Economics

South Africa: Residential property report

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No spark in house prices

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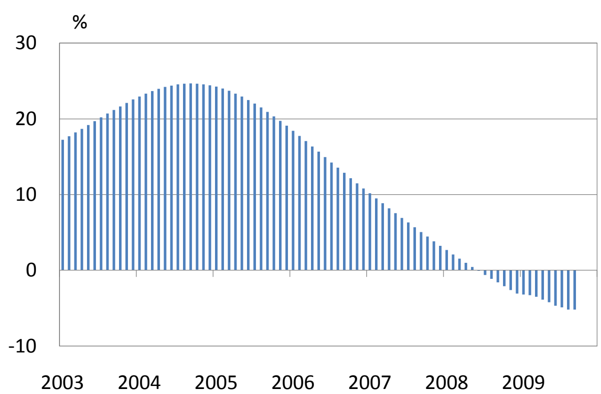
What is the latest? Standard Bank's property book for the first nine months of 2009 revealed an average monthly decline of 4.2% in the median house price. This brings the number of monthly declines to 16 consecutive months. The September smoothed data yielded a rate of contraction of 5.2% y/y, the same decline as in August. In real terms, using our estimate of the CPI in September to deflate nominal house prices, the decline in real house prices comes to approximately 11.5%. The smoothed growth rate for September shows that the value of the median residential properties financed by Standard Bank was R550 000.

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



An uncertain macroeconomic backdrop. GDP contracted by 3.0% q/q seasonally adjusted and annualised (s.a.a.) in Q2 from -6.4% q/q s.a.a. in the first quarter. From an annual perspective, this quarterly contraction set the economy back by 2.8% y/y in Q2, more than twice as weak as the -1.2% y/y recorded in Q1. For the first half of the year, the economy declined by 2% y/y, however, we maintain that an improved second half of the year will leave growth for 2009 at -1.5% y/y.

The latest data from the Reserve Bank confirm that the slowdown in Q2 has been spearheaded by a broad and substantial decline in the major components of domestic demand. Worryingly, contractions in demand for durable- and semi-durable goods, which are interest rate sensitive components of aggregate demand, were reported in Q2. The combination of a shrinking economy, albeit contracting at a slower pace (quarter-on-quarter), and poorly performing interest sensitive sectors of the economy, is bad news for the property market.

Slightly more positive from a household perspective, the household debt-to-income ratio showed a welcome decline, as the first contraction in household debt since 2002 Q3 was reported in Q2. More importantly, the higher pace of increase in nominal income growth of 2.3% q/q s.a.a. in Q2 helped to lower the household debt-to-income ratio marginally to 76.3%. This is significant when viewed against the backdrop of job losses.

Public sector employment declined for the first time in four years in Q1 and the private sector slashed employment since the third quarter of last year, when economic growth was still positive. In Q1, job cuts in the private sector deepened by -7.7% q/q from -2.3% q/q in Q4. While further labour retrenchments cannot be ruled out, we expect the rate of these declines to slow in the coming quarters.

These deteriorating trends have emerged in weaker consumer confidence data released yesterday. Consumer confidence declined in Q3 to one index point from four index points in Q2, which is marginally below the long-term average of two index points, and back at levels that reigned in Q1. 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. This serves to corroborate that a recovery in the property market, despite more lenient lending criteria, is far off.

Despite the generally poorly performing economy, 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 long-drawn-out. 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.

Nonetheless, 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 necessary and an important precursor to a recovery in demand. Indeed, household credit fell by R1.5bn (non-seasonally adjusted) in Q2 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. 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.

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-July 2009 decreased by 46% compared to the same period in 2008. The value of residential buildings reported as completed during January-to-July 2009 decreased by 12.1% compared to the same period last year. Quite clearly, future building activity over the short- and medium-term in our big municipalities will be seriously constrained. A slowdown in the supply of new homes is crucial in order for a recovery realise in the property market. Indeed, with building cost inflation (around 4% according to the producer price index) still running above housing deflation, acquiring an existing home may be more affordable. 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 a sense that the economy may be bottoming out, these indicators are at best only tentative. It cannot be expected that the housing market will flourish when the economy remain under such strain. 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 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 from November to March next year are also likely to put downward pressure on house prices. Other risks include 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. 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 next year.

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.

On the supply side of the residential property market, a sizeable overhang of unsold properties exists. This will constrain prices until such time that normality returns to the market.

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. The most 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 consumer and business sentiment improve. The heady 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. In due course, though, taking into account the accumulated impact of declining interest rates and lower inflation, house prices will be stimulated. This is only expected in early 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	
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.

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