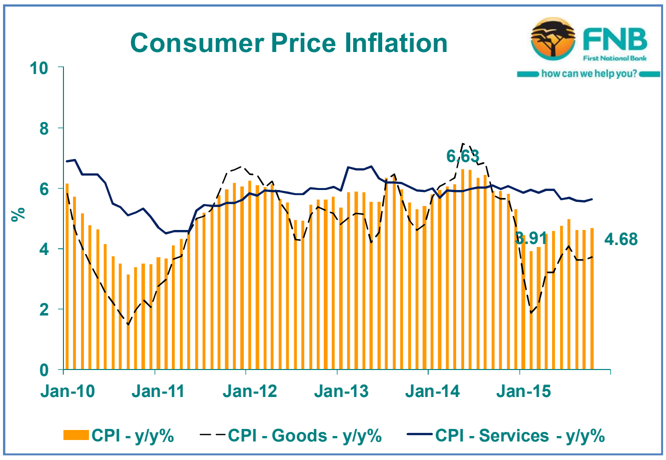
PROPERTY BAROMETER – OCTOBER CPI INFLATION

Housing CPI remains the key "troublesome" part of CPI inflation (although many of its components were not surveyed in October), but perhaps of more concern is that the lower income groups continue to have higher CPI inflation

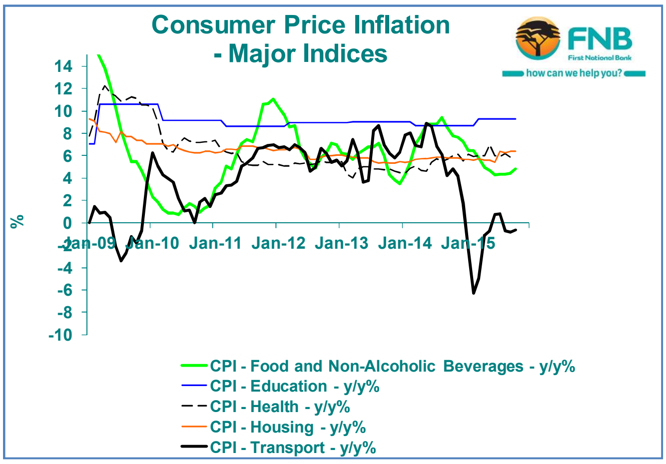
18 November 2015

THE HEADLINE NUMBERS

The October CPI (Consumer Price Index) inflation rate edged slightly higher, from 4.6% year-on-year in the previous month to 4.7%.



Of the main sub-indices in the CPI, there was a slight increase in the Food and Non-Alcoholic Beverage inflation rate, from 4.4% year-on-year in September to 4.8%, while the Transport Sub-Index deflation rate diminished from -0.8% to -0.6% over the same period.



The Education Sub-Index remains the one with the highest inflation rate of the major sub-indices, at 9.3% year-on-year, but the Housing CPI is arguably the most troublesome one because of its far bigger weight in the CPI, and with an inflation rate of 6.4% year-on-year influenced strongly by high inflation rates in Municipal Rates and Utilities Tariffs (Not many of the Housing CPI's components were surveyed in October, however).

Of the 4.7% total CPI inflation rate, therefore, the Housing CPI is the biggest contributor to the tune of 1.6 percentage points, followed by the other big ticket item, namely Food and Non-Alcoholic Beverages (0.7 of a percentage point)..

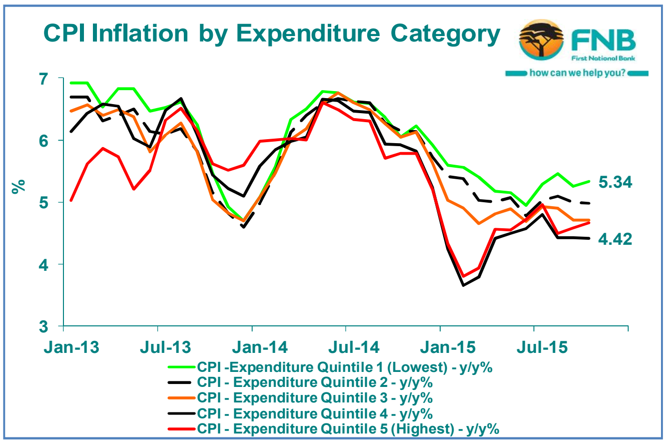
IMPLICATIONS FOR INTEREST RATES

Our expected Monetary Policy Committee (MPC) interest rate decision tomorrow is one of an unchanged Repo Rate.

The slightly higher CPI inflation rate in October remains well within the 3-6% target range, and it wouldn't appear that this number would influence a different decision to what we expect.

CPI INFLATION STILL TILTED AGAINST THE POOR

Examining the CPI Indices by "Expenditure Quintile", Expenditure Quintile 1, i.e. the lowest spending level group, which more-or-less correlates to the lowest income group, continues to have the highest CPI inflation rate of 5.34%. The next quintile up, i.e. Quintile 2, had a slightly lower rate of 5%.



At the lowest end of the inflation spectrum is Quintile 4, the 2nd highest Expenditure Quintile, with a 4.4% inflation rate, while Quintiles 3 and 5 both have a slightly worse inflation rate of 4.7%.

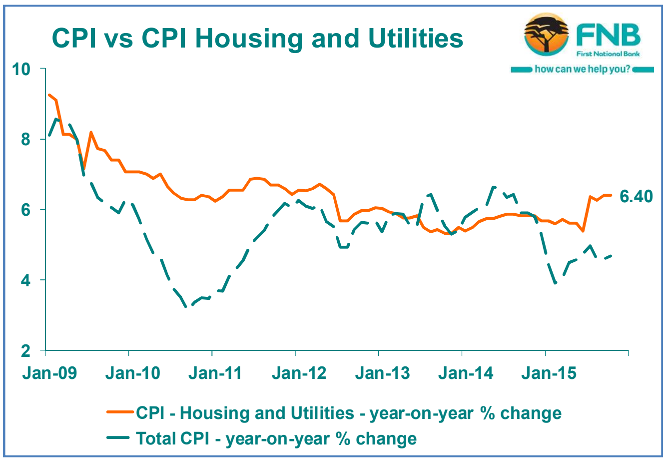
Why do the lowest Expenditure groups have the highest CPI inflation rates? There are 2 apparent reasons. Food Price inflation has an inflation rate slightly above the overall CPI inflation rate, and this category has a huge weighting in the CPI of the lowest expenditure quintiles.

However, more significant is that the lowest quintiles have a far bigger weighting for Public Transport, whereas the high income/expenditure groups are much more exposed to Private Transport, and the Public Transport CPI has not been deflating this year as a result of sharply lower petrol prices, whereas the Private Transport Running Cost CPI has been deflating.

In short, the high income groups benefited far more from the petrol price deflation earlier in the year.

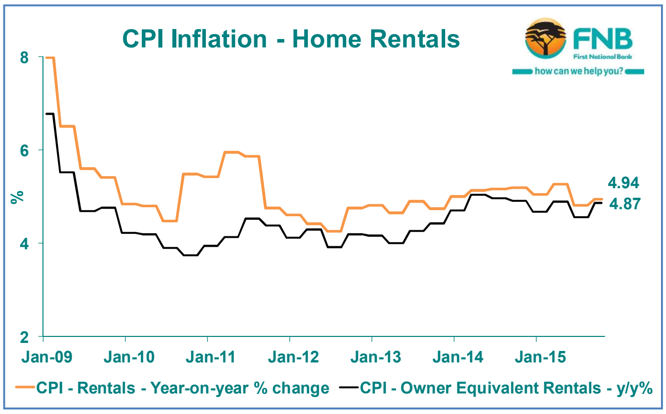
HOUSING CPI REMAINS TROUBLESOME

While little was surveyed in the Big Ticket Housing CPI in October, this sub-index remains the troublesome component of the overall CPI, with a year-on-year inflation rate of 6.4% in October.

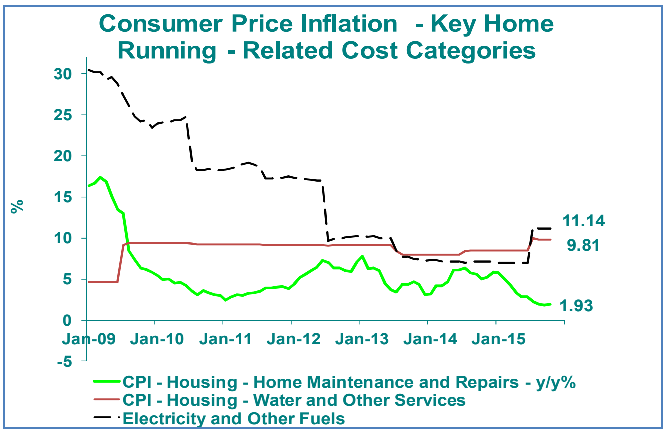


Certainly, the Rental Market doesn't play the major role in this. Actual Rental inflation is 4.94%, while Owner Equivalent Rental inflation is 4.87%.

As these are slightly higher than the overall CPI inflation rate they do exert some slightly upward pressure on it. But these inflation rates remain far below the crucial 6% upper target limit of the SARB.



The key sources of upward pressure, however, are in the area of Municipal Rates and Utilities' tariffs. The Electricity CPI is currently inflating at 11.1% on the back of the next round of Eskom tariff hikes, while the "Water and Other Services CPI (which includes municipal rates) is not far behind at 8.9%.



Working partly against these big housing-related cost increases is a very benign inflation rate in the CPI for Home maintenance and Repairs, to the tune of 1.9%.

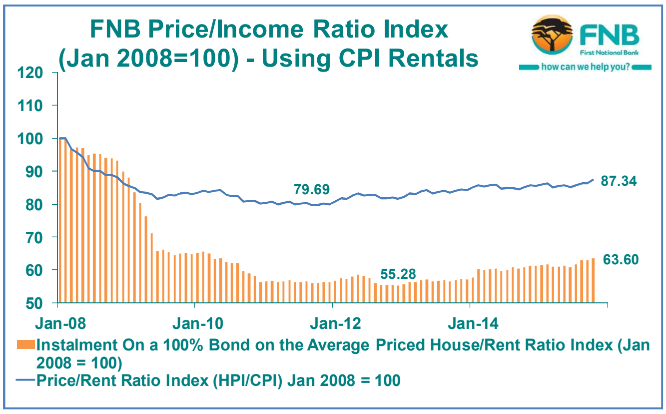
This has the important benefit of keeping home maintenance at currently high levels.

One wonders, however, to what extent the high rates of Municipal rates and utilities tariff inflation is "crowding out" the Home Maintenance Sector, which may be forced into implementing very low price increases in part as a result of these other spiraling home-related costs exerting some pressure on home owner purchasing power?

RENTALS AND THE HOUSE PRICE-RENT RATIO

The CPI for Rentals was not surveyed in October, only being surveyed every 3 months. But based on the September CPI Rental Index (whose value is used in the October CPI), there was a further rise in the Residential Average Price-Rental Ratio Index in October. Whereas the year-on-year Actual Rental

Inflation rate was 4.9%, the Average House Price Inflation Rate in the FNB House Price Index was considerably higher at 7.7%.



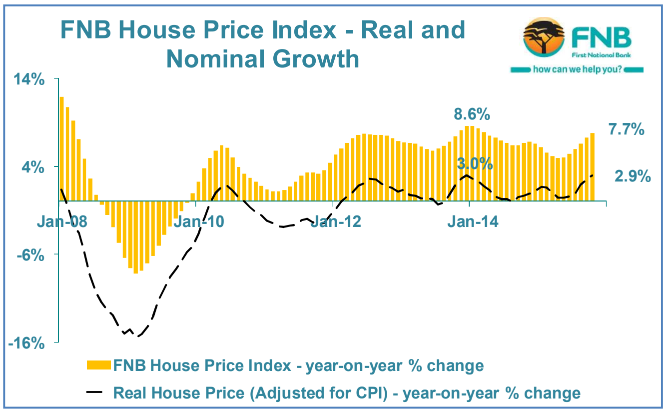
Therefore, the most recent CPI Rental figures continue to show the residential rental option becoming more attractive relative to the relatively expensive home buying option. At an index level of 87.34 (Jan 2008 = 100), the residential Price-Rent Ratio in October was a mere 12.66% below the January 2008 level, and the January 2008 level is believed to have been at or near to the all time high. The Price-Rent Ratio therefore remains high, and this index has risen by 9.5% on its October 2011 Post-Recession low point.

What keeps 1st time home buyer numbers high at this stage? A relatively low prevailing interest rate level, which translates into a far lower level in the Instalment Repayment on the Average Priced Home/Rent Index. In October, this index was 36.4% lower than the level at January 2008, having been driven sharply down by big interest rate cuts around 2009.

However, this Index has also risen, by 13.55% since a low at September 2011, thus also making the home buying option gradually less attractive relative to the rental option.

REAL HOUSE PRICES IN OCTOBER

The CPI inflation rate of 4.7% year-on-year in October, coupled with our FNB House Price Index inflation rate of 7.7%, implies that house prices continued to rise in real terms (when adjusted for CPI inflation), last month to the tune of 2.9% year-on-year.



IMPLICATIONS AND OUTLOOK

The October CPI inflation rate, which was only marginally up from the previous month and still very much in the middle of the SARB 3-6% target range, could do little to change our expectation of an unchanged interest rate decision at tomorrow's SARB MPC meeting. The potential impact on very near term housing demand growth, therefore, is probably neutral.

Housing demand growth at this stage, is probably more at risk from a weak economic growth environment.

Looking into the detail of the data, a concern must be the higher inflation rate for the lower income groups, at a time when social tensions are running high and at risk of manifesting themselves in activity that can be disruptive to the economy (aggressive strike action, service delivery protests and the like)

Looking further, the Housing CPI numbers continue to be supportive of the Smaller-sized housing market, given that sharp and sustained inflation in Municipal Rates and Tariffs.

Low maintenance cost inflation is perhaps the good news for home owners, who as a group are maintaining their homes at considerably higher levels relative to a few years ago.

Finally, although rentals were not surveyed in October (September level gets used in October CPI), recent rental inflation rates have not matched house price inflation, implying that the home buying option continues to get "less attractive" relative to the rental option as the House Price/Rent Ratio rises further.

This ratio is a key ratio used to see whether a housing market is becoming "overvalued", and it remains at historically very high levels, we believe.

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