Economics

South Africa: Residential property report

House prices bottoming out

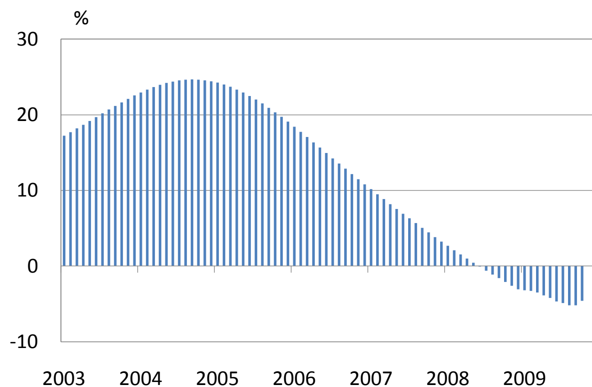
Standard Bank

3 November 2009

Johan Botha

What is the latest? Standard Bank's property book for the first ten months of 2009 revealed an average monthly decline of 4.3% in the median house price. This brings the number of monthly declines to 17 consecutive months. The October smoothed data yielded a rate of contraction of 4.6% y/y, improving slightly from the declines recorded in August and September There are signs that the residential property market is stabilising and that interest in residential property is returning. In real terms, using our estimate of the CPI in October to deflate nominal house prices, the decline in real house prices comes to approximately 10.6% from 11.5% in September. The smoothed growth rate for October shows that the value of the median residential properties financed by Standard Bank was R553 000

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



Although price declines are continuing, the declines have stabilised at around -5% y/y. What is more interesting from our perspective is that that potential buyers are returning and that the loosening of credit criteria announced at the beginning of September is showing some results in terms of the number of loan applications and loans granted in October. We also see first time buyers making use of the opportunity to test the market, while the loosening of the loan-to-value constraint is increasing the demand for lower priced properties. This is in contrast to our experience from November last year to August this year, when the median price of properties financed increased. Conversely, the increase in appetite for lower-priced houses is biasing our raw median price downwards. Of course, improvement in the macroeconomic environment, all be it quite tentative and fragile, will also start to support the property market, but it is unlikely that it will perk up before more convincing signs of a substantial and sustainable upswing emerges.

A slightly improved macroeconomic outlook. The accumulated 500 basis points cut in lending rates since December last year had an immediate impact on the affordability of debt, while the ripple effect of the cuts will in due course support the economy. Further evidence that the economy may be bottoming out is provided by growth in retail and car sales; an uptick in the components of the Purchasing Managers Index (PMI); mining, manufacturing and electricity output; gold, platinum and oil prices; business confidence; and the leading indicator of the South African Reserve Bank. GDP data for the third quarter of the year will be released later this month and is projected to show that the economy is pulling out of the recession. Looking forward, we anticipate that an improved second half of the year will leave growth for 2009 at -1.5% y/y.

Nonetheless, with output falling to the extent that it has, unemployment soared. It is estimated that almost one million South Africans have lost their jobs since the beginning of the year. An immediate improvement on the employment front is also not on the cards given that unemployment is a lagging indicator of economic activity, meaning that even with a turnaround in economic growth, employment will remain weak for an extended period of time. Clearly, the combination of a struggling economy, job layoffs and falling household income is negative for the housing market.

Appetite for credit also plunged through the year. The latest data (September) show that growth in credit extended to the private sector collapsed to only 1.5% y/y, and may in fact fall into negative territory over the next few months. Growth in mortgage loans also showed a steady decline to 4.8% y/y in September from 5.5% y/y in August. More positively, 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 dissolve.

These deteriorating trends have emerged in weaker consumer confidence. Consumers' assessment of their own financial position, expected economic conditions, and the appropriateness of the current time to buy durable goods, deteriorated in Q3. Aside from job losses, other concerns such as the higher electricity tariffs, reduced overtime payments and shorter working hours remain problematic for consumers' financial health.

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-August 2009 decreased by 44.9% compared to the same period in 2008. The value of residential buildings reported as completed during January-to-July 2009 decreased by 15.1% compared to the same period last year. Quite clearly, future building activity over the short- and medium-term will be seriously constrained. With building cost inflation (around -0.5% y/y according to the producer price index for September) still running above housing deflation, acquiring an existing home may be more affordable. Furthermore, a sizeable overhang of unsold properties exists. This will constrain prices until such time that normality returns to the market. Anecdotal property trends confirm that the affordable segment of the housing market is showing signs of life.

What are the risks to the property market? Despite it being perceived that the economy may be bottoming out, these indicators are at best still uncertain. With the economy under tremendous strain, it cannot be expected that the housing market will flourish. Furthermore, the residential property market is likely to lag developments in the economy. A number of downside risks are still present: the global recovery is not yet firmly established; a relatively strong rand could impact adversely on exports and economic growth; a general lack of improved consumer and business confidence; as well as a constrained labour market with deeper job losses. This will make for a tame recovery in the property market, which is unlikely to gather any traction this year. Base effects in the first quarter this year are also likely to put downward pressure on house price growth in the corresponding period next year. This will make for a slow start to 2010. Other risks include further sharp increases of 45% in electricity tariffs mooted for the next three year and possible increases in the price of oil as the global economy gains traction. In addition, as recent wage settlements have been well above the inflation rate, this during corporate financial hardship, companies will be more inclined to provide below-inflation wage increases during the economic recovery phase.

On the monetary policy front it appears that the downward phase of the interest rate cycle has come to an end. The cumulative cuts that commenced since 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 a significant recovery in economic growth soon.

Outlook: 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 improbable. There are signs, though, that house price declines are stabilising and that the economy is bottoming out. It does not appear, however, that house price growth will turn positive before the second quarter of 2010.

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	-5.2
October	24.7	20.3	12.2	4.4	-2.1	-4.6
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://www.standardbank.com/Research, 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.