RICS Global Real Estate Weekly

18th March 2011

Euro area mortgage lending likely to rise further, but risks are shifting to downside

"Economic growth and firming labour markets should lift mortgage lending ..."

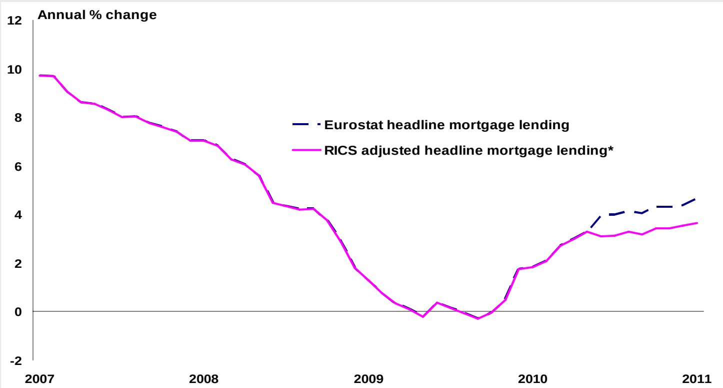
Euro area M3 lending data for February is due from the ECB on Friday 25th. M3 lending fell by 0.5% in January, but annual growth is still flattish at 1.5%. One of the key components of the M3 release is lending (outstanding) for home purchase. At the euro area level, this increased by 0.4% in January, pushing the annual growth rate up to 4.7%, the highest since May 2008.

The latest country breakdown of the ECB mortgage lending data reveals some interesting trends. In Spain and Germany - which account for 19% and 26% of the outstanding mortgage stock in the euro area respectively - annual growth is essentially flat. According to the data, the key drivers of euro area mortgage lending are France and Italy, which account for 21% and 10% of the total mortgage stock respectively. Indeed, annual growth in French mortgage lending is currently running at 8.1% - close to the highest since November 2008 – while in Italy, it is running at 25%. However, we have doubts over the quality of Italian numbers as there was an outsized jump in the series between last May/June, which pushed the annual rate up from 9% to around 25% thereafter. Given the relative size of the Italian mortgage stock, we estimate the headline euro area annual rate could be overstated by as much as 1.5 percentage points. If we assume a more believable 10% growth rate since May, the headline euro area figure would now be closer to 3.7% rather than the reported 4.7%, which suggests a somewhat flatter trend.

Through 2011, we see further upside potential in the reported annual growth rate of euro area mortgage lending, given sustained economic growth across the region and firming labour markets. However, mortgage lending growth is unlikely to move into double digits and the risks to this forecast are shifting to the downside. Indeed, the ECB has already signalled an April rate hike, from 1% currently to 1.25%, given elevated inflation (2.4%). This is likely to weigh on housing demand, particularly if it is followed by additional tightening.

"...but the prospect of rising interest rates makes the outlook more uncertain"

Euro area mortgage lending is probably being overstated



*assuming a 10% annual growth rate in Italian mortgage lending since May

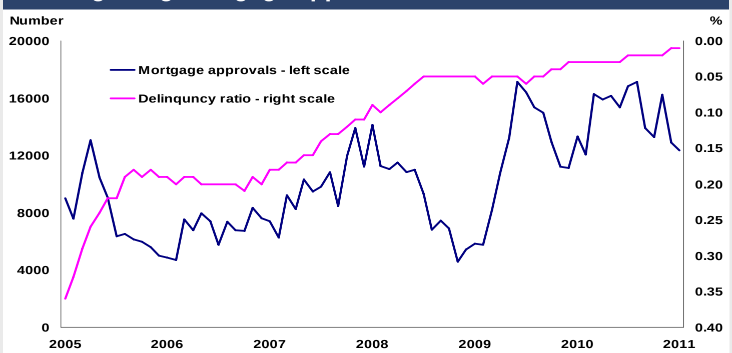
Sources: Eurostat, RICS calculations

Hong Kong mortgage approvals trending down

"Inflation is rising..."

February inflation data is released on Tuesday 22nd by the Census and Statistics Department of Hong Kong. The recent build up of inflationary pressures (owing to food and commodity price increases) remains most acute across Asia and many countries in the region are now beginning to tighten policy in response; for example, China has tightened 3 times since October in reply to inflation breaching 5% in November. Annual growth in the CPI continues to rise in Hong Kong, with January's figure reaching 3.6%, the highest rate in 2 years. This has been attributed to the enlarged increases in the price of food and private housing rents. While inflation may ease in February, it is likely that it will remain elevated (above 3%) as commodity prices remain firm.

Hong Kong mortgage approvals have been volatile of late



Source: Censtatd, HKMA

The impact of rising inflation is likely to indirectly feed through to the housing market as real incomes become squeezed, despite the continuing environment of loose monetary policy. The residential mortgage survey from the Hong Kong Monetary Authority (HKMA) is due next week and will give us the number of mortgage approvals in February. The latest survey suggests that housing demand is trending downwards after it showed the number of new loans approved in January fell 4% from December (down from 12,879 to 12,351); this followed a drop of 21% from November. The January number was also 7% lower than a year ago, suggesting that the rise in prices of residential property, coupled with HKMA macro-prudential measures, is now putting off some speculative investors. Indeed, according to the Centa-City Leading Index from Centadata, residential property prices are currently 22% higher than this time last year. Other results from the latest survey showed that the delinquency rate remained at 0.01% after falling to a record low in December.

Looking ahead, the HKMA will wait to see what effects the measures taken in the second half of 2010 have on the market before implementing further macro-prudential measures.

" ..this could squeeze real incomes and in turn housing demand alongside HKMA cooling measures"

Commercial property remains well underpinned in Poland despite interest rate fears

"NBP will lift the base rate to 4% at the policy meeting scheduled for early April"

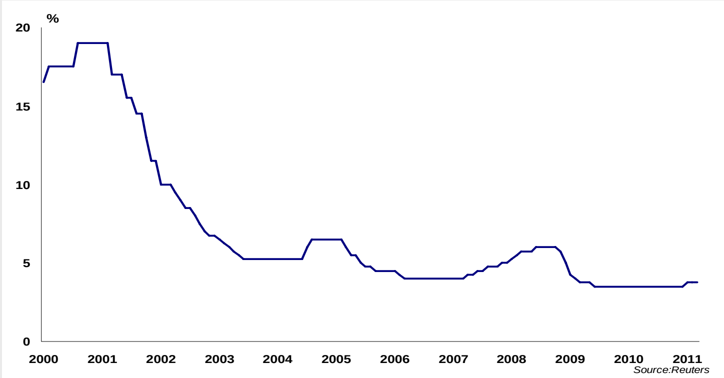
A further update on the trend in core inflation in Poland is due for release on Tuesday 22nd. This is likely to continue to show a more benign trend than the headline number which was published earlier this week and came in at 3.6%. Significantly, this reading was unchanged from the January figure and remains just outside of the 1.5% to 3.5% target range that the National Bank of Poland (NBP) aims to hit. The consensus expectation was for the outturn to be a little higher but the combination of a downward revision to the January number as well as lower food and fuel costs helps explain the more favourable result. Even so, we suspect that the headline rate will edge closer to the 4% area over the coming months.

Monetary policy was left on hold at the last meeting of the central bank earlier this month but governor Marek Belka appeared to be paving the way for a further round of tightening by re-iterating concerns that inflation is set to move higher in the near term while also suggesting that the growth picture would remain firm. Our judgement is that NBP will lift the base rate to 4% at the policy meeting scheduled for early April. However, forthcoming numbers on retail sales and unemployment on Wednesday 30th and the PMI business confidence index on Friday 1st could have a bearing on the decision. Developments in Japan may also be influential.

Sentiment in the commercial property market remains generally positive for the time being benefiting from the favourable economic climate and relatively low interest rates. The most recent RICS survey suggests that expectations for both capital values and rents are positive and towards the upper end of the range of countries that we monitor. Consistent with this are indications that the amount of distressed property coming to the Polish market is continuing to decline. The one major threat to the continuing recovery in the real estate sector is the pace at which interest rates are raised.

"the amount of distressed property coming to the Polish market is continuing to decline"

Polish interest rates are edging up

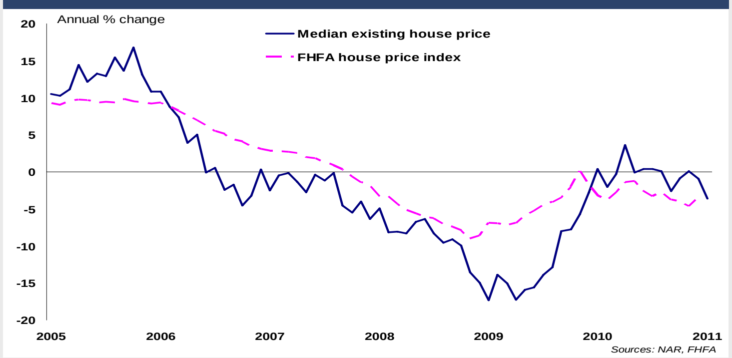


US house price falls leading to more foreclosures

"Median price of an existing home at a nine year low"

The coming week sees the release of data pertaining to the US housing market, starting with existing home sales (February) on Monday 21st, followed by the FHFA housing price index (January) the next day and finally new home sales on Wednesday 23rd. Existing home sales have rebounded in the last few months, with January recording an eight month high at an annualised rate of 5.24 million, up 2.7% on the year. That said, this masks the continuing trend of falling house prices, with the median price of an existing home being dragged down by distressed properties, and now stands at a nine year low. The ongoing investigations into major lenders' foreclosure practices has led to a slowdown in the rate of foreclosed properties coming onto the market, but the payback for this will be seen in the coming months.

US house prices continue to deteriorate



The flow of distressed properties coming onto the market is continuing to put downward pressure on house prices, which in turn is putting more homeowners in negative equity (value of their home is less than the value of their mortgage). As more homeowners slip 'underwater', the more likely it is they will default on their mortgage payments; negative equity is considered a necessary condition to default since homeowners with positive equity can sell or refinance. This in turn, results in more foreclosed properties, leading to a vicious cycle of further price falls and more defaults. Our estimate of house prices falling 5% in 2011 will push another 2.5 million homeowners 'underwater'.

Looking ahead, the recent minutes from the Federal Reserve's monetary policy meeting stated that the central bank will continue on the quantitative easing programme it started in November, with up to $600 billion of Treasuries to be bought by the end of the second quarter. This will keep long term interest rates depressed, including mortgage rates, which are already at historical lows.

"Distressed properties continue to weigh down on house prices"

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