By Stuart Murray
October 2011

The rand is the key

While not unexpected, the residential property market was disappointed by the SA Reserve Bank's decision to hold interest rates at present levels. But there is still the chance of a cut in November, which should help boost sales.

A WEAKENING RAND and worrying tendencies in the United States and Europe put paid to hopes of an interest rate cut by the SA Reserve Bank – a cut which had been widely anticipated as a boost to the country's sluggish economy.

At its September meeting the bank's Monetary Policy Committee decided, for the fifth consecutive time, to keep interest rates on hold. Although Governor Gill Marcus stressed that the decision had been unanimous, she disclosed that one member of the committee had been strongly for a cut. Furthermore, she left the door open for the possibility of a rate cut at the next committee gathering in November.

The bank's caution is understandable, but no less disappointing as far as the residential property market is concerned. Nevertheless, market watchers could only have expected a 0,5 basis points reduction and the net effect on consumer debt, and mortgage bond repayments, is marginal. For example, on an R1million bond, one half percent off the current rate would reduce monthly payments by some R329.

There is, however, a major psychological impact emanating from lower interest rates, namely the boosting of consumer confidence. And this, coupled with improving household finances, is needed to move our sluggish economy up a gear. A resurgent property market is an integral component of the drive for economic growth. The future trend for the demand and supply of new housing will be driven by elements affecting the economy in general, but specifically by trends in respect of household finances. So far this year the number of new housing units constructed has improved by only 3,3% year-on-year. Standard Bank economist Sibusiso Gumbi describes this as "anaemic". The real value of new residential buildings completed in the first seven months of the year came to R7,9 billion, 7,3% lower than the R8,53 billion of a year ago. Analysis of the lower value figure underscores the increasing trend towards smaller-sized homes.

The government's economic priority is that of job creation. Thus a shot in the arm for consumer confidence, translating to increased demand for housing, will significantly impact on job opportunities.

As it is, nominal house price growth continues to lag inflation. Market activity, on the other hand, appears to be picking up, helped by astute buyers shopping around for the many bargains currently available. Dr Andrew Golding, CE of the Pam Golding Property Group, reports a significant improvement in show day attendance and buyer enquiries. "We are finding market sentiment more positive," he says. "For the month of August the group's unit sales have increased by 28% over August last year, while sales turnover for the same period has increased by 21%."

Dr Golding adds, however, that the housing market remains constricted by strict bank lending criteria and buyer affordability.

Impaired consumer credit worthiness is another contributing factor. According to Absa's senior property analyst Jacques du Toit, 46% of 18,6 million credit-active consumers have "tainted" records.

Domestic inflation is also a major concern, rising steadily so far this year. Consumers have had to bear the brunt of increases in home ownership, often in double digits. Eskom's electricity tariffs have risen by an additional 25,8% this year and are set to increase by 25,9% in 2012. Municipal services such as rates, water, refuse removal and sanitation have all increased. Petrol too rose for the second consecutive month in September and, with the rand's slide against the US dollar, will increase further.

Analysts predict that the rand will continue to slide – although this is by no means written in stone. However, across the world, risk-averse investors are shying away from emerging markets. The "carry trade", which has been piling money into South African stocks and bonds this year, has gone into reverse – although why the dollar and, even more so, the euro are deemed less of a risk is anyone's guess. What started the panic was the turmoil in Europe, with market unease spreading and Greece having problems in delivering on its fiscal promises. The US Federal Reserve let it be known that it felt the downside risk to US growth was significant, suggesting that there is a possibility of a slide back into recession. This could undermine the fragile recovery in equity markets and lead to another general sell-off and in the process infecting risky currencies like the rand.

The net result, in September's final week, has been that the rand had plunged from R6, 70/$ to near R8,40/$. A reasonable guess would be that the rand will manage to strengthen to under R8 to the dollar towards the end of the year. Should such a trend become apparent as we move towards November, this could give the Reserve Bank an opportunity to ease interest rates further.

Apart from global volatility, the Bank remains concerned on the domestic inflation front. Gill Marcus views the risks to the inflation outlook as delicately balanced. One the one hand, core inflation (the CPI excluding food, petrol and electricity) moderated to 3,8% in August from 3,9% but on the other hand, overall consumer inflation has reached 5,3%. However, inflation expectations remain within the bank's target range, but have shifted upwards slightly: 5,5% for this year and 5,9% for 2012. So the bank has revised GDP growth prospects downward to 3, 2% for this year.

Amidst all this volatility are there any bright clouds on the residential property horizon? Well, of course, sagging prices and continued low (relatively) interest rates create an environment in which opportunities abound for buyers. The fact that house prices have more or less bottomed out and that buyer activity is increasing, suggests that now is the time to get into the market. The market by its very nature is dynamic; it doesn't lie fallow. Standard Bank concurs: "We believe that current market conditions present an opportunity for buyers who can demonstrate affordability. Holding all things neutral, a low interest rate environment allows individuals to qualify for larger loan amounts, or alternatively pay lower instalments…"

Furthermore, and although not hugely significant, the weak rand offers a window to potential foreign buyers, who have been sitting on the sidelines during the currency's steady strengthening, to re-enter the local market and acquire properties at excellent relative value.