Economics

South Africa: Residential property report

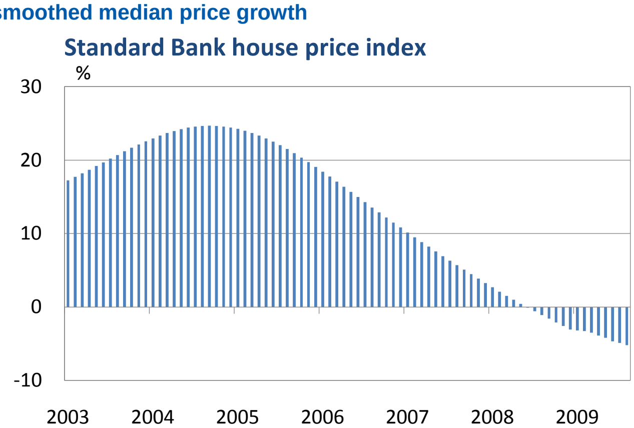
1 September 2009

No spark in house prices

Johan Botha

What is the latest? Standard Bank's property book for the first eight months of 2009 showed an average monthly decline of 3.9% in the median house price. More disconcerting is the fact that monthly declines have been reported in 15 consecutive months and that there is no sign yet that the bottom has been reached. The August smoothed data yielded a rate of contraction of 5.2% y/y - the deepest decline yet in the current downward phase of the house price cycle - compared to -1.1% y/y in August 2008. In real terms, using our estimate of the CPI in August to deflate nominal house prices, the decline in real house prices comes to approximately 11.5%. The smoothed growth rate for August shows that the value of the median residential properties financed by Standard Bank was R521 000. Important drivers of overall growth in the economy, such as the level of household income and debt, as well as the medium-term economic and financial outlook, are such that a quick turnaround in the housing market is unlikely. The best that we can hope for is for price declines to stabilise towards the end of the year as the recent interest rate cuts work their way through the economy and overall consumer and business sentiment improves. The potent mix of industry-wide loan-to-value restrictions, negative income growth and concerns about job security will without doubt weigh on the property market. Furthermore, in the short-term, any easing in credit granting criteria will be mild, as upside risks regarding uncertainty in job security and income growth continue.

Figure 1: Standard Bank's residential property loan book: smoothed median price growth



An uncertain macroeconomic backdrop. According to the World Bank the global economy is expected to contract by 2.9% in 2009, placing further strain on the South African economic outlook. Consensus seems to suggest that, at best, only the second half of next year may see a meaningful improvement in global conditions.

GDP contracted by 3.0% q/q seasonally adjusted and annualised in Q2 from -6.4% q/q in the first quarter. From an annual perspective, the quarterly contraction sets the economy back by 2.8% y/y in Q2, more than twice weaker than the -1.2% y/y in Q1. For the first half of the year, the economy declined by 2% y/y, increasing the downside risks on our forecasts of -1.3% y/y for 2009.

Notwithstanding the generally poor economic growth, we are of the opinion that the domestic recession is reaching an advanced phase, albeit lagging the global cycle. Clearly, the full impact of the recent monetary policy relaxation will start to emerge in the first half of next year. This by no means suggests that a rapid upturn is on the cards – the recovery is likely to be slow and protracted. Employment losses will continue to increase as cost rationalisation remains the order of the day, but the pace of such declines is expected to slow in coming quarters.

However, the intensity of the slowdown should remain concentrated in interest rate-sensitive sectors of the economy in the interim. Vitally, though, the current stage of household debt deleveraging is an important precursor to a recovery in demand. Indeed, household credit fell by R1.5bn (non-seasonally adjusted) when compared to Q1, which marked the first contraction since 2002 Q3. This compares meagrely with an average quarterly increase in credit of R19.7bn since 2000. However, a more severe retraction in corporate credit occurred in Q2, as total private sector credit (excluding households) fell by a whopping R21.5bn relative to Q1. These trends are not entirely ascribed to tight credit conditions, but confirm that uncertainty and a loss in debt appetite have taken their toll. With the pace of credit impairments likely to start moderating in the second half of the year, we anticipate the weakness in the broader financial sector to disperse.

Growth in private sector credit extension (PSCE) decelerated to 3.4% y/y in July from 4% y/y in June against consensus expectations of 3.5% y/y. The slowdown comes on the back of a decrease in mortgage advances, instalment sales credit as well as leasing finance (in absolute terms of –R0.568bn, -R0.653bn and -R0.931bn). Growth in mortgage advances slowed to 6.4% y/y in July from 8.2% y/y in June. On a monthly basis, mortgage advances declined for the first time since September 2002. Credit demand is likely to remain relatively weak for the rest of the year as balance sheet restructuring by corporates and households will remain the order of the day.

Supply of residential housing lagging. On the supply side of the housing market the value of recorded residential building plans passed by large municipalities (at current prices) during January-to-June 2009 decreased by 43% compared to the same period in 2008. The value of residential buildings reported as completed during January-to-June 2009 decreased by 9.5% compared to the same period last year. This is a reflection of the poor performing housing sector.

What are the risks to the property market? It cannot be expected that the housing market will flourish when the economy is under such strain. A number of downside risks are still at play. The global recovery is not yet firmly established; a relatively strong rand could impact adversely on exports and economic growth; inflation may remain high and sticky; a general lack of consumer and business confidence; as well as a constrained labour market with deeper job losses. This will make for a mild recovery in the property market, which is unlikely to gather any traction this year. Further sharp increases of 31% or more in electricity tariffs and possible increases in the price of oil are in the pipeline over the next few years. This will put upward pressure on inflation and interest rates.

On the monetary policy front it looks as if the downward phase of the interest rate cycle has come to an end. The cumulative cuts that commenced in December 2008, however, will still have to filter fully through the economy. The full impact of interest rate cuts on economic growth could take as long as 12-to-18 months, implying that it may be too early to expect substantial economic growth this year.

Outlook: Smoothed growth in the Standard Bank median house price index decreased by a disappointing 5.2% y/y in August, averaging 3.9% y/y in the first eight months of the year. Over the short term, the economic outlook is expected to remain lacklustre; however, relatively positive developments on the inflation front, the global economy and the full impact of lower interest rates, will support the property market in time to come. It is anticipated that house price growth will be negative over the short- to medium term, but likely to improve towards the end of the year as the effect of interest rate cuts impacts the economy and the property market.

Standard Bank median house price growth % (revised, smoothed)

	2004	2005	2006	2007	2008	2009
January	23.0	24.2	18.4	10.2	2.7	-3.2
February	23.3	24.0	17.7	9.5	2.1	-3.3
March	23.7	23.7	17.1	8.8	1.5	-3.5
April	24.0	23.3	16.4	8.2	1.0	-3.9
May	24.2	22.9	15.7	7.6	0.4	-4.2
June	24.4	22.5	15.0	6.9	-0.1	-4.7
July	24.6	22.0	14.2	6.3	-0.6	-4.9
August	24.6	21.5	13.5	5.7	-1.1	-5.2
September	24.7	20.9	12.9	5.1	-1.6	
October	24.7	20.3	12.2	4.4	-2.1	
November	24.6	19.7	12.5	3.8	-2.6	
December	24.4	19.1	10.8	3.2	-3.1	

Note on the methodology used in calculating Standard Bank's house price index

The way in which house prices are measured means that they are inherently volatile, not unlike many other economic indicators. Measuring house prices is complicated by the fact that the available data usually stem from the properties sold during a particular period, rather than from a well-designed sample that is representative of all houses. This is aggravated by the heterogeneity of houses. Changes in the measured prices may be the result of actual changes in the general price level; or changes in the distribution of the houses being sold, for example more sales of luxury houses may push up the measured house prices even without changes in general prices; or the changes may simply be random.

Given these data challenges, the international best practice is to use the median or middle price, rather than, say, the average house price. The median is the price such that half of all houses are more expensive and half less expensive than that price. It is substantially less volatile and less sensitive to the typical problems found in house price data. Standard Bank's data are therefore based on the median house price of the full spectrum of houses. Furthermore, national data from the Deeds Office are available only with a relatively long lag of up to nine months, so data from Standard Bank, which has a market share of about 27.7%, and whose data are generally highly correlated with those of the Deeds Office, are a good proxy for the national market.

Group Economics

Goolam Ballim – Group Economist

+27-11-636-2910 goolam.ballim@standardbank.co.za

International

Jeremy Stevens
+27-11-631-7855
Jeremy.Stevens@standardbank.co.za

South Africa

Johan Botha	Shireen Darmalingam	Danelee van Dyk
+27-11-636-2463	+27-11-636-2905	+27-11-636-6242
Johan.botha@standardbank.co.za	Shireen.darmalingam@standardbank.co.za	Danelee.vanDyk@standardbank.co.za

Rest of Africa

Jan Duvenage	Anita Last	Yvonne Mhango	
+27-11-636-4557	+27-11-631-5990	+27-11-631-2190	
Jan.duvenage@standardbank.co.za	Anita.last@standardbank.co.za	Yvonne.Mhango@standardbank.co.za	
Botswana	**Angola**	**Kenya**	**DRC**
Lesotho	**Ghana**	**Mozambique**	**Nigeria**
Namibia	**Malawi**	**Uganda**	**Tanzania**
Swaziland	**Mauritius**	**Zambia**	**Zimbabwe**

Simon Freemantle
+254 (20) 3269 027
Freemantles@stanbic.com

Kenya
Uganda
Tanzania

Home loans

Robert Katz – Director of Home Loans
+27-11-636-2292
Rob.Katz@standardbank.co.za

Lasath Punyadeera – Director of Home Loans Product
+27-11-636-1292
Lasath.Punyadeera@standardbank.co.za

*All current research is available on the Standard Bank Group Economics home page. In order to receive Group Economics' research via email, all clients (new and existing) are required to register and select publications on the website. Click on http://ws9.standardbank.co.za/sbrp/LatestResearch.do, select **Register** and enter your email address. A username and password will then be emailed to you.*