# Economics

## South Africa: Residential property report

**1 July 2010**

### Momentum slowly gaining traction

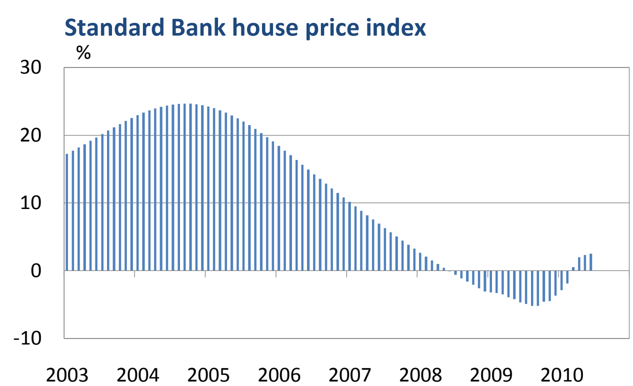
Danelee van Dyk

**What is the latest?** The recovery in Standard Bank's median house price gained traction in June, rising to R588 500 from R579 000 in May. In absolute terms, this level corresponds to the median house price at the start of the business cycle downswing in December 2007. June also marked the fourth-consecutive monthly increase taking the median price 2.5% above its level in June last year. In real terms, however, the property cycle is around 2% below last year's levels, an improvement from the turning point of -12.3% y/y in April last year. Further confirmation of improving demand in the middle-to-upper price brackets was obtained in June, which along with last year's low base, will translate into steepening growth in a few months' time. As indicated in Figure 1, the lower turning point in the property price cycle occurred during August and September last year. This, coupled with lower envisaged inflation in Q3, should see real price growth at zero, if not marginally positive.

**Our view:** Today's data provide a generally encouraging snapshot of market conditions during the first few weeks of the World Cup. Even though it was speculated that the World Cup may have cannibalised demand for asset-backed finance, to some extent, the decline in the volume of applications received in June was nothing out of the ordinary. Indeed, when compared to the typical vacation months, such as December and April, June's volumes actually surprised on the upside. For now it seems that the property market has some catching up to do when compared to broader consumer markets. The slow recovery in the median price financed, along with recent confirmation of higher-income demand returning, speaks of the significant debt cleansing that is underway. The sizeable interest rate relief since December 2008 would usually have heralded a turning point in the property market within six months of the first cut. One can argue that the high debt burden has essentially suppressed the leading indicator properties of the housing market – a trend that may not be as evident in average price metrics. With deleveraging well underway, not by means of physical reduction in credit demand, but through rising nominal income growth, the prognosis for property growth is favourable. Individuals are also slowly shedding debt that is in arrears, which will free up income. As a result, the low interest rate environment may only now become stimulatory as initial breathing space provided by the cumulative declines in the prime rate was hampered by the backlog of loans in arrears. A decline in real income growth and job losses contributed to this trend.

**Macroeconomic cycle supported by improving household demand:** The South African Reserve Bank's (SARB's) *Quarterly Bulletin* indicated that nominal disposable income growth increased by a whopping 15.1% q/q seasonally adjusted and annualised (s.a.a.) in Q1, after falling 2.1% q/q s.a.a. in Q4. In turn, demand for durables and semi-durable goods increased by double-digit rates, of 16.8% q/q s.a.a. and 28.4% s.a.a. respectively. In the case of the latter, this was the highest growth rate in 12 years, as pent-up demand during the recession gained traction, blowing out at the first sign of growth in nominal disposable income. The rate of decline in public and private sector non-farm employment also slowed, having improved to -0.7% q/q s.a.a. in Q4 from a low of -6.7% in Q1 2009. The strong spending and income growth rates are unsustainable and likely to adjust lower from Q2 onwards. Given that the household debt-to-disposable income ratio declined to 78.4% in Q1 from 79.9% in Q4 last year, these advances were predominantly cash-financed. Accordingly, the rate of savings-to-disposable income growth declined to -0.2% in Q1 from 0%

**Figure 1: House price growth**

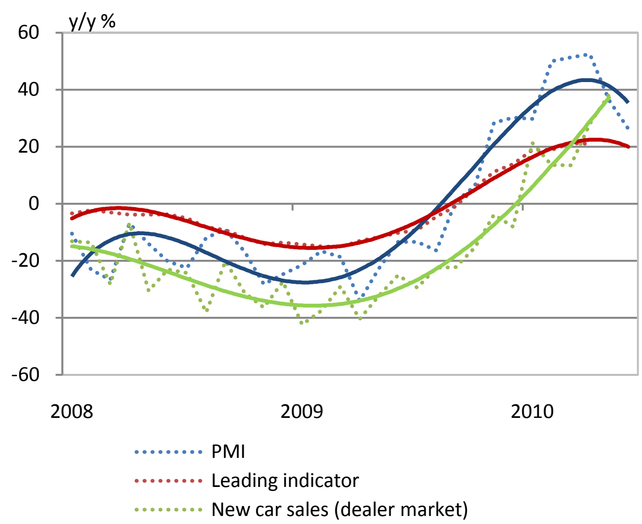



*Source: Standard Bank Group*

in Q4. While a significant improvement from the dissaving ratios of the past (-0.8% from 2006 – growth subsides off a high base, there may very well be some 2008), households have little or no buffer to carry though into Q2, suggesting that if income hangover after the World Cup given the anecdotal strength in retail and restaurant demand reported up to now.

**Risks related to trend:** As indicated earlier, the demand side of the economy has been somewhat slow to recover, given the debt overhang, negative income growth, and job losses. As such, in line with a marginal improvement in fundamentals in Q1, the demand side of the economy seems to be firing. However, the improvement in the SARB leading indicator from October last year, with positive annual growth of 5.5% y/y, was accompanied by improving supply-side dynamics (see Figure 2). The typical leading indicator properties of the vehicle market were also more suppressed, as noticed in the delayed improvement in the growth of passenger car sales through the dealer market. Worryingly, the indicators that led the upside, such as the purchasing managers' index (PMI), are losing momentum. The latest PMI index shows that manufacturing production activity contracted in June following three consecutive months of decline and four-consecutive months of expansion. While some may argue that this could be a "World Cup effect", global growth prospects in advanced economies are reflecting similar momentum loss, and even declines. For example, US new home sales plunged to a record low after the government's credit tax expired. In general, the "artificial" drive stemming from government support packages, supporting the restocking cycle, is maturing. It's now up to internal demand to carry momentum forward. Initial data reveal that this landscape may not be as fundamentally sound as hoped for. The leading indicator has also shown some slowing in April following several months of strong gains. In sum, according to the leads and lags in Figure 2, it is reasonable to expect that the demand-side of the economy may also top out soon, potentially in Q3. This will certainly throw speed bumps in the way of the property market's recovery.

**Figure 2: Leading indicators: demand-side lagging supply-side**




*Sources: BER/Kagiso, NAAMSA, SARB, Standard Bank Group*

**Outlook:** The upward momentum in the median property price financed signals that loans in arrears are improving, freeing up households' income. In addition, the low interest rates are only now beginning to take effect, as the initial spurt in household spending in Q1, was largely cash-financed. The property cycle should recover relatively firmly in the second half of the year, with the low base in Q3 last year supporting this trend. The demand side of the economy has generally lagged the upturn in activity led by supply-side sectors. It is concerning that these sectors are showing fatigue alongside global growth momentum loss.

**Standard Bank median house price growth % (revised, smoothed)**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| January | 24.2 | 18.4 | 10.2 | 2.7 | -3.2 | -2.9 |
| February | 24.0 | 17.7 | 9.5 | 2.1 | -3.3 | -1.9 |
| March | 23.7 | 17.1 | 8.8 | 1.5 | -3.5 | 0.5 |
| April | 23.3 | 16.4 | 8.2 | 1.0 | -3.9 | 2.0 |
| May | 22.9 | 15.7 | 7.6 | 0.4 | -4.2 | 2.3 |
| June | 22.5 | 15.0 | 6.9 | -0.1 | -4.7 | 2.5 |
| July | 22.0 | 14.2 | 6.3 | -0.6 | -4.9 | |
| August | 21.5 | 13.5 | 5.7 | -1.1 | -5.2 | |
| September | 20.9 | 12.9 | 5.1 | -1.6 | -5.2 | |
| October | 20.3 | 12.2 | 4.4 | -2.1 | -4.6 | |
| November | 19.7 | 12.5 | 3.8 | -2.6 | -4.5 | |
| December | 19.1 | 10.8 | 3.2 | -3.1 | -3.7 | |

**Note on the methodology used in calculating Standard Bank's house price index**

The way in which house prices are measured means that they are inherently volatile, not unlike many other economic indicators. Measuring house prices is complicated by the fact that the available data usually stem from the properties sold during a particular period, rather than from a well-designed sample that is representative of all houses. This is aggravated by the heterogeneity of houses. Changes in the measured prices may be the result of actual changes in the general price level; or changes in the distribution of the houses being sold, for example more sales of luxury houses may push up the measured house prices even without changes in general prices; or the changes may simply be random.

Given these data challenges, the international best practice is to use the median or middle price, rather than, say, the average house price. The median is the price such that half of all houses are more expensive and half less expensive than that price. It is substantially less volatile and less sensitive to the typical problems found in house price data. Standard Bank's data are therefore based on the median house price of the full spectrum of houses. Furthermore, national data from the Deeds Office are available only with a relatively long lag of up to nine months, so data from Standard Bank, which has a market share of about 27.7%, and whose data are generally highly correlated with those of the Deeds Office, are a good proxy for the national market.

# Group Economics


*Goolam Ballim – Group Economist*
+27-11-636-2910 goolam.ballim@standardbank.co.za

**International**

Jeremy Stevens
+27-11-631-7855
Jeremy.Stevens@standardbank.co.za

**South Africa**

Johan Botha
+27-11-636-2463
Johan.botha@standardbank.co.za

Shireen Darmalingam
+27-11-636-2905
Shireen.darmalingam@standardbank.co.za

Danelee van Dyk
+27-11-636-6242
Danelee.vanDyk@standardbank.co.za

**Rest of Africa**

Yvette Babb
+27-11-631-1279
Yvette.Babb@standardbank.co.za
**Kenya**
**Malawi**
**Tanzania**
**Uganda**
**Zimbabwe**

Jan Duvenage
+27-11-636-4557
Jan.duvenage@standardbank.co.za
**Botswana**
**Lesotho**
**Mauritius**
**Namibia**
**Swaziland**

Yvonne Mhango
+27-11-631-2190
Yvonne.Mhango@standardbank.co.za
**Angola**
**DRC**
**Ghana**
**Mozambique**
**Nigeria**
**Zambia**

Simon Freemantle
+254 (20) 3269 027
Freemantles@stanbic.com
**Kenya**
**Uganda**
**Tanzania**


*All current research is available on the Standard Bank Group Economics home page. In order to receive Group Economics' research via email, all clients (new and existing) are required to register and select publications on the website. Click on http://www.standardbank.com/Research, select **Register** and enter your email address. A username and password will then be emailed to you.*