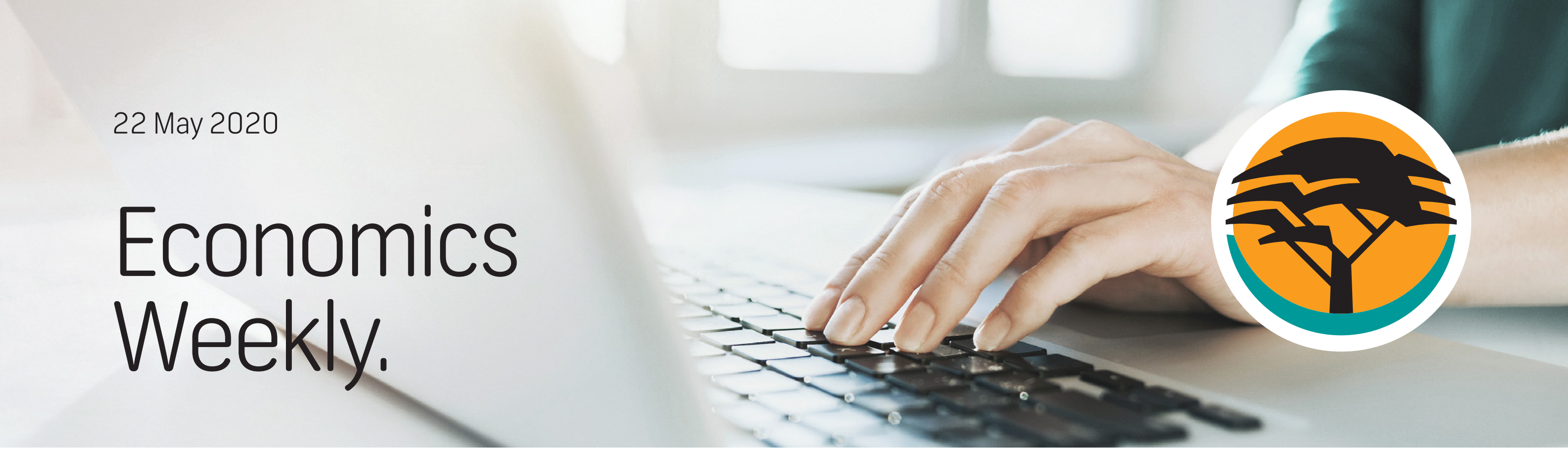
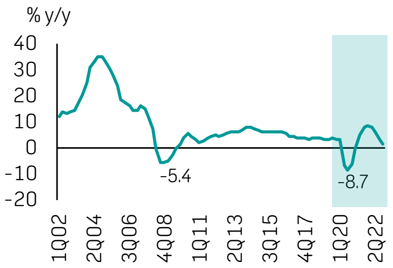


22 May 2020

Economics Weekly.

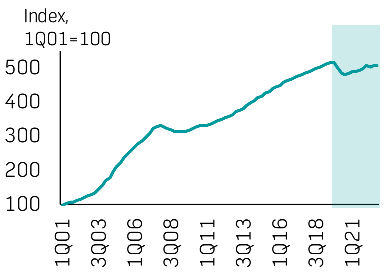
FNB macroeconomic forecasts for 2020: Housing market

Figure 1: House price forecast



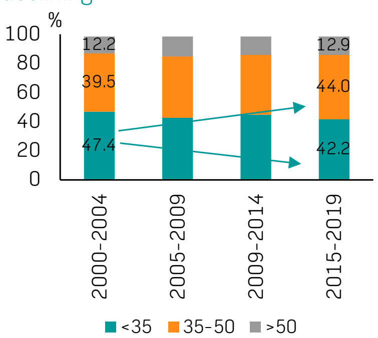
Source: FNB Economics

Figure 2: House price forecast – "Permanent" value destruction



Source: FNB Economics

Figure 3: % share of buyers < 35 is declining



Source: FNB Economics

Annual house price growth fell to 1.9% y/y in April, down from 2.5% in March – the slowest pace since December 2009. Importantly, the impact of the lockdown on the housing market is yet to fully reflect in the data. This is because our house price index is constructed using mortgage approval data, and there is generally a lag between mortgage applications being submitted and approved. Approximately 60% of the April sample relate to applications that commenced prior to the lockdown.

Since the implementation of the lockdown, market activity has come to a halt. Preliminary data shows that volumes plummeted by around 60% y/y in April (or 62% compared to the last twelve months' average monthly volumes). This is consistent with our view that the pandemic will have a much greater impact on transaction volumes than on price.

So, where to from here?

Economic activity is set to contract significantly in the near term, mainly as a result of the stringent measures adopted to suppress the spread of the virus. While the outlook remains uncertain, our estimates suggest a gross domestic product (GDP) contraction of around 8% this year. This will likely have a calamitous impact on labour markets, resulting in loss of income for households and corporates, and will also suppress aggregate demand.

Commensurately, we expect, as a base case, that house prices will decline by around 5% and transaction volumes by around 45% this year. In comparison, prices declined by an average 1.5% (according to the FNB HPI) and transaction volumes by around 40% in 2009 during the global financial crisis. The contraction will be deeper this time around because of the nature of the shock, and the expected magnitude of the impact on labour markets. This also suggests that distressed or forced sales might creep up as property owners grapple with financial pressures. However, we don't expect this to be a significant feature in the current episode (this was an important driver of the property price decline in 2009). Several factors inform this view. For instance, market regulation has greatly improved, giving more protection to consumers and allowing for more rehabilitation options. Furthermore, lending criteria are much stricter today than they were back in the time of the financial crisis, meaning that today's property owner has better chances of weathering the storm.

Fears of a massive oversupply of housing stock are also discounted by the fact that some sellers have already begun withdrawing their properties from the market due to unfavourable selling conditions. This is evidenced by massive declines in new listings on major property portals in the month of April relative to March. Importantly, data from Stats SA also suggests that there is a decline in the volume of new residential units in the planning stage (pipeline supply). Thus, while we expect a significant knock

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on demand, supply should also adjust lower. Heading into 2021, we expect the current supply-demand imbalance to gradually correct itself as market conditions normalise.

The recovery will likely be drawn out due to pre-existing weaknesses in consumer fundamentals, including low income growth and depressed sentiment. Historically low interest rates, the (expected) decline in house prices and lower transfer duties (particularly in the middle-priced segment) will, however, eventually support purchasing activity and facilitate a rebound in 2021. In short, these factors will improve affordability and this could potentially stimulate demand.

This "pent-up" demand will likely come from first-time buyers; millennials, who up to now have been relatively despondent participants in the property market; as well as investor-buyers (buy-to-let market) looking to capitalise on discounted prices. Millennials, crudely defined for our purposes as buyers younger than 35 years old in 2019, currently account for around 40% of market volumes. The same age group accounted for approximately 50% of the market 20 years ago (Figure 3). Accordingly, their participation has declined significantly, in part, due to affordability concerns.

Will this be enough to replace lost demand?

However, this may not be enough to replace lost demand. Therefore, our house price forecast features a "step-change" in level prices, i.e., permanent value destruction (Figure 2). In other words, it will take time for property prices to recover to 2019 levels. This is good for prospective buyers, but not so much for current owners.

A segment perspective

We expect pressure to reverberate across all price segments, although higher-end and luxury markets will likely be the hardest hit. This is mainly due to pre-existing supply-demand imbalances (excess supply) and depressed sentiment. The FNB Estate Agents Survey shows that sellers in this segment have to progressively lower their asking prices in order to close a deal. In 1Q20, the average discount was estimated at 12%, and as high as 17% for properties valued at R3.6m or more. This is also true, though less severe, for the middle segments.

In contrast, we expect a relative resilience in the more affordable housing segment of the market, partly due to a structural supply deficit (i.e., demand is higher than the available stock). In addition, property holds a high sentimental value in the lower end. This is evidenced by the relative infrequency of sales in the segment. That is, the same property rarely exchanges hands, and so the holding period is relatively longer – the average holding period in South Africa is 7.1 years, compared to an average of 9 years in the lower end. Thus, while new building stock is relatively scarce, the structural deficit is made worse by the infrequent listing of existing stock.

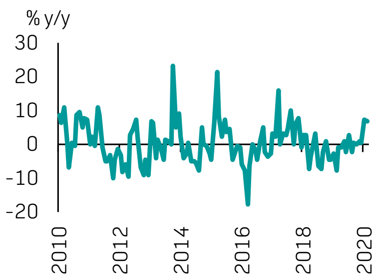
Buy-to-let activity is also stronger in the lower end, which supplements the already strong intrinsic demand. Importantly, however, there could be a wide disparity across regions. For instance, Soweto is currently the best performing region in Gauteng, with 1Q20 house price growth averaging 7.7% y/y. On the other hand, Orange Farm/Lenasia/Lawley, another low- to middle-income region, is the worst performing region, with -6.3% y/y in 1Q20. Similarly, in Durban, the best performing sub-region is Hammersadale, and the two worst performing are Umlazi and Chatsworth. All these are perceived as low- to middle-income areas. Ultimately, a lot will depend on local demand and supply conditions.

Weekly highlights

Mining production increases in February

Mining production increased by 7% y/y in February, following a rise of 7.5% in January. The resilient reading can be ascribed to a combination of base effects, as mining production decreased by 7.5% y/y in February 2019, as well as favourable commodity prices incentivising miners to increase extraction in high-cost areas of their mines.

Figure 4: Mining production



Source: EconoStat, Stats SA

The largest contributors to the February annual print were coal, which increased by 13.7% y/y and contributed 3.8 percentage points (ppt), followed by platinum group metals (PGMs) (+8.7% y/y and 1.8ppt) and gold (+11.5% y/y and 1.5ppt).

On a seasonally adjusted month-on-month basis, mining production actually decreased by 1% in February after climbing by 6.3% in January. The largest detractors were manganese ore (-30.9% m/m and -2.3ppt), followed by "other" non-metallic minerals (-12.2% m/m and -0.8ppt) and coal (-3.1% m/m and -0.8ppt). It should be noted, however, that PGMs were a significant positive contributor to the monthly number, increasing by 10.9% and contributing 2.5ppt.

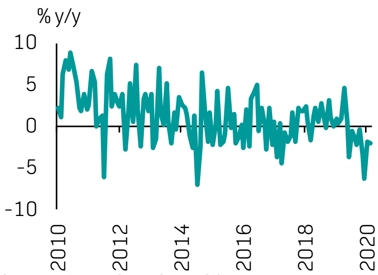
In the short term, we expect mining production to be hampered due to the lockdown in place to curtail the spread of Covid-19. This is because the majority of mining operations will only be permitted in batches and scaled up to full operation by level 3 according to the government's Risk-Adjusted Strategy report (see our Weekly of 15 May).

In a post-Covid-19 environment we expect the overall mining sector to have negative annual growth in 2020. It is worth noting that there are certain silver linings as some commodities will likely benefit from higher prices, such as gold – the price of which tends to rally during times of economic uncertainty as investors flock to safe-haven assets. In addition, PGMs such as palladium and rhodium, due to more stringent vehicle emissions standards particularly in Europe and China, will likely trend higher.

We are also encouraged by the high-frequency data for certain industrial and base metals such as iron ore, which has recently rallied amid higher steel production in China. In fact, production increased by 6% m/m to about 79 million tonnes in March as the Chinese labour force began returning to work after stringent Covid-19 lockdown measures.

Ninth consecutive contraction in manufacturing

Figure 5: Manufacturing production



Source: EconoStat, Stats SA

Manufacturing production decreased for the ninth consecutive month, contracting by 2.1% y/y in February 2020 following declines of 1.8% and 6.3% in January and December respectively. The largest detractors to the annual number were the following: basic iron & metal products which decreased by 4.8% y/y and detracted 0.9 of a percentage point (ppt); followed by wood, paper & publishing & products (-6.3% y/y and -0.7ppt); and clothing, footwear & textiles (-9.1% y/y and -0.3ppt).

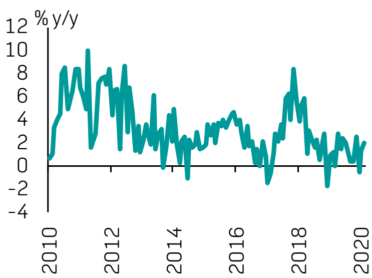
Unsurprisingly, the food & beverages division was the largest positive contributor and grew by 2.2% y/y, contributing 0.6ppt to overall annual manufacturing production. The resilience in this subsector is evident in the historical data. In fact, since 2017, the food & beverages division has only contracted in three months on an annual basis.

On a seasonally adjusted month-on-month basis, manufacturing contracted by 2.2% in February and declined by 2.2% in the December to February period when compared with the previous three-month period (September to November).

The outlook for the manufacturing sector remains bleak, particularly in the clothing, footwear & textiles, and motor vehicle parts & accessories subsectors. This is due to disruptions in global supply chains and strain in the domestic labour market as employment and income growth are expected to come under severe pressure amid stringent lockdown measures.

Valentines volumes propped up retail sales in February; but medium-term outlook is uninspiring

Figure 6: Retail sales



Source: EconoStat, Stats SA

The February retail sales volumes picked up momentum and increased by 2% y/y, from 1.3% in the previous month. Notable outperformers were sales by "Other" retailers (including online sales), which increased by 8.9% y/y, followed by Household furniture/Equipment and Clothing and Footwear, which rose by 4.7% y/y and 1.5% respectively. We ascribe the February spike in the "Other" category to the generally increasing online sales in SA, as well as demand related to Valentine's Day, including sales of jewellery and watches.

By contrast, Pharmaceuticals and retailers of Hardware and paint saw their sales volumes decline by 2% and 0.5% y/y respectively in February.

The seasonally adjusted volumes declined by 0.4% m/m from an increase of 0.5% in January (revised down from 0.9%). Retail sales inflation remained low, averaging just 2.9% y/y in February. We note that retail sales inflation has not broken above the 3% y/y mark in over 30 months. This depicts a muted consumer demand environment and is consistent with rising unemployment, slowing income growth and depressed consumer sentiment.

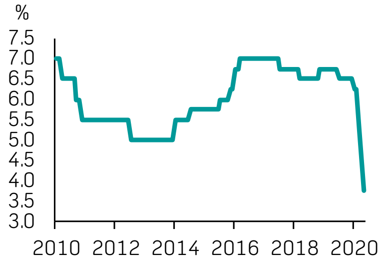
Looking ahead, we expect a spike in the March volume sales to reflect a wave of panic buying by SA consumers in anticipation of the national lockdown. Over the medium term, however, we expect consumer spending to take a significant knock due to: lockdown restrictions; loss of income because of the pandemic; and heightened uncertainty, which could result in an increase in precautionary savings by high-income households.

This view is supported by SA's mobility data which shows that foot traffic to grocery shops and pharmacies spiked in anticipation of lockdown restrictions ("panic buying"). During the lockdown period, data shows a collapse in volume (frequency and time spent in the shop) of these trips, which we read as an indication of muted shopping activity. This is further supported by internal card transactions data which shows a spike in spending in the days before lockdown and a sharp decline afterwards.

As such, we expect a decline in household spending in the medium to longer term, particularly on "non-essential" goods. Nevertheless, there are some factors that could lend support to the consumer during this time. These include aggressively lower interest rates, rising disinflationary pressures (including very low oil prices and rental inflation), as well as marginally lower income taxes – which should somewhat boost discretionary income. However, these factors, in our view, will be counteracted by the impact of a prolonged recession via weaker labour market outcomes and consumer sentiment shocks.

South African Reserve Bank cuts the repo rate by 50bps

Figure 7: Repo rate



Source: EconoStat, SARB

The South African Reserve Bank (SARB) opted to cut the repo rate by 50 basis points (bps) yesterday to 3.75%. Accordingly, the SARB has cut the repo rate by a cumulative 275bps since the beginning of the year. Three Monetary Policy Committee members voted for a reduction of 50bps, while the remaining two members preferred to ease by 25bps.

Stringent lockdown measures have negatively impacted supply chains and domestic demand, which have reduced growth and inflation expectations significantly. The SARB acknowledged that the pandemic is unlikely to end quickly and have downwardly revised their economic growth forecast to -7% (-6.1% previously) this year. Interestingly, the SARB has upwardly revised its growth projections in 2021 and 2022 to 3.8% and 2.9% respectively from 2.2% and 2.7% previously. On the inflation front, the SARB has downwardly revised its forecasts to 3.4% in 2020 (from 3.6%) and 4.4% in 2021 (4.5%), while their 2022 projection remained unchanged at 4.4%. Overall, the SARB views inflation risks as tilted to the downside. This is in spite of the rand depreciating by roughly 20.9% against the greenback since January as the pass-through to inflation is expected to be negligible given that consumers are becoming increasingly price elastic.

The Quarterly Projection Model indicates that the repo rate will be cut by a cumulative 50bps over the next two quarters in increments of 25bps. This is in line with our expectations of a further reduction in the repo rate of 50bps by year end. We maintain that a deterioration in the output gap will lead to a collapse in demand-pull inflation, which will likely embolden the SARB to slash the repo rate even further.

Week ahead

A number of data releases are scheduled for next week, including the March SARB leading indicator on Tuesday followed by March producer price inflation (PPI) on Thursday. The week then closes with April releases of private sector credit extension and trade balance data on Friday.

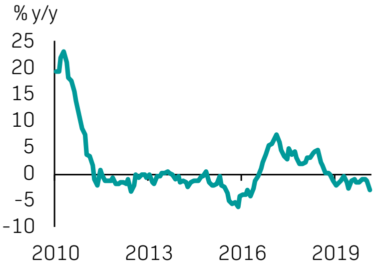
The **SARB leading indicator** has contracted on a year-on-year basis for 16 consecutive months, most recently falling 3.1% y/y in February. We expect much of the same in the March print, which may well begin to reflect the adverse impact on the economy due to stringent lockdown measures.

March **PPI** for final manufactured products is expected to move in tandem with the disinflation trend of CPI. The significant decline in international oil prices, in particular, is expected to keep overall price pressures well contained.

Private sector credit extension to households and corporates surprisingly jumped to 7.8% y/y in March from 5.2% in the previous month. This was solely supported by advances to the corporate sector with the March outrun quickening to 9.6% y/y from 4.5% in the previous month. Part of this demand could have been due to corporates anticipating cash flow constraints associated with the Covid-19 pandemic. Household credit extension growth, on the other hand, continued to moderate, reflective of muted consumer demand and weakening household balance sheets. We expect the April print to likewise depict divergent trends – relatively stronger uptake by corporates, but weaker household credit extension.

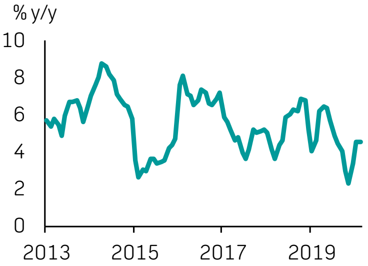
After one of the largest **trade surpluses** on record of R24.3 billion in March, we anticipate that both export and import volumes declined precipitously amid stringent lockdown measures both locally and globally. It is difficult to tell which trade impact will be the larger of the two for April in isolation, however, we anticipate another trade surplus in the April release. While the closure of most mining activity during the month would likely have dampened export sales, we expect the significant drop in oil prices – a sizeable portion of the import basket – and dampened local demand to have constrained foreign purchases even more relative to export volumes.

Figure 8: SARB leading indicator



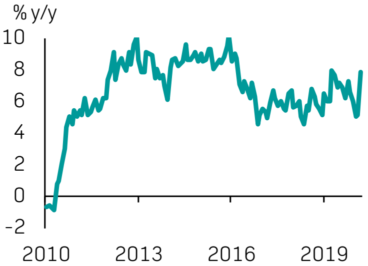
Source: EconoStat, SARB

Figure 9: PPI for final manufactured goods



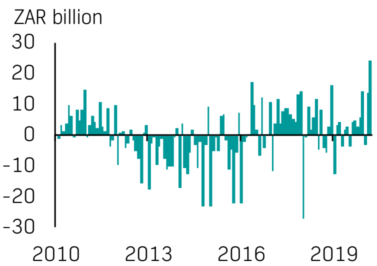
Source: EconoStat, Stats SA

Figure 10: Private sector credit



Source: EconoStat, SARB

Figure 11: Trade balance



Source: EconoStat, SARS

Tables

The key data in review

Date	Country	Release/Event	Period	Act	Prev
15 May	US	Industrial output (% m/m)	Apr	-11.2	-4.5
19 May	SA	Mining production (% y/y)	Feb	7.0	7.5
	SA	Manufacturing production (% y/y)	Feb	-2.1	-1.8
20 May	SA	Retail sales (% y/y)	Feb	2.0	1.3
	UK	CPI (% y/y)	Apr	0.8	1.5
	Eurozone	CPI (% y/y)	Apr	0.3	0.7
21 May	SA	Repo rate (%)	May	3.75	4.25
	US	Existing home sales (% m/m)	Apr	-17.8	-8.5

Data to watch out for this week

Date	Country	Release/Event	Period	Survey	Prior
26 May	SA	SARB leading indicator	Mar	100	103
	US	New home sales (% m/m)	Apr	-21.9	-15.4
28 May	SA	PPI (% y/y)	Mar	-	-
	US	Durable goods orders (% m/m)	Apr	-18	-14.7
	US	Initial jobless claims (000s, w/w)	23 May	-	2 438
29 May	SA	Private sector credit (% y/y)	Apr	7.9	7.8
	SA	Trade balance (ZAR billion)	Apr	19.3	24.2

Source: Bloomberg ("Survey" is the consensus forecast)

Financial market indicators

Indicator	Close	1 W	1 M	1 Y
All Share	51 022.76	3.9%	7.1%	-8.1%
USD/ZAR	17.59	-4.6%	-7.3%	22.2%
EUR/ZAR	19.26	-3.4%	-6.5%	19.9%
GBP/ZAR	21.50	-4.7%	-7.9%	17.5%
Platinum US$/oz	837.65	8.5%	11.8%	2.6%
Gold US$/oz	1 727.00	-0.2%	2.4%	35.5%
Brent US$/oz	36.06	15.8%	86.5%	-50.0%
SA 10-year bond yield	7.26	-7.8%	-18.8%	-14.2%

FNB SA Economic Forecast

Economic Indicator	2017	2018	2019	2020f	2021f	2022f
Real GDP % y/y	1.4	0.8	0.2	-8.0	5.5	0.5
Household consumption expenditure % y/y	2.1	1.8	1.0	-7.0	3.2	0.5
Gross fixed capital formation % y/y	1.0	-1.4	-0.9	-31.6	5.0	-0.6
CPI (average) % y/y	5.3	4.6	4.1	3.0	3.7	4.0
CPI (year end) % y/y	4.7	4.5	4.0	2.5	3.9	4.7
Repo rate (year end) % p.a.	6.75	6.75	6.5	3.25	3.25	3.25
Prime (year end) % p.a.	10.25	10.25	10.00	6.75	6.75	6.75
USD/ZAR (average)	13.3	13.3	14.4	16.9	15.5	16.3

Source: FNB

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