

ECB bank lending survey to highlight increasing squeeze on finance

“The EU construction employment series is at its most negative since the early part of 2010”

The coming week will provide a timely update of how both businesses and households are responding to the on-going uncertainty over the future of the euro area and, most notably, the negotiations surrounding a restructuring of Greek debt. A raft of European Commission (EC) confidence surveys are released on Monday 30th, December labour market statistics are out on Tuesday 31st and the ECB bank lending survey is published on

Wednesday 1st. The already released flash PMI for January provides some reason for encouragement with the composite measure coming in at 50.4, its best outcome in four months. This reading is consistent with a stabilising in the economic climate after a sharp deterioration in the latter part of last year. Financial markets have taken a broadly similar view in the first month of 2012 with risk assets generally firmer and bond markets away from Greece and Portugal rallying despite the S&P downgrade.

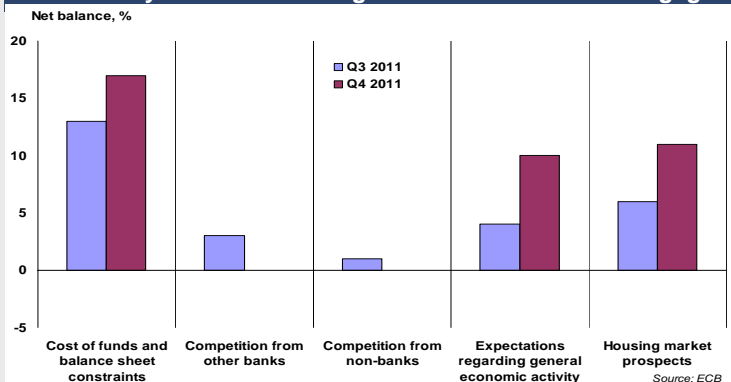
The EC surveys will if nothing else put a little more flesh on the bones of the mood within the corporate sector. Particularly interesting from a real estate perspective could be the results from the construction industry. The December report not only suggested that building activity at a headline level is continuing to soften but also indicated that order books are languishing and that the employment picture in the sector remains grim; the reading for this series is at its most negative since the early part of 2010.

Although a relatively small number of construction businesses highlight finance as a key constraint on activity (far more point to insufficient demand), it is hard to see access to development capital improving

anytime soon. The last ECB bank lending survey noted that margins on riskier loans, which would include those for speculative building projects, have predictably enough increased sharply. Apart from a further extension of this trend, the ECB report will almost inevitably show a further tightening in credit standards for those households seeking finance to purchase a property. Key drivers of this will be the rising cost of funds for banks as well increasing concerns amongst loan officers over both the outlook for the economy and, more specifically, the housing market.

“ECB survey to show further tightening in credit standards”

ECB survey - factors affecting credit standards for mortgages



US construction market trending upwards

“Residential construction has risen 8% since mid-year”

December construction spending data is due for release on Wednesday 1st. In November it hit an 18 month high in, rising 1.2% on the month to \$807bn. Spending on public construction rebounded from October, with outlays on federal projects jumping 5.3%. In the residential sub-sector, construction increased by 1.8% in November, and has now risen 8% since July. This reflects the recently seen rise in housing starts, as

builders start to increase activity on the back of rising rental demand. Indeed, with builders' sentiment on the mend and housing stocks at post-

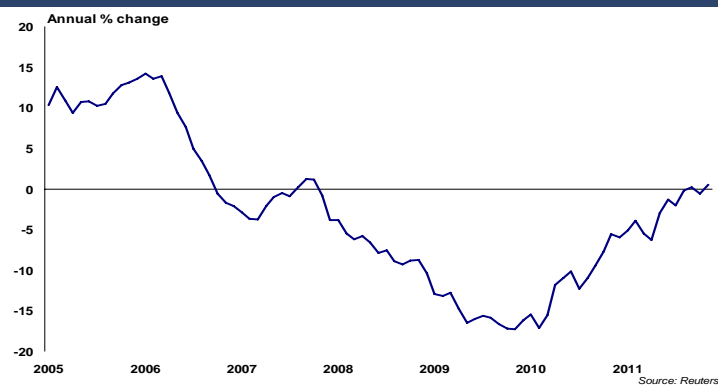
recession low, we expect residential investment to make a positive contribution to economic growth in 2012.

In spite of historically low mortgage rates (currently at 4.1%), a major factor holding back the housing recovery are tight credit conditions, specifically the lack of availability of housing finance. The Senior Loan Officers Survey by the Federal Reserve (the January report comes out on Monday, 30th) is a good indicator of prevailing lending conditions. The October Survey suggested rising demand for housing finance for the first time since early 2010, perhaps due to refinancing activity. That said, lending standards remained broadly unchanged for prime and non-conventional mortgages. Domestic banks also continued to report little change in their standards on commercial real estate (CRE) loans, which were widely described as being at or near their tightest levels since 2005. In contrast, a large fraction of foreign respondents reported having tightened standards on CRE loans, in a substantial shift from the net easing reported by those institutions in the prior two surveys.

Turning to policy, the latest announcement from the Federal Open Market Committee explicitly stated an inflation target, of around 2%, whilst lowering growth forecasts for the year. The chairman of the Fed stated that further stimulus will be warranted if unemployment stays elevated, with many believing that further mortgage backed securities debt will be bought to aid a fragile housing market.

“Commercial real estate lending standards remain tight”

Construction spending is no longer falling



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Downside risks to the Australian housing market prevail

“Labour market data and consumer confidence weakened”

2011 housing data in Australia has underwhelmed. In Q3, housing starts slumped to the lowest level for 2 years and housing finance commitments issued in November showed only a modest rise. The 1.4% month on month increase masked the underlying trend, which suggests demand for mortgage finance remains subdued. Alongside this, there was a softer tone to the December labour market data and consumer confidence

weakened in the final few months of the year. Both these factors are likely to dampen sentiment in the housing sector.

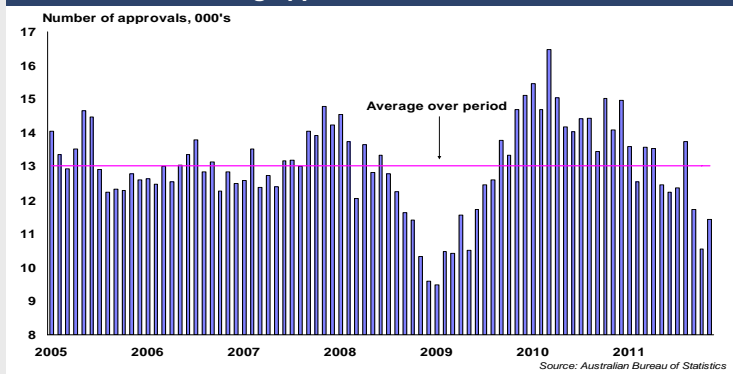
One small positive was the building approvals number, which picked up in November following two months of steep falls. The 8.4% rise to 11,424, while not reversing the 15% and 10% declines in September and October, does suggest that approvals are close to a trough. Following two RBA rate cuts, a number of banks and lenders have also cut their mortgage rates in line with the central bank. The December building approvals figures are released on Thursday 2nd, and may well show a similar rise to that seen in November. Nevertheless, broader confidence in the market is still fragile following a subdued year in which turnover remains low and households are cautious about taking on more debt. With this in mind, we expect the Q4 price data (released Wednesday 1st) to show a flattish picture at best, but the risks are skewed to the downside. Indeed, the RBA easing cycle may help put a floor under prices, but ultimately, we still expect the data to show they fell in the final three months of 2011.

The action by the Reserve Bank to move quickly in response to both the

softer Q3 CPI data and a slowdown in the global economy, especially in major trading partners in Asia, may help explain the pick up in consumer confidence in January. Significantly, the latest CPI data for Q4 paves the way for further action. The Q4 reading was unchanged, printing 3.1% annually, which the RBA may suggest provides scope for further action. As a result, we expect at least one cut in base rates during Q1, which could come in the next meeting on Tuesday 7th.

“We expect the data to show house prices fell in Q4”

Building approvals remain subdued



UK construction sector to remain under pressure

“Construction output fell 0.5% in the final three months of 2011”

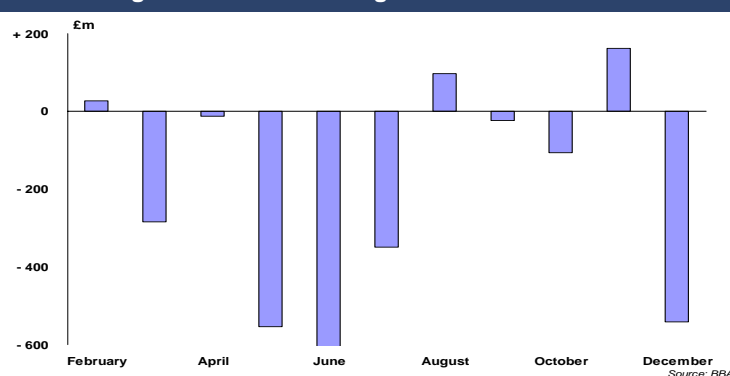
The news that the UK economy contracted in the final three months of 2011 by 0.2% came as a disappointment raising fears that it could be on the verge of slipping back into recession. From a real estate perspective, it was notable that construction output fell 0.5% over the three month period leaving it barely one per cent higher than where it stood at the tail end of 2010. In the light of this, the forthcoming release of the PMI Construction

Survey on Thursday 2nd will be closely watched to see how macro uncertainty is impacting on sentiment in the sector. Our suspicion is that while the headline index contained in this report may remain above the

critical level of 50 (which typically signifies expansion) the underlying tone is set to be more cautious. For what it is worth, we expect construction output for the whole of 2012 to drop by a further 3%.

Alongside the lack of demand for new buildings, a key issue that is clearly impacting on development is the reluctance of lenders to provide finance for anything that has a speculative element to it. Confirmation of this will be visible in figures from the Bank of England for December which are due on Wednesday 1st. They are likely to show that lending to the sector weakened through the course of 2011 with debt outstanding to construction related businesses (on a comparative basis) dropping by around 5%. Significantly, the latest Credit Conditions Survey broadly contained the same message indicating that the tolerance for what may be viewed as risky projects continues to diminish amongst lenders.

Change in debt outstanding to the construction sector



The one bright light that should emerge from the Bank of England data is the slightly more positive attitude to the provision of finance for homebuyers. Previously released figures from the British Bankers Association suggest that the number of mortgages approved in the final month of last year when measured on a seasonally adjusted basis reached the highest level since May 2010 and this story should be re-iterated in the more complete official data. The volume of activity could be given a further lift with the introduction of the Mortgage Indemnity Scheme in the spring.

“Debt outstanding to construction related businesses continues to fall”

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

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

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

RICS Asia

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