October 2019

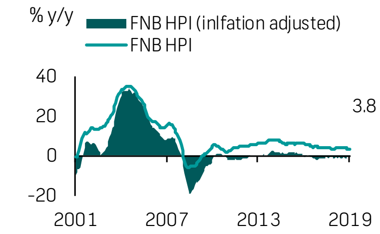
Q3 Property Barometer.

+3.8%
y/y FNB HPI

+0.3%
m/m FNB HPI

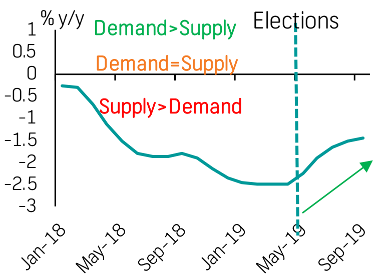
49.1
FNB Valuers' Market Strength Index

Figure 1: FNB HPI



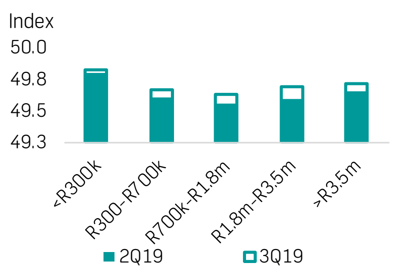
Source: FNB Economics

Figure 2: Supply-Demand gap narrowing post elections



Source: FNB Economics

Figure 3: Market is relatively stronger in the lower end



Source: FNB Economics

Easing lending conditions supportive of purchasing activity

Price developments and market strength

The FNB HPI edged up moderately to 3.8% y/y in September, from 3.7% y/y in the previous month (marginally revised up from 3.6% y/y). This takes average quarterly growth to 3.7% y/y in 3Q19, lifting from 3.4% y/y in 2Q19. While price growth remains below inflation, mild improvements in demand and progressive mortgage lending have supported the residential property market in 3Q19. However, depressed labour markets continue to weigh on household finances, which poses a threat to sustained demand growth.

FNB Market Strength Index (a composite index, which gauges demand and supply strength) has revealed a narrowing demand-supply gap over the past few months. This is on the back of both the mild improvement in demand, and the persistently slowing pace at which properties enter the market for resale. This is countered somewhat by the surge in the supply of new stock (particularly flats and townhouses), as well as the rising emigration-related sales. On the demand side, the improvement can be attributed to the increased bargain hunting amid attractive pricing in the middle- to upper-priced segments, increased competition between mortgage lenders as well as lower interest rates.

A further disaggregation of the 3Q19 data shows that this (market strength) improvement was largely broad-based across price buckets. However, data shows the lower-end of the market to be relatively stronger. This is primarily due to inadequate supply of well-priced properties close to economic opportunities, but also relatively stronger demand. Contrastingly, supply of mortgages (in volume terms) to the lower-priced bands remains relatively conservative, effectively constricting purchasing activity. Noticeable improvements were evident in the affluent segment (price band of R3.5m or more) in 3Q19. This gives credence to our thesis that buyers were capitalising on attractive discounts in higher-priced segments. Nevertheless, the FNB Market Strength Index continues to gauge the overall market to be below equilibrium point, suggesting that market conditions still favour buyers.

Easing lending conditions: Mortgage advances and loan-to-price ratios

While the property market has generally underperformed this year, recent mortgage advances have provided some support, injecting much-needed

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liquidity into the market. SARB data shows that mortgage advances have grown at a progressively faster pace, recording 4.9% y/y in August – the highest growth since November 2010. In fact, since the beginning of this year, mortgage advances have outpaced average house price growth in South Africa for the first time in since June 2011. Transactions data shows that this has boosted transaction volumes, specifically in the R700k–R1.8m and R1.8m–R3.5m price bands.

Using Deeds data, we have estimated the loan-to-purchase price (LTP) ratio for each transaction and averaged these to represent the entire market. We find that LTP ratio has gradually increased over the last two years, reaching 90.6% in 2Q19, up from 88% in 2Q17. While still some distance below all-time high of 96.8% in 4Q07 (at the height of the property boom), this represents the highest LTP in over a decade (since the end of 2008). Thus, not only has there been mild growth in the volume of mortgage transactions, but lenders are also, on average, willing to finance a relatively bigger proportion of the purchase price.

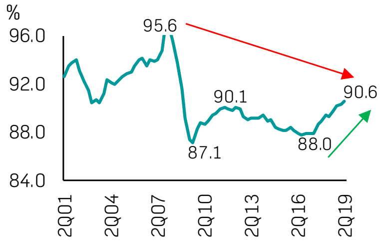
It is difficult, however, to reconcile the rising average LTPs with the deteriorating macroeconomic environment and consumer credit scores. However, examining the LTP ratios distribution by purchase price shows that the rising trend is primarily driven by middle- to higher-priced segments. On average, these segments tend to have lower LTPs and better affordability matrices, based on their higher income levels. The opposite holds true for the lower end of the spectrum. As such, it appears, at least from this data, that the rising mortgage indebtedness has largely been driven by higher income households.

Outlook

While domestic growth rebounded in 2Q19, the latest round of data points to a slow pickup in 3Q19. With the structural impediments to higher growth remaining intact, substandard business and consumer confidence as well as slowing global growth point to persistently low GDP growth for the remainder of the year and into the forecast horizon. As such, barring any exogenous shocks, such as upside pressures to the oil price, inflation should remain contained close to the midpoint of the target over the next year. In turn, this should offer the SARB some room to lower interest rates further. However, we expect the cutting cycle to remain shallow given the fiscal constraints the country faces.

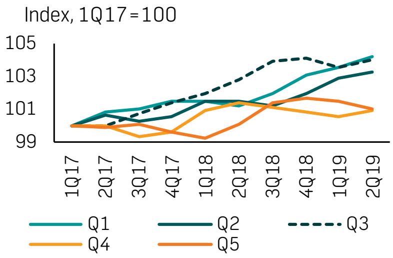
From the residential property market perspective, we expect broader economic developments, especially employment growth, to continue dictating the longer-term trends. Positively, demand has shown mild signs of improvement across all price segments. At the same time, sellers have begun withdrawing properties on the market for resale amid unfavourable selling conditions. This has somewhat curtailed the pace of supply. Nevertheless, there is still robust supply of new stock, as well as emigration-related sales. On the other hand, inbound demand (i.e. from foreigners buying property in South Africa as well as from South African expats buying property locally) remains comparatively subdued. More positively, mortgage advances have been progressive in recent months and LTPs have been rising. This has helped inject liquidity in the market. However, these benefits have mainly accrued to the higher-priced segments, with lending in the lower end remaining broadly conservative. Overall, lower interest rates and constructive lending should provide some support to the property market in the short to medium term.

Figure 4: Loan-to-price ratios drifting up



Source: FNB Economics

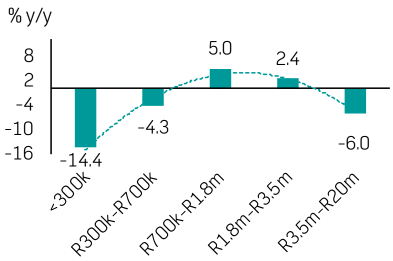
Figure 5: LTP ratios per quintile (Q*) – Middle to higher price bands have seen the most growth



Source: FNB Economics

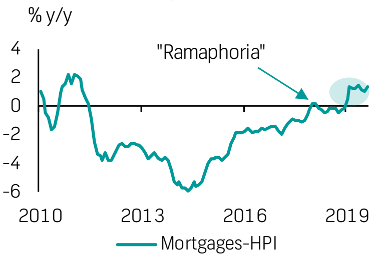
** Q1 is the top 20% and Q5 is the bottom 20%.*

Figure 6: Volumes by price buckets (2qma)



Source: FNB Economics

Figure 7: Mortgage advances have outpaced house prices



Source: SARB, FNB Economic

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	4.9	4.9	4.7	4.4	4.2	4.1	4.1	4.2	4.2	4.2	4.2	3.9
2018	3.3	3.1	3.3	3.6	3.9	4.1	4.1	4.0	4.1	4.2	4.2	4.2
2019	3.9	3.3	3.4	3.4	3.3	3.5	3.6	3.7	3.8			

Forecast

FNB SA Economic Forecast

Economic Indicator	2016	2017	2018	2019f	2020f	2021f
Household consumption expenditure %y/y	0.6	2.1	1.8	1.2	1.6	1.8
Government consumption expenditure %y/y	2.2	0.2	1.9	1.1	1.1	1.2
Gross fixed capital formation %y/y	-3.5	1	-1.4	-1.4	0.5	1.1
Real GDP %y/y	0.4	1.4	0.7	0.3	1.2	1.2
Total exports %y/y	0.4	-0.7	2.6	2.1	1.4	1.8
Total imports %y/y	-3.9	1	3.3	2.1	2.2	2.4
Current account (% of GDP)	-2.8	-2.5	-3.5	-3.3	-3.6	-3.7
CPI (average) %y/y	6.3	5.3	4.6	4.2	4.4	4.5
CPI (year end) %y/y	6.7	4.7	4.5	4.3	4.4	4.4
Repo rate (year end) %p.a.	7.00	6.75	6.75	6.25	6.25	6.25
Prime (year end) %p.a.	10.50	10.25	10.25	9.75	9.75	9.75
USD/ZAR (average)	14.70	13.30	13.25	14.50	14.90	15.50

Source: FNB

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 over the past 18 years.

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 a Hodrick-Prescott smoothing function with a Lambda of 5.

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.