July 2022

Property Barometer.

3.4%
y/y FNB HPI

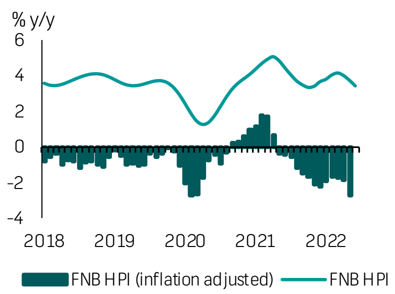
50.60
Market strength index

9 weeks & 4 days
Time on market

Key themes:

- Market volumes remain relatively supported, but softening. Sentiment and forward-looking activity indicators suggest more weakness ahead. However, this varies by location and price segment.
- The risk of a less transitory rise in inflation and higher inflation expectations, and the more aggressive policy tightening in advanced markets, should result in the SARB further front-loading interest rate hikes. We now expect 50bps hikes in July, September and November, bringing rates to 6.25% by end of 2022. We pencil in another 25bps in January 2023, which will bring the terminal rate to the pre-pandemic level of 6.5%.
- The steeper-than-expected interest hikes suggest a less supportive environment for home buying activity. However, the shift in housing needs and the intensifying competition among lenders, should continue to support activity.
- While hiring intentions indices continue to suggest a recovery in headcount in certain industries, we are concerned that the more intense bouts of load shedding may dim these expectations.

Figure 1: FNB HPI

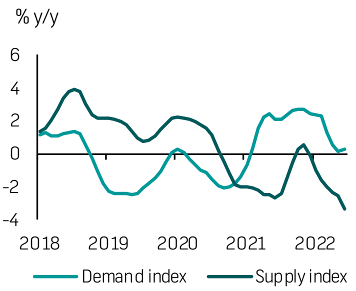


Source: FNB Economics

Annual house price growth moved lower in May

The FNB House Price Index growth moved slightly lower in June, averaging 3.4%y/y from 3.8% in May (revised up from 3.7%) (Figure 1). This takes the 2Q22 average house price growth to 3.7%, versus an average inflation forecast of 6.6% during the same period. Slower price growth is on the back of softer demand, amid higher living costs and the waning interest rate support (Figure 2). Nevertheless, the home buying market remains resilient, as reflected by the still strong market volumes (Figure 3). We maintain our expectation of average house price growth of 3.5% y/y this year, lower than the 4.2% registered in 2021. As we show below, outcomes vary across market segments.

Figure 2: Market Strength indices



Source: FNB Economics

Estate agents survey results for 2Q22

Summary: As expected, the FNB Estate Agents Survey showed signs of a softening market. Market activity weakened in 2Q22, and this is corroborated by the lengthening time properties remain on the market for sale. The survey shows souring sentiment in the KwaZulu-Natal (KZN) region, following the devastating floods. This, combined with the impact of riots in July last year, should have a lingering effect on the KZN property market. The survey also shows renewed resilience in the affordable market, and this is corroborated by internal applications data. As argued before, we believe innovation should support activity in this market, which in the bigger scheme of things, remains underserved relative to the traditional market.

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Market activity weakened from a rating of 6.8 (out of 10) in 1Q22, to 6.1 in 2Q22. This is the lowest rating in the post-pandemic period, but still above the long-term average (since 2004) of 5.9. Softer activity was recorded in KZN and the Eastern Cape (EC), while the Western Cape (WC) reading remained unchanged from the previous quarter. Surprisingly, the survey shows an improvement in Gauteng (GP), supported by stronger buying activity in the affordable market. Activity softened across all the price segments that we track, with the affordable market faring relatively better in 2Q22.

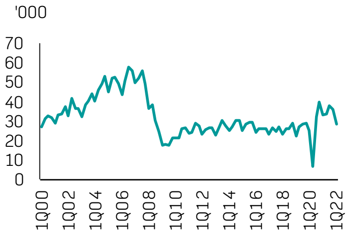
Looking ahead, expectations of near-term activity (in the next three months) deteriorated further, with only 1 in 5 expecting activity to increase from current levels, from a third of respondents (31%) in the previous quarter. Rising interest rates are reported as a key factor in determining agents' expectations, followed by weaker economic outlook. Agents in the affordable market still expect reasonable activity, with 49% expecting a further increase in activity in the next three months, versus 9% in the traditional market.

Average time properties spent on the market for-sale lengthened to nine weeks and four days, from approximately eight weeks in the previous quarter. Nevertheless, this is still below the long-term average of approximately 13 weeks (since 3Q04), but approximately a week longer than the post-pandemic average. This varied markedly across regions, with WC (eight weeks, one day) and EC (nine weeks and four days) faring better. KZN and GP recorded the longest time on market, at approximately ten weeks, up from seven weeks and nine weeks respectively. By price segment, the R1.6m-R2.6m bracket recorded the shortest time of eight weeks and six days, albeit up from six weeks and four days.

Estate agents' sentiment, as measured by the proportion of agents who are satisfied with prevailing market conditions, receded marginally to 73% from 76% previously. This was largely driven by the relative pessimism in the KZN region, which saw sentiment receding to 62% from 75% previously. While concerning, this is still above the riot-induced reading of 51% in July 2021. From a price perspective, the decline in sentiment was more prominent in the R1.6m-R2.6m price bracket, followed by the >R3.6m bracket, where a decline in sentiment coincided with the advent of the Russia/Ukraine war. Overall, data suggests relative optimism in the affordable segments.

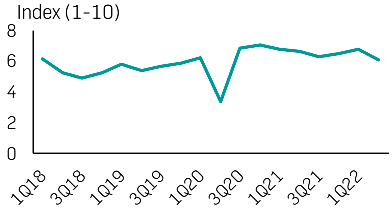
The reason for selling matrix remained broadly unchanged from the previous quarter and shows that sales due to financial pressure are still elevated at an estimated 20% of the market, while emigration-related sales remain stable at around 8%. This ratio, however, increases to around 15% in the R2.6m-R3.6m and >R3.6m segments. Relocation withing SA has increased from 8% in 1Q20 to 13% in 2Q22, in line with the changing housing preferences due to WFH trend. Internal data shows that the semigration trend is largely driven by the relocation path from GP to the neighbouring North West province (Haarteebeersport) as well as coastal towns in the WC (Hermanus, Mosselbay, George, Cape Town) and KZN (mainly Ballito).

Figure 3: Mortgage volumes



Source: FNB Economics from Deeds Office

Figure 4: Estate Agents survey: Activity levels



Source: FNB Economics from Deeds Office

Figure 5: FNB Estate Agents survey: Reasons for selling

	1Q22	<R750k	R750k - R1.6m	R1.6m - R2.6m	R2.6m - R3.6m	>R3.6m
Downscaling due to financial pressure	20%	34%	18%	18%	8%	14%
Upgrading	14%	18%	15%	12%	12%	10%
Downscaling with life-stage	22%	11%	23%	27%	26%	29%
Security concerns	6%	5%	9%	5%	6%	4%
Emigrating	8%	3%	4%	10%	14%	14%
Relocating	13%	14%	13%	11%	15%	14%
Change in family structure	11%	6%	12%	12%	16%	12%
Moving to be closer to work or amenities	6%	9%	7%	5%	3%	3%

Source: FNB

Outlook

Growth outlook: recovery clouded by load shedding and external headwinds

The economy grew by a more-than-expected 1.9% q/q (3.0% y/y) in the first quarter, marking an excellent start to the current calendar year. Subsequently, the level of real GDP reverted to the pre-pandemic level settling at 0.5% above the 4Q19 level. This reflected a complete recovery in the finance, real estate and business services, general government and personal services sectors. Meanwhile, the industrial sectors of the economy, including the tourism-related sectors, had still not completely recovered. This shows the fragility of the ongoing recovery, and is echoed by the protracted recovery in full-time employment while part-time employment has fully recovered.

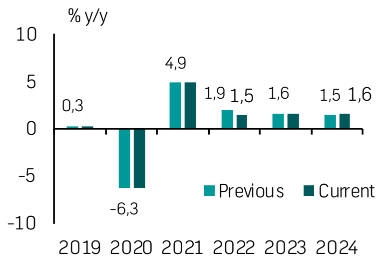
The economy confronts significant headwinds, posing a downside to the recovery. These include elevated production and input costs, infrastructure bottlenecks, and persistent water and electricity supply disruptions. The ongoing resilience in consumer spending will likely wane over the medium term as rising interest rates and higher prices erode consumer purchasing power. We are particularly concerned about the growing impact of higher load shedding stages and the possibility of a worse-than-expected global growth slowdown. Subsequently, we have lowered our current year's growth forecast to 1.5% from 1.9% and we are concerned about the elevated risk of a near-term technical recession, although this is not our base case. Growth should average 1.7% between 2023 and 2025. This forecast reflects our estimate of an economic contraction in the 2Q22, as the economy likely suffered materially from flooding in KZN, intense load shedding and labour unrest. In addition, our growth prognosis assumes a combination of stage three and stage four load shedding in the near-term horizon. Nevertheless, load shedding should ultimately ease in the second half of next year with the ongoing planned maintenance at Eskom and regulatory allowance for the private sector to produce 100MW of power without the need for a license.

Inflation and interest rate outlook: SA not bucking the global trend

SA's headline inflation recorded a quick acceleration in the latest data. This was an indication that local inflation was following the global trend of above-target inflation and aggressive monetary policy tightening as a result. Our expectations of headline inflation have been adjusted upwards and we currently project inflation to peak above 8% and average 7.2% this year. Inflation moderates to 5.8% next year and 4.4% in 2024. The near-term upward adjustment to headline is driven by elevated fuel and food price pressures. Fuel and food inflation are expected to average 41.9% and 8.8% this year, respectively, before slowing considerably in 2023. While fuel and food cost pressures moderate next year, second-round effects from these supply-side shocks keep headline inflation sticky, threatening to be less transitory. More of the elevated input and distribution costs are likely to be passed onto consumers and should reflect in various consumer items, resulting in a broad-based increase in inflation. More importantly, elevated food and fuel costs will create pressure on real incomes, pushing households to seek higher wage increases. This is especially true for lower-income households who allocate over 50% of their spending to food and are severely exposed to rising public transport costs. Wages and inflation expectations are sticky and will lift structural inflation in the economy.

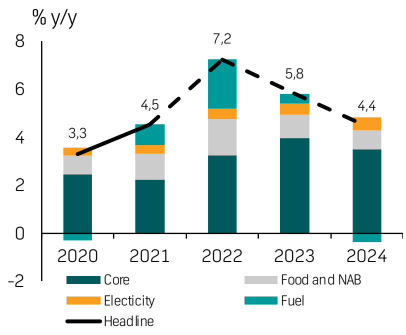
The risk of a less transitory rise in inflation and higher inflation expectations, a faster recovery in GDP, and more aggressive policy tightening in advanced markets, particularly the Fed, should result in the SARB further front-loading interest rate hikes. We now expect 50bps hikes in July, September and November, bringing rates to 6.25% by the end of 2022. We pencil in another 25bps in January 2023, which will bring the terminal repo rate to the pre-pandemic level of 6.5%.

Figure 6: GDP growth outlook



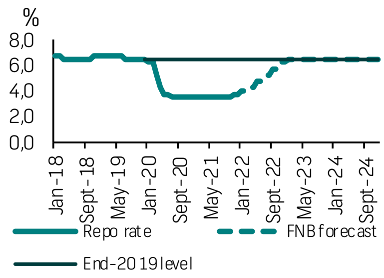
Source: Stats SA, FNB Economics

Figure 7: Inflation outlook



Source: Stats SA, FNB Economics

Figure 8: Repo outlook



Source: SARB, FNB Economics

Residential property market resilient

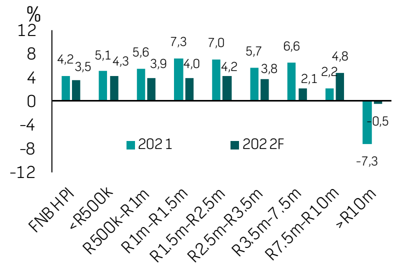
Global context

Global housing markets remain strong following the support from ultra-low interest rates during, and in the aftermath of, the pandemic. Strong demand for housing was particular in advanced economies where aggressive liquidity stimulus was implemented and strong wage growth was recorded when economies opened up. The strength in emerging markets was not as pronounced and household balance sheets were more severely affected by labour market vulnerabilities. Going into 2022, the Russia-Ukraine conflict created a fresh bout of uncertainty, exacerbating supply chain disruptions, slowing the momentum in global growth and raising inflation expectations. In the latest World Economic Outlook, the IMF has lowered global growth projections by nearly a full percentage point relative to their pre-war forecast. Inflation projections are up 1.8ppt for advanced economies and 2.8ppt for emerging markets. The World Bank has also downgraded forecasts for over 80% of advanced economies and nearly 70% of emerging markets, also showing that 100% of advanced economies (nearly 90% of emerging markets) have inflation above target in April 2022. This should place further pressure on monetary policy to raise interest rates to curb inflation, tightening global financial conditions and further slowing activity. This will have a more prominent impact on emerging markets, which are more exposed to financial stress. For the housing market, this should dampen demand, fasttracking the slowdown in house price growth.

Domestic home buying market

Buying activity should soften in the coming months from the pandemic-induced elevated levels as affordability continues to deteriorate due to steeper interest rate increases and higher living costs. Nevertheless, we expect relative resilience. First, the post-lockdown wealth accumulation, buoyed by ultra-low interest rates and changes in housing preferences, helped strengthen houshold balance sheets. In addition, debt-to-income and debt-servicing costs ratios remain low by historical standards. We expect these to remain relatively well-behaved, even with the steeper interest rate hikes. Further, the intensifying competition among lenders for good quality customers, and innovation to boost affordability should support activity, leaning against the effects of rising borrowing costs (more on this below). In addition, non-labour income remains robust, providing impetus in some market segments. Overall, we maintain our forecast of average house price growth of around 3.5% this year, lower than the 4.2% average next year. For next year, we expect house price growth to average 3.4%.

Figure 9: House price growth forecast



Source: FNB Economics

Below, we summarise our segment views:

The affordable market: We expect price growth to moderate this year, relative to the strong growth in the prior few years, as labour market weaknesses and higher interest rates erode affordability. Importantly, however, greater focus on this segment by some lenders, which has yielded innovations to improve affordability such as the greater uptake of longer duration mortgages (e.g. 360 months payment term; collective buying schemes; and the better administration of FLISP[1]) should provide impetus. In part, these dynamics are already reflected in the Estate Agents survey, which shows relative optimism in this segment. Given the inherent property supply deficit and the general preference for ownership, we expect limited downward pressure on price growth in the segment.

Middle priced segments: Buying activity and house price growth should continue moderating from unusually strong levels post-pandemic, as interest rate increases weigh, and rent-to-ownership migration dries up. Our estate agents survey also sees a moderation in activity in the coming months, particularly in the R1.6m-R2.6m price bracket, which was among the post-pandemic outperformers.

Affluent markets: Buying activity has been supported by good pricing, strong recovery in non-labour income, post-pandemic improvement in balance sheets and the WFH trend. Supply-side factors should also remain supportive of price growth as emigration-related sales have slowed since the recent peak in 2019 and there is less supply pressure from the construction of new properties.

Rental market

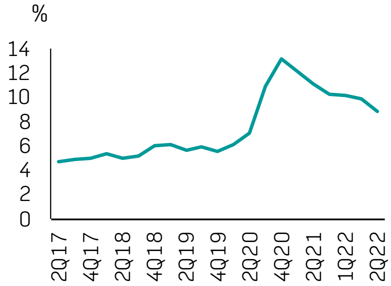
Rental inflation has continued its gradual normalisation, rising by 1.9% y/y in the latest data. We expect rental inflation to lift to over 2.0% on average in 2022, from 0.9% last year. Nevertheless, rental inflation remains muted compared to aggregate core inflation, which recorded 4.1% y/y growth and headline inflation, which was 6.5% y/y in May. The gradual normalisation in rental inflation is in line with improved mobility as more people revert to in-office work, along with the recovery in aggregate incomes and household demand. However, the pace of recovery will continue to be constrained by weak employment growth, full-time employment in particular, and a rising cost of living. Higher petrol prices may also push many

[1] Finance Linked Individual Subsidy Programme, a government subsidy for first-time home buyers.

to continue working from home but this may be dampened by load shedding. Higher interest rates may divert some homeownership demand to rentals, while pushing some landlords to increase rental escalations.

Vacancy rate indicators have slowed from pandemic-induced highs of over 13% to below 9% in the latest data, but remain above the pre-pandemic levels.[2] Indications of rental market strength have turned positive and rising demand should provide further support for rental escalations and lower vacancy rates. However, the advent of office-to-residential property convertions should weigh on the market as indications from our building confidence survey shows some momentum in the conversion of office space into residential (rental) units, particularly in office-heavy areas such as Sandton. In addition, the impact of the elevated cost of living on consumer sensitivity to escalations and business exposure to delinquencies should be another factor. Nevertheless, the ongoing recovery in tourism could alleviate oversupply in some segments, albeit at a slow pace.

Figure 10: Rental market: Vacancies.



Source: Rode's, FNB Economics

[2] TPN 1Q22 Vacancy Survey and Rode's 2Q22 Report on the South African Property Market.

Monthly FNB House Price Index (% y/y)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001		-1,7	-0,7	-0,4	-0,5	0,7	3,0	5,9	8,6	10,6	11,6	11,8
2002	11,6	12,0	12,8	13,8	14,2	14,0	13,6	13,1	13,2	13,5	13,8	13,8
2003	14,0	14,5	15,3	16,2	17,1	18,2	19,3	20,3	21,4	22,9	24,7	27,0
2004	29,4	31,3	32,4	33,2	33,7	33,9	34,5	35,1	35,3	35,2	35,3	35,4
2005	34,8	33,8	32,9	31,8	30,7	29,7	28,8	27,9	26,9	25,7	23,9	21,7
2006	19,9	18,5	17,6	17,3	17,3	17,2	16,9	16,5	15,8	15,1	14,4	14,0
2007	14,0	14,3	14,9	15,7	16,3	16,6	16,3	15,5	14,5	13,2	12,0	11,0
2008	9,7	8,0	5,5	2,5	-0,4	-2,9	-4,7	-5,6	-5,8	-5,6	-5,1	-5,1
2009	-5,0	-5,0	-4,5	-3,8	-2,8	-1,8	-0,7	0,0	0,5	0,9	1,2	2,0
2010	3,0	3,9	4,6	5,2	5,6	5,5	5,0	4,7	4,5	4,1	3,7	3,1
2011	2,4	2,1	2,0	2,2	2,5	2,8	3,3	3,6	3,8	3,9	4,1	4,4
2012	4,7	4,8	4,8	4,7	4,6	4,7	4,9	5,2	5,6	5,7	5,8	5,8
2013	5,9	6,0	6,1	6,1	6,1	6,3	6,5	6,4	6,3	6,5	7,0	7,7
2014	8,2	8,3	8,2	8,3	8,4	8,3	8,0	7,8	7,6	7,2	6,8	6,2
2015	5,8	5,9	6,3	6,5	6,6	6,4	6,3	6,2	6,1	6,2	6,3	6,3
2016	6,3	6,2	6,1	6,0	5,9	5,8	5,7	5,6	5,4	5,1	4,8	4,8
2017	4,7	4,6	4,5	4,3	4,2	4,1	4,1	4,2	4,2	4,2	4,0	3,8
2018	3,5	3,3	3,4	3,5	3,7	3,8	3,9	4,0	4,1	4,2	4,1	4,0
2019	3,8	3,6	3,4	3,4	3,4	3,5	3,6	3,7	3,8	3,7	3,5	3,0
2020	2,4	1,9	1,4	1,3	1,4	1,7	2,3	2,8	3,2	3,6	3,8	4,1
2021	4,4	4,7	4,9	5,1	4,9	4,5	4,1	3,7	3,5	3,3	3,4	3,7
2022	3,8	4,0	4,2	4,0	3,8	3,4						

ADDENDUM - NOTES:

Note on The FNB House Price Index:

The FNB Repeat Sales House Price Index has been one of our repertoire of national house price indices for some years, and is based on the well-known Case-Shiller methodology which is used to compile the Standard & Poor's Case-Shiller Home Price Indices in the United States.

This "repeat sales approach" is based on measuring the rate of change in the prices of individual houses between 2 points in time, based on when the individual homes are transacted. This means that each house price in any month's sample is compared with its own previous transaction value. The various price inflation rates of individual homes are then utilized to compile the average price inflation rate of the index over time.

The index is compiled from FNB's own valuations database, thus based on the residential properties financed by FNB.

We apply certain "filters" and cut-offs to eliminate "outliers" in the data. They main ones are as follows:

- The maximum price cut-off is R15m, and the lower price cut-off is R20 000.
- The top 5% of repeat sales price growth rates, and the bottom 5% of growth rates are excluded fromthe data set.
- Repeat transactions that took place longer than 10 years after the previous transaction on the same home are excluded, as are repeat transactions that took place less than 6 months after the previoustransaction on the same home.
- The index is very lightly smoothed using Central Moving Average smoothing technique.

Note on the FNB Valuers' Market Strength Index:

When an FNB valuer values a property, he/she is required to provide a rating of demand as well as supply for property in the specific area. The demand and supply rating categories are a simple "good (100)", "average (50)", and "weak (0)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of 0 to 100. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating, add 100 to the difference, and divide by 2, so that the FNB Valuers' Residential Market Strength Index is also depicted on a scale of 0 to 100 with 50 being the point where supply and demand are equal.