

Weaker outlook for property sector in Europe

"Weaker economic growth outlook suggests less rosy outlook for the commercial property and housing markets"

Preliminary euro area GDP data for Q2 is due from Eurostat on Tuesday 16th. In Q1, the economy expanded by 0.8% (twice the long run average) but output is still 2.1% below its peak reached in Q1 2008. At the country level, Germany and France expanded by 1.5% and 1% respectively, while Italy and Spain expanded by 0.1% and 0.3%. However, all of the indications to

date point to significantly lower growth in Q2 and a much weaker growth outlook for the remainder of this year. The explanations are by now well known; falling real incomes and profit margins due to rising energy and commodity prices combined with renewed uncertainty relating to the European debt crisis. The global supply chain disruptions following events in Japan are another potential factor.

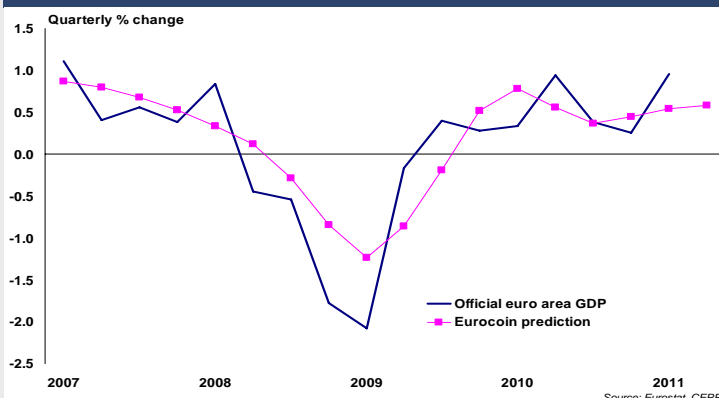
Most telling has been the steep decline in the Euro zone composite PMI index, which fell further to 51.1 in July, having reached 57.8 only in April. This index has historically tended to track quarterly growth in area wide GDP very closely and suggests GDP growth is currently consistent with rate of around 0.1%. Of course, this estimate relates only to the July PMI reading rather than the Q2 period, so the actual GDP result for Q2 is likely to be higher. However, it is indicative of the slowdown presently underway. The Eurocoin indicator, which provides a rolling quarterly estimate of GDP growth, printed 0.5% in June and is likely to be somewhat closer to the mark for Q2 as a whole.

The weaker economic growth outlook suggests less rosy prospects for the property sector. Indeed, the Q2 RICS Global Commercial Property

Survey highlighted deteriorating capital value and rental value expectations in Germany, France, Italy and Spain, although confidence overall still remains positive in the former two countries. Housing market prospects have likewise taken a turn for the worst, given that: a) governments are now under increasing pressure to front-load their fiscal austerity budgets b) that any future labour market recovery is now likely to be gentler at best and c) that banks are likely to lend even more cautiously to the household sector (already indicated by the ECB's Bank Lending Survey).

"Q2 GDP growth is likely to be around 0.5%"

Economic growth outlook has deteriorated in the euro area



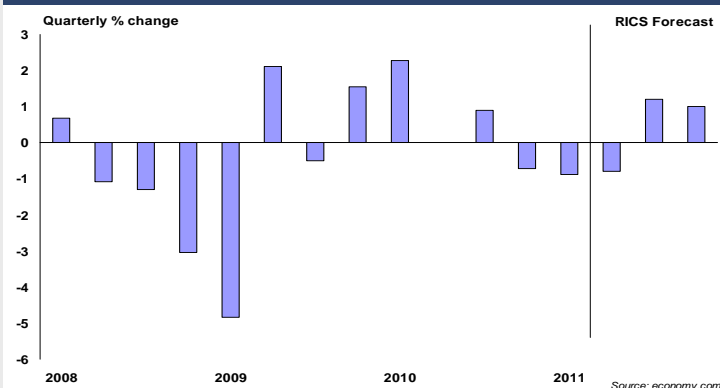
Japanese rebuilding to underpin growth in the economy

"Construction spending fell in May for the third month in succession"

An interesting week in Japan approaches, as the official first estimate of second quarter GDP is published on Monday 15th by the Statistics Bureau, and is followed by data on construction spending for June on Wednesday 17th. Both will give an indication of the rebuilding efforts in wake of the March disaster. The GDP release is expected to show a quarter on quarter fall of

about 0.8% following the supply chain disruption to manufacturers and exporters. Indeed, industrial production fell by 4.7% in the first half of 2011, compared to a 10.1% gain in the final 6 months of 2010.

GDP should pick up in the second half of 2011



However, more recently the IP index has shown improvements, with monthly gains in April, May and June. Notwithstanding this, there are downside risks, most notably the deteriorating global backdrop. The turmoil of the past week has seen a sharp rise in the yen which, if sustained, could cause further harm to exporters.

Construction spending in May fell for the third month in succession, with the annual growth rate falling by 4.3%, the biggest fall since July 2010. We expect spending figures in June to show a similar result again, owing to both base effects and the continued fallout from the earthquake. Despite this, it doesn't appear to be all doom and gloom for the construction sector. Building activity has edged up of late, with Land Ministry data showing that building starts have increased in each month since the earthquake; starts improved by 13% between May and June alone. Moreover, construction orders, having tumbled in April, have recovered to show monthly gains of 19% in May and 28% in June. The rebuild is likely to continue improving during the second half of the year, which should underpin an increase in national output.

Looking ahead, there is reason to believe that economic performance in H2 will pick up considerably, reflecting the recovery in manufacturing and building projects. Consequently, we are forecasting GDP growth to increase by 1.1% in Q3 and another 1% in Q4.

"Despite this, building starts have increased in each month since the earthquake"



RICS

the mark of
property
professionalism
worldwide

rics.org/economics

US housing sector still looking for sustainable recovery

“Builders’ confidence still at decade lows”

The coming week sees the release of a raft of housing related data, starting with the NAHB survey (August) on Monday 15th followed by housing starts (July) the next day. The NAHB survey, an indicator of home builders’ confidence in the market, edged up in July (from 13 to 15) although it remains at very depressed levels (a reading of below 50 indicates builders’ view market conditions as

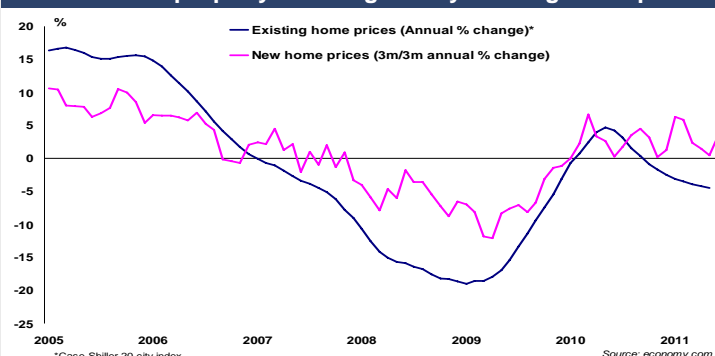
getting worse). Depressed levels of confidence in the residential building sector reflect high numbers of foreclosures, much lower house prices than prior to the downturn and depressed levels of new home sales. Indeed, sales of new homes have been flat over the first half of 2011 and remain over 50% below their long run average. Meanwhile, housing starts have been trending upwards for the past 5 months, reaching 629,000 in June (on an annualised basis). However, because they remain so low relative to the long run average of about 1.5 million (annualised) the recent uptrend has yet to meaningfully feed through to confidence.

Turning to prices, the falls witnessed during the early part of the year seem to have stalled, with the S&P/Case-Shiller 20-city index unchanged in May after rising 0.3% in April. Moreover, the median price of a new house (which is more significant to builders) increased an impressive 8% in June to \$234,375 (7% above year ago levels). That said, the continued supply overhang in the market will remain a hindrance to any substantial recovery in the house building sector for the time being.

In terms of the economic backdrop, better employment numbers recently - private employment rose by 154,000 in May - should aid demand for houses. In addition, recent actions by the Federal Reserve, whereby it explicitly stated that short term interest rates will be kept at very low levels for another two years, will be a welcome sign for current and potential homeowners, as the cost of home financing should stay at record lows. One potential offsetting factor, however, is the recent downgrade of US government debt; this could result in higher borrowing premiums across the board.

“Housing starts remain at depressed levels”

Distressed property affecting mostly existing home prices



RICS data indicates house price falls in the UK are likely to be limited in the near term

“Annual trend in DCLG index is mildly negative”

Official UK house price data for June produced by the DCLG is due Tuesday 16th. In May, the index was 1.6% below year ago levels and 7% below its January 2008 peak, but it had fallen by as much as 15% from its high point. The DCLG index is, however, just one of at least three well established UK house price indices (which include the Nation-

wide and the Halifax). And while the DCLG index is arguably the most representative of the three, as it is based on a much larger sample, it is the least timely. Indeed, the June data for the other two indices showed a slight improvement in their respective annual growth trends

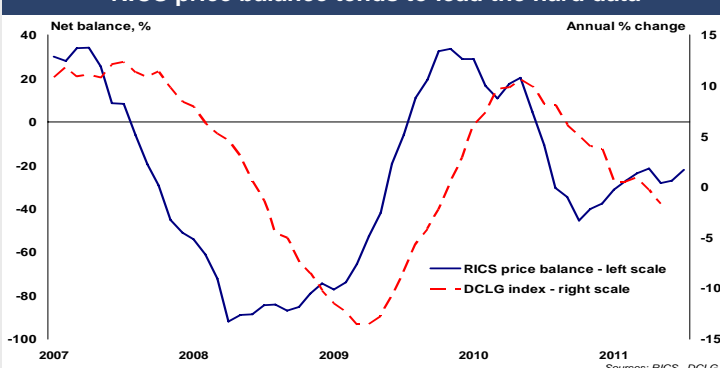
(-1.1% and -3.4%), but at present, larger gaps between their respective pre-recession peaks remain (10% and 18%).

The generally weaker trend in annual house price growth is mainly a lagged response to a stalled recovery in mortgage lending at the beginning of 2010, which is still feeding through to prices. Indeed, official mortgage approvals recovered from 26K in November 2008 to 59K in December 2009, but they subsequently fell below 50K and have been stuck between the 45-50K range ever since.

Looking forward, we do not expect annual house price falls to exceed 5% by year end and we condition this view on our own monthly Housing Market Survey data. The headline RICS price balance has historically been a good lead indicator of the hard data and while it is still negative, it has been gradually improving. On the basis of past relationships, this suggests the annual trend in the DCLG index could weaken further over the coming months, but the near term downside are receding. The main explanations are probably an influx of foreign money into residential property within the capital coupled with a major structural shortage of homes more generally in the UK (100K new homes built annually, versus 240K new households formed). However, the medium term prospects are more uncertain; the deteriorating growth outlook of the wider economy - as evidenced by the latest business surveys - poses greater downside risks to house prices.

“RICS data indicates further price falls will be moderate”

RICS price balance tends to lead the hard data



RICS UK
T +44 (0) 20 7695 1682
pressoffice@rics.org

RICS Europe
T +32 2 733 1019
ricseurope@rics.org

RICS Americas
T +1 212 847 7400
ricsamericas@rics.org

RICS Oceania
T +61 2 92162333
ricsoceania@rics.org

RICS India
T +91 124 459 5400
ricsindia@rics.org

RICS Middle East
T +971 4 375 3074
ricsmiddleeast@rics.org

RICS Asia
T +852 2537 7117
ricsasia@rics.org

This newsletter contains economic and property news and analyses, edited by RICS.
It should not be relied upon as professional advice and RICS accepts no liability for reliance on its contents.



RICS

the mark of
property
professionalism
worldwide

rics.org/economics