PROPERTY INSIGHTS
– SARB Interest Rate Decision

SARB leaves interest rates unchanged, but downward pressure on real property values is expected to remain in place

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FNB COMMERCIAL PROPERTY FINANCE

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Today saw the SARB (South African Reserve Bank) Monetary Policy Committee (MPC) leaving its policy Repo Rate unchanged at 6.5%, which in turn will lead to the Prime Lending Rate of major commercial banks remaining unchanged at 10%.

This unchanged decision was in line with the Firstrand expectation.

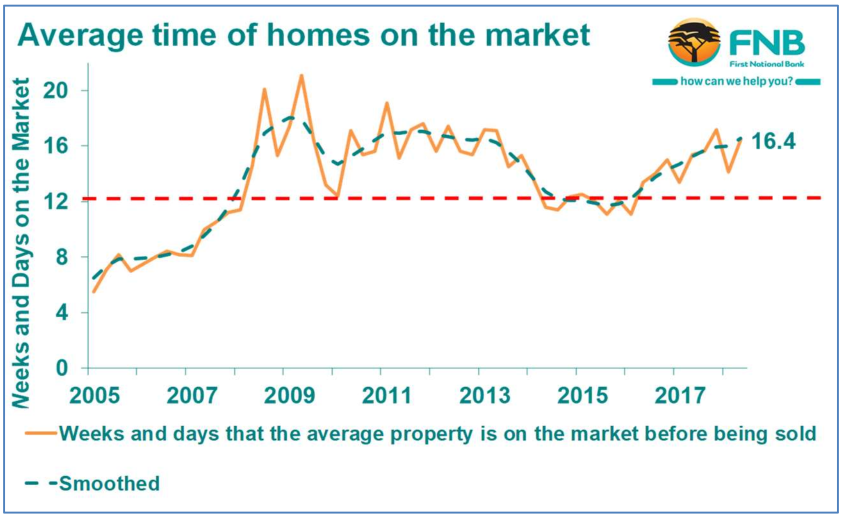
Despite some recent sources of upside inflationary risk, most notably strong oil prices and resultant local petrol price hikes along with recent Rand weakness exerting upward pressure on imported prices, the August CPI (Consumer Price Index) inflation reading was 4.9%, still comfortably within the SARB's 3-6% target range.

For the property market, an unchanged decision at this stage is expected to keep it on a weakening path. Given that the economy plods along in recessionary territory, it would have required rate cutting stimulus to end the gradual decline in real property values under way.

Housing Market expected to remain in real price declining territory as it moves further away from demand-supply equilibrium

In the housing market, low single digit house price growth, according to the FNB House Price Index, has not kept pace with general inflation in the economy, as measured by CPI inflation, translating into gradual house price decline in real terms (when adjusting house price inflation for CPI inflation) since early 2016. The interest rate decision, we believe, will not alter the path of real house price decline in what is currently a very low growth economy with slow job creation and real household income growth.

Accompanying average price decline is expected to be a further shift away from demand-supply equilibrium, reflected in a likely further increase in the average time of homes of the market from our 16 weeks and 4 days estimated average as per the FNB Estate Agent Survey.



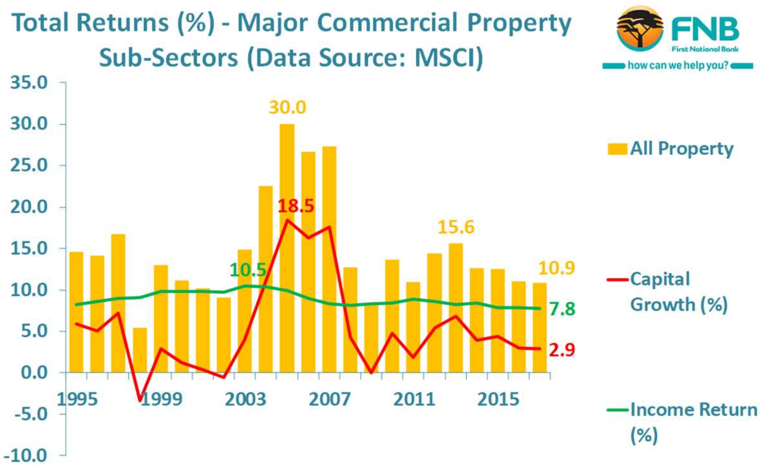
Commercial Market also expected to see real decline in capital values as upward pressure is exerted on capitalization rates

The environment remains one likely to exert upward pressure in capitalization (Cap) rates resulting in property values coming under pressure in real terms.

This we say partly because, although rates did not rise today, our Firstrand expectation is for CPI inflation to move nearer to the 6% upper target limit, precipitating a hiking cycle to commence possibly late this year.

But it is more than merely short term interest rates. An ongoing stagnant economic environment for the foreseeable future, in the absence of interest rate cutting or any other obvious stimulus, is expected to see commercial property vacancy rates rising, exerting downward pressure on rental growth prospects.

Furthermore, a weak economy keeps government tax revenues under pressure, which along with short rate increases in the near term can exert upward pressure on Government Long Bond yields.



We would thus expect higher cap rates and slowing capital growth to translate into declining real commercial property values at the current time and heading into 2019, in similar fashion to the housing market.

Already, we have seen a slowing Commercial Property market for some time, very much tracking residential's direction gradually slower.

MSCI All Property Total Returns have slowed from a 15.6% in 2013 to 10.9% by 2017 with 2018 anticipated to be still weaker.

This has included a slide in average capital growth per square metre (net of capex) from 6.8% in 2013 to 2.9% in 2017 (negative in real terms).

Give the current economic weakness and poor sentiment, the unchanged decision can cause households to become still more conservative in their spending habits

The combination of the ongoing economic weakness and sideways movement in interest rates could cause the consumer to become still more cautious with spending habits. We have already seen signs of this in recent years in the residential market in the form of less selling of homes in order to upgrade, a greater portion of financially pressured sellers opting for rental as opposed to buying, and a slowing pace of non-essential secondary home buying. In Household Sector data we have also seen some rise in the net savings rate in recent times, and we would expect more such increase in the near term as part of the shift to greater caution.

While a higher savings rate has longer term benefits for households, and is desperately needed, in the short term this constrains consumer spend and thus retail sales. A more cautious consumer at a time when job creation and income growth is already constrained by recessionary conditions, can thus be a direct short term constraint for both the Housing and Retail Property Markets.

In short, today's unchanged interest rate decision means no stimulus for an economy already under pressure, and only forecast to grow by 0.7% this year. This mix of economic weakness and lack of rate cutting stimulus leads us to expect a continuation of low single digit house price growth which is negative in real terms, rising cap rates and downward pressure on real commercial property values too, thus sustaining the gradual weakening property market trend of recent years.

The Firstrand forecast is for interest rates to begin to rise late this year.