



Property Barometer.

3.8%
y/y FNB HPI

50.0
Market strength index

7 weeks & 6 days
Time on market

Figure 1: FNB HPI

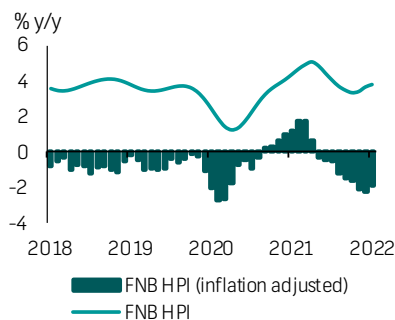


Figure 2: Market Strength indices

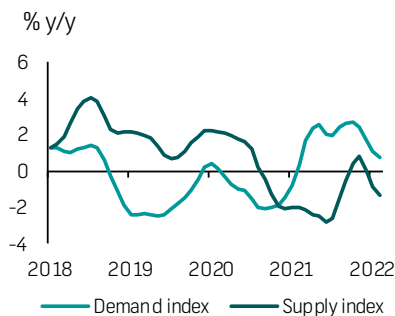
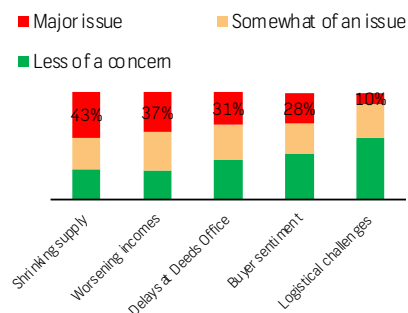


Figure 3: FNB Estate Agents Survey 4Q21: Market concerns



Key themes:

- Market **volumes** may have peaked, but still running above pre-pandemic levels.
- The affordable market** has shown the strongest relative recovery in activity following a more pronounced decline in 2020, due to the harsher impact of the pandemic on lower-income households.
- In **middle priced segments**, buying activity remains strong, but growth is moderating. Activity is supported by lower interest rates, credit availability and pandemic-induced changes in housing needs.
- Current buying activity is largely driven by demand recovery in the **affluent markets**, stoked by good pricing (value for money following significant price declines in recent years), the low interest rate environment, and the work from home (WFH) trend. However, we are concerned about rising geopolitical tensions, which may sour buyer sentiment.
- We expect interest rates to increase by a cumulative 150bps this year, on the back of rising inflationary pressures, exacerbated by the ongoing geopolitical tensions.
- The stagnant labour market, combined with rising interest rates and higher living costs, suggests a less supportive medium-term environment for home buying activity. However, factors such as the ongoing shifts in housing needs and banks' appetite for quality lending could mitigate the impact.

Annual house price growth moved sideways in February

The FNB House Price Index growth moved sideways in February, averaging 3.8% y/y (Figure 1). Price growth appears to have stabilised in the last few months, likely due to the receding supply of properties on the market for sale (Figure 2 and Figure 3). In our previous [report](#), we showed that support on overall house price growth in recent months has come from a strong recovery in the affluent markets, while growth in low to middle segments continues to slow. Regional estimates show the Garden Route as the best performing district (out of 12 selected regions), with activity supported by the pandemic-induced semigration (Figure 4).

Russia-Ukraine conflict: Downside risks to the housing market

The **Russia-Ukraine** conflict is a fast evolving risk factor that poses upside risk to inflation and downside risk to growth. Our baseline view assumes that intense fighting continues until the middle of this year, after which the conflict continues but the intensity reaches a

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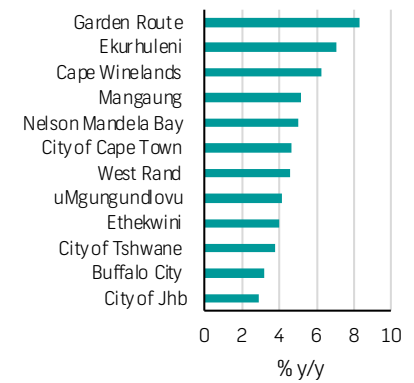
steady-state position, during which the risk premia in global financial and commodity markets gradually declines.

We identify three channels through which the conflict could affect domestic housing markets:

- Cost of living/Inflation and interest rates:** We have revised our inflation forecasts higher on the back of elevated global oil prices and the potential second-order effects to other costs. We now expect inflation to breach the 6% upper target band in 2Q22, and average 5.6% in 2022. The second-round effects should be of particular concern for the central bank. The elevated cost of living could raise inflation expectations and result in above-midpoint wage growth demand, potentially lifting underlying inflation. The central bank will want to avoid the de-anchoring of inflation expectations as this could prove harder to reverse, raising structural inflation that will persist even after uncertainty alleviates. In line with this, we expect the SARB to hike at every remaining meeting this year (125bps more). Thematically, however, we expect that the SARB will keep to its gradual interest rate normalisation path, striking a delicate balance between rising inflation expectations and falling consumer demand.
- Trade/Growth channel:** The EU is SA's biggest trade partner. Due to the Russia-Ukraine conflict, and the resultant commercial sanctions and disruptions to economic activity, global growth expectations have been pared lower, with the EU bearing the brunt. This, combined with lower household disposable income (due to higher living costs) and higher input costs, poses a material downside risk to our domestic growth outlook. As such, we have lowered our GDP growth expectations by 0.5bps, to 1.7% in 2022. This has implications for employment growth.
- Confidence channel:** House price growth of late has been pushed higher by the recovery in buying activity in higher-priced segments. Our initial expectations are for this trend to continue into the medium term. Notably, sentiment tends to have a bigger sway on buying activity in this segment.

Bringing it all together: Naturally, higher inflation, leading to higher interest rates, has a cooling effect on pipeline demand for mortgages, and eventually house price growth. Given the already elevated vacancy rates (weak demand) in the rental market, higher living costs (such as food, fuel, water and electricity prices) will further limit the ability of landlords to raise rental prices and delay the recovery. However, these were already baked into our expectations. A more novel risk is the potential impact of ongoing tensions on buyer sentiment. This is because recent activity (and support to price growth) has been driven by the recovery in higher-priced segments, which tend to be highly sensitive to sentiment. If sentiment is significantly dampened as a result, then our expectations of a continued recovery in affluent segments in 2022 may, likewise, be dampened. For low and middle-priced segments, a lot will depend on the extent to which this translates into further labour market destruction, prompting lenders to significantly tighten lending standards. So far, this is not our base case scenario.

Figure 4: Price growth by region/district: 4Q21



Source: FNB Economics

Table 1: Cosumer balancesheet: GFC vs Covid-19 pandemic

| % annual average | 2007 | 2008 | 2019 | 2020 | 2021 |
|--|-----------|----------|---------|---------|---------|
| Household debt-to-income | 76,8 | 77,6 | 64,2 | 69,2 | 67,3* |
| Debt service cost-to-income | 10,0 | 12,8 | 9,0 | 8,5 | 7,6* |
| Savings-to-disposable income | -3,0 | -1,4 | -0,6 | 0,7 | 0,8* |
| Prime lending rate | 13,1 | 15,1 | 10,1 | 7,9 | 7,0 |
| Inflation | 7,1 | 11,5 | 4,1 | 3,3 | 4,6 |
| HPI annual average | 14,5 | -0,9 | 3,5 | 2,5 | 4,2 |
| HPI (High/Low) | 16.0/11.0 | 9.3/-5.8 | 3.7/3.0 | 4.1/1.3 | 5.1/3.4 |
| Mortgage volumes | 207 331 | 130 320 | 106 958 | 103 655 | 135 931 |
| Average loan-to-price (LTP) | 94,9 | 94,4 | 90,9 | 92,5 | 92,8 |
| Share of vols financed at 100% or more LTP | 22,1 | 22,8 | 7,7 | 9,7 | 10,8 |

*Data up to 3Q21

Source, SARB, StatsSA, Deeds Office, FNB Economics

Table 1 compares a selected list of consumer variables across two most recent global economic calamities: the Global Financial Crisis (GFC) (2007/2008) and Covid-19 (2020/2021). We note that consumers are broadly in better shape going into 2022 relative to the GFC, and Covid-19 pandemic. For instance, savings ratios and debts service costs compare better than in both of the previous periods. This could help counteract the overall impact on the property market, should the ongoing conflict evolve into a global economic recession (not our base case).

Table 2: FNB Macroeconomic forecast

| | 2020 | 2021 | 2022 | 2023 | 2024 |
|-------------------------------------|------|-------|------|------|------|
| GDP growth | -6,4 | 4,9 | 1,7 | 1,6 | 1,5 |
| Disposable income growth | -2,7 | 8,8 | 5,1 | 5,0 | 4,8 |
| Household debt-to-income | 68,7 | 67,4 | 67,1 | 66,9 | 66,7 |
| Savings-to-disposable income | 0,7 | 0,1 | -0,8 | -0,8 | -1,5 |
| Prime lending rate | 7,0 | 7,3 | 8,8 | 9,3 | 9,3 |
| Consumer inflation | 3,3 | 4,5 | 5,6 | 4,4 | 4,6 |
| Employment growth | -4,8 | -0,93 | 0,53 | 0,53 | 0,25 |
| House prices | 2.5 | 4.2 | 3.5 | 3.4 | 3.3 |

Source: FNB Economics

Appendix

Outlook

Global context

Housing markets in advanced economies received renewed strength during, and in the aftermath of, the pandemic shock, buoyed by low interest rates and strong demand for housing. By contrast, emerging markets experienced more volatility, and the uptick in prices during the pandemic was less pronounced. This reflects key differences in policy responses to the crisis and household balance sheets: while advanced economies responded quite aggressively to the pandemic crisis, implementing considerable liquidity stimulus, emerging markets had limited space, and some had to quickly pare back stimulus measures with a build-up of inflationary pressures (predominantly driven by supply bottlenecks, higher oil prices and weaker exchange rates). Furthermore, household balance sheets in emerging markets were more severely affected by labour market vulnerabilities, leaving many households locked out of the market. In its January 2022 Global Economic Prospects report, the World Bank showed that over 60% of households in emerging markets reported income losses during the pandemic and most pandemic-related job losses have not been recovered.

Looking ahead, we expect demand for property and real house price growth to wane as global financial conditions tighten. This could be exacerbated by upward inflationary pressure – exacerbated by geo-political tensions and related supply chain disruptions. Steeper hiking cycles, as inflation continues to surprise to the upside, will likely have a bigger impact on emerging markets, given the pre-existing labour market vulnerabilities in these economies.

Domestic home buying market

We expect buying activity to remain relatively supported in the medium term and price growth should stabilise at lower levels compared to 2021, at around 3.5%, from 4.2%. Rising interest rates will reduce affordability and the attractiveness of homeownership relative to renting. However, we think “marginal buyers” have already brought forward their buying decisions, taking advantage of ultra-low interest rates. In the medium term, we expect that buying activity will predominantly be driven by fewer interest rate sensitive buyers, largely in higher priced brackets. Innovation and heightened competition among lenders should also boost activity. A key constraint is the stubbornly weak employment growth, which continues to lag the economic recovery. However, the wage bill has recovered to pre-pandemic levels (albeit uneven across skill and income levels). This, combined with still-strong growth in non-labour income, and a rising preference for homeownership (behavioural conditions), should counteract the downward pressures on volumes growth and, ultimately, house price growth, mainly in middle to higher-priced segments.

- **The affordable market:** We expect price growth to moderate, relative to the strong growth in the prior years, as labour market weaknesses and higher interest rates erode affordability. However, innovations in the funding space such as the greater uptake of longer duration mortgages (e.g., 360 months payment term) should be a somewhat mitigating factor. Furthermore, the inherent property supply deficit should limit downward pressure on price growth in the segment.
- **Middle priced segments:** Buying activity should continue benefiting from the accommodative monetary policy conditions, credit availability and the pandemic-induced changes in housing needs, albeit to a lesser extent. The relatively milder impact of job losses and a stronger recovery in wage growth should also be supportive of volumes and price stability.

- **Affluent markets:** buying activity should be supported by good pricing, strong recovery in non-labour income and the WFH trend. Supply-side factors should also remain supportive of price growth: emigration-related sales have slowed since the recent peak in 2019, there is less supply pressure from the construction of new properties, and there are fewer properties on the market for sale as some sellers, in response to weaker selling conditions, took a wait-and-see approach during the pandemic. Emigration related sales may well increase as global travel restrictions are phased out, but it is unlikely that volumes will test the 2019 peak.

Domestic rental market

After troughing at 0.6% y/y in March 2021, rental inflation has been gradually normalising, lifting to 1.1% in December 2021. We expect rental inflation to lift to 2.0% on average in 2022, ending the year at around 2.5%. This gradual normalisation is in line with the ongoing recovery in aggregate incomes and household demand, higher interest rates weighing on demand for homeownership, as well as improved mobility that might push people closer to business districts (for work). However, the pace of the recovery will be constrained by weak employment growth and rising cost of living.

Vacancy rates have slowed from pandemic-induced highs but could settle at a new, higher equilibrium. While landlords could square higher vacancies against elevated yields in some provinces such as Gauteng in the near term, it is reasonable to expect landlords to continue reducing portfolios. This is exacerbated by the apparent oversupply, particularly in the affluent market, and a conundrum of weak escalations or exposure to delinquencies given the elevated cost of living. Nevertheless, the recovery in tourism could partly alleviate oversupply in some segments as available stock is diverted from long-term to short-term rentals. We also expect the currently muted construction activity to not exert further upward pressure on the supply of new stock.

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 | 3.8 | | | | | | | | | | |

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 from the 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 previous transaction 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.