3 April 2013

PROPERTY BAROMETER –FNB HOUSE PRICE INDEX – MARCH 2013

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Slower year-on-year house price growth in the 1st Quarter, but quarter-on-quarter growth just showing early hint of improvement

MARCH AND 1ST QUARTER HOUSE PRICE FINDINGS

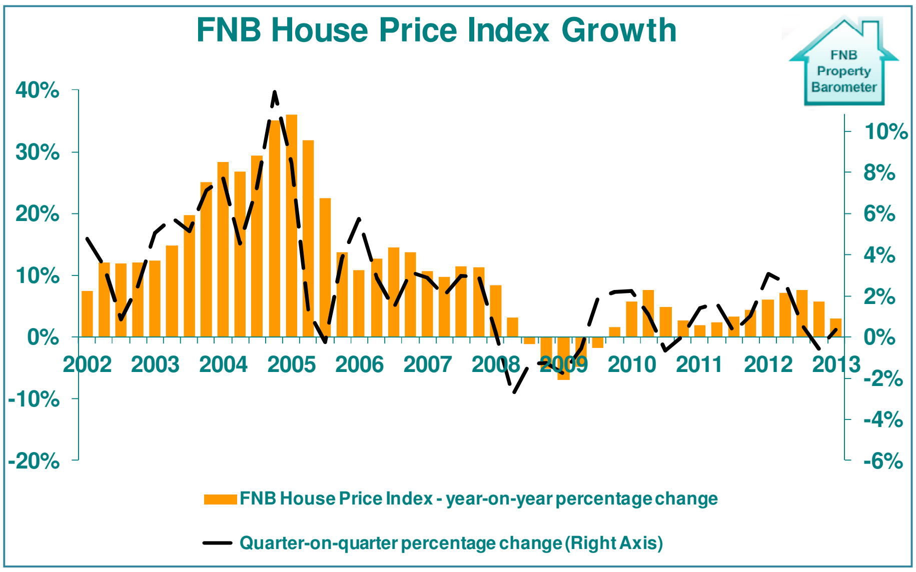
While year-on-year growth was still slowing in the 1st quarter of 2013, suffering from high base effects of a year ago, quarter-on-quarter house price growth just started to show early signs of improvement in the 1st quarter.

The FNB House Price Index for March 2013 showed further slowing in its year-on-year inflation rate, from a revised 2.9% in February to 2.2%. This continues a mild slowing growth trend from a "mini-peak" of 7.7% growth reached in July 2012.

A relatively solid period of house price growth in the 1st half of last year created a high base off which current year-on-year growth comes, and it is this high and rising base effect which is a key contributor to low and slowing year-on-year growth in the early stages of 2013.

The average value of homes transacted in the FNB House Price Index was R850,036 in March.

This slowing year-on-year house price growth does not yet reflect what appear to be some signs from other FNB indicators of growing residential market strength. Examining the house price data on a quarterly basis, the 1st quarter year-on-year growth rate was 3%, and this was slower than the 5.8% of the final quarter of 2012. However, the 1st quarter of 2013 did perhaps start to show early signs of price growth strengthening when examined on a quarter on quarter basis, a better way to examine short term growth momentum. From a mild decline of -0.6%, the quarter-on-quarter average house price growth rate returned to positive territory to the tune of +0.4%. This is early days, but may signal the start of some rising price growth momentum after a lull in the late stages of 2012, which was in line with a significant economic growth slump in the 2nd half of 2012.



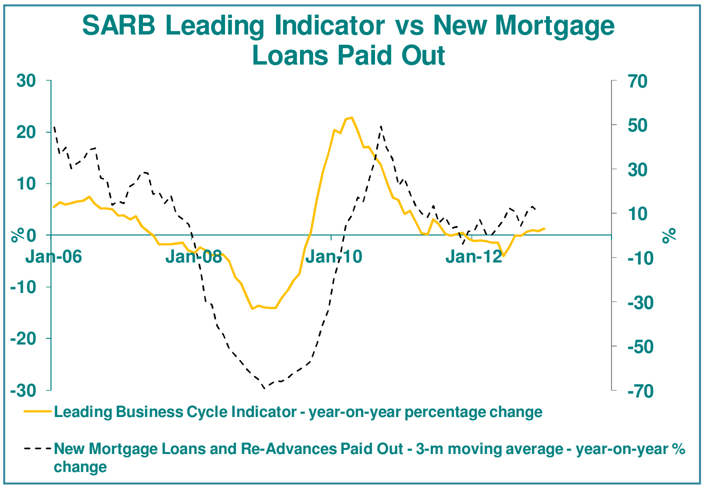
The signs of improvement in the residential market that we allude to emanate from the FNB Estate Agent Survey. In it, the agents' perceptions of residential demand improved noticeably in the 1st quarter of 2013, while the percentage of agents citing residential stock constraints also increased significantly, suggesting an improving balance between demand and supply.

As yet, though, we haven't seen sustained declines in still-lengthy estimated average times that properties remain on the market prior to sale, or in the percentage of sellers having to drop their asking prices. But should higher demand and significant stock constraints be sustained, one would expect such declines to ultimately take place.

Measuring cumulative nominal house price growth since May 2009, the month which marked the end of the period of significant house price deflation linked to the 2008/9 recession, the FNB House Price Index has risen by +19.1% to March 2013. However, in real terms (adjusted for consumer price inflation), the rise over this "post-recession" period up until February 2013 (March CPI data not yet available) has been a mere 0.3%.

OUTLOOK…..

A relatively strong economic period through the summer of 2011/12 to mid-2012 aided a noticeable improvement in the housing market and house price growth in the 1st half of last year, peaking at 7.7% year-on-year in July 2012. During the 3rd quarter of 2012, however, a sharply slower domestic economic growth rate, hampered by widespread industrial action disruptions to production (the most extreme being in the mining sector), was arguably instrumental in causing a slower pace of house price growth in the 2nd half of 2012. Even the demand indicator in the FNB Estate Agent Survey slowed mildly in the final quarter of 2012, probably reflecting the lull in the economy a quarter earlier, and the still-slowing year-on-year house price growth rate early in 2013 is believed to be the result of the lagged impact of that slow economic period, combined with the high base effect from the 1st half of 2012.



However, more recently we have started to see the economic growth situation "normalize". From a lowly 1.2% quarter-on-quarter annualized growth in real gross domestic product (GDP) in the 3rd quarter of 2012, the 4th quarter rate accelerated mildly to 2.1% in the 4th quarter.

The Reserve Bank Leading Indicator, too, has recently pointed to slightly better economic times in the near term. After a period of negative year-on-year growth through much of 2012, its growth rate returned to positive territory from September through to early 2013, suggesting that we were probably headed for mildly better economic growth at the start of 2013 assuming the end of the large scale strike disruptions.

In addition, the FNB Estate Agent Survey for the 1st quarter of 2013 pointed to a significant rise in residential demand, and growing residential supply constraints. This should ultimately lead to some improvement in house price growth from current levels.

Indeed, examining the FNB House Price Index on a quarter-on-quarter basis, we did see a return to mildly positive growth in the 1st quarter of this year, after a brief decline in the previous quarter, and a further acceleration is expected in the 2nd quarter, which would ultimately translate into a rise in year-on-year price growth at a later stage of this year.

However, the economy remains a struggling one at best, and one of the key March indicators just out reminds us not to expect too much. After the February Manufacturing Purchasing Managers' Index, a very useful current indicator of economic direction, rose to above 50, signaling renewed expansion in manufacturing after a late-2012 slump, the March level went back to below 50.

Therefore, while our expectation is that house price growth will begin to rise in year-on-year terms later in 2013, it is still expected to average lower single-digit growth of between 4-5% for the year as a whole, slightly below consumer price inflation and thus negative in real terms. This ongoing moderate expectation is on the back of our forecast for no further interest rate reduction in 2013, and although economic growth is expected to be better than it was late in 2012, a 2.7% 2013 forecast GDP growth rate remains mediocre, constrained by global economic mediocrity as well as a highly-indebted domestic household sector.

Notes:

Note on The FNB Average House Price Index: *Although also working on the average price principle (as opposed to median or repeat sales), the FNB House Price Index differs from a simple average house price index in that it could probably be termed a "fixed weight" average house price index.*

One of the practical problems we have found with house price indices is that relative short term activity shifts up and down the price ladder can lead to an average or median price index rising or declining where there was not necessarily "genuine" capital growth on homes. For example, if "suburban segment volumes remain unchanged from one month to the next, but former Black Township (the cheapest areas on average) transaction volumes hypothetically double, the overall national average price could conceivably decline due to this relative activity shift.

This challenge of activity shifts between segments is faced by all constructors of house price indices. In an attempt to reduce this effect, we decided to fix the weightings of the FNB House Price Index's sub-segments in the overall national index. This, at best, can only be a partial solution, as activity shifts can still take place between smaller segments within the sub-segments. However, it does improve the situation.

With our 2013 re-weighting exercise, we have begun to segment not only according to room number, but also to segment according to building size within the normal segments by room number, in order to further reduce the impact of activity shifts on average price estimates.

The FNB House Price Index's main segments are now as follows:

- *The weightings of the sub-segments are determined by their relative transaction volumes over the past 5 years, and will now change very slowly over time by applying a 5-year moving average to each new price data point. The sub-segments are:*

- *Sectional Title:*
    - *Less than 2 bedroom – Large*
    - *Less than 2 bedroom – Medium*
    - *Less than 2 bedroom – Small*

    - *2 Bedroom – Large*
    - *2 bedroom – Medium*
    - *2 bedroom – Small*

    - *3 Bedroom and More - Large*
    - *3 Bedroom and More - Medium*
    - *3 Bedroom and More - Small*

- *Full Title:*
    - *2 Bedrooms and Less - Large*
    - *2 Bedrooms and Less - Medium*
    - *2 Bedrooms and Less - Small*

    - *3 Bedroom - Large*
    - *3 Bedroom - Medium*
    - *3 Bedroom - Small*

    - *4 Bedrooms and More - Large*
    - *4 Bedrooms and More - Medium*
    - *4 Bedrooms and More – Small*

The size cut-offs for "small", medium" and "large" differ per room number sub-segment. "Large" would refer to the largest one-third of homes within a particular room number segment over the past 5 year period, "Medium" to the middle one-third, and "Small" to the smallest one-third of homes within that segment.

- *The Index is constructed using transaction price data from homes financed by FNB.*
- *The minimum size cut-off for full title stands is 200 square metres, and the maximum size is 4000 square metres*

- *The maximum price cut-off is R10m, and the lower price cut-off is R20,000 (largely to eliminate major outliers and glaring inputting errors).*
- *The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.*