

Johannesburg, June 3, 2015

## Will house prices fall by early 2016?

A HomeBid survey of leading property economists' outlooks on **interest rate rises** and **the possibility of house prices falling in early 2016** has found unanimity in the expectation that interest rates will be raised gradually in the third quarter of 2015 by 25 basis points and by a cumulative 75 basis points in 2016, as posited by Absa Home Loans property analyst Jacques du Toit.

**On the question of whether house prices will fall on the back of those hikes**, views varied little that house prices will show little if any growth nominally in 2015 and into 2016 with FNB household and property sector strategist John Loos's view of our being at the beginning of a "real house price correction" over the long term the most thought provoking.

Says Loos: "We shouldn't necessarily expect an all-out nominal house price decline. That would probably only come should we have a meaningful economic 'shock', for example a significant recession. [What is] more likely, I believe is that we are at the start of the 'Real House Price Correction' phase of the property super-cycle, where nominal house prices inflation over a good number of years is generally below CPI and wage inflation, translating into a long term downward correction in real terms.

"I believe that real house prices still in part reflect that 5%+ growth economy of prior to 2008 as well as the high level of speculative activity at the time. South Africa is no longer a 5% growth economy but probably a 1-2% one if we are lucky, riddled with structural constraints including electricity constraints and labour relations problems. The social tensions are rising, and this can create increasing economic and political instability as we head slowly to what I believe will be the next big political realignments.

"Real prices didn't fully correct downward to reflect all of these structural challenges, because after the boom residential demand has been propped up by an extreme monetary and fiscal stimulus across the globe and locally, including an abnormally low interest rate level in SA and government running unsustainable fiscal deficits.

"The stimulus is unsustainable and needs to be gradually withdrawn now. The South African Reserve Bank has pointed towards interest rate hiking, which we believe will re-commence late in 2015, in part influenced by the possible start of US Fed rate hiking, or at least market expectations thereof, which can exert pressure on the Rand and higher imported inflation.

"So as the impact of various stimuli runs thin, and stimulus gets withdrawn over the next few years, I believe longer term real house price correction will resume.

"I expect over the next six to 12 months that house price inflation in all segments will shift down well into the 0-5% range, while CPI inflation will steadily 'normalise' upward to nearer to 6%, and the gradual real house price decline will commence."

On the question **of banks' attitudes towards lending**, Loos said he would speak not specifically about FNB but of his perception of banks as a whole: "I don't perceive any desire by the sector to become more conservative in their lending appetite yet. It's pretty much 'business as usual' with regards to the risk of the client to who they lend or don't lend to, it seems. I believe that the banks are not overly concerned with the environment at present (their pessimistic economists aside), because their non-performing loans are still very low and lending hasn't been overly aggressive in recent years in any case.

“To the contrary, I get the impression that they want to compete a little harder to retain market share or grow books a little stronger. But this doesn’t seem to be manifesting itself in lending to higher risk clients, but rather in more competitive pricing of home loans. The Ooba stats show a noticeable drop in the average differential above prime on new loans in recent months, from +0.58% late last year to +0.27% by April 2015.”

**Could you elaborate on what you mean by the next big political realignments?** Loos: “I don’t have any hard and fast scenarios as to how the realignments will unfold. A political analyst would probably have some stronger view. However, I see economic stagnation, and a lack of positive structural change in the economy, as a key driver of rising social tensions, rising dissatisfaction, and stronger opposition to the incumbent government. It’s all a gradual process and part of the whole “super-cycle”, and may take a few more elections before the big realignments happen. What they are going to be is also highly unpredictable. But all I can really say is that I think it is likely to be a more turbulent political and economic period”.

On the question of **when do you think interest rates will be raised and how will this impact on the different house categories that you measure**, Absa’s Du Toit says Absa’s view is that rates will be hiked by 25 basis points in September this year and by a cumulative 75 basis points in 2016 to curb the effect of inflationary pressures. “Interest rates movements are important to trends in the property market,” he added, “as many property purchases are financed by means of mortgage loans.”

**In other words, on the back of expected raised interest rates, should we anticipate a fall in house prices, and by how much (in the different categories) and when is this likely?** Du Toit: “We foresee continued single-digit nominal house price inflation in 2015-16, currently around 6,5% over this period, which will mean very little, if any, real house price growth”.

**What other key economic data besides affordability are you monitoring which are likely to have a negative impact on prices?**

Du Toit: “Consumer finances (income growth, savings, debt levels, credit-risk profiles)”. **On the specific question of job growth** Du Toit says “Job growth is expected to remain very much subdued against the background of labour market conditions and factors such as electricity constraints, which have a negative impact on production, capacity utilisation, investment decisions, confidence and economic growth.”

**On business and consumer confidence** he remarked that confidence levels are expected to remain relatively low in view of the economic performance, infrastructure constraints, inflationary pressures and a rising interest rate cycle.

**Can we safely say most economists are expecting the interest rate to be raised in the next six months and there is a strong likelihood of a fall in house prices by early 2016?**

Du Toit: “The view is that interest rates will rise further, which will impact the affordability and demand for housing and mortgage finance, with the accessibility of mortgage finance that may also be affected as household finances are impacted by higher interest rates and consumers’ credit-risk profiles may come under further pressure as a result increasing defaults on debt repayments. Under these conditions the property market may be affected in terms of a decline in demand, while the supply of properties on the market may increase, which may lead to a further drop in property price growth.”

**If all indicators are pointing to a fall in house prices how would that fall compare to the drop in nominal and real house prices we saw in 2009 and 2012 (a fall in the luxury market in the case of the latter)?**

Du Toit: “If there are major adverse economic conditions in the next 12-18 months, property price trends may be much in line with what happened in 2009 and 2012.”

**What percentage drop should we anticipate in the different categories? Can we expect increased demand for lower-priced houses and by how much could we measure that?**

Du Toit: "Because of affordability issues, a bigger demand for lower-priced properties is a possibility."

**In this environment, what are banks' attitudes to lending?**

Du Toit: "Banks will continue to closely monitor economic, consumer and property market conditions, trends and prospects and will adjust their risk appetite and lending criteria accordingly."

Erwin Rode, CEO of Rode & Associates had this to say: "Monetary policy (that is, interest rates) is governed at present not so much by inflation expectations as by US monetary policy, viz. when will the Americans start raising interest rates?"

"This is generally expected to happen this year. SA as a country is living beyond its means, and we are utterly dependent on foreign inflows of money to fund our balance of payments deficit. These inflows are largely in the form of volatile portfolio investments, which can exit the JSE at the drop of a hat. Two examples of such a trigger event are: (1) our interest rates not keeping up with US interest rates and; (2) the rating agencies de-rating SA's government bonds to junk status in the wake of less-than-prudent fiscal policies.

"However, the US is expected to raise its interest rates only very gradually, and so it is reasonable to expect we will follow suit in a similar manner. As for fiscal policy, the National Treasury is fully aware of this danger, so I do not expect the government will cave in to extravagant salary demands by the public sector.

"Gradually rising interest rates will further retard growth in the economy, resulting in additional job losses and a further deceleration of real incomes. In addition, home affordability would be negatively affected through higher mortgage instalments.

"Under this scenario, house prices in middle-class suburbs would decelerate to zero. However, 'affordable' houses (those under R600 000), which are typically financed with 100 per cent bonds, may be harder hit. I do not expect a 'sub-prime' scenario in SA, but it is not inconceivable that prices in this category may actually decline slightly".

Property Economist Neville Berkowitz, acting as an Adviser to HomeBid, says that the views of these three property economists in South Africa canvassed in this HomeBid Survey have identified the likely foreseeable future that home sellers and home buyers face.

At best, home prices are likely to rise at between 1-5% p.a. and it's more likely home prices are going to continue moving sideways as they have in the recent past. Only a sizeable increase in interest rates beyond the anticipated 1% increase during the next 12 months will negatively affect home prices and see them fall into negative growth territory. A "shock" at economic and or political level could also affect the precarious balancing act of home prices and send them into negative growth territory.

Current speculation in the media over the 2016 Municipal Elections and seeing the ruling ANC possibly losing direct control of certain major municipalities could trigger political reactions which may affect confidence levels and, with it, home prices in 2016.

An ANC/DA coalition running major municipalities should boost investor confidence from foreign funders and local investors, however, an ANC/EFF coalition could trigger an outflow of foreign funds and a sharp rise in interest rates, affecting both confidence and affordability levels for homeowners.

The message for seller of homes is to be realistic about the listing prices of their homes should they want to sell them, says Berkowitz.

Buyers of homes will need to factor in the anticipated 1% p.a. increase in interest rates into their budgeting processes as to what they can afford to pay for a home as mortgage lenders will no doubt be assessing their financial applications taking this anticipated 1 % p.a. interest rate increase into account.

Buyers of homes will be more carefully scrutinised by these mortgage lenders as a low growth economy of 1-2% p.a. could spell further retrenchments and limited, if any, wage and salary increases.

Employment figures for 2014 have showed only 142 000 net new jobs being created in South Africa and this is less than 1% employment growth.

Buyers of homes should seek expert advice when sourcing a home loan as there are options available to them, however, the presentation of their financial information identifying their ability to pay for the home loan is crucial. Mortgage originators working with estate agents currently have a failure rate of 30-40% and this is expected to increase as mortgage lenders tighten their requirements for home loans with the sideways movement of home prices and the anticipated 1% rise in interest rates.

Buyers must be financially responsible when applying for a home loan and they should take advantage of the sideways movement of home prices as a good time to buy, says Berkowitz.

**Media contact:**

**For further information please contact HomeBid media liaison Alison Goldberg on 082-323-1254 or [Alison@homebid.co.za](mailto:Alison@homebid.co.za).**