PROPERTY BAROMETER

Price Realism and Market Balance

The National balance between housing demand and supply weakened in the 2nd quarter of 2018, as Ramaphoria tapered off

18 June 2018

**FNB HOME LOANS:
MARKET ANALYTICS AND SCENARIO FORECASTING UNIT**

**JOHN LOOS:
HOUSEHOLD AND PROPERTY SECTOR STRATEGIST
087-328 0151
John.loos@fnb.co.za**

**THULANI LUVUNO:
STATISTICIAN
087-730 2254**
thulani.luvuno@fnb.co.za

**ZHARINA FRANCIS:
STATISTICIAN
087-730 2313**
zfrancis@fnb.co.za

On a national average basis, the 2nd quarter 2018 FNB Estate Agent Survey showed a noticeable lengthening in the average time of homes on the market prior to sales, pointing to a renewed housing market weakening in terms of housing demand relative to supply.

This is reflective of "Ramaphoria" tapering off. In the 1st quarter of 2018 we saw a significant strengthening in our set of market indicators, with agents pointing to a strong positive impact coming from the change in the country's political leadership, most notably the President. In the 2nd quarter, however, the excitement has worn off, and the Household Sector is back to dealing with a "recessionary economy" and rising costs of living.

KEY POINTS

- The 2nd quarter 2018 FNB Estate Agent Survey saw the average time of homes on the market lengthen noticeably, from 14 weeks and 1 day in the prior quarter to 16 weeks and 4 days, reflecting improved housing demand relative to supply in the 2nd quarter.
- From a previous quarter's 91%, the percentage of sellers being required to drop their asking price to make the sale also increased to 96% in the 2nd quarter of 2018.
- The estimated magnitude of drop in asking price also pointed towards a weaker market in the 2nd quarter of 2018, increasing from -8.2% in the prior quarter to -9.2%.
- The Namibian market remains the weak market in the broader Rand Area. Whereas South Africa's estimated average time on the market was 16 weeks and 4 days, Namibia's had risen to as high as 25 weeks and 6 days in the 2nd quarter of 2018.
- In the 2nd quarter of 2018 we saw a mere 4% of agents citing "stock constraints" as an issue in their areas. While this is slightly up from the prior quarter's 3.4%, it remains very low compared to the 24% high of early 2015.
- Within South Africa, there is a major difference in market balance between Gauteng's Metros and the 3 Major Coastal Metros. Whereas Gauteng's average time on the market in the 2nd quarter of 2018 was 14 weeks and 1 day, Tshwane Metro being the strongest market within this region, the aggregated time on market of the 3 Major Coastal Metros, i.e. Ethekwini, Nelson Mandela Bay and Cape Town, was a far longer 20 weeks and 1 day.

THE MAJOR SURVEY INDICATORS OF HOUSE PRICE REALISM ALL POINT TOWARDS WEAKENING, BUT THERE ARE MAJOR REGIONAL DIFFERENCES

INTRODUCTION

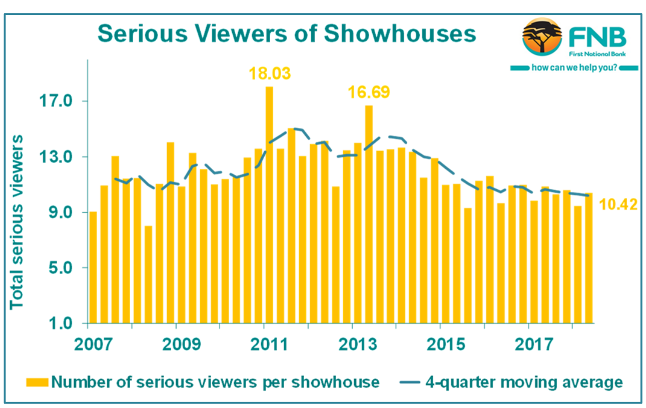
Due to significant resistance by home sellers to downward pressure on house prices in times of housing demand slowdown, house prices do not fully adjust in the short term. Instead, the residential market often moves away from market equilibrium price for lengthy periods of time. Such a move away from equilibrium is reflected in a rise in the average time that homes remain on the market prior to sale.

We have therefore developed indicators which assist us in trying to ascertain whether we have a market moving away or closer to equilibrium, or otherwise put, whether housing demand relative to supply is strengthening or weakening.

AN INDICATOR OF HOUSING DEMAND

Serious viewers of show houses remains moderate

In the 2nd quarter of 2018, we saw a slight quarterly increase in the estimated average number of "serious" viewers per show house before sale. From 9.47 viewers in the 1st quarter, the estimate rose to 10.42. However, due to quarter to quarter volatility we place little emphasis on these small quarterly movements, and use a 4-quarter moving average to examine the broader trend. The 4-quarter moving average for the 4 quarters up to and including the 2nd quarter of 2018 was 10.2 viewers, and this was slightly down from 10.31 for the 4 quarters up to the 1st quarter of this year. It also remains well-below the 14.42 high reached in the final quarter of 2013, just before the early-2014 start of interest rate hiking. The average number of viewers declined steadily through 2014 and 2015, before moving "sideways-to-slightly lower through 2016 to the present time, never really recovering.



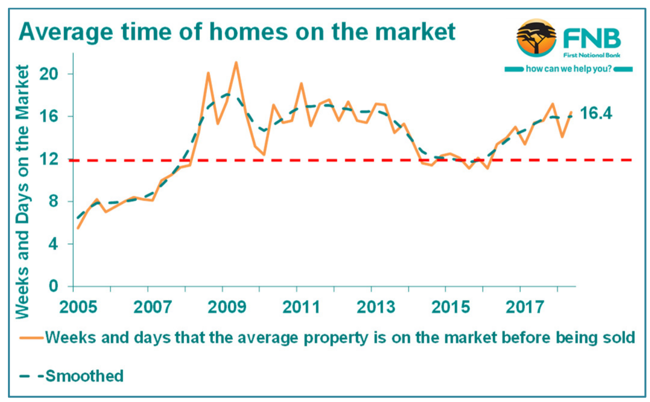
INDICATORS OF MARKET BALANCE AND PRICE REALISM

Average time of homes on the market rose noticeably in the 2nd quarter of 2018

In the 2nd quarter of 2018, we saw the previous quarter's progress made in reducing the average time of homes on the market prior to sales being quickly reversed.

From 14 weeks and 1 day in the 1st quarter 2018 Estate Agent Survey, the average time of homes on the market rose noticeably to 16 weeks and 4 days, almost fully reversing the 1st quarter gains made from the 17 weeks and 2 days average in the 4th quarter of 2017.

We take the, admittedly subjective, view that around 12 weeks (near to 3 months) average time on the market more-or-less represents a market equilibrium situation on a national average basis.



Up until the final quarter of 2017, the market had drifted away from that equilibrium level, reaching that average time on the market of 17 weeks and 2 days at that stage.

The 1st quarter improvement went hand in hand with a jump in market activity, according to the agents, and it appeared to be a "Ramaphoria-related" jump, something we saw briefly in national business confidence too.

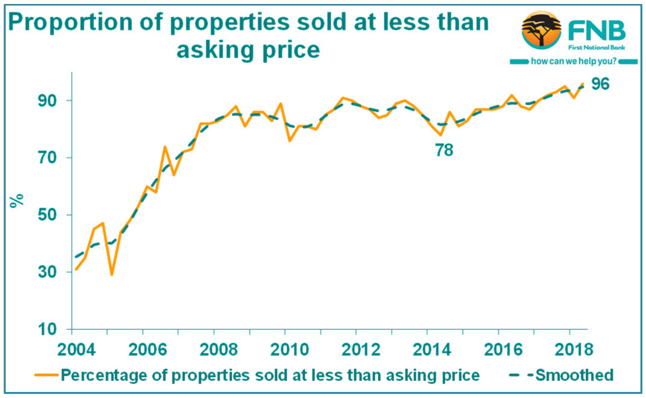
There had been some excitement around the change in the country's president early in the year. However, this excitement appears to have largely dissipated, housing activity was perceived to have dropped again in the 2nd quarter of 2018, average time on the market is longer once again, and it is back to a "business as usual" situation in a stagnant economy.

A higher percentage of sellers is required to drop their asking price to make the sale too

A 2nd question related to price realism and market balance is where we ask the agents to estimate the percentage of sellers ultimately being required to drop their asking price to make the sale.

While the majority of sellers normally tend to start high and allow themselves to be bargained down as a strategy, there is nevertheless a cyclical element to this behavior.

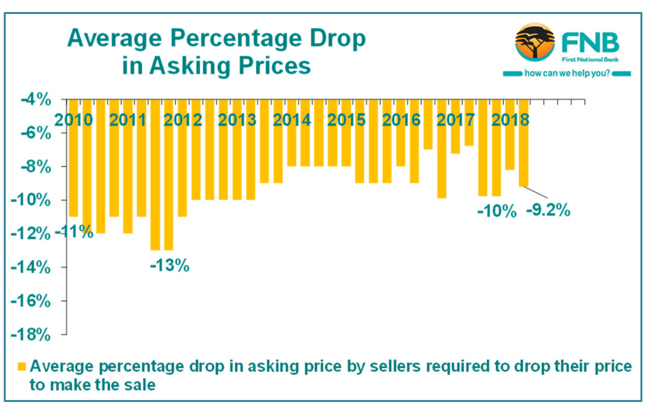
The 2nd quarter 2018 survey showed a rise in this estimated percentage of sellers having to drop their asking price, from 91% in the previous quarter to 96%.



Once again we caution that from quarter to quarter the data can be volatile. But like the average time on the market estimate for the 2nd quarter, an increase in percentage of sellers dropping asking price also points to a shift towards weakening demand relative to supply.

We also see a larger magnitude of estimated average asking price drop

In the 2nd quarter survey, the estimated magnitude of decline, for those being required to drop their asking price, became slightly larger. From -8.2% in the 1st quarter of 2018, the estimated percentage drop in asking price to make the sale increased to -9.2% in the 2nd quarter.



Therefore, in the 2nd quarter of 2018, all 3 key survey responses related to "market balance", or "price realism", point to a quarterly deterioration in the balance between demand and supply of homes.

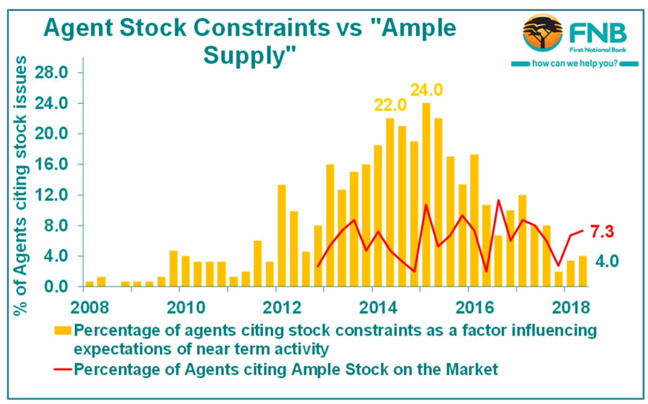
Stock constraints remain low

We see very few agents pointing towards housing stock constraints in the market, and slightly more pointing towards "ample stock".

It is difficult to gauge the strength of supply of residential stock through asking survey respondents for their opinion. But when asking agents about their market expectations in the near term, we allow them to provide a list of factors that influence their expectations, both in a positive and a negative way

The 2nd quarter 2018 Estate Agent Survey continues to point to relatively few agents citing stock constraints as an issue. The percentage of agents citing stock constraints as an issue rose slightly from 3.4% in the 1st quarter to 4% in the 2nd quarter. However, the percentage citing "ample stock available" also rose, from 6.7% of agents in the prior quarter to 7.3% in the 2nd quarter of 2018.

Stock constraints as well as "gluts" thus both remain very low in the 2nd quarter, although the "ample stock" level remains slightly above the "stock constraints" level.

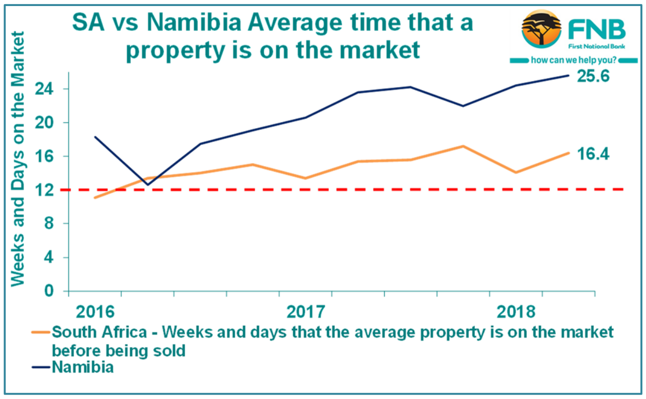


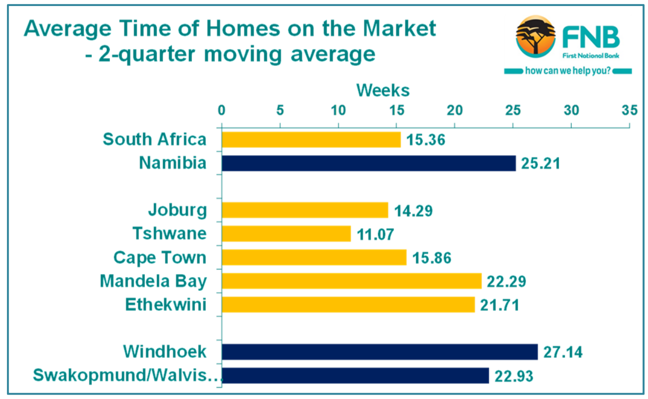
REGIONAL COMPARISONS

In the broader Rand Area's major regions, Namibia remains significantly further away from market equilibrium than South Africa.

When breaking down the key indicators of price realism into the major survey regions, a key feature remains the weakness in Namibia relative to South Africa. The Namibian market is significantly weaker, and further from market equilibrium, than South Africa.

Whereas South Africa's estimated average time on the market was 16 weeks and 4 days in the 2nd quarter of 2018, Namibia's average time had risen further to 25 weeks and 6 days.

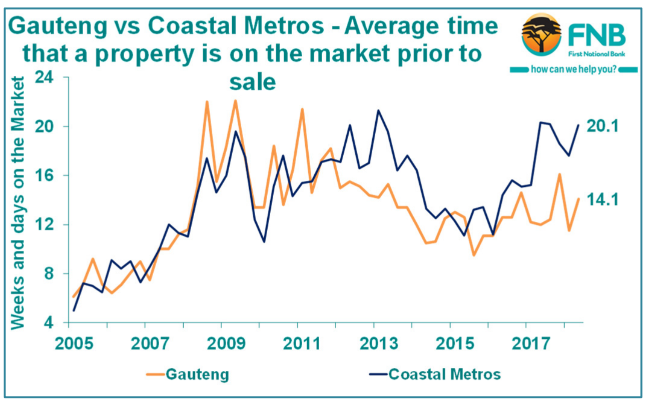




Gauteng remains the strong point within SA in terms of realism and balance.

Within South Africa, Gauteng appears far closer to market equilibrium than the 3 Major Coastal Metro combined.

Whereas Gauteng's estimated average time of homes on the market was 14 weeks and 1 day in the 2nd quarter of 2018, the aggregated Coastal Metro estimate was a far longer 20 weeks and 1 days.



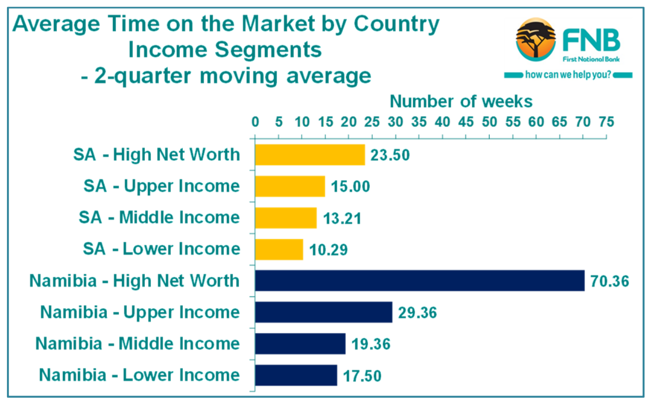
To boost survey sample size when breaking down the survey into more detailed Major Metro regions (to reduce volatility), we resort to a 2-quarter moving average.

Using this 2-quarter average at Metro level, the 3 coastal cities (Cape Town, Ethekwini and Nelson Mandela Bay) have been weaker than the major Gauteng regions. Cape Town, the best of the Coastal Metro regions averaged 15.86 weeks on the market for the 1st 2 quarters of 2018, Nelson Mandela Bay 22.29 weeks, and Ethekwini 21.71 weeks.

By comparison, Greater Joburg (City of Joburg and Ekurhuleni Metros) has averaged a heathier 14.29 weeks and Tshwane Metro an even more impressive 11.07 weeks for the same 2 quarters

The lower end is the "relative hot spot" in both South Africa and Namibia

Examining the average time of homes on the market by Income Area segment, both South Africa and Namibia showed wide differentials between the Lower Income Area end and the High Net Worth end, with the Lower Income end having far shorter average times on the market.



While high end homes do generally take longer to sell, we believe that the wide differential, i.e. 23.5 weeks in the case of the High Net Worth Area segment and 10.29 weeks in the Lower Income Area segment in the case of South Africa, in part does reflect a relatively stronger lower end of the market.

The Namibian differential between the High Net Worth Area end, at 70.36 weeks, and the Lower Income Area segment's 17.5 weeks, is far more extreme than in the case of South Africa.

CONCLUSION

On a national average basis, a noticeable increase in the average time of homes on the market was recorded in the 2nd quarter of 2018, quickly reversing most of the "Ramaphoria" market gains of the 1st quarter.

This ties in with a 2nd quarter weakening of National Business Confidence as per the RMB Business Confidence Index, which also had a brief 1st quarter "spike", something shared by the FNB Residential Activity Rating (covered in a previous report).

The strongest major regional markets appear to be found in Gauteng, most notably the Tshwane Metro region, which has by far the lowest average time of homes on the market of late.

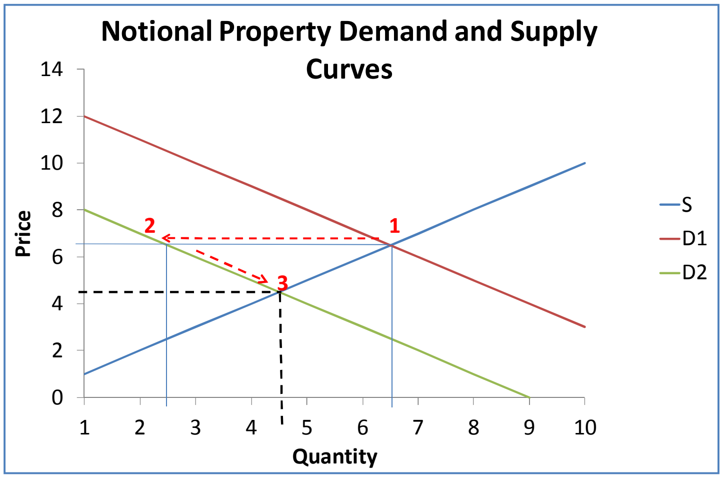
By comparison, the 3 coastal major metros are relatively weak, especially Ethekwini and Nelson Mandela Bay, but City of Cape Town has also cooled off in recent times, a victim of its own strong market pre-2017 and the home affordability deterioration that resulted.

Some of the increase in the average time of homes on the market is likely to be seasonal, given that the 2nd quarter is typically a weak seasonal quarter for home buying. However, we can't ignore the signs of a quick reversal in national sentiment following the early-2018 excitement, driven by political leadership change in the country late in 2017 and early this year.

That wave of relative excitement was perhaps always going to be short-lived, although we had expected it to continue a little longer. But once the "novelty wore off", the reality would remain one of economic weakness and structural impediments to the economy.

NOTE: A THEORETICAL REPRESENTATION OF THE MARKET SHIFT AWAY FROM EQUILIBRIUM

A very simple representation of the theory on a demand-supply graph below, of a shift away from market equilibrium, appears as follows. Let's assume a sudden sharp interest rate hike. As this is not a house price-related residential demand-driver, the Housing Demand Curve would shift to the left from D1 to D2.Given home owner resistance to dropping prices, the average price may not immediately decline, however. Therefore, the market initially shifts from point 1 to point 2 on the graph, the average price initially remaining unchanged but quantity demanded and transacted declining from a 6.5 to 2.5. Initially, however, the supply of homes remains at 6.5, and the market is oversupplied. This move to an oversupplied situation would be witnessed in an increase in the average time of homes on the market. The prices now getting transacted in the market at position 2 are above the market equilibrium prices. Only over a significantly longer period, would the market then gradually make its way to position 3 on the graph, as real prices gradually adjust down, resulting in a partial recovery in demand compared with that at Position 2. The market eventually finds a new demand-supply equilibrium at a lower transaction volume level than prior to the demand shift (Position 1), i.e. 4.5, but higher than straight after the initial demand drop.



We thus always view the full extent of market weakness through average house prices along with average time of homes on the market

Given the market's ability to move away from equilibrium price for lengthy periods, especially in times of economic weakening, it is important not only to focus house price trends. A sizeable part of the market weakness in such times can be seen in the estimated average time of homes on the market prior to being sold, with this average time often lengthening in periods where demand weakens but prices don't fall "sufficiently".

This is all very important for both mortgage lenders and that group of borrowers who become financially stressed. That's because, in cases of mortgage stress, homes need to be "offloaded" quickly in order to settle debt and avoid big holding costs. Often, in order to quickly trade out of the property, the financially-stressed home owners have to go to a level considerably below market equilibrium price to do this, and this may be a "negative equity" situation where the price fetched is insufficient to settle the debt outstanding.