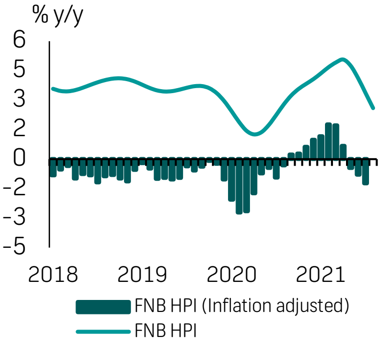
September 2021

Property Barometer.

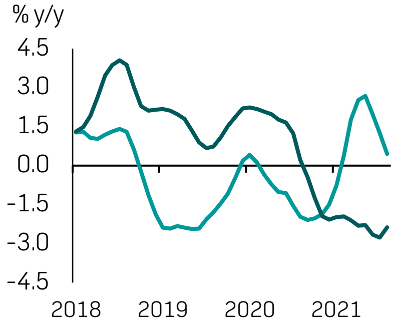
2.6%	0.1%	49.3	8.0
y/y FNB HPI	m/m FNB HPI	market strength index	weeks on market

Figure 1: FNB HPI



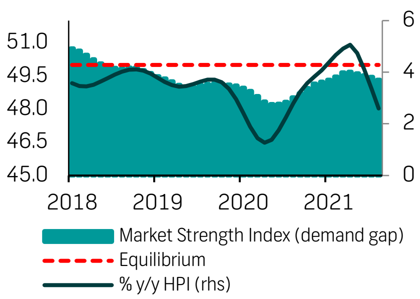
Source: FNB Economics

Figure 2: FNB Market strength indices – Growth in demand may have peaked, ans supply ticking up



Source: FNB Economics

Figure 3: Slowing price growth coincide with widening demand gap



Source: FNB Economics

Key themes

- Our proprietary market strength indicators show that demand is now moderating, following a strong rebound in 2H20 and into 2021. However, these are still above 2019 levels, reflecting the positive effect of lower interest rates on market activity and the changing housing needs due to the pandemic (greater adoption of working from home and homeschooling).

- Mortgage extension continues to grow at a faster pace, while loan-to-price ratios are trending lower. Our investigations show that much of this credit is funding purchases in the middle- to upper-priced segments. As such, mortgage loan sizes have become bigger, reflecting a shift towards higher price brackets.

- Weaker-than-expected 2Q21 labour market data, combined with the potential adverse effects of the recent unrest on employment prospects for 3Q21, suggests that longer-term demand fundamentals will likely take longer to recover to pre-pandemic levels. However, we note a potential upside on non-wage income, especially dividend income, which could boost income growth for affluent households.

Annual house price growth decelerates again in August

The FNB HPI annual house price appreciation decelerated further to 2.6% y/y for August, from 3.4% in July (revised up from 3.1%). The slowing pace of price growth coincides with the weakening market strength index (widening demand gap), as demand growth slows relative to supply (Figures 2 and 3). These indicators are derived from the internal property valuer's database. Activity of estate agents is also moderating across price segments, as shown in the latest FNB Estate Agents Survey. However, all these are still above 2019 levels, despite weaker employment numbers. In part, this suggests that market activity is still benefiting from lower interest rates, albeit to a lessening extent. Current activity is also benefiting from pandemic-induced shifts in consumer behaviour, which leant in favour of home ownership.

Despite slowing demand indicators, mortgage extension soars

Mortgage extension in July rose by 7.2% y/y, the quickest in 12 years (since May 2009). This seems at odds with all demand and market activity indicators (as outlined above), a conundrum compounded by the fact that loan-to-value ratios (proportion of the loan that lenders are willing to finance) have also descended from their recent highs in 4Q20.

To explain this, the first thing to consider is growth in house prices in recent months. According to the FNB HPI, prices have risen by a cumulative 5.6% since January 2020. Second, and related to this, is the average loan size. Deeds registry data shows that this has become bigger, growing by 14.6% in the same period. In a similar vein, internal applications data shows the average purchase price has risen by 14.5% between January 2020 and July 2021 (Figure 4). This is partly driven by higher house prices, and a demand-shift towards

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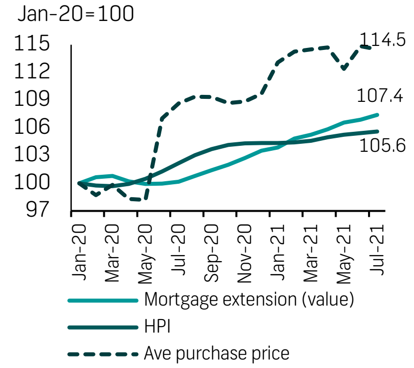
higher price brackets, facilitated by very low interest rates. So, while volumes and loan-to-price ratios may be slowing, which would imply slowing mortgage extension, the rise in purchase prices and loan sizes might have counteracted this, explaining the uptrend.

Outlook

We have consistently argued that property prices have been unusually slow to adjust to the weak consumer fundamentals. We explained that support has come from unprecedented factors, such as historically low interest rates; the nature of the crisis, which incentivised property ownership; the concerted response from lenders that smoothed the impact of severe job losses on housing markets (e.g. through payment holidays and loan restructuring); as well as the relative abundance of credit despite these job losses. However, recent data shows that market volumes may have peaked, and market strength is weakening (i.e. the demand gap is widening). Nevertheless, these remain above 2019 levels.

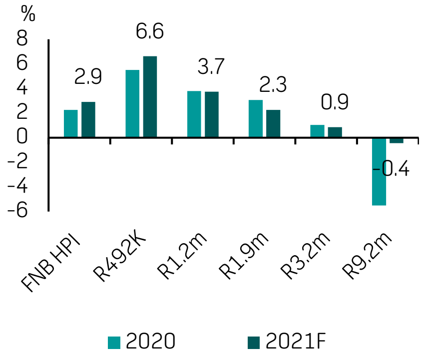
Thematically, the recent deceleration in house price growth is in line with our expectations – reflecting waning interest-rate induced demand and swelling labour market pressures. Demand driven by consumer shifts from renting to owning may also have peaked. This is reflected in the stabilising flat vacancy rates and bottoming rental inflation. These shifts played a vital role in supporting home-buying activity in 1H20 and into 2021, mostly in middle-priced segments. With this demand losing momentum, it is not surprising that the deceleration in house prices is more pronounced in middle-priced segments. Nevertheless, we still expect a better annual house price growth in 2021, reflecting comparatively stronger demand and a brighter GDP growth outlook (Figure 5).

Figure 4: Average purchase price



Source: FNB Economics, SARB

Figure 5: Forecast by price segment



Source: FNB Economics

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	4.7	4.1	3.4	2.6				

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.