RICS Global Real Estate Weekly

26th August 2011

Still negative outlook for Spanish housing market

> **"House prices are down by 15% from their peak..."**

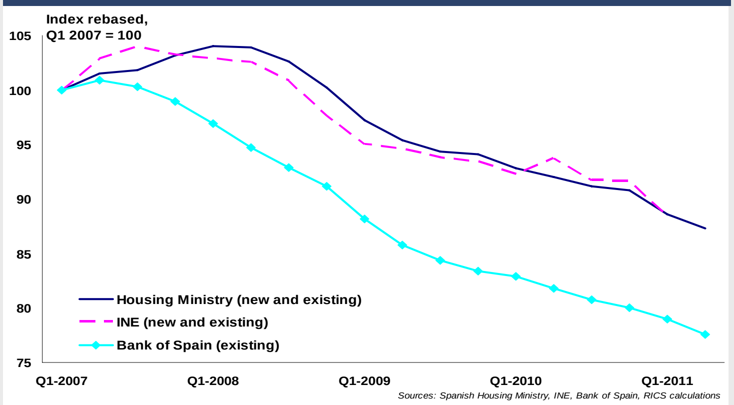
With the release of official Spanish mortgage approvals data (June) on Monday 29th, it's time for a more general update on the state of the housing market. The bottom line is that things have been getting worse, not better and this is likely to continue. Starting with mortgage approvals, the data is choppy, but the monthly count is currently running at just over 60k. This is close to the lowest level on record (the series began in January 2003) and around 66% below the January 2007 peak.

On the pricing front, there are three official measures and they paint a remarkably consistent picture; home prices in general (existing and new) are about 15% below their peak, while existing home prices in particular are about 20% below their peak. Indeed, the INE's (national statistics office) headline index, which covers new and existing homes, is 15% below its peak and the existing homes sub-index was down by 22%. Meanwhile, the MdV (Ministry of Housing) index, which also covers new and existing homes, is 16% below its peak and the Bank of Spain's existing homes index is 23% below its peak.

Looking forward, there is little ground for optimism, at least over the near term. Although the economy exited from recession in Q1 2010, the pace of expansion has since been very lacklustre. Indeed, following an increase of 0.3% in Q1 the economy grew by only 0.2% in Q2 according to Eurostat's flash estimate. This is significantly below the long run average of 0.7% as well as reliable post-crisis estimates of Spain's medium term growth potential of about 0.5% per quarter (as calculated by the Bank of Spain). Consequently, with actual growth running below potential and leading indicators such as the PMI surveys suggesting the economic outlook is worsening again, the labour market is likely to continue deteriorating. This is a problem considering the Spanish unemployment rate is already 21%, the highest on record. Until the labour market starts to recover, the housing market is unlikely to find much traction in the near term.

> **"...and will continue falling until the labour market recovers"**

House prices are still falling

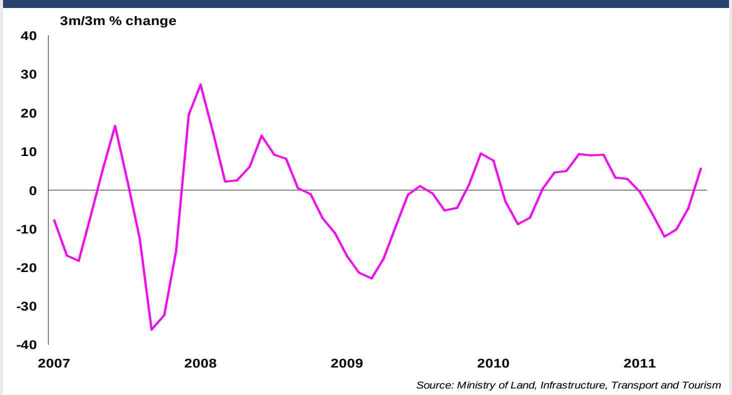


Pickup in Japanese construction activity is being driven by housing starts

> **"Construction orders picked up by 6% in June as the rebuilding process continues"**

More construction data is available next week as the Land Ministry publishes both construction orders and housing starts for July on Wednesday 31st. The latest update from the sector came last week, when construction investment for June was released. Indeed, the data showed a similar annual growth profile to May, falling by 3.2%, owing to the continued fallout from the March disaster. Notwithstanding this, there was a monthly pick up in construction spending for the first time since February; spending in June was 3.1% higher than in May. This was the greatest monthly improvement since December last year. The signs are that activity in the sector is now picking up and we certainly expect a recovery to crystallise over the next six months.

Housing starts have rebounded smartly since March



Annual growth in construction orders fell 11% in March, as the economy reeled from the effects of the Tohoku earthquake, but have rebounded smartly in April and May; by 31% and 25% respectively. The latest data for June also showed an improvement, as orders picked up by a further 6% on the back of rebuilding efforts. One of the leading drivers in construction activity at present is dwelling starts. In June, the number of housing starts reached a six month high of 72,687, rising 5.8% from a year earlier and climbing for a third month in a row. There was even the first month on month improvement since December, as starts picked up 5.6% from May. This positive news flow suggests that progress in clearing supply constraints is supporting the construction sector.

Moreover, there was further positive news as the first estimate of Q2 GDP came in above market expectations; GDP contracted by only 0.3% (against a consensus of 0.6%), driven by stronger than expected industrial production, private consumption and exports in May and June. Furthermore, the latest Reuters Tankan survey, which measures business sentiment amongst large firms, continued to improve in August, indicating there may be an impressive bounce in output in quarters 3 and 4.

> **"Housing starts reached a six month high"**

Recovery in US construction spending likely to be long and drawn out

"Construction spending rose 0.2% in June"

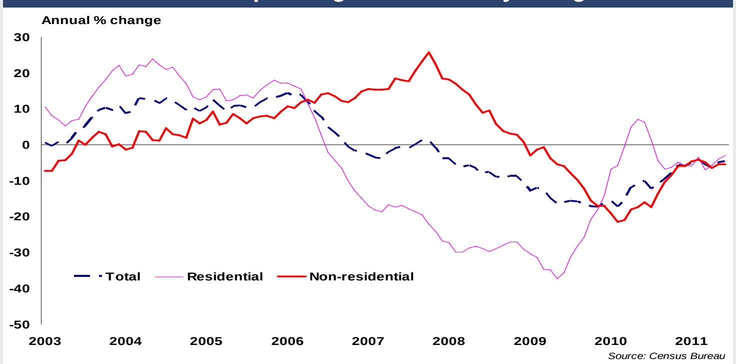
The coming week sees the release of US existing house prices, with the S&P/ Case-Shiller 20-city index (June) due on Tuesday 30th. This is followed by construction spending (July) on Friday 1st. Construction spending surprised on the upside in June, rising 0.2% on the month. Private construction spending outperformed the public sector, rising 0.8%, whilst public construction declined by 0.7%. Within the sub-sectors, private non-residential construction led the way, rising 1.3% on the month, with commercial property outlays rising smartly. Private and public residential construction declined in June, with private residential construction in particular showing no signs of recovery, standing 36% below its pre-recession peak. Indeed, with house builders' confidence at historic lows according to the NAHB survey, the recovery in construction spending will in all probability be a long and bumpy road in spite of recent improvements in the data.

Turning to house prices, the Case-Shiller house price index, which measures the transaction price of existing homes across 20 of the largest metropolitan areas in the country, remained broadly flat in May. The house price index remains 4.5% below year ago levels, and with an excess supply of homes in the market (including foreclosed properties), further declines in house prices look likely. We continue to see house prices ending 2011 around 6% below year ago levels.

Looking ahead, the chances of a recession have increased substantially. Consequently, the downside risks for the housing market have also spiked of late, especially with the labour market in a precarious position. The annual Jackson Hole meeting of Federal Reserve officials will be keenly watched, as last years brought about the first signs of QE2. The markets will be looking to the central bank for assurances that it will do all it can to foster growth. Indeed, with QE3 less of a remote possibility, the pressure will be on Chairman Bernanke to announce some concrete steps to stimulate the economy.

"House prices remain 4.5% below year ago levels, and further declines look likely"

Construction spending is still below year ago levels



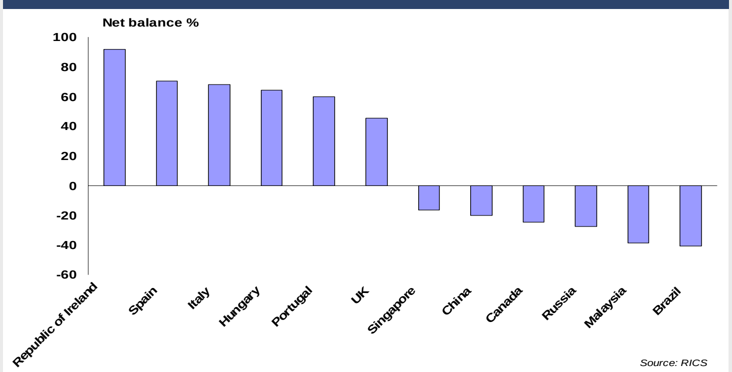
Source: Census Bureau

Demand for distressed assets continues to rise globally

"Supply of distressed property continued to rise in most markets"

This past week has seen the release of the Q2 RICS Distressed Property Monitor, which shows that both investor appetite for, and the supply of, distressed property is continuing to rise across the globe. Of the 25 countries covered by the survey, 15 indicated the supply of distressed property was expected to increase in the coming quarter, most prominently in the Republic of Ireland, Spain, Italy, Hungary and Portugal. Respondents in Africa and the Middle East also indicated they expected more distressed sales next quarter compared to last. In contrast, commercial real estate markets appear more stable in non-Japan Asia, Latin America and Russia where the expected supply of foreclosed properties is anticipated to be in decline. This more optimistic outlook comes despite monetary policy tightening in many of these economies to combat higher inflationary pressures.

Expected level of distressed property in Q3



Source: RICS

Interestingly, respondents suggest that investor appetite for distressed assets picked up in the majority of countries, and at a greater rate than seen previously; all but 4 countries reported rising interest from specialist funds, and 16 of these 21 suggested there was a greater level of demand than seen last quarter. This uptick in demand was greatest in Japan and Hungary, but there were noticeable shifts in sentiment in Poland, Italy and Russia.

Finally, rising interest is outpacing the expected supply in 13 out of 25 countries surveyed (compared to 11 in Q1). However, there are instances where expected supply is greater than demand, particularly in peripheral Europe, where debt concerns are elevated. It is also the case in the UK. It is worth noting that since the results of this survey were collected, there has been a shift in sentiment as the global recovery has stalled in many western economies, forcing central banks to err on the side of caution and leave monetary policy loose as downside insurance. With many more central banks on hold during H2, we would expect to see fewer distressed properties coming to market than might have otherwise been the case.

"Specialist fund interest picked up in all but a handful of countries"

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