RESIDENTIAL RESEARCH

PRIME GLOBAL FORECAST

Q4 2011 edition

Knight Frank

Global slowdown

After two years of growth the world's prime markets look set to cool in 2012. Liam Bailey sets the scene.

> "As wealth portfolios recovered after 2009, demand for prime property rose across the world, leading to a sharp upturn in cross-border property investment flows."

Liam Bailey, Head of Residential Research

Before 2007 the global housing market was a much simpler subject to analyse. Prices and demand rose year-on-year pretty much everywhere and at almost every level of the market. Then came the credit crunch, and things became more complex.

Following the introduction of stimulus measures – the global response to the crisis in late-2008 – a geographical separation opened between the markets in the weakened West and those in the newly resurgent Asia-Pacific, where lower interest rates began to stoke a second boom in pricing.

The stimulus measures also opened a divide between mainstream markets and prime, or luxury, markets globally. Affluent purchasers took advantage of ultra-low mortgage rates, and central bank asset purchases created a wave of investment funds which drove pricing in 'safe-haven' assets higher.

As wealth portfolios recovered after 2009, demand for prime property rose across the world, leading to a sharp upturn in cross-border property investment flows.

Asian demand for new-build development purchases in central London is an obvious manifestation of this latter trend. The same phenomenon has been witnessed in Asia, with more than 30% of Singapore's prime market purchases going to non-domestic buyers, and in North America, where rising demand from wealthy Brazilian investors is helping to drive prices in New York and Miami.

Measuring the world

Knight Frank has been tracking the world's prime markets for several years and we introduced our Prime Global Cities Index in early 2006, to measure the market performance of the world's most important luxury city markets. Since launching the index we have expanded it to cover 21 cities and are working to add more each quarter.

We have taken the pulse of all the markets we monitor to provide an outlook on demand, supply and transactions over the course of next year, and we worked with our global research teams to confirm our view of the full-year price performance for 2011 and for 2012.

Over the next few pages we examine how each market has been performing, how we expect it to develop in the future, and provide an appreciation of the key risks facing our prime city markets.

By concentrating on the world's leading residential city markets we are able to secure a remarkably clear view of wealth, investment and asset market behaviour. There appear to be three key themes that will determine how these markets perform over the short- to medium-term.

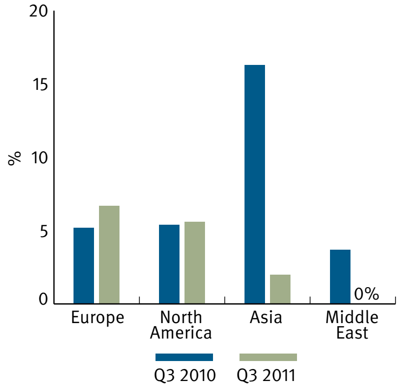
The first relates to wealth creation. There is no doubt that the world's affluent were able to weather the 2008 storm much better than the wider global population, and since this time they have seen their portfolios rise in value. It seems likely, subject to the global economy avoiding a calamity in 2012 (see below, page 2), that this process of global wealth creation will continue. Deloitte recently forecast that the total wealth of millionaire households globally is likely to grow from $92 trillion in 2011 to $202 trillion in 2020.*

It seems likely therefore that there will be more wealthy people with more wealth to spend in 2012 and beyond. The question is whether they will want to place this wealth in prime property, which leads to my second theme: 'safe-haven' investments.

Figure 1

Price performance of luxury homes by world region

Annual % change



Source: Knight Frank Residential Research

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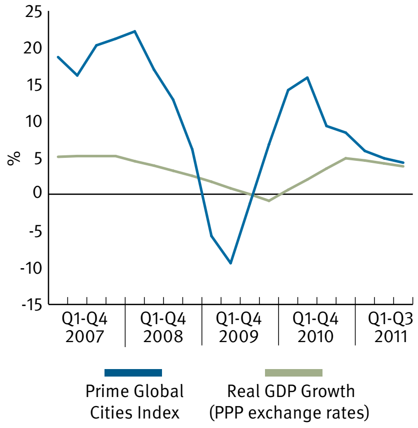
*Deloitte Centre for Financial Services – based on forecasts for 25 leading economies

> “There is no doubt that the world’s affluent were able to weather the 2008 storm much better than the wider global population.”

Figure 2

Prime housing market performance and Global GDP

Knight Frank Prime Global Cities Index (annual % change) and Real GDP growth (PPP exchange rates)



Source: Knight Frank Residential Research, Economist Intelligence Unit

Is property a ‘safe-haven’ investment? The term has certainly been used to describe property purchases in locations such as London, Paris, Geneva and Singapore over the past two years. Transparent legal systems, coupled with a relatively settled political environment, have certainly helped secure inward investment in these markets. But it is the recent wave of political instability across the Middle East and North Africa, together with economic instability in the southern Eurozone, which has effectively confirmed the validity of this claim of ‘safe-haven’ status, with a direct and quantifiable impact on market demand in London and Paris.

This mention of instability in the Eurozone neatly introduces my third and final theme: the growing divide between the performance of prime markets in the West and of those in the rest of the world, particularly in Asia-Pacific.

In Europe and North America, improving conditions in prime city markets since 2009 have taken place against a backdrop of very weak mainstream housing markets, stuttering national economies and a deleveraging cycle which has generally pushed other asset prices lower.

This process highlights a key risk – that prime markets will ultimately be undermined by domestic economic reality, with a convergence between prime and mainstream market performance. If the euro was to collapse, or a similar catastrophe was to strike, all bets really would be off and we would expect much weaker performance across all of our prime markets. But in the event that the West simply sees a prolonged period of weak economic growth, I can see how the prime markets could continue to outperform their benighted national marketplaces – with a continuance of inward investment from emerging market wealth and ‘safe-haven’ purchases.

This process would enhance the potential for an additional risk. The continued outperformance of the top-end property markets, alongside wider poor economic prospects, has already created a political backlash in some locations, and the potential for further targeted tax and regulatory changes to reduce perceived wealth inequality is not impossible.

The situation that prime markets in Asia-Pacific face is very different, with political action focused on dampening down and controlling price growth.

The origin of the problem was the flood of cheap money from stimulus measures, both domestic and from the US and Europe. This prompted asset prices to rally in many emerging markets from the second half of 2009. During 2010 policymakers in these countries embarked on a wave of monetary tightening and a targeted policy response in an effort to squeeze inflation and calm property prices.

The bind that policymakers find themselves in across Asia-Pacific, and China in particular, is a desire to loosen monetary policy to compensate for growing economic weakness in Europe and the US, but to ensure that any change in policy does not refuel domestic housing markets.

Uncertain times are always the most interesting times for issuing forecasts, if not the most comfortable. I hope that you enjoy reading our views and, as always, we welcome you to share your thoughts on our blog: www.knightfrank.com/globalbriefing.

Global trends

Prime global city markets are likely to outperform their mainstream national counterparts, but don't expect all prime markets to deliver positive growth. Kate Everett-Allen examines the numbers.

> "Price growth in a number of the luxury homes markets is being underpinned by the flight of capital from troubled world regions."

Kate Everett-Allen, International Residential Research

Worsening sovereign debt conditions in Europe, weak banking sector performance and a sluggish global economy are weighing heavily on global housing markets. Price growth in the world's mainstream housing markets averaged 0.9% in the year to September, down from 3.5% a year earlier.

With national markets flagging, conditions in the world's luxury city markets are holding up a little better. As our map on page 4 shows, in 2012 we expect prices to either rise or remain flat in around half the cities we monitor.

Following the 2008 credit crunch, the relative outperformance of prime residential property has meant that it continues to be viewed favourably by wealthy investors. This has become more evident as the list of alternative investment options open to investors has shrunk.

While the prime markets may be outperforming their mainstream peers, they are in no way immune from weakening confidence and deteriorating market conditions. Cities across Asia-Pacific are at the sharp end of this process, with weaker sales volumes in many cities starting to feed through into price growth.

Twelve months ago average prices for Asia's luxury homes were rising in value by 16.3% annually. At the end of September this year, the comparable figure was closer to 2%.

Of the cities covered in our forecast, 32% are expected to see luxury house prices fall in 2011, 25% are tipped to remain unchanged, and the remaining 43% are expecting prices to end the year higher than they started. Jakarta and Nairobi are forecast to be the strongest performers in 2011, with prices rising by up to 20% over the year.

Positive price movements this year can largely be attributed to rising cross-border demand from wealthy individual investors (especially in London and Paris), a lack of new supply (Moscow) and strong growth in domestic wealth (Beijing).

For those cities where prices are falling this year, weaker economic activity is a contributory factor in the majority of cases (Geneva, Hong Kong and Sydney), but weakening demand in the Middle East (Manama) and monetary tightening (Mumbai) also feature.

The year ahead

For 2012 our forecasts point to a relatively even split, with price falls expected in 44% of cities, no change in 12% and rising prices in 44%. The detailed breakdown of our forecasts by city can be viewed on page 6.

Perhaps the most interesting trend is the lack of homogeneity across the continents. In Europe, Geneva and Madrid will, we believe, see prices decline in 2012, but we expect Moscow and Paris to be among the strongest performing markets.

Similar disparities can be observed in Asia. Hong Kong is forecast to see luxury prices decline by between 5% and 10%, while prices in Beijing are expected to rise by a comparable amount.

Seven Asian cities are expected to see negative price growth in 2012. In most cases these price falls have been partly driven by government regulation, which was brought in after 2008 in an attempt to cool housing markets before they experienced US and European style crashes.

These steps were bolstered in recent years, as concerns over speculative investment rose and rising household wealth created price pressures. The measures have proved hard-hitting and have included curbing multiple home ownership, halting bank loans for uncompleted projects and increasing interest rates.

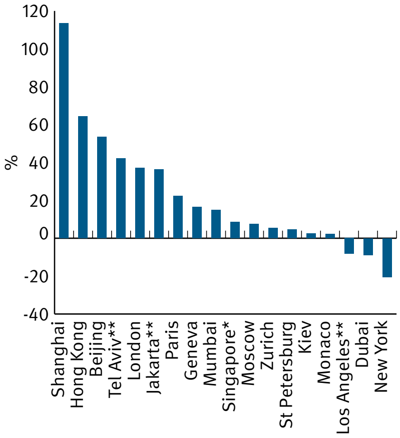
Away from government intervention in Asia, the main reason for price falls in 2012 is the growing global economic uncertainty emanating from the Eurozone and extending to other parts of the world.

Given the seriousness of the economic threat facing the world economy, some might find it surprising that we are forecasting positive growth in 44% of our key global city markets. Limited supply in several markets is the pivotal factor, and it is expected to push prices higher in London, Paris, Moscow, Nairobi and Kuala Lumpur.

Figure 3

Prime market post-credit crunch performance

Price change Q1 2009 to Q3 2011



Source: Knight Frank Residential Research
*Data from Q4 2009 ** Data to Q2 2011

Price growth in 2012 will continue to be underpinned by the flight of capital from troubled world regions, a factor which has certainly aided demand in locations like London, Paris, Singapore and Geneva. Equally important is the desire of wealthy investors to target property and other real assets over financial products, certainly for as long as the current financial turmoil continues.

Figure 4

Prime market activity forecast

Supply, demand and sales forecasts

	Supply of luxury homes	Demand for luxury homes	Volume of luxury home sales
Africa	↑	↗	↑
Asia	↗	↘	↗
Europe	↗	↗	↗
Middle East	→	→	→
North America	→	→	→
Global	↗	↗	→

Source: Knight Frank Residential Research

Have Asian governments gone too far?

Png Poh Soon, Head of Research, Knight Frank Singapore

Annual price growth for luxury homes in Hong Kong, Singapore and Shanghai now stands at 7.8%, -6.8% and 3.8% respectively, down from 19.7%, 15.8% and 29.7% a year earlier.

This dramatic turnaround in pricing poses the question as to whether some Asian governments might be concerned they went too far in imposing anti-inflationary policies to combat fears of a housing bubble.

My view is that some governments, particularly China's, may have considered the issue but most are currently defending the measures. They argue that prices need to be kept in check against a combination of strong inward investment and an inflationary climate.

In Singapore for example, falls in luxury house prices have been driven as much by the EU debt situation, the possibility of a double-dip in the US and stock market volatility.

Is there a chance of control measures being relaxed? I think it is very unlikely. Despite price falls, the volume of sales in the market is proving resilient.

Certainly in Singapore, while domestic fundamentals remain positive, with unemployment rates and interest rates remaining low, it is unlikely that housing market control measures will be rescinded or weakened.

Figure 5

Prime city residential price performance

Annual price growth, 2011 estimated, 2012 forecast

AMERICAS

2011	2012	
➚	N/A	1. Los Angeles
→	→	2. New York

EUROPE

2011	2012	
↘	➘	3. Bordeaux
↘	↘	4. Geneva
➚	↗	5. Kiev
↑	➚	6. London
→	→	7. Monaco
→	➘	8. Madrid
➚	↑	9. Moscow
➚	↗	10. Paris
➚	➚	11. Rome
➚	↗	12. St Petersburg

AFRICA

2011	2012	
→	→	13. Cape Town
↑	↗	14. Nairobi

KEY

↑	Rise by 10% to 20%	➘	Fall by less than 5%
↗	Rise by 5% to 10%	↘	Fall by 5% to 10%
➚	Rise by less than 5%	↓	Fall by 10% to 20%
→	No change	N/A	Not available

MIDDLE EAST

2011	2012	
➘	N/A	15. Dubai
➘	↘	16. Manama
↗	N/A	17. Tel Aviv

ASIA PACIFIC

2011	2012	
↗	↑	18. Bangkok
➚	↗	19. Beijing
↘	➘	20. Hanoi
↘	➘	21. Ho Chi Minh City
➘	↘	22. Hong Kong
↑	➚	23. Jakarta
→	➚	24. Kuala Lumpur
→	↘	25. Mumbai
➘	↘	26. Shanghai
→	➘	27. Singapore
➘	➘	28. Sydney

Source: Knight Frank Residential Research

Key risks

The forecasts we have provided are our central scenario, which represents the most likely outcome we see for the full year in 2011 and also for 2012. Here we discuss the main risks we believe have the potential to blow our forecast off course.

Despite the global nature of many of the economic threats facing world housing markets, it is the performance of the domestic economy and economic policy that are considered to present the greatest risk (see figure 6). Our findings point to six cities in which the domestic economy is felt to pose the greatest risk to their prime housing markets.

Three of these cities are in Asia – Bangkok, Singapore and Beijing. In Bangkok the full impact of recent floods on the national economy has yet to be confirmed and has the potential to weaken the luxury market further. In Singapore and Beijing macro control policies (see box) are starting to stifle performance and could do so further in 2012.

The Eurozone crisis is considered a high risk for 60% of cities. Only in Nairobi and Cape Town are the travails of Europe's currency expected to have a limited impact.

We have ranked interest rate rises, high inflation and consumer debt as low risks for most locations, reflecting the affluent and more equity-rich buyer profile in most of the cities we have considered.

Political and security issues are of greatest concern in our African and Middle Eastern cities, as well as Moscow, where the 2012 presidential election has the potential to provide a destabilising effect.

Beyond our core risks there are opportunities for currency movements and taxation changes to influence prices and demand across many of our cities. Tax changes are always difficult to predict, but the potential for the abolition of the 50% income tax rate in the UK could bolster London's market in the second half of 2012.

Global wealth

The greatest opportunity for the world's luxury housing markets has to be the scale of wealth creation forecast over the next decade.

Among some of the world's top 25 economies the number of millionaire households is forecast to almost double from 38 million in 2011 to 66 million by 2020.

Research from Deloitte suggests that the total wealth among millionaire households will increase by 119% to $202 trillion by 2020. Wealth growth is forecast to be higher in the emerging markets over the next decade (260%), significantly outpacing the growth in developed markets (107%).

Figure 6

Risk analysis

Our forecast is based on assumptions made on global macro-economic outcomes. In this table we examine six macro risks and their impact both globally and on five key world regions.

Risk	Downside scenario and impact	Ranking of risks by sub-market, where 1 represents the largest risk					
		Global	Africa	Asia Pacific	Europe	Middle East	US
Domestic recession	The potential for a domestic recession, with the ensuing negative impact on employment and earnings growth, would have a direct and substantial impact on domestic housing markets. The main effect, however, would be felt in the mainstream rather than prime markets.	1	2	1	2	2	3
Global recession	While a fully-fledged world recession remains an unlikely prospect, a partial world recession covering Europe and North America remains a real possibility. Weaker confidence and wealth creation would reduce demand in global prime markets.	2	5	2	3	3	4
Eurozone crisis	A collapse in the euro would be likely to lead to a return of 2008 lending conditions, with an effective closure of credit markets. The potential for 'safe-haven' investments could soften the blow in some global centres – such as London – but this risk remains significant for nearly all markets.	3	6	3	1	4	2
Political / security concerns	One of the key lessons from the past three years has been the significant value placed on 'safe-haven' investments, as economic and political risks have risen across the globe. In some markets, London and Paris for example, an increase in perceived global instability appears to have enhanced the attractiveness of the market to foreign investors. In others, greater uncertainty actively weakens market demand.	4	1	6	4	1	5
Restricted mortgage availability	Mortgage drought has mainly been an issue in Europe and North America, where the pre-2007 boom was fuelled by cheap and easy credit. In these markets there have been some improvements in recent years, with a greater number of high LTV products in Europe in particular. While the main impact of limited mortgage lending is mainly felt in the mainstream market, prime market purchase activity is enhanced with easier access to finance.	5	4	5	6	6	1
Interest rate rises	Interest rates have been slashed across Europe and North America, partly in an attempt to aid housing market activity. The impact in the prime market has been for cheap debt to push prices higher since 2009. With inflation pushing rates higher in Asia and other parts of the world, the risk if a return to more normal levels of interest rates occurs too rapidly, current levels of prices in prime and mainstream markets will be hard to maintain.	6	3	4	5	5	6

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Figure 7

Forecast reference

Full-year growth

⬆	Rise by 10% to 20%	↘	Fall by less than 5%
⬈	Rise by 5% to 10%	⬊	Fall by 5% to 10%
↗	Rise by less than 5%	⬇	Fall by 10% to 20%
➡	No change	N/A	Not Available

2010			2011			2012		
City	**Region**	**Actual**	**City**	**Region**	**Estimate**	**City**	**Region**	**Forecast**
Mumbai	Asia Pacific	⬆	London	Europe	⬆	Moscow	Europe	⬆
Shanghai	Asia Pacific	⬆	Jakarta	Asia Pacific	⬆	Bangkok	Asia Pacific	⬆
Tel Aviv	Middle East	⬆	Nairobi	Africa	⬆	St Petersburg	Europe	⬈
Singapore	Asia Pacific	⬆	Bangkok	Asia Pacific	⬈	Kiev	Europe	⬈
Hong Kong	Asia Pacific	⬆	Tel Aviv	Middle East	⬈	Beijing	Asia Pacific	⬈
Paris	Europe	⬆	Moscow	Europe	↗	Nairobi	Africa	⬈
New York	North America	⬆	St Petersburg	Europe	↗	Paris	Europe	⬈
London	Europe	⬆	Rome	Europe	↗	London	Europe	↗
Beijing	Asia Pacific	⬆	Kiev	Europe	↗	Rome	Europe	↗
Jakarta	Asia Pacific	⬈	Beijing	Asia Pacific	↗	Kuala Lumpur	Asia Pacific	↗
Monaco	Europe	⬈	Paris	Europe	↗	Jakarta	Asia Pacific	↗
Kuala Lumpur	Asia Pacific	⬈	Los Angeles	North America	↗	New York	North America	➡
Ho Chi Minh City	Asia Pacific	⬈	Singapore	Asia Pacific	➡	Monaco	Europe	➡
Zurich	Europe	↗	Kuala Lumpur	Asia Pacific	➡	Cape Town	Africa	➡
Moscow	Europe	↗	Mumbai	Asia Pacific	➡	Ho Chi Minh City	Asia Pacific	↘
Rome	Europe	↗	New York	North America	➡	Hanoi	Asia Pacific	↘
Hanoi	Asia Pacific	↗	Monaco	Europe	➡	Singapore	Asia Pacific	↘
Bangkok	Asia Pacific	↗	Madrid	Europe	➡	Bordeaux	Europe	↘
St Petersburg	Europe	↘	Cape Town	Africa	➡	Sydney	Asia Pacific	↘
Geneva	Europe	↘	Shanghai	Asia Pacific	↘	Madrid	Europe	↘
Los Angeles	North America	↘	Manama	Middle East	↘	Shanghai	Asia Pacific	⬊
Madrid	Europe	↘	Sydney	Asia Pacific	↘	Mumbai	Asia Pacific	⬊
Sydney	Asia Pacific	↘	Hong Kong	Asia Pacific	↘	Manama	Middle East	⬊
Dubai	Middle East	⬊	Dubai	Middle East	↘	Hong Kong	Asia Pacific	⬊
Kiev	Europe	⬊	Ho Chi Minh City	Asia Pacific	⬊	Geneva	Europe	⬊
Nairobi	Africa	N/A	Hanoi	Asia Pacific	⬊	Tel Aviv	Middle East	N/A
Manama	Middle East	N/A	Bordeaux	Europe	⬊	Zurich	Europe	N/A
Bordeaux	Europe	N/A	Geneva	Europe	⬊	Los Angeles	North America	N/A
Cape Town	Africa	N/A	Zurich	Europe	N/A	Dubai	Middle East	N/A

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Prime Global Cities Index Q3 2011

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