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MORTGAGE MARKET BAROMETER

Mortgage Credit to Households continued to accelerate mildly, contributing to further acceleration in total Household Sector Credit growth

MARKET ANALYTICS AND SCENARIO FORECASTING UNIT

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Growth in Household Sector Mortgage Credit Outstanding continued to accelerate moderately in October, in lagged response to some mild strengthening in the housing market around 2013 and 2014.

This has contributing to further slight increase in overall Household Sector Credit growth.

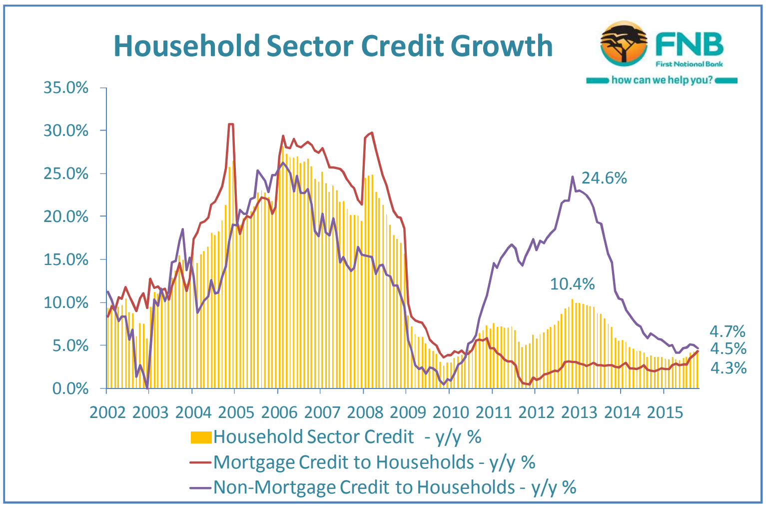
Although the cumulative growth acceleration of recent months has become noticeable, we don't foresee expect too much further growth acceleration, as certain key leading indicators for both the economy and the residential market point towards slowing in new mortgage lending growth to come. In addition, non-mortgage credit growth has been slowing of late.

KEY POINTS

- *On a year-on-year basis, the value of Household Sector Mortgage Credit Outstanding grew by 4.3% year-on-year in October. This represents a further acceleration from a low of 2.0% recorded as at October 2014.*
- *The gradually rising mortgage credit growth has contributed to a rise in overall Household Sector Credit growth from 3.2% year-on-year as at May 2015 to 4.5% by October 2015. Working partly against the acceleration in total Household Sector Credit growth was a slight slowing in Non-Mortgage Credit growth, from 5% year-on-year in September to 4.7% in October.*
- *The acceleration in Total Household Sector Credit growth does raise a mild concern, because should it continue to rise, it could "scuttle" the multi-year trend towards a lower Household Sector Debt-to-Disposable Income Ratio, a trend we believe to have been a positive one.*
- *There is little in the way of either positive or negative "fireworks" in the new mortgage lending environment. Around mid-2015, new bonded registrations in the Deeds Office were showing solid double-digit growth after a lull early in the year (10.6% year-on-year in the 3rd quarter). But this may be short lived, with leading indicator pointing to near term economic weakness, which we expect to begin to constrain new mortgage lending growth.*
- *Recent months appear to have brought a slightly lower effective home loan approval rate according to Ooba stats, but it is too early to tell whether this is the start of any trend change, or whether it is merely normal month-to-month volatility. Recent renewed interest rate rises may have played a role.*
- *The home loan interest rate differential above Prime Rate has been gradually declining, however, as the mortgage market gets mildly more competitive on pricing.*
- ***Investec and to a lesser extent Firstrand have been the 2 noticeable Mortgage Market Share gainers in recent times.***

HOUSEHOLD MORTGAGE CREDIT GROWTH ACCELERATES

Growth in Outstanding Mortgage Credit to Households accelerated further in October, playing a more significant role in the recent acceleration in overall Household Sector Credit growth.



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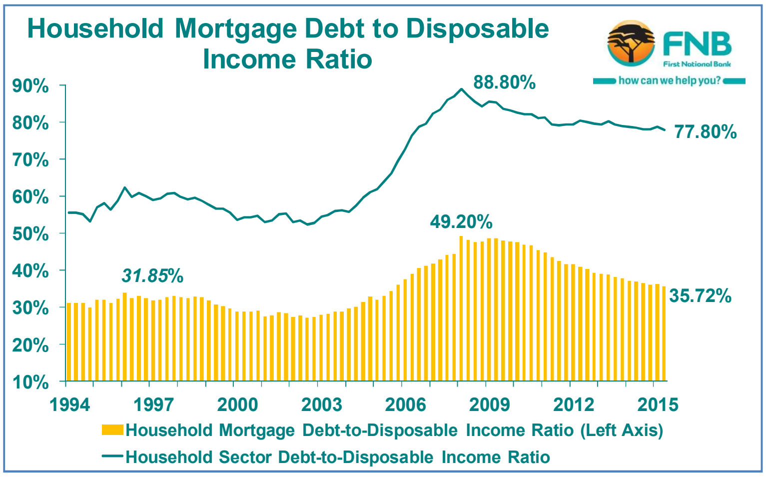
THE HOUSEHOLD CREDIT GROWTH ACCELERATION RAISES MILD CONCERNS

The acceleration in Total Household Sector Credit growth does raise a mild concern, because should it continue to rise, it could "scuttle" the multi-year shift towards a lower Household Sector Debt-to-Disposable Income Ratio, a positive development in recent years which has reduced Household Sector vulnerability to interest rate hiking considerably since 2008.



It is crucial that Household Sector Credit growth remains pedestrian in order to lower the Debt-to-Disposable Income Ratio further, because in a weak economic environment where the possibility of recession is significant, we can't expect much strength in Household Disposable Income growth in the near term.

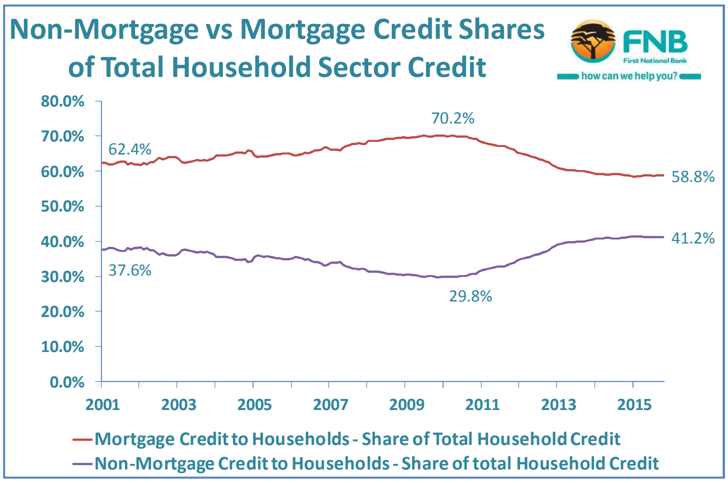
Moderate mortgage advances growth since the end of the 2000-2007 Residential Boom/Bubble has been key to the declining trend in the Household Debt-to-Disposable Income Ratio, due to the sheer size of the Mortgage Credit category. From a high of 88.8% in the 1st quarter of 2008, the Household Debt-to-Disposable Income Ratio has declined noticeably to 77.8% by the 2nd quarter of 2015. This declining trend in the ratio has been greatly assisted by a drop in the Household Sector Mortgage Debt-to-Disposable Income Ratio from a 49.2% peak to 35.7% over the same period.

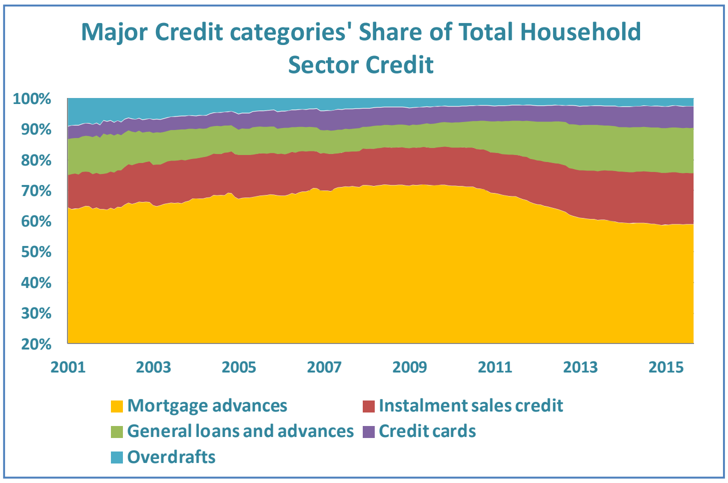
MORTGAGE-TO-NON-MORTGAGE SHARES OF TOTAL CREDIT MOVING ALMOST SIDEWAYS

The years of slow growth in Household Sector Mortgage Credit appear to have largely "normalized" its share of total Household Credit, if we consider pre-boom levels to be "normal.

Whereas Mortgage Credit's share of total Household Credit rose from 62.4% early in 2001 to 70.2% by 2009, this percentage has since dropped back significantly to 58.8% by October 2015. In recent months, however, the percentage is moving more-or-less sideways, with both Non-Mortgage and Mortgage Credit growth rates fairly similar these days.

Of the main categories of credit extended to the Household Sector, however, mortgage lending is by no means the highest. Credit Card Debtors rose by 6.6% year-on-year, as did the General Loans and Advances category. Overdrafts growth was 4.3%, having slowed markedly in recent months. At the low end of the growth spectrum was the Installment Sales Credit category with 2.9% year-on-year growth, a reflection of the current weakness in the Durable Consumer Goods sector, especially motor vehicle sales.





THE NEW MORTGAGE LENDING ENVIRONMENT

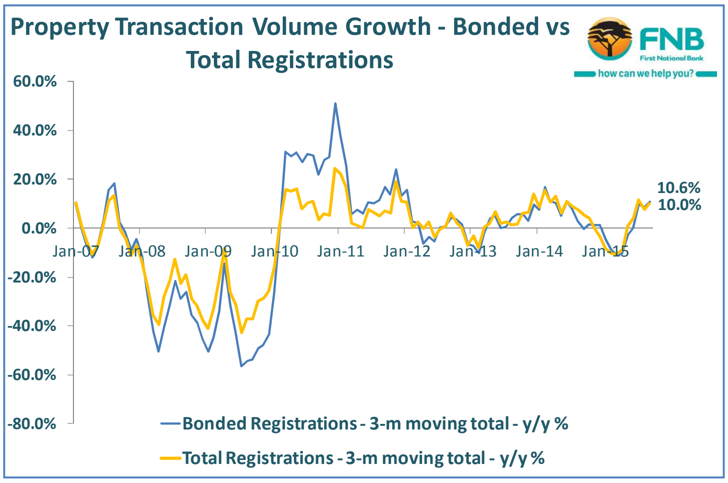
There is little in the way of either positive or negative "fireworks" in the new mortgage lending environment. Recent months appear to have brought a slightly lower home loan approval rate, but it is too early to tell whether this is the start of any trend change, or whether it is merely normal month-to-month volatility. The home loan interest rate differential above Prime Rate has been gradually declining, however, as the mortgage market gets mildly more competitive on pricing.

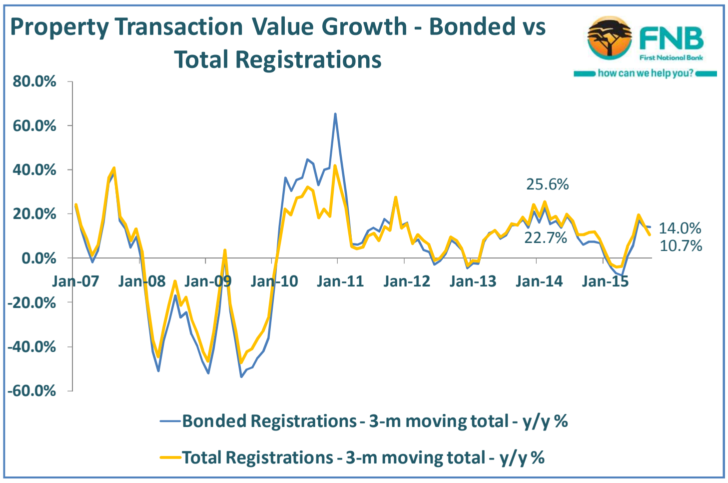
Growth in New Bond Registrations

We attempt to identify all bonded transaction registrations by individuals (natural persons) with the Deeds Office in order to estimate growth in what should be largely residential new mortgage lending.

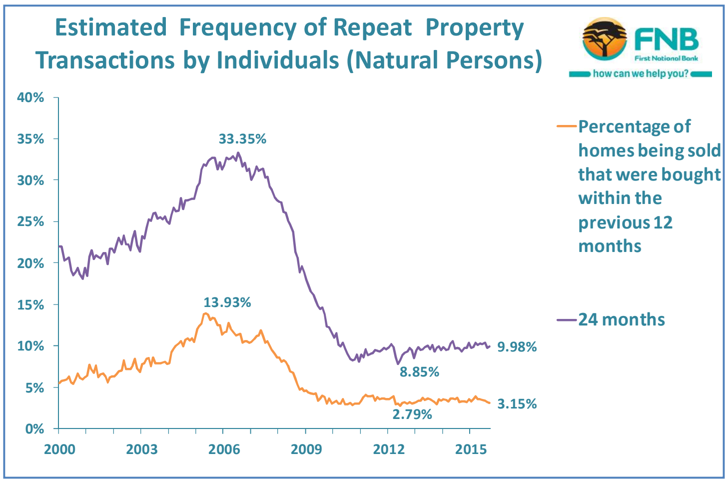
As was the case with NCR data for new mortgage loans to Households, we have seen something of a mini-surge in bonded registrations growth around mid-2015, after a lull earlier in the year. This appears very much the lagged impact of a mild surge in Residential Activity being witnessed in the latter half of 2014 according to our FNB Estate Agent Survey.

More recently, in 2015, however, we have seen agents reporting a decline in residential activity in the Survey, while FNB's valuers have also reported perceived weakening in demand in recent months. We would thus expect to begin to see bonded registrations year-on-year growth slowing in the near term. As at September, however, the year-on-year growth in volume of bonded registration was still a healthy 10.6% for the 3 months to September, and it is possible that this data is not yet quite complete.





Home Loan Cancellation Risk – still low



The weak economic environment keeps the pace of housing "turnover" slow, as a high percentage of home owners stay in the same home for longer, and speculative activity remains muted.

This remains reflected in the relatively low percentage of properties, currently being sold by individuals, which were purchased within the past 2 years. Whereas this level was an extreme 33.35% of all properties traded by individuals (Natural Persons) back in July 2006 at the height of the boom, in October 2015 it remained a mere 9.98%, having only risen marginally from a post-Boom low of 8.85% at a stage of 2012.

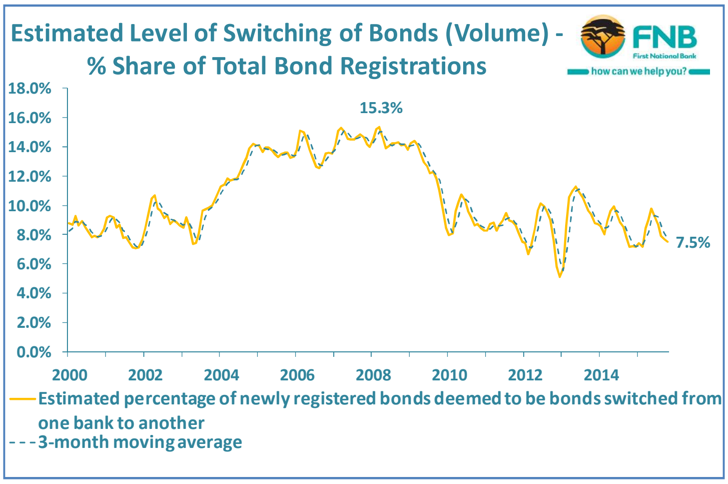
This slow pace of turnover is a key positive for mortgage lenders' profitability, as it increases the possibility of home loans remaining on their books for longer. This is important because, given a significant cost of putting a home loan on the books, it can take a considerable time before one reaches "break even" on a home loans and starts to make money.

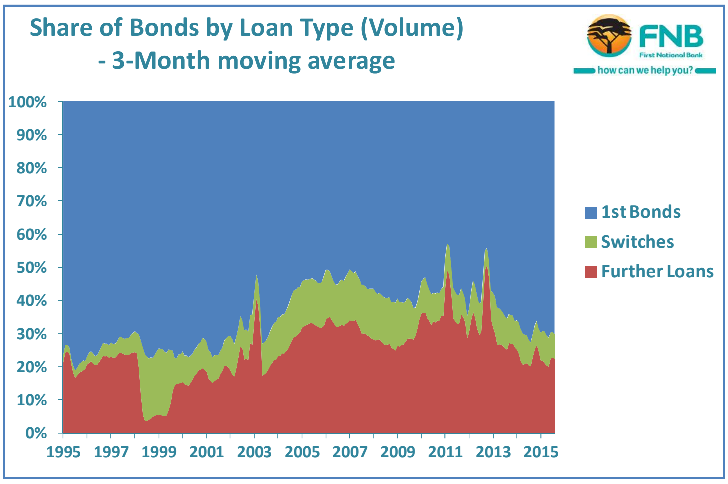
A lower home loan cancellation risk since the end of the boom years has also been reflected in less aggressive drives by mortgage lenders to "switch" home loans from rival banks.

Examining deeds data for bond registrations, we estimate that as at October 2015, 7.5% of all bond registrations for individuals (natural persons) were "switches". This estimate has slowed mildly since 9.8% in May 2015, and remains very subdued since the 15.3% high back in March 2008, which was right at the end of the "Market Share War" of the boom years. The timing of the peak of boom time switching suggests that switching activity can become more aggressive towards the end of a strong growth period, as mortgage lenders try to sustain their sales growth where "natural" market growth is starting to slow. To date, we haven't seen signs of a noticeable re-emergence of such actions yet, despite the signs emerging of an imminent slowing in growth in the residential market.

The other potential indicator of "market madness", i.e. Further Loan registrations, also remains relatively subdued at 22.2% of total registrations in October, slightly above the 20% of 3 months prior, but still a far cry from being consistently above 30% in the last years of the boom period around 2005-7.

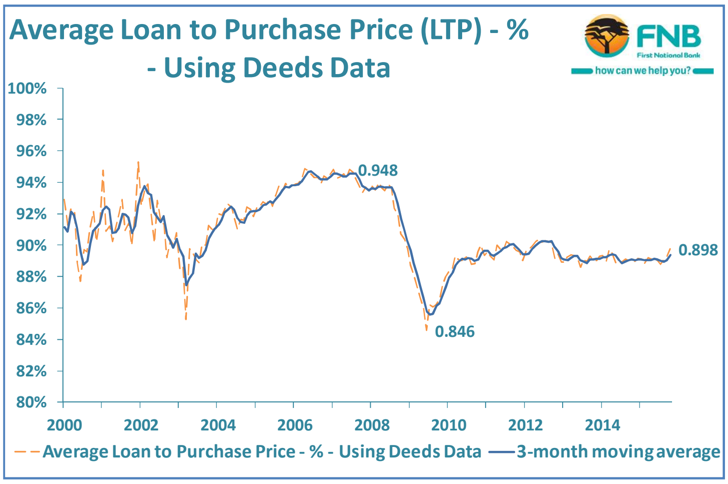
Therefore, the Mortgage Market continues to appear largely "rational", overwhelmingly dominated by 1st Bonds registrations. These made up 70.3% of total bond registrations by individuals in October 2015, far above the estimated 50.7% reached in March 2007 at the back end of the boom.



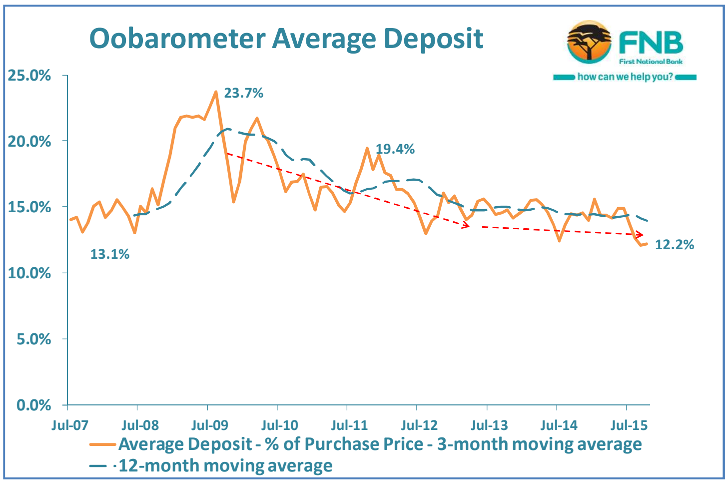


Lending Stance of Mortgage Lenders

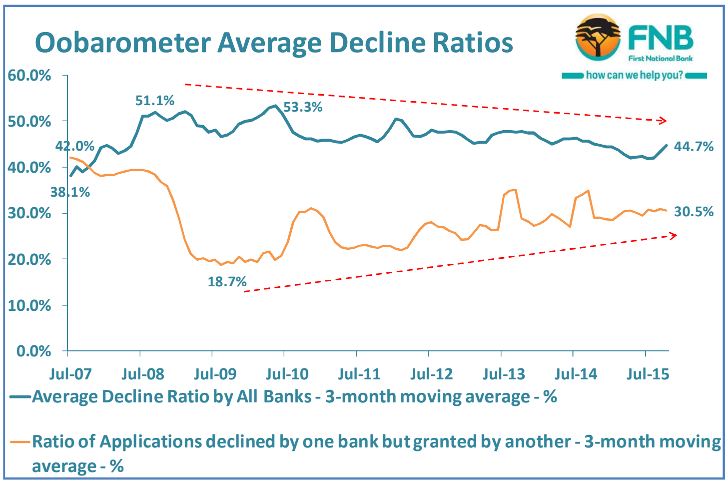
Having said that the market still appears highly "rational", one does get a feeling that mortgage lenders as a group may possibly begin to try to grow their lending a little faster, at a time when natural market growth is far from spectacular.



Using deeds data, our estimated Loan-to-Purchase Price Ratio was 0.898 as at October. This was slightly up from 0.888 3 months prior in July, but the broader trend has been sideways since around 2011, after a prior noticeable rise from a low of 0.846 in mid-2009. At the current level, the average LTP remains well below the 0.948 boom time high in June 2007.

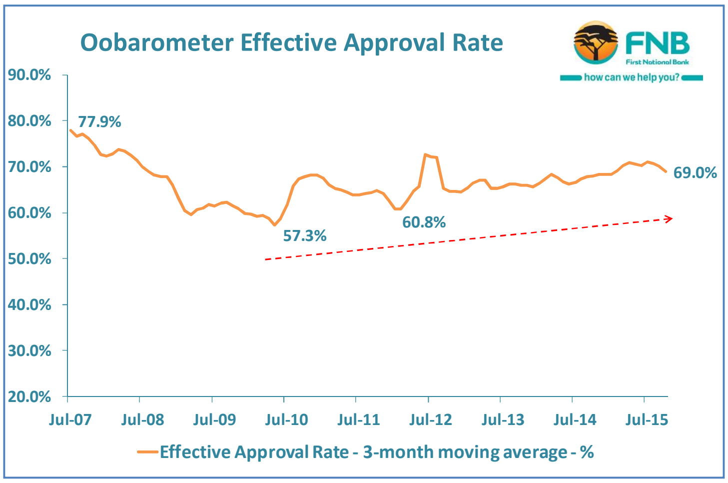


The Oobarometer data tells a not too dissimilar picture to our average LTP, i.e. one of more pronounced decline in the average deposit as a percentage of purchase price through 2009-10, as banks relaxed mildly in response to aggressive SARB interest rate cutting. Then from around 2012 – 2015 the pace of decline in the average size of deposit relative to purchase price was very slow at best.



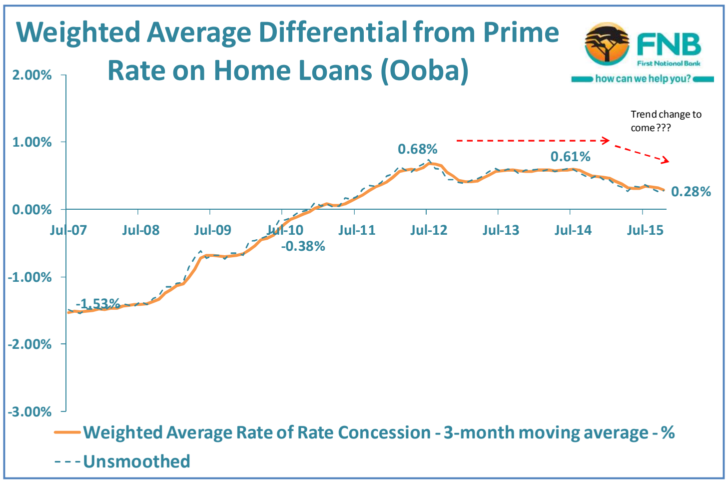
In the past few months, the Ooba data has shown some slight rise in the percentage of home loan applications declined by all banks. Using a 3-month moving average for smoothing purposes, the 3 months to October saw an average decline ratio of 44.7%, slightly up from 41.8% in July. However, it is too soon to draw conclusions as to whether this is mere short term data "volatility", whether it reflects a deteriorating quality of home loan applicant, or whether there has been some credit criteria tightening.

Important to remember is that interest rates have been rising mildly again of late, and the July rate hike may have played a minor role in curbing approvals.



The ratio of decline in applications approved by another bank, however, at 30.5% for the 3 months to October, has not shown a noticeable decline. Putting 1st and 2nd bank approvals together, Ooba's "Effective" Approval Rate of 69% in October was a little down on 71% in July, but we will need a few more months to determine whether this signals a trend change from the broad upward trend in the Effective Approval rate, all the way from 57.3% in mid-2010 to the current levels.

Average Home Loan Pricing

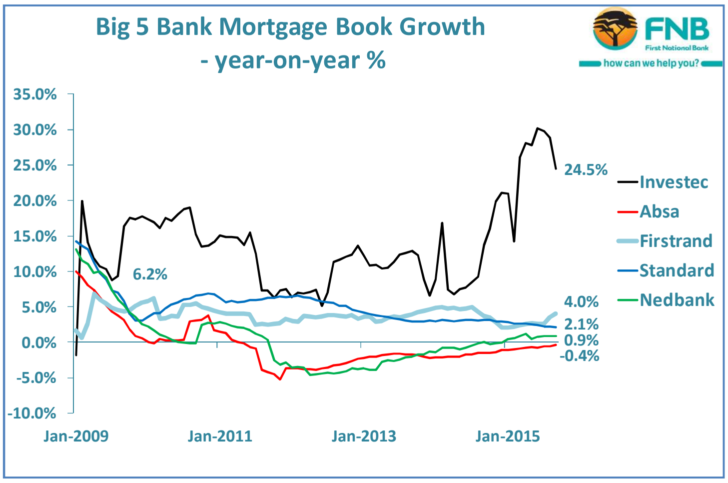


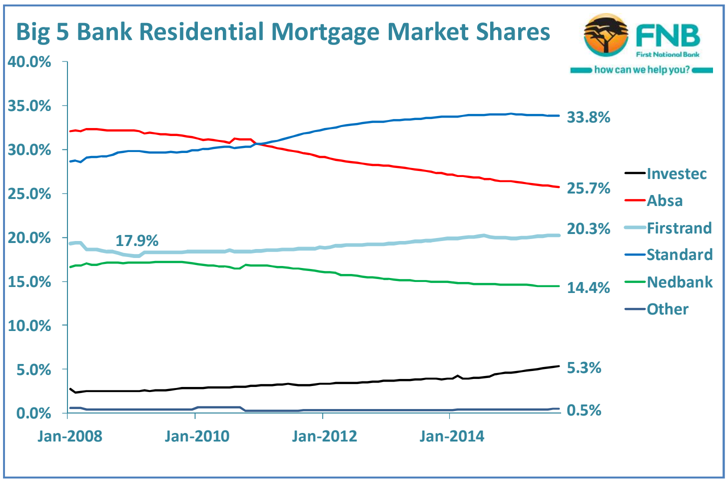
Where we have seen an apparent mild increase in competition levels has been on home loans pricing. According to the Ooba data, from mid-2014 to October 2015, the average differential above Prime Rate has declined from 0.61% to 0.28%, a 33 basis point decline.

Market Shares and Individuals Lenders Residential Mortgages Growth

Most notably, the largest mortgage lender, Standard Bank, has seen its market share rise from 28.6% at beginning 2008 to 33.8% in September 2015. Of the "Big 4", Firstrand is the other longer term "gainer", with a market share rising to 20.3% from a low of 17.9% back in February 2009. Off a low base, Investec's share rise has been significant, from 2.3% in February 2008 to 5.3% by September 2015.

The most aggressive lender in 2015 by a long way appears to be Investec, with its residential mortgage book growth at 24.5% year-on-year at September. Firstrand was a distant 2nd with 4% growth.





OUTLOOK

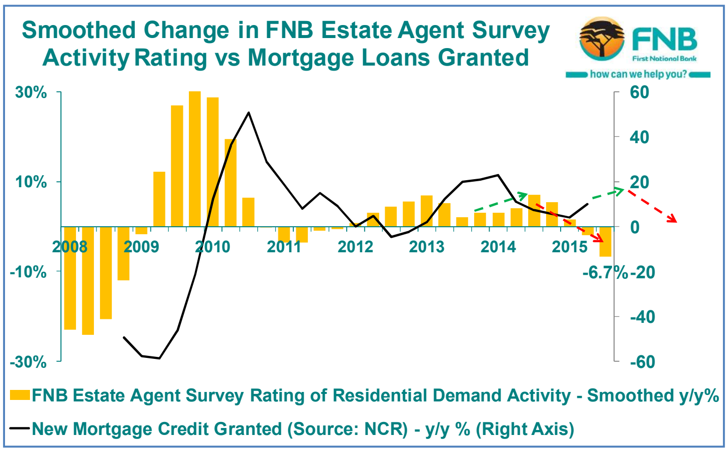
Household Sector mortgage credit outstanding growth could still move slightly higher in the coming months, on the back of the lagged impact of higher new mortgage lending growth post the 2008/9 recession dip. However, we expect this growth to be contained well within single digit territory, as we anticipate a tapering in ***new*** *lending growth in the near term.*

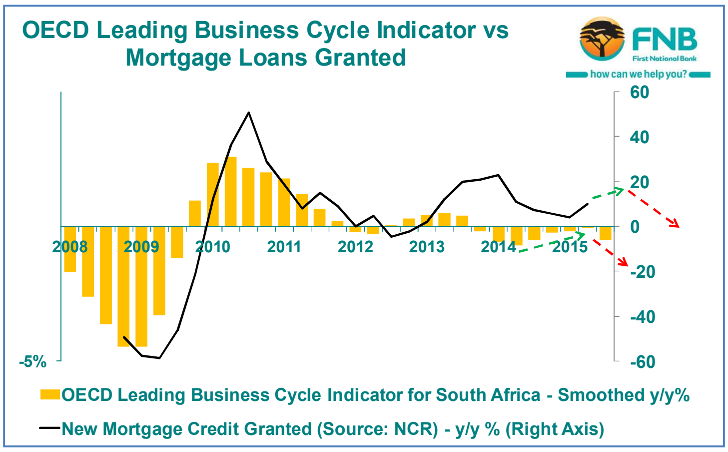
Key Leading Indicators suggest that ***NEW*** *mortgage lending growth is set to slow in the near term, which should ultimately contain outstanding mortgage loans growth.*

One of the national measures of new residential mortgage Loans granted comes from the National Credit Regulator (NCR) in the form of Value of New Residential Mortgage Loans Granted. After a slowing rate of growth through much of 2014 and into early-2015, the 2nd quarter saw year-on-year growth in the value of new mortgage loans granted pick up from 3.9% in the prior quarter to 10%. The 3rd quarter probably saw a respectable growth rate too.

However, this improved growth is the lagged response to the pick up in growth in residential activity levels prior to, and up until, the 3rd quarter of 2014, as reflected in the smoothed year-on-year growth rate of the FNB Estate Agent Survey Activity Rating. Peaks in new loans granted lag the peaks in the Activity Rating's growth rate by about 3-4 quarters. But that Activity rating's growth rate has been slowing since the end of 2004, and has gone into negative territory, suggesting that renewed slowing in new lending growth is due very soon.

A 2nd Leading Indicator is the South African Leading Business Cycle Indicator (OECD version used here), whose year-on-year rate of decline has accelerated in the 3rd quarter 2015 to date. This would suggest a mini-peak in new mortgage lending growth looming in the very near term, this indicator also tending to lead the trends in new mortgage lending growth.





Such an expectation of slowdown in NEW Household Sector Mortgage Lending makes sense against the backdrop of an economy which appears to be continuing on its multi-year growth stagnation, with recession not an insignificant possibility and interest rates having risen.