q3). The Q2 survey showed domestic banks indicated that standards on both commercial and residential real estate (CRE) loans were broadly unchanged over the past quarter. The net portion of domestic respondents indicating an increase in demand for CRE loans in the current survey declined in comparison with the April survey. Indeed, with the mortgage bankers’ association’s mortgage purchase index having fallen 3.5% during Q3, we do not expect much of a pickup in the upcoming survey in terms of demand for loans.

“Senior Loan Officers Survey shows no marked improvement in lending standards”

Housing finance demand remains anaemic



2012 will see winners and losers in European real estate markets

“Deteriorating macro economic news flows indicates growing downside risks”

Recent data flow coming out of Europe indicates a deteriorating growth outlook. The October CEPR/Eurocoin reading – a rolling 3 month estimate of GDP growth - fell to -0.13 i.e. growth is estimated to have contracted by 0.13% in the three months up to and including October. Meanwhile, the European Commission’s Economic Sentiment Index for the Euro area fell to

94.8 in October, the lowest level since December 2009. Finally, the September Composite PMI reading fell to 49.1, the weakest reading since July 2009. Taken at face value, any PMI reading below 50 indicates a contraction in activity levels, but the evidence suggests this figure is

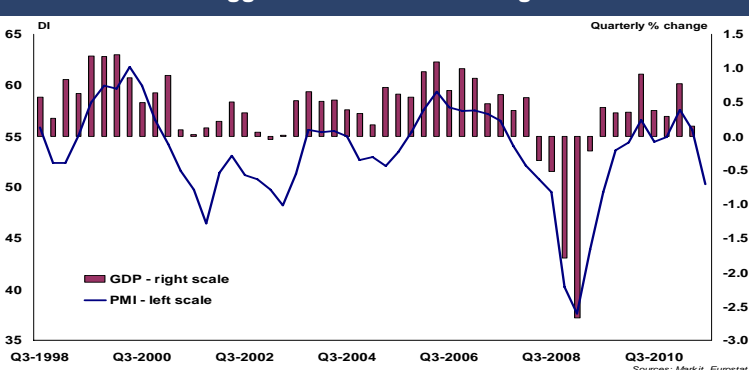
actually about 55, which the PMI has been below since May.

In spite of the worsening macro economic data flow, real estate transaction activity has so far held up relatively well. Indeed, data from Real Capital Analytics shows that volumes were steady during Q2/Q3 at just over €30bn (and are up by 22% on year ago levels). Whether this lasts is a different matter. There is always likely to be some near term inertia in commercial property transaction volumes, but in terms of the outlook going into 2012, the risks for the region as a whole are arguably shifting to the downside.

Nevertheless, although overall activity levels are likely to suffer, certain regions and segments within Europe’s real estate market are likely to perform better than others. Consistent with the ‘safe haven’ and ‘defensive’ themes dominating financial markets recently, the deepest and most liquid real estate markets such as London, Paris, Munich and Stockholm are likely to remain supported. Likewise, within most national markets prime property assets are likely to benefit at the expense of secondary ones. Some of the smaller European prime property markets in those countries relatively unscathed by the euro crises also stand to benefit from greater inflows because yields are still more attractive than in the larger European hubs. Indeed, this has been a consistent message of the RICS Global Commercial Property Market Survey, with the Q3 results again highlighting the buoyancy of the Russian and Polish markets.

“But prime markets and the most liquid markets stand to gain from defensive and safe haven flows”

Data flow suggests weaker economic growth outlook



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