Flash Comment

August 08, 2007

Lars Christensen, Senior Analyst, +45 4512 8530 (direct), larch@danskebank.dk

Baltics: Property prices have peaked

Property prices have been highly dynamic in the Baltic States since the start of the millennium. This has been the main driver of growth in all three countries over the last couple of years, and the construction sector has gradually crowded out other sectors – especially the export-oriented manufacturing sector. However, there are now fairly clear signs that the property market boom has come to an end and that property prices are now beginning to fall in all three Baltic States.

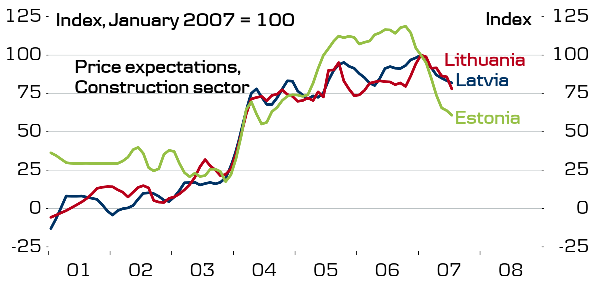
Property price statistics are fairly unreliable and hard to compare from country to country in the Baltics, but most sources now point to fairly heavy declines in property prices – at least in the three capital cities. Property prices have dropped most in Estonia's capital, Tallinn, where official statistics and anecdotal evidence indicate that property prices have dropped around 10% this year. Latvia's capital, Riga, is also experiencing falling property prices – down 5-8% over the last couple of months and most indicators suggesting an acceleration in the rate of decline. There are also signs of slowing property prices in Lithuania's capital, Vilnius, but it is still too early say that property prices are actually declining. There are a number of reasons why property prices are now declining in the Baltic States. In our view the primary reason is simple – prices have simply risen far too much relative to fundamentals. Furthermore, a number of negative shocks have hit the Baltic property markets. Most importantly, interest rates have gone up in line with European rates over the last year. Furthermore, the banks have tightened credit standards on the back of rising concerns about the large imbalances in all three countries.

Hence, it looks like the boom in the Baltic property market is coming to an end. It is very difficult to assess how far property prices in the Baltics could potentially fall, but given the large imbalances in the Baltic economies we think the downturn could be quite severe and long-lasting. It is debatable whether there has been a Baltic property bubble, but there is no doubt in our view that property price growth has been excessive, and therefore property prices should be expected to slide further going forward. The dynamics of the expected drop in property prices will to a large extent depend on a combination of the macroeconomic climate and investor expectations and sensitivities. Anecdotal evidence clearly indicates that a lot of the property investments in the Baltics have been highly speculative, which is of course a worry. Property price statistics throughout central and eastern Europe are notoriously unreliable – mostly due to a lack of quality adjustments. We are therefore reluctant to use, in particular, price comparisons across different countries. On the other hand, we think the various sentiment surveys in the construction sector provide some useful insight. The EU Commission compiles monthly statistics for confidence and expectations in the construction sector in the EU. The Commission's survey shows that sentiment is turning decisively more negative in all Baltic three countries.

The EU surveys are in line with the local data. Hence, Estonia is leading the property market slowdown, and here the slowdown is clearly visible, followed by Latvia, where the softening in the property market is beginning to show but is still not very strong. And finally Lithuania, where activity and prices are slowing but not yet declining.

Concluding, a slowdown is now underway in the Baltic property and construction markets. This will undoubtedly contribute to slowing down economic growth – potentially a lot – in all three Baltic countries. The question still remains, however, how severe the decline in the property markets will be.

Price expectations have eased



This report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank is under supervision by the Danish Financial Supervisory Authority.

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high quality research based on research objectivity and independence. These procedures are documented in the Danske Bank Research Policy. Employees within the Danske Bank Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and to the Compliance Officer. Danske Bank Research departments are organised independently from and do not report to other Danske Bank business areas. Research analysts are remunerated in part based on the over-all profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or dept capital transactions.

Danske Bank research reports are prepared in accordance with the Danish Society of Investment Professionals' Ethical rules and the Recommendations of the Danish Securities Dealers Association.

Financial models and/or methodology used in this report
Calculations and presentations in this report are based on standard econometric tools and methodology. Documentation can be obtained from the above named authors upon request.

Risk warning
Major risks connected with recommendations or opinions in this report, including a sensitivity analysis of relevant assumptions, are stated throughout the text.

First date of publication
Please see the front page of this research report.

Disclaimer
This publication has been prepared by Danske Markets for information purposes only. It is not an offer or solicitation of any offer to purchase or sell any financial instrument. Whilst reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and no liability is accepted for any loss arising from reliance on it. Danske Bank, its affiliates or staff, may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives), of any issuer mentioned herein. Danske Markets´ research analysts are not permitted to invest in securities under coverage in their research sector. This publication is not intended for private customers in the UK or any person in the US. Danske Markets is a division of Danske Bank A/S, which is regulated by FSA for the conduct of designated investment business in the UK and is a member of the London Stock Exchange.