# Economics

Standard Bank

4 May 2009

## South Africa: Residential property report

### House price growth: more of the same

Johan Botha

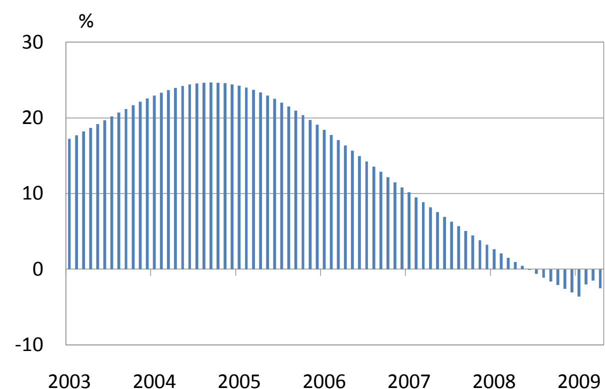
**What is the latest?** After posting the lowest annual growth rate in 12 years in 2008 when a decrease of -0.3% in the median house price of Standard Bank's property book was reported, the first four months of 2009 confirmed that the property market remains in the doldrums. The trend cycle of the April data confirmed that the weakness in the property market is set to continue for longer. The smoothed rate yielded growth of -2.5% compared to a year ago. The first three months of 2009 showed no respite with an average decline of almost 2.5% compared to a year ago. In real terms, using our estimate of the CPI in April to deflate the nominal house price, the decline in real house prices comes to approximately 10.7%. The smoothed growth rate of residential property prices for April 2009 shows that the value of the median residential property financed by Standard Bank was R565 000. Clearly, the overall state of the economy early in 2009 and the medium-term outlook are such that a marked and quick improvement in the housing market is decidedly unlikely.

As is well-known, estimating the increase is house prices is fraud with difficulties. Monthly data tend to be very volatile and is being influenced by the ongoing, policy induced, impact of the National Credit Act (NCA), which effectively led to a tightening in lending criteria. Furthermore, changes in the distribution of property prices lead to formidable statistical problems. This was evident late in 2008 and onwards when a decline in the number of middle- and lower-priced properties processed was reported. This means that the proportion of higher-priced properties making up the bank's loan portfolio increased, resulting in a higher median price (and growth rate) for these months. These effects were further exacerbated by the stricter credit-granting standards and the industry-wide loan-to-value (LTV) restrictions implemented from the latter part of 2008, also ensuing in an upward bias in the value of loans. Also, interest rate cuts in February, March and April lead to higher loan amount that mortgage applicants qualify for, ending up with higher median values for successful applicants.

**What are the overall developments in the housing market?** Growth in Standard Bank's residential median property price peaked in October 2004. An important activating point in the house price cycle occurred in mid-2006 when the upward phase of the interest rate cycle commenced. The 500 basis points increase in the repo rate between mid-2006 and mid-2008 placed huge strain on the economy in general and mortgage holders in particular. High levels of household debt, the reduced affordability of housing, exacerbated by higher mortgage rates, high food and fuel prices, a sharply slowing economy, and the implementation of the NCA, led to a decline in the demand for residential property and a significant temperance in house price growth ensued.

LTV restrictions became binding constraints from November 2008 onwards as these restrictions reduced the ability of households to access finance – thus leading to a sharp drop in the number of mortgage applications. New lending criteria introduced towards the end of 2008 reflect the general tightness in lending by credit-granting institutions. It does appear that higher-income individuals generally have greater capacity to react to more conservative lending practices, which partially explains the increased turnover of more expensive houses financed. This was reflected in the late 2008 and early 2009 data (including the April data) contained in Standard Bank's property book.

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




**The macroeconomic backdrop remains bleak.** The global financial crisis gathered momentum in the latter part of 2008, impacting not only on credit and financial markets, but also on the real economies. With

many countries experiencing recessionary conditions, it is clear that South African exports will not remain untouched by these developments, thus impacting on the wider South African economy. The mining- and manufacturing sectors were particularly hard hit. The international economic environment remains extraordinarily frail. Nobody is sure yet where the global economy is heading, with the industrialised world experiencing its worst recession in almost 80 years and many emerging markets are on the brink of a recession. The overall consensus seems to suggest that at best only the second half of next year may see a meaningful improvement in global conditions.

The current weakness of the economy should not be taken lightly, as recently emphasised by the Governor of the Reserve Bank and the Minister of Finance. The last half of 2008 showed large swathes of the economy under huge stress: economic growth practically came to a standstill in the third quarter of the year and was in fact negative in the final quarter of the year (-1.8% q/q seasonally adjusted and annualised – s.a.a.).

Furthermore, a quick turnaround in economic fortunes is also not on the cards. This sentiment finds support in a number of recent data releases, including manufacturing production (down 15% y/y), mining production (down 12.8% y/y), wholesale trade (down 8.9% y/y), real retail trade (down 4.5% y/y), vehicle sales (down 30% y/y) and building plans approved (down 43% y/y).

From a demand side perspective, equally worrying trends are emerging. Real domestic expenditure declined by 3.9% q/q s.a.a. in Q4 (+0.7% q/q s.a.a. in Q3); the result of a contraction in real household expenditure of 2.7% q/q s.a.a. (-0.9% q/q s.a.a. in Q3) and a slowdown in growth of real capital formation to only 3% q/q s.a.a. from 7.3% q/q s.a.a. in the third quarter. Moreover, in real terms, income growth contracted owing to a sharp decline in bonus payments, operating hours, job layoffs and lower property income. Worryingly, contraction in demand for durable and non-durable goods, as well as for services, were reported. The more conservative spending by households and a limited appetite for debt, though, has brought the household debt-to-disposable income ratio down for 2008 from the high that was recorded in Q1 2008. Nonetheless, the ratio remains at historically high levels (78.5% in Q1 2008 and 76.4% in Q4 2008). Consumers who had over-extended themselves during the low interest rate environment now find themselves under severe financial stress – an extended period of deleveraging will have to take place in order to improve their balance sheets. Fortunately, the recent cuts in the interest rates and a markedly slower accumulation of debt by households will improve, albeit gradually, the financial health of consumers.

As a further indication of the infirmity of consumers' financial health, data from the National Credit Regulator (NCR) is telling. Owing to the still high debt affordability in the final quarter of last year (the debt service cost-to-income ratio is at a nine-year peak of 11.7% in Q4 and Q3 2008), the NCR reported that, of the credit active consumers (17.56m in Q4 2008 compared to 17.53m in Q3 2008) in the economy, 58.4% were in good standing (compared to 59.5% in Q3 2008). Furthermore, those with impaired records increased to 41.6% during the period (from 40.5% in Q3 2008 and 39.6% in Q2 2008).

With consumer confidence at extremely low levels, the demand for big-ticket items, including vehicles and housing, will remain constrained by the deterioration in economic activity. Despite consumer confidence edging up 1 index point in Q1 2009 from -4 in Q4 2008, the rating of the appropriateness of the present time to buy durable goods remained near four-year lows.

Some respite, however, is provided by lower inflation and a declining interest rate cycle. According to the Reserve Bank, inflation is expected to decline to 5.4% in Q4 2010. With the new schedule of monthly meetings for the Monetary Policy Committee (MPC) and the decision reached at the February, March and April meetings, the MPC has indicated that Reserve Bank at the moment prefers active monetary stimulus to support economic growth going forward. Another 150 basis points cut is foreseen for the rest of the year. This will imply cumulative cuts in the interest rate cycle of 500 basis points from the top of the interest rate cycle, thus giving back the 500 basis points increase in the interest rate during the upward phase of the cycle between mid-2006 and mid-2008. Hopefully, though, households experiencing financial distress will use the opportunity provided by cuts in interest rates to reduce debt levels rather than to accumulate new debt. Entering a downward phase in the interest rate cycle does not imply an immediate change in financial and economic conditions. The full impact of interest rate cuts on economic growth could take as long as eighteen months. Patience as far as the housing market is concerned, is therefore required. Despite the positive news that a moderation in inflation brings, inflation tend to be sticky in a downward direction. Further sharp increases of the order of 33% in electricity tariffs are in the pipeline for the next few years and potentially, interest rates. Of course, interest rates will not remain low (or high), for ever. We anticipate the first interest rate hike in the interest rate cycle in June next year.

**What are the risks to the property market?** Obviously, the health of the housing market is a function of the overall state of the economy. It is highly unlikely that a well-performing housing market can exist in a deeply troubled economy. As noted earlier, the outlook for the economy over the short term remains bleak. Statistics are still reflecting a rising number of insolvencies and liquidations. Banks have reported significant increases in bad debt. Households currently owe banks an amazing R1.2 trillion, of which the greater part constitutes mortgage advances. At the moment about a third of South Africans with impaired credit records are more than three months in arrears. Worrying, though, is that anecdotal evidence shows that people approaching debt counsellors have on average twelve credit cards, far higher than the national average of three cards. This implies that conditions on this front may worsen substantially before an improvement can be expected.

**Outlook:** The Standard Bank median house price index (smoothed) decreased by 2.5% y/y in April, following on average declines of almost

2.5% y/y in the first three months of the year. Clearly, households find economic and financial conditions extremely challenging, while the tightening of lending criteria by financial institutions makes it more difficult to access finance. Over the short term, economic conditions are expected to deteriorate further; however, positive developments on the inflation front, as well as the poor performance of the economy, will lead to additional interest rate cuts in 2009. Standard Bank expects a further 150 basis points relief in interest rates this year. It is anticipated that house price growth will be negative over the short- and medium term, but likely to bottom out towards the end of the year as the impact of interest rate cuts filter through the economy and the property market.

**Standard Bank median house price growth data (smoothed*)**

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|
| January | 23.0 | 24.2 | 18.4 | 10.2 | 2.7 | -3.6 |
| February | 23.3 | 24.0 | 17.7 | 9.5 | 2.1 | -2.0 |
| March | 23.7 | 23.7 | 17.1 | 8.8 | 1.5 | -1.5 |
| April | 24.0 | 23.3 | 16.4 | 8.2 | 1.0 | -2.5 |
| May | 24.2 | 22.9 | 15.7 | 7.6 | 0.4 | |
| June | 24.4 | 22.5 | 15.0 | 6.9 | -0.1 | |
| July | 24.6 | 22.0 | 14.2 | 6.3 | -0.6 | |
| August | 24.6 | 21.5 | 13.5 | 5.7 | -1.1 | |
| 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

**South Africa**

| Johan Botha | Shireen Darmalingam | Jeremy Stevens | Danelee van Dyk |
| --- | --- | --- | --- |
| +27-11-636-2463 | +27-11-636-2905 | +27-11-631-7855 | +27-11-636-6242 |
| Johan.botha@standardbank.co.za | Shireen.darmalingam@standardbank.co.za | Jeremy.Stevens@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** |


## 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.*


Analyst certification

The authors certify that: 1) all recommendations and views detailed in this document reflect his/her personal opinion of the financial instrument or market class discussed; and 2) no part of his/her compensation was, is, nor will be, directly (nor indirectly) related to opinion(s) or recommendation(s) expressed in this document

Disclaimer

This document does not constitute an offer, or the solicitation of an offer for the sale or purchase of any investment or security. This is a commercial communication. If you are in any doubt about the contents of this document or the investment to which this document relates you should consult a person who specialises in advising on the acquisition of such securities. Whilst every care has been taken in preparing this document, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by the Standard Bank Group Limited, its subsidiaries, holding companies or affiliates as to the accuracy or completeness of the information contained herein. All opinions and estimates contained in this report may be changed after publication at any time without notice. Members of the Standard Bank Group Limited, their directors, officers and employees may have a long or short position in currencies or securities mentioned in this report or related investments, and may add to, dispose of or effect transactions in such currencies, securities or investments for their own account and may perform or seek to perform advisory or banking services in relation thereto. No liability is accepted whatsoever for any direct or consequential loss arising from the use of this document. This document is not intended for the use of private customers. This document must not be acted on or relied on by persons who are private customers. Any investment or investment activity to which this document relates is only available to persons other than private customers and will be engaged in only with such persons. In European Union countries this document has been issued to persons who are investment professionals (or equivalent) in their home jurisdictions. Neither this document nor any copy of it nor any statement herein may be taken or transmitted into the United States or distributed, directly or indirectly, in the United States or to any U.S. person except where those U.S. persons are, or are believed to be, qualified institutions acting in their capacity as holders of fiduciary accounts for the benefit or account of non U.S. persons; The distribution of this document and the offering, sale and delivery of securities in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by the Standard Bank Group Limited to inform themselves about and to observe any such restrictions. You are to rely on your own independent appraisal of and investigations into (a) the condition, creditworthiness, affairs, status and nature of any issuer or obligor referred to and (b) all other matters and things contemplated by this document. This document has been sent to you for your information and may not be reproduced or redistributed to any other person. By accepting this document, you agree to be bound by the foregoing limitations. Unauthorised use or disclosure of this document is strictly prohibited. Copyright 2004 Standard Bank Group. All rights reserved.