PROPERTY BAROMETER – RESIDENTIAL PROPERTY AFFORDABILITY

2014 may be the year in which home affordability starts to become a little more of a challenge, with slightly higher house price growth and a struggling labour market.

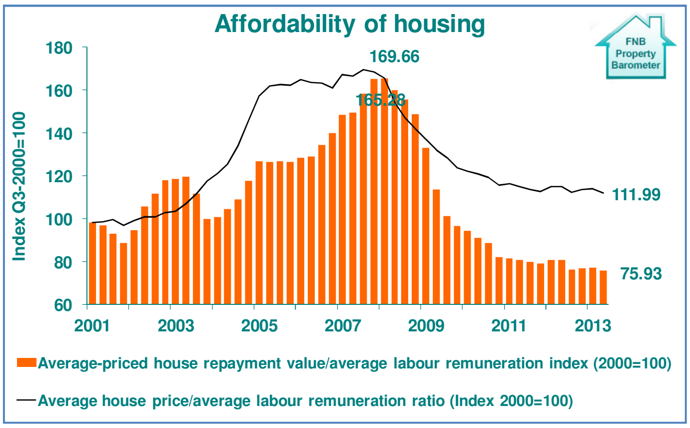
23 January 2014

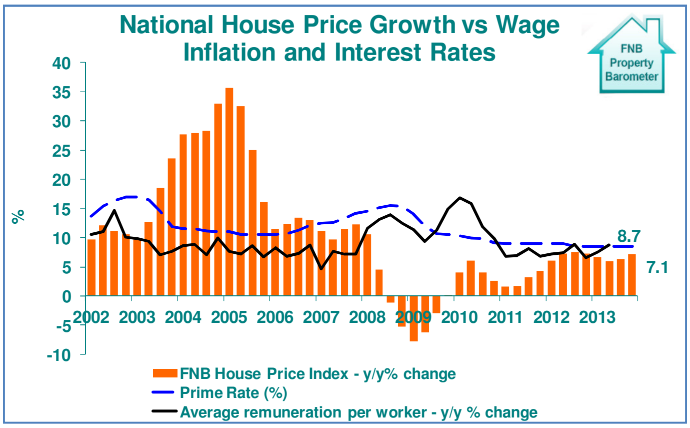
After 6 years of improving residential property affordability, 2014 could be a year in which this improving affordability trend is reversed mildly, and in which affordability becomes slightly more challenging. This is based on our view that 2014 will yield higher house price growth in a supply constrained residential market, interest rates will remain unchanged, and average employee remuneration will show weak growth in an economy not showing any significant employment growth.

The December SARB Quarterly Bulletin enabled us to update our own 2 housing affordability indices for the 2nd quarter of 2013, using the SARB Average Employee Remuneration Index, the FNB House Price Index, and a Prime Rate time series. As at the 2nd quarter of last year, the improving trend in affordability was still continuing, but at a very slow pace, having slowed down noticeably from 2011 onward.

Of our 2 affordability measures, the 1st measure, namely the Average House Price/Average Employee Remuneration Index declined mildly by -1.9% in the 2nd quarter of 2013 compared to the level for the previous quarter. The 2nd measure, namely the "Installment Payment Value on a new 100% Bond on the Average Priced House/Average Employee Remuneration Ratio" Index, also declined -1.9% in the 2nd quarter, with both indices being driven to better levels of affordability by average employee remuneration outpacing average house price growth as per the FNB house price measure.

This brings the cumulative decline (improvement) in the 2 affordability indices to -34% and -54.2% respectively, since their 2007/8 peak levels, with wage inflation outpacing house price inflation for most of this period, and the 2nd affordability measure having the added boost from big interest cuts since late-2008 (7 percentage points' worth of cuts in total).





Looking forward, however, certain key factors look set to work increasingly against further home affordability improvements for the time being, and possibly even bring about some mild deterioration in 2014.

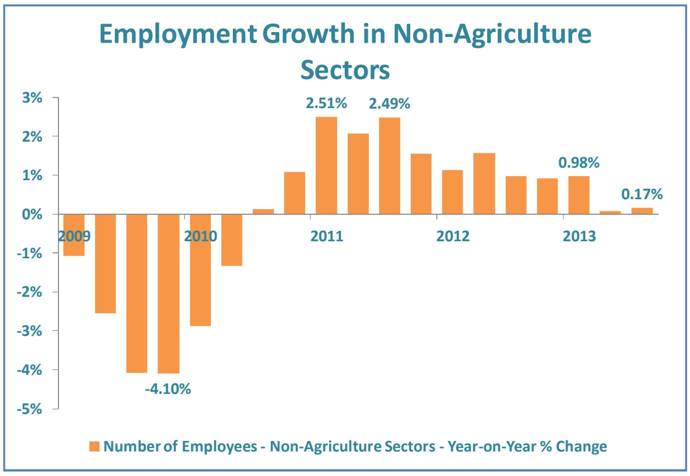
Interest rates aren't yet one of these factors. We believe it unlikely that there will be any further interest rate cutting. The SARB (South African Reserve Bank) has intimated recently that there has been some debate at its last Monetary Policy Committee meeting regarding the timing of interest rate hiking, and indeed with consumer price inflation hovering near to the 6% upper target limit cuts seem unlikely. However, we don't expect interest rate hiking just yet either. Rather, unchanged interest rates through 2014 and hiking only to start in early-2015 is our expectation. Therefore, in 2014 we expect interest rates to be neutral for home affordability.

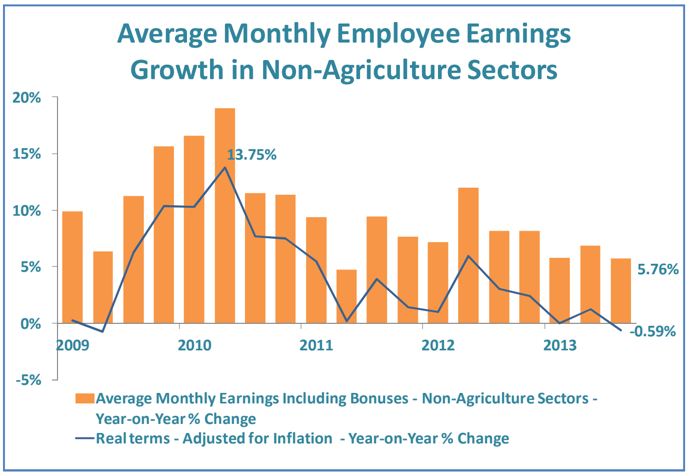
The 2 factors then expected to be negatives for home affordability are a year of mildly faster house price growth in 2014, and struggling labour remuneration growth.

While economic growth looks set to be pedestrian yet again in 2014, our expectation of slightly more rapid house price growth, rising from an average of 6.8% last year to nearer to 9% perhaps in 2014, is based more on our perceptions of increased confidence in residential property, both from a mortgage lender and home buyer point of view it would seem, and mounting *residential supply constraints. Building activity has remained slow for the past 5 years, and our FNB Estate Agent survey reports significant agent stock constraints, while FNB's valuers too are reporting increasingly constrained supply along with gradually rising residential demand.*

Expected house price inflation of 9% could likely exceed average wage inflation. According to the SARB Quarterly Bulletin. The Andrew Levy estimate for average wage settlements for the 1st 3 quarters of 2013 was 7.9%. This is slightly higher than the 7.6% estimate for 2012, but can it continue to accelerate under conditions of almost zero employment growth? We suspect not. StatsSA measures of employment and wage bill growth show employment growth in 2nd and 3rd quarters of 2013 now at very near to zero in a weakened economy, which one would expect to exert some downward pressure on wage increases in the near term.

Indeed, according to StatsSA 3rd quarter 2013 actual employee earnings numbers (one quarter more current than the SARB remuneration index), there was a slight slowing in year-on-year average monthly employee earnings growth to 5.76% (this number includes discretionary remuneration), from the previous quarter's 6.83%, and we would expect more of this slowing in response to economic and employment growth, which slowed further in 2013 compared to 2012.

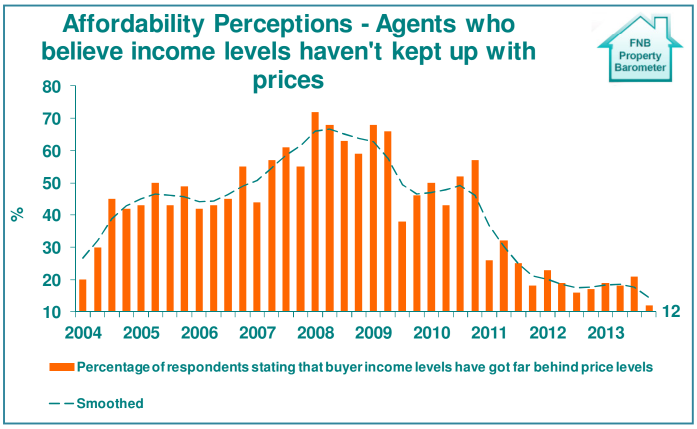


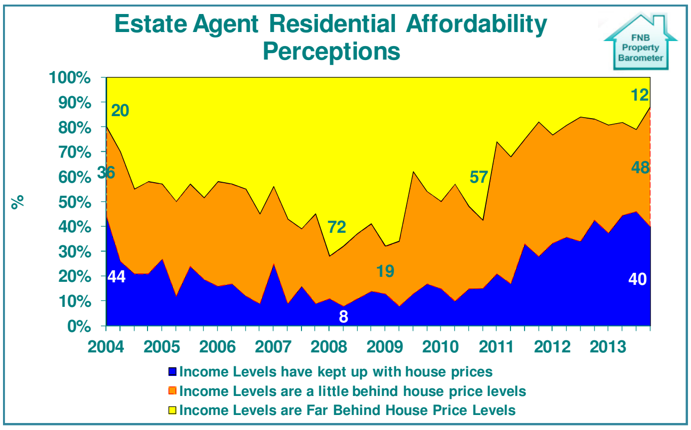


In closing, what do our Estate Agent Survey respondents perceive? The survey asks agents for their perception of housing affordability, through requesting them to choose one of 3 statement options, i.e. "Income levels have kept up with house prices", "Income levels have got a little behind house price levels" or "Income levels have got far behind house price levels".

What we appeared to have at the end of 2013 was a slight deterioration in the average agent perception of residential affordability. This conclusion needs to be qualified, as the percentage perceiving "income levels to be far behind house prices declined from 21% in the preceding quarter to 12% in the 4th quarter 2013 survey. However, those perceiving "income levels to be a little behind house price levels" rose significantly from 33% in the previous quarter to 48%, and the percentage of agents believing that income levels have kept up with prices" declined from 46% to 40% over the 2 quarters.

It is too early to ascertain whether the decline in those perceiving income levels to have kept up with prices in the 4th quarter survey is the start of a mild deteriorating affordability trend, but we expect that this may well come.





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