

Polish interest rates on hold as commercial real estate sector continues to boom

“The NBP is concerned that inflation will prove more intractable than previously anticipated”

The National Bank of Poland (NBP) meets next week to review the current stance of monetary policy with an announcement due on Wednesday 8th; interest rates have been on hold since the middle of last year with the key reference rate at 4.5%. Significantly while central banks elsewhere around the world have either been lowering rates or edging in that direction, the NBP is taking a rather more hawkish approach. Of particular concern for

central bank governor Marek Belka is the likelihood that inflation pressures will prove more intractable than previously anticipated. However, there is also a suspicion in Warsaw that the scale of any slowdown in the Polish economy could be relatively modest. Reflecting this, it is improbable that the authorities will look to shift the policy stance anytime soon.

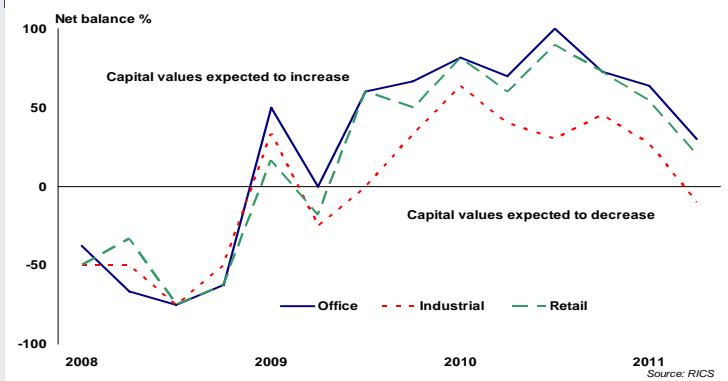
The resilience of the economy - the PMI sentiment series hit its best level in six months in January - is contributing to the generally upbeat mood in the commercial real estate sector. For the record, last year saw a sharp jump in the level of property transactions (totalling Euro 2.5bn according to Jones Lang LaSalle) with office volumes at their best level since 2006 and retail activity at a four year high. The latest RICS Global Commercial Property Survey (GCPS) suggests that this positive picture is set to persist during at least the early part of 2012. Indeed, respondents to the survey also remain generally upbeat on the prospects for capital values particularly in the office sector as the adjacent chart demonstrates. Interestingly, the GCPS indicates that the firm investment market is being underpinned in the occupier market with tenant demand continuing to grow strongly and rent expectations holding steady at close to recent

highs. New development is most visible in the office sector.

The picture in the residential market remains a little more mixed. Loans outstanding to the sector are still rising helped by a government sponsored subsidised housing scheme. However with this layer of support due to end, Swiss Franc loans now looking decidedly less appealing and no early prospect of an interest rate cut the risk is that home prices will continue to soften, albeit only modestly, for a while to come despite the generally healthy economic news flow.

“Last year saw a sharp jump in property transactions and this positive trend is set to persist”

RICS survey shows office and retail values rising further



Pause for thought at Bank of Korea as GDP undershoots

“GDP growth slowed for the 3rd successive quarter”

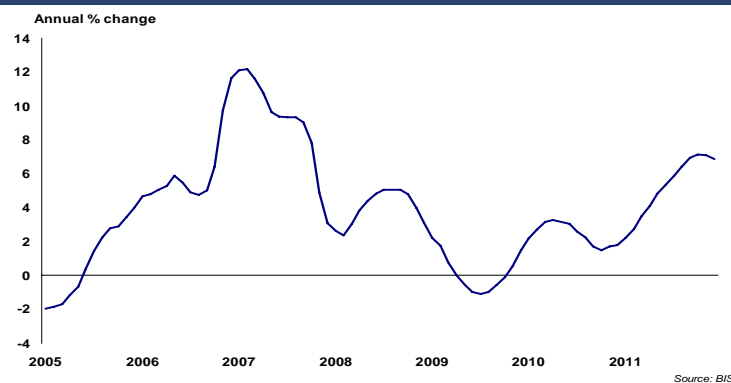
The more challenging global environment softened Korea's GDP growth in the final part of the year, as the quarter on quarter increase slowed to 0.4% from 0.8% in Q3. The export dependant economy suffered as a result of the ongoing euro area crisis and moderation in the high growth emerging markets. Manufacturing and construction output fell by 0.5% and 2.2% respectively, but positive growth in the services

component (of 0.9%) helped to prop up the headline figure. The drop in government spending is likely to see some payback in Q1, as the government forces through spending ahead of the Presidential elections

(in December). Significantly, the weaker GDP reading is likely to mean the Bank of Korea (BoK) take a more supportive stance with regards to setting monetary policy.

The BoK left rates unchanged at 3.25% for the seventh straight month in January, but cited potential downside risks to the domestic economy from events in Europe. The subdued GDP number, alongside a softening in the inflation outlook, provides scope for the BoK to ease policy; the January inflation reading showed price growth slowing to 3.4% from 4.2% in December. The latest announcement from the central bank is due Thursday 9th, but despite inflation falling back within the target range (of 2% to 4%), we expect them to sit on the policy sidelines for the time being even as a European recession looks likely to affect Korean exports further.

House prices are elevated despite sluggish transactions



While it may aid the wider economy, the continued pause in policy is unlikely to provide a kick-start to activity in the housing market. Despite passing measures aimed at stimulating transactions in December, the market remains sluggish; the government abolished restrictive capital gains taxes on multiple home owners that remained as a legacy from 2008. The government also promised to expand the policy of cheap loans for married couples, low income earners and first home buyers. While it is too soon to see any affects of these steps yet, any increase on the demand side is likely to push up prices further; the Kookmin Bank index showed prices climb by 6.9% in December from year ago levels.

“The Bank of Korea may provide support through monetary policy”



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Canadian households debt level reach record high

“New house prices increased by 2.5% over year ago levels in November”

The new house price index is published on Thursday 9th (for December). November's data showed new house prices rose 2.5% over the year. Additionally, Teranet's existing house price index of the 11 major metropolitan areas recorded broadly flat prices in November, although still 7% higher than year ago levels.

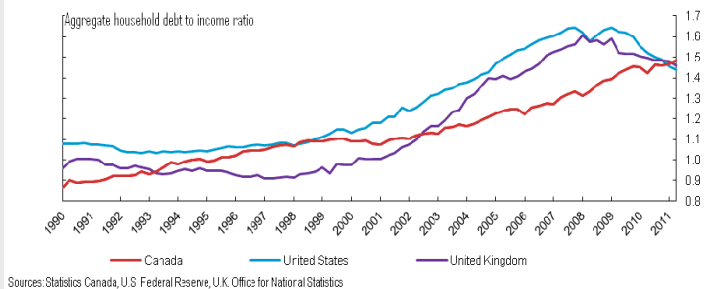
Recently released GDP data showed the Canadian economy remained broadly flat through November, bringing the annual growth rate to 2%. The moderation in growth was mainly due to a 2% fall in the oil and gas sector. In contrast, the housing sector continues to flourish, with housing starts rising 8% in December, bringing the annual rate to 200k. Robust construction activity is being led by a low interest rate environment and booming condominium sales. Indeed, with the stock of mortgage finance rising 8% over year ago levels in November, unlike their US and British counterparts, Canadians continue to become more leveraged. This has led to household debt rising to record levels, and making Canadian households more leveraged than US and British households (the household debt-to-income ratio now stands at 152%, compared to 130% pre-crisis). Rising levels of household debt have resulted in repeated warnings about the pitfalls of unsustainable debt levels from monetary authorities. This, combined with macro-prudential measures and rising uncertainty because of the European debt crisis, has slowed mortgage credit growth recently but not its direction.

The elevated household debt levels in Canada has led many policymakers to become increasingly concerned about the country's housing agency, the Canadian Mortgage and Housing Corporation

(CMHC – the Canadian equivalent to Fannie Mae and Freddie Mac in the US). The CMHC's main function is to insure residential mortgage loans, protecting lenders/ investors in case of default. Hence, if there is a major correction in the Canadian housing market, and defaults rise substantially, the CMHC will likely face a massive bill, and possibly have to be bailed out by the taxpayer, similar to Fannie and Freddie's fate. Indeed, with the CMHC nearing its \$600 billion government mandated balance sheet limit, it will be keenly watched whether the government will approve a higher balance sheet limit in the months ahead.

“Housing starts continue to surge, rising 8% over the month in December”

Canadian households continue to take on more debt



European property sector to remain under pressure, with some exceptions

“ECB rates likely to come down further, though not at next meeting”

The ECB is due to announce its latest interest rate decision on Thursday 9th. The policy rate currently stands at 1%, having been cut from 1.5% last November. The latest cuts were delivered in spite of the headline inflation rate – 2.7% - remaining above the ECB's medium term target (close to but below 2%). However, the ECB's reasoning behind the cuts is that the intensification of the region's sovereign debt crisis has skewed the balance of risks

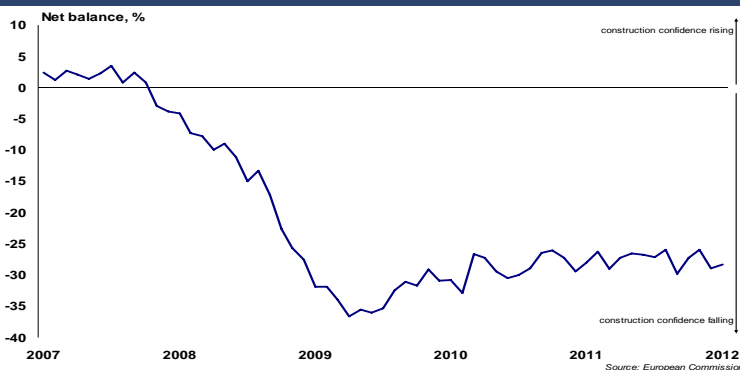
surrounding the growth and therefore inflation outlook to the downside, with the latter now more likely to be below than above the target rate in the medium term.

Lower interest rates should send a positive policy signal that the ECB is acting to contain the spill over effects of summer's financial market volatility to the real economy. However, beyond containment, such actions are unlikely to have much positive impact on economic activity in the near term. The fact remains that the monetary policy transmission mechanism is still severely impaired given the area wide bank deleveraging process underway. As such, any stimulatory effect on the real economy resulting from easier ECB monetary policy is not only likely to be muted, but on balance, more than offset by the recent sharp fall in confidence among businesses and households, the deteriorating labour market and tighter credit conditions.

All of this points to more bad news for the European property sector. Business confidence in the construction sector remains very depressed across the region as a whole. Given the weaker growth outlook and pan-European fiscal austerity drive underway, we see the risks to construction output as still skewed to the downside at least until H2. The outlook for commercial property values is less clear cut; the RICS Q4 RICS Global Commercial Property Survey highlights a divergence in expected performance between some of the larger central and eastern European markets – particularly Germany, Poland and Russia - and the rest of the region. In these three markets, tenant demand and investment activity remains positive and this, combined with a relatively flat development pipeline, is likely to support rents and capital values.

“Easier monetary policy is unlikely to have much impact on the property sector in the near term”

It will take more than just rate cuts to boost builder' confidence



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