

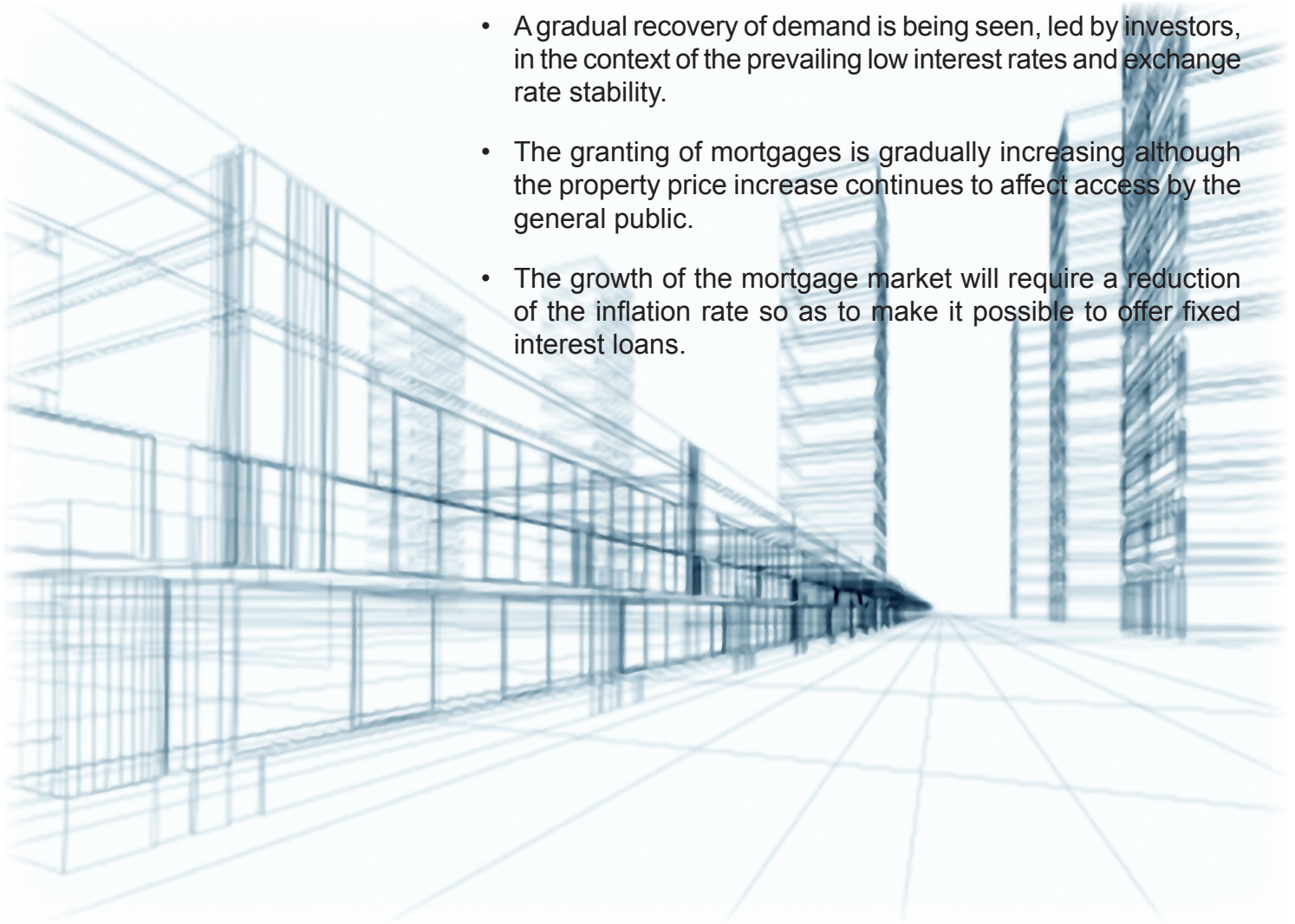
Argentina

Real Estate Outlook

Annual Report 2010

Economic Analysis

- Signs of recovery are observed in residential construction, although the rate will be slower than in other cycles.
- In spite of the internal costs increase—mainly salaries—there are still incentives for broadening the real estate offer.
- A gradual recovery of demand is being seen, led by investors, in the context of the prevailing low interest rates and exchange rate stability.
- The granting of mortgages is gradually increasing although the property price increase continues to affect access by the general public.
- The growth of the mortgage market will require a reduction of the inflation rate so as to make it possible to offer fixed interest loans.



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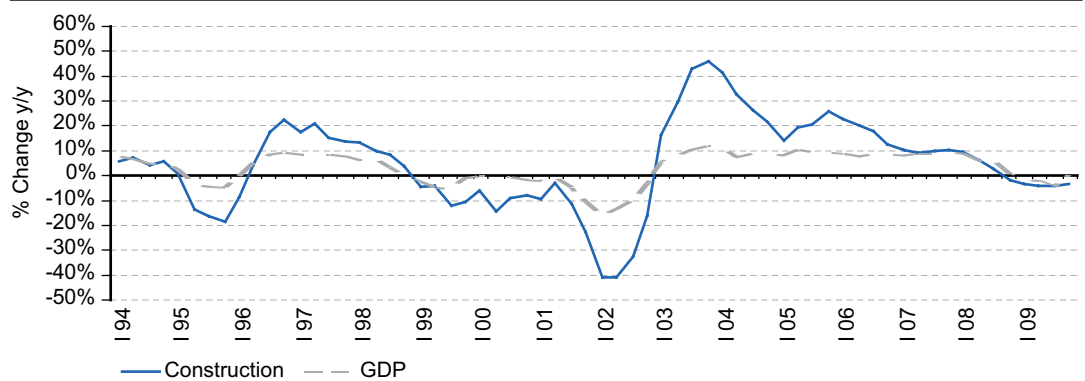
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Closing date: 22 June 2010

1. Housing offer recovers, although at a sluggish rate

The increased uncertainty and financial volatility that resulted from the international crisis at the end of 2008 produced a slowdown in the construction GDP of 3.8% year on year in 2009. Still, unlike in other cycles, the sector did not accelerate the fall of the activity as a whole (Chart 1). This was in part the consequence of public investment, with regard to both the expansion of housing plans and the execution of a number of infrastructure projects. The State disbursed, by way of investment in homes and residential infrastructure works, some \$5.3bn compared to \$3.8bn a year earlier, which represented an increase of nearly 40% in the earmarked resources. This boost is equivalent to 0.5% of the GDP, with an increase of 0.1% over that recorded the previous year. We estimate that were it not for the state's housing programs, the construction sector would have contracted more than 6%.

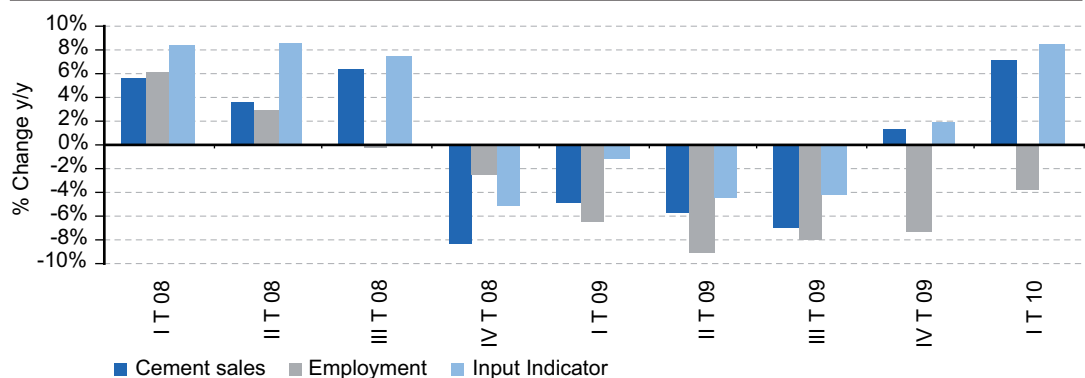
Chart 1
Real GDP and Construction GDP



Source: Research BBVA Banco Francés based on INDEC

So far in 2010, partial indicators are showing a greater demand for industry supplies (cement and others) but, along with it, a slow recovery of employment given that the number of persons working in the sector remains well below the peaks attained in 2008 (Chart 2). Construction GDP grew only 2% year on year in the first quarter of 2010, failing to return to pre-crisis levels.

Chart 2
Construction sector Indicators

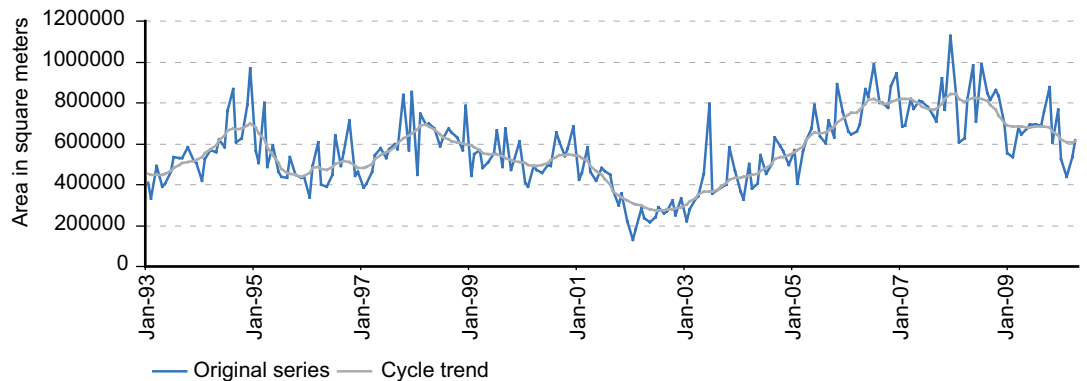


Source: Research BBVA Banco Francés based on INDEC and Cement Production Chambe

New construction projects launches are also lagging behind in the recovery of the sector. Construction permits (whole number had fallen by 15.9% in 2009) continued to decrease in number during the first quarter of 2010, although at a reduced rate (-12.7% year on year) and with inconsistency between the various urban areas (Chart 3). The contraction of the activity in Buenos Aires is still strongly felt, possibly not only as a result of the relative depletion of available construction area in the most desirable neighborhoods, but also as a result of traffic problems and the unfulfilled need for a public infrastructure in other areas still not considered attractive. With this in mind, the city government has launched a series of incentive programs to foster construction in the southern area of the city (up to 25% increase in allowed construction for a standard plot), but significant results are yet to be seen.

Chart 3

Construction permits



Source: Research BBVA Banco Francés based on INDEC

In this context, we estimate that construction will recover 6% in 2010 and around 4% in 2011, at a rhythm similar to the average recovery rate of the economy as a whole. The slower expansion in the cycle compared to other sectors is due to the following mitigating factors in the dynamism of the activity: a) lesser availability of reserve funds outside the financial system; b) greater relative cost of construction and the impact of land value; c) the lesser marginal impulse of public works, even though this could regain vigor in 2011 as a result of the electoral cycle, compensating for the negative impact on private construction of increased political uncertainty.

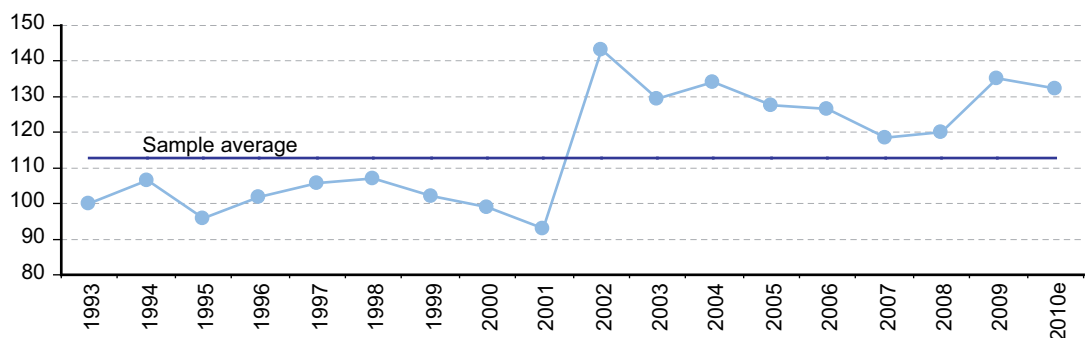
2. In spite of increased costs, incentives to construction investment remain

The wide disparity between the price of properties and salaries in dollars observed during the post-devaluation period decreased until 2008, as nominal salaries rose and the exchange rate remained stable (Chart 4). In 2009, in a market dominated by investors and low indebtedness, the price of the square meter in dollars increased as a result of the scarce interest by owners to sell their properties as they considered them a valuable reserve asset in a period of financial volatility. In addition, the price plunge of materials resulting from the sharp adjustment of raw materials, the impact of greater unemployment in the salary increases agreed, once again boosted construction incentives according to our Tobin's Q indicator¹.

The costs of construction will increase by 16% in 2010, fundamentally as a result of the recent salary agreement for the sector (+27%), which deteriorates the construction incentive in the margin. Still, a new square meter price increase in US dollars (6/7% year on year according to private surveys the first half of the year) could maintain construction incentives at levels well above the average of preceding periods.

Chart 4

Price per square meter / Construction cost Index (Base 1993= 100)

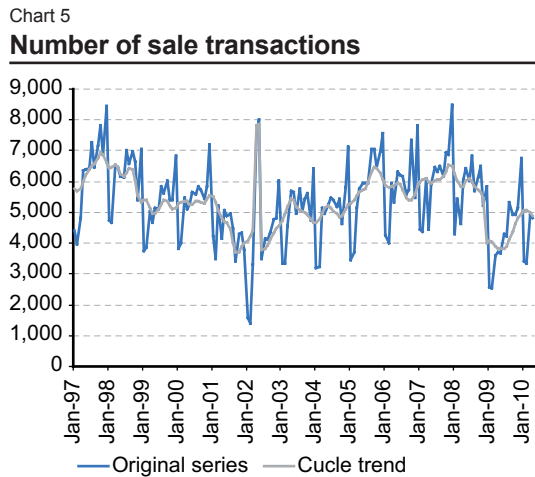


Source: Research BBVA Banco Francés based on INDEC and Reporte Inmobiliario

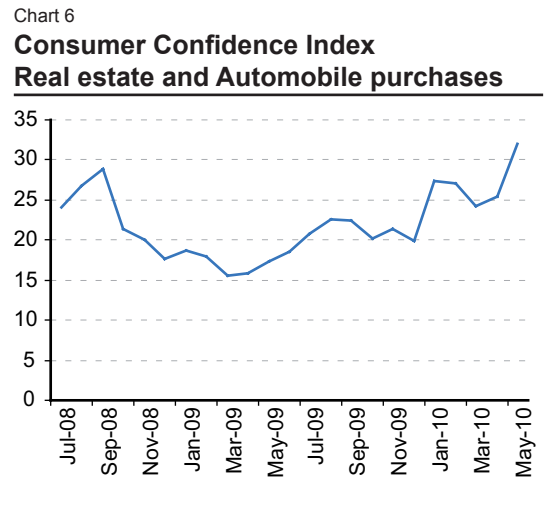
¹: This indicator is obtained from the quotient between the price of the average square meter to be introduced to the market and the costs of construction. If the figure is greater than 100, this is an indication that it is better to build a unit rather than buy it finished

3. The demand in properties is sustained by investors

Following the contraction experienced in the fourth quarter of 2008, reaching a bottom low in the second quarter of 2009, a slow recovery began in real estate demand which became more pronounced in the first months of the current year. This can be appreciated looking at the number of sales deeds signed in the national capital, which grew 32.8% year on year the first four months of this year, after having contracted 39.3% in 2009 (Chart 5). However, the after-effects of the international crisis and local wariness are still being felt, with the number of sales operations still 40% below the peaks reached in 2007.



Source: Research BBVA based Colegio Público de Escribanos de la Ciudad Autónoma de Buenos Aires



Source: Research BBVA based on Univ. Torcuato Di Tella data

The quick recovery of the economy and a lessening of political disputes have had a positive impact on the expectations of consumers, who are increasingly inclined to acquire durable goods as fears of a prolonged international crisis and uncertainty over employment are dissipated (Chart 6).

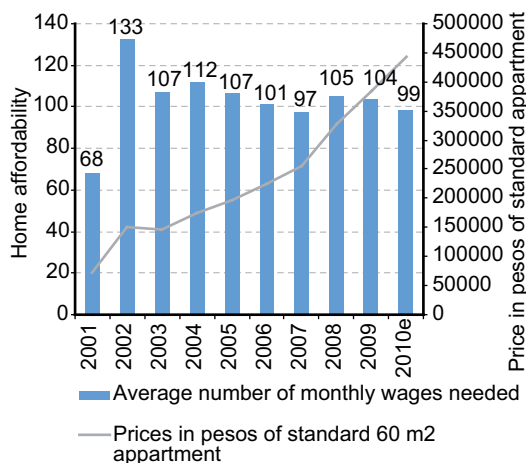
In the current inflationary context, demand for real estate is fueled in addition by low interest rates and exchange rate stability, which make more investors switch to this type of assets as they look for a safe haven. In 2010, the sector will also be positively impacted by the record soybean harvest given the traditional preference of agricultural producers for placing their savings in non-financial assets. Still, current demand is not as firm as it was at the beginning of 2008, with prices in raw materials at their historical peaks before the conflict with the agriculture and livestock sector and the deterioration of confidence both nationally and internationally.

4. Relative prices impair the development of the mortgage market

The crisis also had a negative impact on the issuance of mortgages which returned to 2005 levels following two years of recovery. From the second half of last year, we began to see an improvement in the mortgage market with the launch of loans backed by Social Security (ANSES) funds by Banco Hipotecario, a public-private entity. These loans, with fixed interest rates subsidized for periods of up to 20 years, were promoted by the government so as to give access to home ownership to medium income sectors and received a strong take-up, especially for used properties. Similar initiatives were launched by other public and private banks making a recovery in mortgages lending possible, although mortgage financing still amounts to less than 6% of operations (Table 1).

Chart 7

Home affordability



Source: Research BBVA Banco Francés based on Reporte Inmobiliario and INDEC

Table 1

Mortgage Loans

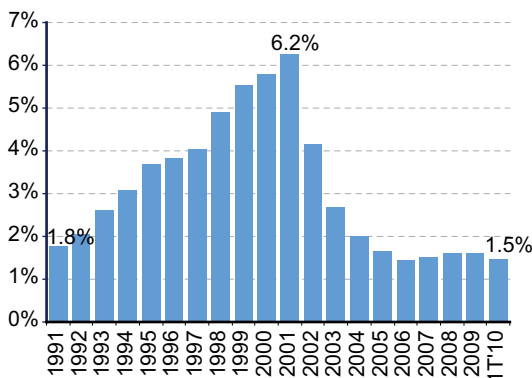
Year	Deeds signed in Buenos Aires city	New Mortgage Loan in Buenos Aires City	% of operations financed by mortgages
2004	6,717	178	2.7%
2005	9,659	683	7.1%
2006	12,214	910	7.4%
2007	15,464	2,108	13.6%
2008	16,549	2,010	12.1%
2009	15,656	724	4.6%
2010*	4,238	240	5.7%
2009*	2,417	144	6.0%

In millions of pesos
* to March 2010
Source: BBVA Research based on BCRA and Colegio de Escribanos de la Capital Federal

Although the real salaries increase made possible an improvement in accessibility with respect to the post-2002 crisis years (Chart 7), given the existing obstacles to widespread access to mortgage loans, the relative contribution of the latter over the total of loans by the financial system to the private sector only represents 12.5% and amounts to 1.5% of GDP (April 2010) (Chart 8). The financial charges of mortgages on families are relatively low compared to the situation in other countries and therefore do not constitute a limiting factor for the expansion of the business (Chart 9).

Chart 8

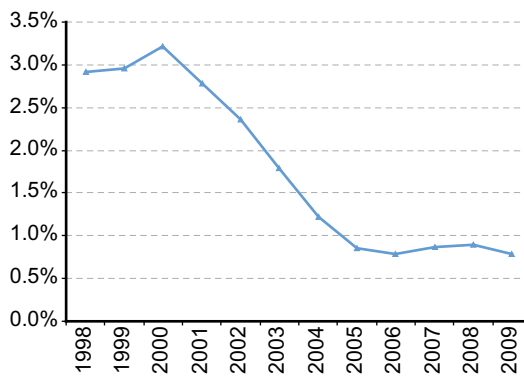
Mortgage Loans as % of GDP



Source: BBVA Research based on INDEC and BCRA data and Ministerio de Economía

Chart 9

Yearly mortgage instalments (capital+interest) as % of total payroll



Source: BBVA Research based on INDEC and BCRA data

The low level of mortgage take-up to carry out real-estate transactions compared to other countries is due to obstacles on both the supply and demand sides.

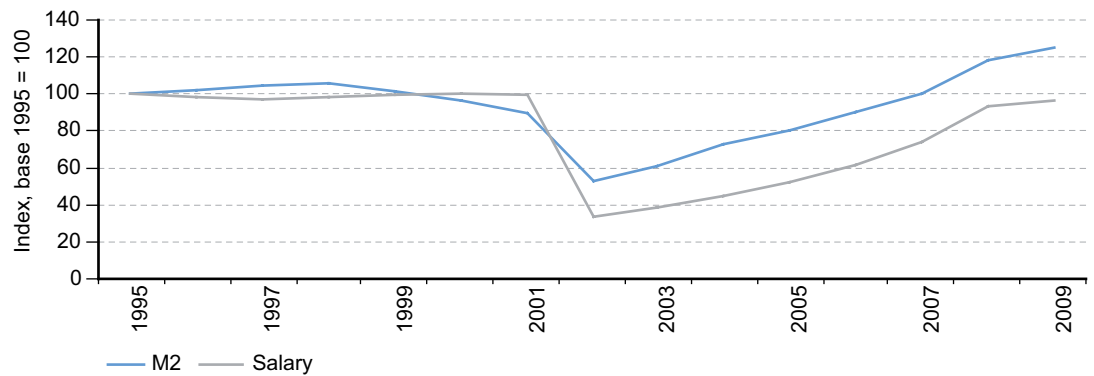
On the supply side, hindrances to the development of mortgage lending come from the structural volatility of the Argentine economy which makes it difficult for financial entities to secure long-term financing and a narrow capital market with a low securitization level. Without legal mechanisms for indexing the valuation of assets, financing is granted at variable rates to counteract inflationary erosion.

Although an unsatisfied demand is believed to exist for around two million properties, the high number of informal workers (36.1%) not qualifying for the financing system reduces demand effectively answerable by way of mortgage loans. Within the formal sector of the economy, restrictions imposed on the installment/income ratio leaves large sectors of the population without a market solution. This restriction is in place because the price of homes has increased at a steadily faster rate than formal

salaries have recovered, demonstrating that a large proportion of those who fulfill their demand are precautionary investors or those using property as an income source despite its low profitability (Chart 10). Currently, gross rental income is around 0.5/0.6% monthly the value of the property which, once maintenance costs have been taken into account, amounts to a net return of 0.2/0.3%.

Chart 10

Real estate prices and wages in USD



Source: Research BBVA Banco Francés based on Reporte Inmobiliario and Economy Ministry

5. Medium-term growth will require a lessening of inflation

The fundamental indicators of the real estate sector are positive on the medium term given to the coincidence of a considerable excess demand currently, the perspective of the formation of new households, and an increase in family incomes resulting from the entry of women into the labor market.

The main obstacles for sustained growth of the construction sector are on the financing side, due to the narrowness of the local capital market following the stabilization of the Retirement and Pensions Funds Administrators (AFJPs), and the limited presence of the public sector in the area of residential property construction. Inflation is also impairing the growth of construction given that it complicates the planning of costs, in particular with regard to salaries, which have a strong impact on the sector.

On the demand side, the improvement of access to mortgage lending is related not only to the correction of relative prices (properties/salaries) but also to the possibility of granting financing at fixed rates for longer periods. Due to a history of bad experiences and the variability of the employment cycle in Argentina, families are reluctant to become indebted at variable rates for the longer periods required by mortgage financing.

With this in mind, a lower inflation rate would have positive impacts on the credit market by reducing the volatility of savings and directing more savings toward the financing system. This will allow financial entities to increase their provision of mortgage loans at fixed interest rates, improving access for families and deepening stable relationships with a clientele that has traditionally shown a low level of defaulting.

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This report has been drawn up by the Argentine Unit:

South America Chief Economist

Joaquín Vial

jvial@bbvaprovida.cl

Argentina Chief Economist

Gloria Sorensen

gsorensen@bancofrances.com.ar

Jorge Lamela

jorge.lamela@bancofrances.com.ar

Juan Manuel Manias

juan.manias@bancofrances.com.ar

In collaboration with:

Laura Rocha

laura.rocha@bancofrances.com.ar

BBVA Research

Group Chief Economist

José Luis Escrivá

Chief Economists & Chief Strategists:

Regulatory Affairs, Financial and Economic Scenarios:

Mayte Ledo

teresa.ledo@grupobbva.com

Financial Scenarios

Daniel Navia

daniel.navia@grupobbva.com

Financial Systems

Ana Rubio

arubiog@grupobbva.com

Regulatory Affairs

Economic Scenarios

Market & Client Strategy:

Antonio Pulido

ant.pulido@grupobbva.com

Equity and Credit

Ana Munera

ana.munera@grupobbva.com

Interest Rates, Currencies and Commodities

Luis Enrique Rodríguez

luisen.rodriguez@grupobbva.com

Asset Management

Henrik Lumholdt

henrik.lumholdt@grupobbva.com

Spain and Europe:

Rafael Doménech

r.domenech@grupobbva.com

Spain

Miguel Cardoso

miguel.cardoso@grupobbva.com

Europe

Miguel Jiménez

mjimenezg@grupobbva.com

United States and Mexico:

Jorge Sicilia

j.sicilia@bbva.bancomer.com

United States

Nathaniel Karp

nathaniel.karp@grupobbva.com.com

Mexico

Adolfo Albo

a.albo@bbva.bancomer.com

Macro Analysis Mexico

Julián Cubero

juan.cubero@bbva.bancomer.com

Emerging Markets:

Alicia García-Herrero

alicia.garcia-herrero@bbva.com.hk

Cross-Country *Emerging Markets* Analysis

Sonsoles Castillo

s.castillo@grupobbva.com

Pensions

David Tuesta

david.tuesta@grupobbva.com

Asia

Stephen Schwartz

stephen.schwartz@bbva.com.hk

South America

Joaquín Vial

jvial@bbvaprovida.cl

Argentina

Gloria Sorensen

gsorensen@bancofrances.com.ar

Chile

Alejandro Puente

apuente@grupobbva.cl

Colombia

Juana Téllez

juana.tellez@bbva.com.co

Peru

Hugo Perea

hperea@grupobbva.com.pe

Venezuela

Oswaldo López

oswaldo_lopez@provincial.com

Contact details

BBVA Research Latam

Pedro de Valdivia 100

Providencia

97120 Santiago de Chile

Teléfono: + 56 26791000

E-mail: bbvaresearch@grupobbva.com