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PROPERTY INSIGHTS
– SARB Interest Rate Decision

SARB decides to hike interest rates, which is likely to sustain the correction in the property market in the near term.

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FNB COMMERCIAL PROPERTY FINANCE

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Today, the SARB (South African Reserve Bank) MPC (Monetary Policy Committee) decided to lift its policy Repo Rate from 6.5% to 6.75%. This will lead to commercial banks lifting their Prime Lending Rates from 10% to 10.25%.

Firstrand Economics Team had expected the hike interest rate hike, although it had been a close call, with the economy weak, the Rand reasonably well behaved recently, and CPI inflation still well within the target range.

The SARB acknowledged an improved inflation outlook since the previous MPC meeting, given a mildly stronger Rand and lower oil prices of late, but remains focused on 2nd round inflation effects that can emanate from the prior oil price spike and Rand weakness. The forecasts CPI inflation rising to 5.5% in 2019, up from a forecast 4.7% for the current year. Such a forecast for 2019 is still within the 3-6% target range, but the MPC noted that this would be above the mid-point of the target range.

Coming at a time when the economy is very weak, the decision is likely to dampen confidence in the Property Market further, sustaining the gradual correction in the market.

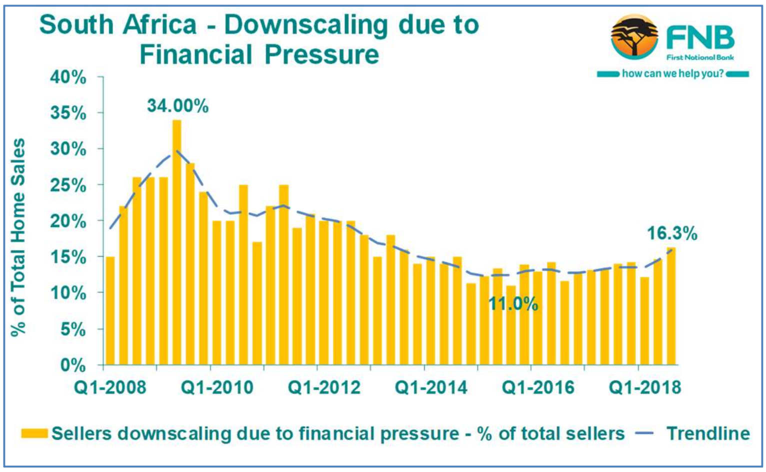
We see potential key impacts of the decision on the Property Market as follows:

1. The Property Market is likely to see confidence levels deteriorate. Although one 25 basis point rate hike makes little difference in rand terms, it comes at a bad time given that SA is into the 7th year of broad economic stagnation, and the property market has been gradually feeling increased pressure. The rate hike is thus likely to contribute the Property Market correction continuing.

2. The All Commercial Property Vacancy Rate is likely to continue to rise in the near term.

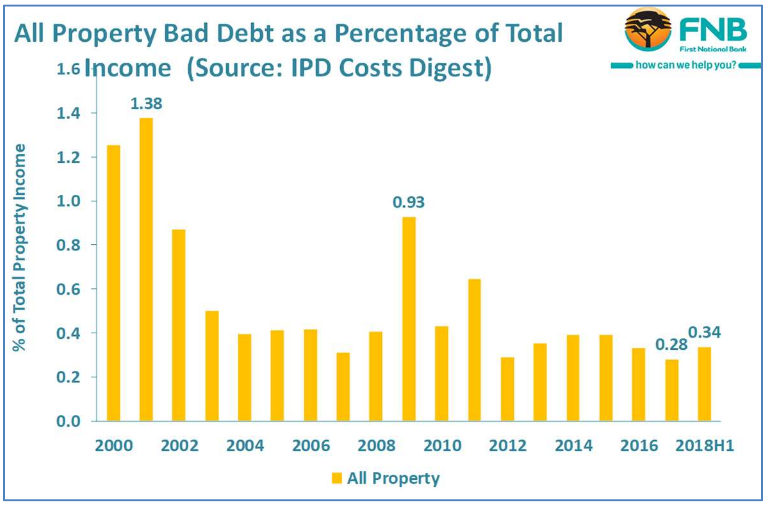
3. Commercial Capitalisation (Cap) rates are expected to rise in the near term. The rising Government Debt-to-GDP Ratio, along with the expectation of further short term rate increases next year, is expected to gradually drive long bond yields higher, while rising vacancy rates should also to play a role in taking Cap Rates higher.

4. The rate hike decision, in the current weak economic environment, is thus likely to keep property values declining in “real” terms, “real” referring to property price growth adjusted for general economy-wide inflation.



Although financial stress levels in the Property Market appear relatively low still, there has been a recent mild increase observed, and this is expected to continue subsequent to the rate hike decision.

In the Residential Market, the FNB Estate Agent Survey returned an estimate of 16.3% of home sellers believed to be "selling in order to downscale due to financial pressure". This comes after a gradual multi-year rise from 11% late in 2015.



On the Commercial Property side we have only seen a small hint of rising financial stress in the tenant market, with the 1st half 2018 IPD statistics showing 0.34% of property income being attributed to bad debts written off along with related costs (such as legal costs), which was slightly up from 0.28% in 2017. This rise is not yet enough to confirm a trend, but we expect a further increase in the near term.